ON THE EU2020 STRATEGY: CONTRIBUTIONS AFTER THE LISBON AGENDA EXPERIENCE*

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* The Lisbon Agenda Group is composed by academics and researchers who have met on a regular basis since 2000 to give contributions to the development of the Lisbon Agenda. Some of them are contributing to this package.
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ON THE EU2020, FROM LISBON

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Annex: Tacking stock of the Lisbon strategy

In the beginning of a new decade, the European Union, while implementing its new institutional setting defined by the Lisbon Treaty, is dealing with two major challenges: redefining its role in the new emerging international order and renewing its development model. This renewal should be guided by a EU2020 succeeding to ten years of a unique experience of transnational coordination of economic and social policies framed by the Lisbon strategy adopted in 2000. This is the moment for a thorough critical assessment of this experience and of the situation we are now after of an also unique financial and economic crisis. This should also be the moment for setting a new ambition with very precise requirements, regarding a central purpose, the strategic priorities, the key-actions and the governance method for the years to come.

1. Our development model is unsustainable

The point of departure should be to recognize that, even if Europe presents the best international example of quality of life and of a development model combining is economic, social and international dimensions, this model is just not sustainable and is driving us to an unacceptable situation.

First, our development model is unsustainable because our patterns of consumption and production are undermining the climate and the ecological balance of the planet. The way our houses manage energy, the way our transports are organised and the way our factories work are translated into carbon emissions which will lead to a major disturbance of this balance, if they are not reversed until 2020. This reversal of the trend we are in will require to increase energy efficiency and to spread renewable energies in all sectors, in order to decouple growth from carbon emissions. Nevertheless, it is not enough to reduce the ratio of carbon emissions in the GDP, in the sense of a relative decoupling. We need to have an absolute decoupling, meaning a reduction of the total amount of carbon emissions. This is only possible with a radical shift of economic activities to low-carbon activities. In the high polluter sectors, such as transports, this will depend on major technological and social innovations. Finally, this will also require a major change in our consumption habits regarding mobility, habitat, domestic equipment and energy and our way of life in general. Ultimately, the central question to underpin this major transformation is: how should we define what is a good way of life and what is prosperity.

Second, our development model is unsustainable because our ageing trends are undermining the financial basis of our social protection systems. Even if the employment rate increases substantially, the European labour force will decrease and the dependency ratio will increase, which might strengthen the financial burden over the next generations or reduce their level of social protection, or most likely, both. This will be unavoidable unless, other factors are brought to this picture such an increase in birth rate, in working life length or in immigration flows, generalised equal opportunities, new priorities in the redistribution of income or an unattended leap in labour productivity, based on new sources of growth. In fact, the relevant discussion for the future is about the right mix of all these factors, if we want to avoid a downgrade of the European welfare systems.

Third, our development model is unsustainable because our financial system is undermining the conditions for the long term investment which is necessary to ensure sustainable growth and jobs in the transition to a low-carbon and knowledge intensive economy. Over the last two decades a major transformation took place in several varieties of capitalism, starting in the Anglo-Saxon one but spreading to others, including the European continental one. By increasing their role in funding companies, the financial markets have taken the driving seat of the economic system submitting it to chronic instability and to a new rule of profitability: not the long term profitability of productive investment which is necessary to sustain growth and jobs creation, but the short-term and short-sighted profitability which is requested by most of the shareholders. Furthermore, this kind of profitability has been developed by new financial instruments which aim at extra profits by gambling with extra-risks (such as short-selling and derivatives).

The banking system was also contaminated by the logic, which was also encouraged by insufficient regulation on capital reserves. Finally, many companies were also influenced by the same kind of logic, when their corporate governance has started to respond the shareholders expectations, rather to all stakeholders' ones, and when their top management was refocused in favour of financial management. Hence, the recent financial and economic crisis is the direct consequence of this major metamorphosis of capitalism. Even if it was possible to control this crisis by an unprecedented public intervention, it will be necessary a major reform of the financial system and of the corporate governance to overcome it and to prevent it again in the future. We should then ask what kind of new economic paradigm should we aim at moving to.

These are fundamental questions Europe can no longer postpone, even more in a decisive moment when a long-term development strategy is to be designed and adopted by the European institutions involving all the relevant stakeholders.

2. A new concept of prosperity

The first question to be answered is what should we mean by prosperity, as a central idea to give us a sense of direction and of progress. The level of material resources measured by the GDP, and the living conditions in terms of habitat, mobility, food and health, even if they remain basic, seem to be an unsatisfactory approach to prosperity. First, because they elude the constraints of global resources we are living in. Second, because they ignore the other dimensions which are necessary for people's well being, even to use these material resources. These other dimensions of well being are: access to capabilities, to useful activities, to initiative, environmental and physical security, social protection, democratic rights, social integration and sense of belonging to a larger community.

This larger and deeper concept of well being should be the driver to renew our development model. To be greater and not simply to be richer and stronger should be the underlying aspiration of our culture. This should have several implications for the central principle of another development model. This principle is simple: once the fundamental needs of material resources are ensured for all population, all the other dimensions of well being should grow in a balanced manner and not be sacrificed in order to increase consumption of material resources.

In this new framework, the way to measure and to compare progress and growth should be deeply revised. The indicators to measure growth should go beyond GDP to take into account these various dimensions of well-being. The added value should no longer be measured by the ratio between GDP and employment ignoring the depletion of natural resources. Furthermore, the increase in labour productivity should be measured not only by comparing GDP growth with employment hours growth but by comparing well-being growth in its various dimensions with the labour hours engaged in these various dimensions. Finally the progress in the various dimensions of well-being cannot be measure on by per capita indicators providing the average, because they can be very misleading; indicators about the relative distribution across the population are indispensable in all these dimensions.

A society where all citizens can satisfy their fundamental material needs, develop their capabilities, engage in useful activities, take initiative, count on environmental and physical security and on social protection, practise their democratic rights and duties with a real sense of belonging. Is this the society we want? This is possible, but with a quite deep transformation.

3. A strategy of innovation for sustainable development

The new long term-strategy of the European Union should be inspired by a central principle: innovation for sustainable development. Technological, economic, social and political innovation. To drive this transformation, some strategic priorities should be clearly defined:

A. To make a shift to low carbon activities

A shift should take place in our patterns of consumption, production and mobility. This shift should concern all sectors, but particularly those which are the most polluting ones such as transports, manufacturing and housing. The expansion of services, business, personal and collective services such as health, education, leisure, creative and communication activities should be encouraged but, if we want to avoid des-industrialisation, it should be combined with a new industrial revolution focusing on low-carbon, smarter and safer products combined with post-sale services. Creating new jobs and greening the existing jobs should be accompanied by measures for a fair transition such as re-skilling of workers.

B. To make knowledge and creativity the main resource of people, companies and regions

Innovation needs to be driven by new demands, but also by new interactions in supply between companies, research and education institutions. This requires to generalize the conditions for innovation in companies, which are organisational change and competence-building, access to technologies and expertise, to venture capital and to markets as well as reduction of the administrative burden. This will also require to develop long-term pan-European research networks addressing the main challenges of this new development model in an interdisciplinary way. Knowledge accumulation has been too much subordinated to competition policy in the European research programmes. Finally, this means, not only to generalise secondary education and spreading higher education, but also to extend the access to lifelong learning based on open learning centres and on learning organisations, which role will increase in the competence-building process. New competences such as team work, networking, learning to learn, sustainable behaviours should be generalised.

C. To make the welfare system to support change and reduce social inequality

To underpin all these changes, we need to build a developmental welfare state, supporting the transitions all over the life cycle, making the best of people's potential and reducing social inequalities. The first concern should be, of course, to reduce long-term unemployment and youth unemployment. An unemployment situation should be quickly turned into a transition to a job, a relevant training or a useful activity or a combination between them. Active ageing should be coupled with a better use of elderly experience and competence. Equal opportunities between men and women should be actively generalised at all professional levels. The conciliation between family working and social life should be made possible by better family care services and better sharing of family responsibilities. The access to learning mobility across Europe should be generalized, paving the way for more professional mobility. Immigration with active social integration should be promoted as a dynamising factor of the European societies. Finally, poverty should be actively combated, first of all by reducing social inequalities and the working poor, second by providing general access to active labour market policies and good public services and, ultimately, by ensuring a basic income and integration scheme to all.

D. To make the financial system serve the real economy

We need to refocus the financial system on the support to real economy. All the financial institutions and products should be regulated in order to control financial instability and to channel the financial resources to support the real economy, sustainable growth and jobs and, more particularly the long-term investments required by the above mentioned strategic priorities. This will also imply to fight against tax havens and speculative practices such as short-selling and many of the derivatives. A stronger supervision of the banks should be coupled with a tighter control of liquidity. Finally, corporate governance rules, particularly the accountancy standards, the top management remuneration and the rights of stakeholders/shareholders should be revised in order to ensure long-term investments and sustainable competitiveness. These principles should also be strengthened by the rating agencies when evaluating private and public debts.

Public finances should also be refocused to support the real economy which is, by the way, the best way to progress towards balanced budgets. This means to redirect public expenses and taxes to support public and private investment for smarter and greener growth.

Are these strategic priorities a wrong or a risky choice because they would create a competitive handicap to Europe? No, on the contrary, they can create the long-term competitive advantage of a first mover in general priorities which will be followed by the others, if the planet is able to create a win-win game and avoid extreme differentiation and collapse. We are assuming that the planet is condemned to a certain level of strategic convergence if it wants to survive (see section 7).

Are these strategic priorities utopian? No, not at all, most of the technological solutions required are already known. The real difficulty is about the political process strong and democratic enough to drive this grand transformation.

In the meantime, the recent financial and economic crisis was controlled, but it is still there to be overcome and prevented regarding possible replications in the future. Hence, the central challenge for this political process is how to make the recovery not only a successful one, but something more than a recovery, a transition to a new development model.

It is crucial to make the right choices when dealing with the various dilemmas which are ahead of us:

- How can we recover growth and jobs creation and reduce carbon emissions at the same time? By refocusing investment, production, consumption and jobs creation on low-carbon solutions.
- How can we recover growth and reduce the public debt which is now much higher after the effort made with the stimulus packages and the financial bail-outs? By actively supporting jobs creation, redirecting public expenditure to key-investments and by launching green taxation.
- How can we recover growth and speed up the transition to a low-carbon and smarter economy? By actively supporting innovation at all levels and in all companies as well as the transition of people to the new jobs.

4. A new approach for policy making in the global era

This transition will involve crucial decisions to be taken by all the stakeholders and, in fact, by all citizens, but it is central to clarify which should be the new approach to be developed by the public policy-making. The full range of available instruments should be used to manage this transition: strategic planning guidelines, regulations and standards, public services, taxes and public benefits, public procurement, public financial institutions, education contents and methods, public communication to frame the public choices, support and incentives to civil society initiatives. The policy mix will certainly require a stronger and more strategic public intervention, which is not at all in contradiction with making the best of new forms of civil society activism. A good example is the public support to be given to networks for innovation and jobs creation, or to networks for social integration, which should be strengthened at regional, national and European level. Moreover, the public services as major regulators, services providers, standards setters, network developers have an unexploited potential to be more fully used when promoting innovation for sustainable development.

Nevertheless, this new approach for policy-making should go further. Nowadays, if governance needs to be multilevel in order to be effective, we need to develop multilevel political actions combining measures at different levels instruments of policy-making. Even if the national level remains central in many policy areas, we need to activate the local level to multiply the initiative, we need to strengthen the European level in order to use the potential of the European space and we need to shape the global level in order to protect our collective choices.

The recent experience of controlling the financial and economic crisis was particularly highlighting about this. The rescue plans and the recovery packages were submitted to an unprecedented effort of European and international coordination. This attempt was very important to avoid a collapse, but its remaining flaws at European and global level were and will be paid with high price, in term of losses of viable companies and of rising unemployment.

National policies are no longer enough due to the level of European and global interdependence we live in. Isolated national measures of macro-economic, industrial policy or social policy can undermine the Economic and Monetary Union and the Single Market. If we want to have a pro-growth macroeconomic policy and an active innovation and industrial policy, to strengthen our social protection systems or to move to a low-carbon economy, we need to coordinate these policies at European level and to complement them with new European instruments. We also need a more coordinated European voice in the international fora.

The internal cohesion of the Single Market should be safeguarded when implementing a joint European recovery plan. This means that state aids to struggling sectors, suffering massive job lay-offs, should not result in unfair competition and should ensure equal treatment to cross-border branches. But the best way to prevent the risk of national protectionism is to strengthen the role of European funding instruments, including the Structural Funds, the Globalization Fund and community programmes, and to enhance the European innovation, industrial and employment policies. Moreover, Member states should have the means to ensure the social protection and the active labour market policies necessary to cushion the industrial restructurings which will be triggered by the crisis.

All this will require more coordination of macro-economic policies. The Economic and Monetary Union, as another major asset of European integration, will only be safeguarded on four conditions: that Member States improve the coordination of their budgetary policies, including tax policies; that the room of manoeuvre of the revised Stability and Growth Pact is fully used; that European instruments are further developed, to enable all Member States to support demand; and, finally, that non-eurozone Member States are better protected against speculative attacks on their currencies.

The political choice seems now clear: either we strengthen European integration to overcome this crisis or this crisis will undermine European integration.

5. Multilevel actions with a stronger European dimension

That is why the future long-term strategy of the European Union should be translated into powerful actions based on a multilevel policy-mix, including global, European, national and local measures. In this policy mix, the European dimension should be strengthened into three different ways: the European coordination of national policies, the implementation of specific European instruments and the definition of a European position in the international fora. According to the strategic priorities which were proposed above, the following key-actions should be given priority:

A. To promote new patterns of consumption and production for a low-carbon economy

At global level, to influence the negotiation to define the post-Kyoto agreement; to introduce eco-standards in WTO negotiations; to promote good practices using the UN sustainable consumption and production framework of programmes.

