EUROPE'S SECOND CHANCE NEEDS TO BE TAKEN

Willi Koll, Andrew Watt

Recent years have seen vigorous debate regarding the future of the European Union (EU), with widely diverging opinions on whether its internal ties should be loosened, even give up altogether, or, rather, deepened. This is particularly true of European Monetary Union (EMU). A forthcoming IMK Study analyses the conditions needed for a successful economic and fiscal union. Important reforms in the financial sector and the deepening of the social dimension of EMU are also considered. The economic dimension is not everything. But without stable economic development, a banking union, for example, will be unsuccessful and social-policy objectives will be difficult to achieve.

Since the beginning of EMU a range of new concepts, procedures and institutions have been introduced, some of which have been reformed in the meantime. They were guided by a belief in restrictive fiscal policy and structural reforms to increase competitiveness, but set aside fundamental macroeconomic conditions and interrelationships.

This narrow theoretical conceptualisation and policy implementation has been a driver of the buildup of critical imbalances and the destructive crisis itself. Worse still, the attempt to tackle the crisis using the same approach of restrictive economic policies 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 need to be recognised. While signs of recovery are visible, the many Member States remain far from stable and vigorous economic development path.

It is not least because of the severe failures of crisis management, 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. In a short period of time, a large number of 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 high cost of leaving the EU, as increasingly revealed by the Brexit drama, and worrying geopolitical hegemonic tendencies in other parts of the world, citizens' support for the EU has increased again. This is a second chance for Europe, but perhaps also the last chance, 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 serious mistakes and shortcomings in economic policy at national and EMU level.

It is therefore crucial, while respecting subsidiarity and proportionality, to examine the new proposals, together with the existing rules and institutions, to see whether they (1) avoid the mistakes of the past and (2) ensure the sustainable prosperity of EMU.

The analysis must address the pathological domestic and external divergence 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.

The findings clearly show that – even after various reforms – 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 in view of the challenge. Last but not least, there is a lack of broadly based scientific expertise to guide policy and underpin its goal-oriented political implementation. 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 the economy must be given greater focus than before. In principle, it is appropriate to call for structural reforms. However, they must be selected and implemented in a target-oriented manner. And even more important, it must be recognised that good 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, in the medium term, with the ECB's inflation target – to avoid further damaging divergences, (2) a growth and employment condition – the ratio of nominal GDP growth and wage developments 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 the existing imbalances, the two conditions must be implemented in such a way that the 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. These indissoluble interactions call for coordination between the players in monetary, fiscal and wage policy. To the extent that fiscal and wage policies ensure stability, monetary policy can and must provide the most favourable conditions possible for investment and employment. This has long been prescribed by the "Broad Economic Policy Guidelines", but also by Article 127 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 are still too focused on fiscal policy and 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 situation are necessary. However, proposals are even more needed to prevent such emergencies from arising in the first place: by guaranteeing 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. Other proposals are controversial among the Member States and their implementation would at best only be possible in a few years.

Specifically, we propose: The establishment (1) of an 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 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 of 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. Such structures do not exist in all Member States; in the course of the post-crisis adjustment, existing structures have even been dismantled. Without 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". Many 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, many reform projects 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.

In view of the high opportunity costs, the development of economically competent and responsible social partnership structures is an extremely worthwhile investment. In deepening and achieving greater convergence in its conceptual and institutional architecture, 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.