Opinion of the European Economic and Social Committee on the Broad economic policy guidelines and economic governance — The conditions for more coherence in economic policy-making in Europe

(2006/C 324/21)

On 19 January 2006 the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an opinion on the *Broad economic policy guidelines and economic governance — The conditions for more coherence in economic policy-making in Europe*

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 7 September 2006. The rapporteur was **Mr Nyberg**.

At its 430th plenary session, held on 26 October 2006, the European Economic and Social Committee adopted the following opinion by 86 votes to 9 with 10 abstentions.

Summary and recommendations

The EESC has decided not to comment on the three-yearly economic guidelines in this year's opinion on economic policy. Instead it will address the formal basis for the guidelines. The basis for European Union action in monetary and fiscal policy matters is to be found in the Treaty rules on the single currency decided upon in Maastricht, in the Stability and Growth Pact and in the Treaty rules on economic policy guidelines. The objective is to arrive at rules that can impact as positively as possible on the overarching objectives of price stability, growth and employment.

In order to avoid one policy area imposing too tight constraints on the other, the European Central Bank and ECOFIN should consider the same set of policy objectives. It is especially important for the ECOFIN euro group and the ECB to take the same approach.

The opinion is divided up into different subject areas: monetary policy, the Stability and Growth Pact, the economic guidelines, wage formation and the link between inflation and growth. However, we have chosen to make our recommendations according to who is expected do what: the European Central Bank, ECOFIN, the Commission and the social partners.

The ECB

— The price stability objective should become a symmetrical objective, e.g. 2 percent +/- 1 percentage point. An objective with a midpoint makes it easier to judge how close to the objective we are, and can also be useful if you want an equal response from the ECB when the inflation rate changes because of falling or rising demand.

— If a policy aims to take greater account of the connection between monetary policy measures and fiscal policy measures, then core inflation is the measure that should be used, as it does not include price changes that the ECB cannot influence or which may be temporary. It is more an indication of the price change trend. Moreover, when assessing price changes, the ECB should consider whether they might be a result of tax changes.

— The price stability requirement for common currency candidates must be reviewed. Officially, this requires a change to the Treaty. However, given that such a change was not even included in the Constitutional Treaty, a flexible interpretation of the Treaty would be appropriate, so that eurozone entry would depend on respecting the spirit rather than the letter of the requirement. The logical solution would be to set the same price stability objective as for eurozone members.

— Stability and a credible monetary policy are not dependent on keeping inflation below 2 %. A somewhat higher level as a measure of price stability would not be a threat to stability. It is more important to know that the authorities are willing and able to control inflation, so that the chosen target can be achieved.

— The ECB should publish the minutes of its meetings.

ECOFIN

— There is little call for a pro-cyclical policy as long as capacity utilisation has not yet reached a level likely to give rise to inflationary pressure. Unemployment is still at unreasonable levels and there is considerable scope for more labour market participation. In years when the economic climate is healthy, economic policy should focus on planning for the economic problems that will flow from demographic trends. The general EU budget and deficit objectives are not enough when the economy is on an upward trend. Member States that have already achieved these objectives cannot rest on their laurels.

— The EESC believes that the indicators for budget balance and national debt should be maintained, but the discussion must be taken a step further, taking the real objectives of economic policy into account.

— The main focus of the three-yearly economic guidelines should be a minimum level of economic growth, a downward trend for unemployment and the Lisbon Agenda percentage objective for the workforce. National objectives should be set, although these must not be lower than the objectives for the EU as a whole.

— Finance ministers must be consistent: they cannot say one thing in Brussels and then do another at home.

The social partners and the Cologne Process

— The interval between Cologne Process meetings should be used to carry out joint studies on economic links, the impact of various policy measures and similar questions.

— The Cologne Process could be the appropriate forum for applying sufficient weight to the requirement for all parties to fulfil their obligations on economic statistics.

— Prior to each meeting the European Parliament should adopt a resolution on the economic situation and the policy required.

