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Lisbon Revisited - Finding a new Path to European Growth

LISBON REVISITED - FINDING A NEW PATH TO EUROPEAN GROWTH

Contents

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Advisory Group

To provide a multidisciplinary perspective on Europe's economic and social models, a high-level Advisory Group was established under the chairmanship of Poul Nyrup Rasmussen, former Prime Minister of Denmark. The EPC and Accenture would like to record their gratitude for the views and assistance provided by the Advisory Group. The members of the Group were as follows:

Chairman:
Mr. Poul Nyrup Rasmussen, Former Prime Minister of Denmark

Mr. Giampiero Alhadeff, General Secretary, SOLIDAR

Mr. Chan Kim, Professor, INSEAD

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INTRODUCTION

Europe's economic and social models are not functioning as well as they could. Despite many impressive achievements over the last 50 years – including increased living standards, security and stability – Europe has not succeeded in raising its growth performance and job creating capacity to the required level. With a few notable exceptions, Europe's economies remain mired in a cyclical downturn, with a less than promising longer term outlook. Many remain blighted by persistently high levels of unemployment, with its corrosive effects of social marginalisation and exclusion.

The reform of Europe's existing models is all the more pressing in the light of the new challenges that Europe now faces. Much has been made of Europe's lack of competitiveness in the face of globalisation and the rise of new economic powers such as China and India. This is compounded by an ageing European population and demographic change, which are undermining the fiscal basis for the European social system. The realities of migration and enlargement put further pressure on European social and economic development.

Building a Europe that can meet these challenges does not imply abandoning long-held traditions of social solidarity and sustainable development in favour of uncontrolled free market forces. On the contrary, Europe can be competitive and socially cohesive at the same time. At Lisbon in 2000, EU leaders set out the key elements of this approach when they committed themselves to a highly ambitious strategy to make Europe the most competitive knowledge-based economy in the world by 2010 through a detailed set of measures around competitiveness and social cohesion. Four years on, despite significant progress in some areas such as the information society, the Lisbon process seems to have foundered, due to a combination of economic pressures, institutional inertia and, perhaps fundamentally, a failure to capture the imagination and support of the wider European public.

To set Europe on a path towards greater and more sustainable growth, this report recommends action in two broad areas. First, a serious effort is needed by all stakeholders in European development to inject new impetus and urgency into the stalled Lisbon process – through better co-ordination of policy development and delivery between the different stakeholders, better integration of Lisbon across different policy areas, and better connection of the Lisbon process and objectives to the lives of ordinary citizens. Second, the Lisbon agenda should continually evolve to reflect best practice among Europe's economies and new thinking on issues such as migration and Europe's distinctive areas of comparative advantage.

The Irish Presidency of the European Union has made a comprehensive review of the successes and failures of the Lisbon Process its key priority for the first half of 2004. The Spring European Council in March will be substantially devoted to this review and to ensuring that the reform process is on track to achieve the 2010 goals. This report contributes to that debate, and aims to stimulate new thinking on European competitiveness and social cohesion in the context of the Lisbon agenda and process.

The European Policy Centre (EPC), in partnership with Accenture, is uniquely positioned to offer a balanced perspective on the public policy, social and business aspects of European competitiveness and social performance. The EPC draws its membership from a broad spectrum of European-wide interest groups with a vital stake in the success of the Lisbon Process – including business, trade unions, and civil society bodies.

Our analysis and recommendations have benefited greatly from the input of a high-level Advisory Group of leading opinion formers throughout Europe, established under the chairmanship of the former Prime Minister of Denmark, Poul Nyrup Rasmussen. The Advisory Group has provided a multidisciplinary perspective on Europe's economic and social models. However, the views and recommendations in the report are those of the two organisations that produced it.

SUMMARY OF KEY RECOMMENDATIONS

Accelerating the pace of Lisbon:

1. Close the policy "delivery gap"

The increasing gap between policy proposal and delivery is beginning to undermine the credibility of the whole Lisbon process. Faster delivery of the Lisbon objectives will require a better strategic match between objectives and the policy "Bag of tools" available to the EU and Member States, as well as more systematic involvement of all the different stakeholders including business and civil society. Specifically:

- The European Council must give the process greater dynamism and provide a sharper focus for the Lisbon Agenda, in particular by reviewing the EU Stability and Growth Pact, and ensuring that Member States deliver on their commitments;

- The European Commission should assume stronger leadership of the Lisbon process, ensuring that best practices from one member state are replicated in others, and improving both quantitative and qualitative comparison across Member States;

- The European Parliament should participate more directly in the Lisbon process to ensure the fulfilment at member state level of Lisbon commitments. This means working with national Parliaments to monitor their implementation of Lisbon policies;

- The Committee of the Regions should ensure that best practice and technical know how is passed on to the accession countries as quickly as possible;

2. Integrate the Lisbon Agenda into key European and national policy areas

To achieve overall policy coherence, the Lisbon objectives should be reflected in other key European and national policy areas, such as the Stability and Growth Pact, the EU Structural and Cohesion Funds, and EU competition policy and industrial policy.

3. Get the right balance of powers and responsibilities

Progress towards the Lisbon objectives could be accelerated through improved co-ordination of procedures within the Commission and between the EU institutions. Equally important to the success of Lisbon is identifying those elements of economic and social reform, which are best, carried out at a European level, and those which are best performed at a national, regional or local level. The Committee of the Regions can play a key role in defining this balance of responsibilities.

4. Build real ownership of the Lisbon agenda among European citizens

European economic and social reform must be supported by Europe's citizens. More active and imaginative forms of communication are needed to make Lisbon meaningful to the lives of ordinary citizens. The Commission should actively consider a Europe-wide "re-branding" exercise for Lisbon with a focus on key elements such as opportunity, quality of life and social justice. The Economic and Social Committee should create a framework for carrying forward the recommendations to social partners and civil society, most especially by ensuring a continued dialogue and debate between the various stakeholder groups. Likewise, European civil society must work towards balancing greater competitiveness with social inclusion and cohesion, and should become more widely involved in policy discussion and implementation.

5. Keep the process together

Lisbon is a multidisciplinary process, and as such it must remain coherent. Viewing policies – and their funding – as an integral whole is key.

Broadening Lisbon to new challenges

1. Learn from the success of the Nordic model

While this report does not prescribe a single European economic and social model, it recognises the remarkable achievement of the Nordic example in combining strong economic performance with social cohesion and sustainable development. The Nordic model offers many interrelated examples of best practice which are potentially transferable to other economies across Europe – such as the focus on lifelong learning as the key to innovation, labour mobility, and knowledge-based productivity growth; high levels of investment in research and development; the potential for entrepreneurial opportunity in the social and environmental fields; and the importance of incentives for investment and entrepreneurship.

2. Develop the European knowledge base

The European capacity for knowledge-based growth, already an important element of the Lisbon agenda, should be vastly expanded by accelerating the development of information technologies across the EU and their application within the workplace. A new focus on lifelong learning is needed, as traditional distinctions between work and education increasingly begin to blur, and job creation increasingly depends on labour adaptability and the development of entrepreneurship. Employers and trade unions should promote access to continuing training in the workforce without which a system of life-long learning cannot be achieved.

3. Develop new areas of competitive advantage through innovation in the social and environmental fields

In a new "Post Fordist" era of economic growth, Europe should seek to foster new areas of entrepreneurial opportunity, for example by exporting social and environmental expertise.

4. Create a positive policy agenda around migration

The often emotive debate around migration needs to be replaced by a more strategic approach that acknowledges the complex economic and social dimensions of migration. Thus far little attention has been given to the role of migration in addressing the effects of an ageing EU population and future skills shortages. A starting point should be a detailed EU-wide analysis of current and future labour requirements by occupation, skill levels and industry sector. Longer term there is a need for positive integration policies – particularly in areas such as labour market and social policy – and greater efforts to secure international agreements on the global management of migration.

EUROPEAN ECONOMIC AND SOCIAL MODELS: ANALYSIS AND ASSESSMENT

To determine how Europe can best combine competitiveness with social cohesion, it is necessary to understand the complex interaction between different elements of economic and social performance. Essentially this means determining the economic and social model or models that will continue to serve the EU, its citizens and its interests in the future. The model(s) chosen will define the balance between individuals, the market and the state, clarifying the role of the political, economic and social dimensions of citizenship.

The European way: the welfare state

"The simplest difference between the USA and Europe is that we have welfare states, and they do not.[1]"

Commentators often refer to a "European model" in discussions of economic and social matters, but does such a distinct model really exist, or is it an amalgam of different approaches across Europe?

To the extent that there is a specific European economic and social model, this has traditionally combined a functioning market economy, a well-developed welfare state and a preference for negotiated solutions to economic and social issues. As such the state mitigates the worst effects of capitalism while the market remains the principal mechanism for the efficient allocation of goods and resources. The much greater role played by the state in Europe compared with other major economies is clearly demonstrated by the share of output that falls within the public sector's competence.

Table 1: Total tax revenue in Europe, the US and Japan

	2002	2003	2004	2005
European Union	45.5	45.8	45.5	45.1
USA	32.1	31.0	30.6	30.8
Japan	31.5	30.9	31.2	31.2

OECD: Economic Outlook No. 74. General government total tax and non-tax receipts. % of nominal GDP.

Origins and key characteristics of the European economic and social model

After the Second World War, European governments began to construct social and economic models built on the lessons and failures of the past. Unfettered capitalist accumulation had produced too many negative social consequences, as well as market failure. The alternatives of central planning and the abolition of property rights were pioneered to the east in the communist satellites of the Soviet Union. However, this level of social engineering ran counter to key European values such as individual liberty, private wealth creation and the right to free association and action. Finding a way of making capitalism work in Europe that offered a better solution than that offered by the communist parties was vital.

