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CONVERGENCE AND STABILITY IN THE EURO AREA THROUGH EFFECTIVE MACROECONOMIC POLICY COORDINATION

Willi Koll[1], Andrew Watt

ABSTRACT

Against the background of the massive Euro Area crisis and especially the inflation and nominal wage developments in different member states that preceded it, this study analyses the serious defects of current – and also proposed – economic governance of European Monetary Union. The fundamental conditions for macroeconomic stability, convergence and growth, at EMU and member state level, are derived, as is the need for coordination between the macro actors at both levels. A proposal for institutional reform is put forward to operationalise this analysis. The approach is preventive and builds on existing rules and institutions. It builds a bridge between risk-sharing and risk-reduction. Specifically, it consists of (1) an Advisory Board for Macroeconomic Convergence to develop scenarios and options economic development that respects the above stability and growth conditions, and (2) a Macroeconomic Dialogue to assess politically and implement suitable development paths, bringing together representatives of monetary and fiscal policy and the social partners. Both bodies should be established at both national and EMU level. The EU and its Member States should commit themselves not only to re-tiling the fiscal and financial-market policy roof anew, but also to strengthening the macroeconomic foundations of EMU as a whole, drawing on support by the social partners.

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[1] Formerly director in the Federal Ministries of Economics and of Finance as well as member of the Economic Policy Committee of the EU, OECD and Macroeconomic Dialogue of the EU.

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Executive summary

Recent years have seen vigorous debate regarding the future of the European Union (EU), with widely diverging opinions on whether inner-European ties should be loosened, even give up altogether, or, rather, deepened. This is particularly true of European Monetary Union (EMU). This contribution analyses the conditions needed for a successful economic and fiscal union, dealing only tangentially with reforms in the financial sector and the deepening of the social dimension of EMU. It makes a set of concrete and politically feasible proposals to underpin balanced, crisis-free growth. Unless real economic trends in the member states can be stabilised and imbalances between them limited, a banking union, for example, will be unsuccessful and social-policy objectives will be difficult to achieve.

EMU was built on a range of concepts, procedures and institutions, some of which have been reformed in the wake of the crisis. They were largely guided by a belief in restrictive fiscal policy and structural reforms to increase competitiveness as economic-governance panacea. This approach ignored certain fundamental macroeconomic conditions and interrelationships and was an important factor in the build-up of critical imbalances and the destructive crisis itself. Worse still, the attempt to tackle the crisis using the same approach has led to new divergences. Particularly serious is the still excessive unemployment in many Member States, but also the hidden dangers of an increasing surplus in the current account balance of EMU as a whole. While signs of recovery are visible, many member states remain far from a stable and vigorous economic development path.

It is not least because of the severe failures of crisis management that many citizens have turned their backs on the EU. Brexit is only the tip of an iceberg of a "renationalist" turning away from Europe in many member states.

Against this background, the EU's Parliament, Council and Commission in particular have sought a fresh start. Many proposals for improving the economic governance of EMU have been put forward, by the institutions themselves, and policy-oriented economists and political scientists. With the Brexit drama revealing the high cost of leaving the EU, and worrying geopolitical hegemonic tendencies in other parts of the world, citizens' support for the EU has increased again. This is a second chance, but perhaps also the last one, especially if the recovery, which has now been going on for many years, but is still fragile, should come to a halt or prove too weak in the long term, because of economic policy shortcomings at national and EMU level.

Our analysis shows the urgent need to address the pathological imbalances between the Member States of EMU that built up due to sustained divergences in both price competitiveness and domestic demand volumes. Given a common monetary policy, both were the result of major differences in economic dynamics on entry into EMU, in subsequent wage and price developments and often of misguided fiscal policy stances – at least partly due to rigid, one-sided fiscal rules. In the course of time, these differences increased persistently and procyclically before coming to a head in an immensely costly crisis.

Even after various reforms we show that there are serious shortcomings in the institutional framework of EMU and policy implementation: institutions and regulations stand unrelated next to each other where linkages are indispensable; they focus on sub-areas where it is the overall policy mix that is crucial. They aim at corrections and sanctions where prevention is more successful. At the same time, inadequate use is being made of existing institutional potential. Although some of the new proposals are ambitious, they are still piecemeal and incomplete. There is a lack of broadly based scientific expertise to guide policy towards mutually consistent policy stances by different actors. Above all, there is a lack of adequate involvement of the national level and here, in view of its importance, especially in terms of wage and price trends. Overall, the macroeconomic dimension of economic policy must be given greater focus than before. So-called structural reforms can sometimes facilitate macroeconomic solutions, but never replace them.

Two fundamental prerequisites, derived from theory, need to be met in all EMU member states for balanced growth: (1) a stability condition – price and unit labour cost developments in line, over the medium term, with the ECB's inflation target – to avoid further damaging divergences, (2) a growth and employment condition – the rates of nominal GDP and wage growth must be such that sufficient employment can be created. Both conditions are, in equilibrium, together necessary and sufficient for an economic policy geared to stability and growth. Given existing imbalances, the two conditions must be implemented in such a way that surplus countries are more dynamic in terms of both volume and price trends than the deficit countries.

Formally, each macroeconomic goal is assigned an instrument for achieving it. However, no instrument is self-sufficient in achieving its objective, nor neutral in relation to the objectives of the other instruments. Experience shows the high-cost of inadequate coordination in the past, such as during the oil-price shocks or following German unification. Coordination via cooperation between the monetary, fiscal and wage policy players can generate substantially better outcomes. To the extent that fiscal and wage policies ensure price stability, monetary policy can and must provide the most favourable conditions possible for investment and employment. This has long been prescribed by the EU "Broad Economic Policy Guidelines", but also by Article 121 of the Treaty on the Functioning of the European Union itself. The problem lies in the lack of responsibility (ownership) and implementation by economic policy actors.

Against this background, many of the new proposals currently under discussion are still too focused on fiscal policy and on resolving serious macroeconomic emergencies once they have occurred. This applies in particular to the macroeconomic stabilisation function and the European Monetary Fund. Effective measures against a crisis are necessary. However, proposals are even more needed to prevent such emergencies from arising in the first place: by underpinning sustainable, stable and dynamic macroeconomic development in all Member States and thus in the euro area as a whole. The proposal described below remains institutionally very parsimonious; in particular, Treaty amendments are not necessary and the concept can be implemented immediately.

Specifically, we propose: The establishment of (1) a body to develop scenarios and options for balanced and prosperous economic development that respects the above stability and growth conditions – an Advisory Board for Convergence, and (2) a political body to assess and implement such appropriate development paths while respecting the autonomy and independence of the actors – a Macroeconomic Dialogue. Both bodies should be established at both national and EMU level. Existing structures can be used and built upon: the Advisory European Fiscal Board and the National Productivity Boards, for the expertise, and the Eurogroup and the EU Macroeconomic Dialogue, integrated into the European Semester, for policy. The decisive factor here is that the mandate of both advisory and policy bodies needs to be extended beyond the previous limitation to fiscal and competitive objectives to the whole macroeconomic policy mix. There is only one completely new body in each Member State to be set up, a Macroeconomic Dialogue at national level, which, within the framework given by the single monetary policy, coordinates national fiscal and wage policies in compliance with the conditions outlined above, and thus gives a substantial boost to the “ownership” at national level that has been lacking up to now.

Wage and price developments in the Member States play a special role here. Social partners with macroeconomic competence and responsibility can and must directly exert their influence with respect to the required stability of wage and price developments and thus also on the primary distribution of income. Industrial relations structures of this type do not exist in all Member States; in the course of the post-crisis adjustment, existing structures have even been dismantled. The development of economically competent and responsible social partnership structures is an extremely worthwhile investment, for without effective social partners, the stabilisation task falls solely to fiscal policy. However, within the framework of existing fiscal rules, this can be impossible or at least cause very high economic costs, coupled with political conflicts over the deployment and extent of the often proposed new European "rescue measures". Critics see the danger here that the use of these instruments, rather than the exception, will become the rule, and their resources will quickly be exhausted. As a result, reform projects involving substantial risk-sharing at EMU level suffer from a lack of political acceptance. To the extent that a functioning social partnership exists or can be established and is given an appropriate place in economic governance, and at the same time national fiscal policy is systematically and symmetrically oriented towards stabilisation, the need for the use of such instruments at the level of the euro zone decreases immensely; the political acceptance for these risk-sharing measures increases accordingly.

Our proposals offer a path forward in a political debate characterised by one side demanding risk avoidance on the part of member states and the other calling for risk-sharing measures that support member states by providing stabilisation at Euro Area level. The proposals we have developed here promote a deepening of and a convergence within European Economic and Monetary Union by intensifying macroeconomic coordination, both between and within the national and EMU levels, and thus can be seen as a providing a lynchpin between risk-avoidance and risk-sharing.

1 Introduction

The global financial and economic crisis has revealed serious shortcomings in the architecture of the European Economic and Monetary Union (EMU). The run-up to the crisis was characterised by serious divergences, and the crisis itself and inadequate response to it show clearly that a substantially higher degree of economic policy coordination is required to keep the economy on a balanced and stable growth path. If the common currency is to be rendered sustainable, decisive reforms will be needed.

While the economic governance reform needs are comprehensive and interlocking, we focus here on what we consider to be the critical issue: the divergence of competitiveness and of domestic demand growth between the member states of EMU, and the related build-up of macroeconomic imbalances. Solving this problem, and ensuring greater convergence, is a necessary condition for stable economic growth in the Euro Area. To the extent that effective macroeconomic policy coordination, particularly at the national level but at the same time ensuring consistency between countries, ensures stability and prosperity – the two main goals of the proposal – and increases the "ownership" of policymaking decisions, the need to resort to new fiscal capacities and instruments at Euro Area level can be limited to exceptional cases. Tying together risk avoidance and risk sharing in this way, with an emphasis on subsidiarity, will at the same time increase the political acceptability of the proposed measures whose introduction, for the time being, remains controversial.

This is an abridged and updated version in English of a study in German (Koll/Watt 2018) and is structured as follows: Section 2 provides a brief analysis of the causal factors leading to the divergences and imbalances that played the decisive role in the crisis. We then sketch out the existing economic governance framework and some of the planned reforms, pointing out their weaknesses (3). In section 4 we derive theoretical conditions for balanced, non-inflationary growth in a monetary union. On this basis we present, in section 5, a reform agenda that as far as possible builds on existing or already planned institutions and procedures. It integrates and coordinates monetary, fiscal and wage policies with a view to ensuring a policy mix that promotes dynamic, tension-free and balanced economic development in individual member states and the currency union as a whole. Section 6 concludes.

