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Co-ordination of economic policies in the EU: a presentation of key features of the main procedures

by

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1. Introduction and overview

1.1 The case for co-ordination

Economic and Monetary Union (EMU), completed in 1999, displays a novel and *sui generis* economic policy framework. A single monetary policy is the sole competence of an independent and supranational central bank, the European Central Bank (ECB),[1] whilst other economic policies, notably budgetary and structural policies as well as wage determination, generally remain the responsibility of national actors.

The ECB formulates its policy in the light of developments in the euro area as a whole. Monetary policy is therefore well placed to respond, if necessary, to any symmetric shocks that might affect the currency area. By contrast, and in line with the subsidiarity principle, national governments are in a position – subject to certain common rules – to deal with their respective economy, e.g. in the case of country-specific problems or shocks.

Economic policy co-ordination: concept and rationale

At the same time, it has been recognised that the proper functioning of EMU requires a well-developed co-ordination framework. In turn, a comprehensive system of co-ordination procedures has been defined. It must be stressed at the outset that in the EU and EMU "economic policy co-ordination" is used as an umbrella term. It encompasses an entire spectrum of interactions among policy actors, including monetary and fiscal actors and the European Commission as representative of the common interest. The range of methods used includes information exchange, discussion of best practices, policy dialogue, peer review as well as, when appropriate, commonly agreed policy rules and objectives and jointly determined actions.

There are good reasons for co-ordination in an economic environment characterised by increasing interdependence, owing to technical progress, the completion of the Single Market, and especially the achievement of EMU. Interdependence is at the roots of spillover effects across Member States and the key objective of policy co-ordination is to take account of spillovers of national policies. This is the background to the development of a co-ordination framework for EMU and also to ongoing discussions on the need to strengthen it further.

More specifically, the rationale for economic policy co-ordination rests on the following grounds. Co-ordination is needed to take account of direct cross-border spillovers of national policies on neighbouring countries. In addition, euro-area participants can also be affected indirectly by national policy actions. The average inflation rate and the exchange rate have become common goods. Thus, a national policy action that affects these variables can in turn impact the ECB policy decision on interest rates or the ECOFIN Council's judgement on exchange rates. Moreover, co-ordination should help countering temptation to resort to free-rider behaviour on the part of the Member States. Finally, besides economic arguments, co-ordination

[1] Monetary policy decisions of the European System of Central Banks are taken by the ECB Governing Council, which comprises the ECB Executive Board and the governors of the national central banks of participating countries.

can also play a useful role from a political-economy viewpoint by helping to implement unpopular but necessary policy actions at national level.

On the other hand, co-ordination is not for free, it involves costs, the concept of subsidiarity and differences in national preferences demand respect. Overall, and in very broad terms, the more obvious and direct spillovers are, the more compelling the case for relatively strong forms of co-ordination. Thus, the degree and the mechanisms for co-ordination differ according to how convincing the economic rationale for co-ordination is in the particular policy area.

Forms of economic policy co-ordination in EMU

	POLICIES	**FORM OF CO-ORDINATION**	**MODE OF CO-ORDINATION**	**ACTORS INVOLVED**	**PROCEDURES**
SINGLE POLICY	**Monetary policy**	Single policy (euro area)	Single institution	ECB	
	Exchange rate	Single policy (euro area)	Co-ordination in the Council	Council ECB Eurogroup Commission	
	Competition policy	Single policy	Implementation by the Commission	Member States Commission Council	
CLOSE CO-ORDINATION	**Budgetary policy (balances)**	- Treaty rules - Commonly agreed rules and objectives - Information exchange - Peer review	Co-ordination in the Council Joint fora	Member States Commission Council Eurogroup	Excessive Deficit Procedure Stability and Growth Pact Broad Economic Policy Guidelines
	Structural policies (Internal Market)	- Rules - Joint decisions - Council directives - Peer review	Co-ordination in the Council	Member States Council Commission	
WEAK CO-ORDINATION	**Policy-mix**	- Dialogue - Information exchange	Joint fora	ECB Commission Council Eurogroup Social partners	
	Budgetary policy (quality of public finances)	- Commonly agreed objectives	Co-ordination in the Council	Member States Commission Council Eurogroup	Broad Economic Policy Guidelines Stability and Growth Pact
	Wage developments	- Dialogue - Information exchange	Joint fora	Social partners Commission Council ECB	Macroeconomic Dialogue (Cologne process) Broad Economic Policy Guidelines
	Labour market policies (structural reforms)	- Information exchange - Discussion of best practices - Guidelines - Peer review	Co-ordination in the Council	Member States Commission Council Social partners	Employment Guidelines (Luxembourg process) Broad Economic Policy Guidelines
	Product and capital market policies (structural reforms)	- Information exchange - Discussion of best practices - Guidelines - Peer review	Co-ordination in the Council	Member States Commission Council	Reports on economic reform --product and capital markets-- (Cardiff process) Broad Economic Policy Guidelines
	External representation and communication	- Agreement on a common understanding (communication only)	Joint fora	ECB Eurogroup Commission	

The large risk posed by fiscal imbalances to euro-area wide stability justifies close rules-based co-ordination in the macroeconomic sphere as regards budgetary policies. The latter are subject to strict provisions that include pecuniary sanctions in case of non-compliance with the excessive deficit constraints. With the exception of binding rules on deficits, macroeconomic co-ordination within the euro area is generally based on dialogue and consensus.[2] It aims at preserving a sound and stable macroeconomic framework, and at optimising the policy-mix in the short run in response to cyclical positions, notably to ensure that economic growth remains close to potential.

The effects of national structural policies on partner countries and EMU common goods are sometimes not easily visible and lagged. This notwithstanding, it is clear that efficiently working flexible markets are key to raising the growth potential and ensuring the well-functioning of EMU. Co-ordination in the structural policy field is mainly based on information exchange, discussion of best practices and peer reviews; a more formal mechanism to ensure progress with structural reforms in the Member States is not foreseen. However, to avoid disturbance of the level playing field and the proper functioning of the Internal Market, those structural policies with a direct impact on the Internal Market functioning and on competition are subject to stronger forms of co-ordination.

1.2 Overview of the co-ordination procedures

The Broad Economic Policy Guidelines (BEPGs)

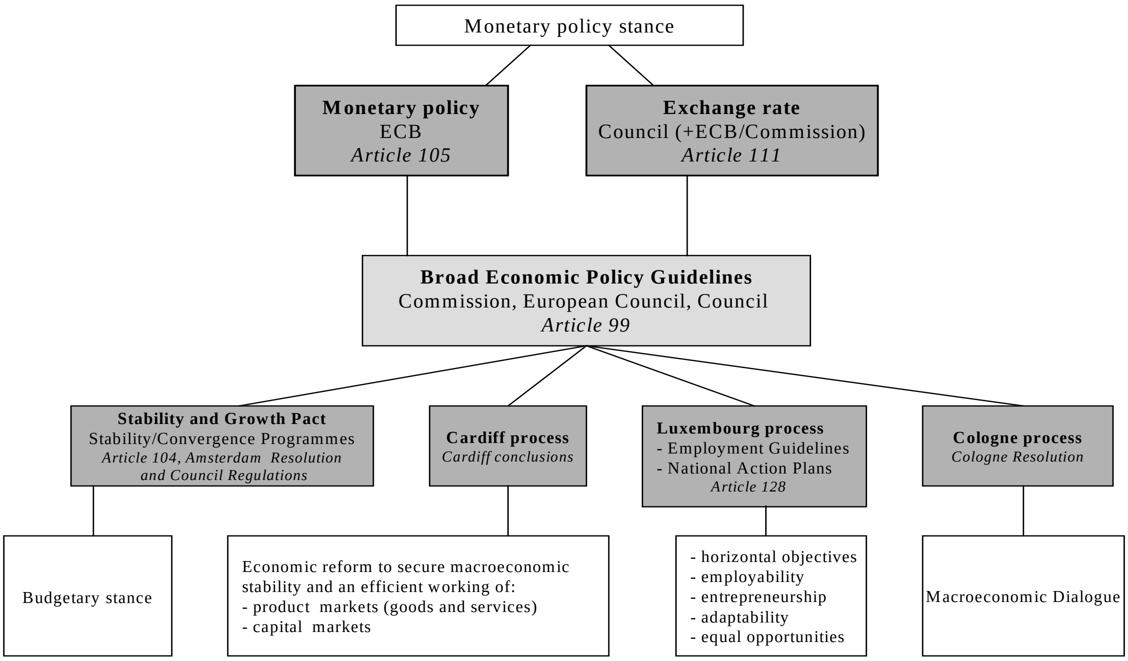
Since 1993, the Council has adopted annually the BEPGs, on the basis of a Commission Recommendation. The aim of the BEPGs is to present in an integrated manner broad recommendations for policy actors on macroeconomic and structural policies, and to provide a yardstick for ex-post assessment in the context of multilateral surveillance. At the outset, the BEPGs were very general in scope, but recommendations became more concrete and specific over time, and country-specific recommendations gradually gained in importance, until broadly providing a mirror image of Community-wide guidelines. This evolution has allowed the BEPGs to become a more effective co-ordination instrument.

The BEPGs are politically but not legally binding; no sanction mechanisms are foreseen. Compliance is voluntary and based on peer pressure. To step up the latter, the ECOFIN Council can issue a recommendation to non-compliant Member States and, if deemed necessary, make it public. This option was used for the first time in 2001.

The effectiveness of the BEPGs as a tool for multilateral surveillance was improved in 2000, with the introduction of an annual Implementation Report that provides ex-post surveillance by assessing the extent to which Member States have followed the recommendations set by the BEPGs. The Implementation Report is presented shortly before the BEPGs of the following year and helps sharpening the focus of the latter.

[2] For some instruments, the Treaty requires a qualified majority in the Council, e.g. for the adoption of the Broad Economic Policy Guidelines.

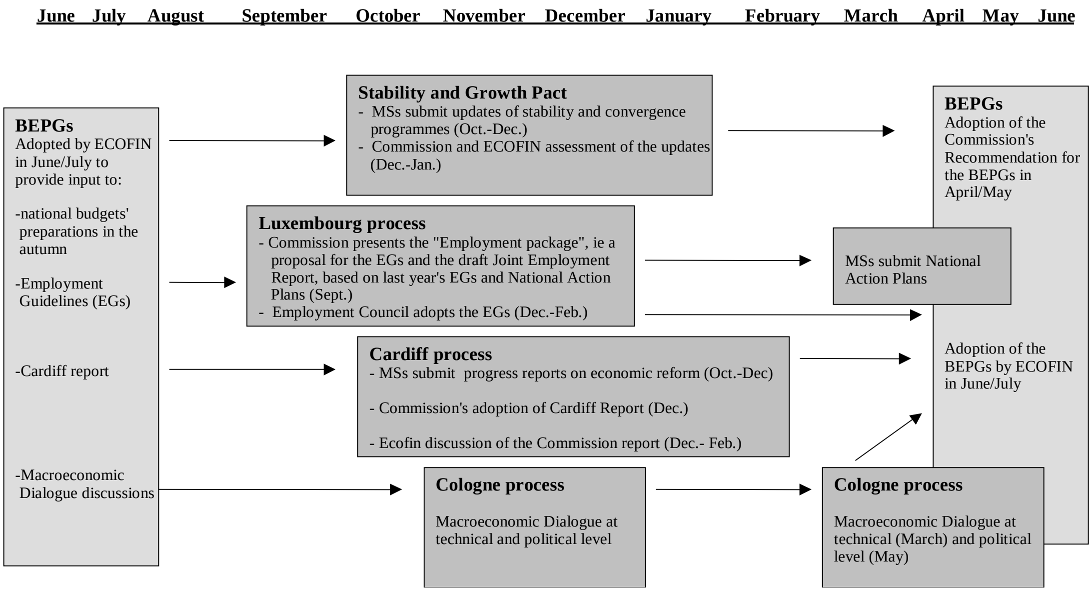
Economic policy co-ordination (including dialogue with the ECB)



The BEPGs are at the heart of the co-ordination process (see chart above). Their recommendations are further developed by more specialised procedures, which *need to be consistent with the BEPGs*. These include the Stability and Growth Pact on the conduct of budgetary policies, the Employment Guidelines on labour markets (Luxembourg process), the Cardiff process on economic reform of product and capital markets and, finally, the Macroeconomic Dialogue to promote responsible wage developments (Cologne process).

Given the fact that the BEPGs both provide general guidance and build on these specialised procedures, the latter are timed with a view to ensure that the BEPGs stand at the start and at end of the annual co-ordination process (see chart below).