A balanced approach – the "Golden Triangle"

The principal answer was to strike a balanced approach between the respective roles of the state and the market through social market economies. 'Keynesian demand management' became the policy of choice in Europe, and this allowed governments to maintain steady growth with full employment by stimulating demand during downturns through public employment projects and monetary and fiscal tools. This balancing act between maintaining open markets while compensating for their failures became a self-reinforcing basis of stability: it permitted mass employment, welfare transfers and the provision of universal and extensive public services. This basic model found different expressions across Europe that reflected the political preferences and legacies of the past at the national level. For example, the UK combined Beveridge's "cradle to the grave" ideals with an essentially liberal uncoordinated market economy; Germany focused on creating a coordinated market economy with occupationally-related social insurance that reflected the will of its middle-classes.

Thus at a broad level it is possible to talk about 'the European economic and social model'. It is characterized by comparatively high taxes, universal public services such as health and education, comprehensive and generous social insurance (in comparison with other OECD countries), relatively high levels of trade union power, extensive workers' rights, some nationalized industries, and a commitment to macro-economic stability through sound fiscal and monetary policies.

The key difference with the models found in other OECD countries is the extent to which the role of the state is used to mitigate the failures and externalities of free-market capitalism. By and large, European populations are more willing to pool risk through the state and pay higher taxes, both to ensure that the state will provide for them when they need it, and to ensure that a degree of social cohesion is maintained.

The unique balance between state, individual and market – sometimes called "the Golden Triangle" - is embedded in European treaties, policy-making and traditions. Social citizenship gives a substance to political citizenship by providing the individual with the right of social inclusion and thus the right to education, health and social security. Economic citizenship indicates a preference for negotiated solutions, but also provides, to varying degrees across Europe, workers' rights to information, consultation, negotiations, co-determination and so on.

The changing balance in the Golden Triangle

The shifting balance in responsibility

European voters expect their political leaders not only to regulate the functioning of markets but also to ensure the provision of a range of public and social goods. Yet the delivery of such services is no longer confined to just the public sector. While governments still have primary responsibility for funding a range of collective services, privatisation has shifted much of the actual provision of the services from the state to the private sector – both commercial and not-for-profit organizations. The result may often be better quality services than those provided by the public sector, although the underlying issue of financing is not resolved.

A new balance is therefore emerging in the *Golden Triangle* between the individual, the market and collective life – with a greater role for the private sector in providing collective services. Nonetheless the varying pace of liberalisation across Europe of what have traditionally been publicly provided services (e.g. telecommunications) illustrates that this trend is by no means universal.

The growing role of European and global governance

Another force shaping Europe's economic and social model is the gradual dispersal of power away from the nation state to the supranational, regional and local levels.

The drive towards European economic integration - for exemple through the single market, common polices for competition and industry, the euro and a single monetary policy - has increased competitiveness through the pooling of economic sovereignty. To a lesser extent sovereignty is also being pooled in other areas, such as social policy and political co-operation. Yet European governance structures have not sufficiently evolved to support this pooling of sovereignty, and are not adequately supported by the citizens they seek to represent. The issue of democratic deficit has not yet been sufficiently addressed, despite the recent Convention on the Future of Europe, which attempted to clarify the distribution of political responsibilities. But even if the draft Constitutional Treaty had been agreed in the form outlined by the Convention, the European electorate would still not have been empowered to make clear choices on a European scale about the balance in the Golden Triangle, or who should take the political decisions to determine that balance. This is a shortcoming that risks undermining political life and the collective spirit in Europe at a time when tough decisions must be taken about the way European societies function, if the EU is to achieve its own competitiveness targets and meet the challenges from global competition.

The role of European governance is further complicated by three conflicting trends – pressure for more effective global governance, devolution of power to regional and local governments, and the increasing role of national governments in some areas. While the governance structures and effectiveness of global institutions (UN, WTO) are justifiably criticised, the role that these seek to play does exert a pull of power away from national governments. At the same time the role of regional power exerts downward pressure on national/ central governments (e.g. Scotland, Wales, the Basque country). However, there has also been an increasing tendency for the same national governments to increase their powers in areas such as security in response to a wider geopolitical environment characterised by instability.

There is therefore an additional balance that must be struck between decisions made and implemented at local, regional, national or supranational levels. Different types of decisions are best made on different levels, and this has clear implications for how Lisbon's goals are best achieved.

Regional and local authorities could play a stronger role not only in bringing the Lisbon objectives 'down to earth', but also by illustrating best practices to be emulated by other regional and local authorities. Examples could be in the areas of employment and job creation, sustainable development, development of the knowledge based economy and social cohesion. Many regions and cities have developed very good solutions to problems in these and other areas, but these need to be transferred and implemented elsewhere in Europe – not least in the new Member States. The EU Committee of the Regions could help, but direct cooperation between regional and local authorities can be powerful, and should be developed.

The different sub-models in Europe

While it is possible to trace the broad contours of a "European economic and social model," it is the different approaches within Europe that are most instructive for policy development – a view implicitly acknowledged in Lisbon's "Open Method of Coordination" which encourages benchmarking and exchange of best practice across the EU Member States. The sub-models outlined below broadly categorise the key variations across the European spectrum. However, there remain wide differences even within these sub models. Ireland and the Netherlands, for example, share characteristics around social partnership and consensus, despite being included below in different categories.

Liberal / Anglo-Saxon (UK and Ireland)

The 'liberal' or 'Anglo-Saxon' economic and social model sees the welfare state as 'residual.' The underlying principle is that the state should interfere as little as possible with 'free markets,' so as not to limit work incentives or individual choice. Tax receipts are comparatively low compared to the rest of Europe - taxes on income and wealth account for about 13.6 % of GDP in countries with the

Anglo-Saxon model (UK and Ireland), compared to 22.6 % in Nordic countries.[2] Social insurance levels are modest with most transfers being means-tested. Entitlement rules are quite strict and welfare state benefits are mainly targeted at low-income state-dependants. Social services beyond health and education are relatively underdeveloped; family provision and policies are relatively poor. There is a low level of employment protection and wage bargaining is relatively weak and decentralised.

The liberal model seeks to encourage market participation in providing social goods such as pensions. It does this both passively – through providing minimum guarantees and provisions and nothing more – and actively through public/private partnerships in public services and through privatising state assets.

The economy of this model can be classified as an 'uncoordinated market economy'. It is characterized by short-term equity financing, limited business coordination, and strong anti-trust laws. There is emphasis on a flexible work force, which is relatively unprotected.

The middle-classes, upon whom the state relies heavily for tax revenues and who form the fulcrum on which political power pivots at general elections, are not strongly attached to the welfare state. Because the welfare state in liberal regimes tends to be residual and minimalist they do not derive the same levels of direct benefit from it and are more sympathetic to tax cuts, hostile to large social insurance extensions and tolerate far more openly hostile positions to the welfare state than are tolerated in other parts of Europe.

Conservative / Continental / Rhineland model (Austria, Belgium, France, Germany, Netherlands)

The conservative or continental model is more diverse than the liberal or Nordic one in that it is the most widespread regime and hence contains the greatest spectrum of policy mixes. Hence this model includes the Netherlands, despite its consensus driven approach to social and economic partnership. However, it is possible to identify some key characteristics.

This model tends to operate with medium-high tax levels - Belgium's income and wealth tax, for example, represents 17.6 % of GDP.[3] High payroll taxes support the social insurance system, which is more generous in its transfer payments than the liberal regime; these transfers are employment-based and earnings/contribution related. The conservative social model also encourages early retirement from the labour market, despite the problems it faces with ageing populations, through the incentives created by the structuring of its social insurance system. The principle of 'subsidiarity' underpins the model in many countries: the state should only step in when family resources are exhausted. Partly as a consequence of this (other factors, including cultural norms must also be considered) there is a significantly lower female participation rate in the workforce -- 59.2 % across the Conservative/ Continental countries, as opposed to 70 % in the Nordic countries.[4]

This system has strong corporatist features: organized wage negotiations are very important. Many workers' wages are set as the result of collective bargaining. Workers also enjoy high levels of employment protection, especially in countries such as Germany and Italy.

The economies of the continental model are 'coordinated market economies'. They have long-term capital financing, strong business associations and highly developed inter-company networks. The production system focuses on high-skill / high-quality products and training is vocationally focused. Coupled with protective labour laws and high social security contributions, this results in low labour turnover, with the emphasis on internal flexibility.

Historical legacies from the first half of the 20th century have heavily influenced the development of the continental economic and social models. Conservative political forces succeeded in institutionalising middle-class loyalties to occupationally segregated social insurance programmes.

Southern European / Mediterranean model (Italy, Spain, Portugal and Greece)

Some studies have classified the southern European countries as belonging to the conservative/continental family. However, there are clearly some specific features of these countries' regimes that suggest it is possible to speak of a distinct southern European model, in particular in terms of welfare state organisation and management. Starting with the Bismarkian principle of guaranteeing replacement income along occupational lines, the institutional design of southern European social protection systems is one of fragmentation within professional groups. This is most visible in Greece, but in all of these countries certain professions enjoy special protection and guarantees.

In contrast to the continental model, southern countries do not have a comprehensive safety net offering minimum basic social protection. It was only during the 1990s that Portugal introduced a guaranteed national basic income. Social safety nets have been introduced at regional level in recent years in Italy and Spain, however gaps in cover persist.

A further significant difference can be found in the health care sector. In contrast to the continental family, the four southern countries all have a universal national health service, where access is based on the rights of citizenship, inspired by the Beveridge model. The transition from the occupationally fragmented mutualistic system to a national health service and universal health citizenship took place largely during the 1970s and the 1980s.

The second distinctive feature of southern countries is the weak role of the state in managing welfare systems. This implies a degree of inequality in the allocation of benefits and a tendency for organised interests, notably political parties, to infiltrate the system.[5]

Nordic / Universal / Social Democratic (Denmark, Sweden, Finland)

This model is well known for high taxation levels and high levels of social transfers and redistribution. The social democratic model is so called because of the hegemony social-democratic parties have maintained over the Scandinavian countries for most of the 20th century.

