

EUROPEAN ECONOMY *news*

The EU at 50

A cause for celebration

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Half a century of economic integration in Europe

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Magazine of the Directorate-General for Economic and Financial Affairs

Editorial



Klaus Regling, Director-General of the Economic and Financial Affairs DG

Dear Reader

The signature of the Treaty of Rome 50 years ago on 25 March 1957 launched a process of progressive European integration that we are celebrating this year. During this time, Europe has come together in many different areas of activity, from space to the seas and corporate governance to consumer protection. It is only eight years ago that the euro, perhaps the most tangible feature of European integration, first appeared. This, one might think, suggests that attention to economic and monetary matters is a relatively recent occurrence in EU affairs, but of course this is not so. The desirability of some form of economic and monetary union has been a continuous thread running through EU thinking over the past 50 years. However, turbulence of global currency markets and economic crises, as well as a lack of policy convergence in Europe, prevented its implementation earlier.

In this sixth issue of *European Economy News* we have invited a number of distinguished personalities to give their views on economic integration in the EU – past, present and future. Our Commissioner of Economic and Monetary Affairs, Joaquín Almunia, sets the broader scene in the first contribution where he reminds us of the real fragmentation of Europe in the initial post-war period, and how progressive enlargement and integration has changed that situation almost beyond recognition.

In the second article, Tommaso Padoa-Schioppa gives a historical overview of Economic and Monetary Union. Now Minister for Economic Affairs and Finance in the Italian government, Professor Padoa-Schioppa was one of the intellectual driving forces behind the introduction of EMU and the euro. His report in 1986 on efficiency, stability and equity laid the foundation for the subsequent development of economic and monetary integration. Director-General of DG ECFIN (then DG II) from 1979 to 1983, Professor Padoa-Schioppa later served as one of the first executive board members of the ECB.

We then have a view from outside the EU, from Michael Deppler who has been Director of the European Department of the IMF since the preparations and launch of the euro. He gives a summary of how international economists have looked at the intricacies of European integration, and in particular economic integration, with both some bemusement and wonder. To complete the contributions, Ivo Maes, Deputy Head of Research at the National Bank of Belgium and Professor at the University of Leuven, presents a history of economic thinking within the European Commission – describing the balance between early Franco-German approaches and later Anglo-American influences and the role of the EU institutions.

Our final article continues our series of Member State economic profiles with a look at the economy of Poland, the largest of the former communist states to join the EU family. In common with other EU-10 Member States, Poland is working to ensure a sustainable economy while achieving economic convergence with the EU.

Klaus Regling
Director-General, Economic and Financial Affairs DG

Editorial information

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Fax: (32-2) 29-80998

E-mail: ecfin-european-economy-news@ec.europa.eu

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What's new from ECFIN

"The euro is a resource and a beginning..."



Together in Ljubljana

... claimed Andrej Bajuk, the Finance Minister of Slovenia, in his keynote address to participants at the 'Conference Slovenia' meeting on 15 January. The day of the meeting coincided with the definitive withdrawal of the old tolar currency as legal tender in Slovenia. In his keynote address to the conference, Commissioner Joaquín Almunia described Slovenia's entry to the euro area as highly symbolic, saying: "As the first of the 2004 accession states to adopt the euro, your country forges a path for others to follow." He also praised the well-prepared and well-managed changeover operation, noting that Slovene citizens, in the run-up to the changeover, were the most knowledgeable and most supportive of the euro among those of the new Member States. Contributions to the conference can be downloaded from the events section on the ECB website: <http://www.ecb.eu>

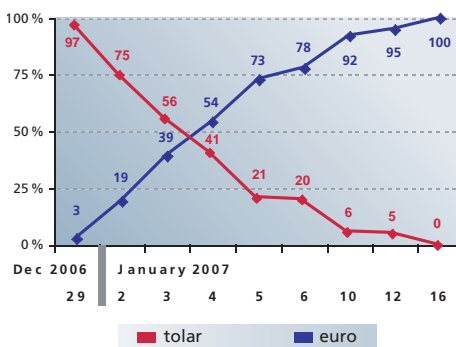
A fond goodbye to the tolar

As soon as Slovenia adopted the euro on 1 January 2007 Slovene consumers entered the 'dual circulation period' – during which euro and tolar circulated together in cash tills and people's pockets. But this did not last long. Retailers and banks worked smoothly to withdraw tolar by not giving them in change for purchases, returning euro instead. The Slovenian changeover plan had specified 16 January as the date when tolar were no



longer legal currency and can only be exchanged at banks. The EU's Eurobarometer survey closely followed the smooth withdrawal of the tolar and its replacement by euro in Slovenian consumer pockets and purses. In the end, the dual circulation period finished faultlessly and on time. For more information see ECFIN's dedicated website on the Slovenia changeover: http://ec.europa.eu/economy_finance/euro/slovenia/main_en.htm

Cash payments in Slovenian shops



Source: Eurobarometer

Lesser-known successes

"Both short-term, and more importantly for businesses, long-term interest rates are at historically low levels, even by German standards," Commissioner Joaquín Almunia told business leaders from the Nordrhein-Westfalen region at a conference there on 9 February, pointing to the favourable financing conditions for businesses and a reduced vulnerability to external economic shocks as clear benefits for enterprise from the macroeconomic stability achieved under EMU. The Commissioner also highlighted the effect on jobs – one of the lesser-known successes of the euro and the growth and jobs strategy. "Twelve million jobs have been created in the euro area since the introduction of the euro in 1999," said the Commissioner. "Contrast this with the 3 million jobs created in the eight years preceding the single currency and I think you'll agree this is quite an accomplishment." Now is the time to pick up the pace and press ahead, he concluded. The presentation on 'The EU economy and the Lisbon Strategy for growth and jobs' can be downloaded from the Commissioner's website: http://ec.europa.eu/commission_barroso/almunia

Brisk growth

In between the major spring and autumn economic forecasts DG ECFIN produces interim forecasts in February and September of each year. These

are based mainly on the economies of the larger Member States and look one year ahead, rather than two years. The February 2007 interim forecast describes 2006 as a remarkable year for growth and jobs in the EU, despite record energy prices and tighter monetary conditions. Brisk economic growth is forecast to continue in 2007, partly reflecting the new resilience of the EU economy resulting from already enacted reforms. With GDP growth predicted at 2.7% in the EU, and 2.4% in the euro area, Commissioner Almunia stressed that, "We must avoid repeating the mistakes of the past and make use of these good economic times to pursue the road of sound public finances and structural reforms, which is the only way capable of delivering a greater and more sustainable economic growth". The latest economic forecasts can be found on the DG ECFIN website.

