Institut d'Etudes Européennes
et Internationales du Luxembourg

Luxembourg Institute for European
and International Studies

EXECUTIVE SUMMARY

Conference on

The Political Economy of the Lisbon Agenda

12 and 13 April 2005
Chamber of Commerce, Luxembourg

Abstract

Within the framework of the Luxembourg Presidency of the European Council, the Luxembourg Ministry of the Economy and Foreign Trade, in association with the Luxembourg Institute for European and International Studies (LIEIS), organised a conference on "The Political Economy of the Lisbon Agenda" on 12 and 13 April 2005 at the Chamber of Commerce in Luxembourg. With a view to recent reforms of the Stability and Growth Pact and to the new guidelines on the Lisbon Agenda adopted by the ECOFIN Council on 12 April 2005, the aim of this conference was to identify the reasons for the implementation gap and to discuss alternative strategies in order to achieve the objectives of the Lisbon Agenda – to transform the EU into the most competitive economy of the world.

The conference brought together approximately 60 participants – academics, policy- and decision-makers – from most EU member states and also from the USA. In the course of extensive discussions and on the basis of a keynote and short presentations, the following three conclusions and 12 concrete policy recommendations emerged:

(1) recognising the current lag and gap involved in implementing the Lisbon Agenda and national structural reforms and adopting a new innovative approach that matches the ambition of the Agenda to turn the EU into 'the world's most dynamic and competitive economy';

(2) highlighting the complementarity of the Lisbon objectives and national structural reforms and forging a consensus on the desirability and the feasibility of structural transformation involving decision- and policy-makers as well as expert communities, the social partners and civil society representatives;

(3) addressing the wider political aspects that arise from structural reforms, including questions of democracy and legitimacy, and developing a common strategic vision on how to build a knowledge society and economy.

The 12 following policy recommendations were put forward by various participants:

A. in order to reduce the implementation lag and gap

(1) relating the streamlining of the Agenda to the reform of the other two pillars of the EU's economic governance, i.e. the financial perspective 2007-2013 and the Stability and Growth Pact;

(2) adopting and extending the 'open method of coordination' in order to align the Lisbon process with national structural reform programmes and to strengthen the macroeconomic dialogue;

(3) focusing on a much smaller set of top priorities, and de-politicising and simplifying the economic indicators by adopting efficiency-related and specific yardsticks (not input-related and aggregate yardsticks);

(4) redesigning and improving the delivery mechanisms and publishing an official scoreboard by the European Commission that ranks member states according to their implementation performance;

B. in order to enhance competitiveness, growth and employment beyond the targets and instruments of the Lisbon Agenda

(5) fostering competition within the common market, especially product-markets (and perhaps including the reduction or abolition of agricultural subsidies and the introduction of corporate tax competition);

(6) increasing immigration in order to ease the pressure on labour-markets, especially in order to address the problem of skill shortage;

(7) raising the retirement age from the current average of 60-65 to 67 or 69 in order to anticipate the looming pension crisis;

(8) strengthening core skills by radically decentralising vocational training and entrusting it, at least in part, to small and medium enterprises;

C. in order to build a knowledge economy and society

(9) conjoining the implementation of structural reforms with a view to higher economic competitiveness with the protection of the European economic and social model based on liberal democracy and social market economy;

(10) developing a common strategic vision on education and research; setting up a system of European universities and an EU Science and Research Council; sharing the fruits of research by creating alternative ways of dissemination;

(11) reinvigorating the EU by associating expert communities to national and EU policy- and decision-making and by renewing bureaucracies and politics;

(12) conducting a debate on the finality of the EU as a political union beyond the Constitutional Treaty.

I. The EU, member states and structural reforms

In the course of the keynote address and the subsequent discussions, it was said that alongside the EC budget and the Euro, the Lisbon Agenda is an integral part of the EU's economic architecture. As such, the structural reforms of the Lisbon Agenda should be seen in the context of the economic governance of the Union, which faces three simultaneous challenges: first of all, the financial perspective 2007-2013; secondly, the future of the Stability and Growth Pact (SGP); thirdly, the implementation of the Lisbon Agenda. The key problem of the Lisbon strategy has been the disconnection from the other two pillars of the EU economic governance (Mario Monti).

