THE LISBON STRATEGY – FIVE YEARS ON

At its meeting in Brussels on 22 and 23 March 2005, the European Council concluded its mid-term review of the Lisbon strategy. Launched in 2000 by the Lisbon European Council, the Lisbon strategy established a comprehensive agenda of structural reforms aimed at transforming the EU into "the most competitive and dynamic knowledge-based economy in the world". Five years on, the results are at best mixed. In the mid-term review, the Heads of State or Government therefore called for the Lisbon strategy to be relaunched without delay and for its priorities to be refocused on growth and employment. To facilitate this process, the European Council also endorsed a new governance framework which aims to improve the delivery of reforms, inter alia by increasing national ownership of the strategy. With a streamlined governance framework and a newly refocused Lisbon agenda, the European Union has a good blueprint for unlocking the EU's growth and employment potential. Attention should now shift towards implementing it.

1 INTRODUCTION

At its meeting in Lisbon in March 2000, the European Council agreed on an ambitious strategy – the Lisbon strategy – with the overall goal of turning the European Union by 2010 into "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion". The Lisbon strategy can be described as a wide-ranging programme of economic, social and environmental reforms. Under these three headings, it covers policy actions to be taken at both the national and the EU level to enhance the standard of living of European citizens.

After briefly describing the rationale for the strategy as well as its content and governance framework, this article considers the implementation record and reviews the relaunch of the strategy following the mid-term review. Given the breadth of the Lisbon strategy, the article concentrates only on selected areas of economic reform. For example, it does not cover the efforts to create a truly single market for financial services, which constitutes an important part of the Lisbon strategy.[1] Moreover, the article does not analyse the social and environmental aspects of the strategy.

2 MOTIVATION AND RATIONALE

The Lisbon strategy was adopted in 2000 against the backdrop of high economic growth rates in Europe. Nonetheless, the Heads of State or Government also acknowledged at their Lisbon summit that the European economy suffered from a number of weaknesses. Unemployment was too high and employment rates were too low. The EU lagged behind in its transition to a knowledge-based society. The gap between the EU and the United States in terms of economic growth and productivity levels was widening, suggesting that the economic performance of EU Member States was below its potential level. It was thought that the implementation of the Lisbon strategy within a sound macroeconomic environment would lead the EU to achieve an average economic growth rate of around 3%. However, in order to achieve this potential and thus maintain its high living standards and social achievements, the EU and its Member States would have to act with determination, especially in the light of mounting internal and external challenges.

The Lisbon strategy has to be seen against the background of three increasingly pressing challenges, each of which require a radical transformation of the European economy. First, through the increasing integration of emerging economies in the global economy, the EU is exposed to growing international competition. Second, the emergence of the

1 For an overview of progress made in the area of financial markets, see the article entitled "The integration of Europe's financial markets" in the October 2003 issue of the ECB Monthly Bulletin.

knowledge economy calls for a concerted effort to increase the creation and diffusion of scientific, technological and intellectual capital. And third, major demographic challenges associated with an ageing population will substantially lower the potential for growth and place significant pressures on the fiscal sustainability of pension and health care systems in EU countries if no reforms are undertaken.

In view of these challenges, structural reforms are needed to increase non-inflationary growth and employment and to enhance the economy's ability to adjust to changing circumstances. By improving the functioning of markets, structural reforms can remove impediments to the full and efficient use of production factors. In addition, they facilitate the adoption of innovations in the production process, thereby enhancing productivity growth. The channels through which structural reforms affect macroeconomic variables, such as output, employment and productivity, are highly complex. Nevertheless, there is substantial theoretical and empirical evidence that structural reforms have a significant positive effect on macroeconomic variables.[2] For example, product market reforms have the potential to reduce monopoly rents in previously sheltered sectors and enhance competition, leading to greater efficiency and productivity growth. Labour market reforms can provide, inter alia, stronger incentives for participation in the labour market. Moreover, more flexible labour markets enable firms to adjust more quickly to a changing market environment and help labour demand to pick up more rapidly following an adverse shock, thereby improving employment prospects. In financial markets too, structural reforms have beneficial macroeconomic effects. More competition among providers of financial services should reduce transaction costs, thus increasing incentives to save (through higher returns on savings) and to invest (through lower financing costs). Finally, financial market integration creates opportunities for greater risk-sharing across borders, which dampens the impact of any asymmetric shocks that may hit one individual country or sector.

In addition, there is evidence that structural reforms in one market can have an impact on other markets.[3] For example, structural reforms in product markets that are aimed at enhancing competition and supporting the entry of new firms into the market can potentially affect wages and employment levels and thereby facilitate labour market reform. These interactions between structural reform policies suggest that it may be beneficial to follow a broad-based reform strategy, exploiting the synergies made possible by a comprehensive approach to structural reform as envisaged in the Lisbon strategy.

3 CONTENT AND GOVERNANCE

The Lisbon strategy initially consisted of an economic pillar and a social pillar, with the economic pillar focusing on reforms to promote productivity, innovation and competitiveness, and the social pillar aiming at modernising the European social model, boosting employment and combating social exclusion. The Göteborg European Council of 2001 added an environmental pillar to the strategy, which tackles aspects of sustainable development.

With a view to achieving the overall goal of making the EU economy more competitive and dynamic, the Lisbon European Council defined specific objectives and policy actions to be undertaken by the Member States and the EU. Subsequent European Council meetings added further objectives to the strategy and, in a number of cases, these objectives were accompanied by quantitative targets. For example, several quantitative targets were

2 See the "OECD Report on Regulatory Reform" (1997) and the European Commission's "Structural reforms in labour and product markets and macroeconomic performance in the EU", The EU economy: 2002 review, No 6, 2002.