The annual economic policy co-ordination process



The Stability and Growth Pact (SGP) / Excessive Deficit Procedure

Budgetary policy rules, notably the SGP, which develops Treaty provisions on the Excessive Deficit Procedure (Article 104), need to strike the balance between the deterrence of national budgetary actions that could adversely affect the euro-area as a whole and interfere with the conduct of monetary policy, and the maintenance of sufficient leeway for budgetary policies to play a stabilisation role. To this end, a system has been defined that combines a rules-based mechanism that can ultimately result in sanctions, with a flexibility element, that envisages no action in case of temporary and exceptional circumstances.

The SGP commits Member States to attain budgets close to balance or in surplus over the medium term. This should allow Member States to deal with cyclical fluctuations, while keeping the government deficit below the reference value of 3 % of GDP. Deficits above this limit will be considered excessive except when temporary and due to exceptional circumstances.

The system builds on preventive and dissuasive elements. *Prevention* is ensured by regular surveillance and an early-warning system that encourages corrective actions in case of a budgetary slippage. Member States submit stability or convergence programmes,[3] which set their medium-term target and the adjustment path, as well as annual programme updates.[4] The programmes are assessed by the Commission and on this basis the Council delivers an opinion. In addition, the Council, on the basis of a Commission assessment, regularly monitors the implementation of the programmes. In the event of a significant divergence, the Council can address a recommendation to the Member State urging corrective action. *Dissuasion* is provided by a detailed clarification and a speed up of sanction mechanisms. The SGP clarifies the excessive deficit procedure by spelling out the exceptional conditions under which the 3 % limit may be exceeded and by specifying the rules on sanctions.

The European Employment Strategy (Luxembourg process)

The European Employment Strategy (Luxembourg process) aims at improving labour market performance through the establishment of common objectives and targets, as well as a process to ensure progress towards the objectives. In the framework introduced by the Amsterdam Treaty, responsibility for employment policies remains with the Member States. The Luxembourg European Council (1997) started the application of the new framework. Reflecting the weaker economic rationale for co-ordination in this field, progress is voluntary and based on a process that includes regular reporting, peer review, general guidelines and country-specific recommendations. The greatest pressure that can be exerted by the Council is a non-binding recommendation to the Member States. This instrument was used for the first time in early 2000, when a recommendation was addressed to all Member States.

The annual Employment Guidelines are prepared by the Commission and adopted by the Employment and Social Policy Council. They have to be consistent with the

[3] Stability programmes in the case of euro-area participants and convergence programmes in the case of the three non-participants.

[4] Although annual updates do not require the full formal procedure (Commission recommendation, Council examination and opinion) established for the programmes, so far all updates have been put on the Council agenda. This aims at strengthening the effectiveness of the SGP in its first years of operation.

BEPGs and provide general orientations based on four thematic pillars (employability, entrepreneurship, adaptability and equal opportunities), which Member States translate into National Action Plans on Employment (NAPs). NAPs are examined by the Commission and the Council, and the results are presented in the Joint Employment Report, which in turn provides the basis for the next Employment Guidelines.

Product and Capital Market Reform (Cardiff process)

Similar to the Luxembourg process, the Cardiff process aims at improving the functioning of product (goods and services) and capital markets through a voluntary EU-wide co-ordination process based on continuous monitoring, exchange of best practices and peer pressure. The process is named after the Cardiff European Council (1998), which introduced a reporting system on product and capital markets. As a result, each year Member States submit national reports on their progress on economic reforms, and the Commission draws up a report on the functioning of EU product and capital markets ('Cardiff Report'). This analysis serves as input to the Commission's assessment of the implementation of the BEPGs in product and capital markets, as well as in the elaboration of the BEPGs of the following year.

Besides, national progress reports and the Commission Cardiff Report lay the basis for the country examinations of the Economic Policy Committee (EPC) on structural reform, which result in the EPC Annual Report on Structural Reform. The latter, which also covers labour market reform, serves as additional input to the BEPGs.

The Macroeconomic Dialogue (Cologne process)

This procedure, introduced by the Cologne European Council (1999) aims at improving the interaction of macroeconomic policies and wage developments with a view to support non-inflationary growth and employment. To this end, all relevant actors, notably the Social Partners, the ECB, as well as Council and Commission representatives meet twice a year for a confidential exchange of views on ways to promote adequate macroeconomic conditions. Meetings take place at political and at technical level.

The Lisbon objectives and strategy

In March 2000, at the Lisbon European Council meeting, the EU set itself a new strategic goal for the next decade: "to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion". The strategy to reach this objective encompasses sound macroeconomic policies, stepping up the process of structural reform and investing in knowledge and people. Overall, the strategy aims at raising productivity and potential GDP growth.

The implementation of the strategy builds on using and improving existing processes, a stronger guiding and co-ordinating role of the European Council and applying a new open method of co-ordination:

- The Lisbon European Council concluded that ***no new co-ordination processes*** were needed. The BEPGs, and the Luxembourg, Cardiff and Cologne processes offered the necessary instruments. However, the processes should be simplified and better co-ordinated. In view of this, the BEPGs procedure has been modified to allow other Council formations to contribute to the work of the ECOFIN Council. Moreover, the BEPGs focus increasingly on structural policies promoting the growth potential, employment and social cohesion while the Cardiff and Luxembourg processes deal with their respective subject matters in greater detail.

- Starting with the Stockholm meeting in March 2001, the ***European Council*** devotes its ***spring meeting*** to economic, social and environmental issues. This helps monitoring progress towards the strategic goal. To this end, the Commission presents an annual Spring Report based on structural indicators relating to employment, innovation, economic reform, social cohesion and the environment. Moreover, the spring European Council seeks to ensure overall policy coherence and provides guidance for the elaboration of the BEPGs.

- Finally, the so-called ***open method of co-ordination*** was introduced as a new additional means, complementing the existing processes, with the aim of fostering the achievement of the new strategic goal. The method helps Member States develop their own policies through the discussion and dissemination of best practices, with the aim of reaching commonly-agreed goals. It involves defining common EU-wide goals, translating these goals into national policies, establishing indicators and benchmarks, periodic monitoring, evaluation and peer review, organised as a mutual learning process. The method has since been applied to provide a framework for the exchange of information concerning, e.g., national strategies for pension reform and social inclusion.

  Obviously, the open method draws on elements that have been successfully applied in economic policy co-ordination and in multilateral surveillance (e.g. common goals, indicators and periodic monitoring). But the method does not change responsibilities of policy makers at the EU and national levels and it does not result in formal policy recommendations, such as those that characterise the BEPGs. As a corollary, the method is also not armed with any formal measures to foster compliance with agreed policy orientations.

*

* *

The remainder of this paper takes stock and presents the key features of the main procedures. In particular, this includes the rationale and legal basis, the background and evolution as well as the annual cycle of each procedure.

This presentation reflects the situation in early 2002. However, economic policy co-ordination is a learning-by-doing process and this calls also for a regular review of the procedures used for organising policy co-ordination. In view of this, the processes are bound to evolve. Future trends will likely see increasing emphasis on implementation and on exploiting possibilities for streamlining.[5]

[5] See, e.g. the Commission Communication on strengthening economic policy co-ordination within the euro area (February 2001) and the Barcelona European Council Conclusions (March 2002).

2. The Broad Economic Policy Guidelines (BEPGs)

2.1 Rationale and legal basis

The Treaty requests Member States to co-ordinate their economic policies. This stipulation acknowledges a case for co-ordination and recognises that closely co-ordinated economic policies are key for achieving the Community objectives of sustained non-inflationary growth and a high level of employment.

> ***Treaty, Part One: Principles, Article 2***
>
> The Community shall have as its task … to promote ... a high level of employment …, sustainable and non-inflationary growth …
>
> ***Part One: Principles, Article 4(1)***
>
> For the purposes set out in Article 2, the activities of the Member States and the Community shall include … the adoption of an economic policy which is based on the close co-ordination of Member States' economic policies …
>
> ***Part Three: Community policies***
> ***Title VII: Economic and monetary policies, Chapter 1: Economic policy, Article 99(1)***
>
> Member States shall regard their economic policies as a matter of common concern and shall co-ordinate them within the Council, in accordance with the provisions of Article 98.

The BEPGs are the central periodic EU policy document and key instrument for policy co-ordination. They are anchored in Articles 98 and 99. The role of the Guidelines is twofold. Firstly, they set out orientations for the policy actors, following a procedure as outlined in Article 99(2). And secondly, they provide the yardstick for the assessment of policies in the context of continuous monitoring by the Commission and Council (multilateral surveillance, Article 99(3)). Moreover, a formal incentive for swift compliance with the BEPGs is provided in Article 99(4) which allows to address recommendations to Member States the policies of which were found to be inconsistent with the BEPGs. But whilst the BEPGs are politically binding, they are not legally enforceable. Recommendations are a strong form of peer pressure, but they entail no (pecuniary) sanctions.

> ***Treaty, Title VII: Economic and monetary policies, Chapter 1: Economic policy, Article 98***
>
> Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Community, as defined in Article 2, and in the context of the broad guidelines referred to in Article 99(2). …
>
> ***Article 99***
>
> 2. The Council shall, acting by a qualified majority on a recommendation from the Commission, formulate a draft for the broad guidelines of the economic policies of the Member States and of the Community, and shall report its findings to the European Council.
>
>   The European Council shall, acting on the basis of the report from the Council, discuss a conclusion on the broad guidelines of the economic policies of the Member States and of the Community.

On the basis of this conclusion, the Council shall, acting by a qualified majority, adopt a recommendation setting out these broad guidelines. The Council shall inform the European Parliament of its recommendation.

3. In order to ensure closer co-ordination of economic policies and sustained convergence of the economic performances of the Member States, the Council shall, on the basis of reports submitted by the Commission, monitor economic developments in each of the Member States and in the Community as well as the consistency of economic policies with the broad guidelines referred to in paragraph 2, and regularly carry out an overall assessment.

   For the purpose of this multilateral surveillance, Member States shall forward information to the Commission about important measures taken by them in the field of their economic policy and such other information as they deem necessary.

4. Where it is established, under the procedure referred to in paragraph 3, that the economic policies of a Member State are not consistent with the broad guidelines referred to in paragraph 2 or that they risk jeopardising the proper functioning of economic and monetary union, the Council may, acting by a qualified majority on a recommendation from the Commission, make the necessary recommendations to the Member State concerned. The Council may, acting by a qualified majority on a proposal from the Commission, decide to make its recommendations public.

   The President of the Council and the Commission shall report to the European Parliament on the results of multilateral surveillance. The President of the Council may be invited to appear before the competent committee of the European Parliament if the Council has made its recommendations public.

…

The BEPGs are the key economic policy document of the EU for a number of reasons.

- *Broad coverage*: These Guidelines, contrary to any other policy co-ordination procedure, cover both macroeconomic and structural policies.
- *Consistency*: By virtue of their comprehensive coverage, the BEPGs provide an integrated view, foster consistency across different policy fields and thereby allow to exploit the mutually reinforcing impact of coherent policies.
- *Policy consensus*: The annual procedure is instrumental in forming policy views and generally yields consensus that is codified in the final document. Policy consensus, in turn, is the basis for exerting peer pressure and essential for successful co-ordination.

2.2 The BEPGs: background and evolution

Already with the Treaty of Rome, Member States have been called upon to co-ordinate their economic policies. In view of this, specialised committees were set up and procedures developed. Success, however, remained mixed, essentially owing to a lack of consensus on appropriate policies which became apparent, e.g., in diverging responses to external shocks like the oil price crisis in the mid 1970s.

A fresh start was made with the run up to EMU. Multilateral surveillance was strengthened with the convergence decision of 1990 and the Treaty of Maastricht introduced the BEPGs as key economic policy document which summarises the consensus view. A first vintage of the Guidelines was adopted at the end of 1993, shortly after ratification of the Maastricht Treaty and before entry into Stage 2. Since 1994, the BEPGs are adopted in late spring/early summer, in time to have a bearing on the budgets for the following year.

The key objective of the BEPGs has always been to achieve strong and sustained non-inflationary growth and job creation, by means of a comprehensive strategy that combines both sound macroeconomic policies and structural reforms. While some goals have disappeared or become less preoccupying, e.g. the issues of exchange rate stability amongst euro-area countries or nominal convergence, others, like (un-) employment, continue to be in the limelight. Evidence to this are the White Paper on Growth, Competitiveness and Employment (1993), the Amsterdam Treaty/resolution on growth and employment (1997) and more recently the ambitious employment rate objectives agreed in Lisbon and Stockholm.

The macroeconomic policy guidelines have consistently aimed at sustainable growth. To this end and within the stability oriented framework of EMU, they have called for a policy mix that combines sound budgets, responsible wage trends and corresponding monetary conditions. Public finances gave rise to concern occasionally, e.g. ahead of the transition to Stage 3 and in view of their impact on confidence of economic actors. Aspects of the quality and long-term sustainability of public finance have been developed over time, with a view to both the economic performance in the shorter term and demographic burdens in the longer term.