The labour market is characterised by a high degree of participation, especially by women. This is due to the very high level of state provision of services, such as childcare, and to the number of jobs created for women through the expansion of public social services. Workers also enjoy high levels of replacement rates with regard to unemployment insurance, and social partners (e.g. employers and trade unions) generally play a strong and participatory role in society in institutional terms.

The political foundations are based on combining this extensive and universal welfare state with acceptable levels of economic performance. Not only are public services extensive, but the Scandinavian countries have also been able to combine them with high quality and high levels of choice, thus incorporating middle-class preferences and needs. Thus support for the welfare state straddles both the middle and working classes, both of which support it, derive benefit from it, and are willing to fund it.

Key elements of the Nordic Model are:

- The strong role of the state is widely accepted as it is seen as providing support for the development of society rather then inhibiting developments. It provides 'value for money.' According to the European Social survey, 46 % of people in the Nordic countries disagree with the statement "the less government intervenes in the economy, the better for country" – the highest level of disagreement among any group of countries;[6]

- The public sector largely represents society, and it is therefore close to citizens and the market, and is not regarded as elitist or distant;

- Strong government regulation has created new industries, for example in the social and environmental field, which has been promoted by entrepreneurs and developed into social capital; more generally, economic growth is seen as consistent with respect for the environment – this is borne out by responses to the European Social survey, where 42 % of Nordic respondents, the highest of any group, disagreed with the statement that "economic growth always ends up harming the environment;"

- Strong social protection systems facilitate greater labour market flexibility. 70 % of business executives in Sweden viewed social protection as vital for long term economic growth;[7]

- Lifelong learning is seen as key to labour market mobility, innovation and knowledge-based productivity growth; the Nordic countries have the highest level of education, with 25 % having completed the first or second stages of tertiary education. This can be compared to 21% in the Northern – Continental countries, 11% in the Southern-Continental countries, and 13 % in the Eastern European countries;

- The Nordic economies are pioneers of the concept and practice of active labour market policies, making unemployment compensation conditional on accepting regular job/ job placement offers. This, allied to flexible labour markets and strong investment in skills and learning, has created an emphasis on people, not job, protection. Active labour market policies have been particularly useful as a short term policy instrument to counteract cyclical unemployment, and have included subsidised employment schemes, work practice programmes (aimed at retraining) and language training for immigrants to facilitate their entry into the labour market;

- Competitiveness is underpinned by high levels of investment in research and development and the widespread utilisation of the information society. Nordic countries are amongst the world leaders in R&D – in 2002 R&D expenditure as a percentage of GDP was 4.27% in Sweden and 3.49% in Finland, compared with 1.99% for the EU as a whole;[8] similarly Nordic respondents in the European Social Survey had the highest levels of internet usage (26%);

- The Nordic states enjoy the benefits of small size and low geographical distance; they are relatively centralised economies with low hierarchical distance, which makes it easier to secure consensus on critical areas of economic and social development;

- High levels of personal taxation are tightly linked to social benefits and public investment. There are relatively low levels of company taxation, providing incentives for investment and entrepreneurship. The ability of public investment to yield social benefit is borne out by the European Social Survey, with 41% of Nordic respondents perceiving state education to be "good," and 26 perceiving their health service to be "good." These were the highest levels of satisfaction found amongst all respondents.

Accession countries

The central and eastern European countries, which will accede to the EU in May 2004, do not share a single economic and social model. For the most part they have a common historical background with the continental model outlined above and with welfare systems built along Bismarckian lines. However, development of these systems was interrupted by the post-1945 communist command economies. Within these economies the state took the main responsibility for ensuring the material existence of all its citizens, with state enterprise and social insurance linked to employment status.

The countries formerly within the Soviet sphere of influence therefore have a multifaceted legacy. Nevertheless, there is a strong national consensus in favour of liberal reform in many of the accession countries (Poland, the Czech Republic, Hungary and the Baltic states). However, within this the pace of social reform has varied. The World Bank assesses social reform based on whether countries have undertaken pension reform, reduced subsidies, streamlined and targeted income transfers, and divested firms of social assets, and according to this the Baltic states lag behind Poland, Slovenia, Hungary and the Czech and Slovak Republics. Nevertheless, the World Bank also analyses the direction of social policy, and concludes that the majority of the formerly Communist accession states are developing into one or other variant of the West European welfare state, combining a mix of Bismarckian-style insurance and Scandinavian-style state financing. Given both the speed and scale of their transitions, the post Communist welfare states have developed in reaction to the failures of the old system. Hungary, for example, has gradually developed into the liberal regime type, while the Czech Republic, Poland, Estonia and Slovenia have taken a more continental route.

Economic and social performance in Europe – an assessment

How have these different models fared in terms of actual economic and social outcomes – and what clues do they provide in the search for increased competitiveness and sustainable growth? To answer these questions, we analysed the performance of the European economies now and across time at both an aggregate and disaggregated level.

A snapshot of current performance

In assessing the aggregate performance of the European economies, our analysis draws on two complementary sources – an Accenture / EPC analysis of economic and social performance; and the competitiveness indices produced by the World Economic Forum.

The Accenture/ EPC analysis examined the performance of European countries across a range of economic and social indicators. The economic indicators included GDP per capita, employment rates, relative unit labour costs, and (overall) unemployment rates. The social performance indicators included the human development index,[9] the incidence of long-term unemployment, poverty rates after social transfers, effective retirement age, and recycling rates. Country scores for each performance measure were ranked (with each measure carrying equal weight). Each country's scores were then averaged for the economic and social performance indicators, respectively. The average of the economic and social performance scores were then plotted on a 2 x 2 scattergram.

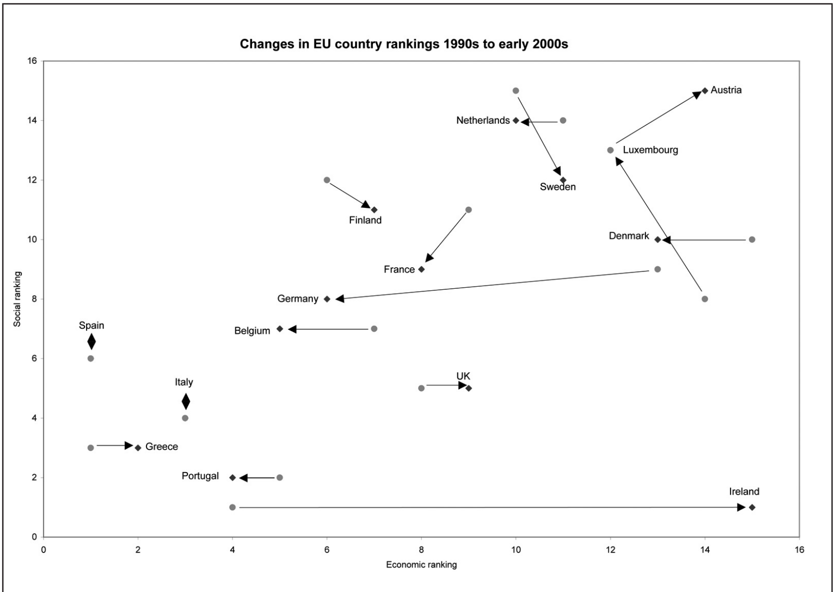
Based on this analysis, three relatively distinct clusters of EU countries can be identified in terms of their economic and social performance (see figure 1):

- *High economic and social performance:* Sweden, Denmark, Austria Luxembourg and the Netherlands;

- *Medium economic and social performance:* Germany, France and Belgium;

- *Low economic and social performance:* Spain, Portugal, Italy and Greece.

Figure 1



Ireland and Finland appear as outliers. Ireland performs very well on economic measures, but poorly on social indicators. Conversely, Finland ranks highly on measures of social performance, but does less well in terms of economic performance. The UK, despite a very successful recent economic performance in terms of growth and jobs, emerges less well on the broader set of measures used in our analysis.

The strong performance of the Nordic countries is confirmed by the competitiveness rankings produced by the World Economic Forum for 2003 (see table 1 & 2). The World Economic Forum produces two sets of competitiveness indices. The growth competitiveness index is based on three broad categories of variables that drive economic growth in the medium-to-long term: technology, public institutions, and the macroeconomic environment. The Business Competitiveness Index is a complementary index that measures variables determining an economy's sustainable level of productivity - including the degree of company sophistication and the quality of the national business environment.[10] Whether measured on the basis of the Growth Competitiveness Index or the Business Competitiveness Index, three of the Nordic economies – Finland, Sweden and Denmark – emerge among the top five most competitive economies in the world.

Table 1 – Growth Competitiveness Rankings 2002 & 2003

Country	Ranking 2003	Ranking 2002
Finland	1	1
United States	2	2
Sweden	3	3
Denmark	4	4
Taiwan	5	6
Singapore	6	7
Switzerland	7	5
Iceland	8	12
Norway	9	8
Australia	10	10

Source: World Economic Forum, Global Competitiveness Report, 2003 - 2004.

Table 2 – Business Competitiveness Ranking 2002 & 2003

Country	Ranking 2003	Ranking 2002
Finland	1	2
United States	2	1
Sweden	3	6
Denmark	4	8
Germany	5	4
United Kingdom	6	3
Switzerland	7	5
Singapore	8	9
Netherlands	9	7
France	10	15

Source: World Economic Forum, Global Competitiveness Report, 2003 - 2004.

Temporal analysis

It is also instructive to look at changes in economic and social performance over time, as depicted by the trend arrows in Figure 1.[11]

Austria improved both its relative economic and social performance. Conversely, France fell in both economic and social terms.

Some countries improved more on one dimension than the other. Ireland has achieved tremendous economic growth, without any apparent gains in social performance. Finland improved its economic performance, with a slight downward dip on the social dimension.

