



# **ZEW-AEI Conference**

## **Economic growth in Europe Mannheim, 23 February 2005**

### **Economic Growth in Europe: Pursuing the Lisbon Strategy**

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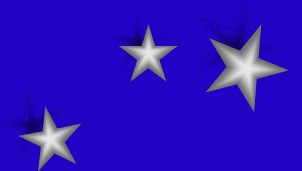




# The Lisbon Strategy

## Overview of the presentation

1. Why the Lisbon Strategy?
2. What is the Lisbon Strategy?
3. Assessment of progress
4. The mid-term review and the “New” Lisbon Strategy
5. Challenges and open issues





# The Lisbon Strategy

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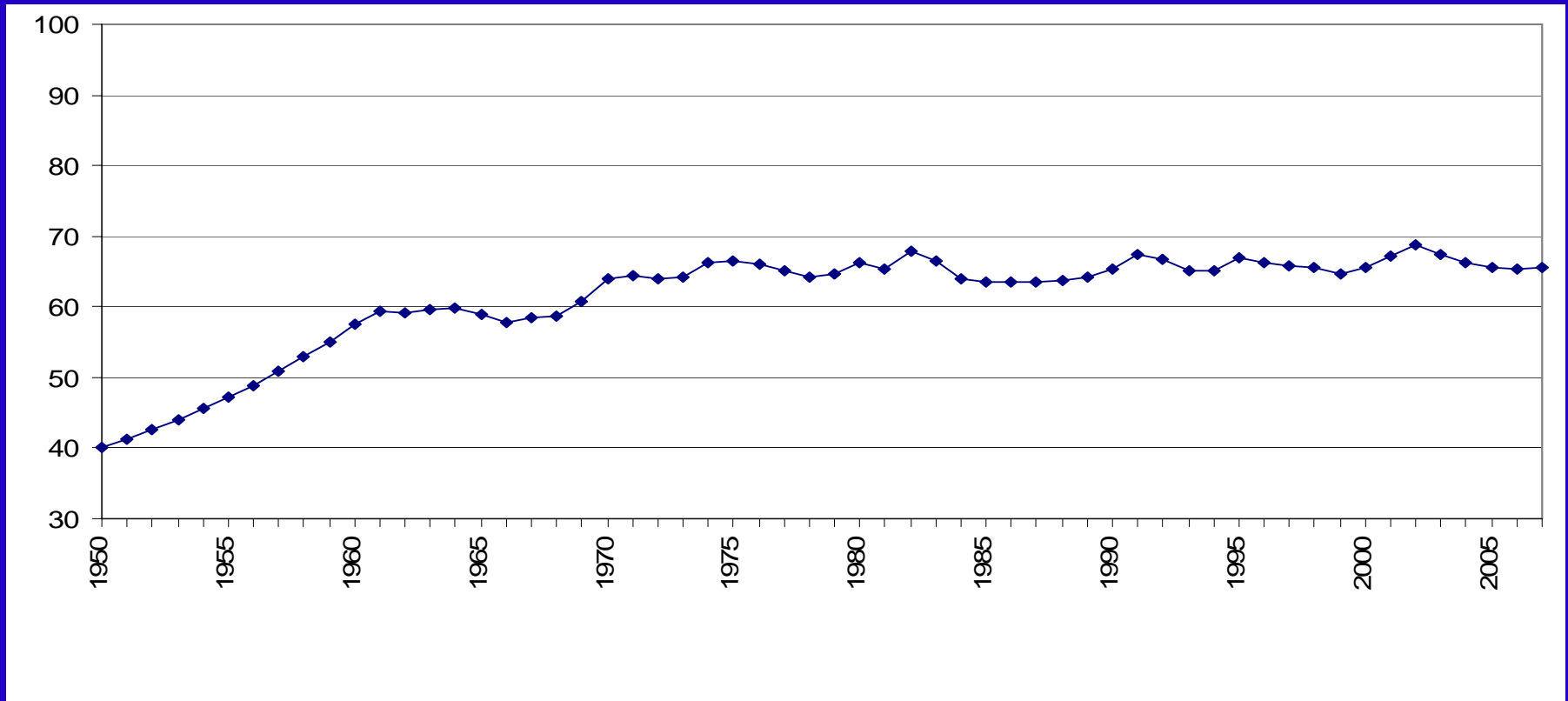
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# Why the Lisbon strategy?

EU 25 GDP per capita in PPS (US = 100)



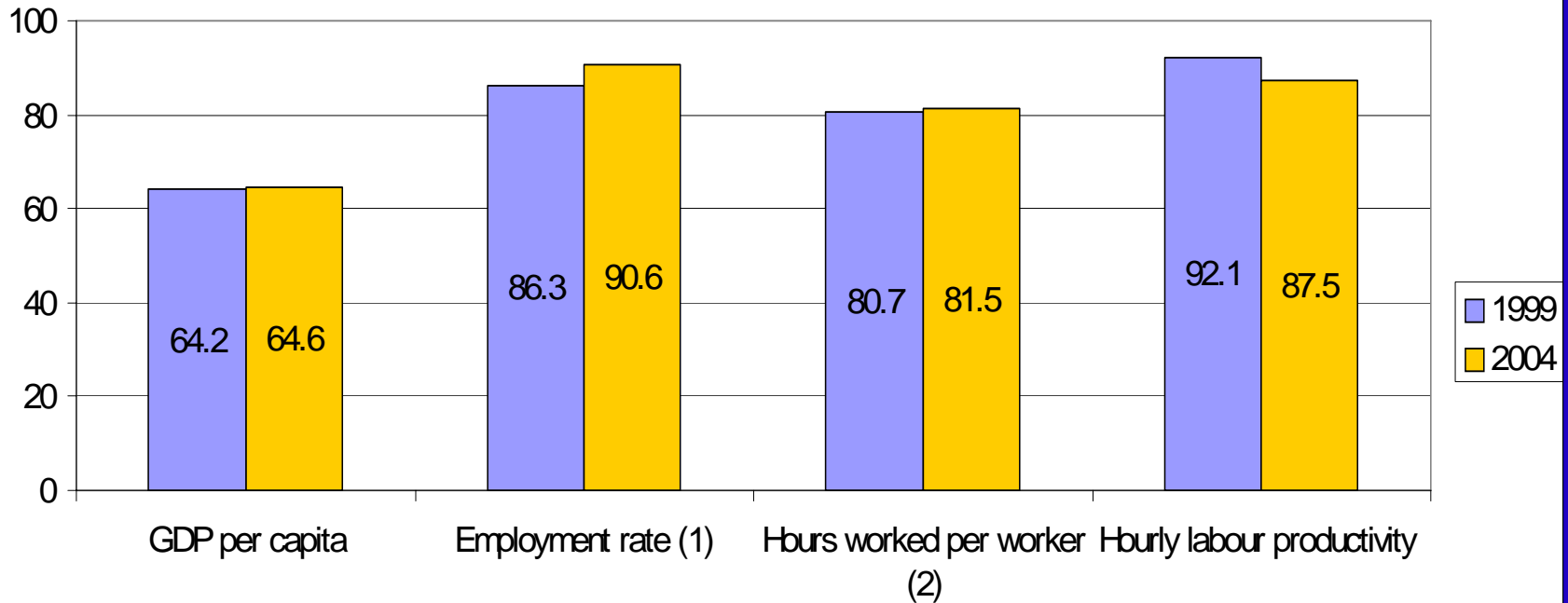
Annual % change of real GDP per capita	EU 25	US
1961-1980	3,3	2,5
1981-1990	2,1	2,2
1991-1995	1,2	1,2
1996-2000	2,5	2,9
2001-2006	1,5	1,7

Source: Ameco (2005-2006 forecasts ; Eu 15 data before 1995)



# Lisbon : Sources of poor growth

European Union performance 1999-2004 (US=100) (3)



1) Calculated - Employment rate =  $100 * (\text{GDP per capita} / \text{Labour productivity per person employed})$

2) Calculated - Hours worked per worker =  $100 * (\text{Labour productivity per person employed} / \text{Hourly labour productivity})$