3 See, for example, G. Nicoletti et al. "Product and labour market interactions in OECD countries", OECD Economics Department Working Papers, No 312, 2001.

set by the Lisbon and Stockholm European Councils with respect to EU employment rates, most notably raising the overall EU employment rate to 70%, the EU employment rate for female workers to 60%, and the employment rate for older workers (aged 55-64) to 50% by 2010. In addition, the Barcelona European Council of March 2002 set the target of raising research and development (R&D) spending to 3% of GDP (see Table 1 for an overview of selected objectives and targets). At the same time, successive European Councils invited the European Commission, the EU Council and the European Parliament to meet qualitative targets, such as the adoption of important EU legislation by specific dates (e.g. the Single European Sky Regulations), or to conclude major projects like the Financial Services Action Plan.

GOVERNANCE IN THE FIRST FIVE YEARS

In order to implement the Lisbon strategy, the Lisbon European Council of 2000 agreed that no new policy coordination processes were needed. Instead, it called for the most efficient use of the existing governance framework as developed in the period since the adoption of the Maastricht Treaty in 1992 and further refined under the guidance of the European Council in the late 1990s. The foundations of this framework are the Treaty-based economic and employment coordination processes, i.e. the Broad Economic Policy Guidelines (BEPGs), and the Employment Guidelines (EGs) adopted under the Luxembourg process which was introduced in 1997. The BEPGs have also received input since 1998 from the Cardiff process, which deals specifically with reforms in product and capital markets.[4] Finally, the BEPGs and EGs were complemented in 2003 by the Internal Market Strategy the aim of which is to fully exploit the potential of the single European market in terms of growth and competitiveness.

While calling for the Lisbon strategy to be implemented through the more efficient use of the existing governance framework, the Lisbon European Council nevertheless introduced two institutional innovations in 2000. First, it decided to hold an annual meeting to review progress made with the Lisbon strategy. Through these "spring meetings" (or summits), which are held in March each year, the European Council has assumed a guiding role with regard to the strategy by providing political impetus and direction. Second, it introduced a new coordination method – the open method of coordination (OMC) – as a means of helping Member States to progressively develop and improve their policies in areas not covered by the existing governance processes. The OMC, being a method of "light" coordination, aims to achieve greater convergence towards the main EU goals by benchmarking and spreading best practice. It has been applied in policy areas such as pension and health care systems, R&D and social inclusion.

Most of the reforms to be undertaken under the Lisbon strategy pertain to areas that are largely the preserve of the Member States. In such areas, the Union plays a role in the coordination of Member States' policies through multilateral surveillance, peer pressure and mutual learning. In order to underpin this coordination, the Lisbon European Council invited the Commission to present an annual synthesis report, which became known as the Spring Report, measuring progress and benchmarking the performance of the Member States in implementing the strategy on the basis of a number of structural indicators. This benchmarking exercise is intended to support peer pressure by providing indications about best practices in the EU and by raising public awareness about the necessity and benefits of structural reforms.

There are also some areas where the EU is competent to promote reform in a more direct way. For instance, in the area of the Internal Market, the EU has binding policy tools at its disposal, such as legislation adopted through

4 For more information about these processes, see the article entitled "The economic policy framework in EMU" in the November 2001 issue of the ECB Monthly Bulletin.

Table 1 Selected objectives, quantitative targets and structural indicators of the Lisbon strategy

Objectives	Targets			Achievements			
Selected objectives set at European Council meetings (in chronological order)	Field/specific target	Target value	Target year	EU15 average[1]	Number of EU15 MS that have met the target	EU25 average	Number of EU25 MS that have met the target
Lisbon (March 2000)	**Economic reform**						
– Develop an active employment policy – create more and better jobs for Europe	Overall employment rate [SI-3] [2]	70%	2010	64.8%	4	63.3%	4
	Female employment rate	60%	2010	57.0%	7	55.8%	9
– Promote competitiveness by eliminating obstacles to the Internal Market	Transposition rate of Internal Market directives	98.5%	2002	97.0%	1	96.3%	2
– Complete the Internal Market for services	Open electricity markets for customers	100%	2007	90.0%	9	87.0%	9
	Open gas markets for customers	100%	2007	94.0%	7	88.0%	7
	Social cohesion						
– Invest in people and combat social exclusion	Early school leavers	10%	2010	18.0%	4	15.9%	9
– Promote life-long learning	Participation in life-long learning, percentage of adults aged 25-64	12.5%	2010	10.1%	5	9.4%	6
Stockholm (March 2001)	**Employment**						
– Attract more people in employment	Overall employment rate (intermediate)	67%	2005	64.8%	7	63.3%	8
	Female employment rate (intermediate)	57%	2005	57.0%	9	55.8%	14
– Invest in human capital and make life-long learning a reality	Employment rate for workers aged 55-64 [SI-4]	50%	2010	41.9%	5	40.5%	7
– Improve the implementation of reforms through better governance	Increase average effective retirement age	65 years	2010	61.4 (2003)	0	61.0	0
– Increase the adaptability of workers and enterprises	Available childcare for pre-school children over three	90%	2010	n.a.	4	n.a.	n.a.
	Available childcare for children under three	33%	2010	n.a.	2	n.a.	n.a.
Gothenburg (June 2001)	**Environment**						
– Combat climate change (namely deliver on Kyoto targets)	Visible progress at reducing greenhouse gas emissions [SI-12]	92% of EU average level in 1990	2008-2012	97.1% (2002)	3	91.0%	10
– Promote wider use of new environmentally-friendly technologies (decoupling economic growth from resource use)	Contribution of electricity produced from renewable energy sources (percentage of gross electricity consumption)	22% of EU15 and 21% of EU25 average	2010	13.7% (2003)	5	12.8%	7

Table 1 Selected objectives, quantitative targets and structural indicators of the Lisbon strategy (cont'd)

