



**EU-Japan Centre for Industrial Cooperation**  
**Brussels, 9 November 2005**

**The Lisbon strategy :  
The right strategy to revive growth in  
Europe?**

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## **The Lisbon Strategy**

**Lisbon objective : To transform the EU into the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion**

**Göteborg : need for an increasing respect for the environment**

### **HOW?**

**By implementing a comprehensive strategy of structural reform**



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# The Lisbon strategy

## Overview of the presentation

1. Politic and economic rationale
2. How to achieve the Lisbon objectives?
3. How to implement the Lisbon strategy?
4. Assessment of progress
5. The mid-term review of the Lisbon strategy :  
main achievements and failures of the  
strategy



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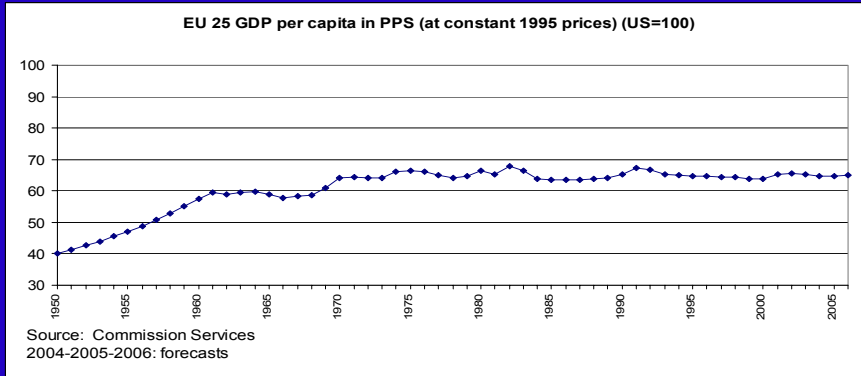


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# Rationale

## Evolution of GDP per capita (US=100)



Annual % change of real GDP per capita	EU 15	US
1961-1980	3,3	2,5
1981-1990	2,1	2,2
1991-1995	1,2	1,2
1996-2000	2,4	2,9
2001-2006	1,3	1,7

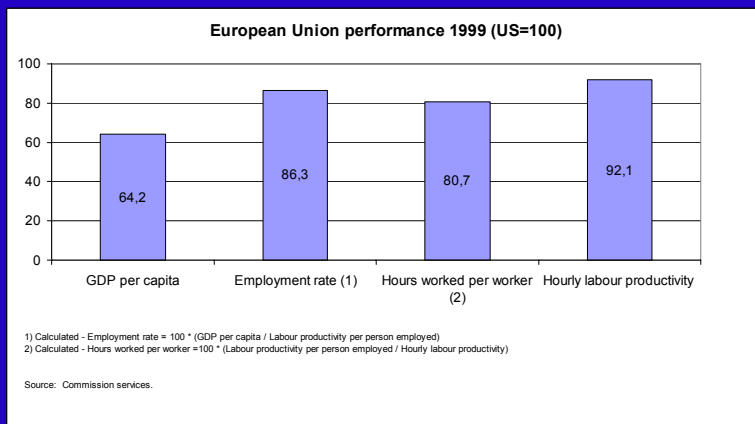
Source: Ameco Autumn 2004-2006 forecasts

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# Rationale

## EU performance (US=100) in 1999



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## Three main challenges

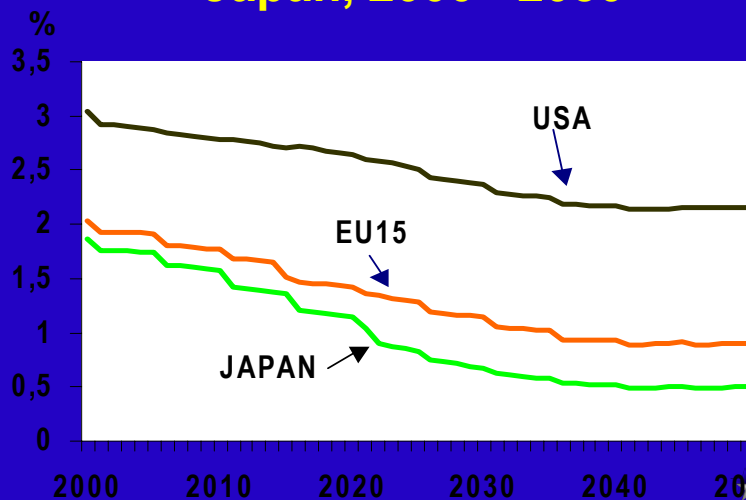
- Ageing
- Enlargement
- Globalisation



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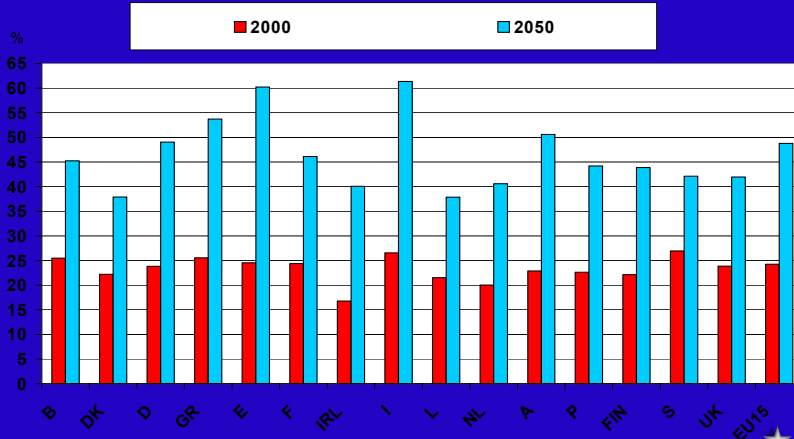
## Potential growth in EU, US and Japan, 2000 - 2050