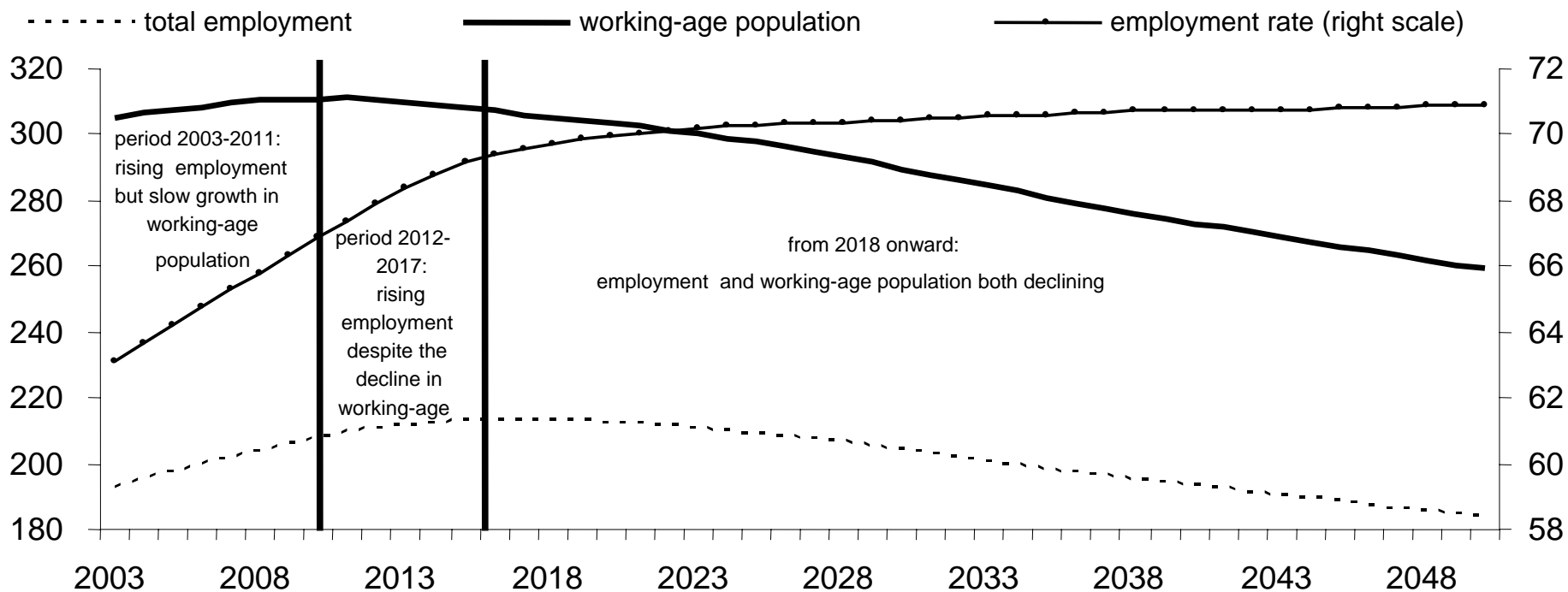
3) 2004: forecasts, Eu15 values for Hours worked per worker

Source: Commission services.



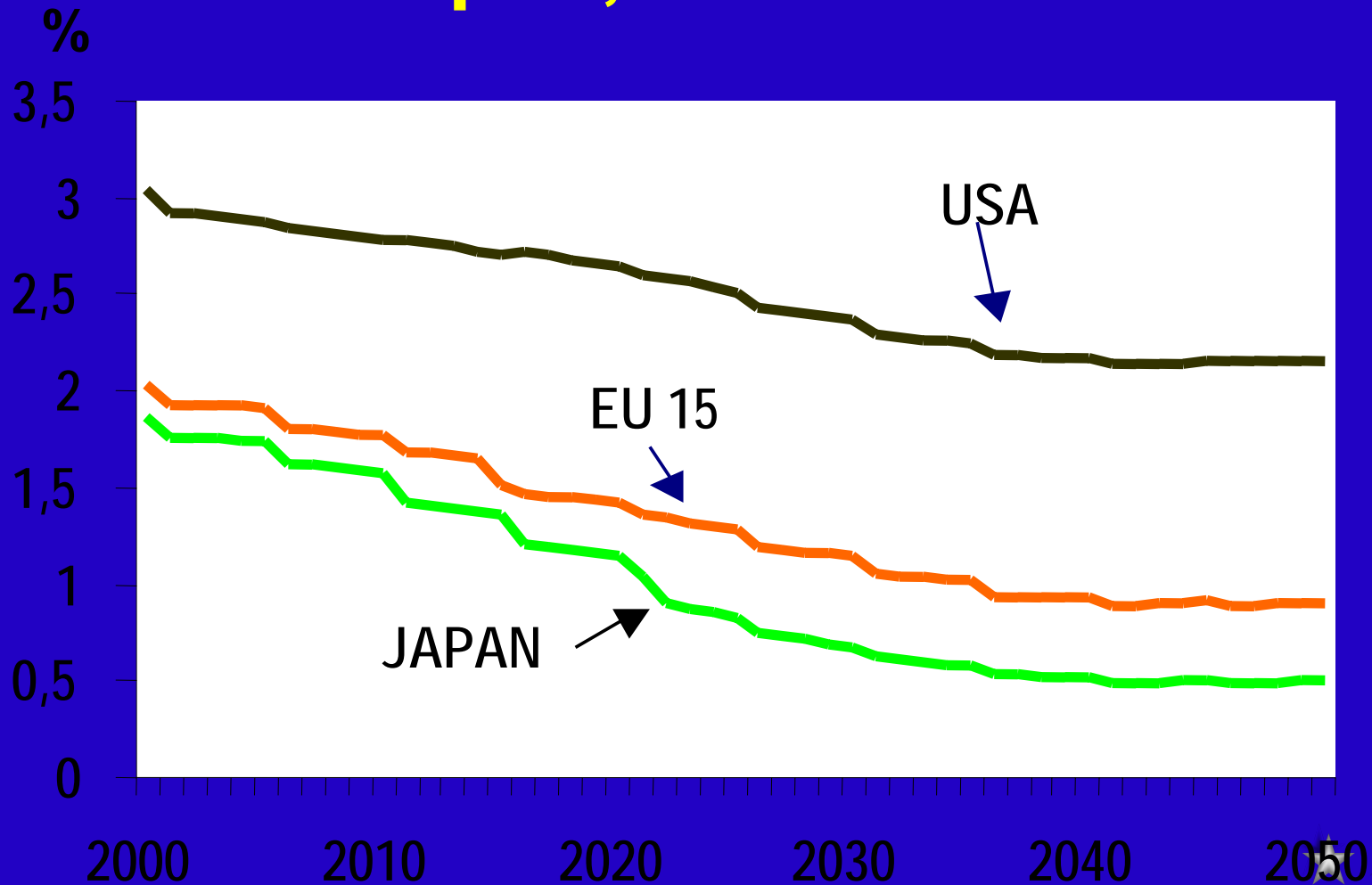
# Despite rising employment rates, employment levels eventually fall

Projected working - age population and total employment, EU25



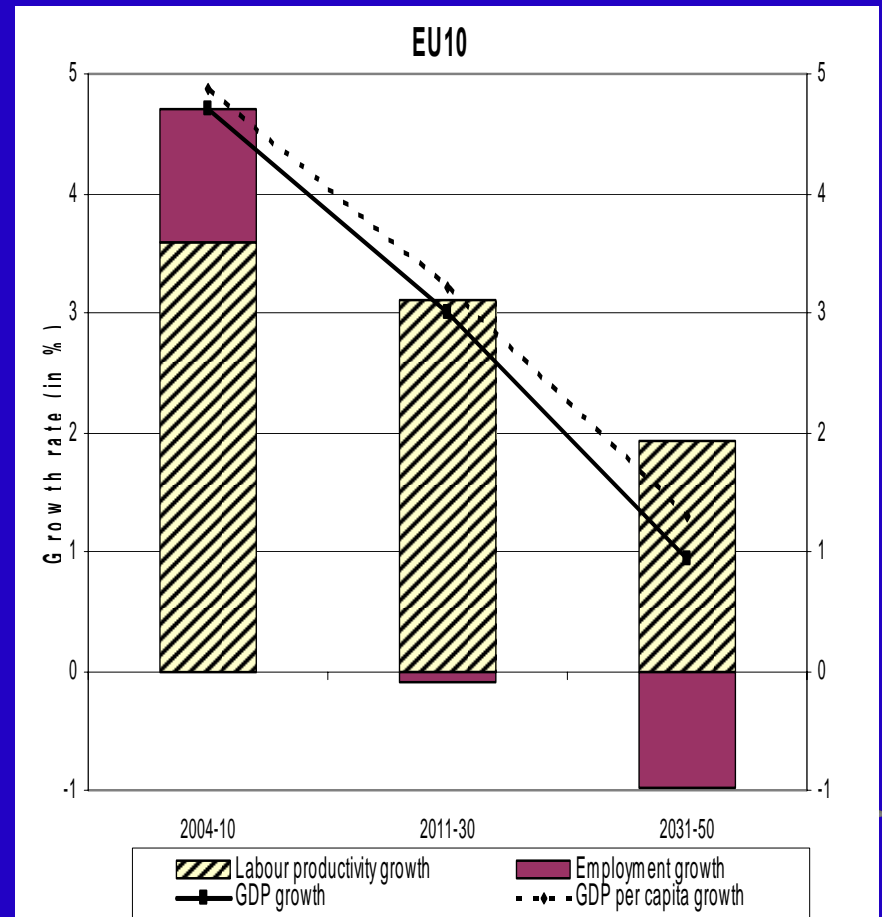
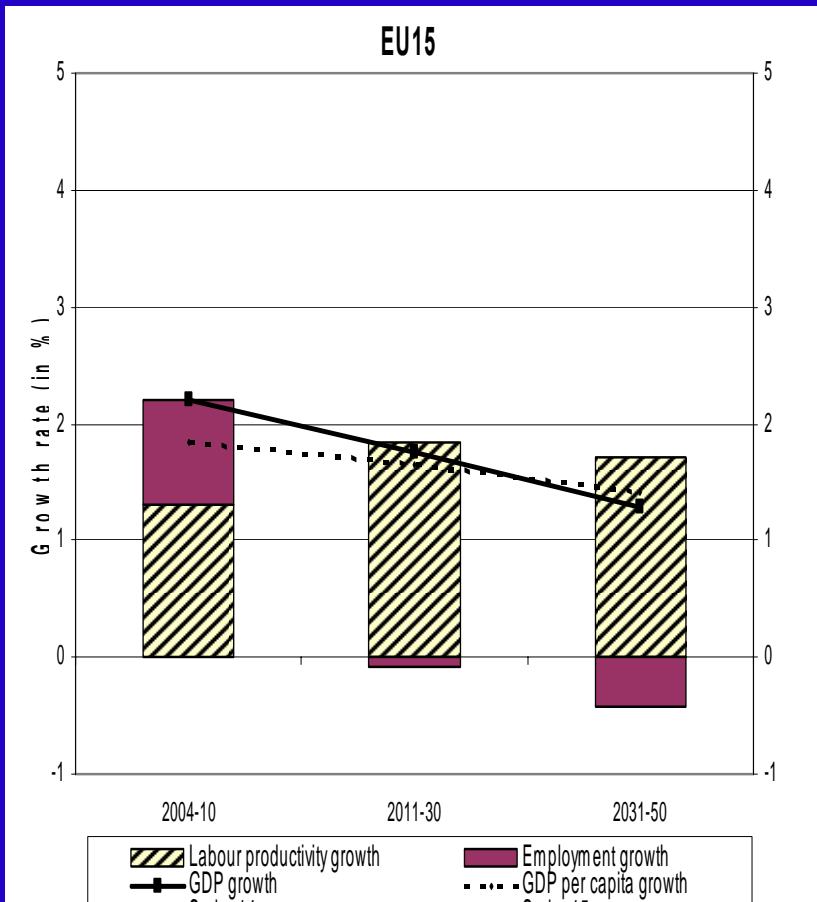


