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EMU, coordinated macroeconomic policies and a boost to employment in the European Union

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EMU, Coordinated Macroeconomic Policies and a Boost to Employment in the European Union

by

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1. The policy agenda*

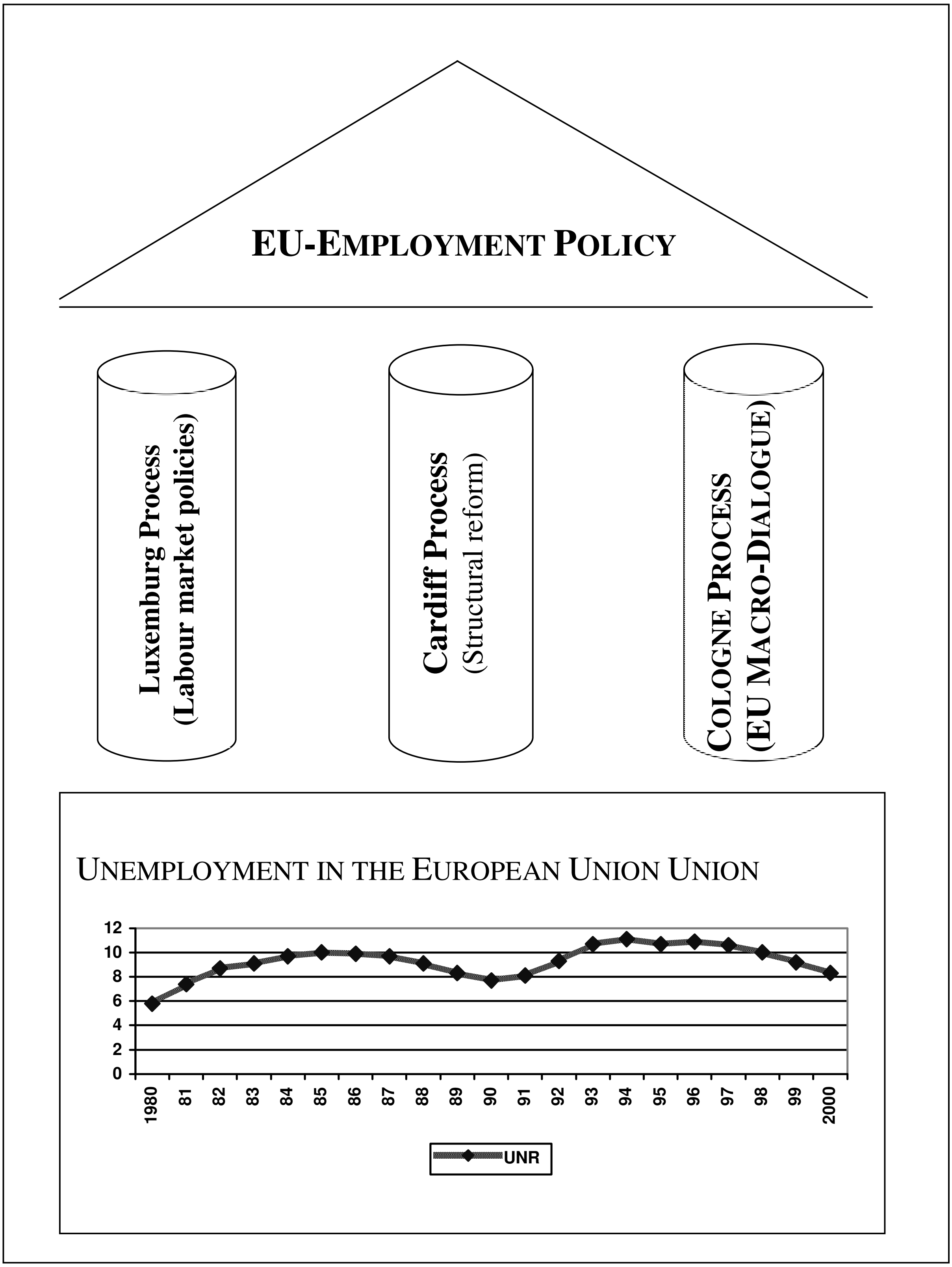
Ever since European integration has been an issue on the political agenda and particularly so in the event of a European Monetary Union (EMU), one of the major arguments in its favour was that it will help boosting economic growth and employment. Yet, deepening integration over the past decades was accompanied by growing unemployment, a slack in economic growth and social reforms which were spelled as curtailment of social systems almost everywhere in the European Union (EU). Although there is no direct link or even causation between these developments, it nevertheless explains why unemployment ranks so high not only on the political agendas of each EU member country but also on the common policy agenda. It became evermore obvious that not European integration *per se*, but only European integration in a certain environment of economic policy orientation will be able to deliver desired outcomes. The inclusion of an 'Employment Chapter' in the 1997 Amsterdam Treaty closed a fundamental loophole in its Maastricht counterpart, signed six years earlier. For, even after the path-breaking agreement on a single currency, critics of European integration had still been able to complain – with some justification – that the convergence criteria set for participation in European Monetary Union (EMU) placed too much weight on the new currency's price stability, and too little on the employment situation in the EU. Indeed, it could be said that the Maastricht Treaty still bore the hallmarks of the economic - and political - priorities of the 1980s, the 'monetarist decade'. As growing importance was attached to combating the rising trend in unemployment, a pressing need became apparent: the European Central Bank's remit to ensure price stability in the future Euro-zone had to be balanced by assigning the Union explicit responsibilities for employment. Thus was a new field of EU policy opened up.

