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Macroeconomic Policy at a Turning Point: 25 Years of EU Macroeconomic Dialogue

This year marks the 25th anniversary of the EU's Macroeconomic Dialogue (MED). Since entering its third decade, the MED has already faced two massive crises: the COVID-19 pandemic and the surge in energy prices. Yet European economic policymakers continue to face multiple macro-structural challenges that will also have an impact on the future work of the MED. This article explores the role of the MED during the two recent crises and considers its evolving responsibilities, particularly in light of the EU's goal of climate neutrality.

The main features of the EU's Macroeconomic Dialogue (MED) were proposed by the Vienna European Council in December 1998, drafted during the German Presidency and adopted by the Cologne European Council in early June 1999 (Koll, 2005). The first meeting at the political level took place under the Finnish Presidency in autumn 1999. The MED includes the Finance Minister of the presidency as chairman as well as the finance ministers of the past and future presidencies, the President of the European Central Bank (ECB), the Commissioners for Economic and Financial Affairs and for Employment, the European associations of employers and trade unions and the moderator of the MED at the technical level. The MED meets twice a year and is prepared by the MED at the technical level. Its agenda includes reaching a common understanding of the situation and prospects for macroeconomic development, identifying economic policy challenges, as well as the contribution that each actor makes to solving them and its expectations of the contributions of the other actors. A corresponding body at the level of the member states was planned; however, it has only been established in Germany.

The aim of the MED is, on the one hand, to avoid conflicts between economic policymakers. For example, in Germany, during the oil price crises of 1973 and 1979 and after reunification in 1990, a lack of coordination between different actors led to massive wage and price increases and equally sharp interest rate hikes. The result was a shock-like increase in inflation and unemployment. Recognising this, the MED is intended to contribute to growth-, stability- and employment-oriented macroeconomic policy through cooperation.

Action is guided by the insight that economic policy actors are neither self-sufficient in achieving their assigned goal nor neutral with regard to the goals of other actors. For example, independent monetary policy could achieve its price stability objective on its own if fiscal and wage policy behave in a way that is contrary to stability. However, this would only be at the high price of a stabilisation recession with a sharp increase in unemployment and fiscal deficits, which might, in turn, jeopardise acceptance of the political independence of monetary policy. This interdependence of macroeconomic actors is described in the 1997 broad guidelines of the economic policies of the member states and of the Community as follows: "The more the stability task of monetary policy were facilitated by appropriate budgetary measures and wage developments, the more monetary conditions, including exchange rates and long-term interest rates, would be favourable to growth and employment" (Council of the European Union, 1997).

The task of the MED is to contribute to such a favourable constellation, especially under the conditions of the Economic and Monetary Union. Given different in-

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terests, mutual signalling through dialogue should lead to a convergence of positions and agreement on a consistent assessment of the developing economic situation. The individual participants are independent. In this respect, there are no binding obligations. The implementation takes place in the decision-making bodies of the respective participants; however, against the background of a cooperative view and strategy, as discussed in the MED. Each actor's cooperative contribution is a prerequisite for the result desired by all, and a refusal to cooperate makes it much harder to realise his own objective.

In the meantime, the President of the Eurogroup also participates in the meetings of the MED and could thus report on the discussion in the regular subsequent meeting of the Eurogroup. The preparation at the technical level (MEDTECH) for the dialogue at the political level (MEDPOL) has been improved.[1]

As a further innovation, after the discussion of macroeconomic development and perspectives, the permanent agenda item "Policy Challenges" includes a current special topic with macroeconomic relevance. Its content is set in advance by the participants, in light, notably, of the priorities of the respective presidency.

Finally, the oft-voiced desire for greater visibility of the MED to the outside world was taken into account without jeopardising the confidential nature of the respective meetings. In addition to a short round-table video on the participants before starting the MED, press quotes are published after each MEDPOL meeting, summarising the key statements of the respective participants (with the exception of the ECB).

The MED and economic governance reform

In February 2020, an EU economic governance review started; it was interrupted by the COVID-19 crisis and then resumed. On 30 April 2024, the new economic governance framework entered into force. The main objectives of the new fiscal framework are strengthening member states' debt sustainability, stronger national ownership with medium-term plans, simpler rules taking account of different fiscal challenges, promoting reforms and public investment, and enhancing enforcement including a rudimentary interlocking of the Stability and Growth Pact (SGP) and the Macroeconomic Imbalance Procedure (MIP) (European Commission, 2024).

