BRUEGEL POLICY CONTRIBUTION

MARCH 2006

LAST EXIT TO LISBON

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Introduction

The Lisbon agenda was drawn up and adopted in Spring 2000 to bolster the growth, innovation and employment performance of the European Union while fostering the inclusiveness of its social models. These goals commanded, and still command, a wide consensus.

Five years later, in Spring 2005, judging the results as "mixed", heads of state and government chose to refocus priorities on growth and employment and decided to streamline the Lisbon process. The main features of the new process are a longer programming period, a single set of Integrated Guidelines, and the preparation by member states of National Reform Programmes (NRPs).

The essential political choice behind these decisions was twofold. First, the failure of the first Lisbon strategy (Lisbon 1) was attributed neither to its goals nor to its principles, but rather to excessive complexity and inadequate process. Second, the lack of political commitment on the part of member states was regarded as a major shortcoming. Accordingly, the revised Lisbon strategy (Lisbon 2) put the accent on national ownership and adopted a more tailor-made, bottom-up approach.

Lisbon 2 is therefore both similar to and different from Lisbon 1. It is similar because the major aims have remained unchanged and because the very rationale of an open coordination of national reform policies has not been questioned. But it is different because some of the initial objectives have been downplayed and because the underlying governance model, where the European Commission played the role of a schoolmaster, has been abandoned in favour of one in which it plays the role of a coach.

One year on, is the EU now on a better path? What are the chances that the revised Lisbon strategy will deliver the results that the initial one failed to deliver? These are the questions we intend to answer in this report.

It is certainly early to provide an assessment. Though adopted, the NRPs have barely been implemented. Measurable first results can in the best of cases be expected only in 2008, at the end of the three-year cycle. Also, after a complex machinery was put in place last year, governments and the European Commission are still in a learning phase. Any evaluation must therefore be provisional. Yet as the Lisbon strategy can hardly afford to disappoint again, it is important to analyse, early on, whether it is on track to deliver the expected change.

To achieve this aim, we start with a discussion of the rationale for a Lisbon-type coordinated strategy and of the challenges it needs to address (Section 1). We then turn in Section 2 to an assessment of the process as implemented in 2005-2006. We essentially base our evaluation on our reading of the National Reform Programmes and their evaluation by the Commission.

[1] Throughout the preparation of this report, we have benefited from Fulvio Mulatero's excellent research assistance and from Jakob von Weizsäcker's substantial contributions. We wish to thank them both.

On the basis of this analysis, we draw conclusions and formulate recommendations in Section 3.

It is important to emphasise that we do not intend to provide any country-by-country assessment of the reform programmes or their implementation. Throughout this report, our focus is on the process as a whole.

1. Rationale and Challenges

The Lisbon agenda was, and remains, political in essence. The growth, innovation, employment and social cohesion goals set out by the European Council were chosen to inspire a European economic and social revival. However, joint endeavours of this sort can only translate into action if supported by a precise definition of the common interest and a clear identification of the challenges arising from the diversity of situations and objectives.

In this section, we wish to discuss three related issues:

- When is there justification for a coordination of national reform policies?
- Is there specific value in practising evaluation and coordination at the EU level?
- What are the challenges that an EU reform coordination process needs to address?

1.1 Motives for acting jointly

The motives for coordinating structural reform policies are of the same nature as those usually given to coordinate budgetary policies. They are also similar to those relied upon in the discussions on whether to allocate a given policy responsibility to the EU or the national level. In a nutshell, there can be two types of reasons to embark on coordination[2].

First, *interdependence* may render independent decision-making undesirable. This can be either because of spillover effects of national decisions, or because EU policies and national policies complement each other.

Spillovers are clearly at work for Research and Development, whose benefits do not remain confined to the spending country (Annex 1). They are questionable for policies that aim at increasing the employment rate or at boosting productivity in areas where interdependence essentially stems from trade and capital markets: a country that succeeds in lowering structural unemployment or in increasing productivity generally does not significantly affect the performance of its neighbours.

Complementarities are at work between product market reforms (the responsibility for which frequently belongs to the EU) and labour market reforms (which belong to the remit of the member states): for example, a combination of product market regulations that aim at favouring entry, and of labour market regulations that aim at preserving existing jobs (or vice-versa), is a recipe for ineffectiveness.

The second main reason for coordination is that governments and civil societies *learn* from the experiences of others. Such *policy learning* can be enhanced by initiatives that facilitate cross-country comparison and benchmarking. A telling example in this respect is the OECD evaluation of the performance of schoolchildren (PISA[3]). By providing an objective and transparent assessment of the achievements of national education systems, the PISA programme helped detect shortcomings and fostered reform. Similarly, by providing an independent assessment, the European Commission can help member states sort out good from bad policies.

[2] For a more developed discussion, see Tabellini and Wyplosz (2004) and Pisani-Ferry (2005).

[3] Programme for International Student Assessment.

It is worth distinguishing these two types of arguments because they call for different forms of coordination. In the presence of spillover, there is a case for joint action, while policy learning merely requires mutual information and transparent assessments. The weights of these arguments also vary from one field to another. As regards the two main objectives of the new Lisbon agenda, the spillover argument is strong for R&D and the learning argument is strong for labour market policies.

1.2 What is the specific EU dimension?

Those arguments are, however, not specific to the EU. Actually, the practice of multilateral evaluation and coordination is by no means limited to the EU. The IMF prepares Article IV assessments which involve assessments of structural reform. The OECD does cross-country comparisons and assessments as well as country-by-country evaluations. It has recently developed a programme for the evaluation of structural reforms (*Going for Growth*[4]), which relies on an extensive range of indicators and on a methodology for selecting country-specific priorities (Annex 1). Both essentially aim at fostering policy reform by learning.

It is therefore important to determine what justifies undertaking *at the European level,* what could take place or is taking place in a different setting. We see two main reasons why the EU is special. In addition, there is a specific euro area dimension.

The European dimension first stems from purely *economic* factors. Since the EU is more closely integrated than the world economy at large, interdependence within it is generally stronger. For example, knowledge and R&D spillovers or complementarities between product and labour market policies are more significant and also easier to deal with at the EU than at the OECD or the global level.

The second justification is a *political* one. As a political entity, the EU has set itself goals whose achievement depends on concrete decisions by all member countries. A telling example is the target of reaching a level of R&D spending of 3% of GDP, which can only be achieved through the cooperation of all member states. More generally, the EU can be regarded as a club of like-minded countries with similar institutions (for example as regards the role of the state as an insurer against economic hazards), or similar preferences in the presence of trade-offs (such as efficiency vs. equity). Similar institutions and objectives make learning within the EU more expedient. For the same reason, participation in an EU-driven reform programme can be used as a commitment device whose potency derives from the strength of the domestic commitment towards the EU.