— Both ECOFIN and the euro group should be present in order to provide input from Finance Ministry circles and from the Finance Ministers that are directly responsible for the fiscal policy that is to be combined with the European Central Bank's monetary policy.

The Commission

— A further analysis should be carried out for core inflation. A more detailed study of the specific policies pursued by countries with a good inflation/growth ratio (i.e. low inflation compared to the growth rate) should provide a basis for future benchmarking.

— It might be useful to carry out an analysis of, for example, the extent to which productivity changes have been responsible for the differences in growth rates? How far do productivity gain differentials depend on different levels of investment and innovation? What methods are generally available for increasing productivity? The EESC therefore calls on the Commission to look into the link between the primary growth and employment objectives and, for example, productivity gains and inflation levels.

Conclusion

Better coordination between monetary and fiscal policy is achieved when price stability, growth and employment are valuable objectives for all economic policy decision-makers: the European Central Bank, the Commission, ECOFIN, the social partners and the Member States. When all the players base their proposed measures on the same three objectives, they are forced to look at all the consequences of their proposals. This produces a more unified policy that gives a better overall result.

1. Introduction

1.1 The European Union's economic guidelines — Broad Economic Policy Guidelines — are now set for a three year period. This year's guidelines contain only minor changes to the 2005 guidelines.

1.2 The EESC has therefore decided not to comment on these changes in this year's opinion on economic policy and to address instead the formal basis for the guidelines. A study such as this cannot be restricted to the formal content of the economic guidelines; it also has to address monetary policy and its links with fiscal policy.

1.3 The basis for European Union action in monetary and fiscal policy matters is to be found in the Treaty rules on the single currency decided upon in Maastricht, in the Stability and Growth Pact and in the Treaty rules on economic policy guidelines. Following the changes introduced in 2005, these guidelines are dealt with under the annual Lisbon Process.

1.4 The aim is to look at the interplay between these rules and their impact on actual policy both in the European Union as a whole and nationally. In order to get a comprehensive analysis, wage formation will also be addressed. The analysis will necessarily be somewhat theoretical in nature, in order to advance the debate and improve policies. The objective is to see whether the current rules are having the best possible impact on the broad objectives for price stability, growth and employment.

1.5 Our recommendations, however, are not confined to current policy but also address rule changes. These changes can be implemented immediately, particularly those relating to the conduct of decision makers. Only in one case do our recommendations involve changes to the Treaty.

2. Maastricht and the common monetary policy

2.1 The European Central Bank's primary objective is price stability. The Treaty rules adopted in Maastricht set a second objective, namely that the European Central Bank is to support growth when price stability has been achieved. In this context, a comparison is usually made with the US Federal Reserve, whose objective is based more on a global view of price stability as well as employment and growth. The wording used might appear to imply only a difference of degree but the differences are clearer in terms of the actual monetary policy pursued. The Federal Reserve is more likely to use employment trends as a reason for interest changes. For the European Central Bank, price stability seems to be the only basis for interest changes.

2.2 In addition to actual monetary policy measures, the way the objective is worded is, consequently, also important to its impact on overall policy.

2.3 In a complete picture of economic policies — including both monetary policy and fiscal policy — it is not just interest rate policy that is crucial to how fiscal policy can be pursued; the choice of monetary policy objectives is equally important. A Finance Minister probably often thinks, 'If I do this, will it be countered by interest changes to curb its impact?' In order to avoid one policy area imposing too tight constraints on the other, the European Central Bank and ECOFIN should consider the same set of policy objectives. It is especially important for the ECOFIN euro group and the ECB to take the same approach. The monetary policy objective should be set with the long term in mind. The European Central Bank has often stated that the 2 percent objective was based on previous ECOFIN positions. Opinions as to what might constitute a desirable level of inflation do not differ significantly, but the objective and measures must be respected by all.

2.4 When the European Central Bank set the objective for price stability, an inflation level of less than 2 percent was chosen. Already in 2003 the objective was changed to below but close to 2 percent. The objective is thus somewhat more realistic since the first objective of under 2 percent could mean that even deflation was acceptable.