At European level, by complying with the targets for emissions reductions and by implementing the emissions trade scheme; implementing the renewable energies directive and developing the European Strategic Energy Technology Plan; adopting the directive on eco-design, supporting leaner production and labelling and greening the supply chains to consumers; defining an harmonized base for public procurement; coordinating and supporting the construction of trans-European and low carbon transport network and of European intelligent energy grid.

At national and local level, promoting energy efficiency and the use of renewable energies using rules, standards, taxes, communication and education; building an intelligent energy grid; pricing fossil-fuel including environmental degradation and foster the use of renewable energies.

B. To actively support innovation, investment and jobs creation in new areas

At global level, to coordinate the stimulus packages and the exit strategies with a focus on jobs creation; to conclude the WTO Doha Round and to move forward in the bilateral agreements with key trading partners; to deepen and to extend the regulatory cooperation with the EU strategic partners regarding environmental, social and intellectual property standards.

At European level, to create sectorial platforms for the coordination of innovation, research and human resources in order to develop a European industrial policy; using regional policy, to develop European networks of clusters in promising activities for investment and jobs creation such renewable energies, ICTs, biotechnologies, nanotechnologies, creative industries, fashion, specialized equipment, health, personal services; to develop a European broadband network, common digital standards and the European contents industry, making the best use of the Web 2.0 tools; to support industrial restructuring with a stronger Globalization Fund; to implement the Small Business Act in order to improve the access to finance, to markets and a better regulatory environment. Finally, to develop European venture capital funds.

At national and local levels, to promote innovation clusters in promising activities and to strengthen the coordination between industrial, innovation, research and human resources policies. To support restructuring with stronger re-training and active labour market policies. To support SMEs and all forms of entrepreneurship.

C. To strengthen the European research potential

At global level, to develop networks for brain circulation and support schemes for joint research with European partner countries; to implement the European strategy for international science and technology cooperation.

At European level, to organise joint programming, joint calls and pooling resources of national research policies in areas of common interest. To develop the public-private partnerships in manufacturing, automotive and construction. To create European long-term research networks and research infrastructures, involving the universities. To use the EIT and the knowledge and innovation communities to foster innovation in the universities. To adopt a community patent regime also considering the needs of knowledge transfer and use.

At national level, to increase the public and private investment in research and higher education; to adapt the universities statutes and careers in order to foster fundamental research on the one hand and innovation on the other hand.

D. Competence-building for all

At the European level, to launch a European-wide programme for "New skills for New jobs" to ensure a massive re-skilling for new jobs. This programme should be financed by public and private spending to be coupled with a refocusing of the European Social Fund, providing tailor-made solutions for education and training to those who will need a "knowledge lift" to get a new job or keep their existing one. This programme requires not only building a European co-ordinated system to anticipate skills needs, but also to develop the European frameworks (EQF and ECVET) to support the transfer and accumulation of learning outcomes. Finally, it also requires widening access to competence assessment centres as well as to new funding instruments for learning activities (learning accounts, social contributions, loans and scholarships). In this framework, all European citizens should have an opportunity for learning mobility, an Erasmus for all. Finally, is also important to create a European network to support the development of learning organization in companies and public services.

At national level, to develop national strategies for lifelong learning, including tailor-made methods, validation and compensation of the learning outcomes; a particular effort should be made about the generalization of secondary education, the increase of higher education graduates and the access to education and training by the lower skilled workers; schemes to enable employers to prevent job cuts, such as "intelligent work-sharing" combining reduced working time with publicly-subsidized training programmes, should be implemented.

E. Supporting professional transitions and reducing social inequalities

At global level, to promote the ILO decent work agenda the Global Employment Pact; defining new regimes of joint management of migrations and co-development with European partners countries.

At European level, to use the employment guidelines to specify the securities to be provided in each type of professional transition over the life-cycle, for instance, to create a European exchange mechanism for internships to foster the professional integration of young people; to support the transformation of the national unemployment insurance schemes into employment insurance schemes; to promote the creation of leave schemes supported by learning accounts or training vouchers for the workers in need of re-training to move to new jobs; to foster the generalisation of equal opportunities at all professional levels, supported by the development of family care services; to encourage different schemes of flexible and phased retirement where unemployment benefits can be used to co-finance in-work subsidies, training and jobs creation; to connect the minimum-income schemes with other policies for social integration; to develop a European coordinated policy for immigration.

At national and local level, to adapt all these measures to the specificities of the national and local labour markets. Moreover the re-distributional and not only the protector and enabler roles of the welfare systems need to be strengthen in combination with tax and wage policies. A European framework should be defined to coordinate this process.

F. Making public services a major innovator for sustainable development

At national and local level, public services should become powerful promoters of key priorities of sustainable development such as of low-carbon economy, entrepreneurship and social inclusion. They can promote low-carbon economies by setting news standards and regulations, using public procurement, introducing green taxes and benefits, and encouraging new behaviours with education and public communication. They can promote entrepreneurship by cutting red tape, providing financial and technical support and spreading education for entrepreneurship at all levels. Finally, they can promote social inclusion and equal opportunities, by improving the quality and performance of health, education, housing, urban planning and infrastructures and other social services in order to strengthen social integration; the top priority here should be to eradicate child poverty.

At European level, a framework directive on services of public interest is important to deepen this potential of public services. They are also supposed to be protected all over the implementation of the services directive.

At global level, the European public services should also be protected in the negotiations for trade liberalization.

G. Reform the financial system and corporate governance for sustainable development

At global level, the regulatory agenda announced by the G-20 needs to be systematically implemented: universal legislation should cover all financial entities, products and transactions; no financial market player should be left out of the system, for example hedge and private equity funds; a careful and continuing analysis needs to be undertaken to monitor and identify operations of financial market players which could cause systemic risks; tax havens and off shore financial centres that are free of regulation and legislation should be covered by regulation through a new international initiative; stronger international supervision and more cooperation between all national regulatory bodies; mandatory "capital requirements" should be defined for all financial players; executive pay and remuneration schemes should be in line with long term performance goals; accountable and transparent credit risk rating and robust and reliable accounting regimes should be ensured.

At European level, the current initiatives should be shaped in this direction: the EU financial supervision with the European Systemic Risk board and the European System of Financial Supervisors; the directive on hedge funds and private equity funds; the recommendations on derivatives and on the remuneration of directors. Moreover, several initiatives should also be taken to reform corporate governance: the accounting standards and the corporate taxation should be revised in order to favour reinvestment of profits, long-term investment and corporate social responsibility regarding the various stakeholders.

H. Public finances to support sustainable development

At global level, the coordination of the macro-economic and structural policies should be improved, particularly in the framework defined by the G-20.

At European level, this coordination is now crucial if we want to make better use of the European spill-over effects of the stimulus packages. Moreover, in the framework of the revised Stability and Growth Pact, Member States able to redirect their public expenditure and tax structures should be allowed to run public deficits above 3%, provided they can demonstrate that this will contribute to higher growth and a consolidation of their public finances. To achieve sustainable public finances in the medium term and avert an unacceptable debt burden for future generations, the choice today is not between raising or cutting taxes: it is between a sluggish growth damaging the life chances of many, or investment in a sustainable and prosperous future with real job prospects for all. This fine-tuning of the macro-economic policies should be underpinned by further technical developments in the definition of indicators concerning the sustainability and the quality of the public finances at both national and European levels.

Also at European level, the Community budget should be adapted to contribute directly to the EU2020 strategy and also to the immediate need for economic recovery, starting with the proposal for the 2011 budget and then also in the forthcoming new financial perspectives.

Finally, Member States should consider new tools to issue public bonds, particularly green bonds to fund the transition to a low-carbon economy. In the present context, characterized by international competition for financial resources, it could be useful to examine the possibility of converting national bonds into Eurobonds. The aim would be to reduce the spreads which are being paid by public debt to launch new investment projects, supporting business in general by decreasing the cost of capital, and attracting domestic and foreign savings and preventing hostile takeovers by foreign investors. A European agency could be created to organize the common issuance of EU denominated bonds, with the guarantees to be provided by all participating Member States.

At national level, selective tax incentives should have as their primary purpose to sustain and redirect domestic demand in a socially fair and effective way. The following measures could be considered: tax incentives for green products and services and for labour intensive services such as health, personal or catering services or reductions in the tax burden in lower incomes or in some basic products. The EU should adopt a bold package of green tax measures in this context. Member States should be encouraged to reduce social security contributions of wage earners and to increase direct aid to more vulnerable households, as appropriate

The EU 2020 should be intertwined with the recovery process and the exit strategy regarding this special fiscal stimulus overburdening the national budgets. This one needs to put the central focus on increasing the growth rate and growth potential, as a pre-condition for the longer term sustainability of public finances. Therefore:

- A early withdrawal of the fiscal stimulus should be avoided until the drivers for a sound recovery are confirmed;
- The public expenditure cuts and the tax increases should comply with social justice and should avoid to over-burden the labour factor. A shift to green and financial taxes should become a clear priority;
- The pace to reduce the fiscal stimulus should be differentiated and adapted to national specificities, under two conditions: on the one hand, a convergence regarding social and green taxes and, on the other hand, stronger European instruments for regional development.

6. To improve governance: participation, coordination and accountability

When defining the post 2010, it is important not to lose the *acquis* of the Lisbon strategy, which is very relevant, even if several of its targets were not reached (see annex):

- a large political consensus on the main strategic direction;
- a European-wide process of coordination of structural reforms and innovations to cope with these challenges, involving European institutions, governments, parliaments, regions and civil society at several levels;
- a gradual re-direction of several policies: employment, social protection, education, research, innovation, information society, single market, energy, regional and macro-economic policies.

The following priorities should be introduced to improve the governance of this political process.

A. The strategy architecture requires some fundamental improvements:

- at the top level, a single strategic framework, with the long term and key strategic orientations, overcoming the current disconnection between growth and jobs, social policy, energy and sustainable development;

- at the intermediate level, the Treaty-based broad economic and employment guidelines as integrated guidelines covering the full scope of the strategy;
- at the operational level the common objectives and key actions to be taken in each relevant policy according to these strategic priorities (and only those, in order to avoid the so called Christmas tree).

B. We need to increase the political accountability, by making clear choices about the priorities and by synchronising this strategy with the political cycles at European and national levels.

C. Identifying clearly the European and national tool-box which can be used by each policy. Promote its better use by each policy, making an upgrade of the policy mix to stronger and more European instruments

D. Improving the implementation by each Council of Ministers formation and by the respective Committees and Groups, aiming a better articulation both at European as well as at national level:

- identify the tool-box available for each Council formation;
- define a general road map for its application;
- improve the Committees' support work to the Council;
- improve the peer review methods regarding the implementation at national level.

E. Improving the implementation of the guidelines and the common objectives:

- improve the consistency between the reporting, the integrated guidelines and the key-actions;
- prepare EU2020 national programme mutually consistent with the national governmental programmes;
- combine the national annual progress(short) reports with annual thematic reports focusing only on some key-actions previously selected;
- define indicators and deadlines regarding the main objectives and invite the Member States to define specific ambitious, but realistic targets for its particular case;
- select the key-indicators to grasp the main dimensions regarding the general well-being, the knowledge-economy and the development potential;
- develop a more intelligent benchmarking, putting good practices in the right context, using progression indicators, developing rankings regarding each Member State capacity to evolve towards the targets set for by each of them;
- improve the monitoring and evaluation process by focusing on the country specific recommendations;

- improve the learning process based on thematic workshops and data bases on good practices;
- introduce positive political and financial rewards for progressing in the common objectives and national targets

F. Improving the coordination between the relevant Council formations:

- by strengthening the coordination role of the European Council;
- by developing the regular interfaces between the Councils' Committees or Groups focusing on concrete issues.

G. Improving the action and articulation of the national Coordinators:

- promoting a more in-depth sharing of experiences between these Coordinators;
- improving horizontal coordination at national government and at the European Commission levels;
- defining a more clear standardization of national programmes and its annual reports in order to underline the progress obtained and the respective responsibilities.

H. Developing the role to be played by the European Parliament and by the national parliaments.

I. Identifying methods to improve the participation and mobilization of civil society and social partners:

- improve the role of the Tripartite Summits and of the macroeconomic dialogue;
- support the role of the European Economic and Social Committee and of its network with the national Economic and Social Councils;
- support the adaptation of the EU2020 Strategy to the specific target-groups;
- develop various types of partnership to implement projects.

J. Improve communication instruments in order to involve different types of actors: civil servants, opinion makers, civil society partners, young people, citizens in general. Communication should be promoted and sufficiently promoted at European, national and local level, by empowering those who can multiply and adapt the message.

K. Develop the methods for a better implementation at territorial level and support the initiatives taken by the Committee of Regions. The implementation of this agenda should now be fully translated at territorial level:

- by tacking advantage of the territorial specificities and ensuring the full use of the endogenous resources;
- by developing European territorial pacts supported by regional policies and a European platform to exchange best practices;
- by enabling cities and metropolitan areas as main hubs for innovation and creativity.

7. To strengthen the interface with the EU external action

The European Union should have an ambitious agenda for sustainable development comprising its economic, social and environmental dimensions, but it cannot achieve it in isolation. The implementation of this internal agenda needs to be supported by an international movement of strategic convergence in the same direction, able to avoid risks of race to the bottom, create win-win games and strengthen collaboration to face common global challenges.

This should be the one of the main goals of the new generation of external policies of the European Union, when reforming global governance and defining agreements with partner countries. This concern should be more systematically integrated in the new generation of the external policies of the European Union, which is now being redesigned and can have a new momentum with the Lisbon Treaty:

- a broader approach should be developed for the external action of the Union, which combines CFSP, trade and cooperation policies with the external projection of the internal policies of the Union. This means that the external action of the EU should also integrate the external dimension of policies such as research, environment, education and employment;
- a new generation of the EU cooperation programmes can be developed, based on the new political orientations defined by the "European Consensus";
- a new approach is being developed in trade policy, which aims at preparing Europe for globalisation using trade combined with basic standards as well as internal markets as a major lever for growth and more and better jobs;
- Europe should take a more active and consistent role in the renewal of global governance, by reforming the Bretton Woods and the UN system and by building on the G-20 process, in order to create a new global framework for sustainable development

A new approach should be developed for a strategic dialogue with partner countries in a globalised world in order to frame a better use of all these instruments of external action. We are assuming that the method for this strategic dialogue will be more effective according to the following steps:

- First, a general discussion on common challenges we are facing together as global partners;
- Secondly, a general discussion on development strategies and on some implications for internal policies to meet these challenges;
- Thirdly, a discussion on new ways of cooperation for capacity building in order to spread better standards;
- Fourthly, a discussion on the implications of the previous themes for external policies, for global standards and for global governance;
- Finally, a discussion to define win-win games to develop the strategic partnership.

