Macroeconomic policy coordination in Europe
and the role of the trade unions

edited by
Eckhard Hein, Torsten Niechoj,
Thorsten Schulten and Achim Truger
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European Trade Union Institute (ETUI)
Institute of Economic and Social Research in the Hans Böckler Foundation (WSI)
Acknowledgements

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Introduction

For more than three years the countries of the European Union (EU) – or the European Monetary Union (EMU) respectively – have been suffering from a pronounced crisis of growth. Real growth of GDP, especially in the European Monetary Union has not been sufficient for increasing employment and preventing unemployment from rising. At the beginning of 2004 the economic indicators show tentative positive signs, but the upturn crucially depends on an international economic environment that is itself extremely precarious. A sustained economic improvement and a decline in the numbers of unemployed is hardly in sight at this point. Therefore, the EU is currently far from reaching the goal set by the Lisbon European Council of 2000, “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion” (Presidency Conclusions, Lisbon European Council, 23 and 24 March 2000). Examining long-term trends reveals, to the contrary, that since the onset of the EMU-convergence process in the mid-nineties, growth rates in Europe systematically fell short of those of the 1980s, but also fell short of the development of the United States’ economy in the 1990s. The situation is especially dismal in Germany, the largest national economy of the European Monetary Union. Growth rates there are even below, and unemployment rates above EMU-average. Apparently the tough budget consolidation policies, structural “reforms” of labour market institutions and social protection arrangements, as well as the interest rate policy of the European Central Bank were not able to generate a constellation conducive to economic growth and prosperity.
The positive effects of European monetary integration, predicted by many observers during the 1990s, have thus failed to materialize so far. Moreover, the procedures of economic policy coordination and the body of rules and regulations of the EU seem to be incapable of addressing the economic challenges. The Stability and Growth Pact has effectively been abrogated in the end of the year 2003, when the enormous fiscal problems, especially in the large countries France and Germany, demonstrated, that the attempt to consolidate the public budgets in the midst of the economic downturn has failed. Especially in Germany the efforts of curbing public spending are inhibiting public investment and with this undermine the long-term prospects of growth to an increasing extent. The European Commission adheres to the Stability and Growth Pact nevertheless. The *Broad Economic Policy Guidelines*, in which the European Council of Ministers formulates the Union’s economic policy goals on a regular basis, have contained the same set of recommendations over and over again ever since these guidelines were first introduced in 1993: Inflation is to be kept at bay by means of committing monetary policy exclusively to the economic policy goal of price stability; fiscal policy is supposed to take on tough efforts at budget consolidation regardless of the economic situation, the public budgets are expected to close with surpluses or at least balanced, and wage setting is assigned the task of securing moderate wage agreements that remain below productivity growth and inflation. If all this were assured, the argument goes, structural reforms – that is, deregulation on the labour market and the product markets – could induce new dynamics of growth.

Inflation rates have been rather low for some time now, though not always under the European Central Bank’s tight target of “below, but close to 2 percent”. Countries have engaged in enormous efforts at consolidating their public budgets, and real wage increases have virtually always remained below productivity growth. Moreover, the deregulation of markets has steadily progressed in the wake of the completion of the Single European Market. Nevertheless – but in fact better: therefore – the countries of the European Monetary Union are a far cry from a robust and sustained path of economic growth. The policy mix of macroeconomic restriction, selected
with the EMU-convergence criteria seems to be the main factor causing the stagnation that we currently experience. The inflation target pursued by the European Central Bank is too narrow for an economic area as heterogeneous as the European Monetary Union, and the exclusive orientation of the European Central Bank towards price stability is pursued at the expense of growth and employment. The Stability and Growth Pact forces the national fiscal policies into a pro-cyclical course of restriction, which augments the economic downturn and weakens public investments in infrastructure, research and education as essential preconditions for long-term growth. The overall too low wage agreements have contributed to a considerable weakness of domestic demand and additionally led several countries to the edge of deflation.

There is no lack of proposals and alternative policy conceptions for overcoming the present economic policy regime in Europe. If the European Central Bank took its mandate to support “general economic policy” when there are no dangers to price stability more seriously, a mandate assigned to the bank by the EU-Treaty, and if the inflation target would be adjusted upward, monetary policy could give the European economies more room to breathe. If fiscal policy in the context of a reformed Stability Pact were allowed to let automatic stabilizers develop their full effects and to finance public investments with credits, then this could support economic recovery, which then – if desired – facilitates a revenue-based budget consolidation. If it were possible to conclude wage agreements largely matching the trend in the growth of the national productivity of labour and the target inflation rate of the European Central Bank, then neither a deflationary nor an inflationary pressure emanated from the development of wages. This kind of an economic policy, however, requires coordination across European countries and actors: on the one hand, that is, coordination of monetary policy, fiscal policy, and wage setting, and on the other hand coordination within fiscal policy and wage policy, in order to be able to confront the European Central Bank in these areas with an actor capable of autonomous action.
The implementation of a macroeconomic policy regime conducive to growth and employment in Europe is accordingly difficult. On the one hand the procedures and institutions of economic policy-making adhere to the ways of thinking about economics and the policy proposals as they are annually defined in the Broad Economic Policy Guidelines. On the other hand many of the actors involved – such as most of the member states’ governments, the European Central Bank, and the European Commission – still hold on to models of economic policy that have clearly proven their inadequacy during the past few years. In order to counter this, political intervention on several levels is necessary: In the institutions and bodies of the EU and on the national level, by means of formulating alternative policy proposals and consistent models of economic policy, and last but not least through political pressure from the public. Sustained political involvement is the only way in which a reorientation of economic policy in the euro zone can be achieved. Important agents in support of such a reorientation are the European trade unions. They have lobbied for a different economic policy conception for years, and have submitted proposals for institutional rearrangements that would support the substantive policy change (see for instance the document by the Deutscher Gewerkschaftsbund [German Trade Union Confederation] “A new Social Contract for Europe” in the appendix of this book). With this volume we seek to point out, what in particular the challenges are that trade unions are facing in the European context, but we also want to present the policy options at their disposal.

The first section of this volume develops the concept of macroeconomic coordination and demonstrates its superiority when compared with the currently dominant economic policy conception in Europe. The tasks of the different actors of economic policy are outlined, and the institutional approaches and policy challenges for macroeconomic coordination at the EU-level are discussed.

In their introductory paper Eckhard Hein and Achim Truger (both from the WSI, Düsseldorf) argue that economic stagnation in real terms and the fact
that convergence has failed to materialize even after five years are largely the result of the restrictive policy-mix pursued by the macroeconomic policy actors of the EU. They first outline the prevailing orientations of monetary, fiscal, and wage policy actors against the backdrop of the institutional conditions of the European Monetary Union and demonstrate that these orientations follow New-Monetarist ideas. Then they sketch alternatives for a more expansive policy-mix, which are based on a (Post-)Keynesian conception of macroeconomics. Since these alternatives require the actors to coordinate an expansive macroeconomic policy and mutually take on the responsibility for monetary, fiscal, and wage policy, the article also discusses the possibilities for implementing such a policy mix under the institutional conditions of the European Monetary Union. The authors conclude that the present institutional arrangements of the EMU are not ideal for a more expansive policy-mix, but that there is the chance for macroeconomic strategies more amenable to employment and growth, if the actors in charge have enough macroeconomic insight or face enough political pressure to develop greater commitment to such strategies.

The importance of “macroeconomic regimes”, that is, the policy orientation and interaction of monetary, fiscal and wage policies, for the economic development of a country is in the focus of the contribution by Ulrich Fritsche (DIW, Berlin), Michael Heine (FHTW Berlin), Hansjörg Herr (FHW Berlin), Gustav Horn (DIW, Berlin) and Cornelia Kaiser (FHW Berlin) as well. This article presents a detailed analysis of the development in the United States during the 1990s. It demonstrates that the US performance, which was markedly better than that of Europe and Germany, was not a consequence of the lesser degree of regulation and the greater degree of flexibility of the US labour market, as the usual labour market centred explanation of the US economic performance would have it. Instead, the authors argue, high growth rates and declining unemployment were the result of a smooth coordination of monetary, fiscal, and wage policies under favourable international macroeconomic conditions. Fiscal policy was anti-cyclical in its effects, and the public budgets were consoli-
dated only once economic activity started to speed up again. The development of wages was no source of inflationary impulses despite the fact that unemployment was declining at the time. The Federal Reserve, finally, as the central actor, discretionarily used the situation’s potential successfully for a continuous growth orientation of its interest rate policy. In the US, however, this constellation was not the result of an explicit strategy of macroeconomic coordination, but it could still serve as a model for growth-oriented economic policy institutions and their coordination.

The two contributions of the second section focus more explicitly on the significance of the economic policy actors and institutions. The article by Torsten Niechoj (WSI Düsseldorf) starts from the meanwhile well-documented finding that implementing a Keynesian economic policy conception could considerably increase growth and employment by coordinating wage, monetary, and fiscal policies. Based on this finding, the author examines whether the actors of macroeconomic policy have positive attitudes vis-à-vis this kind of coordination, and to what extent the existing macroeconomic policy institutions permit such a coordinated strategy. The analysis of the development of economic policy on the EU-level up to now then serves as the basis for deriving and specifying where promising starting points for realizing a Keynesian policy conception would be. Special attention is paid to the questions of what requirements the concept would pose for the trade unions. The author argues that even though one can demonstrate that a certain extent of reorientation of macroeconomic policy towards Keynesian ideas has taken place, the achievements still remain insufficient. Furthermore, if implementation of these achievements continues in a consistent manner, they will lead to a form of Keynesian macroeconomic policy design that will generate massive difficulties for the trade unions in the area of labour market regulation.

Rudolf Welzmüller (IG Metall, Frankfurt) also analyses macroeconomic policy actors and the strategic options at their disposal. He examines the relationship between trade union wage policy and coordinated macroeconomic policy in the European Monetary Union in greater detail. In con-
contrast to the policy conception employed in Europe so far, coordination of economic policy is a central instrument for fostering growth and employment. This comprises international coordination of the national collective bargaining policies aligning wage increases with productivity growth and the inflation rate of the respective country on the one hand, and coordination of wage setting with fiscal and monetary policies on the other hand. Wage agreements without inflationary impulses must be matched by monetary policy with a consistent commitment to employment promotion and price stability. Reservations against the integration of wage policy into a comprehensive economic policy conception, which one can hear sometimes among trade unionists, ultimately present no convincing alternative. Renouncing all attempts at coordination would only put additional pressure upon wage setting to adjust to competitive conditions. National pacts for competitiveness are an example of it. One cannot, however, expect unilateral inputs on the part of the trade unions without reliable signals from the European Central Bank, and as the behaviour of the Bank in the year 2000 has shown, they are not yielding the desired results either.

The third section of this volume consists of several contributions that all address the question to what extent the Macroeconomic Dialogue (MED), created by the Cologne European Council in the year 1999 as part of the European Employment Pact, can form a strategic starting point for establishing macroeconomic coordination on the European level. The article by Willi Koll (Federal Ministry for Economics and Labour, Berlin) first gives an overview over the history and the underlying intentions of the MED as an institution including the actors of fiscal policy, wage policy, and monetary policy, thus all the important economic policy agents bearing responsibility for macroeconomic policy-making. The MED was added to the European Employment Strategy and the economic reforms as the third pillar of the European Employment Pact. In its intention the MED is based on the expectation that employment growth with a stable price level is the result of a smooth interplay of monetary, fiscal, and wage policy. Participants of the dialogue remain independent and autonomous, but they
should use the MED as a forum for exchanging information about the advantages and the preconditions of a cooperative and growth- and employment-friendly policy-mix, which can still maintain price stability. In order to maintain the character of the MED as a dialogue, the number of participants has to be limited. Different spatial arenas of activity and different time horizons pose additional requirements for communication and organization within in the MED, especially in the area of wage setting. In the context of the European Employment Pact, Macroeconomic Dialogue, Coordinated Employment Strategy, and economic reforms cannot act as substitutes for one another, the author concludes, but they can supplement and mutually reinforce each other.

The experience with the MED from the perspective of the European Trade Union Confederation (ETUC) is the subject of the article by Ronald Janssen (ETUC, Brussels). Janssen, too, attributes the dissatisfactory development of employment and growth in the European Monetary Union to an insufficient amount of coordination between the agents of macroeconomic policy, especially those of monetary and wage policy. A course of wage restraint throughout the time period since 1999 has not been rewarded by the European Central Bank, and by this the bank squandered chances for growth and employment in the EMU. The arguments of the ETUC representatives in the MED found no open ear in the European Central Bank, and the other actors, the Commission and the employers’ associations, did not support the trade unions’ positions either. Nevertheless, the author assumes that the Macroeconomic Dialogue is a suitable forum for discussing the economic situation and adequate economic policy responses among the macro-political actors and for building social capital and trust amongst these actors.

Andrew Watt (European Trade Union Institute, Brussels), finally, deals with the prospects for improving the coordination of macroeconomic policy by means of reforming the MED. In the short and medium run, he thinks, this is a realistic possibility for improving European macroeconomic policy: On the one hand fundamental changes in the Maastricht-based
architecture of the European Monetary Union’s institutions are currently unlikely, and on the other hand within the existing institutional context, better macroeconomic results can still be obtained. What is needed for this is especially a more expansive monetary policy, which uses the room of manoeuvre given to it by the moderate wage agreements to pursue an interest rate policy that promotes growth and employment. This in turn requires improved coordination between wage and monetary policy, and a reform of the MED can support this. The article documents the specific proposals submitted by the trade unions for improving the effectiveness of the MED. The underlying view of the MED is, that it offers a chance for the trade unions to defend their status as a strategic agent of macroeconomic policy, counter to all demands for decentralization of collective bargaining. Overall, the combination of strengthening the debate within the trade unions, continuing to challenge the existing regime of economic governance in the European Monetary Union, and searching for possibilities of macroeconomic cooperation is the most promising way to a better economic policy.

The fourth section of this volume, finally, shifts the special role of trade unions into the centre of attention. Thorsten Schulten (WSI, Düsseldorf) begins this section with an article examining the existing approaches to European-level coordination of trade union collective bargaining policy. This is based on an analysis of the long-term trends in collective bargaining policy, in which the European trade unions had rarely been able to fully exploit the scope for distribution given by the development of prices and productivity with their wage settlements. This development has not only resulted in a steady decline of the share of wages in GDP and a continuous redistribution from labour to capital income, it has also undermined the stabilising function of wage policy for private consumption demand and the price level. Trade union initiatives for a European level coordination of collective bargaining, which have been evolving on different levels since the end of the 1990s, seek to reverse this trend in wage policy, strive for a return to productivity-oriented wage policy, and in doing so put limits to competitive underbidding of wages and labour standards in Europe.
European trade unions still have to overcome a number of institutional and political barriers, however, which currently stand in the way of an effective coordination of their wage setting and collective bargaining policies.

In the final contribution to this volume Richard Hyman (London School of Economics) poses the basic question of what position the trade unions should take in regard to the policy pursued by the institutions of the EU. The difficulties in answering this question are rooted in the ambivalence of the process of European integration itself. On the one hand European integration is often considered as a necessary political safeguard in the defence of the “European Social Model” against the generalization of the American model of capitalism. On the other hand it is precisely the central political projects of European integration that have propelled the neoliberal restructuring of economic institutions in European countries and that are destroying the basis of the European Social Model. The European trade union organizations are entwined in the political web of institutions of the EU in numerous ways (such as through the European Social Dialogue) and for this reason feel political pressure to adjust to these European institutions, pressure that systematically constrains the development and articulation of alternative political agendas. The alternative to this dilemma would be to concentrate more on an “internal social dialogue”, in which the trade unions would develop their autonomous cooperation amongst each other and search for shared alternative political projects for which they can jointly mobilize support in the European working class.

The considerations gathered here trace back to a conference that the WSI of the Hans Böckler Foundation held in November 2003. We thank all the presenters and participants for the stimulating discussion. Thanks for organizational and financial support for the workshop and for this publication go to the Hans Böckler Foundation.

Düsseldorf, September 2004
Eckhard Hein, Torsten Niechoj, Thorsten Schulten, Achim Truger
Growth and employment through macroeconomic coordination
Macroeconomic coordination as an economic policy concept – opportunities and obstacles in the EMU

1. Introduction

After three years of economic stagnation across the member states of the European Monetary Union (EMU), the EU Commission is currently forecasting for 2004 only moderate growth of approximately 1.8% in real gross domestic product (GDP) within the EMU. Consequently, the unemployment rate for 2004 will once again climb above 9%, having fallen below 8% in 2001. Clearly, then, even since the creation of the EMU it has not been possible to achieve the higher rates of economic growth in Europe which would lead to a significant cut in the high rate of unemployment. Whereas the average annual real GDP growth rate in the US in the 1990s was running at 3.2%, and unemployment for the same period fell to an average of 5.6%, annual real GDP growth in the countries of the EMU dropped from an already meagre 2.4% in the 1980s to an average of 2.1% in the 1990s. Unemployment rose correspondingly from an average of 8.6% in the 1980s to 9.8% in the 1990s. Even after the slump in growth in 2001, the GDP growth rate in the United States of over 2.5% is now once again appreciably higher than in the EMU.

* We would like to thank Torsten Niechoj and Thorsten Schulten for helpful comments.

For all of the following figures, see European Commission (2003). In the most recent European Commission publication (2003) unemployment figures relate only to eleven of the twelve EMU countries, since Greece is not included.
As can be seen from Tables 1 and 2, however, this unsatisfactory growth and jobs performance within the EMU as a whole is not applicable to each individual country. Whilst the EMU convergence process of the 1990s succeeded to a considerable degree in closing the gap between member states’ nominal variables (short and long-term nominal interest rates, inflation rates and deficit ratios), real variables (GDP growth, output gap, unemployment rate, and labour productivity) tended to diverge.  

Table 1: Real GDP growth rates for EMU countries and the US, 1999–2004 (in %)

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003*</th>
<th>2004*</th>
</tr>
</thead>
<tbody>
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<td>3.8</td>
<td>0.6</td>
<td>0.7</td>
<td>0.8</td>
<td>1.8</td>
</tr>
<tr>
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<td>2.0</td>
<td>2.9</td>
<td>0.8</td>
<td>0.2</td>
<td>0.0</td>
<td>1.6</td>
</tr>
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<td>4.4</td>
<td>4.0</td>
<td>3.8</td>
<td>4.1</td>
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<td>0.2</td>
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</tr>
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<td>1.2</td>
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<td>0.3</td>
<td>2.5</td>
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<td>3.8</td>
</tr>
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</table>

Notes: * European Commission forecast


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2 For further details see Hein/Truger (2005).
Table 2: Unemployment rates in EMU countries and in the US, 1999 – 2004 (in %)

<table>
<thead>
<tr>
<th>Country</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003*</th>
<th>2004*</th>
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<td>7.3</td>
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<td>7.8</td>
<td>8.6</td>
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<td>9.6</td>
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<tr>
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<td>11.0</td>
<td>10.4</td>
<td>10.0</td>
<td>9.5</td>
<td>9.2</td>
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<tr>
<td>Spain</td>
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<td>10.6</td>
<td>11.3</td>
<td>11.3</td>
<td>10.9</td>
</tr>
<tr>
<td>France</td>
<td>10.7</td>
<td>9.3</td>
<td>8.5</td>
<td>8.8</td>
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<td>9.7</td>
</tr>
<tr>
<td>Ireland</td>
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</tr>
<tr>
<td>Italy</td>
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<td>9.4</td>
<td>9.0</td>
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<td>Luxembourg</td>
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<td>4.1</td>
<td>5.1</td>
<td>6.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Portugal</td>
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<td>4.1</td>
<td>4.1</td>
<td>5.1</td>
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<td>7.2</td>
</tr>
<tr>
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</tr>
<tr>
<td>USA</td>
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<td>6.1</td>
<td>6.2</td>
</tr>
</tbody>
</table>

Notes: * European Commission forecast, EU-11 excluding Greece

In the meantime, this real divergence is also having repercussions on the dispersion of deficit ratios. Following the marked reduction, in the run-up to European Monetary Union, towards the Maastricht Treaty’s goal of a current public budget deficit of less than 3% of GDP, now the larger member states in particular, are experiencing considerable difficulty in keeping to the deficit target (Table 3 on the next page). For the third year in succession Germany and France will fail to attain the deficit target in 2004 and as a result are already subject to the excessive deficit procedure of the European Commission and the ECOFIN Council. As in 2001, Portugal’s budget deficit for 2004 will also be too high.

In the course of this contribution we shall explain that after almost five years of EMU, real economic stagnation and the failure to achieve conver-
In the second section, we shall begin by setting out in brief the direction taken by monetary, fiscal and wages policy in the context of the EMU’s institutional framework, before going on to demonstrate that these policies have been guided by ‘new monetarist’ notions of a clear economic policy assignment. The third section will then present alternatives for a more expansive macroeconomic policy mix based on a (post-)Keynesian approach to macroeconomics. Since these alternatives require the various players to implement a coordinated expansive macroeconomic policy in which monetary, fiscal and wages policy share responsibility for growth, employment and price stability, the extent to which it is possible to implement such a policy mix within the institutional framework of the EMU is also discussed. Section 4 briefly draws the following conclusions: the current institutions

Table 3: Total government budget surplus (+) or deficit (-) (as % of GDP) in EMU countries and in the US, 1999-2004

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
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<td>-0.5</td>
<td>-3.4</td>
<td>-5.0</td>
<td>-5.5</td>
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</tbody>
</table>

Notes: *European Commission forecast

may not be ideal for achieving a more expansive policy mix, but with an appropriate appreciation of the macroeconomic context (which could even be brought about by means of political pressure) the relevant players will nevertheless find considerable scope for pursuing policies which are more growth and employment-friendly.

2. The restrictive macroeconomic policy mix of the Maastricht Assignment

The current policy mix in the EMU, characterised by the ‘Maastricht Assignment’ (Issing 2002), follows a concept which can be described as ‘new monetarist’ in line with Arestis et al. (2001) and which in theory derives from a blend of monetarist, neo-classical and new-Keynesian economic policy assignment (Hein 2002). This concept can be summarised in four points:

1. In the long term, the private sector is stable, and both Say’s Law (i.e. every supply produced under least-cost conditions will find a demand) and the classical dichotomy between the real and the nominal sphere apply. Discretionary economic policy has a destabilising effect. As a result, economic policy decisions must be made largely independent of the political regime of the day and must be subject to clear rules.

2. Inflation is exclusively a monetary phenomenon. The role of independent central banks is therefore purely to maintain price stability. By using interest rate policy they can control the inflation rate without real economic costs.

3. Unemployment fluctuates around an equilibrium level, the NAIRU, which is determined by supply-side factors. The NAIRU (Non-Accelerating Inflation Rate of Unemployment) can be reduced by introducing greater flexibility into the labour market, but it remains independent of effective demand on commodity markets.

4. Fiscal policy has no long-term effect on growth and employment and should therefore play a subordinate role to the goal of price level stabil-
ity. Within the context of the economic cycle, however, it should passively accept budget surpluses and deficits.

This policy approach forms the basis of all the key economic policy regulations of the EMU. Thus, for example, the Broad Economic Policy Guidelines (BE PG) as the central ‘coordination instrument’ of economic policy in the EU (EC Treaty, Art. 99) which are drafted by the Commission, debated by the ECOFIN Council and approved annually by the European Council regularly stipulate a clear assignment of the players involved and the tools at their disposal to the economic policy targets as outlined in the ‘new monetarist’ approach. This serves to supporting the ECB in carrying out its primary function – the creation of price stability. The job of fiscal policy, meanwhile, is to achieve a supercyclically balanced budget. Finally, there are a number of recommendations designed to reduce unemployment: the creation of more flexible labour markets; the differentiation of real wages and their alignment with workplace productivity by means of decentralising wage bargaining; increasing the incentives for people to enter employment as well as increasing the mobility of the workforce.

Implicit or explicit ex ante coordination, in which the macropolitical players take joint responsibility for growth, employment and price stability on account of the interdependence of the instruments they deploy, is foreign to this policy approach. Ex ante coordination is actually explicitly rejected by one of the key players, the ECB, with the emphasis instead being on clearly defined competences and responsibilities (Issing 2002).

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3 See European Commission (2002) and Hein (2003) for a more detailed presentation of the economic institutions of the EMU.

4 See the recent recommendations by the Commission for the Broad Economic Policy Guidelines during the period 2003 to 2005 (European Commission 2003a). In a phase of under-utilised capacity and high European unemployment the focus here is on economic reforms to increase the growth potential in Europe and improvements to sustainability of public finances.
The macroeconomic policy pursued since 1999 in the EMU is distinguished not only by its clear assignment of goals and instruments to the macropolitical players in line with the ‘new monetarist’ approach, but also by an asymmetrical degree of centralisation and coordination of individual policies within the euro zone. This gives rise to considerable problems for macroeconomic performance in the EMU.

2.1 Monetary policy

Monetary policy in the EMU has been in the hands of the euro system since 1999, with the ECB at its head (EC Treaty, Art. 105-115). However, the exchange rate regime is established by the European Council after consultation with the ECB (EC Treaty, Art. 111). The primary objective of the ECB is to guarantee price stability (EC Treaty, Art. 105). Provided that achievement of this goal is not compromised, however, the ECB also has a remit to support general economic policy in realising the tasks of the Community, for example, to help bring about a high level of employment and sustained, non-inflationary growth (EC Treaty, Art. 2). However, the ECB sees its contribution to high employment and growth as beginning and ending with the creation of price stability:

“Instead, by maintaining price stability over the medium term, the single monetary policy makes the best contribution it can to achieving sustainable non-inflationary growth and a high level of employment, thereby supporting the general economic policies in the Community, as required by the Treaty.” (Issing 2002, p. 351)

The ECB is politically and economically independent and is also independent in terms of goals and instruments (EC Treaty, Art. 108). In its monetary policy strategy formulated in 1998, it considers its primary goal of price stability to have been achieved if the Harmonised Consumer Price

5 See Hein/Truger (2005) for further analysis of the macroeconomic regime of the EMU and its effects on convergence and growth.
Index (HICPI) increases at a rate of less than 2% per annum in the medium term (ECB 1999). This inflation target represents a very restrictive definition of price stability (Heine/Herr 2001). On the one hand, the price index exaggerates the actual rate of inflation because it fails to take account of quality improvements and substitution processes, with the result that in practice a much lower inflation rate is targeted. Furthermore, sustained upturns in OECD countries have in the past always gone hand in hand with inflation rates above 2%. Even the Federal Republic of Germany, the former key currency country in the European Monetary System (EMS), recorded an inflation rate significantly higher than 2% over the long term.\(^6\) By setting the inflation target at “below 2%”, the ECB is also making it clear that it is not aiming to control inflation symmetrically by combating in equal measure any deviation upwards or downwards from the medium-term inflation target, but favours instead an asymmetrical approach geared to preventing only upward deviations. During the review of the monetary policy strategy carried out in May 2003, the ECB (2003) made it clear that it intended to continue with its restrictive inflation target. Now, however, it specified that there be a “medium-term focus for monetary policy on inflation rates below, but close to, 2%” (ECB 2003, p. 93), believing that this is sufficient to guard against any risk of deflation.

The ECB’s 1998 monetary policy strategy was based on a two-pillar strategy. The first pillar made provision for a reference value for growth of the money supply (M3). The second pillar took account of a number of factors which influence future price trends (wages, exchange rates, bond prices, interest rate structure, real economic activity, fiscal indicators, price and cost indexes, as well as business and consumer surveys). This combination of elements of, on the one hand, a monetarism-inspired control of the money supply, which defines inflation as a ‘monetary phenomenon’ that can be overcome by adequate control of the money supply, and on the

\(^6\) The average annual growth rate in the consumer price index in Germany in the 1970s was 5.1%, falling to 2.5% in the 1980s and 2.3% in the 1990s.
other a Keynesianism-influenced direct inflation targeting, which assumes an endogenous money supply not under the direct control of the central bank and which shifts the causes of inflation instead to the commodity and labour markets, has contributed to the development of a monetary policy strategy which is less than transparent and at times even contradictory (Heine/Herr 2002). During the reform of its monetary policy strategy, the ECB (2003) reduced the importance of the reference value for growth of the money supply by moving monetary analysis to the second pillar. The bank also decided not to give annual reference values for the growth of the money supply. In addition, the ECB emphasised the importance of real economic determinants for inflation, in as far as their analysis now became the first pillar of monetary strategy. The ECB has thus increasingly moved towards a strategy of inflation targeting, such as is currently being practised by a number of major central banks (Meyer 2001).

Certain detailed studies show that in the early years of the EMU the policies of the ECB were characterised by an ‘anti-growth bias’ (Bibow 2002). The ECB did not follow the symmetrical strategy of the US Federal Reserve (Fed), whose policies are considered by many observers to be responsible for the sustained upturn in the US during the 1990s and which even after the recession in 2001 enabled significantly higher growth rates to be achieved in the US than in the euro zone. Instead, the ECB took an asymmetrical approach to combating imminent inflation risks, failing to stimulate growth and employment in phases during which there was no risk of rising inflation (Allsopp/Artis 2003).

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7 These contradictions have a tendency to occur whenever the underlying money supply changes as a result of a restructuring of portfolios, without these influencing in any way inflation potential on the commodities markets, i.e. when there are significant fluctuations in the velocity of circulation.


Figure 1: Federal Funds rate, ECB-interest rate, Euro-exchange rate, and inflation rate in the EMU

As can be seen from Figure 1, in 1999 the US Federal Reserve began raising the key interest rate step by step in order to slow down the share price inflation which accompanied the high GDP growth rates in the second half of the 1990s. When the key interest rate reached a peak of 6.5% in 2000, the Fed effectively triggered an economic downturn in the following year. Despite slower growth in the euro zone, the ECB followed the Fed’s policy of raising interest rates from the end of 1999 onwards. In one year it raised the key interest rate from 2.5% to 4.75%, and in so doing prevented the euro zone from taking over from the US economy as the engine of global economic activity.¹⁰ When there was a global slump in GDP growth, the Fed then began to make significant cuts in its key interest rate from as early as January 2001, continuing to lower it over the course of the next twelve months, until by the end of the year it had fallen from 6.5% to 1.75%, a drop of 4.75 percentage points. The ECB, on the other hand, waited until May 2001, when it was really no longer possible to deny the downturn, before reducing the key interest rate in four small steps from 4.75% to 3.25% by the end of the year, i.e. by just 1.5 percentage points. And in 2002 the ECB refused to lower the key interest rate further – despite ever more distant prospects of an economic upturn – until the very end of the year, when in December 2002 the rate was trimmed back by a further 0.5 percentage points.

¹⁰ For a more detailed assessment of the contribution made by ECB policy to the recession of 2001 see Bibow (2003). If this policy was based on an orientation towards the exchange rate by the ECB, as suggested by Heine/Herr (2002), then it was counterproductive (Bibow 2002). A restrictive monetary policy clouded the prospects for growth in the euro zone, reduced forecast profitability and thus the demand for assets issued within the euro zone and as such did little to aid the recovery of the external value of the euro as determined by the international financial markets. There was no upward revaluation of the euro until in the US growth prospects also began to cloud from 2001 onwards, share prices fell back sharply and uncertainty increased as a result of the September 11 attacks and various corporate American accounting scandals.
Eckhard Hein and Achim Truger

More emphatic interest rate cuts were rejected because the inflation rate was above the medium-term target of less than 2%. As in previous years, however, the failure to meet the inflation target was not due to excessive nominal wage growth, which would have had to be combated by means of a restrictive monetary policy, but to exogenous shocks, i.e. the rise in the price of imported crude oil products and the devaluation of the euro, as well as the rise in the price of food as a result of animal diseases. Monetary policy would have been able to passively accept the one-off surge in prices associated with these events, however, so long as wages policy did not lead to any second round effects. And this had not been the case since the start of monetary union. Nominal wage rates rose moderately at between 2% and 3%, and the rise of unit labour costs by over 2% in 2001 was brought about by the cyclical decline in productivity against the background of a downturn in growth, which was itself a product of monetary policy (Figure 2). Also the two small ECB interest rate cuts totalling 0.75 percentage points in 2003 did not succeed in stimulating the stagnating real economy and were at best no more than a compensation for the revaluation of the euro which had taken place over the same period.

Some observers applying a Taylor rule consider the ECB policy to be entirely appropriate and even rather too expansive in some phases (see, for example, SVR 2003). But using a Taylor rule implies accepting the ECB’s overly restrictive inflation target and the excessively modest assumptions with regard to potential growth. Furthermore, it is unclear whether the equilibrium real interest rate on which the Taylor rule is based is really independent of the monetary interest rate which is decisively influenced by monetary policy. Therefore, even if the ECB follows a Taylor rule, this does not mean that the criticism of an ‘anti-growth-bias’ is unjustified. This ‘anti-growth-bias’ of the ECB will have even more serious effects in the future, since the expansive one-off effects which came about for the majority of EMU countries during the second half of the 1990s as a result of the convergence of their interest rates to the lower German level will disappear now that harmonised interest rates exist.
Figure 2: Unit labour cost, remuneration per employee, and labour productivity in the EMU, 1999/1 – 2003/1, annual growth rate (in %)

One must also add to this hitherto restrictive policy orientation of the ECB the fact that by pursuing this policy the bank is also intensifying structural and regional asymmetries. This occurs firstly because despite convergence there has not yet been complete synchronisation of the economic cycle in the euro zone, and secondly, because the member states of the EMU show widely varying growth trends. This means that the ECB is obliged to use one single instrument – variation of its key interest rate – across an economic area which still has significant variations in growth rates, unemployment rates and inflation rates (Arestis et al. 2002).\textsuperscript{11} For this reason alone, the ECB policy produces asymmetrical effects which are in turn intensified by virtue of the fact that the transmission channels for monetary policy in the member states also vary widely on account of them having capital markets and commercial banking systems which still differ considerably (Cecchetti 1999, Mihov 2001).

2.2 Fiscal policy
In the context of the ECB’s aggregate restrictive and both structurally and regionally asymmetrical monetary policy there is currently no possibility of a compensating fiscal policy at EMU level. The European Union (EU) budget amounts to a maximum of 1.2% of GDP in the EU, it must be balanced each year and is largely used for the Common Agricultural Policy – only a small part of it is available for the Cohesion and Structural Funds. Under such circumstances, therefore, the EU budget is unable to function either as an economic stabiliser or to be used to combat structural or regional asymmetries (Arestis et al. 2001). This means that fiscal policy remains essentially a matter of national responsibility and is coordinated through the Treaty of Maastricht and the Amsterdam Stability and Growth Pact (SGP) (European Commission 2002). As conditions of entry to the monetary union, the Maastricht Treaty sets a maximum deficit ratio (pro-

\textsuperscript{11} This means that the EMU’s largest country, Germany, which has the smallest GDP growth rate and the lowest rate of inflation, faces the highest real rate of interest in the euro zone – a factor which retards growth even further (Hein/Truger 2005a).
portion of current budget deficit in relation to GDP) of 3% and a maximum debt ratio (proportion of public debt in relation to GDP) of 60%. The SGP makes this regulation even tougher by prescribing for the medium term, i.e. a time span which stretches across economic cycles, balanced budgets or budget surpluses in order to reduce the level of debt.\textsuperscript{12} Achieving these conditions is intended, on the one hand, to enable the budget sufficient scope to allow the automatic stabilisers to work during economic downturns without violating the 3% deficit criterion. On the other hand, it should create leeway for any future funding objectives which may arise, especially from demographic developments such as social security provision for the elderly.

There is just as little provision in the SGP for the loan financing of public investments as there is for the medium-term use of budget deficits to stabilise effective demand at a level that is compatible with a high level of employment. The latter implies that a balanced budget in each country must be compatible with every level of employment, including a level of employment which is determined by the supply side e.g. via the NAIRU (Arestis/Sawyer 2003). As we know from macroeconomic accounting, a country’s private savings (S) minus investments (I) is equal to the sum of its exports (X) minus its imports (M) plus government expenditure (G) minus tax revenues (T): \[ S - I = X - M + G - T. \] In the case of a balanced budget, domestic surplus savings must be equal to the export surplus. There are no adjustment mechanisms, however, to achieve this for a given level of employment. Even if a neo-classical interest rate mechanism is assumed to adjust investment and savings, this will have little effect for the individual countries in a monetary union where there is an integrated capital market. The same is true for the balance of exports and imports which is supposed to be achieved via the exchange rate according to the neo-classical theory of

\textsuperscript{12} See Allsopp/Vines (1998), Arestis et al. (2001), Eichengreen (1998) and Semmler (2000) for a more detailed analysis of the SGP.
international trade, since the exchange rate no longer exists between the member states of a monetary union, and between the monetary union and other currency areas it is not determined by the export surplus of any individual country in the monetary union. There is therefore no reason to suppose that for a given level of production and employment, and with decentralised decision-making by companies and private consumers with regard to investments and savings, the budget will always be balanced. Under these circumstances, the balancing of the budget forces either an expansion of export surpluses (or a reduction of export deficits) or a cut in domestic surplus savings. The latter, assuming a stable savings-income ratio, implies a Keynesian-style decrease in domestic employment, whereas the former implies domestic wage restraint with a view to improving international price competitiveness, which cannot, however, go unanswered by competitors within a monetary union, and may therefore trigger a disinflationary and ultimately deflationary process.

The coordination of fiscal policies in the framework of the SGP requires member states to present annual stability programmes to the European Commission which describe how they intend to achieve balanced budgets and which can be employed as early warning systems to give advance notice of when a country is approaching the 3% limit for its current budget deficit. If this mark is overstepped, the ‘excessive deficit procedure’ comes into operation (EC Treaty, Art. 104). If the country is not in a deep recession, defined as an annual fall in real GDP of more than 2%, and if the country

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13 The proposal by Allsopp (2002) and Allsopp/Artis (2003), to facilitate budget consolidation in Germany with a structural domestic surplus saving by further raising export surplus by means of a deflationary wages policy, cannot therefore be supported, because on the one hand such a policy holds the risk of a wage dumping process within the EMU, and on the other the German economy, which is currently experiencing a stagnant GDP development, a rate of inflation below the EMU average, an already high level of export surplus and a weak level of domestic demand, would come closer to deflation. On current deflation risks in Germany see Hein/Schulten/Truger (2004).
in question refuses to put consolidation measures in place, penalties of up to 0.5% of GDP may ultimately be incurred. These financial penalties thereby raise the deficit to be consolidated.

It is clear from this brief outline that the decentralised fiscal policy of the EMU is also hardly in a position to compensate for the restrictive and asymmetrical effects of the ECB’s monetary policy, indeed if anything it reinforces them. The lack of fiscal federalism makes it impossible to combat regional and structural asymmetries. Even in the case of a widespread symmetrical recession, the decentralised fiscal system does not encourage coordinated anticyclical measures; on the contrary, it supports a tendency towards free-riding. National fiscal policies committed to budget consolidation in their stability programmes, will wait for the spill over effects of the active fiscal policies of other EMU member states or other parts of the world, such as the USA. This ‘prisoner’s dilemma’ means that public expenditure will tend to be procyclical and the automatic stabilisers will be negated.

Empirical studies show that fiscal policy in the EMU member states during the EMU convergence process of the 1990s was appreciably more restrictive than in the 1980s (see Figure 3a on page 37). The structural deficit ratio was reduced several times during a downturn phase and thus the measures taken were actively restrictive (Hein/Truger 2005). In addition, the consolidation introduced on the expenditure-side was in particular at the expense of public investment and hence future growth opportunities. The average annual growth rate of public investment in the EMU countries (excluding Greece) in the 1990s was –0.5%, whereas in the USA it was running at 3.2% (Truger 2002). Consequently, in the second half of the 1990s public investment as a percentage of GDP fell to 2.5% in the EMU states, having stood at between 3% and 4% in the 1970s and remained well above 3% throughout the 1980s. In the USA, on the other hand, the public investment ratio stabilised in the second half of the 1990s at a level well above 3%.
During the first three years of monetary union, fiscal policy in the EMU was overall moderately expansive, and the structural budget deficit ratio increased by roughly 0.8% (Figure 3a). Between 1999 and 2000, this expansion ran into a phase of economic upswing and thus had a procyclical effect. In the downturn which began in 2001, the expansion initially had a slightly anticyclical effect in line with the economic situation. However, by 2003 at the latest, fiscal policy was clearly constrained by the limits of the Stability and Growth Pact, and in spite of a further fall in the output gap, 2003 saw a return to a restrictive policy. Given the current prolonged stagnation phase, during which the two largest EMU countries, Germany and France, are being forced to take further active consolidation measures as part of the deficit procedure, 2004 is also set to see restrictive fiscal stimuli which will further destabilise the economy (IMF 2003). Fiscal policy in the USA, on the other hand, was much more expansive and in tune with the economic circumstances (Figure 3b on page 38). In the US, the structural deficit ratio was cut sharply during the long upturn of the 1990s, but after the economic downturn of 2001 emphatic anticyclical measures were taken once more. Almost the same development has taken place in the UK since the early 1990s (Figure 3c on page 39).

Although the general decline in the public investment ratio within the EMU has not continued since the start of monetary union, most member states experienced a clear procyclical fall in their public investment growth rate during the downturn of 2001 (OECD 2003). The SGP therefore made no contribution to increasing the stability of public investment.

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14 For Germany, fiscal policy planning for 2004 and 2005 is already restrictive (Institute 2003).
Figure 3a: Output gap and structural budget deficit in the EMU, 1980-2003 (in % of potential GDP)

Source: OECD (2003)
Figure 3b: Output gap and structural budget deficit in the US, 1980-2003 (in % of potential GDP)

Source: OECD (2003)
Figure 3c: Output gap and structural budget deficit in the UK, 1980-2003 (in % of potential GDP)

Source: OECD (2003)
A disaggregated appraisal of the fiscal reactions to the economic downturn since 2001 in the individual states only serves to highlight further the inappropriate nature of fiscal policy in the EMU given the economic situation. It also highlights very clearly the problem of free-riding. Table 4 compares the variation in the output gap between 2000 and 2003 with the variation in the structural budget deficit ratio.

Table 4: Variation in national output gap and structural budget deficit (as % of potential GDP) from 2000 to 2003 in EMU countries, United Kingdom and USA

<table>
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<tr>
<th>Country</th>
<th>Variation in output gap</th>
<th>Variation in structural budget deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>-3.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Germany</td>
<td>-3.3</td>
<td>-0.6</td>
</tr>
<tr>
<td>Greece</td>
<td>2.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Spain</td>
<td>-1.9</td>
<td>1.3</td>
</tr>
<tr>
<td>France</td>
<td>-2.4</td>
<td>-1.1</td>
</tr>
<tr>
<td>Ireland</td>
<td>-3.6</td>
<td>-4.3</td>
</tr>
<tr>
<td>Italy</td>
<td>-2.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-5.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Austria</td>
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<td>1.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>-4.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Finland</td>
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</tr>
<tr>
<td>EU 12</td>
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</tr>
<tr>
<td>United Kingdom</td>
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<td>-2.5</td>
</tr>
<tr>
<td>USA</td>
<td>-4.2</td>
<td>-4.9</td>
</tr>
</tbody>
</table>

Source: OECD (2003)

Out of all the EMU member states, only Ireland pursued an emphatically anticyclical fiscal policy, with a sharp fall in the output gap of 3.6% leading to an increase in the budget deficit ratio of 4.3 percent. Along with Finland, only the two largest countries, France and Germany, pursued a moderately anticyclical policy throughout the crisis years, although it ap-
pears likely that this will be moderated or even reversed in 2004. All the other countries attempted to balance their budgets as prescribed by the SGP, and in so doing pursued a fiscal policy which served overall to exacerbate the crisis causing them in fact to become free-riders in terms of the economic cycle. If Germany and France had reacted similarly and also made extensive cuts to their structural deficits in order to comply with the terms of the Stability and Growth Pact, the EMU might well have been thrown into deep recession. Fiscal policy in the United Kingdom and the USA, on the other hand, where powerful measures were introduced to counteract the downturn, was used in exemplary fashion.

Even the recent reforms adopted by the ECOFIN Council at the behest of the Commission do little to alter the restrictive and rather growth-unfriendly nature of fiscal policy in the EMU (ECOFIN 2003). Alongside a number of very general appeals to allow the automatic stabilisers to operate symmetrically, i.e. even in an upturn, and to keep an eye on the sustainability of public finances when evaluating consolidation progress, all the ECOFIN Council does is specify that the call for a balanced budget or budget surplus should relate to the cyclically adjusted budget position. Countries which have not yet met this requirement should reduce their structural deficit ratio by 0.5% per annum, despite the current weakness of the economy. This has already led to a situation in which the countries in question, i.e. Germany and France in particular, are not in a position to allow the automatic stabilisers to take full effect.

2.3 Wages policy

In the context of a single monetary policy geared exclusively towards price stability, and a fiscal policy committed to supercyclical budget consolidation, the prevailing view is that the real wage determination is the key factor for determining the level of production and employment and for assimilating symmetrical and asymmetrical shocks. Correspondingly, there is no shortage of proposals aimed at increasing wage differentials, further deregulating the European labour market, decentralising the wage bargaining sys-
tems, reducing the reservation wage arising from wage-compensating benefits, and promoting an active labour market policy geared towards improving the qualifications and mobility of the labour supply. In this view, the high level of unemployment in Europe can predominantly be put down to 'structural' reasons, and monetary integration is often seen as the catalyst for the long heralded structural reforms (e.g. Calmfors 1998, Issing 2002). This position has shaped key areas of the common economic policy agreed on either by the EU or the EMU (European Commission 2002). For example, such demands are a recurring feature of the Broad Economic Policy Guidelines adopted by the European Council (EC Treaty, Art. 99). Likewise, the employment chapter of the Amsterdam Treaty (EC Treaty, Art. 125-130) and the annual employment guidelines (under the 1997 Luxembourg Process) seek to improve the efficiency of the labour market in order to eliminate high unemployment in Europe.\footnote{At the heart of the employment guidelines is the promotion of employability, entrepreneurship, labour market flexibility and equal opportunities for women.}

However, this emphasis on structural reforms in the labour market and the wage bargaining systems ignores the fact that these measures only have an impact on nominal wages determined on the labour market, and not on real wages, if we realistically assume that in imperfect commodity markets, prices come about as a result of a mark-up being added to unit labour costs. For this reason, downward nominal wage differentiation and general wage restraint initially have an effect only on prices, and can only exert a possible influence on growth and employment if the ECB rewards this wages policy with a symmetrical and consequently more expansive monetary policy (Allsopp/Vines 1998). What is required in order for a reduction of the NAIRU, which should arise from structural reforms in the labour market, also to result in a lowering of the actual unemployment rate, is an employment and growth-oriented monetary policy which stimulates investment and effective demand. However, as outlined above, such a strategy has not been pursued by the ECB since 1999.
But the pursuit of a strategy aimed at reducing unemployment in Europe by deregulating the labour market and decentralising wage bargaining entails a further risk. It must not only rely on a symmetrical central bank reaction function, but also on monetary policy having a symmetrical effect, or on a real balance effect which guarantees to close the gap between the demand for goods and the supply of goods linked to the NAIRU (Hein 2004). For such a real balance effect we must assume the dominance of an exogenous money supply which represents a net asset for the economy as a whole. However, when money arises from creditor-debtor relationships in a modern two-tier banking system, this is not the case. In an economy such as this, monetary policy is also relatively unlikely to have symmetrical effects. In the short term, monetary policy may be able to choke a cumulative inflationary process caused by excessively low unemployment by applying the interest rate brake, thus curbing effective demand for goods and increasing unemployment. However, if during a recession unemployment rises significantly above the NAIRU, leading to disinflation and ultimately deflation, then an interest rate cut is not enough to stimulate an economic recovery, when companies have depressed profit expectations and are affected by debt deflation.

Macroeconomic wage externalities can be internalised more effectively by taking a macroeconomic approach to coordinating wages policy in which nominal wage growth rates are determined on the basis of the sum of long-term productivity growth for the economy as a whole and the central bank’s inflation target. This firstly means that ‘effective coordination’ of wage bargaining is able to reduce inflationary pressures when employment is rising and in so doing to lower the employment limit expressed in the

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16 This has been shown recently in a series of works on the interaction between wage bargaining systems and independent central banks. Franzese (2001), Soskice/Iversen (2001) and Hein (2002a) each present overviews containing implications for the EMU.
NAIRU. Such a course makes it possible for the central bank to tolerate a higher level of employment while still meeting its inflation target. Secondly, during a phase of rising unemployment, coordinated wage bargaining can lessen the pressure for wage reductions and thereby reduce the risk of macroeconomically destabilising deflationary processes.

There are, however, considerable obstacles standing in the way of an EMU-wide coordination of wages policy. National wage bargaining systems still vary widely, for example, although they show a much greater degree of national coordination than in the United Kingdom or the US (Borghijis et al. 2003, Hancke/Soskice 2003). Against this backdrop, there have been various attempts on the part of the European trade unions to coordinate wages policy transnationally (Schulten 2002). In the 1998 Doorn declaration, the trade union federations of Germany and the Benelux countries agreed to pursue productivity-based real wage increases in order to prevent tit-for-tat wage dumping between countries. At a sectoral level, the European Metalworkers’ Federation was the first to adopt the concept of European wages policy coordination based on productivity increases and the inflation rate. This concept has since been adopted by almost all the industry federations and by the European Trade Union Confederation. However, the coordinated implementation of such an approach is on the one hand hampered by the sustained pressure for the decentralisation of wage bargaining. This trend follows the decentralisation of corporate decision-making and is strengthened by increased global competition and the increasing dominance of the employer side. Furthermore, in a phase of sluggish growth, social pacts which attempt to strengthen the international

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17 What is meant here by ‘effective coordination’ of wages policy is a functioning horizontal coordination between the sectors of industry which is accompanied by a functioning vertical coordination within the sectors (Kittel/Traxler 2001), which solves the problem of implementation and prevents earnings drift and wage dumping.
Macroeconomic coordination as an economic policy concept

competitiveness of the domestic economy through nominal wage restraint\(^{18}\) have become increasingly widespread throughout Europe at the national levels. Both these tendencies stand in the way of an effective EMU-wide coordination of wages policy.

The lack of EMU-wide coordination of wages policy and the trend towards national corporatist competitive structures are having negative repercussions on macroeconomic performance. In phases of rising employment or when there are negative external shocks which restrict the scope for income distribution, it is not possible to achieve the necessary nominal wage restraint and the ECB may as a result be forced to intervene and cause unemployment to rise.\(^{19}\) In phases of high unemployment, such as at present, countries with a high degree of national wage bargaining coordination can exploit this advantage to strengthen their price competitiveness by means of nominal wage restraint within the framework of social pacts. Such competitive corporatism poses a danger when it is pursued by several countries, especially large ones, since it causes deflationary pressure to be exerted on the euro zone as a whole. General nominal wage restraint and falling wage shares brought about by downward commodity price rigidities then con-

\(^{18}\) See on this subject e.g. Calmfors (2001) and Schulten (2002a). According to Calmfors (2001) when the EMU was introduced there were national pacts aimed at improving international competitiveness in the following countries: Belgium, Germany, Greece, Finland, Italy, Ireland, Netherlands, Portugal and Spain.