Spring Council: energy, climate and Lisbon

During the Spring European Council held on 8 and 9 March, European leaders discussed integrating climate change protection measures, a sustainable energy policy, and the Lisbon Strategy for growth and jobs. With higher growth and falling unemployment, steady progress is being recorded on the Lisbon Strategy and heads of state and government stressed the social dimension, for example with regard to working conditions and equal opportunities. Consensus was also reached on the Better Legislation initiative to reduce the regulatory burden on businesses and thus boost competitiveness. The conclusions of the Spring European Council can be found on the website of the German Presidency: <http://www.eu2007.de>



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Efficient education

The efficiency of spending on education and R&D was the topic of a joint ECFIN-German Presidency workshop held in Brussels on 12 March. Deputy Director-General of DG ECFIN Marco Buti opened the

workshop and participants heard presentations on the links between education, R&D and growth, measuring efficiency in education and the determinants of efficiency in these sectors. For more information see events on the DG ECFIN website.

'The Euro and the Dollar: Partners in Global Finance'

DG ECFIN and the Federal Reserve Bank of New York organised a conference on the role that the euro and the dollar play in global finance. Held on



17 April 2007, the sessions covered macroeconomic development in the US and the EU, the achievements and challenges of EU financial integration and their implications for the US, regulatory convergence and differences in the approaches between the EU and the US, and the role of US and EU financial markets in the global economy. Commissioner Joaquín Almunia, New York Fed President Timothy Geithner, and ECB President Jean-Claude Trichet delivered the keynote speeches.

Further information

The latest news and press releases from DG ECFIN are available at:
http://ec.europa.eu/economy_finance/news/whatsnew_en.htm

Looking ahead

May 2007

On 3 May, on behalf of the European Commission, DG ECFIN will publish its **annual statement on the euro area** and the accompanying annual report on the euro area. This publication gives the Commission's view on the economic challenges facing euro-area members in the light of the increasing economic interdependence brought by the euro and EMU.

May 2007

On 7 May, the Commission will issue its **Spring Economic Forecasts** for 2007 containing two-year projections for a set of macroeconomic indicators for the Member States, the EU and the euro area. These forecasts are prepared by DG ECFIN country desks and then aggregated to provide EU-wide data.

May 2007

On 16 May, the Commission will publish its **Convergence Report** assessing Cyprus' and Malta's fulfilment of the convergence criteria to adopt the euro, following both countries' request for early assessment with a view to joining the euro area in January 2008.

May 2007

The **G8 Finance Ministers** meeting in Potsdam on 18-19 May will deal with macroeconomic and financial issues related to the G8 Summit in Heiligendamm (6-8 June 2007). This year, the German Presidency has chosen 'Growth and Responsibility' as the general topic for the summit.

June 2007

On 13 June, DG ECFIN will publish its report on 'Public Finances in EMU – 2007'. This **annual report** considers the current state of public finances in the Member States and the EU as a whole in the context of their sustainability. The application of the SGP rules on fiscal deficits and debt are reviewed and put into the context of long-term challenges, such as ageing demographics.

June 2007

DG ECFIN will publish the fifth report on practical preparations for the **future enlargement** of the euro area. The report will concentrate on the state of preparations in those Member States that are soon to adopt the euro and in particular their detailed national changeover plans.

A European round-up

"Global rebalancing is under way..."

... said OECD chief economist, Jean-Philippe Cotis, in his press briefing on the OECD interim assessment entitled 'What is the outlook for OECD countries?' Speaking on 13 March, Cotis pointed to low US growth, which is projected to remain subdued in the near term, and buoyancy in the euro area where growth is above potential and outpacing the US. The German recovery has been particularly vigorous and should remain above trend, he said, despite a recent value-added tax hike. These abundant revenues are helping government budgets and, in contrast to similar episodes in the past, are being used for consolidation. However, additional efforts are required, Cotis warned, in the face of rapidly ageing populations and the need for welfare and pension reforms. For further information see the OECD website: <http://www.oecd.org>

"Slovenia has every reason to be proud..."

... said the President of the Eurogroup, Luxembourg Prime Minister Jean-Claude Juncker, to participants at the 'Welcome to the euro' ceremony in Ljubljana on 15 January, referring to Slovenia's remarkable recent journey of independence, rebuilding, reforming, and now – for the second time in a generation – a new currency. Hosted by the Prime Minister of Slovenia, Janez Janša, the ceremony was attended by prime ministers and heads of state from the euro-area countries as well as Commission President José Manuel Barroso and ECFIN Commissioner Joaquín Almunia. For more information see the Slovenian euro website: <http://www.evro.si/en/>

An upbeat G7

At the G7 Finance Ministers meeting held in Essen on 9 and 10 February 2007, Central Bank Governors and Finance Ministers gave an upbeat assessment about the world economy, noting that the US was finally adjusting to a more sustainable growth path, Japan's recovery was on track, and the euro area



Upbeat finance ministers

was "experiencing an increasingly broad-based upswing". While global imbalances are improving, said the ministers, continued vigilance and sound policies are needed. They also called for emerging economies with large surpluses, and China in particular, to look at their effective exchange rates, i.e. their exchange rates vis-à-vis their main trade partners. For more information, also on the G7 Finance Ministers spring meeting, see the G8 summit page of the German Presidency: <http://www.g-8.de>

Extra chairs at the table

The first meetings of the Eurogroup and the ECOFIN Council in January 2007 were a cause for celebration. The Eurogroup of euro-area Member States grew by one as Slovenia took a seat at the euro-area top table, and the accession of Bulgaria and Romania brought the ECOFIN Council to 27 members. Once the furniture was rearranged, EU Economics and Finance Ministers turned to the implementation of the SGP, the 2007 Integrated Guidelines for economic policies and employment, and the current round of stability and convergence programmes. Ministers also assessed Slovenia's introduction of the euro, which has been smooth and successful, and discussed possible lessons for other euro-area candidate countries. In the February Council, a key issues paper on the Lisbon Strategy was approved and the updated Broad Economic Policy Guidelines were finalised. For more information see the website of the German Presidency: <http://www.eu2007.de/en>

Continental drift?