This dialogue can also be supported by a more systematic identification of all the initiatives of international cooperation already underway between the EU and these partner countries in the fields covered by European long-term development strategy, notably: science and technology; markets, entrepreneurship and innovation; environment and energy; education and training; employment and social affairs.

The emerging global order is requiring an urgent re-definition of Europe's position and role in world affairs. The Lisbon Treaty will equip the EU with a service of external representation and will lead to a more consistent and coherent external action comprising CFSP, trade, cooperation, humanitarian aid and the external dimension of internal services such as energy, research, education, employment.

A new EU external agenda should define the orientations for the long term priorities as expanding the neighbourhood policy, renovating the transatlantic cooperation, deepening the strategic partnerships with the key-global players and the macro-regions, strengthening the instruments to support the MDGs. This new external agenda should also frame the European position regarding pressing issues such as the regulation of the financial markets, the coordination of the recovery, the agreement on climate change, the WTO Doha Round or the ILO agenda on decent work. Making the best use of the recent G-20 process and clarifying the European position regarding the reform of the Bretton Woods institutions have also become urgent issues. In a longer term perspective, the time has come for a Global New Deal able to create a new global order with more social justice, sustainable development and respect for multilateral rules democratically defined.

With the emergence of the G-20 at leaders level, it was possible to a launch an unprecedented initiative of global coordination to rescue the financial system and sustain global demand. The G-20 is also building new important mechanisms to govern the global economy, based on:

- the Framework for strong, sustainable and balanced growth defined by the G-20, launching a process of mutual assessment of policy frameworks and their implications for the pattern and sustainability of global growth, while trying to identify potential risks to financial stability. The G-20 members will agree on shared policy objectives for fiscal, monetary, trade and structural policies to collectively ensure more sustainable and balanced trajectories of growth;

- a Charter of core values for sustainable economic activity (macro-economic policies for long term objectives, rejection of protectionism, regulation of the markets for sustainable development, financial markets serving the needs of households, businesses and productive investment, sustainable consumption and production, internationally development goals, need of a new economic and financial architecture.

This new international framework should be fully taken into account when designing the new long term development strategy for the European Union.

8. The implications of the Lisbon Treaty

How can we assess the potential and the limits of the Lisbon Treaty regarding the implementation of the EU development strategy (the Lisbon strategy and its successor)? A preliminary analysis of this Treaty can be undertaken from this particular perspective, focusing on the EU aims and principles, its institutions, its instruments and its policies.

General references

The Union's aims in the Lisbon Treaty confirm the main ingredients of the Lisbon strategy: "The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance." Naturally, we cannot find the articulation of the strategic priorities of the Lisbon agenda, highlighting the central role of a knowledge economy or the purpose to reply to globalisation.

Furthermore, the principles for the external action of the Union are clearly stated in the Treaty encompassing: democracy, rule of law, human rights, peace, humanitarian assistance, sustainable development, environment, free trade.

The Charter of Fundamental Rights includes many of them which call for a more ambitious development agenda such as: the rights to education, to placement services, to social protection, to health, to environmental protection or the freedoms to choose an occupation, to conduct a business or to the arts and sciences.

The horizontal social clause and the protocol on services of general interest are also relevant provisions to frame the main concerns of the Union in sustaining its social model.

Institutions

The reforms to be introduced in the EU political institutions can also have several implications for the Lisbon agenda:

- the European Council is defined as central institution in its guiding role and equipped with a full-time and permanent President;
- the Council will extend the qualified majority area to more fifty new areas, using a new calculation rule after 2014-17, based on a double majority. Besides, the Council will have a new formation, a General Affairs Council clearly distinct of the Foreign Affairs Council, with the purpose of coordinating the internal policies and their interface with the national policies;
- the Presidency of the Council will be provided by a rotating team of three Member States which can organise their tasks in various ways;
- the European Commission will be chaired by a President with a stronger democratic legitimacy because he/she will be elected by the European Parliament;
- a High Representative of the Union for Foreign Affairs and Security Policy, also a Vice-President of the European Commission, will coordinate the instruments for the external action of the Union;
- the national parliaments will more systematically consulted on the Union decisions; a stronger inter-parliamentary cooperation is also envisaged;
- the European Parliament will get co-decision competences with the Council in forty new areas;
- besides a stronger interface between representative democracy ad participatory democracy included in the procedures of the European Economic and Social Committee and the Committee of Regions, a Tripartite Summit for growth and jobs was created, involving the social partners representations.

One can expect a general evolution of this political system in the direction of more legitimacy and more efficiency of decision making process as well as stronger coordination mechanisms, even if some tensions and counter-effects cannot either be excluded. In any case, the positive effects which can be expected are relevant for the EU development agenda, which requires a quicker implementation and a stronger horizontal coordination. The new General Affairs Council can play an important role from this perspective, supporting the European Council. Moreover, the ownership of the Lisbon process can be strengthened by more relevant roles given to the European Parliament, the national parliaments as well as by the bodies of participatory democracy at both European and national level.

The instruments

The instruments of the Union can be either compulsory, as the regulations, the directives and the decisions or not compulsory, as the recommendations and the opinions. Nevertheless the "instrument mix" will be very different according each policy, notably taking into account the different ways to assign competences to the Union and to the Member States:

- the Union has exclusive competences regarding the customs union, the competition policy, the monetary policy, the marine biological resources, the commercial policy;
- the Union shares competences with the Member States regarding: the internal market, the economic, social and territorial cohesion, the agriculture and fisheries, the environment, the consumer protection, the transport policy, the energy policy, health safety, as well as the social policy, for the aspects defined in the Treaty. Regarding research policy as well as development cooperation, the Union shall have competences to carry out activities without preventing Member States to carry out theirs;
- the Union only has competences to carry out actions to support, coordinate or supplement the actions of the Member States regarding the policies for industry, culture, tourism, education, civil protection and administrative cooperation.

Finally, the coordination of the economic policies and of the employment policies shall be undertaken according to common guidelines.

This means that the policies mobilised by the EU development agenda are distributed by the three different types of competence, meaning different levels of Europeanisation:

- in the first type, the monetary, competition and commercial policies;
- in the second type, the internal market, the environment, the research and the social policy (for certain aspects);
- in the third type, industrial and education policies, certain aspects of social policies and administrative cooperation.

In short, when it comes the strategic priorities of the EU development agenda, this framework implies the following instrument mix:

- regarding the regulation of the markets of products and services, capital and labour, the predominant instruments are directives and regulations;
- regarding employment and social policies, the predominant instruments are guidelines, common objectives, common programmes and structural funds;
- regarding environment, the predominant instruments are directives, decisions and structural funds;
- regarding knowledge policies, the predominant instruments are guidelines, programmes and structural funds;
- regarding macroeconomic policies, with the exception of monetary policy, the predominant instruments are guidelines.

The possibility to enforce political reorientations is therefore quite different regarding the various strategic priorities, even it is possible to go further by using the full potential of the available instruments:

- enforcing the implementation of the directives and regulations; identifying the need for new ones, respecting the better regulation process;
- monitoring the implementation of the guidelines with country specific recommendations;
- improving the resources and the effectiveness of the common programmes;
- improving the effectiveness of the structural funds.

It is also important to mention that the external action of the Union shall be deployed by quite different instruments:

- CFSP, by guidelines and decisions;
- Commercial policy, by regulations and agreements;
- Development cooperation, by common programmes and guidelines;
- Economic, financial and technical cooperation, by common measures.

Finally, it is also relevant to evaluate the level of Europeanisation of these policies by identifying those which will become covered by the ordinary legislative procedure, meaning co-decision of the Council and the European Parliament: energy, education, intellectual property, industry, tourism, administrative capacity, structural funds (after 2013), cooperation policy, trade policy and social policy with the exceptions of social protection, lay-offs, information and representation. By contrast, the need for unanimity is kept for these fields as well as for state aids, single market regulations, excessive deficits, tax policy for environment and energy, education, health and cultural services in trade policy, exchange rate, linguistic regime, own resources, common defence and general European elections.

Relevant changes in specific policies

Beyond all these systematic changes introduced by the Lisbon Treaty there are also some particular changes regarding specific policies which are relevant for the implementation of the EU development agenda:

- the move to co-decision regarding intellectual property rights;
- the introduction of the concept of European research area;
- the inclusion of a European space policy;
- the strengthening of the energy policy addressing security issues;
- the strengthening of the environmental policy addressing climate change;
- the reference to both co-decision and to the tools of the open method of coordination in research policy, industrial policy, health policy and social policy;

- the development of a European immigration policy;
- a stronger role of the Commission in monitoring the broad economic policy guidelines and the Stability and Growth Pact;
- a declaration emphasising the need to ensure not only "sound budgetary positions" but also "raising the growth potential" as the two pillars of the economic and fiscal policy of the Union;
- a detailed organisation of the functioning of the Eurogroup, including the external representation of the Euro.

Besides this concrete specification on the Eurogroup, the procedures to organise an enhanced cooperation in various areas are also made stronger. How far can they be useful to foster the implementation of the EU development agenda is still too early to know. Nevertheless, it is important to underline, that even without using these legal procedures, many initiatives taking place in the framework of the Lisbon agenda involved a certain kind of enhanced cooperation, such as the technology platforms and the technology initiatives in research policy or the lead markets in innovation policy.

The implementation of the EU development agenda certainly requires an evolving combination of instruments supporting:

- a level playing field of common rules;
- stronger instruments at European level;
- a convergence of national priorities, respecting the need to adapt to national specificities;
- the possibility of differentiation to move faster in some particular goals.

In spite of its limits, the Lisbon Treaty provides relevant opportunities to enrich and to strengthen the tool box of the EU development agenda. To exploit this potential will also depend on improving the governance of the political process underlying the agenda.

Annex

Taking stock of the Lisbon strategy

Even if there were clear failures, the implementation of the Lisbon strategy should not be considered a failure. We need to be precise in this assessment in order not to throw out the baby with the bath water. When defining the post 2010, it is important not to lose the *acquis* of the Lisbon strategy which is relevant:

- a large political consensus and a real progress on the main strategic direction;
- a gradual re-direction of several policies: employment, social protection, education, research, innovation, information society, single market, energy, regional and macro-economic policies: Starting with the measures defined in the follow-up of the Lisbon European Council of 2000, several hundred of them were implemented even many others were not (see Table 1). Indicators are, by definition, the last feature to move to reflect real changes and here we have a mixed picture;
- and most of all, the building-up of a unique European-wide process of coordination of structural reforms to cope with these challenges, involving European institutions, governments, parliaments, regions and civil society at several levels.

In fact, the development and the implementation of Lisbon agenda can be analysed as political and social process which has involved, in a progressively organised way, the following institutions and actors:

- the European Council, in its several annual meetings with a particular relevance to its Spring meeting, deepening its coordinating role;
- the Council, in seven of its formations: General Affairs, Ecofin, Competitiveness, Employment, Education, Environment, Energy and Telecommunications; their Council committees and groups are also involved;
- the European Commission, involving 15 out of 27 Commissioners and 17 Directorate-General. A smaller group of "Lisbon" Commissioners is meeting on a more regular basis;
- the European Parliament, involving 6 of its Committees;
- the national parliaments, involving at least their European Affairs Committees, and organising a yearly Lisbon conference with the European Parliament;
- the European Economic and Social Committee and its Lisbon network of Economic and Social Councils in the Member States they exist in;
- the Committee of Regions and its Lisbon platform involving more then one hundred regions;

- the European confederations of social partners, representing their counterparts at national level and meeting regularly with the other European institutions in the Tripartite Social Summit;
- last, but not least, the national governments with the involvement of several ministers and ministries as well as the Prime-ministers. A horizontal network of top officials is also emerging due the role of a Lisbon Coordinator, who can be a minister or a top-official reporting to a minister or the Prime-minister.

Beyond this institutional setting, there is vast network of civil society organisations in various areas which are following and feeding in, in a way or another, the development of the Lisbon agenda. Most of them are probably not aware of this European agenda, but rather of its translation into the national level. The same happens with many political and media actors at national level, which explains a level of ownership which remains quite low, even if with many differences when comparing Member States. Still, a quite large network and civil society leaders across Europe are explicitly connecting with the Lisbon agenda in their normal work.

The instruments being used by the Lisbon agenda are also quite diversified: directives, regulations, decisions, recommendations, guidelines, common objectives, community programmes and structural funds. Still, the "instrument-mix" is very different according to various policies covered by the Lisbon agenda: research, innovation, enterprise, information society, environment, energy, employment, education, social protection, macro-economic policies.

Nevertheless, the general orientation of the Lisbon agenda is provided by the integrated guidelines for growth and jobs, based on the Treaty instruments called "broad economic policy guidelines" and "employment guidelines", which enable the Council and the Commission to organise a coordination process, the Commission to issue "country specific recommendations" and the European Parliament to make a follow-up, including a formal opinion in the case of the employment guidelines. The integrated guidelines were defined in 2005, building o the common objectives which were identified by the Member States by using the open method of coordination launched with the Lisbon strategy in 2000, in order to create a new strategic consensus and a larger involvement of the relevant actors. In operational terms, these integrated guidelines are then translated into a Community Lisbon Programme mobilising the relevant European instruments already mentioned above and into national reform programmes by all Member States, mobilising all the relevant instruments. For each three year cycle, some actions can be prioritised at both levels.