Denmark, Germany and the Netherlands have all fallen in the economic rankings – while generally retaining their relative position in terms of social performance.

Greece failed to make any significant inroads in terms of its economic and social performance relative to other countries. Similarly, Spain and Italy remained in the same relative position as 1990. Portugal's economic position declined slightly, with its relative social performance unchanged.

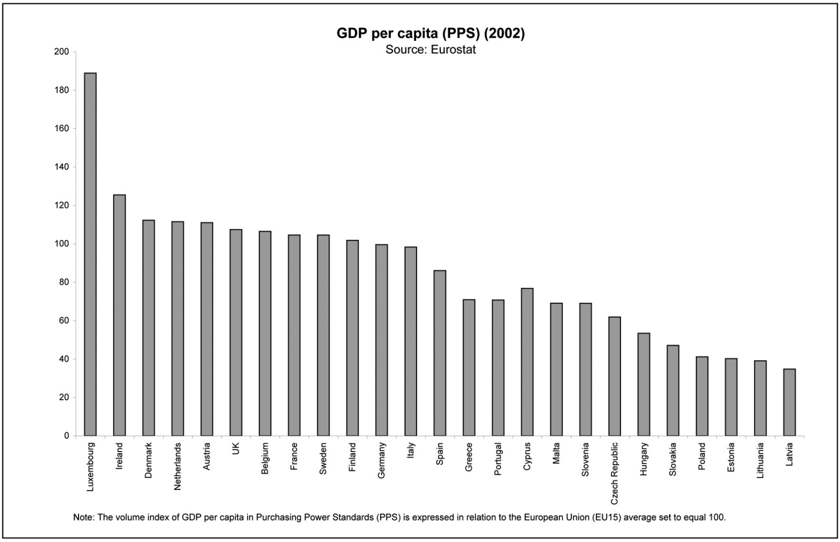
Micro-level analysis

Overall rankings can conceal significant variations which can provide clues to deeper interactions between economic and social performance. For this reason, we disaggregated the overall rankings to examine some individual measures of economic and social performance. This disaggregated analysis highlights a number of interesting differences and relationships between indicators and across the spectrum of the EU-15 and accession countries.

Average incomes:

The comparison of average incomes highlights two points in particular - first, the sheer scale of the income (Figure 2) disparity between the existing EU Member States and the accession candidates, which represents a future challenge to Europe's economic and social models; second, the position of Ireland with the second highest GDP per capita, a result of the booming economic growth of the 1990s; and thirdly, the relatively high incomes of the social democratic model countries including Austria, Denmark and Sweden.

Figure 2



Poverty levels before and after social transfers:

Figure 3 highlights significant differences between European countries in both the extent of poverty and the relative success of social transfers in reducing poverty. Four groups of countries in particular can be discerned:

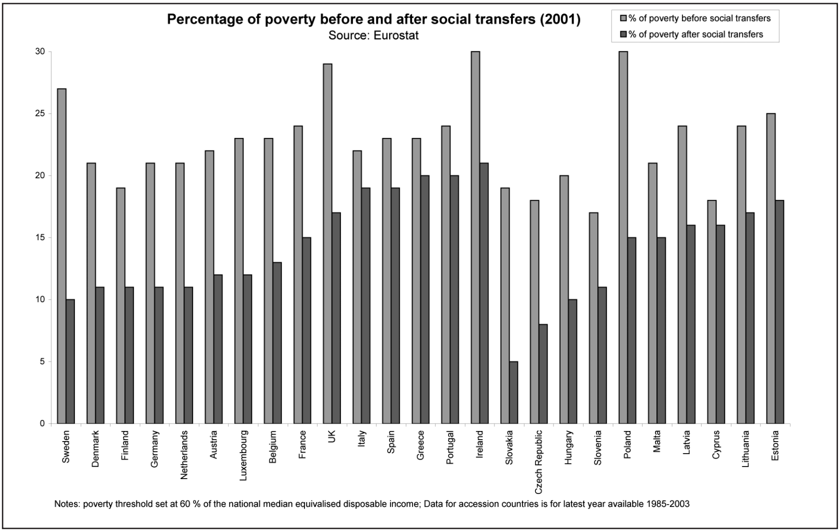
- Germany, Netherlands, Finland, Austria, and Denmark. Poverty is generally less prevalent than in other European countries, and social transfers are very successful in cutting poverty rates, typically halving them;

- Italy, Greece, Spain, France, Portugal: pre-transfer poverty levels are about the same as the first group, but social transfers have much less impact on reducing the prevalence of poverty;

- Sweden, Ireland, and the UK: these have among the highest pre-transfer poverty levels. However, Sweden stands out in that its social transfers dramatically reduce post-transfer poverty levels, to below those of any other existing EU member state in the analysis;

- Of the accession countries it is interesting to note the success of the Czech and Slovak republics, Slovenia, Hungary and Poland in reducing poverty via social transfers. Conversely, the impact of social transfers in the Baltic States, Cyprus and Malta is relatively low. Poland stands out as having particularly high pre-transfer levels of poverty.

Figure 3



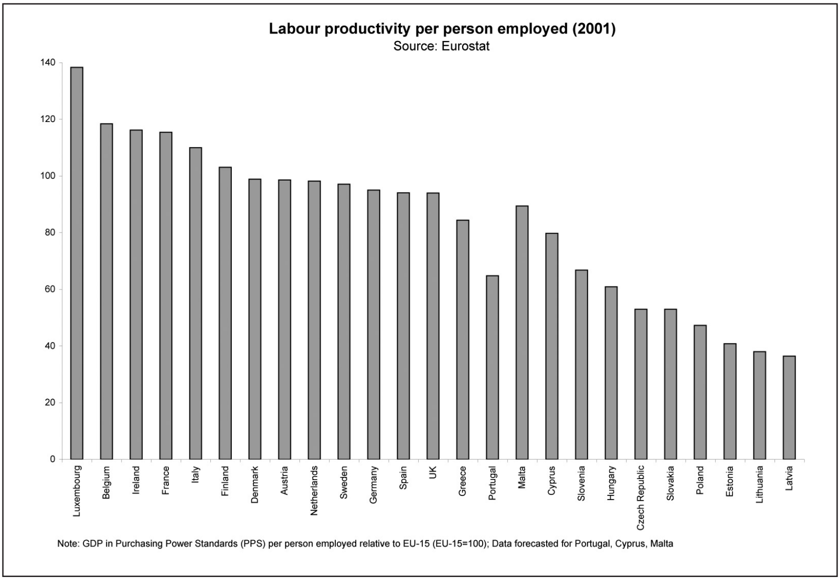
Productivity:

The analysis of labour productivity across Europe (Figure 4) highlights several interesting patterns and findings. First, as expected, there is a huge gulf in productivity between the existing EU Member States and the accession countries, a gap that can be expected to narrow over time as the latter benefit from investment, and the transfer of technology and skills. Perhaps more surprising is the marked variation in productivity within the accession countries. The Baltic States share similarly low levels of productivity, while Slovenia scores significantly better. Malta and Cyprus perform significantly better in terms of productivity than all the formerly communist countries.

Second, the UK's weak performance in productivity terms stands in marked contrast to its employment performance. This reflects in part the greater focus on skills in the continental model, but it also suggests that some of the UK's superior employment performance has come from the creation of less skilled jobs characterised by low levels of marginal productivity.

Third, a relevant question for Europe's economic and social models is the relationship between working hours and productivity. Anecdotal evidence suggests that longer working hours do not lead to greater productivity. France, for example, stands out as having a low burden of work, but a relatively high level of productivity.

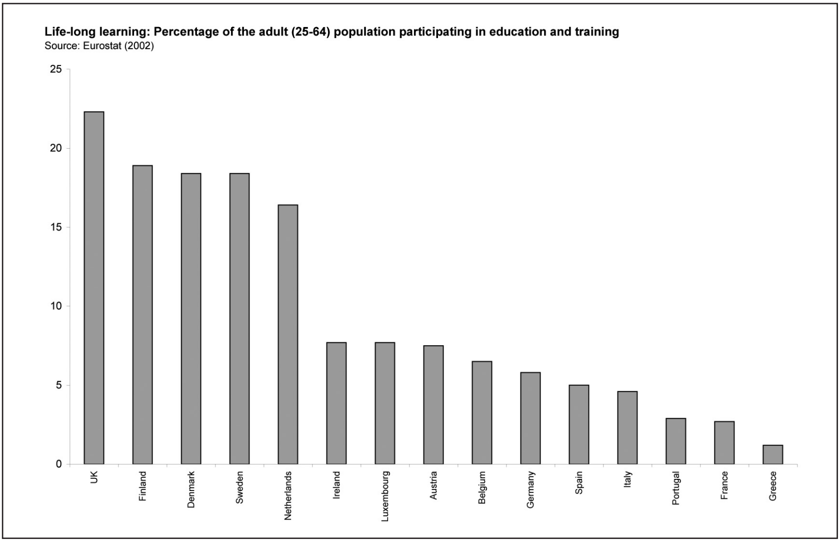
Figure 4



Lifelong learning:

The potentially significant role of lifelong learning in addressing both economic and social aspects of performance has previously been noted. This central importance is confirmed by a comparison of overall economic and social performance against levels of lifelong learning. The best economic and social performers typically have the highest percentage of the adult population participating in education and training, while the opposite is true of the poorer performers.

Figure 5



Long term unemployment:

Austria, Sweden, Denmark, the Netherlands, Luxembourg, and the UK have the lowest incidence of long term unemployment (as a percentage of total unemployment) in the current EU-15. Interestingly, they also experience a sharper drop in the incidence of unemployment at the 12 months, or over, stage compared with the 6-12 month bracket, a drop that may reflect differences in labour market policy and requirements to take up work (e.g. in UK and Sweden).

As expected, the accession countries have markedly higher long term unemployment rates, although levels vary enormously between states.

