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**Macroeconomic governance
in the European Union:
Did we learn the lessons from the past?**

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Abstract

Since the Rome Treaties, the question of the organisation of macroeconomic and monetary policy has been a key issue in the debates on European integration. In this paper we explore the continuity and changes in these debates. We focus on macroeconomic thought at the European Commission in two periods: the 1960s and early 2000. There are important changes, especially in the areas of monetary policy and structural policies. In the early period, exchange rate disturbances (like after May 1968 in France), constituted an important threat to the European project. With the realisation of monetary union and a stability-oriented monetary policy, monetary disturbances and threats have largely disappeared. So, according to the Commission analysis, there has been substantial progress in this area. With respect to structural policy, one can observe profound changes in the underlying economic policy paradigms. While state intervention was high on the agenda in the 1960s, now a more market conform approach is advocated, which is also prominent in the Lisbon strategy. There is also a change in methodology: from "programming" to the "open method of coordination", even if both are set in a medium-term framework. However, looking at the coordination of budgetary policy, the issue is much more complicated. With the Maastricht Treaty and the Stability and Growth Pact, the European Union made a choice for a rules based fiscal framework. However, as is well known, there have been problems in this area. In fact, there are some remarkable continuities here with the 1960s. Several issues, which were prominent on the Commission agenda then (like, how to have influence on Member State policies, statistical governance, the construction of early warning indicators) are still there today. Consequently, the Commission is now, very much in line with a political economy approach, seeking to increase the national "ownership" of the budgetary and reform policies which it advocates.

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Table of contents

1. Introduction.....	4
2. A comparison of the 1960s and early 2000	5
3. Monetary and exchange rate Policy.....	6
4. Budgetary Policy	7
5. Structural Policies.....	9
6. Conclusion.....	10
7. References.....	11

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1. INTRODUCTION

Already in 1958, in a memorandum on economic, financial and monetary cooperation in the Community, the Commission raised some crucial issues concerning the macroeconomic governance of the European Community. Essential elements were a system of economic cooperation of a pre-emptive nature and the need for adequate incentives so that Member States would follow appropriate economic policies: "pour pouvoir être efficacement mise en oeuvre, la coopération économique, financière et monétaire devra être organisée. Cette organisation devra comporter, non pas occasionnellement et pour tel ou tel pays en difficulté, mais de façon régulière et afin de réaliser une coordination de l'ensemble, un examen des grandes questions de la vie économique et financière des Pays membres ... Cet examen devra être entrepris de telle façon que la Communauté puisse se concerter avant que les circonstances n'imposent des décisions aux Gouvernements intéressés. Il serait souhaitable, au moins dans un premier stade, que les examens dont il s'agit conduisent les institutions de la Communauté à émettre des avis auxquels les Gouvernements pourraient facultativement donner suite. Ces avis pourraient cependant revêtir un intérêt accru, si la Communauté pouvait disposer d'une masse de ressources préalablement constituée où destinée à faciliter la mise en œuvre de la solidarité financière en apportant l'assurance que les montants nécessaires à une action de concours mutuel sur le plan financier sont d'ores et déjà réunis. Les Pays membres pourraient compter sur ce concours dans toute la mesure où ils suivraient une politique économique et financière raisonnable et se conformeraient soit à des normes arrêtées à l'avance, soit aux recommandations des organes de la Communauté élaborées en fonction de cas particuliers qui surgiraient au fur et à mesure de l'application du Traité" (Annex 6 to Ferrant and Sloover, 1990, p. 111).

Naturally, in early 2004, important progress had been made in European integration as the Commission notes in a special study "EMU after five years": "The launch of the euro on 1 January 1999, and the introduction of euro notes and coins on 1 January 2002, means that the EU has achieved a long-standing ambition to cement closer economic integration with a single currency." (*EC, 2004, p. 9*). Moreover, economic policy co-ordination is the subject of a series of processes (cf. annex 1). However, some essential issues raised in the 1959 Memorandum are still coming back. So does effective policy co-ordination require: "willingness on the part of all Member States to acknowledge the implications of their policy actions at national level for the euro area and, conversely, to actually implement policy commitments given at EU level." (*EC, 2004, p. 16*).

