

The Lisbon Process—a Compromise between Ambitions and Reality

Peter Becker / Ognian N. Hishov

In Lisbon back in March 2000, the EU heads of state and government undertook to pursue the strategic objective of turning the Union into “the most competitive and dynamic knowledge-based economy in the world” by 2010. The imminent mid-term review of the Lisbon Process constitutes an opportunity to inject fresh momentum into that strategy by focussing on its growth objectives, specifying the associated measures more precisely and developing a systemic approach that weighs Europe’s ambitions against the reality of the situations in its Member States.

The Lisbon Strategy on the EU’s economic and social renewal was developed back in the late 1990s. Its objectives (see Annex, page 9) should be considered against the backdrop of positive experience gained at a time characterised by adequate growth, falling budget deficits, low rates of inflation and interest margins associated with the launch of the euro, falling unemployment, and productivity gains in the USA, which Europe also sought to achieve on the back of innovation. Five years on, the conclusions of the mid-term review, which the heads of state and government will unveil at their summit on 22 and 23 March 2005, will make disappointing reading, for the strategic objective set back in 2000 can no longer be achieved.

Leaving aside the present unfavourable global economic situation, the blame for this failure can be pinned on an overloaded

agenda and poor coordination of the various competing priority objectives. Stronger commitment and concentration on the essence of the Lisbon Agenda are called for at all levels and on the part of all parties. In addition, all the partners have to display a willingness to embrace political change if we are to take the series of tough decisions facing us.

Background

In the mid-1990s, the efforts made by Europe’s welfare states to close the gap between themselves and the United States ground to a halt. By raising the employment rate and boosting labour productivity Europe had set out to catch up again in terms of growth and thereby secure the foundations of the social model shared by its Member States. To this end, the existing

control and coordination procedures for Europe's economic and employment policy would supposedly be expanded to take greater account of the needs of the modern knowledge society.

The following tasks were cited in Lisbon as key elements of the strategy:

- ▶ Pressing ahead with the transition to knowledge-based economic growth by developing information and communication technology and stepping up common education, innovation, research and development programmes
- ▶ Creating a balanced macroeconomic policy mix to promote sustainable growth
- ▶ Improving European competitiveness by implementing structural reforms in employment policy and social security systems and opening up additional segments of the market to the European internal market (markets for services and Internet-related industries)
- ▶ Activating European employment policy and combating social exclusion with a view to boosting the employment rate and stabilising the Member States' social security systems.

The European Council's idea was to embark on a broad programme to stimulate a general process of mutually strengthening reforms in the EU's labour, financial, product-related and service-related markets. The optimism displayed by the heads of state and government in spring 2000 was based on a period of continuous growth over the previous four years, bullish stock markets and a growing demand for labour in the ICT sector. Such a fundamentally optimistic outlook was also fostered by the fact that the governments in 13 of the 15 Member States were either run or dominated by Social Democrats. This party-political affinity between the heads of government led to their similar analysis of problems and objectives and also meant that they shared a similar assessment of the methods to be applied to achieve those objectives.

Accordingly, right from the outset the Lisbon Agenda was dominated by political

considerations and objectives which pushed the prevailing economic situation and essential needs into the background. Moreover, this trend continued as the process went on, and the strategy was altered, new areas of policy (social and environmental policy) were added and additional tasks and objectives were set.

The Lisbon Strategy is characterised by three processes or mechanisms:

a) The European Council's Spring Summit.