Whether the euro area is converging or drifting apart was the topic of a debate with national parliaments hosted by the Economic and Monetary Affairs Committee of the European Parliament on 28 February 2007. Nobel prize-winning economist Joseph Stiglitz spoke on the benefits and drawbacks of a narrow focus on inflation targets, saying, "What matters is not whether you borrow but what you do with the money". In his contribution, Commissioner Almunia painted a positive picture, looking forward to increasing growth, productivity and the prospect of 7 million jobs being created over the next three years. However, he cautioned national governments against 'tunnel vision' and called for them to act responsibly in favour of the euro area as a whole. For more information see 'conferences' on the ECON website: http://www.europarl.europa.eu/committees/econ_home_en.htm

Awaiting a stress test

In a draft report prepared for the European Parliament on the 'Public Finances in EMU 2006' publication (prepared by DG ECFIN),

rapporteur Kurt Joachim Lauk of the EP's ECON Committee largely agrees with the Commission's conclusions and stresses that, while the revised SGP is functioning, and its crucial role in coordinating economic policies and macroeconomic stability has been underlined, this conclusion is only based on one year's experience against a favourable economic background. The real 'stress test' of the revised SGP will happen in the years to come, warns Lauk, and calls on Member States to consolidate their budgets in the good times – pointing out that none of the euro-area Member States show a budget surplus at present. For more information see the website of the European Parliament's ECON Committee: http://www.europarl.europa.eu/committees/econ_home_en.htm



© Leah-Anne Thompson

Savings on bank charges



© Jeffrey Smith

A recent Commission report shows that EU rules on cross-border payments have brought significant savings for consumers without leading to a rise in domestic consumer bank charges. "This EU action has brought real benefits to consumers," said Internal

Market Commissioner Charlie McCreevy. The Single European Payments Area targeted by the EU Regulation is a critical framework to realise the full benefits of the single currency and the single market – previously it cost €24 to make a €100 cross-border transfer. Now it costs €2.50 on average. "By using fully automated payment systems that are of lower cost, this project has enormous potential to bring about huge savings and we fully support it," said the Commissioner. For more information see the website of the Internal Market DG: http://ec.europa.eu/internal_market/index_en.htm



Commissioner Joaquín Almunia: Look back

As Europe celebrates its 50th anniversary, European Economy News asks the Commissioner for Economic and Monetary Affairs for some reflections on both past achievements and future prospects.

Children today were born into a Union that exists around them. But this was not the case for their parents and older Europeans who lived through the progressive construction of the EU over the past 50 years. How would you describe to a young European today what daily life in a Europe with borders was like in the past?

In 1957, when the Treaty of Rome was signed, only ten of the current 27 Member States were democracies – the other 17 were not. In the European Union, we take it as given that peace, freedom and democracy are fundamental for each individual to pursue an autonomous life, free from discrimination and intolerance. Moreover, a prosperous economy and a solid welfare state are important if we are to offer equal opportunities for all. Unfortunately, daily life is radically different when these conditions are not met.

When we compare life in Europe today with 50 years ago, it is not only a question of physical borders and the restrictions they bring, it's also about the limitations on what you can say, think or read or where you can go, it's about poor job opportunities, about a limited access to culture and knowledge. The Union has eradicated many of these restrictions and presents today's youth with many more opportunities than were available, or allowed, to earlier generations.



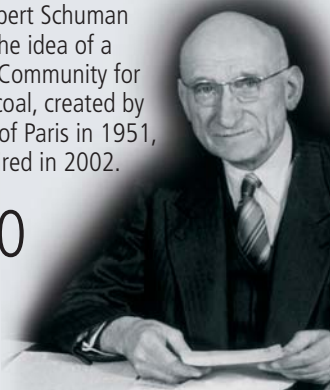
However, although young generations should be aware of Europe's past and the valuable contribution of European integration to building a better present, the EU must prove to its citizens that it is still relevant to face today's challenges. The past 50 years have been a time of many

changes for the better in Europe, but we cannot sit back and rest on our laurels for a job well done. Change is a fact of life in today's world and new challenges are arriving all the time. Today's youth are the leaders of tomorrow, and they will need the institutions and structures to face these

The road to economic and monetary integration

9 May, Robert Schuman launches the idea of a European Community for steel and coal, created by the Treaty of Paris in 1951, which expired in 2002.

1950



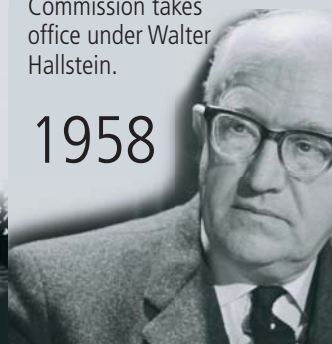
1957

The Treaties of Rome are signed, establishing the European Economic Community and the European Atomic Energy Community.



The first European Commission takes office under Walter Hallstein.

1958



Customs Union is completed: all internal customs duties are removed and a common external tariff is applied.

1968



with pride, look forward with confidence

challenges. And indeed, the EU is a powerful instrument to tackle the 21st century challenges of globalisation, climate change, security or the rise of extremism.

Over the past 50 years Member States have had to give up some decision-making powers, sometimes reluctantly, and pass them on to the EU. In doing this, there often seems to be a tension between 'more Europe' and 'less Europe'. Where do you feel the balance lies in these sovereignty issues for Europe in the future?

When talking about sovereignty, one must distinguish between formal and real sovereignty. Whether we like it or not, formal sovereignty of Member States is an illusion in many spheres, such as capital markets, terrorism, organised crime, and consumer protection, which are by their nature transnational, global phenomena. In these global arenas, individual countries do not have the means to effectively bring their formal powers into force.

Even the largest country in the EU, Germany, represents only 1.3% of the world population. And the GDP of France is lower than the amount of money traded in the financial markets in one single day.

In this context, relinquishing a certain amount of national formal sovereignty to share power at EU level and gain real sovereignty provides Europe with the most effective tools to protect its citizens and consumers. In such cases, it is often not about giving up sovereignty, but rather about co-operating with each other to acquire an effective sovereignty for all of us.

In this respect, the euro is a prime example of where the sum is greater than its parts. Recent experience has clearly demonstrated that the euro protects us against financial market turbulence; it has made the euro-area economy more resilient to external shocks. In the not-so-distant past, national currencies were vulnerable to speculation that brought misery and unemployment to many citizens. With the single currency, euro-area Member States have given up some control, but they have gained a host of advantages. Economic resilience is one example, and low and stable interest rates, which support long-term economic growth, are another.

surpassing initial expectations. As a result, Europe is better protected against external shocks, such as sudden rises in oil prices or turbulence on currency markets. This resilience brings more certainty and stability, allowing us to plan more confidently for the longer term, unlike in the past. This resilience and the added confidence it brings will provide a strong framework for the future growth of European enterprises and European economies. This will be the main role of economic and monetary union for the next 50 years, providing a stable macroeconomic environment that will allow enterprise, innovation and productivity to flourish.

“The EU is a powerful instrument to tackle the 21st century challenges of globalisation, climate change, security or the rise of extremism.”

The same reasoning applies to other policy areas, for example, guaranteeing secure energy for Europe, which can only be achieved through the co-operation of Member States at supranational level. Climate change is another example. Global warming does not recognise national borders or national sovereignty; it is an immediate challenge to Europe and the world as a whole and the response must come at the European and global level.

Looking globally, in the future, the emergence of large economies such as China and India will mean that the relative weight of the US and the EU in the international economy is likely to diminish. In such a multi-polar economy, the euro and EMU will be vital tools for maintaining European competitiveness. But we must not forget that the euro area will expand in the future as more EU Member States adopt the euro – so we will be stronger.