The Luxembourg Presidency has already rendered great services to the Union by reforming the SGP, even if the rules governing expenditure continue to privilege private consumption vis-à-vis public investment and bigger member states vis-à-vis smaller. More generally, these reforms have followed an economic rationale and relegated political considerations, which is problematic insofar as the stability within the Eurozone hinges on a political commitment to the common objective of discipline (M. Monti).

But to improve the SGP is also to drive forward the Lisbon process because more fiscal stability and flexibility enhances growth and employment, while also reducing the possibility of a contagion effect, i.e. the spill-over of fiscal imbalances to monetary conditions and the overall economic situation (Jeannot Krecké, M. Monti). The point is not to rethink the whole Lisbon Agenda, but to modify the delivery mechanisms. The new, integrated guidelines for the Lisbon process which were adopted by the ECOFIN Council on 12 April bring the ownership of structural reforms back into the fold of member states, in the form of national action plans (J. Krecké); this is in response to the widely shared perception that such an approach encounters less resistance than reform proposals put forward by the European Commission, e.g. opposition on the part of trade unions.

On the other hand, it is critical to publish an official scoreboard that ranks member states according to their implementation performance. The European Commission would be best placed to produce such a scoreboard. In turn, this requires a radical simplification of the set of economic indicators that underlie the Agenda (Samuel Brittan). To simplify the indicators and to publish an official scoreboard would raise the political pressure and thereby counter-balance the recent emphasis on the economic rationale of reforms (M. Monti). The aim of reforming the Lisbon Agenda is to align the implementation of Lisbon with national structural reforms in such a way that both processes are complementary, not rival or conflicting (Serge Allegrezza).

A number of problems remain: first of all, how to translate competitiveness, which is a microeconomic concept, to the macroeconomic level? In response to this difficulty, the USA uses indices of competition, of productivity and of living standards. This is because there is a statistically significant correlation between the degree of competition and productivity at the sectoral level and between productivity and competitiveness at the macroeconomic level. Therefore EU competition policy within the common market is a decisive factor for the EU's competitiveness within the world economy (Richard Cooper). Secondly, how to involve the social partners and civil society? Thirdly, how to strengthen investment in the areas of research, education and training in order to build a knowledge society and a knowledge economy?

Europe already lags behind the USA and Japan in general and behind India and China in some particular domains. A substantial increase in investment is therefore paramount to catching up and to helping close the implementation gap of the Lisbon Agenda. In order to achieve this ambitious objective, Europe can draw on some of its strengths like a solid industrial basis and an extensive and intensive capital endowment. The aim is not some race-to-the-bottom at the expense of social justice but to build high value-added products with a high-level labour force so as to minimise brain-drain to the USA and outsourcing to India and China (J. Krecké). Ultimately, the challenge is how to conjoin the implementation of structural reforms with a view to higher economic competitiveness with the protection of the European economic and social model based on liberal democracy and social market economy (M. Monti).

II. <u>Explaining the implementation lag and gap of the Lisbon Agenda (and of national structural reforms programmes)</u>

There was unanimous agreement among the experts and policy- and decision-makers that the results of implementing the Lisbon Agenda have been mixed, i.e. disappointing. The lack of implementation raises three questions (S. Allegrezza):

(1) is there a 'J-curve' effect, rather than an implementation gap, i.e. an initial worsening in the wake of reforms followed by a subsequent improvement?

(2) is there an implementation gap, as a result of a bureaucratic approach and a wrong choice of instruments in order to translate the right objectives into concrete policies?

(3) is the problem at the level of objectives that are misguided and inadequate to improve growth and employment in the EU?