In this paper we analyse macroeconomic governance in the European Union through a look at economic thought at the Commission in the 1960s and early 2000, focussing on monetary and exchange rate policy, budgetary policy and structural policies. We start with a comparison of the situation in the 1960s and early 2000.

2. A COMPARISON OF THE 1960S AND EARLY 2000

When comparing macroeconomic and monetary thought at the European Commission in the 1960s and early 2000, one has to take into account that the situation with which the Commission was confronted was, naturally, very different (an overview is presented in table 1).

The early 1960s was at the beginning of the process of European integration. Crucial issues were the setting up of the common market and the common agricultural policy. Early 2000, European integration was significantly more advanced. The common market and the common agricultural policy, crucial elements of the Rome Treaty, had been implemented. Also, with the Single European Act of 1985, further important progress towards a single market had been made. Moreover, with the Maastricht Treaty of December 1991, the European Union was moving towards Economic and Monetary Union. On 1 January 1999, the euro has been introduced. Meanwhile however, in the early 1970s, the fixed exchange rate system of Bretton-Woods had fallen apart. So, the community currencies started floating against the United States dollar. Also, in the 1960s the Community consisted only of the six founding countries (France, Germany, Italy and the Benelux), while on 1 May 2004, the European Union was enlarged from 15 to 25 countries.

Table 1 - Some stylised facts on the the 1960s and early 2000

	1960s	Early 2000
State of the process of European integration	Setting up of common market and common agricultural policy	Single currency is introduced on 1 January 1999
International monetary system	Bretton-Woods	Floating
Membership of EU	Six countries	Enlargement from 15 to 25 countries on 1 May 2004
EU economic performance	Golden sixties	Slow growth
Policy paradigm	Keynesian economics	Stability- oriented policies
Focus of Commission analysis: - EU integration - Economic strategy	Payment imbalances (threat to the common market) Programming	SGP (compatibility of policies for EMU) Lisbon-strategy

As far as economic performance was concerned, the 1960s are, rightly, known as the "Golden sixties". It were also the high days of Keynesian economics. Also at the Commission was

Keynesianism influential, even if also German ordo-liberal ideas played a role. During the ensuing decades, this picture changed dramatically. Also due to the oil shocks, stagflation ravaged the European economies. It led to a fundamental change of economic paradigms, with a switch among policy-makers to stability-oriented policies. However, early 2000 was still characterised by a slow economic growth performance.

Against this background, one can discern some remarkable changes, but also continuity in the Commission analysis. A first focus of the Commission analysis concerned the state of the European integration process. In the 1960s, this was very much focussed on balance of payments imbalances, as they could threaten the common market project. In early 2000, the focus was on the Stability and Growth Pact. However, there is some remarkable continuity, as in both cases, the real underlying issue was the necessity for a compatibility of policies to sustain the European integration process. The second focus of the Commission analysis concerned the economic growth performance. In the 1960s the Commission was very much involved in attempts to have some "programming" at a European level in order to strengthen economic growth. Early 2000 the Lisbon strategy, with the open method of co-ordination and benchmarking became the crucial strategy to improve Europe's economic performance. However, in both cases, it concerned strategies which were explicitly set up in a medium-term framework.