2 Imbalances and the crisis: a causal analysis

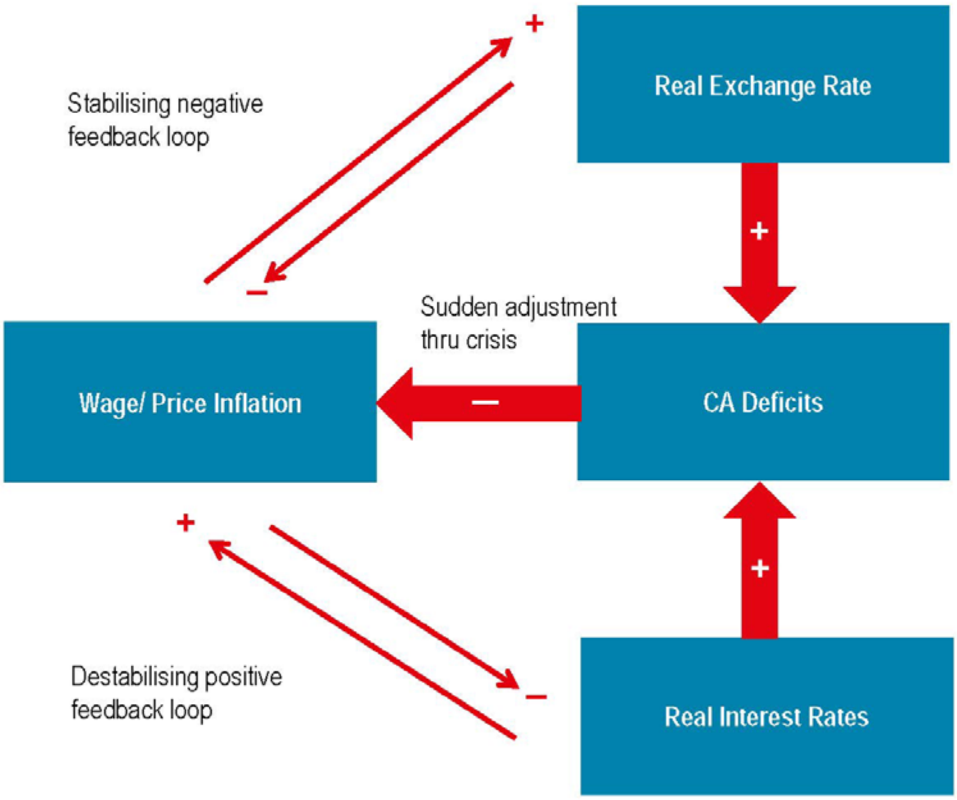
2.1 How macroeconomic imbalances arose

The euro crisis was not primarily a consequence of lax fiscal policy or an initial lack of competitiveness on the part of those countries hit hardest by the crisis. Rather the cause lies in the lack of an effective framework guiding economic policy, appropriately institutionalised, both at national and at Euro Area level, one that effectively counters an in-built tendency for self-reinforcing, broadly symmetrical, pro-cyclical divergence. This view – which was advanced by the present authors long before the crisis (e.g. in Koll 2004, Watt 2004) only gradually gained traction in the academic debate (see for instance the "consensus" in the contributions to Baldwin/Giavazzi 2015) and has only recently led to some concrete policy initiatives.

The susceptibility of the monetary union to crisis results, in this view, primarily from three systemic institutional weaknesses.

First, the centrifugal forces unleashed by differences in real interest rates – which reflect the different price and nominal wage developments between countries with a given common nominal interest rate – are much stronger in the short and medium run than the re-equilibrating forces of the difference in the real exchange rate. Even in rather open economies, the latter effect – higher inflation at a given nominal exchange rate reduces competitiveness and thus dampens demand and price pressures – has a very weak corrective impact, until a massive divergence has built up, accompanied by rising foreign indebtedness. Only at this point does adjustment occur, but it takes the form of a sudden shock and huge crisis. Moreover adjustment pressure is one-sided, on the deficit countries. The way that the initially weak, equilibrating real exchange-rate effect and the stronger, disequilibrating real interest-rate effect work is illustrated in a simplified form in Fig. 1, for the case of a country like Spain in the run-up to the crisis.

Figure 1:
Weak stabilising and strong destabilising feedback effects in EMU



Second, the fiscal rules are inappropriate to the task of ensuring convergence. They do not force member states experiencing a boom, and where high rates of nominal growth paint the fiscal indicators in a rosy light, to tighten fiscal policy; they do not prevent a pro-cyclical stance in such cases. At the same time they force countries with low rates of nominal GDP growth and high unemployment to pro-cyclical tightening.

Third, there was no effective institutional structure to oversee nominal wage and price developments and, where there is persistent divergence, to bring about a symmetric adjustment to trajectories consistent with stable growth.

It is in particular this third point to which we now turn, taking a closer look at the role of nominal wages, more specifically of nominal unit labour costs – which adjust wages to account for productivity – and thus the role of wage-setting or "wage policy" in the formation of macroeconomic imbalances within the monetary union.

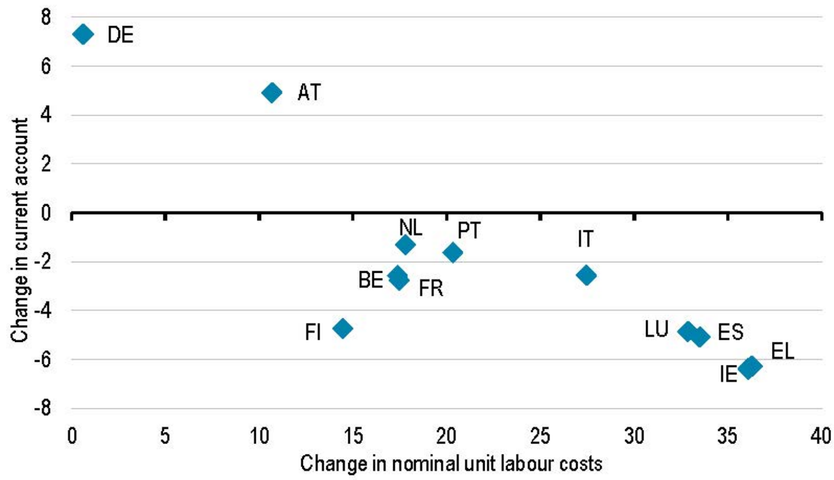
2.2 Wages: driver or bystander of the crisis?

The starting point of the debate is the undisputed empirical fact that there is a close correlation between changes in nominal unit labour costs and the current account since the introduction of the euro (Fig. 2). Up until the crisis those countries in which nominal unit labour costs increased at below-average rates – Austria and, by a large margin, Germany – experienced a pronounced shift into surplus of the current account position. On the other hand, those countries in which unit labour costs grew very rapidly experienced ever-widening deficits on current account. The

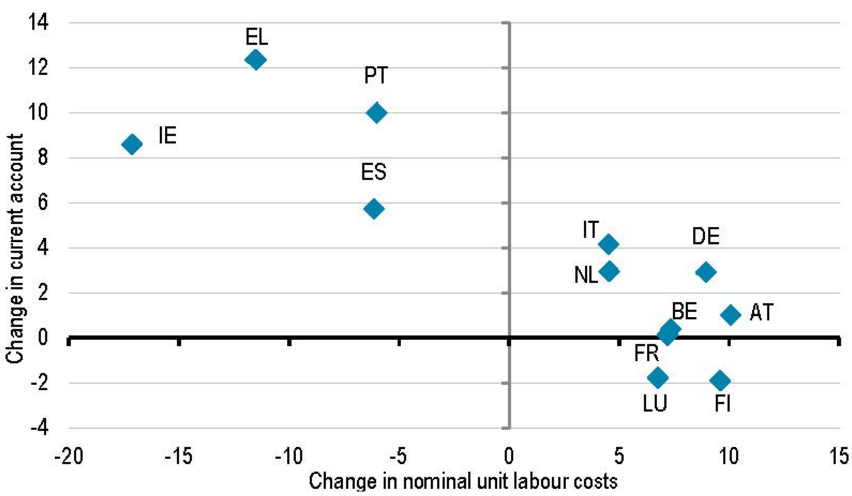
same correlation holds during, and in the recessionary phase following, the crisis, whereby in most cases the position of the countries reversed compared to the pre-crisis position, although, as noted above, without the desirable symmetry of adjustment between (former) surplus and deficit countries. As a result almost all the EMU member states moved into surplus and the current account position of the currency area as a whole exceeded 3% of GDP.

Figure 2:
Change in nominal unit labour costs (in %) and in the current account (in pp of GDP)

a) 2000-2008



b) 2009-2015



Sources: AMECO, own calculations.

Clearly, then, there is a link between nominal wage trends, allowing for productivity (i.e. unit labour costs) and changes in the current account. If the latter is held to be endogenous and a criterion for macroeconomic stability, then it would appear, at first sight, reasonable to consider wage (or unit labour cost) trends to be a critical variable. Yet a lively debate has taken place on how the relationship should best be understood.

A number of arguments have been put forward why focusing on wage developments as a causal factor behind imbalances and thus for the crisis is inappropriate[1]. We discuss some of the more important strands in the debate here.

- Not only wage developments, but also profits need to be considered, because there is no 1:1 relationship between unit labour costs and domestic prices. This is fundamentally correct. It is not wages themselves – whether collectively agreed or effective wages – and not even unit labour costs that exert direct effects. Price competitiveness and the real interest rate depend solely on price developments; distribution and thus the expenditure side of national income (consumption, saving) depend also on prices. There is thus no question that – in addition to taxes – profit margins need to be incorporated into the macroeconomic analysis and also policy recommendations. It follows that, as part of a consistent macroeconomic policy mix, it is vital to maintain and if needed re-establish effective product-market competition such that in the medium run prices and unit labour costs do not diverge substantially. At the same time it should be recognised that, even if capital mobility is far from perfect, profit margins cannot be squeezed indefinitely. Nor can the wage share fall into a bottomless pit without severe macroeconomic consequences. Consequently, the fact that unit labour costs and prices often diverge in the short (cyclical) and even medium term, does not mean that they are not linked in the longer term.
- A criticism often made of those focusing on wage policy in the crisis narrative is that both wage and price trends and changes in the current account are driven by (relative) demand dynamics rather than by changes on the cost side. From this point of view nominal wages are purely endogenous. In support of this argument it is frequently pointed out that there is only a weak correlation between unit labour cost developments and export performance; what drives the current account, it is argued, is the import side and therefore demand. This line of argument does scant justice to the complexity of the interrelationships, however. It is correct that the pace at which wages increase is affected by demand, and thus also by whether, for instance, a country is pursuing an expansionary or contractionary fiscal policy. But at the same time, wage trends influence, via their impact on prices, and thus via the real-interest rate channel described earlier, aggregate demand; in this way they also influence (alongside price competitiveness) the import side. It is therefore incorrect to restrict the analysis of the impact that wages have to a simple competitiveness effect. Wages also influence demand and imports. Not just that: the price effect (competitiveness) and the quantity effect (demand) push the current account in the same direction; in other words they are mutually reinforcing.
- Doubt is sometimes raised concerning the link between the price of exports and imports and current account developments. What is certainly true is that it is not the volume of imports and exports, but rather the corresponding values at current prices that are reflected in the trade and current account balances. If the price elasticity of demand is less than one, an increase in export prices driven by higher wages would lead to a fall in real exports, but to an increase in nominal terms (Horn et al 2017). However, the final result depends on the way the international competitors react to changes in export prices.