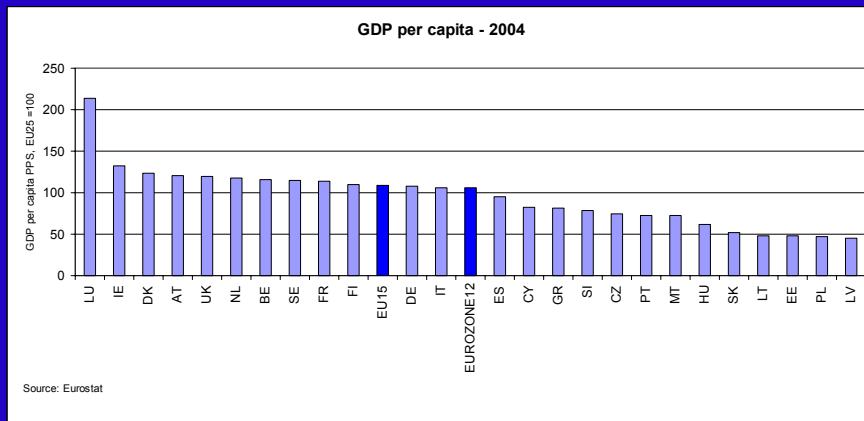
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## Old-age-dependency ratio (people more than 65 years old as a % of 15-64 years old)



## Enlargement



Source: Eurostat

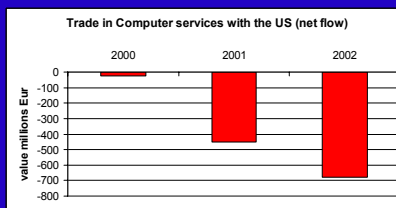
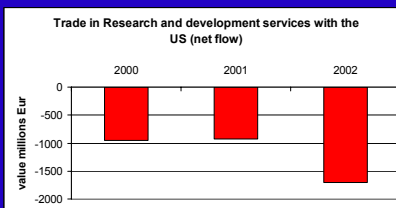
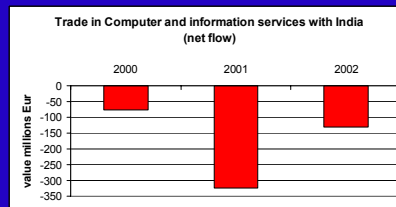
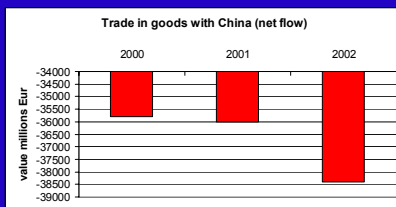


## Globalisation : Intensification of international competition

- **China** for manufacturing products
- **India** in particular for the service sector
- **US** in R&D and high value added activities



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Source: Eurostat



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## Why the Lisbon Strategy?

1. EU unable to match the US performances in terms of GDP per capita, employment rate and productivity
2. Face the challenges of ageing, enlargement and globalisation



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## How to achieve the Lisbon objectives?

**Lisbon is a process of structural reforms**

**Structural reforms are**

- microeconomic reforms
- aiming at improving the functioning of markets in order to increase growth potential
- and at ensuring the sustainability of the standard of living

**They also reinforce the ability of countries to adjust to country-specific shocks.**



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## Lisbon is a process of structural reforms

Structural reforms aim at increasing growth potential by :

- Improving product and capital market functioning
- Improving labour market functioning
- Stimulating investment in knowledge and innovation



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## Product market reforms

Further opening of markets

and

Improved business environment

⇒ Increased competition ⇒

- Increased allocative efficiency
- Increased productive efficiency
- Increased dynamic efficiency



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## Empirical evidence in support of reforms (Example of liberalisation of network industries)

Evolution of labour productivity per hour  
worked in gas, electricity and water utilities  
(change per year)

	1979-1990	1990-1995	1995-2001
EU-15	2.7%	3.6%	5.7%
US	1.1%	1.8%	0.1%



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## Economic impact of other Lisbon-type reforms

- **EU financial integration** ⇒ lower cost of capital and better access to finance
- **Investment in knowledge** (develop framework conditions supportive to investment in human capital and R&D, promote access and use of ICT) ⇒ positive impact on productivity growth
- **Labour market reforms** (reforms of tax/benefit systems, of wage bargaining systems) ⇒ higher employment rates

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## Macroeconomic impact of Lisbon-type reforms

- **Product and labour market reforms over the period 1996-2001** → Increase in GDP growth rate of almost  $\frac{1}{2}$  percentage point
- **Increased knowledge investment** → another  $\frac{1}{4}$  percentage point
- **Over a ten-year period, this would imply an increase in the GDP level of up to 7 or 8%**

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## Lisbon is a comprehensive strategy of reforms

- To improve the coherence of reforms and maximise positive spillovers from one market to another
- To better integrate structural reforms and macro-economic policy



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## Potential trade-offs between the three pillars of the Lisbon strategy

Welfare = f (standard of living, economic and environmental sustainability, social cohesion)

Standard of living = f (productivity, employment rate, demographic changes)

Structural reforms aimed at increasing growth potential may have negative effects on the environment or on social cohesion

**But : Growth is pre-condition for progress elsewhere**

- Place growth objective at centre of Lisbon strategy.
- Better exploit complementarities between three pillars



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## How to implement the Lisbon strategy?

### Governance instruments :

- Open method of Coordination
- Spring European Council
- Annual policy cycle to monitor  
progress on Lisbon



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## How to implement the Lisbon strategy?