All this applies to the EU as a whole. However, there is in addition a specific euro area dimension. In a monetary union, a country that reforms its labour market – say, lowers the unemployment threshold below which inflation accelerates – or its product market – say, increases the rate of growth of productivity – does exert an effect on its EMU partners, because the ECB is bound to lower its interest rate in response to a change that lowers the euro area inflation rate. However, the ECB can only react in proportion to the weight of that country in the euro area, which means that the country undertaking reform will benefit from a less forthcoming monetary environment than would have been the case in a monetary autonomy regime. Economic reform in one country lowers interest rates throughout the euro area, but the reforming country cannot benefit from the same macroeconomic support as in a flexible exchange rate regime. Since this may act as a reform trap, there is a motive for coordinating reforms among euro area countries[5].

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[4] See OECD (2005, 2006).

[5] The argument is further developed in Duval and Elmeskov (2005) and Pisani-Ferry (2005).

Furthermore, specific reform priorities can arise from the objective of improving the functioning of the euro area: for example, to strengthen the channels of transmission of monetary policy or to make national economies more quickly responsive to a loss in competitiveness, especially in countries which have been experiencing higher-than-average inflation. Here again, there is a common interest in addressing such deficiencies, as persistent divergence within the euro area has the potential of greatly complicating the task of the ECB.

1.3 Difficulties in designing a strategy

To have identified motives for coordination is only a prerequisite for designing a common strategy. In practice, a major difficulty which needs to be addressed is that the member states of the EU are diverse.

Structural heterogeneity is the trickiest challenge. The Lisbon strategy of 2000 was conceived for a relatively homogenous group of high income economies. After enlargement it now applies to a much more diverse group, and diversity is set to increase further with the future enlargements. Whether there is a common set of objectives and policies that are appropriate for all EU member states is an issue that needs to be addressed explicitly.

Again, take R&D. The EU has an overall target for R&D spending, but how does it translate into objectives for the various member states? Should Finland, where R&D represents 3.5% of GDP, spend more, or less? Should Malta, where it represents 0.3%, spend more, or less? Recent research on the determinants of growth suggests that investment in research and higher education is essential for countries close to the technology frontier, but not for countries at an earlier stage of development[6]. Furthermore, R&D spillovers imply spending should be concentrated where it is most efficient. In the US, R&D intensity exceeds 5% in Maryland and Massachusetts but is as low as 0.5% in Louisiana[7]. The dispersion is thus as large as in the EU, although income disparity is much less. This example suggests that from an overall efficiency standpoint, R&D should be concentrated where the aggregate return on each euro spent is the highest, which may involve spending less in some countries and more in other.

Heterogeneity does not stop there, however. Besides structural heterogeneity, *policy heterogeneity* must also be addressed. It makes policy priorities dependent on domestic institutions and flanking policies, even if the end-goal is the same.

In addition to the euro dimension already mentioned, a case in point here is the labour market. Labour market institutions still vary a great deal from one country to another, with regards to, for example, the structure of wage negotiations or the features of unemployment insurance. In such a setting, gradual labour market reforms cannot respond to a 'one size fits all' prescription, since some well-intentioned reforms that deliver results in a given environment can be inefficient or even counterproductive in another one. To reach the same goal, priorities must be selected on a case-by-case basis.

1.4 Conclusions

Table 1 sums up our conclusions with regards to the main Lisbon objectives. Neither the motives for EU coordination nor the main difficulties that need to be addressed by the common strategy are identical for R&D spending and employment policies. In addition, the first domain does not involve a strong euro area dimension, while the second does.

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[6] See Acemoglu, Aghion and Zilibotti (2006).

[7] Source : National Science Foundation, National Patterns of R&D Resources, 2003, www.nsf.gov/statistics

Table 1: Rationale, challenges and dimension of EU coordination

	R&D	Employment
Main motive for EU coordination	Interdependence	Learning
Main difficulty	Structural heterogeneity	Policy heterogeneity
Euro area dimension	Weak	Strong

This provides criteria for assessing the coordination process. In what follows, we will examine whether the new Lisbon strategy helps to identify and correct the weaknesses of independent policymaking; discuss whether it focuses on fields and objectives where there is a strong rationale for coordination and a specific European added value; analyse how the processes in place address the difficulties of structural and policy heterogeneity; and assess where there is a case for specific euro area action.

2. Analysing the Process

We now turn from abstract to concrete, starting with a recap of the main changes introduced in 2005 to the Lisbon strategy (2.1). Since these changes were largely made in the name of national ownership, we begin our evaluation with an assessment of the degree to which there is now effective ownership in the Lisbon strategy and the National Reform Programmes (2.2). We then turn to the methodology issues involved in the evaluation of those programmes by the European Commission (2.3) and to our own assessment of this evaluation (2.4).

2.1 From Lisbon 1 to Lisbon 2

In March 2004, the European Council invited the Commission to establish a High Level Group headed by Wim Kok to carry out an independent review of the Lisbon strategy[8].

The Kok report found that the European Union and its member states had clearly failed to implement the Lisbon strategy. This disappointing delivery was ascribed to an overloaded agenda and to shortcomings in governance. In the words of the report, “Lisbon is about everything and thus about nothing. Everybody is responsible and thus no one.”

The Kok report proposed to remedy the delivery problem first of all by refocusing the strategy’s economic, social and environmental dimensions on growth and employment. The idea was not to abandon the social and environmental dimensions, but to recognise that growth and employment were essential “in order to underpin social cohesion and sustainable development”.

As far as governance is concerned, the Kok report proposed a three-pronged approach:

- First, member states were asked to take ownership of the process and to commit themselves to delivering the agreed reforms by presenting national programmes, which should be subject to debate with national parliaments and social partners;
- Second, the Commission was asked to improve the central elements of the so-called open method of coordination – peer pressure and benchmarking – by delivering “in the most public manner possible” an annual league table of member state progress towards key targets. Stronger reliance on “naming, shaming and faming” was thus advocated;
- Third, the EU common policies – including the EU budget – were invited to reflect more closely the Lisbon priorities.

As the title of its Communication to the 2005 Spring European Council – *Working Together for Growth and Jobs: A New Start for the Lisbon Strategy* – amply demonstrates, the Barroso

[8] See Kok (2004).