[1] There is an extensive literature on this issue. The following discussion relates primarily to Storm and Naastepad (2015a and b), Storm (2016) and Bofinger (2015 and 2016); see also Horn/Watt (2017, Watt (2007 and 2012).

- Particularly regarding the role of Germany, it is often argued that the country's export success has little to do with domestic costs (especially wage costs). Germany exports primarily to countries experiencing rapid growth, selling products in which non-price competitiveness plays an important role. This ignores the fact that all products are ultimately substitutes, to some degree, and are thus in competition via relative prices. If prices rise in a sustained fashion a threshold will be crossed, sooner or later, in which the accumulated price differential is tangible, leading to a quantity effect.
- Finally, some commentators have emphasised that core and periphery economies in the Euro Area do not compete on the same markets. A change in relative wages/prices would, therefore, have little practical impact on competitiveness and the current account. It is correct that product ranges do differ, and this suggests that the direct bilateral effects of wage trends might be limited. But this ignores, again, that the main impact is indirect, running through the real-interest-rate channel to demand. There is also the common exchange rate to consider. If the pace of unit labour cost and price increases pick up, in Germany for instance, this would be expected (ceteris paribus) to be associated with a weaker external value of the euro, which improves the external competitive position of the other member states. More generally, arguments relating to national export structures, price elasticities and productivity trends, put forward to downplay the role of prices and wages, refer to slow-moving variables that are hard to change in the short and even medium run. This means they are not well suited to explaining the very pronounced shifts in current account positions over a comparatively short period. In policy terms, they imply that while an industrial policy or other measures to increase productivity are likely to be helpful, they will at best exert a positive impact in the longer run.

For the purpose of our study we can draw the following theoretical and empirical conclusions from the previous analysis:

- In the absence of substantial risk-sharing measures and instruments for inter-regional transfers within the monetary union to promote convergence, macroeconomic imbalances are a massive threat to the effective functioning of the common currency.
- Nominal wage developments – whatever the precise degree to which they are exogenous or endogenous – play a crucial role (for a given productivity growth), in the creation of macroeconomic divergences between the member states.
- This impact works both through price channels – competitiveness and the terms of trade on both the export and import side – and through demand-side channels, including the real-interest-rate effect on import quantities.
- Economic governance instruments within a monetary union should consequently be such as to ensure that wage and price developments in each member state are in accordance with the price stability target of the monetary union as a whole.
- The extent to which wage policy can be actively deployed to this end depends on institutional characteristics that are met to varying degrees in the different member states. Wage policy certainly cannot perform all the needed adjustment: in any case member state macroeconomic (demand-side) policies need to adopt a consistently counter-cyclical, i.e. stabilising stance. This is primarily the task of national fiscal policy; in some circumstances an anti-cyclical macroprudential policy – for instance to rein in a housing boom – can be deployed. Counter-cyclical policy should be deployed symmetrically in boom and recession.

3 Overview and critique of existing and envisaged economic governance structures

3.1 Existing institutions and rules

The economic governance of the EU and the Euro Area relies on a large number of different regulations, institutions and procedures. The overarching roof is currently provided by the Europe 2020 Strategy which sets five headline targets for 2020 to deliver smart, sustainable and inclusive growth. The Broad Economic Policy Guidelines form part of the structure. Since the early days of the EU, they have been at the heart of attempts to coordinate member state economic policy; more recently they have been integrated with specific guidelines referring to employment policy to form the Integrated Guidelines in the context of the Europe 2020 strategy.

The main instrument to monitor and guide fiscal policy is the Stability and Growth Pact (SGP), as subsequently extended and deepened by the directives of the so-called six-pack and two-pack. An additional layer was added for most countries (including all Euro Area members) with the intergovernmental Treaty on Stability, Coordination and Governance (TSCG), usually known as the Fiscal Compact.

With a view to the divergences that built-up prior to the crisis a directive was passed establishing a Macroeconomic Imbalance Procedure (MIP), modelled on the SGP, and involving an Alert Mechanism Report by the EU Commission and in-depth monitoring of countries held to be exhibiting excessive macroeconomic imbalances.

The economic governance process was put on an annual cycle – known as the European Semester – in 2011. Taken together these processes and regulations form a decidedly complex web of governance channels.

3.2 Institutional reform initiatives

A substantial number of new initiatives have been put forward as part of a debate about deepening EMU. We briefly discuss some of the most important and relevant in the context of our own proposals:

The report *Completing Economic and Monetary Union* by the presidents of five European institutions (Commission, Council, Parliament, Central Bank and Eurogroup), usually referred to as the Five Presidents' report (Juncker, Tusk, Dijsselbloem, Draghi, Schulz 2015) was issued in mid-2015. It proposed completing EMU by moving towards an economic, financial and fiscal union in a two-stage process, and ultimately towards a political union.

The *Council Recommendation on the Establishment of National Productivity Boards*, of 13 June 2016 (Council of the European Union 2016) was the first concrete and binding step that issued from the Five Presidents' Report. The aim of the productivity boards is to monitor and coordinate productivity and competitiveness trends within the Euro Area, seeking to increase the "ownership" of national reform agendas by the member states.

The European Parliament Committee on Constitutional Affairs issued a report *On possible evolutions of and adjustments to the current institutional set-up of the European Union*, with Guy Verhofstadt as rapporteur (European Parliament 2016). It undertakes a profound critique of the inadequacies of governance in the EU more generally and, consequently, makes recommendations for deepening the Euro Area that go considerably beyond those of the Five Presidents' Report. In particular a "convergence code" is called for which would combine macroeconomic, fiscal and monetary policy instruments and substantially reduce the economic policy-making autonomy of Member States in favour of greater authority for a European Finance Minister, who would be Commission's Vice-President, accountable to the Council and Parliament.

The European Commission has issued a series of proposals, starting with a *White Paper on the Future of Europe* (European Commission 2017 a) which sketched out five different scenarios, with differing degrees of integration, for the European Union to the year 2025. It was followed by a *Reflection Paper on deepening Economic and Monetary Union* (European Commission 2017 c), in which the Commission made concrete proposals to implement the ideas of the Five Presidents' Report (for a commentary see Koll 2017: 704ff.)

The most recent paper was the *Roadmap for deepening Europe´s Economic and Monetary Union* as part of the so-called Nicholas Package of the Commission, issued in early December 2017 (European Commission 2017 d) with proposals for an initial deepening to 2019 and initiatives aiming at completing the process of deepening EMU by 2025. The most important measures are: setting up a European Monetary Fund; incorporating the intergovernmental TSCG – the so-called Fiscal Compact – into EU law; new budgetary instruments to (1) support member states conducting structural reforms (2) promote convergence by EMU candidate countries, (3) provide a backstop for banking union and (4) provide stabilisation against asymmetric shocks, and a proposal for an economy and finance minister who could be Commission vice-president and chair the Eurogroup.

Alongside initiatives by the EU institutions, there has been no shortage of proposals from academics and think-tanks. Particularly noteworthy among them is the recent paper on *Reconciling risk sharing with market discipline: A constructive approach to euro area reform* (Bénassy-Quéré et al. 2018; for critiques see s. Hüther and Matthes 2018, p. 30-34, Watt 2018). In it a group of 14 German and French economists presented a detailed package of reforms that seek to match "risk-sharing" with greater role for "market discipline" which is supposed to force member states to reduce risk. The most important proposals are:

1. Completing banking and capital market union, introducing a common deposit insurance mechanism and financial disincentives for banks to hold highly concentrated portfolios of bonds issued by their own government
2. Replacing the Maastricht fiscal rules with an expenditure rule, under the supervision of independent fiscal councils, with the aim of avoiding pro-cyclical fiscal policy.
3. A procedure for orderly government debt restructuring for countries whose solvency cannot be re-established with the help of bridging loans.
4. A stabilisation fund for countries facing large crisis, provided they have conducted policy in accordance with the rules.
5. A new financial product (ESBies) consisting of a pooling of government bonds, the tranche of which is to serve as the safe asset for the Euro Area financial system.

3.3 Critical evaluation of the economic governance status quo and reform debate

The economic governance of the EU and the Euro Area consists of a bewildering diversity of existing and proposed institutions and procedures. However, as economic developments prior to, during and in the wake of the Euro crisis have shown, the already existing instruments and those introduced as part of crisis-management strategies failed to keep national economies and that of the currency area as a whole on an acceptable macroeconomic trajectory.

Several of the institutional reforms put forward for discussion since then do hold out the promise of bringing about greater convergence and resilience. Yet taking existing and proposed measures that stand a chance of political implementation together, it must be doubted whether they are sufficient. There are a number of reasons for this.

Ensuring balanced macroeconomic developments across the Euro Area means taking full account of the interdependencies between different policy areas. This is precisely what the current economic governance architecture fails to do. The SGP, together with the other fiscal rules, have led a life of their own, conceptually and institutionally, from the outset. The MIP is also a largely self-contained process. In addition, because the trigger values for the indicators that make up the scoreboard are set asymmetrically, penalising deficit countries, it fails to take adequate account of the interdependencies between Euro Area countries. The lack of a lynchpin holding together the SGP and the MIP, as the two crucial elements of the economic governance structure is a critical weakness.

The framework does not cover all key macroeconomic interrelationships. Monetary policy is not adequately tied into the broader economic governance framework. Nor are wage developments and wage policy, which as section 2 shows are critical for balanced economic growth. Related to that, income and wealth distribution – here in terms not primarily of social outcomes, but rather of their impact on domestic demand, current account positions and the financial sector – are also sidelined.

Above all what is lacking is a conceptual and institutional framework that ensures an interaction between monetary, fiscal, and incomes policies that is oriented towards stability, convergence and prosperity, and mechanisms to weigh policy trade-offs and avoid negative while promoting positive spillovers.

At the same time it is true that existing institutions have a potential governance capacity that is not being anything like fully exploited. The Broad Economic Policy Guidelines are, on paper, *the* economic policy coordination instrument of the EU. Long before the SGP, not to mention the MIP, were introduced, what was then Article 99 of the EC-Treaty and is now Article 121 of the Treaty on the Functioning of the EU (TFEU) set out in detail a procedure to monitor, and make recommendations on, member state economic policy, with the possibility to issue warnings and, ultimately, sanctions. For decades the BEPGs have called for member states to ensure that nominal wages grow on a path compatible with price stability and real wages in line with productivity. Yet the authorities have failed to make active use of Article 121 and have relied on "market forces" to correct the crisis-inducing nominal divergences.[2]

The National Reform Programmes that were introduced as input by member states to the European Semester largely consist of statements of what has already been decided – in Germany for instance in the Annual Economic Report (*Jahreswirtschaftsbericht*) of the government - without substantial European value-added. The Country-Specific Recommendations that are the result of the European Semester have until recently primarily focused on structural reforms and not on macroeconomic issues.