Structural reforms touch on sensitive areas of national competence



Subsidiarity principle  
Soft method of coordination

The « open method of co-ordination »:

- Agreements on targets with timetables
- Translation of these targets into national policies
- Use of indicators and benchmarks
- Periodic evaluation of progress made



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## Stages of policy implementation

Three stages :

- Policy impulse      ⇒      Spring Report
- Policy decisions      ⇒      Spring Council  
+ Guidelines package  
(BEPG, EG, IMS)
- Policy implementation      ⇒      Implementation package



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## The Spring Council

### **Lisbon Council (March 2000) :**

- Comprehensive strategy of reforms

### **Stockholm Council (March 2001) :**

- Focus on employment and social cohesion

### **[Göteborg Council (June 2001) :**

- Integration of sustainable development into the Lisbon strategy]

### **Barcelona (March 2002) :**

- Focus on opening up of markets (energy, internal market) and R&D

### **Brussels Council (March 2003) :**

- Focus on implementation of agreed reforms and on deadlines for actions

### **Brussels Council (March 2004) :**

- Launch of the mid-term review of the Lisbon strategy

### **Brussels Council (March 2005)**

- Revision of the Lisbon strategy in terms of substance and governance



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## The Spring Council: targets and objectives

- Employment rate of 70% in 2010
- Halving the number of early school leavers by 2010
- Increase the transposition rate of Internal Market directives to 98.5%
- Opening up of energy markets for business in 2004 and for domestic users in 2007
- Increase R&D spending to approach 3% of GDP by 2010
- Reduction in greenhouse gas emissions



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# The Lisbon strategy

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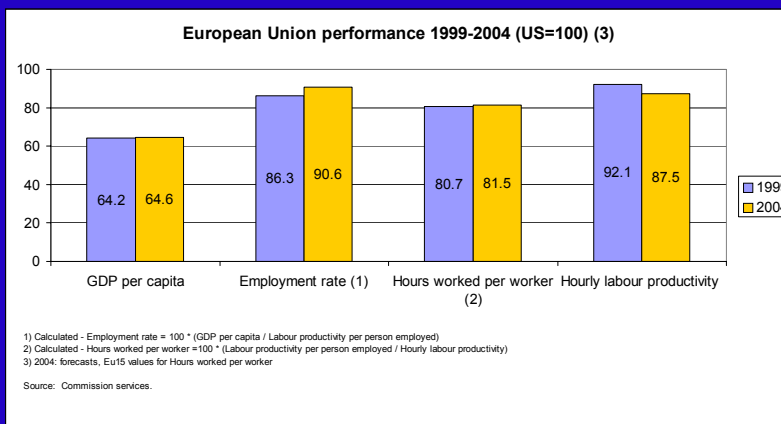
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## Progress on the Lisbon Strategy at the time of the midterm review



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Progress of Member States on the Measurable Targets of the Lisbon Strategy (Jan. 2005) <sup>1</sup>

Lisbon Strategy	Target	Target year	Reference year <sup>2</sup>	EU 15 average	EU-15: target achieved	EU 25 average	EU-25: target achieved
<b>Employment</b>							
Overall employment rate	67%	2005	2003	64.4%	7	63.0%	8
Overall employment rate	70%	2010	2003	64.4%	4	63.0%	4
Female employment rate	57%	2005	2003	56.1%	9	55.1%	14
Female employment rate	60%	2010	2003	56.1%	7	55.1%	8
Employment rate for workers aged 55-64	50%	2010	2003	41.7%	4	40.2%	6
Increase in average effective retirement age	by 5 years to EU average 65	2010	2003	61.4	0	61	0
Available childcare for pre-school children over three	90%	2010	2004	81.3%	4	n.a.	n.a.
Available childcare for children under three	33%	2010	2004	24.5%	2	n.a.	n.a.
<b>Research, Innovation, Information and Society</b>							
R&D spending/GDP	3%	2010	2003	1.99%	2	1.93%	2
Business participation in R&D spending	2/3	2010	2003	56.0%	3	55.4%	3
All schools with internet connection	100%	2002	2002	93.0%	1	n.a.	n.a.
All teachers to have training in digital skills	100%	2003	2002	56.8%	0	n.a.	n.a.
Internet penetration in households	30%	2002	2004	47.0%	12	44%	15
eGovernment: basic services online	100%	2002	2003	45.0%	0	n.a.	n.a.



<b>Economic Reform</b>							
Transposition rate of internal market directives	98,50%	2002	2004	97,0%	1	96,3%	2
2 years timelimit for transposition of internal market directives	0 directives	2002	2004	n.a.	3	n.a.	3
Open electricity markets for customers	100%	2007	2004	93,0%	9	77,0%	9
Open gas markets for customers	100%	2007	2004	82,3%	7	63,3%	7
Cross-border energy transmission capacity relative to installed production capacity	10%	2005	2003	n.a.	11	n.a.	19
<b>Social Cohesion</b>							
Reduce the number of early school-leavers	by 50%	2010	2000-2003	-6,70%	-	-7,60%	-
<b>Environment/Sustainable Development</b>							
Visible progress at reducing greenhouse gas emissions	Reach EU average of 92% of the 1990 level	2008-2012	2002, 1990=100	97,1%	3 respect national targets	91,0%	10 respect national targets
Contribution of electricity produced from renewable energy sources to gross electricity consumption	Reach EU-15 average of 22% and EU-25 average of 21%	2010	2002	13,5%	0 respect national targets	12,7%	0 respect national targets

n.a.= not available

1-If data not available for reference year, earlier data has been taken for some Member States



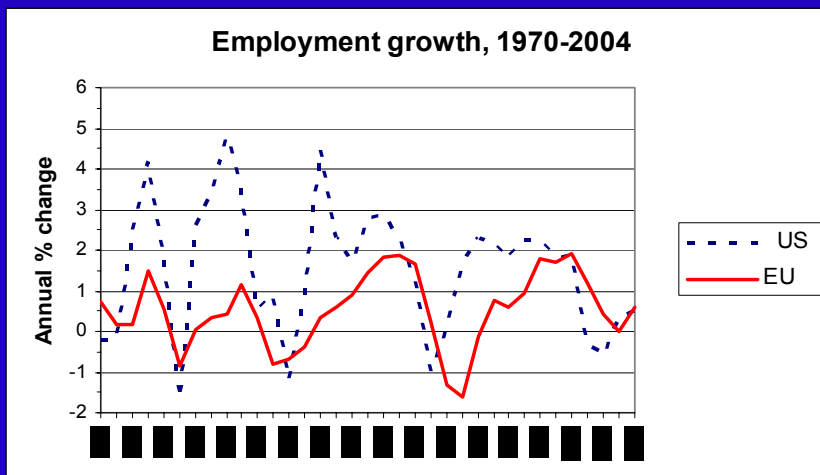
## Employment rate

%	EU rate in 1999	EU rate in 2004	target rate in 2010	US rate in 2004
Total employment rate	62,6	64,7	70	71,2
Employment rate of women	53	56,8	60	65,4
Employment rate of older workers	37,1	42,5	50	59,9