As regards the role of the MED in the course of these and previous reforms, the establishment of a MED for the specific coordination needs of the euro area has been called for before, as in the Five Presidents Report in June 2015, but without further action. In general, the MED has had a life of its own outside the European Semester and the reform agenda. The amendment of economic governance is essentially limited to the fiscal part; the MIP is referred to only briefly. However, an equally fundamental reform of the MIP itself is still pending. It is all the more important because, unlike the reformed SGP, the MIP covers the entire macroeconomy. Last but not least, excessive macroeconomic divergences in domestic demand and external balance between the member states led to crisis in the euro area.

The danger still exists; it should be averted by a more powerful MIP with other macroeconomically relevant and symmetrical indicators, as well as stronger ownership by the member states (Koll & Watt, 2022). The appropriate place for discussing the development of macroeconomic imbalances and their correction is the EU Macroeconomic Dialogue as well as corresponding macro-dialogues at the national level; they have yet to be established and integrated into the European Semester. The European Parliament as well as numerous contributions from the scientific community have spoken out in favour of the complete inclusion of the MED in the economic governance of the EU at the national and euro area level (European Parliament, 2021).

Recent crises and the role of the MED

Since the COVID-19 pandemic began in 2020, the MED was confronted with supply bottlenecks, as well as nationwide short-time work and closures of various kinds that led to a massive slump in the economy, with strong sectoral distortions such as in tourism and other service sectors. The MED supported activating the SGP's general escape clause and the labour market support measures provided by the SURE instrument. Against this background, the Recovery and Resilience Facility under the NextGenerationEU programme played a particularly important role. Social partners in the MED stressed the importance of being actively involved in its national implementation.

Economic developments had just begun to recover from the pandemic when the war in Ukraine broke out in Feb-

1 For example, the MEDTECH mediator now reports on the results of the dialogue at the technical level in a letter to the respective chairperson of the subsequent MEDPOL. The Chair develops a key issues paper from this, which combines the discussion at the MEDTECH level with key political statements and attaches discussion questions. The key issues paper is then sent to the participants of the MEDPOL in time for the next meeting, thus enabling each actor to be better prepared.

ruary 2022. Higher world market prices for energy, raw materials and food threatened to cause widespread inflation. The exchange of ideas in the MED was therefore aimed at avoiding secondary inflation via wages and prices feeding on each other. To this end, the social partners were asked to observe responsible wage setting. On the one hand, it was argued that price increases caused by external shocks cannot be fully compensated for by wage increases. On the other hand, the representatives of the trade unions referred to the associated substantial real wage cuts. From their point of view, the incipient inflation was driven by a profit-price spiral. Representatives of the employers on the other hand argued that producer prices had risen significantly more sharply than consumer prices.

At the same time as the MED of 23 May 2022, the President of the ECB announced a "normalisation" of monetary policy by ending the Asset Purchase Programme (APP) and gradually raising interest rates in view of a harmonised index of consumer prices (HICP) that had risen by almost 10% and a "homemade" core inflation of 3.5%. While some considered this step necessary to fight inflation, others pointed to the slump in investment activity caused by it. Some participants emphasised the robustness of the labour market, others pointed to the low level of hours worked compared to 2019 and advocated for an extension of the SGP's escape clause. All participants called for effective reform of the EU's economic governance that takes equal account of debt sustainability, investments and structural reforms.

Recently, the discussion in the MED has focused on maintaining the competitiveness and attractiveness of the EU as a business location in the face of tendencies to relocate investments outside the EU. In particular, the differences in energy costs and investment promotion between the USA and the EU were addressed. Actors called for relief in energy prices, a reduction in administrative and regulatory requirements, combating the shortage of skilled workers in the face of demographic change, the creation of a single capital market and a permanent EU investment instrument, also in response to the US Inflation Reduction Act. The transformation towards climate neutrality must be combined with maintaining competitiveness within the framework of the Net-Zero Industry Act. In addition, measures of upskilling and reskilling in view of the green and digital transitions were discussed, along with the need to enhance EU defence financing.