There are many possible influences on the level and duration of long-term unemployment – including the extent and nature of active labour policies, income replacement ratios, wage rates, the operation of the benefits system, and employment regulation. Another potential explanatory variable is education and lifelong learning, which can promote continual upgrading of skills within the labour force and ease transition from one occupation or job to another, or from unemployment back to work. There is evidence of a negative statistical association between life long learning and long term unemployment, with those countries having higher rates of lifelong learning tending to have lower levels of long term unemployment (see Figure 7). The UK is an exception to this pattern, in that it has high levels of lifelong learning but is not among our group of countries with high economic and social performance (however, it does perform well in terms of its low levels of long term unemployment – see Figure 6). The precise relationship between lifelong learning and long-term unemployment, is an area that merits further analysis and attention from a policy perspective

Figure 6

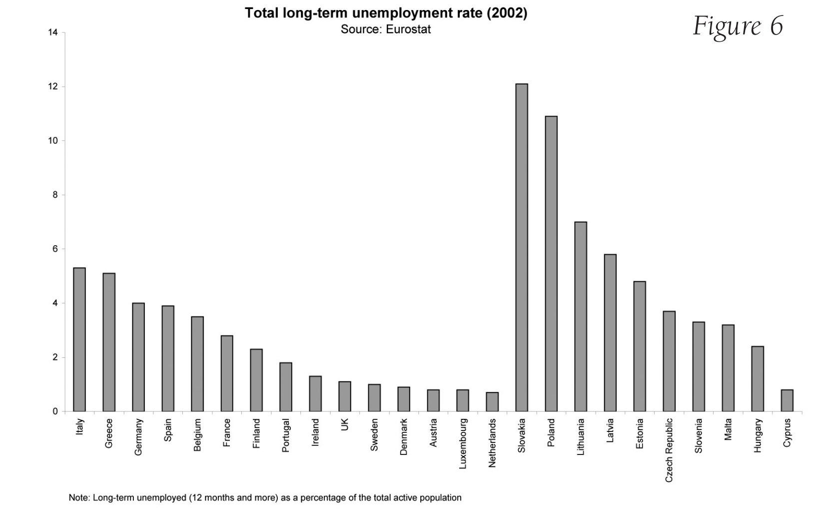
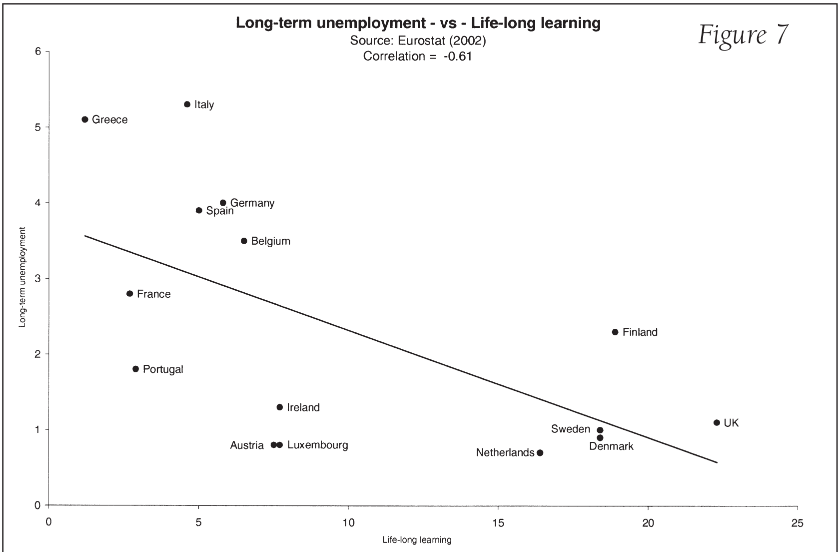


Figure 7



CHALLENGES FACING THE EUROPEAN ECONOMIC AND SOCIAL MODEL

Western Europe has enjoyed unprecedented prosperity and peace for much of the last 50 years, and the models identified have largely served Europe well in promoting economic growth and maintaining social justice. In the wider context the EU has provided an institutional framework that that helped to foster peace, democracy, security, and stability. This has been achieved against a background of strong transatlantic security and economic partnership and by pooling sovereignty to achieve common aims and resolve conflicts of national interest through shared institutions. These achievements should not be underestimated.

However Europe's success is now being called into question. Tough challenges and a new geopolitical reality are affecting the EU's ability to generate economic growth while retaining social cohesion. Indeed criticism has focused on Europe's distinct economic and social model, thought to be at the root of high unemployment, ossified labour markets, excessive social insurance and a business climate stifled by regulation.

Some criticism is justified - there are anachronistic aspects to all of Europe's models. For example, passive unemployment insurance is widely regarded as a disincentive to work unless qualified with an 'active' accompanying requirement. It is therefore vital to understand the current and emerging challenges facing Europe in order to identify how Europe's models should best evolve in the years ahead.

Below we set out the key pressures and threats that the EU must address if it is to achieve the Lisbon goal of becoming the world's most competitive, knowledge-based economy by 2010.

External challenges

The rise of the knowledge-based economy: comparisons with the US

Europe has been failing to deliver satisfactory growth for some time.

Since the 1980s, growth rates have been disappointing, both in absolute terms and in comparison with the US. US GDP growth has consistently been above 3 per annum: it was 3.2 per annum in 1980 – 1990, rising to an average of 3.6 per annum in the period 1990 - 2000. In contrast, EU economic growth was 2.4 between 1980 and 1990, declining to 2.1 between 1991 and 2000.[12] Over the same period, employment has been rising at a faster rate in the US than in Europe as a whole. The European Union has been growing at an insufficient rate to generate enough new job opportunities for unemployment to come down and new labour market entrants to find employment.

As a result, Europe has also suffered a relative decline in average incomes compared to the US. During the 1990s, real GDP per capita in the US rose by 2.12 annually, while EU countries saw real GDP per capita grow at an annual rate of 1.62.

This clear gap in performance, and Europe's failure to capitalise fully on the anticipated economic benefits of the single market programme, are demonstrative of the changing nature of comparative advantage and economic growth. Traditional bases of productivity growth and physical economies of scale have been supplanted with knowledge, innovation and powerful network externalities, and these create value in entirely different ways to more tangible forms of capital.

The US has been extraordinarily successful in making the transition to a knowledge-based economy. Few other countries have benefited to the same extent from the application and implementation of new technologies, or exploited commercially the opportunities inherent in information and communications technologies (ICT). With the possible exception of the Nordic countries, Europe is not perceived as being innovative. The European Commission has made a creditable contribution towards promoting the knowledge based economy in the EU – and this should be recognised – but more remains to be done. Investing in knowledge and increasing the knowledge intensity of all sectors is vital for the growth prospects of the European Union. Furthermore, investment in human capital to secure the long-term availability of a highly skilled workforce is an integral part of the knowledge accumulation process.

During the last two years the slow down of US growth, combined with dramatic geopolitical shifts, the collapse of the dotcom bubble and regulatory failures, have created scepticism about the sustainability of the US new economy growth model. However, Dr. Luc Soete argues that these events '*have not rendered the diagnosis of Europe's failure in knowledge investment any less instructive. Rather, what the US growth slowdown has brought to the forefront is that intra-European best practice comparisons have become more instructive. In particular, they highlight the possible, diverse routes towards the knowledge-based economy Europe might take, illustrated in the success stories of individual Nordic countries and of Ireland, the Netherlands and Portugal.*'[13]

> Without the right foundations for a knowledge-based economy, Europe's competitive advantage and prospects for long-term growth will be further eroded, making it increasingly difficult to finance and sustain current high levels of social provision.

The challenge from Asia and the Far East

Europe's economic imperative is not only to catch up with the US. It must also compete with the emerging economic giants of China and India. The latter is establishing itself as an IT powerhouse and outsourcing destination; the former has the largest reserves of labour in the world, and is gradually opening its vast internal markets to global trade. America may soon consider the Asiatic countries its most strategically important political and economic partners. Initially competition with the Asiatic countries was centred primarily on manufacturing, forcing European countries to concentrate their efforts on activities higher up the value chain. Now, as Asian countries ascend further up their own value chain, Europe is forced to do likewise, raising domestic issues relating to "re-skilling" and facilitating the shift to new areas of European comparative advantage. Nonetheless that comparative advantage is based on multiple factors, including location and infrastructure, as well as skills and labour costs. The Central and Eastern European accession countries have a significant advantage with respect to these many of these factors, and have a strong role to play in re-establishing Europe's position.

International trade and labour competition from Eastern Europe and Asia is generating ever-increasing income divergences between skill sectors, with Asia having a labour cost advantage – in absolute terms as well as relative to productivity – which means that European and global firms are increasingly switching production and operations to countries in Asia. There is therefore a need to respond to these challenges through "re-skilling" and developing new areas of competitive advantage.

Globalisation and capital mobility - the end of Social Europe?

Globalisation has rendered social and economic relationships between global actors deeper, wider and more powerful than ever before. In many respects this process has served Europe well to date: Europe, the USA and a handful of other OECD countries benefit from globalisation more than any other part of the world. Since 1973 Europe's GDP has grown at an average of 2.3 per year as economies have become more integrated. The liberalization of financial markets, increasing levels of free trade and the opening up of new markets following the collapse of the communist economies have led to huge increases in prosperity in Western Europe.

However globalisation is accompanied by two counter trends. First, the seemingly inexorable trend toward greater integration of markets for goods, services, capital and labour is producing a reduction in national governments' policy sovereignty as fiscal and monetary policies in individual states become increasingly interdependent. At the same time the fiscal basis of social welfare is being eroded as greater capital mobility and unemployment limit revenue from taxation.

Secondly there is a growing backlash against globalisation amongst the wider population. This includes those who are concerned about the adverse effects of globalisation, but who are willing to work with business and governments to mitigate those effects. It also includes a small but growing vocal minority who completely rejects the neo-liberal economic model as a basis for ordering society.