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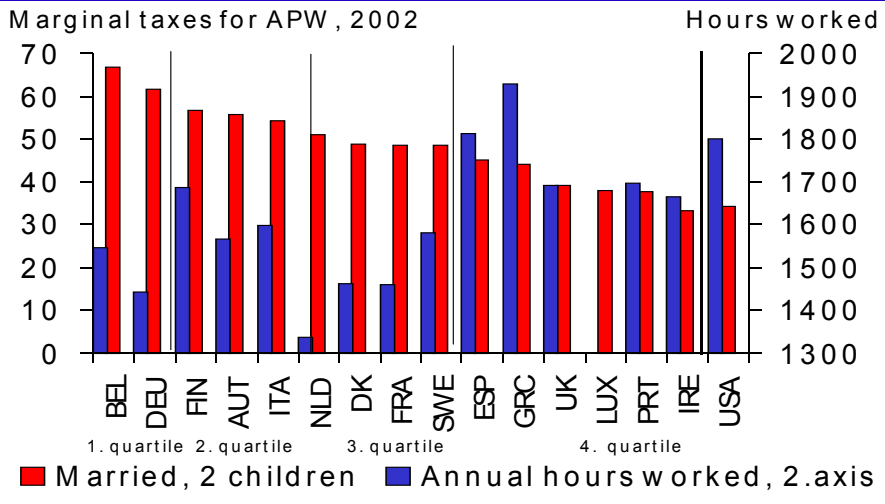
## Employment growth in the EU and the US



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# Taxes and Labour markets

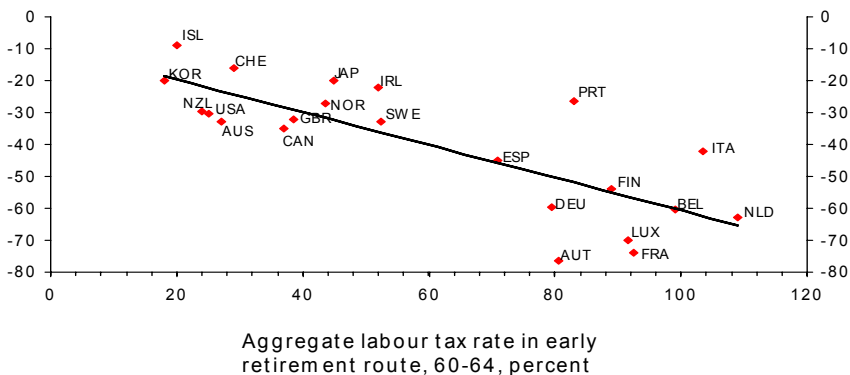


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# Incentives to retirement and employment rate of older workers

Percentage change in labour force participation between 55-59 and 60-64

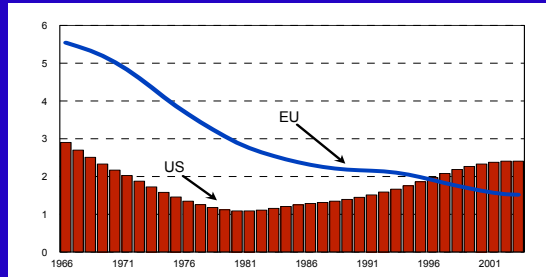


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## Progress on the Lisbon Strategy Decomposition of EU 15 and US average GDP growth rates

	Labour productivity per hour		hours worked		GDP	
	EU 15	US	EU 15	US	EU 15	US
1966-1970	5,6	1,8	-0,6	1,6	5	3,4
1971-1980	3,8	1,6	-0,6	1,6	3,2	3,2
1981-1990	2,2	1,4	0,2	1,7	2,4	3,1
1991-1995	2,4	1	-0,7	1,4	1,7	2,4
1996-2003	1,4	2,2	0,8	1	2,2	3,2



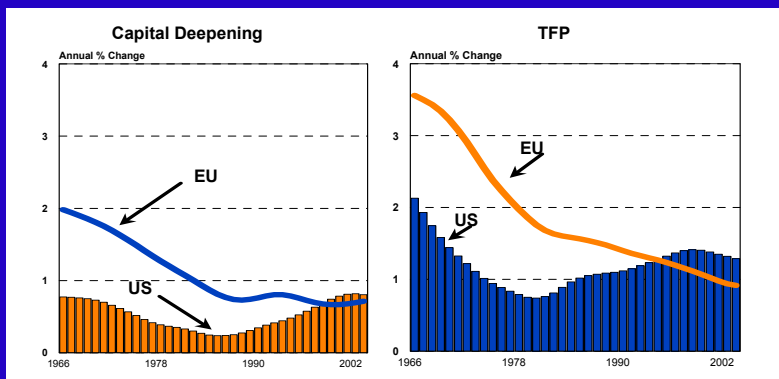
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## Progress on the Lisbon Strategy

Decline in labour productivity growth since the mid-1990s due in equal parts to :

- a decline in capital deepening (business investment growth)
- a deterioration in total factor productivity growth



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## Progress on the Lisbon Strategy

A decline in capital deepening (business investment growth) :

