MAGYAR TUDOMÁNYOS AKADÉMIA
KÖZGAZDASÁGTUDOMÁNYI INTÉZET

INSTITUTE OF ECONOMICS
HUNGARIAN ACADEMY OF SCIENCES

MŰHELYTANULMÁNYOK

DISCUSSION PAPERS

MT–**DP.** 2005/20

THE MACROECONOMIC CONDITIONS OF EU-INSPIRED EMPLOYMENT POLICIES

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Magyar Tudományos Akadémia
Közgazdaságtudományi Intézet

Budapest

KTI/IE Discussion Papers 2005/20
Institute of Economics Hungarian Academy of Sciences

The macroeconomic conditions of EU-inspired employment policies

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The Hungarian version of this study was part of a comprehensive collaborative volume prepared for the Hungarian Ministry of Employment and Labour Affairs: Köllő, J. (Ed.) *Evaluation of the Hungarian Employment Policy in the Context of the European Employment Strategy based on the experience of the past five years*, Institute of Economics, Hungarian Academy of Sciences, Budapest, August 2005, 261+30 pages (in Hungarian). The author is grateful for the support of the Hungarian Ministry of Employment and Labour Affairs, as well as of the Hungarian Research Fund (OTKA) project No. T/16 T046871 and of the National Social Science Research Fund (OKTK) project A/0157/2004.

ISSN 1785-377X
ISBN 963 9588 64 4

Published by the Institute of Economics Hungarian Academy of Sciences
Budapest, 2005

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GÁCS JÁNOS

AZ EU ÁLTAL INSPIRÁLT FOGLALKOZTATÁSPOLITIKA MAKROGAZDASÁGI FELTÉTELEI

Összefoglaló

Az EU a tagországok foglalkoztatási és munkapiaci politikáját olyan impulzusokkal és koordinációs kezdeményezésekel igyekszik irányítani, mint az európai foglalkoztatási stratégia*, illetve az annak részét képező* foglalkoztatási irányvonalak*. Az egyébként korszerű munkapiaci intézményi megfontolásokra alapozott foglalkoztatási irányvonalak egészen a 2005-ig foghíjasak maradtak, mert a makrogazdasági irányításért felelős uniós intézményekkel való feladatmegosztási feszültségek miatt olyan lényeges területekkel nem foglalkozhattak, mint a munkabérek alakítása, a béralku rendszere, illlteve az aktív munkapiaci intézkedések költségvetési hatása. Az EU foglalkoztatásra irányuló inspirációi makroszempontból elméletileg nem eléggé megalapozottak. Erre példa a* lisszaboni folyamatnak *a makroszintű hatékonyság és foglalkoztatás szimultán gyors növelésére vonatkozó célkitűzése, amely nem vet számot e két tényező között hosszabb távon is érvényesülő átváltási összefüggéssel. Az EU fejlesztési filozófiájának és intézményeinek feszültségeket okozó széttagoltsága megmutatkozik a magyar középtávú makrogazdasági illetve foglalkoztatási stratégia (a Konvergencia Program és a Nemzeti Foglalkoztatási Akcióterv) nem túl erős, de zavaró inkoherenciájában is. Van lehetőség azonban arra, hogy a tagországok (és így Magyarország) az EU-keretek között makroszinten megalapozott foglalkoztatási stratégiát dolgozzanak ki és valósítsanak meg, ha az uniós inspirációkat kevésbé szolgaian követik, a hazai körülményeket reálisan veszik számba, és a káros intézményi megosztottságot legalább saját apparátusaikon belül kiküszöbölik*

Kulcsszavak: európai integráció, foglalkoztatási stratégia, szakpolitikák koordinációja

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THE MACROECONOMIC CONDITIONS OF EU-INSPIRED EMPLOYMENT POLICIES

Abstract

With its impulses and coordination initiatives the EU makes efforts to influence the employment and labour policies in its Member States. Here the principal instruments are the European Employment Strategy and its main constituent, the Employment Guidelines. The latter, while based on modern professional ideas about the institutional determinants of the labour market, have been incomplete up to 2005: due to departmentalism reflected in the tensions between the EU institutions responsible for employment and macro-policies crucial fields were kept out of the employment guidelines such as wage-setting policies, the wage bargaining system as well as the budgetary implications of active labour market policies. The macroeconomic support of the EU-inspired employment policies is theoretically not sound. An example of this is the objective of the Lisbon Process of simultaneous ambitions improvement of both macro-level productivity and employment. This target ignores the trade-off between these two factors prevailing even in the long term. The division and inconsistency between the philosophy and operation of various EU institutions is reflected in the moderate, but disturbing inconsistencies between the mid-term macroeconomic and employment strategies of the Hungarian government (the Convergence Programme and the National Action Plan for Employment). There are, however, possibilities for the member countries, including Hungary, to prepare and carry out employment policies in the EU framework that are supported by sound macro-policies: they have to be less slavish abiding by specific EU recommendations, have to take into account the domestic conditions realistically, and get rid of detrimental institutional divisions, at least in their indigenous administration.

Keywords: European integration, employment strategy, coordination of policies

JEL codes: F150, E610, J200, O110

INTRODUCTION

The European Union has had a considerable role in influencing the trends of economic development in Hungary, its pace and dynamism ever since the beginning of political and economic transition. The (bilateral) liberalisation of foreign trade relations and community support to the transformation of this country started as early as 1989, to be followed in 1991 by the signing of the Association (Europe) Agreement, the official declaration by the EU in 1993 of the possibility of accession, and by the commencement of accession talks in 1998. In the literature of the process of economic transition the view is often emphasized that the relatively speedy transformation of the Central European and Baltic states, a process that was free of political and economic disasters, is largely attributable to the geopolitical fact that, from the start of transition, these countries had subordinated their development to the very objective of a timely accession to the Western European block. As a result, the transition process was managed with close links to the European Union, which gave shape to positive popular expectations and lent credibility to political and economic reforms (on this subject, cf. e.g. Roland, 2000). The start of accession talks in 1998 ushered in a new period when the reforms of the transitional period were directly linked to the established criteria of EU membership (cf. Gács, 1999).

Given that, in parallel with the accession process, Hungary was gradually invited to participate in the coordination of EU matters, one is faced with the important question of to what degree the initiatives (strategies, action programmes, guidelines etc.) coming from the EU are consistent in themselves, and whether the nature and depth of their coherence actually favours their application in Hungary. In keeping with our defined subject, we shall look into the relationship of the European Employment Strategy (EES) and the Employment Guidelines (EGs) with the Broad Economic Policy Guidelines (BEPGs), which set out short- and medium-term macroeconomic goals, and with the (non-employment) components of the *Lisbon Strategy*, that outlines a long-term development strategy. A further important indicator of future developments, and therefore a subject of this discussion, is the degree to which the recently completed Hungarian EU programmes, the Convergence Programme and the National Action Plan for Employment harmonize with each other. Finally, the *Appendix* looks at the more general question of which matters call for national decisions and which ones need Community decisions, and also discusses that which of these categories employment and labour market issues fall into.

THE CONSISTENCY OF THE BROAD ECONOMIC POLICY GUIDELINES AND THE EMPLOYMENT GUIDELINES

The Broad Economic Policy Guidelines (BEPGs) aim at formulating the main short- and medium-term macroeconomic strategy of the European Union. The Employment Guidelines are one of the key components of the EES: they set out, for several years in advance, the overall themes of the National Action Plans for Employment (NAPEs), the government work to be realized on the basis of NAPEs, the so-called peer-review and benchmarking processes, etc.

The BEPGs have been used to monitor the economic development of EU Member States since 1993 and to ensure the consistency of their economic policies. Each year, the European Council approves the broad guidelines and the ensuing recommendations broken down for the member countries; their overall and country-by-country implementation is also assessed on an annual-basis. The importance of BEPGs has grown since the end of the 1990's, given that the EMU has connected EU Member States and created a "12-head dragon" sharing a common monetary and exchange rate policy as a result of which macroeconomic coordination has acquired greater significance.

The idiosyncratic nature of the relationship between the BEPGs and the Employment Guidelines **(**EGs) is highlighted in a brief history of the development of the EES.

In the 1990's not all political factions and Member States of the EU supported the planned establishment of the EMU, especially after the drawing up of the Maastricht criteria. Many feared that the social achievements of past decades would be lost. As is well known, macro-level regulation of demand is much constrained in the EMU, especially in terms of managing demand in the individual countries. The supply side may contribute to the stabilisation and improve competitiveness of the EU economy chiefly by making labour markets, and wage regulations more flexible. Many understood this to imply that adjustments will always be implemented to the detriment of employees. The various forces guarding the employment and social achievements of the past were not satisfied with the fact that the BEPGs also dealt with, and often at great length, the issues of employment and labour markets because the BEPGs represented for them the primacy of stabilisation, a "neo-liberal" approach and the pursuit of flexibility on labour markets at all cost.[1] It followed from these concerns that several important documents (for instance the famous 1993 Delors White Book) and a series of EU summits declared the need for macroeconomic policy aimed at reducing unemployment, increasing employment, and sustaining, as much as possible, the existing social achievements. This line of

[1] Cf. Barbier (2001).

thought eventually led to the formulation of the European Employment Strategy and the related Employment Guidelines.