Promoting the flexible and efficient working of product and labour markets has also been on the agenda from the very beginning. First with a view particularly to competitiveness and job creation, and more recently as key ingredient to the proper working of EMU and also as instrument to raise potential growth. More attention has been given to the role of capital markets since 1998, and since 2000 separate sections in the BEPGs have been devoted to the knowledge-based economy and environmental sustainability.

The 1993 BEPGs were a short document of 4 pages, exclusively with general guidelines. But already in 1994 some brief country specific recommendations were included (for public finance). Gradually country specificity gained in importance. Other aspects were covered, beginning with inflation, and country recommendations became more extensive (full paragraphs on the budget of each Member State as of 1997). In 1997, European Councils in Amsterdam and Luxembourg gave additional impetus. They urged to develop the BEPGs and provide more concrete and country-specific guidelines. In response, the 1998 edition was more concrete and detailed on the policies while a complete part transposing the Community-wide guidelines into the specific context of each Member State was added in 1999. Each of these two steps implied a doubling in size of the document. Moreover, the euro area has been recognised as an entity of its own from the very beginning of Stage 3, i.e. 1999.

Monitoring the implementation of the BEPGs is crucial for their effectiveness. From the beginning, specific reports were made and discussed in varying forms and fora -- with the exception of 1998/1999, when the Commission's convergence report preceded the introduction of the euro. In line with the ECOFIN Council report on policy co-ordination endorsed by the Helsinki European Council (1999), the Commission is now adopting an Implementation Report ahead of each new vintage, to strengthen peer pressure and prepare the next recommendation. Moreover, the Luxembourg European Council invited the Council to be more ready to use the instrument of the Article 99(4)-recommendation.

European Council Conclusions:
Political basis for the development of the BEPGs

Stockholm (March 2001)	New procedures implemented. The European Council: • Endorses the Key Issues Paper on the BEPGs. • Invites the ECOFIN Council and the Commission to take account of the European Council conclusions in the draft 2001 BEPGs.
Feira (June 2000)	• Invites the Council to implement its conclusions on practical steps forward to enhance the co-ordinating role of the BEPGs in close co-operation with other Council formations.
Lisbon (March 2000)	Confirms existing co-ordinating processes, but these should be simplified and better co-ordinated among them. To this end: • BEPGs to focus increasingly on the medium and long-term implications of structural policies, on reforms to promote the economic growth potential, employment and social cohesion, and on the transition to a knowledge-based economy. The Cardiff and Luxembourg processes will deal with their respective subject matters in greater detail. • As regards the BEPGs procedure: ➢ Other Council formations to contribute to the ECOFIN Council's preparation of the BEPGs. ➢ The European Council to take a pre-eminent guiding and co-ordinating role to ensure overall coherence. A meeting every spring will be devoted to economic and social questions.
Helsinki (December 1999)	• Endorses the ECOFIN Council report on policy co-ordination, which ➢ Puts the BEPGs at the centre of the co-ordination process, as instrument that defines the main policy objectives and orientations and puts forward an integrated view. ➢ Calls for a close review of the implementation of the BEPGs on the basis of a Commission report prior to a new vintage. • Notes that the BEPGs provide the framework for the definition of overall policy objectives and orientations. • Requests to further develop the synergy between the BEPGs, the Employment Guidelines and the monitoring of structural reform, under the political guidance of the European Council. • Suggests enhancing the role of the ECOFIN Council in economic policy co-ordination while ensuring coherence between the different Council formations.
Vienna (December 1998)	• Invites the ECOFIN Council to report in Helsinki on how economic policy co-ordination has functioned in Stage 3 of EMU.
Luxembourg (December 1997)	<u>Resolution on economic policy co-ordination in Stage 3 of EMU</u>: • BEPGs to become more concrete and country-specific. • Focus on smooth functioning of EMU and measures to improve the growth potential. • Multilateral surveillance: Implementation of BEPGs to be monitored. Council to be more ready to make recommendations to a Member State in case of policies inconsistent with the BEPGs.
Amsterdam (June 1997)	<u>Resolution on Growth and Employment:</u> • The BEPGs to be enhanced and developed. • Focus on sustained convergence, competitiveness, growth and employment.

Following an initiative of the Commission, a public recommendation was addressed to a Member State because of policy inconsistency with the BEPGs for the first time in February 2001. In this case, the budgetary policy in Ireland was found expansionary and pro-cyclical and therefore inconsistent with the corresponding country-specific recommendation of the 2000 BEPGs. The country-specific recommendations are of particular importance with a view to an appropriate policy mix in individual euro-area countries and trends in their competitiveness.

2.3 The annual procedure

The role of the BEPGs patterns their procedure within the framework set by both Article 99 and by the political guidance from the European Council. The present arrangements reflect the Lisbon decision to hold an annual European Council meeting devoted to economic and social questions and subsequent ECOFIN Council conclusions to allow for an improved co-ordination of the work of different Council formations. In particular this seeks to ensure that the ECOFIN Council can draw on contributions of other Council formations in a timely manner and that the European Council is in a position to give effective political guidance. The Feira European Council endorsed these conclusions and they were applied for the first time with the 2001 BEPGs.

Policy co-ordination in the EU is based on consensus views. These views emerge from analysis and discussion, and they draw on insights gained in monitoring and assessing. Moreover, the BEPGs attempt to provide overall and broad economic policy guidance. Their role is to ensure consistency across the different co-ordination procedures by putting forward an integrated view while leaving it to these other processes to deal with their respective subject matters in greater detail. Simultaneously, insights from these procedures are taken on board, previous initiatives are thus validated and combined. In this sense, the BEPGs stand at the beginning and end of an annual process of policy formulation, implementation and surveillance.

All the above elements are mirrored in the BEPGs procedure which may be usefully divided in a preparatory phase, resulting in the Commission recommendation, and a finalising phase, yielding the definitive policy document (see also chart at the end of this section).

The preparatory phase

In autumn, prior to any work on the next BEPGs proper, the Commission provides general input for discussions in its annual Review of the EU Economy, an analytical publication that deals with topical policy issues. Early in the following year, the Commission prepares the ECOFIN orientation debate on the upcoming BEPGs and moreover its annual Implementation Report on the preceding BEPGs. This work draws on reporting by Member States under various procedures and monitoring of economic developments and policies by the Commission. Particular attention is paid to budgetary trends as they emerge e.g. from the updates of the stability and convergence Programmes and to progress with the structural reform process. Based on analytical work by the Commission services, the Economic and Financial Committee (EFC) discusses budgetary trends and the Economic Policy Committee

(EPC) examines how structural reforms proceed in the Member States.[6] Moreover, contributions from Council formations other than ECOFIN in their fields of expertise are input for the ECOFIN orientation debate on the upcoming BEPGs. On the basis of the orientation debate, the Council draws up a paper that sets out the key issues, on which the European Council is invited to focus in the part of the annual spring meeting that has a direct bearing on the BEPGs. The Commission takes into due account the political guidance from the European Council, but also other views and own assessments, when it elaborates and adopts its recommendation for the BEPGs.

The finalising phase

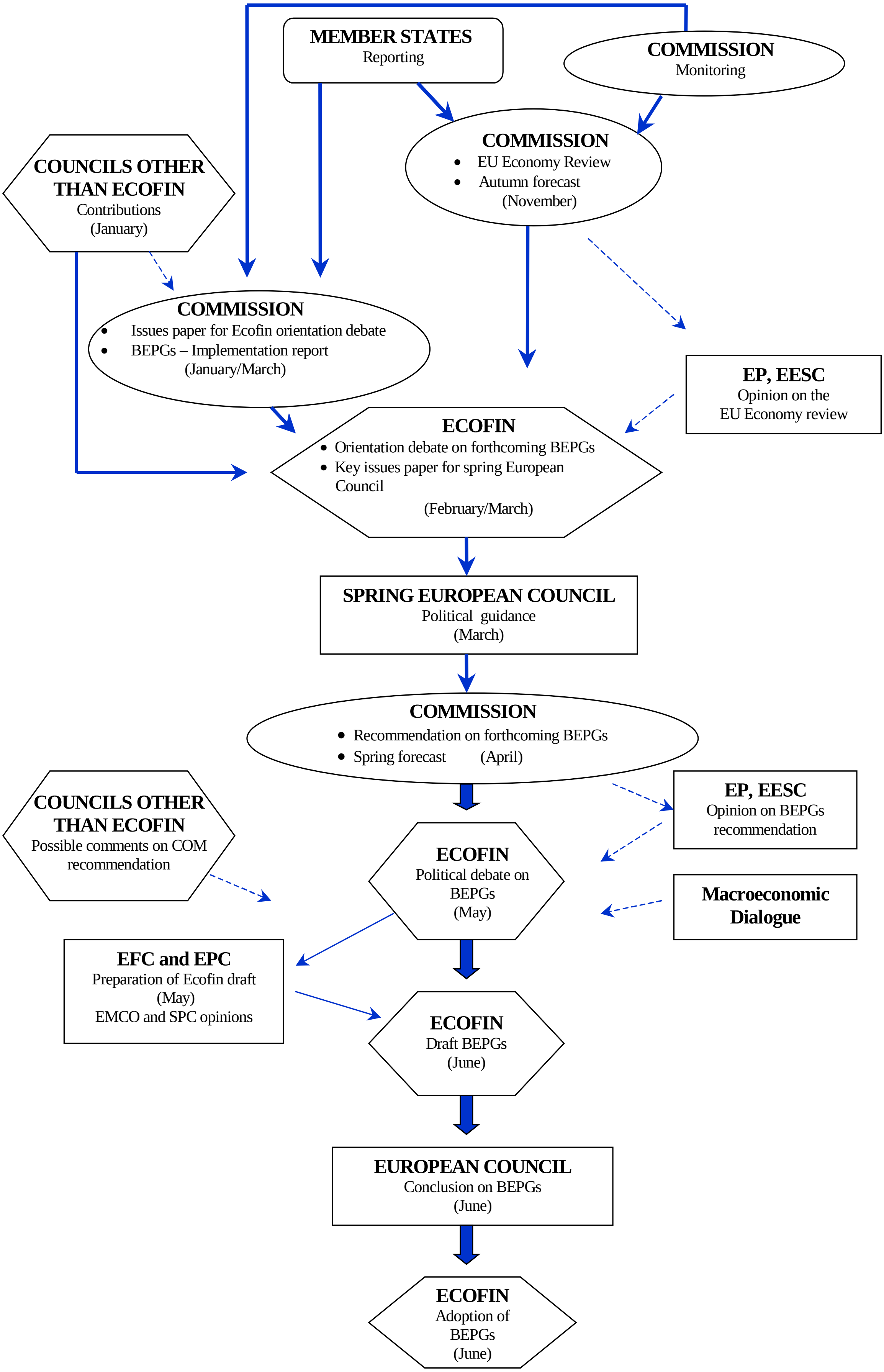
The Commission recommendation is the starting point for the further work of the ECOFIN Council. It is also regularly used by other Community institutions[7] as a device that allows expressing own policy views, and moreover potentially object of comments from other Council formations. Possible changes to the Commission recommendation are essentially proposed in the Committee work process following a first political ECOFIN Council debate. The EPC scrutinises the structural policy sections while the Employment Committee (EMCO) and the Social Protection Committee (SPC) provide each an opinion on those parts which are of particular interest to them. The EFC deals with the macroeconomic policies and virtually finalises the overall text before submitting it to the June ECOFIN Council for adoption as Council draft. The original input from the Commission is generally retained in the Council draft while some of the stronger messages may have been diluted during the process.

Even though the Treaty foresees Council adoption on the basis of a qualified majority, the draft is generally adopted on a consensual basis without formal voting. Thereafter, the June European Council discusses the draft and adopts a conclusion on the basis of which the Council formally adopts the final BEPGs. These conclusions have not triggered any changes to Council drafts so far. Since 2000, the ECOFIN Council, in response to its 1999 Helsinki report, has taken the last formal step speedily, in the margins of the European Council meeting, to facilitate swift implementation of the BEPGs.

[6] See also sections 3.3 and 5.3, on budgetary surveillance and the Cardiff process.

[7] The European Parliament (EP) and the European Economic and Social Committee (EESC) have taken a stance on a regular basis; the Committee of the Regions has adopted opinions occasionally.

THE BROAD ECONOMIC POLICY GUIDELINES



3. The Stability and Growth Pact

3.1 Rationale and underlying legal basis

The Treaty requests Member States to comply with the principle of sound public finances and to avoid excessive deficits. In operational terms this essentially means that Member States are called upon to keep budget deficits below 3 % of GDP.

Treaty, Part One: Principles, Article 4(3)

… activities of the Member States and the Community shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

Part Three: Community policies
Title VII: Economic and monetary policies, Chapter 1: Economic policy, Article 98

… The Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4.