\(^{19}\) Astonishingly, Hancke/Soskice (2003) see here the main danger arising from EMU wages policy, resulting from there no longer being a central wage policy player to stand up to the ECB, unlike was previously the case with the Bundesbank and the IG Metall. As evidence for the risks which this situation poses to stability they point to the long periods during which the inflation rate in the EMU rose above the target rate, without however posing the question where the causes of these missed targets might be found. In circumstances of general wage restraint, therefore, they recommend a coordinated effort on the part of the trade unions in Germany, France and Italy towards further wage moderation in exchange for state-sponsored initiatives with the aim of improving growth in productivity.
tribute to macroeconomic destabilisation. Figure 4 shows the long-term effects of deflationary nominal wage pressure on the labour income share, which followed a downward trend in the EMU countries from the early 1980s on, then fell sharply during the convergence process in the mid 1990s and has remained almost stable since 1999, i.e. in 2001/2 it did not rise again, as would be usual in a period of weak economic activity. This last fact points to greater downwards flexibility of nominal wages, which thus cease to act as stabilisers during economic downturns. In the US, on the other hand, a similar – if not quite so marked – downward trend in the labour income share could be observed from the beginning of the 1980s, but this was halted by the mid 1990s. In the 2000/2001 recession the wage share rose sharply, before falling back again in the ensuing upturn.

2.4 An overall restrictive policy mix

Summing up, the EMU is dominated by an overall restrictive policy mix which has already been responsible for the low growth, the high unemployment and the inadequate real convergence witnessed in the 1990s.\textsuperscript{20} The ECB’s monetary policy, the primary goal of which is to create price stability, exhibits a clear ‘anti-growth bias’ and has considerable asymmetrical effects on the countries of the euro zone. There is a danger that the restrictive and asymmetrical effects of such a monetary policy will become even more apparent in future, since the compensating expansive effects of the general interest rate convergence to the lower German level are disappearing now that there is a single interest rate. Without mature fiscal federalism and with the restrictions imposed on national fiscal policy by the SGP, there are no fiscal instruments to counteract regional and structural asymmetries and to stabilise the macroeconomy in a recession, especially if the ECB continues to stick to the letter of its remit as it has done in the past (Spahn 2003). Given that the larger countries, in particular, are now threatening to exceed the limits imposed by the SGP and have been forced

\textsuperscript{20} For more on the restrictive policy mix of the EMU convergence process, see for example Bibow (2001), Lombard (2000) and Semmler (2000).
Figure 4: Labour income shares in the EMU and the US, 1980-2003 (in %)

to adopt a markedly procyclical fiscal policy, what one might actually expect from fiscal policy is an additional restrictive effect. Inadequate EMU-wide coordination of wages policy in combination with further deregulation of labour markets, decentralisation of wage bargaining and the dominance of national competitive corporatist structures reinforces deflationary tendencies and real divergence. As the euro zone is essentially a large closed economy, the improvement of international competitiveness linked to these deflationary tendencies and the associated rise in export surpluses can only ease the strain to a very limited extent.

3. The alternative of a coordinated macropolicy and the scope for its implementation in the EMU

3.1 The concept of a coordinated macropolicy

One alternative to the ‘new monetarist’ policy approach and assignment is a (post-)Keynesian approach which could form the basis for a more expansive, employment-oriented macropolicy. The essential characteristics of this approach can be summarised under the following four points:21

1. In a money economy, Say’s Law and the classical dichotomy between the monetary and the real spheres do not apply either in the short or the long term. The private sector is unstable and is therefore in need of a policy stabilising effective demand in the short and long term. In order to do this, what is required is a coordinated monetary, fiscal and wages policy geared towards the medium to long term.

2. In the short term, the central bank’s interest rate policy influences effective demand, and in particular private investment, via delayed effects on the capital market interest rate, and in the long term it affects functional income distribution. Monetary policy therefore has considerable real effects in the short and long term. Its short-term effects are asymmetrical, however: by raising interest rates the central bank can

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put a stop to any boom, but cutting interest rates when businesses have depressed profit expectations cannot end a recession. To do this it requires the support of fiscal and/or wages policy.

3. The nominal wages policy agreed by the social parties has no direct influence on employment. Instead, it influences the nominal unit labour costs for a given level of labour productivity and the price level for a given mark-up applied by businesses when setting prices. Changes to distribution are only possible if this is allowed by the factors that influence the mark-up, such as the intensity of competition on the commodity markets or the long-term prevailing interest rate. The level of employment is a product of effective demand on the commodity market, the development of which is essentially determined by private investment, which is in turn dependent on the relationship between the expected profit rate and the interest rate.

4. Fiscal policy can stabilise the economic cycle in the short term by accepting cyclical deficits and surpluses, and in the long term it can increase effective demand and potential growth by means of a policy of investment-oriented borrowing. Moreover, the distribution of available income can be modified by means of tax policy and social policy, and this can in turn influence consumer demand which is the largest demand aggregate. Government competition policy influences the level of competition on the commodity market and also therefore mark-ups and functional income distribution.

On account of the interdependencies of the instruments used by the economic players and the fact that the target variables are in each case influenced by different instruments, the (post-)Keynesian approach prohibits a strict assignment of players and instruments to just one single economic policy goal. As a result, coordination of the means employed is indispensable. This coordination may be achieved implicitly by individual players taking account of the interdependencies, or it may be achieved explicitly in the framework of institutionalised ex ante coordination. What is vital, how-
ever, is that the players are aware of the interdependence of their activities and that there is agreement on the likely effects of the instruments used. As such, coordination requires a minimum level of consensus with regard to the analysis of economic circumstances, the diagnosis and prognosis for the economic situation and the economic objectives to be achieved (Priewe 2002).

The first objective of a coordinated macropolicy in a world where fundamental Keynesian uncertainties exist must be to stabilise the expectations of private investors by means of an economic policy focused on the medium to long term, which supports market configurations with stable effective demand and therefore in particular with stable private investment demand (Heine/Herr 1998). As part of a coordinated macropolicy, wages policy has the task of providing an anchor for price level stability by basing nominal wage growth on long-term productivity growth for the economy as a whole and on the central bank’s inflation target. In this way it not only eases the pressure on monetary policy in the fight against inflation, but also prevents the occurrence of deflationary processes which would be damaging to the economy as a whole. Furthermore, a productivity-based wages policy ensures that consumer demand, as the largest demand aggregate, grows at roughly the same pace as output. In order to perform this task successfully, there must be a high degree of effective macroeconomic coordination of wages policy. If the pressure on monetary policy can be relieved by wages policy in this way, then monetary policy will be able to tolerate lengthier upturn phases with rising employment without having to provoke stabilisation crises. In addition, on account of its short-term asymmetrical effect and the considerable delay before the effects of using its interest rate instrument are felt, it also has the responsibility to react promptly to any incipient downturns in order to prevent deep recessions from coming about, where monetary policy is ultimately impotent. This requires a monetary strategy which provides for a symmetrical response when targets are not met, as well as taking into account growth and employment effects. In the long term, monetary policy should aim for a policy of low interest rates on account of its distribution effects, in order to prevent income redist...
tribution in favour of asset owners and in order to stimulate investment in real assets. Fiscal policy should on the one hand allow the automatic stabilisers to take effect and thus stabilise economic activity, but in so doing it should avoid destabilising discretionary interventions. On the other hand, fiscal policy should be able to use loan-financed public investment in infrastructure and human capital in order to stabilise effective demand for the long term and to raise productivity growth for the economy as a whole. Given a correspondingly high self-financing ratio achieved by higher growth and the pursuit of a low interest rate policy by the central bank, there will be no threat to the sustainability of public finances as a result of the loan financing of investments. A strengthening of private consumer demand should come about as a result of taxation and social policy boosting the disposable income of high-spending consumers in the lower income brackets.

3.2 Coordinated macropolicy in the EMU

The implementation of a coordinated macropolicy in the EMU will necessarily require the key players to reject the policy mix which has been applied until now. Moreover it faces institutional problems, since the current regulations for monetary and fiscal policy, as well as the conditions governing wages policy in the EMU, do not support a coordinated expansive macropolicy and indeed to some extent stand in its way. Over the pages which follow we shall briefly outline possible approaches in the EMU for achieving a more expansive policy mix, together with any necessary institutional reforms, for each of the individual policy areas and their coordination.

3.2.1 Wages policy

In order for wages policy to be able effectively to carry out its role as a nominal and real stabiliser as outlined above and not to exacerbate regional disparities, nominal wage growth in the individual member countries of the EMU should be aligned with long-term national productivity growth and the ECB’s inflation target. Wage dumping between member states is there-
fore as much to be avoided as inflationary settlements which call for restrictive intervention from the central bank. No attempt should be made, therefore, to use wages policy to directly influence distribution or employment. For a nominally stabilising wages policy, what is required is the effective coordination of wage bargaining not only nationally but also in particular at a transnational EMU level. These in turn require trade unions and employers’ associations at national levels which are able to bargain and develop strategies effectively and are in a position to conclude and guarantee the implementation of settlements oriented towards the economy as a whole (Kittel/Traxler 2001). Key instruments to this end are sectoral collective agreements and the universal validity of collective agreements. The decentralisation of collective bargaining and promotion of individual company-level wage settlements recommended in the Broad Economic Policy Guidelines are as diametrically opposed to these requirements as a further deregulation of the European labour market. Although the European trade unions have now accepted that wage settlements should be based on productivity growth and the rate of inflation,22 in almost all EMU member countries the national trade union organisations have also become involved in social pacts aimed at increasing national competitiveness by means of wage restraint, which place deflationary pressures on the euro zone as a whole. These national competitive corporatist structures also act as an obstacle to responsible macroeconomic coordination of wages policy in the euro zone.

In order to give wages policy in the EMU the opportunity to fulfil its role within a coordinated macropolicy, therefore, not only must there be a fundamental abandonment by economic policy of the current strategy of labour market deregulation and decentralisation of collective bargaining, but

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22 What is meant here, however, is usually not the target inflation rate of the central bank but consumer price inflation. Implementation of such a wages formula may, of course, set off a cumulative inflation process for businesses applying cost-oriented price fixing, if the distribution demands of the state or other countries rise, e.g. as a result of an increase in the net tax and fiscal charge rate or in import prices (Hein 2002a).
also increased efforts by the trade unions to achieve an effective European-level coordination of their wage demands are required (Schulten 2002a).\(^{23}\) Until this happens, especially in periods of high unemployment such as at present, wages policy will create a deflationary pressure which gives monetary and fiscal policy a particular responsibility for growth and employment.

3.2.2 Monetary policy

In the context of a coordinated macropolicy, monetary policy also assumes responsibility for growth and employment, especially when there is no inflationary pressure from wages policy or fiscal policy. The ECB should therefore make much more fundamental changes to its monetary strategy than in the last review in May 2003, and formulate its inflation target as a point or corridor target which it can then aim for in a symmetrical fashion. The ECB might well use the monetary strategy of the Bank of England as a model. The Bank, which is otherwise independent, is currently charged with the task of achieving an inflation target of 2.5% prescribed by the Treasury. Deviations of one percentage point in either direction must be explained to the Chancellor of the Exchequer.\(^{24}\) This means that, in contrast to what the ECB has done thus far, the central bank must not only combat upward deviations from its inflation target but must also combat downward deviations equally vigorously. Accordingly, the ECB’s inflation target should be raised to at least the level set by the Bank of England, or perhaps even higher, in order to take into account the fact that the member states of the EMU have different long-term growth trends and accordingly

\(^{23}\) In the EMU, a coordination approach such as this must be based on existing national coordination mechanisms and should seek to network these transnationally. Such a decentralised approach might for example mean that the trade unions in the metalworking industry could take on the role of wage leadership in Europe. This would mean that the collective bargaining policy of Germany’s IG Metall in particular would play a central role. See Traxler/Mermet (2003) on a similar approach.

\(^{24}\) See Meyer (2001) on various monetary policy strategies.
different rates of inflation. Moreover, the target should really be treated as a medium-term goal, allowing the effects of supply shocks (e.g. energy price rises) to peter out, and only kicking in again if a cumulative price-wage-price spiral is triggered as a result. Furthermore, the ECB should keep a closer eye on growth and employment targets and from time to time test the growth potential of the euro zone by means of a controlled monetary expansion, along the lines of what the US Federal Reserve did in the second half of the 1990s (Allsopp 2002). Such a policy takes account of the fact that potential growth or the NAIRU are not exogenously determined variables, but are in fact jointly determined by actual real GDP and employment trends both of which are also influenced by monetary policy (Kaldor 1957, Hein 2004).

Should the ECB stick to its anti-growth and anti-employment course, then the legal framework would have to be changed in line with the above. However, any attempted amendment to the EC Treaty would be faced with major obstacles, since there would have to be agreement among all member states. The core of any such amendment should be the requirement for a medium-term inflation target set by economic policy (e.g. through the European Parliament) which the ECB should seek to achieve in a symmetrical fashion as well as the elevation of growth and employment to monetary policy objectives with the same status as price stability. At the same time, monetary policy should be required to increase cooperation with the other policy areas, e.g. in the Macroeconomic Dialogue, but without encroaching upon the independence with which it chooses its instruments.

Even if a growth and employment-oriented realignment of monetary policy in the EMU were achieved, considerable macroeconomic instability risks could still be expected if a deflationary wages policy continued to be pursued and unemployment remained high. One issue is the asymmetrical and sometimes significantly delayed effects of monetary policy during the

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25 See Fitoussi/Creel (2002) for a proposal along these lines.
course of the economic cycle. Should there be a failure to react in time to an emerging downturn or a negative shock, allowing the economy to plunge into a deep recession, then monetary policy will be powerless to do anything about it. In addition, not even a more expansive monetary policy for the euro zone as a whole can take account of regional and structural asymmetries. So for both reasons, there has to be coordination with fiscal policy.

3.2.3 Fiscal policy

At present, any use of fiscal policy in the EMU to stabilise the economy, combat regional asymmetries and improve the long-term growth trend would contravene the regulations of the SGP.26 Neither the super-cyclical target of balanced budgets or budget surpluses – and the concomitant asymptotic reduction of the debt-GDP-ratio to zero – nor the 3% limit on the current deficit have any reasonable economic justification as target figures. Moreover, the budget deficit is an endogenous variable of the whole macroeconomic process and cannot therefore be directly controlled by fiscal policy. However, the consolidation pressure imposed by the SGP is at its greatest at times of recession and forces the adoption of a procyclical fiscal policy with its particularly negative effects on public investment, whereas there are no consolidation regulations for economic booms.

Nevertheless, coordination of national fiscal policies in the monetary union is necessary in order that the automatic stabilisers can be allowed to take effect in economic downturns, to avoid free-riding by individual member states, and to prevent inflationary budgetary behaviour by individual member states during economic booms. As part of a coordinated fiscal policy in the EMU, therefore, individual countries should be obliged to allow the automatic stabilisers to operate symmetrically, i.e. during both downturns

26 Even the most recent reforms adopted by the ECOFIN Council have brought no fundamental improvement, as already explained above.
and upturns.\textsuperscript{27} To this end, as an alternative to the SGP the individual countries should in our view establish expenditure paths for non-investment, non-cyclical spending, which would be financed in the long term by current tax revenue. Cyclical spending should then be allowed to float freely around this target without being constrained by budget deficit limits. In a downturn, increases in expenditure and falls in revenue bring about budget deficits which are financed by borrowing, thus increasing the level of debt. In an upturn, on the other hand, budget surpluses are created, which are used for consolidation purposes. If non-investment, non-cyclical spending grows at a higher rate than the nominal production potential, then the result is rising super-cyclical budget deficits, whereas if it grows at a slower rate, then structural deficits are reduced. Alignment of the expenditure path with a growth rate below that of the nominal potential GDP path can therefore contribute to a revenue-side budget consolidation, if a structural deficit requiring consolidation existed at the outset.\textsuperscript{28}

For public investment, the possibility of loan financing should exist as a matter of principle (the Golden Rule). Each member country of the EMU should therefore be able to decide for itself on the level and financing of public investment. Even if the other current SGP regulations were maintained, this alone would be enough to mean that consolidation pressure would no longer continue to force down the level of public investment (Blanchard/Giavazzi 2003). Member states could use public investment to stabilise long-term effective demand at a level compatible with high employment (Allsopp 2002). Public infrastructure investment could be used

\textsuperscript{27} See Fitoussi/Creel (2002) on a similar proposal to that outlined here. Buti et al. (2003) give an overview of a series of reform approaches which for reasons of space cannot be discussed here.

\textsuperscript{28} This formed the basis for the process of budget consolidation in the US of the 1990s (Horn/Scheremet 1999). On a similar proposal for Germany see Bartsch et al. (2002) and Eicker-Wolf/Truger (2003).
to increase potential growth and to accelerate the closing of the productivity gap between countries.

In the context of a modernised stability pact, both the expenditure paths for non-investment, non-cyclical public spending and the level of public investment should be a matter for coordination and agreement between member states. With regard to public investment, government deficits should not be allowed to lead to an overloading of the production potential and thus to inflationary pressures. Should such a situation arise – which is relatively unlikely, given the current under-utilisation of production capacity – then the country in question would be obliged to cut public investment accordingly or to finance such investment in part through tax revenues. In addition, under a modernised stability pact there should be checks to ensure that individual countries comply with the prescribed expenditure paths for non-investment, non-cyclical public spending. Moreover, the appropriateness of these expenditure paths themselves should also be subject to regular review, since the reference variable, i.e. the nominal potential GDP path, is liable to change as a result of public and private investment activity.

From time to time, the criticism has been made that expenditure paths imply a very specific concept of the desirable public spending ratio (Buti et al. 2003a, p. 104) and that they therefore restrict national governments’ room for manoeuvre. However, it should be pointed out that in the context of the concept presented here, firstly the paths established are country-specific, so that there is no danger of the solution being too uniform. Secondly, the paths approach does actually allow for changes to the public spending ratio. In this case, however, an increase in the public spending ratio would have to be financed through additional taxation. A reduction in the public spending ratio – something which we would view with some scepticism – would be possible by lowering the expenditure path. Although this would have the effect of increasing the average restrictiveness of fiscal policy, the adjustment would nevertheless be smoothed out and the automatic stabilisers would be able to continue operating around the lower
path. Furthermore, unlike most of the other approaches that have been considered, the expenditure path concept has the advantage that it can also be applied in the current situation and could significantly ease the current economic problems of Germany and France, the two countries which at present are particularly restricted by the SGP, without abandoning the goal of medium-term consolidation.

3.2.4 Coordination of wages, monetary and fiscal policy

An alignment of monetary and fiscal policy in the manner discussed, together with a re-orientation of wages policy, would constitute a move away from the restrictive ‘new-monetarist’ policy mix and would lead to implicit coordination insofar as the interdependencies in economic policy making would be taken into account. This could therefore make a considerable contribution towards stimulating growth and reducing unemployment in the EMU. However, since a coordinated macropolicy requires a minimum of agreement between the players on economic causalities, the diagnosis and prognosis of the economic situation and on the goals to be pursued, the effectiveness of any such coordination could be increased significantly if there were an explicit ex ante agreement among the players regarding the means to be used. The appropriate institutions for this already exist within the EMU in the form of the Broad Economic Policy Guidelines and the Macroeconomic Dialogue. As a forum where a consensus could be achieved between the monetary, fiscal and wages policy players, the Macroeconomic Dialogue could be given a leading role in shaping the BEPG which would serve as the key instrument for a true macrorconomic policy coordination in the EMU.

4. Conclusion

This contribution traces the euro zone’s inadequate macroeconomic performance in recent years back to the predominance of a restrictive macroeconomic policy mix based on a ‘new monetarist’ approach to economic policy. A coordinated macropolicy approach based on a (post-)Keynesian analysis was presented as a growth and employment-oriented alternative to this restrictive policy mix.
The implementation of a coordinated macropolicy geared towards the promotion of growth and employment within the EMU requires a fundamental break with the policy mix pursued hitherto. It calls for a fundamental move away from a policy which pursues structural reform of the labour market and differentiation and decentralisation of wage bargaining structures, promoting instead the creation of conditions which will better enable trade unions and employers’ associations to act strategically so that they are able to take into account the macroeconomic role of wages policy. For the unions, this policy approach would involve largely abandoning attempts to use wages policy for distributional or employment policy ends. Rather, it would be necessary to gear collective bargaining policy towards EMU-wide coordinated nominal stabilisation. Since it will at best only be possible to achieve effective implementation of such a reorientation of collective bargaining policy in the long term, given the widely differing national labour market institutions and the very national orientation which still exists with regard to wages policy, in the short term this means that the key goal must be a re-orientation of monetary and fiscal policy. As these both have a considerable effect on employment and income distribution, the European trade unions should strive to increase significantly the degree of influence they have on policy-making in these areas.

First and foremost, greater pressure must be brought to bear, by the trade unions as well, to force the ECB, as the main culprit responsible for the current stagnation, to abandon its ‘anti-growth bias’ and fundamentally alter its monetary policy strategy. The inflation target must be raised and pursued in a symmetrical fashion. Moreover, full exploitation of potential growth should be included as an additional goal of monetary policy. Should the ECB be unwilling to accept such a re-orientation, then the fundamental principles of monetary policy set out in the EC Treaty should be modified to the effect that EMU economic policy decision-makers would set monetary policy an inflation target to be pursued symmetrically, although it would continue to enjoy independence with regard to the instruments used to achieve this target. Furthermore, growth and employment should be
established alongside price stability as equal-ranking monetary policy objectives. As far as fiscal policy is concerned, the SGP regulations must be modified so as to allow for investment-oriented public debt on the one hand (Golden Rule), and on the other the replacement of deficit targets with expenditure paths for non-investment, non-cyclical public spending. This will ensure that the automatic stabilisers operate symmetrically.

This new orientation of individual policies will require coordination of the instruments used, in the sense that macroeconomic interdependencies will have to be taken into account. The effectiveness of this implicit coordination can be strengthened by turning the Macroeconomic Dialogue into a genuine forum for promoting consensus among the players with regard to economic causalities, the diagnosis and prognosis of the economic situation, the goals to be pursued and the means to be deployed. The Broad Economic Policy Guidelines jointly agreed on by the Macroeconomic Dialogue could then become an instrument for implementing such an explicitly coordinated macropolicy within the EMU.

References


Macroeconomic coordination as an economic policy concept


Macroeconomic policy coordination in Europe


1. Introduction

Throughout the 1990s, differences were apparent in the development of the western industrialised nations. There was, for example, significant divergence between the unemployment and GDP growth rates of the USA and Germany. We will argue that these undeniable differences between the two countries (and between the USA and other western industrialised nations) are a reflection of different macroeconomic regimes, i.e. of differing approaches to monetary, wages and fiscal policy.

There are, of course, highly divergent opinions among economists about the best way of defining a functional wages, fiscal and monetary policy. This is a reflection of the fact that there are various competing paradigms in economics theory. It is customary to explain the differences in the development of the USA and continental Europe (and Germany in particular) over the course of the past 15 years by alluding to the relatively unregulated and more flexible US labour market, by pointing to the fact that US economic policy has done more to promote innovation, or by identifying other factors in the field of microeconomic allocation and incentives. The authors, however, are sceptical about this reasoning which is rooted in the neoclassical paradigm. We will argue that improvements in allocation and macroeconomic growth are fundamentally independent of each other. Improved allocation may well increase an economy’s productivity, but whether this in turn leads to a higher growth rate is quite another matter (cf. Riese 2001).
At a theoretical level, our analysis is based on a Keynesian approach which is explained in more detail below. According to this model, cyclical fluctuations are not governed by long-term trends. Our approach follows the sequential economy model where statistical trends are the result of a succession of short-term phases (cf. Hahn 1984) and money is never neutral, either in the short term or the long term.

The second part of this contribution will explain exactly what we understand by the term ‘regime’. Using this analysis as its basis, the third part will analyse the example of economic development in the USA during the 1990s. The final section will summarise our arguments.

2. Macroeconomic regime and its scope

2.1 Regime as the interaction of different policy areas

On the one hand, an economic regime is characterised by the policies of the key macroeconomic players, i.e. by the specific characteristics of fiscal and monetary policy as well as wages trends and the external economic scenario. On the other hand, the success of a regime is not solely determined by how functional different policy areas have been individually. Rather, it is a question of the extent to which different countries are able to achieve a smooth interaction between different policy areas (Heine/Herr 1998, Herr 1995). Our approach adopts Hicks’ (1979) or Stiglitz’ (1996) methodology by explicitly including economic policy, institutional frameworks and political factors in its analysis. This is because there are differences between societies in terms of, for example, their attitudes to economic policy and the economic policy actions taken by the relevant social groups, monetary policy strategy and the degree to which the various players cooperate, it is also true that there are differences with regard to the expectations of the economic units, the mechanism to determine wages, the financial system or the country’s specific place in the global economy. It is this set of conditions characterising an economy or a society and going beyond economic factors in the narrow sense of the term that we consider to constitute an economic policy regime. While we believe a country’s monetary policy to be the most important macroeconomic area, monetary policy does not exist in a vacuum...
and must necessarily respond to factors such as wages trends, exchange rate fluctuations, and changes in fiscal policy or external economic conditions, etc. Since there is only one agent, monetary policy is always strategic, and this is also at least partially true of fiscal policy. The extent to which a wages policy can be said to exist depends on whether or not there are macroeconomic agents in the labour market, and more particularly trade unions and employers’ associations. Finally, external economic conditions can only be partially influenced by any given country.

Economic policy regimes tend to be long in duration and consequently they determine the medium-term or, if they remain stable for a long time, the longer-term prospects of an economy. As such, economic policy regimes generate supercyclical economic prosperity, stagnation or crises. A regime need not be the result of a conscious macroeconomically coordinated policy, as is obviously true in the case of regimes which are not beneficial to a country’s development. Since regimes are embedded in a whole range of specific institutional frameworks, they cannot simply be created by economic policy. Nevertheless, the debate surrounding regimes does have an important role in economic policy. In the following section, an ‘ideal’ regime will be outlined which is also normative in nature and could be used as a model for economic policy.

Our analysis of regimes will adopt a two-pronged methodological approach. First an econometric study of macropolitical factors will be undertaken. Thereafter, a ‘narrative’ approach to the elucidation of specific regimes will be taken, along the lines of, for example, Romer/Romer (1989).

2.2 The different elements of a regime

2.2.1 Wages Policy

Wage increases are functional in the Keynesian sense when they are based on the productivity gain trend plus the inflation target and do not deviate significantly from this basis in either direction. Wage levels determine price levels rather than the level of employment (cf. Keynes 1930, Riese 1986). If wage settlements are too high they result in inflationary pressures, and if
they are too low they bring about deflationary pressures. Since wages policy cannot have a direct influence on real wages, the only yardstick that can be used is that of nominal wage trends. Consequently, a nominal wages policy which reflects productivity trends and takes the inflation target into account can be said to be of paramount importance to keeping price levels in check.

Functional wage trends remove the burden from monetary policy, allowing it to remain expansive in the long term: conflict between wage trends and monetary policy is thus typical of an unsuccessful economic regime. If an economic upturn and the concomitant fall in unemployment lead to high pay settlements, this in turn triggers a wage-price spiral, which the central bank will sooner or later be forced to tackle with restrictive monetary policy measures, at the expense of growth and employment.

Different central banks have opted for different inflation targets (cf. Bofinger 2001; Heine/Herr 2004). The European Central Bank has gone for a particularly low explicit inflation target of just under 2%, while the Bank of England’s explicit target is 2.5%. The US Fed, on the other hand, does not have an explicit inflation target, although it is said that throughout the 1990s it had an implicit inflation target of 3% (cf. Mankiw 2001). Our view is that an inflation target of under 2% is very low. With such a low target, it is easy for economic shocks to result in deflation. In addition with very low inflation rates the central bank has very little scope radically to lower the short-term real interest rate, and economic upturns which are always accompanied by demand inflation are stifled too quickly.

2.2.2 Fiscal policy

A functional fiscal policy has the role of stabilising aggregate demand and thereby also stabilising the national product. By increasing demand during cyclical slumps, it can have a positive influence on an economy’s long-term growth trend, while it can also reduce demand inflation during boom phases and potentially prevent a restrictive monetary policy from being necessary. This briefly outlined principle allows the theoretical conclusion to be drawn that cyclical trends emerge endogenously from market proc-
esses and are not the result of repeated erroneous monetary and fiscal policy decisions. Consequently, an anticyclical fiscal policy serves to promote economic stability.

It is our view that a fiscal policy which in the long term results in an increase in public debt as a percentage of GDP cannot be said to be functional. It is true that there are no hard economic facts to support the argument that there should be an upper limit on the level of public debt as a percentage of GDP. Indeed the situation in countries where public debt is more than 100% of GDP, such as Belgium, is no worse than in countries where it is around 60%, such as Germany or the USA. Nevertheless, a high public debt does have a number of drawbacks which there is no room to discuss here (cf. Heine/Herr 2003). Notwithstanding this, it is the cyclical direction of fiscal policy and not the long-term trend of public debt as a percentage of GDP which plays an important role in the definition of a medium-term regime.¹

The extent to which fiscal policy meets the criterion of functionality as described above can be gauged first and foremost on the basis of trends in discretionary expenditure. It is not possible to influence the income side of the budget in the short term, since changes to the tax system require time to take effect. Consequently, decreasing tax revenues during economic downturns will cause an endogenous fall in public revenue, whereas public revenue will rise endogenously during economic upturns. This endogeneity also characterises the portion of expenditure accounted for by cyclical spending which is fixed by law, in particular statutory social transfers. An anticyclical fiscal policy at least allows the automatic stabilisers to take effect, meaning that during cyclical downturns or upturns, the portion of expenditure which can be varied in the short term remains constant. The

¹ Fiscal policy has various allocational and distributional effects which are however not central to the subject of our investigation.
result of a functional fiscal policy of this nature is that the budgetary balance develops completely endogenously. It is also now apparent why the criterion of whether an upper limit for the budget deficit has been met or not is not valid as a yardstick for evaluating fiscal policy, since budget deficits cannot be set exogenously by politicians – they come about endogenously, even if attempts are made to stabilise the budget via a discretionary fiscal policy. As such, the European Stability and Growth Pact is an example of a non-functional fiscal policy regulation. It cannot be a surprise that so many countries fail to fulfil the regulations of the pact.

In addition to accepting the automatic stabilisers, it is possible for a country also to implement an active fiscal policy. In this scenario, discretionary expenditure would rise in a cyclical downturn and fall in a cyclical upturn. There is no doubt that during times of pronounced cyclical movements such an approach to fiscal policy can be functional.

2.2.3 Monetary policy

In our view, monetary policy is always the same thing as interest rate policy, since a central bank has the power to determine money market interest rates but can fail to achieve a given monetary target as for example M3 (cf. Heine/Herr 2004). Monetary policy cannot be as discretionary as it likes, since the markets impose certain ‘rules’ upon it with which it has to comply. The reference made by Bernanke/Mishkin (1997) to ‘constrained discretion’ is an apposite description in this respect. They actually use this term to refer to central banks’ now popular strategy of announcing an explicit inflation target, but their arguments also hold in the absence of explicit inflation targets. It is above all the financial markets which subject central banks to certain constraints. If, during an inflationary period, investors begin to switch en masse from financial to non-financial assets, then price levels rocket and the monetary system is eroded. However, as a rule, it is the exchange rate, i.e. the flight from the currency, which before very long forces the central bank to adopt a severely restrictive monetary policy. Deflationary trends have equally dramatic effects on economies, and they too contain cumulative elements (cf. Fisher 1933). Monetary policy loses
its effectiveness when combating deflation, since in this case it can do nothing to prevent the real interest rate from rising. This is why central banks try their hardest to prevent deflationary scenarios from arising in the first place. Rather than striving for zero inflation, they aim instead for positive inflation rates.

Central banks have to react to the continually changing circumstances of history by changing money market interest rates. As far as this aspect of monetary policy is concerned, our observations are in the tradition of Wicksell (1898) and Keynes (1930, 1936), both of whom stressed the need for a discretionary monetary policy. Money supply rules in the tradition of Friedman (1976) have long since ceased to be attractive, and there can hardly be a central bank in the world which still tries to achieve a stable annual growth rate in accordance with a monetary aggregate such as M3. In actual fact, central banks have always had to pursue a discretionary monetary policy, irrespective of their monetary philosophy. But what makes a discretionary monetary policy functional? According to our definition, a functional discretionary monetary policy is when a central bank consistently uses whatever monetary policy leeway exists in order to promote growth and employment. Such an approach has two key components:

a) Monetary policy should not be geared exclusively towards the goal of price level stability, it should also take into account cyclical trends. Accordingly, if we disregard exchange rate fluctuations for the time being, central banks should use interest rate policy to react to deviations of the inflation rate from the inflation target and to respond to cyclical trends. Taylor (1993, 1998, 1999) showed with his Taylor Rule that in practice all central banks take both inflation and cyclical trends into account when formulating their monetary policy. Nevertheless, when inflation and GDP growth fail to meet their targets, different central banks attribute markedly different weightings to these two elements. Central banks adopt three kinds of approach in this scenario: (i) those which attribute by far the greatest weight to inflation, (ii) there are those which attribute by far the greatest weight to cyclical
trends and (iii) there are those which attribute equal weight to inflation and cyclical trends. In our view, the first two approaches are not functional. In approach (i), growth is unnecessarily sacrificed for the sake of a monetary policy which seeks to achieve price level stability at all costs. In approach (ii), there is a danger that the central bank might not do enough to ensure price level stability and in some cases may not react strongly enough to cumulative price level changes. It is approach (iii) that we consider to be the appropriate way for central banks to respond. If a central bank attributes high weightings to both inflation and cyclical trends, this signals that while it is not losing sight of price level stability, which is after all the primary goal of all central banks, it nevertheless also attaches a lot of importance to GDP growth.

b) A functional monetary policy also requires the adoption of an approach which reacts always to actual economic development. A restrictive monetary policy should only be resorted to when real inflationary dangers exist, and even then interest rates should only be raised in small increments, in order to avoid unnecessarily burdening economic growth with excessive rates. If inflation gets out of hand, however, a significant interest rate rise is essential in order to bring inflation back under control. In the event of a cyclical downturn, interest rates should be lowered promptly and sharply, in order to remove the burden of interest costs from the private sector as soon as possible and to prevent businesses and consumers from waiting for further interest rate cuts before making investments or purchasing durable consumer goods.

2.2.4 The limitations of monetary policy

National economies are increasingly bound up in the global economic context which undoubtedly influences the scope and limitations of national economic policy. A stable international financial system which limits uncertainty favours economic growth and employment worldwide, thereby also promoting economic growth in individual nations. On the other hand, the global prospects for growth and employment are curtailed by an unstable
international currency regime and financial system which produces pronounced nominal and real exchange rate fluctuations and an international current account balance structure which regularly causes countries (particularly developing countries) to become overindebted\(^2\). Exchange rate movements have an extremely significant impact on economies and monetary policy, since in a floating exchange rate environment, the exchange rate is anything but a neutral filter which allows individual nations to pursue an independent monetary policy with an exclusively national focus. Exchange rate fluctuations can have two effects:

a) They can trigger an inflationary or deflationary process in a country. Currency devaluations cause import prices to rise, leading to a jump in price levels. If this results in a wage-price spiral, then an inflationary process is triggered. Devaluations can thus cause a devaluation-inflation spiral which leaves the real exchange rate largely unchanged, a process which is unacceptable for a central bank. On the other hand, devaluations can also be beneficial when the inevitable increase in price levels that they provoke does not trigger an inflationary process. The jump in price levels associated with devaluations is smaller in countries which are less dependent on imports than in countries which are highly dependent on imports. The relative size of the domestic market in countries like the USA or a currency union like the euro zone means that the conditions for devaluations are more favourable than in Switzerland or Denmark, for example. The inflationary effect of devaluations has indirect consequences for central banks which have set an inflation target, since if the devaluation has an inflationary effect

\(^2\) We would dispute the assertion that exchange rate movements are neutral in real economic terms, as posited by purchasing power parity theory, which extends the quantity theory of money to the international economy. The suggestion that in a floating exchange rate environment, countries are freely able to determine their own inflation rate and monetary policy (cf. Friedman 1953, Johnson 1972), is one of the greatest misconceptions of neoclassical monetary macroeconomics.
and causes inflation to rise above the inflation target, the monetary policy response will be to raise interest rates. However, in some cases when there is a devaluation, central banks do not wait for the inflationary shock waves to spread through the economy until the inflation target is under threat. Central banks which assume that devaluations will have a strong inflationary effect will respond to exchange rate movements with immediate interest rate adjustments. When a currency strengthens, on the other hand, the opposite effect can be expected. Thus, for example, in spring 2003 the IMF (2003) warned that Germany was threatened with deflation, among other things because of the strength of the euro. When the currency strengthens, a functional monetary policy according to our definition should respond by lowering interest rates.

b) The exchange rate not only determines the price-competitiveness of a country, it also influences the financial markets, since devaluations lead to losses for investors whose assets are held in the devalued currency. If an economic unit has debt in a foreign currency, a devaluation causes the real debt burden to rise if the debtor’s earnings are in the domestic currency (for example if firms sell their products in the domestic currency). Countries with a high level of foreign currency debt need to be especially careful during devaluations, since sharp devaluations destabilise the national financial system. A long-term period of devaluation can undermine a currency’s reputation and trigger a cumulative flight of capital resulting in a serious impact on the exchange rate. Since these are non-linear processes, a central bank can never know exactly at which point in a devaluation cumulative capital transfers will occur. Conversely, a one-off devaluation which does not result in an inflationary process can enhance a currency’s reputation if it serves to put an end to the previous speculation about a devaluation. These effects on financial assets and the reputation of currencies serve as further evidence of the fact that devaluations restrict what central banks can do in the field of monetary policy, whereas if the currency strengthens, the central bank’s room for manoeuvre increases.
3. The US regime in the 1990s

3.1 Growth and its drivers

After a period of high growth in the 1980s, economic growth in the USA fell to 1.8% in 1990 followed by a negative growth figure in 1991. At the same time, by 1992 unemployment had risen to 7.5%. However, from 1992 on the US entered a period of sustained growth which at times rose above 4%, while unemployment fell to 4%, a much lower value than the expected NAIRU (Non-Accelerating-Inflation-Rate-of-Unemployment) at the time. During the 1980s, falling unemployment had been accompanied by a rise in inflation, apparently backing up the predictions of the NAIRU theory. But in the 1990s, inflation moved in the opposite direction and fell hand in hand with falling unemployment, reaching a figure of 1.5% in 1998 (see Figure 1 on the next page).

In the 1990s, growth in the USA was driven mainly by private consumption and, if 1991 and 1995 are discounted, private investment, whereas the contribution of government consumption expenditure and government investment was overall rather small (see Figure 2 on page 81). The huge US current account deficits in the second half of the 1990s had the effect of reining in the runaway private demand. The high consumption demand was closely linked to the fall in personal savings, which strengthened the multiplier effect of the autonomous demand components. The frenzied consumption of US private consumers was in no small measure determined by the soaring share prices during this phase. Private investment was high, since businesses were plainly expecting to make positive profits and monetary policy throughout the whole of the 1990s did everything it could to promote investment.
Figure 1: Real growth and unemployment in the USA (1990–2003)

Figure 2: Contribution to growth* of the various demand components in the USA (1990–2002)

* The contribution to growth of a value x in relation to a value y is expressed as \[(x(t)-x(t-1))/y(t-1)\]x100. The sum of the contributions to growth is expressed as \[(y(t)/y(t-1))-1\]x100, i.e. the percentage change in the value y.

Source: CEA and own calculations
3.2 Fiscal policy

In 1990, the Budget Enforcement Act came into force. Unlike a number of related Bills in the 1980s, this Act no longer sought to limit the budget deficit, but was aimed instead at restricting expenditure. A distinction was drawn between expenditure determined by statute and discretionary expenditure which was to be set afresh in every fiscal year. If a congressman or congresswoman proposed a rise in discretionary spending or a tax cut, they also had to make a proposal as to how such a measure would be funded (cf. Blinder/Yellen 2001).

By stabilising discretionary spending in this way, an anticyclical fiscal policy was achieved. It was now unnecessary to cut spending during recessions, since only an upper spending limit was fixed, while there was no such limit on the deficit. Thus it was possible for the government to run up a higher budget deficit during times of recession and allow the automatic fiscal stabilisers to take full effect. During times of economic prosperity, on the other hand, higher revenue did not result in higher expenditure, since spending could not exceed the upper limit. Consequently, the increase in revenue resulting from higher growth led to budget consolidation (cf. Horn/Scheremet 1999, p. 4).

The Council of Economic Advisors specifically emphasised the functionality of the automatic stabilisers: “A balanced budget amendment would throw the automatic stabilizers into reverse. The congress would be required to raise taxes or cut spending programs in the face of a recession, to counteract temporary increases in the deficit. Rather than moderate the normal ups and downs in the business cycle, fiscal policy would be forced to aggravate them.” (CEA 1995, p. 30)

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3 The spending determined by statute was mainly social security expenditure, the level of which could not be influenced by the government. The discretionary expenditure came under the three headings of ‘defence budget’, ‘international budget’ and ‘domestic budget’, and was set anew every year, meaning that it could be varied. Each of these expenditure headings was combined with certain taxes in ‘PAYGO pools’. If the upper spending limit was exceeded, this had to be funded by tax rises and/or spending cuts somewhere else within the relevant pool.

4 The Council of Economic Advisors specifically emphasised the functionality of the automatic stabilisers: “A balanced budget amendment would throw the automatic stabilizers into reverse. The congress would be required to raise taxes or cut spending programs in the face of a recession, to counteract temporary increases in the deficit. Rather than moderate the normal ups and downs in the business cycle, fiscal policy would be forced to aggravate them.” (CEA 1995, p. 30)
During the 1991 recession, central government spending rose to 21.5% of GDP, and the government ran up a deficit of 3.6% of GDP (see Figure 3 on the next page). In 1992, the budget deficit grew further, rising to 4.7% of GDP in the face of a further increase in statutory spending and no change in the level of discretionary spending. In 1992, America’s GDP grew by 3% in real terms. Fiscal policy thus gave a strong expansive boost to the burgeoning recovery. The additional revenue in the subsequent upturn was prevented by law from automatically leading to an increase in spending, and thus as of 1993 the budget deficit started to shrink until in 1998 it was finally turned into a surplus which continued to grow over the course of the following two years. On the one hand, the sustained growth of GDP led to a growth in the tax base, while on the other, the budget consolidation was supported by tax rises in 1993 which were mainly aimed at people in higher income groups and which were accompanied by an expansion of the negative income tax for the ‘working poor’ (cf. Priewe 2001). Low interest rates also had a positive effect— despite the budget deficits, there was hardly any nominal rise in net interest payments by public households during the first half of the 1990s (cf. Blinder/Yellen 2001, p.17).

Econometric estimations suggest that from the 1980s onwards, the USA pursued a policy of public spending stability. In the 1960s and 1970s, the ratio of the long-term elasticity of public spending to nominal GDP was still clearly higher than 1 and consequently had a destabilising effect. At the beginning of the 1980s, however, the elasticity fell below 1, and a further fall in the long-term elasticity of public investment was witnessed in the 1990s, demonstrating that government spending policy was stable over the cycle.

The US government’s fiscal policy managed those elements which it was actually in a position to control, i.e. discretionary spending and taxation. This meant that during times of recession they had no problem accepting deficits of well above 4%. This would have disqualified them from joining
Figure 3: Public spending in the USA (1990-2002)

Source: CEA 2003
the European Monetary Union, since the European Stability and Growth Pact sets a deficit limit of no more than 3% of GDP. The Pact thus places upon all the Member States and candidate countries the burden of controlling an endogenous quantity, i.e. the budget balance. What this means is that in practice it is impossible to pursue an anticyclical economic policy, since in times of recession governments are forced to cut spending and/or increase revenue, whereas in times of economic prosperity the abundant tax base and low level of social welfare spending encourages governments to implement a procyclical fiscal policy.

3.3 Wages trends

During the 1992 recession, unemployment in the US stood at 7.4%, but by the end of the 1990s it had fallen to 4.2%. According to Blinder and Yellen, the NAIRU was estimated to be between 5.5% and 6% in the early 1990s (Blinder/Yellen 2001, p. 35). This would have led one to expect wage increases and price rises to follow. In actual fact, however, gross labour costs (i.e. wages plus non-wage labour costs) rose overall only modestly during the 1990s, despite falling unemployment. Productivity gains during the first half of the 1990s were rather modest and it was only from 1996 onwards that annual gains of over 2% were achieved. While it is true that, as one might expect, there was a clear correlation between unit labour costs and price levels, nevertheless the overall rise in unit labour costs in the 1990s remained below inflation (see Figure 4 on the next page).

This was partly due to developments in the realm of non-wage labour costs. While in the 1980s the annual growth in non-wage labour costs borne by employers had been higher than the growth in wages, this trend changed in the 1990s (cf. CEA 1995, p. 173), when increases in non-wage labour costs slowed down substantially. This can be put down principally to changes in the structure of the healthcare sector, according to which doctors were no longer paid on a fee-for-service basis. Instead, employees became members of ‘Managed Care Organizations’, which signed service contracts with hospitals, doctors, and other service providers. As a result, these organisations were in a position to influence benefits, and were able to keep costs down, leading to a reduction in employer insurance contributions.
Figure 4: Unit labour costs and inflation in the USA (1990-2002)

Source: CEA 2003
Econometric identifications with a wage-price system support the assertion that wage restraint was exercised during the first two thirds of the 1990s. A wage-price system with time-variable coefficients was estimated, in order to identify wage and price shocks. We have followed the model of Blinder/Yellen (2001) which expresses the following correlation:

\[ \dot{W} = \lambda^w + \dot{P} + f(U - U^*) + z^1 + \varepsilon_w \]

\[ \dot{P} = \dot{W} - \lambda^f + z^2 + \varepsilon_p \]

where \( \dot{W} \) is the growth rate of nominal wages, \( \lambda^w, \lambda^f \) refer to the productivity gains expected by employees and employers respectively, \( U, U^* \) refers to actual and inflation-neutral unemployment, and \( \dot{P}, \dot{P}^\text{f} \) refers to actual and forecast inflation. The system can be combined into a single common equation:

\[ \dot{P} - \dot{P}^\text{f} = \Delta \dot{P} = \lambda^w - \lambda^f + f(U - U^*) + z^1 + z^2 + \sum_{j=m,n} \varepsilon_j \]

However, this model is still not identified. Nevertheless, processes can be estimated for \( \lambda^w, \lambda^f \), and \( (U-U^*) \) can be approximated using a filter (e.g. a band pass filter or a Hodrick-Prescott filter). This allows a time-variable estimate for \( z^1 \) and \( z^2 \) to be made using a stochastic decision space model. In this instance, the time-variable shock \( z^1 \) is a wage shock and \( z^2 \) is an inflation shock (e.g. an oil price hike or demand inflation). In this way, it is possible to identify phases of wage shocks and inflation shocks. We specifically approximated the productivity figure used by employees in their wage
demands ($\lambda^{\rho}$) on the basis of a five-year backwards sliding average, and inflation forecasts ($\bar{P}^{\rho}$) with a two-year backwards sliding average. Inflation-neutral unemployment was determined using a Hodrick-Prescott filter. Since a constant is also estimated, $z_t$ offsets the deviations from a (backwards-oriented) productivity-based wages policy.

A subsequent step involved using $z_t$ in a wage-price system to identify inflation shocks which do not stem from the wages policy rule being broken. These shocks can be either positive or negative and can for example be attributed to the first-round effects of oil price shocks, technological changes, devaluations or changes in taxation, etc.

Figure 5 shows how, according to this identification model, the USA went through two phases. In the 1970s, successive non-wage inflation shocks were apparent, clearly as a result of a nominal wages policy trend which was not productivity-based (perhaps underpinned by strong monetary policy support). As we move into the 1980s, a sea change in wages policy can be observed. On the basis of the structural wage equations estimated for the whole period, there is clear evidence of nominal wage restraint during the first two thirds of the 1990s. Inflation was largely driven by factors other than unit labour costs or price rises caused by the labour market situation, which in the light of high domestic demand could be taken as a sign of demand inflation. In the second half of the 1990s, the situation turns around again, with a return to modest wage cost inflation. However, overall inflation remained largely stable because nominal wages policy trends were counteracted by the effects of other factors during this period, in particular falling raw material prices and the strong dollar.

In the 1980s, average real hourly wages in the private sector had fallen continuously, and they remained at rock bottom during the growth phase of the 1990s. It was not until 1999 that real hourly wages once more rose above the 1986 level. While employees thus took a clear cut in their real wages, this did not result in high nominal pay claims. However, these average wage trends hide major changes in pay structures.
Figure 5: Wage shocks and other inflation shocks in the USA (1965-2003)

Source: Own composition
Traditionally, low-skilled workers have had very little bargaining power as far as their pay is concerned, and this is just as true in the United States as elsewhere in the world. There is a large number of migrant workers, mainly from Mexico, in this sector of the US labour market, causing wages in the sector to remain low. While in 1970, there were 700,000 Mexicans living in the US, by 2000 the figure had risen to 8 million. Two thirds of adult Mexicans living in the States do not have a high school qualification, which means that they end up competing for the dwindling number of low-skilled jobs. In a study carried out by the Center for Immigration Studies in 2001, Camarota estimates that during the course of the 1990s, Mexican immigrants were responsible for a 5% reduction in the wages paid to workers without high school qualifications (cf. Camarota 2001, p. 5). Furthermore, the lowest paid workers do not usually belong to a trade union. Of all those workers directly affected by the raising of the statutory minimum wage in 1996/97, only 4.4% were trade union members.

The statutory minimum wage was raised four times during the 1990s. The 1996/97 increases from $4.25 to $5.15 directly affected 8.9% of all workers, and these rises allowed low-paid workers to maintain their income levels. However, it is also clear that the statutory minimum wage is far from being a reliable instrument. Indeed, the minimum wage was not increased at all between 1981 and 1990, while towards the end of the 1990s there was talk in the US of raising it by 90 cents, but then the recession struck and it has remained at $5.15 per hour until the present day.

Despite the boom of the 1990s, people in middle income groups were only able to achieve modest wage increases. In the first half of the 1990s in par-

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6 By way of comparison, 10% of US citizens do not have a high school qualification.
7 During the 1990s, the number of low-skilled jobs fell by 400,000.
8 These workers were predominantly women, more than 70% were over 20 years old and two thirds were white. Almost half of them had full-time jobs, and a third worked between 20 and 34 hours a week.
ticular, people in this group suffered a reduction in their real hourly wages, and even in the second half of the decade the increases were small. As a result, the gulf between middle income and high income groups widened, whereas the difference between middle income and low income groups got smaller.

In what they term the ‘traumatized worker hypothesis’ (Blinder/Yellen 2001, p. 39), Blinder and Yellen put this wage restraint down to workers’ fear of being made redundant, in other words job security was more important to them than higher pay. At the root of this attitude lies the radical restructuring of businesses and the rise of unemployment to almost 10% that workers experienced throughout the 1980s. A study by Farber (2003) concludes that during the boom phase of the mid-1990s, the ‘job loss rate’ was surprisingly high despite low unemployment. In other words, the number of people losing their jobs as a result of employers making them redundant did not fall to the same extent as unemployment. In order not to lose or in order to regain their health insurance, job seekers accepted the first new job that came along, even though these were often less well paid than their previous jobs. The Council of Economic Advisors considers the fall in trade union membership to be a further reason for the low wage increases⁹.