Objectives	Targets			Achievements			
Selected objectives set at European Council meetings (in chronological order)	Field/specific target	Target value	Target year	EU15 average[1)]	Number of EU15 MS that have met the target	EU25 average	Number of EU25 MS that have met the target
Barcelona (March 2002)	**R&D, ICT and Education**						
– Increase the mobility of researchers and attract and retain high quality research talent	R&D spending as a percentage of GDP [SI-6]	3%	2010	2% (2003)	1	1.95%	1
– Improve private research investment, R&D partnerships and high technology start-ups	Business participation in R&D spending	66.6%	2010	56% (2001)	4	55.4%	4
– Promote school twinning via the internet	All schools with internet connection	100%	2002	93% (2002)	1	n.a.	n.a.
– Adapt the skills base to the needs of the knowledge society	All teachers to have training in IT skills	100%	2003	56.8% (2002)	0	n.a.	n.a.
– Create conditions for e-commerce to flourish	Internet penetration in households	30%	2002	45.0%	13	42%	15
– Stimulate e-government	Government basic services online	100%	2002	49.0%	0	42%	0
– Achieve a substantial increase in per capita spending on human resources; raise the quality of and access to education	Educational attainment level (20-24 years old) [SI-5]	85%	2010	73.5%	3	76.4%	8
	Maths, science and technology graduates (per 1,000 persons)	15/1,000	2010	13.1/ 1,000 (2003)	3	12.2/1,000	4
Structural indicators belonging to the shortlist and not referred to above	[SI-1] GDP per capita in Purchasing Power Standards; [SI-2] Labour productivity; [SI-7] Relative price level; [SI-8] Business investment; [SI-9] At risk-of-poverty rate; [SI-10] Long-term unemployment rate; [SI-11] Dispersion of regional employment rates; [SI-13] Energy intensity of the economy; [SI-14] Volume of freight transport.						

Source: Eurostat (http://epp.eurostat.cec.eu.int/) and Commission SEC (2005) 385, "The Economic Costs of non-Lisbon" of 15 March 2005.
Legend: EU15 = The 15 Member States of the EU until 1 May 2004; EU25 = The 25 Member States of the EU since 1 May 2004; MS = Member State(s) of the EU; n.a.= not available.
1) Unless otherwise stated, data refer to 2004. If data are not available for 2004, the most recent data available have been used.
2) On 8 December 2003, the EU Council adopted a shortlist of 14 structural indicators. These structural indicators are numbered in square brackets, e.g. [SI-1].

the standard EU procedures, i.e. through the so-called Community Method. In the field of R&D, the EU also plays a direct role by means of budgetary financing.

SHORTCOMINGS

A number of shortcomings came to light during the first five years of operation of this governance framework. The expansion of the scope of the Lisbon strategy and the proliferation in the number of objectives and targets have been widely perceived as a dilution of the essence of the strategy. The report by the High Level Group headed by Wim Kok talked in this respect about the risk of the strategy becoming "about everything and thus about nothing".[5]

The lack of focus, as well as the inconsistency of some objectives, were in part linked to the blurring of the competences and responsibilities of the various national and European actors involved in the strategy. The

5 "Facing the challenge – The Lisbon strategy for growth and employment", report of the High Level Group chaired by Wim Kok, November 2004, p. 16.

coexistence of different coordination processes at the EU level sometimes also proved difficult to manage and complicated priority-setting. It led to a heavy reporting burden at the national level, as Member States were asked to produce, on an annual basis, national "Cardiff reports" on structural reform in product and capital markets, National Action Plans for Employment and reports on the various policy areas covered by the OMC. As a corollary, the governance framework also engendered multiple assessment reports, which complicated the monitoring of progress (e.g. the Commission's Spring Report to the European Council, the Commission's BEPGs Implementation Report, the Joint Employment Report of the Commission and the EU Council). The large number of processes and reports rendered the strategy difficult for the public at large to understand which, in turn, hampered public awareness.

Moreover, the effectiveness of the soft coordination procedures and, to a certain extent, the Community Method, was shown to depend very much on the political will of the Member States to live up to their commitments. However, the incentive structure to enforce and maintain this political will proved to be a problem. In particular, national ownership of the strategy was limited in the first five years of its implementation. Stakeholders, such as national parliaments and social partners, were hardly involved, which, in turn, may have reduced the pressure on governments to implement reforms. Furthermore, national governments were not always very consistent in the programming of and reporting on their implementation efforts, and tended to shift coordination problems to the EU level instead of dealing with them locally.

All in all, the governance framework during the first five years of the Lisbon strategy proved inadequate for delivering the ambitious goals that the Heads of State or Government had announced in March 2000.

4 ECONOMIC REFORM UNDER THE LISBON STRATEGY

This section discusses the progress made on structural reform under the Lisbon strategy in the EU, and the euro area in particular, concentrating on the policy areas which are most directly relevant from a macroeconomic point of view. The analysis is largely based on a shortlist of structural indicators which was adopted by the EU Council on 8 December 2003. This shortlist was aimed at measuring progress made in achieving the Lisbon goals (see Table 1 which puts the structural indicators into the broader context of the strategy).

The analysis does not cover the new EU Member States as they have not taken part in the Lisbon strategy for most of the period since 2000. It should be noted that it is difficult to assess the impact EU enlargement will have on the successful implementation of the strategy. On the one hand, the achievement of the strategy's objectives may become more challenging as many new Member States are still further away from the targets than the other EU Member States.[6] On the other hand, the accession of the new Member States could help to achieve the Lisbon targets, as it may increase competition and raise the pressure on governments to introduce structural reforms.

GENERAL ECONOMIC BACKGROUND

Around the time of the adoption of the Lisbon strategy in March 2000, an economic slowdown began which was caused by a number of shocks, including increases in oil prices and the bursting of the information and communication technology (ICT) bubble. In combination with various rigidities hampering the capacity of Europe's economies to adjust to these shocks, economic growth in Europe has been rather subdued since the launch

6 See the article entitled "The EU economy following the accession of the new Member States" in the May 2004 issue of the ECB Monthly Bulletin.

of the Lisbon strategy. This has made the achievement of the Lisbon targets substantially more difficult.

A summary indicator of the general economic background is GDP per capita. Developments in real GDP per capita can be broken down into the contribution of labour productivity (real GDP per hour worked) and that of labour utilisation (see Table 2). In turn, developments in labour utilisation can be further broken down into developments in the number of hours worked (per person employed) and in the number of persons employed. Since the launch of the Lisbon strategy, the increase in real GDP per capita in the EU15 has been accounted for by gains in labour productivity, whereas the contribution of labour utilisation has been limited. In almost all the countries shown in Table 2, the progress made over the last few years in increasing the number of persons employed has been partly offset by a decline in average hours worked per person employed. In many countries, this development reflects the increasing number of women in the labour force, as women are more likely to work part time.