3. MONETARY AND EXCHANGE RATE POLICY

In the 1960s the main concern of the Commission, in the area of monetary and exchange rate policy, was the stability of exchange rates, as exchange rate volatility could threaten the common market project and the common agricultural policy (Maes, 2006). In 1962, in its Memorandum on the Second Phase, the Commission argued even that the common market implied a monetary union: "Quant à la politique monétaire, elle est d'une importance vitale pour le marché commun. L'union économique implique, en effet, au moins après la période de transition, la fixité des taux de change des monnaies des États membres, sous réserve de variations dans des limites très étroites. Les suggestions de la Commission prennent appui sur la collaboration qui existe déjà entre les six pays, mais de nouvelles procédures de consultations préalables sont envisagées et devraient conduire progressivement vers une union monétaire véritable" (EC, 1962, p. 9).

In 1969, the so-called Barre Memorandum argued for the creation of a "Mechanism of Monetary Cooperation", so that the Community would dispose of financing mechanisms if a country was confronted with serious balance of payments problems. However, the Barre Memorandum stressed that this mechanism should not lead to the delay of necessary policy adjustment, but should support the co-ordination of economic policies in the Community: "ce mécanisme doit se garder de favoriser des politiques de facilité. Il doit non seulement s'inscrire dans un cadre précis de coordination des politiques économiques tel qu'il a été précédemment défini, mais encore comporter des verrous de sûreté, de façon à ce que le processus nécessaire d'ajustement ne soit pas différé" (EC, 1969, pp. 9-10).

Naturally, early 2000, the situation was completely different. With EMU realised, the exchange rate issue had disappeared. The credibility of the common monetary policy and the ECB became now the crucial policy issue: "As regards monetary policy, the task facing the ECB at the start of EMU should not be underestimated. It needed to quickly establish its anti-inflation credibility, but without pursuing an overly restrictive monetary policy." (EC, 2004, p. 12). The Commission was also very complimentary of the monetary policy strategy of the ECB: "The ECB succeeded in developing a monetary policy strategy reflecting the experiences of the most successful central banks in Europe and incorporating the latest economic thinking" (EC, 2004, p. 12).

However, while the ECB, through its strong commitment to price stability, helped to create the kind of stable macroeconomic environment, an essential precondition for an improved economic performance over the longer term, Europe's economic performance remained lacklustre in early 2000. Structural reforms were seen as the key to improve Europe's economic performance: "A single currency was seen as necessary to fully exploit Europe's single market. Similarly structural reforms to raise potential growth rates and improve market flexibility are necessary to maximise the possible gains of the single currency. A lesson from the past five years, however, is that EMU by itself is not sufficient to generate these reforms, and that a radical shift in attitudes leading to concrete action is indispensable. The challenge now is to reinforce "E" in EMU through economic reform" (EC, 2004, p. 15).

4. BUDGETARY POLICY

Both in the 1960s and early 2000 the Commission was groping with the issue of how to impose the necessary discipline on budgetary policies in the Member States. The 1969 Barre Memorandum argued strongly for a strengthening of the consultation procedures, so that the Commission could have an impact on the member States economic policies: "La Commission estime que, en ce qui concerne les politiques conjoncturelles, le progrès le plus important à réaliser est un renforcement et une application plus effective des procédures de consultation avant l'adoption définitive des mesures économiques envisagées par les États membres" *EC, 1969, p. 11*).

The Barre memorandum also stressed the importance of adequate statistical information and proposed the development of a system of early warning indicators: "Pour faciliter la coordination des politiques conjoncturelles, la Commission estime qu'il importe d'améliorer les informations mutuelles sur l'évolution de la conjoncture dans les États membres, ce qui implique des progrès permanents en matière statistique et des efforts accrus dans le domaine des moyens d'analyse ... La coordination des politiques économiques des États membres, et en particulier la correction au moment opportun des déviations par rapport aux normes indicatives d'évolution, seraient amplement facilitées par l'application d'un système d'indicateurs d'alerte. Ceux-ci devraient être choisis de manière à déceler aussi rapidement que possible les risques d'écarts significatifs par rapport aux objectifs fondamentaux. Dès que ces indicateurs dépasseraient un certain seuil, il

conviendrait d'entamer, au niveau de la Communauté, un examen de la situation du pays concerné" (*EC, 1969, p. 12*).