The discussions in the MED were unanimously welcomed by the participants themselves as substantial and helpful. It remains unclear to what extent the discussions of the situation and prospects as well as economic policy challenges and solutions influenced the decisions of the actors.[2] In reality, wages and profits caused a secondary inflation and monetary restrictions. The participants of the MED had warned of this several times. This discrepancy between macro dialogue and reality gives rise to a self-critical assessment of the effectiveness of the MED.

The MED and climate policy preserving macroeconomic stability

At present, economic policy faces multiple macrostructural challenges, as enumerated in the European Council's Strategic Agenda 2024-2029, the 2024-2029 guidelines of the President of the European Commission or the recent Letta (2024) and Draghi (2024) reports. Among these challenges, the achievement of global climate neutrality is urgent and important in view of its damage incidence, irreversibility and duration. For this reason, we look at the role of the MED in coping with the structural change induced by climate policy while preserving the traditional macroeconomic goals such as full employment and price stability.[3]

Climate policy with the goal of climate neutrality is a global task and so is its implementation. However, an initiative on a global scale is still largely missing and is therefore mostly limited to regional areas and initiatives. A prominent example of this is the EU's commitment to achieve climate neutrality by 2050. To this end, the Green Deal 2019 and the European Climate Law 2021 were adopted. Through the NextGenerationEU programme package, the community has provided member states with significant earmarked resources under the Recovery and Resilience Facility to implement the structural changes required to avert climate change. National CO_2 taxes or CO_2 certificates within the framework of Emission Trading Systems ETS I and ETS II for fossil products and production are intended to steer the economy towards climate neutrality via price signals. The recently passed Net-Zero Industry Act in the wake of the Clean Deal Industrial Plan was created to combine transformation and competitiveness.

Like the costs of migration and defence, the climate policy transformation involves a fiscal challenge. This concerns the revenue from CO_2 pricing and its use as well as the policies to promote climate-neutral private investment and expand public infrastructure. As with

2 This question should be answered in the context of a self-evaluation of the MED, as proposed at the end of the article.
3 For this section, see Koll (2024).

the energy price shock, climate policy also threatens to provide a strong price impulse, this time not from a geopolitical shortage of fossil energy. Rather, the danger comes from the progressive increase in the price of fossil fuels through CO_2 taxes or certificate prices.[4] The aim must be to limit their impact on the HICP and thus on the real purchasing power of private households and on the price stability target of monetary policy. A wage-price spiral resulting in higher core inflation must be avoided. A number of measures are proposed for this purpose: reducing demand for fossil energy by promoting climate-neutral private investment and public infrastructure as instruments of a green industrial policy at national and EU level; specifying a predictable, stable CO_2 price path (Schulmeister, 2022; Draghi, 2024) and stabilising price fluctuations for both fossil and renewable energies in systemically significant sectors, in particular through buffer stocks and regulation (Weber et al., 2024);[5] and the return of the revenue from CO_2 taxes and certificates. Different procedures are proposed for the return of CO_2 revenues:[6]

- A reduction in the value added tax (VAT) or other levies by the same amount of CO_2 revenues, given their full passing on in companies' price setting, can fully compensate for the effects of the increase in the price of fossil fuels on HICP.

- A return via transfer payment, e.g. in the form of the lump sum "climate money" for Germany, if implemented in a completely revenue-neutral manner, can preserve the nominal purchasing power of private households. Unlike a reduction in levies, however, it cannot avoid the price-driving effect of CO_2 levies on HICP and thus on the real purchasing power and the price stability target of monetary policy due to the current price elasticity of the demand for fossil energy less than one (Bach et al., 2019; Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, 2019, p. 112).

- The promotion of climate-neutral private investment in companies and measures in private households as well as development of a public climate-neutral infrastructure would also contribute to the return of CO_2 revenues.[7]

Comparing the aforementioned instruments raises the question of how much and how quickly climate-neutral technological progress and transition can be achieved by promoting private investment and public infrastructure.[8] Climate-neutral investments take time during their gestation and therefore require frontloading of investment promotion. On the other hand, a prompt return of CO_2 revenues to private households immediately relieves the pressure on purchasing power. It also has a high level of visibility and may partly be focussed on support for people in need. All of this seems necessary for people to accept climate policy and for politicians to be able to enforce it. However, a partial or even preferential use of CO_2 revenues for supply-side support measures would then not be available for fully stabilising purchasing power and avoiding threats to the price stability target of monetary policy. Not least for this reason, but also for a fair intergenerational allocation of benefits and costs, the promotion of private investments and public infrastructure investments should be financed through loans, e.g. from special funds, financed by public authorities or by private investors.