Without doubt this development was due in part to the constant political pressure applied by those member states which have traditionally had more active labour market and employment policies, namely Sweden and Austria. But it can also be attributed to the EU's gradual 'social-democratisation', a process whose crucial moment was the arrival in power of Lionel Jospin in France and Gerhard Schröder in Germany. Yet the Union's assumption of employment policy responsibilities in the Amsterdam Treaty was merely the beginning of a conceptual process which shaped the three pillars of current EU employment policy (see fig. 1). These are:

- the *'Luxembourg Process'*, initiated at the 1997 Luxembourg Summit, which established that member states would coordinate their labour market policies.
- the *'Cardiff Process'*, named after the Cardiff Summit of 1998, which embodies the hope that liberalization of product and financial markets can stimulate the structural changes and dynamism required to create knowledge-based economies in the various European countries, while simultaneously deepening European integration.
- the *'Cologne Process'*, the most recent of the three. Agreed at the 1999 Cologne Summit, it recognises that a favourable macroeconomic situation is the prerequisite for lasting improvements in growth and employment, and that coordination of budgetary, monetary and incomes policy – so-called 'EU macro-dialogue' – is therefore desirable. For the first time the ECB's activities have been set in an employment policy context, and the European social partners tied in to the process.

* This paper has been produced for a conference on 'European Integration and Social Justice: Conflicts and Policies' organised by the Friedrich Ebert Foundation and held in Bonn 18 – 19th of July 2002.

Figure 1: European Employment Strategies



Both the Luxembourg and Cardiff processes stress the importance of functioning markets, and are thus unmistakably based on microeconomic considerations of allocation theory and supply-side policy; they are explicitly concerned with improving 'employability' rather than purely quantitative 'employment'. By contrast, the Cologne Process is founded on macroeconomic, demand theory notions, so that it can also be seen as part of a 'Euro-Keynesian' strategy (see Aust 2000).

As the political body of the European Union does not have the financial potentials to pursue employment policy on its own account and responsibility – it only commands 1.27% of EU-GDP –, employment policy as established in the Cologne Process can merely be 'economic governance' in the sense that it coordinates national policies. And the concentration on the Cologne Process and the neglect of the Luxembourg and Cardiff processes in the following analysis is not an arbitrary decision but results from my elsewhere explained belief (see Heise 1998, Heise 1999, Heise 1999/2000) that a lasting improvement in economic growth and employment can only be achieved by macroeconomic policies. There are two distinct levels of coordination and also two distinct procedures of coordination to be distinguished: First, we distinguish between *horizontal coordination* of national policies within a certain policy field such as the Stability and Growth Pact (SGP) coordinating national fiscal policies and *vertical coordination* of monetary, fiscal and incomes policies in order to create of cooperative policy game. Secondly, we distinguish between *hard coordination* implying clear rules and sanctions on the one hand and *soft coordination* on the other hand which has to rely on peer pressure. Before taking a closer look at both levels and procedures of policy coordination, let us first establish the need for policy coordination within EMU.

2. Economic policy coordination in the Euro-zone: what is the issue?

2.1 Horizontal coordination

The rational for policy coordination within certain policy fields is seen in the need for providing a public good (for a survey of the literature see Mooslechner/Schuerz 2001). This is best explained by taking the example of fiscal policy – which is mentioned in the European treaties – but could also be established for incomes policies. Monetary policy, however, must no longer be horizontally coordinated as a single currency is created in the Euro-zone since monetary unification in 1999:

1. In a monetary union, national risk premia on interest rates, which governments will have to pay according to their (expected) fiscal behaviour, will be levelled out. Or to put it differently: The cost of an overly expansionary fiscal policy can be externalised to all members of EMU, while the benefits of such a policy – growth effects or social policy spending – can largely be internalised. This, it has been argued, poses the incentives for member countries to neglect fiscal restraint or, even worse, forces member countries into an overly expansionary fiscal policy in order not to end up as 'willing victim'. Therefore, coordination must impose clear restrictive rules and sanctions if the European Central Bank (ECB) is not to be left alone with combating inflationary pressures which may arise in case of overly expansionary fiscal policies.

Although this reasoning cannot be rejected outright, its aplomb has often been exaggerated: On the one hand, the possibility of externalisation only exists if national governments bail out each other in times of financial troubles. Accordingly, the

European treatises include a *'non-bail out clause'* which is very credible as the national governments still retain taxing power and, thus, are in a position to determine public revenues to a very high degree.[1] On the other hand, fiscal policy will not be pursued simply and predominantly with regard to the externalisation possibility but rather with regard to a trade-off between today's and tomorrow's fiscal room for manoeuvre – and this depends much more on the level of public debt than on interest rates (see Heise 2001a). These caveats, at least, reduces the risk of running into a situation of overly expansionary fiscal policies within EMU.