Also in early 2000, the coordination of budgetary policies was a hot topic, especially given the difficulties with the functioning of the Stability and Growth Pact: "It is striking that the three largest euro-area countries have all failed to respect their budgetary commitments. In most cases, the budgetary problems facing Member States today can be traced back to the failure to run sound fiscal policies in the early years of EMU when growth conditions were favourable, and deficit levels are not especially high at this juncture of the economic cycle This reveals that peer pressure may have helped several smaller euro-area countries tackle growing budgetary imbalances. However, in large countries especially, peer pressure and enforcement mechanisms have proved less effective. This is a matter of considerable concern." (*EC, 2004, p. 13*).

Also the 2005 report of the Commission emphasises the need for better statistical data: "Strengthening the framework for the coordination of economic and budgetary policies. Perhaps the most pressing issue to is to re-establish a credible and effective framework for the surveillance and coordination of budgetary policies, which combines the need for sustainable fiscal policies with flexibility to cater for changing economic conditions and country-specific circumstances. The challenge is not only to rejuvenate fiscal rules. It also encompasses the need for enhanced surveillance of Member State economies based on improved statistics and a more pre-emptive approach to identifying economic policy challenges that are relevant for the euro area." (*EC, 2004, p. 15-16*).

The report further stressed that countries far too often made far too optimistic growth hypotheses: "Indeed, a general tendency has emerged in several Member States in recent years to base budgetary projections on overly optimistic growth assumptions, which inevitably leads ex post to budgetary targets being repeatedly missed." (*EC, 2004, p. 94*).

However, the Report also stressed the lack of "ownership" by the Member States of the Stability and Growth Pact: "Political ownership of the SGP by Member States has diminished with a divergence between budgetary commitments and concrete actions to achieve stated targets, and unwillingness to acknowledge the implication of EMU on the conduct of fiscal policy at national level. More generally, Member States failed to play their role in exerting peer pressure on countries that miss budgetary targets by a wide margin via the enforcement mechanisms of the SGP." (*EC, 2004, p. 103*).

The failure of key member states to respect the SGP triggered a heated debate. One of the key reasons is the lack of a consensus on how best co-ordinate fiscal policy (Fischer, Jonung & Larch 2007).

5. STRUCTURAL POLICIES

The 1960s were the high days of Keynesian economics. Moreover, French planning ideas were influential at the Commission (Maes, 2002). In the 1962 Memorandum the Commission clearly stressed the role of the State in economic life: "il importe de réaliser que, dans le monde d'aujourd'hui, l'ordre économique fondé sur la liberté ne peut subsister sans une présence permanente de l'État dans la vie économique. Cette présence de l'État se manifeste d'une double manière: d'une part l'État soumet à un cadre réglementaire l'ensemble des domaines de l'économie, ainsi que tous les domaines qui sont en contact avec l'économie; d'autre part l'État intervient sous la forme d'une modification constante des facteurs en jeu, par les actes innombrables dans lesquels se traduit son action journalière sur le monde économique, en un mot: en pratiquant une "politique" au sens propre du terme." (*EC 1962, p. 3*).

In the 1962 Memorandum, very much in line with French planning ideas, the Commission argued for a long term approach also to correct national and regional imbalances: "Ce qui reste à accomplir, c'est la fusion progressive des politiques économiques nationales en une politique commune à court terme et à long terme. Cette politique devrait assurer une expansion aussi rapide que possible, la stabilité et une atténuation des fluctuations conjoncturelles et des déséquilibres nationaux et régionaux. Elle implique nécessairement la fixation par la Communauté d'objectifs à long terme". (*EC 1962, pp. 3-4*).