There is therefore an urgent need to find new approaches towards the management of globalisation and to reconcile the opportunities it creates with the difficulties that accompany it. In practice this means ensuring that economic prosperity for some is not achieved at the cost of social exclusion for others. Moreover, the economic and social imperative to find a better means of international cooperation is reinforced by the uncertain global geopolitical context. The threat of insecurity and the growing role of trans-national forces (e.g. global warming, terrorism, disease) cannot be addressed by states in isolation from each other – but rather demand international cooperation.

Potential threat: Globalised international competition and greater capital mobility will erode the capability of European economies to maintain the fiscal basis of their social models.

Internal challenges

European governance structures

The EU has developed a strong basis for economic cooperation since 1945, but its governance structures have not kept pace with economic, political and social developments, and the EU remains predominantly an intergovernmental organisation (with a budget only slightly higher than 1 of the total GDP of the 15 EU Member States). There is a lack of clarity over responsibilities regarding the implementation of legislation, and the division of powers between national and EU institutions, and indeed between the EU institutions themselves. The Accession States will not add proportionally to the economy, but they will add greatly to the political complexity of the Union.

Attempts to create a 'bottom-up' approach to governance structures for the enlarged Union through the *Convention on the Future of Europe* have thus far failed, reflecting a fundamental disagreement on the optimum level of integration in Europe, and on the extent to which the European Union should extend shared sovereignty beyond the economic sphere.

Lack of flexibility in the EU's economic governance structures is clearly illustrated by the fiscal constraints of the Stability and Growth Pact which applies to the 12 eurozone states. The Pact has resulted in significant budgetary consolidation since the introduction of the euro in 1999, but has left governments with little room for fiscal manoeuvre to boost their flagging economies. Clearly the Pact should not be changed to suit individual economies, but it can be revised to suit wider macro-economic shifts. More importantly it is constraining the ability of governments to make investments in the very areas where the Lisbon Agenda is attempting to foster growth and progress, for example education. Rethinking the Stability and Growth Pact so that its limits exclude certain forms of capital expenditure would be a significant step towards bringing it into line with the goals of Lisbon.

Potential threat: Governance structures will be inadequate to cope effectively with change and to keep the momentum in an enlarged EU, leaving Europe fragmented and unable to provide a unified response to the challenges it faces. The lack of macroeconomic coordination poses a risk for economic development and social stability by prohibiting an adequate fiscal response to monetary decisions by the European Central Bank. A Stability Pact out of tune with current economic challenges could put European economies in a straightjacket that prevents economic growth and development and, consequently, the achievement of the Lisbon objectives.

Demographic change

The success of the European economic and social model to date has been based on the availability of labour and on high levels of productivity growth. Demographic changes challenge these foundations.

Three major demographic trends are currently evident in Europe. The first two are declining birth rates and higher life expectancy at birth, which inevitably results in an ageing population, supported by fewer people of working age. This clearly puts pressure on the sources of pension and health care provision, and the degree to which Member States are equipped to deal with – or have responded to – these challenges varies. Moreover, the effects of these trends on the distribution of global output are striking, with the Commission estimating that the EU will produce only 10 of global output in 2050, compared with 18 in 2000. The negative impact on growth is clear: there is an estimated reduction in the EU's potential growth from the present rate of more than 2 to about 1 by 2040, unless a falling labour supply is offset by increases in productivity. In comparison the US is projected to *increase* its share of global output by 3 percentage points, underpinned by population growth (due to both natural increase and immigration) of about 2.5 per year in 2040.[14]

The third key element of demographic change is migration. Eurostat assumes moderate immigration into the EU of 600,000 people per annum until 2050, of which 450,000 people per annum will be of working age. The potential benefits of migration as a tool to manage demographic challenges and skills shortages have long been apparent. As the European Commission states, *'maintaining the working-age population and even more so maintaining old-age dependency ratio, would require massive increases in immigration until 2030'*[15] above the current trend and projections of flows. This applies to shortages of both highly skilled workers (for example IT professionals, doctors), and low-skilled workers.

Migration therefore both responds to skills shortages and supports social provision via taxation. In this respect it is key to reinvigorating the EU's economic growth. However it also creates the considerable challenge of creating policies that combine an emphasis on full participation in society with respect for cultural and religious diversity. European migration policy is still in its infancy, but must tackle the considerable and complex problems of integration and diversity seriously from the outset if its social aspects are to be appropriately addressed.

Addressing Europe's demographic changes is a multidimensional undertaking, involving addressing the falling birth rate, the decline in the working-age population, the reality and necessity of migration, and the challenges of increased demands on welfare provision (pensions, healthcare), at a time when its fiscal basis is being undermined.

Potential threat: A shrinking EU working population could result in falling growth undermining the whole basis of the economic and social model unless this is balanced by a corresponding increase in productivity levels. Lack of understanding of the benefits of – or issues surrounding – immigration will hinder the chance of developing effective policies and attitudes towards migration.

THE EUROPEAN RESPONSE: THE LISBON STRATEGY

Recognising the scale of the threat to Europe's future competitiveness and growth prospects, EU leaders meeting in Lisbon in 2000 set out a major programme of reforms aimed at making Europe the most competitive knowledge-based economy in the world by 2010. Yet, after a promising start, progress towards the Lisbon objectives has all but stalled, and the focus of policymakers' attention shifted elsewhere. Two questions immediately arise: is Lisbon still relevant to the wider challenges Europe now faces; and, if it is, what is preventing faster progress on Lisbon from being achieved?

The Lisbon agenda – progress to date

Key elements

The Lisbon process was created primarily to stimulate qualitative economic growth and job creation. As such it is built on the idea that growth should be knowledge-based and should work to maintain or strengthen social cohesion, while respecting the principle of environmental sustainability. The aim of creating the world's most competitive knowledge-based economy by 2010 required economic and social reforms. More specifically, the elements defined at the Lisbon European Council included:

- Sustaining the healthy economic outlook and favourable growth prospects by applying an appropriate macro-economic policy mix;

- Preparing for the transition to a knowledge-based economy and society by formulating policies favourable to the information society and R&D, as well as stepping up the process of structural reform for competitiveness and innovation and by completing the internal market;

- Modernising the European social model, investing in people and combating social exclusion;

- Considering the impact of these policies on the environment (added at Gothenburg in June 2001).

Lisbon aimed to limit as far as possible new legislation at a European level, and instead to identify best practices which could be replicated throughout the Member States by benchmarking. This 'Open Method of Coordination' was founded on the belief that governments and other stakeholders would take the process seriously and address shortcomings by adapting their own systems and methods in line with European best practice.

A strategic framework

Progress in the first phase of Lisbon was notable, and these achievements should not be underestimated. Moreover, delivery of programmes of societal change tends to be exponential rather than linear. Successes to date include:

- Translating the strategic thinking into policy instruments at European level, including Directives, EU programmes, action plans and recommendations;

- Adding an environmental dimension and building an approach towards sustainable development;

- Introducing basic instruments for implementation, including dedicating the Spring European Council to the Lisbon process, reorganising the work of the Council of Ministers around the competitiveness agenda, developing the Open Method of Coordination and involving the European Parliament, the social partners and civil society in the process;

- Starting implementation in EU Member States, although this process is still uneven between regions and countries.

Lack of real progress

However, this strategic framework has not been translated into results in the real economy, and there is widespread agreement that much faster and deeper progress is needed if Lisbon is not to stall completely. The internal and external challenges to Europe's competitiveness discussed previously only add to the sense of urgency.

There has been no great take-up of best practice and reforms, and the agenda has not received the same level of attention as, for example, the internal market project did prior to 1992. The Lisbon objectives are not legally binding, but rather are recommendations that 'can wait' if reform initiatives prove politically difficult in a domestic context.

Moreover, Lisbon – and its lack of progress – has failed to capture the attention of the European public, in part because it has been badly communicated. This suggests that the need for reform is not fully recognised in different national or regional priorities and models. In other words, it is 'business as usual.'

While there are clearly limitations to what could be expected of the Lisbon process in the first phase, which concentrated on establishing the framework for the process and linking strategy to policy, tangible results would clearly be expected as the halfway point of the 2000-2010 period approaches.

Is Lisbon still relevant?

Given the slow degree of progress towards the Lisbon objectives, the question inevitably arises as to whether this is a problem of form – i.e. the process is not working - or substance – i.e. the objectives are not right or no longer valid.

The Lisbon Agenda was formulated on the basis of what were at the time positive economic prospects for the EU. That context has changed dramatically since 2000, and as the mid-term review approaches, a new set of dynamics needs to be taken into account:

- Uncertain economic prospects in Europe and globally;
- An EU of 25 in 2004 with the expectation of significantly increased diversity in performance and cohesion across the Union;
- Changes in global dynamics, including a stronger performance by the Asiatic economies;
- The prospect of a new constitutional treaty for Europe with inadequate provisions, in particular, for strengthening economic governance of the Union in the next phase of its development.

Most commentators seem to agree that, if anything, these changes reinforce the critical importance of Lisbon's key elements – a stable macro-economic framework, policies for the information society, stronger investment in research and development and human capital, more competitive markets leading to higher productivity and innovation, and a modernised social model that combats the effects of social exclusion.

Yet Lisbon must also be viewed as a living process, constantly adapting to new challenges and opportunities that may be just on the horizon. This broadened agenda encompasses challenges as diverse as the management of migration, equipping Europe to deal with the effects of demographic change and an ageing population, and finding new ways to deepen the European knowledge base. A new understanding of Europe's new areas of potential comparative advantage is needed – for example, in particular technologies, or social and environmental expertise - and how these can be developed as a basis for stronger economic growth. Above all, there is a need for more connected thinking and policies that address multiple economic and social issues together – for example, policies that promote knowledge and learning alongside social opportunity and labour market flexibility.