# Potential growth in EU, US and Japan, 2000 - 2050





# Productivity: Increasingly important source of growth

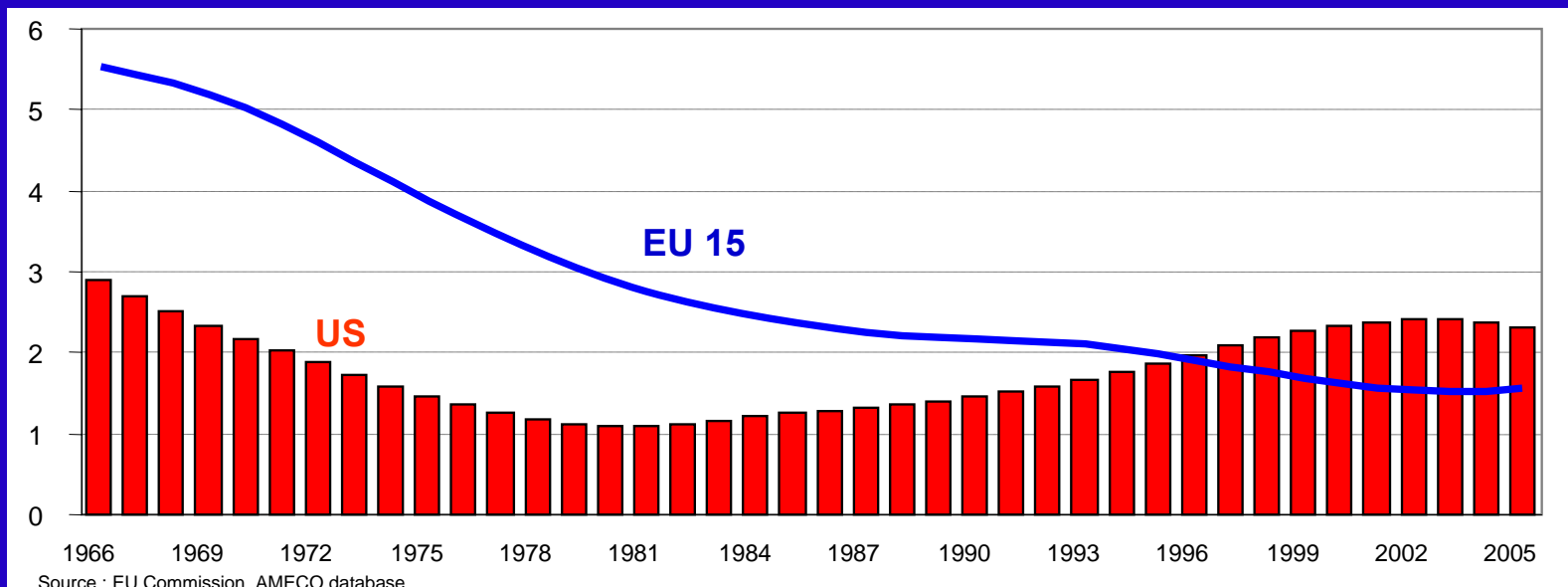






# However, there is a decline in productivity growth

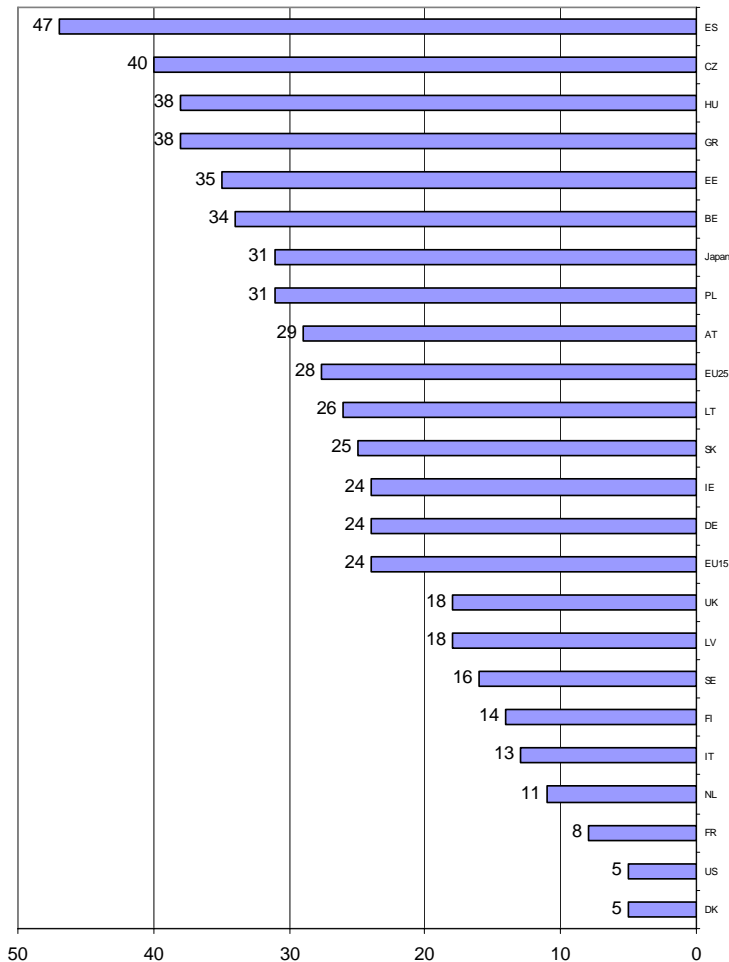
Average % change previous year	Labour productivity per hour		Total hours worked		GDP	
	EU 15	US	EU 15	US	EU 15	US
<b>1966-1970</b>	5.3	2.5	-0.8	1.4	4.5	3.9
<b>1971-1980</b>	3.8	1.5	-0.8	1.5	3.0	3.0
<b>1981-1990</b>	2.4	1.3	-0.1	1.8	2.3	3.1
<b>1991-1995</b>	2.1	1.7	0.1	1.4	2.2	3.1
<b>1996-2000</b>	1.8	2.2	0.4	1.1	2.2	3.3
<b>2001-2005</b>	1.6	2.4	0.5	0.8	2.1	3.2





