

Executive Summary

The European Union faces two overriding economic and social challenges in the decades ahead

- a. Europe's lack of competitiveness vis a vis the United States of America
- b. the ageing of Europe's population.

In response to these challenges, the heads of state and government decided, at the European Council of Lisbon in 2000 to make Europe : *the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.* The European Council at Gotenberg subsequently added the concept of environmental sustainability.

The Lisbon Agenda is a wide ranging set of policies which reach into all aspects of the European economy and much of society. It covers areas such as Information Society; Enterprise Policy; Innovation Policy; Research Policy; Single Market; Education; Employment; Social Protection; Social Inclusion; Environment; Macroeconomic Policies.

Its implementation is to take place by a mixture of European and national policies, not on the basis of legislation and sanctions, but rather a range of commonly agreed targets and benchmarking among member states – known as the Open Method of Coordination.

There is now a widespread belief that the range of initiatives which started in 2000, have not made the progress that might have been expected, and that commitments have been made by member states, but not delivered.

1. The relationship between the European Council and the other Council formations might be reviewed. The role of the Competitiveness Council has made the management of the Lisbon agenda more transparent. There should

be a stronger role for this Council, and, in particular, a standing committee, reporting directly to the Council, as the Economic and Monetary Committee reports to Ecofin.

2. The European Commission needs reorganisation to enable it to service the policy needs of the Process more effectively. It is precisely the way in which the Process cuts across the boundaries of traditional administrative areas, that gives it dynamism, but increases the difficulty in identifying deliverables. COSAC supports moves to appoint a Vice President of the incoming Commission with particularly responsibility for coordinating and driving the achievement of the targets set.
 - a. However, the number of targets and indicators is far too great. It should be the first task of the incoming Vice President to simplify and make more transparent the reporting process. There should be a clear number of headings, under which there can be Annual Reports. Fewer, clearer indicators would facilitate bench marking.
 - b. Revised targets and reporting procedures could lead to a more comprehensive report to the European Parliament and a matching annual report on national strengths and weaknesses to national parliaments.
3. In spite of the fact that the drop in numbers employed in the next two decades has been at the basis of the Lisbon Agenda, no efforts appear to have been made to quantify imminent skill shortages. This has implications for education, training and immigration policy. A Europe wide review of skills needs should be undertaken urgently.
4. The next generation of EU funding needs to be more closely targeted at addressing the Lisbon Agenda, and the employment guidelines and targets in particular. Increased emphasis should be given to promoting and improving public and private investment in research and human capital.

5. While it is important in the longer term to strive to address the demands of the Lisbon Agenda, this should be done as a by-product of a coherent national growth strategy for each member state.

Europe in Twenty first Century

The European Union has delivered both economic and political stability to its citizens. It created a unique set of political institutions which allowed the members of the Union to pool sovereignty to carry out tasks that individual countries alone could not achieve, and has created a complex series of relationships to mediate power. The “Community Method” has allowed small and large countries, rich and poor countries, work together to an agreed set of rules, and has created a zone of stability and of prosperity. The attractiveness of the model established by the original Treaty of Rome and developed by succeeding Treaties is shown by the continuing enlargement of the Union.

A distinguishing aspect of the growth of western European economies since the end of World War II has been the parallel building of the European Social Model. The Model has traditionally been defined as a functioning market economy where the worst effects of a possible capitalist free for all are mitigated by the state, together with a well-developed welfare state and some kind of system for negotiated agreements on economic and social issues. It is characterized by comparatively high taxes, universal public services and comprehensive social insurance.