However, there were a number of political circumstances that exerted an important influence over this process. First of all, the European Trade Union Confederation (ETUC) developed a positive strategy for modifying the objectives and the institutions of the monetary union, a strategy that supported the cause of employment; secondly, a political shift occurred among EU members following the 1995 accessions, as the new members Sweden and Finland also considered it a priority to retain their own social model; and, as a third factor, labour and socialist governments came to power in prominent Member States such as Britain and France. Allan Larsson, a Swedish politician, gained influence in the Commission apparatus; the European Council heard Tony Blair and Lionel Jospen speak about bringing the issue of employment to the forefront, and President-in-office Jean-Claude Juncker, a left-leaning Christian Democrat, also embraced the emerging recommendations. All this led to the extraordinary summit in Luxemburg in 1997 that chose job creation as its main theme, which adopted the European Employment Strategy in which the aspirations concerning employment were finally assigned an institutionalised format. [2]

The first EGs, developed in 1997, bore the imprint of the "third way", supported at the time by European Social Democrats and the experience of the Scandinavian countries: "employability", a term that sounds as odd in English as in any other language, emerged as the most important concept in the EGs and almost all policies were permeated by the spirit of active labour market policies. This meant that labour market policies, similarly to other policies, focused on the supply side, and abandoned the idea of influencing demand in the spirit of Keynes.

The first EGs were prepared for 1998, and were later subdivided into several further guidelines and supplemented with new ones during 1999-2002. The initial 13 guidelines (amounting to 21 by 2002) were grouped into four pillars. These were: employability, a business-friendly environment, adaptability and equal opportunities for men and women. The guidelines linked to the pillars of employability and equal opportunities formulated specific employment goals, whereas the pillars of entrepreneurship and adaptability aimed at improving the entrepreneurial and business environment in an effort to contribute to improving employment results.

The EGs were reformulated in 2003. The 10 new guidelines served three main objectives, namely full employment, high-quality and productive work, as well as social cohesion and combating social exclusion. And finally in 2005, within the framework of the relaunch of the Lisbon Process, the EGs were once more

[2] Cf. Jenson and Pochet (2002).

reformulated; as of 2005 there are only 8 guidelines capturing the aims of the EES.

It is worth mentioning that already in their first, 1998 version the EGs included some *quantitative objectives*, which, however, focused exclusively on courses leading the unemployed back to employment. (An example of this is the target that each young unemployed person must be offered the opportunity of a new start by the end of the 6^{th} month spent in unemployment at the latest, whereas in the case of unemployed adults the maximum length of this period was set at 12 months). In 1999 the Council called on the countries to compile comparable data and to also include, on the basis of such data, quantitative employment goals in their National Action Plans. From 2000 onwards the Commission has gradually developed the *structural indicators of the Lisbon Process*, the employment section of which was intended to support progress within the EES. Starting from 2001, i.e. one year after the commencement of the Lisbon Process, horizontal EG objectives were also set for the whole of the EU, reflecting the well-publicized Lisbon objectives calling for full employment, a 70% general rate of employment and a 60% rate among women, all with a target date of 2010. From 2003 onwards the guidelines added a number of other quantified objectives, developed under the Lisbon Strategy gradually, as applicable usually to the Union as a whole, but sometimes interpreted also to each individual Member State. According to the website of the European Commission, a total number of 117 structural indicators of the Lisbon Process were analysed in November, 2004, 22 of which were related to employment. At the same time, the European Union Employment Committee (EMCO) requested the Member States to calculate, analyse and monitor the development of 40 key indicators and 26 further so-called context indicators for the purposes of the annual joint evaluation of the EES. In contrast, the 8 EGs issued in April, 2005 formulated only three quantified employment objectives (regarding total employment rate, the employment rate of women and of the older workers) and no longer set a deadline for 2010.

As regards the interrelation and coherence of the BEPGs and the EGs, even a first glance reveals a very high number of features shared by both groups of guidelines. The BEPGs issued for the year 2000, for example, included 9 main recommendations and therein 52 sub-recommendations. Two of the 9 main recommendations relate explicitly to the labour market: they call for promoting appropriate development of wages and invigorating the labour market. At the same time, there are explicitly labour-market-focused sub-recommendations under several other main recommendations as well. For example, the main recommendation regarding “the improvement of the quality and sustainability of public finances” includes, among others, the sub-recommendation for “the review of benefit systems, in order to make work pay”. Overall, 16 of the 52 sub-recommendations relate to employment and the labour market and many of the latter can also be found among the EGs as well.

The employment guidelines normally reflect a particular attitude to labour markets, and there is a clear expectation to ensure that Member States adapt their National Action Plans for Employment and, of course, their policies to this approach. Because the EGs reflect the compromise of a long process of political negotiation, it is naturally impossible to guarantee absolute coherence among the guidelines. Nevertheless, one can discern that the EGs reflect the currently generally accepted scientific view that unemployment levels in a given country are approaching a long-term equilibrium level, which in turn is determined by the institutional characteristics of the given economy. Researchers normally consider the following institutional factors as the most important: social security benefits; tax rates, especially taxes on labour; employment protection; wage bargaining and the strength of trade unions; geographical and occupational mobility; the qualifications and skill of the workforce; active labour market policies; and job matching.

A comparison of the above institutional features and the guidelines confirms that the EGs correctly reflect, in terms of their objectives and their content, the results identified by contemporary research.[3] The guidelines do of course formulate some objectives that appear to be political slogans rather than well-defined targets. An example is the concept of "flexicurity", which stands for the goal of introducing much more flexible work contracts while also retaining an acceptable level of employment security.

Nevertheless, one subject area was conspicuously absent from all groups of employment guidelines in the period beginning in 1997 up to as late as 2004, namely the objectives and the system of *wage setting* and also the organization of *wage bargaining*. Rather absurdly, this was an area that the EES was simply prevented from entering into. The degree of absurdity is well evidenced by the fact that the EGs have traditionally always dealt with opportunities for reducing non-wage type labour costs and the burden on labour in general, such as wage-related contributions, as a means of influencing demand for labour (or the supply of labour, depending on who pays the contribution). However, any discussion of wage setting has been taboo. This attitude is further evidenced by the fact that almost all of the *structural indicators* applied in the course of drawing up the National Action Plans for Employment and the monitoring of the EGs were indicators in kind or ratios that did not relate to nominal or real wages.[4]

[3] Cf. Ardy and Umbach (2004).
[4] Only two of the 66 EMCO indicators relating to the 2004-2005 period concerned wages: key indicator no. 28, which shows the gender differences in wages, and context indicator no. 5, which measures the increase in real unit labour costs.

Neither was the increase in work hours at unchanged wage levels ever included in the EGs (this is a method that multinational companies have lately been employing in order to retain their locations in Western Europe). The obvious reason for excluding this element is that, by reducing unit labour costs and thereby increasing corporate competitiveness, such moves also realize an effective reduction in wages.

Dealing with the principles of wage setting was limited to the Broad Economic Policy Guidelines. The BEPGs tended to recommend to Member States to take price stability considerations into account and increase nominal wages at a restrained pace, and real wages in proportion to the increase in labour productivity, so as to give incentives to investments in general, and specifically to investments that increase employment.

This absurd *“blindness to wages”* in the EES can be explained by two factors. One is the continental European approach that, in contrast with Anglo-Saxon attitudes, does not treat employment problems based on the understanding that the open labour market can supply a sufficient number of jobs, and full employment may necessitate the flexible adaptation of each component of the labour market. The Anglo-Saxon approach works on the assumption that, even if certain other factors remain inflexible, the movement of wages is capable of clearing the market, thus leading to full employment. The European approach presupposes a more closed market and operates institutions to ensure the realisation of the social objectives of the given society, including the protection of the achieved wage levels and provide for wage increases that are considered justified. Accordingly, the focus is on enhancing flexibility in *other* fields. One consequence of this approach is that wages do not have to be coordinated at the European level, as they are agreed upon nationally, in the course of the bargaining process between the social partners.

However, the establishment and operation of the EMU has brought about the need for continuously ensuring price stability, therefore EU bodies need to provide some guidance to Member States concerning the desirable trends in wages. The other reason for “wage-blindness” is related to departmentalism within the Commission, according to which the various EU Council formations and the Directorates-General of the Commission have long since strictly delineated the institutional responsibility of coordinating the development of wages. Although it is not responsible for EES coordination, the Directorate-General for Economic and Financial Affairs (EcFin) was adamant that it should formulate the recommendations concerning wage development and make public them in the BEPGs. This is partly due to the fact that this Directorate-General is in favour of decentralised collective wage bargaining, whereas the Directorate-General for Employment and Social Affairs is unclear on this matter. Also, the

EcFin has an incomparably stronger capacity for macroeconomic analysis than the Employment DG.[5]

The European-level dialogue on *wage bargaining* was initiated in the spring of 1999 by Oscar Lafontaine, finance minister of Germany, the country that ran the Presidency at the time. This marked the start of the *Cologne process*, which regularly brings together pan-European representatives of the social partners and the representatives of the Council, the Commission and the European Central Bank for rounds of talks. Progress in this process is halting, though, and barely any news is emerging about it. Analysts believe the reasons include Lafontaine's disappearance from politics after just half a year[6], the inability of the participants, mainly the trade unions, to properly coordinate their views, and a general lack of trust, which would be necessary for any meaningful European dialogue about wages.

The EES first included a substantive treatment of wages in the Wim Kok Report in 2003 and then in the Recommendations of the Council on employment policies for certain countries, among them Hungary, in 2004. The EGs first refer to the wage setting mechanism only in 2005.