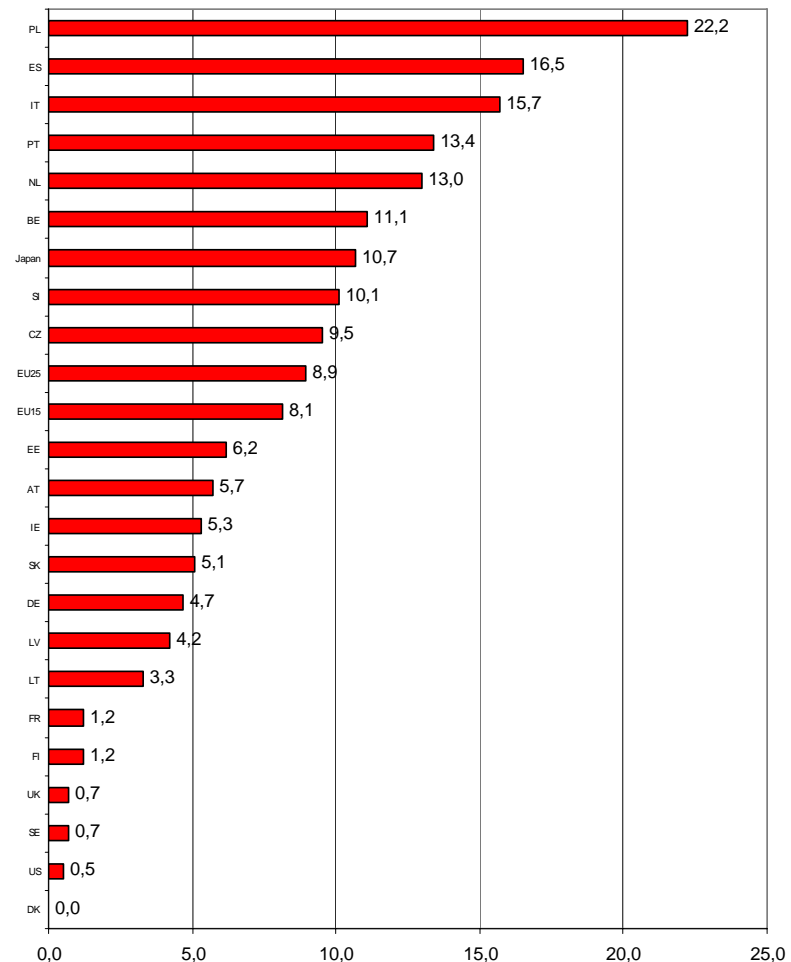
# Typical time and cost required for setting up a company 2005

Time to start a business (days)



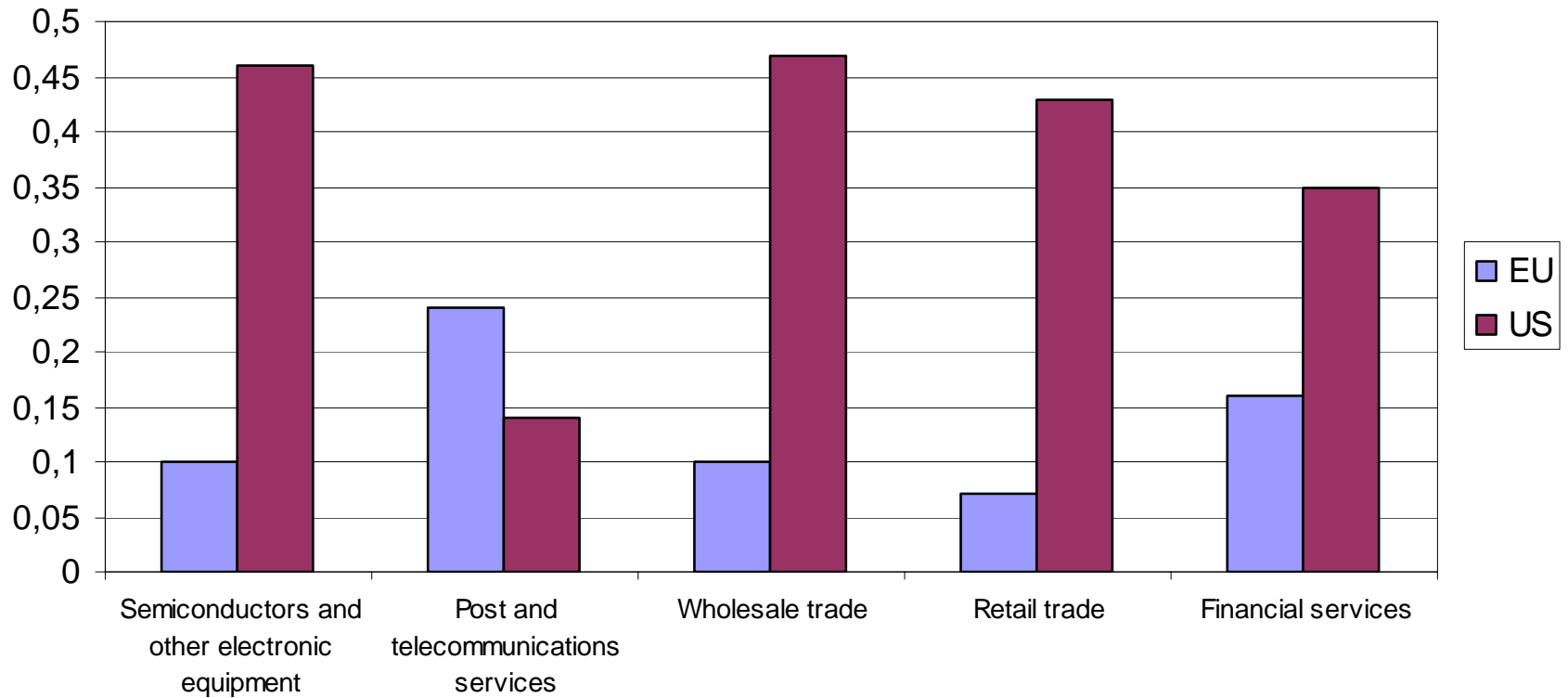
Source: World Bank

Cost to start a business (% of GNI per capita)



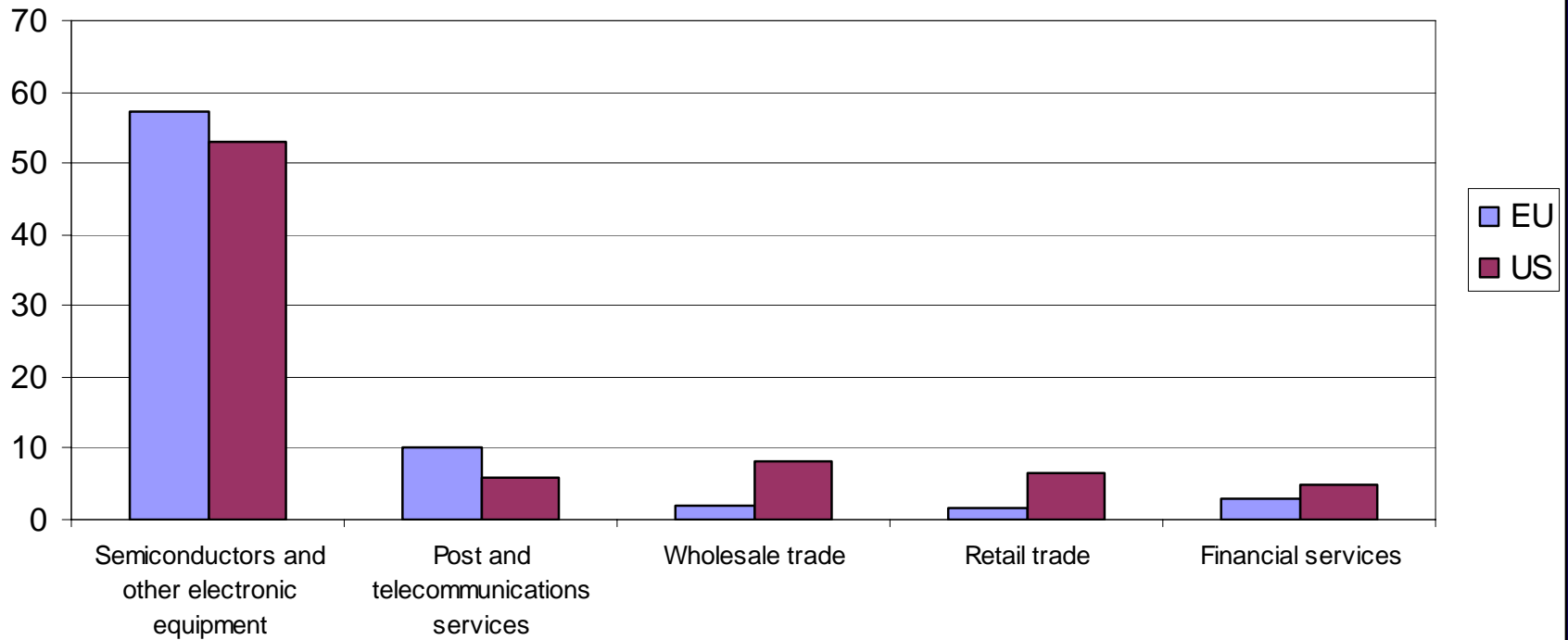


Contribution to total productivity growth (96-2000)