The Macroeconomic Dialogue of the European Union (EUMED) was set up under the German Presidency at the European Council meeting in Cologne in 1999. It is a forum at which leading representatives of monetary, fiscal and incomes policies can, in the light of the interdependence of these policy areas, exchange views on the preconditions and actions

[2] „It was a mistake to have focused above all else of government budgets. We should have monitored a wider range of macroeconomic parameters….the development of unit labour costs, current account deficits, real-estate bubbles. The Commission would have needed a mandate to take action to counter these imbalances in just the same way as against excessive government debt." (Original: „Es war ein Fehler, dass wir vor allem auf die Staatsfinanzen geschaut haben. Wir hätten ein breiteres Spektrum makroökonomischer Parameter überwachen sollen...Die Entwicklung der Lohnstückkosten, Leistungsbilanzdefizite, Immobilienblasen. Die Kommission hätte ein Mandat gebraucht, gegen diese Ungleichgewichte genauso vorzugehen wie gegen zu hohe Staatsverschuldung."), Regling (2010: 2). Klaus Regling was at the time Director-General at DG Ecfin, and is currently head of the European Stability Mechanism.

necessary for a tension-free macroeconomic policy mix delivering stable growth. It meets twice a year. Binding decisions are not taken, nor conclusions published; the autonomy of the actors is thus ensured. The goal is to promote mutual understanding and confidence between them. Thus, the EUMED has considerable potential, bringing together as it does, in principle, all the relevant policy areas identified above. Yet to solve the specific coordination problems of EMU, its effectiveness is very limited, for two main reasons. First the MED is an institution of the EU, not the Euro Area; the enhanced coordination needs of countries sharing a common currency cannot be adequately taken into account in such a framework. Second, participants in the EU MED represent the European level, and as such focus on the macroeconomic aggregates across all countries. They cannot speak to national developments and policies. There is no formal exchange with the decisive actors at national level: governments, primarily for fiscal policy, and the social partners, the "wage and price-setters". The European Semester does attempt to form a bridge between the national and the European level, but the effect has been limited, as shown for instance by the persistent failure to constrain Germany to reduce its excessive current account surplus.

The economic governance architecture also suffers from the fact that, while preventive measures are foreseen, they often do not have an effective constraining effect or are even counter-productive. As a result the focus of the measures in practice is in correcting past failures, rather than prevention. This is true of the SGP as well as the MIP. Both of the central indicators – the government budget balance and the current account balance – are variables that are determined at the end of a long causal chain involving both domestic and external economic processes.

Moreover, many of the proposals for further deepening currently under discussion, as sensible as they might be in themselves, are likely to be "end-of-pipe" in nature as well. This is true, for instance, of the planned macroeconomic stabilisation capacity or a European Monetary Fund.

Some of the new proposals are likely to be politically infeasible. The suggestions made by the EP's Committee for Constitutional Affairs, and even the much more limited proposals by the EU Commission in its Nicholas package substantially constrain the policymaking autonomy of national economic and fiscal policy. So far at least – up to and including the June 2018 Summit it has proved impossible to reach agreement on even very modest risk-sharing measures. Resistance in national capitals is strong, often justified with reference to the "moral hazard" that such capacities create for member state policymaking. Quite irrespective of whether such fears have a strong basis in reality or not, it appears that a compromise permitting corresponding changes to be made to the treaties will not be forthcoming. At the same time, all these proposals, including that of the 14 Franco-German economists virtually completely skate over the role of the social partners and wage policy, which must be seen as serious omission given the analysis above.

4 Theoretical conditions for stability, growth and coordination

Before moving to our own proposals, we present here the theoretical relationships that underpin the analysis and also the recommendations in a formal way.[3] Some readers may prefer to skip the following sub-section and resume at 4.2.

4.1 Theoretical conditions for stability and growth

The stability condition

In a monetary union, starting from an initial position of equilibrium and over the medium term, the price target of the central bank for the euro area as a whole must be met, while at the same time the inflation rate in all Member States must be in line with the price target, so as to avoid competitive imbalances.

Let (w) be the average annual change in nominal wages, (prod) the medium-term change in labour productivity and (p) the GDP deflator (so-called home-made inflation) for each Member State (i), and (pEZB) the price target of the ECB, then the following condition must hold in each MS, and also in the aggregate, over the medium term[4]:

(1) p(i) = p(euro area) = pEZB

If, additionally, all Member States respect the condition:

(2) w(i) - prod(i) = p(i)

then, under a common monetary policy,

- the (short-term) real interest rate is the same in all MS
- the functional income distribution (between labour and capital) remains constant.

As a consequence:

- the overall economic savings rate remains constant – in as far as it is determined by income distribution
- the ratio of domestic demand to net exports will remain unchanged, to the extent that it is determined by the savings rate, real interest rate and price competitiveness,
- macroeconomic divergences are avoided,
- the single monetary policy has the same effect on all MS,
- the real exchange rate of the euro area – insofar as it is determined by price competitiveness – tends to remain unchanged,

[3] See Flassbeck (1986), Koll (1988: 19 ff.), Hallwirth (1998: 117 ff.), Koll (2004: 137 ff.), Watt (2012 and 2017: 47ff.).

[4] For the sake of simplicity we abstract from changes in the tax share as a factor in the GDP deflator; terms of trade effects, reflected in a difference between p and the HICP – are to be accepted by the macroeconomic actors.

- the ECB can – and in accordance with its mandate, must – support the general economic policies of the Union, i.e. promote growth and employment, as price stability is not threatened[5].

The stability condition can be violated in several ways:

- The price trend in one Member State differs from that of the others, whereby the others comply with the ECB's price target:

$$(1a) \qquad p(i) \quad >/< \quad p(j),$$

(where p(j)= pEZB and p(i,j) is the deflator of GDP in Member State i and j respectively, and with j = 1 to n-1 and n is the number of Member States)

In this case, the price competitiveness of Member State i changes in relation to that of the other Member States. Furthermore, the ECB's price target is cumulatively breached, to an extent depending on the weight of Member State i and the inflation-rate differential. The real interest rate also changes in comparison with that in the other Member States, and thus also domestic demand and net exports. In the case of a permanent and persistent upward or downward breach by one or more Member States, this creates divergences which – as the previous analysis has shown – can build up, precipitating a crisis.

- Functional distribution changes in a Member State:

$$(2a) \qquad w(i) \quad >/< \quad prod(i) \; + \quad p(i),$$

In this case, the functional income distribution in Member State i changes, as do all variables dependent on it, such as savings rate, domestic demand and imports.

A particularly serious case arises from the simultaneity of the two cases mentioned above, with the result that the effects are cumulative; for instance, if the following applies:

$$w(i) \quad < \quad prod(i) \; + \quad p(i) \quad \textit{and}$$
$$p(i) \quad < \quad p\,(j) \qquad \text{mit } p(j) = pEZB$$

In this case, a decline in the wage share and (because of lower inflation) a relative increase in the real interest rate, which are both likely to squeeze domestic demand, is accompanied by an improvement in price competitiveness in the same country. Together this leads to an cumulative upward pressure on the current account balance – implying growing current account deficits in other MS – and, in the long run, to increasing divergences and a crisis.[6]

[5] The stability condition for all member states can be presented in a number of ways, whereby in each case p(i) = p EZB:

w(i) = prod(i) + p(i)
This is the golden rule of nominal wages.
p(i) = w(i) - prod(i)
This is the price rule for a neutral functional income distribution.
prod(i) = w(i) - p(i)
The additional output is fully absorbed by a change in the real wage

[6] This describes for instance the causes behind the bilateral divergence between Germany and France in the run-up to the financial crisis. In Germany the wage share fell while price competitiveness improved, whereas in France both variables remained more or less unchanged, and inflation was broadly in line with the ECB target.

The growth condition

The stability condition is not sufficient for growth to be achieved beyond the increase in productivity thus creating more employment. Another condition must be met for this:

It is definitionally true, taking ynom as the change in nominal and y in real GDP, that:

$$(3) \qquad ynom \quad = \quad y \quad + \quad p$$

and taking (e) as the change in employment that:

$$(4) \qquad y \quad = \quad e \quad + \quad prod$$

If the stability condition is met, i.e. (5) w = prod + p, then inserting (4) and (5) in (3) results in:

$$(6) \qquad e \quad = \quad ynom \quad - \quad w$$

i.e. employment changes in step with the difference between the change in nominal output and nominal wages.

To the extent that nominal output can be influenced by demand-side (monetary and fiscal) policy and nominal wage growth by some form of wage policy, the resulting change in the growth rate of employment can be steered by a coordinated economic policy.

4.2 Coordination

What follows from the theoretical relationships and the practical experience of EMU for policy-making?

A monetary union with simultaneous union-level and national responsibilities for macro-policy, we need to be concerned about:

- the appropriate role of each macroeconomic policy area
- the interaction of all macroeconomic policy areas to form a policy mix at the respective level
- the interaction of the macroeconomic policy mix between the national and currency union levels.

As far as the different macroeconomic policy areas are concerned, the following holds:

- Monetary policy should ensure that the ECB's inflation target is hit over the medium run. As long as the ECB's price target is met, the monetary authority must, in accordance with the Treaty, support general economic policies aimed at achieving the Union's economic policy objectives. In concrete terms, the central bank should create the most favourable macroeconomic conditions possible, using all monetary instruments, for fully utilising existing, and expanding potential employment and output.
- Fiscal policy, whether automatic or discretionary, performs a stabilising function for the macroeconomic policy mix. The stabilisation function is used both in the event of serious business-cycle fluctuations and asymmetric shocks. It thus contributes to achieving and maintaining the above-mentioned conditions of stability and growth in the respective country through a consistent countercyclical orientation.
- Wage developments must comply with the golden rule at national level. According to this, starting from an equilibrium situation, nominal wages should develop in line with medium-term productivity plus the ECB's price target.

- In the case of existing imbalances – such as continue to exist in the euro area, despite some convergence – this rule must be modified to take account of the need for adjustment between countries, so as reverse the divergences. This means that the wage rule needs to be temporarily exceeded in the surplus countries (or countries with below-average inflation), while nominal wage growth should be somewhat lower in deficit countries (or those with excessive inflation). This can be termed the Extended Golden Wage Rule.
- Competition policy at national and EU level must help to ensure that effective competition means that prices do not rise more than (unit labour) costs in the long term.

These basic conditions have several important implications:

- To the extent that national fiscal policies stabilise the real economy and prices, action at euro area level is less necessary.
- If nominal wage outcomes at national level conforms to the guidelines, there is no need for wages to be coordinated at euro level.
- Where, on the other hand, the national level is overburdened with its stabilisation responsibilities and there is a risk of persistent over- or undershooting in real and nominal developments, the European level must take subsidiary countermeasures.
- Per capita growth and prosperity are achieved by permanently increasing labour productivity (while maintaining or achieving full employment). Structural reforms that make macroeconomic sense, an efficient infrastructure as well as microeconomic innovations and investments are decisive determinants of productivity. The latter are stimulated by favourable demand conditions with simultaneous nominal stability.
- The implementation of the above agenda ensures – at least in normal times – compliance with existing coordination rules such as the SGP and the MIP (at least if the scoreboard underpinning the latter were symmetrical).