There is another area where consistency between the BEPGs and the EGs has not been provided for, necessitating Member States to solve the matter themselves.[7] Clearly, the implementation of the Employment Guidelines has a *bearing on state budgets*, which may not match, *par excellence*, the guidelines formulated in the BEPGs. Many of the guidelines among the EGs have the obvious impact of increasing budgetary expenditures or reducing taxes and contributions payable on labour and other items, but they offer no suggestion of any method for matching these consequences to ensure the macroeconomic requirement of keeping budget deficits under control.

Since the launch of the European Employment Strategy in 1997, almost all European summits have issued final documents that highlighted the need for increasing the consistency of the Broad Economic Policy Guidelines and the Employment Guidelines. Given that EU institutions tend not to be loquacious when it comes to criticism of their own activities, the various official documents fail to shed light on what consistency problems were identified at the summits. We believe these may have been the inconsistencies in substance as described above (wages, budget) and problems caused by the time differences between the operating cycles of the two guideline packages.

[5] Cf. Jenson and Pochet (2002).

[6] At least until his re-emergence in 2005.

[7] Moreover, the Council document on EGs for the 2003-2005 period explicitly states that consistency (harmonisation) between the two groups of guidelines should be provided for at the national level.

In March 2005 the European Council amended the objectives and operating mechanisms of the *Lisbon Process*.[8] This involved integrating the macroeconomic guidelines, the micro-level reform proposals and the Employment Guidelines. The integration efforts also extended to the publication, monitoring and realisation of all these guidelines. In April 2005 the Commission published its recommendation for guidelines, reflecting the above resolution, for the 2005-2008 period, entitled “Integrated Guidelines for Growth and Jobs”. Numbering a mere 23, the guidelines essentially integrated Maastricht, Cardiff, Luxembourg and Lisbon, and even the R&D-focused Barcelona.

The new system seems to be resolving the aforementioned problems of consistency. The new employment guidelines already include an objective concerning wage setting and wage bargaining (to ensure employment-friendly growth of wages and other labour costs,…etc.). Wherever an employment guideline will evidently impact the state budget, the relevant macroeconomic guidelines are referenced and vice versa. And finally, the Member States must develop their strategies in the form of three-year national reform programmes, therefore they are forced to develop themselves a measured and harmonised development strategy within the rather wide framework of opportunities offered by the 23 macroeconomic, microeconomic and employment guidelines in a way that conforms to both the strategic targets of the EU and their own needs.

THE IMPLICIT GROWTH STRATEGY OF THE LISBON PROCESS

Launched in March 2000, the *Lisbon Process* more or less incorporated the earlier Luxembourg and Cardiff processes, supplementing their objectives with the goal of building of a knowledge-based economy, reinforcing social cohesion and protecting the natural environment. As a result, the ongoing EES needed to be aligned not only with the shorter-term Broad Economic Policy Guidelines, chiefly aimed at stabilisation, but also with the Lisbon plans outlining objectives on a longer term up to 2010.

The Lisbon Strategy (LiS) is a (somewhat unstructured) conglomerate of desirable and respectable goals for catching up with the dynamic leading macro-regions of the world (the USA and East Asia) and also retaining the European

[8] The mid-term review of the Lisbon reform process found that Europe is lagging far behind the defined objectives. In its presidency conclusions, the European Council stated that Member States should give the process a new impetus and therein focus efforts primarily on economic growth, increasing employment and the reinforcement of a knowledge-based economy. There are other EU-coordinated initiatives in support of social cohesion and the sustainability of the natural environment such as the *Social Agenda 2005-2010* and the *Sustainable Development Strategy*, which is to be updated in the near future.

values of full employment and social justice. At the same time, the LiS outlines, albeit implicitly, a growth strategy that can be formulated within the framework of conventional growth models as well: the strategy sets the aim of fast growth in productivity, while at the same time targets the use of a currently significantly underutilised production factor: labour. EU analyses written at the end of the nineties all emphasised that the performance of the United States surpassed the European Union not only in terms of macro-level productivity, but that the US, unlike the EU, was also able to increase its employment. The Commission's *Competitiveness Report* for 2000 for example documented how the process of the EU's efforts to catch up with the living standards of the United States progressed uninterrupted since 1950, but halted in the 1990s. The Report identified the faster rate of growth in employment in the US as the primary cause of the lag, and the acceleration of productivity growth in the United States as its secondary cause (CEC, 2000b). Also, the Commission document drawn up in preparation for the Lisbon summit highlighted the need for a paradigm shift to ensure that the EU can capitalise on the advantages of globalisation and a knowledge-based economy, thereby increasing productivity, while emphasised that efforts should be made to achieve the same employment rates as the US, so that Europe's full employment potential be utilised (CEC, 2000a).

However, the requirement that increased labour productivity should be combined with employment growth is a rather difficult one to satisfy. We say this not simply in view of the arithmetical identity that, at a given level of output, output equals the product of employment and labour productivity, which means that a higher level of either factor implies a lower level of the other. In real life, output levels are not fixed and unchanging, therefore both factors of the above multiplication could in principle grow at the same time. In practice there are a number of preconditions to allow for such growth, among them the trends in population growth in the given economy, changes in the age and qualification structure of the population, labour market institutions and labour market regulation, the characteristic feature of technical development in the particular development stage, the sectoral structure of the economy in question, and also certain traditionally accepted preferences of the society concerning work and leisure. Of the above, we shall discuss here only the characteristic features of *technological development* and the importance of *preferences*; based on analysis of data we shall also give support to our hypothesis that, in the long run, there is a *trade-off* between the growth in labour productivity and the growth in the quantity of labour inputs.

THE ROLE OF TECHNOLOGICAL DEVELOPMENT

Analyses of economic growth using a variety of models over the past few decades have revealed that the main drivers of progress are technological development and the expansion in human capital. The quantity of work is of lesser importance in boosting growth, especially in the most advanced economies, where wages have achieved, and have been stabilized at a relatively high level, while the new technologies generated by technical progress tend to increase capital intensity and have a labour-saving effect. Figure 1 relies on the results of Jorgenson's work (2004)[9] to indicate the respective weights of the various production factors contributing to growth in the three developed macro-regions of the world over the past 21 years and during the sub-periods of that period. As is seen in the figure, both the European Union and Japan registered capital deepening as the most important factor in all the three periods under review. In the United States, the increase in the quantity of labour was an important factor of growth, unlike in the other two regions, where changes in the quantity of labour had negligible positive or even negative, impacts on economic growth.[10] Other sources reveal that the growth in employment in the United States, to a substantial extent, has been linked to the relatively faster population growth.[11]

Figure 2 essentially represents the chronologically consolidated last two (EU) columns of Figure 1 relating to the 1990s, broken down by individual EU Member States. The results shown here come from calculations other than the sources for Figure 1, but the methodologies of the two analyses are the same. Figure 2 and the subsequent figures are based on calculations whose authors did not handle the improvement in labour quality as a separate production factor, instead, they included it in the overall changes in total factor productivity.

The lesson from Figure 2 concerning our subject matter is that the growth in the quantity of labour has played a minor role in the expansion of output not only in the EU 15 as a group, but also in most of the old EU Member States individually. With the exception of three countries (Ireland, the Netherlands and Spain), the growth of labour contributed less than 0.5 percentage points to the average GDP increase over the decade.

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[9] Jorgenson's study (2004) belongs to the modelling trend called "growth accounting". This, albeit incapable of adequately capturing cause-and-effect correlations, is a useful method in empirical analyses relating to relatively short time periods. Incidentally, many rely on Jorgenson's calculation for reference.

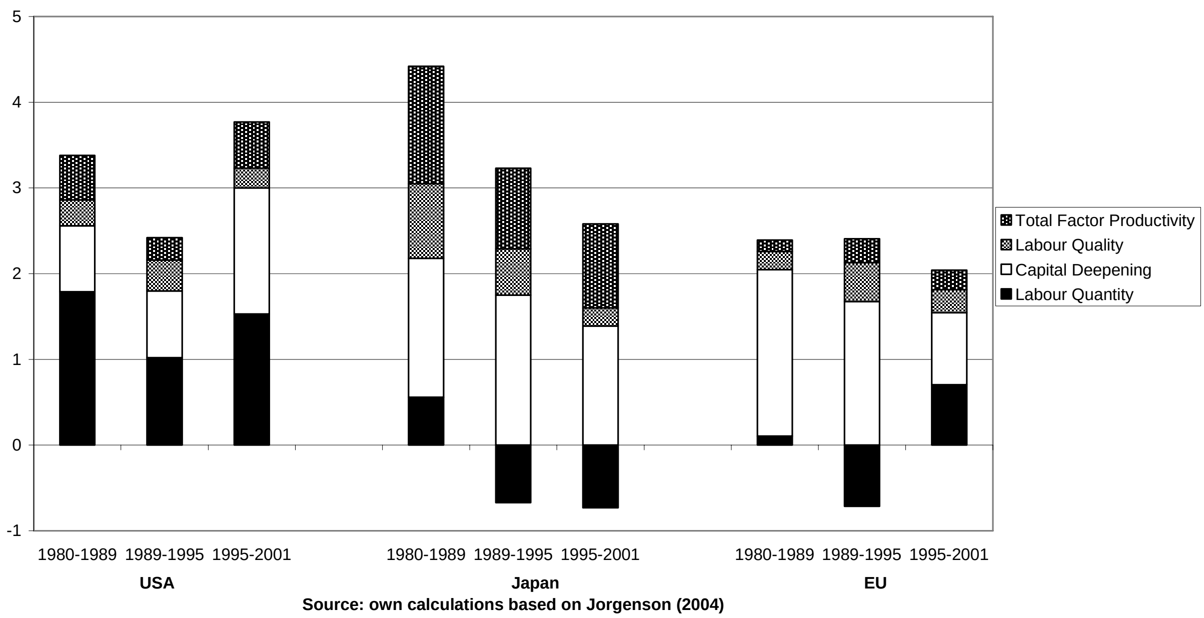
[10] In this calculation, the quantity of labour is to be understood to mean the number of hours worked.