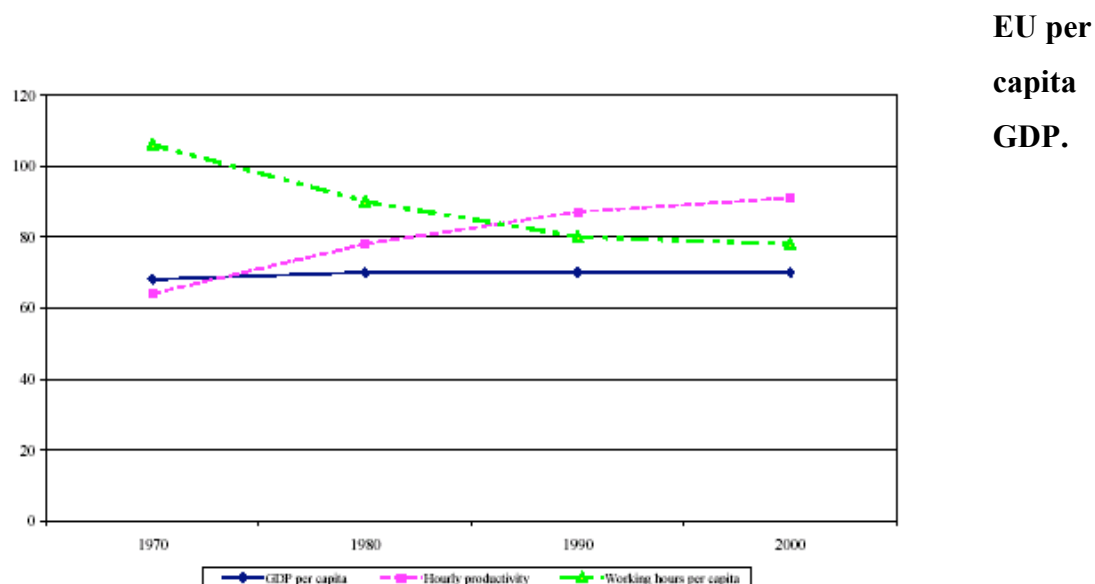
Its development was crucially dependent on the high European growth rates of the ‘fifties and ‘sixties and it has been sustained since then by economic growth, although at a lower level. Its continuation depends on economic growth because with the expectation of rising living standards, solidarity among socio-economic classes and generations is easier. With growth also it is easier to introduce change and structural reform. Social security which is financed by levies on payrolls increases at time of rising employment and increasing productivity. However, with a decline in both employment and the rate of growth of productivity, as well as a growing number of dependents, charges need to be increased to maintain existing level of benefits. This leads to an increase in the tax wedge, which in itself is a disincentive to employment growth. So it is possible that the preservation of the Social Model is under threat, given present low levels of economic growth in much of the European Union, plus the burden of an ageing population.

The post war economic system has changed and this change has contributed to current low levels of growth and a rigidity of much of the European economy. Patterns of both consumption and production have shifted in favour of different types of product requiring different forms of industrial organisation. A significant part of this change is the shift in demand from products to services. Between 1980 and 2000, the share of services in the EU economy increased by 13 percentage points to 70%:

The changes in the structure of the European economy called for new organisational forms, less vertically integrated firms, greater mobility both intra and inter firm, greater flexibility of labour markets, a greater reliance on market finance and a higher demand for both R&D and higher education¹

The Sapir Report demonstrates

the strong divergence between EU and US performance on employment and labour productivity both absolutely and relatively over the last 30 years. While the US jobs machine was generating employment as well as maintaining working hours, Europe's employment performance was weak and working hours fell consistently. On labour productivity the reverse occurred. As a result, the steep fall in the numbers of hours worked per head of population in Europe compared to the US exactly compensated for the rise in relative labour productivity per hour.



[US=100]

¹ *An Agenda for a Growing Europe: Making the EU Economic System Deliver* (Sapir Report) July 2003

The main social and economic challenges which the EU is confronting are

- a) the accelerated pace of economic restructuring in the context of economic integration within the enlarged Union and worldwide. Economic change is affecting everybody but mostly those individuals, member states and regions which are least equipped to deal with it.
- b) the ageing of Europe's population. Even if the EU meets its target of having an employment rate of 70% by 2010, the fall in working age population during the subsequent 20 years will result in a sharp decline in employment. This will require either higher productivity gains and/or immigration flows.

In response to these challenges the Heads of State and Government committed themselves at the Lisbon European Council of 2000 to the "Lisbon Process". The range of policies adopted then were:

Employment, Economic Reform and Social Cohesion

A Strategic Goal for the Next Decade

The Union has set itself a *new strategic goal* for the next decade: *to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.*

Achieving this goal requires an *overall strategy* aimed at:

- preparing the transition to a knowledge-based economy and society by better policies for the information society and R&D, as well as by 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;
- sustaining the healthy economic outlook and favourable growth prospects by applying an appropriate macro-economic policy mix.