Every year since their meeting in Lisbon the heads of state and government have held a summit focussing on the economic and social issues associated with the Lisbon Strategy. They use these meetings to set priorities for further measures designed to bring the strategy's objectives within reach, and base those measures on a summary report of the situation drawn up by the European Commission.

b) The Open Method of Coordination

(OMC). In the Open Method of Coordination, which was first tried out in 1997 in the area of employment policy after the adoption of the Treaty of Amsterdam, the common definition of objectives replaces legally binding harmonisation. A graduated process was then devised to ensure that the implementation of the agreed Lisbon objectives became measurable. This process may comprise various measures, such as the adoption of European guidelines, the definition of quantitative and qualitative structural indicators and benchmarks, the drafting of reports on the respective national measures taken to implement guidelines in the Member States and relevant areas of policy, or simply an exchange of information and experience. The method is currently being applied both in areas of policy where the EU is competent to legislate and/or in areas which it is responsible for coordinating, as well as in areas where the Union has no legislative powers even though a need for action at European level has been acknowledged.

c) Structural indicators. To measure the progress made and serve as a basis for comparing respective national reports, the Member States and the Commission agreed on indicators for the core areas identified in Lisbon (economic reform, employment, innovation and research, social cohesion, sustainability and the environment). By the 2004 Spring Summit no fewer than 107 structural indicators had been listed, which were subsequently condensed into a short-list of 14 main indicators.

This array of various quantitative and qualitative objectives is associated with a multitude of jointly agreed timetables, humble declarations of intent and recommendations, legally binding regulations, directives and legislative decisions, action plans, benchmarks and statistical indicators as well as with detailed reporting. So all things considered the agenda includes some highly specific individual measures and legal acts as well as declarations of political intent, suggestions, desires, hopes and prognoses, whose sole real value is that they were adopted at the highest political level.

Despite these instruments, neither of the strategy's two core objectives have been achieved, namely job creation and the boosting of the employment rate, on the one hand, and the allocation of up to 3% of GDP for research and development, on the other.

Interim result 1: Growth and productivity

Soon after the adoption of the Lisbon Strategy real economic growth started running out of steam. Indeed, the estimated average annual growth of 1.4% in the euro-zone between 2000 and 2005 has been particularly unsatisfactory. This average was dragged down by the results of some of the continent's leading economies—Germany, France and Italy—which contrast starkly with markedly better performances by other partners, in particular Ireland, Greece and Spain. The

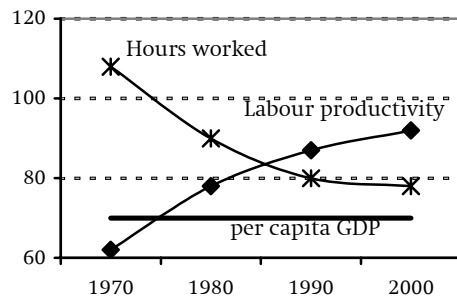
upshot of this is a further shift in the prosperity rankings, measured in per capita GDP in Europe, but also between the major economic blocs. One ominous sign is the dramatic slide by the Federal Republic of Germany in comparison to its western European partners and to the accession countries from Central and Eastern Europe. Whereas in 1995 Germany still boasted per capita income that was 10% above the average for the EU-15, by 2003 its performance had already dropped below that average and it is now close to the average for the enlarged 25-member Union. In other words, implementing a common EU-wide strategy for growth and employment has not helped Germany to narrow its persistent gap with the USA in terms of per capita income.

The reason for the unchanged income differential is the clash between two trends in the EU which had cancelled each other out over the past few decades. Firstly, labour productivity rose steadily compared with the USA; secondly, the number of hours worked declined at the same rate. Thus the income differential was maintained (see Figure 1, page 4). Consequently, if the productivity gap was narrower and working time increased, the per-capita income differential would shrink. However, this outcome is thwarted by the long-term trend of a decline in the rate of employment within the EU. Between 1970 and the end of the 1990s the employment rate in Europe levelled off at around 60% (in Germany at approx. 65%), whereas the other major economic regions continually maintained higher rates of employment.

At the close of the 1990s the general employment rate in the EU-15 started to rise. By 2003 it had reached 64.4%, and in the enlarged Union it is one percentage point below that figure. Thus the gap between Europe and both the USA and Japan has narrowed. However, over the same period the number of hours worked has decreased by 5.5%, largely eclipsing the output effect of rising employment.