2. There is another, almost contradictory reasoning for coordination once the possibility of 'free riding' is taken into account. EMU members may act as 'free riders' – i.e. refrain from stabilisation policy – if they expect the other members to do the job (particularly in the case of a small country) or, contrary, if they expect the others to be 'free riders' themselves (particularly in the case of a big country). Under such circumstances, only clear rules and sanctions will provide an expansionary fiscal policy which is able to stabilise the Euro-zone.

Both reasoning, here a coordination for *restrictive purposes* in order to prevent excess public deficits, there a coordination for *expansionary purposes* in order to provide effective stabilisation policies, seem to contradict each other. Yet, this only hints on the different positions of EU members: Bigger and more closed economies cannot profit very much from free riding-behaviour but may be induced to externalise interest rate effects of expansionary fiscal policy. Smaller and more open economies, on the other hand, do not succeed in internalising the positive growth effects of fiscal stimuli but may want to wait for a locomotive to free ride on. In both cases, without an effective policy coordination, the provision of a public good will be difficult to achieve: Fiscal discipline on the one hand and stabilisation policy on the other hand (see Jacquet/Pisani-Ferry 2001).

2.2 Vertical coordination

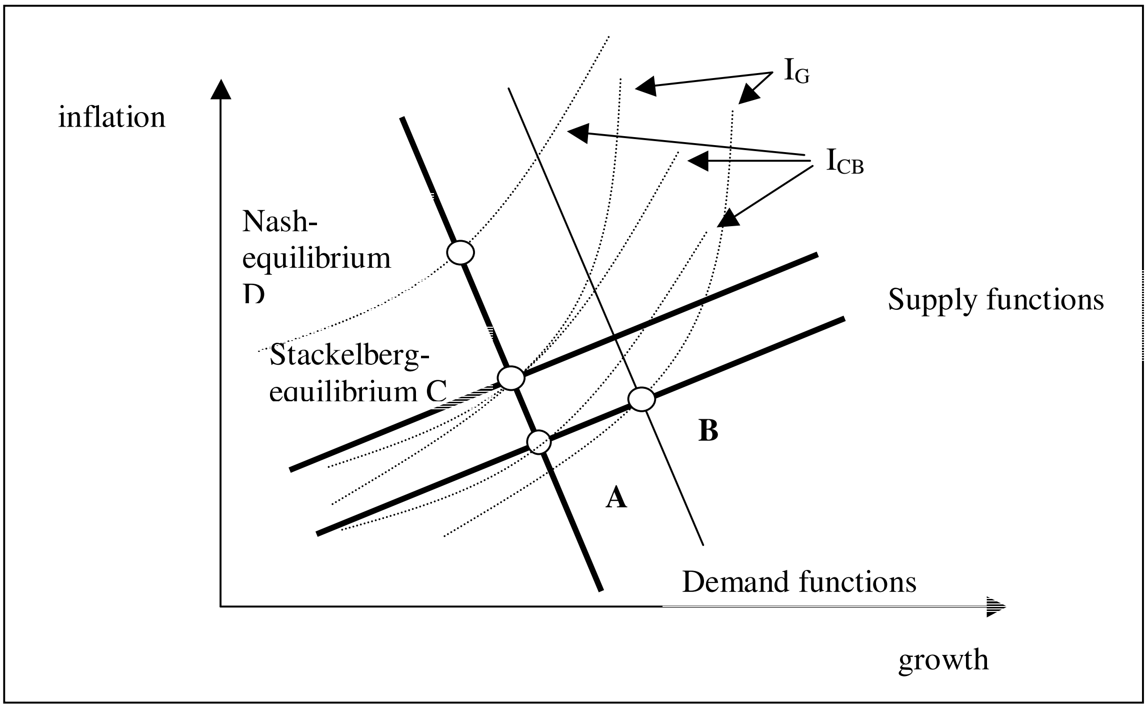
The interdependence of the various policy areas – ie monetary, fiscal and incomes policies – can be justified by construction of a Phillips curve, in which those responsible for them pursue the *common goal* of a given combination of price stability and labour market parameters, but display *differing preferences* with respect to inflation and unemployment. Using a formal model (see e.g. Carlin/Soskice 1990, Layard/Nickell/Jackman 1991, Nordhaus 1994) it can be shown that, if behaviour is not coordinated, none of the political actors can reach their desired utility, expressed by a position on the Phillips curve. In that case all actors – central bank, government and social partners – must accept a loss of utility relative to the situation where cooperation occurs. Specifically, it transpires that monetary policy is tighter than would be required merely on price stability grounds, while budgetary policy is subject to 'hegemonic coordination' by the independent central bank, the result being higher borrowing and reduced room for manoeuvre of public authorities. Meanwhile incomes policy, and in particular the unions, must accept increased unemployment with no compensating distributional improvements. Were it possible to compare an economy with horizontal coordination against another without it, then the latter would display not only higher interest rates and higher prices (or inflation), but also higher unemployment and more public debt (see Heise 2001b: 61ff.) This is shown in figure 2 which portrays – for the

[1] And, in this they are quite different from German *Länder* or US States.

sake of simplicity – the preferences of two actors only (the central bank and the government) in a growth-inflation space. Non-coordination results in a Nash-equilibrium position D or, if one actor is taken as what is called Stackelberg-leader, in position C – both of which are clearly inferior to either A or B or some point of coordination in between.