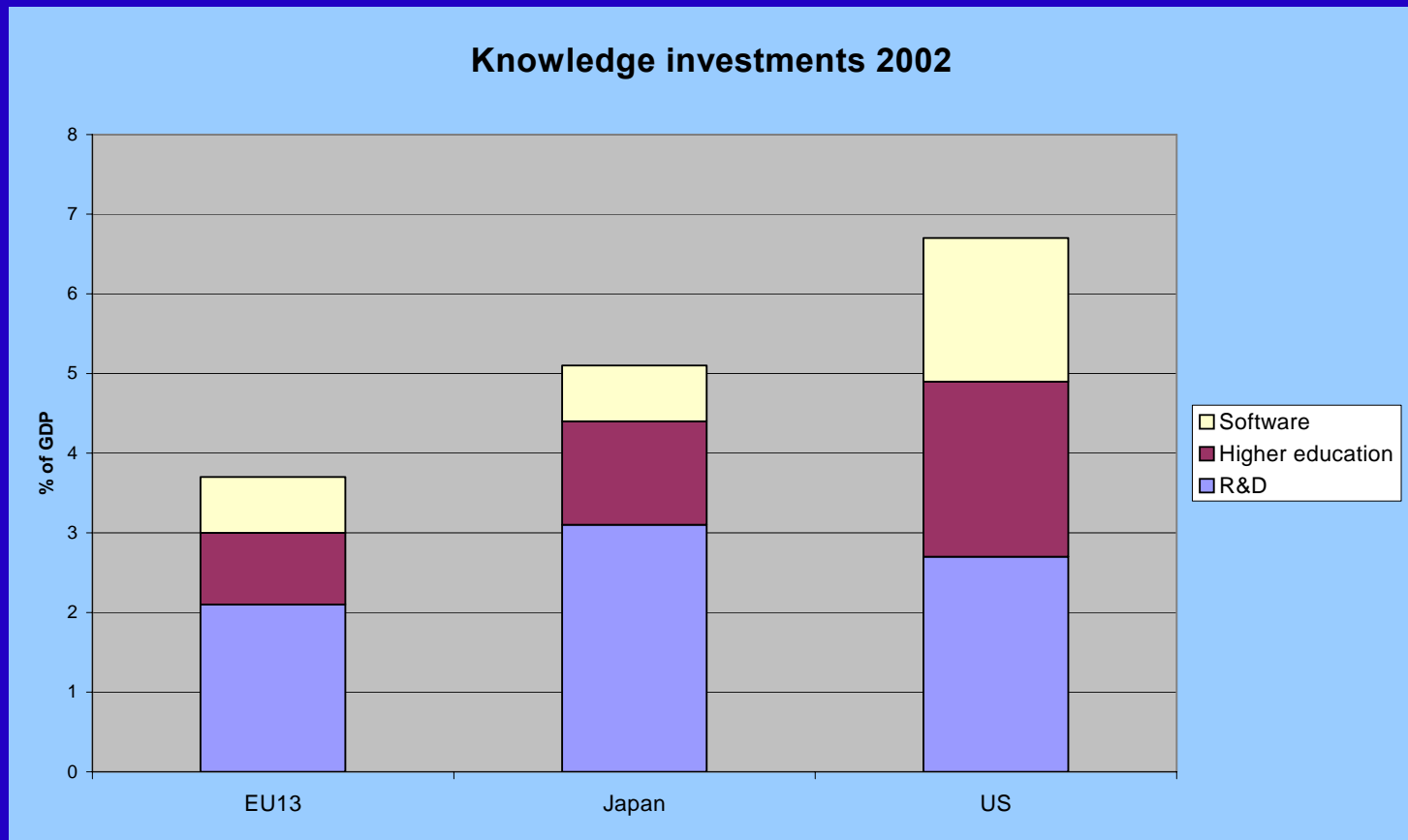


Hourly labour productivity growth rate (av annual growth rate % - 96-2000)





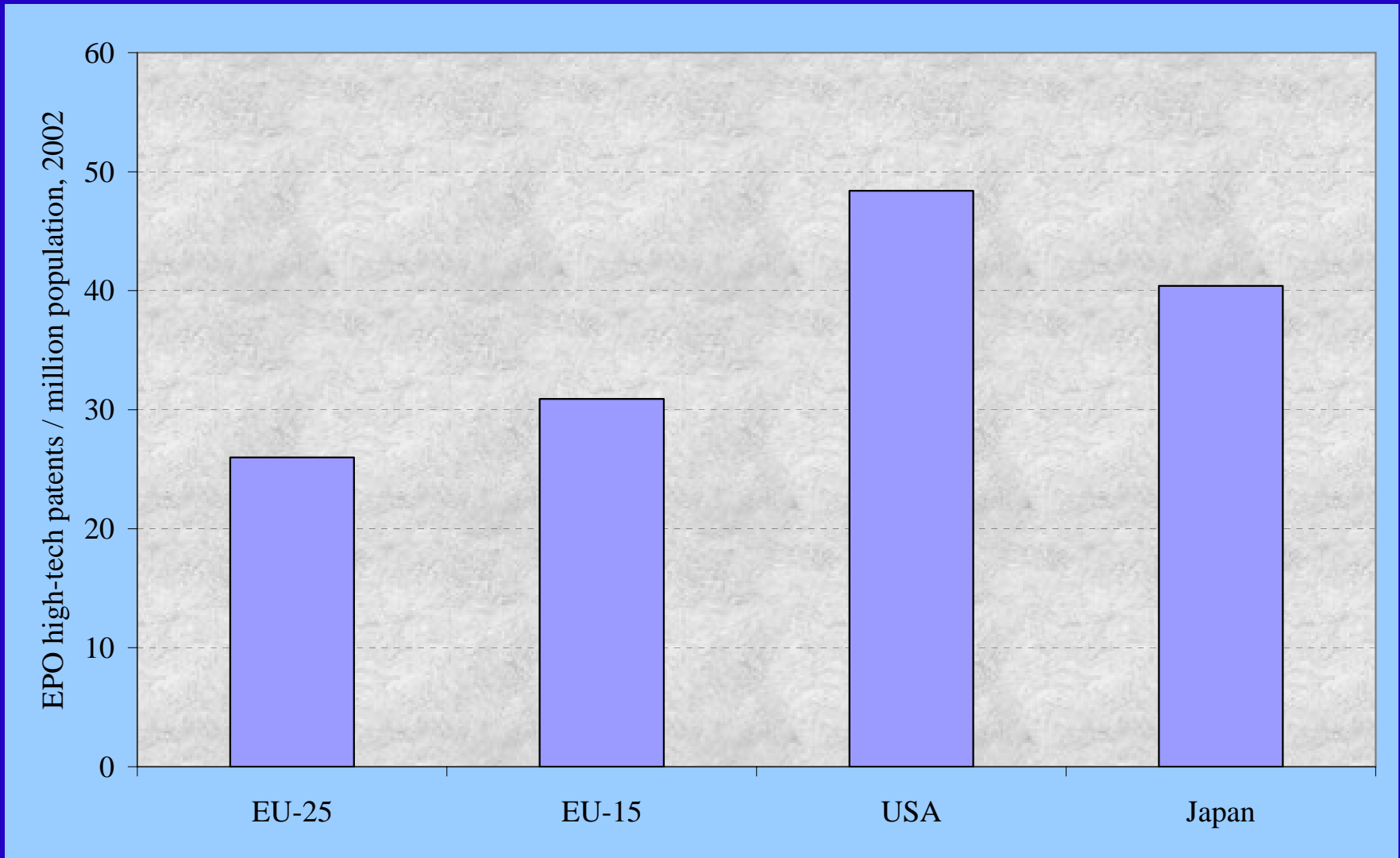
# EU invests less in knowledge...



Source: OECD



# EU has fewer high tech patents...



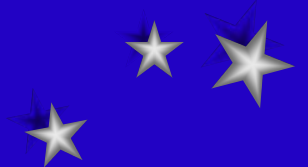
Source: Eurostat.