It is, however, difficult to draw policy conclusions on the basis of this simple accounting framework, given the interconnections between the components. For example, in countries with increasing employment, labour productivity growth may, at least temporarily, be relatively low if newly employed people have below-average labour productivity. A short-run trade-off between employment and labour productivity growth may also exist if the capital stock is slow to respond to the increase in employment, reducing the available stock of capital per worker when employment expands. As a result, labour productivity growth slows as production becomes less capital intensive.

Table 2 Real GDP per capita growth since the launch of the Lisbon strategy

(average annual percentage change 2000-03)

	Real GDP per capita (a=b+c)	Real GDP per hour worked (b)	Labour utilisation (c=d+e)	Hours worked per person employed (d)	Persons employed in total population (e)
Belgium	1.3	1.0	0.4	-0.1	0.4
Germany	1.0	1.5	-0.5	-0.6	0.1
Greece	4.0	4.2	-0.2	-0.1	-0.1
Spain	2.2	0.9	1.3	-0.2	1.5
France	1.6	2.4	-0.8	-1.6	0.8
Ireland	4.8	4.7	0.1	-1.2	1.3
Italy	1.1	0.2	0.9	-0.4	1.3
Netherlands	0.5	0.0	0.5	0.1	0.4
Austria	1.2	1.4	-0.3	-0.3	0.1
Portugal	0.5	1.1	-0.6	-0.8	0.2
Finland	2.5	2.9	-0.5	-1.4	0.9
Euro area	1.2	1.2	0.1	-0.6	0.6
Denmark	1.1	1.9	-0.9	-0.3	-0.5
Sweden	1.9	2.4	-0.5	-1.3	0.8
United Kingdom	2.0	2.3	-0.3	-0.7	0.3
EU15	1.4	1.4	0.0	-0.6	0.6
Japan	0.8	1.7	-0.9	-0.1	-0.8
United States	1.3	2.9	-1.6	-0.9	-0.7

Source: ECB calculations on the basis of Eurostat data. Data for hours worked are compiled from the Groningen Growth and Development Centre and The Conference Board, Total Economy Database, January 2005 (http://www.ggdc.net). Data for Luxembourg are not available.

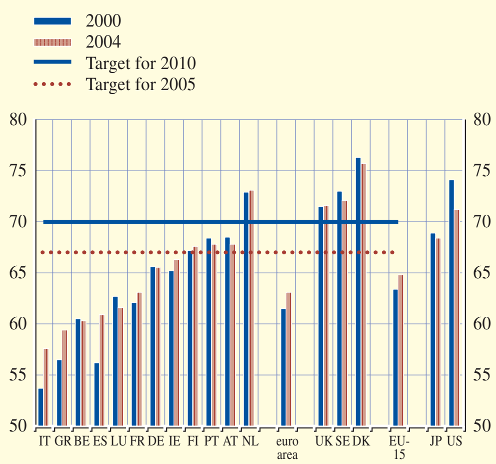
EMPLOYMENT

A key objective of the Lisbon strategy in the field of labour markets is to raise the employment rate. To achieve this, the strategy sets out a number of policies that focus on removing disincentives to labour participation by improving the adaptability of companies and workers and promoting investment in human capital.

From 2000 to 2004, the total employment rate in the euro area increased by around 1.5 percentage points to 63.1%. In the EU15, the employment rate rose by a similar amount to 64.8% in 2004. In most euro area countries, the employment rate increased, although the size of the increase differed between countries. Euro area countries with relatively low employment rates saw stronger increases, suggesting some convergence across them. In 2000 four euro area countries and the three non-euro area EU15 countries (Denmark, Sweden and the United Kingdom) had already met the intermediate Lisbon employment target (see Chart 1).

Chart 1 Total employment rate

(employed persons aged 15-64 as a percentage of the total population of the same age group)



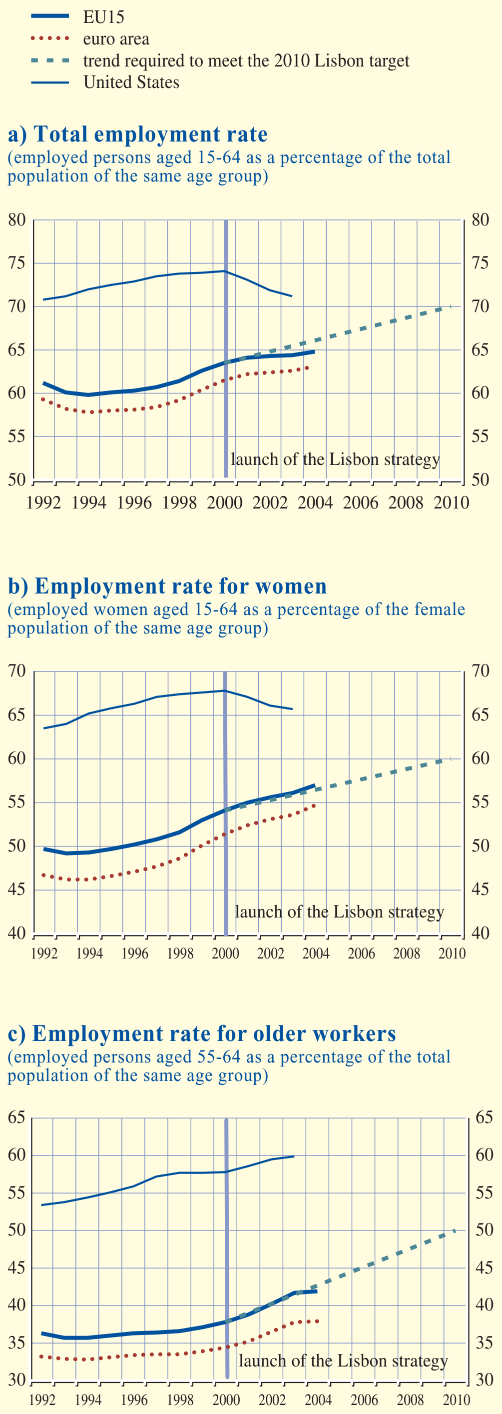
Source: Eurostat. Data for US and JP refer to 2003 instead of 2004.