What role will EMU play in the Europe of tomorrow, and in the global economy?

That the euro has become the second most important international currency only a few years since its introduction is already a major accomplishment,

However, remaining strong will depend on willing co-operation and coordination of economic policies between the euro-area Member States and, further, the external representation of the euro should become more consistent if the EU is to make its voice heard in the international arena. ■

1969 The Werner report sets out a path towards EMU.

1971 The Bretton Woods monetary system is partially abandoned; economic instability results.

1972 The European monetary 'snake' is adopted to limit currency fluctuations.

1973 First enlargement: Denmark, the UK and Ireland join. End of Bretton Woods: the main international currencies are floated. Oil crises and instability put the 'snake' under pressure.

Europe and economic growth

By Tommaso Padoa-Schioppa

In 1965, a young middle-class Italian born in 1940 possessed no car, took cheap holidays, had already graduated from university, did not wait for financial security before starting a family, which was of course founded in marriage, and believed that his future would be more prosperous than that of his parents. If he did well as a student, he would find a job quickly and could afford his rent from his starting salary; after working for 15-20 years he could, with the help of a loan, afford to buy a house.

The situation of his son born in 1970 is almost the reverse: long-drawn-out studies, conspicuous consumption, no job, or only temporary contracts, no problems about living together outside marriage but fewer prospects of a family. We have gone from enriching the poor to impoverishing the rich. Today's sense of decline appears to be the corollary of the sudden comfort which the previous generation had been the first to enjoy.

Throughout the post-war period, the economy of Europe was more dynamic than that of America. Europe gradually caught up with the United States, which appeared to be a country in decline. There was talk of alternatives to capitalism and many studies encouraged America to follow the European or Japanese model: fewer redundancies, a paternalistic and corporatist attitude, strong ties between worker and firm, stable ownership, fewer stock exchange raids and takeovers, more social welfare.

Then, about 15 years ago, these trends went into reverse: Japan ground to a halt, Europe began to lag behind, the United States re-entered the race. For the first five years of the new century, Europe's economy suffered from the longest period of stagnation since the end of the Second World War; compared with the normal rates of growth in previous decades, it suffered a much greater loss of income than would have been caused by a real recession followed by a real boom.

The disease from which Europe's economy suffered at the start of the third millennium, and which is only now showing signs of overcoming, was low growth, not a cyclical slowdown. Economists and politicians know a lot about the economic cycle but not as much about growth, a phenomenon which they find difficult to forecast or create, which usually takes them by surprise both when it comes and when it goes, and which they normally study only in hindsight.

The enlargement of the European Union – to 25 countries and now to 27 – nevertheless means that Europe is bound to grow in future. There are those who regret, quite rightly, the urgent need for structural reforms; but the important reforms of recent years should not be overlooked. They lie behind the current recovery which shows some signs of being durable.

The discussions of recent years reveal certain constant factors. If it is not to be squeezed between competition from America's high-technology services and Asia's low-cost manufactured goods, Europe must increase its productivity, expand into new sectors of industry and services and, in the traditional sectors, aim at the higher quality brackets. To do this, it must develop a capability for more rapid change, shift labour and capital more easily from the old to the new, from firms and sectors that are in the red, or only marginally profitable, to those that are more competitive. The watchword is no longer 'stability' but 'flexibility'. Today, the obstacles to rapid change are the laws, regulatory provisions and labour agreements which protect the old economy and spare it from the effort of conversion. The forces with a vested interest in the status quo have more influence on governments and the political system than those who would benefit from change.

This is a European story in that it is French, German, Belgian and Dutch, not merely Italian. But is it also European in the sense that it derives from a



Tommaso Padoa-Schioppa is currently the Minister for Economic Affairs and Finance in Italy. He was previously an executive board member of the ECB from its foundation in 1998 until 2005, and Director-General of DG ECFIN from 1979-1983.

congenital defect in the European Union or from some error in the way it exercises its own powers? And if there is an error, whose is it?

A truly united Europe is perhaps the only way of providing guidance which would offer hope to young people, encourage families to live and spend, give businesses confidence and a desire to invest, and provide the will and resources to undertake ambitious research projects and develop infrastructure. In this sense, it is true that many of the remedies are to be found in Brussels.

But it would be a serious mistake to think that national policies have no part to play or do not bear considerable responsibilities.

First of all: despite everything, Europe includes economies which are growing, as well as stagnant ones; and the differences between the two are largely a result of the national behaviour of governments, the captains of industry and society as a whole.

The European Regional Development Fund is set up to support the poorest regions; it later becomes one of the Structural Funds, spending a significant part of the EU budget.

1975



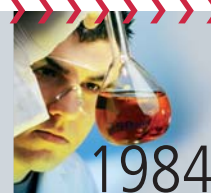
The European Monetary System is launched consisting of an Exchange Rate Mechanism based on the ECU, a basket of all the Community's currencies. It proves successful in promoting currency stability for the next decade.

1978



1981

Second enlargement: Greece joins.



1984

The first EU Framework Programme for Research and Development is launched.

Third enlargement: Spain and Portugal join.

1986



The watchword is no longer 'stability' but 'flexibility'

A country which works better than the others becomes more competitive and secures a premium, which is increased by its participation in Europe. Similarly, the penalty suffered by the country which performs less well than the others is more severe.

Secondly: it is true that the errors and omissions in European policies which act as a brake on growth come from Brussels, but they are decided on by the national governments meeting there. It is true that Brussels houses the government of Europe (the Commission) but it is also the venue for meetings of the cartel of national powers (the Council) which not infrequently has hindered Europe's forward march. It is this cartel which prevents progress on policies for energy, research, transport and infrastructure, which blocks the Community budget, which gives birth to the worst excesses of regulation and which impedes political union.

In Brussels, we sometimes waste time legislating on minutiae, at the expense of the Constitution or joint defence: still less do we complete important projects, because we are wasting time on trivia. We have both too much Europe and too little. Things have not substantially changed in the last decades. During my years in Brussels, at the beginning of the 1980s as the head of DG ECFIN, I had the same mixed feelings. In spite of this, it was perhaps in those years that the seeds were sown for the developments that led to the single market and the single currency.

Growth is a social process even more than an industrial, productive or commercial process; what grows is society, even more than the economy. The things that accompany growth, dynamism, optimism and the desire to improve one's lot are a reflection of society as a whole and, in particular, of that part of it which, through its influence and ability to guide, emerges as the managing class. Only Europe can provide an institutional framework and basic direction to release the dynamic forces which are both able and willing to confront today's global challenges. ■



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1986



The Single European Act sets a deadline for achieving the Single Market in 1992.

1989



Delors report maps out the road to EMU in three stages.

The Madrid Council agrees a timetable to achieve EMU.

The Berlin Wall comes down, ending the division of Europe.