To make things worse, in recent years the Europeans have turned around the

Figure 1
Index of hourly productivity, hours worked
and per capita income in the EU-15
(USA [benchmark] = 100)



Source: André Sapir et al., *An Agenda for a Growing Europe. Making the EU Economic System Deliver*, Oxford 2004, Table 4.2.

trend towards closing the productivity gap. The European Union has not experienced any ICT revolution comparable to the one that occurred in the USA, which has handed back the lead in productivity to the US economy over the last few years. The occasionally invoked higher hourly productivity figures in some EU Member States are revealed to be fallacious as soon as the statistical effect of shorter working times and higher unemployment is taken into account. Accordingly, the actual gap between the level of productivity throughout the European Union, on the one hand, and its counterpart in the USA, on the other, is in fact wider than the measured difference—including in Germany.

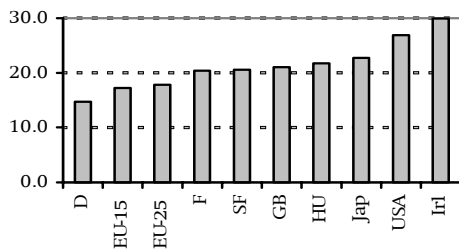
Interim result 2: **Technology and knowledge**

The leeway for knowledge-based high-tech growth within the EU is not being exploited. For instance, in the 1990s the EU-15 overtook the USA in productivity growth in the low-tech sector, whereas the annual gain in productivity in Europe's ICT sector remained roughly 1.5 percentage points behind that of its American counterpart. Furthermore, in the EU-15 the high-tech sectors' share of GDP (33%) is smaller than is the case in the USA (38%).

The reason why Europe is lagging behind here is the hesitation displayed in the past to implement new technologies. Only the Nordic countries find themselves in the leading group here, whereas some major EU economies, especially France, have only put in a mediocre performance in this connection. Another unfavourable fact is that the share of expenditure on ICT in the EU-15 appears to be declining. Consequently, research and development (R&D) are not yet playing the role they were intended to play. One problem is that the Union as a whole invests a lower proportion of its GDP in R&D than the USA and Japan; another is that R&D spending by some major EU economies, like France, is waning, whereas in the United Kingdom it is stagnating, and Germany too is lagging behind the USA and Japan in this respect. Moreover, it is still true today that less corporate research is being conducted in Europe than in the USA, yet it is that very research which determines an economy's ability to innovate, for state-organised R&D tends to be more basic and therefore impacts less on growth and modernisation than application-oriented research conducted by businesses. Again, some major EU economies, in particular France, Italy and the United Kingdom spend comparatively little on the latter kind of research.

As a result, European products tend to be less high-tech, a fact that becomes most readily apparent when considering export figures. The share of high-tech exports among all EU exports is relatively low in the European Union and especially low in Germany (see Figure 2). This is problematic because it causes the terms of trade in the EU as a whole to deteriorate, for low-tech and medium-tech products earn relatively low prices or income through exports. This in turn forces the economy to boost its exports to finance its imports. And amongst the major industrial countries, champion exporter Germany is lagging way behind, selling only a moderate proportion of high-tech products abroad, with an export value of just under 15%, even behind some small

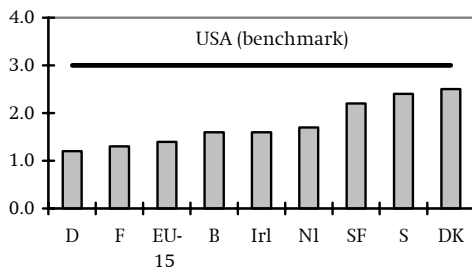
Figure 2
Share of high-tech products* in overall exports in 2003 (in %)



* Aircraft, computers, office machinery, electronics, instruments, pharmaceuticals, electric Machinery and arms.

Source: Eurostat, *New Cronos database of structural indicators*, <http://europa.eu.int/comm/eurostat/newcronos/reference/display.do?screen=detailref&language=de&product=STRIND_INNORE&root=STRIND_INNORE/innore/ir140>

Figure 3
Total expenditure on higher education in 1999 (as a percentage of GDP)



Source: *André Sapir et al., An Agenda for a Growing Europe. Making the EU Economic System Deliver*, Oxford 2004, Table 4.5.