Within the EU, there is a consensus on the need for structural reforms (healthcare, pensions, labour-markets, etc.) in order to boost competitiveness and thereby economic growth and employment. However, a number of factors pose an obstacle to the agreement on reforms and their implementation. First of all, there are some 'rational' reasons for opposing reforms such as the prospect of loosing privileges, the initial worsening of the economic situation (also known as 'J-curve' effect) and uncertain outcomes in the wake of reforms. All these factors are compounded by the increasing emphasis on the short-term and the ensuing short-sightedness of socio-economic actors. Secondly, there are 'reasons' for opposing reforms which are due to limited or 'bounded' rationality, e.g. preferences for the *status quo*. Thirdly, there are country-specific obstacles to reforms: smaller countries react faster to crises than bigger countries; the unclear designation of responsibility within federal structures; the experience of deep recessions that generate a sense of crisis and of the need for profound change (Friedrich Heinemann).

Both the Lisbon Agenda and national structural reform programmes pose further problems to the effective implementation of successful reforms, above all in terms of the nature of the economic indicators and yardsticks. The Lisbon Agenda privileges input-related indicators, which not only favours high-income countries vis-à-vis lower-income countries but also fails to encourage efficiency and output (F. Heinemann). Such input yardsticks and the target culture they are part of would not have enabled the major scientific discoveries of the 19th and the 20th century and are not propitious to creating a knowledge economy and society (S. Brittan, Robert Skidelsky). It is therefore economically preferable to use efficiency-related measures. Equally, the aggregate yardsticks of the Lisbon Agenda lack any serious economic foundation and do not allow for diverse objectives and different weights. They only make sense on very specific objectives like labour-market flexibility or the Bologna process, but not for the complex objective of enhanced competitiveness (F. Heinemann).

The Lisbon Agenda also suffers from a lack of effectiveness at the level of implementation and delivery, which is due to the wrong method of coordination. Instead of using a hybrid combination of the intergovernmental and the supranational Community-method, the so-called 'open method of coordination' would be more appropriate to set EU-wide objectives, while also allowing national autonomy to translate these objectives into concrete measures and to implement them (F. Heinemann). This in turn would allow the alignment of the Lisbon Agenda with national structural reform programmes.

More fundamentally, the 'open method of coordination' would also help ensure an adequate provision of collective goods like public services. Exclusive emphasis on competition would privilege national interests at the expense of community interests, reinforcing the phenomenon of free-riding or strategic substitutability. As a result, there would not only be a lack of collective goods but also an increase in externalities. The only alternative is to highlight the convergence of national interests towards the common provision of some collective goods via the 'open method of coordination' (Stefan Collignon).

Finally, according to some participants, neither the Lisbon Agenda nor national structural reform programmes address some of the most fundamental problems of the European economy. First of all, the absence of exchange-rate flexibility within the Euro-zone constitutes a lack of adjustment in the face of internal and external challenges. Secondly, labour-market rigidities, especially the privileges defended by trade unions, price large parts of the active population out of employment and thereby prevent the necessary and possible clearing of labour markets at a much lower natural rate of unemployment (S. Brittan).

However, other participants contended that the EU would benefit not so much from supply-side as from demand-side policies. An unemployment rate of over 10 million and sluggish growth mean that the EU is already facing a socio-economic crisis, which warrants a substantial increase in public investment, e.g. public works or education and training (Reiner Hoffmann). The problem is how to re-integrate fiscal policy into the overall economic policy mix of the EU, while also taking into account that fiscal policy is accountable to national constituencies (S. Collignon).

More fundamentally, the prescriptions and the insufficiencies of the Lisbon Agenda raise questions about the desirability and the feasibility of the European economic and social model. According to some participants, the Lisbon Agenda is all things to everyone, either a catalyst for neo-liberal supply-side reforms or the blueprint for a federalist demand-driven European economic model (Nicolas Jabko, S. Brittan, Angus Maddison). Moreover, the European model is neither European, nor social and should not be a model to any country, in the sense that in its present configuration it combines the worst elements of the nation-state with the worst elements of a federation. In the absence of national exchange-rate flexibility, what is needed is a coherent policy mix that includes tight fiscal discipline to match the monetary policy discipline. The 10 new member states show the way to the EU in terms of a flat corporate tax and tax competition (S. Brittan).