In spite of the comprehensive character of this process, there are many flaws regarding accountability, coordination and participation. The time has come to move from a technocratic to a political process. Even more important would be to have a citizens' movement in the same direction.

Table 1: The Lisbon agenda: relative achievements and failures

Policy field	(Relative) achievements	(Relative) failures
Information society	• Schools connected with Internet • Public services: access via Internet • Extension of broadband	• Scale in content industries
Research	• European research networks • European research infrastructure • Technology platforms • European Institute of Technology	• Community patent • Mobility of researchers
Innovation	• Joint technology initiatives • Clusters • One stop-shop for start-ups • Galileo	• Interface business-universities • Venture capital
Lifelong learning	• Extension of early-school education • Extension of vocational and technological education	• Modernisation of universities • Extension of training for adults
Single market	• Telecommunications • Single sky • Financial services integration • Services directive • Reducing red tape	• Energy • Portability of pensions • Better regulation
Trade	• Bilateral agreements	• Doha Round
Employment	• Net jobs creation (15 million) • Modernisation of employment services • Women employment rate • Restructuring management	• Flexicurity • Employment of young people • Immigration management
Social protection	• Pensions reform	• Active ageing
Social inclusion	• Childcare services	• Poverty rate reduction
Environment	• Environmental awareness • Emissions trade scheme	• Renewable energies

Source: Rodrigues, M.J. (ed.) (2009) *Europe, Globalization and the Lisbon Agenda*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar.

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How New Will the Next Regulatory Regime Be?[1]

1. Twenty years of "laisser-faire" orthodoxy challenged

With the victory of conservative governments of Miss Thatcher and President Reagan and the triumph of the new classical macro-economy, the previous regulatory regimes for good, labour and especially financial markets have been "reformed", i.e. largely eroded or even dismantled. A new *doxa* had been diffusing all over the world. Basically, markets are self equilibrating, State interventions are the problem and no more the solution, therefore a light touch approach to regulation has prevailed. It was especially so for finance.

With the collapse of the American financial system after the subprime bubble, the fallacy and danger of such a market fundamentalism becomes clear. Firstly, financial instability and the recurrence of speculative bubbles make an impressive comeback: therefore an ad hoc State intervention is again welcome in order to restore one of the first public goods, i.e. financial stability and the credibility of money. Secondly, self-regulation and light touch regulation are now considered to be replaced by an explicit surveillance and control of finance by public authorities in the next regulatory national and international regimes. Thirdly, given the huge costs of the bailing out of many financial entities, economists, analysts and politicians begin to reconsider their previous beliefs according which "It is impossible to prevent financial crises; it is only required to cure them and public authorities have the related knowledge". Do the collapse of Lehman Brothers and the subsequent systemic crisis mean an unprecedented financial divide?

2. State against markets: a false debate

The history of economic doctrines as well of major crises suggests the equivalent of long waves. A generation suffers from a quasi economic collapse due to the unlashing of market mechanisms and then sets regulations and institutions in order to prevent the repetition of such dramatic episodes.

[1] Contribution to the SASE International Conference, July 2009, Paris.

This configuration is first successful but it always ends up into a new form of crisis…that a new generation tends to attribute to excessive regulations. Hence a process of deregulation and quasi complete oblivion of the lessons of the past…and this sets up into motion a "laisser-faire" regime that encounters finally its structural crisis.

No surprise then if the subprime crisis is commonly interpreted as the revenge of interventionists over laisser-faire! Since Milton Friedman has been wrong about the stabilizing nature of speculation, then John-Maynard Keynes is right! Unfortunately, the debate is not that simple.

On one side, especially in the United States, regulations are feared because they could negatively affect financial innovations and hence the dynamism of its economy. Implicitly and sometimes explicitly, economists consider that extensive regulations could lead to the equivalent of an American *Gosplan*.

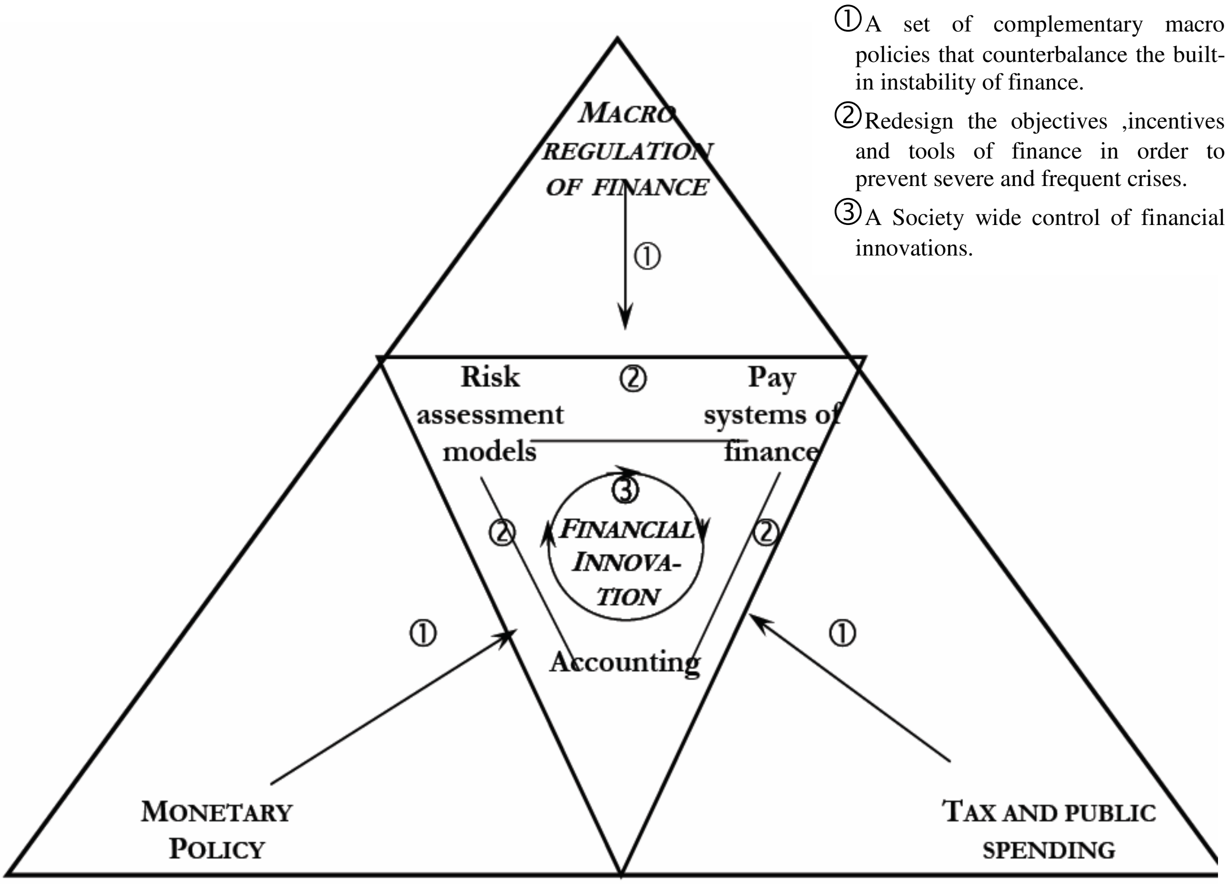
On the other side, a vocal minority of experts and policy makers have a dissenting view about the origin of the financial crisis: the public guarantee granted to Freddie Mac and Fanny Mae would be the origin of a major moral hazard problem that led to a frantic speculation. Let us privatize them and this episode will not repeat itself.

These two opposite positions share a common, and false, premise i.e. that State and Markets are alternative and define exclusive coordination mechanisms. The first statement totally disregards the teaching of financial history: the Golden Age engendered an unprecedented stable and fast growth along with a clear collective control over the autonomy of finance. The second similarly misrepresents the involvement of Freddie Mac and Fanny Mae in the subprime crisis: it might well be the injunction to mimic the private sector that exacerbated the speculative bubble. Last but not least, AIG, a totally private entity, went nearby collapse and was finally quasi nationalized for excessive risk taking in search for extra profit. The causality is clear: from financial crisis to public intervention ands not only the reverse as assumed by free market *doxa*.

De facto, adequate regulations are necessary for the viability of any market, especially financial one where promises to pay are especially uncertain and require a form or another of "convention". Consequently, the misleading struggle between the defenders of "pure markets" and the proponents of State intervention should be replaced by the search for relevant complementarities between these two coordinating mechanisms. In this respect, between the mythical pure market economy and the caricature of a centrally planned one, there exists a whole spectrum of *mixed economies*, combining a complex architecture of institutional arrangements.

The challenge associated to the subprime crisis is thus the following: in what direction will the various national mixed economies evolve? *A priori* several paths are open for developed economies (figure 1).

Figure 1 – At least, three major strategies in the search for new viable regimes



3. A common objective: correcting the structural unbalances that generated the sub-primes crisis

Far from being a pure accident that could not be anticipated (Boyer, 2008; 2009), it came after many warnings about the entering of the American economy into a zone of financial fragility (figure 2).

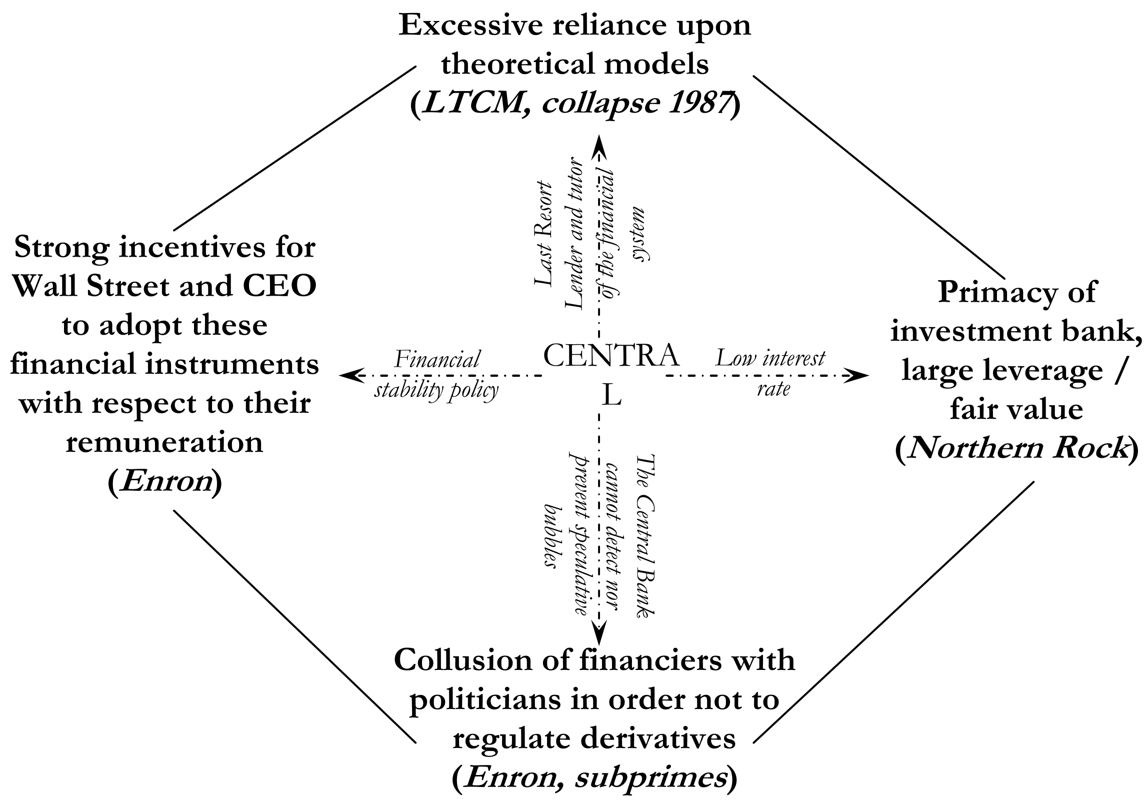
- First, the Stock Market crash of 1987 shows that individual optimal strategies for minimizing risk, when they are diffused to all actors, might well trigger a systemic instability. It was the first, and neglected, warning concerning the limits of *conventional mathematical finance*.

- The collapse of LTCM back in 1998 should have shown the danger of models that seemed to entitle very *large leverage effects* for innovative and therefore risky, hedge funds, at odds with the much more prudent strategy of typical commercial banks. Excessive credit is a major source for financial crises.

- *The remuneration* of the key actors in the financial system was indexed upon the total volume of activity. Given the under-pricing of risk, this has induced an explosion of quite exotic and complex financial products and the new business model "originate and redistribute" has progressively diffused a large irresponsibility of all the actors of the mortgage market. This feature was already detected when ENRON went bankrupt, and this collapse also pointed out the lax American *accounting system*.

- During all these episodes, *the silence of regulatory authorities* is deafening, but it is not a pure hazard. Actually, the new financiers were so rich and promising that they easily convinced the administration and politicians that all these new financial products were stabilizing the economy and had a positive impact on efficiency. Therefore any regulation would be detrimental. Thus the financial laisser-faire was paradoxically strengthened. It is why the subprime crisis is so deep: all the previous unbalances are piling up and trigger a complete melting down after the Lehman Brothers bankruptcy.

Figure 2 – The origins of sub-prime crisis: the spill-over of various perverse mechanisms and strategies



- Finally, *the Central Bank* was part of this process. It was the lender of last resort to overcome the 1987 Stock Market crash, it kept a very low interest rate after its victory against inflation –measured by consumer prices but not asset prices – and thus allowed a speculative bubble, it declared unable to detect. The financiers were strengthened in their beliefs that they were "too important to fail": the FED and the Treasury would bail them out when the bubble would burst out.