Based on the traditional allocation of instrument to objective (assignment), monetary policy is responsible for price stability, wage policy for employment and fiscal policy for stabilisation.[7] However, the effects of the respective instruments on the objectives traditionally assigned to them are not so clear or direct. Under normal circumstances, i.e. a situation without serious imbalances in macroeconomic development and in the policy mix, monetary policy primarily affects demand and wage policy primarily impacts price levels, distribution and price competitiveness. Thus in the traditional assignment each instrument of macropolicy is neither self-sufficient in relation to its own goal nor neutral in relation to the goals of the other instruments and therefore involves externalities. In this respect, each policy area is both active and reactive, driving and driven, exogenous and endogenous.

Under these conditions, can a favourable macroeconomic policy mix be expected to come about and be sustained "automatically"? Historical experience gives a clear negative answer. To mention just a few examples of lack of coordination with high welfare losses:

- In the two oil price crises of the early 1970s and 1980s, the combination of inflationary wage policy and restrictive monetary policy in Germany and other countries caused employment to collapse and unemployment to rise just as sharply. The interim attempt to counteract with expansive fiscal policy, while interest rates remained high, brought only modest results and a sharp increase in public debt.

[7] In the case of fiscal policy, however, the effectiveness in counter-cyclical stabilisation is limited by the demands of the SGP, national debt brakes under the six- and two-packs and the fiscal compact. Indeed, under certain conditions it is forced to follow a stance that is destabilising.

- After German reunification in 1990, an expansive wage and fiscal policy met with a restrictive monetary policy that pushed Germany into recession and caused the EMS to break up.
- The strong appreciation of the euro in the period 2002 - 2004 thwarted the positive effect on competitiveness that many economists and political actors had hoped for from the wage moderation that was permanently demanded and in some Member States also practiced.
- The so-called troika adjustment programmes, due to their fiscal and wage-policy austerity, without simultaneous expansion of demand in surplus countries, led to a surge in unemployment and the impoverishment of large sections of the population in the programme countries. At the same time, the euro area as a whole was dangerously close to deflation and driven into an unsustainable current account surplus.

These policy conflict scenarios – and many more could be cited – are sufficient to refute the assumption that macroeconomic aggregates follow quasi-permanent more or less stable trajectories or that "market forces" exert a timely corrective effect in order to avoid crises and their consequences. This result is not surprising from a theoretical point of view, because all actors make decisions with long-lasting effects in the face of fundamental uncertainty about future developments, including the (re-)actions to be expected from other actors. This produces – similar to the paradigmatic case of the prisoner's dilemma – suboptimal results, which nevertheless represent an equilibrium and, once achieved, are therefore difficult to break away from.[8]

Can such policy conflicts, which have a negative, and sometimes disastrous effect on growth and employment, be avoided in the future? From a game-theoretical point of view, the aim must be to transform a non-cooperative game into a cooperative one. As the prisoners' dilemma shows, a simple signaling can alter a non-cooperative situation with massive benefits on all sides. A precondition, though, is confidence in the reliability of the signals. At the same time, the advantages from cooperation for all economic policy actors provide a strong, lasting motivation, thus ensuring the stability of a cooperative solution to the game.[9] To these ends, principles and rules can be established which are necessary, perhaps even sufficient:

- bring together all macro-economically relevant actors around the table,
- arrive at a fundamentally shared view of the interdependencies of macroeconomic policies described above,
- produce a shared analysis of the current situation and, above all, the evolving macroeconomic prospects,
- identify the resulting economic policy challenges, leading to quantifiable alternative policy scenarios,
- show a willingness by all actors to contribute to a conflict-free growth and stability-oriented orientation of the macroeconomic policy mix through information, communication and cooperation.

[8] The literature on policy coordination is reviewed in Watt (2017: 40ff).

[9] Before the monetary union was established, the Broad Economic Policy Guidelines have identified this interdependence and formulated the implication in a succinct way. "Indeed, 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." European Commission (1998), p.9.

4.3 The current situation: what would a cooperative policy scenario look like?

The situation before, during and after the euro crisis was and is far removed from the equilibrium case outlined above. True, there are now signs of an upswing in all countries. But monetary policy remains extremely expansionary and, despite all efforts, the core inflation rate remains persistently and significantly below the ECB target. Austerity has been discontinued, but fiscal policy does not provide a strong stimulus. In some countries, government debt ratios remain very high, limiting the scope for fiscal policy. Wage developments in the surplus countries are far from compensating for their prior undershooting of the golden wage norm. In the deficit countries, the consequences of wage cuts, cuts in social benefits and redundancies have not yet been overcome. Unemployment there is now on a downward trajectory, but still unbearably high. The current account balances continue to diverge. Once-sided adjustment via austerity has contributed to an unsustainable surplus in the euro area current account balance as a whole. The current macroeconomic policy mix must therefore be defined in the light of this exceptional situation.

The question is where exogenous influence can and must be exerted. Companies and households react to the macroeconomic policy mix following a microeconomic rationale; the global economy is exogenous. The main contenders are therefore monetary policy, fiscal policy and, where the institutional preconditions are in place, an active nominal wage policy.

As a starting point for answering this question, we consider past developments in the most important surplus country, Germany. For the divergences in domestic demand and the current account imbalances between the Member States of the euro area, it is one blade of the scissors that had been widening for years in the run-up to the crisis. Wage and price developments violated the above-mentioned stability condition and domestic demand in Germany has lagged behind the euro area average. This came to an end after the crisis, but the imbalance was not reversed, at least not sufficiently.

A wage trend that observed the stability condition in accordance with the Golden Rule, would have led to significantly stronger domestic demand and a significantly lower external surplus in Germany (see the simulation study by Horn, Lindner, Stephan, Zwiener 2017 and Horn/Watt 2017). Such a wage development can be divided into two components. Firstly, a catch-up effect that brings unit labour costs into line with price developments (GDP deflator). This does not give rise to any real interest rate and price-competitiveness/terms of trade (TOT) effect, but possibly a drop in the savings rate and thus a quantitative effect on demand and imports. Secondly, a price-increasing effect that brings the distribution-neutral wage and price development achieved in the first step closer to the ECB's price target. This creates a real interest rate and competitiveness/TOT effect, i.e. a real demand and a price effect, which also affects the current account.

In addition there is also a clear boost to the government budget (because the state coffers benefit from higher nominal wages and prices). If this additional revenue were spent, demand would be boosted further and so would imports; the current account surplus would fall further.

Sequencing in the opposite way would lead to a similar result: an expansionary fiscal policy exogenously increases demand. Demand-driven increases in nominal wages and prices, and thus in government revenues, mean that the budget would likely remain balanced, while the current account is pushed towards balance. This sequence is particularly recommended in the case of a limited capacity to influence nominal wage developments.

Turning to the (former) crisis countries of the euro area, nominal wage restraint (and reduced inflationary pressures) in the crisis countries will only achieve the needed regaining of competitiveness while delivering good economic outcomes if it is flanked by appropriate economic policy measures (see simulations by Limbers, Petersen, Bohemian 2016, pp. 122 - 127). These include faster wage increases in surplus countries, transfer payments to promote investment and the – at least temporary – acceptance of higher inflation rates in the euro zone. Given the undershooting of the ECB's price stability target, the latter is not a problem, indeed it is desirable.

The upshot of these simulation studies and our knowledge of policy interactions for the analysis of the current situation is simple: what would have helped to avoid the crisis is now – in a higher dosage – necessary to correct it.

An expansionary wage and fiscal policy in the surplus countries is needed to relieve the pressure on the monetary policy in its efforts, via extremely expansionary measures, to revive growth and investment dynamics in the euro zone. This is not to be expected from lower nominal interest rates and a monetary-policy-induced weakening of the euro alone, especially if the trading partners also devalue. A gradual normalisation of monetary policy will require stronger impetus from fiscal and wage policies. Where wage developments are largely decentralised and endogenous, an anti-cyclical fiscal policy is needed in order to keep wages and prices on the desired path. Such a policy mix would allow (former) deficit countries more room to reduce legacy problems from the crisis without them having to resort to expansionary measures themselves, which could cause fiscal and current account problems.

These examples, based on the current situation, show how a scenario can be developed, in which a coordinated approach that respects the principles derived above would permit an adjustment process that achieves significantly better results significantly faster for all the actors involved.

4.4 Summary

What are the consequences of our theoretical and empirical analysis for the needed reform of the economic governance?

- Macroeconomic developments and the policy mix must be placed at the heart of economic governance in EMU.
- A significantly stronger coordination of macro policy is needed. This applies both horizontally, i.e. between different instruments at both national and euro area level, and vertically, i.e. between national and euro area level.
- Coordination must be carried out both in normal and exceptional times, adapted to the respective situation.
- Coordination must be based on policy-oriented macroeconomic expertise, i.e. analysis, diagnosis and quantitative macroeconomic policy scenarios.
- The assessment of these options and the selection of the best alternative must be carried out jointly by the macroeconomic policy actors, with due respect for their independence, autonomy and responsibilities.
- Generating the required policy-oriented expertise and achieving the necessary coordination and cooperation between the policy areas require a deepening of the institutional structure.

5 A reform proposal: More dynamism and convergence through conceptual and institutional improvements in macroeconomic coordination

On the basis of the economic and political-institutional analysis presented above, this section sketches out a plan for conceptual and institutional reform of the euro area. Some of the institutional prerequisites for a better coordinated economic policy that enables tension and crisis-free growth are already in place. By developing them in a pragmatic way, altering their remit, substantial progress towards improving economic governance could be made quite quickly and without Treaty amendments. What will certainly be needed is to set aside or at least adjust counterproductive rules and procedures and, more importantly, bring about a change of mind-set so as to breathe life into the idea, enshrined in the Treaty, of economic policy as a matter of common European interest.[10]

5.1 Conceptual basis: Macroeconomic policy coordination under Art. 121 TFEU

In order to incorporate the conceptual guidelines discussed above into the economic governance of EMU, it is not necessary to create completely new structures. Article 121 TFEU, formerly Article 99 of the EC Treaty, provides in paragraph 1 the legal framework for the necessary coordination: "Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council, in accordance with the provisions of Article 120". Article 120, in turn, refers to the "Broad Guidelines of the Economic Policies of the Member States and the Union" in Article 121, paragraph 2, and to the "Principles" in Article 119, which include "... stable prices, sound public finances and monetary conditions and a sustainable balance of payments" (paragraph 3). Article 120 also refers to Article 3 TEU, which sets out the aims of the Union, including “sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment”[11] and also “combat(ing) social exclusion and discrimination, and (promoting) social justice and protection, … economic, social and territorial cohesion, and solidarity among Member States”. Art. 120 and Art. 121 refer in particular to the central role of the "broad guidelines" for coordination. The coordination procedure to be followed – including the steps to be taken in the case of non-compliance – is described in detail in subsequent paragraphs of Art. 121.