IT-oriented economies like Ireland, Finland and Hungary.

Furthermore, by international standards expenditure on university-level education in the EU-15 is relatively low. As we all know, there is already a North-South divide in connection with this indicator, too, for the Nordic countries spend more. However, the EU average is largely determined by the continent's leading economies, namely Germany, France and Italy, countries which still invest relatively little in university education. The specific combination in the EU of a high standard of technology and relatively high proportions of people with a simple or medium educational background

is counterproductive in the long run. Moreover, the situation in the EU is typified by the very low proportion of private expenditure on university-level education. In the USA such spending accounted for roughly 1.6% of GDP back in 1999, not only outstripping government spending in that domain, but also exceeding total spending (by both the public and the private sectors) by most EU countries (the 1999 average is 1.4% of GDP, Figure 3). But whilst in America higher education is viewed as an investment in the country's own national human capital, spending in this domain in European countries is frequently just considered burdensome.

A shift in attitudes towards R&D could push down underemployment and accelerate growth. Bearing this in mind, it is worth taking a critical look at the growth model embraced by the EU in the past: The savings rate and rate of investment of the EU-15, but also of other developed economies (such as Japan) have both been relatively high over the last few decades. But whilst the Europeans invested more in physical capital, they neglected to invest in education or research and development. By contrast, the US economy had a lower savings rate and rate of investment, but focussed more on education and allocated more resources to new technologies, and thereby achieved higher growth and less underemployment.

From all this we can derive clear objectives for our policies on growth, education and technology, the implementation of which could enable us to make a success of the Lisbon Agenda.

Required reforms and action

Yet the EU has undeniably scored some successes with regard to parts of its Lisbon Strategy. For instance the European Commission estimates that more than 6 million jobs have been created since the year 2000. Long-term unemployment is also clearly down, from 3.5% in 2000 to 3% in 2003.

Nonetheless the overriding attitude as we approach the mid-term review is one of scepticism, the main criticisms of the Lisbon Strategy being the following:

1. The overcrowded general concept, which endeavours to link virtually all EU policies to the Lisbon objectives, is introducing a random element into the strategy, resulting in overloaded programmes, the absence of clear priorities, and conflicting definitions of the objectives themselves.

2. Whereas the overall coordination of the Lisbon Process should be in the hands of the European Councils annual Spring Summit, the heads of government are dependent on the preparatory work done by individual Council meetings. However, each Council formation focuses on its own specific priorities. Consequently, the conclusions of the European Councils since March 2000 on issues to do with economic, employment and social policy or sustainability read like a loose jumble of results which the various Council meetings have cobbled together in an uncoordinated fashion.

3. The all-embracing strategy has generated a flood of reports, action plans, national reports on implementation or transposition, opinions and conclusions that are merely aggravating the strategy's lack of focus. At the same time they have weakened the pressure actually brought to bear by the Open Method of Coordination (OMC) through its benchmarking and ranking of the Member States.

4. In the areas of employment policy, social policy, social security systems, education policy, health policy and youth policy the OMC has resulted in the incorporation into the EU framework of so-called 'OECD mechanisms,' i.e. non-binding soft law instruments (exchanges of experience and information, guidelines, peer review procedures and best practice comparisons). This in turn has prompted the watering down of Community policy through inter-governmental approaches. The outcome of all this is that both the Commission and European and national parliaments have

been weakened in comparison with the European Council and national governments.

Ever since the proclamation of the Lisbon Strategy, there has been a mismatch between the tasks in hand and their applicability. Whilst the strategic objectives are above criticism, the use of resources and the group encompassed by the measures are definitely not. Since competence in the strategy's key policy areas—economic, social and employment policy—are divided between the EU and the Member States, successes in attaining the Lisbon objectives inevitably depend on the convergence of interests between the European level and the Member States. As a result, so far:

- ▶ Either the only objectives spelt out had to be so general that every respective government or lobby group could embrace them,
- ▶ or agreement was reached on measures that were so specialised that the group of people affected was limited,
- ▶ or all that resulted were declarations of intent which were so non-binding that their approval did not entail any mandatory implementation.