To achieve this there would be a *new open method of coordination*

Preparing the Transition to a Competitive, Dynamic and Knowledge-based Economy

- *An information society for all*
- *Establishing a European Area of Research and Innovation*
- *Creating a friendly environment for starting up and developing innovative businesses, especially SMEs*
- *Economic reforms for a complete and fully operational internal market*
- *Efficient and integrated financial markets*

- *Coordinating macro-economic policies: fiscal consolidation, quality and sustainability of public finances*

Modernising the European Social Model by Investing in People and Building an Active Welfare State

- *Education and training for living and working in the knowledge society*
- *More and better jobs for Europe: developing an active employment policy*
- *Modernising social protection*
- *Promoting social inclusion*

The European Council in Gotenberg subsequently added the objective of sustainable economic growth.

In spite of the efforts made since 2000, and the fact that the mid-term review of the process is due to take place in 2005, there is a view that it has stalled. According to the Spring European Council of March 2004

the pace of reform needs to be significantly stepped up if the 2010 targets are to be achieved.

Issues raised

Governance

Open Method of Coordination

The Open Method of Coordination was discussed at length at the Convention on the Future of Europe and many members believed that it should be included as a policy instrument in the Draft Treaty. It was defined by the Working Group on Complementary Competences as²

a mutual feedback process of planning, examination, comparison and adjustment of the (social) policies of (EU) Member States, all of this on the basis of common objectives.

There was a wish to define more clearly how it might operate and a particular concern, in a number of working groups to ensure the inclusion of an obligation to the maximum transparency of the process and the fullest possible participation of all relevant bodies and stakeholders, including social partners, civil society organisations, national parliaments, and local/regional authorities, in accordance with national laws and practices. While this was not included ultimately in the Draft Treaty, there was general agreement with the objectives of the procedures.

The principle of the Open Method of Coordination is that there are no formal sanctions for those failing to meet targets set, but rather a naming and shaming. The Sapir report describes the current problems in the European economy and reviews the Lisbon Process as a prescribed cure for Europe's ills. The Report is of the view that the Lisbon Process has become a catch all which covers

- a list of objectives,
- a strategy to meet these objectives and
- a method³.

² CONV 375/1/02

³ This may reflect the confusion in naming the project: is it an Agenda or a Process?

The objectives are correct, the strategy is correct but the method leaves a lot to be desired

We also see merit in coordinating the corresponding reform efforts, because their short-term impact is stronger in an environment where monetary policy is able to reap the benefits of better functioning markets. The immediate benefit from reforms is larger when they are undertaken simultaneously in individual EU countries and for that reason, we support coordinating their timing in the different Member States.

However, we doubt that relying on the ‘Open Method of Coordination’ alone, i.e. by issuing guidelines, agreeing benchmarks and comparing performance, would be sufficient to implement the strategy and reach the objectives. It is clear from experience so far that the outcome will continue to depend on what can be achieved within individual countries and for that reason, implementation of the Lisbon Strategy must rely on the joint efforts of the Union and the Member States. To claim that soft coordination will suffice to reach the objectives partly implies that obstacles on the way are minor ones, when the reality is that a very great deal needs to be done in the Member States and by all concerned.⁴

However the challenge posed the project should not be underestimated - the Lisbon Process reaches into some of the most complex areas of national economic reform, such as labour market reform, the social welfare system and tax.

The template for the Open Method of Coordination is the process used in achieving the Maastricht convergence criteria which encouraged the member states make the budgetary adjustments necessary to enter monetary union, and brought public opinion on side, in the, often difficult, attainment of a public policy objective. This process worked and it is useful to reflect on what made it effective.

It had clear visibility and public ownership. There was widespread political “buy in” to the process and the criteria were discrete, well defined and capable of being widely understood – “Maastricht criteria” were part of daily discussion. There were clear rewards and penalties and a immovable deadline. None of these apply to the methods used in applying the Lisbon Process.

⁴ Sapir

There are something of the order of 100 indicators in the present system. This means that even the research task involved in measuring compliance is huge: with 25 member states involved in the process, following 2,500 indicator becomes a task in its own right, let alone measuring success.

Better use must be made of the Open Method of Coordination. There should be fewer targets, and these should be clearer, and capable of being understood by a wider public.

Leadership

The locating of policy making for the Lisbon Strategy in the European Council has both advantages and disadvantages. The advantage is the political clout of the prime ministers and presidents who make up the Council and the focus which the Spring European Council (dedicated to this process) brings to the rest of the policy apparatus.