Part Three, Title VII, Chapter 1: Economic policy, Article 104

1. Member States shall avoid excessive deficits.
2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of … two criteria:

   (a) whether the ratio of the … government deficit to GDP exceeds a reference value, unless … the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

   (b) whether the ratio of government debt to GDP exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

…

Protocol on the excessive deficit procedure, annexed to the Treaty

1. The reference values referred to in Article 104(2) … are:
   - 3 % for the ratio of the … government deficit to GDP …;
   - 60 % for the ratio of government debt to GDP… .
2. [Definition of government, deficit, investment and debt]
3. … governments of the Member States shall be responsible under this procedure for the deficits of general government… The Member States shall report their … deficits and … debt promptly and regularly to the Commission.

…

A certain degree of arbitrariness attaches to the Protocol figures for the Treaty reference values, not different from any other numerical threshold. The Maastricht figure for the debt ratio was slightly above the EU average when the Treaty was negotiated while the deficit reference value was below, though it had been met in the late 1980s. But irrespective of the precise numerical thresholds, clear economic arguments underpin the Treaty stipulations for sound public finances. Fiscal profligacy can easily lead to conflicts with monetary policy, undermine the capacity to stabilise economic activity through the budgets and rapidly result in spiralling debt, all of which is detrimental to sustainable economic growth.

3.2 The Stability and Growth Pact (SGP): background and evolution

The Maastricht Treaty represents a clear commitment to sound public finances, both in response to the preceding secular upward drift in government spending, deficits and debt, and in view of EMU, in which sound budgets are necessary to support price stability and strengthen the conditions for sustained growth and employment, in the euro area at large and the constituent countries.

Yet also after ratification of the new Treaty, the discussion of public finance issues continued. Two opposing concerns were voiced. On the one hand, the Treaty (Article 104) was perceived as not clear and biting enough to effectively counter gross errors. On the other, Member States were concerned about unduly constraining fiscal stabilisation through additional rules and moreover did not want to tighten the criteria for accession to Stage 3. Political agreement on how to combine a rules-based quasi automatic procedure to prevent excessive deficits and maintaining leeway for fiscal stabilisation in severe economic downturns was reached at the Dublin European Council in late 1996. This paved the way for the formal adoption of the SGP in 1997.

The pact consists of three parts, a European Council resolution and two regulations, with focus on the prevention and dissuasion of excessive deficits, respectively:

- *Resolution on the SGP*. -- It recalls the economic rationale for sound public finances and highlights the objective agreed to this end: sound budgetary positions of close to balance or in surplus. These allow to deal with normal cyclical fluctuations while keeping the balance within the deficit reference value of 3 % of GDP. In view of this, the resolution provides strong political guidance to implement the pact in a strict and timely manner to all parties concerned, i.e. the Member States, the Commission and the Council.
- *Regulation on surveillance and co-ordination*. -- It introduces stability programmes as instrument of multilateral surveillance. Goals are (i) to reach and sustain a medium-term objective for the budgetary position of close to balance or in surplus that provides for a safety margin to ensure the avoidance of an excessive deficit, (ii) to prevent at an early stage the emergence of an excessive deficit through adequate monitoring, notably by giving early warning, and (iii) to promote surveillance and co-ordination at large. To these ends the regulation defines the contents of stability programmes and sets out rules for their submission, examination and monitoring.
- *Regulation on the excessive deficit procedure (EDP)*. -- Its purpose is to speed up and clarify the EDP set out in Article 104, in order to deter excessive deficits and, if they occur, to further their prompt correction, by means of an integrated set of rules for the application of Article 104. This includes the definition of concepts, the setting of deadlines for implementing steps in the procedure and the specification of sanctions together with guidance on their application.

Resolution of the Amsterdam European Council on the SGP

I. … Adherence to the objective of sound budgetary positions close to balance or in surplus will allow all Member States to deal with normal cyclical fluctuations while keeping the government deficit within the reference value of 3 % of GDP.

IV. The European Council solemnly invites … the Member States, the Council … and the Commission … to implement the Treaty and the SGP in a strict and timely manner.

Member States

1. commit themselves to respect the medium-term budgetary objective of positions close to balance or in surplus set out in their stability .. programmes and to take the corrective action they deem necessary to meet the objectives …

7. commit themselves not to invoke the benefit of Article 2(3) of [regulation 1467/97 on the EDP, unless there is a severe economic downturn with] an annual fall in real GDP of at least 0.75 %.

The Commission

1. will exercise its right of initiative … in a manner that facilitates the strict, timely and effective functioning of the SGP; …

The Council

1. is committed to a rigorous and timely implementation of all elements of the SGP in its competence; …

Regulation 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies

1. This Regulation sets out the rules covering the content, the submission, the examination and the monitoring of stability programmes … as part of multilateral surveillance by the Council so as to prevent, at an early stage, the occurrence of excessive … deficits and to promote the surveillance and co-ordination of economic policies.

3. … A stability programme shall present … the medium-term objective for the budgetary position of close to balance or in surplus …

5. Based on assessments by the Commission and [the EFC], the Council shall, within the framework of multilateral surveillance under Article 99, examine whether the medium-term objective … provides for a safety margin to ensure the avoidance of an excessive deficit … and whether the economic policies of the Member State concerned are consistent with the BEPGs. …

6. As part of multilateral surveillance in accordance with Article 99(3), the Council shall monitor the implementation of stability programmes … In the event that the Council identifies significant divergence of the budgetary position from the medium-term budgetary objective, or the adjustment path towards it, it shall, with a view to giving early warning in order to prevent the occurrence of an excessive deficit, address, in accordance with Article 99(4), a recommendation to the Member State .. to take the necessary adjustment measures.

Regulation 14676/97 on speeding up and clarifying the implementation of the EDP

1. This Regulation sets out the provisions to speed up and clarify the EDP, having as its objective to deter excessive … deficits and, if they occur, to further their prompt correction. …

2. (1) The excess of a .. deficit over the reference value shall be considered exceptional and temporary … when resulting from an unusual event outside the control of the Member State concerned and which has a major impact … or when resulting from a severe economic downturn. ...

   (2) The Commission, when preparing a report under Article 104(3) shall … consider an excess over the reference value resulting from a severe economic downturn to be exceptional only if there is a fall of real GDP of at least 2 %.

   (3) The Council when deciding, according to Article 104(6), whether an excessive deficit exists, shall in its overall assessment take into account any observation made by the Member State showing that an annual fall of real GDP of less than 2 % is nevertheless exceptional in the light of further supporting evidence, in particular on the abruptness of the downturn or on the accumulated loss of output relative to past trends.

6. Where the conditions … [Article 104(11)] are met, the Council shall impose sanctions …
7. If a .. Member State fails to act in compliance with the successive decisions of the Council … the decision of the Council to impose sanctions, in accordance with .. [104(11)] shall be taken within 10 months …
11. Whenever the Council decides to apply sanctions …a non-interest bearing deposit shall, as a rule, be required. …
12. … the amount of the first deposit shall comprise a fixed component equal to 0.2 % of GDP, and a variable component … Any single deposit shall not exceed … 0.5 % of GDP.
13. A deposit shall, as a rule, be converted … into a fine if two years after the decision to require … a deposit, the excessive deficit has … not been corrected.
14. … the Council shall abrogate the sanctions … depending on … the progress made in correcting the excessive deficit.

In line with the Dublin political agreement on how to proceed in the case of severe economic downturns, an annual fall in GDP of up to ¾ % is no reason for considering a deficit above 3 % of GDP as exceptional and thereby stopping the EDP (see box on SGP: Resolution, Member State commitment, item 7). In the range ¾-2 %, the Council has discretionary room for an overall assessment while a severe downturn of at least 2 % is as a rule considered exceptional (SGP box: EDP regulation, Article 2(2) and (3)) and a possibly ensuing deficit of more than 3 % of GDP is not excessive. Under such conditions, the working of automatic stabilisers will not trigger sanctions.

Surveillance of budgetary positions

In Stage 2, convergence programmes proved a valuable instrument in preparing national economies for EMU. The SGP builds on this and introduced annual stability programmes for the euro-area countries.[8] Their core element is the medium-term budgetary objective of close to balance or in surplus. Member States are requested to set, reach and sustain such an objective that will allow to deal with normal cyclical fluctuations -- contrary to severe economic downturns -- while keeping the deficit within the reference value.

The logic of the pact suggests to consider as medium term the length of the business cycle. The reasoning clearly points to the fact that what is essentially sought at any point in time are sound *underlying* positions in cyclically-adjusted terms; only these provide the necessary room irrespective of the current cyclical position. An actual budget balance close to balance in a given year could simply reflect a favourable cyclical situation and be an insufficient safeguard against passing the 3 % threshold when a large negative output gap emerges.

The importance of sound underlying positions was stressed in an 1998 opinion of the Monetary Committee on the content and format of stability programmes. An update of this code of conduct of July 2001, again endorsed by the ECOFIN Council, confirms this: "objectives have to take explicit account of the cyclical position". Cyclically-adjusted balances should continue to be used, in addition to nominal balances, as a tool when assessing the budgetary position.

[8] Non-participating countries submit convergence programmes. In contrast to stability programmes, they deal also with monetary policy and aim at achieving sustained convergence.

In the 2001 code of conduct, the EFC takes the Commission services' cyclical adjustment method[9] as a useful approach for assessments. The services have calculated "minimal benchmarks", based on the responsiveness of budgets to cyclical variations and historic GDP volatility, that indicate the safety margin necessary to avoid excessive deficits in coping with cyclical fluctuations. Most Member States had surpassed these benchmarks by 2000 while in some cases a temporary sliding back occurred in 2001 in response to discretionary tax measures. The EFC acknowledges the benchmarks as a working instrument, but not as target per se. For the medium-term objective several other elements need to be taken into account.

Over and above the possibility to deal with adverse cyclical developments and economic shocks,[10] these other elements include, according to the 2001 update of the code of conduct for stability programmes: the need to take account of other sources of variability and uncertainty in budgets, the need to ensure a rapid decline in high debt ratios, to cater for the costs associated with population ageing and, moreover, the room a Member State may consider desirable for the possible use of discretionary policy. The present code reflects also the increasing drive towards improving the quality of public finances. Important budgetary consequences of measures to this end should also be considered. A Commission services' estimate considers a margin of ½-1 % of GDP as appropriate for pure fiscal shocks such as unexpected shortfalls in tax revenue, spending overruns and interest rate surprises. [11]

Altogether, it appears that underlying budget balances of close to balance or in surplus[12] are warranted and meet the SGP requirements. In line with this, the 2001 BEPGs call on Member States to ensure that cyclically-adjusted budgetary positions move towards, or remain in, balance or surplus in the coming years.[13] Furthermore, the EFC insists in its opinion that in the annual programme updates objectives for future years must not become a moving target, i.e. are not simply being rolled forward in case of temporary slippage.

Experience with the stability programmes has resulted in proposals as to their contents, coverage and timing. The July 2001 code of conduct builds on the ECOFIN Council report to the Helsinki European Council on experience with policy co-ordination in Stage 3. The new code encompasses a set of standardised tables. These foster the use of common macroeconomic assumptions underlying the projections in the programmes and the provision of a comprehensive, coherent and comparable set of data. Moreover, Member States are invited to follow a model structure for their updates. As to the coverage of the programmes, it is now being extended to issues of medium to longer-term sustainability, in particular problems related to population ageing. Finally, the code suggests to cluster the submission of the annual updates in autumn, within a period of 1½ months.

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9 Different methods have been investigated. Based on this work, eventually a switch from the present so-called Hodrick-Prescott filter method to a so-called production function approach is envisaged. For a comprehensive presentation of the issue see DG ECFIN, Public Finances in EMU – 2002, chapter 3.

10 The EFC labels this "unforeseen risks" (cf. July 2001 code of conduct, section on objectives).

11 DG ECFIN, Public Finances in EMU – 2000, p. 42.

12 A surplus would seem adequate for countries with a comparatively high cyclical sensitivity of the budget or a high cyclical volatility of GDP. See DG ECFIN, Public Finances in EMU – 2001, p. 31.

13 Council recommendation on the 2001 BEPGs, p. 13.

These new elements enhance the comparability of the programmes. Up-to-date budgetary information derived from macroeconomic projections established within a short period of time and based on a common set of external assumptions is more coherent and better comparable than that from programmes scattered over half a year. Comparability facilitates the assessment process, including the aspect of equal treatment, and monitoring. Moreover, it renders more reliable the euro-area view that is obtained from aggregating national programmes and which is key information for macroeconomic policy making. The letter and spirit of the SGP, as recalled at the informal ECOFIN of spring 1999 in Dresden, make sure that the importance attached to the aggregate view in no way implies neglect of discipline at the country level.