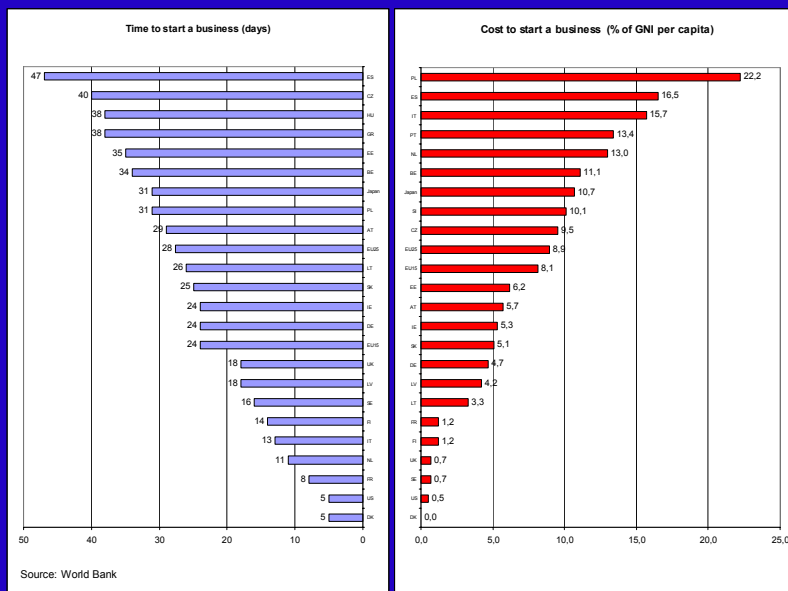
- Too high business set-up costs and an inappropriate business environment
- Higher ICT investment prices than in the US
- But also to employment creation associated to labour market reforms



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## Typical time and cost required for setting up a company 2005



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## Progress on the Lisbon Strategy

A deterioration in total factor productivity growth :

- Difficulty to reorient its industrial specialisation towards high-tech industries
- Lower productivity performances of ICT producing industries and more limited use of ICT in services

This can be explained by :

- Insufficient R&D and education spending
- Lower capacity of innovation <sup>★</sup>(as measured by the number of patents <sup>★</sup>)

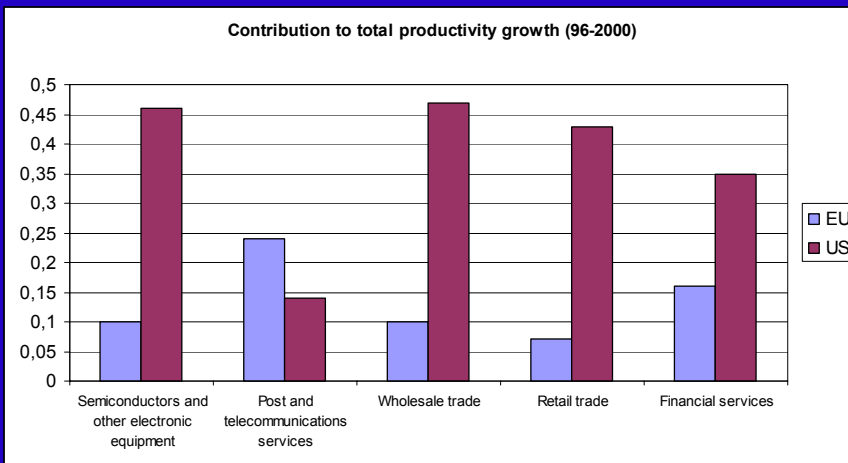
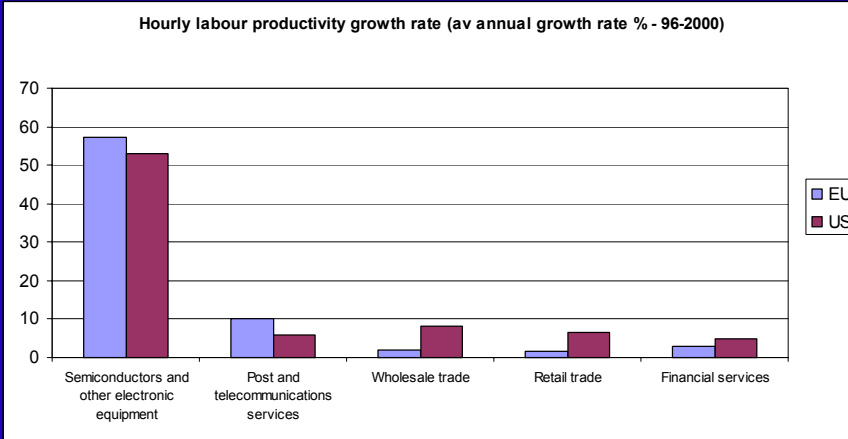
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Table 1 : Breakdown of Total Economy into 3 categories – 2 ICT categories (ICT producing + Intensive ICT-Using) and 1 category of Less Intensive ICT using (i.e. more traditional) Industries

	Hourly Labour Productivity (Average % Change)		Value Added Share		Contribution to Total Change in Hourly Labour Productivity	
	1991-1995	1996-2000	1991-1995	1996-2000	1991-1995	1996-2000
<b>Total Economy (1+2+3)</b>						
EU	2.3	1.6	1	1	2.3	1.6
US	1.1	2.3	1	1	1.1	2.3
<b>1. Manufacturing Sector</b>						
EU	3.7	2.6	0.23	0.21	0.9	0.5
US	3.6	4.6	0.19	0.18	0.7	0.8
1(a) ICT-Producing Manufacturing Industries						
EU	(9.6)	(17.1)	0.02	0.01	(0.2)	(0.2)
US	(16.4)	(26.0)	0.03	0.03	(0.4)	(0.7)
1(b) Intensive ICT-Using Manufacturing Industries						
EU	(2.6)	(2.0)	0.07	0.06	(0.2)	(0.1)
US	(-0.6)	(1.4)	0.06	0.05	(0.0)	(0.1)
1(c) Rest of Manufacturing (Less-Intensive ICT using)						
EU	(3.6)	(1.6)	0.14	0.13	(0.5)	(0.2)
US	(2.6)	(0.6)	0.10	0.11	(0.3)	(0.1)
<b>2. Private Services Sector</b>						
EU	1.9	1.4	0.52	0.54	1.0	0.7
US	1.0	2.7	0.53	0.54	0.5	1.5
2(a) ICT-Producing Service Industries						
EU	(4.8)	(6.8)	0.03	0.03	(0.2)	(0.2)
US	(2.4)	(0.8)	0.03	0.04	(0.1)	(0.0)
2(b) Intensive ICT-Using Service Industries						
EU	(1.8)	(2.1)	0.20	0.21	(0.4)	(0.4)
US	(1.6)	(5.3)	0.23	0.25	(0.4)	(1.3)
2(c) Rest of Services (Less-Intensive ICT using)						
EU	(1.7)	(0.2)	0.29	0.30	(0.5)	(0.1)
US	(0.2)	(0.3)	0.27	0.26	(0.1)	(0.1)
<b>3. Rest of Economy (Primary Industries + Public Services) (Less Intensive ICT-Using)</b>						
EU	2.0	1.1	0.25	0.25	0.5	0.3
US	-0.3	-0.1	0.28	0.27	-0.1	0.0