[11]11 It should be noted here that, in the given period, the population growth in the US was largely due to continued net immigration.

Let us now continue with a similar analysis of Hungary and the transition economies. International comparative studies suggest that in the second half of the 1990s, the transition economies, Hungary among them, relied almost exclusively on increasing overall productivity to achieve growth (cf. Figure 3)[12]. Changes in the quantity of labour did not contribute to growth, neither did capital play a significant role. This surprising growth pattern was attributable to the fact that, following the transformational recession, productivity underwent a radical improvement thanks to quality replacements of fixed assets, the introduction of the institutions of a market economy and also the positive impacts of the EU Association Agreements. Mention should be made here of the growth of allocative efficiency, the economies of scale of businesses, and the so-called x-efficiency realized in organisational revamping of business and government.

Figure 1

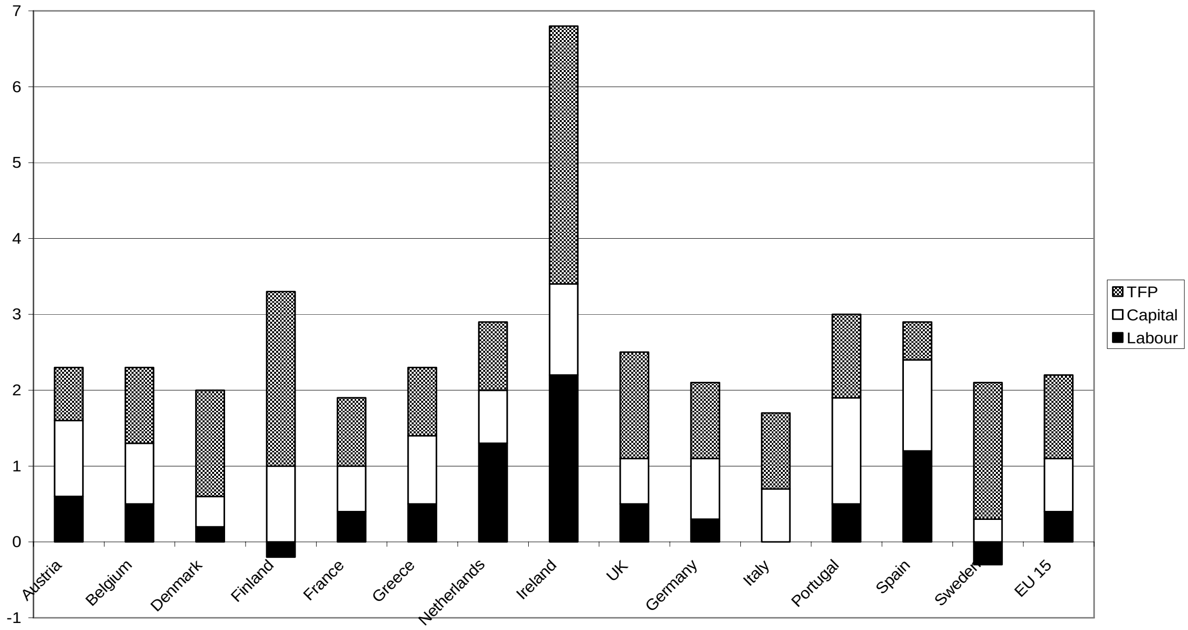
Distribution of the average GDP growth rate among the sources of economic growth in the three macro-regions, 1980-2001, %



[12] Cf. Dobrinsky (2003) and Gács (2003).

Figure 2

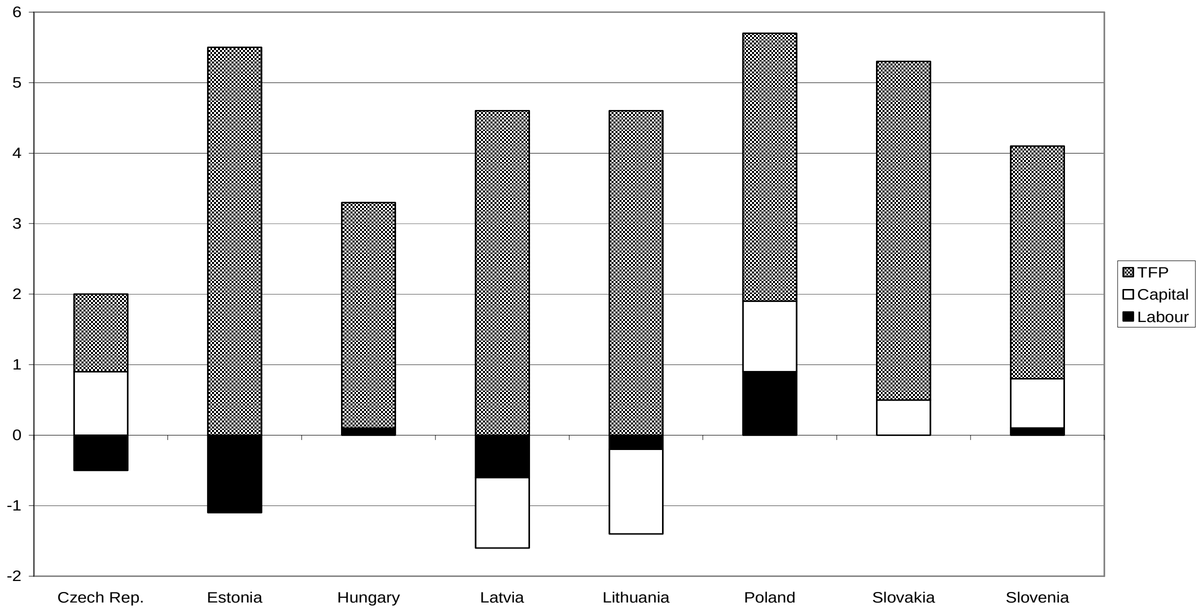
Distribution of the average GDP growth rate among the sources of economic growth in the Member States of the European Union, 1991-2000, average annual growth rate, %



Source: based on Denis, Mc Morrow and Röger (2002)

Figure 3

Distribution of the average GDP growth rate among the sources of economic growth in the eight new Central and Eastern European Member States, 1995-1999, %



Source: based on Dobrinsky (2003)

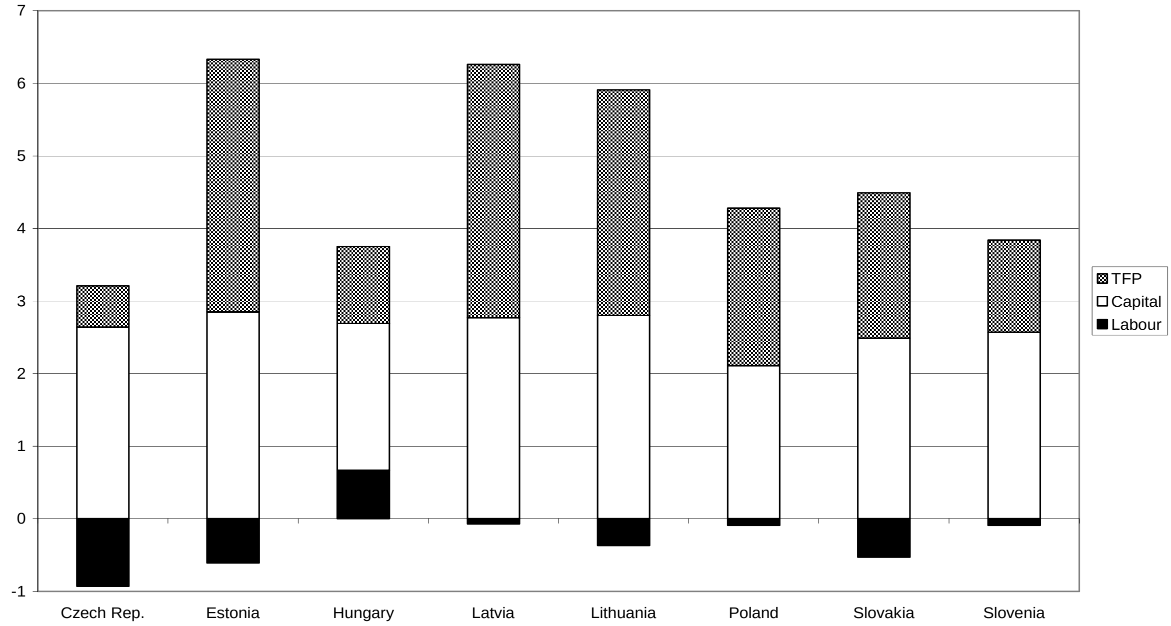
Growth calculations and forecasts for the period after 2000 show a very different distribution of factors. Capital comes to the foreground as a factor that supports growth, with a better utilisation of labour again contributing, albeit to a limited extent, to economic growth in most of the countries under review (cf. Figures 4 and 5)[13]. In its forecast for the 2006-2010 period, the European Commission ascribes an especially important role to the increase in capital. This evidently correlates with the high-volume of infrastructural investments planned in the new Member States, to be implemented with reliance on the structural and cohesion funds of the EU. As is well-known, infrastructural investments exert their efficiency-boosting influence only indirectly and only in the long run. It is probably due to this fact that in the coming years the role of total factor productivity (TFP) can be expected to be relegated to the background compared to capital in most of the new Member States, Hungary included.