Irrespective of the specific reasons, nominal wages trends in the US were functional in macroeconomic terms and made an expansive monetary policy possible. It appears that a number of special circumstances were responsible for this surprising wage restraint at a time of low unemployment, including a traumatised workforce, weakened trade unions and the legislative intervention with regard to non-wage labour costs. Consequently,

⁹ “For example, increased domestic and international competition, a decline in unionization, and increased concern about job security are possible reasons why, at current levels of unemployment, wage and price pressures have been so subdued” (CEA 1996, p.53).
rather than being based on a model of social cooperation between trade unions, employers and the State, the wage restraint witnessed in the US ‘arose’ as a result of different developments in different sectors of the labour market. It is thus not possible to speak of a wages policy in the US, since no single player was responsible for bringing it about. At the beginning of the 1990s, the US labour market as a whole was threatened with deflationary pressures, since the gap between the average wage and the wages of lower income groups was widening, and the wages of middle income groups had also started to plummet. It was in particular the raising of the minimum wage which served to prevent a further widening of the gap between the different income groups and worked as a nominal anchor.

3.4 External economic factors
The external economic situation in the 1990s was favourable for the United States. By the start of the 1990s, the sharp devaluation of the US dollar in real terms which had begun in 1985 had wiped out the huge US current account deficit.

Greater international competitiveness meant that at the end of the 1980s the trade balance helped the United States through the economic crisis at the start of the 1990s (see Figure 6 and Figure 2). During the first half of the 1990s, the real exchange rate remained more or less constant, and imports grew faster than exports thanks to the acceleration in growth. The fact that imports continued to rise in the first half of the 1990s, despite the devaluation of the US dollar, can be put down among other things to the fact that many purchases were made in dollars. As such, a significant number of foreign goods did not become more expensive as a result of the devaluation of the dollar. The unique position of the USA as the country with the world’s leading currency allowed Americans to carry out a large percentage of their capital and current transactions with other countries in dollars. This phase saw the re-emergence of a balance of trade and current account deficit, which then grew as a result of the significant nominal and real revaluation of the US dollar during the second half of the 1990s (see Figures 6 and 7 on page 94).
Figure 6: Index of the nominal and real effective exchange rate of the US dollar (1980-2003)

Figure 7: US imports and exports and current account balance (1990-2002)

Source: CEA 2003
Three aspects of the external economic situation in the 1990s had a positive effect on the US economy. Firstly, the gradual elimination of the current account deficit after 1985 helped to overcome the cyclical economic crisis at the start of the 1990s and acted as an additional driver of growth during this phase. Secondly, the growing current account deficit in the second half of the decade had the effect of preventing the economy from overheating. Thirdly, the revaluation of the US dollar served to put the brakes on price rises, contributing to falling inflation in spite of the high demand and wage pressure towards the end of the 1990s.

Oil prices, and raw material prices in general, did not have any lasting negative effect on the development of the US economy. Oil prices shot up during the 1990/91 Gulf crisis, but by 1992 they had fallen back down just as swiftly and they continued to fall slowly until 1994. They then rose again between 1995 and the end of 1996, only to fall once more thereafter. The 1995/96 rise in oil prices did bring about some slight inflationary pressure, but thanks to the wage restraint at the time, this did not turn into an inflationary spiral. World oil prices fell between 1997 and the end of 1998, counteracting the wage pressure during this period. It was only from 1999 onwards that a steep rise in oil prices was matched by a similar rise in the US inflation rate.

A current account deficit is only sustainable if it is accompanied by a capital account surplus in order to balance out the balance of payments. In fact, it is the capital flow which only makes the deficit in the current account possible. When interest rates are low and the current account deficit is rising, it is usually difficult for a country to attract foreign capital. This is because in such cases there is normally too great a risk of the low interest rates failing to compensate for the losses sustained in the event of a devaluation. In this type of scenario, countries have to offer high interest rates in order to stimulate capital inflows. However, this clearly doesn’t apply to the US. Interest rates in Germany were higher than in the US between the end of 1989 and the end of 1994, and they have been continuously higher in the UK since the middle of 1984. Nevertheless, in spite of the high current
account deficit that the US ran up during the 1990s, capital imports into
the US grew steadily. In the second half of the decade, the dollar began to
strengthen to an extent that had not been expected. This revaluation of the
dollar and a current account deficit of approximately 5% of GDP in 2000
were mainly due to direct investments and portfolio investments (cf. Ev-
ans/Herr/Heine 2001). In the second half of the 1990s, the expectation
that the dollar would further strengthen and the high reputation of the US
currency were evidently strong enough factors to allay investors’ fears about
the high current account deficit and the relatively low interest rates and
convince them to continue to invest in the USA. A series of currency crises
– in Asia in 1997 and Russia in 1998 – only served to strengthen the dollar
still further, so that investors saw the US currency as a ‘safe haven’.

3.5 Monetary policy

Monetary policy since the beginning of the 1990s can be divided into four
different stages:

In the first stage which lasted from 1991-1993, the Federal Open Market
Committee (FOMC) showed itself ready to react to recessionary pressures
with immediate and decisive interest rate cuts (see Figure 8). When the
recession began, the Fed reduced the Federal Funds Target Rate from 8.25% to 5.75% between July 1990 and April 1991, giving a real interest
rate\(^\text{10}\) equivalent to less than 1%. There were a further six cuts in 1991 and
three in 1992 until a nominal rate of 3% was reached. Since inflation stood
at around 3% at the time, this meant that the real interest rate was zero.

Even at a time when the economy had started to grow again and unem-
ployment was falling, the Fed left the Federal Funds Target Rate at a real
value of around zero for some one-and-a-half years (cf. Blinder/Yellen
2001, p. 13). If we compare this with the European Central Bank’s (ECB)
policy, it is striking how the Fed saw no reason to pursue a restrictive policy

\(^{10}\) For our purposes, the real interest rate is defined as the nominal interest rate minus
the current inflation rate (consumer price index).
Figure 8: Real interest rates and nominal money market rates in the US (1990-2004)

Source FED, Bureau of Labor Statistics and own calculations
even though inflation stood at 3%. The ECB’s inflation target of less than 2% would have left it unable to pursue the comparatively expansive monetary policy implemented by the Fed\textsuperscript{11}.

The second stage, between 1994 and 1995, clearly demonstrates the Fed’s cautious approach to interest rate rises. The economy had grown by 3% in real terms in 1992 and by 2.7% in 1993 and inflation was stable, yet throughout this period the real Federal Funds Rate had remained at around zero. In order to prevent the economy from overheating, the decision was taken at the FOMC meeting in February 1994 to raise interest rates by 0.25%. The rate was then gradually increased to 5.25% by February 1995. Six members of the FOMC had already spoken out in favour of raising the Federal Funds Rate back in December 1993, since they had identified clear inflationary risks owing to the strong growth in GDP and the fall of unemployment to the 6% NAIRU rate which was the accepted figure at the time. Nevertheless, the rate was left unchanged in December following Alan Greenspan’s strong recommendation\textsuperscript{12}. Between July 1995 and January 1996, the Fed was already lowering interest rates again, owing to a slight fall in the GDP growth rate. At the FOMC meeting in July 1995, not all the Committee’s members were convinced that the threat of inflation had been dealt with, since the May unemployment figure was 5.7%. Nonetheless, in view of the economic uncertainty and the modest nature of the 0.25% cut, all but one of the members voted in favour of the decision.

\textsuperscript{11} The Fed had stopped trying to control the money supply as early as the beginning of the 1980s and was noticeably less concerned about the development of the monetary aggregates.

\textsuperscript{12} Some members of the FOMC argued for a decisive 0.5% rise in order to prevent a cyclical overshooting. Indeed, in the first vote, 10 out of 17 of the Committee’s members voted in favour of such a rise. However, Alan Greenspan was extremely insistent that the rise should be no higher than 0.25%, since the market was not expecting a 0.5% rise and, according to Greenspan, such an increase would cause a hard landing, whereas it was Greenspan’s explicit goal to achieve a soft landing. In the end, the FOMC held a second vote in which it approved a 0.25% rise.
despite the fact that several of them would have preferred to delay the cut a bit longer (cf. Fed 1995, p. 160). Thereafter, the Federal Funds Rate remained unchanged until December, when it was again cut by 0.25%\textsuperscript{13}, and in January 1996 the FOMC approved a further 0.25% cut. At this stage, most of the Committee’s members saw little danger of inflation and were more concerned about the danger of growth falling behind potential (cf. Fed 1996, p. 122). Blinder and Yellen rightly conclude that by the end of 1995 the Fed had achieved its soft landing, in view of the high growth rate and an unemployment rate of 5.6% which was considered to be a low figure on the basis of the accepted NAIRU rate at that time (cf. Blinder/Yellen 2001, p. 31). The Fed’s behaviour, which was embodied most particularly in the person of Alan Greenspan, demonstrated above all that it always sought to pursue as expansive a policy as possible. At the very most it would approve small interest rate rises or no rise at all, and if in doubt would always opt to lower rates.

In the third stage, which coincided with a period of high growth and low unemployment, the Fed kept interest rates stable for a long time (see Figure 8). When the FOMC met there was always discussion of possible inflationary pressures owing to the very low unemployment rate (5.3%) and the relatively high growth rate\textsuperscript{14}. Overall, the forecasts of the Committee mem-

\textsuperscript{13} At the December FOMC meeting, the members were once again not all in agreement about the economic outlook and the associated inflationary pressures. Several of them argued that if the growth rate continued to rise even higher than the current level there would be a risk of inflation, and consequently they wanted to leave the Federal Funds Rate unchanged. In the end, however, they agreed to lower the rate by just 0.25% (Fed 1995, p. 195).

\textsuperscript{14} At its meeting in May 1996, the Committee found that “recent developments indicated that the economy was stronger and rising inflation down the road could not be ruled out”. Nevertheless, it decided to leave the existing Federal Funds Rate unchanged. Furthermore, it was agreed not to make any statements hinting at possible future rises, in order to avoid raising expectations of such a rise being approved at the Committee’s next meeting in July (Fed 1996, p. 139). At the Committee’s
bers and the Federal Reserve Bank presidents who are not FOMC members tended to predict an inflation rate of between 3% and 3.5% for 1996 and between 2.75% and 3% for 1997 (cf. Fed 1996, p. 145). However, rather than showing any signs of rising, the current inflation rate actually fell. At this point, the Committee’s members once again voted against a rise in the Federal Funds Rate, although they did recommend that the current inflation rate should be particularly closely monitored (cf. Fed 1996, p. 149). In February 1997, the Committee decided to continue its ‘wait-and-see’ policy stance (cf. Fed 1997, p. 113), and inflation in fact remained at just under 3%. It was not until March 1997 that a 0.25% interest rate rise was approved, and this was followed by another long period where the Fed left the rate unchanged. In September 1998, interest rates were cut three times by 0.25% on each occasion. These cuts were principally designed to protect the US economy against the repercussions of the turbulence on the international financial markets which had been triggered by the crises in Asia in 1997 and Russia in 1998. In addition, many banks had tightened their lending policy, and the cuts sought to counteract this trend (cf. Fed 1998, p. 177). The expansive phase of monetary policy only came to an end in June 1999 when the Fed began once again gradually to raise interest rates.

meeting in July 1996, the members continued to be preoccupied with the threat of inflation: “[…] the members saw a substantial risk that if economic growth did not slow in line with their current forecasts, the resulting added pressures on resources would at some point translate into higher price inflation” (Fed 1996, p. 147).

15 The May 1999 meeting clearly demonstrates the extremely cautious attitude of the FOMC members with regard to raising interest rates: “Although their concerns about the outlook of inflation had increased significantly since the previous meeting, the members felt that there was still a reasonable chance that the current stance of policy would remain consistent with containing price pressures for some period of time.” At this meeting, the Committee decided to leave the Federal Funds Rate unchanged, but to make an announcement following the meeting that at the next meeting it was much likelier that they would decide to raise interest rates rather than lower them (cf. Fed 1999, p. 231f.).
with a view to preventing inflation from rising in the face of a high demand for labour (unemployment had by now fallen to 4.2%) and continuing high consumer demand. Interest rates were raised a further three times in 2000 by a total of 1.0%.

The fourth stage showed how, in contrast to its reluctance to raise rates, the FOMC was prepared to move swiftly and decisively when interest rate cuts were necessary, as had already been witnessed at the beginning of the 1990s. Inflation rose to 3.4% in 2000, while economic growth fell to 3.8% in the same year and 0.3% in 2001. Between January and May 2001, the Fed lowered the Federal Funds Rate five times by 0.5% on each occasion, followed by two further 0.25% cuts in June and August of the same year. Following the September 11 attacks, the Committee held a teleconference during which it was decided to cut rates by another 0.5%, and the rate was cut three more times between October and December, by a total of 1.25%. The cautious interest rate rises followed by these heavy cuts constituted an attempt by the Fed to achieve a soft landing as it had done in the first half of the 1990s. This time, however, they were unable to pull it off. Gloomy investor sentiment and the bursting of the 1990s US stock market bubble meant that even before 11 September monetary policy had been failing to stimulate aggregate demand. However, the extent to which the heavy interest rate cuts helped to alleviate the US economy’s liquidity and solvency problems at the time should not be underestimated, and this policy also helped to combat the fall in share prices.

These conclusions are supported by econometric analysis, and in particular by the estimation of a Taylor Rule with time-variable coefficients. According to the Taylor Rule, the central bank sets the key interest rate depending on the risk to miss the inflation target and to miss the growth potential of GDP. Econometric analysis shows that in the US, failure to meet the inflation target and growth target both receive a high weighting, whereas in the case of the German Bundesbank, only the inflation rate received a high weighting and the importance attributed to growth when setting interest rates was clearly lower than in the US. However, for both central banks
there are major variations in the weightings of both factors over time. While the importance attached to inflation over long timespans is low (in line with an accommodating policy), it increases sharply during particular phases of higher inflation rates when monetary policy is being tightened. Consequently, central bank react nonlinear and respond to the specific inflation rate at any given time.

4. Conclusion

The four elements of a macroeconomic regime combined in optimal fashion in the United States during the 1990s. However, the overall functionality of the macroeconomic regime was not achieved thanks to any conscious coordination of the various relevant policies, but came about instead at least in part as a result of a number of factors which could not be planned.

An anticyclical fiscal policy was in place at the very latest by the time President Clinton had taken office. A high budget deficit was accepted during the economic crisis at the start of the 1990s, whereas fiscal policy’s consolidation strategy during the subsequent phase of strong growth had a dampening effect on prices and helped to prevent the economy from overheating.

A key factor was the lack of turbulence as far as wages were concerned. Despite the high economic growth during the course of the 1990s, nominal unit labour costs rose only modestly. Overall, wages rose in line with productivity, and the NAIRU turned out to be a fairly meaningless concept in terms of economic policy. The global economic situation also contributed to a positive regime. Thanks to the fall in the value of the US dollar from 1985 onwards, by the beginning of the 1990s the US economy had become more competitive, causing exports to rise. When the dollar then strengthened and the US ran up its huge current account deficit, the external economic situation helped to keep prices in check and prevent the economy from overheating. Had it not been for this dampening effect, the high investment and consumption demand in the second half of the 1990s would almost certainly have led to runaway demand inflation which would in turn
most probably have triggered a wage-price spiral. The strength of the dollar meant that monetary policy had more options at its disposal.

Monetary policy emerged as the regime’s key policy area. Starting in 1992, the Fed was able to support growth by pursuing an expansive monetary policy with real interest rates of zero for more than two years. This served to counteract the potential deflationary pressures arising from the labour market situation at the time. Inflationary tendencies only started to emerge in 1994, and only once these had been carefully monitored and checked did the Fed respond by raising the Federal Funds Rate. Once the threat of inflation had subsided, interest rates were swiftly lowered again. The economic boom in the second half of the 1990s was characterised by falling inflation and a cautious monetary policy. The Fed was extremely cautious about raising the Federal Funds Rate, preferring to rely on the higher real interest rates resulting from lower inflation to prevent the economy from overheating. Monetary policy only became more restrictive again in 1999. Overall, right up until 2000 the Fed pursued as expansive a monetary policy as it possibly could, with low nominal and real interest rates. The conditions for such a monetary policy were extremely favourable. The developments with regard to wages, the exchange rate, the current account and fiscal policy were all positive, and there were no inflationary pressures from any quarter. This was a rare if not unique opportunity, and the Fed made the most of it, achieving sustained growth together with high employment.

Overall, the 1990s demonstrated that a discretionary monetary policy is key to a successful macroeconomic regime. Greenspan showed that an economy can grow successfully if the most is made of opportunities to cut interest rates and if a cautious approach is taken to raising rates, albeit allowing for more radical rises when necessary. US monetary policy during the 1990s also demonstrated that there is little to be gained either from strict adherence to a money supply rule in the Milton Friedman tradition or by sticking rigidly to a concept such as the NAIRU. Monetary policy must be pursued both with an awareness of the historical moment but also without paying too much attention to the past and without any knowledge of the
future. In other words, when it comes to monetary policy there is no option but to respond to events as they happen.\(^\text{16}\)

The extremely positive regime in the US during the 1990s can be partly put down to fortuitous circumstances which were not actively engineered by policy. This is especially true of the aspects of the regime connected with wages and the external economic situation. Nevertheless, the way in which these circumstances were consistently taken advantage of was extremely significant. The positive economic development in the United States was possible thanks to the combination of a consistently anticyclical fiscal policy with a discretionary monetary policy geared towards expansion.

This case study of the United States reveals that it is possible for a macroeconomic regime approach to offer an alternative to the neoclassical approach. It is the macroeconomic situation of a country and not improvements in allocation and deregulated markets which accounts for growth trends. Much of what happened in the US came about without explicit coordination, and developments with regard to pay structures during the 1990s were far from positive. However, a functional macroeconomic wages trend is not determined by pay structures. In different circumstances, a functional wages trend could still have been achieved even if the same pay structures had remained in place. In general terms, it is debatable whether the United States will be able to reproduce the successes of the 1990s at will, since so many elements of the regime were unplanned. A regime that happens by chance to achieve a functional combination of the different elements of a successful regime is not something which we should be striving for. What we should be aiming to do is to build institutions in a coun-

\(^{16}\) See also Mankiw (2001, p. 51): “Despite this environment, and the fact that a prominent conservative headed the U.S. central bank, the Fed during the 1990s avoided any type of commitment to a policy rule. Conservative economists are sceptical about policies that rely heavily on the judgements of any one man. But that is how monetary policy was made over this decade, and it was hailed as a success by liberals and conservatives alike.”
try or currency zone that are able intentionally to create a functional regime through macroeconomic cooperation. Only then will the requirements for longer-term economic stability be met.

References


Coordination and actors’ interests
Keynesian macro-coordination at EU level: attractive to the trade unions?

Growth, and consequently employment, can be boosted significantly by means of alternative – Keynesian – monetary, wage and fiscal policies, as demonstrated both by empirical findings and by theoretical arguments (see Bartsch et al. 2003, Kasten/Soskice 2001, Fritsche et al. 1999, Krupp 1994). Organisational blueprints for institutions pursuing the goals of Keynesian economic policy have already been devised (see Arestis et al. 2001, Hein 2003a). What cannot however be inferred from Keynesian ideas, be they of post- or new Keynesian origin, is how to impose them on a political majority swayed by mainstream macroeconomics.

The aim of this paper is to close this knowledge gap just a little. I should like to determine how open-minded – or otherwise – the players at European level are towards macroeconomic coordination along Keynesian lines. I wish to make it clear from the outset that I am not seeking to elaborate normative policies; I am working on the assumption that a Keynesian policy can successfully increase growth and employment and is hence desirable. What I do wish to look at is whether or not, in the minds of the players at EU level and in the relevant institutions, there are any points of departure for implementing Keynesian ideas. I shall look in particular at the role of the trade unions, addressing the specific question of whether the unions are able to steer European economic policy in a Keynesian direction and, indeed, whether or not they wish to do so.

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The paper is therefore structured as follows. It begins with a brief overview of Keynesian economic policy, based mainly on the new and post-Keynesian strands of the theoretical construct (section 1). It then discusses to what extent elements of this policy agenda might prove attractive to the trade unions (section 2). Next, in so far as it is relevant to macroeconomic policy, I describe the network of institutions at EU level (section 3). This current state of affairs is compared with Keynesian ideas (section 4): does the institutional and practical manifestation of EU economic policy already conform to Keynesian precepts? What overlaps and contradictions are there? Having clarified these issues, I investigate what demands the implementation of these ideas makes on the trade unions, as a key player in macroeconomic policy, and what alliances and favourable circumstances might exist when it comes to putting Keynesian policies into practice (section 5).

The paper ends with a summary and conclusion (section 6).

1. Policies advocated by new and post-Keynesianists

Keynesian authors advocate policies that diverge from the prevailing macroeconomic way of thinking, which feeds on neo-classical, new classical and monetarist considerations and hence rejects discretionary policies. Seen from a Keynesian perspective, economic policy-makers are duty-bound to take positive action to boost growth and employment, since without stabilising measures the private sector will not of its own accord exploit the full potential for growth and employment.

The new Keynesian economic model is similar to neo- and new classical models, inasmuch as it is predicated on the Arrow-Debreu paradigm of general equilibrium (see Arrow/Debreu 1954, Debreu 1987 [1959]). In contrast to this model of a competitive equilibrium on all markets, according to which any intervention in the economy is conceived of purely as disturbing the optimal equilibriums, the analysis of new Keynesian authors includes inflexibilities and adjustment frictions, such as efficiency wages or cost-intensive price adaptations (see Snowdon et al. 1994: 290–318). Such factors may explain why real markets do not correspond to the neo-classical ideal and could be the starting point for a policy of stabilisation.

Since
under new Keynesian models money is not neutral in the short term, but – in contrast to new classical arguments – most definitely has an effect on the investment and consumption behaviour of economic subjects, the mechanisms and policies advocated in the monetary and fiscal spheres differ from those posited by neo-classical thinkers (see Mankiw 2002: ch. 14). It is acknowledged that fiscal policy can absorb exogenous shocks in the short and medium term. Automatic stabilisers should also be put in place, in order to guard against a slump in effective demand at times of recession. Government investment is desirable and can raise the level of growth and employment. Inflation targeting of monetary policy is recommended so as to protect the economy from inflation, but also from deflation. Investment decisions are affected by the level of interest rates, because interest rate reductions lessen the burden of debt on businesses or facilitate fresh borrowing.

New Keynesian thinking differs little from the mainstream in respect of wage and labour market policies. Even though certain labour market rigidities are demonstrably the consequence of subjectively rational behaviour and are thus justified to an extent, new Keynesianism singles out various sources of market inflexibility which create unemployment and should therefore be overcome. This stance is self-evident, in that new Keynesian models are generally constructed on the notion of a structurally determined rate of unemployment, the NAIRU (non-accelerating inflation rate of unemployment) (see Blanchard/Katz 1997). In similar vein to neo- and new classical models, a certain proportion of unemployment is attributed to a disruption in the market mechanism. In this case, the disciplining force of unemployment is weakened by protective labour market regulations and the presence on the market of strong trade unions. This weakness should be overcome by making the labour market more flexible (see Landmann/Jerger 1999: 121–132, Jerger 2003, Lindbeck 1996, Lindbeck/Snower 1987). It should also be pointed out that, generally speaking, the results of new neo-classical and monetarist economic theory returns to the fore in the long
term. Whereas monetary and fiscal policies can stabilise the economy, ultimately only labour market policy can successfully generate growth.

The post-Keynesian approach is further removed than new Keynesianism from new/neoclassical monetarist thinking (see Hein 1998, Hein 2003b). Post-Keynesian authors work on the assumption that short- and medium-term monetary and fiscal policy measures have long-term effects, so in the long term the general equilibrium paradigm does not apply, but the right fiscal and monetary policy measures certainly can increase growth and employment on a lasting basis. Moreover, greater labour market flexibility is not called for, since on flexible labour markets the employers and the trade unions are no longer in a position to set similar rates of pay for large groups of employees with an equalising effect over the economic cycle. There is then a risk of deflationary pay settlements during economic downturns, and of uncontrollable spurts in inflation during boom phases. The effect of interest rate policy is asymmetrical. A rise will always curb investment activity while a reduction cannot force people to invest, so monetary policy is largely ineffectual at times of recession. Both strands of Keynesianism do, however, concur that a non-inflationary wage policy allows the Central Bank greater scope to reduce interest rates, in that wage factors will not endanger the price level and thus there is no reason to combat price rises by means of a high interest rate policy.

If we set aside differences in theoretical analysis and confine ourselves solely to the short term, what emerges is a common Keynesian policy agenda consisting of the following principles and rules:

- monetary policy is required, by means of interest rate variations, to keep the price level within an inflation-target corridor, in order to avoid disruptive spurts in inflation and to prevent deflation. Interest rates should be kept low as a rule so as to encourage investment.

- government fiscal policy should gear budgets more towards public investment and allow public consumer expenditure to fluctuate in response to the economic cycle, thereby enabling the automatic stabilis-
ers to operate, but always in such a way as to prevent excessive deficits in the long term.

– wage rises should be geared to productivity trends in individual countries plus the inflation rate tolerated by the European Central Bank (ECB) for the EU area. From a new Keynesian perspective, this guideline constitutes a maximum level. Lower wage rises are helpful because they encourage companies to recruit more staff. From a post-Keynesian perspective, the sum of productivity trends and inflation rate must be divined as accurately as possible, because falling short of it might lead to growth-impairing deflation and monetary policy is powerless in such a situation.

If these guidelines are observed and economic subjects look to the future with optimism, Keynesianists predict that the economy will embark on a path of increasing, job-creating growth. Their recommendations likewise take account of interdependence between different policy areas. A wage policy geared to inflation plus productivity makes it easy for the Central Bank to keep price rises within its target corridor, so that a growth-promoting monetary policy becomes possible. Such a monetary policy in turn stimulates the level of investment, thereby preventing fiscal deficits; wages can rise without any effect on distribution. The proposed fiscal approach serves to stabilise the economy and bring about a lasting rise in growth levels, fuelled by investment, all of which attenuates the distribution conflicts associated with wage policy.

Such interdependence is also what justifies policy coordination. If the players involved in individual policy areas are conscious of the effects of their actions on other policy areas, adverse effects can be avoided and positive ones reinforced. This kind of coordination can take place implicitly as long as the players abide by the recommendations made. Explicit compliance with economic policy recommendations can however have advantages over purely individual observance. If all the players exchange information and reach explicit agreements with one another, they thereby reduce the uncer-
tainty about other people’s actions; misgivings, delays and misunderstandings can thus be avoided. For instance, if the social partners can credibly promise the Central Bank that their wage policy will be productivity-oriented, the ECB can lower its safety margin for the stabilisation of the price level. With no potential threat from wage policy, interest rates can be kept lower. All that would be needed is a forum where everyone concerned can exchange information about their intended actions, provided of course that they are all prepared to play the game by the Keynesian rules. If this is not the case, exchanges of information can of course minimise uncertainty about others’ intentions, but there is then no guarantee of a joint, consistent course of action.

2. Keynesian coordination – attractive to the trade unions?

Keynesian-style policy coordination holds out the promise of improved growth and employment. It must however be put into practice; there have to be players who are prepared to initiate and perpetuate such coordination. We shall now turn our attention to a player with a crucial part to play in coordination: the trade unions. Does the Keynesian agenda appeal to the trade unions, and are they subject to any particular constraints or obligations that limit their chances of pushing through Keynesian policies?

If we take a look at the European Trade Union Confederation’s diagnosis of the current situation and its recommendations for an alternative economic policy, we detect a high degree of affinity with Keynesian views on economic policy. According to the European Trade Union Confederation (ETUC), a misguided policy of consolidation which is out of step with the economic cycle has taken hold and has undermined growth. Interest rates are too high and fiscal policy is insufficiently investment-oriented (see European Trade Union Confederation 2003). For this reason the ETUC calls above all for macroeconomic measures, by which it means an anti-cyclical and investment-strengthening fiscal policy, low interest rates and wages geared to productivity and inflation (see European Trade Union Confederation 1999a). The ETUC considers that such a wage policy would prevent wage restraint and secure productivity gains for employees. To the
trade unions, therefore, productivity serves as a guide in attempting to make common cause against wage dumping in Europe. Furthermore, the ETUC is trying to bring about a Europeanisation of national collective bargaining systems (see European Trade Union Confederation 1999b; see also European Trade Union Confederation 2002). It aspires to enforce at European level basic trade union rights such as freedom of assembly and the right to strike.

Does this mean that the trade unions unreservedly endorse the Keynesian ideas outlined in section 1? Do they pursue their goals of higher incomes, a well-balanced wage structure and low unemployment by means of Keynesian policies? If the trade unions were to be guided by Keynesian principles, they would enjoy distinct advantages in respect of monetary and fiscal policies. Were the ECB to operate along Keynesian lines, the trade unions would benefit hugely. It would cost them nothing whilst being highly compatible with their interests. Lower interest rates would lead to more growth and consequently more jobs, without the trade unions having to sacrifice anything in return for the ECB’s stronger growth orientation. The only minor drawback is that the ECB might be more hesitant – or else more proactive – about taking growth into consideration. The unions would prefer the ECB to take an expansionary approach to interest rates, rather than a conservative and tentative one.

The same applies to fiscal policy. Fiscal stabilisation of the economy relieves the pressure on companies to lay off workers during a downturn. Fiscal policy may be more positive or more negative for the trade unions and their members, depending on the composition of fiscal expenditure and revenue. So long as the burden of taxation does not fall solely on employees and businesses are not given free hand-outs, but money is invested in infrastructure and training, the unions ought to be able to agree.

Let us assume that wage coordination were to take hold and pay rises were guided by the formula “inflation plus productivity”. The advantages are self-evident. There would be a bottom line below which wage dumping
could not go, and a self-sustaining effect would kick in. Area-wide collective agreements, initially a precondition for wage coordination, would in turn be further consolidated and strengthened by effective coordination. Redistribution to the detriment of employees would moreover be prevented. In addition, such a policy would be effective in avoiding wage-price spirals, i.e. wage-induced spurts in inflation which destabilise the economy and jeopardise the Central Bank’s price-level target. Yet the implementation of wage coordination is no mean feat and can even be disadvantageous to the trade unions. Indeed, whereas area-wide collective agreements are widespread in the EU, they are increasingly coming under pressure to decentralise. What is more, pay bargaining between employers and trade unions is guided primarily by what is achievable in terms of the balance of power, and scarcely at all by the needs of society as a whole. The yardstick of productivity trends plus inflation also forestalls efforts to achieve redistribution in favour of employees by means of higher nominal wage rises. Such a yardstick requires, rather, that binding rules be adhered to. Instead of each organisation defining its own wage target for every pay round, this would already be covered by the rules. Redistribution through wages is equally outmoded, but that is not a disadvantage in the context of the Keynesian model, since nominal wage rises in excess of the indicative wage rates can sometimes merely fuel inflation, without boosting real pay. If the trade unions were to go down the Keynesian road, they would have to turn their backs on political pay setting and wave goodbye to the notion that redistribution can be brought about through wages.

Although at first sight this might seem an unreasonable demand to make of the trade unions, it need not necessarily conflict with the unions’ own perception of themselves as an autonomous political force. For, on the one hand, wage regulation is self-imposed and not dictated by others. On the other, the surrender of redistribution through pay can be compensated for if redistribution can be achieved through the political process, i.e. via the taxation system and social security systems. Admittedly, such thinking is currently unpopular. Keynesian economists need to marshal additional arguments here to back up the trade unions.
Things would look rather different if the trade unions were to go along with the trend towards decentralised, below-productivity deals (with wage settlements lower than the sum of productivity and inflation), as called for by the European Council’s recommendations in its “Broad Economic Policy Guidelines” (2003) or by new Keynesian authors. The current state of affairs would probably change little in respect of wage policy, although the trade unions would have to accept lower wage rises while unemployment (minus residual unemployment calculated, for instance, in accordance with the NAIRU) remained high. In addition, the question that arises about below-productivity deals is how low they should go. If below-productivity pay settlements create jobs, then so do ones entailing a real loss of pay.

This comparison shows just how attractive the Keynesian agenda, at least in its post-Keynesian variant, can be to the trade unions. On the downside, self-restraint must be exercised in respect of wage policy; apart from that there is much to be gained. The advantages also outweigh the drawbacks in respect of society at large, always on the proviso that the Keynesian economic model is put into practice and is able to keep its promises on growth and employment.

3. The EU institutions and players specifically involved in macroeconomic coordination

The way in which EU policy is administered, i.e. goals are agreed and implemented, varies considerably for monetary, wage and fiscal policies. The basic thrust of EU policy is laid down by the European Council, which consists of the heads of state and government of the EU Member States, at summit meetings held at least twice a year (see Fig. 1 on the next page). The key institutions are the Council of Ministers and the European Commission (see Tömmel 2003: 56–146). The Council of Ministers – also known as the Council of the European Union – is the EU’s law-making body and hence its supreme decision-making institution. Each of the (at present) fifteen Member States sends a representative, normally a minister, to the Council of Ministers, although more than one specialist minister
may attend depending on the subject under discussion. The Council in turn comprises many subordinate bodies, the most important of which in the field of economic policy is the “EcoFin Council”, made up of economics and finance ministers. Another subordinate body is the so-called Eurogroup, an informal gathering of finance ministers from the euro zone countries, in other words without the United Kingdom, Sweden and Denmark. Although not formally constituted under the Treaty, the Eurogroup holds prior consultations in a number of areas and thus in practice paves the way for decisions in the Council of Ministers (see Pütter 2003). The European Commission combines both legislative powers (above all the right of initiative for legal acts and the adoption of regulations) and executive functions (implementation of legislation passed and monitoring of enforcement by the Member States).

Since being attributed a purely consultative role under the Treaty of Rome in 1957, the European Parliament has acquired a number of additional powers and now possesses rights of consultation and co-decision in many

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**Fig. 1: Decision-making powers in the EU**

Source: Own composition
areas. In terms of economic policy coordination, however, the Parliament plays only a secondary role.

The European Council, the Council of Ministers and the European Commission together determine the legal basis and procedural mechanisms in the field of economic policy. Different methods of managing monetary, wage and fiscal policies have arisen over time (see Directorate-General for Economic and Financial Affairs 2002). As concerns monetary policy, there exists in the form of the European Central Bank an autonomous institution responsible for managing monetary policy. It can take, and also implement, the relevant decisions single-handedly. This is a direct, central form of control. The Stability and Growth Pact (SGP), for its part, coordinates the fiscal policies of the EU Member States. Since the Pact can compel the EMU member countries to adopt adjustment measures in accordance with specific fiscal criteria and can enforce these by means of legally binding sanctions, this form of control is referred to as hard coordination. The number of players involved is manageable because only representatives from the EU Commission and the national governments take part in the process.

The third form of control, soft control, applies to all other policy coordination processes. Labour market, wage and structural policy decisions are laid down only in outline and, where need be, “naming and shaming” takes place if the required measures are not being implemented. Thus convergence is achieved by means of best practice – comparison of individual countries’ measures and imitation of successful ones – and peer pressure. This form of coordination is now referred to by the EU as the open method of coordination (see Hodson/Maher 2001, Linsenmann/Meyer 2002, Goetschy 2003). What is meant by the “open method” is a process for devising guidelines without issuing direct instructions, but rather by organising exchanges of views among national stakeholders whose powers remain undiminished (see Council of Ministers 2000: 6).

In practice, what this implies for monetary, wage and fiscal policies is that the following coordination takes place within policy areas (i.e. intra-coordination), (see Fig. 2 on page 123):
– **Monetary policy**

Following the completion of monetary union, monetary policy became the preserve of the ECB, which takes instructions from no one. Potential changes to the exchange-rate system remain the competence of the Council of Ministers in agreement with the European Central Bank, the Eurogroup and the Commission (see EC Treaty 2002, Art. 111). The Central Bank is obliged only to supply information to bodies other than these, even though it is expected to support EU economic policy wherever possible. Monetary policy is institutionally bound together with the other macroeconomic policies in the context of the Macroeconomic Dialogue; the ECB cannot however be compelled to take action as a result of this Dialogue.

The objective of the ECB, as laid down in the Treaty, is “to maintain price stability. Without prejudice to the objective of price stability, the ESCB [i.e. the European System of Central Banks: the ECB and national central banks, ed.] shall support the general economic policies in the Community” (EC Treaty 2002, Art. 105(1)). The ECB interprets this objective in a rather curious manner. Its activities are unambiguously geared to stabilising the price level, whereas it sees itself as having already fulfilled its other objective of supporting economic policy. Achieving price stability, according to the ECB’s reading, leads to a monetary climate favourable to growth and employment where no further action is required (see Issing 2000). Nor does the ECB consider national differences in inflation, growth and employment as a reason for diverging from its inflation target (see European Central Bank 2003a, European Central Bank 2003).

Even since the review of its monetary strategy, concluded in May 2003, the ECB has continued to base its monetary policy on a two-pillar strategy, which involves monitoring not only inflation but also growth in the monetary supply, in keeping with the monetarist way of thinking (see European Central Bank 2003a, Issing 2003, European Central Bank 2003b). Once it became plain, however, that despite
### Fig. 2: Macroeconomically relevant policies and processes at EU level

<table>
<thead>
<tr>
<th>Field</th>
<th>Attributes</th>
<th>Form of control</th>
<th>Main aims</th>
<th>Means</th>
<th>Players involved</th>
<th>Institutional embedding</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intracoordination of monetary policy</strong></td>
<td>ECB policy</td>
<td>Direct, central</td>
<td>Price stability</td>
<td>Conservative inflation targeting</td>
<td>European Central Bank</td>
<td>Autonomous organisation, intergovernmental treaty (EC Treaty, Art. 105, 108)</td>
</tr>
<tr>
<td><strong>Intracoordination of fiscal policy</strong></td>
<td>SGP</td>
<td>Hard coordination, reinforced by sanctions</td>
<td>Reduction of deficits, surplus budgets</td>
<td>Deficit criteria, automatic stabilisers operate around consolidation trend, discounting of cyclical components</td>
<td>Council of Ministers, European Commission</td>
<td>Intergovernmental treaty (EC Treaty, Art. 99, 104; Protocol annexed to Maastricht Treaty, Amsterdam Resolution, Council regulations 1466/97 and 1467/97)</td>
</tr>
<tr>
<td><strong>Intracoordination of wage and labour market policy</strong></td>
<td>Luxembourg Process</td>
<td>Soft coordination</td>
<td>Flexible labour markets</td>
<td>Best practice, National Action Plans</td>
<td>Council of Ministers, European Commission, Member States</td>
<td>Intergovernmental treaty (EC Treaty, Art. 125, 126, 128)</td>
</tr>
<tr>
<td></td>
<td>Doom Initiative, ETUC decisions</td>
<td>Soft, informal coordination</td>
<td>Distribution-neutral wage growth</td>
<td>Wage coordination</td>
<td>Trade Unions</td>
<td>Multi-employer bargaining</td>
</tr>
<tr>
<td></td>
<td>Macro-economic Dialogue</td>
<td>Soft coordination</td>
<td>Internalisation of external effects</td>
<td>Exchange of information</td>
<td>Council of Ministers, European Commission, ECB, trade union &amp; employer umbrella bodies</td>
<td>European Employment Pact (conclusions of Cologne European Council, Cologne Resolution)</td>
</tr>
</tbody>
</table>

Source: Own composition
substantial growth in the money supply inflation was not rising to the same extent, the ECB attached less importance to the money-supply pillar and downgraded it (see Watt/Janssen 2003). The Bank now concentrates on its medium-term inflation target of just under 2% and includes money supply growth as just one criterion among others when determining the inflation forecast (see European Central Bank 2003a). This inflation-centred approach, in evidence since the inception of monetary union, can be interpreted as inflation targeting, since it satisfies the three key definitions of that term (see Svensson 2000): firstly, the ECB aims for a certain quantitative inflation target in the medium term; secondly, in so doing it is guided by inflation forecasts; and, thirdly, it communicates these in its monthly reports. It has however set a very low target figure for inflation and prefers to avoid inflation rather than deflation (see Allsopp/Artis 2003, Fourçans/Vranceanu 2002), which is why I would describe the ECB’s inflation targeting as conservative.

– Fiscal policy

Fiscal integration has not progressed as far as that of monetary policy. There is of course a common EU budget, but at around one percent of EU GDP it is very small; fiscal policy decisions still overwhelmingly lie with the individual Member States. National fiscal policies are coordinated at European level through the Growth and Stability Pact, which deals with the indebtedness and budget deficits of Member States.

The Pact is the embodiment of the excessive deficit procedure defined in Article 104 of the EC Treaty. In addition to a resolution adopted at the Amsterdam summit, it consists of two regulations defining the Pact itself (see European Council 1997, Council of Ministers 1997a, Council of Ministers 1997b). The aim of the SGP is to compel the EU countries to keep their national budgets balanced or even in surplus in the medium term and to limit their level of indebtedness. The current government deficit may not exceed 3% of gross domestic product, and indebtedness must amount to no more than 60% of GDP (see Proto-
col 1992, Art. 1). This is to be achieved through stability programmes, as well as through the sanctions laid down in the excessive deficit procedure for euro zone countries and convergence programmes for the remaining EU Member States.

In the case of the euro zone countries, the Council of Ministers checks whether the stability programmes are likely to avert deficits and whether they are consistent with the Broad Economic Policy Guidelines. In addition, the Council of Ministers, together with the European Commission, keeps an eye on financial developments and can address an early warning to a country looking likely to diverge from the target set (see Council of Ministers 1997a). If the targets are missed and there are no exceptional circumstances, the Council of Ministers may introduce the excessive deficit procedure by a qualified majority (i.e. 71% of the votes), and may impose sanctions amounting to between 0.2% and 0.5% of GDP by a two-thirds majority (see European Council 1997, Council of Ministers 1997b). Exceptional circumstances exist when the deficit limit is merely exceeded temporarily as a result of an extraordinary external shock or a severe economic downturn (see Council of Ministers 1997b, Art. 2, European Council 1996).

The procedure is somewhat different for EU countries not belonging to the euro zone. They are subject to convergence programmes containing not only fiscal targets on deficits and national debt but also monetary guidelines. They are not subject to the deficit procedure, so sanctions cannot be imposed (see Council of Ministers 1997a, Art. 7 ff.). The purpose of these programmes is to bring the overall macro-economic data for these countries into line with the data for the European monetary area.

The institution responsible for implementing the procedure is the European Commission, which so far has always adhered to the consolidation rate with budgets that are balanced or in surplus over the
medium term. It should nevertheless be possible to bring the automatic stabilisers into play to counter short-term economic fluctuations (see European Commission 2002b: 3, 7). The present attempts at consolidation are intended to enable the automatic stabilisers to take full effect in the medium term with due regard for the 3% deficit criterion. These days, the Commission corrects even the cyclical components of the deficit figures for Member States (see European Commission 2003); yet overall deficits continue to be what counts for the deficit criteria. In short, the Commission pays lip-service to the operation of the automatic stabilisers but, in cases of doubt, precedence is always given to consolidation and in reality the stabilisers simply cannot operate automatically. Moreover, the SGP is geared solely to avoiding deficits during downturns; it offers no incentives either for an investment-oriented policy or for the reduction of indebtedness during boom periods.

- **Wage and labour market policy**

There is no common wage policy at EU level; pay will continue to be negotiated within the individual countries, and furthermore at different levels, for the foreseeable future. Nevertheless, efforts – in the form of the Luxembourg process and trade-union attempts at coordination – are being made to alter wage policy in the medium term and give it a stronger European dimension. The Luxembourg process is not directly about collective bargaining, as is the case with trade-union wage coordination. However, since the structural labour market changes discussed in the course of that process can have a huge impact on the negotiation of collective agreements, labour market policy also has to be mentioned here.

The employment strategy forming part of the Luxembourg process is intended to improve the situation on national labour markets (see EC Treaty 2002, Art. 125 and 128). Thanks to a process of reporting and comparison, coupled with recommendations from the Council of Ministers, the EU countries receive suggestions as to how they can im-
prove training for the labour force and make the labour market more adaptable to economic change. Employment Guidelines and Employment Recommendations, drawn up by the EU Commission and adopted by the Council of Ministers, are addressed to the Member States annually (see Council of Ministers 2003a, 2003b). The governments must then translate the Employment Guidelines into National Action Plans. Trade unions and employers’ federations are able to comment on the government’s draft Plan in most countries, but their influence extends no further than that (see EIROnline 2003).

Implementation of the measures is then verified in a Joint Employment Report, drawn up by the Commission and adopted by the Council of Ministers. A number of bodies, such as the European Parliament and the Committee of the Regions, are involved in the employment strategy process in an advisory capacity.

The Employment Recommendations are aimed primarily at structural changes to the labour market, seeking not only to boost training potential but also to make labour more flexible and to strengthen the incentives to take up work (see Goetschy 1999). They therefore follow a neo-classical approach to the labour market, whereby rigidities should be reduced as far as possible. Thus, on decentralised labour markets, the trade unions have less influence than before over the fixing of wage rates, and their ability to push through common rules in many spheres is diminished. A trend towards smaller wage rises and a greater diversity of settlements can be expected as a consequence.

In parallel with the official EU procedure to coordinate employment, the trade unions have for some years been stepping up their coordination of wage policy. A cross-border group of trade union representatives from Germany and the Benelux countries, as well as – more recently – France, has established the Doorn Initiative (see Kreimer-de Fries 1999). They aim for wage settlements equivalent to inflation plus the full extent of productivity gains. Part of the wage increase determined in this manner may however be exchanged for job-creating...
measures such as reductions in working time. The European Metalworkers’ Federation has decided on a similar approach at sectoral level (see Schulten 1999), and in 2000 the European Trade Union Confederation adopted the same rule of thumb (see European Trade Union Confederation 2000). The room for manoeuvre on wages generated by the productivity rule has not always been fully exploited until now. But if this were to happen, it would strengthen the trade unions’ identity as a pan-European movement and would secure EU-wide wage rises ensuring that employees suffer no loss of real wages and that they benefit from GDP growth. Yet in several ways both of these aspects conflict with the approach of the Luxembourg process, which does involve the trade unions in shaping the labour market but seeks to downplay their negotiating position and to decentralise the level of bargaining. The employers too have thus far rejected all efforts to go beyond national systems of bargaining (see ibid.).

Over and above the processes and policies described above, there are two further processes which mediate between policy areas and hence serve the purpose of inter-coordination. The Broad Economic Policy Guidelines and the Macroeconomic Dialogue are intended to bring about an alignment of national policies, helping to minimise or keep under control any external effects in one policy field arising from action taken in another.

– **Broad Economic Policy Guidelines**

When the European Commission published its White Paper on Growth, Competitiveness and Employment in 1993 (see European Commission 1993), it set out a blueprint for an economic policy capable of creating a stable macroeconomic framework for Europe with a view to boosting growth and employment. These considerations formed the basis of the Broad Economic Policy Guidelines (BEPGs), first published in that same year, which have contained a country-specific part since 1999 (see EC Treaty 2002, Art. 98, 99). Although the BEPGs are not exactly a talking point among the general public, they lie at the very heart of E(M)U-wide coordination. On the one
hand they contain recommendations for all policy areas related to the economy and, on the other, all the other coordination processes must produce results that are in keeping with the BEPGs. As from the 2003 edition of the Guidelines, they no longer apply only to the coming year but encompass recommendations for a three-year period (see European Commission 2002a). The procedure is that the Commission draws up an annual report on the economic situation in the EU (see European Commission 2003a) and then prepares a draft of the Guidelines in conjunction with the EcoFin Council and various other bodies. The draft is amended by the Council of Ministers where appropriate and then adopted. The proposed measures are scrutinised by the Commission in its Implementation Report, produced every year since 1999; however, no provision is made for sanctions compelling Member States to act on the proposals made. The Guidelines apply the principle of sound macroeconomic policy, which in the main consists of arguments deriving from new classical and monetarist economic theory. The policies to be implemented are aimed at consolidating government finances by balancing budgets in the medium term, a monetary policy which ensures stability of the price level, and a wage policy which keeps pay deals at moderate levels, i.e. equal at most to productivity gains plus inflation. Structural reforms on the commodity and labour markets are intended to promote growth (see Broad Economic Policy Guidelines 2003: 4-10).

Macroeconomic Dialogue

At the Cologne summit in 1999, the European Council added to the Luxembourg and Cardiff processes a further coordination process as part of the so-called European Employment Pact: the Macroeconomic Dialogue (MD) (see European Council 1999). Representatives of the Council of Ministers, the Commission, the European Central Bank, trade unions and employers meet up twice a year in the MD. The aim of this forum is to promote growth without inflationary pressure and to create jobs (see European Council 1999). To this end, the partici-
pants are expected to strive to synchronise monetary, wage and fiscal policies. The MD is purely a forum for exchanging information and issues neither reports nor guidelines; moreover, proceedings of the meetings are kept confidential. The MD itself is preceded by a round of more technical talks (see ibid.). A working group consisting of members of the Economic Policy Committee, the Employment and Labour Market Committee, the Commission and the social dialogue macroeconomic group endeavours to arrive at a common interpretation of the economic situation, based on a statistical analysis of the economy by the EcoFin Directorate General. Following this preliminary work, an exchange of views on policy coordination takes place at political level in the MD, usually involving high-ranking representatives of all concerned, such as ministers or chairpersons.

As will have become clear from this description, both of these processes amount to “soft” coordination, not entailing any binding sanctions. Consequently, the system of institutions and players in the EU is highly asymmetrical. On the one hand there is an autonomous Central Bank with exclusive responsibility for monetary policy while, on the other, all other policy areas are subject to processes which are coordinated with varying degrees of rigour.

4. Status quo vs. a normative approach

Having described the Keynesian approach to overcoming weaknesses in growth and employment, as well as the existing system of institutions and players, a comparative assessment can now be made. To what extent do the normative policy approaches based on Keynesianism correspond to the current state of affairs (see Fig. 3 on the next pages)?