What do the above considerations mean for the role of MED in climate change?

For an uncertain transitional period, despite support measures for private investment and public infrastructure, due to the current very low price elasticity of the demand for fossil energy, the progressive increase in CO_2 levies, weighted by the volume of fossil use, has a significant effect on the HICP (Dullien, 2024; Draghi, 2024). Compensating for or accepting this price effect from CO_2 taxes and certificates requires coordination between the macroeconomic actors.

- The price effect of CO_2 levies on the development of the HICP must be determined. There must be agreement that it results from the increase in the price of a single, albeit widely used fossil good. This price signal is necessary for the transformation and should not represent inflation.

4 "Whether this increase will be a one-off or a slow-moving, prolonged process of higher inflation depends on the policy design" (ECB, 2021, p. 123). One of the decisive factors here is the change in the price elasticity of demand for fossil and renewable energy in the process towards climate neutrality.

5 This will smooth out the price development of fossil energy; however, its price trend and hence its impact on the purchasing power remain upward due to the progressive increase in CO_2 levies to achieve climate neutrality.

6 "Carbon pricing would generate significant fiscal revenues that could be used to reduce more distortionary taxes and support the groups most vulnerable to the transition" (ECB, 2021, p. 32). See also Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, 2019; Koll, 2024; Heussaff et al., 2024.

7 "The report recommends earmarking a larger share of ETS revenues to Energy Extensive Industries" (Draghi, 2024, p. 46).

8 "[T]he emergence and effects of innovations are difficult if not impossible to forecast" (ECB, 2021, p. 123). "All pathways to a net-zero economy rely to a certain extent on novel or evolving technologies that so far are unproven at large scale" (Heussaf et al., 2024).

- If revenues are recycled through a reduction in VAT, businesses must pass this reduction on in full in their pricing. This requires functioning competition. In the case of monopoly-like structures, price controls are proposed (Weber & Wasner, 2023).

- In the event of a restitution through a reduction in taxes on wages and other wage-related levies, nominal wage growth should be correspondingly less high. This would achieve the same net wage level as higher nominal wage but without the return. As in the case of the reduction in VAT, companies in their price setting will have to take full account of the fact that unit labour costs have risen less sharply than they otherwise would have.[9]

- As described above, a return by climate money preserves the nominal purchasing power of incomes of private households, but not the real one. At the same time, the price stability objective of monetary policy might be threatened. Both effects must be borne by the respective economic policy actors: wage- and price-setters must not use the CO_2-related increase in HICP as an opportunity for secondary core inflation but must continue to be oriented towards the price stability objective of monetary policy plus productivity growth. Monetary policy must not react to the CO_2 price effect with restrictive policy. It must exclude this effect from the HICP and disregard it in policy decisions as long as core inflation is avoided by the stability-oriented wage and price setting required above.[10]

- In terms of foreign trade, a significant price effect caused by climate policy must be neutralised. Partial protection will be offered by the Carbon Border Adjustment Mechanism (CBAM). It has been tackled on a trial basis, i.e. for three years and without the imposition of import duties; however, it must be supplemented by a corresponding relief of export prices. Alternatively, an international carbon price floor or climate clubs are proposed.

The MED at the EU level, supplemented by a corresponding body at the level of the member states, is the place to develop a common and consistent view of the problems and solutions as described above and to contribute to appropriate action by the respective macroeconomic actors in their area of competence and responsibility. In the wake of the energy price shock, a so-called Concerted Action has met several times in Germany to limit the consequences. Its composition was roughly the same as that of the MED. However, unlike the energy price crisis, achieving climate neutrality is an ongoing task. Therefore, this coordination requires permanent institutionalisation, as is the case in the MED. Uncertainty, climate-related problems on the financial markets and, above all, structural change can dampen growth and employment. An expansionary macro policy, especially comparatively lower interest rates, must counteract this (Horn, 2005).[11]

