Austrian Social Partners' Advisory Council for Economic and Social Affairs
The Macroeconomic Policy and the Lisbon Strategy of the European Union

The studies produced by the Austrian Social Partners' Advisory Council for Economic and Social Affairs (Beirat für Wirtschafts- und Sozialfragen) contain opinions and recommendations for economic policy which have been agreed upon by the four major Austrian social partners (Austrian Economic Chamber, Federal Chamber of Labour, Austrian Federation of Trade Unions, Standing Committee of the Presidents of the Austrian Chambers of Agriculture).
The following text consists of a translation of the summary and recommendations from the Advisory Council's enclosed study "The Macroeconomic Policy and the Lisbon Strategy of the European Union" (Die makroökonomische Politik und die Lissabon-Strategie der EU). The translation was provided by Pedrick Moore.

SUMMARY AND RECOMMENDATIONS

With this study, it is the intention of the Advisory Council for Economic and Social Affairs not to deliver a comprehensive mid-term review of the Lisbon Strategy, but rather to fill a gap. Numerous commentaries from various sources assessing the disappointing development so far have mostly ignored the role of the macroeconomic framework within which the strategy is to be implemented. Accordingly, in this publication, the Advisory Council aims to explain the significance of the macroeconomic policy mix and present suggestions for improvements.

The EU within the Global Context

Achieving dynamic competitiveness means maintaining and increasing high real incomes within the framework of advanced social and environmental standards over the long term. Thus, to compete globally, Europe must constant upgrade itself – simply competing on cost and price with less developed regions is neither a promising nor a sensible option.

The Lisbon European Council observed that Europe lags behind the

USA in terms of income level and competitive strength. Comparing European income per capita with US standards shows that GDP per inhabitant of the Euro-zone amounts to only 71% of that in the USA. Taking productivity (GDP per hour worked) as a benchmark, however, which is more important for international competitiveness, reveals a significantly smaller difference of 9%. Nevertheless, it should be noted that, since 1995, productivity has seen a less positive development in Europe than in the US.

Such global comparisons ought, however, to take into account the special elements of the different models which are not normally expressed in quantitative analyses. GDP as a measure of the standard of living, for example, ignores the non-monetary value of free time – an element that explains a large part of Europe's lag behind the USA. The rest of the difference consists more or less in the underutilization of labour (as a result of higher unemployment and a lower labour participation rate), which itself largely stems from a lack of economic dynamism.

All of this suggests that Europe should not measure itself against the standards of other countries alone. Factors arising inherently from its own past (for example, productivity and social cohesion) are of fundamental importance, and these would make more appropriate benchmarks against which the balance sheet of the Lisbon Strategy could be monitored, assessed and implemented.

Economic Growth and Policy Mix in the EU

As a rule, economic growth facilitates the achievement of most other goals of economic policy and cushions the impacts of reforms. Reaching the Lisbon target of 3% growth per year, which was chosen partly with this in mind, necessitates careful use of all levers of economic policy at both national and international levels.

Current EU policy, which has been based for years upon the "Broad Economic Policy Guidelines", lacks a sufficient focus on growth. Finance ministers and the European Central Bank are responsible for the targets of government spending and inflation, but there is no authority responsible for delivering the targets for growth as set out in the Lisbon Strategy. When these targets conflict, budget and price stability take priority.

Europe's persistent slump in growth, which followed the collapse of the world economy in 2001, was caused primarily by a weakness in domestic demand. The policy postulated in the "Broad Economic Policy Guidelines" could not react decisively enough in the short term to the challenges of the economic situation and the labour market and so failed to counter the weakness in demand. The policy mix set out in these "Guidelines" is out of balance, for it is a) based upon achieving stability at the expense of growth and b) focused mainly upon supply-side measures. It neglects the fact that reforms to increase the potential for growth must be complemented by measures to stimulate effective demand.

Therefore the Advisory Council for Economic and Social Affairs recommends a re-focusing of the "Broad Economic Policy Guidelines" and improved co-ordination of the various areas of macroeconomic policy; it also encourages all decision-makers (governments, ECB, social partners) to work together to fulfil their responsibilities towards the growth and employment targets set out in Lisbon.