Proposed improvements can only be successfully implemented if there is the political will to pursue a dynamic, concentrated and dependable reform policy. This applies both to hard policy, i.e. legislation, and to soft policy, which involves ranking the Member States to flesh out the benchmarking system. Now undeniably, without overlooking the benefits of the OMC or wishing to call into question the Member States' capacity to learn, the non-binding method of the soft law approach does not impose the same obligations or pressure to apply it as the hard law approach does in the form of European directives and regulations. The Commission, as guardian of the EU treaties, is definitely empowered to require the transposition of a legally established solution and failure to comply with that requirements can be punished by the European Court of Justice.

Some parts of the Lisbon Agenda would be well suited to being covered by European legislation, one example being the EU regulation on the coordination of social security systems. However, this regulation can only be applied once the associated implementing provisions have been adopted, i.e. probably not before the end of 2006. A second example would be the European Community Patent—in the pipeline since 2000—which would supposedly improve European companies' ability to innovate and boost their competitiveness. Although the European Council already said in Lisbon that the adoption of the European Community Patent was a core issue in promoting innovation, no draft regulation devoted to it has yet been drawn up. Both examples cited above clearly show that the Member States' seriousness about actually implementing the Lisbon Agenda only becomes apparent in the political tug-of-war over legislation designed to further develop the internal market.

The mid-term review may well constitute our last chance not only to modify the Lisbon Strategy, but to fundamentally reshape it. Mindful of the original intention of turning the European Union into the "the most competitive and dynamic knowledge-based economy in the world," the focus should shift to three clear objectives:

1. Achieving sustainable growth and boosting productivity
2. Shoring up competitiveness and promoting research, development and innovation
3. Increasing the rate of employment.

Ten points for a reform

1. The Lisbon Strategy should clearly spotlight the importance of growth dynamics, shoring up competitiveness and promoting R&D and innovation.

2. The priorities set by the European Commission are quite correct and merit the support of Germany's federal government. The present structure of the EU budget needs to be reformed further. Instead of

channelling excessive funding into the 'old' agricultural sector, intensive efforts should be made to promote research, education and development. Europe's promotion of research should act as a catalyst for national and company-level programmes.

3. As with the 1988 Single Market Programme, the Commission should present a coherent programme for implementing the Lisbon Agenda, including proposals for legally binding harmonisation measures, timetables and steps towards implementation, and then prevent the Member States from taking the politically comfortable route of falling back on the non-binding OMC.

4. As a matter of principle, those measures agreed within the framework of the Lisbon Agenda at European level should also have counterparts at national level. Prerequisites for this include a certain compatibility between the objectives and procedures involved and also legally imposable obligations to ensure their implementation. One conceivable measure would entail a transparent evaluation system in the Commission's summary reports, the ranking of Member States and—as with the negotiations on enlargement—annual progress reports drawn up by the Commission on the implementation of Lisbon-related measures by the various EU partners.

5. At the Spring Summit only a report providing a general overview of the pillars of the Lisbon Strategy (economic development, employment, social cohesion and the environment) should be presented, which could be complemented by the Commission's progress reports on the situation regarding implementation in the Member States.

6. The European Council should restrict its involvement to proposing 'buzzwords' and serving as a body providing political guidance. The heads of state and government should not have to deal with individual implementation issues or the details of how to word objectives, but instead only

step in as and when conflicts over objectives flare up, as they no doubt will.

7. The Competitiveness Council formation should be made the technical co-ordination council for all individual programmes and reform processes. This 'Lisbon Council' should operationalise the European Council's formulation of policy objectives. In the Member States a designated 'Lisbon officer' could then be placed in charge of their domestic implementation. Within the German federal government this 'Lisbon coordinator' could be offered a permanent observer's seat at meetings of the Committee of Secretaries of State on European Affairs.