Adapting the MED to the new challenges

Like economic policy as a whole, the MED must also adapt itself, after 25 years, in view of the many new challenges. On the one hand, the current agenda must be maintained, i.e. achieving a common understanding of the situation and prospects for macroeconomic development and the identification of economic policy challenges in order to safeguard traditional macroeconomic goals such as price stability and a high level of employment at the national and EU level. The observance of these goals is a necessary condition. However, it will only be sufficient if it achieves this while incorporating the new macrostructural targets. This requires a fundamental evaluation of the MED. It can be done internally by the participants and/or by an external institution. At this point, only a few suggestions can be made or repeated, which result from the ample literature, previous experience and new challenges (e.g. Hallwirth & Koll, 2009; Koll, 2020).

The establishment of a MED for the euro area was proposed very early on and several times. As the crisis in the euro area has shown, the disappearance of national currencies and the single monetary policy require stronger coordination and cooperation than for non-EMU member states.

The establishment of a MED among all national members of the EU (MEDNAT), which brings with it an agenda that is the same as that of the MED at the EU level. This measure is indispensable. The euro area crisis has already shown that macroeconomic stability in the euro area as a whole is no guarantee against the emergence of massive macroeconomic divergences between the member states. This is all the more true for the implementation of the macrostructural agenda towards cli-

9 "When the funds are used to reduce social contributions, labour costs are reduced and employment increases" (ECB, 2021, p. 58).

10 „In the first instance, the central bank "looks through" the relative price shock and targets only core inflation" (ECB, 2021, p. 131).

11 "Several risks related to climate change may imply a dampening force on the natural rate of interest (r*)" (ECB, 2021, p. 108). Due to additional uncertainty and higher costs of climate-friendly investment activity, a comparably stable investment volume can only be expected at a correspondingly lower interest rate level (Koll, 2023).

mate neutrality. The more these and other tasks are implemented at the national level, the less there is a need for subsidiary (emergency) measures at the EU level. The Independent Fiscal Institutions (Barnes, 2022) as well as the National Productivity Boards and their links to the EU level could be starting points for the formation of a MEDNAT. The prerequisite for such a MEDNAT is the existence of effective social partners at the macroeconomic level. At present, there are still considerable deficits in this area, which will need to be eliminated as is foreseen by the EU directive on minimum wages and strengthening collective bargaining.

Economic expertise in the preparation and support of the MED at national and EU level. At the EU level, the European Fiscal Board could take over this task; at the national level, there are bodies with macroeconomic expertise that could address this.

Inclusion of the MED in the framework of economic policy coordination at EU level. If the MED is to take over these tasks, in particular within the framework of the MIP, it must be integrated into the agenda of the European Semester and other activities in an appropriate place while preserving the independence of the participants.

Creation of a permanent chair of the MED. So far, the chairmanship alternates with the respective presidency. The new chairperson has to become familiar with the agenda of the MED every time. In view of the permanence of the macro-structural problems, this constant short-term change stands in the way of a corresponding continuity of the work of the MED. A suitable candidate for a permanent presidency is the president of the Eurogroup, who participates in the MED anyway.

Improvement of the institutional constitution of the MED. This includes, for example, regular and effective feedback on key results of the dialogue to the ECOFIN Council and the Eurogroup, but also to the committees of the other participants by their members in the MED.

Duration, possibly also the number of meetings should be adapted to the agenda including the above-mentioned macrostructural issues. Within the meetings and for the same reason, more time must be set aside for a substantial exchange of views.

More intensive preparation of the MED at the political level by the MED at the technical level. The MEDTECH must also meet the increased requirements and contribute to the effective operation of the MEDPOL. This means more time, more expertise, better support from a separate secretariat and topic-specific workshops with quantified policy scenarios at both the national and EU level.

Conclusions

In the 25th year of its existence, the MED is facing a fundamental change in the economic policy agenda. Maintaining macroeconomic stability must now be achieved at the same time as addressing macrostructural challenges. In order to do justice to this dual task, the MED must also adapt itself by its concept and institution. Some suggestions for improving its architecture have been made in this article. Others could be identified as part of an internal and/or external evaluation. In any case, closer integration between the EU and national levels is indispensable. Above all, however, it is necessary to develop a common view of the participants on the extended agenda for economic policy actions as outlined above.

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