Of the above, what concerns our subject most is the extent to which the expansion of labour input can contribute to economic growth. The European Commission forecast cited in the Figures takes into account trends experienced so far and the most likely development paths to come to the conclusion that the new Member States will achieve an average GDP growth that is twice as fast as that of the old EU 15 Member States in the 1990s, i.e. 4.4% on average per year. However, labour will contribute less than 0.5% in the eight new East European Member States, just as it did in the old EU 15 Member States in the 1990s. This means that achieving the growth in employment targeted by the Lisbon Process would necessitate a momentous, radical change, one that would represent a fundamental break with the domestic and international trends of the past.

[13] Cf. European Commission (2004).

Figure 4

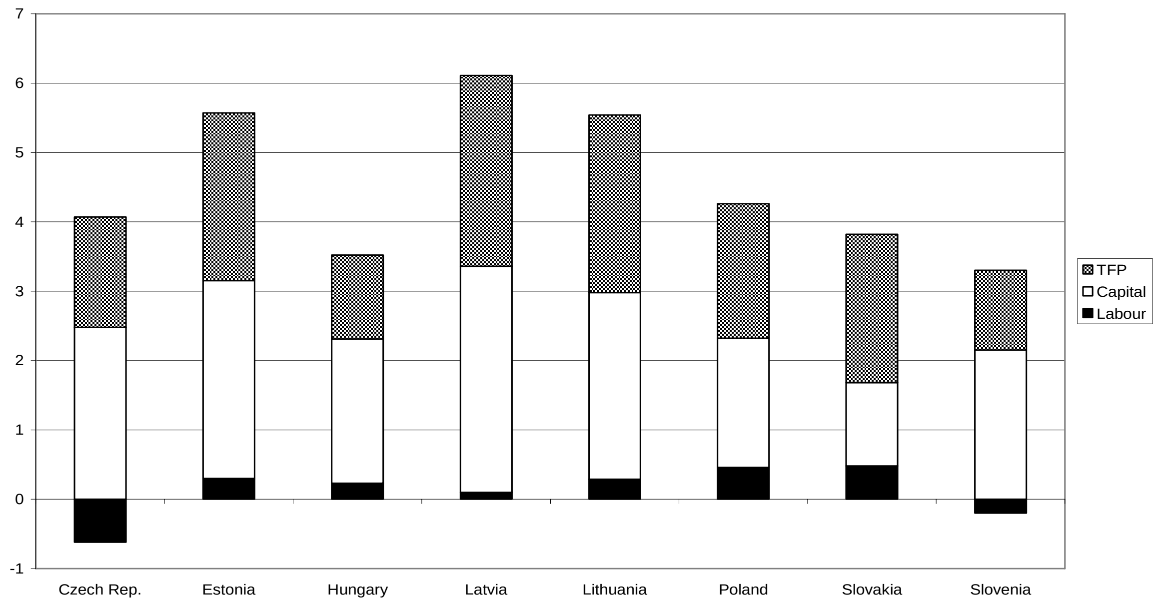
Distribution of the average GDP growth rate among the sources of economic growth in the eight new Central and Eastern European Member States, 1996-2005, %



Source: based on CEC (2004)

Figure 5

Distribution of the average GDP growth rate among the sources of economic growth in the eight new Central and Eastern European Member States, 2006-2010, %



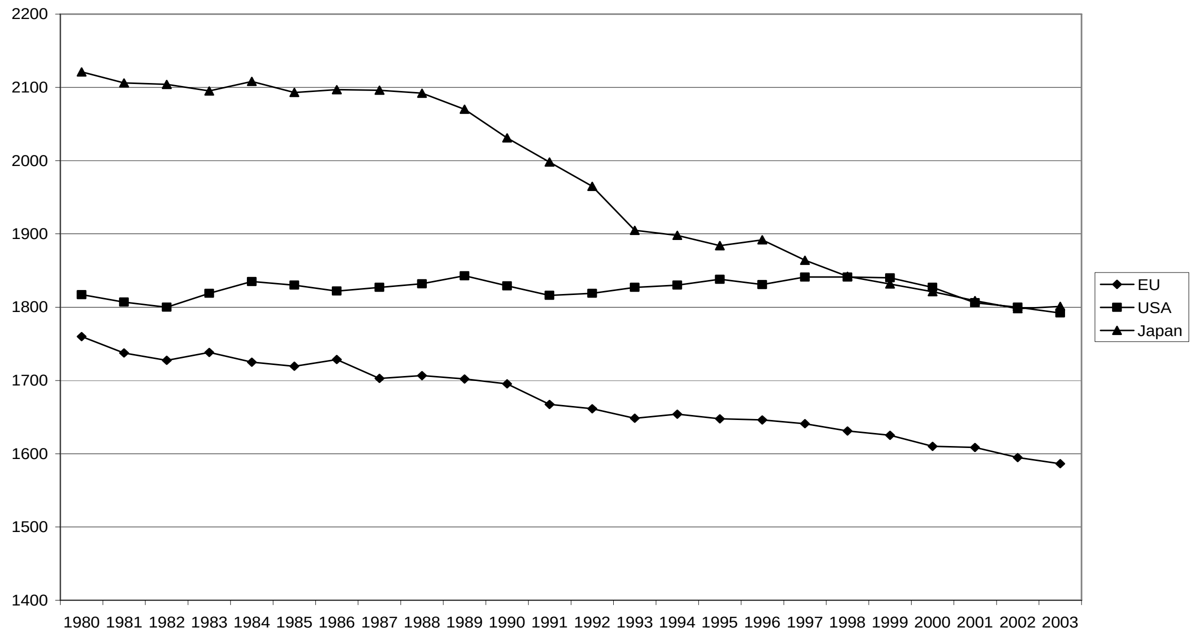
Source: based on CEC (2004)

THE ROLE OF PREFERENCES

Having looked at the relative ratios of labour, capital and factor productivity, let us now focus on a key component of the labour input of production, namely the time intended and used for work. Increasing publicity has been given recently to the fact that employable workers who find jobs actually work much more in the United States than their equivalents in the EU. This is due to the shorter working week, the higher number of paid holidays and the much longer paid leaves required by law in Europe. Figure 6 shows the number of hours actually worked in three major regions of the world. It reveals that while the number of hours worked has remained level in the United States over the past 20 years, it has decreased by 10 per cent in the EU and by 15 per cent in Japan. As a result, employees on average worked 13-14 per cent less in the European Union in 2003 than their equivalents in the United States and Japan. Unfortunately, there is no comparable absolute working hour information for Hungary, but data published for change reveal that the annual number of hours worked in fact *increased* between 1992 and 2003 by 2.7 per cent (OECD, 2005).

Figure 6

Average hours actually worked by persons in employment during the year



Source: own calculations based on data from OECD Labour Market Statistics homepage

In principle, the considerable difference between the leading regions of the world in terms of hours worked may be traced back to a number of factors: the differences in preferences concerning leisure and work, the shift in the proportion of part-time workers and the differences in taxes on labour. Although there is no full consensus in the relevant literature on the respective weights of the above factors[14], there is strong evidence to suggest the prevalence of the first factor, namely the fact that European employees themselves prefer (and enforce, generally through their interest representation organisations) leisure to longer working time (and thus higher income).

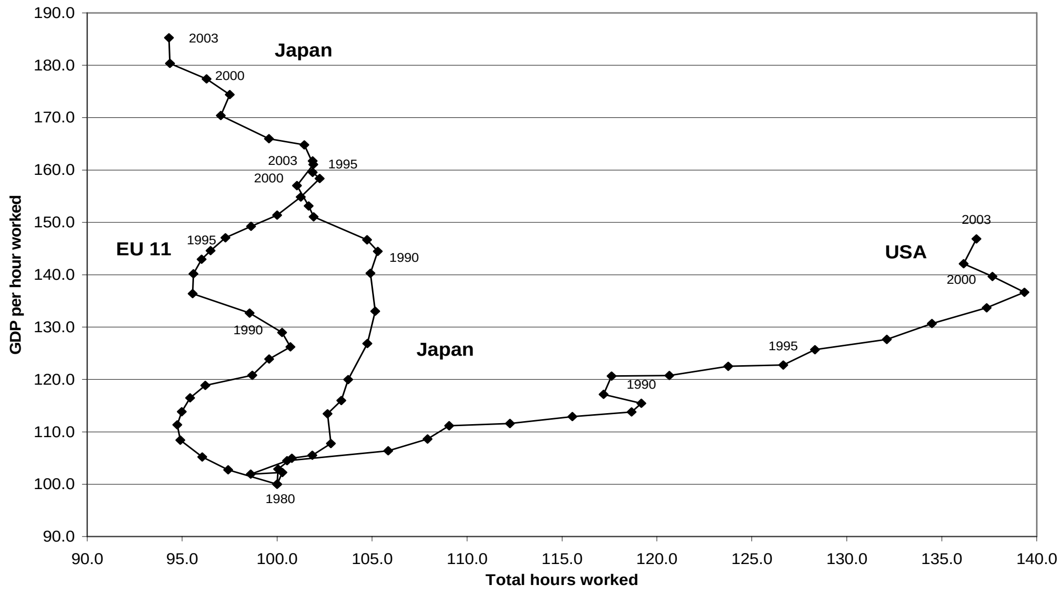
TRADE-OFF BETWEEN THE GROWTH OF LABOUR INPUT AND LABOUR PRODUCTIVITY

In Figure 7 the differing development paths of the three regions under investigation are demonstrated by two important indicators defined in the Lisbon Process: growth in productivity and labour input. We can see that during the past 23 years Europe has not been lagging behind the US in terms of increasing productivity (calculated as GDP per hours worked), quite the opposite. Although most recently, notably since 1995, a gap in favour of the US has developed, it is by no means dramatically large. Nevertheless, the United States is following a path characteristically different from the European or Japanese model in terms of labour inputs providing the basis for the expansion of production. Figure 8 adds Hungary to the picture: development since 1992 of the same indicators as in Figure 7 is shown here for the three regions plus Hungary. The decline in Japan and the improvement in European employment over the past decade (reflected by the "hours worked" indicator) are naturally exaggerated in this Figure compared to the previous one. The Hungarian economy, which started essentially from an all-time low in 1992, increased labour productivity faster than any of the three regions, yet the growth of its labour input was rather modest.