8. The Lisbon Strategy must pay greater attention than has been shown in the past to the prosperity gap between the old and new EU Member States in today's 25-member Union. Conceivable changes might include more flexible target corridors or a graduated quantification of employment rates, growth rates or the provision of national budget funding for research and development.

9. One particular feature of the OMC is the national governments' dominance in this process. Since action taken at European level regarding the Lisbon Agenda has so far not entailed the adoption of EU legislation (directives or resolutions), the European Parliament has barely been involved. National parliaments have only been brought in when European guidelines were supposed to be anchored in the respective national legislation. To guarantee a greater sense of obligation at all levels towards the Lisbon Agenda than has been displayed in the past, parliaments at both national and European level need to be more intimately involved in the process of defining and implementing objectives.

10. The Lisbon Strategy is an extension of a long list of European initiatives for more "growth, competitiveness and employment" (see Delors' White Paper dating from 1993). Consequently, the original target date of 2010 should be honoured. However, where the determination of

interim objectives, legislative plans and agendas for implementation is concerned, the timetables and deadlines set should extend beyond that date.

Annex: Summary of the key quantitative and qualitative objectives of the Lisbon Process

Quantitative objectives

- ▶ An average economic growth rate of 3% per annum
- ▶ To increase the employment rate to 70% (60% for women) by 2010
- ▶ To achieve an employment rate of 67% amongst all those in work and 57% amongst women by 2005
- ▶ To raise the employment rate for older workers (between 55 and 64 years old) to 50% by 2010
- ▶ To steadily increase total expenditure on research and development to 3% of GDP by 2010, with two-thirds of such funding being provided by the private sector
- ▶ By 2010 to provide care for 90% of all children between three years old and school age as well as for 33% of children aged under three
- ▶ By 2010 to halve the number of 18- to 24-year-olds whose sole qualification is their completion of secondary education
- ▶ To ensure that all directives adopted by 2003 concerning the internal market are transposed
- ▶ To reduce state aid to 1% of GDP
- ▶ To increase the proportion of renewable energy used to meet primary energy needs to 12%, the proportion used to meet gross energy requirements to 22% and the proportion used in the transport sector to 5.75% by 2010
- ▶ To provide Internet access for all schools by 2001 and improve the ratio of computers to schoolchildren to 1 computer for every 15 children
- ▶ To boost national development aid first to 0.7%, and then to 0.33% of GDP by 2006
- ▶ To create a favourable environment for companies (especially SMEs): Deregulation, SME Charter
- ▶ To inject fresh life into the European internal market: Services Directive, tax package (savings tax), liberalisation of network services (electricity, gas, post, telecommunications), action framework for financial services, creation of a Single European Sky, modernisation of competition policy, European Community Patent
- ▶ To create an information society: Internet access for schools, provision of all citizens with the skills required to thrive in an information society, provision of high-speed Internet access
- ▶ To modernise our social systems and consolidate social cohesion within the EU: Modernisation of the European Social Model on the basis of the EU social agenda, equal opportunities for the disabled, gender equality, the eradication of poverty, securing the long-term viability of pension schemes
- ▶ To achieve full employment by conducting an active employment policy: Improving employability and closing any gaps in training and qualifications, structurally reforming labour market policy, involving the social partners in the attainment of the Lisbon objectives imposing obligations on them in that connection; providing better jobs, offering decent, flexible work organisation
- ▶ To embrace a sustainable environmental policy: Meeting the Kyoto objectives, ensuring 'fair prices' as an inducement to consumers and manufacturers, protecting biodiversity, implementing a policy geared towards sustainability in four areas—climate change, transport, public health and natural resources
- ▶ To consolidate budgets and guarantee the sustainability of public finances

Qualitative objectives

- ▶ To create a European Research and Innovation Space: Greater mobility for academics, networks linking research centres, an innovation scoreboard, the 6th Research Framework Programme

© Stiftung Wissenschaft und Politik, 2005
All rights reserved

SWP
Stiftung Wissenschaft und Politik
German Institute for International and Security Affairs

Ludwigkirchplatz 3-4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org