Commission squarely adopted the recommendation of the Kok report to refocus the Lisbon strategy. The Commission also followed two of the three proposals made by the Kok report to improve governance. It proposed that member states present national programmes for growth and jobs, after broad discussion at national level. The Commission also proposed to better use the EU common policies, including the EU budget, in order to help implement the Lisbon strategy.

However, the Commission strongly rejected the proposal to 'name and shame' and nearly abandoned benchmarking altogether. The reason for this was probably that the large member states (above all France and Germany) were determined – having just succeeded in trimming the wings of the Stability and Growth Pact (SGP) – that Lisbon would not be yet another thorn in their side. The Commission thus decided to stop lecturing the member states and to embark on a partnership with them instead.

A few months later, the Council dealt a further blow to the Community involvement in the Lisbon strategy, when it rejected the EU budget proposal of the Prodi Commission, endorsed by the Barroso Commission, which envisaged a substantial increase in EU funding for research. The prospect of supporting the Lisbon strategy through budgetary incentives, which had been advocated by the Sapir report[9], was thus abandoned.

At this stage, therefore, the question is whether the new Lisbon strategy can fly with a governance system that relies only on one of the three elements that were suggested by the Kok report. For the new governance regime, which rests almost exclusively on national action programmes - with little or no benchmarking and little or no EU funding - to deliver where the old set-up had failed, very significant advance in national ownership of the reform programmes would be necessary.

2.2 Ownership of the National Reform Programmes

Political ownership by member states was to be achieved by more intensive discussion within each country on national reform priorities and actions for meeting the Lisbon targets, culminating in the adoption of national reform plans. Such a more decentralised approach to the Lisbon agenda makes good sense in principle, not least in view of the large degree of diversity among member states that was mentioned earlier.

Can such advances in ownership be observed in practice? To answer this question, we rely on the following three criteria:

- Criterion 1: Attention devoted to the development of National Reform Programmes (NRPs) by national governments.
- Criterion 2: Involvement of respective national parliaments and other stakeholders in the design and adoption of the reform programmes.
- Criterion 3: Media coverage surrounding the design and adoption of the NRPs, and the evolution of public perception regarding the targets of the Lisbon agenda in general and of national reform plans in particular.

A comprehensive evaluation of these three criteria is beyond the scope of this study. Instead, we offer an indication with regards to the first two and provide informed speculation about the third one.

Criterion 1: The Commission had called upon member states to appoint a "Mr or Ms Lisbon at government level".[10] The inclination of member states to follow this recommendation can thus be regarded as a proxy for the level of attention devoted by national governments to the

[9] See Sapir et al. (2004).

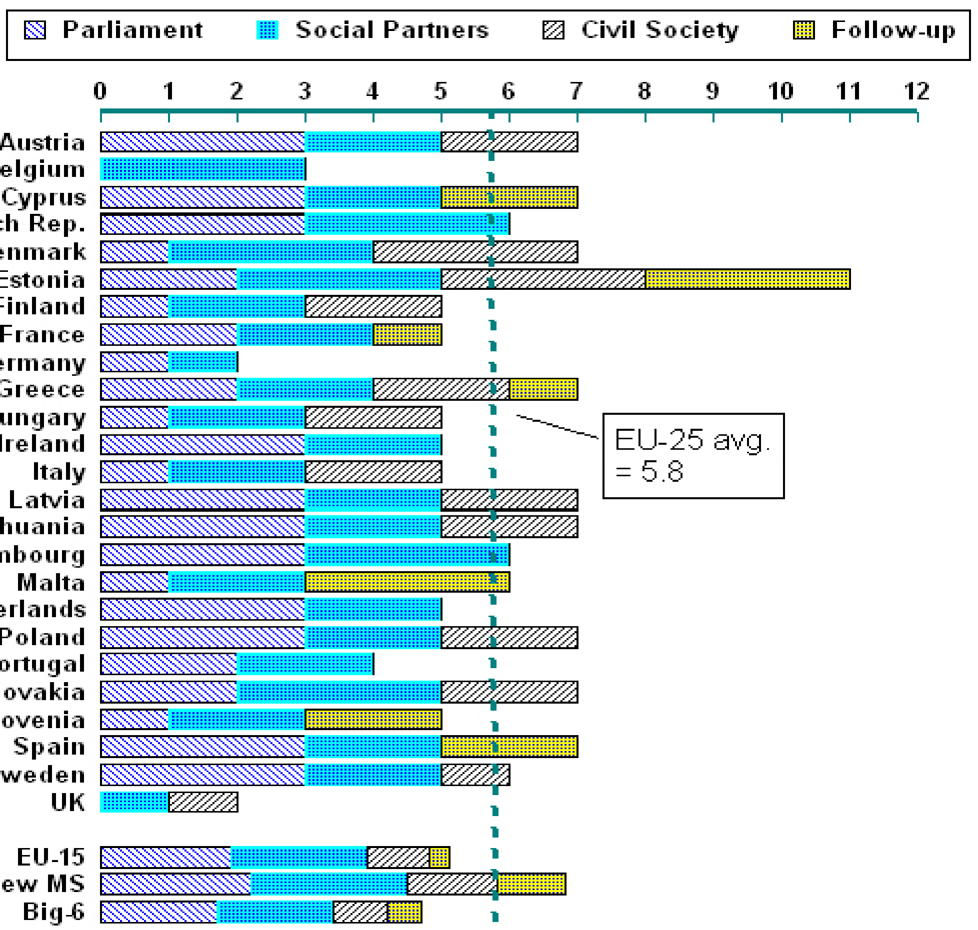
[10] European Commission (2005a)

development of national reform plans. It turns out that only 11 out of 25 countries[11] have followed the recommendation. In a majority of countries[12], the coordination of the preparation of the national reform plans was instead delegated to senior or even mid-level civil servants. This points in the direction of a failure of Lisbon 2 to inject political ownership in the process. Instead, it appears to have largely retained the bureaucratic character that marred Lisbon 1.

Criterion 2: The involvement of national parliaments and other stakeholders is summarised in Annex Table 1 and Chart 1 below. The first notable feature is the great diversity of approaches among member states. It is striking that 9 out of 25 national governments did not even engage their respective parliaments at the committee level. Moreover, 18 out of 25 gave no indication at all on the potential follow-up to their reform programmes.

It is instructive to also examine the overall ratings, which were obtained by simply adding the individual ratings for the four indicators (Parliament, Social Partners, Civil Society and Follow-up), with higher ratings pointing to better ownership performance (the maximum score is 12). The overall rating for new member states is substantially above the rating for old ones (6.8 versus 5.1). It is also noteworthy that the average rating is substantially smaller for the 6 large countries (France, Germany, Italy, Spain, Poland and the UK) than for the 19 smaller ones (4.7 versus 6.1). This suggests that the degree of ownership is in fact uneven and follows a systematic pattern.