# **Productivity :**

## **Causes of the decline in growth**

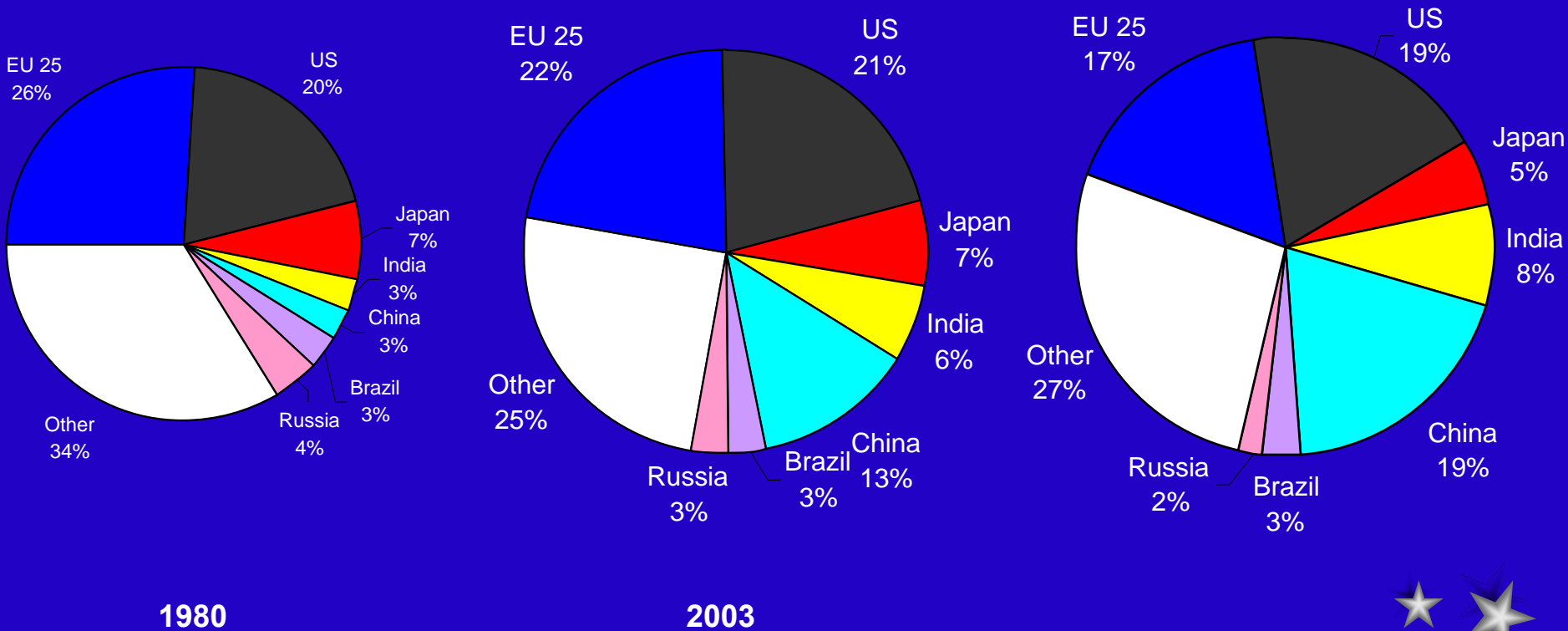
- Inappropriate business environment: too high business set-up costs**
- A more limited use of ICT in services**
- Difficulty to reorient its industrial specialisation towards high-tech industries**
- Insufficient investments in knowledge**
- Lower capacity of innovation**





# Globalisation

Shifting Shares in global output, 1980-2015  
in purchasing power parity terms



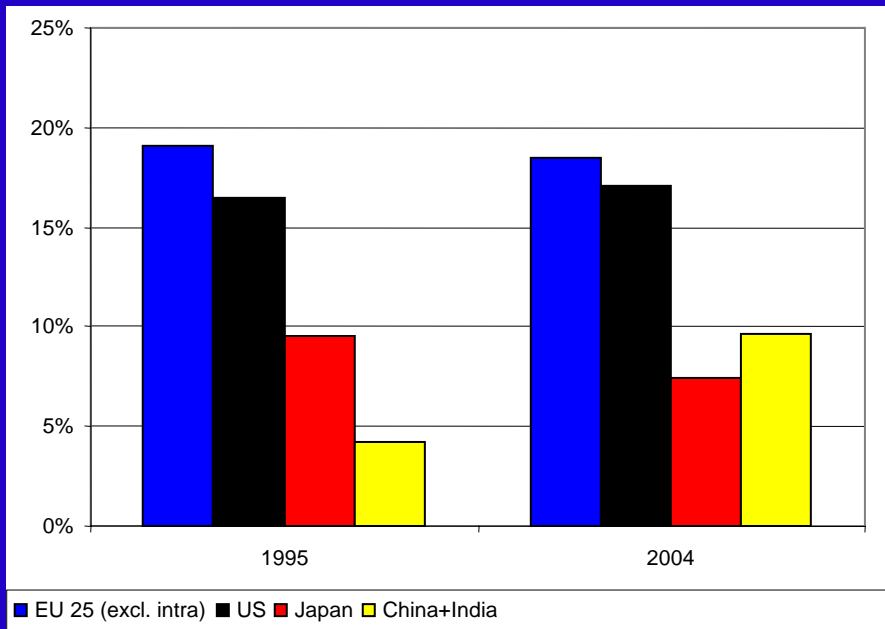
Note: Areas indicate size of global economy  
Source: IMF, Consensus Forecast, HM Treasury







# Shares in world trade in goods (excl. Intra-EU-25 trade)



	1995	2004
EU 25 (excl. intra)	19.1%	18.5%
US	16.5%	17.1%
Japan	9.5%	7.4%
China	3.4%	8.4%
India	0.8%	1.2%

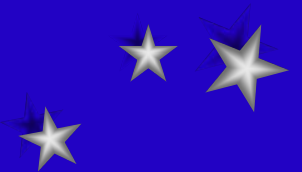
Source: WTO statistical database and IMF (DOTS)





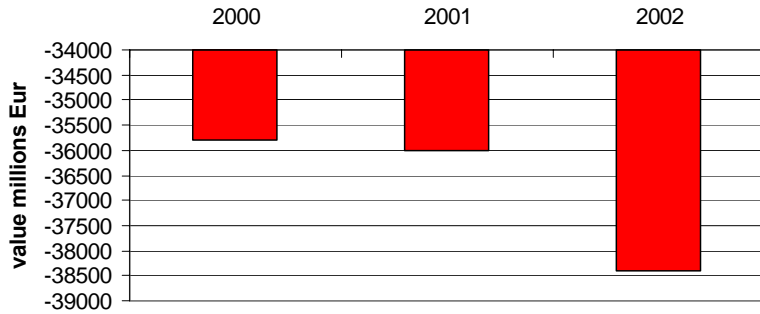
# Globalisation : Intensification of international competition

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

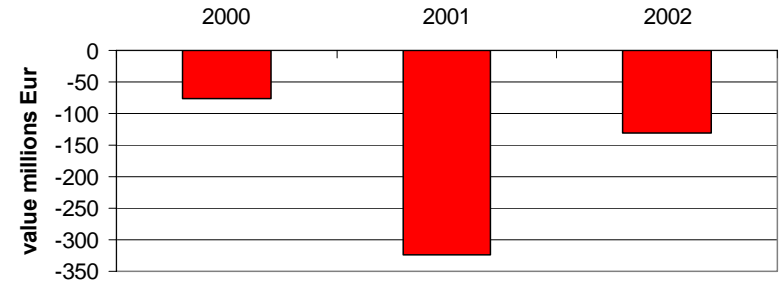




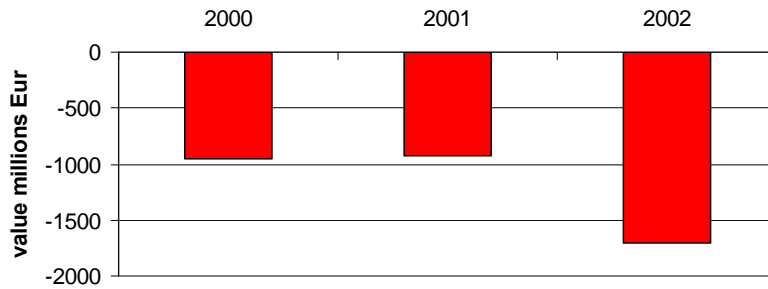
Trade in goods with China (net flow)



Trade in Computer and information services with India (net flow)



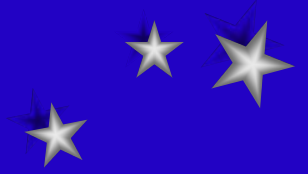
Trade in Research and development services with the US (net flow)



Trade in Computer services with the US (net flow)



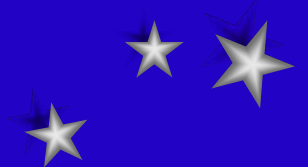
Source: Eurostat





# Why the Lisbon Strategy?

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

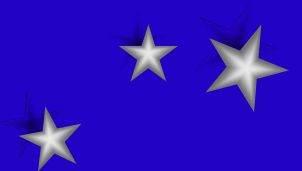




# The Lisbon strategy

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# Lisbon reforms

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

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

**Lisbon is a comprehensive strategy of economic, social  
and environmental reforms aimed at:**

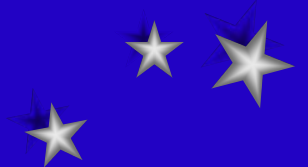
- 1. Increasing the EU's growth potential**
- 2. Maintaining the European Social Model**
- 3. Ensuring environmental sustainability**

**Since the 2005 Mid-Term Review increased focus on  
growth and jobs, but need to consider trade-offs and  
maximise synergies between different objectives**



# Economic impact of structural reforms

- **Labour market reforms**
  - ⇒ higher employment rates
- **Product market reforms**
  - ⇒ increased productivity and lower prices
- **Reforms encouraging investment in knowledge and innovation**
  - ⇒ positive impact on productivity growth
- **Capital market reforms**
  - ⇒ lower cost of capital and better access to finance