[14] On this subject cf. for example the dispute between Prescott (2003) and Blanchard (2004) on the role of tax burden on labour.

Figure 7

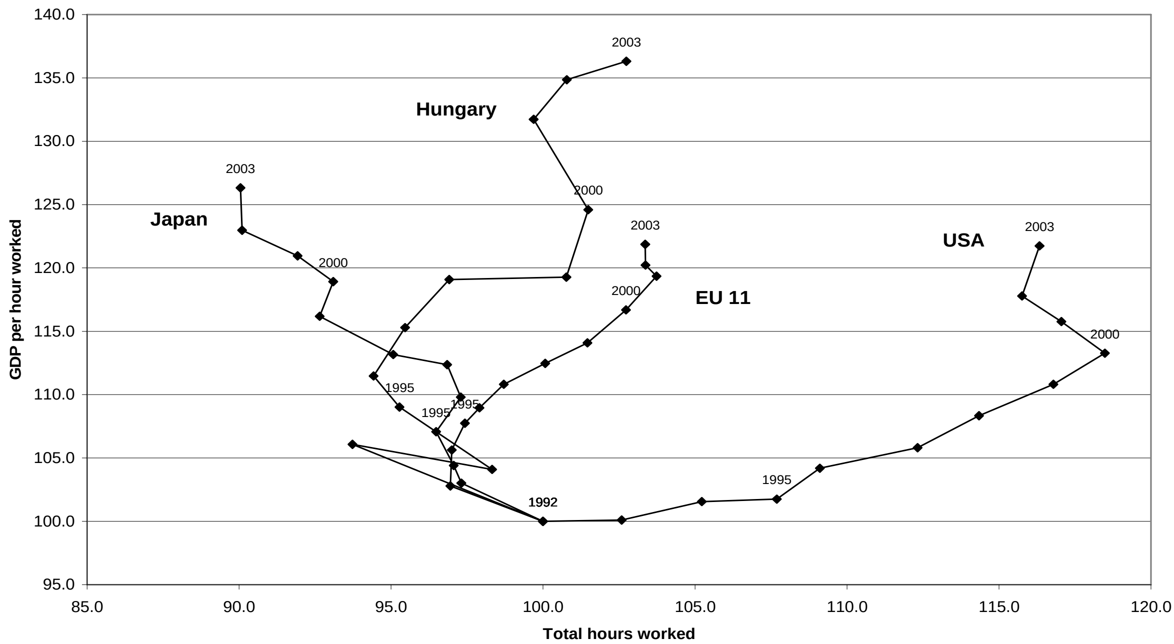
Labour input and productivity indices in the three regions, 1980=100



Source: own calculations based on data from OECD Labour Market Statistics homepage

Figure 8

Labour input and productivity indices in the three regions and in Hungary, 1992=100



Source: own calculations based on data from the OECD Labour Market Statistics homepage

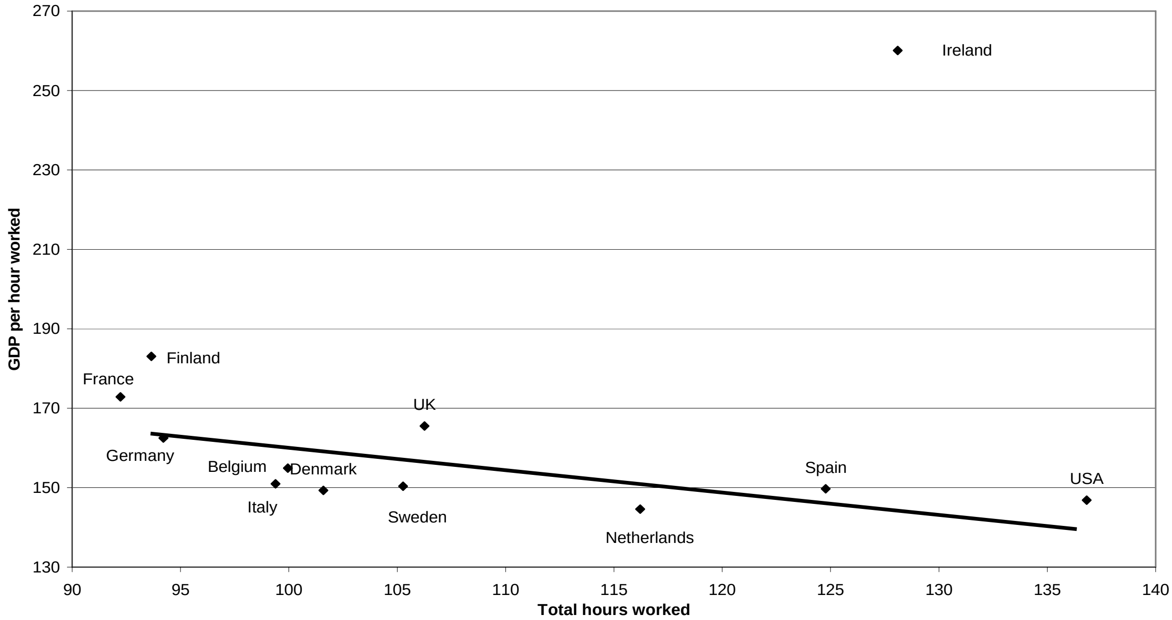
The European Union is far from being an economic area made up of uniform economies. Figure 9 presents the diverging growth paths of 11 member countries over the past 23 years, with the two cumulative indicators of development defining a point that represents the country the indicators relate to. One conspicuous feature, which seems to echo our above comments, is that all the countries, except for one (Ireland) are situated alongside a *trade-off line*, which represents the correlation between growth in productivity and in the quantity of labour. There is no qualitative difference between the United States and the European countries, only in their respective locations along the trade-off curve. Greater productivity growth coincides with less increase in the quantity of labour and vice versa. The only exception is Ireland, but there are very specific reasons for this.[15]

As above, we have run a comparison with Hungarian data, in this case for the period between 1992 and 2003 (this is the period for which data are available, and, due to the shock of the change in the political system, in fact data can be interpreted in a meaningful way only for the period following 1992). The result, Figure 10 presents a picture that is in certain senses different from, and in certain other aspects similar to Figure 9. Figure 10 no longer has the United States leading ahead of the rest of the countries in terms of growth in labour input, but even more noticeable is Ireland's outlier position. What is unchanged is the manifest trade-off between productivity growth and increases in labour input. This trend also applies to Hungary, which achieved the third highest productivity growth within the group of countries analysed here, but only a modest increase in the quantity of labour during the 11 years under investigation.

[15] Ireland has indisputably achieved outstanding productivity growth over the past two decades, but this is somewhat exaggerated by all GDP-based indicators. (The Irish economy is dominated by foreign multinational companies, therefore the income enjoyed by the country is reflected in the GNI indicator better than in the much higher GDP.) The special demographics of the country also helped increase employment. Female fertility is outstanding in Ireland: throughout most of the past 23 years, Ireland has been reporting the highest fertility rates in the EU. Also, earlier Irish émigrés are returning in high numbers to their home country in times of economic prosperity, and thereby augmenting the rate of employment.

Figure 9

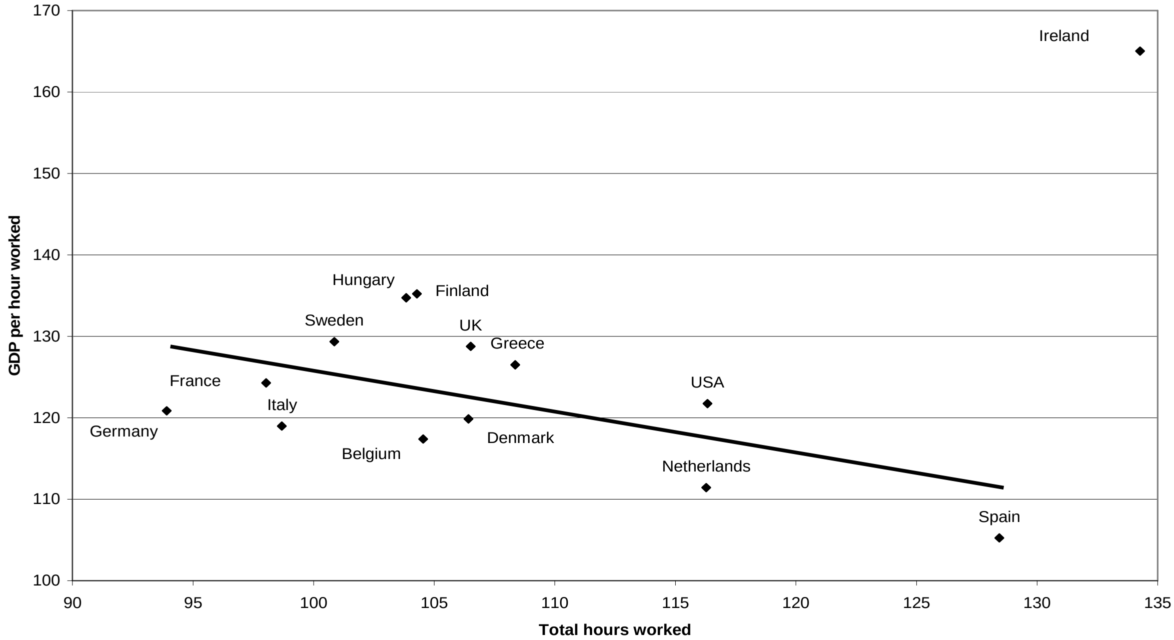
Cumulative growth of labour input and productivity 1980-2003, %