SOURCE : GGDC AND ECFIN CALCULATIONS





## The contribution of ICT to US-EU productivity growth gap

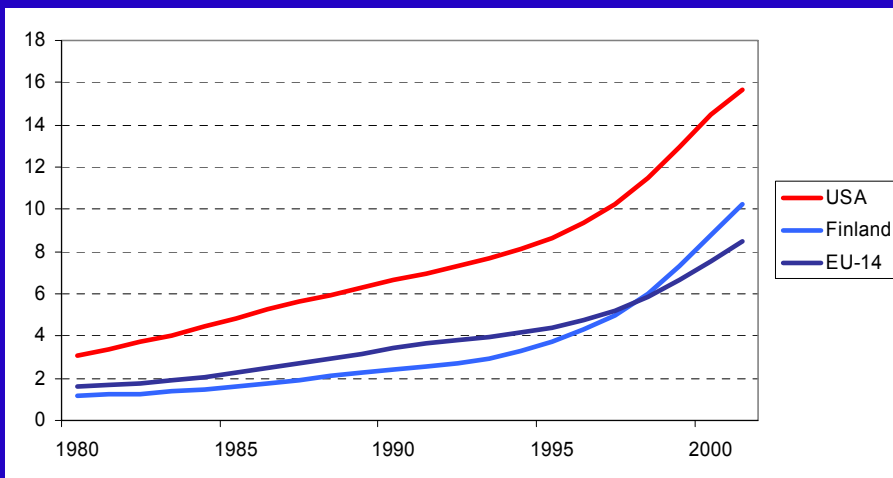
The superior performance of the US in ICT-producing manufacturing and intensive ICT-using service industries is a source of the diverging EU-US productivity growth differentials.

- Out of a total of 56 sectors, 6 dominate the overall growth patterns, with all of these sectors in the ICT-producing and ICT-using areas
- Of these 6 sectors, the US outperforms the EU in 5
  - in 2 ICT-producing manufacturing industry (i.e. office equipment and semiconductors & other electronic equipment)
  - in 3 ICT-using services (wholesale trade; retail trade; and financial services)
- The EU is dominant in one ICT-producing service industry, namely telecommunications
- The bulk of the growth differential can be explained by TFP differences in wholesale, retail, financial services, which are typically labelled as ICT intensive use sectors

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## Europe lags behind the US in ICT adoption (share of ICT capital in the total capital stock, %)

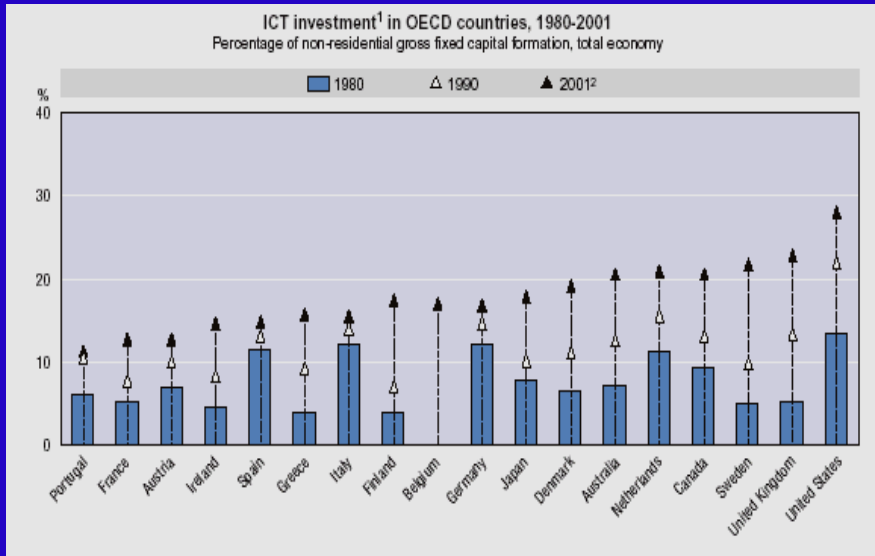


Source: Timmer, Ypma and van Ark (2003), IT in the European Union

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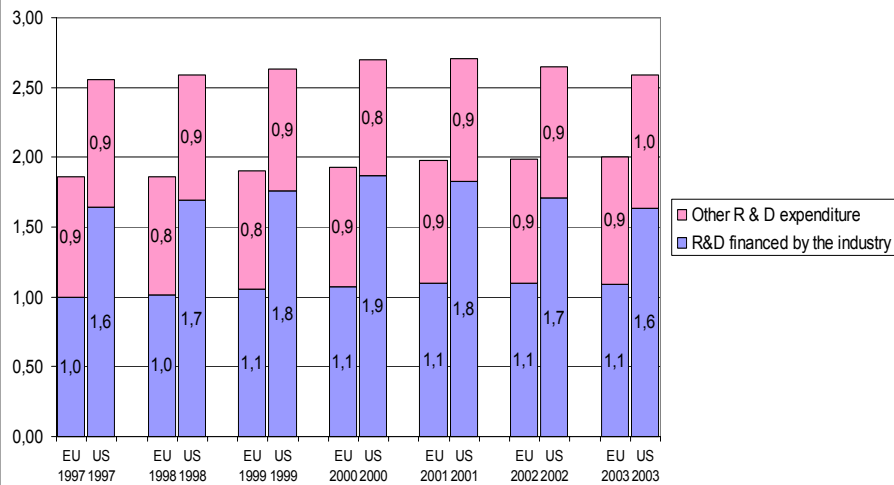
## Europe lags behind the US in ICT investment