2.5 There remain, however, two problems with this definition: it is almost impossible to decide how far we are from the objective and what distance is acceptable. A symmetrical objective leaves a space around the most desirable rate of inflation. Given the European Central Bank's call for a level close to 2 percent, the best formulation of the objective would be 2 percent +/- 1 percentage point. Such an objective would also remove some of the concerns that arise around occasional changes at promille level. The EESC believes there is every reason to change the European Central Bank's objective to a symmetrical objective. An objective with a midpoint can also be useful if you want an equal response from the ECB when the inflation rate changes because of falling or rising demand. In the past, the interest rate rose quickly when the European economy was doing well before the turn of the millennium, whereas rates fell considerably more slowly when there was a downturn a couple of years later.

2.6 The remaining problem is, what type of inflation is being measured? The European Central Bank's formal objective uses the HICP (Harmonised Index of Consumer Prices), i.e. it measures the overall level of inflation. Items such as energy prices or food prices can be removed from this in order to produce inflation levels that can be considered to be more sensitive to monetary policy and that do not depend on factors beyond our control. This is mainly to offset the impact of oil price increases, which are temporary changes which can head off in the opposite direction quite suddenly. A modified price index is necessary in order to avoid temporary changes impacting directly on the European Central Bank's policies. Notwithstanding the likely long-term increase in energy prices, temporary oil price rises can never be offset by interest rate changes, which are only thought to have an impact after 1-2 years.

2.7 What is usually referred to as 'core inflation' is the measure of inflation trends in the domestic economy (the euro area for the European Central Bank). These price level changes are more symptomatic of trends, and it these that the European Central Bank needs to work on most. The most direct impact of interest rate changes on the rate of price increases ought logically to be found between this inflation measure and the European Central Bank's interest rate policy. If the European Central Bank accepts a rate of inflation above its stated objective then this is most probably because it has also taken one of these reduced inflation scenarios into account. If core inflation is also referred to, the ECB will find it easier to get its policy across. If a policy aims to take greater account of the connection between monetary policy measures and fiscal policy measures, then core inflation is the measure that should be used. This would make it easier for macro-economic policy to impact more positively on growth and employment.

2.8 A comparison between the official inflation rate according to the HICP and the measures that apply to core inflation shows (see Appendix) only small variation. The only appreciable difference was in 2005, when energy prices impacted on general prices. A comparison of inflation with the European Central Bank's target shows that core inflation only came in well below target in 2000 and 2005. If a core inflation target had been set, policy in 2005, for example, should have been less restrictive.

2.9 Another factor that affects the inflation level, without being a direct consequence of domestic demand, is changes to taxes and duties. If, for example, the Member States increase VAT in order to reduce the budget deficit, inflation also rises. This could induce the European Central Bank, if using the HICP to measure inflation, to raise interest rates. But VAT increases stifle consumer demand and should therefore, taking a holistic approach to economic policy, actually be accompanied by a cut in interest rates. In situations such as these, e.g. when Germany raises VAT from 16 % to 19 % at the end of this year, the European Central Bank should look closely at the causes of inflation and remember that a one-off event will not result in a trend towards higher inflation. Furthermore, if the ECB allows this type of tax hike in one country to influence monetary policy, it will also have a negative impact on all the other eurozone countries.

2.10 In order to join the single currency, the Member States that are not yet part of the eurozone must, according to the Treaty, have an inflation rate that is 'close to that of, at most, the three best performing Member States in terms of price stability'. 'Close to' means a maximum differential of 1.5 %. 'Best' in this context means the lowest inflation level. This objective is not as logical today as it was at the start of the 1990s. Given the situation over the last few years, this could mean a lower inflation rate than in the eurozone countries. The requirement is even more absurd given that it is based on inflation in the EU Member States rather than just on that in the eurozone countries. In recent times, non-eurozone members have been the three to follow for the price stability requirement for countries that wish to adopt the euro. The price stability requirement for single currency candidates therefore needs reviewing. Officially, this requires a change to the Treaty. However, given that such a change was not even included in the Constitutional Treaty, this change would take so long that most eurozone applicant countries would be forced to try to meet the current requirement. A flexible interpretation of the Treaty would therefore be appropriate, so that eurozone entry would depend on respecting the spirit rather than the letter of the requirement. The logical solution would be to set the same price stability objective as for eurozone members. If this objective were to be adjusted to 2 percent +/- 1 percentage point, then the same should apply to euro candidates.