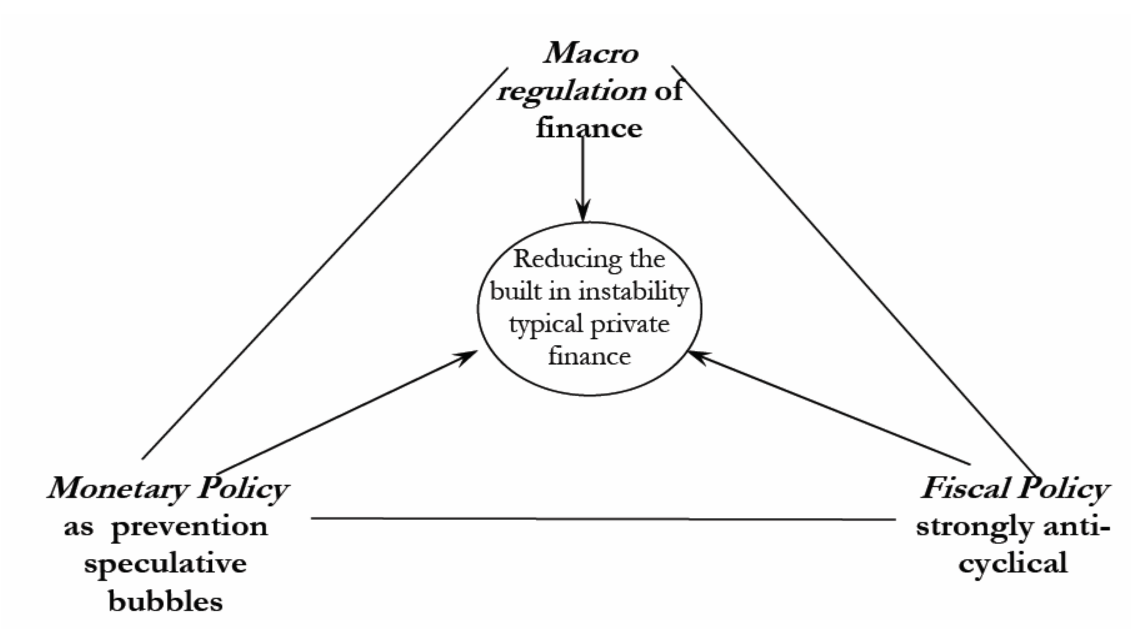
If one follows this analysis, the post September 2008 chaos is not at all the unexpected outcome of an adverse exogenous and external shock: it was the logical consequence of cumulative unbalances within the financial sector and the economy. Let us now explore various avenues for reforming this system.

4. Converging macroeconomic regulation, monetary and fiscal policy: a first possible new paradigm

This proposal derives from two important premises. Firstly, instability is a structural feature of finance that deals with uncertainty as well as risk. Furthermore the entrenched power of contemporary financiers is such that it would be quite difficult for any government to interfere directly with finance internal organization. But this does not mean that public authorities are powerless in preventing crises: basically they may adopt strong *anti-cyclical* and *anti-speculation* policies that could be efficient enough to drastically reduce the risk of a major economic crisis generated within the realm of finance (figure 3).

- On top of existing regulations at the level of each entity and asset, State should design a *macro prudential regulation*. A special agency should be in charge to make, in real time, stress tests about the resilience of the whole financial system in response to the mimetic diffusion of speculation and its bursting out, and/or adverse macroeconomic shock, affecting simultaneously all the entities. Facing a clear risk of financial collapse, this Agency should be given the right to increase capital requirements at an early stage of the speculative boom, however unpopular it might be among financiers. In a sense, this is no more than converting the stress tests made after the subprime crisis into a permanent and ex ante exercise and complementing the international micro regulations of Basel I and II – themselves reformed – by a national tool adapted to each domestic macroeconomic juncture.

Figure 3 – Prevent that a financial crisis might trigger any major economic crisis by typically macroeconomic tools and regulations



- Of course, the *monetary policy* has too a role to play. Ideally, the Central Bank should be given the objective of a maximum rate of inflation, measured synthetically by the purchasing power of money in terms of goods, services…and assets. Therefore, when an acceleration of asset prices not explained by a clear rise of real rates of return takes place, the short term interest rate should be raised, accompanied by a statement of the type: "Given the Central Bank present information and analysis, the economy is entering into a speculative bubble with a x % probability; if this diagnosis is confirmed by next data it will orient the future decisions about interest rate and refinancing of banks". If authorities fear to trigger an unwarranted recession due to a false alarm, the Central Bank may continue to target consumer price inflation and move accordingly its interest rate policy but it will increase the reserve ratio of bank to remove the excessive liquidity that may trigger an asset bubble. Furthermore, these reserve coefficients could be differentiated in order to penalize speculative activities but not the financing of productive investment. Of course, there is a need for coordinating this policy with the macro regulation by capital requirements previously mentioned.

- The third pillar of this macroeconomic approach relates to *fiscal policy*. In the American system, the deduction of interest payments associated to mortgage credit generates a bias toward credit and against saving and this may finally imperil macro stability when this device converts some households into "Ponzi speculators". This is also part of the story that leads to the subprime crisis. Therefore there is a room for a reform of the tax system: cancel interest payment deduction and increase marginal taxation for the financial earnings that excess a threshold for normal rate of return in the rest of the economy. This would help to reduce the public deficits that are expected for a long period after the costly bailing out of finance. Another major change is required: public policies that tended to become more and more pro-cyclical should be reformed to converge again towards a typical *anti-cyclical* "Keynesian" stance.

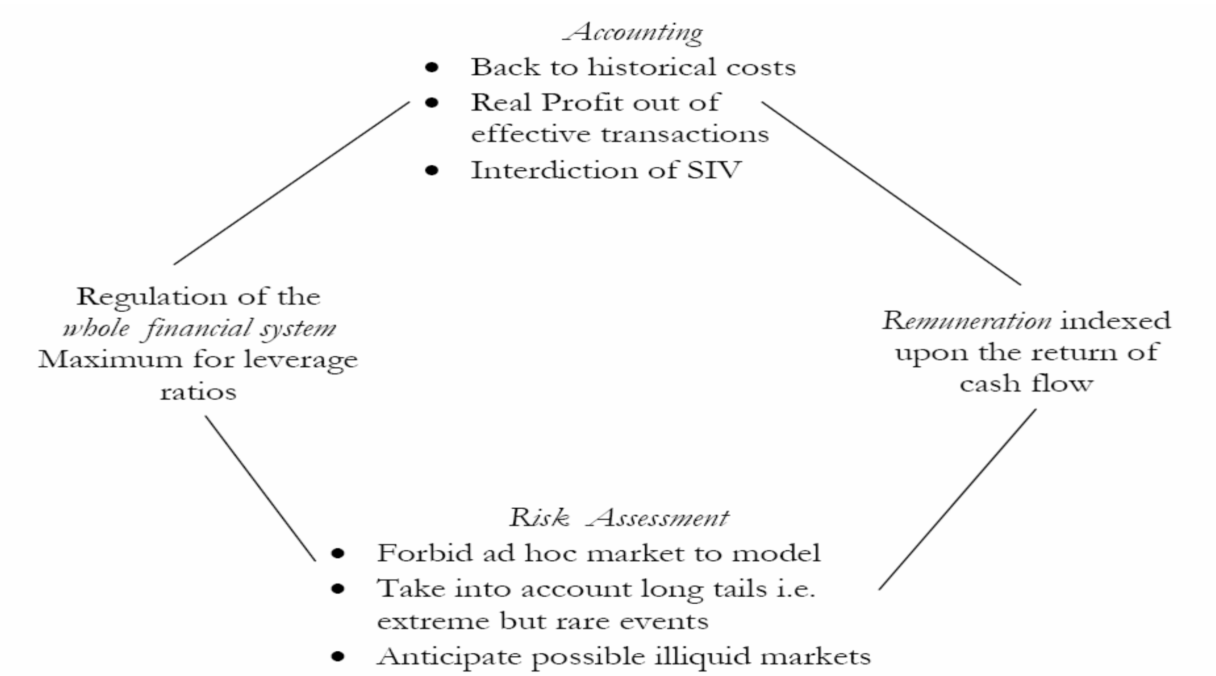
To sum-up this paradigm brings back into favour State intervention, without directly interfering with the incentives, tools and objectives of finance. This does not mean that powerful actors would easily accept such a drastic reversal of the policies of the last two decades. Hence why not reform the very internal sources of financial instability?

5. Redesign the objectives, incentives and tools of finance in order to foster a more resilient system

One of the corner-stone of this second approach relates to the *reform of remuneration* of all actors of finance according to the ex post medium term performance of related credit, asset or merger, at odds with the previous system. For instance sellers of mortgage credit should be paid according to the reimbursement flows, thus taking into account the risk of default. One can expect thus a greater moderation of credit. Similarly, stock options should be banned since they move according to so many factors far away from a direct measure of the contribution to the performance of the firm and are typically promoting excessive risk taking (figure 4). This seems far better than capping arbitrarily financiers' remuneration, without redesigning the very core of incentives.

- This calls for a drastic reappraisal of fair value *accounting principles*. They have a clear responsibility in the size of the bubble and conversely the collapse of so many banks since they introduced another acceleration mechanism on top of the well known financial accelerator. Furthermore it is meaningless to distribute totally virtual profits that would only be generated if the firm would stop its activity and sell all its assets…at the current price! It is time to come back to the conventional conception and measure of profit as value creation, to adopt a modernized version of historical costs once inflation has been drastically reduced. Similarly it is important to forbid all the Structured Investment Vehicles and other accounting tricks that allow to hide looses and costs and put forward only inflated and invented profits. It is time to learn from the ENRON scandal: the fraud was in conformity with the general principle of American accounting!

Figure 4 - *Redesigning internally finance*, the incentives, accounting principles and models in order to drastically reduce the frequency and severity of major financial crises



- The failure of risk assessment by the conventional models of modern mathematical finance calls for the rebuttal of firm specific model evaluation, and the elaboration of a new generation of risk assessment models that would correct their clear short comings as evidenced during the subprime crisis: relatively high frequency of quite *extreme events, endogeneity* of bubbles, need for anticipating a possible *freezing* of markets and access to credit…Financiers should not be entitled anymore to build their own model of this new generation: a form or another of certification, hence standardization, should be welcome. In other cords risk assessment at the micro level is too serious to be left at the initiative of overconfident *quants*, and their opportunistic use by top managers of the financial sector.

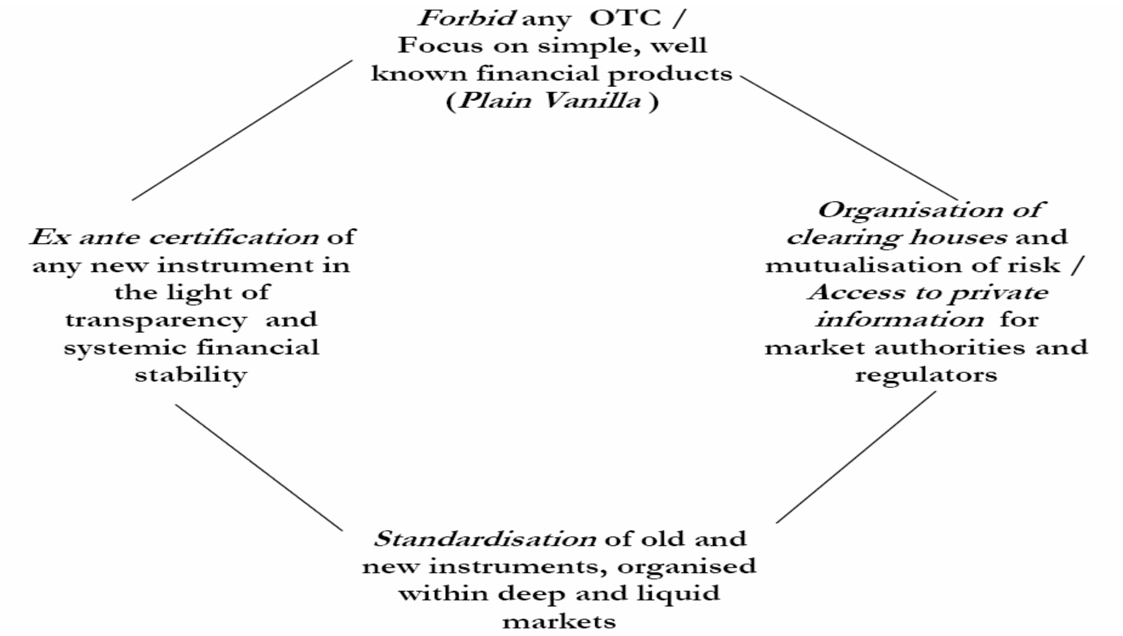
- Finally the growing interdependency between commercial banks typical activity and the dynamism and inventiveness of investment banks calls for an *integrated regulation* of the whole financial system. Since now in the US, Wall Street entities have been incorporated into the common status of holding bank they benefit from the same access to deposit insurance, liquidity from the Central Bank and credit from the Treasury, they have to comply with the same reporting rules, surveillance mechanisms, transparency and security for the public. The de-leveraging that takes place since Lehman Brothers collapse should converge towards safer leverage ratio, just to prevent the repetition of LTCM type crisis.

To be frank, this is more easily to propose than to actually implement, since it assumes a drastic shift in the bargaining power of national governments and public administrations with respect to a still powerful international finance. Thus a third strategy might be suggested.

6. A collective control of financial innovations: still another possible paradigm

It addresses to one of the interpretation of the subprime crisis: the *laisser faire* applied to finance has induced a wave of innovations, so powerful that they have destabilized the whole economic system. In any other domain, the public authorities have designed rules in order to prevent that a given innovation might display negative externalities upon the rest of the society. This is the case for medicine, security of transport, equipment, work organization, construction.
In the very domain of finance, it took nearly two centuries in order to design and implement regulations in order to prevent the bank runs that used to threat the basic relation of any market economy: the resilience of the monetary system. *Mutatis mutandis*, the task of public authorities is nowadays to invent rules and mechanisms in order to prevent the collapse of modern financial systems under the unexpected feed back of a bunch of powerful, but potentially dangerous innovations, such as securitization allied with complex derivatives (Boyer, 2008). The task is to invent for investment bank activity the equivalent of that has been done in the past for commercial banks (figure 5).