The disadvantages are

- prime ministers do not have domestic responsibility for the implementation of sectoral policies;
- the Spring European Council can easily be distracted by more immediate and more urgent policy issues, and there is a twelve month gap before the momentum can be recreated.

The role of the Competitiveness Council has already made the management of the Lisbon Agenda more transparent, and its role should be strengthened further. In particular, there should be a standing committee, reporting directly to the Council, as the Economic and Monetary Committee reports to Ecofin.

The European Commission needs reorganisation to enable it to service the policy needs of the Agenda more effectively. It is precisely the way in which the process cuts across the boundaries of traditional administrative areas, that gives it dynamism, but increases the difficulty in identifying the deliverables. The

Committee supports the suggestion of the appointment of a Vice President of the incoming Commission with special responsibility for the Lisbon Agenda. The primary responsibility of this office should be to review the issues outlined above and to ensure that targets are clear, transparent and few.

The Lisbon Process has been very effective in highlighting the fading competitiveness of the European economy. However, there is a strong view that the identification of the problems and the composition of strategies has gone as far as it can

The success stories of a number of Member States show that apart from a clear vision about the path to sustainable growth and social cohesion, strong political will and co-ordinated efforts of all actors are crucial for increasing adaptability, activating labour supply and equipping people for jobs. Sustainable reform requires investment in “political capital” and efforts to develop intelligent and effective institutions.

Action at national and EU level should be inspired by the principles of proportionality and subsidiarity to ensure decisions are taken at the appropriate level and are proportionate to the objective; participation of stakeholders, openness and accountability towards citizens; and effectiveness, efficiency and coherence within an increasingly complex system.⁵

National Involvement

The discussion of how the Maastricht Convergence criteria mobilised policy makers and a wider public in the member states illustrated that clear targets can provoke clear commitment. The absence of clear targets in the Lisbon Process has already been identified, but the question does arise as to who should take operational responsibility for its implementation, how transparent that process can be and the extent to which it can involve the citizen, whose future is so crucially affected.

There should be a debate in each National Parliament based on an Annual Report on the achievements and failures under a number of headings.

⁵ *Jobs, Jobs, Jobs Creating more employment in Europe* (Kok Report) December 2003

Demographics

Ageing of the population will accelerate in the coming years. The population structure of central and eastern Europe is even less favourable than in western Europe. It is expected that from 2010 to 2030 there will be a decrease of European workers of one million per annum, totally 20 million due to the ageing of the population. Higher immigration will make a contribution, but is not the solution.

Ageing populations create a number of additional difficulties, for example, lower consumer demand as older people do not demand consumer goods. There is also less dynamism, entrepreneurship and higher pension provision requirements etc

The impact of demographic change⁶ has often been discussed and can be illustrated by a number of different scenarios. Under the Eurostat assumption of moderate immigration, demographic ageing will cause the EU-25 working age population to fall from 303 to 297 million by 2020, and to 280 million by 2030. This decrease is due to the long lasting effects of the reduction of fertility rates since the mid-1970's and it will be coupled with an increase in the age group of the over 65. Under the same assumptions, the number of people in this age group will increase from 71 in 2000 to 93 in 2020, up to 110 million in 2030 for EU-25, thus causing the old age dependency ratio to increase from 23% to 40%. Moreover, the number of those aged 80 and over in EU-25 is projected to increase from almost 16 million in 2000 to some 30 million in 2030.