The EDP

In all Member States except Ireland and Luxembourg an excessive deficit existed in Stage 2. The EDP has been applied since the ratification of the Maastricht Treaty. The necessary operational details, building on Article 104 and the Treaty Protocol on the EDP, have been provided in a separate text, regulation 3605/93. It specifies the necessary terms -- government, deficit, debt, … -- in more detail and furthermore sets out the rules and coverage governing the requested Member State reporting. However, the EDP was applied in a trimmed down version during Stage 2. Since there was not yet a legal obligation to avoid excessive deficits there were also no sanctions[14] and the EDP regulation 1467/97 entered into force only in 1999 with the transition to Stage 3. All decisions on the existence of an excessive deficit had been lifted prior to that, with one exception. The abrogation for Greece occurred in December 1999, paving the way for the adoption of the euro[15] in the Hellenic Republic in 2001.

No experience had to be made with speeding up the implementation of the EDP in Stage 3 so far. Reporting and monitoring under the EDP continue along the established lines. The only change hitherto was the switch to the new version of the European System of Accounts (ESA 95). The changeover to ESA 95 for the purpose of the EDP had been delayed intentionally to reduce uncertainty about the reliability of budgetary data in an early stage of applying the new national accounts system. But since the beginning of 2000, the ESA 95 framework is in use.[16]

3.3 The procedures

Two distinct procedures serve to implement the SGP. Stability programmes are submitted annually to foster sound budgets and regular surveillance whereas the core of the EDP is activated only when the need arises.

Surveillance of budgetary positions

Member States submit annually updates of their programmes. A country that introduces the euro switches from convergence to stability programmes and presents a new programme within 6 months from the Council decision on participation. The July 2001 code of conduct foresees to base the programmes on common extra-EU

[14] Member States *endeavoured* to avoid excessive deficits. Article 104(1), .."*shall* avoid" such deficits, became effective only in Stage 3. The same holds for the sanctions under 104(11). But it was already possible and required to address recommendations (104(7)-(8)) to the Member State concerned to bring the excessive deficit to an end. See the transitional provisions in Article 116(3)-(4).

[15] There are no sanctions for non participating Member States. Article 122(3) stipulates that Article 104(11) does not apply. In turn, the corresponding parts of the EDP regulation apply only to participating Member States.

[16] The necessary changes to regulation 3605/93 were made in regulation 475/2000.

Documents related to the development of the stability programmes

Code of conduct (July 2001)	The ECOFIN Council endorses an ***opinion of the EFC*** and the appended code of conduct on the content and format of stability .. programmes. The update: • Adds to the elements to be taken into account in setting the medium-term budgetary position which respects the close to balance or in surplus rule (compared to the 1998 list): ➢ Other unforeseen risks [affecting the economic growth path]; ➢ Important budgetary consequences of measures aimed at improving the quality of public finances. • Suggests a set of standardised tables and a model structure for the programmes, also to facilitate equality of treatment. • Furthers the use of common external assumptions. • Extends the list of measures to be described in the programmes (strategy and measures to cope with the effects of ageing). • Suggests to include summary data for a longer time period (analysis of sustainability issues). • Suggests a more condensed calendar for the annual procedure to improve comparability of programmes, consistency of assessments and equality of treatment.
ECOFIN report on policy co-ordination (November 1999)	In its report to the Helsinki European Council on economic policy co-ordination in Stage 3 of EMU, the ***ECOFIN Council*** makes ***proposals*** to strengthen budgetary surveillance within the SGP through: • Stricter compliance with the code of conduct on the format and contents of stability programmes. • More emphasis on longer-term sustainability issues. • A commitment of Member States for submission of up-to-date programme updates.
Code of good practice (October 1998)	The ECOFIN Council takes note and endorses a ***Monetary Committee opinion*** on the content and format of stability .. programmes and appended guidelines (code). The documents note that: • The time frame for interpreting the medium term would be the length of the business cycle. • The medium-term budgetary position has to take account of the possibility to deal with adverse cyclical developments whilst respecting the deficit reference value. Other considerations of major importance in setting the objective are: ➢ Take account of other sources of variability and uncertainty in budgets; ➢ Ensure a rapid decline in high debt ratios; ➢ Cater for the costs associated with population ageing; ➢ Create the necessary room where there is a wish to use discretionary policy. • Data and information provided must be suitable for multilateral surveillance and allow for comparison across Member States. • Assumptions to be provided (regulation 1466/97) should be underpinned by indications that facilitate the programme's analysis. • Measures to be described (regulation 1466/97) should be consistent with the BEPGs; an indicative list of measures is given. • Data may be provided for more than the required minimum 5 years.

economic assumptions. The programmes are submitted in autumn, shortly after governments present their budget proposals to the national parliament. The Commission assesses all programmes. While the regulation on budgetary surveillance allows the Council to delegate the examination of annual updates to the EFC, it was decided right with the first round of updates (1999/2000) that for the time being the Council would not use this possibility. This acknowledges the importance of the procedure and concern for equality in treatment. It also entails that the Council always delivers an opinion, on the basis of a Commission recommendation and a discussion in the EFC. The Council opinion notes in particular whether the budgetary objective provides a safety margin to avoid an excessive deficit, whether the proposed policy measures are sufficient to meet the objective and are in line with the BEPGs. The opinion may invite the Member State concerned to adjust the next update where considered necessary. Moreover, acting on a recommendation from the Commission, the Council may also decide to apply Article 99(4) and make a recommendation, e.g. if policies set out in the programme are assessed as inconsistent with the BEPGs.

The regulation on the stability programmes calls also for monitoring the implementation of the programmes, within the framework of multilateral surveillance. The Commission monitors developments and regularly prepares assessments. The practice has emerged to provide an assessment in winter, after a round of updates has been completed, and in summer in view of incoming data on budget execution and news on plans for the next year, for discussion in the EFC, the Eurogroup or the Council.

A critical juncture in the process of budgetary surveillance was reached in early 2002. Germany and Portugal had missed the deficit targets for 2001 set down in their stability programme updates of late 2000 by a wide margin of over 1 % of GDP, and there was a clear risk of 2002 deficits approaching the 3 % of GDP reference value for the budget deficit. In the face of this, the Commission recommended in January 2002 that an early warning[17] be sent to both countries. The Commission acted to preserve the credibility of the legal and political obligations of the SGP. As a result of discussions in the ECOFIN Council on the Commission's draft recommendation for an early warning, Germany and Portugal gave firm political commitments which responded to the Commission's concerns.[18] The Council therefore decided to close the procedure and restated at the same time the importance of the early-warning system in the overall framework of budgetary surveillance.

The EDP

The EDP as provided for in Article 104 and with detail added in the relevant regulations may be usefully divided in several parts. The chart visualises the sequence of events and the envisaged timing; reference is made to the pertinent paragraphs of Article 104[19] on which the EDP-regulation 1467/97 builds.

[17] See section 3.2, box on the SGP, regulation 1466/97, point 6.

[18] Both countries stated their willingness to implement their new stability programme updates in full so as to avoid a breach of the 3% of GDP reference value, to resume the process of budgetary consolidation and to reach their medium-term targets in 2004.

[19] The EFC shows in the chart where Article 104 mentions the Committee explicitly. Obviously it is also involved in other steps of the procedure in its quality as the Committee that contributes to the preparation of the work of the Council in the EDP (cf. Article 114(2)).

The entire procedure builds on Member States' reporting and Commission monitoring. Twice a year national reports on recent and prospective public finance data are transmitted to the Commission. These reports are short, less forward looking and of a more technical nature than the stability programmes. If and when, on the basis of these reports or its own assessment, the Commission sees a risk of an excessive deficit or concludes that the requirements with respect to the deficit or debt criterion are not fulfilled, it will trigger the EDP proper by drafting a report.

Member States respond to the Commission report by means of an EFC opinion. If the Commission maintains its view it will address to the Council an opinion and a recommendation for a decision as to the existence of an excessive deficit. The Council will then take the pivotal decision on the basis of an overall assessment. This assessment may yield a conclusion different from the Commission's opinion. In particular, the Council has some discretionary room in deciding whether a deficit owing to a severe economic downturn is exceptional and hence not excessive.[20]

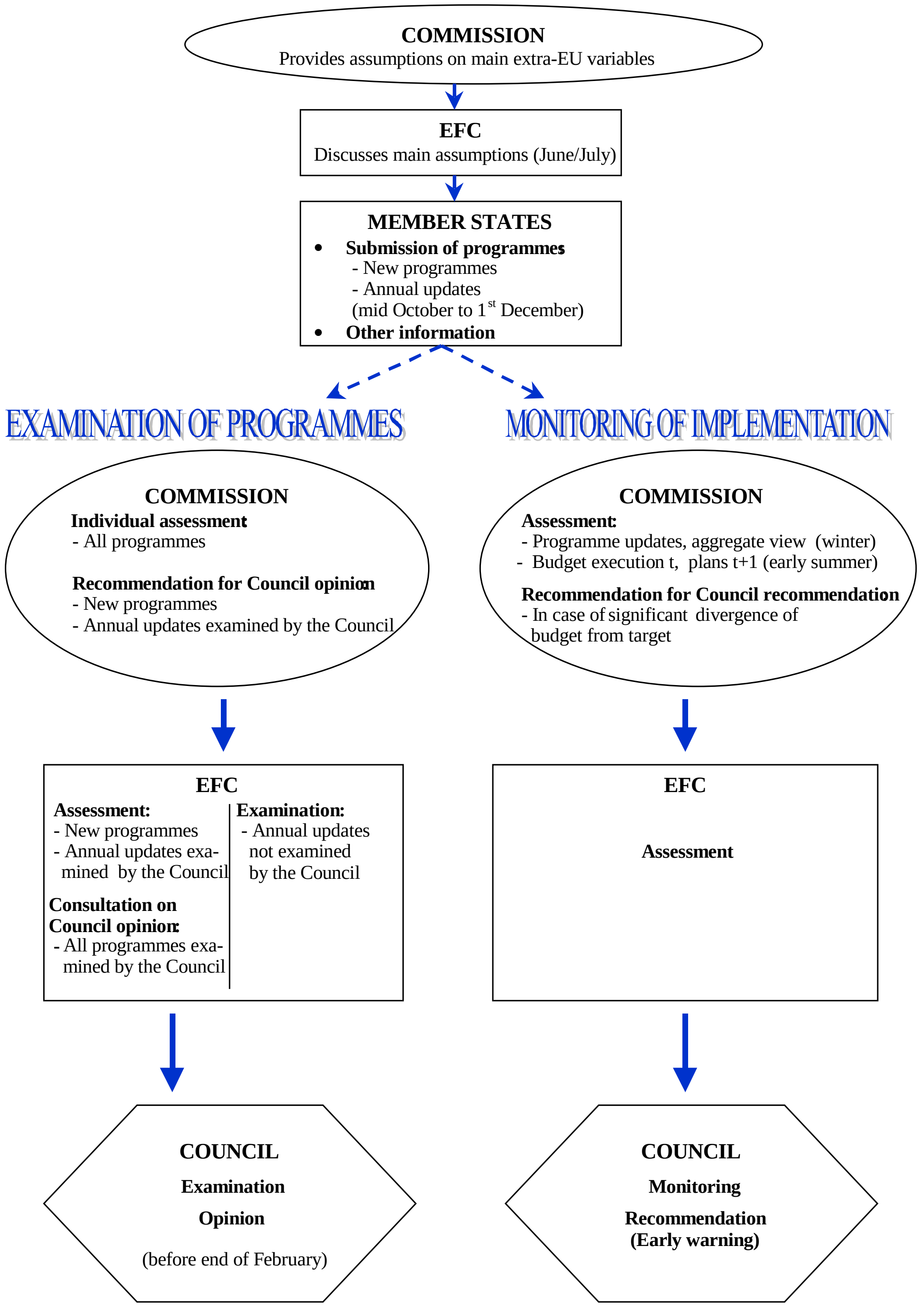
If it is decided that an excessive deficit exists, the procedure follows a recurrent pattern. Community incentives to correct the situation are given and the Member States' response is assessed. If the assessment is negative, the incentives are strengthened and ultimately sanctions are imposed. The EDP-regulation is more specific on these than the Treaty. It sets a deadline for decisions on sanctions[21] and requires, as a rule, a non-interest-bearing deposit, which is to be converted into a fine if two years later the excessive deficit still persists.

When there is progress in correcting the excessive deficit, sanctions can be abrogated. However, the request for a deposit will be lifted only once the Council concluded that the excessive deficit had been corrected. Fines will not be reimbursed. The decision on the existence of an excessive deficit requires a qualitative majority in the Council (some 71 % of the votes), for all later decisions on incentives, sanctions and to abrogate two thirds of the Council votes are necessary, excluding the votes of the Member State concerned.