Cooperation therefore seems desirable, in that it increases utility - and not just for the individual actors but also for the economy as a whole. It might therefore be expected to arise spontaneously. Yet empirical studies clearly indicate that coordinated behaviour occurs by chance, if at all. That does not mean that actors are ignorant, ill-directed or downright malicious, however. Rather they are both rational (ie they pursue defined goals in a consistent manner) and selfish (ie they value increases in their own utility more highly than those of other actors). Under these circumstances, actors will be caught in the classic *'Prisoner's Dilemma'* unless it is somehow assured that all the actors concerned will play their part in cooperation (in the case of macroeconomic coordination, that would involve the central bank permitting a more expansionary monetary policy, the government adopting a less restrictive, but sustainable budgetary policy[2], and the social partners agreeing to a non-inflationary incomes policy which seeks for distributional stability). Otherwise it remains preferable, and indeed necessary, for the individual actors to accept a macroeconomically inferior outcome in a situation of general non-cooperation. For the alternative is to become a 'willing victim' who makes the concessions required by cooperation, and is exploited by other actors who do not.

Figure 2: Uncoordinated policy game of monetary and fiscal policy in a growth-inflation space



[2] This should certainly not be understood to mean an undifferentiated policy of deficit spending. The notion is rather that the empirically-established positive long-term effects – on growth and employment – of expansionary budgetary policy should be combined with the requirement for sustainability, ie the maintenance of a level of public debt perceived as optimal, eg 60% as under the Stability and Growth Pact (see Heise 2001a). Such an approach to budgetary policy requires precisely a coordinated policy mix, however, if it is not to fall into the debt trap (see Rankin 1998).

Game theory considerations do not merely warn us against unjustified assumptions of 'spontaneous cooperation', however. They also point to the conditions which must be fulfilled if the Prisoner's Dilemma is to be resolved, and cooperation occur. The most elegant option would be to bind the actors contractually, making non-cooperation sanctionable, but that is effectively ruled out in the case of macro-dialogue. A binding agreement of this type would involve dependence on a third party, to decide whether the actors had, in fact, fulfilled their contractual obligations, and is in any case barely conceivable for independent actors. The alternative is an implicit agreement, under which sanctions take the form of non-cooperation costs (the so-called 'long shadow of the future'). In this case institutional structures must be devised to minimise the danger that 'willing victims' are exploited.

(1) The first essential is that the actors must be willing and able to *communicate* with each other; without communication a 'cooperative game' is unthinkable. However, 'communication' must go beyond the mere exchange of information which could in any case be gleaned from the actors' own relevant material or press statements. Rather, communication here implies exchanges about cooperation itself, about potential gains and the costs of non-cooperation, about a cooperative strategy and about anything which might increase actors' trust that cooperation on their part will be reciprocated by others.

(2) Communication is a necessary, but not a sufficient condition for cooperation. It must also be possible to specify and *monitor* actors' individual contributions to cooperation. Only when it is clearly and generally accepted that all such contributions have been made can behaviour in 'the next round', ie in future interactions, be determined. And that means that *guidelines* must be established to enable contributions to be verified.

(3) To avoid the first-mover trap a *sequence*, ie a succession of cooperative actions and responses, must be established. That also addresses the problems arising from the fact that, in pursuing their policies, individual actors may have to consider other market players as well as the other policy actors involved in the 'game'. Specifically, a central bank cannot ignore the financial markets, if it wishes to have any chance of achieving its goals. Indeed, the markets may demand complete central bank independence as a prerequisite for its credibility. In that case the bank cannot be a 'follower' – an actor who responds to the cooperative contributions of others – but must be a 'leader' setting the cooperation agenda.

(4) Finally, a '*game strategy*' is required that minimises the utility losses for an actor who nonetheless becomes a 'willing victim'. Here game theory prescribes 'tit-for-tat' as the ideal strategy. Simple and unsophisticated, it signals willingness to cooperate while punishing non-cooperation mercilessly.