Employment rates, however, need to increase much more rapidly if the 2010 Lisbon target is to be met. Chart 2a shows that the increase in the employment rate for the EU15 has fallen behind the trend required to achieve an overall employment rate of 70% by 2010. At the same time, developments in the total employment rate mask more favourable developments for some groups (see Charts 2b and 2c).

The employment rate for women, in particular, has increased significantly and is moving towards the 2010 target of 60%. The employment rate for workers aged between 55 and 64 also picked up between 2000 and 2003, although it seems to have stabilised in 2004 and is still a long way off the 50% target for 2010. In addition, it must be borne in mind that the ability to attain these targets by 2010 will be influenced by the demographic changes associated with the ageing of the population. Notably, the number of people in the 55 to 64 age group will continue to increase substantially over the coming years, making it more of a challenge to meet the target for this group.

Several factors have shaped the evolution of employment in recent years, including developments related to the economic cycle, demographic change and economic policies. As regards labour market policies, many euro area countries have made considerable efforts to improve incentives for labour participation, although the intensity of the reforms has differed markedly between countries. Most progress seems to have been made with regard to lowering labour tax burdens, particularly on low incomes. In addition, a number of countries are restricting eligibility for early retirement schemes, or phasing them out, leading to an improvement in financial incentives for postponing retirement. Some countries have also restricted eligibility for, or the duration of, benefits. On the other hand, the approach to reforms of employment protection legislation has been rather selective, concentrating mainly on relaxing legislation on temporary jobs, whereas legislation on permanent positions has

Chart 2 Lisbon employment targets for 2010 and progress made



Source: Eurostat.
Note: The trendlines in Charts 2a, 2b and 2c are straight lines connecting the starting points in 2000 with the targets for 2010.

been maintained or strengthened. Moreover, reforms of wage bargaining structures have been very modest. Overall, while labour market reforms have been moving in the right direction, they have thus far not been sufficient to create the conditions necessary to remain on track for the Lisbon employment targets.

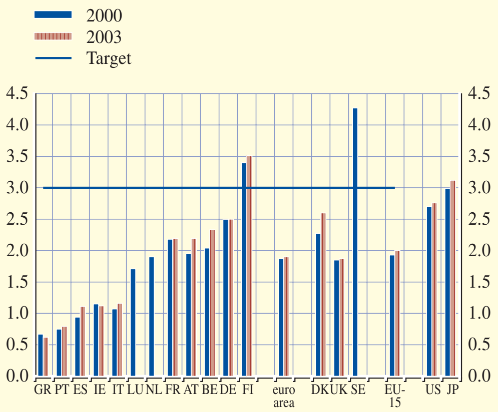
INNOVATION AND RESEARCH

The Lisbon strategy calls for measures to promote ICT accessibility and sets out goals for increasing inputs to research, which are seen as key determinants of technological progress. Regarding the spread of ICT, there has been clear progress in some areas, with a substantially higher proportion of households and schools now connected to the internet. At the same time, Europe has not been able to fully exploit the benefits of ICT for productivity purposes and is clearly lagging behind the United States in this respect. In the field of research, developments have also been less positive. A key structural indicator included in the shortlist is expenditure on research and development as a percentage of GDP. Since 2000 the ratio of R&D expenditure has increased only marginally and, in 2003, it stood at 1.9% of GDP in the euro area, slightly below the share in the EU15 and substantially below the 3% target (see Chart 3).

Productivity growth can also be boosted by more and better education and training. The right skills and competences are required to reduce mismatches in the labour market and allow for a smoother reallocation of workers between companies or sectors. In addition to R&D expenditure, another structural indicator that was included in the shortlist in the field of innovation and research is the percentage of the population aged from 20 to 24 who have completed at least an upper secondary education. In the euro area, this share stood at 72.5% in 2004, slightly below the average for the EU15 and broadly similar to the share in 2000, though well below the 85% target (see Chart 4). Some euro area countries have made significant progress whereas, in others,

Chart 3 Research and development expenditure

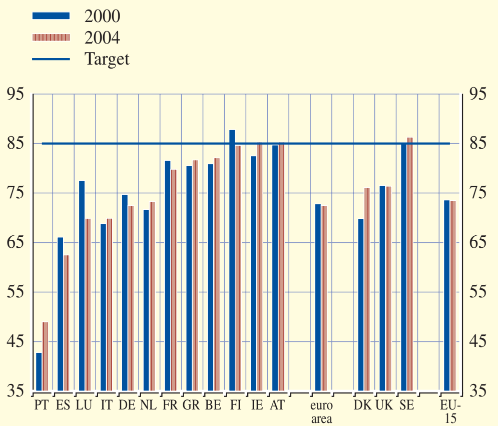
(percentage of GDP)



Source: Eurostat.
Note: Figures for GR and PT refer to 1999 instead of 2000. Figures for IT, UK and JP refer to 2002 instead of 2003. Figures for SE refer to 2001.

Chart 4 Educational attainment

(percentage of the population aged 20-24 having completed at least upper secondary education)



Source: Eurostat.
Note: Figures for LU and NL refer to 2003 instead of 2004. No comparable data are available for JP and US.

educational attainment has worsened somewhat since 2000.

ECONOMIC REFORM

Economic reform, another key area of the Lisbon strategy, is aimed at creating well-functioning, competitive and efficient markets and favourable framework conditions for economic growth. In a number of fields clear progress has been made. For example, most network industries (industries that are characterised by the presence of a bottleneck infrastructure with natural monopoly characteristics) are now fully or largely open to competition, in particular those in telecommunications and air transport and, to a lesser extent, in energy markets. It is, however, difficult to enforce effective competition, and so the market share of former monopoly-holders remains high in many cases. Another area where some progress has been made is in the reduction of excessive business regulation, for example, by reducing the time and costs required to set up a business.