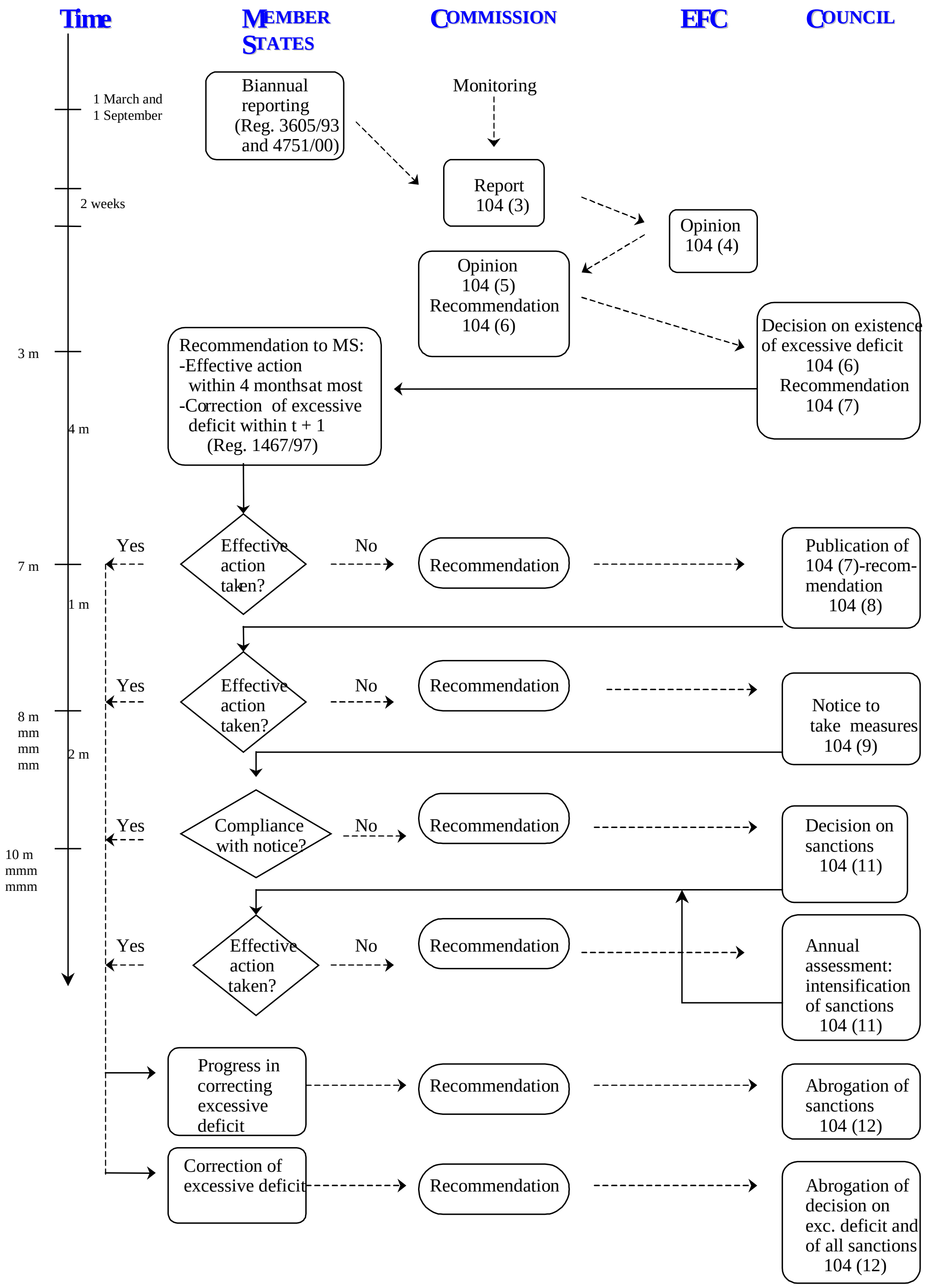
[20] Cf. article 2 of regulation 1467/97 and section 3.2 above. The Commission has to apply tighter rules for qualifying an excess over the reference value as exceptional than the Council.

[21] Deadlines, to speed up the EDP, are set for several procedural steps, as indicated in the chart.

STABILITY AND CONVERGENCE PROGRAMMES



EXCESSIVE DEFICIT PROCEDURE



4. The Employment Guidelines (EGs)

4.1 Rationale and legal basis

The Treaty requests Member States to co-ordinate their economic policies at large (see section 2.1) and moreover calls specifically for a co-ordinated strategy for employment (Article 125). In particular, promoting an apt workforce and flexible labour markets is recognised as crucial input for achieving the economic objectives defined in the Treaty. Promoting employment is considered as a matter of common concern and Member States, while retaining the responsibility for their policies, are called upon to co-ordinate their action in this field. Policies shall be consistent with the strategy set out in the BEPGs.

Treaty, Part One: Principles, Article 2

The Community shall have as its task … to promote ... a high level of employment …, sustainable and non-inflationary growth …

Part Three: Community policies
Title VIII: Employment, Article 125

Member States and the Community shall, in accordance with this Title, work towards developing a co-ordinated strategy for employment and particularly for promoting a skilled, trained and adaptable workforce and labour markets responsive to economic change with a view to achieving the objectives defined in … Article 2 … .

Article 126

1. Member States, through their employment policies, shall contribute to the achievement of the objectives referred to in Article 125 in a way consistent with the [BEPGs] adopted pursuant to Article (99)2.
2. Member States, having regard to national practices related to the responsibilities of management and labour, shall regard promoting employment as a matter of common concern and shall co-ordinate their action in this respect within the Council, in accordance with the provisions of Article 128.

The EGs, anchored in Article 128, are the central EU policy document that deals on a regular basis specifically with labour market issues. Their role is twofold. Firstly, they set out orientations for the policy actors in the Member States, following a procedure outlined in Article 128(2). And secondly, they provide the yardstick for the assessment of policies in the context of continuous monitoring by the Commission and the Council (Article 128(3)-(5)), an application of the principle of multilateral surveillance. Moreover, a formal incentive for swift compliance with the EGs is provided in Article 128(4) which allows to address recommendations to Member States if considered appropriate. These recommendations are a strong form of peer pressure, but they entail no (pecuniary) sanctions.

Treaty, Article 128

1. The European Council shall each year consider the employment situation in the Community and adopt conclusions thereon, on the basis of a joint annual report by the Council and the Commission.
3. On the basis of the conclusions of the European Council, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European

Parliament, the Economic and Social Committee, the Committee of the Regions and the Employment Committee …, shall each year draw up guidelines which the Member States shall take into account in their employment policies. These guidelines shall be consistent with the [BEPGs].

3. Each Member State shall provide the Council and the Commission with an annual report on the principal measures taken to implement its employment policy in the light of the guidelines for employment … .

4. The Council, on the basis of the reports referred to in paragraph 3, and having received the views of the Employment Committee, shall each year carry out an examination of the employment policies of the Member states in the light of the guidelines for employment. The Council, acting by a qualified majority on a recommendation from the Commission, may, if it considers it appropriate in the light of the examination, make recommendations to Member States.

5. On the basis of the results of that examination, the Council and the Commission shall make a joint annual report to the European Council on the employment situation in the Community and on the implementation of the guidelines for employment.

4.2 The EGs: background and evolution

Employment has been a matter of concern in the EU at least since the first oil price shock in the mid 1970s. Following the ratification of the Maastricht Treaty, an increasingly refined strategy to achieve sustained non-inflationary economic growth and job creation has been laid out in the BEPGs. Sound macroeconomic policies augmented by comprehensive structural reforms are essential for an endogenous growth process which fuels employment. The White Paper on Growth, Competitiveness and Employment (1993) analysed problems with employment in the EU and highlighted *inter alia* labour market rigidities, the need to develop human resources and called for a co-ordinated European strategy. Further backing in this respect came from the Essen European Council (1994) and with the northern enlargement in 1995. Finally, the Amsterdam Treaty, in its new title on employment, called for co-ordinated action specifically as regards the labour market and introduced the EGs. The Amsterdam resolution on growth and employment noted that economic and social policies are mutually reinforcing, urged to enhance further the BEPGs and suggested to immediately put to work the EGs procedure, i.e. ahead of the ratification of the new Treaty. In turn, the special European Council meeting on employment in Luxembourg started the “Luxembourg process” in practice in November 1997: it decided to apply the new Article 128 and adopted, on the basis of Commission input, conclusions that, in form of a Council resolution, became the first EGs.

The EGs put emphasis on active measures and prevention to improve employment and counter unemployment. They reflect a common strategic approach and are addressed to all Member States, whilst the latter are called upon to implement them in a way geared to their specific situation. The guidelines give policy guidance in four thematic fields called pillars. The first, labelled improving employability, deals with enhancing access to and participation in the labour market by ensuring adequate skills and incentives in tax and benefit systems. The entrepreneurship pillar aims at facilitating job creation by making it easier to start and run businesses, and by making the taxation system more employment friendly. The third pillar addresses the issue of raising adaptability of businesses and their employees to continuous structural change.

Finally, guidelines under the fourth pillar seek to enable women and men to participate in the labour market with equal opportunity and responsibility.

A first review of the Luxembourg process was carried out in 2000 by the Employment Committee (EMCO), which prepares the Council work in the EGs procedure.[22] The review identified some strengths and weaknesses and moreover examined the implications of the Lisbon European Council on the EGs. Subsequently, in the 2001 EGs, an introductory section was added to the four pillars. It emphasises overarching, horizontal objectives and means. These comprise the goal of moving towards full employment, the need of lifelong learning in an increasingly knowledge-based economy and comprehensive partnership with social partners in implementing the EGs. An impact evaluation of the Luxembourg process is foreseen for 2002.

The effectiveness of the process hinges on swift implementation of the EGs. Reporting and monitoring routines have been established. Surveillance and policy assessments are facilitated when, where possible and appropriate, quantified targets are used and pertinent statistics or indicators become operational. Efforts to this end have been made from the very beginning. They were encouraged by the emphasis which the Lisbon European Council put on structural indicators. Furthermore, the EGs procedure foresees that recommendations can be addressed to Member States. Based on its monitoring and assessment, the Commission has considered appropriate to recommend to the Council to use this device. Recommendations have been addressed to all Member States since 2000, emphasising where policy action was particularly warranted. A difference between recommendations made so far under Articles 99(4) and 128(4), which also reflects the Treaty formulation, is that in the former case the recommendation called on one country to remove a well specified policy inconsistency with the BEPGs. In the latter, a reminder was addressed to each Member State to proceed with action in a number of fields of particular relevance for the country concerned -- similar to the recommendations in the country specific part of the BEPGs.

4.3 The annual procedure

The EGs procedure is based on the Treaty. Implementation in practice has evolved with the experience gained since the first application in 1997/98, e.g. as regards reporting by the Member States, and in view of political guidance from the European Council. For instance, the Education Council was invited to contribute to the Luxembourg process.

Since the ratification of the Amsterdam Treaty, i.e. as of the EGs for 2000, the procedure must follow the formal rules set out in Article 128. It calls on the Commission to make a proposal. This implies a comparatively strong position of the Commission. The Council can amend a proposal only unanimously whereas changes are easier to make when it acts on a Commission recommendation.[23] However, in practice the Commission has sought to reach broad consensus through an intense exchange of views with Member States prior to adopting its EGs proposal. This implies that even though the Commission has a stronger legal position, the outcome in

[22] EMCO is based on Article 130. Its functions in the Luxembourg process are comparable to those of the EFC and the EPC in the BEPGs procedure.

[23] The Council needs a qualified majority to adopt the final BEPGs (Article 99(2)), i.e. including any amendment to the Commission recommendation it deems appropriate.

Documents related to the development of the EG

Employment Committee's review of the Luxembourg process (May 2000)	EMCO reviews the Luxembourg process, in line with a mandate from the Lisbon European Council. The Committee: • Identifies with respect to the process ➢ strengths (increased public awareness, incentives through common quantitative targets, …), ➢ and risk factors (uneven implementation of the four pillars, problems in dovetailing the financial implications of the EGs with the budgetary process, …). • Explores how best to translate the messages of the Lisbon European Council into the EGs. The suggestion to add an introductory heading to the annual guidelines is implemented with the 2001 EGs. The new introductory section: ➢ Emphasises the aim of moving towards full employment, recalls the EU targets for 2010 and encourages Member States to set national employment rate targets. ➢ Stresses the importance of lifelong learning, as contribution to the realisation of a knowledge-based economy. ➢ Calls on Member States to develop a comprehensive partnership with the social partners in implementing and monitoring the process. ➢ Urges Member States to give due attention to all four pillars in translating the EGs into national policies. ➢ Calls for strengthening the development of common indicators to evaluate progress in implementing the pillars. • Discusses the EGs procedure with a view to its simplification and raising its effectiveness.
Luxembourg European Council (November 1997)	The European Council: • Decides to apply straight away in practice and by consensus the future Article 128 of the Amsterdam Treaty. • Adopts, on the basis of a Commission communication, conclusions on the 1998 EGs which centre on four main lines of action: ➢ Improving employability. ➢ Developing entrepreneurship. ➢ Encouraging adaptability in businesses and their employees to enable the labour market to react to economic changes. ➢ Strengthening equal opportunities policy.
Amsterdam resolution on growth and employment (June 1997)	The European Council: • Notes that economic and social policies are mutually reinforcing. • Suggests that the procedure envisaged in the new Title on Employment should be made immediately effective.

practice has been similar to that in the BEPGs procedure. The input from the Commission is generally retained in the final product while some of the stronger messages may have been diluted during the process.