1990



Launch of the first stage of EMU: economic policy coordination and the removal of obstacles to financial integration.

1991



The Maastricht economic convergence criteria are agreed.

1992



Signature of the Maastricht Treaty.

Economic and monetary integration in Europe as seen from outside

By Michael Deppler



Michael Deppler is the Director of the European Department of the International Monetary Fund.

From small beginnings in the early 1950s premised on the notion of gaining collective strength through economic integration, Europe has blossomed into a continent that is widely admired as prosperous, diverse, and caring. Along the way, forward-looking political leadership has built up institutions that have enshrined the increasing economic integration – the European Economic Community, the European Union, and the Economic and Monetary Union. In the same way, the impulse toward enlarging the Union has been generous, with the EU first the beacon and now the mantle for the transition economies of Eastern Europe. This is remarkable, and indeed unique.

This is not to say that all has proceeded without controversy among economists. The impulse to fix exchange rates met with considerable scepticism, and to a certain extent still does. Why forgo a degree of freedom (monetary independence) unnecessarily? The answer, that freedom had – in the tug-of-war between stability and solidarity endemic to much of Europe's recent economic history – been misused often, did not satisfy. Monetary union met, in some quarters, with even greater scepticism, all the more so given the rigidities in Europe's labour markets. The view that the single currency might prompt a removal of those rigidities was viewed, in this instance rightly,

as putting the cart before the horse. In the same vein, the ECB's emphasis on its monetary pillar has puzzled many given the elusive links to inflation, even if not to longer-term stability. Similarly, many have been sceptical of the Stability and Growth Pact – not so much for its objectives as for the rigidity with which the process deals with signs of instability (fiscal deficits in excess of 3% of GDP). Above all, Europe's continuing preoccupation with stability in the face of disappointing long-term growth has been a source of headshaking.

To this observer at least, these controversies – fed by the on-the-ground clamour associated with establishing new institutions – have masked a more pragmatic reality. This is the case with respect to the ECB's interest rate decisions which, to a first approximation and with allowance for differences in cyclical contexts, are difficult to distinguish from those of other central banks. The same is broadly true of the Stability Pact, where the implementation in the downswing was broadly in line with what one would have expected on historical grounds and which was in due course modified to make it more cycle-friendly.

Finally, while critics have applauded Europe's commitment to and success with integration, they have significantly underestimated the extent of Europe's commitment to reform in the past decade or so. Reform still has far to go in virtually all respects, but the progress made so far is nonetheless impressive, whether in public pensions and health, network industries, or labour markets. Perhaps the most graphical illustration of this is the euro area's outpacing of US business sector employment growth over the decade ending in 2005, by 14% to 12%. In the main, European policy-makers deserve more credit than they have often received from economists.

Nonetheless, growth is widely agreed to have been disappointing, particularly in the countries that historically have been the strongest proponents of integration and are the most integrated in the monetary sphere. For a decade, real per capita income growth in the euro area has fallen short of that in the United States by 0.5% a year. Moreover, whereas slow growth in earlier decades could be argued to reflect a preference for leisure rather than the high tax burden, the recent weakness stems from productivity growth which has lagged by about 1% per year.

Worryingly, the confluence of this disappointing structural performance, the recent cyclical downturn, and various political developments have prompted a resurgence of economic nationalism – the view that 'Europe' is part of the problem rather than of the solution to the problems confronting Member States. Manifestations of this include the controversy over the Constitution, the extent to which enlargement became an issue, the perceptions that the introduction of the euro had damaged national economies, and the general drift toward less reformist and more inward-oriented political platforms.

This is worrying because the opposite is more nearly the case. The weakness in performance is traceable not to the external sector, as is wrongly perceived from the periodic relocation of activities mandated by competition and comparative advantage, but to the more sheltered service sectors (notably distribution and financial services), parts of which are the segments of the economy least exposed to competition.

Those sectors, while indeed relatively stable, are the sources of the drag on growth. Correspondingly, if one looks at the countries in Europe which have had relatively strong performances over the years, one finds that a common strand in their policies is openness to the world, openness to markets,

1992-1993

Foreign exchange speculation destabilises the ERM and forces several currencies out: the fluctuation bands are widened.



The Single Market is now in operation: goods, services, people and capital move freely throughout the EC (the 'four freedoms').

1993



1994

Start of the second stage of EMU: nominal convergence and creation of the European Monetary Institute (EMI), the forerunner of the ECB.

Fourth enlargement: Austria, Finland and Sweden join.



50 years of economic thought at the Commission

By Ivo Maes

i.e. stances quite at variance with the notion that 'Europe' or globalisation more generally is the source of the problem. Integration and competition are the answer, not the problem.

The policy answers to the inertia at the core of a number of EU countries are of course manifold, with main drivers necessarily being national policies to strengthen competition and incentives in the most sheltered markets, notably labour and services markets, including financial services. But, in this endeavour, integration has a key role. It injects, or at least has the potential to inject, the contestability that is key to raising productivity in these markets, following the undeniably large benefits that the integration of trade in goods and enlargement has already conferred.

In this regard, it is to the credit of EU and national policy-makers that they are pressing ahead with integration. This is apparent in the adoption of the albeit watered-down Services Directive and, closer to having real effects, the Financial Services Action Plan and related initiatives to integrate financial markets. These are important initiatives and I remain hopeful that past and present reform and integration steps will lead to a gradual improvement in performance despite the rather negative attitudes that prevail currently.

In sum, there is much to celebrate on this 50th anniversary of European economic and monetary integration. The touchstone of future success will be satisfactory growth however, and here the challenge remains considerable. It requires instilling competition and change in segments of the society that have so far remained relatively sheltered. But then, 50 years ago, this applied to much of the tradable goods sector as well. Given where we are now on this score, surely one can expect European integration, cheered on by the international community, to succeed in meeting its present challenges as well. ■



Ivo Maes is a Deputy Head of Department at the Research Department of the National Bank of Belgium and Robert Triffin Professor at the Institut d'Etudes européennes of the Université catholique de Louvain and at the Katholieke Universiteit Leuven. His principal publications concern economic thought and the process of European monetary integration. He has been a Visiting Professor at Duke University (North Carolina) and at the University of Paris - Sorbonne.

famous for its five-year plans. The Planning Office, while being part of the 'Colbertist' tradition, was also a spearhead of Keynesian economics in France, with the national accounts at its heart.

Naturally, German ideas also played a role. Two tendencies can be distinguished. The free market school emphasised that economic policy was, in essence, *Ordnungspolitik*, i.e. a policy to create a sound and secure framework within which markets can operate. The other tendency, more Keynesian, emphasised a dialogue between the trade unions and employers, as a crucial element of its strategy to stimulate growth and employment. Moreover, in matters of monetary integration, 'convergence', especially in terms of inflation and budgetary positions, was a key German idea.