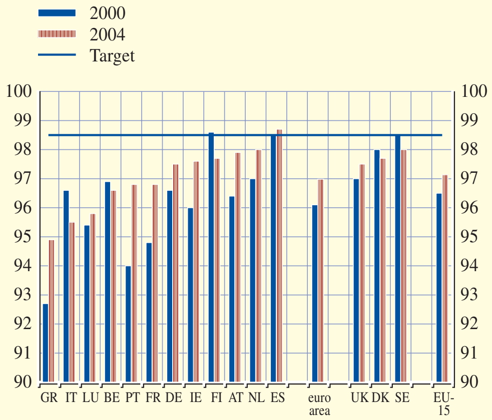
An important area of economic reform relates to the completion of the Internal Market. While considerable progress has been achieved, significant parts of the EU economy are still not integrated. This is partly because Member States have been slow to fully implement all Internal Market legislation and have not yet managed to increase the "transposition rate" (directives that have been transposed into national legislation) to more than 98.5% of all directives, as called for under the Lisbon strategy (see Chart 5).

The field where further progress in the completion of the Internal Market is most needed is the services sector, which accounts for almost 70% of the euro area economy and comprises a relatively large proportion of small and medium-sized enterprises. The services sector represents a significant unexploited potential for growth and employment due, in many cases, to national regulations that hamper the cross-border provision of services. This lack of integration is one of the factors that has prevented further convergence of price levels across countries (see Chart 6).[7]

7 See also the article entitled "Price level convergence and competition in the euro area" in the August 2002 issue of the ECB Monthly Bulletin.

Chart 5 Transposition rate

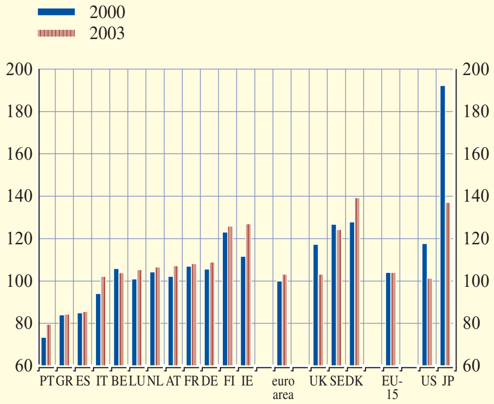
(percentage of Internal Market directives transposed into national legislation)



Source: European Commission.
Note: The data refer to May 2000 and November 2004.

Chart 6 Comparative price levels

(price levels of final consumption by private households including indirect taxes, EU25=100, based on purchasing power parities)



Source: Eurostat.

To sum up, progress has been made on structural reforms in the period since 2000, but its extent has differed widely between countries and policy fields. Some progress has been made regarding the removal of obstacles to employment, the spread of ICT and the liberalisation of network industries. Nevertheless, employment rates remain far too low, productivity growth has been insufficient and significant parts of the EU economy are still not fully integrated. Although structural reforms have been moving in the right direction, they have thus far not been far-reaching enough, and much greater efforts are needed if Europe is to achieve the Lisbon goals.

Box

THE ACADEMIC DEBATE ON THE LISBON STRATEGY

The Lisbon strategy has been at the centre of a lively academic debate. Academic views on the strategy can be broadly divided into two groups. One concentrates on the economic diagnosis underpinning the Lisbon strategy, while the other focuses on the institutional set-up of the strategy and, more generally, the political economy of structural reform.

As regards the first group, some academic observers argue that Europe's economic performance has not been as weak as often described.[1] In particular, they suggest that the higher economic growth rates seen in the United States are associated with a higher level of immigration and that the higher GDP per capita level in the United States is due to the fact that people work on average longer hours in the United States than in Europe. They argue that Europeans choose to work less

1 See, for example, O. Blanchard (2004), "The Economic Future of Europe", Journal of Economic Perspectives, Autumn, vol. 18, No 4, pp. 3-26.

than their US counterparts, which naturally reduces economic growth in Europe. Others, however, have argued that Europeans work less as a result of higher marginal tax rates and tax wedges (the difference between total labour costs for employers and take home pay of employees), generous unemployment benefits, legislation on working time and labour market policies aimed at reducing working time.[2] Although the debate is still ongoing, most academics share the view that Europe is facing a number of major economic challenges that require far-reaching structural reforms.

The second group has focused on the way the Lisbon strategy is organised as an explanation for the disappointing progress on structural reforms in the past five years.[3] Some academics suggest, for example, that its large number of objectives makes it difficult to identify priorities, allowing governments to focus on objectives that are easier to achieve and reducing the incentive to implement more critical reforms. Moreover, it has been argued that some of the objectives may conflict. For example, it may be difficult to simultaneously raise both employment and labour productivity, as there may be a short-term trade-off between an increase in these two variables. In addition, some academics question the fact that the Lisbon targets are identical for all countries, arguing that different countries have different policy needs.

Another aspect of the academic discussion is the question of the extent to which the EU should have a coordinating role in the structural reform process.[4] The principle of subsidiarity suggests that competences should remain with the Member States unless there are good reasons for coordination. It has been argued that a valid reason for coordination by the EU is the cross-border impact of structural reform measures. Some have suggested that the size of the impact may depend on the policy area, with labour market measures having less of a cross-border impact than changes in product markets. In addition, it has been argued that the large number of actors and processes involved make it difficult to ensure that the various pillars of the strategy are properly coordinated.

Finally, the political economy literature investigates the reasons why governments insufficiently introduce structural reforms, despite the macroeconomic benefits they will bring.[5] An important strand of this literature stresses the role of interest groups, which may lobby against a reform measure that will harm their interests. Such a lobby may be able to affect policy decisions, particularly if the interest group is well organised and able to voice its concerns effectively. Resistance to structural reforms may also arise if their economic effects and their distribution are initially uncertain. This resistance may be particularly strong if the costs of the reform measure arise in the short term and the benefits only in the longer term. Some have therefore stressed the importance of public awareness of the benefits of structural reforms, suggesting that it is crucial to convince the public that structural reforms are needed.