To enable lasting cooperation between macroeconomic actors, these parameters must be set in an *institutional context* (so-called 'structural embeddedness'). This must give actors security and confidence and so underpins cooperation. In particular, communication must occur within a stable institutional framework. Monitoring of actors' behaviour and establishment of generally accepted guidelines requires a 'neutral' authority, which must be equally respected by central bank, government and social partners – only then will its decisions be effectively binding. Elsewhere I have proposed (see Heise 2001b: 98ff.) a 'Socio-Economic Committee' (SEC), composed of representatives of the various policy actors, and an 'Expert Committee' (ExC)[3], made up of academics enjoying the relevant actors' trust, which together could serve as the institutional framework for macro-dialogue. The ExC would take on the monitoring role, working on the 'papal' principle; in other words at specified points in time it would be required to issue unanimous recommendations. That would prevent individual members' views from being imposed by a majority, while creating pressure for agreement. The results of the monitoring process would be communicated in the SEC, which would then discuss and communicate sanctions.

All in all, the prerequisites for successful vertical coordination of macroeconomic actors' behaviour in the context of a macro-dialogue are numerous. Yet the underlying conditions are clearly favourable. Since all actors can profit from cooperation by approaching their desired position on the Phillips curve more closely, the game has a positive sum. Unlike in a zero-sum game such as the situation of 'antagonistic cooperation', there is no need for them to be constantly on guard against losing out in the process of give-and-take. That should make it relatively easy for actors to obtain the internal legitimation necessary to participate in macro-dialogue, either from their members (in the case of the social partners) or from voters (in that of the government).

3. …and what has been achieved?

In the Maastricht treaty as well as in its revision, the Amsterdam treaty, EU members have agreed upon coordinating economic policies. But what was the underlying rational for this agreement and what is its purpose? 'Multilateral surveillance' is the nucleus of economic policy coordination in the Euro-zone in which *Broad Economic Policy Guidelines* (BEPG) are being issued by the European Commission. Over the past years, the guidelines were of orthodox neo-liberal orientations: they over and again recommended fiscal parsimony, wage moderation and labour market de-regulations. National governments are required to take the recommendations of the BEPG into account and respond to them in their annual economic reports. Although the BEPG are merely general statements, this type of 'soft coordination' – which includes *Employment Policy Guidelines* (EPG) of the Luxembourg Process and, additionally, the annual reports of the Cardiff Process – is far from being ineffective: even without clearly established sanctions, peer reviewing and peer pressure may be very supportive in enforcing a common (neo-liberal) policy outlook.

'Hard coordination', ie clear rules of conduct and sanctions[4] in case of misbehaviour, has been reserved for horizontal coordination of national fiscal policies which has been euphemistically called '*Stability and Growth Pact*'(SGP). The purposes of the SGP are evident: on the one hand, it aims at fiscal constraint in a 'tying one's hand' manner by issuing zero-deficit guidelines (see Buti et al. 1998). Negative growth impacts of such fiscal constraint are downright rejected. On the other hand, binding policy guidelines are expected to lend the newly established European Central Bank more credibility in pursuing a policy of price stability exclusively (see Artis/Winkler 1998). And thirdly, the SGP enacts a type of vertical coordination which has been called 'assignment' and implies a strict separation of policy responsibilities or, to make it more clearly: the SGP

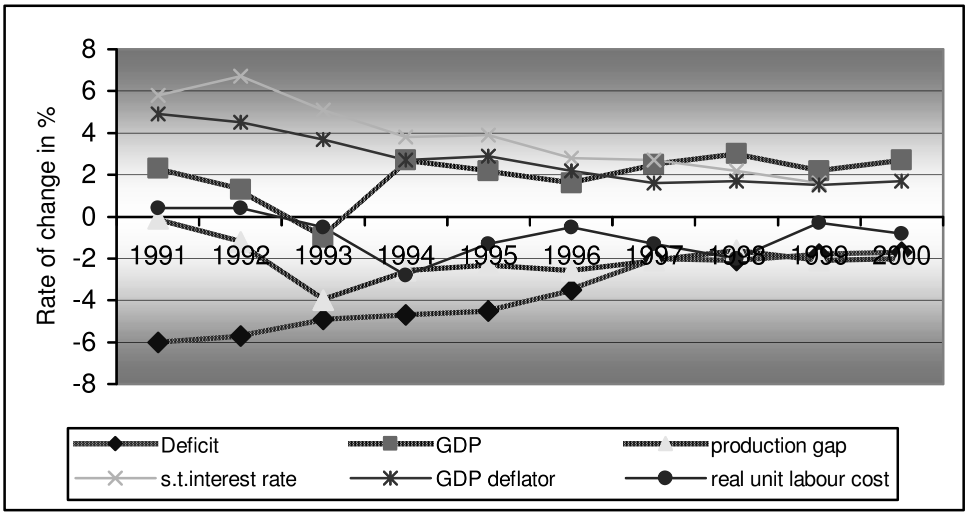
[3] This has less in common with the German 'Expert Committee on Macroeconomic performance' than with the Austrian 'Advisory Committee on Economic and Social Issues' or the Dutch 'Employment Foundation'.