From the 1970s onwards, Anglo-American ideas became more influential. The entry of the United Kingdom and, especially, the growing dominance of Anglo-American ideas in the academic world were important factors in this. Such ideas were probably more prone to 'fashion', with the succession of Keynesianism, monetarism and supply-side economics. This was also true at the Commission, even if monetarism was not so influential. From a methodological point of view, a more analytical approach was favoured, in particular the development of econometric models.

During the second half of the 1970s, economic thought at the Commission shifted from being dominantly Keynesian toward a more supply-side-oriented approach. Failure of the very Keynesian 'Concerted Action Plan' of 1978 was an important factor here. At the beginning of the 1980s, the Commission's analytical framework basically became medium-term-oriented, with an important role for supply-side and structural elements and a more cautious approach towards discretionary stabilisation policies.



The Stability and Growth Pact is agreed at the Amsterdam European Council.

1997



1998

The European Council and Parliament agree that 11 of the 15 Member States meet the criteria to adopt a single currency. The European Central Bank is created with a mandate to decide monetary policy for the euro area.



The euro is launched as the single currency for 11 Member States. National banknotes and coins continue to circulate as subdivisions of the euro until 2002.

1999

European Union Charter of Fundamental Rights sets out the whole range of civil, political, economic and social rights of European citizens and all persons resident in the EU.



2000



The Commission has always advocated a strengthening of economic policy coordination and monetary co-operation



The Berlaymont: Commission headquarters in Brussels

As already mentioned, the Rome Treaty determined the Commission's mandate, which focused strongly on the creation of a common market. Macroeconomic policy-making was mainly at Member State level. The responsibilities of the Commission concerned the orientation and coordination of these national macroeconomic policies.

The most extensive discussion of macroeconomic issues was in the chapter 'Balance of Payments', as payments disequilibria could threaten the common

market. It led Robert Triffin to characterise the monetary dimension of the Treaty as "a Hamlet in which the role of the Prince of Denmark is almost totally ignored". However, the Treaty also gave the Commission a general right of initiative.

In line with the mandate of the Treaty of Rome, the Commission has always advocated a strengthening of economic policy coordination and monetary co-operation. In 1958, the Commission had already developed a plan for a 'European Reserve Fund'. The

basic idea was that the weight of the Commission's policy recommendations would be stronger if the Community disposed of resources to facilitate financial solidarity. In its Action Programme of 1962, the Commission presented, for the first time, an official programme for an economic and monetary union.

The 1969 Barre Memorandum was more modest and pragmatic (also in comparison with the 1970 Werner Report). Furthermore, it was characterised by a mixture of German and French ideas, especially in the part on 'Convergence of medium-term economic policy', where the French-inspired medium-term analysis was applied to the German notion of convergence. In the following decades, the Commission played an important role in relaunching and furthering the process of European monetary integration with the creation of the EMS and the Maastricht Treaty as highlights. Intellectually, one of the Commission's most important contributions was 'One Market, One Money' (1990), an analysis of the costs and benefits of EMU. The Commission's May 1995 'Green Paper on the Practical Arrangements for the Single Currency' was important in bringing the issue of the changeover to the fore. With the advent of EMU, the Commission focused on the coordination and surveillance of economic policies in an asymmetric EMU.

So, over 50 years, macroeconomic and monetary thought at the European Commission has undergone important changes. However, as in other policy institutions, economic thought at the Commission has always been close to the policy-making process. Two constant concerns can be discerned: furthering the process of European integration, and strengthening the economic performance of the Community. ■

Greece joins the euro area.

2001



2002

Euro banknotes and coins are introduced across the 12 euro-area Member States.



The Erasmus programme, started in 1987, celebrates its millionth student studying abroad.

Fifth enlargement: the three Baltic States, Poland, Hungary, the Czech Republic, and Slovakia, Slovenia, Cyprus and Malta join.

Constitutional Treaty signed, though rejection in French and Dutch referenda subsequently prevent its full ratification.

2004



Bulgaria and Romania join the Union, bringing membership to 27, and Slovenia joins the euro area.



The economy of Poland

Poland is at a crossroads. Economic growth is robust, inflation is under control, and the country is gradually closing the gap with the EU-25 average in terms of living standards. However, employment levels are low, investment is still below the economy's potential, and public finances have yet to be put on a sound footing. Policy-makers have a critical opportunity to implement macroeconomic and institutional reforms to reap the full benefits of EU membership.

Poland is the largest of the ten mainly Central and Eastern European countries that joined the EU in May 2004. After distinguishing itself during communist times as a key centre of steelmaking and shipbuilding, Poland has branched out into a more diversified export base with the EU as its most important export market. Despite its commitment to eventually join the euro, Poland has not yet set a target entry date as it struggles to control public finances.

Transitional shocks

Unlike most of its neighbours, Poland's transition from a centrally planned economy to a market economy began with a big bang. Following the collapse of communism in 1989, the government adopted the Balcerowicz Plan, named after the finance and deputy prime minister at the time, to combat hyperinflation and bring macroeconomic stability. Often dubbed 'shock therapy', the plan called among other things for allowing foreign companies to invest in Poland, lifting most price controls, freeing exchange rate transactions, and abolishing preferential treatment for state-owned firms. While some experts note that modern Poland would be much poorer without these reforms, the plan was highly controversial and socially costly.

Under communism, Poland was an important centre for steel, coal and shipbuilding amid an abundance of raw materials and of skilled and unskilled labour. Today, Poland enjoys a strong competitive position in other capital-intensive and low- to medium-skilled industries, in contrast to some of its neighbours which have branched out into technology-driven industries. The economy has gained a relative advantage in pulp and paper, metal products, rubber and plastics, and printing and publishing. On the other hand, similar to its peers, Poland has seen its comparative advantage in labour-intensive industries drop sharply since the mid-1990s, especially in basic metals and clothing.

Catching up

Over the past decade, real GDP growth has exceeded 4%, above the average of the new Member States (3.8%) and significantly above the EU-15 average (2.2%). The Polish central bank has projected 5.7% growth this year and about 5% annually in coming years. Poland has experienced a sustained, albeit periodically interrupted, long-term disinflation trend since the late 1990s. Inflation was below 1.5% at the end of 2006.

While Poland has made progress in closing the income gap and its GDP per capita relative to the EU-25 average, the difference with EU income levels remains wide. Despite noticeable improvement recently, at 15% Poland still had the highest unemployment rate in the EU and the lowest employment rate (about 51%) in 2006. The labour market has suffered in part from a large emigration of educated, highly skilled workers to other EU Member States.

