

Comment on von Hagen and Mundschenk: The political economy of policy coordination in the EMU

Johnny Åkerholm*

The paper by Jürgen von Hagen and Susanne Mundschenk (H&M) discusses economic policy coordination in EMU under the unique circumstances of one monetary and twelve fiscal policies. The authors attempt to show that, assuming short-term demand effects of monetary policy, there is a need for coordination between fiscal policy authorities and/or between these and the central bank. After analysing the present arrangements, they conclude that these are not solid enough to provide the necessary framework for coordination.

I welcome this kind of analytical approach for the assessment of the consequences of the new institutional setting. No doubt, it gives more rigour to the political debate. In my remarks, I will, however, concentrate only on the institutional arrangements and argue that at present, these are largely in place, or that they can be developed on the present basis, in case there is proper analytical basis and sufficient political will.

A pre-requisite for an application of H&M's suggestions is a common identification of shocks (external or policy-induced) and a common view of how the economy responds to these shocks. Neither exists at the moment.

The analysis (assessments and forecasts) of the euro area is still mostly based on a country-by-country approach, and a euro area perspective is then obtained simply by adding the assessments of the twelve individual countries. In many cases, the analysis is restricted to one or a few of the largest countries, still euro area-wide conclusions are drawn. This might have been conceivable in the initial phase of the monetary union, but this approach becomes increasingly unsatisfactory as integration develops further. Not only do the dynamics start to reflect the fact that we have a common economic area, but behaviour is also changing. The latter is particularly true for price and

* *Johnny Åkerholm is Under-Secretary of State for Economic Affairs in the Ministry of Finance, Finland.*

wage behaviour, on which the monetary union should be expected to have a direct impact.

How does behaviour evolve and at what speed? The academic profession is invited to contribute empirical analyses but, of course, policy makers will have to assess the situation and take decisions even if such results are absent. Hence, there is a constant need to assess the situation, the dynamics, and to identify shocks and evaluate their impact.

The Euro Group provides an excellent forum for the policy part of such discussions, as it is an informal setting for discussions between Ministers and the ECB President. These monthly discussions do not impinge on the independence of the ECB and have provided an opportunity for a deepening of this dialogue. No doubt, there is ample of room for improvement, however. In the decision-making, the ECB naturally takes its independent view and implements its independent policies.

Ex ante coordination of policies is considerably more demanding both practically and politically. Practically, this implies that budgetary plans (not only the balance but also tax and expenditure structures) should be discussed at the euro area level before they are presented to the domestic audience; the possibilities to modify such plans become much more limited once they are out in the public. At that stage, it becomes a question of who decides and who has to adjust plans. As shown by recent experiences, such discussions easily get out of proportions. Indeed, it is not always feasible for a minister to present plans to his foreign colleagues before presenting them to his colleagues in the government (in particular if the discussions have a real impact on policies). In order to change these procedures, we would have to re-work the balance of responsibilities in fiscal policies between EU and domestic institutions.

But even if the institutional framework were in place, the planning process is more demanding than is perhaps implied in the H&M paper. In early spring, one must agree on the budget plans for the following year both for the area as a whole and for the individual countries. When looking 18 months back in time, we realize how little we actually knew about economic developments and possible shocks within such a time-frame.

This kind of coordination is also difficult for the ECB. As such, the clear policy targets of the ECB provide a good framework for discussions. But even if the achievement of the “medium-term inflation

target” provides room for short-term deviations in the adjustment to shocks, there is no way of quantifying these in advance or introducing mechanistic rules.

This is not saying that there is no room for improvements. Even if a rigorous implementation of the “H&M-scheme for policy coordination” does not seem analytically or practically feasible, much can be done to improve the coordination process and deal with the concerns expressed in the paper. In particular, the grounds for common assessments and policy discussions should be improved. It should also be possible to discuss different policy plans in advance, even if these would not amount to a full-scale ex ante coordination.

Moreover, a large number of procedures have been developed over the years. They engage considerable resources, but they do not necessarily contribute to a clear picture of policy intentions in the euro area, nor do they ensure the implementation of the numerous plans. In principle, the Broad Economic Policy Guidelines (BEPGs) provide the framework under which economic policies are coordinated. However, in practice, this document is still suffering from fragmentation and lack of focus. Indeed, instead of being “broad guidelines”, the BEPGs are currently burdened with excessive details. In particular, they should give a clear picture of the policy challenges as seen by decision makers and present the plans to deal with these challenges.

In short, the BEPGs should amount to the policy statement of the euro area and there should be mechanisms in place to ensure that the plans are implemented.