[4] The whole range of sanctions has been laid down in the ‚procedure in case of an excess deficit', see e.g. Canzoneri/Diba 2001.

truly is a **substitute** for vertical cooperation of the different policy actors (see Artis/Winkler 1998, Gatti/Wijnbergen 1999). Precisely in order to render cooperation proper unnecessary and to avoid 'exploitation' of the ECB by the budgetary policies of (some) EU members the SGP had been invented. Using a 'hard coordination' procedure in the case of horizontal coordination of national fiscal policies secures that new orientations – probably extracted from alternative macroeconomic paradigms – will have no chance to infiltrate the practise of European economic policy.[5] Against this background, vertical policy coordination of the Cologne Process – the so called macro-dialogue – becomes rather futile. Not surprisingly, the Cologne Process is neither subject of any kind of 'hard coordination' nor part of the 'multilateral surveillance'-type of 'soft coordination'.

Has this peculiar type of coordination already left its marks on the economic situation and development of the Euro-zone? The reduction of public deficits from 4.8% of EU-GDP on average over the period 1990-1995 to 2.2 % on average over the period 1996-2000 seems to be in accordance with the objectives of the SGP (and its forerunner, the Maastricht convergence criteria) but could also be attributed to a coincidental business cycle upturn. However, if the public deficit is controlled for business cycle distortions, the result is quite the same: structural deficits have been cut back from 5.3 % on average between 1990 and 1995 to 1.9 % on average between 1996 and 2000 indicating that this restriction has been accompanied by a slump in the second half of the 1990ies (see fig. 3).

Figure 3: Euro-zone; selected indicators

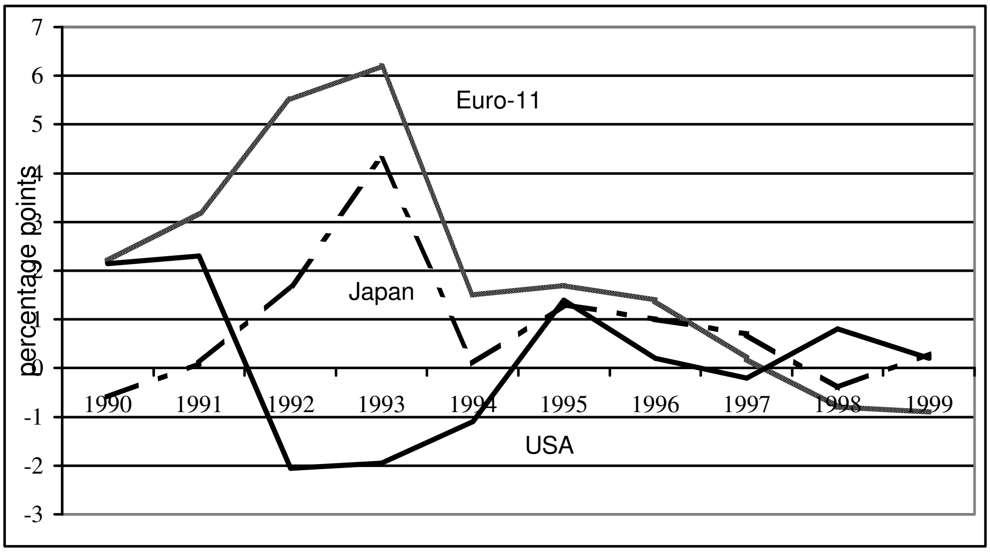


Notes: Deficit = structural public deficit; GDP = rate of change of real GDP; production gap = difference between production capacity and production potential; s.t.interest rate = short term nominal interest rate – GDP deflator; data for 2000 are estimations.
Source: European Economy, Nr. 68, 1999

[5] The occurence of a severe flood causing massive destruction in eastern Germany in combination with a dull economic situation at the end of 2002 provoked a discussion about the feasibility of the SGP. Although the case against a compliance to the SGP under all circumstances was not a theoretical but rather a purely practical one, the ‚defender of oath' silenced the dispute by simply refering to the alleged creditibility effect which only holds if the SGP is followed strictly.

Also, the huge deviation in national deficits has drastically been narrowed at the end of the decade: while in 1991 the highest deficit was 11.5 % of GDP in Greece as contrasted by a 1.9 % surplus in Luxembourg, the differential was down to -2.4 % (in France) and +2.8 (in Denmark) in 1999. The directly negative demand impact of such a restrictive budgetary policy could have been counterbalanced only if monetary and incomes policy had switched into an expansionary mode. However, fig.3 nurtures the suspicion that this was unsuccessful in terms of closing the production gap which opened up during the recession in the early 1990ies. Although short-term (real) interest rates came down from 7 % in 1992 to 2 % in 2000, this only matched falling inflation rates being a result of reduced (real) unit labour cost. Yet, once fiscal and incomes policies remain constraint, monetary policy has to carry the whole burden of stabilising the economy – and this includes much stronger monetary pushes than the Bundesbank (until 1998) and the ECB (since 1999) were willing to give: while the short-term real interest rate (as an indicator of central bank's policy orientation) was close to zero on average during the 1970ies, it never undercut 2% during the 1990ies (and recalling that GDP growth rates were higher during the 1970ies than during the 1990ies).