Thus a framework for coordination exists and has been in place for a long time. It was refined by formulating specific Recommendations for the Euro area and Country-Specific Recommendations. In this context, the BEPG’s should give guidance as to the scope and the direction of the National Reform Programmes of member states as well as of the Country-Specific Recommendations, which should now be restricted in number and focused on macroeconomic and social issues.

However, what is decisive is the way it is implemented and how compliance with its contents is ensured.

[10] An earlier and shorter version of the proposal was presented in Koll/Watt (2017).

[11] On incorporating environmental protection in economic policy coordination, also at European level, see Koll (2016 a: 48ff.).

The guiding objectives for the coordination of the individual policy areas must be, as derived from the previous analyses: (1) full utilisation and expansion of potential output, (2) compliance with the price stability target and (3) avoidance and, where necessary, symmetrical correction of harmful divergences, pro-cyclical policies and excessive budgetary and external imbalances. The goals complement and support each other.

In order for the procedure under Art. 121 TFEU to be enforced, it must be possible to impose appropriate and effective sanctions. Under current law, sanctions for repeated non-compliance with the recommendations – comparable to those in the SGP – are possible in principle. However, they have not been applied. The proposal by the EP's Committee on Constitutional Affairs suggests blocking access to EU funds and other new fiscal instruments in the event of infringements (European Parliament 2016, point 17). The CEPR report by the 14 economists also wants to move away from the "stick" towards the "withdrawal of carrots". We are in favour of this approach, but we do not go deeper at this point into the specific form of a sanctions regime. As we set out below, we intend to significantly increase the degree of ownership by the member states, which should ensure greater “voluntary” compliance. Nevertheless, the system of economic governance will not work without the real possibility of ultimately imposing sanctions in well-justified cases. Proposals for risk-sharing, solidarity-based measures such as a fiscal capacity for the Euro Area – which we do not discuss here (see Watt/Watzka 2018) – will be politically unenforceable without measures that reduce the risk of moral hazard.

What is needed in order to deepen the convergence of EMU is to strengthen this coordination with regard to two elements in particular:

- the provision of in-depth and comprehensive macroeconomic expertise and
- its implementation by economic policy as part of a goal-oriented macroeconomic strategy

Both activities have to be implemented within an appropriate institutional framework as described below.

Macroeconomic expertise must be brought together to model the entire policy mix in qualitative and quantitative terms, with a view to achieving the aforementioned objectives. Forecast scenarios must be calculated depicting alternative policy constellations, resulting in a comprehensive report.[12] This requires suitable bodies at both national and EMU level, whose tasks go beyond already existing institutional provisions; they are described in Section 5.2.1.

As far as the second element, policy implementation, is concerned, complementing the procedure described in Art. 121, monetary, fiscal and wage policies need to be jointly assessed, in their respective contributions and in their interaction, with a view to meeting agreed policy objectives, in an appropriate body – a Macroeconomic Dialogue for the euro area (EUROMED, see section 5.2.2), which is to be enshrined in Article 121 TFEU. As representatives of those responsible for wage and price developments, the leaders of the European social partners are to be included in this assessment process,

SGP and MIP have so far been the focal points of coordination. Both processes will initially be pursued, but subordinate to the coordination under Art. 121. This applies irrespective of whether the deficit and debt procedures, the MIP and the CSR are merged de jure into a single "convergence code" with legally binding character and sanctions, as called for in the proposal of the EP Committee on Constitutional Affairs. Once the coordination process with a leading role

[12] Forward-looking scenarios are also called for by Belke/Gros/Schnabel (2016: 549-553), albeit only with respect to the Macroeconomic Imbalance Procedure.

for Art. 121 has become well established, it will become apparent whether or not SGPs and MIPs – in whatever form – are ultimately still needed as separate processes.

The "close coordination of economic policy" required by the Treaty also requires close integration of expertise and policy at the EMU level with that at the national level. The political link between national and EMU levels is established through the National Reform Programmes (NRP), the Stability Programmes and the Country- Specific Recommendations (CSR).

The NRP is the national economic policy input for the European level. In line with the new coordination structure, the NRP must also contain macroeconomic aspects, where possible in quantified form. In other words, the previous content would be shortened, and the following elements added:

- an opinion on the report of the national Advisory Board for Macroeconomic Convergence (ABMC, see Section 5.2.1) This expertise includes in particular alternative quantified forecast scenarios,
- the economic policy objectives for the current year as an annual projection based on the national accounts and setting out alternatives,
- a description of the economic policies needed to achieve these objectives (here, too, with alternatives).

Institutionally the following changes would be needed:

- Monetary, fiscal and wage policies are considered in their respective contributions and their interaction in the preparation of the National Reform Programme in an appropriate political body - a Macroeconomic Dialogue at national level (MEDNAT, see Section 5.2.2), which is enshrined in national law.
- Fiscal policy is represented by the national finance ministry.[13]
- For EMU Member States, monetary policy is represented by the national representative of the ESCB, for all others by the President of the respective national central bank.
- The NRP process will need to involve the leaders of the national social partners

Finally we need to consider how the contributions of both the expertise and the political body are arranged within the European Semester, in particular within a more Integrated European Semester as proposed in Annex 2 of the Five Presidents Report. This is shown in Fig. 3.

Within the European Semester, there are two starting points: one at national, one at Euro area level[14].

At national level, the procedure starts with the national Advisory Board for Macroeconomic Convergence (ABMC) which, using the Country Report of the EU Commission drafted on the basis of a bilateral fact-finding mission, produces a report, as described above. This report is presented to the Macroeconomic Dialogue on national level (MEDNAT) and to the Euro Area ABMC. The MEDNAT examines the proposals of the ABMC and drafts, as outlined above, the National Reform Programme as well as the Stability Programme, both to be sent to the Eurozone-ABMC and to the Macroeconomic Dialogue of the Eurozone (EUROMED).

On Euro Area level, in a first step, the Euro-ABMC examines these two programmes, the reports of national ABMCs, and documents prepared by the EU Commission such as the

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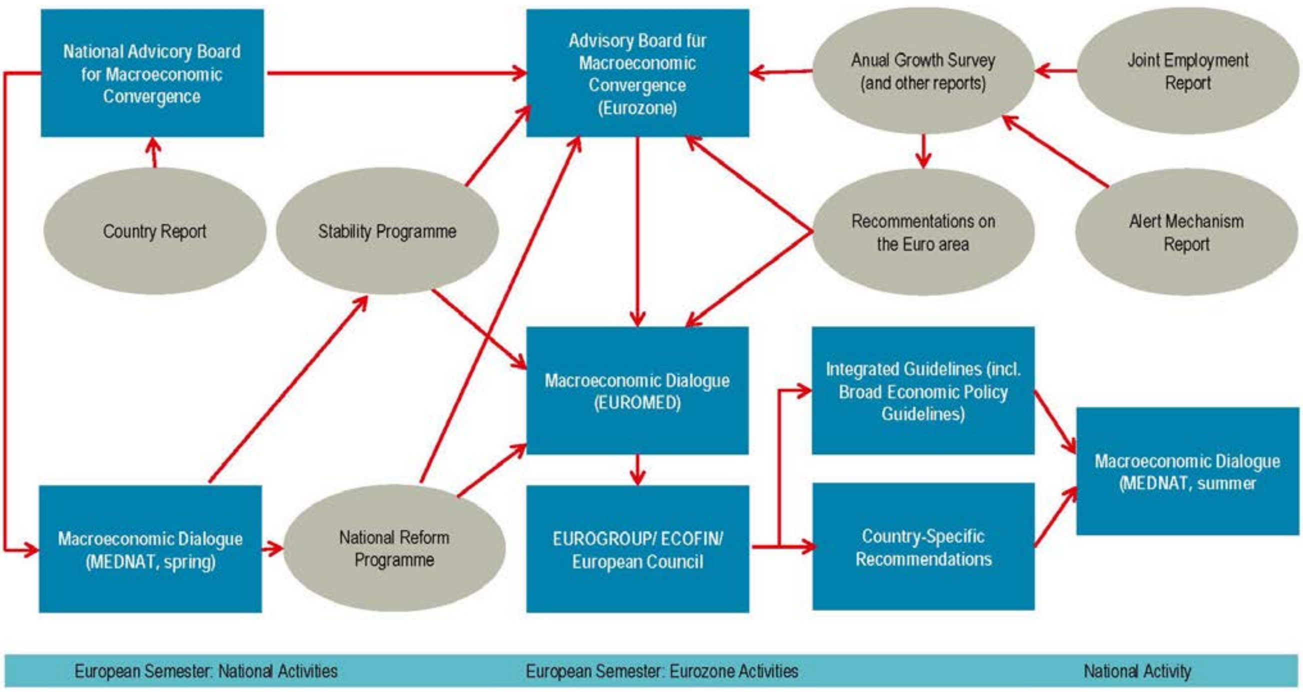
[13] In Germany, where a MED exists at the technical level, representatives of the Chancellery, of the Ministries for Economics and for Labour are also present.

[14] For the sake of simplicity, the European Semester is not described in full detail. This would include in particular multiple discussions with the European Parliament in the course of the ES.

Annual Growth Survey (including the Alert Mechanism Report and other newly introduced reports), the Joint Employment Report, the draft Recommendations for the Euro area and opinions on the Draft Budgetary Plans of Euro area member states. In addition, the Euro-ABMC extracts helpful information from the National Reform Programmes and Stability Programmes of all member states. As result, it drafts a comprehensive report, including options for the entire policy mix in qualitative and quantitative terms, covering alternative policy constellations and sends it to the EUROMED.

The EUROMED examines the report of the Euro-ABMC the National Reform Programmes and the Stability Programmes of all member states. The EUROMED then drafts suggestions with regard to the updating of the Integrated Guidelines, i.e. the Broad Economic Policy Guidelines and the Employment Guidelines and to the Recommendations for the Euro Area (including the list of in-depth country reviews) and the Country-Specific Recommendations; all these documents are based on draft reports by the EU Commission. The contributions of the EUROMED are sent to EUROGROUP and ECOFIN. Using the proposals of the EUROMED, these Council formations formulate the final versions of the Recommendations for the Euro area, for the update of the Integrated Guidelines and for the Country Specific Recommendations (CSR), which are then endorsed by the European Council (EC) and decided by the Council by the end of the European Semester. The CSR are sent to the member states where the MEDNAT, in a second session in late summer, contributes to their implementation into national macroeconomic policy, including their Draft Budget Plans for the next year.