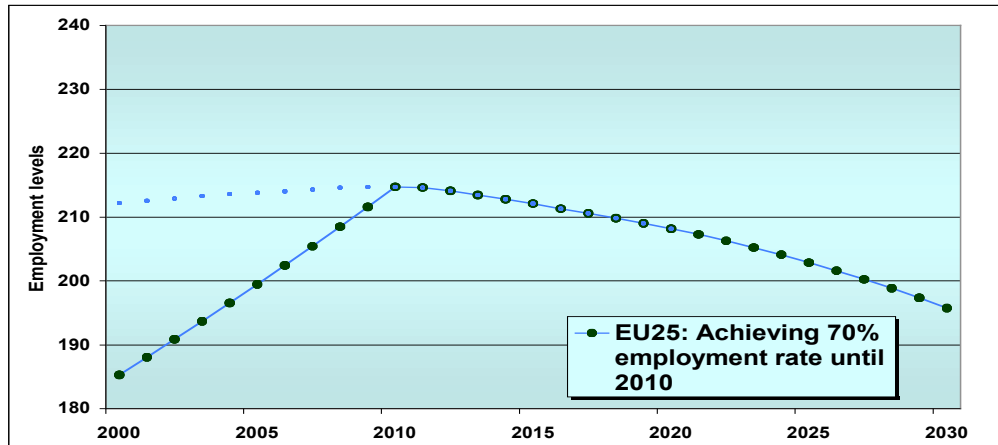
The significance of these demographic developments for employment growth can be brought out by an illustrative demographic scenario incorporating the achievement of the Lisbon target of a 70% employment rate by 2010 and a constant rate of employment afterwards. In such a scenario, an overall decline of employment could be expected after 2010 (see graph below) and the fall in the number of employed people between 2010 and 2030 would be in the order of 20 million workers for EU-25[13 million workers for EU-15.] In an alternative scenario where the employment rate rose above the 70% target after 2010 to reach 75%, the decrease in the volume of employment would occur anyway, but at a later point in time and it would be smaller. This fall in employment expected in these scenarios with constant employment rate as of 2010 or 2020 cannot be reversed by (unexpected) increases in fertility rates, as it would take more than

⁶ The source for this material is COM (2003) 336 final Communication from the Commission.... on immigration, integration and employment

two decades for "new baby boomers" to reach their working age and contribute to the growth of total employment.

Scenario of future employment levels (EU-25, period 2000-2030)

Total employment (in millions) assuming an employment rate of 70 % in 2010 and for the following period until 2030.



The decline in the total volume of employment implies a negative contribution of employment to economic growth since the latter is the combined impact of employment and productivity growth. The negative contribution of employment to economic growth could be compensated by increases in productivity growth.

However, under the assumptions of the demographic scenario presented above, an average GDP growth rate at 2.5% (average EU growth since 1990) would imply that, between 2010 and 2020, productivity growth would have to reach 2.8% and between 2020 and 2030 it would have to climb beyond 3.0%, in order to compensate for the fall in employment. The increase would have to be even higher if a 3% growth rate were to be achieved, which would be an extrapolation of the performance envisaged at Lisbon. Under the assumptions that no adjustments in other variables affecting productivity and growth would take place, these results are indicative of the magnitude of the effects involved when the Lisbon target of a 70% employment rate by 2010 is achieved and maintained.

Can an ageing population commit itself to the change agenda of Lisbon, when their primary objective is security?

In spite of the fact that the drop in numbers employed in the next two decades has been at the basis of the Lisbon Agenda, no efforts appear to have been made to quantify imminent skill shortages. This has

implications for education, training and immigration policy. A Europe wide review of skills needs should be undertaken urgently. The Irish High Level Group on Future Skills Needs might provide a useful example.

Renewal v Cohesion

The Sapir report envisages an overhaul of the EU funds. It advocates a convergence fund and a restructuring fund. The convergence fund should only be allocated to (low-income) countries, not regions. The arguments for this approach are convincing: richer countries having one ‘poor’ region obtain transfers due to *juste retour* considerations, the effectiveness of transfers is reduced by a lack of concentration and money (from net payers) is pumped around requiring a cohesion bureaucracy for no good reason.

The restructuring fund would serve as a complement to national funds for e.g. displaced workers. Instruments would include retraining, help with industrial relocation or assistance when setting up a new firm. But if developing (or lagging) countries wish to work towards the Lisbon Agenda, what is really essential is to have guiding national development strategies that are appropriate and coherent. This might be characterised as the second – or “European” – view on promoting economic success.

National Development Plans (in the context of Structural Funds) need to be linked with industrial and service sector strategic policy thinking, and every effort made to ensure that they are mutually reinforcing. Growth and development strategies need to be carefully built around the EU-aided National Development Plans and Structural Funds. Ireland has shown that – given the right social and economic context - these provide a unique opportunity to produce a step-change in economic performance. Focus on getting the NDPs right, and success in meeting the Lisbon Agenda will almost certainly follow.

The EU mobilises considerable financial resources especially to promote the development and structural adjustment of Member States and regions

that are lagging behind. The next generation of EU funding needs to be more closely targeted at addressing the Lisbon Agenda, and the employment guidelines and targets in particular. Increased emphasis should be given to promoting and improving public and private investment in research and human capital.

While the objectives of the Lisbon Agenda are crucial, they should be addressed as a by-product of a coherent national growth strategy.