Chart 1: Ownership of Reform Programmes



[11] Source: Radlo and Bates (2006), Table 3, plus own research for the member states not covered there.
[12] Three countries did not appoint a Mr./Ms Lisbon at all.

Criterion 3: Exploration in the standard media coverage databases suggests that while the Lisbon strategy is to a certain degree part of national policy debates, the design and adoption of the National Reform Programmes have received limited attention. The media attention received by the Lisbon strategy appears to derive mainly from its overall goals and each country's relative performance in achieving them, rather than from the innovations of Lisbon 2. This tentative conclusion is reinforced by the impression that even the media savvy national elites seem to be mostly unaware of the very existence of the NRPs, let alone the process of their preparation. National surveys would probably reveal, therefore, that the wider public in most member states has remained entirely unaware of the NRP process.

In this context, it is worth noting that only Criterion 2 features in the European Commission's assessment of the ownership of the national reform plans. The other two potential criteria were not explored. While it could be argued that a rigorous pursuit of Criterion 1 might have put the European Commission in a politically awkward position, it is less clear why Criterion 3 was not explored, especially since the Commission has considerable experience with the analysis of media impact and polling.

Overall, the level of national ownership is clearly disappointing, especially since it was meant as the principal innovation of Lisbon 2.

2.3 The NRPs and their evaluation: methodology

Lack of political ownership is certainly a weakness. But it could be argued that such an ownership can by nature only develop over time. After all, the Maastricht criteria or the Stability Pact started as purely technocratic devices, and only gradually gained in visibility and effectiveness. There is therefore a need to assess the intrinsic quality of the NRPs and of their evaluation.

The discussion in Section 1 has shown that preparing and evaluating mutually consistent National Reform Programmes raises significant challenges. A good starting point is to assess whether the EU has been able to develop a methodology to deal with those challenges. Has an approach been articulated to decide on policy priorities in any given country? Have criteria been developed to determine the contribution of individual member states to common goals? What about the euro dimension? Without clarity on these points, the very time-consuming process of preparing and evaluating 25+1 reform programmes runs a substantial risk of adding little value in the end.

The *Integrated Guidelines for Growth and Jobs (2005-08)* adopted by the Council in 2005 are in principle the main instrument for achieving coherence. They set out objectives to which all member states are expected to adhere and which should both ensure consistency and provide a basis for evaluating national programmes. The idea was to integrate two sets of guidelines that were not sufficiently coherent with one another in the past, the Broad Economic Policy Guidelines (BEPGs) and the Employment Guidelines.

Unfortunately, the Integrated Guidelines are simply a juxtaposition of the BEPGs and the Employment Guidelines. Even worse, they comprise no less than 24 guidelines: six macroeconomic, ten microeconomic and eight employment guidelines, each of which includes several prescriptions that can be regarded as sub-guidelines.

The main problem with the Integrated Guidelines is not their complexity, however. It is that they offer no direction as to which of the 24 guidelines should be pursued as priorities by individual member states. The heterogeneity challenge we have identified in Section 1 is thus not addressed and the same prescriptions are offered to all countries rich and poor, technological leaders and laggards, inclusive and unemployment-ridden. This creates two potential problems. On one hand, there is a risk that national programmes would simply be laundry lists with no priority at all. On the other, if national programmes actually establish priorities among the 24 guidelines or simply ignore them altogether, it would be difficult for the Commission, which is in charge of evaluating national programmes, to pass a solid judgement on their validity. There is certainly no published document that provides guidance for selecting national priorities among the 24 guidelines.

Discussions with Commission officials in fact left us with the impression that their evaluation of national programmes had to rely on common sense and on consensus prescriptions from international organisations, rather than on a set of ex ante priorities and a methodology for dealing with heterogeneity.

The contrast with the OECD's *Going for Growth* exercise, also launched in 2005, is striking. Confronted with a similar challenge – in fact a simpler one, as the organisation does not set out goals for the OECD area as a whole and only aims at giving advice on the policy packages that are best suited to individual countries' needs – the OECD has defined and published its methodology[13]. As developed in Annex 2, the OECD work starts, as in any benchmarking exercise, with the identification of each country's performance weaknesses vis-à-vis clearly specified objectives such as employment and productivity. Then, a fixed number of policy priorities are identified, again for each country. The selected priorities are those with the highest potential for delivering an improvement on the performance weaknesses.

The OECD methodology is certainly not without its own shortcomings. But at least it provides a reasonable explicit framework for undertaking consistent country-by-country assessments. Unfortunately, the same cannot be said for Lisbon 2.

Unlike the OECD, the EU is admittedly a political organisation with an agenda of its own and objectives that go beyond the maximisation of country-by-country performance indicators. But this does not make the task any simpler. On the contrary, it increases its difficulty. The example of R&D spending is again telling. The OECD considers it an instrument that may, or may not, feature among the policy priorities for individual countries. For the EU, however, it has been decreed as a common objective. As indicated in Section 1, this immediately raises difficult questions: should R&D spending be a priority for every country? Or should national spending levels be chosen instead so as to equalise marginal returns on R&D spending across member states and maximise the *overall* EU innovation capacity and growth potential? Depending on the answers to those questions, very different assessments can be given on national spending levels. Again, however, it does not seem that the EU has rigorously addressed those questions.

As to the euro area dimension of the reform process also emphasized in Section 1, it is barely addressed within the framework of the Lisbon strategy. Euro area surveillance involves structural aspects but no explicit link is made with the National Reform Programmes, which do not include a euro area dimension. In principle, the euro area fiche prepared by the European Commission is recognition of a separate euro area dimension. However, in practice it does not go beyond the aggregation of individual country fiches. This may have the unfortunate effect of overlooking reforms that have an essential bearing on the functioning of the euro area, as the Commission does not base its evaluation of the national programmes on a proper analysis of the euro area priorities.

[13] See OECD (2005), Annex 1.A.2, and Annex 2 to this report.

2.4 The NRPs and their evaluation: results

The National Reform Programmes are very diverse in scope, ambition and degree of precision. Against this background, the Commission evaluation of those programmes often includes sensible remarks and suggestions that point to the weaknesses of national strategies. Thereby, the European Commission adds value in this collective exercise of reflection and assessment.