2.10.1 A more flexible approach to price stability might also be needed in countries with rapid economic growth. Ireland, for instance, is an example of the need for somewhat higher inflation as a necessary adjustment in a strongly expanding economy.

2.11 Inflation is a statistical measure needed to underpin economic policy, but the public sees price rises differently, reacting strongly to rises in rent, food and petrol prices, etc., whereas few people even notice that some goods have come down in price. What is more serious, however, is the fact that different people are affected in very different ways. When it is chiefly basic essentials that rise in price, it is the poor that suffer the most, as a general price rise of 2 %-3 % can mean a significant increase in their cost of living. Politicians must take note of these effects and counteract them by means of various policy measures. This is not so much a question of the scope of budget policy as its specific content.

3. The 2005 Stability and Growth Pact

3.1 Have Member State policies changed since the Stability and Growth Pact was reviewed, and has the Commission's and subsequently the Council's assessment of the countries changed? It would seem that only Lithuania has clearly used the new Pact's explanations for a deficit. Nevertheless the new Pact has resulted in all Member States establishing medium/long-term national objectives for public finances. The objectives are framed according to the individual country's actual situation.

3.2 Given the economic developments following the review of the Pact, it is logical that it has not had any visible effect. Most of the changes introduced referred almost exclusively to periods of major economic problems, whereas we have just seen a revival of the economy and improvements that can also be discerned in the Pact's indicators.

3.3 Economic expectations for 2005 and 2006, particularly in the light of more positive developments in Germany, point to a generally improved compliance with the Stability and Growth Pact indicators. The fact that this is taking place against a backdrop of very high oil price rises shows that the economic improvements are quite robust. The extent to which oil price rises will impact on individual countries will depend on how far they are dependent on oil imports. Even in 'good' years, however, some countries are still some way from achieving the budget balance target. They should benefit from the positive trend in other EU countries.

3.4 In most countries, however, the growth rate achieved or expected is not at a level that would call for the Pact's more stringent stance on budget measures during economically 'good' years to come into effect. There is little call for a procyclical policy as long as capacity has not reached a level likely to give rise to inflationary pressure. Unemployment is still at unreasonable levels and there is considerable scope for more labour market participation. The interplay between fiscal policy and monetary policy is under fresh strain compared to the very weak economic situation of previous years. In years when the economic climate is healthy, economic policy should focus on planning for the economic problems that will flow from demographic trends.

3.5 The general EU public sector budget and debt objectives are not enough when the economy is on an upward trend. Member States that have already achieved these objectives cannot rest on their laurels. It is important that they should use the national objectives in accordance with the new Stability and Growth Pact to improve their economic situation.

3.6 In addition to the fact that the difficult economic situation prior to 2005 was the main source of problems in clarifying the Pact's indicators, there are statistical explanations that are seldom noted. When there is low inflation in the economy, national debt retains its value. Specific measures are needed to reduce it. When growth is strong the national debt as a percentage of GDP is reduced without any need for action, and budget balance improves. When inflation is high, the cost of the public sector's economic subsidies as a share of GDP falls, giving a statistical improvement in budget balance and national debt. When there is growth, revenue increases without any need to raise taxes. To some extent then, the difficult statistical impact on national debt and budget balance in recent times has been succeeded by positive statistical effects.

3.7 Another of the consequences of the bad years is that saving has been unusually high. The lack of investment opportunities in Europe has given rise to capital flight to the US. With the growing confidence in the economy that comes with better times, it is to be expected that reduced concern about the future will mean that people will save less. A virtuous circle could be created through even stronger demand.