The Stability and Growth Pact

In the context of the current debate over the Stability and Growth Pact, the Advisory Council calls for a significant reform of the Pact that gives equal attention to both growth and stability with the **following goals**:

- Every member state must consider itself duty bound by the common economic policy goals of the EU, for public finances of individual states can influence the stability of the entire currency union and the general confidence in the common currency.
- Fundamental to this is the preservation of fiscal sustainability, measured especially in terms of the total burden of debt, which should be monitored at EU level.
- Moreover, public finances of individual member states should be better co-ordinated in view of common goals such as growth, full employment, fairness of income distribution and cyclical stability.
- At the same time, national budgets should be able to react appropriately to a variety of situations, and at least be in a position to fulfil their responsibilities with regard to demand and employment. Generally speaking, budgets that are balanced over the course of the economic cycle contribute to the flexibility that allows national fiscal policy the necessary room to manoeuvre.

With these goals in mind, the Advisory Council proposes the following **critical actions for reforming the Stability and Growth Pact:**

- A stronger emphasis on the long-term sustainability of debt in the process of monitoring new public deficits.
- The present undifferentiated view of budgets should be replaced by assessments that take more into account the structural and qualitative aspects of public finances, so that revenue and expenditure are focused towards growth and employment.

- Procyclical developments should be avoided at all stages of the economic cycle.
- In recognition of the fact that investment is an important factor in improving competitiveness, achieving growth and stabilising the cycle, financial rules could be applied that would allow public sector borrowing to the extent of public sector investment over the course of the cycle without endangering stability over the long term. Open issues arising from this (such as definitions and clarifications) would have to be resolved quickly.
- International and national situations, as well as regional conditions, should be taken into account when defining medium-term budget targets or instituting disciplinary procedures for excessive deficits, without, however, permitting a relaxation of budgetary discipline.
- More timely measures to correct budgetary failures should be ensured, and peer pressure on member states should be increased, so as to prevent assymetrical budgetary policies. The European Commission should have an early warning mechanism that comes into operation as soon the sustainability of a member state's budget is recognisably endangered.
- In drawing up the details of their national budgets as required by the Stability and Growth Pact, and in balancing them across the overall economic cycle, the member states should align them to the common economic policy goals of the EU – bearing in mind global competition, the aging of society and EU enlargement.
- Moreover, the individual components of the EU budget should be aligned more closely to the targets of the Lisbon Strategy and thus create more growth and employment.

This suggested framework for fiscal policy creates scope for action through budgetary measures that allow a flexible response to different economic situations. But in itself it cannot solve all the problems. Even the best budgetary controls in a currency area are no substitute for serious co-ordination of a macroeconomic policy focused upon growth and stabilising the economic cycle. Thus, other decision-makers in economic policy – above all, the independent ECB – are called upon to make their contributions to the common economic goal.

Monetary Policy

Monetary policy, too, carries a responsibility towards the development of the real economy. Thus it would be sensible to require the ECB to adhere to a broader stability target that focuses more closely upon growth and employment. Proposals to create a more transparent and understandable monetary policy in the currency union are:

- Reform the ECB's "two pillar strategy" away from targeting the money supply and towards a modified and more pragmatic targeting of inflation, which would also support the widening of the Euro-zone;
- Give equal priority to the ECB's targets of growth and price stability;
- Institute better co-ordination between monetary, fiscal and wage policy. An important first step would be to develop an open and ongoing dialogue on the assessment of the state of the economy and the possibilities for economic policy.

Wage Policy

Wage policy should be pursued via the autonomous collective bargaining framework between employers and employees. Incomes should be seen as drivers of both cost and demand. On the one hand, as a cost factor, they are an integral part of price competitiveness; at the same time, wages and salaries are a major determinant of private households' demand. When, over the medium term, nominal incomes rise in line with the growth of productivity plus the rate of inflation (or the Central Bank's inflation target), then, *ceteris paribus*, unit costs of labour remain constant.