In general, governments seem to have largely ignored the Integrated Guidelines when drafting their NRPs. These usually refer only vaguely – if at all – to them, raising the suspicion that in several cases NRPs consist simply of a repackaging of existing measures. What is even more disturbing is that in its assessments of the NRPs the Commission also refers to them very loosely. The apparent lack of relevance of the Integrated Guidelines in the process is most probably the result of the two problems identified in the previous section: the large number of guidelines and the lack of criteria for selecting those which should be pursued most vigorously by each member state.

In some cases, however, the Guidelines are unambiguous and the policy emphasis is unmistakable. It is thus useful to analyse two such cases, which are both essential to the Lisbon strategy and feature numerical targets: the participation rate of older workers (Lisbon target: 50% in 2010) and R&D spending (Lisbon target: 3% of GDP in 2010). Most EU members are underperforming on both accounts. In addition, these two policy areas can highlight different dimensions of the challenges involved in the design of a common strategy. As discussed in Section 1, structural heterogeneity and the existence of externalities are major issues in the case of investment in R&D, whereas they are less important for the participation rate, where learning can instead play a greater role.

Annex Table 2 presents the situation for the participation of older workers. Of the 19 member states currently below the 50% target, only seven set a target in their NRP, sometimes actually below 50% or for a date later than 2010.

Annex Table 3 provides similar results for R&D. Here, of the 23 member states that currently invest less than 3% of GDP in R&D, 18 set a target in the NRP[14], although sometimes it is less than 3%, or for a date different than 2010.

Beyond the well defined issue of numerical targets, the degree of concreteness of the NRPs varies greatly from country to country and it is on average quite low. A commitment to deliver on Lisbon should rely – as stressed by some of the guidelines – on timetables, intermediate targets, benchmarks, a clear financial planning, the introduction of proper legal/fiscal incentives, and so on. The use of such instruments has been generally limited. With respect to plans for increasing the participation rate of older workers, some member states substitute concrete plans for numerical targets. But overall, most plans to increase the participation rates of older workers appear to lack concreteness.

Overall, the Commission evaluation does not appear to follow the letter of the guidelines very closely, just as the NRPs themselves. Instead, the Commission's assessment appears to focus on national prioritisation, although, as indicated above, an explicit methodology is lacking.

We found it instructive to compare the reform priorities as implied by the Commission to those identified by the OECD[15]. As a proxy for the Commission's take on national priorities,

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[14] Two member states set their target after the completion of the NRP. See Annex Table 3.

we use the "major strengths and weaknesses" spelled out in the conclusion of the Commission's assessment of the NRPs[16].

Regarding the participation rate of older workers there seems to be a close correspondence between the Commission's and the OECD's prioritisation (Table 2). For the 19 EU countries that are OECD members, the Commission and OECD agree whether older worker participation is a priority or not in 15 cases (priority in 8 cases, no priority in 7). Even in the remaining four cases, there is only a weak[17] discrepancy between the two institutions. This suggests that the evaluation was more based on the prevailing consensus among international organisations than on a direct implementation of the guidelines.

TABLE 2
CONSISTENCY OF COMMISSION AND OECD TARGETS

	PARTICIPATION RATE OF OLDER WORKERS	R&D SPENDING
Austria	✓	✗
Belgium	✓	✓
Cyprus	n/a	n/a
Czech Republic	✓	✗
Denmark	✗	✗
Estonia	n/a	n/a
Finland	✓	✗
France	✓	✗
Germany	✗	✗
Greece	✗	✓
Hungary	✓	✗
Ireland	✓	✓
Italy	✗	✗
Latvia	n/a	n/a
Lithuania	n/a	n/a
Luxembourg	✓	✗
Malta	n/a	n/a
Netherlands	✓	✓
Poland	✓	✓
Portugal	✓	✓
Slovakia	✓	✗
Slovenia	n/a	n/a
Spain	✓	✗
Sweden	✓	✗
United Kingdom	✓	✓

[15] In OECD (2005, 2006), national reform priorities are identified by the OECD for all EU member states other than the Baltic States, Cyprus, Malta, and Slovenia.
[16] While, technically, these are not priorities as such (but priorities relative to the existing NRPs), in practice this is the most immediate indication of the Commission's views regarding national priorities that is available to the public.
[17] All of these weak discrepancies are cases where neither Commission nor OECD lists older worker participation but either one (but not the other) lists a related reform issue such as disability benefits as a priority.

By contrast, we find little systematic correspondence of Commission and OECD priorities regarding R&D spending. For the 19 countries covered by both organisations, there is agreement on 7 countries and disagreement for 12. In 10 out of 12 cases, divergence is due to the Commission viewing an increase in R&D spending as a priority while the OECD, which focuses on innovation rather than R&D per se, does not; the reverse is observed only for the remaining two cases. Hence, the discrepancy is mainly driven by the fact that the Commission sees R&D as a priority for more countries than the OECD.

There are two possible explanations for these patterns. On the one hand, it may be that the R&D priority is so intimately linked to the Lisbon agenda that it receives special, and possibly excessive emphasis by the Commission. On the other hand, it may be that the OECD's methodology does not fully factor in cross-border spillover effects, which are at the core of the Lisbon agenda and therefore receive due attention by the Commission[18]. The fact that most member states have committed to substantially increase R&D expenditures in their NRPs is consistent with the latter explanation.

Summing up, in spite of some noticeable progress the new Lisbon process is far from what would be needed to effectively support the goals of the Lisbon agenda.

3. Conclusions and recommendations

3.1 Should Lisbon be saved?

There were two problems with Lisbon 1: ineffective coordination and lack of political ownership. The so-called open method of coordination borrowed from the old "competition for performance" approach that had been used with success in the macroeconomic sphere, but could not rely on any strong incentive. To be effective, it would have required at the very least the setting up of a benchmarking framework. Unfortunately this was never done. Even then, this would have been benchmarking with neither sanction nor incentive, and therefore a very weak form of coordination. The second problem with Lisbon 1 was the lack of political ownership by national authorities. Altogether, therefore, Lisbon 1 had commendable goals and helped foster cross-country comparisons and increasing public awareness through the publication of statistics. But as regards implementation, it was essentially a low-quality, bureaucratic benchmarking enterprise.

Lisbon 2 could have attempted to remedy the two dimensions of the problem, seeking to improve both the effectiveness of coordination *and* the degree of political ownership. This is essentially what the Kok report had suggested. Instead, Lisbon 2 chose to focus on the ownership problem. It was implicitly predicated on the assumption that the EU was confronted with a trade-off, and that more political ownership could only be gained at the expense of transparency in performance assessment. This was a questionable assumption in the first place.