Figure 4: USA-Japan-EU; interest rate-growth differentials



Source: Flassbeck 2001

To summarise, its seems evident that the slack economic growth situation in the European Union is, at least partly, due to an unsuccessful vertical macroeconomic policy coordination (see also Hein/Truger 2002) – a result which is supported by a comparison with the prosperous development in the USA during the second half of the 1990ies (see Flassbeck 2001; Lombard 2000; Semmler 2000) and which becomes obvious when interest rate-growth differentials – as an indication of monetary pushfullness – in both regions are contrasted (see fig. 4). Notwithstanding the fact that the experiences with macroeconomic policy coordination of the Cologne Process are still too limited for final conclusions, it is yet clear that expectation should not be too high:

- Macro-dialogue was established as a reaction to the Stability and Growth Pact, and – it may be surmised – as a concession in the light of its terms. Only when 'a window of opportunity' opened after the elections of social democratic governments in Germany and France and an outspoken 'policy maker' such as the German finance minister Oskar Lafontaine took office, it was possible to embed the ECB in a macroeconomic employment policy strategy. After the resignation of Lafontaine from his post early in 1999, the macro-dialogue as policy orientation lost momentum.

- Macro-dialogue was forced into a straitjacket of requirements (acceptance of the provisions of the SGP, acceptance of autonomy of the involved policy actors) which eroded its feasibility and secured the dominance of (restrictive) horizontal coordination.
- Finally, the institutional framework of the Cologne process – a 'technical level' at which information and 'points of view' are exchanged and a 'political level' of mutual confidence building – is insufficient to overcome the 'Prisoner's Dilemma'-situation of vertical cooperation (see Heise 2002).

4. … what should be done?

Prior to the search for a better coordination of macroeconomic policies must be the acknowledgement of a paradigmatic shift in economic policy – for the established problems of coordination within the Euro-zone are no 'technical' faults but are due to a misconception of what coordination is supposed to be. Therefore, what is needed is no less than a conceptionally new orientation – or, rather, a re-orientation as the dominance of fiscal restriction by the SGP and monetarist policy by the ECB falls back to a level of pre-Keynesian knowledge. Having said this, neither political agony nor an uncritical revival of the 'Keynesian revolution' is hoped for. Political agony is misplaced because the frontline of restrictive horizontal coordination and vertical assignment is not as closed as it sometimes appears to be: the political elites of some other EU member countries (eg France) are much more critical towards the established EMU architecture than the German elites dare to be – remember that it was the German finance minister Theo Waigel who 'imposed' restrictive fiscal coordination. And due to the debt problem of German unification, expansionary fiscal policy – however necessary it may be – is still a non-issue in German politics. But a very slow re-direction of the discussion seems to be under way[6] and even the president of the European Commission has announced his growing scepticism by calling the strictness of the SGP 'stupid'.[7] And the UK, although no member of EMU, has only recently established budgetary rules which go far beyond the stabilisation potentials of the SGP (HM Treasury 1997). An uncritical return to bastard-Keynesian[8] ideas of the 1960ies is unwarranted as the blind spots in bastard-Keynesianism – particularly the twin perils of inflation and public debts – are at the very roots of the renaissance of pre-Keynesian myths in the 1970ies and 1980ies.

A proper shift in economic policy must take the conceptions of an EU macro-dialogue serious – which involves an institutional strengthening of the Cologne Process as well as a re-interpretation of the SGP:

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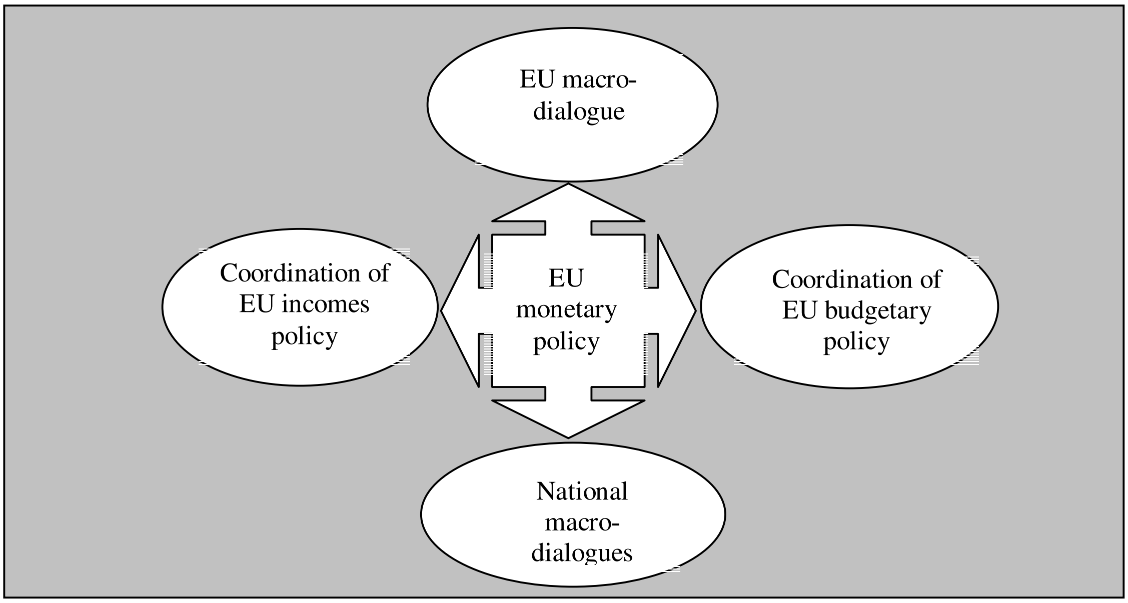
[6] Leading economic research institutes have only very recently proposed to accept an 'excessive deficit' for the short period and the Deutsche Institut für Wirtschaftsforschung (DIW) has even advocated to abandon the SGP all together in its present form; see DIW-Wochenbericht Nr. 32/2002.