Foreign direct investment, while still low compared to elsewhere in the region, has played a significant role in supporting Poland's labour-intensive and medium-technology sectors, and in giving it a new advantage in motor vehicles and electrical machinery. Although Poland has had a harder time than its peers in absorbing new technologies, it enjoys a diversified export base including

Poland (Polska) 

Currency: zloty

Population: 38.1 million

GDP per capita in purchasing power standards (EU-27=100): >53% (2006)

Real GDP growth rate: 5.8% (2006)

Public sector deficit (as % of GDP): 3.6% (includes pension reform cost) (2006)

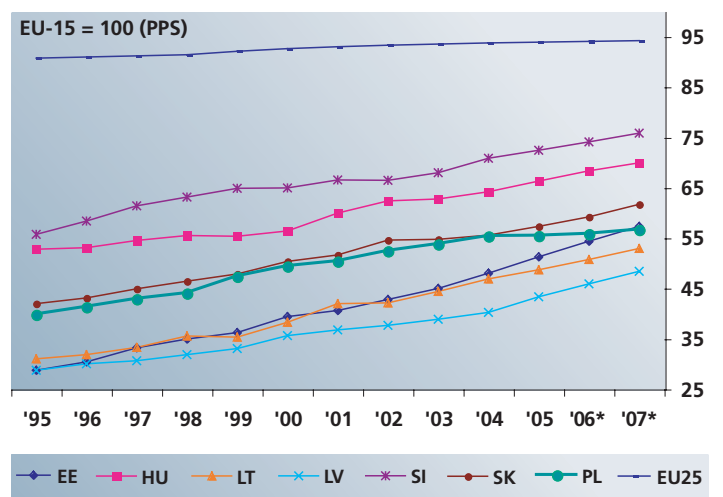
General government debt (as % of GDP): 48.2% (2006) (includes pension reform cost)

Source: European Commission

automobiles, electronics, home appliances and LCD monitors; service centres are also thriving.

Compared to other large Central European countries, Poland's export performance fluctuated substantially between 1995-2004, reflecting external shocks and changes in competitiveness. In response to loss of export markets in the Commonwealth of Independent States, Poland reoriented its trade towards the EU-15, now its main export market.

Chart 1: Labour productivity – GDP per person employed relative to the EU-15



* forecast

Thanks to the pension reform, Poland is among the Member States with the lowest budgetary impact of ageing

Public finances

Poland has been running up high fiscal deficits in the last ten years: on average, the general government deficit reached 3.5% of GDP in 1996-2005. This figure does not include the cost of the pension reform introduced in 1999, which in the short term has a deficit-increasing effect (estimated at ca. 2% of GDP in 2006), but in the long term is beneficial to the sustainability of public finances. Thanks to the pension reform, Poland is among the Member States with the lowest budgetary impact of ageing. This justifies why a part of the pension reform costs can be taken into account when considering the excessive deficit procedure.

Loose fiscal policy required higher-than-desirable real interest rates in order to rein in inflationary pressures with adverse effects on private-sector investment and growth. Additional reform efforts are needed to enhance the contribution of public finances to economic growth and employment. The nominal deficit anchor of PLN 30 billion introduced

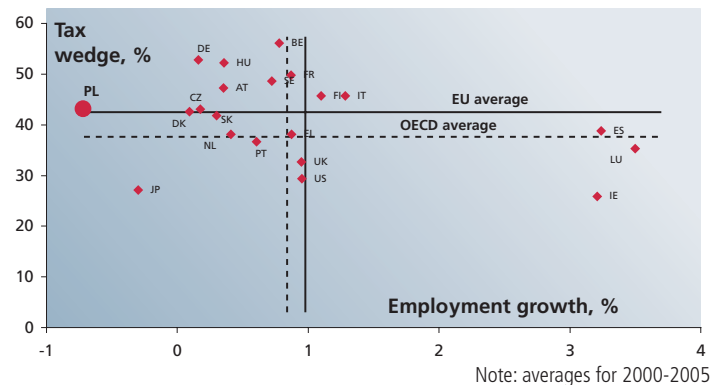
in 2006 is a step in the right direction, but it is limited to the state budget and not very ambitious.

Influenced by the political election cycle, general government deficits have been expenditure-led, tailoring tax revenues to planned spending levels. The structure of public expenditure and taxes hampers growth and job creation. Spending on social protection in Poland accounts for a disproportionately high share of total government expenditure compared to the other Central European Member States (about 17% of GDP compared to 12% of GDP). It may weigh on the incentives to work and limits the scope for increasing public investment in infrastructure while crowding out private investment.

The task-oriented budgeting, planned for 2009, whereby funds are allocated to the most needed projects, is a promising initiative which could make the composition of expenditure more efficient. However, many other reforms are needed to tackle the problems of too-generous indexation rules, poorly targeted disability benefits, the heavily subsidised special farmers' pension and disability system (KRUS), lobby-specific early retirement schemes and a high level of state aid relative to GDP.

Poland spends 17% of GDP on social protection, compared to 12% of GDP for other Central European Member States. This may discourage work and limits the scope for increasing public investment in infrastructure while crowding out public investment. Poland also has a relatively high tax wedge, defined as taxes plus social contributions paid by employers and employees, as a percentage of total labour costs. According to OECD (2005) data, the tax wedge in Poland (43.1%) exceeded the OECD average (36.5%), the EU (41.4%) and the average in the new Member States (42.7%).

Chart 2: A high tax wedge hampering employment growth in Poland



Preparing for the future

Poland faces an important macroeconomic challenge to reduce the general government deficit and reorient the composition of public spending to foster economic growth and employment. Towards this end, in its assessment of Poland's progress towards the 'Lisbon' objectives the Commission has recommended spending restraint and additional reform efforts. More concretely, an expenditure rule could supplement the national rules on public debt; and a reform of the tax system to improve incentives to work.

"Achieving sustainable convergence will require determined policy efforts over the coming years to increase the economy's growth potential, to which better use of the currently unemployed or inactive labour resources should make an important contribution," said Filip Keereman, head of the unit responsible for monitoring and analysing Polish economic and budgetary developments. "This will require action to modernise the economy and to complete the public finance reform."

Further information

More information can be found on the Member States' country pages on the DG ECFIN website:
http://ec.europa.eu/economy_finance/about/activities/countryeconomy/main_en.htm

Poland Country Study:
http://ec.europa.eu/economy_finance/publications/occasional_papers/2006/occasionalpapers27_en.htm



Poland: renovating fast

Recent research and analysis published by DG ECFIN

The pension reform challenge in Turkey

By Dirk Verbeke of DG ECFIN. COUNTRY FOCUS, Volume IV, Issue 3, February 2007, European Commission.

Facing a rapidly growing social security deficit of 4.8% of GDP in 2005, Turkey is introducing a comprehensive pension reform to unify the currently dispersed system and reduce the deficit to less than 1% of GDP by 2035. Yet with a young and growing working-age population, Turkey should not have a deficit. Furthermore, today's demographic advantage is expected to disappear within the next 30 years. This study reviews the relevant factors and the pension reform package and concludes that, while the reforms are a commendable step in the right direction, they are not enough to build a sustainable system for the future – more comprehensive reforms are needed urgently.