2 On the role of institutions for labour markets outcomes, see, for example, S. Nickell, L. Nunziata and W. Ochel (2005), "Unemployment in the OECD since the 1960s. What do we know?", Economic Journal, January, vol. 115, No 500, pp. 1-27.

3 See, for example, A. Alesina and R. Perotti (2004), "The European Union: A politically incorrect view", Journal of Economic Perspectives, Autumn, vol. 18, No 4, pp. 27-48.

4 See, for example, G. Tabellini and C. Wyplosz (2004), "Supply-Side Policy Coordination in the European Union", Report prepared for the Conseil de l'Activité Economique.

5 See, for example, D. Rodrik (1996), "Understanding Economic Policy Reform", Journal of Economic Literature, March, vol. 34, No 1.

5 THE MID-TERM REVIEW

At its spring meeting in March 2004, the European Council decided to initiate a mid-term review of the Lisbon strategy in view of the mixed results obtained in the first five years. It felt that, while the goals of the strategy remained valid, the pace of reform needed to be stepped up significantly, especially since the challenges facing the EU had become even greater. As a first step in the mid-term review, the Heads of State or Government invited the Commission to establish a High Level Group headed by Wim Kok to carry out an independent assessment in order to identify the weaknesses of the strategy and its governance framework. The establishment and composition of the "Kok Group" reflected the intention to draw on the views of the different stakeholders. The Group submitted its report to the Commission in November 2004 and, on that basis, in February 2005 the Commission produced its proposals for making the Lisbon strategy sharper in focus and its governance framework more coherent. Following preparations by the EU Council, the Brussels European Council brought the mid-term review to a close on 22 and 23 March 2005. In its conclusions, the European Council welcomed the proposals of the Commission and relaunched the Lisbon strategy by refocusing its priorities on economic growth and employment, while acknowledging the continuing relevance of the social and environmental pillars. A number of changes were also introduced to the governance framework of the strategy.

IMPLICATIONS FOR ECONOMIC REFORM

As regards economic reform, the spring 2005 European Council took the view that, given the mixed results of the strategy, urgent action is required. Four main policy areas were identified in order to refocus the strategy: promoting knowledge and innovation, making the EU an attractive area to invest and work in, fostering growth and employment based on social cohesion, and promoting sustainable development.

While not recalling all targets of the Lisbon agenda, the European Council reiterated, in particular, the target of investing 3% of GDP in R&D. In addition, the Council called for specific intermediate R&D targets to be set at the national level. The conclusions also put forward a number of additional detailed policy options (including tax incentives for private investment in R&D) to promote knowledge, innovation and investment in human capital. Moreover, they recalled the importance of the completion of the Internal Market and of making the regulatory environment more business-friendly. In this respect, the conclusions called for the draft Directive on Services in the Internal Market to be modified in the legislative process so as to ensure a fully operational Internal Market for services, while at the same time preserving the European social model. Although many specific policy measures mentioned in the conclusions have existed for some time but have not yet been fully implemented, the conclusions also contain some new policy initiatives. These include the adoption of a European Youth Pact to "improve the education, training, mobility, vocational integration and social inclusion of young Europeans" and the call for an "active industrial policy" to strengthen the competitive advantages of Europe's industrial base.

IMPLICATIONS FOR THE GOVERNANCE FRAMEWORK

In addition to refocusing the content of the strategy, the spring 2005 European Council recognised that changes in the governance framework were necessary in order to improve the delivery of structural reform. It was considered necessary to facilitate the identification of policy priorities, improve the implementation of these priorities by increasing Member States' involvement and streamline the monitoring procedure so as to provide a clearer picture of the implementation of the strategy. The mid-term review thus resulted in a modified governance framework aimed at streamlining policy coordination processes over time, across policy areas and between the EU and the national level. This new governance framework is also aimed at increasing the consistency of national programming, reporting and assessment.

At the core of the new framework are the Integrated Guidelines, which bring together the BEPGs and EGs. The incorporation of the two sets of guidelines into a single package aims at improving consistency between economic and employment policies. Moreover, as the Integrated Guidelines are adopted for a period of three years, consistency over time is also enhanced. The three-year policy cycle will begin with the EU Council's adoption in summer 2005 of the package of Integrated Guidelines for the period from 2005 to 2008. The Integrated Guidelines will be adjusted each year, if necessary, in line with the provisions of the Treaty establishing the European Community (Articles 99 and 128). Within the Integrated Guidelines, the BEPGs continue to cover the whole range of macroeconomic and microeconomic policies, as well as employment policy, insofar as this interacts with those policies. In addition, the BEPGs seek to ensure the general consistency of the economic, social and environmental strands of the Lisbon strategy.

In line with the priorities of the Integrated Guidelines, Member States are now required to submit national reform programmes which consist of policy commitments under the Lisbon strategy. These programmes will be drawn up for the first time in autumn 2005. As a counterpart to the national programmes, the Commission will present a Community Lisbon Programme covering all action to be undertaken at the Community level, which is to be endorsed by the European Parliament and the EU Council. Both the national reform programmes and the Community Lisbon Programme will remain valid until 2008, although they may be adjusted as appropriate in the intervening years.

This novel approach of integrated policy-setting will be accompanied by unified national reporting on the progress made in implementing the national reform programmes. Each Member State is to provide a report every autumn in the form of a single document covering the whole range of policy actions undertaken in the preceding year. This will bring together the former national reports on employment, reports on structural reforms in product and capital markets (Cardiff reports) and the reporting with respect to the OMC in certain policy areas (e.g. research and development).