Moreover, since the Amsterdam Treaty entered into force, the Council is taking a decision on the EGs.[24] However, this does not imply that the guidelines are legally

[24] Before that the EGs were adopted by means of a resolution.

binding.[25] The decision requests that Member Sates take the EGs into account in their employment policies. Member States remain responsible for their policies, subject to their Treaty obligations, according to which employment is a matter of common concern and co-ordinated policies have to be consistent with the BEPGs (Article 126). The principles of economic policy co-ordination in the EU apply. Policies are not imposed but an effort is made to convince Member States to apply the policies deemed desirable. While this may include using formal incentives by addressing recommendations to a Member State, the process at large builds on achieving policy consensus, monitoring and a willingness to adjust to peer pressure.

The pivotal event in the annual procedure is the presentation of the “employment package” by the Commission in September. It comprises the proposal for the EGs for the subsequent year (Article 128(2)) and as underlying document a draft for a joint Commission-Council employment report (JER) which reviews the employment situation in the EU at large and furthermore assesses country by country the measures taken in response to the preceding EGs (Article 128(1),(5)). Moreover, in view of the experience with the implementation of the previous EGs and the assessment in the draft JER, the Commission may present recommendations for Council recommendations addressed to individual Member States (Article 128(4)). The preparatory work is done ahead of the release of the package, while its elements are finalised downstream (see also chart).

The preparatory phase

In response to the EGs, Member States formulate national policies. They report to the Council and the Commission on their past actions and future plans (Article 128(3)). The Commission monitors developments in general and in particular reviews these National Action Plans on employment (NAPs) which are due at the beginning of May. The NAPs are assessed in bilateral contacts with the Member State concerned and discussed in the EMCO. On the basis of this work and taking into account the new BEPGs, the Commission prepares during the summer the employment package with its draft for the mandatory JER and the EGs proposal, topped by -- when deemed appropriate -- drafts for country specific Council recommendations. The latter has been the case since 1999.

The finalising phase

The September package is transmitted to the Council, and for opinion to the EP, the EESC and the Committee of the Regions. On the Council side the Employment and Social Policy Council (ESP) is in charge, but ECOFIN is also involved given that the EGs have to be consistent with the BEPGs. In view of this the practice has emerged that the EMCO and the EPC work closely together on the package, which may result in joint opinions. Other committees are also involved, e.g. the Standing Committee on Employment with representatives of the social partners or the Social Protection Committee. Political guidance to the Committee work is given in an initial policy debate at Council level in early autumn while the Council politically finalises the package later in the autumn.

[25] Contrary to what the term “decision” might suggest in view of Article 249 which stipulates that decisions are binding in their entirety on those to whom they are addressed.

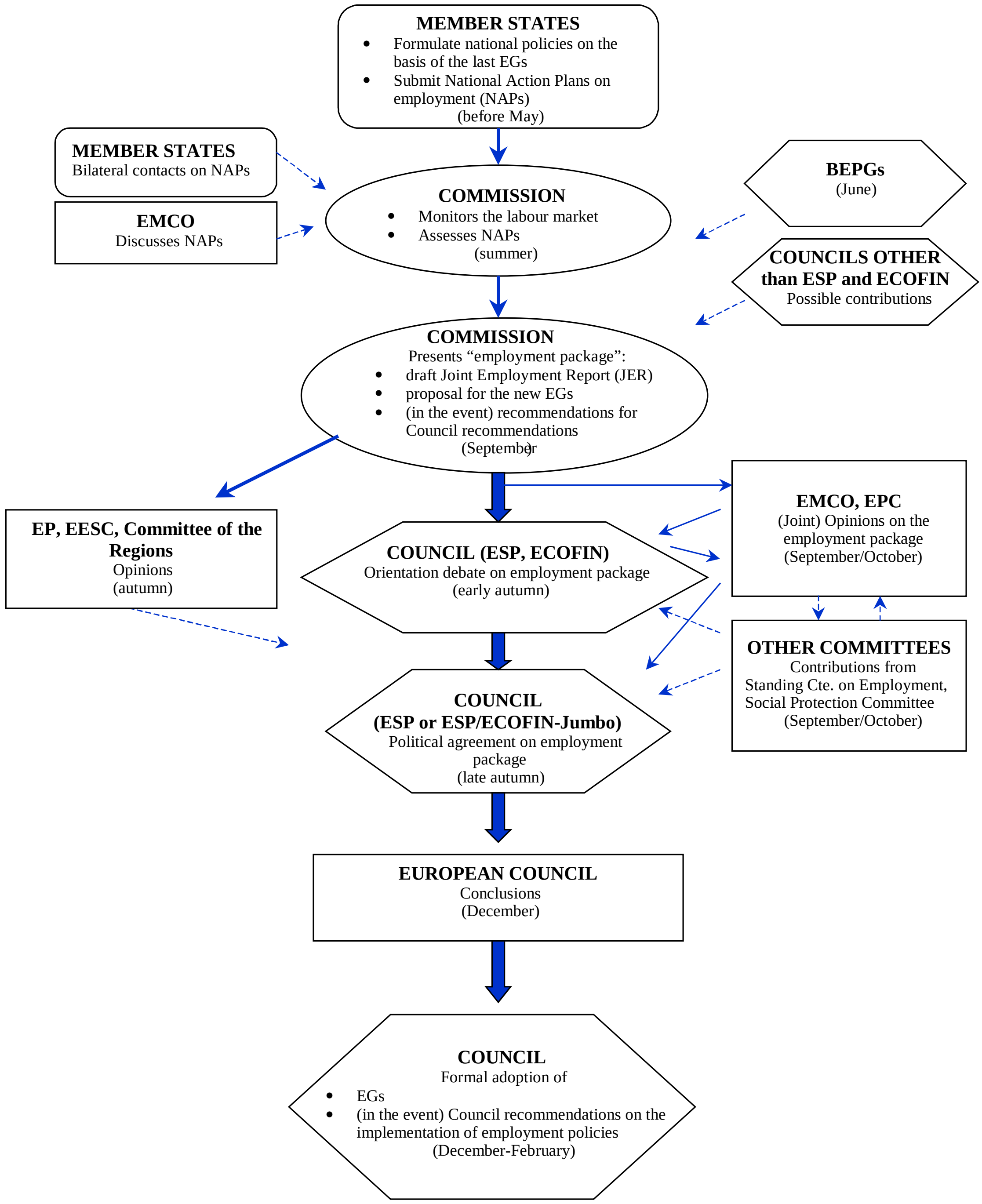
The Commission can present an amended proposal for the EG at any stage in the process,[26] e.g. taking into account opinions from other EU institutions or from the committees. The Council is free to deviate from the Commission proposal if it agrees unanimously on an altered text.[27] No fixed rule determines in which formation the Council reaches political agreement on the package. In earlier years this was achieved in joint ESP-ECOFIN meetings, so-called “jumbos”. Agreement was arrived at solely in the ESP Council under the French presidency in 2000 against the background of a previous understanding in the committees on joint EMCO/EPC opinions on the various aspects of the package.

Following the political agreement in the Council, the package is transmitted to the December European Council, which responds in its conclusions. Subsequent to the European Council endorsement, the Council formally adopts the EGs and, in the event, country specific recommendations.

[26] Cf. Treaty Article 250(2).

[27] In 2000, the Commission presented an amended proposal in response to an opinion of the EP. In a legislative resolution it had requested an altered proposal. The Council did not retain all elements of the second proposal. It could do so in view of unanimity within the Council; see Article 250(1).

THE EMPLOYMENT GUIDELINES



5. The Cardiff process for economic reform

5.1 Rationale and legal basis

Structural policies are part and parcel of economic policies at large. Member States and the Community are called upon to contribute through their closely co-ordinated policies to the common objectives of non-inflationary economic growth and a high level of employment.[28] Moreover, Article 98, expanding on Article 4 in the Treaty's Part One on objectives and means, reminds of the underlying principles which are key to the spirit of the reform process.

> ***Treaty, Part Three: Community policies***
> ***Title VII: Economic and monetary policies, Chapter 1: Economic policy, Article 98***
>
> … Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources…

The Cardiff process cannot be equated with any single periodic policy document. While a specific reporting system on reforms on product and capital markets was set up under the procedure, obviously the reform agenda is broader. It encompasses all markets, as the Council stressed in its Declaration of May 1998 at the eve of EMU that was subsequently endorsed by the Cardiff European Council. Ultimately, the Cardiff process is a tributory to the BEPGs procedure.

> ***Declaration of 1 May 1998 by the ECOFIN Council and the ministers meeting in that Council accompanying the Council's recommendation on the Member States participating in EMU***
>
> 1. On 1 January 1999, the euro will be a reality…
> 2. The move to the single currency enhances further the conditions for strong, sustained and non-inflationary growth conducive to more jobs and rising living standards. …
> 3. We, the ministers, are strongly committed to the actions necessary to realise the full benefits of economic and monetary union and the single market in the interests of all our citizens. …
> 8. We will attach particular importance to increasing the degree to which growth can be translated into additional employment. We will thus put emphasis … on the following structural reforms:
>
>   -- making product, labour and capital markets more efficient, ...
> 9. The Council intends to establish a light procedure, fully respecting the subsidiarity principle, for monitoring progress on economic reform. … the BEPGs will draw on short assessments of progress and plans by Member States and the Commission on product and capital markets, as well as on the employment action plans.
>
> ***Cardiff European Council, June 1998***
>
> 11. Economic policy should focus on promoting growth and employment and on securing macroeconomic stability and an efficient working of labour, product (goods and services) and capital markets. The European Council welcomes the decision by the Council to establish a light procedure under which Member States and the Commission will produce short year-end reports … on product and capital markets. …

[28] See section 2.1.

5.2 The Cardiff process: background and evolution

The economic process is characterised by continuous change in demand patterns and supply conditions. Flexible markets which allow a swift reallocation of resources in response to signals sent by adapting relative prices are necessary to cope with structural change without leaving factors idle or aggravating price pressures. Moreover, with the transition to the single currency flexibility has further gained in importance as a means to tackle surprises like temporary demand shocks that hit specific countries or sectors. Last but not least, flexibility strengthens economic dynamism and helps raising the speed limits to growth, an objective emphasised by the Lisbon European Council.

Following the Cardiff European Council, a specific reporting system was set up. Member States submit annually national reports on reforms in product and capital markets while the Commission presents a report on the functioning of the Community product and capital markets, the so-called Cardiff report. However, given the need for a proper working of all markets, the Commission monitors and analyses the reform process also by drawing on other information, e.g. from the National Action Plans on employment. This analysis serves as input for the BEPGs process. It is moreover used by the EPC in its work on economic reform which yields an annual report on structural reform. In this report the EPC covers the reform process at large and in addition addresses selected topical issues. Past and prospective topics include the long-term sustainability of public finances, the tax-benefit systems, R&D and the transition to the knowledge-based society, as well as environmental policies and reforms of network utilities.

European Council Conclusions:
Political calls for advancing economic reforms

Göteborg (June 2001)	The European Council provides guidance for economic policy. It encourages structural reform and urges to: • Continue to implement with determination the economic policy strategy set out in the BEPGs. • Combat emerging inflationary pressures through supply-side action to remove bottlenecks in labour and product markets. • Vigorously pursue the modernisation of the European economy to achieve the Union’s strategic goal. • Rapidly implement structural reforms to enhance competition in markets for goods, services and capital.
Stockholm (March 2001)	Confirms the Lisbon strategic goal and notes that: • Economic reform, employment and social policies are mutually reinforcing. • Well functioning markets are vital for increasing consumer benefits and creating an entrepreneurial environment. • The success of earlier reforms provides a strong incentive for further progress.
Lisbon (March 2000)	Notes the challenges resulting from globalisation and a new knowledge-driven economy. Calls for EU action to reach a clear ***strategic goal***: • To become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth, with more and better jobs and greater social cohesion. To this end, it is necessary, *inter alia*, to: • Step up the process of economic reform.