Figure 5 – Collective control of financial private innovations, highly profitable but that are powerful enough to destabilize the whole economy



How to prevent the repetition of the 2008 collapse? First it has to be recognized that granting credit to people unable to pay back was a highly profitable idea for the originators only because securitization was shifting the risk to less informed agents. A regulator should have forbidden such myopic risk transfer. When they did for example in Spain, the real estate bubbles were not prevented but no toxic derivatives have been worsening the crisis when prices have declined. Second, subprime holders were betting upon an unlimited rise of real estate prices: it was thus transforming them into "Ponzi speculators" and it is well known that such a scheme is bound to burst out with probability one. The governments that maintained strict rules concerning mortgage credit, such as Canada or Germany, did not experience at all the same trajectory as the US.

Consequently a third regulatory paradigm would focus upon financial innovations and propose an *ex ante* certification of new instruments, standardization of a limited variety of these instruments, organization of clearing houses with mutualisation of risk, real time access by regulatory agencies to the full information generated by deep and liquid markets, and finally interdiction to sell Over the Counter Products to badly informed agents.

To sum-up, again the purpose is simple to explicit, but hard to implement: embed into any new financial instrument first the requirement of transparency for the buyer, and sometimes the seller, second explicit mechanisms that would stop any negative externality in terms of systemic stability. This had been achieved for commercial banks this has to be obtained for the activity of investment banks.

7. The search for a new institutional architecture: a response to a systemic and structural crisis

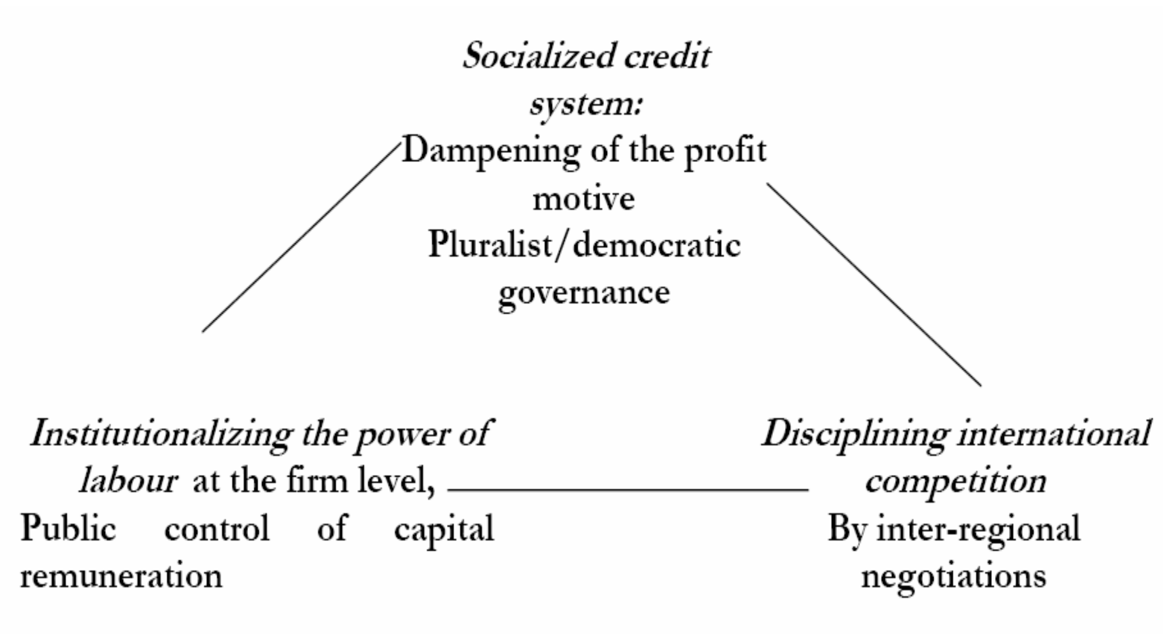
The previous analyzes focussed mainly on the domain of finance and its relations with public interventions. Nevertheless the deep and long lasting economic crisis that derives from the quasi collapse of the American financial system calls for a wider analysis (Boyer, 2009). Was not the subprime invention a trick to overcome the long term stagnation of the real income of the less privileged fraction of the population? Has not the global 2008-2009 recession shown the international system has drastically changed under the opening of most economies to trade, direct investment and finance? This is an invitation to shift from a micro approach to *regulation* to a macro analysis of the role of different financial systems in the dynamism and resilience of growth regimes, i.e. *régulation* in the French meaning (Boyer, Saillard, 2001).

Clearly, the profit motive has had a clear responsibility concerning the succession of financial crises and the power acquired by finance with liberalization and globalization has induced predatory strategies from high finance. In a sense, this is a Polanyi type of crisis: the full commodification of finance has led to the collapse of its funding pillars, i.e. trust. Therefore could emerge a totally different conception of finance: to the banks and other entities would be delegated the management of a public service, named access to credit and money (Lordon, 2009). Their governance structures should give a voice to each stakeholder (credit holder, depositor, wage-earner, citizen, communities, State…) in order to mitigate the absolutism of the profit motive (figure 6).

Basically the credit should be no more a substitute for poor and stagnating incomes. Consequently, the power of labour at the firm level should be strengthened, either by a reform of the governance of non financial firms, or by a public control of capital remuneration. Last but not least, the weakening of workers bargaining power is itself the outcome of the pressure of foreign competition, the high mobility of capital and the productive overcapacity associated with the entry of China, India and other emerging countries into world competition. Disciplining international relations by interregional negotiations would open a new phase of internationalization, better accepted by workers and citizens than the present unintended effects of large interdependence without clear collective rules (Lordon, 2009).

Such a path is far from deriving mechanically from the present state of the world economy, but the rupture of some of the past determinisms makes it less irrelevant than in the past. Every thing is up to the collective actors able to start the exploration of such a reconfiguration of national economy and international relations.

Figure 6 – Finance as a public utility, reinstituting some power of workers and new deal for international relations



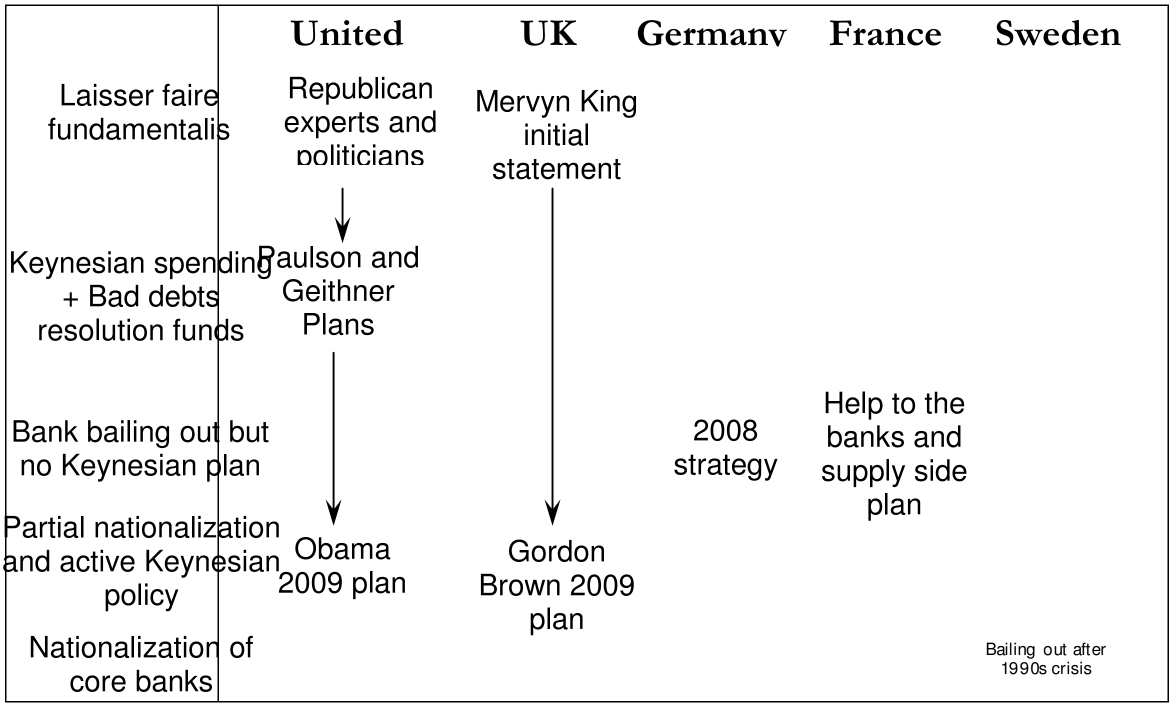
8. Financial stability has become a global public good…but still typically national strategy?

The synchronization of the 2008-2009 recession all over the world has shown an unprecedented interdependency among countries. Even the economies that have not been playing the game of financial led growth have been severely hit by the freeze of the American financial system. No surprise then if their governments are ready to impose drastic limitations to the autonomy of finance and its ability to generate structural / systemic crises. But this is not all in the interest of the countries, such as the US and UK, that have a definite competitive advantage in international financial intermediation.

De facto, the initial responses to the financial crisis have been highly contrasted. One is struck by the lack of legitimacy of a fully fledged nationalization and a strong control of finance in the US. Conversely one observes a clear reluctance to adopt any Keynesian reflation plan in Germany. In France, a large acceptance of State intervention and a form of public control over finance are prevailing. In the UK, there is still another configuration: pragmatic approach and acceptance of partial nationalization but light touch regulation. The benefits of a typical social democratic approach to financial crisis are quite clear in Sweden (figure 7). Not to speak about the Chinese strategy: brutal relaxation of bank credit, huge public spending, slow but definite reduction of the purchase of US Treasury bonds, persisting control over the exchange rate.

The present state of globalisation displays an overwhelming paradox: rhetoric efforts in the direction of general and common principles for financial regulations by the G20…but creeping protectionism in finance and trade and search for typically national strategies (Boyer, 2009)?

Figure 7 – Ways out of the crisis: a matter of political compromises and national style for policy making



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Innovation and Democracy in the Greening Learning Economy

Introduction

1. The Lisbon Strategy recognized the critical importance of innovation for economic development and in the 2020 strategy innovation it is characterized as one of the major drivers not only for economic growth but also as a prerequisite for sustainability and social cohesion.

2. But innovation remains a vague plus-word in the proposed text. To develop appropriate policies and meaningful action it is important to specify the understanding of the innovation process and relate it to the general objectives of the strategy - growth, social inclusiveness and green economy.

A need for a holistic approach

3. Innovation represents a collision between technical opportunities and user needs. Investment in science and technology contributes to expanding the knowledge base. So far this understanding has been behind the most immediate public policy response in Europe: the Barcelona agreement on raising the BNP share of R&D to 3% in all member countries.

4. This agreement reflects a general bias in innovation policy toward the supply side. Recently, and as a reaction, there has been a growing interest for what has been called 'user-driven' innovation and in the next call of the 7th Framework program a major effort is made to engage researchers in analyzing 'demand-driven' innovation.

5. Rather than engaging innovation research and policy in a zig-zag movement where the focus shifts between supply and demand side factors Europe should base its policy on a balanced approach investing both in the supply of and the demand for knowledge. A third and critical element is to promote the interaction between the two through institutional design.

On the importance of interaction among diverse agents - policy implications

6. To transform investments into innovation requires interactive learning among diverse agents. The innovation process starts with a combination of disparate elements into a *new idea*, followed by *design* of new products and processes and ending with *use* of new products and processes. At each stage feed-back and interaction among diverse agents is a key to success.

7. This perspective has important implications for public policy in different sectors. Science policy should give incentives for engaging scientists in cross-disciplinary efforts. Education policy should aim not only at high quality in terms of reading and math competence but also promote individual and collective creativity as well as social skills. Reducing barriers between disciplines and professions is a way to stimulate the formation of *new ideas*.

8. For a successful *design* process at the level of the firm it is crucial to reduce barriers between functions, including external partners such as suppliers, users and knowledge institutions. The cultural, educational and work experience background of the people involved will have a major impact together with the characteristics of the national innovation system.

9. Both in the design phase and when it comes to use new technologies success will reflect a broad participation among employees with corresponding low social distance between bosses and workers. The more turbulent the economy the bigger the need to democratize working life and to transform workplaces into learning sites.

10. Some of the crucial factors supporting the innovation process seem to lie outside the realm of public policy and sort under the prerogatives of business. But recent research shows that the design of education and training systems as well labour market policy has a major impact upon the innovation process.

11. Egalitarian education systems that give equal weight to theoretical and practical elements promote participation in organizations. The same is true for labour markets that combine high mobility with economic security and life-long training program. One way to promote innovation is thus to reform education systems and labour market institutions.

Linking innovation to empowerment and to the green economy

12. In the 2020 strategy three objectives are listed:

1. ***Creating value by basing growth on knowledge.***
2. ***Empowering people in inclusive societies.***
3. ***Creating a competitive, connected and greener economy.***

On the basis of our understanding of the innovation process we see a great potential in combining the three objectives. Empowering people is a key element in promoting value creation on the basis of knowledge. There is also a great potential in linking innovation to the green economy.

13. Historically important technological breakthroughs came about with major government intervention. This is true for the Industrial Revolution, for the construction of Railways and for the ICT-revolution. A coordinated effort to promote a green economy is necessary to avoid global warming. History indicates that it may also be seen as a way to establish a new growth path.

14. It is important that such an effort recognizes the need to take into account all dimensions of the innovation process. Investment in research needs to be linked to markets and to actual use. Proposals for R&D-efforts now with application at some moment in the distant future are misleading. Without feedback from experiences from use little progress will be made.

Multi-level innovation policy

15. Innovation policy may be implemented at different levels. The formation of links between actors such as private firms and universities may be stimulated at the local level, cities may make efforts to attract creative firms and creative people.

16. In most European countries education systems and labour market institutions remain national and here national governments have a major responsibility for upgrading skills, stimulate creativity and prepare people for the learning economy.

17. Europe has a role in promoting innovation policy in this broad sense. Imposing illusory 'best-practices' on member states may, given the systemic features of the knowledge based economies, be less efficient than organizing 'learning by comparing'.