The ECB has such far-reaching effects on growth and employment that a change to its policies would be essential for the pursuit of a Keynesian policy (see Hein 2002a). The ECB would have to relinquish its one-sided focus on price stability and, in the context of what has so far been a subsidiary objective – monitoring employment and growth – pay greater atten-
<table>
<thead>
<tr>
<th>Field</th>
<th>Attributes</th>
<th>Aims</th>
<th>Means</th>
<th>Institutional embedding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intracoordination of monetary policy</td>
<td>– ECB policy</td>
<td>Same importance attached to price stability as to supporting growth; stabilising distribution</td>
<td>Expansionary inflation targeting</td>
<td>Discretionary scope with autonomy or through closer political integration</td>
</tr>
<tr>
<td>Intracoordination of fiscal policy</td>
<td>– SGP</td>
<td>Growth trajectory, sustainable level of debt</td>
<td>Fully functioning automatic stabilisers, &quot;golden rule&quot;</td>
<td>Discretionary scope within an intergovernmental treaty</td>
</tr>
<tr>
<td>Intercoordination of monetary, wage and fiscal policy</td>
<td>– Broad Economic Policy Guidelines</td>
<td>Interest rate policy to support growth, sustainable fiscal policy &amp; wage rises below productivity gains (New Keynesian) or distribution-neutral wage growth (Post-Keynesian)</td>
<td>As hitherto: Guidelines, implementation report, peer group pressure</td>
<td>As hitherto: Intergovernmental treaty</td>
</tr>
<tr>
<td></td>
<td>– Macroeconomic Dialogue</td>
<td>Harmonisation</td>
<td>Discussion</td>
<td>As hitherto: European Employment Pact</td>
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</tbody>
</table>

Source: Own composition
tion to the effects of interest rate levels on investment. In other words, a rethink of economic policy is required, and this can be achieved either by altering the relevant reference models within the ECB or through institutional change. The most suitable method from a Keynesian perspective would be expansionary inflation targeting, which might mean aiming for a higher average inflation rate while at the same time going for a symmetrical inflation corridor, i.e. guarding against both inflation and deflation (see Allsopp/Artis 2003). Moreover, the inflation-forecasting instrument must be further developed. It is however worth noting that, as a result of the asymmetrical effectiveness of monetary policy, whereby interest rate policy can curb growth but can only encourage – and not impose – it, a more Keynesian orientation would bear fruit only in the medium term.

The SGP is unilaterally geared to curbing deficits and must be altered in such a way as to guarantee the full effect of the automatic stabilisers and boost public investment. The Commission’s recent reinterpretations of the relevant size of deficits and the role of fiscal stabilisers constitute an initial, albeit inadequate, step in the direction of a Keynesian model. Unlike the Commission itself, Keynesian authors would like to see a comprehensive revamp of the SGP (see Arestis et al. 2001, Priewe 2002). They call for public investment to be removed from the calculation of deficits (and hence promoted), as well as for the automatic stabilisers to be allowed to fluctuate in line with the economic cycle. The objective of achieving a balanced budget or even a budget surplus in the medium term is rejected as unjustifiable. It can be concluded that, in the fiscal domain, both an overhaul of economic policy and a comprehensive makeover of the relevant institutions would be required before EU policy could come anywhere close to the Keynesian model.

There is little dispute in the Keynesian camp that the current approach to monetary and fiscal policies is misguided. The analysis from a new Keynesian and a post-Keynesian perspective may differ on certain points, but the policy recommendations are similar. However, the same does not hold true for wage policy. Here, it is crucial to distinguish between the different
strands of Keynesianism. Post-Keynesianists believe that wage coordination must be expanded, so as to be in a position to impose rules which effectively forestall inflation and deflation (see Hein 2002b, Fritsche et al. 1999). Certain new Keynesian authors likewise advocate wage coordination, but with a view to achieving wage moderation (see Hancke/Soskice 2003). Generally speaking, for new Keynesian authors the productivity yardstick represents only a broad guideline, which can in particular be used in decentralised wage bargaining. Thus the recommendations range from accepting or promoting the current trend towards decentralisation, through wage coordination with the hope of wage-moderating (i.e. wage-reducing) pacts, to enhanced wage coordination among national trade unions in order to fully exploit the scope offered by inflation plus productivity. Appraisals of the Employment Guidelines diverge in similar fashion. Support for local pacts and greater labour market flexibility is either welcomed or rejected.

It is generally agreed that individual policy areas need to be capable of acting if the Keynesian model is to be put into practice: monetary, wage and fiscal policies must be capable of achieving the objectives set. Coordination of these policies with one another is equally desirable, since it is assumed that policies are interdependent and can be subjected to political processes.

The Macroeconomic Dialogue could therefore play an important role in Keynesian terms, by providing for this coordination of players and policies (see Heise 2002). The institutional structure, with its technical and political levels, together with the preparation of a common database, constitutes a favourable point of departure. The non-binding nature of the MD, however, is ill-suited to this coordinating role. If no agreement is reached, nothing happens. More far-reaching institutional changes, fostering cooperation among the players, would be feasible; if the autonomy of the players is to be respected – and this is not in question – the MD will always have to cope with free riding and self-interest on the part of those concerned. But it must first be ascertained whether or not the players actually believe that coordination can lead to a positive-sum game, and hence whether or not they are prepared to embark on in-depth talks about common economic
policy objectives. If their world view is such that they are sceptical about coordination and Keynesianism, ultimately not even the best institutional back-up can bring about a coordinated Keynesian policy. The situation today is that, whereas many players do accept the need for coordination, their approach to economic theory is mostly at odds with Keynesianism. This certainly applies to the ECB, which is moreover sceptical about all forms of coordination, and to the employers; yet it also overwhelmingly applies to the Commission and representatives in the Council of Ministers, as will be demonstrated in the next section.

The Broad Economic Policy Guidelines, the EU's second inter-coordinating policy process, are not binding either, but they have nevertheless had an influence on national policy-making (see Begg et al. 2002). They could therefore be of assistance in macroeconomic coordination. However, the economic policy they represent largely runs counter to the Keynesian model. The Guidelines would lend themselves to Keynesian thinking inasmuch as the Commission – primarily responsible for them – is receptive to coordination, since it acknowledges the interdependence of policies and sees coordination as a means of strengthening its own hand as the central coordinating body (see Broad Economic Policy Guidelines 2003: 15–17). This coordination, however, is predicated on objectives and methods of operation that differ from the Keynesian model. Coordination is designed to ensure that wages remain moderate, national budgets do not run up excessive deficits and structural reforms are driven through.

5. Development trends and alliances
Should the trade unions wish to act on Keynesian recommendations, they will not be in a position to push through the necessary institutional and political changes single-handedly. They need to form alliances and must (help to) shape monetary, fiscal and wage policies. In so doing, they must take account of – but perhaps can also utilise – the existing trajectories and dynamics of particular policy areas. So as to demonstrate what is possible and what is scarcely feasible in the medium term, developments in the field
of monetary, fiscal and wage policies are summarised below, as is the process for coordination between policy areas.

5.1 Monetary policy

Until 1999 the currencies of most EU Member States were linked together in the European Monetary System (EMS), established in 1979. This was a system of exchange rates which were set bilaterally, yet adjustable, and had relatively wide fluctuation margins (see Polster 2002: 171–201). The next step, the transition to a monetary union, was not inevitable. But internal and external factors ultimately led to increased support for a monetary union. The Deutschmark had always acted as a regional reserve currency under EMS (see Thomasberger 1993: 179–201). The adjustments of other currencies to the Deutschmark, resulting from the latter’s dominance, were causing tension in economic and political circles. Criticism became particularly outspoken in France in 1987 and culminated in a memorandum drawn up by the then Minister for Economic Affairs, Édouard Balladur (see Balladur 1993 [1987]). Further thinking about a monetary union designed to downplay the status of the Deutschmark then followed, and the Hanover EU summit called for a report to be produced under the direction of Jacques Delors. The report was published in 1989 (see Delors Report 1989); its ideas appeared especially relevant at that time, in the run-up to German reunification. The German government now had to show consideration for the fears of neighbouring countries about the territorial enlargement of the Federal Republic, since it was dependent on the goodwill of the Second World War allied states to honour the Two-Plus-Four Treaty on reunification. The German government could use monetary union as an indicator of Germany’s strong European ties. Nonetheless, neither the government nor the Bundesbank wished to jeopardise the stability of the German currency. Consequently, at the 1991 Maastricht summit a specific and irreversible timetable was laid down for the introduction of the new currency. The primacy of monetary stability and the autonomy of the European Central Bank were set in stone at the same time.
The outcome is that we now have a single currency area with twelve participating countries and an ECB which is sovereign in monetary affairs. The ECB’s role within macroeconomic policy coordination can be demonstrated on three principal counts:

- The ECB follows a new classical/monetarist line, which takes it for granted that monetary policy is neutral in the long term and that variable, high inflation has a destabilising effect (see Issing et al. 2001: 8–31). Against this theoretical background, and legitimised by the EC Treaty and its own statutes, the ECB considers that its prime objective is to preserve price stability with a low rate of inflation (see Issing 2001). The best way in which the Bank can support economic policy, in its own view, is by pursuing a consistent policy on the price level (see Issing 2000: 319–321). Consequently there is no trade-off between the inflation target and growth objectives; the former takes precedence and the latter are achieved as a by-product.

- The European Central Bank adopts an assignment-based approach, whereby it sees a clear division of labour between monetary, wage and fiscal policies (see European Central Bank 2003c, Issing 2002). The ECB rejects as counter-productive any active coordination, by which it means agreements between policy areas and common action. It considers that such a policy would be exceedingly awkward to put into practice (see European Central Bank 2003c: 43): firstly, arriving at an appropriate coordinated response to shocks would be difficult, since the effects of shocks and policy responses could only adequately be determined on the basis of a jointly accepted economic model – yet there is no prospect of that. Secondly, the ECB points out that coordination would lead to a confusion of competence and hence potentially to more laxity in the attainment of objectives. Thirdly, implementation difficulties would arise owing to the lack of any instruments to monitor and implement coordinated action. Therefore, according to the ECB, given the right institutional structure and a clear allocation of tasks, there is no need for ad hoc coordination.
What the ECB does advocate is that other policies should fall into line with ECB policy: “[I]f national governments and social partners take the single monetary policy’s commitment to maintain price stability as given, when deciding on their own actions, this will lead to implicitly coordinated policy outcomes ex post” (Issing 2002: 346, emphasis in original, see also European Central Bank 2003c). Since the ECB influences prices and growth through its monetary policy, the other policy areas – particularly wage and fiscal policies in the individual countries – must factor its activity into their own activities. The ECB, by contrast, finds itself in a comfortable position, able to pursue its interest in price stability without being dependent on any other players. Moderation in the field of fiscal and wage policies is of course to the Bank’s advantage when pursuing its own inflation target, but it would successfully achieve its inflation target even without such moderation, by means of sufficiently high interest rates. This explains the ECB’s reluctance to countenance policy coordination. It has acquired virtually all the power that exists in its field and merely needs to guard against losing any of its competence.

Under these circumstances, are there any factors at all which might bring about a change in respect of monetary policy? I should like to discuss four possibilities:

- Public pressure could perhaps cause the ECB to shift its position. The Central Bank has not really been perceived until now as a relevant player with (shared) responsibility for economic growth; few people establish a link between interest rate policy and poor economic growth. One significant exception here is traders on the financial markets, who certainly do see asset values reacting to interest rates. Businesses ought to react just as sensitively to high interest rates. Investment financed through borrowing is subject to a high rate of interest, which increases the burden of debt, making certain investments no longer appear worthwhile. However, such considerations have not yet made their mark on the views of employers’ organisations.
The draft European Constitution produced by the European Convention contains a number of changes to the status quo. Contrary to what the ECB is currently advocating, the price-level target is not presented as an objective of the European Union; it does however remain the prime objective of the ECB in the Treaty provisions relating to the Bank (see European Convention 2003: Part I, Title IV, Chap. II, Art. 29(2) and Part III, Title III, Chap. II, para. 2, Art. III-77(1)). Unlike hitherto, the ECB is explicitly designated an “other institution” of the EU, yet this does not imply any restriction on the Bank’s autonomy. The voting rules in the Council of Ministers are altered in certain areas. Decisions are henceforth to be taken by a qualified majority rather than unanimously. But it would be erroneous to imagine that this change will have the slightest impact on monetary policy. The draft Constitution makes provision for simplified procedures in several fields and for the transition to qualified majority voting (see Wessels 2003: 288–290), no doubt because of the risk that the unanimity requirement for decision-making would frequently be blocked by vetoes, owing to the large number of countries involved following EU eastward enlargement. Overall, should these changes enter into force in their present form, they are unlikely to result in any substantial modifications in the ECB’s attitude and policy.

The change in ECB director from Duisenberg to Trichet may perhaps make more of a difference. Even though organisations are defined by a principal/agent relationship which locks their executives into a system of norms (see Niechoj 2003: 80–82) that can never be entirely transformed by individuals, Trichet might chart a slightly more moderate course. Shifts such as a reinforcement of the inflation yardstick and greater attention to short-term growth effects could occur. It remains to be seen how Trichet will position himself in future, but he does after all originate from a country – France – whose economic policy has traditionally been receptive to Keynesian ideas.
One economic development that might bring about a re-think at the ECB would be deflation. Were prices to fall steadily, its powers of control would be undermined. If companies shun loans – and hence investment – as a reaction to deflation, the economy is plunged into crisis, which further fuels deflation. Under such circumstances the ECB could no longer adhere to its inflation target of just under 2%. Nor would it be able to make businesses invest more, even in the presence of sharply falling interest rates: interest rate reductions have no impact when the prospects for investment look bleak due to the crisis situation. Once matters have progressed so far, not even an expansionary monetary policy can be of much assistance. Nevertheless, the ECB sees no risk of this happening and is currently not taking any precautions to prevent deflation.

There are hardly any reasons why the ECB would wish to alter its conduct. The trade unions will have to live with ECB policy, for better or worse, for the foreseeable future and are obliged to avoid wage-price spirals. It is somewhat unlikely that the ECB will head off in a new direction; moderate corrections can however be expected. The only course of action left open to the trade unions is to put pressure on the ECB in public.

5.2 Fiscal policy

The Stability and Growth Pact is a consequence of the way in which European Monetary Union came into being. It represents a concession to countries which feared that, without national monetary sovereignty and without institutional restrictions, fiscal deficits could get out of hand and adversely affect all the other EMU countries. The SGP’s mode of operation was heavily influenced by the German government and the Bundesbank (see Costello 2001, Stark 2001, Heipertz/Verdun 2003).

The Pact has considerably been put to the test three times so far. In 2001 Ireland pursued an expansionary fiscal policy which had a strongly procyclical effect. This was problematical above all for the implementation of the Broad Economic Policy Guidelines, but it also provided convincing
evidence that the SGP was ill-equipped to curb pro-cyclical, expansionary fiscal policies. In Ireland’s case, the Eurogroup decided unanimously – with the exception of the Irish Finance Minister – that the expansionary fiscal policy must be reined in (see Pütter 2003). The picture was rather different in the case of subsequent deficits in Germany and France. When, at the beginning of 2002, there was talk of issuing an early warning to the German government because of the likelihood that the 3% deficit criterion would be exceeded, not all countries shared the Commission’s view that Germany’s finances were in dire straits. The Finance Minister, Hans Eichel, was initially able to stall for time and avert an excessive deficit procedure by issuing assurances of his intention to abide by the Pact. However, once it was announced in February 2002 that a balanced budget would not be achieved until 2006 (instead of 2004), and Chancellor Schröder announced loud and clear his refusal to see the procedure introduced, the situation took on a new, political dimension. Several smaller countries – in terms of their share of the EU internal market – became fearful of double standards, whereby large countries like Germany would receive an especially lenient assessment of their deficits. Matters came to a head just one month later, when French President Jacques Chirac announced that, should growth prove insufficient, he would not consider himself bound by the Pact. Unlike Hans Eichel, who had always promised to abide by the Pact, France now called the Pact into question. All the other Ministers, including Eichel, opposed France’s position. Despite these countries’ efforts at consolidation, the deficits persisted. The Commission responded in May 2003 by removing cyclical factors from its calculation of deficits and by postponing the deadline by which balanced budgets must be achieved.

Whereas consolidation was a broadly accepted objective in the early days of the Pact, the test cases described above altered the situation. By the end of November 2003, before the Council of Ministers resolved to tighten the procedure in respect of France and Germany, a polarisation had occurred between those who championed strict observance of the Pact and those who preferred to see it modified (see Fig. 4).
Half of the smaller countries insisted on strict observance of the Pact: Spain, Austria, Finland and the Netherlands argued emphatically in its favour. Apart from the Netherlands, all these countries were some distance away from the deficit criteria in respect of new debt and the level of indebtedness (see Fig. 5 on the next page). Some of the smaller countries took a moderate line. Ireland, not itself in danger of reaching the deficit limits, expressed sympathy for a less stringent enforcement. Luxembourg, previously another hard-liner, now proved more moderate. The same goes for Belgium, which opposed any changes to the Pact whilst showing understanding for a less strict interpretation in view of the prevailing economic climate. Whereas these countries did not adopt this stance on account of their own economic situation, the same cannot be said of Greece and Portugal. Greece was in a rather uncomfortable position as concerns indebtedness, and Portugal had every reason not to push through the imposition of financial penalties, given its own infringements of the SGP and meagre rate of growth.

Deficits in the two large countries France and Germany were once again running at above the 3% mark. Once all previous attempts at consolidation had proved unsuccessful, the French and German governments justified their deficits as best they could. Both insisted, ahead of the Council of
Ministers meeting, that the Pact should be managed “more flexibly”, i.e. the rules should not be applied rigorously. Italy was still burdened with the crippling debt which had taken it well above the 60% limit at the start of monetary union and has hardly been reduced since. It too was approaching the 3% threshold.

The individual countries’ debt figures go some way to explaining how they positioned themselves in this conflict about adjusting the SGP. Those with debt problems argued for changes; those with small deficits or surpluses wished to preserve the Pact in its current form. Yet the debate concerning the SGP was not just about the countries’ differing economic circum-
stances; nor was it just an altercation about good rules and how best to interpret them. Rather, it was in addition a confrontation between small and large countries which can be summed up in the question as to whether the large countries can do whatever they like, and whether agreements reached in the past have now become meaningless.

The EcoFin Council on 25 November 2003 was supposed to resolve the conflict by imposing financial penalties on Germany and France; it ended with a compromise (see EcoFin Council 2003: 15–22). Countries outside of the euro zone were not entitled to participate in the vote, and nor were the countries concerned, Germany and France respectively. Under the rules of the Pact, the Council of Ministers should have tightened the procedures against Germany and France at the end of 2003 in view of their persistent deficits, and should ultimately have demanded the payment of fines. It did not come to that. At the meeting only Spain, the Netherlands, Austria, Finland, Belgium and Greece voted in favour of an initial decision to impose more stringent measures. Once the variable numbers of votes allotted to each country were added together, deadlock ensued. Votes against additional stringency were cast by France in the decision about Germany and by Germany in the decision about France, as well as by Italy, Portugal, Ireland and Luxembourg. The Italian presidency then made a compromise proposal – to halt the procedure – causing Greece and Belgium to shift their positions and enabling the compromise to be adopted.

The suspension of the procedure, however, solved neither the underlying economic problem nor the political one. Deficits will continue to deviate from the norm, and the large countries will continue to overstrecth the mechanisms of the SGP. Two scenarios appear possible: either the SGP will formally be left intact, and once growth picks up in the USA and subsequently in the EU, consolidation at just under 3% will again become possible in most countries within the foreseeable future. The misguided economics of the Pact will be glossed over, and only a future downturn will reveal whether or not the Pact formally implodes. Or the national governments will learn from the crisis over the Pact and endeavour to find an

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economic and political solution. There is no shortage of – sometimes con-
tradictory – proposals for reforming the Pact (see for example Blanch-
ard/Giavazzi 2004, Arestis et al. 2001, Buti et al. 2003, Linsenmann/Wes-
sels 2002, Lossani et al. 2002). Admittedly, the governments are in a posi-
tion of having to square the circle. They must modify the rules in a way
that makes economic sense but cannot be interpreted as conceding power
to the large countries.

5.3 Wage policy

The single currency area should in principle make it easier for small coun-
tries to gain wage-cost advantages over other countries by means of wage
moderation, given that there is no longer a threat of exchange-rate reac-
tions. Yet there has so far been no reduction in wages as a result of down-
ward competitive pressure. Generally speaking, wage increases in the euro
zone are small but positive. Pay rises in countries such as Spain and Ireland
are higher; in other countries, such as in the Netherlands at present (see
Schulten/Mühlhaupt 2003), the trade unions are being compelled to ex-
change wage gains in return for secure jobs and to prevent cuts in social
benefits. The pressure of disinflation currently facing the euro zone is com-
ing above all from a large economy, and Germany, rather than from the
small countries (see Hein/Truger 2004).

Despite this differentiated picture, minimal pay rises or even pay reductions
constitute a latent threat to the trade unions. The wage coordination initi-
ated by the unions is designed to counter this threat by setting a minimum
basis for wage increases, amounting to the formula “productivity gains plus
the rate of inflation”. Can this be successfully secured through wage coor-
dination at EU level? A number of preconditions must first be met by the
trade unions:

– It is crucial to take account of the externalities affecting pay deals, i.e.
  above all the effects of wage undercutting on other countries and of
  potential surges in inflation triggered by the trade unions. For this rea-
  son the unions must see themselves – as Olson puts it – as encompass-
  ing organisations seeking to represent a wide range of interests (see Ol-
son 1982: 47–53). This appears unlikely in that, even though collectively agreed pay deals are legitimised by the parties in terms of their economic impact, as a means of substantiating their positions, the outcomes of negotiations are ultimately the result of power relations. Pay deals are determined primarily by the forcefulness of the negotiating parties; the economic or political demands made of them play only a secondary role. The consequences of external factors are not necessarily taken into consideration.

– It would be purely coincidental if the recommendation of productivity gains plus the rate of inflation were to be spontaneously achieved, given that no incentives of an institutional or non-institutional kind exist on either the trade union or employers’ side to ensure that they comply with it. Worse still, given that wage moderation makes a good deal of economic sense for small countries, there may be some deliberate free riding. Incidentally, wage-induced inflation may appear attractive in certain circumstances, in that it pushes down country-specific real interest rates in a single currency area. Consequently, from a global economic perspective, what is needed is for the trade unions – but also the employers – to be compelled to abide by the rules, or for both parties to undertake to do so. Because supranational umbrella organisations or initiatives can only coordinate pay bargaining conducted in the individual countries, with responsibility for negotiations remaining at national level, it is all the more important that safeguards be constructed at supranational level against divergences from the agreed productivity rule; after all, if the rules are persistently flouted, wage coordination becomes obsolete. One possible solution for the trade unions may be a coordinating body which reports on the rules and their implementation, ensures compliance with them and makes proposals as to the way ahead. Such coordination already exists in embryonic form on the trade union side and could be taken further. Sectoral information meetings are held and regular meetings of experts take place, for instance in the context of the Doorn Group. These
links, which increasingly involve those responsible for national pay bargaining, should be expanded and could usefully be coordinated by the European Trade Union Confederation.

– However, even if the players do commit themselves to binding rules, they will not necessarily be able to enforce them. Wage policy coordination at supranational level can only succeed if the negotiating parties at national or sectoral level are capable of acting. This can be ensured either by means of centralised negotiations or by setting a pattern by one of the trade unions. The situation here is complicated by eastward enlargement of the EU, because wage bargaining systems in the new Member States tend not to be based on multi-employer bargaining, which makes coordination considerably more awkward (see Schulten 2004).

– The current economic and social situation does not help. When almost everyone concerned is pushing for decentralisation and pay cuts, and when the economic climate is poor, the trade unions are not in a position single-handedly to effect wage coordination of the type envisaged.

Assistance is therefore required. But where can the trade unions find partners with a favourable attitude towards wage coordination? An examination of the positions of the players at EU level and of the ongoing coordination processes reveals few sources of support for trade union wage coordination:

– What has already been said above about the ECB and coordination applies all the more so to coordination of wage and monetary policies. Its assignment-based way of thinking leaves no scope for this. The ECB likes to see the trade unions exercising wage restraint for the sake of stabilising the price level, but it makes no concessions on interest rate policy in return.

– The employers at EU level have been represented by two umbrella organisations since the 1970s: the Union of Industrial and Employers’ Confederations of Europe (UNICE) and the European Centre of En-
terprises with Public Participation and of Enterprises of General Economic Interest (CEEP). Both UNICE and CEEP are favourably disposed towards collective agreements in principle, because they bring about lower transaction costs and create the same conditions for everyone. However, they regard industrial relations as primarily – and pay bargaining as exclusively – a national affair (see UNICE [n.d.]: 6, 12 ff., UNICE 1999). European economic policy should focus on boosting corporate competitiveness and on reforming the labour market, although structural reforms of this type are largely a national concern (see UNICE [n.d.]: 3, UNICE [n.d.]). UNICE approves of the recommendations set out in the Broad Economic Policy Guidelines and likewise argues for price stability and budgetary discipline (see UNICE [n.d.]). It welcomes low wage rises on the grounds that profits, and consequently economic activity, will thereby be stepped up.

- It is in the Commission’s own interest for policies to be coordinated and for the trade unions to be involved, since it wishes to strengthen the supranational level, i.e. itself. It sees itself as the key organisation of macroeconomic coordination, drawing together individual interests and turning them into a coherent strategy. As stated in the White Paper on European Governance, the Commission regards coordination as an appropriate means of involving other players in the policies of national governments and at European level (see European Commission 2001a). Coordination of this type is basically geared to corporatist solutions. The Commission wishes to discover the preferences of the other players and take on added responsibilities, albeit without impinging on framework legislation adopted by the Council of Ministers and the Commission: “The open method of coordination should be a complement, rather than a replacement, for Community action” (European Commission 2001a: 22). The Commission simultaneously aims to strengthen supranational control by claiming more powers for itself and the Eurogroup, referring to this too as coordination (see European Commission 2001b). The Commission’s inclusion of the
trade unions and employers secures allies for all concerned. Support for the trade union position and wage coordination looks unlikely, however, given that the Commission’s statements and attitudes – at least within the Directorate General for Economic and Finance, which is responsible for economic policy coordination – are dominated by views on economic policy which have little in common with those of the trade unions.

This emerges clearly from what is said about wage negotiations and wage coordination in the Broad Economic Policy Guidelines, drawn up by the Commission and adopted by the Council of Ministers. Pay rises should be kept below the level of productivity gains, so as to reduce costs for businesses and hence create jobs. The Guidelines call for structural reforms of both the labour market and commodity markets; investment in education and research is worthwhile by way of an accompanying measure, in order to raise the level of investment and productivity (see Broad Economic Policy Guidelines 2003: 4–10, European Commission 2003b: 29–37, European Commission 2003c: 22–25).

By participating in the Luxembourg process, the trade unions have gained in status at European level and been recognised as stakeholders. In this way the trade unions are now able to feed in their ideas and argue their case with the other players. Yet by becoming involved they have also made themselves jointly responsible for the outcomes. Thus the ETUC finds itself in a similar position to trade unions in the individual countries, which are part of a corporatist system. If, through their participation, the trade unions legitimise the decentralisation of pay bargaining, they are themselves undermining the basis for effective wage coordination, which has to be founded on structures ensuring that the settlements achieved are homogeneous and the target figures achievable.

The Macroeconomic Dialogue has hitherto offered few opportunities for trade union wage coordination. Quite the opposite, in fact: the
ECB and certain government representatives hope that the MD will produce wage moderation rather than coordination. This is hardly surprising because, after all, the players go into the Dialogue with the positions that they also hold outside of that forum. For this reason, the trade unions are more likely to be confronted with demands for pay restraint than with organisational support for wage coordination.

In view of these factors, a wage coordination scenario is an ambitious goal for trade union policy-makers to adopt. But that is not all: even more is required of the trade unions, because in addition to effective wage coordination they also need to push for an overhaul of monetary and fiscal policies if they wish to successfully reorient economic policy in a Keynesian direction.

6. Policies in the new Keynesian mould?

The conclusion that I draw from the foregoing considerations may seem surprising: economic policy in the European Union has moved closer to a new Keynesian approach. This trend could go further still, as illustrated by developments affecting policies and processes:

– Money supply issues now play a less significant role for the ECB than in the past. According to its latest pronouncements, the Bank now not only guards against excessive inflation but likewise against deflation. By so doing, it has begun to engage in inflation targeting, although clearly still in a rather restrictive manner as concerns the level of the inflation target, the lower limit for the inflation rate and potential inflationary shocks.

– Even before the failure to sanction countries unable to comply with the deficit criteria at the end of 2003, changes were made to the way in which the SGP was interpreted. More emphasis has been given verbally to automatic stabilisers, and the current economic situation is for the first time taken into account due to a new method of calculating deficits. If the Commission were to follow through this logic and really did allow the automatic stabilisers to fluctuate freely in future, and if it...
were also to gear the 3% criterion to the structural deficit, then it would be fully in line with new Keynesianism. The suspension of sanctions against Germany and France has not removed the pressure for the Pact to be reformed; a modification of the Pact is therefore not beyond the bounds of possibility. Even if the anticipated cyclical upturn leads to a modest resumption of growth, the EU will still have to revise the rules. The only question is how extensive this revision will be, and whether or not the Pact will be entirely consigned to history.

– Wage policy is similarly in keeping with new Keynesian thinking. The trend towards decentralisation is continuing and wage rises remain lower than productivity plus inflation.

Nonetheless – and at first sight this might seem just as surprising as our identification of a shift in economic policy towards new Keynesian attitudes – this “re-Keynesianisation” does not herald any truly satisfactory prospects for the trade unions and their interests. Indeed, for the trade unions, whose interests and ideas are somewhat closer to post-Keynesian thinking, this is by no means a comfortable situation. New Keynesian policy does admittedly constitute an initial step towards a policy that compensates for cyclical fluctuations, yet a long-term increase in growth is still a good way off. Moreover, a new Keynesian approach does not significantly alter existing attitudes to trade union wage policy. By calling for pay rises lower than productivity plus inflation, as well as decentralisation and flexibilisation of wage bargaining, new Keynesian authors themselves advocate redistribution at the expense of employees. That puts the trade unions under particular pressure in their intrinsic field of operation, wage bargaining.

The chosen course of action – committing national trade unions to union-led pay guidelines – nevertheless remains an appropriate objective. However, if the trade unions wish to alter the basic thrust of economic policy at European level, they cannot confine themselves to their intrinsic area of responsibility, wage policy. They must use their channels of influence – and are in fact already doing so – to steer monetary and fiscal policies too in the direction of a post-Keynesian agenda. To this end, they need to bring the
various players round to new ways of thinking and exert pressure on them in institutions, through public campaigns and via think-tanks. Their efforts will all be in vain unless the ECB rethinks its strategy and fiscal policy is revamped. Wage coordination alone, even if it were to function as hoped, is insufficient.

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Trade unions’ wage policy and macroeconomic policy coordination in the European Monetary Union

Trade unions have a twofold interest in the redefinition of EU-level economic policy. On the one hand they generally seek to shift macroeconomic policy back into the centre of a strategy geared toward promoting growth and employment, and on the other hand coordination of the different actors’ strategies should increase the effectiveness of this strategy. The key parameters of economic development, interest rates, exchange rates, unit labour costs (wages in relation to productivity), and aggregate demand, do not “blindly emerge” from the open interplay of market forces. Instead, to a considerable extent, they are influenced – or even determined – by the intentional political choices of institutions and collective actors. The European Central Bank (ECB) exerts influence through its monetary policy, the governments of European member states use their fiscal policies, and the partners to a collective agreement their agreements. The fact that wage policy is part of this nexus of policies in need of coordination sometimes puts labour unions in a difficult situation. Nevertheless, of all the available alternatives, policy coordination is the most appealing option. Macroeconomic policy coordination, if implemented, would not only improve overall economic performance, it would also relieve wage policy of some of the overextended expectations that currently weigh heavily on this policy field

In the European Union’s economic policy conception of the 1990s, macroeconomic policy played only a minor role – it was limited to ensuring that

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1 For discussions of this topic see the contributions by Hein/Truger and Fritsche et al. in this volume.
member states stayed within the parameters of the Maastricht-criteria. The treaty of Maastricht itself still rested on the assumption that monetary policy by an autonomous central bank, combined with private markets in most other areas, could be a minimalist conception of macroeconomic policy, sufficient for steering economic development in the limited extent to which this was necessary. Fiscal policy was conceptualized as essentially neutral: It was supposed to deliver balanced budgets and only in times of recession could budget deficits be used to stabilize growth, but this only in the amount of maximally three percent of GDP. In this conception, wage policy had the function, and the obligation to produce collective agreements that consistently stay below the growth of productivity for the medium-term future. Apart from these sparse guidelines, EU-level policy-making, under the banner of its approach to “enhance competitiveness”, focused on the micro-level and the intermediate-level and addressed the issues of realizing the Single European Market, deregulating product markets and labour markets, and redesigning the instruments of regional regulatory intervention.²

The European Monetary Union (EMU) of January 1, 1999 created a new situation for economic and wage policy. With the creation of the EMU economic policy actually regained much of its capacity for intentional action and constructive strategizing: The union, after all, comprises an economic system that is nearly a closed economy: Only nine percent of the EU’s aggregate demand is satisfied by imports. In other words, almost all impulses emanating from monetary policy or fiscal policy will manifest themselves in EU, rather than on international markets. Thus, the EU has a domestic market, in a size similar to that of the United States.

Moreover, the dynamic of speculating against a particular currency on the financial markets is suspended, as the EURO covers the entire area. Curb- ing this danger of currency turbulences has also enhanced the scope for independent macroeconomic policies in the EMU. All these developments

² See the contribution by Niechoj in this volume.
have rendered the EU a powerful actor in the global economy, and the EU is at the mercy of a diffuse globalization (national governments have so far referred to this authority only when they sought to justify their inactivity in the field of macroeconomic policy). However, the EU not only failed to use this new potential to its advantage, it even created rules that constrained its own scope of activity. These constraints come from both the goals and the rules in the Amsterdam Stability and Growth Pact of the year 1997: The dominant checkpoints of that economic policy conception – still adhering to the resolutions of the Maastricht treaty of the year 1991 – are price stability and the reduction of the scope of state activity in favour of private markets. Rules concerning admissible amounts of public debt, public deficits and the possibilities of sanctions, negotiated after the Stability and Growth Pact had been enacted, are operationalisations of the latter goal, reducing the scope of state activity. Further deregulation and privatization on the markets for goods and services, designed on the EU-level and imposed from there in what is known as the Cardiff-Process of 1998, complement this policy. However, upholding this narrow conception of economic policy turned out to be not possible, because the labour market problems became too pressing. As a result, an employment chapter was added to the treaty of Amsterdam, which defines “the promotion of employment” as “a matter of mutual interest” and obliges the member states to develop a coordinated employment strategy (Art. 125 EC Treaty). Moreover, article 99 of that treaty requires economic policy coordination.

However, it was not until the development of the Macroeconomic Dialogue that the first step toward institutionalizing the employment chapter’s obligation to develop a coordinated employment strategy was taken, because this step for the first time combines all realms of macroeconomic policy – fiscal policy, monetary policy, and wage policy – in one forum of negotiation. Even that step, however, has not changed the flawed ascription of roles in the macroeconomic policy domain: Price stability is still the sole responsibility of the ECB, fiscal policy-makers are in charge of balanced budgets only, and the entire area of employment promotion is the respon-
sibility of wage policy. A promising strategy would be look differently. It would assign responsibility for employment and growth to the ECB, declare stabilizing the development of employment across business cycles and the provision of an infrastructure conducive to economic growth the task of fiscal policy, so that the primary role of wage setting would be to make sure that no inflationary impulses emanate from collective bargaining. The current inadequate assignment of tasks, combined with the additional restrictions of the Stability and Growth Pact of 1997, resulted in a situation in which the Macroeconomic Dialogue has degenerated into a purely formal gathering (see Welzmüller 2002), which does not take the opportunity for reaching meaningful substantive agreements. In Germany the impulses of fiscal policy on aggregate demand were contractive in the years 1997 through 2003, with 2001 being the only exception of this trend (DIW 2002: 480), and this contributed to the enduring weakness of growth and employment in the EU. Thus, sluggish growth and persistent unemployment are to a large extent the result of inactivity in the field of macroeconomic policy. This retreat of macroeconomic policy, which left the field to the restrictive policy of the ECB, shifted all the adjustment burdens onto wage setting. This was especially severe in the first years of the EMU.

The national alliances for jobs and stability, which developed into a form of smaller-scale policy coordination during the late 1990s, can be explained in terms of this lack of an EU-level policy of growth-promotion: They were substitute solutions on the national level, but intending to function as instruments of macroeconomic coordination, they could not even figure as second-best solutions. It is hard, if not impossible, to reconcile the idea of national pacts with the idea and the realities of a Single European Market.

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3 The DIW assessed the ECB’s monetary policy during the first years of the EMU as too restrictive “in the sense that it did not acknowledge and reward wage restraint in its monetary policy” (see DIW 2001: 451).

4 The DIW classified the development of wages during the initial years of the EMU as “comparatively moderate” (see DIW 2003: 13).
and European Monetary Union. In a transnational economic system, national solutions tend to resort to policies, in which countries seek short-term competitive advantages, at the expense of neighbouring countries within the common market.\(^5\)

Rather than shifting the burdens of the particular member states’ structural problems onto other countries, addressing these problems should be the task of EU-level structural policies. As structural policy instruments are available to all EU-members on equal terms, there are no arguments against it from the standpoint of competition policy. The problematic effects of national pacts are a further reason for the European trade unions to strive for a conception of coordinated European economic policy, a strategy that fosters growth and employment and facilitates a stable economic and social development.

In this perspective the central question for Europe’s trade unions is the following: What would it take to formulate a constructive economic policy strategy for the next three to five years, which is committed to fostering growth and employment and which lends itself to procuring enduring political support by the diverse reformist forces of Europe? How would such a strategy look like?

In the current practice, what little the EU has in terms of macroeconomic policy is completely dominated by the ECB. In this minimalist macroeconomic “strategy”, the fiscal policies of the member states, as well as wage policy, have nothing to do but assist this ECB-led macro-strategy. This situation is not sustainable for much longer. What is needed, instead, is a

\(^5\) See Schäfer 2002, who sees a danger of a race to the bottom, in which social policies and collective bargaining agreements gain importance as competitive factors in a dynamic of locational competition between national economies. According to Schäfer, the national employment pacts are indications of this danger. If this competition on wage levels continues, then aggregate demand can wind up systematically too low (Schäfer 2002: 21).
new concept of coordinated economic policy, which would enable EU-institutions and actors to foster growth and employment and thus relieve wage policy from the unrealistic expectations, according to which this policy area must simultaneously induce employment, secure adequate distributive outcomes, and avoid inflationary pressures.

Wage policy retains a critical coordinating function in any case, though: There are no shifts in exchange rates that could act as buffers, so that any wage increase in one country will manifest itself on the product markets and levels of aggregate demand in the other member states. The danger of wage-competition has increased in the EMU. The European trade unions are aware of the fact that under these conditions national collective bargaining can only be successful when they take into account their direct effects on the dynamic of wage-competition within the European economic system. Therefore, the common interest shared by all European unions is to protect themselves, collectively, by a coordinated wage policy from the destruction that a competitive dynamic in which member states try to underbid each other in terms of wages, would deal out. The guideline meanwhile operationalizing this mutual interest is to align collective bargaining with productivity growth and the inflation rate. This guideline also defines an “anchor” for the development of wages, which – if adhered to – helps stabilize aggregate demand and averts the danger of deflationary tendencies.

The second key question – besides coordination between the different trade unions of Europe – concerns mutual adjustment of strategies with other major actors in the macroeconomic policy arena, the ECB and the agents of fiscal policy. One viable course of action in this realm would be to reach a temporary agreement on the following formula: Wage policy can offer agreements with no inflationary tendencies, but in return formulates expectations that fiscal policies and monetary policies should fulfil. The ECB’s monetary policy should be geared explicitly toward the dual goal of employment promotion and price stability. Fiscal policies of member states should be anti-cyclical in orientation (which means that they should not interfere with the built-in stabilizers of the public budgets, they should
engage in deficit spending in periods of economic downturn and consolidate the budget when economic growth picks up), and they should foster strategies of economic growth that are sustainable in the long run (which calls for public investment, especially in areas such as R&D). Coordination among the key actors of macroeconomic policy in this sense could help develop and implement an economic policy concept that is based on the conditions of the current economic situation but at the same time presents a medium-term strategy.

Some observers argue that the trade unions should dispense with their demands for explicit coordination and instead take further unilateral steps of adjustment to the ECB’s current economic strategy, hoping that the ECB would then use the room for manoeuvre that this would open up for a monetary policy of growth and employment promotion. One specific suggestion, for instance, is to negotiate collective agreements with long-term validity, in order to prove unions’ credible commitment to the orientation toward stability in collective bargaining (see DIW 2001: 451). Another suggestion, widespread in mainstream economic analysis for a long time already, is to call for wage settlements that stay below the target of productivity and inflation.

Trade unions reject the latter proposal, not only because it induces a change of income distribution at the disadvantage of the employees, but also because it would have a negative impact on aggregate demand. Regarding the first proposal, trade unions are not in principle against long-term collective agreements – in fact, there have been several instances of such agreements in the past. However, consent with this strategy has been a function of what is offered in return. For instance, the gradual implementation of the 35-hour workweek was linked with long-term collective agreements. In line with this principle of mutual accommodation, the ECB

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6 For more details about an adequate assignment of tasks for fiscal policies on the basis of a reformulated Stability and Growth Pact see Welzmüller (2003).
would have to send trustworthy and reliable signals beforehand. Unilateral concessions, informed by the mere hope for something in return, would bear too high risks for the trade unions. The wage agreement of the year 2000 is an example of these risks: Back then the ECB did not use the opportunity, opened up by the moderate agreement, to pursue a course of growth and employment promotion in its monetary policy. This demonstrates that coordination will not work if one party has to give up its identity, accept a systematically disadvantaged position, or present unilateral concessions – some still demand such concessions from the trade unions, hoping that the other players would then follow suit and “do the right thing”.

A realistic chance for a cooperative and coordinated economic policy will ensue not unless the interests of all actors involved are taken into account. What are these interests? Specifically, what interests can the actors have, under the current social and economic conditions, in a coordinated course of action in macroeconomic policy-making?

The ECB is fully aware of its unique position of autonomy, backed by law. The bank’s senior economist Issing has categorically refused any kind of ex-ante coordination (see ECB 2001: 64), and the ECB does not depend on cooperation by the other actors in the macroeconomic arena, in order to do what it intends to do, especially as high unemployment and economic distress have a disciplining effect on trade unions. Only in times of inflationary pressures could the ECB develop an interest in coordinating with the trade unions, in order to strike a deal in which employment-promoting monetary policy gets traded for collective agreements with no inflationary impulses. Inflation, however, is not the problem of the European Union at this time. As a consequence, it is unlikely that the ECB will develop great enthusiasm – or willingness at all – for a coordinated macroeconomic strategy. The only hope remaining is that a change of the people in charge of the institution could alter the bank’s orientation.

The situation of the member states’ governments is different. Depending of their partisan affiliation, these governments have an interest in bringing
down unemployment to varying degrees, because they must justify their policies vis-à-vis their electorates. Pursuing this interest, however, must be possible in the context of their budgetary institutions, and here the EU-level criteria of the Stability and Growth Pact impose constraints. Moreover, not only are the fiscal policies of the individual member states not coordinated amongst each other, the national fiscal policy systems themselves are a far cry from having the capacity for the kind of cross-national coordination that would be conducive to an employment-friendly fiscal policy: Their public budgets are often still in a state of fragmentation, segmented spending authority and unable, even, to pursue the same fiscal policy strategy and speak with one voice within one country let alone acting in concert across different countries. But only a fiscal policy “speaking with one voice” could effectively act and negotiate with the ECB. In the years of 1998 through 2000 the political preconditions for such a reorientation of fiscal policy were favourable, because the Council of the European Union was led by a majority of Social Democratic governments that endorsed employment-friendly economic strategies. However, with the exception of the procedural innovation of installing the Macroeconomic Dialogue, there were no significant changes in macroeconomic policies. The problem of legitimating a set of policies that produce high unemployment ultimately seems to be not pressing enough yet to induce a more serious commitment to the goal of employment promotion. Part of the problem has also been that the alternatives to the prevailing course of market integration with minimal coordination were not very well-developed conceptually (see Schäfer 2002: 15). Nevertheless, in the field of fiscal policy the chances that the behaviour of governments will change under the pressure of mounting problems of legitimacy and increasing dangers of electoral backlash are higher than in the field of monetary policy.

Under the conditions of persistent and high unemployment, trade unions are the one actor in the macroeconomic policy domain with a clear interest in macroeconomic policy coordination, because this is a crucial instrument for fostering growth and employment. Reluctance against the “co-optation”
of wage setting in the context of a coordinated economic policy, which one encounters occasionally in the ranks of the union movement, have no convincing basis. It is completely overlooked that without macroeconomic coordination, wage policy will only face even stronger pressures of downward adjustment, and that the national alliances for jobs and stability, negotiated in lieu of European level macroeconomic coordination, will only intensify competitive underbidding between the national subsystems of the monetary union.

References


The Macroeconomic Dialogue – opportunities for economic policy coordination?
Macroeconomic Dialogue –
development and intentions

1. Introduction

The Macroeconomic Dialogue (MED) was initiated by the European Council in Cologne, in the beginning of June 1999, briefly after the start of European Monetary Union (EMU). This marks more than a mere temporal coincidence. The MED is the product of EMU for economic reasons in particular. Nothing characterizes the transition to European Monetary Union’s macroeconomic policy regime more pronouncedly than the single monetary policy, and no policy field is more strongly macroeconomic in nature than monetary policy.

With the start of EMU, any independent macroeconomic policy-mix of the member states has ceased to exist. With the loss of nationally autonomous monetary policy, it lacks its decisive element. Autonomous macroeconomic policy does not exist on the level of European Monetary Union either, however. In fact, the agents of economic policy are structured very differently: monetary policy is homogeneous on the European level, fiscal policy is enclosed by European limitations on public deficits and public debts, but in its substance still largely determined on the national level, and wage-set-
ting, finally, has cost and price effects that leave their imprint on EMU’s harmonized consumer price index, but collective bargaining institutions are still oriented toward the national level. A completely new architecture of macroeconomic policy can thus be discerned since the start of European Monetary Union. Old, by contrast, are the problems that EMU is facing: high unemployment, a low employment rate, and the repercussions of exogenous shocks.\textsuperscript{2} The Macroeconomic Dialogue is part of the set of policy instruments that seek to contribute to solving these problems.

This article sketches the development, the institutional structure, and the intentions of the Macroeconomic Dialogue. The experience of this institution to date, and considerations for its reform are explicitly not subject of this article (about these issues see, for instance, Janssen 2004, Watt/Hallwirth 2004, Dullien 2004, Welzmüller 2002, Heise 2001).

2. Development

2.1 The Macroeconomic Dialogue as an element of the European Employment Pact

The goal of a “European employment pact” has its first national-level expression in the coalition agreement of the German Red-Green government of the fall of 1998.\textsuperscript{3} The passage in that document does not contain further elaboration about the substance and institutional structures of such a pact, however, but is followed by explanations of the Employment Guidelines of the Luxembourg process instead.

\textsuperscript{2} In the EU about 14 million people were registered as unemployed in the year 2003. The employment rate was 64.3%; compared to the Lisbon target of 70% this amounts to a deficit of about 14 million jobs (cf. European Commission 2004).

\textsuperscript{3} “The new federal government seeks to place the fight against unemployment in the centre of European policy-making. Its goal is a European Employment Pact.” Coalition Agreement (1998; Chapter XI.)
In his statement of December 10, 1998, federal chancellor Schröder announced a memorandum, written together with the French president Chirac, in which the two heads of government suggest that the Vienna European Council should be assigned the task of forging a European Employment Pact, which was to be enacted in Cologne, under German EU-presidency.4

Under Austrian presidency the Vienna European Council on December 11 and 12, 1998 then agreed upon reporting to the Cologne European Council about the progress of elaborating a European Employment Pact in the context of the Luxembourg process (Bulletin 1999; Issue 7: 69, No. 2).5 The Vienna European Council declares about this: “Employment policy has to be embedded into a comprehensive approach, encompassing macro-economic policies directed towards growth and stability, economic reform promoting competitiveness, and the Employment Guidelines, which are designed to improve employability, adaptability, equal opportunities and job creation in existing and new enterprises.” (Bulletin 1999; Issue 7: 72, No. 28)

More specifically, the document furthermore states: “For the future success of the Luxembourg process a broad and intensive dialogue between all the actors involved, i.e. the Council, the Commission, the European Parliament, Social Partners, the European Central Bank and the European Investment Bank, is of prime importance, contributing to the overall strategy for employment, growth and stability.” (Bulletin 1999; Issue 7: 73, No. 37)

4 “We seek to use the German presidency of the EU in order to bundle the initiatives, that have been initiated in Vienna, into a European employment pact […] A Stability Pact without an Employment Pact is doomed to remain ineffective in the long run”, Bulletin (1998, Issue 80: 966).

5 Contrary to how Heise (2001) portrays the process, it was in this sense the German EU-presidency that substantively and institutionally fulfilled the task set by the Vienna European Council (cf. Heise 2001: 396).
The Vienna European Council apparently sought to place the new employment policy conception in the context of the Luxembourg process. The main subject of that process of 1997 is the so-called coordinated strategy for employment, as codified in the EU-Treaty (cf. EU-Treaty, 1997, Title VIII, Employment). This, however, primarily aims at what is widely known as active labour market policy, but not so much at macroeconomic policy fields.

A short time afterwards the 1999 Annual Economic Report of the German federal government described a European Employment Pact as the task of the German presidency, beginning in January. Analogously to the scheme envisaged by the Vienna European Council, that Employment Pact was supposed to comprise macroeconomic policy in addition to active labour market policy and structural reforms. Macroeconomic policy was not supposed to become part of the Luxembourg process however, but instead a separate institutional forum, outside the Luxembourg process, and on the same level as this process. In this employment pact the individual macroeconomic policy areas – monetary policy, fiscal policy and wage setting – were supposed to work together smoothly, in order to facilitate higher

Macroeconomic coordination entails:

- “An increased coordination of economic, fiscal, monetary and currency policy. What is especially important in this is to pursue fiscal policies and wage setting policies that conform with the stability criteria and with this create the preconditions for a monetary policy that can contribute to making more jobs profitable while at the same time adhering to the goal of price stability, the principle of an independent central bank and the terms of the EU-treaty.

- A labour market policy that increases employment and improves adaptability and equal opportunities in labour market structures. For this the Employment Guidelines and the National Action Plans for Employment Policy must be cogently implemented.

- Structural reforms that foster the functioning of the markets for goods, services, and capital in the Single European Market, and that promote the competitiveness of companies […]” (Annual Economic Report 1999: 69, No. 123)
growth rates but still maintain price stability. Moreover, the Annual Economic Report assigns priority and instrument for each policy area:

- “Fiscal policy must be oriented toward stability and must restructure public finances toward investment into the future, but it must at the same time keep an eye on the development of aggregate demand.

- Wage setting must evolve on a trajectory that is reliable in the medium run, with aggregate wage increases within the margin of the trend of productivity growth, while at the same time keeping an eye on the goal of maintaining price stability as set by the European Central Bank, in order to have an employment-inducing effect.