The Lisbon process could also be improved in some ways. Key reforms could be better targeted and prioritised. Benchmarking and the Open Method of Coordination have not produced the expected degree of learning and exchange of best practice across the EU economies. This may be because key pressure points – such as public and media scrutiny of progress towards Lisbon – have not functioned as well as expected; or it may reflect a lack of transferability due to poor adaptation of best practice to the different economic and social models across Europe. Although Europe's economic and social models are slowly beginning to converge, the Member States are still characterised by differences in their values and approaches, and each views Lisbon's attempts to balance knowledge-based growth, social cohesion and environmental stability differently.

Why is Lisbon not delivering faster?

Notwithstanding the need to broaden and improve the Lisbon agenda and process, most critics start from the point that the Lisbon strategy itself is broadly on the right lines, but that the fundamental problem is one of delivery on the objectives.

Some of the reasons why Lisbon is not working as anticipated are outlined below.

Ownership of the process

Heads of State agreed at the original Lisbon conference to take ownership of the project, and to review progress annually against a benchmark of key indicators developed specifically for this purpose. However, too often the Spring Council is taken over by other issues; while conclusions are produced, personal ownership and discussion amongst the peers about how to reproduce best practices have not yet emerged.

Moreover there has been a marked lack of downward dissemination of the Lisbon process, and its goals have not been adopted by the lower echelons of governments, regional governments, civil society, the press or the public. Europeans are no doubt sympathetic to Lisbon's overall objectives, but they have not been engaged in the process and the press is correspondingly disinterested – apart from a few days around the Spring Summits. The lack of public debate means that there is no bottom-up pressure for the achievement of Lisbon's goals. This should be contrasted with the internal market process and public/ press interest leading up to 1992.

Coordination of the process

Stronger leadership at European level is required to make the Lisbon project succeed; collective leadership is also necessary, but similarly absent. There is a lack of coordination at both Head of State level in the European Council as well as sector ministerial level, and this has resulted in a lack of drive for the process. Similarly, although there is some degree of coordination within the Commission, this is mostly at the technical, rather than the policy level; policy at both European and national level remains compartmentalised and this results in a lack of coherence.

Is the Stability and Growth Pact hampering the process?

The Stability and Growth Pact, which governs the fiscal policy of the 12 eurozone states while also influencing the fiscal policy of the 3 non-eurozone Member States, has undoubtedly brought order to European public finances since its introduction. However it also acts as a constraint in a period that has been characterised by a weak real economy, and a number of countries have pushed against the Pact's limits, including the two largest euro-zone economies. This constraint has hampered the ability of governments to commit funds, even to capital expenditure where this would be in accordance with Lisbon's goals. Some flexibility to allow for stronger demand management may indeed help boost the weak economy.

This is not to say that the Pact should be rewritten, merely to suggest that modifying it so that its rules are more closely linked to Lisbon's goals may be beneficial. For example capital investment in initiatives that directly link to achieving the Lisbon objectives could be exempt from the Pact's rules, as such investments should lead to stronger economic growth (and higher tax receipts) in the future.

Is the process too complicated?

Lisbon's overall objective is clear, but the process for achieving this has become less so with additional goals agreed at Stockholm and Barcelona. The strength of Lisbon – its aim of linking knowledge-based growth to social cohesion and environmental sustainability, by way of adopting best practice from other Member States as appropriate – lacks clarity. There is no single vision of what this means in practice, and no mechanism to ensure adherence to policy agreed in principle, since this sits outside of the formal bureaucratic structure. Moreover the benchmarking system has not provided as useful a basis for comparison as expected, since its data lack rigour and quality. In reality the Agenda has become overloaded with targets and overlapping processes which make coordination and delivery difficult to achieve. Patchy progress on social issues disguises the overall failure to change the dynamics of the interrelated set of policies encompassed within the Lisbon remit.

Some of the issues in the Open Method of Coordination relating to benchmarking are being addressed, but, without a common view of what the challenges and objectives are, performance will remain difficult to compare.[16] In addition, the method risks becoming powerless, as it essentially disguises the fact that in some areas it is simply not possible to develop strong European polices or agree on common targets. Issuing qualitative guidelines may work in some cases, but more formal policy agreements may be more appropriate in other cases.

An elitist project?

The Lisbon process has not attracted bottom-up support at a grass roots level, and the absence of the press and civil society engagement has resulted in a process that is seen as removed from the citizens for whom it claims to operate. While the project remains owned and managed from the top-down, the serious lack of information surrounding Lisbon will continue to limit the urgency and momentum of the process, and weaken the legitimacy of that ownership. Key stakeholders are not sufficiently involved in the Lisbon process, particularly at the early stages of policy formation, at a European, national and regional level. Learning from the example of the single market programme in terms of managing an effective information campaign would be beneficial. At present Lisbon is at serious risk of being regarded as an elitist project. This is in some respects symptomatic of the wider issue of democratic deficit within the Union and its institutions.

Although Europe is making progress towards the social, economic and environmental objectives set out by Lisbon, it is clear that this is not happening quickly enough. Performance levels vary significantly across Europe and, in some cases, the performance gap is increasing. As a result, the EU is currently not on target to deliver its objectives by 2010, leaving it increasingly vulnerable to the internal and external challenges outlined in previous chapters.

KEY RECOMMENDATIONS FOR SUSTAINABLE ECONOMIC AND SOCIAL DEVELOPMENT IN EUROPE

The Spring Summit in March 2004 is of critical importance if the Lisbon dynamic is to be re-ignited. 2004-5 should be grasped as the pivotal year in which to recapture the sense of urgency and commitment without which the Lisbon goals will not be secured. Failure to deliver the Lisbon commitments will endanger the framework of policies binding the Member States together in the Union. Furthermore, a major effort is required on the part of the Accession countries to ensure that they fully take on board the Lisbon 'acquis.'

The recommendations made below can be divided into two broad categories: those which recognise that Lisbon's goals are broadly correct, but which attempt to accelerate and improved the process intended to achieve these, and those which relate to the nature of the economic and social model which Lisbon should attempt to generate, given the new challenges Europe now faces. More specific recommendations are then made to key stakeholders.

Accelerating the pace of Lisbon

Close the policy "delivery gap"

- Make fulfilment of the commitments entered into by Member States a priority domestic political issue by instituting regular scrutiny by members of both National Parliaments and the European Parliament, organised on the model of the recent Convention on The Future of Europe;

- Ensure greater and more systematic involvement of other stakeholders – including business and other civil society organisations;

- Make optimal use of the policy "Bag of tools" available to the European Union and its Member States including both the Open Method of Coordination and EU legislation, using the different methods available accoring to the specific issues, and political context, raised in each policy area;

- Encourage a renewal of the Lisbon goals by requiring Member States to publicly commit an appropriate proportion of the national budget to achieving concrete Lisbon targets, for example in areas such as education, and by holding Member States accountable for failure to deliver on such commitments.

Integrate the Lisbon Agenda in key European and national policy areas:

- EU leaders should clarify the financial basis for implementing the Lisbon strategy, and particularly its relationship with a number of EU funding sources – the Growth Initiative, the current and future financial perspectives, the priority actions of the European Investment Bank and the fine tuning of the Stability Pact – by redirecting public expenditure to key investments and by rewarding private investment in human resources and innovation;

- EU resources are limited and a substantial proportion of the funds needed to invest in the Lisbon strategy have to come from national budgets;

- The Stability and Growth Pact must ensure that its practical functioning reinforces and does not weaken investment led programmes by Member States designed to achieve the objectives set out in the Lisbon Agenda;

- The EU Structural and Cohesion Funds must be geared towards helping to realise all the goals of economic, social and environmental reform, and offering value for money in these areas;

- The goals of Lisbon should also be reflected in other key EU policy areas - competition, industrial and above all research and development policies.

Get the right balance of powers and responsibilities

- Between institutions: It is imperative to establish the right balance between the national and the European level, improve coordination of procedures within the Commission and between the EU institutions, and reform the EU budget – combined with ideas for improving the use of different funds, including from the European Investment Bank, to boost the achievement of the Lisbon targets;

- Between European, national, regional and local: equally important to the success of Lisbon is identifying those elements of economic and social reform which are best carried out at a European level, and those which are best performed at a national, regional or local level.

Build real ownership of the Lisbon agenda among European citizens

- Broaden ownership of the Lisbon process: it is politically essential to broaden the ownership of the process while maintaining the overall leadership of the Heads of State and Government. Stakeholders in business, civil society, regional and local administrations must become more engaged and should be enabled to share best practices and learn from each other. A serious information effort is needed so that the average citizen in the enlarged EU feels interested and involved in the process, which, ultimately, is designed to create a better Europe for all by the end of this decade. The role of the press in politicising the process cannot be underestimated;

- Institute a "Re-Branding" of the Lisbon Process to encourage far greater public understanding and support for economic and social reform, in particular by linking it to the goal of improved employment, prosperity and social justice.

Keep the process together

- With its emphasis on economic growth, improvement of the knowledge base, improvement of social cohesion and building on sustainable growth, the Lisbon process can be said to have something for everybody. However, it is important to keep the process as an integral whole because it presents a coherent approach that balances the different considerations that are so important to the different European economic and social models. It is equally important to get the priorities right. As the European Commission's General Secretary, David O'Sullivan, has noted: "The social model is crucial, but dependent, and there is a need to demonstrate how we hope to generate the wealth to pay for it."[17]

Broadening Lisbon to new challenges

Learn from the success of the Nordic model

- There is no one European "economic and social model." There are a number of different models examined in this report – including the "Anglo-Saxon" model, the "Continental or Rhineland" model, and the "Southern European or Mediterranean model." All have their strengths and weaknesses. However the "Nordic" model demonstrates that economic, social and environmental performance can go together, and that the role of the state is crucial for achieving competitiveness. This model offers a credible and realistic European alternative to the free-market model. Not only are the Nordic countries leading in the implementation of the Lisbon process, they are also ahead in most global competitiveness surveys, including the recent IMD World Competitiveness Report, and are highlighted as exponents of best practice in job creation and innovation;

- Member States should be encouraged to learn from and adapt in an appropriate fashion the most relevant "best practice" from the Nordic experience.