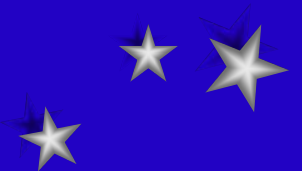


# Product market reforms

**Product market reforms = Changes in product market regulation**

**Product market reforms include measures that :**

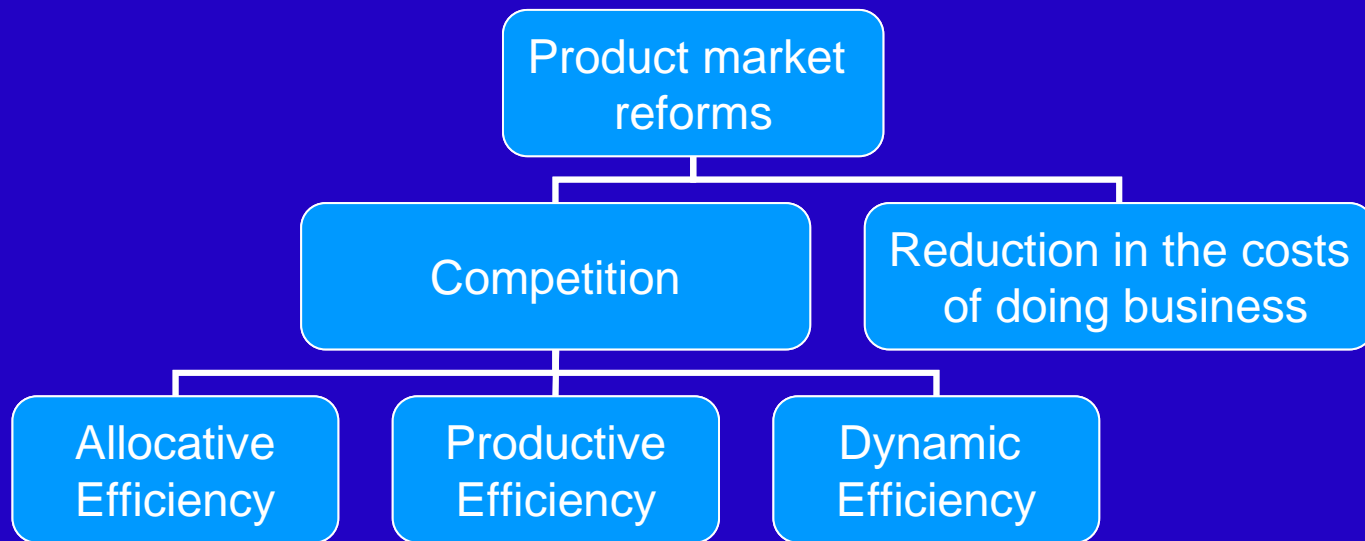
- **Open up product markets from competition from abroad (IMP)**
- **Open up product markets to new entrants (liberalisation of network industries)**
- **Create a more business friendly environment (reduction in time and costs to set up a new business)**
- **Reduce state involvement in the economy (reduction in state aids)**





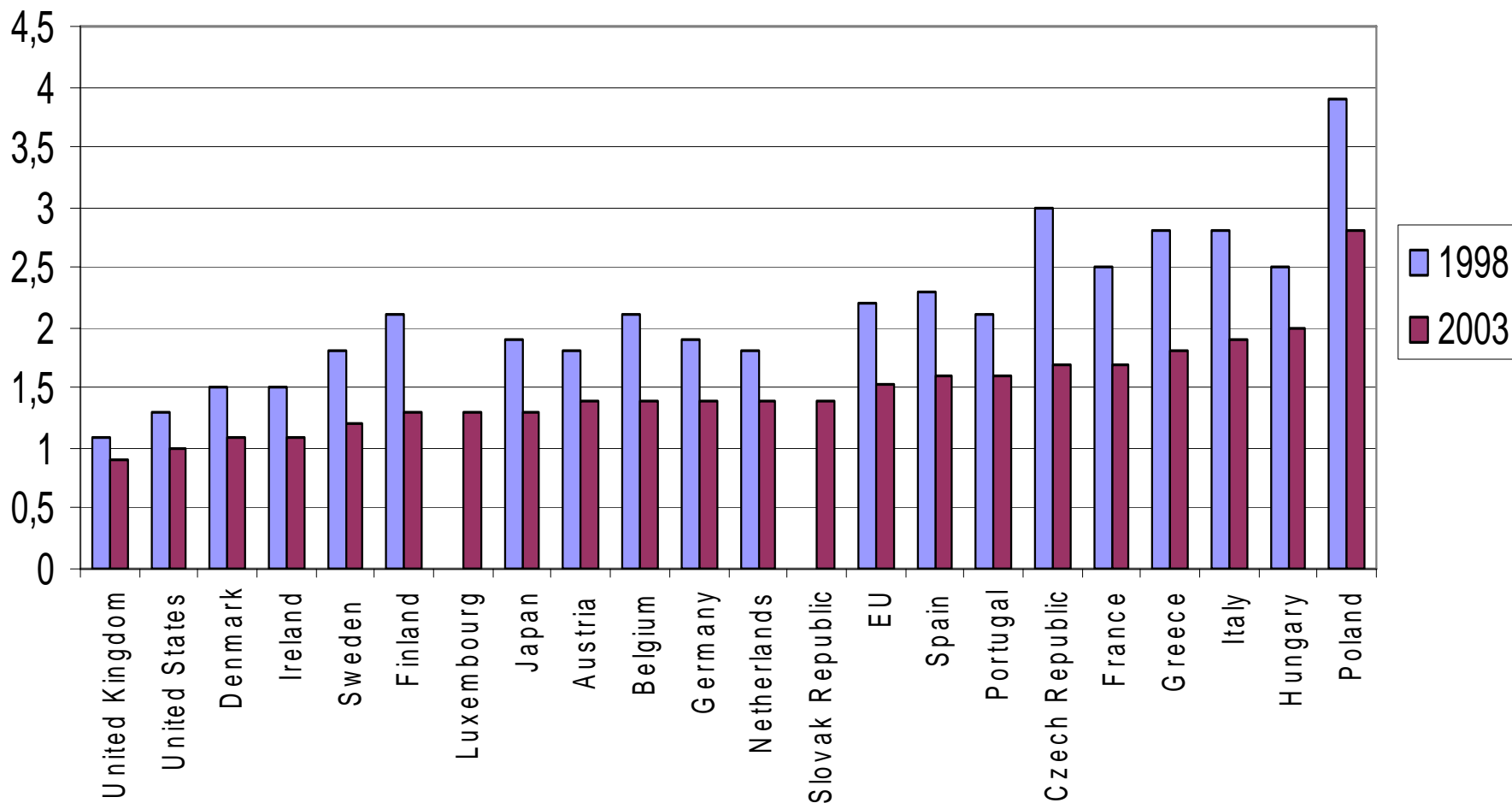


# Product market reforms





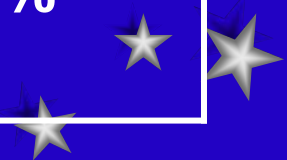
# Product market regulation





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

<b>Evolution of labour productivity per hour worked (average growth rate 1996-2003)</b>			
	<b>Transport/ Communications</b>	<b>Wholesale and retail trade; restaurants and hotels</b>	<b>Total business services</b>
<b>EU-12</b>	<b>4.9%</b>	<b>0.7%</b>	<b>1.1%</b>
<b>US</b>	<b>3.2%</b>	<b>5.1%</b>	<b>3.0%</b>





## The costs of “non-Lisbon”

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

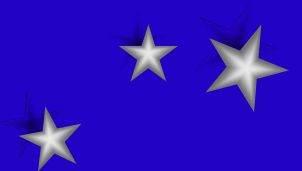




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# Progress of Member States on the measurable targets of the Lisbon Strategy (Jan. 2005)

Lisbon Strategy	Target	Target year	EU-15 target achieved	EU-25 target achieved
<b>Employment</b>				
Total employment rate	70%	2010	7	8
Female employment rate	60%	2010	7	8
Empl. rate of older workers	5%	2010	4	6
↗ in average effective retirement age	By 5 years to EU average 65	2010	0	0
Childcare facilities for pre-school children over 3	90%	2004	4	n. a.
<b>Research, Innovation, ITC</b>				
R&D%GDP	3%	2010	2	2
Share of business R&D	2/3	2010	3	3
All schools with internet connection	100%	2002	1	n. a.
Internet penetration in households	30%	2002	12	15
E-government : basic services on line	100%	2002	0	n. a.