- This way fiscal policy and wage setting support monetary policy in its primary goal of maintaining price stability. Monetary policy then is in the position to fulfil its additional task, assigned to it in the EU-treaty, namely to foster the expansion of economic activity and employment in the Euro-area, without endangering the stability of prices.” (Annual Economic Report 1999: 39, No. 48; about the policy fields in greater detail, see No. 53, 57-61)

The 1999 Annual Economic Report at the same time envisaged bringing the European Employment Pact together with Germany’s national “Alliance for Jobs, Training, and Competitiveness” (Annual Economic Report 1999: 41, No. 49). In addition, the Annual Economic Report emphasized the necessity to coordinate wage setting policies between the member states of European Monetary Union.7

The European Employment Pact received its final institutional form at the Cologne European Council under German presidency from June 3 through

7 “Such a strategy can ultimately be successful only if the same orientation of wage setting policy persists throughout the European Monetary Union, namely the alignment of wage agreements with the medium term growth of productivity and the price stability goal of the European Central Bank.” (Annual Economic Report 1999: 50, No. 60)
4, 1999. With its goal set as “aiming at a sustainable reduction of unemployment”, and designed as a “comprehensive overall approach bringing together all the Union’s employment policy measures” the European Employment Pact comprises the Coordinated Strategy for Employment (Luxembourg process), the Economic Reforms (Cardiff process) and – as the new element which became known as the Cologne process – the Macroeconomic Dialogue.


Elaboration of these documents was preceded by intense negotiations in the respective bodies of the EU, as well as bilateral consultation especially with representatives of the monetary authorities and the social partners. Sensitivity and tolerance vis-à-vis diverging positions were just as important in these negotiations as the readiness for compromise.

The term “wage policy”, for instance, was unacceptable to the delegates from the UK, as in their country wage settlement is decentralized; but the term “development of wages” was acceptable. The ECB was against the terminology of “coordination”, but accepted the term “cooperation”. The term “policy-mix”, even though widespread in economic theory, was not supposed to be mistaken as implying a loss of full autonomy, on the part of the participants of such a “policy-mix”. Moreover, the MED was often seen as slightly in competition with the Luxembourg process, which claimed to be the roof under which any kind of employment policy was to take place. The participation of representatives of the former “Council for Labour and Social Policy” on (nearly) equal terms was one of the factors contributing to the
2.2 The institutional context of the Macroeconomic Dialogue

For the first time explicitly mentioned and envisaged as an independent “process”, the Macroeconomic Dialogue and its goals were described in the “Presidency Conclusions” of the Cologne European Council as follows: “Coordination of economic policy and improvement of mutually supportive interaction between wage developments and monetary, budget and fiscal policy through macro-economic dialogue aimed at preserving a non-inflationary growth dynamic (Cologne process)” (Bulletin 1999; Issue 49: 509, No. 7).

The resolution of the Cologne European Council states, analogously, “[t]o the coordinated employment strategy and economic reforms, the Macroeconomic Dialogue is added as the third pillar of the European Employment Pact. This new element is intended to improve the conditions for a cooperative macro-economic policy mix geared to growth and employment while maintaining price stability. […] In a macroeconomic dialogue based on mutual trust, information and opinions should be exchanged in an appropriate manner concerning the question of how to design macroeconomic policy in order to increase and make full use of the potential for growth and employment” (Bulletin 1999; Issue 49: 520, No. 2 and 5).

The relationship between the Macroeconomic Dialogue and the EU’s central instrument of economic policy coordination, the Broad Economic Policy Guidelines is described as follows: “The European Council considers the Macroeconomic Dialogue […] as an effective way to approach implementing the growth- and stability-oriented macro-economic policy that forms part of the Broad Economic Policy Guidelines as pursued by the Member States and the Community” (Bulletin 1999; Issue 49: 510, No. 8).

growing acceptance of the new forum MED, evolving in addition to the already established institutions of the Luxembourg process.
The report specifies about the participants of the MED: “The European Council deems it necessary, in addition to the Luxembourg and the Cardiff processes, to set up a regular Macroeconomic Dialogue (the Cologne Process) within the framework of the ECOFIN Council in cooperation with the Labour and Social Affairs Council and with the participation of representatives of both formations of the Council, the Commission, the European Central Bank and the social partners.” (Bulletin 1999; Issue 49: 510, No. 6) In this the member states are represented by what is called a “forward-looking troika”, that is, by the ministers of the respective present presidency of the EU, as well as the next two incoming presidencies, each of them members of the Council for Economic and Financial Affairs, the ECOFIN Council. The president of the ECOFIN Council is also the chairman of the MED. Furthermore, two representatives of the Council for Employment, Social Policy, Health, and Consumer Affairs, the former Labour and Social Affairs Council, also participate based on their responsibility for labour market policy and for the Social Dialogue. As representatives of the Commission, the Commissioners for Economic and Monetary Affairs and for Employment and Social Affairs are part of the Macroeconomic Dialogue. The social partners are represented by the European employers’ associations under the coordination of UNICE (Union of Industrial and Employers Confederations of Europe) and UEAPME (European Association of Craft, Small and Medium-sized Enterprises) in the private sector, the CEEP (Centre for Enterprises with Public Participation) in the public sector, and by the European Trade Union Confederation (ETUC). The monetary policy authorities are represented by the European Central Bank (ECB) and by a representative of the central banks of the countries outside the Eurozone.

The political level of the MED (MED POL) is prepared by a working group, the Macroeconomic Dialogue on technical level (MED TEC). In addition, a steering committee is in charge of preparing these two forums of the dialogue. Both bodies of the MED meet twice a year, in the first half of the year in the context of devising the Broad Economic Policy Guidelines,
and in the second half of the year in the context of specifying the Employment Guidelines.\(^9\)

In its composition the MED is the only forum among the policy-making bodies of the EU that brings all agents that are instrumental for macroeconomic policy making together at one table. In the ECOFIN Council or in the Eurogroup, for instance, representatives of the Commission meet with the economics and finance ministers and the ECB, but the social partners are not part of these meetings. The social partners, in turn, participate in other committees, such as the Macroeconomic Group of the Social Dialogue, where they consult representatives of the European Commission, but there the representatives of the monetary policy authorities and of the member states’ governments are missing. Things are similar for the Council for Employment.

The substantive core of the MED is an exchange of information and ideas.\(^{10}\) The Report to the Cologne European Council states: “In the course of this dialogue, the starting position and future prospects could be discussed on the basis of statistical data and analyses, and ideas could be exchanged as to how, while retaining their respective responsibilities and preserving their independence, those involved consider that a policy mix can be achieved that is conducive to growth and employment under conditions of price stability.” (Bulletin 1999; Issue 49: 522)

With this specification of goals and procedures the MED is neither subject to the Stability and Growth Pact’s strict rules about avoiding excessive deficits, as the field of fiscal policy is, nor is it subject to what is known as the

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9 In the context of the streamlining of coordination in the EU, starting in 2003, the Employment Guidelines have been devised together with the Broad Economic Policy Guidelines in what is called “Guidelines Package” in the first half of each year.

10 Among the institutions and procedures of economic policy coordination in the EU, the MED is considered as one of the instruments of “soft” coordination (European Commission 2002: 4).
Open Method of Coordination, as the Luxembourg process or the Cardiff process are. Keeping in mind the background of its participants, the MED has to bear in mind the independence of monetary policy, the autonomy of the social partners, the differences in the national collective bargaining institutions, and it has to comply with the criteria of the Stability and Growth Pact and conform to the principle of subsidiarity. For this reason, the MED does not produce binding agreements. It also has no means of sanctioning. Furthermore, there are no minutes, communiqués, and no participation of the public.

3. Intentions

3.1 More employment while maintaining price stability

The goals of the MED become clear when looking at the wording of the official documents. Especially the “Report to the European Council on the European Employment Pact”, in the context of the Presidency Conclusions of the Cologne European Council goes into great detail in describing the intentions and the conception of the European Employment Pact generally, and the Macroeconomic Dialogue in particular: “The goal of the European Employment Pact is to pave the way for a reduction in unemployment and for sustained job-creating growth by achieving growth rates which substantially exceed increases of labour productivity and labour supply. […] Firstly, it is important to make the best possible use of existing production and employment potential. At the same time, it is necessary to achieve a high level of investment so as to permit durably higher rates of growth and more jobs via the expansion of productive capacities. This requires making full use of the employment potential […] In order to achieve strong employment growth while maintaining price stability, it is vital that the macroeconomic instruments should interact in a smooth fashion. Such a policy mix provides an important basis for job-creating investment. […] In the interests of an effective and balanced policy mix, it is important that the different areas be organised in the following way: Fiscal policy is required to respect the objectives of the Stability and Growth Pact […] At the same time, it must not lose sight of macroeconomic developments. Wages must
keep to a sustainable path, with wage developments that are consistent with price stability and job creation. The primary objective of monetary policy is to maintain price stability. For this, it is crucial that monetary policy be underpinned by fiscal policies and wage developments of the type described above. Without prejudice to the objective of price stability, monetary policy will support the general economic policies in the Community with a view to contributing to sustainable and non-inflationary growth and a high level of employment.” (Bulletin 1999; Issue 49: 521 and 522)

Accordingly, the goals of the European Employment Pact, and especially the Macroeconomic Dialogue, are:

- To reduce unemployment and to regain full employment, that is, to fully utilize the existing employment potential, and
- to increase the investment dynamic and the employment rate (as the relation between people who are gainfully employed and the population between 15 and 65 years of age), that is, to extend the growth and employment potential itself.

Unlike the so-called Lisbon Strategy one year later, the original ideas of European Employment Pact and Macroeconomic Dialogue did not contain specific quantified targets, for instance, for reducing unemployment by a specific percentage or for increasing the employment rate or the real growth rate by a specific amount.\footnote{Despite many initiatives, it was not possible to reach an agreement on quantified targets in the run-up to the Cologne European Council.}

The goals of the Macroeconomic Dialogue and the conception of the policy mix needed for reaching these goals are thus described. Before creating and endorsing a new institution such as the MED the question has to be addressed, however, of whether these goals could not have been reached within the existing set of institutions and procedures for macroeconomic coordination.
3.2 The Stability and Growth Pact, the Coordinated Strategy for Employment, and the economic reforms

Like no step of European integration before the start of European Monetary Union has changed the distribution of tasks and responsibilities in macroeconomic policy and with this also changed the amount and the kind of coordination needed.

The first response to this situation was the Stability and Growth Pact, which was enacted at the European Council in Amsterdam, 1997. The Stability and Growth Pact specifies the regulations of monitoring the budgetary policies of the member states and the procedures for cases of excessive budget deficits according to Article 104 of the EU-Treaty. The goal of the Stability and Growth Pact is to protect the European Monetary Union as a whole from the negative repercussions of unsound fiscal policy regimes on the part of individual member states by limiting the maximal budget deficits and overall public debts that member states can have. Over the business cycle, automatic stabilizers are supposed to develop their effects starting from a balanced budget, and pro-cyclical public spending with its effect of intensifying cyclical fluctuations is to be avoided.

At the same time, the resolutions of the Amsterdam European Council declared employment policy a core area of the EU’s economic policy and its coordination by inserting a separate title on employment policy into the EU-treaty. Annual Employment Guidelines, approved by the European Council, their implementation in National Action Plans (NAP) for Employment Policy, and their inspection in the context of a Common Report on Employment at the EU-level are manifestations and instruments of the Coordinated Strategy for Employment. This strategy primarily aims at the employability of individual employees, the promotion of entrepreneurial spirit, the improvement of firms’ adjustment capacities, and the promotion of equality of labour market chances for men and women.

One year after Amsterdam, the Cardiff European Council (1998) extended this agenda of coordination further by adding the Cardiff process, which comprises the reforms of the markets for goods, services, and capital.
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member states annually account for their reform activities in these areas in the so-called “Cardiff reports”; the contents of their reports are inspected both by the European Commission in its “Implementation Report” and by the Economic Policy Committee of the EU in connection with its country analyses. The essential goals of the Cardiff process are to increase competition and to improve the competitiveness on all markets, especially by raising productivity and strengthening the innovative capacity of firms.

3.3 Macroeconomic determinants of employment

With the Stability and Growth Pact, the Coordinated Strategy for Employment, and the Economic Reforms three instruments of economic policy coordination thus existed even before the MED was created, which were designed as comprehensive strategies in their respective policy fields. The question is whether one can expect these instruments to be sufficient for generating enough jobs in order to reduce EU’s high unemployment and simultaneously extend the employment potential. This question calls our attention to the determinants of employment.

These can be derived from a spectrum of different theoretical approaches. This article is not the place to engage in this theoretical debate and provide a comparative overview over these different approaches. Instead, a framework of analysis will be sketched, which is starkly simplified but still internally consistent from a macroeconomic point of view. It allows us to derive answers to the question of whether a kind of cooperation beyond the three established procedures is necessary for a promising macroeconomic policy stance conducive to creating more employment.

The starting point is the aggregate quantity equation. According to this equation the product of the money supply \( M \) and the velocity of money \( V \) equals the product of aggregate price level \( P \) and the real national income \( Y \):

\[ M \times V = P \times Y \]

Expressed in rates of change:
\[ m + v = p + y \]

From this one can derive a simplified function for the demand for money – likewise in rates of change (cf. Bofinger 2003: 374):

\[ m - p = y - v \]

Assuming, for further simplification, that the velocity of money is constant \( (v = 0) \), the function for the demand for money obtains as:\(^{12}\)

\[(1) \quad m - p = y\]

Assuming a simplified production function with only one factor of production, namely labour, or employment \( (E) \), and a linear relationship between

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\(^{12}\) About the stability of the demand for money see European Central Bank, Monthly Bulletin (2001: May and 2004: January), and several ECB Working Paper Series. Equation (1) is the same as saying that the change of the nominal income \( (Yn) \) corresponds to the change of the money supply, where \( Yn = y + p \) is given by definition: \( (1a) \ Yn = m \). There is a large literature about the transmission mechanisms of monetary impulses. (See, for instance European Central Bank, Monthly Bulletin, 2000: July, 2002: October and 2004: January, and European Central Bank 2004: 44–49, as well as several ECB Working Paper Series, Bofinger 2001: 40 ff., Council of Economic Advisers 1998: No. 261 ff.). From (1a) follows: \( y = m - p \). That is, the real national income evolves on a trajectory parallel to the development of money supply in real terms. Any increase in the nominal money supply, and thus the nominal income, which is not absorbed by an increase of prices, contributes to the increase of the real national income. This connection has received support by recent empirical analyses: “As in the case of inflation, we can observe a positive correlation between the growth of global money supply in real terms and the real economic growth rates on a global scale: Time periods in which the worldwide growth of GDP was relatively high appear to be correlated with time periods in which the real global money supply is likewise increasing relatively fast (and vice versa)” (European Central Bank, Monthly Bulletin, 2004, January: 14).
aggregate output and this factor, where $\Pi$ denotes the average productivity of labour, we obtain:

$$Y = \Pi E$$

Written in rates of change:

(2) $y = \pi + e$

Furthermore, the model assumes a constant income distribution, that is the aggregate nominal wage ($W$), which includes all payroll costs, evolves parallel with the sum of the productivity of labour and the price level:

(3) $w = p + \pi$

(3) implies for the development of prices:

(3a) $p = w - \pi$

Substituting (2) and (3a) in (1) yields:

(4) $e = m - w$

Under the simplifying assumptions of the model the change of employment equals the difference between the change of the money supply and the change of the nominal wage rate. In other words, any increase in money supply that is not absorbed by increases in nominal wages contrib-

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13 In the case of a Cobb-Douglas production function this assumption is compatible with optimal deployment of production factors.

14 About this derivation cf. Flasbeck (1987), and in detail Koll (1988).
utes to increasing employment, as long as the economy has not yet reached the production potential and a state of full employment.\textsuperscript{15}

In order to secure stable prices, equation (3a) implies that only one out of the multitude of possibilities for wage agreements is permissible, namely the nominal wage for which equation (5) holds:

\begin{equation}
(5) \quad w = \pi + p^* 
\end{equation}

Here $p^*$ is the price stability target of the monetary policy strategy of the central bank.\textsuperscript{16} This orientation of wage setting ensures that the target for the development of prices is maintained in both directions, that is, the development of wages exerts neither inflationary nor deflationary pressure on prices.

The connections sketched above warrant two further conclusions. On the one hand equation (4) makes clear that a change of productivity ($\pi$) \textit{ceteris paribus} has an impact on real growth, according to (2), but no direct impact on employment.\textsuperscript{17} On the other hand, one can see the theoretical reason for

\textsuperscript{15} This statement becomes clearer economically, when substituting equation (3a) in equation (4), so that $e = m - (\pi + p)$. Any increase of the money supply, which is not absorbed by a price increase, and that is not needed for the "purchase" of an increased aggregate supply as a result of an increase in productivity, means excess demand inducing and at the same time alimenting higher production and as a result higher employment.

\textsuperscript{16} As one can easily see, the employment formula (4) is derived from the same relation, as the one that usually underpins monetarist policy prescriptions: $m = p^* y - v$, where $y$ has to be interpreted as the change in the production potential.

\textsuperscript{17} This is immediately obvious: On the one hand an increase in productivity increases the real money supply inssofar as competition forces firms to pass the productivity gains on to lower prices. On the other hand, this increase of the real money supply is fully necessary in order to absorb the increase in aggregate supply brought about by the increase of productivity (at constant employment) on the demand-side. For maintaining employment in the case, assumed here, of productivity-oriented wage
the empirically well-documented fact of the parallel development of employment and investment. If the velocity of money is relatively stable, the money supply has its impact on aggregate nominal demand, and the nominal wage has its impact on labour costs, then the difference between the two variables causes the internal profitability of an investment, and by this the “inducement to invest” to be affected in the same direction as employment (cf. Hallwirth 1998: 111). This influence in the same direction, resulting from a positive constellation of the development of money supply and wage rate, which has a positive effect on the growth of both investment and employment, does not only cause the existing capacities to be fully utilized, it also accelerates the growth of the production potential itself.

The connections derived here are the result of the underlying model and its starkly simplified structure. An approach more demanding theoretically and closer to reality empirically would require us to generalize and supplement some of the assumptions made by the model. The premise of a constant velocity of money would have to be replaced with a function for the demand for money, containing additional arguments, such as the interest rate. Furthermore, “management of money supply” could be replaced with “interest rate policy”, if one took into account the tendency of an inverse relation between the short-term interest rate and the development of money supply.\textsuperscript{18} One would also have to account for time lags in the effects of monetary impulses on real economic variables. The production function, for instance, would have to take explicit account of the stock of capital. For the specification of the wage equation one would have to develop an adequate understanding of the expected development of productivity; in addition, one would have to modify the assumption of a constant distribution.

\textsuperscript{18} For widely known reasons, this inverse relationship is not as clearly developed in the M3 definition of money supply.
Finally, one would have to introduce uncertainty and expectations into the model. If one wanted to use the model for purposes of empirical estimation, it would need specifications in the directions outlined.

The question for our purpose is, however, if the findings derived above still hold if the model is refined as sketched. The core findings were the following:

- Employment depends on the development of money supply and of nominal wage, and can thus be exogenously influenced by means of variables at the disposal of political intervention by monetary policy and wage setting policy.

- A productivity-oriented development of nominal wages can contribute to adhering to the stability goal of monetary policy.

- Under conditions of a stability-oriented development of wages, monetary policy can contribute to employment without damaging the goal of price stability.

Representatives of different theoretical paradigms answer the question of whether these findings still hold under a refined model specification differently. One undertaking of the MED should be to strive for as much of a common understanding as possible about the economic preconditions for more employment in a regime of stable prices among its participants.

The question is also an empirical one, however, as any theoretical finding ultimately has to be evaluated by its empirical validity.

Figure 1 shows the trajectory of the difference between the change in money supply and the change in nominal wage (m-w), as well as the trajectory of the change in employment (e) across the entire time period between 1971 and 2004. It indicates the same tendency of these two graphs to evolve that has been theoretically derived above. However, note that in figure 1 the difference of the money supply and the wage rate is depicted as lagging by one year. In reality, the change in employment is lagging behind the respective combination of money supply and wage rate by an average
Figure 1: Money Supply, Nominal Wage, and Employment in the Eurozone

Legend: Eurozone: money supply minus nominal wage (m - w, lagged by one year, scale on the left-hand side), and employment (e, scale on the right-hand side) 1971-2004; annual change in percent. With (m) as money supply (M2/M3) in the end of each year; (w) as nominal compensation per employee; total economy; (e) as employment persons, all domestic industries. National accounts.

Source: European Commission, Statistical Annex of European Economy 2003
time lag of about one year until about the mid-nineties, and since then with
an increasing time lag.\textsuperscript{19}

For EMU only five years of a common development of employment are
available. These five years are characterized by a strong increase in employ-
ment during their initial phase. The peak was marked by an annual growth
of employment of 2.2\% in the year 2000, which, however has declined to
stagnation by the beginning of the year 2003. For the time period before
that consolidated data for the Eurozone are available. Noteworthy about
these is the fact that employment did not evolve on a steady path during
this time period. When the decline in employment was taking place, it
happened in spurts, during few and short time periods. These were the
years immediately following the drastic increases in oil prices 1973/74 and
1979/80, as well as the years following the German unification boom of the
years 1990/91. These phases share a relatively similar pattern of macroeco-
nomic development: an inflationary development of wages, partly in re-
sponse to a drastic increase of oil prices, and a restrictive reaction of mone-
tary policy, in order to maintain or to regain price stability. All time periods
that have experienced strong losses of employment or at least a dampening
of the employment dynamic, therefore, have been preceded by a negative
combination (m-w < 0), that is, by a conflict between wage setting and
monetary policy.

The periods of favourable development of employment were the first and
the last third of the 1970s, the second half of the 1980s all the way to the
year 1991, and the second half of the 1990s, with its peak in the year 2000.

\textsuperscript{19} Since the summer of 2001 the ECB has found an “[… apparent de-coupling of the
growth of the money supply from the development of nominal GDP […]).” The
ECB explains this by way of “[… a stronger preference of the economic subjects for
secure forms of investment with high liquidity (as they are included in the broad
definitions of money supply) […],” (European Central Bank 2004, Monthly Bul-
etin, January: 14 f.). This pronounced shift in the velocity of money also manifests
itself at the short end of figure 1.
These time periods were all preceded by a positive combination of monetary policy and wage setting (m-w > 0). Payroll costs were distinctly disinflationary compared to each of the preceding phases, apart from the 1970s, and in recent years even explicitly stability-oriented, and they were aligned with a relatively expansive monetary policy.

These empirical correlations call for a differentiated analysis as well, which would go beyond the scope of this paper. However, even the sketchy evidence contained in the findings reported above lends rough support to the conclusion that there is a connection between the constellation of monetary policy and wage setting on the one hand and the development of employment on the other. However, in spite of the distinctive significance of these two variables, the policy mix favourable for employment growth under stable prices cannot be reduced to the interplay of wage setting and monetary policy, but instead always has to take into account fiscal policy as well. Viewed across the entire business cycle maintaining a balanced budget is the task assigned to fiscal policy by the Stability and Growth Pact. Fulfilling this task will not generate a direct and strong impulse for more employment, but throughout the business cycles letting the built-in stabilizers of the public budgets develop their full effects can generate an environment conducive to employment stabilization. In the exceptional case of economic stagnation fiscal policy can also contribute to the revitalization of economic activity by means of discretionary intervention.

### 3.4 One-dimensional assignment of tasks and mutual interdependence

In the predominant assignment of policy instruments and economic policy goals, monetary policy is usually considered in charge of price stability, wage setting responsible for employment, and fiscal policy for balanced public budgets in the medium run. Each of the macroeconomic policy actors is perceived as independent and autonomous in this kind of assignment. This institutional arrangement of roles faces the economic reality that the individual policy instruments are hardly autonomous in relation to the pursuit of their own political goals, and that they are also not neutral in relation to the goals of the other institutional realms and agents of macro-
economic policy. There are external effects of pursuing one particular objective. This kind of interdependence is also emphasized in the European Employment Pact: “The macroeconomic policy areas are independent as regards the decisions taken in each of them, but they do influence one another.” (Bulletin 1999; Issue 49: 522)

- In the case of an inflationary reaction of wages to a negative external shock, such as a drastic increase in energy prices, or in the case of a more persistent inflationary development of wages, monetary policy can reach its goal of price stability only at the price of a “stabilization-recession”, with the side-effect of a drastic decline in employment and a high cyclical budget deficit.

- Wage setting can seek to induce employment solely by means of wage cuts, the well-known “monetary management by the trade unions”. Drastic aggregate wage decreases can lead to deflationary tendencies, however, if competitive pressures force firms to pass on their cost savings to prices, and deflation would indicate a violation of the stability goal of monetary policy, just as inflation does. For the public budgets deflation is likely to affect the revenue-side most directly and strongly, so that it is probably not neutral in its effect on fiscal policy either.

- Public finance policy can hardly attain its goal of balanced budgets if monetary policy and wage setting curb the cyclical development of the economy and by this place a burden onto the revenue and the spending side of the public finances. Conversely, drastic tax increases aiming to consolidate the public budget would hardly leave growth and employment unaffected.

The EC-Treaty and the Broad Economic Policy Guidelines take this interdependence of the macroeconomic policy fields into account. Art. 105 of the EC-Treaty defines price stability as the primary goal of monetary policy, but it also states, in the second clause of the same article: “Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to
the achievement of the objectives of the Community as laid down in Article 2.”20 Among the objectives of Article 2 are a “high level of employment” and “sustainable and non-inflationary growth” of the economy.

The Broad Economic Policy Guidelines of 1997 characterize the interplay of monetary policy, wage setting, and fiscal policy as follows: “The more the stability task of monetary policy is facilitated by appropriate budgetary measures and wage developments, the more monetary conditions, including exchange rates and long-term interest rates, will be favourable to growth and employment.”21 The Cologne European Council converts this general understanding into a specific obligation for the agents of macroeconomic policy: “The European Council calls on governments and both sides of industry to support monetary policy in its priority role of maintaining stability” (Bulletin 1999; Issue 49: 511, No. 20) Sometimes one can even hear calls for opening up the one-dimensional assignment of tasks altogether, according to which wage setting policy is supposed to be also directly responsible for price stability, and by the same token, monetary policy should be obliged to pursue the employment goal as well (cf. Welzmüller 2002: 15 and Jerger/Landmann 2003: 13).

In view of the independence of monetary policy and its primary responsibility for price stability, and in view of the autonomy of the social partners in their collective bargaining activities and the national sovereignty of governments in devising their public budgets, the previous considerations can be summarized as follows: The more wage setting and fiscal policy contribute to the price stability goal of monetary policy, the more scope exists for using the instruments of monetary policy in order to foster growth and employment without dangers of violating the stability goal (cf. Jerger/Landmann 2003 and Annual Economic Report of the Federal Gov-

20 A similar formulation can be found in the “Guidelines” of 1998 and 2002 as well.

Monetary expansion hits its limit, however, when it increases the danger of inflation.

3.5 Maintaining price stability

Inflationary impulses can have two different kinds of causes: Demand-pull inflation has its source in excess demand resulting from expansive fiscal policy and high deficits in the public budgets under full utilization of the productive capacities. Cost-push inflation is brought about by nominal wage increases that markedly exceed the margin set by productivity growth and the inflation-target of monetary policy. Exogenous shocks such as drastic increases of oil prices per se should not be considered as distinct factors causing inflation. As long as they do not trigger so-called “second round effects” in the development of wages and prices, their impact on the price level is of a limited and only temporary nature, due to adjustment effects in the domestic structures of prices and demand.

As pointed out above, the Stability and Growth Pact was the outgrowth of concerns that “excessive budget deficits” in individual member states of the Union could compromise the macroeconomic development in other member states and in the Union as a whole. What was especially important on the level of the EU was to protect the internal and the external value of the new currency from being corrupted by demand-pull inflation due to disproportionate budget deficits. In the resolution of the Amsterdam European Council about the Stability and Growth Pact this is formulated as follows: “The European Council underlines the importance of safeguarding sound government finances as a means to strengthening the conditions for price stability and for strong sustainable growth conducive to employment

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22 This conditionality can also expressed differently, as follows: “In sum, whether or not inflationary pressures will stem from the excess liquidity in the euro area depends on the purposes for which this excess liquidity is used.” (European Central Bank 2003, Monthly Bulletin, October: 9)

23 Parts of this nexus are also the extension of profit margins and the increase of administratively set prices.
creation. It is also necessary to ensure that national budgetary policies support stability oriented monetary policies.” (Resolution of the European Council about the Stability and Growth Pact of June 17, 1997 in Amsterdam)

Empirical evidence indicates, however, that it is hard to verify an unambiguous connection between the size of budget deficits and the development of prices, and that avoiding demand-induced inflation is not a sufficient condition for avoiding inflation in general. Therefore, it is equally important to avoid cost-induced inflationary pressure, or else there will always be an open flank for the goal of price stability in the European Monetary Union.

Compared to the strong monitoring of the fiscal policy goals primarily with regard to price stability, the possibility of dangers to price stability emanating from the development of wages receives much less attention in the European Monetary Union, and this despite the fact that the close connection between unit labour costs and the development of prices can clearly be shown empirically and theoretically.

It may be part of the core of the Broad Economic Policy Guidelines to point out that the development of nominal wages should be in equilibrium with price stability and the development of real wages should be aligned to the growth of productivity, but breaches of this wage guideline remain without consequences, in stark contrast to the consequences of defection in the fiscal policy field.

Searching for the explanation of this discrepancy, two reasons are often pointed out: On the one hand many member states grant the constitutional right of collective bargaining autonomy to their social partners, or elsewhere collective bargaining is decentralized to a considerable degree. In both cases wage setting is removed from political intervention, and the development of wages could not be part of the “tight” coordination that is standard for fiscal policy, where the governments themselves can commit themselves to the stability criteria.
On the other hand, many observers expect different wage levels to converge under the conditions of a monetary union, as no bilateral exchange rate barriers can compensate for the decline of the price-competitiveness in the high-wage regions. The fact that wage agreements in violation of the stability criteria now fully and immediately manifest themselves in each country’s trade balance, the argument goes, is enough of a threat to make too high wage agreements prohibitively costly and enough of a sanction to engender a swift correction of the defection from the stability-abiding wage guideline.

The idea of an “automatic correction” of damaging trends is not supported by empirical evidence, though. The difference of inflationary developments among the member states increased again after the start of the European Monetary Union. To the extent that this is due to differences in the “maturity” of the cyclical development and the structural adjustment of the different economies in the currency union, this may be neither surprising nor a problem. It can become a problem, however, if national wage agreements crucially contribute to exceeding the inflation target of EU-level monetary policy over long periods of time and in this exert a negative influence on the orientation of the monetary policy of the European Monetary Union in general.

It is also doubtful, for this reason, if more stability-oriented national economies do indeed benefit from inflationary developments in other member states due to the increase of their firms’ price competitiveness, which often serves as the justification for calls for a greater degree of tolerance vis-à-vis

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24 However, this kind of heterogeneity is a background condition for an adequate inflation target of the European Monetary Union in any case.

25 Against the backdrop of the consistently stable development of wages in Germany since the mid-1990s the Federal Government expects “[...] all the other member states to make their contribution to price stability within the Eurozone and so enable the ECB to continue its stability-oriented course with monetary conditions that are as favourable as possible” (Annual Economic Report 2004: 22, No. 4.).
the high wage-agreements in some member states. On the one hand it is an open question whether there is a significant improvement of price-competitiveness at all, if the price increases – in accordance with the Balassa-Samuelson-Effect – occur primarily in the “shielded” areas of the countries in violation of stability-conformist wage developments. On the other hand there are inertia in the adjustment processes in trade among the member states. What is certain, however, is that monetary policy will counter such dangers to its price targets with a restrictive stance, in order to offset inflationary expectations right from the beginning. This would definitely and immediately disturb the domestic dynamic in the stability-oriented countries. This alone can overcompensate the positive effect of the improvement in competitiveness for the stability-oriented countries. In the second place, however, the monetary restriction also dampens the internal dynamic in the countries violating price stability and therefore their demand for products from their stability-oriented neighbours. Due to this negative demand-effect even the trade surplus of the stability-oriented countries comes out as lower than one would anticipate based on expectations about the change in the price competitiveness of the stability-abiding member states.

4. Implementation

4.1 Communication and cooperation

The preceding reflections have considered macroeconomic policy in the European Monetary Union from different perspectives in order to highlight the significance of a growth- and stability-oriented interplay of monetary policy and wage setting as safeguards for additional growth and employment in a monetary union. When the European Monetary Union was en-

26 See, for instance the assessment of the OECD: “However, the recent sharp fall in German inflation to among the lowest in the euro area means that real short-term interest rates risk dampening the recovery of demand in Germany to an extent, which may not be compensated by the corresponding gain in competitiveness.” (OECD 2003: 6)
acted, however, there was no forum in which the policy issues emanating from these macroeconomic relations could sufficiently be addressed. To fill this gap was the intention of the Macroeconomic Dialogue.

The construction of the MED set up the institutional and substantive pre-conditions for mutual sharing of information and communication among the participants. The responsibilities and the standing agenda of the new forum reflect this purpose. The MED’s tasks and agenda consist of two parts, namely:

- The analysis of the macroeconomic conditions and future perspectives, and

- the exchange of information and ideas among the agents of macroeconomic policy, addressing the question of “[…] how they think a policy-mix can be achieved which promotes growth and employment while safeguarding price stability” (Bulletin 1999; Issue 49: 524).

The second point invites the participants to present their conceptions about their own contribution to such a policy-mix and to formulate their expectations about the contribution of the other actors.

The goal of this exchange of information and ideas lies in avoiding misunderstandings and conflicts between the agents of macroeconomic policy, in stabilizing expectations, building trust and developing a shared understanding about the conditions and advantages of a growth- and stability-oriented policy-mix for the European Monetary Union.

Insight in the mutual benefits of cooperative behaviour and in the damaging effects of defection and unilateral action should be incentive enough for a sustained cooperation among all actors involved. The preceding reflections have demonstrated that cooperation under the common goal of growth and employment promotion while maintaining price stability is a

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27 Communication is a necessary condition for overcoming the non-cooperative “prisoners’ dilemma” and for developing cooperative behaviour.
win-win situation for the actors of monetary policy and fiscal policy, as well as for the social partners. It is also a win-win situation between the social partners in particular, because a constellation for monetary policy and wage setting that is positive for additional employment and growth is at the same time positive for the expected return on investment. In that sense it is only rational that the social partners subscribe to stability-oriented collective bargaining agreements and contribute to a policy-mix in which even under constant distributional shares, the income of both sides can significantly increase due to increased employment and higher investment activity.

The precondition of all this is that all participants exploit fully the mutual advantages of cooperative behaviour without compromising their autonomy and the pursuit of their respective primary goals.

4.2 Consistency across space

As an important prerequisite for cooperative behaviour, it was essential to bring together all economic policy actors, who are jointly in charge of the macroeconomic policy-mix. At the same time, it was equally important to retain the new institution’s capacity of providing a forum for a real dialogue. For this reason, the number of participants had to be limited. The ECOFIN Council and the Employment Council, for instance, can only send three delegates, or two respectively, to represent their institutions in the Macroeconomic Dialogue deliberations. The situation is similar for the other groups. However, as the MED is not designed as a decision-making body, all the insights and the exchange of ideas in its context would remain “idle capital” if the substantive ideas were not at least reported back to the broader plenum of each respective policy field, in which the decision-making powers and implementation capacities are in fact located. This act of reporting back is all the more important as no official minutes get written, which would summarize the results of the Macroeconomic Dialogue’s sessions.

The problem of representation and intermediation does not only exist between the MED and the main (decision-making) fora of its different European-level macroeconomic policy fields. More importantly, it also exists
between the European and the national level of policy-making both for the MED as a whole and for each one of its policy fields.

The designers of the MED’s conception during the German presidency saw these problems very clearly. The report to the Cologne European Council explicitly mentions this issue: “In particular, with the introduction of a single currency and a single monetary policy, new interactions between the national level and the EU level have materialised. The purpose of the European Employment Pact is to ensure that these levels work together in a consistent manner so as to boost employment while maintaining stability […]” (Bulletin 1999; Issue 49: 521).

Here is also the reason why Germany originally envisioned a tight coupling between the national “Alliance for Jobs, Training and Competitiveness” and the European Employment Pact. In the further development, an exchange of ideas between the national “Alliance” and the MED did not take place, however. An equivalent to the EU-level MED on the national level is also missing in the other member states of the European Union (Fig. 2). What has at least been created in Germany is a committee for preparing the MED’s sessions, a national-level body whose composition and assignment matches that of the European-level Macroeconomic Dialogue.

**Figure 2: Levels of activity of the Macroeconomic Dialogue**

<table>
<thead>
<tr>
<th></th>
<th>Political Level</th>
<th>Technical Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>MED POL</td>
<td>MED TEC</td>
</tr>
<tr>
<td>National Level</td>
<td>Not yet: MED POL</td>
<td>Not yet: MED TEC</td>
</tr>
</tbody>
</table>

Source: Own composition

Within the individual policy fields of the MED, monetary policy is least affected by the problem of intermediation (Fig. 3). The European Central Bank only exists on the level of the European Monetary Union, and in the
non-members of the European Monetary Union, national sovereignty of monetary policy remains unaffected. The non-EMU participants together send one representative into the MED, who reports back to the national monetary authorities.

**Figure 3: Participants of the Macroeconomic Dialogue and their level of activity in the European Monetary Union and the EU (without EU-COM)**

<table>
<thead>
<tr>
<th>Monetary Policy</th>
<th>Fiscal Policy</th>
<th>Wage Setting</th>
</tr>
</thead>
<tbody>
<tr>
<td>EMU or EU respectively</td>
<td>European Central Bank</td>
<td>ECOFIN Council/Eurogroup</td>
</tr>
<tr>
<td></td>
<td>ECOFIN Council/Eurogroup</td>
<td>European Peak Organisations (UNICE, CEEP, ETUC)</td>
</tr>
<tr>
<td>National Level</td>
<td>Central Banks of Non-EMU countries</td>
<td>National Legislator, enacting budget laws</td>
</tr>
</tbody>
</table>

Source: Own composition

Fiscal policy occupies an intermediate position with regard to the difficulties of mediation between the EU-level and the national level. Preparation and “post-processing” of the MED can draw on the resources and take place in the context of the ECOFIN Council and the Eurogroup. Responsibility and decision-making authority remain on the national level, albeit constrained to some extent by the Stability and Growth Pact.

Intermediation between the EU-level and the member state level is most difficult in the area of wage setting. In this policy field, the decision-making authority on collective bargaining agreements is still exclusively on the national level, and even there it is in many countries not the peak-level confederations, but instead individual trade unions that negotiate wage agreements with their counterparts on the side of the employers’ associations. Further complicating parts of the picture are those member states, such as...
the UK in particular, in which wage setting is predominantly a decentralised process.

During the planning and design stages of the Macroeconomic Dialogue one idea had already been to create a subcommittee in charge of monitoring wage setting in the EU, in order to handle the extraordinary complexity in the synchronization needed in this area. It was mainly due to the time pressure under which planning and design of the MED was taking place, and the amount of additional work connected with establishing only the MED itself, that this idea of a specialised wage monitoring committee on the EU-level was not further pursued at the time.

4.3 Consistency across time

Apart from the consistency of the macroeconomic policy-mix across different levels, consistency across time is also a complex and a necessary issue to consider.

For instance, if monetary policy declares the stability-orientation of the wage development *a prerequisite* for an expansive orientation on its own part, then the duration of stability-oriented wage setting should be at least as long as the time-lag of the real effects of monetary impulses. If a monetary policy decision unfurls its effects on the development of real macroeconomic variables with a time lag of six to eight quarters, then collective bargaining should seek to ensure stability-oriented wage setting for this time period at least. In the case of collective bargaining agreements, this

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28 “The Governing Council has to focus on the outlook for price stability in the medium term as only this perspective allows for the time lags for monetary policy to work through the economy.” (European Central Bank, Monthly Bulletin, 2001: May 10)
condition could be met by concluding wage agreements with a term of two years.  

For a sustainable expansive orientation of monetary policy this synchronization of the time-horizons of decision-making could also be obtained by concluding two-year wage agreements for one initial period and then annually updating the agreement for the year after the next, in accord with the stability criteria for the development of wages. The critical issue here is the feasibility of such proposals in their implementation. Another possibility would be reliable, rule governed wage agreements. The guideline could be the development of productivity under consideration of the price stability target of monetary policy. (See for instance: Annual Economic Report of the Federal Government 1999: 49, No. 59). The European trade unions in particular have begun to try to coordinate national wage setting processes and to give some measure of orientation to these processes, without interfering with the national autonomy of wage setting institutions. What is known as the 1998 “Coordination Guideline” of the European confederation of metalworkers’ unions, for instance, suggests the alignment of wage setting with the inflation rate and the growth of productivity (cf. Welzmüller 2002: 18). In December 2000 the European Trade Union Confederation’s executive committee ratified a “Coordination Guideline” and with this provided a general orienting standard “[…], which takes account of the new situation, introduced by the euro, including price stability.” (European Trade Union Confederation 2002)

29 This precondition has been given in Germany repeatedly due to collective bargaining agreements in the metalworking industry with a term of about two years both in the years 2000/01 and in the years 2004/05.

30 “Another possibility would be to conclude collective bargaining agreement not for the current year, as is customary at the moment, but instead for the respective following year. This would send early and clear signals to the monetary authority, on what the medium run trajectory of wages will be […]”. (DIW Berlin et al. 2001: 42)
When the Macroeconomic Dialogue was originally envisioned and designed, such long-term collective bargaining agreements and commitments were hardly known of. The expectation was that such contractual settlements could be supplemented and maybe even partly replaced, in their functions, by the building of trust among the participants of the MED. One trust-building factor could be the empirical reality of wage agreements that have on average remained on a stability-oriented trajectory since the mid-nineties.31

5. Macroeconomic Dialogue and structural reforms

The formation of the Macroeconomic Dialogue has strengthened the macroeconomic element in the European Employment Pact, which has so far been under-represented. At the same time, the newly established Macroeconomic Dialogue is connected with the existing policy processes of the EU in multiple interdependent ways.

Successful active labour market policy schemes resulting in an increase of the employment potential, for instance, can only become fully effective when supplemented by a macroeconomic policy-mix oriented toward growth and stability. This becomes immediately obvious when examining the relation between the number of unemployed and the number of job openings in periods of high unemployment.32 Without favourable macroeconomic background conditions there is also the danger that an improvement in the environment for part-time work, for instance, will lead to crowding-out of full-time employment opportunities with an overall con-

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31 “Wage moderation will have to play an important role in containing inflationary pressures in the coming years. When looking back, […] the development of wages seen so far has been satisfactory.” (European Central Bank, Monthly Bulletin, 2001: June 6)

32 According to the official numbers about the situation in Germany, the relation there between the unemployed and the available job openings was around 10:1 in the average of the year 2003.
stant volume of employment, instead of strengthening both working time regimes.

Conversely, an improvement of the supply-side of the labour market can help ensure that a dynamic macroeconomic development does not prematurely hits bottlenecks bearing inflationary risks before the overall employment potential is exhausted. Successful structural reforms on all markets permit a situation in which stability-oriented wage setting policy remains compatible with high real increases of per capita incomes, once the attempts at restructuring firms and markets manifest themselves in increases of productivity.

Even in the emergence and the reduction of unemployment itself the macroeconomic policy-level is connected with the other policy fields of the European Employment Pact. Of course, to the extent that part of the unemployment the EU is experiencing has structural causes, it cannot be eliminated by way of macroeconomic expansion. The reverse argument also holds. Between these two extremes, however, there are intermediate areas. Part of the unemployment with originally cyclical causes has become structurally entrenched, because a strong and immediate macroeconomic impulse was lacking after a cyclical downturn, in which the unemployed could have found jobs again. At the same time, part of the people who are already long-term unemployed could have greater chances of being re-integrated into the labour market, possibly supported by active labour market policy programs, if there were strong and sustained macroeconomic dynamics.

Generally, the combination of a growth- and stability-oriented policy mix and structural reforms leads to a situation in which an increase in employment places no burden upon the development of productivity, and increases in the productivity of labour do no harm to the development of employment. A scenario, that is, in which more employment and higher productivity and resulting from that higher per capita incomes become possible at the same time.
For these reasons, the Macroeconomic Dialogue is open to taking into account these interdependencies between macroeconomic policy, labour market reforms and other structural reforms. The composition of the Macroeconomic Dialogue’s participants is also conducive to this consideration of the macroeconomically relevant aspects of structural reforms. It would be advantageous if all the committees involved in structural reforms of markets did the same and paid keen attention to the macroeconomic underpinnings of the success of their restructuring efforts. What is not intended in all this, however, is to turn the Macroeconomic Dialogue into a forum for thorough discussion of structural reforms themselves. Structural reforms are part of the Coordinated Strategy for Employment; they are the subject of the Cardiff-process and other institutions dealing with questions of competitiveness and issues of the Single European Market. If the Macroeconomic Dialogue were to engage in detailed discussions of all these topics as well, the value added would be low, but the opportunity costs extraordinarily high, the Macroeconomic Dialogue, after all, being the only forum the EU has in which all macroeconomic agents are present and can exchange their views about macroeconomic policy-making.

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Policy coordination in the Macroeconomic Dialogue of Cologne: Experiences from the ETUC

1. Coordination of macroeconomic policies: Theoretical background

Economic theory puts the idea forward that a coordination of macroeconomic policies can build what is called an ‘optimal policy mix’. Such an ‘optimal policy’ would have the ability of maximizing growth while at the same time avoiding the spectre of galloping inflation. And a prolonged period of sustainable growth will create high productivity/well paid jobs, thereby bringing the economy closer to the objective of full employment.

In practice, a growth friendly optimal policy is expected to work through the following channels:

– First of all, ‘stability’ conflicts with the central bank will be avoided. ‘Stability’ conflicts are indeed very costly. They imply a situation in which fiscal policy is overstimulating the economy and pushing growth far beyond potential. In that case, monetary policy would need to step in and cool the economy down by increasing interest rates. This kind of macroeconomic policy mix inevitably results in increasing unemployment, and is ultimately followed by wage moderation efforts from workers. Wage moderation and underutilization of productive capacity eventually bring high inflation back down.

– However, non-inflationary growth can be substantially supported if the right kind of macro policy coordination is followed. Restrictive fiscal policies may increase the aggregate savings surplus of the economy, thereby crowding in private investment by pushing down (long term)
interest rates. Responsible wage agreements may help in accelerating this process. They may help in those cases where profitability compared with the return on risk free assets is too low, thereby making it more attractive for firms to engage in new investments. More generally, a wage policy that provides an anchor to price stability, is helpful in avoiding that inflation accelerates in the early phase of the economic upturn when unemployment is still high. Finally, an active monetary policy stance provides the ‘missing link’ in this supply side agenda. Through loose monetary policies that inject new demand in the economy, an aggregate deficit in demand is to be avoided. Fiscal restriction and wage moderation are then indeed transformed in effective higher investment. And once investment takes off, the final result is a dynamic equilibrium in which aggregate supply (the capital stock of the economy) and aggregate demand are growing at the same pace and are mutually reinforcing themselves. At the same time there is no danger that economic growth would bump into a lack of productive capacity, thereby triggering an acceleration of inflation.

– In short, by assigning different functions to the different policy actors (governments, social partners and central bank), macroeconomic policy coordination can implement supply and demand policies and result in economic success. Note that this sharing of tasks does not confirm the traditional picture. In the traditional picture, there is a clear distinction between the policy actors. The central bank should care for price stability, whereas trade unions are expected to consider the goal of employment creation by means of wage moderation and flexibilising the labour market. In the theory of the ‘policy mix’, it’s rather the other way around. There, the fact that a successful economic policy requires both supply and demand policies implies that the central bank should not limit itself to the objective of price stability but should also stabilize aggregate demand of the economy. Likewise, cutting the purchasing power of wages can most certainly push inflation down, but whether this results in employment creation depends on the question, whether the deficit in aggregate demand, that wage moderation makes,
is taken care off by an expansionary monetary and/or fiscal policy. These effects imply that monetary, wage and fiscal policies are interdependent and should be approached in a coordinated way.

The theory of the ‘optimal policy mix’ is sometimes described more lively by referring to the evolution of the macropolicy mix in the United States. In the early eighties, the Volcker/Reagan policy mix was having fiscal policies boosting growth while monetary policy was fighting inflation, resulting in an overvalued dollar and record high public deficits. The nineties saw a Greenspan/Clinton policy mix with restrictive fiscal policies and loose monetary conditions. This resulted in one of the longest periods of US economic growth without the US economy encountering high inflation problems.1

2. Coordination of economic policies: unexpected but dubious support from the IMF

It is no exaggeration to say that the IMF tends to think in the terms of a neo-liberal economic framework in which flexible markets are a necessary and sufficient condition to reduce unemployment. Therefore, it doesn’t come as a surprise that the April 2003 World Economic Outlook carried a chapter in which a frontal attack was made on the regulation of labour markets in Europe (IMF 2003). Simulations were made which concluded that Europe could cut unemployment substantially by bringing unemployment benefits and employment protection legislation into line with the much lower US standards. However, the figures of the econometric regression the IMF published also allow to draw out a rather alternative policy agenda. Indeed, the econometric equation the IMF used to attack European welfare states delivered another strong conclusion and one that remained hidden in the IMF’s text. It concluded that a combination of high

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1 The present policy mix in the US can be labelled as a Greenspan/Bush policy mix in which both fiscal and monetary policies are aggressively injecting aggregate demand in the economy, showing that such a policy mix is also possible.
central bank independence with low coordination of wage formation resulted in higher unemployment. In this case, the decentralised/uncoordinated bargaining process is not able to internalize the strong price stability discipline that a highly independent central bank wants to pursue. A stability conflict between the central bank and wage formation results and its cost can be counted in low growth and higher unemployment. On the other hand, a high degree of coordination of collective bargaining, together with an highly independent central bank, has the effect of bringing unemployment down. The IMF regression results show that coordinated systems of collective bargaining are better able to cope with the strict price stability orientation of an independent central bank, thereby avoiding the stability conflict described above. Another implication is that the efficiency costs of having more coordination of wage formation (and therefore also lower wage inequalities between workers) are offset by an improved macroeconomic stability regime. Coordination of wage bargaining, in combination with high central bank independence, clearly has superior results. These results are illustrated in figure 1 where a combination of uncoordinated bargaining (measured by an index of 1) and high central bank independence results in an unemployment rate that is almost one percentage point higher. On the other hand high central bank independence in combination with highly coordinated bargaining (index of 3) forces unemployment down by 1.5 percentage point.

The importance of these conclusions for the euro area are obvious. With the ECB being the most independent central bank of the world, watching over average price stability in the euro area, and with 12 different systems of wage formation (which on top of that sometimes differ substantially from each other), the challenge with which the euro area is confronted is

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2 Other factors determining employment in the IMF’s equation concerned employment protection legislation, unemployment benefits, tax rates on labour. For a complete and critical assessment, see Baker/Schmitt (2003). It turns out that the ‘good’ labour market institutions such as coordination explain the major part of the overall relationship between labour market outcome and its institutions.
not to deregulate labour markets and unemployment benefits, but to come to a satisfactory interaction of macroeconomic policies, in particular between monetary and wage policy.

**The US: Good employment results and no coordination of collective bargaining**

The critical reader may observe that the experience of the US economy contradicts the IMF’s results concerning the link between employment performance and the combination of highly coordinated levels of collective bargaining and a highly independent central bank. Indeed, the US does not have collective bargaining coordination and yet achieves low unemployment rates.