18. In some areas of science, technology and industry there are scale economies exploited more efficiently at the European level. But the tendency to apply 'airbus-perspective' to all fields of science, technology and industry is problematic since it undermines sound competition.

19. In some areas even Europe is too small to go alone. This is true for 'mega-science' projects related to the oceans, major diseases and for developing, diffusing and using technologies that may reduce global warming.

20. Finally Europe should engage in non-technical innovation together with the rest of the world. Increasingly sophisticated technologies are of little use without a new system of global governance that can tackle problems of global warming, financial instability, global inequality and terrorism.

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European research policy at a crossroad

The global financial crisis represents a window of opportunity for more radical reflections on the relationship between Community and national research policies. As questions start to become raised about the long term financial sustainability of knowledge investments in Europe following the impact of the financial crisis on private R&D funding and rapidly growing public deficits in most Members States (MS), the time seems ripe for a reassessment of the balance between private and public funding of research and the role of national versus European policy in research.

With respect to the financial sustainability of Europe's drive towards a knowledge-based economy, the Lisbon strategy and the ensuing so-called Barcelona targets setting 3% of GDP – divided unequally between a 2% private and 1% public target – as 2010 EU R&D investment target, have undoubtedly contributed to much stronger support in MS for R&D activities and for fostering innovation in firms. However, most policy measures in MS have been taken without much consideration for their overall European impact. At the start of 2010, one can only conclude that the overall result at EU level has been disappointing. Private R&D investment as percentage of GDP has remained flat since 2000 just below 1% of GDP; the gap with the US has remained more or less the same and a new gap has emerged with China. The policy focus on private R&D has, in many ways, been misconceived. It has moved the policy attention away from the lack of priority given to public funding support for research in many MS and to a national obsession with increasing incentives to private R&D. The latter has led to intra-European competition in private R&D tax schemes with ultimately no overall positive EU effect but rather intra-European tensions with respect to R&D location as a result of widening differences in firms' R&D personnel costs. Ultimately, the aggregate business R&D deficit in Europe should be viewed as a private investment decision outcome: a reflection of Europe's attractiveness to private research investment. From this perspective, Europe's apparent limited attractiveness over the last decade reflects not only the existence of other global opportunities for private R&D investment; it also reflects a poor capacity to support the growth of significant new businesses. Compared to other regions in the world, the remaining fragmentation of

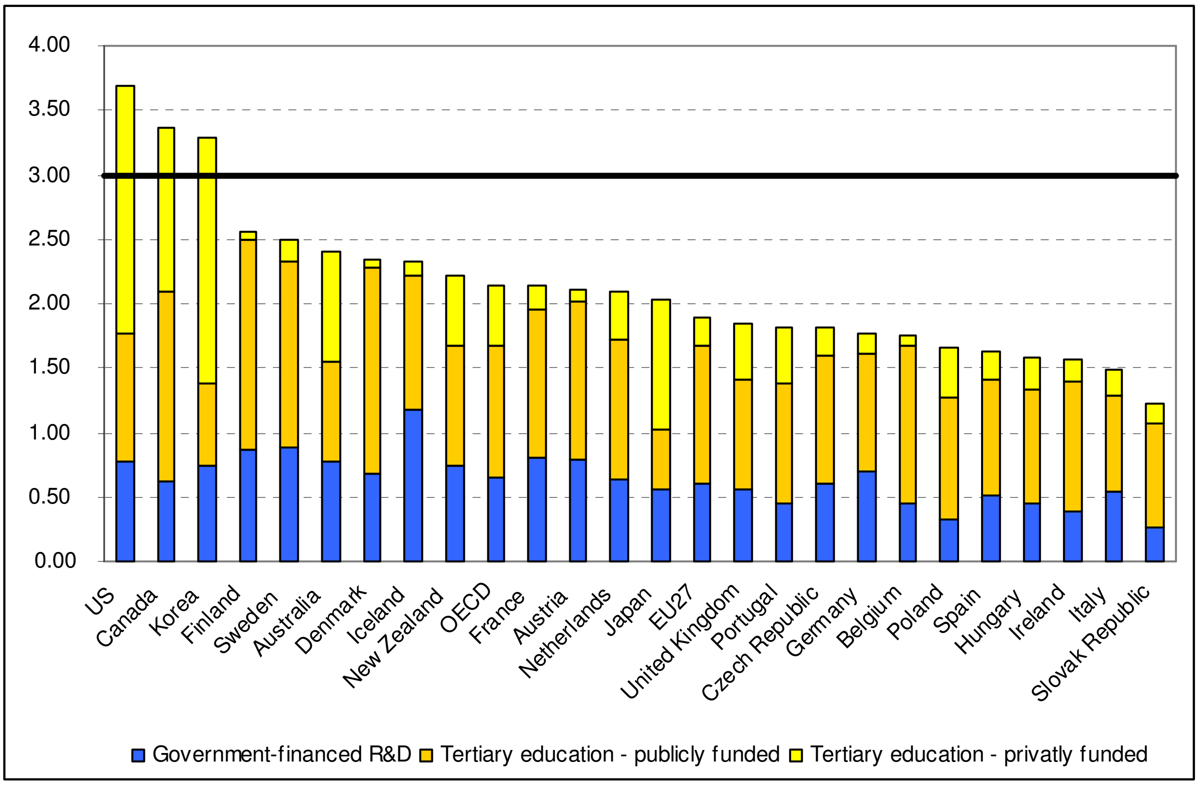
European national markets e.g. in high-tech services, is likely to have increased the uncertainty of the expected rate of return to R&D investments in Europe, representing a structural impediment to an increase in Europe of private investment into R&D.

At the same time and given the likely future environment of severe fiscal austerity in many MS, there is today a need for a more explicit commitment of European governments to knowledge investment. Hence the proposal for a new 3% knowledge investment target: to be achieved by the EU in 2020 and consisting of the old 1% Barcelona public R&D funding target and a 2% higher education target[2]. It has a number of clear policy advantages over the Barcelona 3% target. First of all, it focuses directly on what governments and policy makers are directly responsible for: whether in terms of funding or setting funding rules such as in the case of tuition fees with respect to higher education. It is a target in other words for which governments and policy makers in MS can be held responsible and accountable for. Second, none of the European MS is near, or likely to come near, this target in the years to come, as illustrated in the attached Figure. In political terms the target offers in other words credibility. All MS are being challenged to either find own public resources to increase such knowledge investments, alternatively to call upon private resources to invest in individual's future human capital. By leaving the latter to the individual choices of MS, the target provides also sufficiently political freedom to MS to decide how they intend to try to achieve the target by 2020.

Turning now to the implications of the crisis for the intervention logic of Community versus national research policy and for the balance in Community research policy between competition versus cooperation in allocating resources, it seems appropriate to also push here reflections in a more radical direction. Given the fragmented responses to the financial crisis, by and large dominated by MS' own interests, how can Community research policy play an effective catalyst role with respect to MSs national research policies? How can new instruments such as the ERC and the EIT, introduced as new Community research policy tools well before the crisis, take on a more structuring role over the years to come, providing the EU with direct instruments to restructure the fragmented European research landscape towards a truly European Research Area (ERA)? It is clear that as fiscal pressures mount in each MS, the effectiveness of many national (and regional) research funding agencies operating within the sometimes relatively narrow geographical boundaries of their domestic national, sometimes regional research area, is likely to become increasingly scrutinized. From this perspective, the future, post-crisis MS landscape of fiscal austerity offers actually opportunities for a truly European based "*common*" research policy: a new era for the ERA.

[2] In the latter case based on public or private contributions.

A new 3% target



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January 2010

International competition in Higher Education and the role of this sector in the EU's post-2010 (post-Lisbon) strategy

1. Competition and comparisons

Globalisation has given to the world of Higher Education (HE) a truly international character, and more cost-conscious policies of HE have transformed this sector into one where competitiveness has become a key strategic issue. The measurement of competition in HE originated in the United States, namely in the field of business education (MBA programs). Ranking lists of HE institutions were produced from the mid-seventies on mainly in national frameworks. That means U.S. institutions were compared only with each other while British, German, French and other national ranking lists of HE institutions also included their domestic universities or business schools only.

The picture started taking an international character in the mid-nineties when first business school rankings (e.g. Financial Times, Business Week), later university rankings (Shanghai Jiao Tong University, The Times Supplement on HE) were produced based on a worldwide approach.

The ranking methodologies utilized to produce the latter lists still raise a few questions. Such questionable issues include but are not limited to the following ones:

1. Knowledge creation taking the form either of R&D or teaching/training is not given equal treatment; some lists consider only publications;
2. The role of reputation related indicators (e.g. Nobel prizes won by persons affiliated to a given institution decades ago) tends to be exaggerated;
3. Some lists are to a great extent survey-based which reflects real institutional quality less than highly developed networks and good PR work;
4. Post-education careers (alumni careers) are only rarely considered – but if they are, they tend to be considered mainly in the case of business schools.

In spite of these and other methodological problems, the picture of worldwide competition demonstrated by basically all international ranking lists of

HE institutions should stimulate strategic thinking in Europe in this field as well. The top players are almost exclusively American universities with only 2 British universities and 1-1 Japanese or Swiss school in the pack of leaders. American dominance is also evident in the midfields of the lists (approximately the first 100). The leading universities of some European countries with quite considerable tradition and strength in HE (e.g. Italy, Spain, Belgium, Austria, Russia, Poland or Hungary) are not even in the midfield of several ranking lists.

It is quite typical that "follower" (that is high quality but by far not "Ivy League" level) universities in the U.S.[1] **fare better than universities considered representative of old European culture[2]. This makes it imperative to consider not only the future and competitiveness of R&D in Europe, but also the perspectives of European HE as a strategic issue crucial for productive post-Lisbon thinking.**

2. Strategic options

This kind of strategic thinking should take at least two directions:

1. A critical assessment of the technologies currently used for preparing international ranking lists of HE institutions is urgently needed. Such an assessment should not have a too much technical character. It should go into conceptual details of how international competition and competitiveness in HE should be understood. On the other hand, the measurement of knowledge creation by R&D and also by education/training should be given priority attention in the sense of the "knowledge triangle" (the content of which needs further precision). Such measurement techniques should incorporate both input and output factors. Regarding output, the contribution of HE to competitiveness on the macroeconomic level should be given as much consideration as the role of R&D (and R&D spending) in promoting economic competitiveness has been given in recent publications.

2. Country cases, with special emphasis on the U.S. case of course, should also be given in-depth attention. The financial strength of leading U.S. universities is beyond doubt.

Harvard, Johns Hopkins or MIT (first of all the American universities with sizeable medical schools) spend close to 1 billion USD on R&D per year which is in the range of the GERD of EU member countries such as Greece, Portugal, the Republic of Ireland, Hungary, Romania or Slovakia. Besides the fund-raising capacity of these American universities however, their prominent role and high prestige within society should also be given serious attention. An important factor of their good fund-raising performance is the strength and the extensive character of their alumni networks. This is rather a social than an economic phenomenon

[2] A string of German, French or Italian universities could be listed here.

which makes it necessary to assess the soft factors of competitiveness also in this field.

Beyond financial issues, performance assessment in U.S. HE is also an issue to be considered when thinking in terms of the future of the university world in Europe. Despite a quite ambitious strategy of creating a single European market also in HE (see the Bologna process), performance assessment in HE is still far from being unified in Europe. National funding systems of HE make it that accreditation is also national (except for some internationally networked business schools) which is a considerable factor of segmentation of the European "market" of HE.

A last important point to be addressed is related to the quality of HE output in Europe. There is a seemingly never ending debate on the real value of diplomas on the labour market with two extreme views. One of these is the "demand-pull" approach focusing on the transfer of practical (easy-to-learn-and-use) knowledge and skills to students at HE institutions. This approach seems to neglect to some extent the role of universities in producing human capital also for R&D, HE and top-level government and business work, not only for routine-based professions (with one word the training of professional elites which could not be left to PhD programs only). This approach may have obtained some intellectual support from the experiences of realising of the Bologna process in its current form. Some critics of the process namely say that the widespread practice-oriented training of theoretically not sufficiently prepared students will lead to the mass production of "receptionists" with some language, communication and computer skills but nothing else to speak of in the scientific sense.

The other viewpoint is rooted in the old European continental tradition which attached a great value to the production of intellectuals with strong analytical firepower in basically any field of science (the "supply-push" approach). This way of thinking is based on the conviction that the productions of high-quality intellectual capital will quasi automatically create its market in industry – as it used to be the case in Germany and Austria-Hungary at the beginning of the last century[3]. This may be a very useful approach in strictly social terms, while its economic/financial feasibility is very strongly challenged by current and probably increasing fiscal tensions in most countries of the EU.

In my opinion, Europe's (or its standard-setting countries') policy approach to HE has been shifting (and is increasingly biased) towards the first kind of approach in recent years. While a movement in the opposite direction may be desirable to some limited extent, the strategic approach to the future of HE in Europe should be based on trying to strike a sound balance between the two ways of HE policy thinking.

[3] See references to this in "The Vertigo Years" by Philip Blom (Weidenfeld & Nicholson, 2009).

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EU 2020: Which IPR regime to face the challenges of a green and knowledge based economy?

Foreword

Since their very beginnings the establishing of IPR and patent systems have been controversial issues. Designed to overcome some specific and important market failures (the "public good" character of information and knowledge) and to incentivise the production of knowledge, IPR systems since they consist in granting (temporary) monopolies may seriously hinder the good functioning of market-based economies. From the beginning, the debate on IPR systems was how to balance the benefits of increasing the stock of knowledge (through incentives to innovate) with the social costs paid by the society due to the granting of legal monopolies.

1. Learning from to the past

After a "golden age" during when patent systems seemed to have been reasonably balanced, the last decades were marked by dramatic changes.