Develop the European knowledge base

- In a period of increasing global competition, the European capacity for knowledge-based growth should be expanded, and the development of the use of information technology across the Union should be accelerated. Successful development of new technologies and integration of them in practical applications through a workforce with a vastly improved knowledge base is crucial for future competitiveness. This is a key factor behind the success of the Nordic model, which is leading the world in innovation and R&D and in integration of the knowledge base in industry and in the workforce, and a key factor to continued increased employment and productivity;

- Increase the adaptability of workers and enterprises, for example by investing more efficiently in human capital, promoting flexibility combined with social security on the labour market, and fostering creation of new businesses and – in particular - growth of small businesses as proposed by the Wim Kok report.[18]

Develop new areas of competitive advantage through innovation in the social and environmental fields

- In a new "Post Fordist" era of economic growth, Europe should seek to foster new areas of entrepreneurial opportunity, for example by exporting social and environmental expertise. In this way the distinctive values defended by the European Union in the field of social rights and standards and protection of the environment can be turned into new springboards for economic growth – notably through worldwide export of European social and environmental know how, products and services;

- A good example of environmental regulation leading to innovation is provided by the major reform of the Swedish energy tax system in 1991, when the Environmental Tax Commission introduced a carbon dioxide tax to complement a general energy tax. In 1993, amid fears of a loss of international industrial competitiveness, industry was exempted from the energy tax and had to pay only 25 of the general carbon tax. In 1997, the carbon tax on industry was raised to 50. The most important result of the new taxation system has been the development of biomass technology for use in district heating systems. This has accelerated the development of new methods of biomass extraction in forestry, and in turn led to the implementation of more efficient heat plants in district heating systems.

Create a positive policy agenda around migration

- Address the mismatch between labour demand and supply in the EU economies now and in the future. A detailed EU-wide analysis of current and future labour requirements by skill level and sector is urgently needed as a follow up to the report of the Employment Taskforce chaired by Wim Kok;

- Emphasize positive integration policies for immigrants and develop immigration and integration policies in different areas, but in particular in the labour market;

- Move the focus to "managed globalisation" including international agreements on the global management of migration, encompassing the rights of migrant workers and effective measures to ensure integration of migrants into host country economies and societies.

Recommendations to key stakeholders

In order to maintain the momentum and to demonstrate tangible effects of the Lisbon strategy on the European economy, it is essential to accelerate the process as we enter the second implementation phase and the mid-term review. The Spring European Council in 2004 will be absolutely crucial in this respect. If this opportunity missed, the whole process may be in jeopardy. Some stakeholders should assume a special responsibility and we are making the following recommendations to these institutions and groups in society:

To the European Council:

- The European Council must give the process greater dynamism by:

  - Ensuring Member State governments commit themselves to improving their mechanisms for the coordinated delivery of their Lisbon commitments;
  - Streamlining and coordinating the work of successive Councils so that their agenda is clear and actions prioritised, thus ensuring maximum progress at each annual spring review;
  - Ensuring Member States deliver on their promises, including decisions on crucial issues such as the European Patent, liberalisation of utilities and the creation of a better environment for start-ups and SMEs;
  - Encouraging Member States to involve different stakeholders - particularly social partners and those in industry, civil society and regional and local levels of governance – in Lisbon's implementation and delivery, in order to promote a wider base of support for the Agenda;
  - Requesting from Member States a critical assessment of their progress in implementation before the EU mid-term review in 2005. This should include progress in adopting domestic policies and budget priorities in the light of Lisbon commitments.

- The European Council should reiterate the core priorities of the strategy in order to give this sharper focus. A particular effort should be made to ensure the rapid integration of the new Member States in the Lisbon process;

- The European Council should swiftly move to review the Stability and Growth Pact to bring this into line with the goals of the Lisbon Agenda;

- The mismatch between labour demand and supply in Europe must be addressed. This should involve a detailed EU-wide analysis of current and future labour requirements by skill and sector, establishing best practices in labour market management in line with the recent report from the Employment Task Force chaired by Wim Kok. Conclusions should be integrated into the mid-term review of the Lisbon Agenda to ensure rapid action in this sphere;

- The next phase of EU development (2007-2012) should give the highest priority to ensuring the application of the Lisbon strategy. In particular, the Structural Funds must be directed at promoting investment in innovation and R&D as a key to developing the knowledge based economy. In addition to financial additionality, policy additionality should be established as a necessary criterion for using the funds.

To national governments:

- It is crucially important that EU Member States take their commitments seriously, adapt their national systems to deal efficiently with Lisbon, implement their legal obligations and improve their use of the Open Method of Coordination;

- Each Member State should publicly commit an appropriate proportion of national budgets to achieving the Lisbon targets, for example in areas of lifelong learning and development of the information society.

To the European Commission:

The European Commission should assume stronger leadership of the Lisbon process. It should review its internal arrangements to better coordinate its contribution to the Lisbon Strategy and it should put in place a mechanism with the Member States to enhance public awareness of the Lisbon goals and the implementation of policies. The Commission should also rapidly work to improve the background statistics for the evaluation of progress and the dissemination of best practices in the Open Method of Coordination.

To the European Parliament:

The European Parliament should participate more directly in the Lisbon process to ensure the fulfilment at national level of Lisbon commitments. Making Lisbon a serious priority in national politics could be helped by giving a higher public profile to regular scrutiny of governments' performance by members of the national Parliaments and by the European Parliament. This implies setting up a joint mechanism between national Parliaments and the European parliament, to ensure regular monitoring of implementation. The crucial issue of politicising the national contributions to the process and communicating with the European citizens should also be a primary responsibility of the European Parliament.

To the Committee of the Regions:

The CoR should be urged to place the achievement of the Lisbon goals at the centre of its policy agenda. It should examine the effectiveness of regional participation, both constitutional and otherwise, in the Lisbon process, and this includes assessing how commitments are delivered. A shop window of good practice should be set up by the CoR to encourage consistency and coherence across Member States, and in particular to transfer know how to the new Member States.

To the Economic and Social Committee:

The EESC is uniquely placed to create a framework for carrying forward the recommendations to social partners and to civil society as set out below. The EESC has already focused on the Lisbon Agenda, with a dialogue between senior European politicians and stakeholder groups in autumn 2003. Following this initiative, the EESC concluded that more operational, rather than philosophical, conclusions need to be drawn. It would be warmly welcomed if the EESC would provide a continued framework for development of operational responses by important stakeholders.

To Employers and Trade Unions:

The Social Partners should be encouraged to reach agreement on access to continuing training in the workforce without which a system of life-long learning cannot be achieved. An overall European pact on the financing of continued training should be established between the state, companies and the individual, and it should be facilitated by a framework of tax incentives, especially targeting SMEs. The social partners should also agree jointly to make recommendations about the supply and demand side of the future European labour market, and on best practices in labour market modernisation, including the needs for education, training, implementation of new methods of working and integration of immigrants into the labour market.

To Civil Society at European level:

In order to ensure a balance between greater competitiveness and social inclusion and cohesion, European platforms of NGOs should intensify their involvement in the discussion of policy choices. The European platforms should also be encouraged to disseminate information about Lisbon Agenda and its implementation within Member States. They should also establish a scorecard to assess the mechanisms adopted by each Member State to engage civil society more actively in the Lisbon process.

[1] James Wickham, "The End of the European Social Model: Before It Began?" National Forum on Europe (2002): 1.
[2] European Commission, Statistical Office of the European Communities, Current Taxes on Income and Wealth (Brussels: European Union) Reference dad11024.
[3] European Commission, Statistical Office of the European Communities, Current Taxes on Income and Wealth (Brussels: European Union) Reference dad11024.
[4] European Commission, Statistical Office of the European Communities, Employment Rate: females (Brussels: European Union) Reference em012.
[5] M. Ferrera, "The Southern Model of Welfare in Social Europe," Journal of European Social Policy Number 1 (1996).
[6] European Social Survey 2002/2003 2nd ed. (Oslo, Norwegian Social Science Data Services, 2002). The results of the ESS are often in a cumulative form e.g. on various questions, a 0 – 10 scale was used to record answers (e.g. 0 = 'Extremely Dissatisfied', 10 = 'Extremely Satisfied'). Where this is the case, the extreme values have been grouped together (e.g. 0,1,2 = Dissatisfied, 8,9,10 = Satisfied).
[7] Accenture Business in Europe survey (forthcoming).
[8] European Commission, Statistical Office of the European Communities, Statistics in Focus: Science and Technology Theme 9 – 8/2003 (Brussels: European Union, 2003)
[9] United Nations, Development Programme, Human Development Report 2002 (New York: United Nations, 2002)
[10] Global Competitiveness Report 2003-2004 (Switzerland, World Economic Forum, 2003) chapters 1.1 and 1.2.
[11] Accenture / EPC analysis.
[12] European Commission Presidency, Report of an Independent High-Level Study Group, An Agenda for a Growing Europe (Brussels: European Union, July 2003)
[13] Luc Soete, L. Technology and the Future of European Employment (Edward Elgar Publishing, 2002) 52.
[14] European Commission, Communication from the commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on immigration, integration and employment COM (2003) 336 (Brussels: European Union, 3.6.2003) 8.
[15] Ibid, p.17.
[16] The Structural Indications for benchmarking in the 2002 Spring Report deal with general economic background, employment, innovation and research, economic reform, social cohesion and the environment. All in all 36 indicators are developed under these headings.
[17] European Union, European Economic and Social Committee, Report on the Lisbon Strategy conference (Brussels: European Union, October 2003)
[18] European Commission, Employment Taskforce chaired by Wim Kok, Jobs, Jobs, Jobs. Creating More Employment in Europe (Brussels: European Union, November 2003)
[19] Ibid.

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