The Cardiff process in itself does not set policy guidelines. Instead, it advances economic reform through monitoring, analysis and bringing peer pressure to bear -- by using both information emerging from the ongoing work on carefully selected structural indicators and the policy benchmarks set out in the BEPGs. The Commission work under the process is input for the structural part of the BEPGs Implementation Report[29] which relies for its effectiveness primarily on naming, praising and shaming. Moreover, the EPC, building on the Member States' reports and Commission work, conducts country examinations once a year. Almost a week is devoted to non-public sessions in which each country is being examined by another Member State. Shortcomings in structural policies are pinpointed and examples for best practice are identified.

5.3 The annual procedure

Under the Cardiff process Member States prepare by mid-November national reports on structural reforms. These present an economic assessment of the performance of product and capital markets. They use structural indicators and describe reforms undertaken or envisaged in view of the BEPGs. The Commission, drawing on its own monitoring and the national reports, prepares the Cardiff report with the Community perspective by year-end.

Subsequently, and with a view to advance the economic reform process at large, additional information is used, e.g. as provided in national reports under other procedures. In the further proceedings it is useful to distinguish two -- mutually enhancing -- strands, one led by the Commission, the other by the EPC. Both ultimately feed into the next BEPGs. Moreover, the Internal Market Council may contribute through conclusions on internal market aspects of the economic reform process (see chart).

The Commission strand

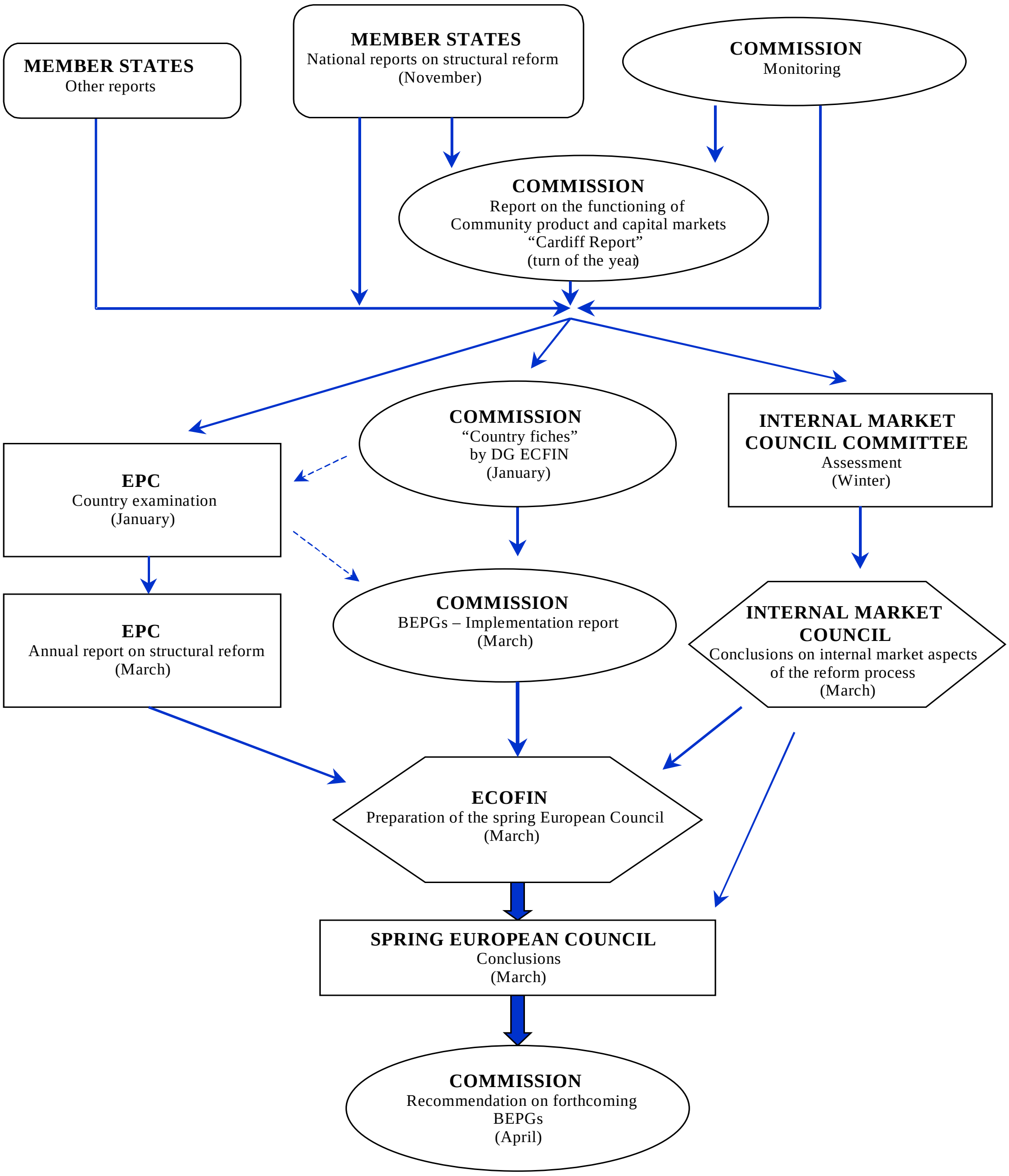
The Commission services underpin the further proceedings by compiling short internal country fiches that assess the structural reform process in product, capital and labour markets with reference to the previous BEPGs. These fiches are essential analytical input for the structural part of the Commission's report on the implementation of the previous BEPGs. The report is transmitted to the Council and the reports' conclusions give orientations for the next BEPGs.

The EPC strand

The EPC holds its country exams in January. The Commission country fiches help assessing the Member State performance in a thorough and comparable way. The findings in the exams are synthesised in an annual EPC report on structural reforms. Moreover, the examination exercise helps the Commission to refine further its own assessment. Thus the EPC screening feeds into the Commission work while the Committee's report is also sent to the Council in the run up to the spring meeting of the European Council.

[29] See sections 2.2/2.3.

THE CARDIFF PROCESS



6. Macroeconomic Dialogue under the Cologne process

6.1 Rationale and legal basis

With a view to enhancing the economic performance, the Treaty requires Member States to co-ordinate their economic policies; monetary policy is primarily called upon to secure price stability and the social partners, through wage agreements, also impact on macroeconomic trends and the conditions for growth and employment. At the same time the principles of subsidiarity and independence apply. The independence of the ECB in the conduct of monetary policy as well as the competencies and responsibilities of the social partners must be respected.

Treaty, Part Three: Community policies
Title VII: Economic and monetary policies, Chapter 1: Economic policy, Article 99(1)

Member States shall regard their economic policies as a matter of common concern and shall co-ordinate them within the Council …

Title VII: Economic and monetary policies, Chapter 2: Monetary policy, Article 105

The primary objective of the ECB shall be to maintain price stability. Without prejudice to the objective of price stability, the ECB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. …

Article 108

When exercising the powers and carrying out the tasks and duties conferred upon them … neither the ECB nor a national central bank shall seek or take instructions from Community institutions … any government of a Member State or from any other body. …

In view of these objectives and in full respect of the agreed institutional rules the Cologne European Council decided to set up a Macroeconomic Dialogue at EU level. A regular exchange of views between the main actors aims at promoting macroeconomic conditions that are conducive to non-inflationary growth and employment.

Cologne European Council, June 1999

8. To the European Council, a macroeconomic dialogue in which representatives of the Council, the Commission, the ECB and the social partners participate is an effective way to approach implementing the growth and stability oriented macroeconomic policy forming part of the BEPGs as pursued by the Member Sates and the Community. …

Resolution of the Cologne European Council
Part III: Macroeconomic Dialogue for the promotion of growth and employment

5. In order to bring about strong growth in employment while maintaining price stability, fiscal policy, monetary policy and wage developments must interact in a mutually supportive way. The European Council calls upon all those who decide or influence economic and employment policy to contribute to more employment on the basis of strong, non-inflationary growth, respecting, at the same time, their independence and autonomy in their own areas of responsibility. In a macroeconomic dialogue based on mutual trust, information and opinions should be exchanged in an appropriate manner concerning the question of how to design macroeconomic policy in order to increase and make full use of the potential for growth and employment.

6. The European Council deems it necessary … to set up a regular Macroeconomic Dialogue (the Cologne process) within the framework of the ECOFIN Council in co-operation with the [Employment and Social Policy Council] with representatives of both formations of the Council, the Commission, the ECB and the social partners. …

6.2 Background and evolution

In many Member States dialogue between management and labour on matters of common interest has a long tradition. It serves to advance co-operation without collusion, between partners that are mutually dependent in a market economy. Such dialogue has also been practised at the EU level for many years and the Commission has actively contributed to it in line with Treaty Article 138, including a regular dialogue on macroeconomic matters.[30] Moreover, examples exist for national dialogues on economic issues that include the government.[31] A major objective of many of these endeavours has been not to eliminate fluctuations in the output gap but to avoid extreme situations, especially as regards output losses, by improving mutual understanding of policy tasks and intentions -- which counters early on the risks of policy conflict, an unbalanced policy mix and set backs to growth and employment.

This is also the key task of the Macroeconomic Dialogue initiated in Cologne. Participants discuss the economic situation and exchange their views on the policy implications. Moreover, special topics of common interest can be analysed, e.g. the determinants and effects of investment. Meetings are not open to the public, there is no ex ante co-ordination procedure nor is there any common paper output, all with a view to render the dialogue as open and outspoken as possible. These basic elements have been maintained since the inception of the process. Overall, it serves to avoid misconceptions, to pattern behaviour in line with the stability-oriented framework of EMU and to build mutual trust.

The effectiveness of a dialogue like this is inherently difficult to measure. Moderate wage agreements conducive to employment gains and thereby to sustainable growth owe to many factors. But regular meetings of key players certainly contribute to better absorb the rules of the game in Stage 3 and to improve the economic performance.

Presidency report to the Cologne European Council in preparation of the Macroeconomic Dialogue

… The task of creating the conditions for more employment and growth … must be based on … structural reforms and a balanced macroeconomic policy mix. This is the way to make the best use of the framework for stronger growth set in place by [EMU]. …

[Objective is the] mutually supportive interaction to the greatest possible extent between wage developments, fiscal policy and monetary policy. …

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[30] The Commission chairs meetings of the social partners in the Social Dialogue Committee. This Committee has set up a macroeconomic working group which regularly discusses the economic situation and where participants draw conclusions as to appropriate policies. -- Article 138(1) states that the Commission shall have the task of promoting the consultation of management and labour at Community level and shall take any relevant measure to facilitate their dialogue by ensuring balanced support for the parties.

[31] In arguing for the Macroeconomic Dialogue in 1999, the German Presidency of then probably had in mind the “Konzertierte Aktion”, an instrument in the German “law for stability and growth” of 1967 which allows the federal government to formulate (non binding) macroeconomic orientations and to invite the social partners to tripartite meetings in an endeavour to seek their implementation.

The conditions for a smooth interaction of macroeconomic instruments should be improved by stepping up the exchange of information and opinions between the economic policy actors concerned. …more intensive co-operation in the interests of more growth and employment in Europe must be undertaken,

Without jeopardising either the independence of the [ECB],…
Without questioning the autonomy of the social partners in collective bargaining,
While taking account of different systems of wage determination, …
While complying with the [SGP]
And while observing the principle of subsidiarity. ...

For a consistent policy mix to be implemented successfully it is helpful to have a fruitful macroeconomic dialogue between social partners, fiscal and employment policy makers and monetary policy makers within existing institutions. In the course of this dialogue, the starting position and future prospects could be discussed on the basis of statistical data and analyses, and ideas could be exchanged as to how, while retaining their respective responsibilities and preserving their independence, those involved consider that a policy mix can be achieved that is conducive to growth and employment under conditions of price stability.

6.3 The procedure

The Dialogue is held twice a year. On the agenda are the economic situation, current policy challenges and other topics of common interest. The meeting in the autumn is held at the time of the Commission's economic forecasts and EU Economy Review which analyses topical policy issues. The scheduling of the spring meeting allows an exchange of views specifically with respect to the new BEPGs.

The meetings in autumn and spring each comprise three gatherings, all with representatives from Member States, the monetary authorities, the social partners and the Commission. A steering group sets the draft agenda for the Dialogue at the technical level. Discussions at the technical level, under the chairmanship of a neutral moderator, generally build on written contributions from the Commission services (DG ECFIN, which moreover provides the secretariat) and serve to prepare the meeting at the political level. The political level Dialogue is chaired by the Presidency and starts off with a report on the technical level discussion by the moderator.

At the political level, the participating groups are represented by, respectively, ministers (Council troika, ECOFIN and ESP) and the chairmen of the EFC, the EPC and the Employment Committee; a representative each from the Governing Council of the ECB and a non-euro-area central bank; the presidents or general secretaries of the European associations of the social partners; and the Commissioners for economic affairs and employment.

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