Other participants defend the core targets of the Lisbon Agenda which combines demand- and supply-side policies that promote national sovereignty within a common framework (S. Collignon). Yet other participants questioned the economic rationale of raising the growth target from 2% *per annum* to 3% *per annum* and the labour participation rate from currently 60% to 70%. In the light of the demographic decline of the European society and the high capital endowment of the European economy, both targets are either bureaucratic fantasies or political illusions. By any standard, there is no crisis in Europe. The so-called pension bomb can also be disabled. For instance, the US pension system will only pose a problem in the absence of more immigration or of a higher retirement age, e.g. 67 or even 69 instead of 65 (R. Cooper). Such or similar solutions could also be found for the EU.

A number of concrete proposals follow from the obstacles to reform and the insufficiencies of current reform programmes: first of all, de-politicising the economic indicators; secondly, adopting and extending the ‘open method of coordination’; thirdly, increasing immigration to ease the pressure on labour-markets (e.g. skill shortage); fourthly increasing competition within the common market (perhaps including the reduction or abolition of agricultural subsidies and the introduction of tax competition).

III. <u>The relationship between competitiveness, economic growth and institutions</u>

According to some participants, the implementation lag and gap betrays not so much a ‘J-curve’ effect as a partially misguided approach. This is because despite a long list of structural reforms, productivity rates have changed little over time. The list of structural reforms within the EU over the last 10 years or so is by any standard impressive: the adoption of the European Single Act and the creation of the single market; the implementation and enforcement of an ambitious competition policy; extensive deregulation and privatisation across a wide array of sectors; the enlargement of the common market to 10 transition economies; the extension of international trade; the large-scale introduction of new technologies (especially ICTs); more recently, both labour-market and product-market reforms (e.g. reducing and limiting unemployment benefits and the European Commission’s service directive). Yet at the same time, productivity rates and productivity growth have not increased significantly in the wake of these reforms (Allan Larsson).

Moreover, the EU as a whole is in a number of respects a more open economy than the USA, in the sense that the USA gives more attention to domestic growth via consumption, while the EU tends to focus on external stability and savings. Among other things, this means that there is a potential tension between national and EU economic objectives which the Lisbon Agenda needs to address (A. Larsson). This points to the necessity of reinforcing macroeconomic coordination among member states, including social partners, not least because there are many commonalities, e.g. the stability of the overall policy mix secures workers' income and consumers' purchasing power. Sound macroeconomic policies require strong demand policies, i.e. real wage increases that match productivity growth. Yet while productivity has been growing steadily, real wages have increased by less than 1% over the last 10 years (R. Hoffmann).

One conclusion that follows from this analysis is that the macroeconomic dialogue between national governments and the social partners needs to be extended and that demand policies need to be boosted at the EU and at the national level (A. Larsson, R. Hoffmann, S. Allegrezza). More fundamentally, other participants called into question the scope for action on the part of social partners in the face of the growing weight of multinational corporations. The extent of 'corporate' capital and the increasing dependency on such capital has tended to generate not only volatility but also inequality and poverty. Instead of risking a repetition of the Latin American experience, especially Argentina, the EU should construct a single composite indicator and therefore promote real changes (Arno Tausch).

However, other participants advocated more supply-side policies in order to promote competitiveness within the EU. The first element of such a strategy is to set some clear priorities, not to pursue a multiplicity of heterogeneous objectives. The attempts on the part of the European Commission to streamline the Lisbon Agenda in this respect are a first step, but the shorter list of priorities still conflicts with the large number of policy areas (Tito Boeri). The second element of a supply-side strategy in order to revive the Lisbon process is to concentrate efforts on one pivotal factor of productivity, namely product-markets. Liberalisation of product-markets has not been exhausted as a means to improve productivity. Via the service industry, product-market reforms could have a significantly positive effect on investment and thereby on growth and employment. The third element is to concentrate the reform efforts on one strategy rather than one supranational Agenda and national action plans. This is because political sanctions are critical to the successful implementation of structural reforms but tend to be less well enforced at the EU than at the national level (T. Boeri).