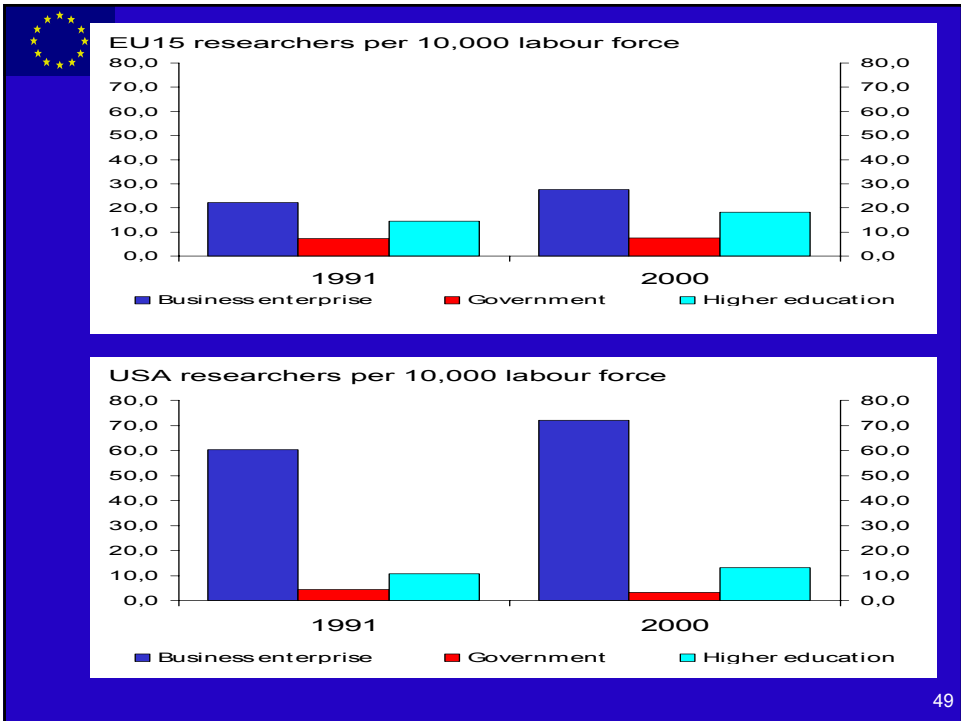
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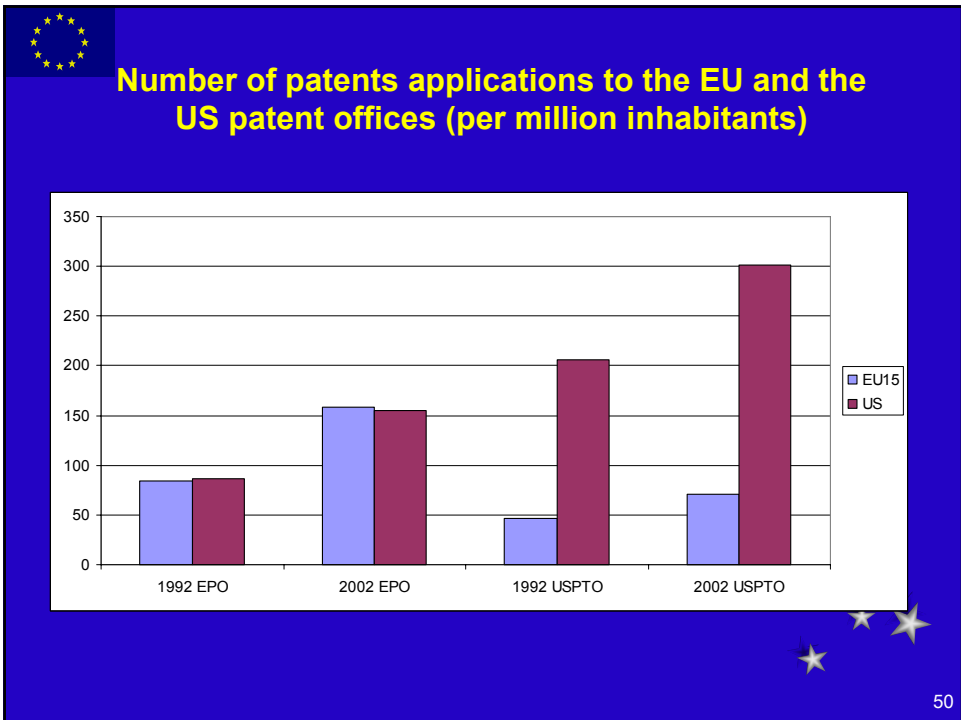
## GERD (Gross domestic expenditure on R&D) as a % of GDP



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# Progress on Lisbon

Limited progress

**Why?**

- Insufficient participation of women and older workers
- Lack of dynamism of the European economy
  - Markets still too fragmented
  - Barriers to entrepreneurship
  - EU lagging behind in the development and use of new technologies
  - R&D and innovation insufficient



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# Progress on the Lisbon strategy

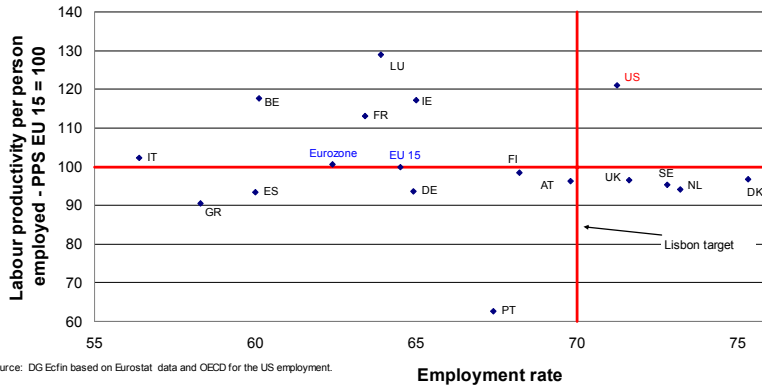
**Key challenges are different among Member States**