[7] Larry Elliot (2002), economics editor of THE GUARDIAN, comments: "The stability pact is the Mick Jagger of economics, long past its sell-by date but still cavorting about the stage as a goulish remnant of the golden age of monetarism. (…) The stability and growth pact is deflationary, anachronistic and should be scrapped. It only remains to be seen whether it is killed off quickly or has a long, painfull death. At present, regrettably, the odds are on the latter, with Europe's unemployment paying the price."

[8] This expression, although slightly unkind, has been attributed to the late Joan Robinson.

- The division of macro-dialogue into technical and political levels has so far impeded creation of an institution which would draw up binding, generally accepted policy rules, and enables the various policy actors' behaviour to be monitored. In order to become such an institution, the technical level would have to be markedly upgraded and its subordinate remit correspondingly extended. Only then could it form the basis of a European 'Expert Committee'.

Figure 5: Multi-level Policy in the European Union



- It should not be forgotten that, as yet, only in the monetary policy field does an actor genuinely capable of decisive action exist at EU level; the ECB. For budgetary and, above all, incomes policy, such actors are lacking. Macro-dialogue would therefore require multi-level coordination between the various policy areas, on the one hand, and the relevant national actors in the fields of budgetary and incomes policy on the other (see Figure 4). As a result it is in danger of falling into Scharpf's (1993) notorious 'interwoven policies trap' (*Politikverflechtungsfalle*). Without doubt EU macro-dialogue could be more easily initiated, and later consolidated, if it could build on *national macro-dialogues* at member state level. For then it could be restricted essentially to coordination within the policy fields and to providing feedback for the various national dialogues, with common monetary policy providing the necessary binding element. Certainly, though, the establishment of national dialogues would itself require a spill-over process from the EU level, as experienced during the discussion on monetary and budgetary policy in the run-up to EMU.
- The SGP must be re-interpreted in a way which allows for a coordination of budgetary policy beyond a zero-deficit orientation (see Arestis et al. 2001) without neglecting the need for sustainability. After long political discussions, 60 % of (national) GDP has been accepted as the hallmark for sustainability within EMU. This hallmark is important as it determines another benchmark which is more important in year-by-year budgetary decision-making: the public deficit. Under the assumption of an annual GDP-growth rate of nominal 5 % (on average), a budgetary deficit of 3 % will be sufficient to stabilise a debt of 60 % of GDP. Of course, this is a measure of structural (ie controlled for business cycle distortions) deficits which may be surpassed in times of recession and undercut in times of booms. Shifting this

benchmark towards a zero-deficit and re-interpreting the 3 %-margin as the sanction-free maximum can be economically harmful in terms of growth perspectives and, definitely, contradicts its initial purpose to stabilise a sustainable debt. It is in this sense that the SGP must be put back on economic foundations.

Sometimes, the claim for changes in the neoclassical-monetarist orientation of EU-architecture is rejected by arguing, international financial markets would ‘punish’ such a strategy shift because actors would fear for the credibility and independence of the European Central Bank – resulting in capital outflows (if not flights), interest rate increases and a depreciation of the Euro. However, recent developments after the 9-11-terror attacks can be read in a quite different way: responsible action taken to secure economic growth may keep institutional investors aboard. Hence, financial markets not only care for (expected) inflation differentials but also for (expected) growth differentials.

Vertical and horizontal policy coordination within the Euro-zone is vital for growth and employment perspectives of Europe. The experience of the past decade – in preparation for and the first few years of EMU – displays that an optimal policy mix has not yet been found, theoretically grounded speculation suggests that we must not expect changes to the better as long as the architecture of European integration and the institutions of EU economic governance are not thoroughly challenged. How realistic is such a development? On the one hand, the fragility of multi-level coordination procedures, such as the macro-dialogue suggested here, must be admitted. However, as long as there are no European political actors able and legitimised to form a European (economic) government, there is no alternative to economic governance of the proposed kind. More important than the institutional peculiarities seem to be the fundamental lack of political support for the necessary changes: The ‘political cycle’ has still not given fair-well to neoclassical-monetarist outlooks and there is no ‘policy maker’ at hand who could build an alternative agenda and give the macro-dialogue new momentum. But as long as things are not changing, the Cologne Process and its macro-dialogue will be an empty shell and growth and employment perspectives will remain dull for Europe.

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