However, there was disagreement about the relative importance of labour-market reforms in relation to product-market reforms. According to some participants, labour-market reforms cannot be controlled as effectively as product-market reforms. They also restrict the use of the subsidiarity principle in order to coordinate action at the EU level. In turn, this raises the question of whether EU targets for labour-market flexibility make sense, especially in the face of heterogeneity, political specificities and potential policy failures (T. Boeri). Another objection to labour-market reforms based on wage rigidity alone is the fact that the EU suffers from a rate of labour mobility which neither matches the potential within the common market nor reaches comparable international levels (R. Skidelsky).

Other participants contended that a key aspect of the debate on strengthening competitiveness is the interaction between monetary policy and structural reforms, in particular labour-market reforms (Serge Kolb). Structural reforms determine the level of resistance to exogenous shocks in terms of wage and price flexibility and they also shape consumer and producer confidence. As such, structural reforms have an impact on the real economy. In turn, the extent of wage and price flexibility is decisive in implementing monetary policy. Rigidities cause slow price adjustments and they therefore can either compound exogenous shocks (e.g. oil price rise) or fail to transmit policy impulses (e.g. interest rate cuts). Labour-market flexibility can also contain second-round effects, thus limiting inflationary pressures. (S. Kolb).

Finally, the combination of structural reforms and monetary policy not only contributes to price stability but can also have welfare effects. This is because there is a move from the Keynesian short-run adjustment (via quantities rather than prices) to the "classical" long-run: an increase in competition (as a result of structural reform) can improve the effectiveness of monetary policy by reducing the output loss through a reduction of the monopolistic power of both producers and workers. So the best possible contribution of monetary policy to competitiveness, growth and employment is to help provide a stable macroeconomic environment favourable to carrying out structural reforms which, in turn, will facilitate monetary policy and make it more effective (S. Kolb).

IV. The modalities of implementing structural reforms: how to transform European societies (democracy, the markets and the media)?

The implementation lag and gap raise not only questions about the Lisbon Agenda *per se* but also more fundamentally about the feasibility of reforming and transforming European societies by forging a genuine consensus between different actors and devising a common project and method of implementation. In this sense, competition is crucial to both the economic and the political realm (Nicolas Tenzer). At the level of the economy, the EU should not exclude *a priori* the possibility of corporate tax competition among member states, not least because the welfare effects in some of the 10 new EU countries (S. Brittan). All that is needed is to abolish domestic constraints and to remove barriers to the implementation of corporate tax competition. Moreover, at the level of politics, socio-economic and political elites can no longer afford to retain their privileges without loosing credibility and ultimately the power to effect any changes (N. Tenzer).

There was wide agreement on the absolute necessity to build not only a knowledge economy but also a knowledge society. However, a number of rival visions were put forward. For some participants, the key lies in adopting a more proactive and selective immigration policy that consists in attracting a high-skilled labour-force that maximises the potential of the EU's rich capital endowment (R. Cooper). For other participants, EU investment in education and research is – or at least should be – the main priority. One way to generate higher competitivity is to introduce sensible competition among European universities. Properly understood, 'academic' competition would help create powerful bodies with a critical mass and with strong incentives to achieve excellence. The motto of competition would be something like 'emulation through excellence'. This requires budgetary choices that prioritise investment in research and education and innovative instruments to translate the ideas into policies and thereby to make the ideal of a knowledge economy and society real (N. Tenzer).

Such a project would aim at charting an alternative both to centralised state-run and to privatised market-dominated higher education and research. Universities as we know them could be transformed into autonomous foundations that set their own standards and raise funding (Rolf Hasse). Establishing a European university system could involve the creation of a European Research or Science Agency with coordinating and advisory functions (Boris Walbaum). Based on specifically European needs and talents, European universities could also be grouped according to different areas of specialisation and excellence, e.g. economics at Bocconi University in Milan. At the same time, central functions like vocational training could be radically decentralised and entrusted, at least in part, to small and medium enterprises which play an insufficient role within the Lisbon Agenda (R. Hasse).