3.8 Finally, it can be said that EU level fiscal policy has a special problem, i.e. that the people responsible for framing it and ensuring it is complied with are constantly changing. It can happen that a quarter of finance ministers are changed in any one year, and the new ministers do not feel the same sense of responsibility for the policies of the previous incumbents. ECOFIN therefore needs more long-term decisions so that a new set of ministers cannot stymie a policy that is already up and running. The constant change of ministers also makes it difficult to get an ECOFIN with the political will to implement a common policy.

4. **The Economic Guidelines and the Lisbon Process**

4.1 The Broad Economic Policy Guidelines have existed since 1993. They initially dealt with fiscal policy only, but employment issues were included later and since 2005 they have been grouped together with the employment guidelines and the Lisbon Agenda as part of a comprehensive process. This is basically a national policy matter, where the Commission and the Council provide guidelines. There is nothing about pecuniary sanctions, unlike with the Stability and Growth Pact.

4.2 Ever since EMU was created, the discussion has been dominated by the imbalance between a central monetary policy and a fiscal policy that continues to be national. The Stability and Growth Pact is a ‘hybrid’ that also contains elements of common policies and pecuniary sanctions, while the economic guidelines are underpinned by recommendations.

4.3 What avenues are open for developing the economic guidelines? In order to find them, we need to distinguish clearly between the establishment of economic policy objectives and the means used to try to achieve them.

4.4 With regard to the Stability and Growth Pact, budget balance and government debt as a proportion of GDP have, in the general debate, come to be considered as objectives. However, these two elements do not, in themselves, constitute ultimate objectives. They are more indicators of the direction policy is taking. A balance or surplus in the official budget is targeted in order to be able to make use of it in an economic recession. A budget surplus thus becomes a means to boost the economy at some later date. The EESC considers that the indicators for budget balance and national debt should be maintained, but the discussion must be taken a step further, taking the real objectives of economic policy into account.

4.5 The broad objectives for all economic policy — both monetary and fiscal — are price stability, growth and full employment. These objectives must be formulated. Price stability has already been addressed. The basis for the economic guidelines should therefore be that the European Union also defines desirable growth and full employment. In practical terms, there are real problems associated with this. If the objectives are to be realistic, they must be seen in relation to the current economic situation. This means that they may need revising rather often, and not be set for such a long term as the price stability objective.

4.6 It is debatable how far growth can be used as a measure of economic development. The measures normally used do not take social and environmental effects into account. However, when considering purely economic growth, there are two established measures: an increase in real GDP per inhabitant and the same measure in terms of purchasing power parity (PPP). The latter attempts to equate the actual economic situation in various countries. It does not matter which measure is used as it is the rate of increase that is targeted. It hardly differs from year to year depending on which type of GDP is measured. Some years ago attempts were made to establish the rate of increase at which unemployment starts to fall. The objective then was to achieve that growth rate for GDP (approximately 3 %) at the very least. However, this type of growth objective can vary over time, as it can between different economies. In view of the problems in reducing unemployment, it is, however, difficult to imagine a growth objective that is lower than when unemployment is starting to fall. Not many countries have actually achieved a minimum growth level such as this in recent years.

4.7 When comparing countries and growth-oriented policy options, its is important to make a distinction between the two chief methods to secure growth. Either growth increases when more is produced using the same technology, usually by employing a bigger workforce; or through productivity gains, where more is produced using the same workforce. Over the next few years it will still be possible to use the first method, whereas a few years hence only the latter method will be available, owing to demographic trends.

4.8 It is considerably more difficult to find an objective for employment. The objective must be twofold: it is partly a question of the proportion of the working age population in the labour market (employment level); and partly of how many are unemployed. The Lisbon Agenda set objectives for the employment level as a whole (70 %), for women (60 %) and for people between 55 and pensionable age (50 %).

4.9 No percentage goals were set for unemployment. To begin with, there are various methods for measuring unemployment. However, owing to the existence of open unemployment and the fact that some people are covered by some form of labour market policy measures, at least two objectives are necessary. Given that very few countries are close to what might be called full employment (i.e. just a few percentage points of unemployment, which is always to be found in a dynamic economy, where change must be a constant), it might be appropriate to set — as an objective for the long term — a certain percentage reduction in unemployment.