Figure 3:
Advisory Board for Macroeconomic Convergence (ABMC) and Macroeconomic Dialogue (EUROMED/ MEDNAT) on national and Eurozone level within the European Semester



5.2 Institutional basis: Advisory Boards for Macroeconomic Convergence and Macroeconomic Dialogue for the euro area and Member States

5.2.1 Reform in provision of technical expertise: Advisory Boards for Macroeconomic Convergence (ABMC)

Euro area level

At present, as described, there are many institutions that provide diagnosis and analysis, including forecasts. What is crucial, however, is that, in addition to their respective specific goals, expertise is provided that takes all macroeconomic interdependencies into account.

To this end, we propose to set up an expert panel to analyse macroeconomic developments in the euro area. This could be achieved by extending the remit of the European Advisory Fiscal Board, to make it an "Advisory Board for Macroeconomic Convergence in the Euro Area (EURO ABMC)". Or a body is set up from scratch. In either case its mandate should cover the formulation of quantitative scenarios and options for a common macroeconomic economic policy in the Euro Area, combining monetary instruments as well as aggregate fiscal and wage policy development. In addition, at euro area level it must also provide a synoptic assessment of the individual reports of the national-level convergence boards (which are outlined below). The Convergence Board coordinates expertise at the level of the euro area. In doing so, it should also pay attention to mutual consistency. This is particularly important in order to prevent "beggar-thy-neighbour" approaches in national strategies or recommendations, or at least to identify them at an early stage.

Its results feed into the deliberations of the EUROMED (s. 5.2.2).

National level

Given the central economic-policy importance of the national level, an "Advisory Board for Macroeconomic Convergence (ABMC)" is also required in each euro area member state.

Institutionally, the productivity boards currently being set up in member states could be used as a starting point. Their mandate, which had initially been foreseen to focus primarily on (foreign trade) competitiveness, was already extended to the (domestic) dimension of productivity in the revision of the Council Recommendation. However, here too, a broader mandate is required to analyse and forecast macroeconomic developments, which in turn also have a significant impact on productivity and competitiveness.[15]

Accordingly, the most important elements of the boards' mandate are compliance with the stability condition (including the golden wage rule and inflation in line with the ECB target) and the growth condition, the functional distribution of income and its impact on overall economic development as well as the orientation of national fiscal policy (and, if necessary, the macro-prudential policy of the respective central bank). Their role – as with the productivity boards – is limited to analysis and development of alternative scenarios and policy options. Recommendations are not within its competence; hence the title "Advisory". As envisaged also for the national productivity boards, the national convergence boards should be in contact with each other "…

[15] This is not in contradiction to the view of the EU Commission, which in the Council recommendation for the National Boards emphasised the reverse direction of causality, it merely supplements this one-sided, rather microeconomic view with the macroeconomic direction of causation.

and, where appropriate produce joint analysis, also taking into account the broader Euro Area and EU dimensions"[16].

5.2.2 Translating expertise into consistent policies focused on dynamism and convergence: Macroeconomic Dialogue for the Euro Area and Member States

Like the provision of expertise, its evaluation and implementation by policymakers requires appropriate institutionalisation at both euro area and national level.

Macroeconomic dialogue for the euro area (EUROMED)

Aggregate developments, specifically the alignment and interaction of monetary policy with aggregate fiscal and wage/incomes policy, are at the forefront of the economic policy agenda at euro area level. The revitalisation of the procedure under Art. 121 AEVU, as explained in the conceptual/procedural part, requires appropriate institutionalisation in order to significantly strengthen "ownership", realise the advantages of cooperation within a monetary union, reduce moral-hazard fears and minimise end-of-pipe interventions with politically difficult-to-enforce sanctions procedures.

As an instrument guiding the implementation of the growth- and stability-oriented macroeconomic policies, a Macroeconomic Dialogue for the Euro Area (EUROMED) is to be established[17]. Its agenda should reflect the interdependencies of all macroeconomic actors and instruments, while respecting their independence, autonomy and responsibility, as already regulated in the existing Macroeconomic Dialogue at EU level (EUMED).

Above all, it should function as a coordinating body for the MEDs at national level (see below), which are also to be newly established. The establishment of a EUROMED is necessary – and has been since the creation of the common currency area – because of the greater coordination requirements of countries that have abandoned their own monetary policy and bilateral exchange rates.

One could object that after Brexit – if it comes about – the weight of the non-euro countries within the EU will become relatively small. Ultimately, the distinction between euro and non-euro Member States would entirely disappear if – in accordance with the Treaty – the demand made by Commission President J.-C. Juncker in his speech in Brussels on 13 September 2017 became a reality: "The euro is destined to be the single currency of the European Union as a whole". Thus one might argue that the existing EUMED could do the coordination job.

But even if all members of the existing EUMED were also members of the euro area, the coordination problem would remain unresolved at a crucial point: only a "troika" of finance ministers – i.e. representatives of the "rolling" previous, current and next presidencies of the EUMED – would be represented there. However, the finance ministers of all Member States – alongside representatives of the ECB, the EU Commission and the European umbrella organisations of the social partners – must be represented in a MED appropriate to the coordination challenge, in order to provide the vital link between the euro area and the national level.

- The agenda of a EUROMED would be basically the same as the EUMED agenda, as it was defined by the resolution of the European Council in Cologne in June 1999: discussion of the overall economic situation and prospects in the euro area,

[16] Council of the European Union (2016) para. 6.

[17] This idea was also suggested in the Five Presidents' Report: Juncker et al (2015), Annex 2, p. 22.

- identification of the need for economic policy action to achieve and maintain a macroeconomic policy mix of monetary, fiscal and wage policies in the euro area that is oriented towards sustainable, tension-free growth and stability,
- identification of the own contribution of each actor and of their expectations regarding the respective contributions of the other macroeconomic actors in achieving this objective.[18]

To account for the other changes proposed here, the "classic" agenda of the EUMED should be enriched by adding the evaluation and, if necessary, implementation of the report of the ABMC for the euro area proposed here and the scenarios and policy alternatives contained therein. This covers both the ex-post analysis of the ABMC, but above all ex ante analyses based on alternative quantitative macroeconomic policy scenarios. In addition, if other institutional developments currently under discussion see the light of day, the EUROMED remit should also take due account of a fiscal capacity or of a subsidiary unemployment insurance by the euro area level, a fund for macroeconomic stabilisation, evaluating the activities of an EMU Finance Minister, a Treasury (Bibow/Flassbeck 2018: 217 ff.) or a European Monetary Fund.

There are several options for the institutionalisation of a EUROMED. The first is the creation of a separate EUROMED with the mandate just described. In view of the increased need for coordination, it could and should at the same time be significantly strengthened institutionally compared to the current EUMED. Suitable measures would include increasing the frequency of meetings and setting up a permanent secretariat. However, the main difference with EUMED – as has already been pointed out – is the presence of finance ministers from all EMU Member States. Such a body would be a new institution alongside many existing ones. However, given the importance of its task, the establishment of a new institution would be more than justified.

A second option would be to ensure effective macroeconomic coordination within the existing Eurogroup, in line with the requirements described above, as part of a process of strengthening and developing the Eurogroup itself; for example, by appointing a President who does not come from the ranks of national finance ministers but rather acts as EU Finance Minister and/or Vice-President of the Commission.

A solution on these lines would have a number of advantages over the current EUMED. The EUMED is chaired by the Council presidency: every six months a new presidency has to deal with the preparation and implementation of the Macro Dialogue. However, the very nature of the problem calls for greater continuity. The integration of the macroeconomic agenda (including wage and price issues) into the structure of the Eurogroup would also have the advantage that the negotiations in the Eurogroup, so far focused on fiscal policy issues, would be conducted more in an overall macroeconomic context. In addition to the representatives of the ECB and the EU Commission, the Eurogroup is already attended in full by the finance ministers of all Member States. This ensures the indispensable direct feedback between the national and Euro Area levels in both directions. Irrespective of whether such and other reforms of the Eurogroup are implemented, what is decisive, and new in our proposal, is the involvement of the social partners and thus the integration of wage and incomes policy aspects.

[18] S. Koll (2013: 52) and European Council (1999), III. 1; on the signaling function of the EUMED see also Hallwirth and Watt (2003: 610).

Experience with EUMED shows that success depends on the establishment of a preparatory technical level, also involving the social partners. Institutionally, this technical body could be linked to the Euro Working Group of the EU Economic and Financial Committee (EFC), including its secretariat.

Should an immediate and regular extension of the mandate and the participants of the current Eurogroup not yet be possible, a pilot phase would be conceivable as a third option. This could consist, for example, of inviting representatives of the leading European organisations of the social partners to an Informal Extended Eurogroup, with the agenda, as described above, every six months. In light of the experiences with this structure, a further deepening could then be decided upon. The technical preparation would be organised as just described.

Macroeconomic dialogue in all Member States (MEDNAT)

Within the framework of the current treaties, national economic policy remains paramount, particularly in fiscal policy and above all in terms of wage and income policy. This was made clear not least by the crisis: in aggregate the stability condition was met, but at the same time its national components had developed a destructive divergence. Conversely, if each Member State respects the objectives, the aggregate is automatically correct. The key challenge is therefore to avoid imbalances within the aggregate so that coordination pressure on euro-area institutions is relieved and rescue measures and sanctions become absolute exceptions.

A body with this objective must be set up in each Member State, meeting a set of uniform minimum requirements. As at the level of the euro area, it will be organised in two stages: a political and a preparatory technical level. The mandate of such a body should reflect those of EUROMED and contain the following elements (Koll 2013: 70 ff.):

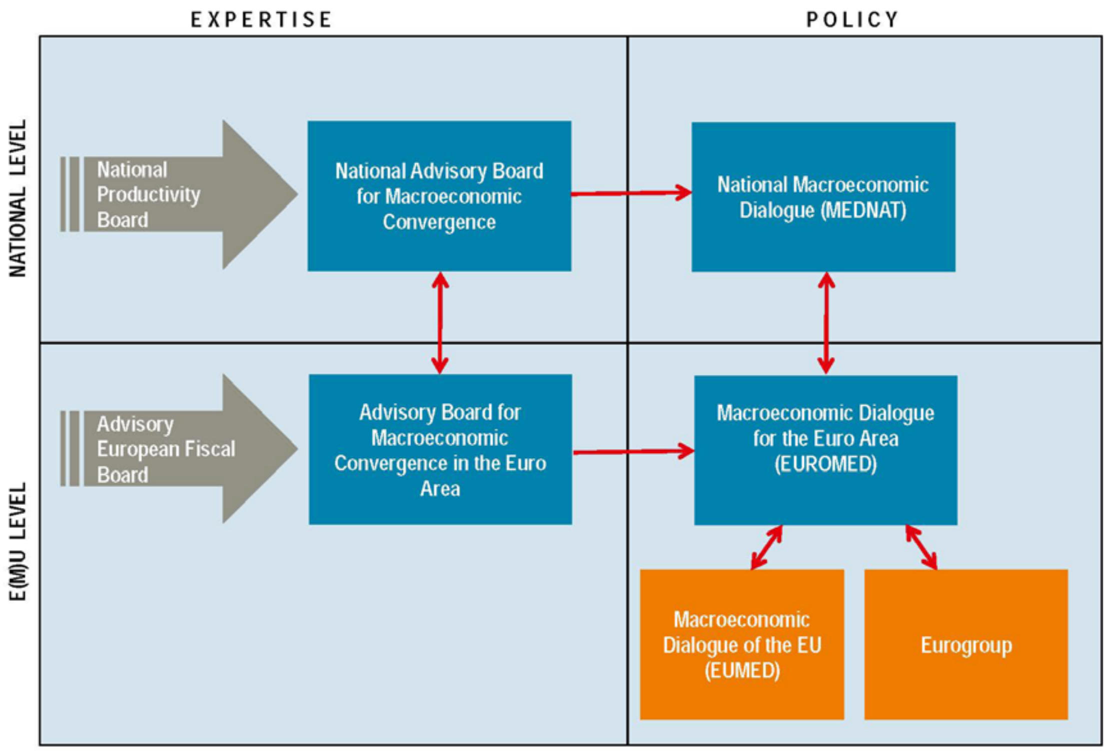
- evaluation of the analyses of the respective national ABMC,
- discussion of alternative macroeconomic development paths outlined by the ABMC,
- identification of macroeconomic policy requirements and the contributions of national fiscal and wage policies and, where appropriate, macro-prudential policies of the national central bank.