However, this is a superficial contradiction. Firstly, the level of independence of the Federal Reserve (Fed) is not as high as the level of in-
dependence of the ECB. In the US, a simple parliamentary majority is sufficient to change the Fed’s statutes. This forces the Federal Reserve to walk ‘a thin line’ and take objectives that are closer to the interest of American politics (such as the objective of full employment) into account. The fact that the Fed never has stipulated an exact inflation target, thereby giving itself more leeway in formulating policies, testifies to this approach. Also, the Federal reserve would most probably view the ECB’s inflation objective of ‘below but close to 2%’ as too tight. In practice, inflation rates in the US have been consistently higher than the 2% European threshold.

The ECB, on the other hand, is the most independent central bank of the world. If politicians ever wanted to change the ECB ’s statute or mandate, they would need an overhaul of the European Treaty, which would need to be ratified by 15 (25) national parliaments. This gives the ECB a statute of independence which is even more outspoken than the one the German Bundesbank had.

Not only is there more leeway installed in US monetary policies, moreover the US labor market was able to enjoy a (temporary) ‘free lunch’. The expansion of the business cycle and growing employment in the nineties did create serious bottlenecks in the labor market. At the end of the nineties for example, as high as 90% of American firms reported problems in finding workers for their vacancies, leading to increasing wage demands. These wage demands, however, did not threaten price stability because the stock exchange at the same time provided a ‘windfall profit’. With the stock exchange rising, pension funds and (private) health insurances were able to cut premiums, thereby offsetting the impact of rising wage demands on total wage costs. Workers were also rewarded with ‘stock options’ and shares, giving firms the possibility of ‘printing their own money’ (shares) to compensate workers. In this sense, the stock exchange in the US replaced the role of coordinated collective bargaining. However, it also created a serious ‘bubble econ-
3. The growth performance and the policy mix in practice under the process of the Macroeconomic Dialogue of Cologne

3.1 What has happened to growth in practice?
Essentially, figure 2 answers the question about since the establishment of the macroeconomic dialogue. After the excellent growth year 2000, where growth exceeded 3%, economic growth went substantially down to reach a meagre 0.4% in 2003. This brings the number of years that the euro area has experienced below potential growth at three consecutive years from 2001 on. Moreover, behind the official forecast for 2004 (1.8% growth) hides the fact that this is a leap year with an additional working day that is pushing the growth statistic for 2004 artificially up. When correcting for this 'leap year' effect, forecast growth 2004 falls back to 1.6%, turning the slowdown into a slump of four years.

Figure 2: GDP-growth in the euro area

Another way to look at this is to use the statistics on the output gap. This indicator provides an estimate to what extent the economy is performing below (or above) its level of full productive capacity. A negative output gap means that aggregate demand is below potential aggregate supply and that positive demand policies can be implemented without any danger of accelerating inflation. OECD estimates of the output gap in figure 3 show that four years of below potential growth have resulted in a situation that is now comparable with the deep recession of 1993. Recall that in 1993, economic growth actually turned negative, resulting in an economy that was operating 2% below its possible productive capacity. After three years of slow growth from 2001 on, the euro area economy is now faced with the same amount of underutilization of productive capacity. Not only is this a waste of economic resources, it also implies dangers for future potential growth (cyclical unemployment turning into structural unemployment, economy sliding into disinflation and deflation).

Figure 3: Output gap in the euro area

\[\text{Figure 3: Output gap in the euro area}\]

Source: OECD (2003)

3.2 The role of the macro policy mix in explaining poor growth performance

The poor growth record of the euro area is not that surprising and can be explained by the macro policies that were implemented over these years. Of
course, the initial origin of the slowdown in Europe is to be found in the pricking of the ‘bubble-economy’ of the US, which dragged down the rest of the world with it. But the fact that the US itself, as well as other major trading partners of the euro area (UK, Canada, other non-euro European countries), recorded considerable better growth figures over the same period, testifies to the fact that domestic policy mistakes inside the euro area are important in explaining why the recovery in the euro area gets delayed year after year.

Concerning the fiscal policy pillar, figure 4 shows that governments have not fundamentally strayed away from the stability orientated fiscal policy regime.

**Figure 4: Cyclically adjusted net lending in the euro area**

*(in percent of potential GDP)*

Source: OECD (2003)

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It can be argued that it was the Fed that pricked that bubble by raising interest rates, while at the same time allowing a major increase in the dollar’s exchange rate.
Net lending, when adjusted for the impact of the business cycle, has increased only moderately, with the average euro area structural deficit marginally increasing from 1.9 in 2000 to 2.3% in 2003. This is in sharp contrast with the fiscal policy orientation outside the euro area, where the US and the UK have boosted growth by providing a massive fiscal impulse. In the case of the US, this has turned the budget surplus into a deficit that is practically twice the average deficit of the euro area.

Moreover, the demand impulse that is going out from the 0.4 percentage point deterioration of the public deficit in the euro area has to be qualified. The 0.4% of GDP increase in the public deficit is constituted of tax cuts on the one hand and savings on public expenditure (social expenditure, public sector wages) on the other hand. And since the marginal propensity to consume from the income generated by public expenditure is higher than the propensity to consume from tax cuts, the net impact on aggregate demand of the increased public deficit is reduced and may even have been negative.

### 3.3 The role of wage formation

The oil price shock of 2000 and the depreciation of the euro in 1999-2000 generated the fear that wage formation would translate the initial inflation shock into persistent inflation through a wage-price spiral. In practice, developments have shown that this fear was unfounded. Wage formation in the euro area has on average avoided the trap of an inflationary wage-price spiral. Recent trends in collectively negotiated wages (see table 1, based on figures of the ECB itself) learn that nominal wages barely reacted to the 2000 shock in inflation, thereby driving the real value of negotiated wage increases fundamentally down. In 1999, real negotiated wages still increased with 1% but stagnated in 2000 as a consequence of the inflationary shock. In 2001 and 2002, wages recovered somewhat but remained very modest with a rate of real wage increase of 0.3/0.4%. All in all, nominal wage increases of 2.5% and real wage increases limited to 0.3/0.4% can hardly be labelled as ‘inflationary’ wage developments.
Table 1: Negotiated wages, inflation and real wage increases in the euro area

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<tbody>
<tr>
<td><strong>Negotiated Wages</strong></td>
<td>2.2</td>
<td>2.2</td>
<td>2.6</td>
<td>2.7</td>
<td>2.4</td>
</tr>
<tr>
<td><strong>HICP</strong></td>
<td>1.1</td>
<td>2.1</td>
<td>2.3</td>
<td>2.3</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Real negotiated wage increase</strong></td>
<td>1.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
</tr>
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</table>


It should be noted that the pattern of moderate average wage developments on the level of the euro area is hiding diverging wage evolutions in different member countries. This is in turn due to the incidence of relatively higher inflation in some euro area member states. Confronted with this, trade unions in these countries have indeed taken up their role of defending the purchasing power of wages, while at the same time moderating real wage outcomes. A comparison of the two extreme cases (Germany versus Spain) shows that, despite nominal wage moderation in Germany, real wage increases in Spain have been much lower (see table 2 on the next page).  

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4 It can be argued that nominal wage outcomes, lower than present inflation, would have brought inflation down, and thereby in the end still deliver real wage increases. Whether wages can bring inflation forcefully down in economies that are overheating can however be discussed. OECD (2003) for example notes that one third of inflation in Spain is generated by increasing corporate profit margins. Moreover, the wage formation system in Spain is (as is the case in Italy) ‘forward looking’. Collective wage settlements are organised on the basis of a rather low inflation forecast. Only when inflation exceeds this forecast, revision clauses come into play that index the wage on the higher inflation. This mechanism prevents wage increases that are based on high inflation forecasts from becoming a self-fulfilling prophecy. On the
Table 2: Real wage increases in Spain and Germany

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
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<tbody>
<tr>
<td><strong>Wage per hour in Spain</strong></td>
<td>3.7</td>
<td>3.8</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>Inflation in Spain</strong></td>
<td>3.5</td>
<td>2.8</td>
<td>3.6</td>
<td>3.1</td>
</tr>
<tr>
<td><strong>Real wage increase in Spain</strong></td>
<td>0.2</td>
<td>1.0</td>
<td>0.3</td>
<td>0.8 (average over the period 0.35)</td>
</tr>
<tr>
<td><strong>Real wage increase in Germany</strong></td>
<td>1.4</td>
<td>0.8</td>
<td>0.8</td>
<td>0.9 (average over the period 1%)</td>
</tr>
</tbody>
</table>


The obvious policy question is whether this situation of nationally diverging inflation rates would have been a stumbling block for the ECB in its interest rates policy. The answer is no. The ECB is responsible for the whole euro area and should in principle not care about national inflation rates. As argued above, wage developments resulting from collective negotiations on the level of the euro area have been behaving quite responsible in accommodating the oil price shock, thereby leaving the ECB’s hands free to counter the cyclical downturn that was imported from the US.

3.3 The role of monetary policy: ‘Act on inflation, wait and see on economic growth’

Monetary policy had to address two events in the period 1999–2003/2004. A first challenge was the oil price shock that pushed inflation rapidly up from 1% in 1999 to 2% and 2.3% in 2000 and 2001. Such an oil price other hand, when high inflation eventually materializes itself and gets translated into wage increases, then inflation does get pushed through the system. Italy has a similar forward looking mechanism in order to anchor price stability in wage settlements but the adaptation of wages to higher than expected inflation is not automatic and needs to be negotiated in the following sectoral agreement.
shock can be considered as a shift in relative prices, reflecting the need to change consumer and producer choices in order to improve the way scarce resources are handled. A central bank need and should not act on a shift in relative prices that in principle only implies temporarily higher inflation. At the same time, however, a central bank should indeed beware of 'second round' effects that would translate this temporary higher inflation rate into a permanent one. ‘Second round’ effects operate through wage-price spirals, but also through the price setting behaviour of corporations that try to transfer the cost of higher energy input to consumers. The ECB policy reaction to this event was extremely forceful. In the autumn of 1999, a series of seven interest rate hikes was launched which almost doubled rates in a span of less than one year. There can not be much doubt that this policy also was at the basis of the downturn that followed in 2001.

The next policy challenge was then to address the downturn the ECB itself partly initiated. In addressing this downturn, the ECB has indeed cut interest rates. When comparing with historical averages, rates are indeed very low. However, a closer look at the exact timing of these rate cuts reveals a ‘wait and see’ attitude (see table 3 on the next page). Interest rate cuts were systematically lagging behind the different negative shocks and essentially constituted a reaction to a much earlier shock. At the same time, new shocks were arriving, bringing growth further down. In other words, the point is not that interest rates are historically low, the point is that rate cuts came too late and in the end did not go far enough.
Table 3: The ECB and the shocks hitting the euro area economy

<table>
<thead>
<tr>
<th>Time of the shock</th>
<th>Shock to the economy</th>
<th>Official Reaction of the ECB</th>
<th>Timing of interest rate cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Middle of 1999</td>
<td>Oil price increase, euro falls sharply</td>
<td>Avoid second round effects from spilling over into permanent inflation</td>
<td>Almost immediate in Autumn 1999; seven consecutive rate hikes</td>
</tr>
<tr>
<td>Middle of 2000</td>
<td>US economy goes down; First crash of the stock exchange along with first out-break of corporate scandals in US ('Enronitis')</td>
<td>Euro area economy is sufficiently closed. US crisis will have limited effects in Europe</td>
<td>September/December 2001 (i.e. one year after the shock !)</td>
</tr>
<tr>
<td>First half of 2002</td>
<td>More corporate scandals in US. Major stock crash in US and Europe</td>
<td>A recovery for the end of 2002 is on its way</td>
<td>December 2002/first half 2003 (i.e. despite the stock exchange crash, the cycle of interest rate cuts that was initiated in the last months of 2001 was put on hold for one whole year!)</td>
</tr>
<tr>
<td>Second half of 2002/first half of 2003</td>
<td>Major appreciation of the euro vis-à-vis the dollar</td>
<td>Revival of US demand will compensate the worsening of the competitive position of European industry. A recovery is on its way</td>
<td>June 2003 (an interest rate cut of 125 basic points over 2002/2003 still remains insufficient to compensate for the cumulated effects of a stock crash and the fall in the dollar)</td>
</tr>
</tbody>
</table>

Source: Janssen/Mermet (2003)
3.4 The consequences of poor macropolicy coordination

The basic idea of macroeconomic policy coordination (see above) is that the sharing of responsibilities between the different policy actors results in a policy mix in which demand and supply channels work together to create non-inflationary growth. Unfortunately, what happened in practice in recent years is that all the policy actors essentially pursued one single track, the supply track of ‘stability’ orientated policies. Fiscal policy, wage policy as well as monetary policy were essentially managed in order to defend the objective of price stability. With no single policy actor taking up the responsibility for aggregate demand, it should come as no surprise that the growth record of Europe has been disappointing. In particular, with fiscal and wage policy posing no threat to price stability, the ECB could have done more to support growth.

The supply side orientated policy mix also resulted in disappointing outcomes on the field of monetary stability itself. Government deficits in the euro area have increased considerably under the influence of slow growth. But there’s also a link with the record on inflation.

Indeed, one striking feature of the last couple of years is the slowdown in labour productivity. Whereas the trend growth rate of labour productivity in Europe is normally about 1.5% to 2%, productivity in 2001 only increased with 0.3%. In 2002, a similar increase of 0.4% was recorded. Even in 2003, productivity increases (1.1%) were still far below the trend rate. While wage outcomes remained moderate, this slowdown in productivity growth pushed unit wage costs upwards to an extent that was incompatible with the price stability target of the ECB. This was especially clear in 2001, when unit labour cost in the euro area increased with 2.6%, which is considerably above the price stability threshold of 2%.

However, this fall in labour productivity is not all that surprising. Productivity figures fall in every slowdown. This is because firms exhibit ‘labour hoarding’ behaviour. When there is a dip in activity, firms initially keep them on board instead of retrenching workers. Hiring and finding the right
qualified people is very often a costly business, and firms may count on the idea that the dip in activity might be short-lived. A lower growth rate of production, together with identical staff, of course implies a fall in labour productivity growth.

This has several important implications for the relationship between monetary policy and wage building:

- As argued above, wage formation on itself cannot assure job creation. Nor can it be completely responsible for keeping inflation down. Moderate wage building can potentially trigger disinflation. Whether this will immediately result in lower inflation depends on productivity and unit wage costs.

- The ECB itself is to blame for the high increases in unit wage costs in 2001 and 2002. If the ECB would have engaged sooner and more strongly in supporting economic activity in the euro area (or refraining from laying the ground for the slowdown with its series of interest rate hikes in 1999-2000), growth would have been somewhat higher and the rate of increase in productivity wouldn’t have fallen that much.\(^5\)

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\(^5\) A third policy conclusion even goes further. Although productivity slows down in every cycle, the extent to which it has slowed down in the present cycle may now be out of the ordinary. What we have actually seen the recent couple of years is an extreme slowdown of growth, together with rising and not just stable employment. One explanation might have to do with the extreme and long lasting wage moderation efforts of the previous decade. Economic theory predicts that this will change the relative price of capital and labour, thereby inducing firms to change more labour intensive production processes. Capital is substituted away to the advantage of workers. To a certain extent, the fall in labour productivity 2001/2003 might therefore be structural, not cyclical and being driven by wage moderation efforts. To the extent that the downfall in productivity indeed represents such a structural break in the economy, it does not pose a problem for inflation. In that case, the downfall in labour productivity and the ensuing acceleration in unit wage costs are then compensated by an increase in the productivity of capital, holding overall costs stable.
thereby improving the compatibility between wage formation and price stability.

In other words, the fact that inflation has been rather ‘stubborn’ and has not fallen rapidly below 2% may well be due to the ECB’s policy itself. Another policy scenario in which the ECB had been more responsive for the objective of supporting growth, would have seen a fall in labour productivity growth and an increase in unit wage costs that would have been less outspoken and that could have brought inflation faster down.

Another important issue concerns the relationship between fiscal policy and price stability. As mentioned above, the failure of monetary policy in supporting growth over the last past years has increased government deficits. Under pressure of the ECB and the Stability and Growth Pact (SGP), as well as in order to finance direct tax cut operations, many governments have been raising indirect taxes, mainly on items such as tobacco, alcohol and gasoline. In doing so, governments have created another shift in relative prices, thereby preventing inflation from coming down. There’s a certain paradox here. One of the main reasons why the SGP is there is to enforce fiscal discipline so that price stability can be defended. But if governments pursue the SGP by raising indirect taxes, and the ECB then decides that inflation is ‘sticky’, then policy coordination has a problem. Of course, governments have the right to raise taxes, certainly on ‘unhealthy’ products. The problem is the narrow price stability target of the ECB (inflation slightly below 2%), which practically forces the ECB to act on interest rates any time there’s a certain shock to the economy (including a hike in indirect taxes).

and not triggering an inflationary clash between profits and workers (see ECB (2003a) for a similar reasoning).
4. Inside the Macroeconomic Dialogue process of Cologne

4.1 European trade unions have taken up the challenge

The ETUC has always held that the introduction of the single European currency would increase the need for more coordination of economic policies at the European level. Fiscal, taxation and wage policies of the different member states need to be in line with the single European monetary policy. Put differently, European monetary integration logically needs European economic governance.

Therefore, at the ETUC congress of Helsinki in 1999, trade unions re-organised themselves to address this challenge and decided to install a committee on the coordination of collective bargaining in Europe. This ETUC committee has three main goals:

– preventing the risk of social and wage dumping and moving beyond wage restraint,
– preparing the ETUC to engage in discussions on wage policy in the framework of the process of the Macroeconomic Dialogue of Cologne,
– ensuring that the catching-up process of the enlargement countries is accompanied by a rise in worker’s living standards and real wages.

Each year the ETUC committee presents an annual report and a draft resolution which the Executive then amends and approves. From its start, the formula of having collective bargainers pursuing wage increases that are in line with inflation and productivity has been adopted by the ETUC Executive Committee. The latest ETUC resolution (end 2002) also specifically mentioned the objective of price stability, thereby referring to the need to have wage and monetary policies that are compatible with each other.

4.2 Have our messages been listened to?

In the meetings of both the technical as well as the political Cologne group, the ETUC has tried to make good use of the information coming from the ETUC’s representatives of collective bargainers by giving the other policy actors strong messages about the course to be taken in order to reach
growth as well as price stability. Over these years, some four important moments can be distinguished:

- In Autumn 1999, participants in the Cologne dialogue observed an adequate policy mix, conducive to growth and stability. Some days later, the ECB increased interest rates, thereby starting a series of hikes that doubled interest rates in a time span of one year.

- The Cologne meetings in 2000 continued to be overshadowed by the oil price increase and its effect on inflation. ETUC members, and in particular the DGB with the wage policy orientation decided under the German ‘Bündnis für Arbeit’, pointed to the fact that wage policy would not transmit these inflationary pressures into the economic system. Despite this strong message, the policy of interest rate hikes continued.

- Over 2001/2002, ETUC members expressed their doubts on the expected recovery on several occasions. But again, the policy reaction from the ECB as well as from the Commission and the Economic Policy Committee was one of complacency. For example, the comparison with the US (where an active and aggressive fiscal policy was implemented) was not accepted, because ‘automatic stabilizers’ in the US were less developed so that any comparison with Europe on the basis of ‘structural deficits’ was flawed. Meanwhile, figures on the 2000/2003 change in public deficits in the US and Europe now convincingly show that the US, with an effective public deficit over 5% of GDP, has gone much further than the euro area where the deficit is after all still limited to 2.5% of GDP. Also, some participants continued to point to ‘Ricardian’ effects, hoping that wage moderation and fiscal expenditure restraint would somehow restore economic confidence and lower household’s savings instead of sapping purchasing power.

- At the end of 2003, a new misunderstanding may be in the making. Again basing itself on the information from the collective bargaining committee, the ETUC delegation warned that wage increases over
2003/2004 would fall back. Instead of remaining stable at 2.6% (as expected by the Commission) or increasing (as expected by the European employers’ association UNICE), member trade unions report wage settlements end 2003/beginning 2004 falling back to 2%. This is hardly surprising. Four years of slump, continuing employment restructuring and rising unemployment are indeed increasing the pressure on the negotiating position of many trade unions. But wage increases that barely keep up with inflation do not bode well for the recovery scenario of the Commission and UNICE. With real wages stagnating, a recovery in consumer demand is not very likely, putting the strength of the 2004 expected recovery in serious doubt. At the same time, this discussion also helps to understand why business sentiment indicators are improving at the end of 2003. In its Autumn 2003 outlook, UNICE reported that its member organisations were expecting a recovery of household demand based on *increasing* wage settlements and higher purchasing power (in that sense, European employers are after all still ‘keynesian’!). But if on the contrary the scenario is one of wage restraint, then the confidence of business in the improvement of the economic cycle may well turn out to be a false signal.6

Developments in economic policy making itself (see section 3) suggest that the ETUC’s considerations have – unfortunately – not been taken on board. The ECB for instance has maintained a rather ‘technical’ profile, maintaining that their mandate is about price stability and avoiding a discussion on forward looking policies. Occasionally, the Commission did try to open the discussion on monetary policy by arguing in 2002 that the spread between interest rates on corporate bonds and government loans tightened monetary conditions and constituted a drag on investment. But

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6 In the beginning of 2002, leading indicators of the business cycle also gave a false message. They signalled a recovery that never was to materialize.
the Commission did not engage in a full fledged discussion on supply and demand policies.

4.3 The strategy of employers’ organisations

Objectively speaking, employers’ organisations have an interest in realising an equilibrated policy mix in which supply and demand support each other. After all, businesses do go more bankrupt in an economy in which growth is almost absent. In practice however, the positions European employers have been taking are somewhat disappointing:

- On the Stability and Growth Pact, employers have stuck to a strict reading of it, discarding all attempts to have a more flexible interpretation.

- Likewise, any direct criticism of the ECB has been shunned. For example, although the statistical tables in UNICE’s spring outlook 2003 reported two thirds of their members judging interest rates as being too high, the UNICE delegation did not really stress this fact in the meeting itself.

- Instead, employers have pushed the agenda of ‘structural reform’ and competitiveness, thereby threatening to bring the already distorted equilibrium between supply and demand policies even further out of balance.

Nevertheless, employers’ organisations are not always a uniform block. Small and medium sized enterprises, reflecting the fact that these enterprises are more dependant on domestic demand, hence on domestic purchasing power, have indeed called for supply and demand policies. And public employers from their part are also more sensitive to trade union arguments when the role of the public sector and public enterprises is concerned.
4.4 Building confidence and mutual understanding

One positive outcome of the Macroeconomic Dialogue needs to be underlined. Over the past four years, trade unions, employers, central banks, Commission and government officials have been meeting regularly to discuss the economic situation and the appropriate response of economic policy making. Although the different actors clearly do not share a common understanding on the ‘fundamentals’, this dialogue has made it possible to listen to and understand each other’s point of view. There is also a certain sense of confidence that has been built. In other words, a certain amount of ‘social’ or ‘trust’ capital is now present in these Cologne meetings. It can be hoped that this may form the basis of more fruitful discussions in the future.

5. Conclusion and ETUC proposals for improving the Macroeconomic Dialogue process

5.1 Not throw the baby out with the bad water

Developments over 2000/2003 show that the Macroeconomic Dialogue can not be seen as a complete success. At the same time, however, these developments show the need to have more, not less dialogue. If Europe wants to return to a path of high growth without inflationary pressures, a strong consensus between the different policy makers has to be built. This is especially the case for the countries of the euro area, where 12 different wage systems and 12 different fiscal policy regimes now have to be brought in line with one single monetary policy regime.

The Macroeconomic Dialogue of Cologne remains the only forum where all actors, including the ECB, are present and where such an attempt for consensus can be made. This opportunity should be grasped. Failure to do so would leave member states no other possibility of going for jobs, either through competitive wage/tax policies (which causes the danger of deflation!), or through far reaching reforms on the labour market that import the US model of ‘hamburger jobs’, social exclusion and sharp wage inequalities.
5.2 ETUC proposals for an improved dialogue

In order to strengthen the Cologne process and by drawing on the experiences of the last years, the ETUC has recently put forward a number of proposals, that would enable to increase the time for in-depth discussion (instead of having an agenda that is dominated by official representations) and that would allow for more (bilateral) interaction with other policy actors, in particular with the ECB. This would involve, for example, regular workshops to deepen the understanding of the policy mix and to come to a joint analysis of certain challenges. It could also imply the joint development of alternative policy scenarios that illustrate the benefits of coordination or signal likely policy reactions to a change in the policy stance of one other actor. Also, there is a need to support the Cologne Macroeconomic Dialogue through the creation of similar discussion opportunities at the national level, thereby creating a channel through which the discussions on the European level have a more significant impact on national policies. It could also make sense to publish some conclusions or summary from the Macroeconomic Dialogue meetings in order to signal the most important lessons to these actors at the national level.

Meanwhile, the ETUC itself is considering the possibility of linking up its committee of collective bargainers with its trade union economists. This would have two objectives: On the one hand, the policy messages that are to be directed towards the ECB, the European Commission and the governments can thus be strengthened. On the other hand, this would also allow a more in-depth discussion inside the ETUC on the compatibility of wage formation in the different EMU member states and overall monetary policy.

On this last point, there is once again another consideration about the appropriateness of the ECB strategy that needs to be signalled. It concerns the narrow price stability target the ECB continues to use. Despite its recent examination of its monetary strategy, the ECB is still using a strict target of ‘slightly below 2%’. Not only is this a target that is extremely low for a
monetary union that is after all still heterogeneous and in which inflation pressures coming from workers in sectors that are sheltered from international competition and who try to keep up with wage increases in the open/higher productive sectors, can tip the inflation balance quickly over the 2% (Balassa-Samuelson effect). Moreover, an intensive coordination of wage policies between national trade unions may be more fruitful when led by a number of limited participants. For instance, the three major economies of EMU represent a weight in the average euro inflation rate of 70%. Mathematically, there is a certain trade off here. The lower the inflation target, the higher the number of countries that need to participate in an intense coordination exercise in order to respect the 2% inflation benchmark. For example, with two of the major economies going for 1.5% inflation, the third one having 2% inflation, and the remaining 30% of EMU members going for 3% inflation on average, inflation on the euro level amounts to 2.05%, thereby breaching the ECB’s stability target. Intense coordination of collective negotiations would then need to be organized with a higher number of participants, thereby making matters somewhat more complicated.

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Can reform of the Macroeconomic Dialogue improve macroeconomic policy-making in Europe?

1. Introduction

Several contributions to this volume deal with the theoretical arguments for a coordinated economic policy in the European Economic and Monetary Union (EMU). On the basis of both economic and political-science analyses, they show why the assignment of economic policies to policy-makers set out in the Maastricht Treaty can lead – and has actually led – to sub-optimal economic and employment performance in Europe (see also Watt/Hallwirth 2003). Other articles (Koll in this volume) describe the intentions behind, the scope of and the institutional workings of the Macroeconomic Dialogue (MED), as an element in the coordination of economic policy in the European Union (EU).

This contribution forms a hinge between these two types of work. It takes as given the need for a different and deeper form of coordination of macroeconomic policy – conceived as encompassing monetary, fiscal and wage policies. It does not, however, set out an ‘optimal’ alternative economic policy-making architecture. It is of course necessary to take forward theoretical development in this area. However, the political reality of governance structures in the EU are such that, for the foreseeable future, the best that one can expect is an incremental reform of precisely those institutional structures that constitute the current economic policy-making regime and thus those that, in the view of Keynesian-oriented economists and actors (notably the trade unions), are a ‘part of the problem’. Why this is the case is explained in the first section. The article then considers to what extent
progress can be made within the existing policy-making regime and poses the question whether a more effective MED could be 'part of the solution'.

2. Fundamental reform of the Maastricht architecture unlikely

2.1 Institutions and reform in the EU

The term ‘reform’ has arguably become the most over-used buzzword in political discourse and in the media. Demands for reform from politicians and commentators have become an incessant mantra. On the other hand innumerable reform obstacles and blockages have been identified, caused by those who, in defending their sectional interest, block those changes whose implementation is considered vital in the general interest: often trade unions are seen as being the worst culprits in this regard.

The debate about reforms – conducted in Europe under the umbrella of the so-called Lisbon Strategy to make the EU the ‘most competitive’ economic region in the world by 2010 – exhibits a number of paradoxes. Clearly there is a deep-seated dissatisfaction and uncertainty in our societies that make reforms seem necessary. Often this necessity is linked to the supposed demands of globalisation and faster technological and market change. On the other hand it appears to be extremely difficult to get majority political support for any one reform strategy. It is widely held that some countries have made more progress in the ‘reform race’. Indeed it has been argued that small countries have an advantage over their larger neighbours in a period of fundamental change, as it is easier, so the argument runs, for them to reach the necessary social compromises.

Yet all these claims suffer from challenges and contradictions. For a start, it is far from clear that the structural changes under way in our societies are actually occurring at a faster pace now than in recent decades. At least, both productivity growth and demographic trends are slower than, say, in the 1970s. Nor does the alleged advantage of small countries appear to be consistent either over time or geographically.

Another paradox is that, in a society and economy that are increasingly seen as ‘globalised’, the need for reforms is perceived to be almost exclusively at
the national level. Although demands for reform are also addressed to the European or even the global level, this is very largely in the context of vague political speeches that remain without political consequence. It is very much the national (or sub-national) level that is at the cutting edge of the reform process, at least in Europe.

There is then, perhaps, something in the ‘small versus large’ distinction, although it takes a rather different form from that commonly supposed. Changes and reforms are more likely to be achieved when there is a political culture across a territory that is conducive to social discourses leading to compromises that enable the institutional framework to react to changes in the environment in such a way that the ‘losers’ can accept the changes and/or be compensated for them.

Clearly there is virtually no scope for such processes at global level. It remains a Hobbesian world in which the rule of law does little to constrain the representatives of (supposedly) national interests in their dealings with one another. Each country has an opt-out and — with exceptions such as Iraq confirming the rule — a right of veto regarding its so-called ‘internal affairs’.

As is well known, the EU is located somewhere between the traditional nation-state and the intergovernmental ‘world order’ (or disorder). It has supranational elements — such as the European Parliament and the European Commission, and policy ‘competence’ in a number of areas (trade, agriculture). However, key areas, and certainly the economic policy areas that we are primarily concerned with here, remain largely in the hands of the Member States, even if there is some ‘soft’ policy coordination at EU level. Major decisions still require unanimity, while the size of the majority required for other decisions is much larger than in Member States (where 50%+1, and sometime less, is sufficient), within a much more fragmented polity. Even if the EU is ultimately on a road to a federal union, which is by no means certain, that road is clearly long and winding.
Alongside cultural, linguistic and other factors, one of the consequences of this is that decision-making processes in the EU are famously tortuous, as evidenced by, for instance, the ‘thirty-year war’ over the European Company Statute. This, in turn, has another implication, one that is less commonly recognised. If agreement is reached at a particular juncture within a regulatory field, leading to a decision on a political-institutional change in the EU, then this outcome is effectively ‘set in stone’: the outcomes of lengthy negotiating processes, often strung together in the form of substantively incoherent ‘packages’, once reached, are extremely difficult to unpick. Changes in existing institutional forms generally thus require a ‘window of opportunity’ in the form of a crisis in those institutions or a favourable political constellation. To sum up: the reverse side of the coin of lengthy and difficult negotiating processes in a fragmented polity is the inertia of collectively agreed ‘solutions’ once they have been established, even if they are ineffective or their primary raison d’être – as with the common agricultural policy – has long ceased to exist.

The impact of these two fundamental facts about the way the EU operates can be seen in exemplary form in the case of economic and employment policy.

2.2 Establishing and reforming economic policy-making institutions in the EU

At the risk of oversimplification, two phases of institutional development in the economic and employment policy field can be distinguished. The first, and more important one, took place in a period of neo-liberal, the second, as it were ‘compensatory’, phase during a period of social-democratic political hegemony. The first phase, which built on the Single Market programme of the late 1980s, brought us in the mid-1990s the Maastricht Treaty that led to the common currency, the euro, at the end of that decade. Given the strong veto position held by Germany (and in particular the German Bundesbank) and the predominance of liberal-conservative governments – not to mention the longer-term predominance of neo-classical/monetarist economists within the discipline – the single currency
could only be realised at the ‘price’ of an institutional regime that, formally, was oriented to an extreme extent towards the goal of price stability. The European Central Bank was established as the most independent in the world (Janssen in this volume). It was given the primary task of ensuring price stability, and was allowed itself to define its own target, unlike other inflation-targeting central banks, such as the Bank of England, whose inflation target was set by the UK government. The target set by the ECB – initially ‘below 2%’, subsequently revised to ‘below but close to 2%’ – has not been achieved by any industrialised country in recent decades, not even by Germany, the anchor country of the European Monetary System with its role-model ‘stability culture’.

At the same time the Maastricht criteria forced countries seeking to enter EMU to adopt a strict consolidation course in their fiscal policy, at a time when many were struggling to emerge from the recession of the early 1990s. These principles were maintained, and indeed tightened significantly, for the EMU members in the form of the Stability and Growth Pact (SGP), which requires member states, under threat of massive financial sanctions, to achieve a balanced budget or a surplus over the cycle. In an economy with positive nominal economic growth, this means that govern-

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1 This critique is in no way intended to belittle the importance of reducing inflation from its previous excessive levels, nor more generally of ensuring stable price developments. However, inflation is now at historically low levels throughout the world. Japan has been struggling against persistent deflation for years. Particularly in such an environment, it would be rational for policy to focus more on other goals, such as maximising economic growth and employment opportunities. This more balanced approach seems to be the one pursued by the US Federal Reserve. It remains the case, however, that, in the absence of inflationary pressure the ECB is obliged by the Treaty to support the ‘aims of the Union’, which include a high level of employment.

2 This section describes the formal rules: we return to the inability to make them stick later.
ment debt will decline to zero in the longer run. Here again, there is no precedent for such a policy approach in successful industrialised economies in recent times. The fact that a convincing economic argument for the validity of this goal for fiscal policy was never provided shows the strength of the conventional wisdom prevailing during that period and the absolute dominance of the goal of price stability for the entire policy-making architecture.

In the second half of the 1990s, however, the political wind began to turn. One after the other, liberal-conservative governments were replaced by centre-left administrations: at the end of the decade Spain was the only country ruled by a right-wing government. At the same time, and obviously linked to this, unemployment, which had been rising since the recession of the early 1990s, reached record levels in a number of EU Member States. This political-economic constellation opened the way for the second phase of institutional development at EU level.

In this second, social-democratic phase, two institutional innovations were established that can be interpreted as attempts to give, within the institutional regime established by the first, neo-liberal phase, greater weight to the goal of higher employment. These were the European Employment Strategy (EES), including the incorporation of an employment chapter in the Amsterdam Treaty (1997) and the establishment of the Macroeconomic Dialogue (MED) in 1999.3

As indicated at the outset, it is not the purpose of this contribution to describe the functioning or role of these two processes (see Watt 2004 for the EES and Koll in this volume for the MED). What is important in this context is that these institutional innovations aimed to increase the attention given to raising economic and employment growth at the European level,

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3 These are sometimes known as the Luxembourg and Cologne processes, respectively, according to the location of the European Council meeting at which they were first introduced.
without, however, calling into question the essential ‘pillars’ of the Maastricht architecture. This was achieved in a slightly different way in each case. The EES, while having some constraining impact on Member State employment policies, was focussed on labour market (and to some extent social) policy and was thus tangential to the fundamental consensus on macro policy that underpinned the Maastricht Treaty: indeed, the EES can be criticised for distracting attention from the essential macroeconomic dimension of any successful employment policy. The MED, on the other hand, did indeed impact on some of the central concerns of the Maastricht architecture, and in particular the so-called ‘policy mix’, the assignment of policy tasks between the actors. However, the degree of influence exerted by the MED on these policy areas and actors is rather weak, a point to which I return below.

A further window of opportunity for more far-reaching reforms of the economic governance regime appeared to open up at the end of 2001 with the establishment of the European Convention that was tasked with drawing up a new European constitution for the enlarged Europe. In view of the renewed deterioration in the economic situation and growing dissatisfaction with aspects of the regime (especially with the SGP, but to some extent also with monetary policy), there was some optimism that the Convention would call for far-reaching reforms (see for example Watt 2002). These hopes were dashed by the difficulty of generating a consensus in the working group set up to consider economic governance, and then by the failure of the Rome Summit at the end of 2003, at which the heads of state and government could not agree on the draft proposed by the Convention (cf. Schubert 2003)4. The working group is a case in point of the above-

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4 Since then a Treaty has been accepted by heads of state and government (July 2004), although it faces a lengthy and difficult ratification process. Noteworthy in the present context is, in particular, the inclusion of ‘price stability’ as one of the goals of the European Union. This substantially bolsters the position of the ECB, as it now also has its primary goal, stable prices, among the list of its secondary goals.
mentioned conservative bias of the EU: shifting minorities were sufficient to block the various reform proposals made, even those supported by a majority.

The conclusion of this section is sobering. In the form of the Maastricht assignment, liberal-conservative forces have managed to put in place a legal-institutional regime that systematically puts price stability ahead of potentially competing concerns. From the perspective of Keynesian-oriented economists and actors such as trade unions this initial, and most important, battle – to the extent that it was even seriously fought – was lost. Even given favourable political constellations and, at times, unfavourable economic developments, no reforms that would call this economic governance regime into question have been implemented. The outcome of the Convention makes this unlikely in the future. On the other hand, within that paradigm, some smaller fights have been won, leading to innovations that serve, at least, to establish a number of counter-weights within the system.

From the above, those opposed to the Maastricht settlement might draw the conclusion that things must become a lot worse before they can get better, that the ‘pain’ must rise above a considerably higher threshold before the pressure for more fundamental changes becomes irresistible. In my view reliance on such a mechanism is a high-cost and high-risk strategy, if it can be called that at all. To see why, it is necessary to go beyond the rather formalistic view of the economic governance regime described in the previous section. The rest of this article seeks to make a case that the existing instruments within the economic governance regime could be used more effectively and that changes in actor behaviour are possible within the existing rules of the game that would enable the EU to make progress in achieving faster economic and employment growth.

If ratified this would virtually immunise it from criticism that it has not paid enough attention to the real economy.
3. Important considerations regarding the economic performance of EMU

This short section does not seek to provide a comprehensive evaluation of the performance of the EMU (cf. Hein/Truger in this volume). However, it is important in determining the strategic approach to be taken to EMU that evaluations are based not only on what is set out in the treaties, or indeed on the views expressed by certain representatives of the institutions involved, but on the actual path taken by policy-makers.

A number of salient facts, sometimes forgotten by EMU critics, must be taken into account in any such evaluation. The first is that the EU created around 12 million jobs between 1997 and 2001, the employment rate rose from 60% to over 64%, and progress was made in reducing unemployment – the average EU rate fell from over 10% to 7.3%. Of course it is also true that this phase was short-lived, indeed was brought to an untimely end, not least due to the excessively restrictive stance of monetary policy in 2001/2. This can indeed be seen as the result of an excessive (or misconstrued) stability orientation (e.g. Watt/Hallwirth 2003, Horn 2003 and Ronald Janssen and Hein/Truger in this volume). Even so in the current phase of rising unemployment it should not be forgotten that substantial economic and employment growth is possible under the current economic governance regime. The key issue, then, is to find ways of stabilising and prolonging the growth process. This means that collective wage bargainers need to assume a greater role in holding down inflationary expectations, especially in the case of external supply shocks.

Secondly, alongside this ‘time’ dimension, the spatial dimension also needs to be considered. Germany, which since the early 1990s has been struggling with the consequences of unification for its fiscal and wage policies, leading to slower growth and low inflations, has so far been the clear ‘loser’ of EMU. No-one – not even those who consider that the monetary policy of the ECB has been consistently appropriate for the euro area as a whole – disputes that real interest rates have been too high in Germany. A re-
incarnated Bundesbank would certainly have set base rates for Germany lower than the ECB has done for the entire currency area. It must be recognised, however, that this problem exists in all currency areas: faster-growing regions with higher inflation have lower real interest rates, and vice versa. In any evaluation, justified German complaints about the impact of the governance regime on growth and employment must be set against the very substantial economic successes that have been achieved by some – smaller – EMU countries. Particularly in the case of Spain and Greece, this success is very obviously a direct consequence of monetary union: EMU removed the risk premiums that these countries had to pay, which increased borrowing costs and thus reduced investment and growth. Via trade effects this faster expansion will increasingly feed back into higher export demand for the other EMU countries.

A third important fact is that the uncompromising stability rhetoric has at times been precisely that: rhetoric. Since January 1999 the HICP inflation rate has been above the maximum rate of 2% tolerated by the ECB for more months than it has been below. This has led to criticism from liberal economists (cf. Gali et al. 2004). This indicates that in reacting to negative supply shocks the ECB, irrespective of its rhetoric, has in practice recognised the real economic costs of (too) rapidly bringing down the inflation rate in the wake of an up-tick induced by higher import prices.

Fourthly, a similar case can be made with regard to the SGP. Whatever is written on paper, the fact is that the Pact has proved unworkable in practice.

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5 Such national differences need to be addressed by national policies, in particular fiscal policies – which is one of the main reasons why the SGP is so inappropriate – and wage policies. At the same time these policies need to be set within a European coordination framework (these issues are discussed in Allsopp/Watt 2003).
and currently finds itself in a major crisis. The large economies have been able to run fiscal deficits in excess of 3% for extended periods\textsuperscript{6}.

Both monetary policy and the SGP have recently been evaluated by their respective institutions at European level. In the case of the ECB a number of pragmatic reforms were introduced that, in sum, served to close the gap somewhat between rhetoric and reality: the inflation target was re-specified and the monetary pillar downgraded (for details and a critique see Watt/Janssen 2003). At the time of writing the European Commission is preparing a major review of the SGP. It is expected that measures will be proposed to make the fiscal policy rule more symmetrical, and possibly making greater allowance for capital spending and the level of outstanding government debt\textsuperscript{7}.

A fifth consideration is that, however justified the criticisms made of the current economic governance regime are, the weaknesses of its predecessor should not be forgotten. In the situation characteristic of 2003, for example, marked by a strong depreciation of the US-dollar, serious tensions would have emerged within the European Monetary System (EMS), with negative consequences for growth and employment. In fact, more generally the creation of the euro area opens up the opportunity of reducing the external constraints on expansionary macroeconomic policies that European countries had experienced during the 1980s and 1990s. What is disap-

\textsuperscript{6} Note that this is merely to point out a discrepancy between theory and practice, and not to argue that governments should not be allowed to run larger deficits to offset phases of weak demand. They should.

\textsuperscript{7} Press statement by Commissioner Almunia, 24 June 2004. It seems therefore that fairly far-reaching reforms are in fact possible in the area of fiscal policy. It is important to note in this context that the SGP does not form part of the Treaty, but is an agreement between heads of state and government, and is thus correspondingly easier to renegotiate.
pointing and worthy of criticism is the failure to make use of this opportunity.

In order to avoid any possible misunderstanding, the point of this section has not been to defend the current economic governance regime in the EMU. It is and remains the case that to a very substantial extent the supposed ‘structural’ problems facing the European economy are in fact the result of a one-sided approach to policy-making that has imparted a restrictive bias to the policy mix and kept unemployment higher than necessary. A somewhat higher and clearly symmetrical inflation target – which the ECB could decide to adopt autonomously – would be one important step towards a more balanced policy-mix. This critique must be repeatedly put forward in public debates on the subject. However, in terms of the strategic debate as to how best to achieve better employment and economic growth outcomes, given the very high degree of inertia characteristic of European policy-making and the continued predominance of neoliberal economic thinking, it is vital to start from a realistic and balanced analysis of the existing regime that focuses on actual outcomes over time and in the area as a whole. In particular, little is gained by constructing a ‘straw man’ based on Treaty texts and statutes or political declarations.

The political conclusions emerging from the analysis so far can be summarised in the following three theses.

– Fundamental reforms of the economic governance regime are highly unlikely;

– A strategy of ‘waiting for the crisis’ – on top of its short-run costs – is unlikely to succeed, as the regime has shown itself to have sufficient flexibility and the political actors enough sense of realpolitik to avoid serious crises: what would be more likely would be an extended period

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8 Given that this would imply a loss of credibility for the ECB, such a step is unlikely, however. Otherwise it would surely have taken the opportunity of the review of monetary policy in the spring of 2003 (discussed above) to take such a step.
of sluggish economic performance, during which, over time, the expectations of actors adjust downwards so that, while the pain increases, the pain threshold also rises;

– On the other hand this flexibility opens up some scope for a better economic policy, in the absence of (unlikely) changes to the Treaty. Such a better policy requires behavioural changes by the key actors and a strengthening of existing institutions that coordinate their actions.

It is to this last aspect that we now turn, with a focus on the MED.

4. A more effective MED as part of a reform strategy

What do we want European economic policy to do? Leaving aside fiscal policy for a moment, the key issue is to ensure a sufficiently expansionary monetary policy, as in the short run it is monetary policy that determines effective demand and thus economic and employment growth. In both political and economic terms, this is only possible if other policies are used to ensure an adequate degree of price stability. In principle this is possible by means of coordinated wage policies, by virtue of the strong links be-

9 As noted above, a number of improvements are in the pipeline in this area. Moreover, fiscal policy does not play a central role in the MED, which is the focus of attention here. If it proved possible to establish MEDs also at the national level (see below) the role of national fiscal policy and its coordination with wages policy in particular would once again move centre-stage.

10 Contrary to the conventional wisdom, monetary policy can also have positive effects on employment in the long run because, buttressed by appropriate labour market and other policies, the additional investment it induces and the incorporation of additional people into the labour market (discouraged workers, induced employer-provided training) reduce not only the unemployment rate, but also the level of structural unemployment (or the NAIRU). That this works in practice is evinced by the USA in the latter part of the 1990s, where unemployment was reduced far below what was universally considered to be the NAIRU (cf. Wart-Hallwirth 2003, Hein 2004).
between nominal wages, nominal unit labour costs and the rate of inflation (for details see Watt/Hallwirth 2003: 622ff.). In the context of a coordinated wage policy oriented towards the maintenance of price stability, the central bank can and should constantly ‘test the water’ by maintaining an accommodating policy stance to find the maximum level of employment (or minimum level of unemployment) consistent with stable prices.

Overall there has been no lack of the necessary wage discipline in Europe in recent years. Indeed, in the aggregate the growth of real wages has lagged behind the rate of productivity growth, implying a continuation of the shift in the distribution of income in favour of owners of capital and to the detriment of wage-earners, and downward pressure on inflation. Where this was briefly not the case, it was largely due to the unexpectedly sluggish growth of labour productivity, which, in turn, is partly explained by the failure of monetary policy adequately to shield the real economy from the downturn (Jansen/Mermet 2003). At least, this finding of a stability-oriented wage policy in the euro area as a whole emerges from an ex post analysis. However, this did not have a sufficient impact on the course set by monetary policy, because the ECB sets (or is supposed to set) interest rates today in the light of its forecasts for economic developments 12-18 months hence. Without going into detail on the games-theoretical considerations behind this (see for instance Heise 2001), it is clear that the ex post maintenance of wage discipline is not a sufficient condition for the central bank to focus on growth and employment; rather the stability-oriented course of wage policy must be credible ex ante, in terms of future developments, and irrespective of unexpected shocks (such as higher import prices). Two conclusions can be drawn from this for economic policy.

Firstly, collective wage bargaining must be reliably oriented towards medium-term variables, in particular the rate of productivity growth and the target inflation rate of the central bank. This is the task of the social partners and particularly the trade unions. This can be termed ‘internal social dialogue’. The very substantial obstacles to establishing such a strategy and making it stick cannot simply be wished away. But at this point I merely
refer to the efforts made by the European Trade Union Confederation (ETUC), the European Metalworkers Federation (EMF) and various cross-border regional initiatives (notably the so-called Doorn group); further details can be found in Janssen/Mermet 2003 and Janssen in this volume. A prime aim must be to increase the extent to which unions can commit affiliates and members, sustaining and strengthening collective bargaining coverage and multi-employer bargaining. To achieve this will require overcoming some resistance from parts of the trade union movement itself, but particularly, of course, from those who see an untrammelled decentralisation (or even individualisation) of wage determination as a path to better economic performance in Europe.

Secondly, those responsible for wage policy and monetary policy must interact constructively: forms of cooperation and coordination must be found and strengthened. This can be termed ‘external social dialogue’. In the context of EMU this implies, given the limited scope for major institutional reform identified above, in the first instance strengthening interaction by developing and expanding the MED.\(^\text{11}\).

5. Reforming the Macroeconomic Dialogue

During the first MED meeting at technical level of 2003\(^\text{12}\), it was decided to perform a sort of internal evaluation of experiences with the first four years of the macro dialogue. All the actors were requested to put forward their views to the second meeting concerning the way the institution had performed and, where appropriate, to make suggestions for reforms. At this second meeting the trade union delegation presented a position paper in

\[\text{\textsuperscript{11} It is not difficult to envisage more intensive forms of institutionalised coordination, such as have existed in a number of countries (Austria, Belgium); the point is that they are likely to be politically unfeasible at EMU level for the foreseeable future, hence the need to develop the already existing MED.}\]

\[\text{\textsuperscript{12} The reader is reminded of the detailed description of the MED by Koll in this volume.}\]
response to this call, containing an analysis and a series of reform proposals. Unfortunately this effort was not matched by the other actors. Nonetheless, the presentation by the ETUC delegation did give rise to a lively debate on the purpose and effectiveness of the MED.

In the ETUC analysis the MED was welcomed as a useful forum for dialogue, the only occasion in which all those actors responsible for the policy mix come together. However, the MED has not achieved the potential opened up by the Cologne Council (not to speak of a more far-reaching policy coordination). Specifically, the trade unions raised the following main points of criticism.

- The time available for discussion – 13 hours per year (!) at the technical and around four at the political level – stand in no relation to the importance that should be attached to a process of on-going exchange on the economic policy mix. Moreover, of the limited time available, a substantial proportion is used for exchanges of well-known facts and positions (not least on discussing the Commission’s economic forecast). As a result genuine debate on the policy mix to be aimed for, policy goals (for instance in the context of the EU’s Lisbon targets) and the scope for coordinated action is few and far between. Discussions are too focussed on the past and the present, and too little towards future policies.

- The concrete impact of the MED on its participating institutions and on policy-making remains unclear. In particular, there is currently no way for the MED to send out ‘signals’ to the outside world, which could have a stabilising impact on expectations and thus on the economic developments themselves.

- The MED, meeting solely at the European level, does not take the multi-level nature of policy-making in the EU into account: there is a lack of articulation between activities at the different levels.

- Fiscal policy is inadequately represented. Representatives of the ECOFIN Council have tended to use the MED to push the agenda of
structural reforms, which is not a focus of the MED and for which there are numerous other forums.

– There is a lack of ongoing communication between MED meetings and documents are often only made available shortly before meetings (and in some cases not at all).

Based on this analysis the ETUC delegation proposed the following steps to render the MED more effective, as part of the development of a European MED, articulated with comparable bodies at national level, as the core of a system of European economic governance.

– Various ways of extending discussion time and focussing the debate were suggested: additional meetings (quarterly), longer meetings, an enhanced role for the preparatory steering committee meetings, workshops between meetings on relevant technical issues, etc.