4.10 Given this reasoning, the main proposal of the three-yearly economic guidelines should be to focus on a minimum level of economic growth and a downward trend in the unemployment rate. The Lisbon Agenda percentage objective for the workforce can be maintained until further notice. The situation that applies to monetary policy — with clear objectives against which policies can be assessed — is also needed for fiscal policy.

4.11 The role of the economic guidelines should subsequently be more a matter of the Member States reporting what they are doing to achieve the objectives, with the Commission and the Council assessing how adequately the objectives have been achieved. If the objectives have not been reached the EU should be able to criticise the policies chosen and make proposals based on benchmarking of successful policies pursued in other countries. Each country must, however, be assessed on the basis of its circumstances and its current economic situation.

4.12 Since fiscal policy continues to be a national question, the current emphasis on the broad economic situation within the European Union is not particularly relevant when assessing each country's policies. The economic guidelines should therefore be amended. Future guidelines should set national objectives for the overall objectives, which should not, however, be less ambitious than those for the EU as a whole, and countries should be assessed in terms of how they meet their objectives.

4.13 With greater emphasis on what individual Member States are doing, based on their economic circumstances, and with stronger links with the Lisbon Agenda's clearer employment objectives, the economic guidelines can tie in more closely with the broad thrust of the Lisbon Agenda. Broad economic policy could be more of a natural feature of the Lisbon Agenda national reform programmes, and thus speed up implementation of the Lisbon Agenda as a whole.

5. **Wage formation and the economic guidelines**

5.1 The year 1999 saw the creation of what has come to be known as the Cologne Process. This annual forum for discussing current policies for ECOFIN, the European Central Bank, the Commission and the social partners (ETUC,UNICE/CEEP) is little-known. It has, however, probably played an important role in raising the awareness of those involved of each other's policies and their opinions with regard to economic policy.

5.2 These discussions take place on two levels: an expert level and a high level group. The meetings usually take place every six months and focus on views of the current economic situation and the policies needed.

5.3 The discussions and conclusions from 2005 show how far perceptions and suggested measures diverge. The Commission highlights the improved economic situation. The European Central Bank stresses how important it is to have wage moderation, which is, of course, a feature of UNICE's contribution. The CEEP talks about the need for public investment. The UEAPME does not only talk about the need to look after small businesses but also says that higher inflation might have to be accepted. ETUC highlights the need to stimulate the general economy in order to kick-start domestic demand, and says that salaries are not just a cost but the main prerequisite for demand and that salaried workers have done their bit over the years to keep inflation down through salary increases that are lower than productivity gains.

5.4 Given this scenario, one might wonder whether the Cologne Process might be in need of a fresh start. How can it be moved forward? Thus far, the Cologne Process dialogue has been a matter of getting together and exchanging opinions. This could be improved by, for example, using the time between meetings to draft joint studies on economic relations, on the impact of various policy measures and similar questions. This could move the parties closer together in their understanding of the economic reality that must be the starting point. This proposal could also tie in with the EESC's earlier proposal for a body for independent economic studies ([1]).

5.5 A less ideological question — but one that is nevertheless crucial to the choice of policies pursued — is the reliability of statistics. It goes without saying that all Member States should manage to make the necessary statistics available at the same time. To choose policies on the basis of faulty statistics wreaks havoc. Perhaps the Cologne Process conversations are the best place to bring home to those involved the need to fulfil their obligations on economic statistics. The European Parliament has also repeatedly called for better statistics.

5.6 With regard to the formal structure, change might also provide a more lively discussion. The European Parliament's role could be strengthened. Instead of a merely formal presence, prior to each meeting the EP could adopt a resolution on the economic situation and the policies required. An appraisal such

([1]) OJ/2006/88 68 Strengthening economic governance — The reform of the Stability and Growth Pact.

as this could be set against the more formal review that the Commission can be expected to deliver. Both ECOFIN and the euro group should be present in order to provide input from Finance Ministry circles and from the Finance Ministers that are directly responsible for the fiscal policy that is to be combined with the European Central Bank's monetary policy.