Country Study: Raising Germany's growth potential

By the staff of DG ECFIN. EUROPEAN ECONOMY, OCCASIONAL PAPERS, No 28, February 2007, European Commission. ISBN 978-92-79-04686-5

Germany's GDP growth in 2006 was the strongest for the last six years, benefiting public finances and employment. This study analyses whether this economic upswing will be lasting, or is only a cyclical swing around a feebler trend. The authors show that although the drag on economic performance resulting from reunification is easing, other factors are restraining potential growth and causing low labour force participation and high unemployment, such as finance and tax obstacles to investment. It then proposes ways to boost productivity and argues for a comprehensive reform agenda.

Foreign Direct Investment in the Czech Republic: A challenge for domestic firms

By Neil Kay of DG ECFIN. COUNTRY FOCUS, Volume IV, Issue 2, February 2007, European Commission.

Among the countries of Central and Eastern Europe, the Czech Republic has been one of the primary recipients of investment from abroad. Sound economic policies and early privatisations have

attracted substantial foreign investments over the past 15 years, which have, in turn, profoundly affected the structure and performance of the economy. In this article the author looks at how this FDI has influenced productivity and markets, and considers the spillover effects on domestic firms.

Steps towards a deeper economic integration: the Internal Market in the 21st century. A contribution to the Single Market Review.

By Fabienne Ilzkovitz, Adriaan Dierx, Viktoria Kovacs and Nuno Sousa of DG ECFIN. EUROPEAN ECONOMY, ECONOMIC PAPERS, No 271, January 2007, European Commission. ISSN 1725-3187

Later in 2007, the European Commission will publish a review of the European single market, also called the internal market. In preparation for that review, the authors present empirical evidence on trade figures, FDI, M&A, price developments and regulation. This is then analysed to discover the achievements of European economic integration and what barriers still exist. The authors reflect on possible improvements, including promoting an internal market for knowledge and encouraging more consistency between the internal market rules and external trade policies.

101 Proposals to reform the Stability and Growth Pact. Why so many? A Survey.

By Jonas Fischer, Lars Jonung and Martin Larch of DG ECFIN. EUROPEAN ECONOMY, ECONOMIC PAPERS, No 267, January 2007, European Commission. ISBN 92-79-03843-5

The problems some EU Member States had with meeting the requirements of the Stability and Growth Pact in recent years led to a heated debate on how to reform it. A measure of this 'heat' is the number of different proposals for improvement – 101 in all – presented by professional and academic economists from across the EU. In this paper the authors analyse these proposals and classify them broadly into four schools of thought on how best to coordinate fiscal policy. The reason for so many proposals, say the authors, is the evident lack of consensus in the profession on fiscal policy coordination, in sharp contrast to the general agreement on monetary policy issues. ■

A new periodic publication from DG ECFIN

The **European Economy Research Letter** is a new publication aimed at professional and academic economists with an interest in the academic research work of the Directorate-General.

Content includes articles on the current research under way at the DG, including work in progress and upcoming research publications. Recent publications and DG ECFIN conferences and workshops are also covered, as is the work of visiting fellows and partner research institutions.

The Research Letter will be a regular electronic publication available on the DG ECFIN website. Interested readers can subscribe to an email notification service.

The first issue will be on-line from April 2007.

http://ec.europa.eu/economy_finance/publications/researchletter_en.htm

The Directorate for Economic and Financial Affairs publishes frequently on economic research relevant to the European Union; only a selection of these articles is reported here. A complete list of downloadable publications is available at http://ec.europa.eu/economy_finance/publications_en.htm

Selected upcoming publications:

- Public Finances in EMU – 2007
- Exchange rate regimes in the Balkans
- Pensions and fiscal targets
- Saving in an ageing economy

For your diary

The Brussels Economic Forum

31 May to 1 June 2007, Brussels

Global adjustment and EMU

The BEF is DG ECFIN's premier conference on European economic issues. The 2007 BEF looks at EMU in the world through three sessions: unwinding global imbalances, adjustment and integration dynamics in EMU, and fostering catching-up and cohesion in the EU. Conference contributors will come from countries and international organisations from across Europe as well as the US and Asia. Registration is now open on the DG ECFIN website.



Euroframe conference

8 June 2007, Bologna

Towards an ageing and globalising Europe: challenges for the European Social Model(s)

The Euroframe group of research institutes will hold its fourth annual conference on economic policy issues in the EU: in this case, concentrating



on demographic change, globalisation and the challenges these pose for European social models. Participants will consider social reforms that have been undertaken in the Member States, what lessons they hold, and how economic forecasting tools might help evaluate different options for the future. For more information see the Euroframe website: <http://www.euroframe.org>

OECD World Forum

27-30 June 2007, Istanbul

Measuring and fostering the progress of societies

The second OECD World Forum on Statistics, Knowledge and Policy, organised in co-operation with the European Commission, the UN and the World Bank, will be held on the Bosphorus in 2007. The conference will provide opportunities for in-depth discussions on measuring progress in the face of climate change, health concerns and economic globalisation. Commissioner Joaquín Almunia will join other high-profile speakers in contributing to this international dialogue on identifying gaps in our knowledge, and how these might be closed through new, widely applicable indicators for progress. More information is available from the OECD website. <http://www.oecd.org>

DG ECFIN research conference

11-12 October 2007, Brussels

Growth and income distribution in an integrated Europe: does EMU make a difference?

This annual ECFIN research conference will answer questions on the complex links between growth and income distribution in an increasingly integrated EU. How is wealth distribution changing? What factors are driving changes? Does EMU make a difference? And more. With keynote speakers from across Europe and the US, the conference will include academic and practising economists contributing original work on these issues. For more information see events on the DG ECFIN website.

ECB workshop

14-15 November 2007, Frankfurt

The analysis of money market: role, challenges and implications from the monetary policy perspective

The money market's expectations and behaviour are strongly influenced by monetary policy stance and decisions of the European Central Bank. At this workshop, central bankers, researchers and practitioners involved in money market analysis will discuss issues of the linkages between monetary policy and money markets – covering predictability, expectations, transmission mechanisms and volatility. For more information see events on the ECB website: <http://www.ecb.eu>



ECB workshop

30 November to 1 December 2007, Frankfurt

Forecast uncertainty in macroeconomics and finance

This fifth ECB workshop on forecasting techniques will present recent theoretical and empirical contributions on forecast uncertainty in the areas of macroeconomics and finance. The assessment of forecasts is of particular interest to those who use them, and who are confronted with the need to evaluate the importance of forecasts from different sources and models. For more information see events on the ECB website: <http://www.ecb.eu>

Further information

A list of events organised by DG ECFIN is available at:

http://www.economy_finance/events_en.htm