– In order to make the debates more policy-relevant, quantitative development scenarios for the European economy should be developed (with the support of external research institutes) to indicate possible consistent mixes of actions by the participating actors. Working groups should be set up to reach agreement on appropriate indicators and definitions.

– In order to intensify the weak vertical communication linkages, the establishment of a parallel structure of national MEDs should be considered (cf. Willi Koll in this volume). Such meetings are already being held at technical level in Germany. Of course, in many EU countries diverse forms of tripartite coordination and exchange occur between the social partners and government. On top of, or as part of this, and respecting national specificities, regular meetings of the national fiscal authorities, the national central bank and social partners should be held to ‘shadow’ the MED at EU level.

– Consideration should be given to finding ways in which, without en- croaching on confidentiality and thus also the open nature of ex-
changes, the MED could be used to strengthen the confidence of wider actors in European economic governance. One option might be for the meetings at political level to issue a joint communiqué.

The reaction of other actors, seemingly unprepared for such an initiative, was cautious and, in some cases, negative. The Commission and ECB, in particular, insisted on the need for a ‘light’ form of institutionalisation of the MED. However, the opposition seemed focussed more on raising the ‘inputs’ in terms of the time devoted to the Dialogue. The proposals for a more effective and policy-oriented discussion were well received. The institution of national MEDs was not rejected, but was thought to be a matter primarily for national actors to decide on. The debate continued at the first meeting of the steering committee in 2004. A set of technical reform proposals was presented, largely based on the input given by the trade union delegation to the previous technical level meeting. A considerable degree of agreement was reached in all those areas in which the work of the MED could be made more effective, although there was continued resistance to the commitment of additional resources. Delegations were encouraged to sound out their national-level memberships regarding the MEDs at national level.

Thus the debate on reform of the MED is set to continue in the course of 2004. The broadly encouraging response to trade union proposals, limited in scope as they are, poses the question as to the priorities for European trade unions – and for researchers and academics sympathetic to the labour movement – in this area in the future.

6. Outlook

On the basis of the preceding analysis, the priorities for European trade unions in the short run regarding the MED should in my view be the following:

– Ensure that those organisational improvements to the MED which appear to have won support, or at least acceptance, from other actors are actually implemented.
Reform of the Macroeconomic Dialogue

- Improve and intensify the unions' own contributions to MED meetings. This implies a greater degree of cooperation both between the ETUC and its affiliated union federations, and between those officials responsible for economic and for collective bargaining policy, at both European and national level. Already it is planned to pool and channel national trade union views on economic and wage developments more effectively, so that they can be fed into the MED at EU level.

- Launch an initiative among national affiliates to promote the establishment and development of national MEDs. Attempts should be made to obtain financial and/or organisational support from the European Commission, as is provided for other aspects of the so-called Social Dialogue.

And in the medium term? A number of building blocks of the Maastricht compromise have begun to shift, albeit slowly. The changes so far are small and their importance as such should not be overstated. But they are all steps in the right direction, suggesting a shift in the framework of the debate. Already the actions of the policy-makers are more pragmatic than their words – and it seems that it is the words that are being adapted to reflect practice, and not the other way around. There are grounds for optimism that trade union efforts to reform the MED will bear at least some fruit in the course of 2004.

It is my conviction that the trade unions should seize the opportunities opened up by the MED. Of course trade unions and their members will benefit in a general way from any improvement in the economic and employment situation brought about by a more coordinated economic policy. Historically low unemployment has been a condition for the realisation of a whole range of progressive social goals. But there are more specific reasons. Higher nominal wages do not necessarily – and not even probably – lead to higher real wages. And for as long as unemployment remains high, unions are in any case hardly in a position to push for substantially higher wages. The problem is that this ‘wage moderation’, whether due to weakness or a
recognition of longer-term interests, has not sufficiently been rewarded by an expansionary monetary policy. The string of interest rate hikes in 2000, which helped bring the European recovery to an untimely end, would have been, in part, unnecessary, if the ECB, in advance of the fact, had been convinced that nominal wages would not respond to rising inflation on the back of higher import prices – which is in fact what broadly happened. One must hope that good arguments ultimately prevail. The ECB must understand that intensive cooperation with trade unions is an opportunity for a better monetary policy, and not a threat to the monetary authority, and thus lies in its own interest. This is the pre-condition for simultaneously achieving stable prices and full employment.

At the same time, this offers trade unions the chance to establish themselves as strategic actors. Given the substantial pressure in some quarters for a more or less uncontrolled decentralisation of wage determination, with all that implies for social cohesion in our societies, the trade unions have a considerable interest in overcoming the barriers to dialogue with the ECB (and national central banks) and gaining a recognised seat at the economic-governance table. It is true that the ECB is among those actors calling for decentralised collective bargaining. Yet at the same time it calls on wage bargainers to take on responsibility for the overall economy, for employment. This clearly contradictory position cannot be maintained indefinitely. In this area academic research – including that by international organisations such as the OECD and IMF that cannot be suspected of pro-union bias – exhibits an unusual degree of agreement: coordinated wage policy is associated, particularly in the context of an independent central bank, to better macroeconomic performance (both unemployment and inflation); see OECD 1997, IMF 2003; for a critical review see Howell 2004).

The ECB is the most independent central bank in the world. The potential advantages of more intensive cooperation between it and the trade unions are substantial. The performance of the European economy is unsatisfactory, and the degree of dissatisfaction with the economic governance regime
is growing, including among mainstream commentators. On the other hand, given its very strong legal position, the ECB cannot be forced to do what is in its own interest. A difficult, but in my view the most promising, strategy is one that simultaneously seeks to strengthen the ‘internal social dialogue’, in order to increase the degree to which unions can enter into commitments on wage trends and increase their bargaining power; continue and intensify the rigorous, but constructive, criticism of the economic governance regime; make greater efforts to point out the advantages of co-operative behaviour between actors, building on existing and conducting additional research in this area; and continue the dogged search for viable institutional forms of such cooperation and the political majorities needed for their implementation.

References


The role of the trade unions
Foundations and perspectives of trade union wage policy in Europe*

1. Introduction

Since the 1980s most European trade unions have lost much of their organisational and political power and influence. Against the backdrop of persistent mass unemployment and increasing numbers of precarious jobs, trade unions in most European countries have suffered significant losses of membership. At the same time, trade unions are weakened by neoliberal reforms of labour market institutions and welfare state regimes, whereby they often lose their former channels of access and influence on political decision-making.

The increasing political and organisational weakness of the European trade unions is not without repercussions on collective bargaining and wage formation. Conceptions of solidaristic wage policy, developed and applied by the trade unions in the post-war period, are in deep crisis, and trade unions are less and less capable of fulfilling their political and economic core function – namely to “take wages out of competition”. The dominant maxim, instead, is the neoliberal concept of competitive wage policy, in which the development of labour costs is the core parameter of international competition between countries and regions as business locations.

* This paper summarises key results of a large study, recently published in German under the title “Solidarische Lohnpolitik in Europa” (Schulten 2004a).

1 For a comprehensive overview over the development of the European trade unions see, for instance, the study by Boeri, Brugiavini and Calmfors (2001).
The crisis of solidaristic wage policy has far-reaching consequences in the realms of both distributitional politics and economic policy. The position of wage earners in the income distribution has gradually deteriorated vis-à-vis the recipients of capital income, while the income differentials between different segments of the workforce have substantially increased. At the same time wage policy is becoming increasingly incapable of fulfilling its main macro-economic functions. During the past decades, wage policy could neither contribute to sufficiently strengthening private consumption, nor was it an adequate safeguard against deflationary tendencies in the development of prices.

Overcoming the defensive position in collective bargaining has become a matter of survival for the European trade unions, without which they are unlikely to surmount their political and organisational weaknesses. Considering the degree of political and economic integration in Europe, trade unions can no longer stick to purely national strategies. Since the 1980s the key political projects of European integration have played a major role to force the neoliberal reorganisation of European capitalism (Bieling and Steinhilber 2000). Especially the introduction of the European Monetary Union has turned out to be an important political catalyst, which put the need for a Europeanisation of wage policy and collective bargaining on the trade unions’ agenda. A number of trade union initiatives have meanwhile developed, aiming at European coordination of wage policy. The first goal of these initiatives is to lay down a set of shared ground rules and objectives for national wage policy, which are supposed to prevent competitive underbidding of labour costs and wage dumping. Although the majority of these initiatives are still on their initial stages one can already identify several points of contention and impediments to full success, which might obstruct effective collective bargaining coordination. The experience hitherto indicates that it will not be enough to establish collective bargaining coordination as a mere technocratic procedure. The trade unions need an overarching political project instead, which will amount to nothing less than striving for a reconstruction of solidaristic wage policy in Europe.
2. The concept of solidaristic wage policy

Against the backdrop of an increasing socialisation of wage policy and the recognition of its macroeconomic significance, in the first decades of the 20th century European trade unions started not only to demand for as high as possible wage increases but to justify these demands with economic arguments. In addition to the moral economy of trade union wage policy an independent political economy has emerged which is not only based on normative concepts such as fair compensation or equitable income distribution, but which also claims to be economically “rational” in order to contribute to a better functioning of capitalism. The concept of solidaristic wage policy as it was developed by the European trade unions in the post-war period can be understood as an integrative approach connecting both moral economy and political economy of wage formation (see Table 1 on the next page). The core importance of solidaristic wage policy lies in the principle of decommodification, according to which the price of labour is not set by supply and demand, as it is for a regular commodity, but instead by collective agreements, which are themselves the result of political struggles and regulation. From the perspective of trade unions, solidaristic wage policy includes both normative and economic objectives.

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2 The concept of the moral economy was originally developed by the British social historian Edward P. Thompson (1971), who sought to conceptualise the relevance of everyday norms and values for economic behaviour. Later it was especially Peter Swenson (1989), who made the concept amenable for the study of trade union wage policy and promoted an integrated approach comprising both the moral and the political economy. See also Schulten (2004a 136ff.).

3 The term solidaristic wage policy was coined originally in Sweden during the 1920s, and after the Second World War it was used to characterise the Swedish collective bargaining system (Swenson 1989). I will use the term more broadly in this article, in order to depict the basic principles of solidaristic wage policy, which extend beyond the specific Swedish context and could be found in one way or another in almost all European countries (see also Schulten 2004a: 134ff.).
Table 1: The concept of solidaristic wage policy

<table>
<thead>
<tr>
<th>Distributional conflict</th>
<th>Between classes (capital and labour)</th>
<th>Within classes (between different groups of employees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal goals of wage policy</td>
<td>High wages</td>
<td>Egalitarian wage structures</td>
</tr>
<tr>
<td>Normative goals (moral economy)</td>
<td>Redistribution (expansive wage policy)</td>
<td>Equal pay for equal work</td>
</tr>
<tr>
<td></td>
<td>Distributional neutrality (productivity-oriented wage policy)</td>
<td>Fight against wage discrimination</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Reduction of wage dispersion</td>
</tr>
<tr>
<td>Economic goals (political economy)</td>
<td>Stabilising demand (consistency between mass production and mass consumption)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Improving innovations and productivity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Safeguarding monetary stability</td>
<td></td>
</tr>
<tr>
<td>Institutional precondition</td>
<td>Multi-employer bargaining</td>
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</tbody>
</table>

Source: Author’s compilation on the basis of Schulten (2004a)

At the outset of every collective bargaining round there are more or less clearly articulated normative views about distributive justice, with which the trade unions justify their wage claims, and which form the most important political-ideological resource for political mobilisation of trade union members. In this, trade union wage policy always faces a twofold distributive conflict, comprising distribution between capital and labour on the one hand, as well as potential distributional conflict “within one class”, that is, between different groups of employees, on the other hand.

Regarding the former, distributive conflict between capital and labour, the trade unions seek to obtain significant wage increases. In the moral economy of trade union wage policy, one can distinguish two variants of this. The first variant is the concept of expansive wage policy, in which the goal is to correct the current income distribution between capital and labour,
deemed inequitable by the trade unions. A redistribution of income from capital to labour could be reached by expansive wage increases, that are, wage increases that exceed productivity growth. The second, more modest variant is the concept of *productivity-oriented wage policy*, which aims at a situation in which capital and labour get an equal share in the fruits of productivity growth. The normative goal of this more modest variant is not the modification of the existing income distribution between capital and labour, but in principle neutrality of wage policy in its distributive effects.

With regard to the distributional conflict "within one class", the normative goal is to fulfil the principle of “equal pay for equal work”. What is at issue here is wage setting according to criteria that are politically agreed upon and “objective” in the sense that they relate to things like an employee’s skills or a workplace’s tasks, and not to the economic situation of the firm in which an employee works. Another facet of the principle of equal pay for equal work is that it also seeks to eliminate wage discrimination of specific groups of employees, such as women, migrant workers etc.. Finally, solidaristic wage policy aims at reducing overall wage differentials between the different groups of employees in order to get a more egalitarian wage structure.

The moral economy of wage formation finds its complement in the *political economy* of trade union wage policy, according to which the concept of solidaristic wage policy is associated with certain macroeconomic functions of wage developments, aimed at fostering economic growth and stability. *In the first place*, this pertains to the function of wage policy as one crucial factor to stabilise consumer demand in order to make sure that mass production and mass consumption are in a consistent relation to each other. This demand-function of wage policy has to be supported by collective agreements that exhaust the growth of productivity or even supersede it as well as by a more egalitarian distribution of income.

*In the second place* solidaristic wage policy has a specific function of fostering innovation at company level, because it prevents enterprises from trying to
obtain competitive advantages primarily by way of reducing their labour costs. Solidaristic wage policy acts as a “productivity whip”, forcing the firm onto a trajectory of permanent innovation. Connected with solidaristic wage policy, therefore, is a particular model of capitalism, which pursues a “high-road-strategy”, with the nexus of high wages and high productivity as the centrepiece of that strategy.

In the third place, solidaristic wage policy fulfils an important function for safeguarding monetary stability. In boom-times the orientation toward an egalitarian wage structure and a parallel development of wages across sectors and firms prevents competitive outbidding of particularistic wage claims and can thus curb the danger of wage-price-spirals. In times of economic slowdown solidaristic wage policy forms an important safeguard against deflationary tendencies that can result from wage cuts in absolute terms and a disproportionate amount of wage restraint.

The realisation of solidaristic wage policy hinges on a number of political and institutional preconditions. An important aspect of these conditions is the existence of politically influential trade unions with high mobilisation capacity. In addition, the trade unions need centralised collective bargaining institutions, facilitating the regulation of wage structures above the firm level. Collective bargaining must have a high degree of centralisation, and bargaining agreements must either be reached on the national level, or when reached on the industry level, they must be coordinated across industries on the national level. Only then is it possible to attain an overarching orientation of wage policy, capable of fulfilling the normative and economic goals of solidaristic wage policy.

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4 Potential inflationary dangers can be the result of an expansive wage policy, by contrast, if labour unions are able to achieve collective agreements above the productivity growth over longer periods of time. The expansive variant of solidaristic wage policy, unless it generates productivity growth that ex post justify the expansive wage increases, depends on a supporting economic policy, which prevents firms from shifting their increased labour costs onto the prices.
3. From solidaristic to competitive wage policy – long-term trends in Europe

In the first two decades after World War II the European trade unions were more or less successful in putting the concept of solidaristic wage policy into practice. The majority of (western) European countries established fairly robust centralised collective bargaining institutions, which ensured the orientation of wage policy toward national goals and complemented the prevailing Keynesian approaches to macroeconomic policy. The periodic wage increases tended to follow the growth of productivity and generated a parallel development of capital and labour incomes, as demonstrated by the fact that the share of labour incomes in national income remained fairly constant over time (see Table 2 on the next page). Moreover, existing wage differentials between the different groups of employees could be levelled in many European countries, so that in many places the overall wage dispersion could significantly be reduced. Bolstering private consumption, securing monetary stability, and fostering productivity growth were the effects of the relatively successful implementation of solidaristic wage policy, which also contributed to the largely prosperous and smooth economic development.

Against the backdrop of a strong political expansion and thriving of the European labour movement, the European trade unions were even able to realize the expansive variant of solidaristic wage policy during the first half of the 1970s. For the first time the trade unions accomplished wage increases above the growth of productivity for several collective bargaining rounds, which effectively led to a drastic increase of the wage share (see Table 2). It also went along with a convergence in the income levels of different groups of employees and a decline of wage dispersion. The radicalisation of solidaristic wage policy, however, was taking place in a period of time in which the lasting prosperity of the post-war era was already coming

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5 For the following passages see Schulten (2004: 164ff.).
Table 2: Adjusted wage share* in the European Union (1961-2000)

<table>
<thead>
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<td>Austria</td>
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<td>75.9</td>
<td>76.3</td>
<td>73.0</td>
<td>69.2</td>
</tr>
<tr>
<td>Belgium</td>
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<td>67.2</td>
<td>72.2</td>
<td>72.1</td>
<td>72.1</td>
</tr>
<tr>
<td>Denmark</td>
<td>67.7</td>
<td>71.5</td>
<td>74.3</td>
<td>72.6</td>
<td>68.2</td>
</tr>
<tr>
<td>Finland</td>
<td>76.7</td>
<td>76.0</td>
<td>73.5</td>
<td>71.9</td>
<td>66.7</td>
</tr>
<tr>
<td>France</td>
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<td>74.8</td>
<td>76.1</td>
<td>75.2</td>
<td>68.8</td>
</tr>
<tr>
<td>Germany</td>
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<td>71.6</td>
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<td>78.3</td>
<td>76.3</td>
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<td>67.5</td>
<td>80.9</td>
<td>73.8</td>
<td>75.0</td>
</tr>
<tr>
<td>Spain</td>
<td>69.6</td>
<td>72.4</td>
<td>74.0</td>
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<td>Sweden</td>
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<tr>
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<td>72.3</td>
<td>73.0</td>
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<td>72.1</td>
<td>72.9</td>
<td>74.4</td>
<td>72.4</td>
<td>69.2</td>
</tr>
</tbody>
</table>

* Nominal compensation per employee in % of GDP at factor costs per employee


to its ultimate close, and the development of the economy started to be characterised by shrinking growth rates, increasing unemployment, and an overall crisis-prone development. To make things worse, wage policy could not act as an anchor for macroeconomic stability any more, because expansive wage policy began to contribute to a significant increase of inflation.

The worldwide economic crisis of the mid-1970s marked the beginning of the end of a period of time in which the European trade unions had managed to reach their principle goals in the field of wage policy and collective bargaining. Since then, the paradigm of solidaristic wage policy has increasingly given away to a new neoliberal paradigm of competitive wage policy.
Drawing on neoclassical wage theory, wages are solely seen as labour costs, and as such are a key variable in the global competition between countries and regions for capital and investment. In this role, wage policy is also being held responsible for economic development and the safeguarding or creation of employment. The neoliberal concept of competitive wage policy pursues a dual strategy. On the one hand “moderate” wage developments, that is, wage increases constantly below the level of productivity increases, are supposed to foster the price competitiveness of the domestic companies vis-à-vis their foreign competitors. On the other hand competitive wage policy calls for a significantly greater extent of wage dispersion, in which wages are a function of the respective economic situation in individual firms and industries.

The crisis of solidaristic wage policy has a material and a political-institutional dimension. In material respects, the European trade unions have rarely been able to realise their distributional goals in recent years. Since the 1980s wage increases have practically continually remained below productivity growth in almost all European countries, which led to a nearly continuous decline in the share of wages in national income and to the massive redistribution of income from labour to capital (see Table 2). At the same time the previous trend toward reduced wage dispersion in the economy has reversed, and the extent of wage inequality between different groups of employees has drastically been on the rise again, even though there is still considerable variation among the different European countries (see Figure 1 on the next page).

With regard to the political-institutional dimension, the crisis of solidaristic wage policy manifests itself in an increasing decentralisation of collective bargaining, and its shift to the company level. Even though there has not been a full-fledged systemic change of the collective bargaining systems in any western European country except the United Kingdom, and centralised collective bargaining still remains the most important institutional form of wage formation in Europe (Schulten 2004b), the company level of regula-
Figure 1: Development of wage dispersion D9/D1 in Europe and the US

tion has become more and more important within the existing centralised bargaining structures. The regulatory power of centralised bargaining agreements is getting undermined to an increasing extent 6.

Moreover, during the 1990s new forms of institutionalised labour relations have evolved, which structurally enforce the principle of competitive wage policy (Bieling and Schulten 2003, Schulten 2004a: 245ff.). On the national level this includes new tripartite social pacts, which commit the trade unions to a competition-oriented wage policy in the context of competitive corporatism 7. The firm-level counterpart of this are the company-level “pacts for competitiveness” burgeoning in many European countries. The latter are based on a kind of “concession bargaining”, in which the company usually promises a limited job guarantee and in return expects consent, on the part of its employees, with various measures designed to reduce labour costs, concessions that in part openly violate regulations of the centralised wage agreements.

The transition from solidaristic to competitive wage policy essentially reduces the role of wage formation to a mere managerial parameter at the disposal to individual firms, whereas its macroeconomic governance capacity is largely lost. The consequences of this micro-economically rational strategy of competitive wage policy are dysfunctional when considered in a macroeconomic perspective. In Germany, for example, the extremely moderate development of wages in recent years is one of the factors explaining why private consumption has fallen short of its potential by far, and important possibilities for economic growth and new employment could not be

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6 Moreover, most of the new member states of the European Union in Central and Eastern Europe do not have centralized wage setting institutions, and collective bargaining agreements – to the extent that they exist at all – are mostly negotiated at the company level (Schulten 2004b).

7 A classical example is the social pact concluded in the fall of 2003 in the Netherlands, in which the trade unions agreed to two years freeze of basic pay (Schulten and Mühlaupt 2003).
used. Equally problematic are the consequences of competitive wage policy for the development of prices, because the strategy is permanently creating deflationary pressure, driving up real interest rates and hindering investment activity.

Finally, within Europe the concept of competitive wage policy essentially boils down to the attempt to solve national economic and employment problems by means of wage dumping and at the neighbouring countries’ expense. Such Beggar-thy-Neighbour policies can be successful niche-strategies for smaller countries for a certain period of time, but sooner or later they will always prompt counter-reactions on the part of the other countries. The largely parallel development of wages in most European countries indicates that a European dynamic of competitive underbidding has already got in motion. Counter to the neoliberal prediction, this significantly diminishes the potential for economic growth and employment, and it is at its core a strategy of continually worsening the position of wage earners in the distributive struggle.

4. Attempts at European coordination of trade union wage policy

With the establishment of competitive wage policy the European trade unions are step by step losing their core function to place political limitations on competition over wages and labour costs. Politically and institutionally secured decommodification of labour is replaced with the mounting re-commodification, which is driven by the neoliberal restructuring and the de facto undermining of existing labour standards and social security arrangements. In view of these developments the European trade unions are caught in a vicious circle. In their core competency of wage policy their influence is waning, which is the decisive factor contributing to their loss of legitimacy, mobilising capacity, and attractiveness vis-à-vis potential new

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8 For the current connection between wage development and deflationary pressures see Hein, Schulten and Truger (2004).
members, which only weakens their bargaining power in collective bargaining further. Therefore, regaining innovative capacity on the terrain of wage policy is one of the central tasks in which the future relevance of European trade unions will be decided.

In view of the extent of European integration already attained, it is reasonable to assume that lastingly overcoming competitive wage policy will not be feasible when restricted to the national level. European integration with its key political projects – such as the Single European Market and the European Monetary Union – is itself one of the crucial factors contributing to the present situation in which the national economic institutions, once supporting and facilitating solidaristic wage policy on the national level, are subject to permanent competition between national regimes and institutional arrangements. The Single European Market has dramatically increased the intensity of competition on the product markets and thus intensified the pressure on companies’ wages and labour costs. At the same time the Single Market project has spurred a comprehensive transnational wave of restructuring within the companies and along with this broadened companies’ exit options from national collective bargaining arrangements (Andersen 2003). Furthermore, the European Monetary Union has created a new macroeconomic context, in which the development of wages has direct repercussions on the price-competitiveness of firms, as the instrument of exchange rate policy is not available as a tool for adjustment any more (Schulten 2001a). Finally, the actors in charge of European economic policy, such as the European Central Bank, the EU Commission’s General Directorate for “Economic and Financial Affairs”, and last but not least the European Council have an important function in lending crucial political and ideological support to the paradigm of competitive wage policy by elevating that paradigm into the status of a guiding principle in their regularly published “Broad Economic Policy Guidelines”.

In view of all these developments, there are currently no reasons to believe that the loss of governance capacity at national level will be compensated with new, supra-national regulatory structures at European level. Some
people refer to the consultation between employers’ associations and trade unions in connection with the European Social Dialogue as “European collective bargaining” (e.g. Sadowski, Ludewig and Turk. 2003), but this is misleading as these talks are in practice part of a mainly “symbolic Euro-Corporatism”, (Schulten 2004a: 262ff.), and has a completely different functional logic. The European Social Dialogue is a precarious institution, only feasible if it remains limited to issue areas which either have a high degree of overlap in the interests of European trade unions and employers’ association or have primarily symbolic character.

For coping with wage setting and distributive conflict, the European Social Dialogue is not a suitable instrument. Even if the EU-Treaty had not explicitly excluded wage policy from the EU’s responsibility (Art. 137, No. 5 of the Treaty), initiatives in the area of wage setting would have been unlikely to appear on the agenda of the European Social Dialogue, because of the structural conflicts of interest between employers and trade unions in this area (Streeck 1999). While for the trade unions limiting wage competition on the European level is one of the crucial preconditions for regaining some of their strength in national collective bargaining, the employers’ enhanced power position is the result of precisely that lack of European wage coordination and results from the possibility to use the European wage competition strategically in the national collective bargaining.

As European level collective agreements are not forthcoming in the near future, the European trade unions must search for alternative ways in which wage competition on the European level can be politically restrained. In contrast to the European Social Dialogue, which has always had also the function to commit the European trade unions to the predominant projects of European integration⁹, in this task the trade unions can hardly hope for much support from the European institutions. The Europeanisation of wage policy will therefore have to be initiated in the context of autonomous and unilateral cooperation among the European trade unions themselves.

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⁹ See the contribution by Richard Hyman in this volume.
Since the late 1990s, a number of new trade union initiatives have in fact evolved, which seek to coordinate wage policy and collective bargaining at European level. The pioneering initiative is the Doorn-Initiative, set up in 1997 between Germany and the Benelux countries, which for the first time set up shared transnational guidelines for collective bargaining policy. Moreover, almost all European Industry Federations, organising the national industrial labour unions, have meanwhile initiated more or less far-reaching initiatives for a European coordination of collective bargaining at sectoral level. The European Metalworkers’ Federation (EMF) plays an important role in leading the way, and its approach for European level coordination of trade union collective bargaining is furthest developed both with regard to its substantive and conceptual positions and with regard to its implementing institutions. Most of the other European trade union committees have learnt from the EMF’s experience when devising their own schemes of wage policy coordination.

Since the year 2000 the European Trade Union Confederation (ETUC) has also been working on a European coordination of wage policy at cross-sectoral macro-level. An independent initiative on the part of the ETUC became necessary on the one hand in order to consolidate the different sectoral approaches and give them some degree of substantive coherence. On the other hand, it also became a forum for the ETUC for developing its own positions for the coordination of wage policy at macro-level, which

10 For an overview over the different trade union initiatives on a European coordination of collective bargaining see: Dufresne (2002) and Schulten (2003, 2004a: 276ff.).

11 The Doorn-Initiative has the name of the Dutch town Doorn, in which the trade unions of the participating countries met in the year 1998 and agreed on a common policy statement about the transnational coordination of collective bargaining, the “Statement of Doorn”, the first written agreement of its kind.

12 For a detailed case study about the EMF’s strategy for collective bargaining coordination see. Schulten (2001b; 2004a: 284ff.).
was important as a tool for gaining some leverage in dealing with the other EU institutions and social actors (European Central Bank, European Council, European Commission, Macroeconomic Dialogue, etc.) as an autonomous and powerful macroeconomic actor.

While the European trade unions had considered collective bargaining an exclusively national task until in 1990s, they have successfully established collective bargaining as a central European political arena since then. The ETUC (1999) has even declared the coordination of collective bargaining — along with European social policy legislation, the European Social Dialogue, and the European Works Councils — as one of the four pillars of a “European system of labour relations”. The trade unions’ conception of coordination explicitly does not seek to establish a supra-national system of wage formation or to reach European level collective bargaining agreements, however, but instead focuses on the coordination of national collective bargaining policies.

At the core of all these trade union initiatives toward coordination is consultation and mutual agreement on shared guidelines and targets, which, when implemented, constrain competitive underbidding of wages and labour standards, and promote the gradual convergence of national minimal standards for collective bargaining. The central point of all these initiatives is the return to a productivity-oriented wage policy, which taps the full potential of distribution as determined by the national development of prices and productivity. The initiatives subscribe to the concept of a wage

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13 For instance, the EMF’s 1989 resolution entitled ”Collective bargaining with the Euro” states: “The key point of reference and criterion for trade union wage policy in all countries must be to offset the rate of inflation and to ensure that workers’ incomes retain a balanced participation in productivity gains. The commitment to safeguard purchasing power and to reach a balanced participation in productivity gains is the new European coordination rule for coordinated collective bargaining in the metal sector all over Europe.” (EMF 2001: 336, my emphasis) In most of the trade union initiatives at coordination the question of which specific numbers for the price and productivity guidelines should form the basis of wage setting coordi-
policy which is neutral to competition and uphold this as an alternative to the predominant pattern of competitive wage policy. In this alternative conception the participants take a conscious decision to give up trying to obtain national competitive advantages on the expense of neighbouring countries by means of wage restraint. Furthermore, the trade unions have begun to define minimum standards in other areas of collective bargaining policy (such as working times, or questions of vocational training and further training), which should be implemented in the national collective bargaining.

The European trade unions associate both distributive and economic policy goals with their approach of a European coordination of collective bargaining (Traxler and Mermet 2003). Regarding distributional politics, a European coordination of wage policy is supposed to halt the trend, going on for 20 years now, of redistribution from labour to capital incomes and ensure a fair share of the employees in the fruits of productivity growth again. Beyond that, the ultimate goal is to strengthen the principle of decommodification of labour again by setting politically negotiated limits for competition based on labour costs. Apart from the distributional goals, the European coordination of wage policy is supposed to contribute to a situation in which wages can fulfil their constructive and supportive macroeconomic steering function again and contribute to securing a dynamic

nation was not further specified. While the ETUC has lately appeared to approach a post-Keynesian view according to which – especially in the Eurozone – the national trend of productivity growth and the European Central Bank’s target rate of inflation are considered adequate guidelines, (Janssen and Mermet 2003), most national trade unions still consider their country’s inflation rate the decisive point of reference in wage negotiations.

The demand for a return to the productivity-oriented wages policy has the problem, however, that it cements the distributive conditions of the past few years, so that many trade unionists see it merely as a minimal demand, which could be superseded with a more expansive wage policy, once conditions permit.
economic development. Both the reinforcement of private consumption and the support of monetary stability are part of this function. With their economic policy the European trade unions presume comprehensive macroeconomic coordination at European level, which enables wage setting policies, monetary, and fiscal policies all to be oriented toward the goals of growth and employment promotion.\footnote{For this see the contributions by Eckhard Hein/Achim Truger und Torsten Niechoj in this volume. See also the position paper of the DGB about “A New Social Contract in Europe”, which is also documented here.}

5. The trade unions’ “coordination approach” – problems of implementation and future perspectives

With the European “coordination approach” the European trade unions have developed a new strategy for overcoming the crisis of trade union wage policy in Europe. From the perspective of the trade unions, this approach comprises at least four strategic advantages:

First, the strategy takes the existing variety of different national collective bargaining systems as its starting point and refrains from aspirations at a comprehensive institutional reconstruction of European bargaining structures towards a harmonised system.

Secondly, the strategy seeks to overcome the dichotomous view of national versus European collective bargaining policy and connect the two levels with one another in a potential win-win-constellation, in which the stabilisation of the national collective bargaining and their coordination on the European level mutually support each other. The coordination approach intends to make the transnational interdependencies of national wage setting visible and connect the wage policies of the national trade unions with one another in such a way that the power and bargaining positions of the trade unions are strengthened on both the national and the European level. At the same time it rescues the European trade unions from the illusion that the mere transfer of collective bargaining competencies from the na-
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Tional to the European level could compensate for the weaknesses of the trade unions in the domestic arena.

Third, the coordination approach frees the trade unions from their obsession with supranational collective bargaining agreements, an obsession that will always be paralysing, as it always sees union activity on the European level limited by the lack of an organised counterpart on the employer side. All experiences with the European Social Dialogue have clearly shown that the European employers’ associations will refuse to accept any European level collective agreements as long as they are facing no powerful political and trade union actors at European level.

The coordination approach emphasises a fourth point, namely the necessity to build new and autonomous trade union structures in Europe and to create a European trade union movement capable of independent action. Accordingly, the trade unions have developed numerous new collective bargaining institutions at European level and are in the process of further building transnational networks of cooperation among national trade union actors, so that the density of communication and exchange among the European trade unions has considerably increased.

Various political and institutional problems and obstacles still persist, however, which have so far stood in the way of an effective coordination of trade union wage policy. The first, fundamental problem of all trade union coordination initiatives is the fact that the entire approach is voluntaristic. The European trade union organisations have neither the legal right nor the political power to commit their national member federations to a certain behaviour. From a legal perspective, the European coordination guidelines are nothing more than declarations of goodwill, or expressions of a moral obligation, which national union federations define for themselves and which need active support of the national unions to become effective.

As the trade unions act in the national arena in the first place, and also draw on their bases of power and legitimacy as defined in the national context, the political authority of the European trade union organisations is
rather weak vis-à-vis their national member associations. This holds especially for the core task of collective bargaining. Accordingly, all the resolutions about European coordination of collective bargaining are careful to emphasise the bargaining autonomy of the national trade union associations. The European trade union organisations have no instruments at their disposal, with which they could impose “hard” sanctions and punish any violation of the mutual agreements by one of the national member associations or even put a stop to this “misconduct” on the part of this national union federation. The voluntaristic network character of the trade unions’ coordination approach creates a structural dilemma for the European trade union organisations. The more national member associations violate the European coordination guidelines and pursue the strategy of competitive wage policy, the greater the pressure on the remaining organisations becomes to follow suit and back out of the coordination of collective bargaining as well.

Besides these problems with enforcing the politically binding character of the coordination approach, structural obstacles in its implementation on the national level are a second large complex of obstacles. What is at issue here is the question whether the national trade unions have enough political power to enforce collective bargaining agreements that abide by the European coordination guidelines vis-à-vis their employers. An additional problem is that European coordination of collective bargaining hinges on

16 The only conceivable sanction would be the expulsion of the national member association from the European trade union organization, but this would be not as easy to enforce in the first place, and in the second place not be desirable, as it would not ensure a change of behaviour on the part of the national union concerned. The powerlessness in dealing with national trade union confederations violating the negotiated European coordination guidelines has become very clear in the context of the social accord concluded in the Netherlands in the fall of 2003 (Schulten and Mühlaupt 2003). The majority of the European trade unions in the ETUC had de facto strongly rebuked the Dutch labour unions’ agreement with two consecutive years of pay freeze, but officially the European trade union organisation did not even issue a critical statement.
certain political-institutional preconditions that must exist in the national collective bargaining systems (see Table 3).

Table 3: National collective bargaining systems and attempts at transnational coordination of trade unions’ collective bargaining policy

<table>
<thead>
<tr>
<th>Level of collective bargaining within nation states</th>
<th>Transnational coordination of collective bargaining</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>Interregional</td>
</tr>
<tr>
<td>Cross-sectoral collective agreements/ national coordination</td>
<td>Doorn-Initiative</td>
</tr>
<tr>
<td>Sectoral</td>
<td>European trade unions</td>
</tr>
<tr>
<td>Sectoral collective agreements</td>
<td>Transnational networks of sectoral trade unions</td>
</tr>
<tr>
<td>Company</td>
<td>European industry federations</td>
</tr>
<tr>
<td>Company agreements</td>
<td>Bi- and multilateral contracts within transnational corporations</td>
</tr>
<tr>
<td></td>
<td>European works councils</td>
</tr>
</tbody>
</table>

Source: Own composition

For instance, the coordination on the macro-level as aimed by the Doorn-Initiative or the ETUC can only be effective if there are either centralised collective bargaining agreements at national level, or if bargaining policy is coordinated on the national level by national peak level confederations. In Germany and the UK the trade union peak organisations, such as the DGB (Deutscher Gewerkschaftsbund) and the TUC (Trade Union Congress), do not have any collective bargaining competencies besides few exceptions in select issue areas. The sectoral coordination by the European Industry Federations faces similar problems, as they too depend on industry-level collective bargaining or at least a sectoral coordination of company bargaining. The problem is greatest for countries in which collective bargaining is
widely decentralised and wage formation takes place only at company level, like in the United Kingdom or most of the Eastern European countries. In the political-institutional logic of the British collective bargaining system, for instance, it makes much more sense to pursue European coordination of collective bargaining not on the level of sectors, but on the company level, for instance in the context of the European works councils (Marginson 2001).

An increasing decentralisation of national collective bargaining structures and a growing role of company agreements would work against any macroeconomic orientation of wage policy. Effective coordination, therefore, depends on the existence of coordinated wage setting institutions on the national level (Traxler/Mermet 2003). Even then, national and European coordination of collective bargaining are compatible only if their substantive orientation is the same, which is by no means automatically the case. As pointed out above, during the 1990s wage policy in many European countries has become part of a national-level competitive corporatism, which has as its main goal the implementation and smooth functioning of competitive wage policy, and which is in fundamental opposition to the concept of the European coordination approach, in which the central idea is to constrain wage competition (Schulten 2004a: 252ff.).

In view of the voluntaristic character of the European coordination approach and in view of the many institutional and political problems of its implementation at national level, the strategy’s prospects of success at first sight look bleak. A pessimistic outlook is also backed by the fact that the coordination initiatives of the European trade unions have hardly had any discernible bearing on national collective bargaining disputes so far, and many European countries do not fulfil the requirements of the European coordination guidelines (Schulten 2004c). As the political project of European coordination is still a relatively young one, which aspires nothing less, than a comprehensive reversal of a trend that had dominated wage setting in Europe for the last 20 years, one should not prematurely predict the failure of this approach, in spite of the considerable obstacles. After all, the
European trade unions have been successful in establishing wage policy as a new policy field at European level without any support from the EU institutions and against the resistance of the European employers. The trade unions’ coordination approach thus still has a lot of potential for future development, which must be acknowledged as an obligation and a mission for the trade unions’ future political development. However, there is a need for both enhancing European cooperation among trade unions institutionally and further developing the coordination approach substantively, until it becomes a vibrant and attractive political project.

The political relevance and binding character of the positions for collective bargaining policy developed at European level is highly dependent on suitable institutions and procedures of interest mediation, designed for making sure that national wage disputes are integrated into a process of European level coordination. Because of the political structure of the European trade union organisations as a confederation of national member associations, all forms of hierarchical coordination are a priori inapplicable. Since the field of wage policy plays such a central role for their political legitimacy and recruitment of members, the national trade unions will not be willing to turn decision rights over to the European level in the short and medium run. The European trade union organisations will thus have to live with the fact that they have no truly “hard” means of sanction at their disposal for enforcing their wage policy goals. Even responding to frequent demands and significantly enlarging the organisation and staff of the European trade union organisations’ central offices in Brussels, which have remained understaffed up to now\(^\text{17}\), would only improve the potential for intensified policies.

\(^{17}\) The Brussels-based central office of the European Metalworkers’ Federation (EMF), with its about 6.5 million members throughout Europe, has 12 staff members at this time. By contrast, the local office of the German Metalworkers’ Union (IG Metall) in Cologne alone, which is in charge of about 45,000 members, has a staff of about 20 people.
cooperation, but by itself it could not be the solution for the coordination problem.

In order to increase the binding power of wage policy coordination at European level, the European trade unions must look for new, non-hierarchical forms of coordination. One possibility could be the “Open Method of Coordination”, which has stirred so much interest within the EU over the last few years. The procedure was first developed in the context of the European Employment Strategy and has evolved into a new form of governance in many policy fields since then. (De la Porte, Pochet and Graham 2001). The Open Method is at its core a form of governance that seeks to implement goals determined at European level while at the same time maintaining the formal autonomy of the national actors. Permanent monitoring and benchmarking of the strategies chosen are the tools at the disposal of EU-level actors, with which they seek to contribute to the diffusion of “best practices”.

When transferring this mode of governance to the coordination of wage policy within the European trade union organisations, the analogy with employment policy would suggest the following procedures and practices: (Schulten 2003: 133): The European trade union organisations first determine certain goals for wage policy and develop time schedules for the short, medium, and long term implementation. Then the national member associations develop action plans with specific targets and measures for national collective bargaining. On the European level these national action plans and their implementation are then subject to a procedure of permanent monitoring. At the same time good practices of collective bargaining policy are identified in a procedure of “trade-union-benchmarking”. This practice could help the European trade unions to shift from ex-post coordination to ex-ante coordination of wage policy. In this the rules of coordinated behaviour could become more than a criteria for the evaluation of the results of finished collective bargaining rounds after the fact, but instead manifest themselves ex ante, in the formulation of trade unions’ wage claims (IG Metall 2003, Janssen/Mermet 2003).
For the European trade union organisations the Open Method of Coordination has the advantage that they can use this method to increase the political pressure needed for the implementation of common wage objectives in national collective bargaining rounds, without questioning the formal autonomy of the national member associations. Systematic procedures of monitoring and benchmarking would provide the European trade union organisations with new tools of governance, which comprise at least “soft” forms of sanctioning defection on the part of national trade unions by building up the permanent obligation to justify such behaviour. However, implementing the Open Method of Coordination in the field of wage policy presupposes a certain minimum set of institutional arrangements as well, which do not necessarily exist in most of the European-level trade union organisations. Apart from the further expansion of the central offices of the European trade union organisations, the main task in this context is in efficiently connecting the national resources of the trade unions across national borders.

Whether or not this effective coordination of wage policy will become a reality is not only a function of the European trade unions’ success in building adequate institutions and procedures. The experience with non-hierarchical forms of governance such as the Open Method of Coordination suggests that such practices have the desired results primarily when they are backed by a hegemonic political project that is shared by a majority of the participating actors (De la Porte, Pochet and Graham 2001). This draws the attention back to the substantive and normative foundations of the European coordination approach.

The substantive core of the European coordination approach has so far been the demand for a return to a productivity-oriented wage policy, since only this approach is able to limit the scope of competitive underbidding of wages and labour costs. Ironically the European trade unions draw on a wage policy conception, which in its heyday after World War II had the function to impose wage restraint and limit the trade unions’ wage claims under the conditions of full employment (Schulten 2004a: 108ff.). Nowa-
days, by contrast, against the backdrop of the development that had been dominant in Europe since the 1980s, the productivity-oriented wage policy today appears as an ambitious far-reaching union agenda to push for higher wages, which can only be realised in the long run, and in hard collective bargaining disputes, if it can be realised at all.

The fundamental weakness of the concept of the productivity oriented wage policy, however, has always been its thoroughly technocratic character, which ignores the existing conflicts of interest and the social dynamic of collective bargaining disputes. Some of the Keynesian models of macroeconomic coordination have the same problem, that trade unions and wage policy are superfluous at the end of the day, as the “optimal” scope for wage increases is always already given – exogenously prescribed by the macroeconomic model. Even though the European trade unions meanwhile subscribe to the Keynesian arguments for coordination of wage policy at European level, their own strategy of coordination is always informed by redistributive goals as well. An approach of collective bargaining coordination that amounts to nothing more than the technocratic registering of certain “wage formula” for coordination would be doomed to failure from the outset. What is needed instead is a European coordination of wage setting and collective bargaining policy, acknowledged as a political project that at its core aims at the reconstruction of solidaristic wage policy.

The cornerstones of a “European solidaristic wage policy”, understood as a mission statement for European trade unions, have already been formulated by the ETUC (1999) a few years ago. According to this agenda the goal of collective bargaining policy is,

- To secure a fair income for workers and employees;
- To prevent competitive underbidding of wages and working conditions;
- To counter income inequality, which is still very high in some countries and to limit the scope of the low wage sector;
- To contribute to the harmonisation of living conditions throughout Europe, and
- To put the principle of equality between men and women into practice.

The reconstruction of solidaristic wage policy in this sense, unlike the technocratic fixation on productivity-oriented wage policy, has to be an appealing and attractive political project, which comprises the spheres of moral and political economy in equal measure, and which takes the different dimensions of the distributional conflict (both within and between the classes) into account. Only on the basis of such a political project will the European trade unions be able to mobilise their members for a European coordination of collective bargaining and strive for a new model of wage policy beyond the current hegemony of the neoliberal paradigm of competitive wage policy.

References


Negative integration
and the dilemmas for European labour

1. Introduction

My contribution fits a little uneasily within the context of this symposium, with its central theme of macroeconomic coordination. First, because other participants have far greater command than I of the technical detail involved. Second, because my focus is on the broader – and even more contentious – question of how trade unions should engage with the process of European integration and with the institutions of European Union (EU) governance. Until we can clarify our approach to this overarching strategic question, we lack a framework within which to formulate any more specific policy agenda.

Trade unions exist to defend and advance the rights and interests of their members, and of the working class more generally. But unions’ understandings of the nature of their constituency, the range of their interests, and the appropriate means of pursuing their rights, has varied markedly both within and between countries. European integration has posed radical challenges to these understandings, and three decades after the founding of the European Trade Union Confederation (ETUC), unions are still grappling to make sense of a rapidly changing environment and to fashion appropriate responses.

My aim is to explore the relationship between national systems of industrial relations – and the trade union movements which are embedded within them – and the dynamics of Europeanisation. Two connected questions are of key importance here: to what extent is economic internationalisation
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Richard Hyman

(‘globalisation’) undermining nationally-based systems of employment (and welfare) protection which are commonly identified as essential components of the ‘European social model’? And how far can the model be defended, or reinstated, by regulation at EU level?

I argue that the meanings of ‘Europe’, and of EU regulation, are ambiguous and contested. In consequence, there is a risk that too close an involvement in the mainstream politics of EU governance can disable trade unionism in its task of asserting a model of social Europe which gives priority to workers’ interests. More than this, too close an identification with the genteel elitism of EU consensus-building can alienate unions from their own constituents, who are then more easily susceptible to the appeals of ultranationalist and xenophobic politics. I end with some tentative suggestions for possible alternative means of engagement with Europeanisation.

2. National industrial relations systems and global challenges

Industrial relations constitutes both a field of social relations and an area of academic study, which developed in the twentieth century in Britain (with parallels in the USA) as the outcome of the historical construction of a relatively autonomous institutional arena within which conditions of employment were regulated – notably through collective bargaining.

Industrial relations can be understood as the regulation of work and employment through some combination of market forces, state intervention and collective bargaining. None of these elements can be seen as independent. For example, markets are always socially constructed; laws, to be effective, must be interpreted, observed and enforced by employers and employees (and their organisations); and the status of collective agreements, and of the bargaining parties, is in most countries statutorily defined. But the relative importance of each of the three elements varies very considerably across countries. Certainly this variation makes the idea of a common European industrial relations system rather difficult to imagine, yet alone implement (Ebbinghaus 1999). Nevertheless, there are significant common features in
continental western Europe which to some extent justify the label 'European social model' (Visser 1998: 234-5). In important respects, 'labour is not a commodity': both socialist and catholic traditions reject the idea of work as primarily or exclusively a market transaction, and insist on the need for collective regulation of the employment relationship and for protection of the weaker party in the employment contract – often through a comprehensive framework of law. There is broad social and political acceptance that labour possesses distinctive collective interests which (whether or not defined as antagonistic to those of the employer) need independent representation. Collective agreements have priority over individual employment contracts, limiting the freedom of individual labour market actors; while centralised bargaining and in some countries legal extension mechanisms result in high levels of coverage (even when union density is low). In the political arena, the 'social partners' have a key role in shaping and administering the welfare regime, hence co-determining the development of the 'social wage'. Almost universally, there is a standardised system of workplace representation at least partially independent of management (underwritten by law or peak-level agreement, or both). The autonomy of employers is thus constrained to a degree unknown elsewhere in the world.

Industrial relations systems in most countries emerged on a local and occupational basis, but in the twentieth century became consolidated within national institutional frameworks. Each acquired unique characteristics, reflecting nationally distinctive economic structures, political traditions and social practices. As we understand the term today, industrial relations is an invention of the era of the nation-state. National industrial relations systems were conditioned by the extent to which national economies were relatively self-contained and national governments relatively autonomous. Has globalisation changed all this?

We need to be clear what we mean by globalisation, which has tended to become more a slogan than a precise analytical concept. Sometimes the reference is more to a cultural homogenisation (McDonalds, MTV) than to economic integration. When the focus is specifically economic, a number
of different factors are often emphasised: the internationalisation of product markets (both goods and services), reinforced by trade liberalisation; cross-national investment flows, mergers and acquisitions, and the rise of multinational companies (MNCs); and the liberalisation of financial markets and the intensification of speculative pressures on individual currencies.

Some writers have argued that in combination these factors inevitably undermine national systems of employment regulation. MNCs can escape national industrial relations regimes, choosing locations where wages are low and employment protection rules are weak, thus precipitating a ‘race to the bottom’ (Gray 1998). Financial markets are increasingly volatile, and punish governments which fail to follow the rules of ‘sound’ monetary policy, putting downwards pressure on macroeconomic policy and social welfare systems. The conclusion is often drawn that the autonomy of national industrial relations cannot be sustained. Globalisation leads to inexorable pressures to eliminate labour market ‘rigidities’ by reducing or removing employment protection legislation and encouraging company-specific regulatory structures, and to ‘modernise’ welfare states by curbing in particular the taxation obligations on companies. The countries of western Europe, with their highly developed systems of labour market regulation and social protection, are the most vulnerable to these imperatives. The pressures to sustain national (indeed company and workplace) competitiveness force unions to engage in concession bargaining, a form of ‘beggar-your-neighbor’ behaviour from which all ultimately are losers.

Others have contested these pessimistic interpretations. For example, it is argued that in some respects, economic internationalisation has a long history: a century ago, trade and investment were as ‘globalised’ as today. Hence the idea of globalisation should be seen primarily as an ideological weapon, to support a political project of deregulation (Hirst and Thompson 1996). It is often noted that some of the most open European economies (Sweden, the Netherlands) have had the most generous welfare states: competitiveness does not obviously dictate low social standards. From a different perspective, it is evident that the locational decisions of MNCs
reflect a complex of factors: access to markets, infrastructural advantages, political stability, availability of skilled labour; levels of wages and corporate taxation are not necessarily the most important determinants, at least in some areas of production. More generally, the notion of globalisation is often considered misleading: economic integration is primarily regional in character (the ‘Triad’ of North America, East Asia and Western Europe being the main poles of integration) (Ruigrok and van Tulder 1995).