Source: own calculations based on data from the OECD Labour Market Statistics homepage

Figure 10

Cumulative growth of labour input and productivity 1992-2003, %



Source: own calculations based on data from the OECD Labour Market Statistics homepage

For the first time since the start of the Lisbon Process, a recent more or less official EU document (CEC, 2004) has admitted the possibility of trade-off as shown above, but it immediately tried to allay any related fears. The study claims that a trade-off between the growth in productivity and employment occurs only within the theoretical framework of comparative statics, and that in the short and medium terms. While similar relationship may emerge in a long-term dynamic framework as well (for instance, positive employment or wage shocks may have a negative effect on the increase in productivity), model calculations show this effect to be limited and of a transitory nature. And even if certain labour market reforms may reinforce this kind of trade-off, the labour market reforms advocated by the LiS do not belong to these reforms.

All we can add to this opinion here is that the empirical analysis we have shown in this section, using recent and earlier historic data, suggests that a trade off exists, and it definitely does for the long term as well. The Lisbon Process would need to bring about an epoch-making shift or break to eliminate the indicated trade-off relationship If its targets were to be implemented.

CONSISTENCY BETWEEN THE HUNGARIAN CONVERGENCE PROGRAMME AND THE NATIONAL ACTION PLAN FOR EMPLOYMENT

In line with the applicable EU rules, Hungary has been compiling *Convergence Programmes (CP)* in the recent years. After a series of antecedent documents, the first comprehensive *Hungarian National Action Plan for Employment (NAPE)* was also prepared in 2004 with the aim of summarising Hungary's employment policy. In this context the question of consistency is justified, i.e. to what extent are these two basic documents, designed in response to differing EU expectations and syllabuses, consistent with each other.

The 2004 NAPE discussed the 2004-2006 period and was issued in September 2004. In contrast, the 2004 CP was drafted for the 2004-2008 period and, was submitted on 15 May 2004; in view of the next year's budget, however, it was updated by the Ministry of Finance and then approved by Government in December 2004. There is thus a certain lack of synchronism between the two drafts (incidentally, this is reminiscent of the problems due to the different submission deadlines of the BEPGs and the EGs). It is still worthwhile to look at the interrelation of the two plans.

The NAPE naturally follows the EGs and therefore focuses on employment and the labour market, whereas the CP reviews the full range of macroeconomic issues and therein allocates small scope to the matter of employment. Nevertheless, a comparison of the critical areas is possible.

It is natural that the authors of the NAPE identify themselves with their cause, trust the effectiveness of the recommended labour market policies in boosting employment and labour market activity; therefore it is no surprise that they are much more optimistic when it comes to employment and activity trends in the forthcoming years than the authors of the Convergence Programme. On this issue cf. Table 1. The difference is noteworthy by all means, especially when it is seen accumulated for several years (cf. Figure 11).

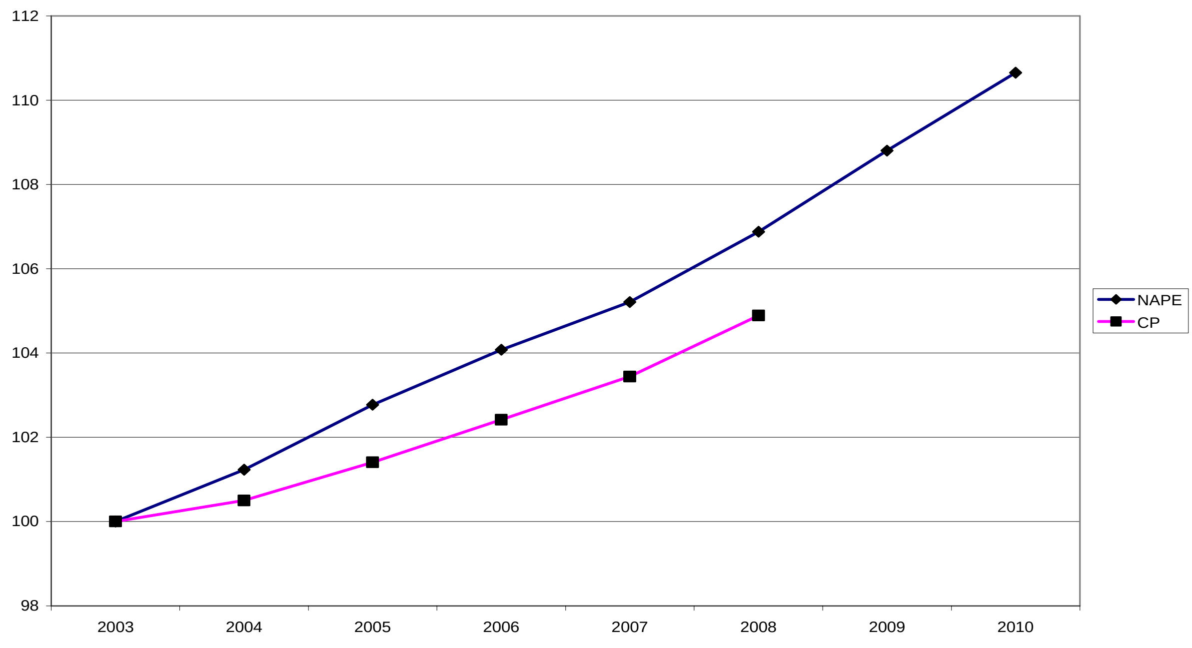
Table 1

Employment forecasts in the Hungarian National Action Plan for Employment (NAPE, 2004) and the Hungarian Convergence Programme (CP, 2004-2008)

	Annual growth in employment, %			Activity rate (15-64 age group), %		
	NAPE	Conv. Progr.	Actual	NAPE	Conv. Progr.	Actual
2003				60.6	60.6	
2004	1.23	0.50	1.0	61.1	60.8	60.5
2005	1.52	0.90		61.7	61.2	
2006	1.27	1.00		62.3	61.6	
2007	1.08	1.00		63.0	62.4	
2008	1.59	1.40		64.0	63.5	
2009	1.80			65.2		
2010	1.70			66.4		

Figure 11

Employment forecasts according to the NAPE and the CP, 2003=100



On the positive side one has to mention that the Hungarian NAPE lays much greater emphasis on harmonisation with the overall thrust of economic policy and such specific policies as education, training, and social policies, than would directly follow from the EGs. The plan also reflects the policy for wage setting and earnings; the discussion of these issues was mostly inspired by EU employment recommendations addressed to Hungary. It is a special asset of the Hungarian NAPE that the critical issues in the action plan and the substance related to the EGs were presented to the Hungarian social partners, and the comments of the social partners are summarized in Appendix No. 6 of the document. It is likely that the Hungarian authorities will take into account some of these, often conflicting, comments when implementing the Action Plan.

In two other Appendices (Nos. 3 and 4) to the NAPE, the authors try to quantify, item-by-item, the budgetary impact and financing sources of the measures stipulated in the NAPE. This also represents an improvement compared to the blinkered labour focus of the EGs. It is a pity that there is neither a summary nor a time schedule for the expected NAPE related expenditures, as this would have helped putting together the CP, which mainly focuses on the annual budget.

And finally, let us allude to a recurring, typical motif in the Convergence Programme, which the authors of the NAPE should have noticed and formulated their plans accordingly. The CP makes several references to the fact that a streamlining of the operation of the state and reductions in public spending are foreseen. Various methods are planned to be applied to rationalise the operation of the systems of education, healthcare and local governments. This, albeit not explicitly, nevertheless clearly means that considerable headcount reductions are expected, and many employees, currently working in the public sector, will be forced to change: to retrain, to become unemployed or to take early retirement. The NAPE shows no reflection to these plans. It seems that the close alignment of the NAPE with guidelines received from the EU, the calculation and analysis of indicators required by the EU template have used up the energy and dedication of the authors of the NAPE, and they have not carried out an assessment of the projected situation of employment by sector and industry, though the planned momentous shift in the public sector would have necessitated a survey of this kind. Naturally, this would have required concrete information from the Ministry of Finance concerning the method, extent and schedule of the planned reorganisation of the public sector, which was also missing from the CP.

SUMMARY

Ever since the launch of the European Employment Strategy in 1997, European Union Member States have been developing their employment policies, among other things, on the basis of EU inspirations and coordination initiatives.

The Employment Guidelines, originally developed within the framework of this strategy in 1997 and then reformulated in 2003, highlighted the desired institutional features of the economies, such as tax rates and employment protection, skill and mobility of labour, active labour market policies etc., that have been proven by recent research to have key impact on the equilibrium level of employment and unemployment. However, two important aspects were neglected.