These reflections raised fundamental questions about the focal point of sovereignty. For some participants, the nation-state remains – or should remain – at the centre of decision-making and the EU should only act together if and when all national interests are thereby preserved and furthered. This involves the abolition of agricultural subsidies as part of the CAP that distort competition and absorb scarce resources (A. Maddison). Other participants acknowledge the current disconnection between Brussels and the member states yet at the same time advocated the overcoming of the nation-state as the sole repository of political legitimacy and the embrace of something like a 'variable geometry' that secures different levels of commitment to a common European project. Short of 'thick legitimacy' which is beyond the EU's immediate reach, the 'thin legitimacy' of variable geometry would enable the Union as a whole to differentiate countries without either imposing uniform targets or ostracising those who wish to opt out (R. Skidelsky). The debates on the wider economic and political modalities of structural reform and transformation illustrate not only the insights of political economy but also highlight the need for a fundamental debate on the future of Europe beyond the Constitutional Treaty.

Adrian Pabst
LIEIS

Présidence luxembourgeoise
du Conseil de l'Union européenne

Luxembourg Ministry of the Economy and Foreign Trade
Luxembourg Institute for European and International Studies

Conference on
"The Political Economy of the Lisbon Agenda"

12 and 13 April 2005
Chamber of Commerce, Luxembourg-Kirchberg

Programme

Tuesday, 12 April 2005

17.00 – 17.15	**Opening Address**:	**Jeannot Krecké**, Minister of the Economy and Foreign Trade, Luxembourg
17.15 – 18.00	**Keynote Address**:	**Mario Monti**, former European Commissioner; Chairman of the Board, Brussels European and Global Economic Laboratory (BRUEGEL), Brussels; President, Bocconi University, Milan ***"The political economy of structural reform: Lisbon and beyond"***
18.00 – 18.30	**Comments**:	**Samuel Brittan**, Commentator, Financial Times, London **Richard Cooper**, Professor, Center of International Affairs, Harvard University, Cambridge MA **Robert Skidelsky**, Professor, Dept. of Economics, Warwick University
18.30 – 19.30	Discussion	

Wednesday, 13 April 2005

09.00 – 10.45

Session 1: Explaining the implementation lag and gap of the Lisbon Agenda (and of national structural reform programmes)

Speaker: **Friedrich Heinemann**, Head of Department "Public Finance", Zentrum für Europäische Wirtschaftsforschung (ZEW), Mannheim

Discussants: **Samuel Brittan**, Commentator, Financial Times, London
Stefan Collignon, Professor, European Institute; London School of Economics and Political Science
Nicolas Jabko, Research Fellow, Centre d'Études et de Recherches Internationales (CERI), Institut d'Etudes Politiques de Paris

11.15 – 13.00

Session 2: The relationship between competitiveness, economic growth and institutions

Speakers: **Allan Larsson**, Professor, Chairman, University of Lund; former Minister of Finance of Sweden; former Director General for Employment, Industrial Relations and Social Affairs, European Commission
Reiner Hoffmann, Deputy Secretary General, European Trade Union Confederation (ETUC), Brussels

Discussants: **Arno Tausch**, Adjunct Professor of Political Science, University of Innsbruck
Tito Boeri, Professor, Innocenzo Gasparini Institute of Economic Research (IGIER), Bocconi University, Milan
Rolf Hasse, Professor, Dean, Institute for Economic Policy, University of Leipzig
Serge Kolb, Executive Director, Central Bank of Luxembourg

14.45 – 16.30

Session 3: The modalities of implementing structural reforms: how to transform European societies (democracy, the markets and the media)?

Speaker: **Nicolas Tenzer**, President, Centre d'étude et de réflexion pour l'action politique (Cerap); Director of the Journal *Le Banquet*

Discussants: **Richard Cooper**, Professor, Center of International Affairs, Harvard University, Cambridge MA
Robert Skidelsky, Professor, Dept. of Economics, Warwick University
Boris Walbaum, Conseiller référendaire, Cour des Comptes, Paris