The Memorandum also argued for a Community industrial policy. "La puissance publique est souvent obligée d'intervenir pour faciliter les adaptations nécessaires et aider entreprises et main-d'œuvre à se reconvertir à de nouvelles activités ... Une politique communautaire des structures est donc le complément nécessaire de la politique de développement. Elle se présente sous deux aspects différents, selon que l'on considère les différents secteurs de l'économie ou les régions dans lesquelles les usines sont ou devraient être localisées" (*EC 1962, p. 79*).

Early 2000, industrial policy is not on the agenda any more, the emphasis is on structural reforms. There is a certain disappointment with the euro as a catalyst of reform: "A critical question when considering the impact of EMU on market integration is whether the euro has provided a catalyst to increase the pace and ambition of structural reforms five years on. Five years on, it is clear that the slow and steady pace of reform evident before the launch of the euro has continued, but that the advent of the euro has not led to any noticeable acceleration in the pace of reforms, and they fall well short of what is required if the EU is to achieve the strategic goal of the Lisbon strategy." (*EC, 2004, p. 140*).

"For the euro area as a whole, though, there is no doubt that progress over the five years since 1999 has been disappointing. Where progress has continued, it has tended to be in somewhat "easier" areas, such as tax cuts, active labour market policies and strategies for lifelong learning. But in the politically more difficult areas highlighted in most empirical studies of labour market institutions as key influences on unemployment and employment - especially wage-bargaining and

benefit systems - there has been very little advance. So far, therefore, it must be concluded that EMU has had no noticeable impact on the pace or ambition of labour market reforms." (*EC, 2005, p. 163*).

With the open method of coordination, a new approach has been added to the instruments of economic policy coordination. However, the question of the effectiveness of economic policy coordination, as already raised in the 1958 memorandum, remains: "Both the Cardiff process and the Lisbon strategy rely mainly on peer pressure and benchmarking to achieve their goals. The open method of coordination puts pressure on Member States to explain what they are doing in terms of the implementation of structural reforms and why certain goals have not been reached. By relying exclusively on "peer pressure", persuasion and the issuing of policy recommendations, these processes lack the disciplining instruments that may be needed to guarantee that the policy measures considered necessary or desirable are actually implemented. Therefore, the question should be considered whether these coordination processes are effective: do they really influence Member States' policy choices; do they induce Member States to initiate reforms that they would not have chosen to undertake anyway? Clearly, the non-binding character of the open method of coordination means that the Member States are not going to be forced, say, to cut State aid or to reduce the administrative burden on business if they do not wish to do so." (*EC, 2004, p. 152*).

6. CONCLUSION

Since the Rome Treaties, the question of the organisation of macroeconomic and monetary policy has been a key issue in the debates on European integration. In this paper we explore the continuity and changes in these debates. We focus on macroeconomic thought at the European Commission in two periods: the 1960s and early 2000. There are important changes, especially in the areas of monetary policy and structural policies. In the early period, exchange rate disturbances (like after May 1968 in France), constituted an important threat to the European project. With the realisation of monetary union and a stability-oriented monetary policy, monetary disturbances and threats have largely disappeared. So, according to the Commission analysis, there has been substantial progress in this area. With respect to structural policy, one can observe profound changes in the underlying economic policy paradigms. While state intervention was high on the agenda in the 1960s, now a more market conform approach is advocated, which is also prominent in the Lisbon strategy. There is also a change in methodology: from "programming" to the "open method of coordination", even if both are set in a medium-term framework. However, looking at the coordination of budgetary policy, the issue is much more complicated. A fundamental reason is that, with the Maastricht Treaty and the Stability and Growth Pact, the European Union had made a choice for a rules based fiscal framework. However, as is well known, there have been problems in this area. In fact, there are some remarkable continuities here with the 1960s. Several issues, which were prominent on the Commission agenda then (like, how to have influence on Member State policies, statistical governance, the construction of early warning indicators) are still there

today. Consequently, the Commission is now, very much in line with a political economy approach, seeking to increase the national "ownership" of the budgetary and reform policies which it advocates.

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Annex 1

Economic policy co-ordination in the EU