In particular, taking monetary policy orientations at EMU level as given, issues such as the following need to be discussed from a national perspective:

- cyclical and structural orientation of fiscal policy
- orientations regarding wage developments
- review of price developments and the intensity of competition in the economy
- income and wealth trends and their impact on overall economic development
- possible developments on financial and asset markets that could jeopardise stability
- compliance with the SGP and the MIP – following a revision of both procedures so that they are conducive to balanced macroeconomic developments – and
- implementation of the Country-Specific Recommendations in the macroeconomic context

Figure 4 summarises the proposed institutionalisation of expertise and policy implementation at national and EMU level, building on existing structures.

Figure 4:
Existing and proposed national and euro area bodies



5.3 Accompanying measures

5.3.1 Strengthening the social partners

The structures for formulating and implementing national economic policy differ greatly between Member States. In the area of collective bargaining in particular, there are significant differences, for example, in the degree of unionisation, the degree of coordination, the coverage of collective agreements and the role of the state in wage-setting.[19]

This heterogeneity must be taken into account when setting up national institutions such as the ABMCs and, above all, MEDNAT. However, it is not a fundamental obstacle to the implementation of the strategy proposed here.[20] In principle, the choice of suitable instruments can be left to the individual member states. In the end, what is important is that the theoretical conditions developed in the previous section are fulfilled.

Where institutional arrangements provide for a high degree of collective wage determination, the social partners can and must play a macroeconomically relevant role in ensuring nominal stability, avoiding imbalances and stabilising the business cycle[21].

[19] For overviews see Visser (2013), Watt (2017: 82 ff.); see also Koll (2013: 47ff).

[20] Various elements of the collective bargaining system operate as „functional equivalents". For instance, in one country the task of ensuring that poorly organised workers participate in general productivity increases may be performed by a statutory minimum wage, in another by a system of declaring collective agreements generally binding across an entire sector. As a result, the effective degree of heterogeneity is less than the apparent degree.

[21] The European Commission also appears to have realized the advantages of wage coordination: "With a more centralized approach, it is more likely that the impact of wage developments on the performance of the whole economy is taken into account by participants." European Commission 2017:.5.

Where macroeconomically relevant social partnership structures are weak and wage determination is predominantly decentralised, the legal extension of collective agreements should be considered.[22] Where the economic policy instrument of wage and income policy is more or less entirely absent, the stabilisation function must be assumed more or less entirely by fiscal policy. Outcomes are steered in the desired direction by adopting an appropriate fiscal stance and the resulting macroeconomic dynamics, to which nominal wages and prices are endogenous. This may require substantial discretionary measures, expansionary during a recession and restrictive during a boom. Where national funds are not sufficient for a strong expansionary orientation of fiscal policy, the instruments at EMU level must be used subsidiarily and under clearly defined conditions. This implies both the revision of existing regulations such as the SGP or the MIP and the installation of new instruments now under discussion (e.g. Watt/Watzka 2018). Both aspects remain highly controversial politically.

It follows that fiscal policy alone is likely to encounter limits in it stabilisation capacity, and cannot completely replace a stabilisation role played by nominal wage determination that is in line with the golden rule.

However, a strengthening of national wage determination structures cannot be expected in all countries in the short term. As long as this is not the case, policymakers must be able to rely on strong fiscal instruments at both national and, subsidiarily, euro area level. Put another way, the pressure on fiscal instruments, particularly at the euro area level, would be relieved to the extent that a stabilisation role is played by national social partners that have the relevant capacity to act. This is not the only, but in itself a strong argument for the (re-)establishment of an effective social partnership at national level, with a macroeconomic orientation, in as many countries as possible.

In view of the scientific findings that a high degree of wage coordination goes hand in hand with good economic performance (Watt 2017, S. 82 ff.), it is therefore strongly recommended that European institutions and Member States work towards establishing and strengthening structures among the social partners that are capable of pursuing a macroeconomic orientation (Koll 2013: 62 ff.). To this extent it is welcome that the EU Commission recently recommended a strategy for “capacity building”[23].

5.3.2 Involvement of Parliament and the public

The coordination of economic policy deserves and requires the involvement of the European Parliament. In particular, the Committee on Economic and Monetary Affairs should interact closely with EUROMED. If the design of EUROMED is chosen in the form of the "Informal Extended Eurogroup", the existing links between the Eurogroup and the EP could be used to create the needed interaction.

Regarding the MEDNATs, one of the requirements should be to maintain an appropriate link with the national parliament. The exact form of this connection should be decided by each Member State in accordance with national practices.

[22] “The existence of a procedure to legally extend collective agreements…can significantly broaden the coverage of collective agreements. Extensions may help overcome coordination problems, reduce the transaction costs of a highly decentralized setting and improve working conditions.” (European Commission 2017 e: 6).

[23] „[The social partners] shall be encouraged to negotiate and conclude collective agreements in matters relevant to them...Support for increased capacity of social partners to promote social dialogue shall be encouraged“, European Commission (2017 b) para 8.

The public, and not least the financial markets, should be interested in the results of the MED, both at euro and national level, which could provide important signals for future economic development.

However, there is a certain tension between the public awareness and confidentiality of the discussions in EUROMED. So far EUMED did not produce conclusions (like those from the European Council) that are made available to the public. In the meantime, however, the need for and willingness to communicate has increased, not least in the wake of crises. The ECB now publishes the minutes of its meetings. In this respect, it should not be a problem to publish at least important consensus results of the EUROMED's deliberations by the President of the Eurogroup or in the form of a communiqué. National MEDs could do the same.

The involvement of Parliament and the public contributes to the integration of the legislative and executive dimensions of economic policy; it increases the visibility of the macroeconomic dimension and the link between the national and European levels.

6 Deepening EMU: charting a path between risk sharing and risk reduction

How do the proposals presented here relate to the current discussion on deepening EMU? Our proposals offer a path forward in a political debate characterised by one side demanding risk avoidance on the part of member states and the other calling for risk-sharing measures that support member states by providing stabilisation at Euro Area level.

As a starting point it needs to be recognised that full risk reduction, i.e. the avoidance of all kind of macroeconomic risks by member states, is not possible because they can no longer deploy key instruments (monetary policy, exchange rate) needed to offset shocks and ensure prosperity. On the other hand, full risk-sharing, in which all risks accruing at the national level are assumed by the union of states making up the Euro Area, is not politically accepted. Thus it is also a non-starter.

Politics and policy reforms must therefore navigate between these two extremes, seeking an optimal combination of risk-avoidance and risk-sharing. As we have shown in section 4 of this analysis, the first-best option is to ensure that all member states pursue a macroeconomic policy mix that fulfils the stability condition. Given that, the area-wide monetary policy can – and in accordance with the Treaty, must – provide as favourable monetary conditions as possible, supporting the national-level policy mix and fulfilling the growth and employment condition that was also derived above.

Within each member state, it is fiscal policy and wage/incomes policy – on occasions supported by macroprudential policy – that is tasked with meeting the stability condition. Meeting it also implies, over the medium run, that domestic demand is growing in step with the productive capacity of the economy in question. Substantial and persistent macroeconomic imbalances are avoided.

In countries with strong structures of social-partnership and where social partners meet the need to keep nominal wage and price developments on track and limiting distributional shifts, national fiscal policy can play a supportive role in stabilisation. For this reason we highly recommend investing in promoting such social-partnership structures. Then, risk-sharing measures at the level of the currency area as a whole are deployed only subsidiarily; thus, the frequency and extent of their use is tightly constrained.

Where social partnership is still weak, a stronger anti-cyclical role will have to be played by fiscal policy, which can, in addition, increase the need of recourse to risk-sharing mechanisms at Euro Area level.

In no way should this approach be taken to imply a rejection of new fiscal stabilisation capacities at Euro Area level. We are convinced that these are necessary to stabilise expectations and make the currency union crisis-proof. But by building up structures and instruments that strengthen the "ownership" at national level for a policy mix that delivers stability and prosperity, recourse to the actual use of the risk-sharing instruments at Euro Area level will be kept to exceptional circumstances. Hence, concerns about abusive use of the risk-sharing mechanisms ("moral hazard"), unjustified bail-outs and an out-sized role for "Brussels", which serve as arguments against providing subsidiary support at European level, will diminish or even disappear. The stronger are the structures ensuring responsible and mutually consistent policies at member state level, the greater the political acceptance of new and effective instruments at EMU level, and the more likely they are to be achieved in practice.

In short, the proposals we have developed here promote a deepening of and a convergence within European Economic and Monetary Union by intensifying macroeconomic coordination, both between and within the national and EMU levels, and thus can be seen as a providing a lynchpin between risk-avoidance and risk-sharing.

This is precisely the direction of travel that the renowned philosopher and sociologist Jürgen Habermas, in a recent, widely discussed speech, urged European policymakers to follow: It is not just a matter of making the Euro Area able to resist speculative attacks, he argued. Rather, it must acquire "the means to intervene to keep the member states from further drifting apart economically and socially. It's not just about fiscal stabilization, but about convergence – the credible political intent of the economically and politically strongest member states to fulfill the common currency's broken promise of convergent economic developments."[24]

In order to deepen its conceptual and institutional architecture and achieve greater convergence, the European Union and its Member States should therefore commit themselves not only to re-tiling the fiscal and financial market policy roof anew, but also to strengthening the macroeconomic foundations of EMU as a whole. Our analysis aims to contribute to this.

[24] From a speech on being awarded the French-German media prize in July 2018; text available at: https://www.socialeurope.eu/are-we-still-good-europeans

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Phone: +49-211-7778-331, IMK@boeckler.de, http://www.imk-boeckler.de

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