3. The relevance of European integration

The ‘regionalisation’ argument connects directly with any assessment of the industrial relations consequences of European integration. In one sense, Europe can be seen as a particularly strong instance at continental level of transnational product market integration, corporate restructuring and financial liberalisation – thereby eroding the traditional basis for autonomously created national socio-economic regimes. Hence in much of continental Europe it is widely argued that Anglo-Saxon principles of ‘shareholder value’, and associated practices of labour market flexibility, are necessary concomitants of the single market.

But conversely, European integration is sometimes seen as a bulwark against globalisation. Even though individual national economies may be increasingly internationally open, some 90% of trade is within the boundaries of the EU itself. In other words, European economies have become Europeanised rather than globalised. There is no compelling reason why the remaining 10% of trade should dominate policy (Hoffmann 2002).

The bias of opinion – there is certainly no consensus – would seem to be that the relatively integrated European market (the EU, or the somewhat wider EEA) is sufficiently self-contained to be potentially insulated from ‘global’ challenges to the ‘European social model’ of employment; that the ‘four freedoms’ of economic activity within this space nevertheless pose a threat to many traditional safeguards for the status and standards of workers at national level; that rule-making at European level increasingly impinges on, without displacing, national regulatory systems; and that if this
supranational regulation remains weak and 'negative integration' is the norm (Scharpf 1999), this is the result of political contingencies rather than economic imperatives.

Underlying these political contingencies is the existence of rival visions of Europeanisation. Most fundamentally, ‘Europe’ itself is an ambiguous and disputed ideal. Attali (1994: 9) cautions that ‘Europe, evidently, does not exist. It is neither a continent, nor a culture, nor a people, nor a history. It is neither defined by a single frontier nor by a common destiny or dream. Yet there exist diverse Europe, which elude us when we seek to grasp their contours too precisely.’ Others identify the idea of Europe as ‘an essentially contested concept’ (Cederman 2001: 2), and an ideological resource deployed in support of particularistic interests or projects. ‘Europe’ is not a neutral reality but a contested concept’ (Diez 1999: 602); ‘it was always politics masquerading as geography that determined the definition of Europe’ (Delanty 1995: 49).

In the contemporary EU, three understandings predominate. The first, the most prosaic but almost certainly the most powerful, is the idea of Europe as a common market tout court. Whatever the broader ideals and visions of its ‘founding fathers’, what the Treaty of Rome established was a European Economic Community. If the central adjective was quietly expunged from official communiqués a quarter of a century later, this was perhaps in embarrassed recognition that the relaunch of European integration (‘completing the single market’) was driven above all by the neo-liberal project of eliminating obstacles to free trade within what was by now the Europe of the twelve: winning popular commitment required a more positive social gloss (Boyer 2000: 26-7).

A second conception focuses on the ‘politics of identity’ (Laffan 1996: 82). EU integration itself displaces certain symbols of national identity (not least, within the euro zone, national currencies); and political symbolism abhors a vacuum. A consequence has been an essentially artificial attempt to invent a common European identity (Kohli 2000): artificial not only because the boundaries of Europe are unclear, but also because the relations
among its component states have historically been marked as much by an-
tagonymism as by commonality, and because the continent is in reality ‘a field of multiple, overlapping and sometimes even conflicting identities’ (Cal-
houn 2001: 52). The twelve-star flag may have become an innocent fashion accessory; but in practice, the project of creating unity out of diversity is most readily achieved in counterpoint to an alien outsider. This was the moslem world in the formative era of the European idea, the ‘dark contin-
ent’ in the heyday of colonialism, the soviet threat during the cold war, today those who fall outside an ethno-cultural identity of Europe as a re-
pository of white, judao-christian civilisation (a conception linked to the exclusionary model of Fortress Europe). Ironically, while a radically differ-
ent understanding of Europe from that of a neoliberal market, these two conceptions may be seen as strangely complementary, mediated by a mar-
ket-based understanding of ‘EU citizenship’ (Hansen 2000).

A third meaning is closely allied to the notion of ‘social Europe’, a central element in EU discourse from the time of the Delors presidency of the Commission but in some respects a subtext of the arguments for economic integration from the creation of the original EEC: a promise of the upward standardisation of outcomes across the Community. More modestly, the EU can be regarded as a potential mechanism of ‘collective defence’ of the existing architecture of social regulation in the member states, in the face of external pressures to dismantle workers’ rights at national level (Grahl and Teague 1997). Such a conception is clearly unappealing to powerful actors whose vision of Europe is simply as a free trade zone. As Hay has argued (2000: 521), ‘the irony of the process of regional economic integration in Europe is that although initially conceived – some may question this! – ‘as an attempt to secure the continued viability of a distinctly European “social model”, the nature of the ensuing process of economic and monetary inte-
gration may well serve to establish and institutionalize a distinctly “subver-
sive liberalism”’. As an example one may consider the European Employ-
ment Strategy (EES), often regarded as one of European labour’s achieve-
ments: two of it four pillars are adaptability and entrepreneurship. What do
these mean in practice? The business understanding of adaptability is as a synonym for flexibility. Labour should be disposable: it should be easy to hire and fire in order to respond rapidly to fluctuations in product demand. (Variable capital, someone once called it.) Entrepreneurship is typically identified with the self-employed and the small employer. But self-employment is commonly a form of economic dependency marked by long hours, small rewards and precariousness. And it hardly needs emphasis that small firms are not always model employers. Trade union representation and (in countries where these are legally prescribed) functioning works councils are usually absent, and nationally defined statutory employment rights may have little if any purchase. Demands for ‘administrative simplification’ in the interests of entrepreneurship will weaken workers’ rights even further. Hence any serious pressure to defend and extend ‘social Europe’ contradicts a dominant logic of actually existing European integration. Are trade unions able and willing to fight for their own vision? I explore this question in the remainder of my contribution.

4. EU regulation: biases and limitations

As we all know, for Rosa Luxemburg the work of trade unions at national level was ‘a sort of labour of Sisyphus, which is nevertheless indispensable’. Even more is this the case at international level; and within the EU, defending workers’ interests is an uphill struggle for reasons many of which have already been indicated.

As Scharpf (1999) has argued, the preferred mode of Europeanisation has been ‘negative integration’, the elimination of national regulations which constitute obstacles to the free movement of goods and services, capital and labour. This deregulationary bias is not conducive to the construction of a new framework of positive law at European level. Negative integration reflects the priority of economic over social and political integration: a common market can be understood primarily in terms of freedom from regulations which inhibit cross-national exchange, whereas the creation of a social community depends on rights which are entrenched in new regulatory institutions. Not surprisingly, as Schmitter and Bauer (2001: 55) laconically
comment, the EU ‘has made only fitful and erratic progress in defining its social citizenship’. The Treaty of Rome established Community competence primarily in market terms; the Single European Act was most mandatory and specific in the field of market-making (with the formalisation of qualified majority voting primarily directed to this end); the Maastricht Treaty, though celebrated by the trade union movement for its social chapter, was most binding in outcome in respect of the notorious convergence criteria for monetary union; the draft constitution, had it been adopted, would have reaffirmed neo-liberal economic imperatives in unambiguous terms while giving far more diffuse a commitment to social goals.

In the uphill struggle for a meaningful social Europe, trade unions confront not only the gravitational pull of the existing constitutional framework, but also the force of weighty opponents. There is the familiar imbalance within the institutions of the EU itself: the Parliament, the most ‘popular’ (directly elected) element in the decision-making architecture, and the most reliable supporter of an effective social dimension to European integration, is also the most limited in its powers. The Commission, while dependent for its own status on the extent of EU regulatory capacity, is at best an ambiguous ally. While DG EMPL may be sympathetic to many trade union aspirations for social regulation, its own influence is subordinate to that of the many Directorates-General with a primarily market-making mission. Note than in recent years, DG EMPL has always been assigned a Commissioner from a ‘peripheral’ country, after the more influential briefs have been carved up amongst the heavyweights.

To these inbuilt biases is of course added the imbalance of influence between labour and capital. This is not primarily a matter of organisational resources: in many respects, the ETUC is organisationally more robust than UNICE (though we should not forget the ranks of lobbyists and representatives retained in Brussels by individual companies and national associations, vastly outnumbering the European officials of national trade unions). The issue is rather that employers and industrialists work with the grain of entrenched EU policy, while trade unions (if they are serious about ‘social
Europe) seek a major change of course. In such a context, veto power is typically more effective as well as more discreet. Recall the argument of Offe and Wiesenthal (1985: 191-3) concerning the ‘structural asymmetry’ of capital and labour in their relationship with the state. Since governments are dependent on the investment decisions of a multiplicity of individual firms, capital exerts political pressure without the need to mobilise collectively. The normal economic rationality of company decision-makers has a political significance which may not even be intended. Against this background, the relative organisational weakness of UNICE may constitute a strength for capital: even if its professional representatives were inclined to compromise on principles which some employers consider sacrosanct, it lacks the capacity to commit those it supposedly represents.

Not surprisingly, then, there is a strong tendency within the EU to adopt ‘symbolic politics’ (Streeck 1998: 447). At national level, employment regulation typically takes the form either of collective agreements between unions and employers (in many countries, with binding status) or of legislation, the two commonly operating in conjunction. In the EU, the analogue to national collective bargaining is the social dialogue, only exceptionally resulting in anything more than ‘joint opinions’, with the number of agreements reached under the Maastricht social partners’ route still minimal; while the analogue to national legislation is the directive, an instrument which is always slow (that on European Works Councils was first proposed in 1980), and rarely does more than codify existing practice in the great majority of member states.

Constitutionally, the possibility of the type of regulation familiar at national level is obstructed by the fact that the EU lacks a government in the normal sense of the term. For this reason it has become common to use the alternative notion of ‘governance’: which means, if I understand correctly, the process of control and regulation. Bulmer (1998: 366) has argued that ‘governance […] has particular value in examining the pattern of rule in the EU. The EU does not resemble, or have, a government, so governance offers some descriptive purchase on the character of the polity.’ To counter-
pose governance to government is to indicate the uncertainty of agency: who does what, and with which, and to whom? As Jachtenfuchs has suggested (2001: 258), ‘the governance approach […] has a strong bias towards effective and efficient problem-solving and almost completely ignores questions of political power’ (hence, one must add, fails to consider who has the power to define what are problems and what are efficient solutions).

Again, in pessimistic mode it can be argued that the ‘external coercive laws’ of the European market impose a set of outcomes which governance can merely ratify: obstacles to competitiveness are the overriding problem. More optimistically, however, some suggest that the dynamic can be channelled as a means at least of damage limitation; governance can provide a ‘steering’ of market forces.

Current analysis of EU governance has developed a repertoire of concepts such as soft law, thin policy integration and flexible regulation. The notion of ‘steering’ seems to imply a looser, less visible mode of control than is customary in economic regulation by national governments. But is it possible to steer a tiger? Also popular is the concept of multi-level governance (Marks et al. 1996). It denotes the extent to which the locus of policy determination in the EU is diffuse: ‘EU public policy-making is non-hierarchical, heavily bargained and fragmented in different institutional settings’ (Laffan 1998: 242). Most recently, the EES has given us the principle of the open method of coordination (OMC), celebrated as an alternative to hard law regulating European labour markets – which would almost undoubtedly be politically unattainable. Yet is ‘openness’ – the involvement in the EES of a wide array of interests and actors – actually at the expense of coordination? A sceptical view would be that it underpins a form of neovoluntarism, that in the absence of enforceable norms it assures the primacy of market dynamics over social protection.

Once more, very different readings of this phenomenon are possible. Viewed negatively, the fragmentation of regulation favours non-decision-making, underwriting multiple bases of veto power and offering wide-ranging scope for economic actors to escape the regulatory net. Viewed
more positively, it provides a framework for new types of regulatory initiative: ‘new strategic alliances and loose neocorporatist arrangements’ emerge that can exploit ‘the fact that global capital is still organizationally and environmentally dependent on local political, economic and social contexts’ (Martínez Lucio and Weston 2000: 205). Here too the question arises: who participates in such strategic alliances, and around what type of agenda? I pursue such questions in the final section of my contribution.

5. The fatal attraction of the elitist embrace

A few years ago, Ramsay (1997: 528) wrote that ‘ETUC efforts are focused almost entirely in the EU lobby circuit’. Is this true, and does it matter? No doubt it can be argued that the ETUC has always played an important information and coordination role, has attempted to transform the diverse and at times conflicting aims of its affiliates into a coherent policy agenda, and has even organised the occasional mass demonstration in support of these objectives. Nevertheless, it remains the case that its limited resources are substantially concentrated on engagement with the Brussels institutions: a priority which generated some debate at the recent Prague Congress. Is this a problem?

The answer is that, with too one-sided an engagement with the Brussels machine, unions can succumb to an elitist embrace. Dølvik (1997), in his detailed insider study of the ETUC, distinguishes between a ‘logic of membership’ and a ‘logic of influence’. The former requires unions to maintain their representative credentials by articulating the wishes and interests of their constituents. The latter requires them to adapt their aims and methods to the actual decision-making processes on which they wish to exert an impact. Balancing the two logics is a difficult art: neglect the logic of influence and one’s demands are ineffectual; neglect the logic of membership and one loses representative legitimacy. The Brussels embrace can all too easily achieve the second outcome.

The decision-making process within the EU is often termed ‘comitology’: initiatives are formulated, analysed, revised, debated, further amended and
reformulated, within an elaborate network of interacting committees, until an outcome emerges (or fails to emerge). This process has a strong technocratic bias: the focus of argument is diverted from principle to detail. One could say that this takes the politics out of policy.

This approach is reminiscent with what, at the British Trades Union Congress, is known as the composite resolution. Different member unions submit conflicting proposals on a contentious policy issue, but are then pressed to agree through backroom negotiation a form of words which somehow embraces the opposing viewpoints. In this way, potentially embarrassing disputation is removed from the public arena. The outcome of Brussels comitology seems similar. For example, take the EES: a political compromise, and as such an attempt to achieve the unity of opposites. From the Delors white paper through Essen, Amsterdam, Luxembourg and all subsequent elaborations, the underlying message seems to have been that the prescriptions of Keynesianism and monetarism, of social regulation and of deregulation, can somehow be harmonised through a technocratic fix which transcends hard political choices. The Lisbon European Council in March 2000 famously declared that ‘the Union has today set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’.

Again, can all these desirable goals be achieved simultaneously; and if not, what are the priorities? In the evolution of policy since Lisbon, the goal of ‘better jobs’ has been transformed into the mantra of quality, which has in turn been redefined primarily in terms of productivity. Competitiveness links directly to the ‘adaptability’ pillar of the EES, with its synonym flexibility. Does this entail the abolition or erosion of the social protections which unions achieved with such difficulty over many decades? Do not fear, flexibility can easily be reconciled with security: comitology has even given us a new term, ‘flexicurity’, a composite resolution in a single word! Yet do such attempts to square the circle risk abandoning the ‘European social model’ by stealth?
The ETUC is sucked into this process in part because of material constraints: as Martin and Ross (2001) put it, it depends on ‘borrowed resources’. ‘Because national union movements in Europe were reluctant to allocate resources and to grant it significant opportunities to acquire capacities on its own, the ETUC had to seek its building materials elsewhere, from friendly, but self-interested, European institutional elites’ (2001: 54). Gobin (1997) has charted in detail how this material dependence has constrained the ETUC’s agenda and made comitology the line of least resistance.

More insidious, perhaps, is the subtle interaction between discourse, ideology and practice. All of us who are familiar with the Brussels process, whether as participants or as observers, have come to talk a strange language. We speak easily of horizontal objectives and open methods, of the social partners’ route and co-decision, of macroeconomic dialogue and transposition. We can master a whole lexicon of acronyms. When we refer to Barcelona, Stockholm or Nice we do not – unlike most normal people – think of them as tourist destinations. Welcome to the world of Eurospeak! European integration has generated an organising discourse which – presumably unintentionally – most effectively distances professional Europeans from the citizenry of European states. There is ‘a multitude of common understandings, inter-institutional agreements and informal modes of behaviour which are reproduced every day in the political and administrative practice of the EU’; and ‘a lobbying community has produced an entire political class that shares the language’ (Christiansen et al. 1999: 539, 541).

To the extent that Eurospeak has become the working language of the ETUC (and national union representatives active within its structures), their logic of membership is undermined by the fact that they speak a different language from those they seek to represent. Not only different, but actually opposed: ‘analysis of the official statements of the ETUC clearly shows a gradual integration of the employers’ vocabulary and, increasingly, a vocabulary produced by the administrative apparatus of the Commission, at the expense of a vocabulary expressing traditional trade union demands’ (Gobin 1997: 116).
The consequence of the elite embrace is a suppression of both political alternatives and mobilisation capacity. Political alternatives are suppressed because, in effect, European unions lack the nerve to say no, which in turn dilutes the logic of influence. Take two of the biggest issues of economic integration. The ‘social dimension’ was invented by Delors to provide a ‘human face’ to the completion of the single market, and to turn the trade union movements of Europe from potential opponents into reliable allies. This offered the opportunity for significant influence, if and only if the unions had been prepared to campaign against the Single European Act unless it gave labour social rights which matched the economic benefits for capital. Likewise with economic and monetary union: ‘despite judging the design of EMU as fundamentally flawed, the ETUC continued to back it, arguing that it was needed politically to keep integration going’ (Martin and Ross 1999: 349; 2001: 72). Yet if the Maastricht convergence criteria were the price for the single currency, it was a Faustian bargain.

Having assented to the underlying architecture of actually existing Europe-anisation, unions’ capacity to mobilise around an alternative vision of social Europe is neutralised. In consequence, it is left to other political forces to campaign uninhibitedly against the current bias of European integration as an elitist project which brings unemployment, labour market deregulation and the erosion of social protection. Trade unions are ill placed to offer a powerful political antidote to the poison of ultra-nationalism and xenophobia.

6. **Is there an alternative; or, how are social rights achieved?**

We all know, and often use, the slogan: *Europa sozial gestalten!* But how can this be achieved? Perhaps we should start by asking how, in the past, workers’ protections were gained at national level. First, they were typically the outcome of *contention*: trade unions and other advocates of reform asserted a claim for rights which contradicted the orthodoxy of the time. Recall Marx on the Ten Hours’ Act in Britain: ‘this struggle about the legal restriction of the hours of labour […] told indeed upon the great contest
between the blind rule of the supply and demand rules which form the
political economy of the middle class, and social production controlled by
social foresight, which forms the political economy of the working class'.
Advances were won because labour movements challenged the seeming
'naturalness' of the market society which had been imposed at such human
cost, and insisted that a different society was possible.

Second, new rights were normally won only when workers' organisations
were able to mobilise, campaign and protest in support of their own alterna-
tive agenda. To the force of argument was added the argument of force: the
relatively weak discovered that only through mass action, if necessary dis-
ruptive, could they redress the balance and create what Tarrow (1998) has
called 'power in movement'.

Both aspects of historical experience are relevant to trade unions in Europe
today. Imig and Tarrow (2001: 8) have argued 'that Europe's authorities
not only tolerate but encourage the expression of claims through lobbying
and other routine forms and that this has a containing effect on more con-
tentious forms of collective action'. European labour needs to break out of
this cage. I am reminded of the sombre comment of Panitch and Gindin
(1999: 5), that 'every progressive social movement must, sooner or later,
confront the inescapable fact that capitalism cripples our capacities, stunts
our dreams, and incorporates our politics'. By treating 'globalisation' as an
ineluctable objective imperative, by accepting that 'there is no alternative',
the only response can be to embrace the fundamental capitalist logic of
competitiveness. The result is a series of desperate and mutually self-
defeating efforts by local and national union representatives to find local
and national solutions – in partnership with 'their' managements and gov-
ernments – to a global crisis. Solidarity becomes redefined as its opposite,
what Streeck (2001) terms 'competitive solidarity'. The ETUC, with its
policy of bargaining coordination, has attempted to moderate the pace of
retreat, but without any real conception of a different strategic direction.
Working for marginal adaptations to the dominant orthodoxy of actually
existing Europeanisation is the line of least resistance, the new realism and
practicality of a trade unionism which has lost its former utopian inspiration.

Yet the corollary of the new practicality is that unions lack what was once their greatest strength, their status as a ‘sword of justice’ defending the weak and underprivileged (Flanders 1970). They appear instead as a ‘vested interest’, imprisoned in the past rather than envisaging the future. The starting point of an alternative direction must be to contest the pessimistic thesis that competition is the greatest good and the only option. As the Canadian Auto Workers declared two decades ago: ‘competitiveness is a constraint, but it is not our goal’ (quoted in Panitch 2000: 374). There is indeed a coercive economic reality to globalisation, but it is to an important extent politically created and ideologically reinforced. ‘To the extent that functional imperatives related to globalization do exist, they are mediated by nation-specific structures and politics. Policy outcomes are thus primarily influenced by domestic political conflict’ (Alber and Standing 2000: 112).

As trade unionists, engaging in domestic (and European) political conflict means that we should be bold in rethinking the world of work to match citizens’ needs and aspirations. But this entails abandoning the ‘composite resolution’ and openly confronting fundamental policy choices: redefining ‘the political economy of the working class’ – or as Thompson (1971: 78) called it, the ‘moral economy of the poor’ – in ways which offer hope of a better world and a better Europe. To regain the moral high ground, it is essential to make the labour movement’s traditional values of solidarity relevant and credible in the new millennium. In the nineteenth and twentieth centuries, unions insisted that markets should serve humanity, humans should not be slaves to market forces. We need to shape a vision of what this principle implies for the Europe of the future.

A vision is no more than a beautiful dream unless it is shared collectively. This calls for strategies of mobilisation and contention, a clear conception
of our potential allies and predictable opponents, and – if our ambitions are to be genuinely European – new understandings of internationalism.

Eight decades ago, one of the leading figures in international trade unionism, Edo Fimmen, insisted that the process of economic integration across national boundaries required a corresponding extension of regulation. 'One of the most notable of the economic phenomena of the post-war epoch in Europe is the vigorous concentration of capital' (1924: 15). Employers, he added wryly, 'do not hold congresses; they do not pass pious resolutions about international class solidarity. Nevertheless, they think and act internationally.' By contrast, 'the workers have international organisations; hold international congresses; pass numerous and high-sounding resolutions. None the less, they continue to restrict their activities to the national arenas.' National unions, he added, were 'terribly alarmed' lest the international organisations which they themselves had created should interfere in their national affairs (1924: 104).

Perhaps these arguments sound familiar. The principle of subsidiarity is the implicit presupposition of trade union action today – even though it is one which unions criticise when it drives, or restricts, the politics of the EU. All too often, official trade union practice seems implicitly to accept that internationalism is an elite concern, that it is safer if the membership does not learn too much of policies which they might perhaps oppose. In some unions, certainly, international issues are given reasonable prominence in internal communications and education; I fear that this is far from typical, though openness may be increasing as unions struggle to find a response to 'globalisation'. In any event, since effective international solidarity is impossible without a 'willingness to act' on the part of grassroots trade unionists, it is unattainable without an active strategy by union leaders and activists to enhance knowledge, understanding and identification of common interests cross-nationally. This means engaging in what might be termed an ‘internal social dialogue’ (Hyman 2001: 174). The external social dialogue, introduced by the Delors Commission in the 1980s, has been described as a mechanism ‘for teaching union leaders gradually to accept in part the em-
employers’ neoliberal positions’ (Gobin 1997: 116). The internal social dialogue, by contrast, must be an open-ended method of shaping unions’ own goals and methods, in which leaders and officials certainly offer strategic direction but in which members themselves contribute to shaping policies which they understand and own – and on behalf of which they are prepared to act collectively.

An old principle of trade unionism, in Britain at least, is ‘know your enemy’. To some advocates of social partnership, this slogan is today ridiculously old-fashioned. Yet how much partnership is really possible with advocates of ever more liberal product markets and ever less regulated labour markets? The area of potential agreement with employers at European level, or with the majority of Commission representatives, is narrow indeed – unless trade unionists, in pursuit of agreement at any price, surrender their own principles.

One reason for pursuing compromise almost irrespective of content is that union representatives recognise their own weakness. Across Europe, unions have lost membership and public status. In their interactions with the powerful, unions acting alone have diminished negotiating power. Yet rather than accepting the inevitability of concession bargaining, an alternative option is to seek to mobilise support from the relatively weak (which was indeed how unions in the main originated). It is significant that, in Europe and in the world more generally, what were once known as ‘new social movements’ – though by now many have become middle-aged and institutionalised – have been able to engage effectively in forms of ‘contentious politics’ (Tarrow 1998) which most trade union leaders until very recently considered signs of immaturity. Among trade unions, there is increasing acceptance of the need to seek alliances with other collective agencies once viewed with distrust and disdain (Munck 2002). This does not mean that trade unions should become NGOs (except to the extent that outside dictatorial regimes they surely are, and have to be, ‘non-governmental organisations’); nor that they should subordinate themselves to NGOs. Unions have a distinctive constituency, agenda and terrain of action, they have a
democratic rationale which not all NGOs possess, and they have the organisational capacity for long-term strategy which most NGOs lack. We should also note that the European Commission has had some success, with its concept of ‘civil dialogue’, in subjecting many NGOs to the same elitist embrace as trade unions. Nevertheless, there is much that unions can learn from the imagination and spontaneity of NGOs, their capacity to engage the commitment and enthusiasm of a generation which in most European countries has failed to respond to the appeals of trade unionism.

To conclude: Europe is a continent rich both culturally and materially, but the dominant politics of European integration subverts this heritage. The duty of the trade union movement – and the necessary foundation of its own future – is to convince those we seek to represent that a different Europe is possible.

References


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A new social contract for Europe – Recommendations to the European Convention

from the Deutscher Gewerkschaftsbund (German Trade Union Confederation)

2nd DGB position paper on the debate about a European Constitution
Approved by the Federal Executive on 08 October 2002

Preamble

The Deutscher Gewerkschaftsbund (DGB) has been following the Convention’s deliberations attentively. As the themes and focal issues of the European Convention’s debate have taken shape, the DGB has fine-tuned its views on the future Europe, adding further core demands to its initial recommendations (cf. First DGB position paper on the constitutional debate in Europe of 22 April 2002).

This present document, entitled “A new social contract for Europe – Recommendations to the European Convention from the Deutscher Gewerkschaftsbund”, focuses on a theme to which the German trade unions attach crucial significance within the framework of Constitutional debate: the redefinition of European economic and social policy and the integration of these two policy fields to create a coherent framework for action aimed at re-establishing full employment in the European Union.

This is how the DGB sees the issues to be addressed by the European Convention under the heading “Europe’s economic order”. It is no longer ten-
able for economic policy on the one hand and employment and social policy on the other to exist side by side with very little to bind them or, indeed, pursuing mutually inconsistent objectives. By thoroughly revamping the European economic order these policy fields, which have hitherto functioned in isolation from one another, must, in the DGB’s view, be united towards a common target perspective, clustering the various strands of action initiated in their pursuit. The diverse tasks of which they consist must in future be defined and fulfilled under the umbrella of a single, all-round conceptual approach, and the contractual basis for achieving this needs to be laid now. In this respect, the DGB’s demands are founded on the legally binding incorporation of the Charter of Fundamental Rights into the new corpus of Treaties.

1. **The European Union needs an integrated economic and social policy**

The successful implementation of Economic and Monetary Union (EMU) contrasts starkly with hitherto inadequate efforts by the Community to exploit its abundant growth and employment potential to the full. Progress down this road is of crucial significance to the future of the Community; it will only be achieved by means of a better designed and better coordinated economic policy.

When EMU took effect on 1 January 1999, the conditions for additional growth and employment improved, but at the same time the weaknesses of the European Treaties became patently obvious. These must be extended or revised if we are to meet the objective set by the Lisbon Council of making the EU the most competitive and dynamic knowledge-based economic area in the world, capable of achieving sustainable economic growth with more and better jobs, greater social cohesion and a high rate of employment approaching full employment within the next 10 years.

The DGB calls for visible progress towards genuine economic and social union, which will strengthen civil awareness of our political community and pre-empt a relapse into nationalism and protectionism. Our vision for
Europe is one of a common area of solidarity and social justice, political liberty and stability, prosperity and human rights.

**Full employment and sustained growth in combination with price stability are a realistic proposition.** For years, however, millions of citizens have been permanently or temporarily denied access to work and thereby to an opportunity to provide for themselves out of their own earned income. An employment- and stability-oriented macroeconomic policy mix is necessary to re-establish full employment and exploit the Union’s versatile growth potential. The European social model requires further development to make the EU a shining example of economic and social policy within the context of globalisation.

The present Treaties and their practical implementation do not provide an adequate basis for coordinated economic policy, nor do they permit efficient governance in the field of economic policy towards the aim of full employment. In the DGB’s view, and without prejudice to the future structure of a European Constitution, the following additions must be made to the Treaties in the interests of Europe’s economic order.

1.1 Monetary policy and the responsibility for growth and employment

The Central Bank must adjust long-term growth in monetary and borrowing parameters to match long-term economic potential in order to increase macroeconomic output and thereby effectively achieve the targets of maximum employment, stable prices and moderate long-term interest rates.

- Article 105 of the Treaty establishing the European Community (EC) must be altered to ensure that the monetary policy of the ESCB (ECB and central banks of Member States) not only pursues a stability objective but takes equal account of a growth and employment objective, similarly to the provisions of the US Federal Reserve Act and Germany’s Stability and Growth Act.

- The Treaties (Art. 2 of the Treaty on European Union and Art. 2, 3, 4 and 98 EC) must also express more clearly the need for economic pol-
icy to make an essential contribution to fulfilling Community employment and growth targets.

– In order to express clearly the European Union’s obligation to observe the principles of a social state, enshrined in the constitutions of most Member States, the term “open market economy” in Art. 4, 98, 105 and 133 should be replaced by “social market economy”. The aim reflected in the Treaties of a “high level of employment” should be replaced throughout by “full employment”, as explicitly endorsed in the conclusions of the Barcelona Council. The aim of full employment must, in particular, be incorporated into Art. 98. The text of Art. 108 must be amended accordingly in this context.

– The ECB should be charged with formulating a medium-term inflation target, for example by defining an inflation corridor, and with justifying any deviations above or below this target as reflected by the HCPI (Harmonised Consumer Price Index) or else with responding to these by means of monetary policy. It must be ensured that Member States with below-average inflation rates are not disadvantaged as a result.

– Finally, Art. 113 EC must be amended to make the ECB account for its policies to the democratically constituted institutions (European Parliament, Council) in open session. The ECB must furthermore reveal its policies more openly in the light of changing developments and motives. The minutes of ECB meetings should be published in pursuit of this aim.

1.2 Improved dovetailing of economic policies

So far the EU has not been endowed either with the institutional prerequisites to conduct an effective macroeconomic policy or with a political conception of how to restore full employment. The procedural regulations on coordinating economic policy are inadequate. Establishing macroeconomic dialogue would be a major step towards a coordinated European economic policy. This would include the European Central Bank participating in
regular, institutionally enshrined consultation with all other key macroeconomic players – those responsible for financial policy and for collective bargaining processes.

- Even achieving the economic policy aims formulated in Art. 2 requires more effective coordination between Member States in the field of financial policy and a greater dovetailing of economic policy among economic policy players in the Member States. The DGB demands that the macroeconomic dialogue created as part of the European Employment Pact (Cologne Council, June 1999) be enshrined in Art. 99 (1) EC.

1.3 Instruments for a coordinated EU economic policy

The procedure for determining “broad economic policy guidelines” has been regulated to date by Art. 99 (2). Art. 99 makes no provision for hearings involving the social partners (management and labour) or the EP, and non-public discussion of the guidelines remains confined, until their adoption by Council, to government committees (essentially the Ecofin economic policy and economic and financial committees and Ecosoc employment committee), attended by representatives of the Commission and the ECB. New instruments of coordination are needed at Community level, not only for the Single Market, but even more urgently for the euro zone.

- The DGB calls for a new paragraph to be inserted after Art. 99 (1) EC enshrining the function of these instruments in the Treaties and creating a demarcation of competence:

“The broad economic policy guidelines of the Member States and of the Community are a central instrument in the coordination of economic policy in the European Union. They are adopted each year by the Council acting by qualified majority on a proposal from the Commission after hearing the European Parliament, the Macroeconomic Dialogue and the Employment Committee referred to in Art. 130 and having reviewed the employment situation in the Community and the conclusions derived from
this by the European Council, thereby enhancing the coherence between different policy fields. They constitute a framework and contain recommendations for the economic policies of the Member States and of the Community, facilitating growth- and employment-oriented sustained economic, social and ecological development in Europe in the following areas:

- a harmonious macroeconomic policy mix applied in conjunction with monetary and fiscal policy and with trends in wages and incomes to achieve an enduringly high rate of employment - structural policy, including reforms of the markets for goods, services and capital along with their impact on employment and sustainable development - labour market policy within the framework of and pursuant to a coordinated employment strategy (Title VIII EC).”

Apart from the broad economic policy guidelines there are a number of unconnected and parallel “processes”, some of them based on Art. 128 (2) of Employment Title VIII, which have derived from Community procedure: the Luxemburg, Cardiff and Cologne processes.

- In order to gear economic policy substantively towards a coordinated employment strategy and to render it more transparent, the DGB believes that these diverse “processes” should be integrated systematically into the annual procedures for drawing up the “broad economic policy guidelines” adopted each year, with the additional effect of democratising the consultation and participation procedure (management and labour, EP). The procedure would be simplified and processes would no longer need to run in parallel.

1.4 Budgetary rules for a common financial policy

The Stability and Growth Pact imposes arbitrary limits on expanding budgetary deficits and public debt. Financial policy has thereby sacrificed (national) autonomy without compensating by regaining autonomy at supranational level. The latter can above all be achieved by merging as yet disparate national financial policies into one financial policy voice, taking into account a redefinition of roles for the macroeconomic players.
The allocation of roles to date, regarded by the DGB as inappropriate, results in the ECB being responsible for price stability only, financial policy for a "neutral", balanced budget, and management and labour policy for employment. The right approach would be for the ECB to take responsibility for employment and growth as well as price stability, and financial policy for the cyclical stabilisation of employment ("automatic stabilisers") and for providing an infrastructure which encourages growth. Growth in incomes should not exert inflationary pressure.

The Stability Programmes which Member States have revised annually since 1999 take no account of (global) economic cycles in pursuing the consolidation objective of eliminating budget deficits by 2004 and in the longer term creating surpluses to reduce public debt.

- The budgetary rules laid down in the Treaty with a view to ensuring that the national budget policies of Member States do not conflict with centralised monetary policy (Art. 101 to 104 EC), and supplemented by the reference values in a Protocol attached to the Treaty and by the Stability and Growth Pact of 1997 (which does not have Treaty status), must be amended such that:
  - loan-financed public investment in sustainability-oriented infrastructure is not in future subjected to the 3% deficit rule (inclusion of Golden Rule in EC) if it is established that total public spending, in particular spending financed by borrowing, is of a quality designed to achieve sustained macroeconomic growth
  - and the "automatic stabilisers" built into the tax and social system can function without impediment.
  - The EMU countries must coordinate their financial policy effectively, gearing it to changing cyclical and growth requirements and enabling public budgets to cater for a fair distribution of income. The Euro Group which has been meeting informally to date should, therefore,
be granted formal Treaty status in the context of the budgetary regulations referred to above.

The principal aim of the requested amendments is to create a macroeconomic framework within which public investment is able to keep pace with modernisation requirements in each national economy while companies also have adequate leeway for investment.

For this reason, having been revamped accordingly the Stability and Growth Pact should acquire Treaty status. Incentives are needed to generate a sustained consolidation strategy able to respond to the needs of the economic cycle, i.e. to combine consolidation with economic upturn, so that budget policy can maintain a desirable flexibility throughout the economic cycle within the broad economic policy mix, providing continuity for growth and for expanding employment.

The national Stability Programmes should introduce reference values for spending in these categories and these should be monitored at Community level. In order in future to take due account of the quality of public spending, greater attention must be paid to the structure of public budgets (investment vs. consumption) rather than focusing simply, as at present, on the balance sheet.

1.5 Services of general interest

Services which serve a public interest, whether they are performed by a public or a private agent, exercise an indispensable function towards achieving economic and social progress in Europe and maintaining regional cohesion. Past attempts by the European Commission to strengthen services of general interest (SGI) have not been very successful. A future European Constitution should take a decisive step forwards:

- The creation of framework conditions permitting the provision of high-quality and universally accessible SGI should be included in Article 2 as a Community task and in the list of activities under Article 3 EC as a policy objective equal in importance to competition policy and the creation of an internal market.
A new social contract for Europe

Macroeconomic policy coordination in Europe

Provision for this activity should if possible be more precisely defined in a chapter of its own. At the very least Article 16 should be amended as follows:

- “(1) Given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions.

- (2) The national, regional and local authorities of Member States must, in accordance with the laws and practices of the respective state, retain the power to decide freely how they wish to operate a service of general economic interest.

- (3) Without prejudice to the exercise of official or non-profit-making activity, the [EU] rules of competition shall only apply to the organisation and operation of services of general economic interest to the extent determined for each sector by the Council and the EP (by qualified majority and on the basis of co-decision) with consideration for the principles and objectives of services of general economic interest. Neither state aid provided for the organisation of services of general economic interest, nor special or exclusive rights shall be regarded as practices which distort competition if the sums granted are appropriate in order to achieve a determined objective.”

In addition to this,

- The European Constitution should explicitly endorse the principle of neutrality with regard to ownership.

- The basics of a Community policy of this kind to strengthen SGI should also be an explicitly binding feature of the Union’s foreign and commercial policy.
1.6 Composition of the Economic and Financial Committee (EFC)

Art. 114 (3) entrusts the composition of this most important committee in terms of economic policy to a qualified majority of the Council acting on a proposal from the Commission. Since 1998, before the third stage of EMU took effect, seats on the EFC have been held not only by the ECB, but also by the national banks of the Member States, although since 1 January 1999 they have no longer been responsible for their own monetary policy. This has created an economic policy imbalance, with representatives of central banks outnumbering representatives of governments. The DGB therefore demands:

– deletion of Art. 114 (3), with Art. 114 (2) clause 3 to be amended as follows:

“The Member States, the Commission and the ECB shall each appoint no more than two members of the Committee, the ECB simultaneously representing those central banks in the ESCB participating in EMU. Member States not participating in EMU may appoint representatives of their domestic central banks as Committee members.”

1.7 The Employment Title of the EC Treaty

The inclusion of the Employment Chapter in the Treaty of Amsterdam (Art. 125 to 130 EC) and the coordination procedure outlined there, with its focus on labour market policy, annual employment guidelines, national action plans and evaluations, and recommendations to Member States by the Commission, has essentially proved its worth and should be retained. The formulation of quantitative targets must, in particular, be upheld to make this commitment as binding as possible.

In practice there are insufficient links between the coordination of economic policy (Art. 98 ff. EC) and employment policy. In the light of developments since the Treaty of Amsterdam and the demand raised by European management and labour to set up a growth and employment committee to accompany the “Lisbon strategy”, the DGB calls for Treaties to be amended in order to
create a meaningful link between macroeconomic and employment policy coordination. This link should be founded on paramount prioritisation. This requirement also derivesthe Commission’s desire to synchronise the drafting of the broad economic policy guidelines and the employment guidelines.

The European management and labour organisations have jointly called for the Treaty to institute a “growth and employment” committee to replace the Standing Committee on Employment. Moreover, the right envisaged in Art. 130 EC for management and labour to be heard by the Employment Committee should be reinforced.

1.8 Union social policy

To reflect the European Union’s commitment to the principles of the social state more clearly, the objectives formulated in the following Treaty provisions should be amended as below:

– Article 2 clause 1 EU, 1st indent: “[…] to promote economic and social progress, full employment and a high level of social protection […]

– Article 6 (1) EU: “The Union is founded on the principles of liberty, democracy, social justice, respect for human rights and fundamental freedoms, and[ […]”

– In Article 136 (1) EC the phrase “proper social protection” should be replaced by the phrase “a high level of social protection”.

During the present deliberations of the European Convention, any attempts to alter the substance of the Social Chapter or to dilute it must be countered. The DGB demands a more strongly defined policy of minimum social standards to narrow gaps in living and working conditions as the fruit of progress.

– The present option envisaged in Art. 137 (2) EC needs, therefore, to be replaced by the following wording: “To this end, the Council shall
Furthermore, the DGB reiterates its demands that

– the principle of decision by qualified majority should become the rule in social policy, with few exceptions;

– the European Parliament should participate in creating social legislation in all matters requiring adoption by a majority based on the participatory procedure described in Art. 251 EC; and

– alongside the Commission the EP should also be granted the right to initiate European social legislation, at least in the field of social policy.

The unanimity principle should only be retained for those matters referred to in Art. 137 (3) EC which either “have a financial impact or are constituent elements of the national social order”, as the DGB argued in its position paper on the Intergovernmental Conference in Nice. All the matters listed in Art. 137 (3) EC requiring unanimous agreement should be retained in that provision.

The DGB believes that the impact of integrating the Charter of Fundamental Rights in the European Treaties, above all on social policy provisions and specifically Article 137 EC, merits a legal appraisal of its own which should be presented during the course of the Convention’s deliberations.

The Open Method of Coordination – applied, for example, to co-operation between Member States in the field of social insurance – is a useful option wherever the basis for a Community procedure is not yet adequate or where a joint procedure does not serve the objective. Enshrining this method in the Treaty must respect the following two conditions:

– The method must ensure complete transparency and also the participation of management and labour and of the European Parliament.

– It shall fulfil merely a supplementary purpose without undermining the priority of minimum social standards.
1.9 Union commercial policy

Trade in goods and services has been a matter of Community policy since the Treaty of Amsterdam. However, a culture of secret negotiation dominates commercial policy. As commercial policy kicks in with broad structural reforms and an impact on employment and social policy,

– Article 133 should be amended as follows:

“(1) The common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies and to establish internationally recognised social and environmental standards in the worldwide trade and investment regime. In commercial policy the Member States and the Community act in accordance with the principles of a social market economy with free competition and promote the efficient and sustainable use of resources.”

“(2) The Commission shall submit proposals to the Council for implementing the common commercial policy after hearing the European Parliament, the Economic and Social Committee and management and labour.”

“(3) Where agreements with one or more States or international organisations need to be negotiated, the Commission, after hearing the European Parliament, the Economic and Social Committee and management and labour, shall make recommendations to the Council, which shall, after joint decision with the European Parliament, authorise the Commission to open the necessary negotiations. The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council and the European Parliament to assist the Commission in this task and within the framework of such directives as the Council and the European Parliament may issue to it.”

In spite of a transfer of competence, the unanimity requirement currently takes account of the particular political sensitivity underlying trade in ser-
vices in so far as the labour market and immigration are affected. The Treaty of Nice now envisages a qualified majority for Council decisions, with a small number of exceptions.

As a result, foreign trade is increasingly becoming a motor of structural change. In future, markets in the service sector can be forced to open up in spite of resistance from individual Member States, triggering sweeping reforms in the labour market of the country concerned.

– As long as the international economic order does not recognise minimum social and environmental standards as fair terms of competition, the unanimity requirement for trade in services as described in Art. 133 of the Treaty of Amsterdam must not be relinquished.

2. The European Union needs workers’ participation

Codetermination is an essential precondition for the effective defence of workers’ social and economic interests. In addition, workers’ participation in corporate decision-making enhances efficiency and reduces implementation costs. Finally, codetermination helps to ensure the necessary societal and political checks and balances which contain any excesses of economic power.

A reformed EC Treaty should enshrine workers’ participation as an indispensable component of a democratic economic and social order. The aim must be for regulations on co-determination to create a framework for the fair balancing of interests between capital and labour, taking due account of societal and economic conditions. In addition, workers’ participation in Europe must be conducted in such a manner, in the context of our increasingly globalised economy and society, that structural change is compatible with social justice and human dignity. Workers’ participation in Europe must serve the aim of protecting workers’ rights, designing a humane working environment and ensuring, not merely that participation is possible, but that it can be updated over time.

From the DGB’s perspective this means enshrining the following rights in the EC Treaty:
the right of all working men and women to be represented in their
company regardless of its size and of the nature of their employment
contract, and without their employer obstructing the democratic des-
ignation of their representatives,

the right of all working men and women to detailed information,
consultation and negotiation in all major company matters, and

equal participation of working men and women in all company deci-
sions of significance to them.

One task of the European Community is to implement a common market.
The key objective is “to promote throughout the Community a harmoni-
ous, balanced and sustainable development of economic activities” (Art. 2
EC Treaty). This, however, includes those interests worthy of legal protec-
tion of all persons whose economic and personal existence depends on
companies in which they have no stake under company law. That is why
particular importance needs to be attached to creating a genuine economic
and social democracy which extends to all working men and women.

Working people’s right to information, consultation and participation
must, therefore, be recorded in the very principles of the EC Treaty.
The above-mentioned participatory rights must be included in Art. 2
as a Community task and in Art. 3 as the object of a common policy
shared by the Community as a whole.

The provisions of Art. 136 EC Treaty must, in addition, stipulate as
an explicit objective the equal participation of working men and
women in all company decisions of significance to them.

3. The European Union needs social dialogue

The European social model is deeply influenced by the active involvement
of management and labour at European and national level. Articles 137 to
139 create the foundations for forms of consultation in the drafting of
social policy legislation and make provision for autonomous negotiations.
Furthermore, the European Economic and Social Committee (ESC) (Arti-
cles 257–259) is a consultative body which plays an important complementary role, enjoying extended technical competence in all essential policy areas and exercising its ability to draw in addition on the participation of organised civil society.

– The future Constitution and structure of the EU should facilitate closer interaction and linkage between the basic components of social dialogue and consultation, reinforcing and efficiently updating them, partly with a view to the consequences of integrating the Charter of Fundamental Rights into the Treaty.

Strengthening social dialogue primarily means granting management and labour greater scope for action at European level. To make use of this they need the necessary instruments, an institutional and legal framework and a clearer profile than in the past. The following fields of action can essentially be outlined:

– The Treaty basis of European social dialogue (Articles 137-139) should be amended to do justice to the various processes of consultation and negotiation in which management and labour engage by differentiating between the different levels and enhancing the inter-play between general and sectoral negotiations and consultations. A clear distinction must be drawn between civil dialogue and the bilateral social dialogue between management and labour. Consultation procedures should be rendered more efficient, their outcomes and conclusions should be available more swiftly and the factors taken into consideration should be presented more intelligibly and in a more binding form. Sufficient incentives should at any event be provided for autonomous negotiation to be outcome-oriented and produce binding results.

– There must be improved interplay between the various bodies of social dialogue and the outcome of their efforts. One way to achieve this would be to facilitate the binding exchange of information by means of a common institutional substructure. A locus of this kind might si-
multaneously strengthen the autonomous dialogue between management and labour in Europe. Ideas should be developed on how to institutionalise this and under what conditions. One possibility would be for a reformed European Economic and Social Committee to provide this support in future, although two important conditions would have to be met: total respect for the autonomy of management and labour and non-impairment of the ESC’s role as a forum for civil dialogue, i.e. a clear separation of the two functions.

– An efficient clustering of the social dialogue at European level would also enable the sectoral committees for social dialogue to interact more closely with the overarching social dialogue, encouraging a better exchange and better mutual support without sectoral dialogue sacrificing its independence. This creates an important bridge to the work of the European works councils. The direct connection from European to national level is a key element. Appointment procedures and opinion-forming processes will have to be structured accordingly, with more support in future for the European management and labour organisations.

Reinforcing management and labour at European level does not call for an imposed harmonisation of different national systems of industrial relations. All efforts aimed at an artificial standardisation of national traditions in dialogue between these two partners would in fact prove counterproductive, as it would almost inevitably provoke a blockade. It is equally true, however, that only the common experience and practice of healthy European social dialogue, including scope for social action, can pave the way for a European system of industrial relations. The DGB will continue working on ideas for the structure and functioning of European social dialogue, and this will include examining the merits of alternative models, such as an independent European foundation for management and labour or a separate European management and labour committee.
4. The European Union needs true gender equality

The European Community has been noted in the past for the major steps it has taken towards gender equality and the great progress which it has prompted in the Member States, not least Germany. Tried and tested elements of the EC Treaty should, therefore, be retained by the new European Constitution. The DGB concludes from this that:

– the existing Articles of the EC Treaty devoted specifically to matters of equality derived from gender or women’s policy (Art. 2, 3 (2), 13, 141 EC) should not be amended, except in so far as improvements are proposed below.

Nevertheless, fundamental inequalities persist in crucial areas:

– The average income of women in full-time gainful employment is still very different from that of men. The gender wage gap in the Union is 14% on average.

– The employment rate for women is still considerably lower than for men.

– Women are found more rarely in leading positions or the higher echelons of company management.

– For all they progress, especially in certain EU Member States, women are still heavily under-represented in political positions.

4.1 A new constitutional framework for the European Union should do justice to the fundamental objective of equality by means of broad provisions and new instruments

Art. 2 EC Treaty, which designates tasks for the Community, includes equality between men and women. However, the other objectives listed are formulated in isolation from this aim and should, therefore, be defined more clearly in terms of real equality. This would make it clear that any measure taken to achieve a particular objective must also be a step towards true gender equality. For example, if the DGB calls for full employment as
an objective, adding the words “for men and women” indicates graphically that this objective should also work towards equality.

4.2 Policies on women and equality as a separate policy area

In the past – apart from the principle of gender mainstreaming in Art. 3 (2) EC – the Community has not formulated any independent activity to be targeted specifically at women. For the effective implementation of its objective, therefore, the Union should establish a new field of action.

The existing EC Treaty does refer in general terms to a number of equality demands (Art. 2, 3 (2) EC Treaty) and to certain responsibilities for eliminating gender discrimination (Art. 13 EC Treaty). However, more detailed formulations are only envisaged in one particular policy field, i.e. in the Chapter on social policy (Art. 141 (3 and 4) EC Treaty).

There are, nevertheless, other fields of policy apart from social policy for which the EU has to date taken no or only incipient responsibility but which are of considerable importance in defending the interests of women in the EU. Certain new competences should, therefore, be created, with due consideration for the principle of subsidiarity, for example in the following areas:

– combating traffic in women,
– violence against women,
– equal rights in political decision-making processes.

Although the existing Art. 3 (2) EC Treaty calls for the application of gender mainstreaming across all policy areas, this has not been sufficiently implemented. Concrete tasks should, therefore, be defined to ensure that this approach is actually implemented in each specific policy area. Examples of these are:

– health, reproductive health,
– foreign and foreign trade policy,
– budgets.

Summing up our position on Treaty reform in this respect, the following equality policy demands must be taken into account:

– Policy on women and equality must be adopted as a field for independent Union activity (so far Art. 3 EC).

– A new Chapter on equality policy is needed which will express the general objective of equality in concrete terms; with all due consideration for the principle of subsidiarity, this means defining the appropriate competences and procedures (qualified majority).

– Specific goals must be adopted for the Union’s other policy areas, envisaging effective measures to achieve gender equality in each respective field.

Conclusion

The Deutscher Gewerkschaftsbund calls upon the members of the Convention, in drawing up a Constitutional Treaty, to pay greater attention than hitherto to social aspects. The aim of deliberations in the European Convention must be a new social contract for Europe. The legal foundations must, therefore, be created for a Union which can guarantee the men and women who live in it economic stability and social justice, democratic participation and solidarity. The Deutscher Gewerkschaftsbund champions this vision.
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