If the implementation of the Lisbon strategy actually requires effective coordination *and* a high degree of political ownership, then the new approach was unlikely to succeed where Lisbon 1 failed. Worse, Lisbon 2 does not seem to have succeeded in increasing the political ownership of the Lisbon strategy by national authorities. The preparation and adoption of National Reform Programmes is certainly an important and positive step but the examination undertaken here suggests that progress as regards ownership has not been significant, at least so far.

[18] This also reflects the fact that the OECD does not see R&D as an end in itself but as an instrument.

These serious shortcomings of Lisbon 2 might call into question the whole Lisbon process. When a company or a state is confronted with a project and when that project does not deliver, the criterion for deciding whether to rescue or to drop it is not how much capital has already been invested, but whether the project still has value. The same applies to Lisbon: whatever political capital has been invested in it, it should be stopped if there is no value in it.

The reason why we think that the Lisbon agenda should not be abandoned is that we still find value in it. We strongly believe that Lisbon continues to be crucial for the future of Europe. The Lisbon goals continue to reflect the major challenges that European economies are confronted in this age of accelerated globalisation and technological change. These goals and the recognition of interdependence that they embody still command wide consensus.

However, we do not consider that Lisbon 2 is on track to succeed. On the contrary, our assessment is that it will fail unless its current shortcomings are addressed as a matter of urgency. It is the responsibility of the European Council of March 2006 to acknowledge the current weaknesses of the strategy and to correct them.

3.2 Recommendations

The weaknesses of Lisbon we have identified are the unevenness of the rationale, the weakness of the instruments and the inadequacy of the process. In order to salvage Lisbon 2, substantial corrective action in each area will be required. In addition, we see a case for addressing the euro area dimension of the reform process.

Strengthen the rationale. The very nature of the Lisbon process implies EU involvement in policy domains that primarily belong to the responsibility of member states. The legitimacy of this involvement rests on the existence of a rationale for coordination or joint action. At present, this rationale is rendered confused by the number and complexity of guidelines and objectives. They need to be reduced to ensure greater consistency of the EU dimension of Lisbon 2. Also, the EU rationale of any item on the Lisbon 2 agenda should be spelled out explicitly. Otherwise, Lisbon 2 will in effect be continued to be treated like a Christmas tree: everybody would continue trying to add everything they feel strongly about, recreating the lack of focus that marred Lisbon 1.

Reinforce the instruments. The Kok report had proposed to use three instruments for implementing Lisbon: National Reform Programmes, benchmarking with peer pressure and the EU budget. We deplore the fact that Lisbon 2 has retained only the first instrument. Benchmarking and appropriate EU funding are also crucial for the success of Lisbon.

Along with the National Reform Programmes, peer pressure and benchmarking should be integral parts of the political process that underpins Lisbon 2. Transparency benefits the democratic process as it empowers national electorates to review the performance of their own governments and it helps focus the public debate on key areas of underperformance. The use of league tables facilitates this process.

Also, the EU budget would need to be substantially amended in order to better reflect the Lisbon priorities. The budget review in 2008 will, in that sense, be a critical litmus test.

The example of Research and Development illustrates well how benchmarking and the EU budget need to complement National Reform Programmes. The commitment by member states to increased R&D expenditures is certainly one of the notable achievements of the NRPs and of new Lisbon process to date. But equally important is a commitment to improve the quality of R&D policy, both as regards the efficiency of public R&D and the effectiveness of incentives to private R&D. Here, benchmarking ought to play a leading role. At the same time, it is clear that, given the scope of R&D externalities within the Union, there is a case for R&D spending at the EU level. The fragmentation of public R&D funding along national lines in Europe is increasingly inefficient. Provided EU research programmes are adequately managed, the European economy as a whole would benefit from an increased R&D spending effort at the European level.

Improve the process. The new Lisbon strategy has put the NRPs at the centre of the process. We have assessed here their two central facets: ownership by member states and methodology design and implementation by the Commission. We strongly believe that both facets need to be improved.

While national ownership of the reform agenda was meant to be a key feature of Lisbon 2, the outcome in this respect has been mixed at best. Based on our findings, we would recommend that member states strive to adopt minimum standards regarding the involvement of parliaments and the transparency of follow-up arrangements. Also, the Commission should make use of media impact analysis and opinion polls to measure successes and failures of bringing the whole process closer to the ultimate sovereign, namely the peoples of Europe.

The process of designing and evaluating the NRPs would benefit greatly from a more explicit methodology for determining national priorities and evaluating reform plans. This will require a major conceptual and analytical push on the part of the Commission. At the moment, the methodological underpinnings of Lisbon 2 are much weaker than those of the OECD *Going for Growth* project, although the goals of Lisbon are more ambitious. An improved methodology will need to make the evaluation of national programmes and policies consistent with the underlying rationale for EU engagement in different areas. In practice, this means a more systematic and consistent comparative assessment of the quality of national policies in areas such as employment, and concrete recommendations to member states for action in areas such as R&D where the rationale is interdependence. The latter would help ensuring that the goodwill shown by EU countries in their NRP translates into actual deeds for promoting innovation, and that R&D efforts are increased where they have the best potential for efficiency.

Address the euro dimension. Reform interdependence within the euro area is significantly stronger that in the EU as a whole, but this does not translate into effective policy processes. What is required is first recognition of this interdependence through a greater common ownership of reform programmes in the euro area. This should call for extending the practice of holding meetings of ministers of the euro area beyond the Eurogroup, including, if well prepared, at the European council level. Second, the National Reform Programmes and their evaluation by the Commission should derive policy priorities from the need to improve the functioning of the euro area and to redress harmful divergence within it. The euro area evaluation should go beyond a mere aggregation and be used as a basis for developing a euro area reform programme discussed within the Eurogroup.

There is urgency to define a reform agenda for the countries in the euro area. The economy seems set to rebound in the short run, but for the recovery to be lasting the reforms that will pay off in two or three years and enhance the potential for non-inflationary growth have to be undertaken without delay. A joint commitment to such reforms by the governments of the euro area could and should be met with a more accommodative response from the ECB and would thereby enhance the potential for redressing the disappointing performance of the last five years.

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There is still value in the Lisbon agenda. But despite last year's reforms, it is still not effectively supported by the Lisbon process. This continued discrepancy between ends and means puts the whole strategy at risk. To prevent a failure of the joint endeavour, the 2006 Spring European Council should urgently request from the European Commission a proposal to simplify and prioritise the guidelines; the Commission should develop a methodology for the assessment of the National Reform Programmes and it should resume the publication of comparative performance assessment tables; the member states should ensure better national ownership of their reform commitments; and the Eurogroup should start preparing a proper euro area reform programme.