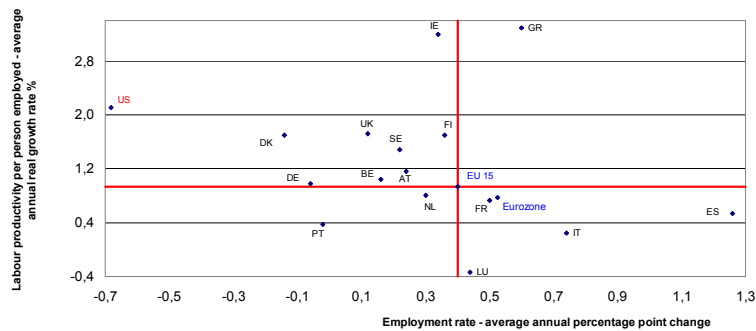
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### Employment and productivity - 2004



### Employment and productivity developments in the EU - 1999-2004





## Is this picture of the EU situation not too pessimistic?

### Two issues debated

#### 1. The preference of Europeans for leisure :

Europeans work to live /Americans live to work!

Europeans freely choose to work a fewer number of hours

The GDP per capita gap mainly due to a different model of society

#### 2. The productivity setback :

Gordon/Blanchard/IMF: slowdown in labour productivity per hour is temporary and the reverse of the medal of employment growth

Sapir/ European Commission : slowdown in technological progress



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## Any implications for the Lisbon strategy?

Social preferences explain a part of the GDP gap between the EU and the US

But agreement : There is a GDP/capita gap between the EU and the US  $\Rightarrow$  Structural reforms can contribute to reduce this gap

Difficult to conclude firmly whether EU productivity slowdown is mainly temporary or more permanent in nature

Nevertheless, need to act on both fronts : employment and productivity :

- Labour and product market reforms are complementary
- Improving productivity performances is crucial in the medium term, especially with ageing population



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## Main achievements and failures

### Positive elements of the Lisbon strategy:

- Greater emphasis on structural reforms
- A comprehensive reform agenda
- Better tools to monitor progress
- First steps towards a streamlining of EU economic policy coordination



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## Main achievements and failures

Poor performance due to :

- Too many priorities and conflicting objectives
- Lack of credibility of the targets
- Lack of national ownership
- Lack of peer pressure at the level of the MS (effectiveness of the OMC?) and insufficient incentives for reforms
- Too complex coordination
- Poor communication



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## Midterm review of the Lisbon strategy

**2004 Spring European Council :**

- Mid-term review of Lisbon carried in 2005

**Objectives of the midterm review:**

- Assess progress made towards the agreed targets
- Define priorities for the next 5 years
- Assess the instruments of governance
- Improve the communication



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## The re-launch of the Lisbon strategy

### Main elements of reforms

1. **To refocus the Lisbon strategy on growth and jobs :**
  - The renewed Lisbon strategy focuses on growth and jobs as a means to preserve the EU social model and to ensure environmental sustainability
  - Reforms to be chosen in order to maximise synergies
2. **To improve and streamline the governance of the strategy :**
  - To establish a new partnership with MS based on a clear distribution of tasks and a simpler reporting system
  - To increase the ownership of MS through the establishment of National Reform Programmes

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## The re-launch of the Lisbon strategy

### Main elements of reforms

#### A renewed Lisbon Action programme

#### Three main priorities :

1. Support knowledge and innovation for growth
2. Make Europe a more attractive place to invest and work
3. Create more jobs for more social cohesion



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## To improve and streamline the governance of the Lisbon Strategy

1. To establish a new partnership with MS based on a clear distribution of tasks and a simpler reporting system
2. To increase the ownership of MS through the establishment of national Lisbon programmes



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## The re-launch of the Lisbon strategy Main elements of reforms

**New 3-year cycle of governance :**

**In 2005 :**

1. Commission strategic report : political orientations
2. Integrated Guidelines Package (BEPG + EG) : Recommendations to the MS
3. Community Lisbon programme and National Reform Programmes

**In 2006 and 2007 :**

1. An annual progress report made at the EU level
2. A single report by each MS on progress made in implementing the NRP



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## The re-launch of the Lisbon strategy

### Main elements of reforms

#### A simplified reporting system

1. At the level of the MS ⇒ A single National Reform Programme
2. At the level of the EU ⇒ A single Community Lisbon Programme and an integrated progress report for the European Council including an assessment of the Community Lisbon programme and of the NRP (thus replacing the Spring Report, the implementation reports on the BEPG, EG and Internal Market Strategy)

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### National reform programmes: a major novelty

- to be presented by the autumn 2005 (mid-October)
- identifying main challenges to achieve higher growth and employment and specific measures to be (or which have been) taken over the 3 next years (possibility to amend every year)
- subject to a broad political debate at the national level (Parliament, social partners, broad public...)
- to bring together all the previous national reports relevant to the Lisbon strategy + some OMC
- annual national implementation reports

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## Why do MS fail to implement structural reforms?

### Low public acceptability of reforms

- Short-term (concentrate) costs versus long-term (dispersed) benefits
- Influential interest groups succeed in influencing decision making process
- Beliefs and fallacies generate opposition against reforms
- Status quo bias



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## How to improve the implementation of structural reforms?

### 1. Carrot or/and stick?

- Stick = Peer pressure
- Carrot = Rewarding actions going in the right direction

### 2. Compensate or not the losers?

- Design of such a compensation scheme to avoid delaying reforms?
- Role of accommodative macroeconomic policies? (Aghion)

Difficult to ignore this question in the present political context



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## How to improve implementation of structural reforms?

### Be smart:

1. **Exploit the synergies**
2. **Find the right sequencing**

Product market reforms make labour market reforms easier by reducing the bargaining power of trade unions? (Blanchard and Giavazzi, Boeri,..)

3. **Find the proper timing**

– Bad times : feeling of urgency but good times: more resources

⇒ Period of recovery following a period an extended period of slow growth

But difficult as the timing determined by legislative rules and the electoral cycle



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## Are these reforms sufficient?

- **Success not guaranteed**
- **Need to convince the MS of the benefits of reforms**
- **Need to increase the incentives to implement reforms**



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## List of Key references

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