5.7 Although each party — the European Central Bank, Finance Ministers and the social partners — pursues its policies independently, the improved cooperation we advocate is urgently needed. Independence does not mean absence from the general debate, nor does it mean not listening to good advice. Neither is independence undermined if a party goes public instead of always pointing out that it makes all its assessments entirely alone and is not influenced by anyone. Finance ministers must be consistent: they cannot say one thing in Brussels and then do another at home. The European Central Bank should be able to publish their minutes, as do the central banks in the United Kingdom and Sweden.

6. **The inflation-growth link?**

6.1 The European Parliament had this to say about the integrated guidelines for growth and jobs on 26 May 2005: '*… growth in the euro area and the 25-member European Union is failing to achieve its potential on a sustained basis and is still too weak, particularly in the four leading economies in the euro area; … household consumption is still faltering and the economic outlook for 2005 and 2006 continues to be unsatisfactory, contributing to a continuing high level of unemployment which will decline only slowly; … despite the lowest interest rates since the Second World War, there is little willingness to invest.*'

6.2 The classic dichotomy in economic literature is inflation and unemployment. A good result for one seems, statistically, to lead to a poor result for the other. We have decided, using *inter alia* scenarios such as that described by the European Parliament, to try instead to establish relationships between inflation and growth.

6.3 In a given economic situation it is possible to compare growth in countries with low inflation and in countries with high inflation. We can also see how growth varies in a country in various situations when inflation varies. Our tables may not be scientific, but they do point clearly to the fact that an awareness of the relationship between inflation and growth is important in order to find the right policy mix.

6.4 When we see countries with relatively high inflation and high growth and, on the other hand, countries with low inflation and low growth, it would seem only logical to ask whether there is more than a statistical connection between inflation and growth. In order to see whether these really are causal connections, some statistical correction is first necessary, as economic situations can differ, especially where development levels (GDP) are concerned. It also has to be ascertained whether some specific economic policy might have led to high or low growth when different inflation levels are present. This means that the focus is often on certain countries so it is perhaps not possible to draw conclusions about general connections between inflation and growth.

6.5 The growth rate is a real problem, at least for the 'old' EU-15 countries. According to Commission statistics, their growth has been so low that they have lost approximately half of one percent of GDP per year compared with other industrialised countries (1995 — 2005) (2). (N.B. a reference to the Commission document is needed below.) During the same period, domestic demand in these countries fell by around one percent compared to other industrialised countries. The relatively good years after the turn of the millennium were entirely dependent on increased demand for European products from other countries. An analysis of the reasons behind this almost catastrophic growth rate must be carried out in order to find a better policy for the future.

6.6 This description of the 'costs' of low inflation can be compared to another description of the costs of high inflation in a letter from the former ECB president Wim Duisenberg to the European Parliament: '*The ECB's quantitative definition of price stability reflects sound and well-established economic criteria. By allowing for only low rates of increase in the price level, it permits the minimisation of the costs of inflation, which are well-known to the general public and which have been extensively documented in the literature.*'

6.7 When searching for the optimum inflation target, it is important to remember the need to preclude costs induced by high inflation, as well as those resulting from the difficulty in securing satisfactory growth. It is also important to realise that inflation in itself is neither a solution nor a problem; it is rather a question of the flexibility that a certain level of inflation brings to the economy and the catastrophic impact of high inflation on confidence, long-term thinking and incomes distribution.

6.8 The Appendix contains information on inflation (HICP and 'core inflation') and growth (real increase in GDP) for the EU countries. The figures go back to the year the European Central Bank became operational.

6.8.1 Generally speaking it was a period of low inflation and low growth. Only in 2001 and 2002 was the growth rate almost acceptable, and from 2004 for some countries. For nearly all of these countries inflation and growth go together. Following the growth levels seen in the initial years (1999-2000) as a result of demand from the rest of the world, EU

(2) Commission database AMECO (http://ec.europa.eu/economy_finance/indicators/annual_macro_economic_database/ameco_en.htm). EU15 GDP growth in comparison to a reference group of industrial countries (comprising the US, Canada, Japan, Korea, Australia, New Zealand, Norway and Switzerland.

internal demand has been unable to create a satisfactory growth rate. During those years and since the recent improvement, inflation has not risen much above 2 %.