Those are immediate stopgap measures only. In the medium run, we remain convinced that the Lisbon agenda must be more strongly buttressed by Community policies and the EU budget. But difficulty in building a medium-term consensus should be no excuse for short-term inaction.

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Annex 1 – R&D externalities within the European Union

The scope for R&D externalities within the European Union is large. Several transmission mechanisms are at play and their role is especially strong in Europe. A first natural way for knowledge to spread across borders is through direct contacts between researchers, the movement of qualified workers, international conferences, joint research projects and so on.

But knowledge can spread also through commercial contacts, such as foreign direct investment (FDI) and trade.[19] Inward FDI has for long time been thought to originate knowledge spillovers through the creation of clusters, reverse engineering, training of qualified workers, and so on. More recently, empirical research has shown that outward FDI can also be beneficial: spillovers go in both directions.[20]

A third channel is trade. Recent economic literature has shown that importing knowledge-intensive intermediate goods may allow firms to benefit from positive externalities stemming from research conducted abroad, even if it is difficult to exactly quantify the effects.[21] This does not mean that it is possible to free-ride on the R&D conducted abroad: to be able to reap the benefits of foreign innovation it is indeed crucial that firms and countries perform a relevant amount of R&D of their own. This highlights the desirability of a coordinated effort at the EU level.

The rationale for concerted efforts in R&D in the EU is then very strong. The high flows of within-EU trade and investment are likely to generate important cross border externalities. However, member states will be able to capture all the benefits generated from research conducted in other member states only if a coordinated effort is promoted.

[19] For a comprehensive review of the literature, see Keller (2004).
[20] See, for instance, Branstetter (2006).
[21] The empirical literature originated from the seminal paper by Coe and Helpman (1995).

Annex 2 – The OECD methodology for selecting country-specific priorities

The overall methodology the OECD uses to select priorities for structural reforms is outlined in the Annex 1.A.2 to the 2005 *Going for Growth* [22]. In 2006, the same approach was adapted to the specific case of innovation.[23]

The identification of priorities is based on a two-step procedure:

1. The identification of performance weaknesses.
   A series of indicators aimed at measuring economic performance is outlined. These include, among others, labour productivity and unemployment (for the labour market) or R&D and patent intensities (for innovation). A country's performance is then evaluated using the OECD average as a benchmark.

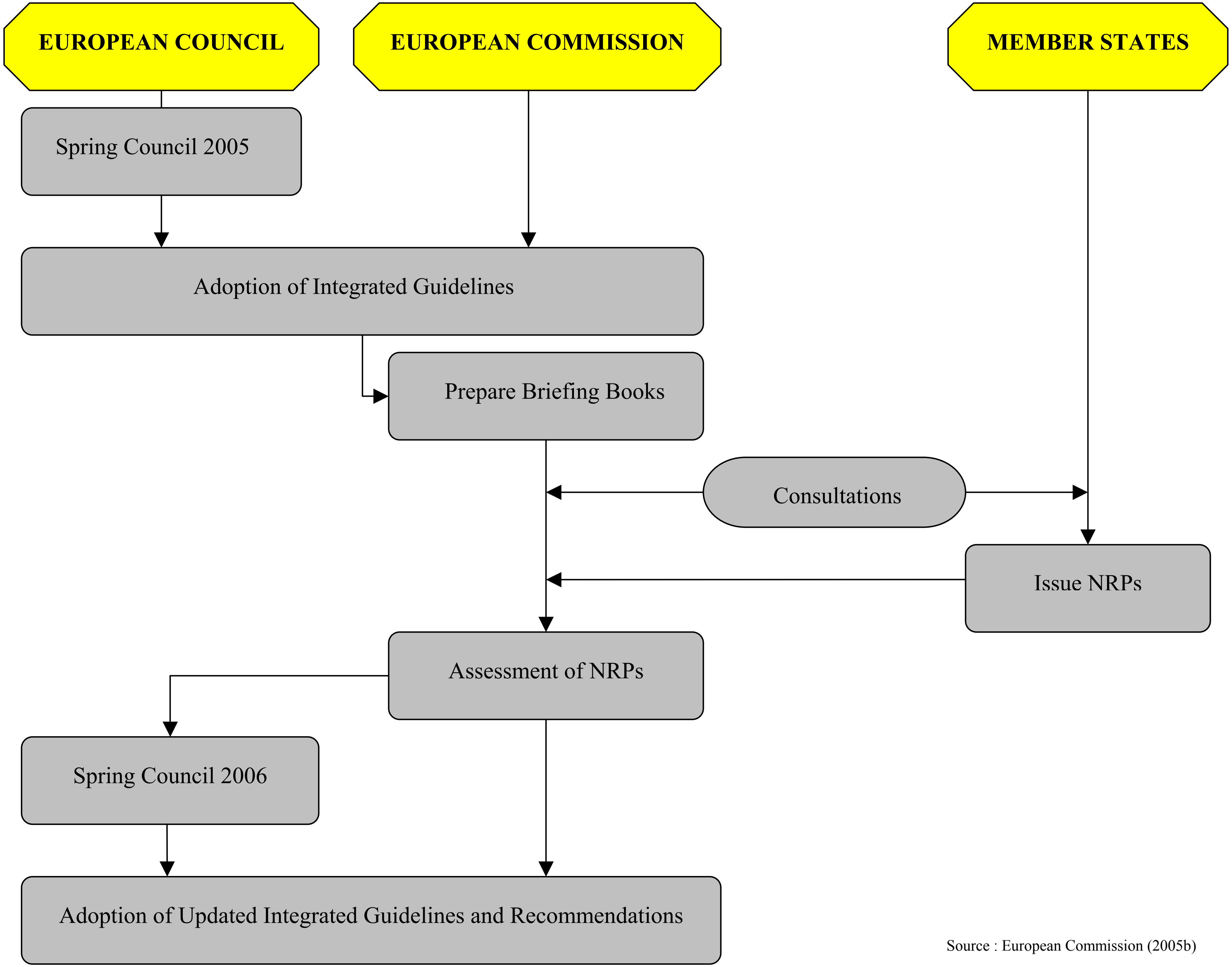
2. The identification of weaknesses in policy instruments.
   A series of policy indicators aimed at assessing policy tools is outlined. These reflect instruments that are under direct control of the government and that are known to have an impact on performance. These include, among others, the implicit tax on continued work (for the labour market) or the protection of intellectual property rights (for innovation). Again, the policy stance of a country is evaluated against the OECD average.

