

#### **Box 4**

##### **The European Employment Pact**

The high level of unemployment and the low rate of employment in Europe are the most challenging issues currently faced by the European Union. In the past two years there has been a marked increase in initiatives at the Community level to address these issues. The conclusions of the last four European Council meetings reflect the progressive implementation of concerted European initiatives to reduce unemployment and promote employment growth in a context of price stability.

A key element of recent initiatives at the Community level has been the emphasis placed on the need for economic reforms, as it is widely accepted that unemployment in Europe is largely structural in nature. At its meeting on the co-ordination of economic policy in EMU in Luxembourg (12 and 13 December 1997) the European Council devoted a special session to the labour market issue. It was agreed that co-ordination was also required in the employment area. The co-ordinated employment strategy lies within the framework of the Broad Economic Policy Guidelines, the Employment Guidelines and the National Action Plans. While the National Action Plans, which are prepared by the Member States, determine specific areas of action for each country, the Employment Guidelines define general principles to improve labour market performance. These principles point in four directions: (1) at improving employability, in particular that of young people and the long-term unemployed; (2) at developing entrepreneurship by making it easier to start up and run businesses; (3) at encouraging the adaptability of businesses and their employees, notably through more flexible working arrangements; and (4) at strengthening equal opportunity policies for women and men, which should permit a higher participation rate for women.

The European Council meeting in Cardiff (15 and 16 June 1998), which addressed the issue of economic reforms, also added a crucial second pillar to the European employment strategy. This process aims at initiating reforms that improve competitiveness and the functioning of the markets for goods, services and capital. Positive employment effects can be expected from a better functioning of markets and the further development of new technologies. The Cardiff process also provides an important opportunity to ensure that structural reforms are as conducive as possible to employment growth.

At its Vienna meeting (11 and 12 December 1998), the European Council decided that a policy for more employment, encompassing both a macroeconomic policy directed towards growth and stability and the implementation of structural reforms, needed to be enhanced by a broad strategy. The European Employment Pact, which was adopted at the summit meeting in Cologne (3 and 4 June 1999) supplements the two pillars stemming from the Luxembourg and Cardiff processes with a third pillar, which consists of a regular macroeconomic dialogue at the EU level between all the economic actors involved, i.e. the governments, the European Commission, the European Central Bank and the social partners.

The regular economic dialogue established by the European Employment Pact provides an opportunity for policy-makers to assess progress towards lower unemployment and higher, non-inflationary employment growth, while, at the same time, respecting their independence and autonomy in their own areas of responsibility. It recognises the tasks and responsibilities of individual policy areas, i.e. the observance of the objectives of the Stability and Growth Pact, the maintenance of price stability and the determination of wages, with employment-promoting pay rises in line with the price stability objective of the European Central Bank. This dialogue could prove to be valuable, since important lessons in this area can be drawn by exchanging views on national experiences. Among these lessons, the analysis of national experiences shows that reforms should be of a comprehensive nature, since countries which are at a more advanced stage of implementing a wide range of reforms have been more successful in reducing unemployment. This should give incentives to other countries to continue and reinforce their efforts in this area. Moreover, as implementing reforms is a lengthy process and benefits take time to materialise, any delay would hamper swift progress in employment creation and the reduction of unemployment.

In this context, the best contribution monetary policy can make to fostering employment growth and reducing unemployment in the medium and long term is to maintain price stability. An environment of price stability reduces the inflation risk premia in long-term interest rates, thereby helping to reduce the cost of financing productive investment. It also facilitates the investment decisions of economic agents (firms, households and governments) by stabilising their expectations. Furthermore, it prevents costs from being incurred when inflation or deflation exacerbates the distortions created by tax and benefits systems. Overall, it creates favourable conditions to support the long-term growth potential, which is necessary to foster employment over the medium term.