Co-ordination of Economic Policy

The advantages of a common market and currency union can be realised only by stronger co-ordination, which is currently hindered by the opaque competition between the European states. The multiplier effect of the EU as a whole creates a greater potential than the mere sum of the smaller, open national economies of its member states. The Advisory Council for Economic and Social Affairs sees the following opportunities in particular for improving the co-ordination of various elements of economic policy within the European Union which need to be fully utilized:

- better co-ordination of national budgets within the framework of a reformed pact for stability and growth;
- wider awareness of the importance of national and regional wage settlements for cost competitiveness and private consumer demand;
- improved balancing of monetary and budgetary policies, both of which should focus on economic growth;
- better co-ordination of wage and monetary policies, in order to ensure price stability;

- using the Cologne Process discussions as a forum for improving communication of macroeconomic fundamentals with a view to ensuring better policy co-ordination;
- upgrading the role of the social partners in the co-ordination process by developing the tripartite social summit held to prepare for Council meetings into a true partnership forum for growth and employment; supporting stronger involvement of the national social partners in so-called "reform partnerships" for the better implementation of the Lisbon Strategy at a national level; inclusion of such partnerships should not be limited purely to industrial relations, but should also entail the involvement of representative bodies of the social partners in all other areas of economic and social policy;
- harmonising taxation systems to improve transparency, simplify taxation, close tax loopholes and reduce the public sector's leakage of revenue so as to ensure sufficient provision of public sector services;
- co-ordinating monetary policy at the global level in order to prevent excessive currency fluctuations;
- A European Research Council as proposed in the Kok Report could contribute to the international co-ordination of research activities provided that certain conditions (for example, transparent processes for setting priorities, complementarity to and work sharing with national efforts) are met.

The Advisory Council calls upon all the relevant institutions and decision-makers to take up their responsibilities for implementing the proposals outlined above. In accordance with the open method of co-ordination, the member states of the EU themselves are also responsible for achieving the Europe-wide targets. The national action plans proposed in the Kok Report are basically positive, but they must avoid any duplications or additional administrative costs.

Elements of a Growth Strategy for Austria

Advanced international integration has clearly reduced the scope for purely national economic policies. Therefore a major task of policy consists in vigorously influencing European economic policy in line with the proposals above so as to increase the emphasis on growth.

Nevertheless, there remains substantial scope for national policies that target growth and employment within the Austrian economy. Although these objectives are generally recognised and accepted, they have little influence on the actual budget structure. A large part of public expenditure (about 50%) serves other objectives, as do most regulations. In fiscal and monetary policy as well, stability targets clearly dominate over the growth ideal contained in the Lisbon Strategy.

The Advisory Council for Economic and Social Affairs therefore recommends the development of a national consensus among all major economic and social forces, a common mission for the future of the Austrian economy and society. To this end, the Council identifies the following areas for action:

- The structure of public sector revenue and expenditure should be focused upon increasing growth.
- Public budgets should make full use of their room to manoeuvre, especially for stabilising the economic cycle.
- Infrastructural development should be targeted at achieving growth, taking into account the challenges of EU enlargement and technological change.
- The quality and quantity of research spending should be improved. It is important to recognise that numerous innovative small and medium-sized enterprises in the technology sector make a significant contribution to growth, employment, productivity improvement and sustainable development. As well as the focus on basic research, special emphasis must be given to applied research. Given its high income level and well-developed economy, Austria must aim to be among the global leaders in innovation, research and development.
- Qualitative improvements in education (from apprenticeships to post-graduate studies) and in continuing education (from the basic school requirement through to internationalisation) as well as an emphasis on lifelong learning are fundamental to developing a knowledge economy and ensuring knowledge transfer.
- The conditions for technology sharing should be improved so that it can become ever more common at all levels (schools, businesses, public sector).
- Headquarter functions must be retained, developed and actively extended.
- The development of clusters and the reaping of "double dividends" should be encouraged by directing the environmental, health and cultural sectors towards areas that promise high growth.
- Regulation and deregulation programmes should be designed with growth objectives in mind.