At the EU level, the assessment of overall progress will also be carried out in a more integrated manner. Progress will be monitored and assessed annually in line with the multilateral surveillance processes envisaged in the Treaty for the BEPGs and the EGs. The Commission fulfils its role in the assessment of progress by reporting to the European Council by way of an annual EU progress report. In order to streamline assessment, this progress report is to incorporate the BEPG Implementation Report and the Joint Employment Report provided for under Articles 99 and 128, respectively, of the Treaty. On the basis of this progress report, the spring European Council will decide on any necessary adjustments to the Integrated Guidelines for the following year.

The strategic direction of the Lisbon strategy will be reassessed in its entirety every three years. Therefore, in 2008 a new three-year cycle will begin by way of a strategic report by the Commission which will be examined by the relevant Council configurations and discussed at the spring European Council meeting. The spring meetings of the Heads of State or Government will continue to provide direction and impetus to the Lisbon strategy by establishing political orientations for its three strands.

One of the main features of this new governance framework is its emphasis on increasing national ownership of the Lisbon strategy. This is seen as key to the implementation of the strategy, as the design of structural reforms and, even more so, their implementation, are the prerogative of the Member States. Therefore, Member States need to be fully committed to the policies they endorse at the EU level and must consult the stakeholders, such as national parliaments and social partners, that are involved in drawing up and implementing these policies at the national level. This should, in turn, improve the implementation records of the Member States.

The main modification to the governance framework aimed at increasing national ownership is the adoption of national reform programmes. These provide Member States with the opportunity to reaffirm their policy commitments on the basis of the Integrated Guidelines for 2005-08, gearing their policies to their particular needs and situation. The possibility is left open to Member States to include in the national reform programmes timetables and roadmaps for implementing the concrete measures that they announce. Having a single national programme for structural reforms requires Member States to be consistent in their pronouncements for the various policy areas. In this context, Member States have also been invited to appoint a Lisbon national coordinator to further enhance the internal coordination of actions related to the strategy.

The streamlining of policy-setting and reporting under the new governance framework should help to improve consistency between policy-makers' views and goals and make the assessment of progress on structural reform more effective at the EU level. An important aspect of this assessment is benchmarking. In this regard, the recommendation of the Kok High Level Group was to continue using benchmarking, but in a more effective way, concentrating on a limited number of indicators in the form of EU league tables in order to challenge Member States to improve their implementation record. Against this background, and while emphasising national ownership, the Commission announced its intention to continue assessing the progress of Member States through the use of benchmarking, among other things.[8] Such practice does indeed appear useful in focusing attention on the challenges at the national level. It should also help to ensure that there is appropriate follow-up at the EU level to the commitments made by Member States in their national reform programmes.

6 THE ECB AND THE LISBON STRATEGY

The ECB welcomes and supports the impetus given by the Lisbon European Council to the economic reform process. Well designed structural reforms in product, labour and financial markets, as envisaged by the Lisbon strategy, will increase the flexibility of the euro area economy, enhance its resilience to economic shocks and ultimately result in a higher, sustainable long-term growth rate and a higher level of employment.

There is a two-way interaction between monetary policy and structural reforms. On the one hand, by ensuring price stability, monetary policy contributes to a stable macroeconomic environment, thereby supporting the implementation of structural reform. On the other hand, structural reform improves the flexibility of the economy and the prospects for non-inflationary economic growth, thus facilitating the conduct of the single monetary policy and enhancing its effectiveness.

Through monetary policy, the ECB provides an important contribution to the achievement of the Lisbon goals. By maintaining price stability over the medium term, monetary policy makes the best contribution it can to achieving sustainable non-inflationary growth and a high level of employment. Price stability has a direct bearing on growth and employment in that it reduces risk premia on interest rates, thereby supporting investment. In addition, a stable macroeconomic environment may facilitate the implementation of structural

8 "Working together for growth and jobs – A new start for the Lisbon strategy", European Commission communication, COM (2005) 24, p. 15.

reforms from the political decision-making point of view. Indeed, macroeconomic stability should help economic agents to focus more on the long-term benefits associated with the implementation of structural reforms, rather than on possible short-term costs.

Conversely, structural reforms facilitate the conduct of the single monetary policy. An enhanced adjustment capacity of markets is likely to result in a more rapid adjustment of the economy to shocks, which should dampen their effects on the business cycle. Indeed, structural reforms go hand in hand with enhanced price and wage flexibility and greater mobility of production factors, which are prerequisites for the smooth functioning of the single monetary policy for the euro area. As a consequence, structural reforms lower the risk that price shocks may have long-lasting effects on inflation. This, in turn, facilitates the task of the single monetary policy.

7 CONCLUSION

Five years on, the overall picture of the Lisbon strategy is mixed. Progress has been made in some areas but, all in all, the reforms undertaken have not been far-reaching enough. Greater efforts are needed to achieve the Lisbon goals and face up to the challenges of globalisation, technological change and an ageing population.

The mid-term review has set the scene for a welcome revitalisation of the strategy. With a streamlined governance framework and a newly refocused Lisbon agenda on growth and employment, the European Union has a good blueprint for unlocking the EU's growth and employment potential. Attention should now shift towards implementing it.

Ultimately, the success of the mid-term review largely depends on the determination with which the Member States implement the necessary reforms. By implementing the Lisbon agenda with a high degree of commitment, the Member States can set in motion a virtuous cycle of reforms. Convincing the public about the need for structural reforms is a major challenge. Appropriate communication is therefore of the essence. It is crucial for both consumer and business confidence that the public at large has a clear understanding of the long-term benefits structural reforms will bring to the economy as a whole.

The streamlined governance framework should allow the European Union to set priorities and facilitate delivery through peer pressure and benchmarking. Moreover, the EU should do its utmost in areas where it can contribute directly to the success of the Lisbon strategy, such as the completion of the Internal Market.

The ECB fully subscribes to the ambitions of the renewed Lisbon strategy and supports the efforts undertaken in that context by governments, parliaments and social partners. It will continue to contribute to the success of the Lisbon strategy by pursuing a stability-oriented monetary policy and by informing citizens of the benefits of structural reforms. A forceful implementation of the Lisbon agenda is a prerequisite for fully exploiting the advantages of the single monetary policy for the euro area.