When a country has both a weak performance with respect to an indicator and a weak policy response in that domain, the corresponding policy is selected as a priority. Moreover, to reflect the possibility that some policy areas might be hardly synthesised by quantitative indicators, two further policy priorities are selected. These are based on country expertise and may or may not be reflected in the indicators. A total of 5 recommendations for labour market, and four for innovation policy reforms is then set out.

The fixed number of policy priorities for each country implies that for the worst performing economies some relevant policies will be left out. Similarly, for the best performing some priorities may address dimensions where the country is doing better than the OECD average.

[22] See OECD (2005), pp 31-36 and OECD (2006), pp 76-77, for more details.
[23] OECD (2005) focused on labour and product markets; OECD (2006) follows up in these two areas and broadens the analysis to innovation policy.

Annex 3 – The Preparation and Evaluation of National Reform Programmes (NRPs)



Source : European Commission (2005b)

Annex Table 1 - Ownership Index					
Country	**Parliament (1)**	**Social Partners (2)**	**Civil Society (2)**	**Follow-up (3)**	**Total**
Austria	3	2	2	0	7
Belgium	0	3	0	0	3
Cyprus	3	2	0	2	7
Czech Republic	3	3	0	0	6
Denmark	1	3	3	0	7
Estonia	2	3	3	3	11
Finland	1	2	2	0	5
France	2	2	0	1	5
Germany	1	1	0	0	2
Greece	2	2	2	1	7
Hungary	1	2	2	0	5
Ireland	3	2	0	0	5
Italy	1	2	2	0	5
Latvia	3	2	2	0	7
Lithuania	3	2	2	0	7
Luxembourg	3	3	0	0	6
Malta	1	2	0	3	6
Netherlands	3	2	0	0	5
Poland	3	2	2	0	7
Portugal	2	2	0	0	4
Slovakia	2	3	2	0	7
Slovenia	1	2	0	2	5
Spain	3	2	0	2	7
Sweden	3	2	1	0	6
United Kingdom	0	1	1	0	2

Averages	
Overall	**5,8**
EU15	**5,1**
New MS	**6,8**
6 Largest	**4,7**
Small MS	**6,1**

(1) Parliament: 0 = no involvement
1 = informed
2 = committee level
3 = broad involvement/plenary discussion

(2) Social Partners/Civil Society: 0 = no involvement
1 = informed
2 = consultation
3 = major involvement

(3) Follow-up: 0 = no follow-up
1 = committee
2 = at minister level
3 = at prime minister level

Sources: European Commission (2006), National Reform Programmes

Annex Table 2 - Participation Rate of Older Workers					
Country	**Current (1)** *(%)*	**NRP Target (2)** *(%)*	**EC Evaluation (3)** *Priority*	*Assessment*	**OECD** *Priority*
Austria	28,8		yes	-	yes
Belgium	30,0	50,0 (asap)	yes	+	yes
Cyprus	49,9	53,0	no		n/a
Czech Republic	42,7	47,5 (2008)	no		no
Denmark	60,3		no		(yes)
Estonia	52,4		no		n/a
Finland	50,9		yes	-	yes
France	37,3		yes	-	yes
Germany	41,8		no		(yes)
Greece	39,4		no		(yes)
Hungary	31,1		no		no
Ireland	49,5		no		no
Italy	30,5		(yes)	(-)	no
Latvia	47,9	50,0	no		n/a
Lithuania	47,1	50,0	no		n/a
Luxemburg	30,8		yes	-	yes
Malta	31,5	35,0	no		n/a
Netherlands	45,2		yes	+	(yes)
Poland	26,2		(yes)	(-)	(yes)
Portugal	50,3	50,0	no		no
Slovakia	26,8		(yes)	(+)	(yes)
Slovenia	29,0	35,0 (2008)	yes	-	n/a
Spain	41,3		no		no
Sweden	69,1		no		no
United Kingdom	56,2		no		no

(1) Data refer to 2004; Lisbon target is 50%.
(2) For 2010 if not otherwise stated.
(3) Priority: "yes" means tat the issue is cited in the conclusions of the EC assessment.
A parenthesis means it has been referred to only indirectly.

Assessment: "+" = on track
"-" = not realistic/not enough

Sources: European Commission (2006), National Reform Programmes, OECD (2005,2006)

Annex Table 3 - Research and Development Spending (% of GDP)							
Country	**Current (1)**		**NRP Target (2)**		**EC Evaluation (3)**		**OECD**
	Total	*Public*	*Total*	*Public*	*Priority*	*Assessment*	*Priority*
Austria	2,26	0,86	3,00		yes	o	no
Belgium	1,93	0,61	3,00		no	o	no
Cyprus	0,37	0,29	0,65 (2008)		yes	o	n/a
Czech Republic	1,28	0,47		1,00	yes	+	no
Denmark	2,63	0,82	3,00		yes	+	no
Estonia	0,91	0,55	1,90		yes	+	n/a
Finland	3,51	1,05	4,00		yes		no
France	2,16	0,80	3.00 (5)		(yes)		no
Germany	2,49	0,74	3,00		(yes)	o	no
Greece	0,58	0,41	1,50		yes	-	(yes)
Hungary	0,89	0,52			no		yes
Ireland	1,20	0,43	2.50 (4) (2013)		yes	-	(yes)
Italy	1,14	0,60			no		(yes)
Latvia	0,42	0,23 0,00	1,50 (2008)		yes	+	n/a
Lithuania	0,76	0,60	2,00		yes	o	n/a
Luxembourg	1,78	0,20	3,00		yes	o	no
Malta	0,29	0,19		0,20 (2007)	no	-	n/a
Netherlands	1,77	0,75	3.00 (5)		no		no
Poland	0,58	0,41	1,65 (2008)		yes	-	yes
Portugal	0,78	0,52		1,00	yes		yes
Slovakia	0,53	0,27			yes	-	no
Slovenia	1,61	0,65	3,00		yes	-	n/a
Spain	1,07	0,49	2,00		yes	+	no
Sweden	3,74	0,99		1,00	yes	+	no
United Kingdom	1,88	0,64	2,50 (2014)		yes	-	yes

(1) Data refer to 2004. For Italy, Luxembourg, Portugal and UK, they refer to 2003.

(2) For 2010 if not otherwise stated.

(3) Priority: "yes" = The issue is cited in the conclusions of the EC assessment. A parenthesis means it has been referred to only indirectly.

Assessment: "+" = on track

"o" = ambitious but achievable if efforts are stepped up

"-" = not realistic/not enough

(4) Percentage of GNP.

(5) France and the Netherlands announced targets after the transmission of their programmes

Sources: European Commission (2006), Frank (2006), National Reform Programmes, OECD (2005,2006)