6.8.2 We could comment on the situation in various countries, but we will restrict ourselves to the following:

Some countries are at odds with the low inflation/low growth climate experienced by the majority of countries. Ireland — with high inflation and high growth — has been able to maintain a higher growth rate while inflation has slowed. Greece combines high inflation with high growth. In Italy and Portugal inflation is somewhat too high, while growth is virtually non-existent. Spain has satisfactory growth, with inflation above 2 %. The Spanish debate reveals that growth is noticed by the public, but such a high level of inflation only concerns the economists. Finland is extremely unusual in combining high growth in 2004 with zero inflation (partly as a result of reduced alcohol duty). Slovenia has managed to gradually reduce the inflation rate while maintaining fairly high growth. Lithuania has had high growth and low — but rising — inflation. The Czech Republic has improved growth without increasing inflation, whilst Estonia has pushed growth even higher but at the price of rising inflation. Latvia has increased its growth to the highest level in the EU, but inflation has shot up.6.8.3 If inflation is the yardstick against which general demand in the economy is measured, then both of them have — with a few exceptions — been too low. Given that it is difficult for the economy to readjust satisfactorily when overall price changes are small, inflation has been an obstacle to growth. This has been too uncomfortable for some to contemplate, despite the fact that it is generally accepted that a certain level of inflation is needed to oil the wheels of a dynamic economy. In the current globalised economy, dynamic changes have become essential in order to cope with international competition.

6.8.4 Stability and a credible monetary policy are not dependent on keeping inflation below 2 %. A somewhat higher level as a measure of price stability would not be a threat to stability. It is more important to know that the authorities are willing and able to control inflation, so that the selected target can be achieved.

6.9 A further analysis can be carried out using time series for core inflation. With the exception of 2005, the differential between the consumer price index and price trends excluding energy prices has been rather small. A more detailed study of the specific policies pursued by countries with a good inflation/growth ratio (i.e. low inflation compared to the growth rate) should provide a basis for future benchmarking.

6.10 The Appendix also contains figures for labour productivity per hour worked. The figures do not refer to individual national trends but to performance as compared to the EU15 average. The table shows how close a country is to the average.

6.10.1 There ought not be any rapid change in the ranking over a six-year time period, and this is true for most countries. There are, however, a few exceptions. Greece, with low productivity, is rapidly catching up with the rest. Ireland is now above average and continues to see productivity gains. During the same period Italy has fallen behind the rest, as has Portugal, which started off from a low base.

6.10.2 A more detailed analysis could be useful here, too. For example, to what extent have productivity changes been responsible for the differences in growth rates? How far do productivity gain differentials depend on different levels of investment and innovation? To what extent do different education systems lead to innovation differentials? What methods are generally available for increasing productivity? The EESC therefore calls on the Commission to look into the link between overall growth and employment objectives and, for example, productivity gains and inflation levels.

6.11 However, a preliminary conclusion that can already be drawn from the inflation and growth statistics is that there must be better coordination between monetary and fiscal policy, with price stability, growth and employment becoming valuable objectives for all economic policy decision-makers: the European Central Bank, the Commission, ECOFIN, the social partners and the Member States. When all the players base their proposed measures on the same three objectives, they are forced to look at all the consequences of their proposals. Measures that are excellent for achieving price stability in one economic situation can be entirely wrong in another. In certain contexts they can boost growth and employment, while having the opposite effect in others.

6.12 The European Central Bank's February 2004 edition of its Monthly Bulletin seems to point to a new understanding, which could be a starting point for a new integrated policy approach. It lists the most important factors for kick-starting investment: satisfactory profitability, sufficiently available financing and the right conditions for demand.

Brussels, 26 October 2006.

The President

of the European Economic and Social Committee

Dimitris DIMITRIADIS