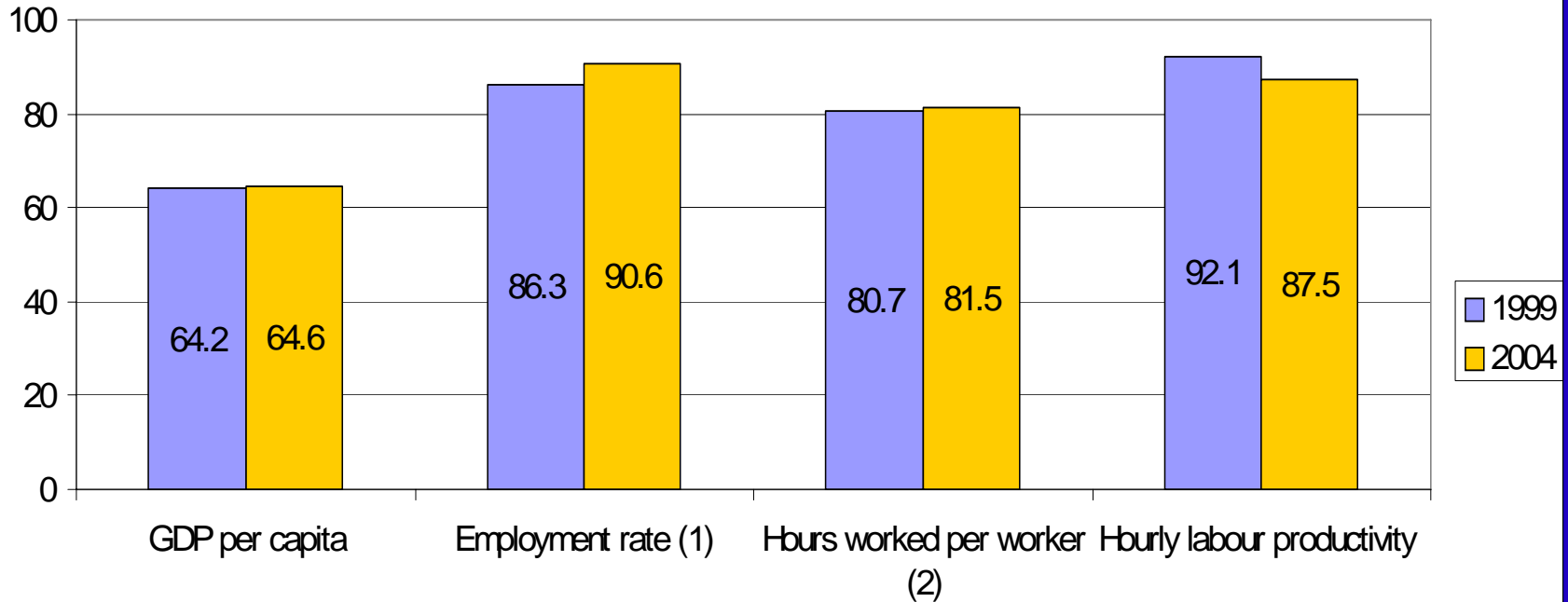
# Progress of Member States on the measurable targets of the Lisbon Strategy (Jan. 2005)

Lisbon Strategy	Target	Target year	EU-15 target achieved	EU-25 target achieved
<b>Economic Reform</b>				
Transposition rate of IM directive	98.5%	2002	1	2
Open electricity markets for customers	100%	2007	9	9
Open gas markets for customers	100%	2007	7	7
↗ cross-border energy capacity relative to installed production capacity	10%	2005	11	19
<b>Sustainable development</b>				
↘ in greenhouse gas emissions	92% of the 1990 level	2008-2012	3 respect national targets	10 respect national targets
Share of electricity produced from renewable energy sources	2/3	2010	0 respect national targets	0 respect national targets 



# Lisbon : Sources of poor growth

European Union performance 1999-2004 (US=100) (3)



1) Calculated - Employment rate =  $100 * (\text{GDP per capita} / \text{Labour productivity per person employed})$

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3) 2004: forecasts, Eu15 values for Hours worked per worker

Source: Commission services.

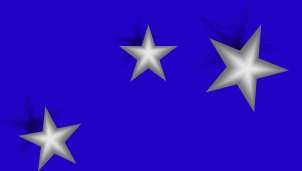




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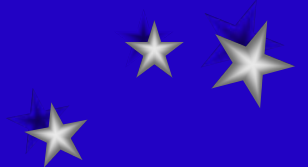
# The mid-term review

## 2004 Spring European Council :

- Mid-term review of Lisbon carried in 2005

## Objectives of the midterm review:

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

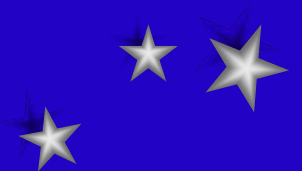




# The mid-term review

## Positive elements of the Lisbon strategy:

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

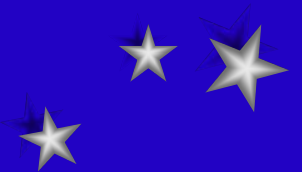




# Main achievements and failures

Poor performance due to :

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





# The “new” Lisbon strategy

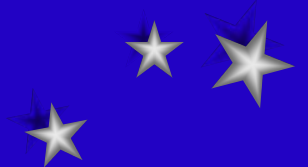
## Main elements of reforms

### 1. Focus on growth and jobs :

- The renewed Lisbon strategy focuses on growth and jobs as a means to preserve the EU social model and to ensure environmental sustainability

### 2. To improve the governance of the strategy :

- To streamline the process
- To increase the ownership of MS





# Focus on growth and jobs

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

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

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



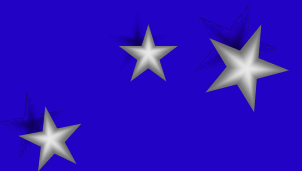


# The “new” Lisbon strategy

## A renewed Lisbon Action programme

Three main priorities :

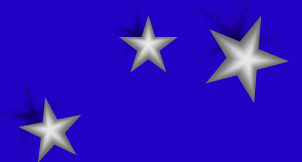
1. **Support knowledge and innovation for growth**
2. **Make Europe a more attractive place to invest and work**
3. **Create more jobs for more social cohesion**





# How to do it better?

1. **Simplified reporting : one single “Lisbon Report” both at the EU and national level**
2. **EU level**
  - Community Lisbon Programme
  - New Integrated Guidelines
3. **National Level**
  - National Reform Programmes
  - “Mr” or “Mrs” Lisbon at the government level







# The new policy co-ordination cycle – YEAR 1





# The Annual Progress Report

- Published on 25 January
- Analysis of the policy response to the Lisbon challenge - the Community Lisbon Programme and the National Reform Programmes (NRPs)
- Identifies 4 areas for urgent action:
  1. Knowledge and innovation;
  2. Business potential;
  3. Employment and ageing;
  4. Efficient, secure and sustainable energy
- Identifies the strengths and weaknesses of the NRPs and of the euro area



## **National reform programmes: a major novelty**

- **Presented in the autumn 2005 (mid-October)**
- **Identifying main challenges to achieve higher growth and employment and specific measures to be (or which have been) taken over the 3 next years (possibility to amend every year)**
- **Subject to a broad political debate at the national level (Parliament, social partners, broad public...)**
- **Annual national implementation reports**





# The National Reform Programmes

- **Agreement on the key challenges :**
  - Sustainability of public finances
  - Increase labour supply
  - Increase R&D and innovation
  - Improve the business environment
  - Environmental sustainability
- **But insufficient focus on competition and opening up of markets**
- **Targets, timetables and budgetary impact of the measures proposed often missing**





# The National Reform Programmes

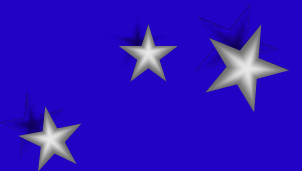
- **Good progress in :**
  - Pension reforms and measures to expand working life
  - Implementing active labour market policies
  - Improving the business climate by better regulation
  - Creating fiscal incentives for R&D and innovation
- **Reform shortages in :**
  - Improving the quality of public finance and reverting the upward trend in public debt
  - Reform of benefit systems
  - Removing barriers to entry (in services) and fostering the Internal Market
  - Creating the right framework conditions for private R&D and increasing the efficiency of public R&D



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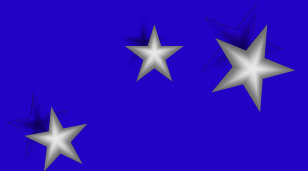




# Why do MS fail to implement structural reforms?

## Low public acceptability of reforms

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





# How to improve the implementation of structural reforms?

## 1. Carrot or/and stick?

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

## 2. Compensate or not the losers?

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

Difficult to ignore this question in the present political context





# How to improve implementation of structural reforms?

## Be smart:

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

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

3. **Find the proper timing**

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

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

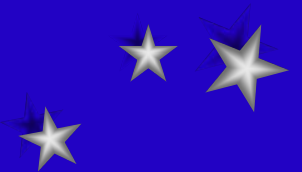
**But difficult as the timing determined by legislative rules and the electoral cycle**





# Are these reforms sufficient?

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





# List of Key references

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[http://europa.eu.int/growthandjobs/key/index\\_en.htmf](http://europa.eu.int/growthandjobs/key/index_en.htmf)**
2. **“European Commission (2005), “The economic costs of non-Lisbon. A survey of the economic impact of Lisbon-type reforms”, Directorate General for economic and Financial Affairs, European Economy, Occasional paper n°16, March  
[http://europa.eu.int/comm/economy\\_finance/index\\_en.htm](http://europa.eu.int/comm/economy_finance/index_en.htm)**
3. **Dierx A. and Ilzkovitz F. (2004),”Economic growth in Europe: Pursuing the Lisbon Strategy”, paper presented at the INFER/ZEI workskop.**
3. **Dierx A. and Ilzkovitz F. (2005), “Potential benefits of structural reforms undertaken within the context of the Lisbon strategy”, paper presented at the XVII Villa Mondragone International Economic Seminar “Capitalism and Entrepreneurship Dynamics : Benchmarking Europe’s Growth”, University of Rome “Tor Vergata”, July.**
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**Thank you for your attention**