While giving suggestions concerning a large number of factors influencing employment, the Guidelines were remarkably silent on wage setting and the system of wage bargaining, which are also important factors impacting the equilibrium level of employment and unemployment. The taboo status of wage setting and the system of wage bargaining was all the more perplexing, because the Guidelines did in fact take into account the impact of the formation of other labour cost items (such as non-wage type labour costs, payroll taxes and contributions) on potential labour demand or supply. Also, the Guidelines failed to draw attention to the need for recognising the budgetary impact of the various proposed reforms.

The EU Employment Guidelines left it to the Broad Economic Policy Guidelines to look at the principles of wage setting and to take into account the budgetary impact of the proposed labour market reforms. In recent years, inconsistency problems between the economic policy guidelines and the Employment Guidelines, as well as other problems led to attempts to harmonise and unify the guidelines that cover different fields. These efforts eventually bore fruit in the spring of 2005, when, under the umbrella of restarting the Lisbon Process, the Employment Guidelines were reworked once more and integrated with the guidelines concerning macroeconomic control and microeconomic reforms.

The long-term EU goals, which are apparent in the employment guidelines as well, and the mechanism for achieving these were redefined by the Lisbon Process, launched originally in 2000. Among other things, it added ambitious

quantified employment targets to the EU's employment strategy and set the objective of an exceptionally fast improvement of competitiveness (i.e. productivity) for Europe. A comparative analysis of international historical data indicates, however, that it is more or less impossible to achieve both these goals (i.e. fast increases in employment and in productivity) simultaneously; the growth of one is realized at the expense of the other, and vice versa.

Already the aforementioned consistency problems are sufficient to deter individual Member States from mechanically following EU initiatives in their own action plans. This warning is especially justified in the case of the recently joined Member States, which have tied their transitional reforms and, to a certain degree, their economic policies also, directly to the membership criteria ever since the start of their accession talks. Instead of an unconditional adoption of the values communicated by the EU in their employment policies, and a slavish abiding by specific EU recommendations, they should look on EU coordination more as a learning process, an exchange of professional ideas, and a force that disciplines domestic management which is always exposed to short term local political pressures.

Naturally, it will take some time before the administrations in the new member states learn the methods of developing medium-term macroeconomic and sectoral strategies that both gain acceptance in the EU and match the country's own requirements. It is not at all surprising therefore that the latest Hungarian macroeconomic action programme (the so-called convergence programme), developed in line with EU guidelines, and the targets in Hungary's first national action plan for employment have not turned out fully consistent: the forecasts in the employment action plan are somewhat more optimistic than the relevant forecasts of the convergence programme. A likely reason for the discrepancy is partly that the employment action plan fails to take into account the expected employment consequences of the reforms planned under the convergence programme with the aim to rationalise the public sector, i.e. national and local government, education and training, and healthcare.

The main lesson from this study is that the Community initiatives of the EU, launched and operated in different areas, are not always consistent and in harmony. This is partly due to the tendency that resolute and spirited politicians tend to overwrite theoretically and professionally sound concepts, and partly due to the divided nature and sometimes rivalry of approaches and/or organisations within and among EU institutions. The recent streamlining of EU policies (which concerned both the so-called guidelines package and the implementation package), and also the simplification and unification process carried out as part of the revival of the Lisbon Process, make us hope that inconsistencies will be reduced.

Forecasting and planning employment in an integrated approach should take into account the development stage that the Hungarian economy can be expected to enter in the coming decade. Following the development programmes launched with EU support and aimed primarily at improving physical and human infrastructures, development will be much more capital-intensive in the future than in recent years. Total factor productivity will contribute to growth at a lesser degree and, unless there is a radical, momentous change, the type of development now foreseen will not generate a significantly growing demand for employment.

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APPENDIX

IN WHICH SUBJECT AREAS DOES CENTRALISED DECISION-MAKING AND COORDINATION MAKE SENSE AND IS FEASIBLE?

Any assessment of EU initiatives must first look at the reasons for launching these and the expectations from them. Evidently, when an important initiative such as the EES gets underway, one should ask the question which matters should be decided at the national and which ones at the Community level, and which level the employment and labour market issues should belong to.

To determine decision-making levels, the European Union follows the fundamental principle of *subsidiarity.* In short, this means the requirement for passing every decision at the level as close as possible to the people, except for those areas that are allocated by the EU Constitutional Treaty to the exclusive competence of the Community.16 This preference for decentralisation *in principle* has not prevented the EU from continuing to extend Community competences in successive EU agreements and therefore *in practice* as well. This was a consequence of the ideals of European Union founders for an "*ever closer union"* and also of the institutions conceived to solve the problems that have emerged from time to time.

As regards the theoretical approach to this issue, there is a consistent conceptual framework for the distribution of roles among the various decision-making levels, namely the theory of *fiscal federalism*. On the assumption that politicians work toward the well-being of the whole of society, this theory declares that centralisation of decision-making powers is justified if significant *spill-over effects* are felt (i.e. when the activities of one country influence the other), or if there are considerable *economies of scale* benefits to be had from uniform action by the countries, and at the same time, one may assume that there are no fundamental differences between the prevalent *preferences* in the different countries.17

As the EU evolved, most institutional changes tended to concentrate the control of the *demand side* in a shared, central decision-making mechanism or to increase central influences over it. This concerned chiefly exchange rate and

[16] Cf. Baldwin and Wyplosz (2003) Chapter 3, also the EU Treaty (*Treaty…* (2004) Article I-11, Par. 3).

[17] Cf. Oates (1999), Jackman (2001), and Tabellini and Wyplosz (2004). This issue can and should be analysed for cases when it is assumed that the politicians do not serve the well-being of the whole of society because they pass their decisions within tight political constraints, directly influenced by their desire for re-election or by the pressure of organised interest groups. A lack of space does not allow us to discuss this subject here in detail.

monetary policies, but partly fiscal policy as well. The centralisation of decisions concerning *supply* is a product of the most recent years. Tabellini and Wyplosz (2004) follow the core principles of fiscal federalism when they declare that central coordination of supply-side economic policies *is not acceptable as a general rule*. The starting point is the assumption that every country will profit from its own efficient supply-side policies; in addition, the measures it decides on and implements do not hurt, but may even help, its partner countries. The competition of Member States through supply side policies is *a priori* advantageous. The only exceptions to this rule (and therefore justifiably in need for centralised regulation) are measures that allow each producer equal access to the Single Market, for instance reduce state subsidies and market distortions that, as a rule, prevent competition.

As far as employment and the labour market is concerned, analysts have clearly found many reasons for justifying common or coordinated policies. The creation of the European Monetary Union has appreciated the flexibility of labour markets and wages, as in the absence of own national currencies and monetary policies these means can allow the economies of the Member States to fend off the negative impacts of so-called asymmetric shocks. Also, tying the growth of real wages, in each Member State, closely to improvements in productivity boosts the efficiency of the common monetary policy. And finally, increased flexibility of labour markets helps the European Union retain its competitiveness. Competitiveness here means the ability of companies operating within the EU to successfully compete with their equivalents outside the EU in attracting and retaining sufficient direct investment.

In spite of all the above theoretical reasons, one must not forget that the differences between the national labour markets are largely due to the differences in local political values and social preferences. It follows from this that the goals and constraints of national policies are different, therefore the conditions for a common policy are not given. The potentially necessary labour market reforms threaten strong and politically sensitive local interests, and therefore their successful implementation is possible only within a national framework. The European-level powers simply lack the political legitimacy to exert substantive influence in this field.18 Community-level coordination initiated under the *Luxembourg process* and the EES is therefore rather circumscribed by definition: it may set the agenda for reform discourse, propose the inclusion of international benchmarking exercises in the course of the national discussions of labour market reforms, help consolidate national

[18] Of the conditions listed above, the sharp difference between *preferences* of the various countries constitute the obstacle here to EU-level decision-making and coordination. Jackman (2001) believes that the limited migration of labour among Member States means that the outside economic impacts of national labour market policies is inconsiderable, which makes a common policy even less justified.

employment and labour market regulations into a programme that other EU Member States and EU organisations can also follow up, but it should by no means force uniform, ready-made reform packages on the Member States (cf. Tabellini and Wyplosz, 2004, also Jackman, 2001).

Although, based on the above presented arguments the possibilities for an EU-level common policy tend to be rather narrow, from the second half of the 1990s the European Union started the *EU-level coordination* of several processes taking place in the Member States. Accordingly, the Luxembourg, Cardiff and Cologne processes were launched (to coordinate employment and labour markets, structural reforms, and the macroeconomic dialogue); the stability and convergence programme was set up to monitor budget and the process of indebtedness in support of the Stability and Growth Pact; the system of Broad Economic Policy Guidelines was launched for coordinating economic policies; the Lisbon Process, which extends to almost all areas, was born; the Internal Market Strategy, the European Social Agenda etc. were launched.

Typically, the aforementioned processes spread a practice developed during the second stage of the EMU, whereby national policies are subjected to multilateral surveillance. The procedure is always the same: a formation of the EU develops, with the participation of Member States, EU guidelines for one or more years, which are (or may be) supplemented with recommendations targeting individual countries. The Member States, in the form of or without, action plans, interpret the guidelines for themselves; as the year ends, developments and the efforts to achieve the goals are evaluated at the national and the EU level, and new or remaining tasks are defined.

Experience from the past decade makes it apparent that the aforementioned coordination processes have proliferated, become too complicated and intransparent over time; their credibility and awareness of them is low, and any exact assessment of their impact is almost impossible. It is not by accident that from time to time a need for streamlining the coordination mechanisms arises, a task that the EU often carries out with more or less success.