What happened is no less than a general change in *IPR regimes* and systems, marked by an unprecedented strengthening of *all types* of IPR, a considerable *extension of patentable subject matters* and the *strengthening of the rights granted to the owners.* The list of changes can be presented as follows:

- Generalization of the right to patent the research results funded by public funds and to sell them through exclusive license to private for profit entities (Bayh-Dole Act);
- Dramatic extension of the domains of patentability: to living entities, software and mathematical algorithms, data bases;
- Relaxation of patentability criteria;
- Extension to 70 years of the Copyright protection;
- Internationalisation of patent laws through the signing of the TRIPS imposing "minimum standards" at world level;
- Strengthening of *enforcement* laws and measures (often under the name of fight against "piracy" and "counterfeits" products);
- Moreover some institutional complementarities were established between IPR regimes and financial regulations opening new rooms for the commoditization of knowledge and creating markets for R-D intensive firms (venture capital, Nasdaq).

This has resulted in an unprecedented surge of patents. But since the quality of the patents granted has sharply decreased, the costs of litigations rose dramatically.

It has to be noticed that in this process of changes: *Europe has always been a follower*. All the institutional or judicial innovations were first introduced by the US authorities, and then incorporated into the EU corps of laws and doctrines; often after a long resistance emanating from diverse institutions of the civil society or even from key political bodies, beginning by the European Parliament (patenting of living entities or mathematical algorithms).

2. *The present situation and the challenges to be faced*

Wither the benefits of such a change continues to be a matter of discussions, a series of negative effects could hardly be contested. Among them:

- tensions in the field of creation and diffusion of knowledge (the debate on the "scientific commons" and the "tragedy of the anticommons"); critiques around the dilution of the rules of "open science";
- multiplication of cases of "patent abuses" and related lawsuits (Microsoft, Motorola, the pharmaceutical industry,…to morrow Google…);
- serious North/South tensions: to day as regards the impacts of the TRIPS on access to medicines and care, to morrow as regards green and clean technologies (see below);
- contradiction between copyright laws and internet communities and practices.

Important reports, emanating from the highest scientific authorities (in the US for example from the National Academy of Sciences, in the UK from the Royal Commission on IPR) are now calling for revisions and more or less profound amendments to the present patent and IPR regime.

At the same time a large variety of actors operating in the fields of innovation and/or production of knowledge have opened new avenues, finding ways to escape from the rules of "exclusivity" (and monopolies) which is at the basis of the present patent and IPR systems. This is the case of the open source (FLOSS) movement in the software industry, a movement that now begins to spread into the life sciences and biotechnologies industries. It is noteworthy that even some very large firms (such as Sun or IBM) do not hesitate to use the opportunities opened by the FLOSS products. Moreover many different types of "intellectual commons" are experimenting new protocols to share access to knowledge and invent new ways to promote "commons based" production and innovation[3]. At the same time the claims to restore the values and practices of "open science" and to promote an enlarged public domain are growing.

[3] On this key issue see the remarkable contributions of the last Nobel price winner in Economics: E. Oström.

3. ***Perspectives***

In the near future, major problems are pointing in the horizon. Just to mention few of them:

- How to cope with the new global pandemics? The lessons drawn from the fight against SRAS, H1N1, H5N1, and above all HIV/AIDS have clearly demonstrated that the present patent regime is just unsustainable;
- How to cope with the challenges posed by climate change and the need to pass to green technologies? A series of major tensions are already opened between DC's and Developed countries, the access to knowledge as regards these technologies being a central issue;
- Last but not least, the tensions between the copyright laws and internet technologies are far from having found their solutions, a situation which maintains under serious threats a series of key industries and activities.

No satisfactory solution can be found to the problems above mentioned if one doesn't admit that major shifts should be assumed in the design of our IP systems. The implicit vision behind the changes of the last decades is that the continuous strengthening of IPRs is a wishable perspective not only because the granting of IPRs are viewed as incentives to innovate, but also because *IPR systems* considered as such *are the pillars on which knowledge markets are built and come to existence.* The implicit idea that organized the initiatives in favour of the endless strengthening of IP rights and systems is that the buying and selling of licenses (based on granted patents) and more generally the commoditization of knowledge is the *cornerstone for the building of opulent societies.*

What this vision doesn't see or dramatically underestimate is *that the types of markets created by the IPR system are very fragmented, highly imperfect and subject to systematic strategic behaviours from the patent owners.* Moreover one should recognize *that the commoditization of knowledge is just one of the ways – and probably not the most appropriate one – to stimulate the creation and diffusion of knowledge and innovation.*

The above mentioned initiatives organized around the principles of free and/or shared access to knowledge, more generally around "commons based" production and innovation networks, often deployed to overcome the restrictions and limitations put by the present IPR regime, clearly demonstrate at the same time, the *need* and the *feasibility* of new ways to achieve the tasks of knowledge creation and diffusion.

What is now on the Agenda is:

- putting an end to the race towards more and more exclusive rights, and exploring the opportunities opened by alternative uses of the existing property rights to promote shared and common based innovation communities;

- re-establishing right lines of departure between patentable and non patentable subject matters (especially in the two key fields of biotech and information technologies);
- redefining patentability criteria to re-establish trust and confidence to the patent systems and lower the costs of litigations;
- strengthening and protecting the public domain and the rules of "open science";
- promoting networks and communities of innovators, joining public and private entities, small and big firms, scientists and developers;
- exploring the opportunities incorporated in the TRIPS agreements to find ways to promote, on a win/win basis, cooperation with developing countries, especially in the fields of access to knowledge and transfer of technologies.

In doing so, the EU will, at the same time design the appropriate tools to face the challenges at stake and build on its fundamental cultural and philosophical values.

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Web 2.0 and the digital economy

While the EU2020 strategy certainly mentions ICT, digital development and digital commerce in a prominent way, underlining its importance for the EU and its competitiveness – just as the new Commission includes a designated Commissioner for that area – the strategy does not sufficiently focus on Web 2.0 ('Ambient Intelligence') and its implications. The interactive world is more than a tool or platform, but rather the technology that is currently changing the lives of Europeans more radically than anything else, including information, interaction and indeed identity (Facebook, Twitter, Google, Skype, Wikipedia, YouTube), well beyond the Internet alone, although hardly any area of human life can be called 'beyond' anymore. While this is often not fully appreciated by "digital immigrants", it has direct bearings on every level of human interaction, but with a particular focus, in the context of the EU2020 strategy, on knowledge and learning on the one side and business and commerce on the other – but also on social aspects such as inclusion and equality, as well as on public administration and governance, *q.v.* In several aspects, Europe is greatly lagging behind the United States and it only has one locally developed and maintained platform of any significance that unites the interactive and commercial world, namely Skype, and there is neither enough ICT innovation nor enough innovation based on ICT. The EU2020 strategy, while otherwise focusing on the both normatively and empirically most important aspects of global and European development, has to boldly, explicitly and substantively address this challenge, well beyond references to the European Digital Agenda, a common digital economy and some possibilities in various fields of education and life-long learning. In order to avoid the air of the Web 1.0 world, it must focus on the citizens / users who are both being transformed and transform the current political, economic and social world, who are driven and drivers at the same time, and it must provide well-working and competitive, safe and secure yet non-limiting structures and institutions for the inevitable establishment of the global network society in Europe. To be part of this process and in many instances and ways to lead it as well is the task of the EU if it wants to accomplish its goals during the next decades, and it needs to be a central issue of the EU2020 agenda.

Public administration – once again the missing dimension

Although the EU2020 strategy has public policy and public-policy making as its central focus, once again the public administration (PA) and management perspective is completely missing, excepting a few negative *en passant* statements regarding "administrative burden" (4), "administrative simplification" (5), making "government services easier and more efficient to deliver" (6), and one explicit statement referring to "enhancing the efficiency of public administration" (11). Overall, the strategy is formulated throughout in a passive voice; while it suggests a comprehensive development strategy to be implemented via coordinated governance, it makes no reference to who it is that should actually coordinate and carry out the strategy. To an overwhelming extent, this will have to be done via PA, and as the Lisbon Strategy has shown, policy success depends on PA performance and hence PA quality. It has to be recognized that a high-quality, high-competence, high-capacity PA, entailing the civil service and the entire field of policy, is absolutely vital for reaching the goals of the EU2020 strategy and for implementing the strategy itself.

This is even more strongly the case during the current crisis and the exit from it, which – due to its increased role, coordinating and otherwise, of the public sector – will require a particularly well-working PA, both on the side of the European Union and of the Member States on all levels of governance. Arguably, during the next half decade or two, the focus has therefore to be on PA effectiveness first – efficiency should not be forgotten, but it can not be the primary goal.

Generic complaints about PA inefficiencies, while frequently justified and certainly worth dealing with because of the centrality and the massive scope of the public sector, should not obscure the fact that European PA generally is one of the great competitive advantages of Europe on the level of effectiveness, transparency, competence and commitment. Especially at a point in time when the problems of earlier, simplistically managerialist reforms ("New Public Management") which have actually decreased PA capacity have been recognized and a new, specifically European pattern of high-quality administration is emerging (the "Neo-Weberian State"), reference only to reducing, curtailing and limiting the public administration, which represents the generic attitude of PA reform in the pre-crash paradigm with its overall scepticism of the state and its functions, is sending precisely the wrong message.

We therefore suggest that the EU2020 strategy includes an explicit paragraph referring to the high quality of PA in Europe which, while still in need of efficiency-enhancing reforms in many places and on many levels, is a strong asset of the EU and which needs to be developed towards even higher capacity, competence and effectiveness in order to deal with the challenges facing the EU, now and during the years to come, as such PA is a *conditio sine qua non* for the success of the strategy and for Europe as a whole.

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Employment and social dimensions in the post-Lisbon Strategy

Employment policy co-ordination has been in place since the launch of the Luxembourg process in 1997 and has achieved considerable successes both in re-shaping policy thinking and in pushing governments to implement policy reforms. In so doing, it has undoubtedly contributed to substantial transformations in the EU labour market and to the steady development of flexicurity as an underlying framework. Nevertheless, the European Employment Strategy, as a key component of EU 2020, now faces one of its greatest challenges. It has to ensure a convincing and coherent EU level response to the severe recession from which the EU is struggling to emerge, while also maintaining the momentum of economic reforms and anticipating emerging influences on the EU economy.

Although the knowledge-intensive economy and social cohesion aims of Lisbon I, and the growth and jobs of focus Lisbon II remain essential goals for the EU, a range of other goals have become more prominent. The Commission communication of the 24th of November puts forward three possible themes for EU and it is likely that, even if they are modified in subsequent stages of decision-making, they will feature prominently in what is eventually adopted. The second of these themes - *empowering people in inclusive societies* - is most directly relevant to the employment and social dimensions, yet plainly needs to be elaborated and refined. But it is almost axiomatic now that the EU 2020 strategy will have to encompass responses to climate change.

The crisis undoubtedly demands a fresh look at the underpinnings for policy, but may also fundamentally change what is expected from EU level co-ordination. For the EU, and in particular for the Member States facing the greatest post-crisis problems of adjustment, there will be difficult tensions to reconcile. These include possible widening of inequalities and a resurgence of long-term unemployment and detachment from the labour market. But there are also economic, social and political pressures to raise job quality, to foster labour market mobility, to develop a consistent approach to the whole life-cycle of education, active life and retirement, and to enhance human capital.

The longer-term drivers of change are well-known, but despite their familiarity have arguably not hitherto featured sufficiently in the policy strategy; they include:

- Demographic change that will alter patterns of demand for services and for the occupations they require.
- Sectoral developments including the further tertiarisation of the economy. The knowledge economy is also part of the sectoral change.
- Intensified international competition as a result of globalisation.
- Societal change, notably the continuing rise in female employment, demands for work-life balance and so on.
- Climate change as a threat.

Precisely because these drivers are long-term, their effects are not easily seen in obvious turning-points. Yet their impact is cumulative and calls for fresh ideas and interpretations of the evolving labour market. In particular, timely action will be needed to increase labour supply and to raise the skill level of the workforce. The EU cannot hope to sustain its competitiveness by lowering labour standards or curbing social protection. Nor can EU countries realistically hope to undercut emerging countries with much lower wage levels by resorting to wage cuts.

Looking forward, there are still strong reasons for having common EU level employment guidelines, but new emphases should be considered and the policy content should shift, notably to give greater weight to the supply and quality of labour. An important legacy of the last decade has been to push all Member States to support employability as a response to unemployment. While the short-term consequences of recession will still require policies to mitigate unemployment, longer-term considerations point to a more comprehensive underlying goal of increasing labour supply. Such a focus would imply paying greater attention to marginalised groups, but also to the management of immigrant labour supply.

In parallel, greater efforts will be needed to develop the supply of skills that reflect emerging labour demands, notably in the knowledge economy and to bolster 'green' jobs. The knowledge economy is often associated with competition in leading-edge, science-based industries, but a more general perspective is that is about 'brain-power' as a factor of production that confers a competitive edge, along with the application of technological advances (notably in ICT) across the whole gamut of activities and occupations. Absolute shortages in knowledge-related skills may have declined compared with a few years ago, but mis-match is a widespread phenomenon, so that policy needs to address the causes of it, including by revisiting the curricula of tertiary education. Moreover there are still sizeable qualitative and quantitative skill gaps for some of the activities central to the knowledge economy. The policy implication is that lifelong learning and post-education training have to become more orientated towards the skills demanded by the knowledge economy, and the rising importance of softer skills – communication, management etc. – should be stressed.

From the next decade onwards, the EU as a whole, and most Member States (albeit to varying degrees) will have to face up to a decline in the ratio of the working population to the elderly dependent population that will, if not dealt with, put severe strains on public finances and inter-generational 'contracts'. Some Member States will see their working population decline. While there is still scope to increase the participation rates of certain groups and, as a result, to boost the effective labour supply from the projected population, there is still likely to be a labour supply gap that can only be filled by immigration. Managing the existing stock and future flow of immigrants will, then, become a key policy issue. It is one that is, inevitably, complicated by the vexed social and security issues that go hand in hand with economic migration, especially when the likely sources of immigrants are from neighbouring regions such as North Africa or the near East (including Turkey) which are seen as predominantly Muslim.

There are two distinctive immigration flows to consider. The first is politically fairly straightforward: in some leading-edge occupations, the labour market is global and there is already a concern that the EU does not offer sufficient incentives to attract the 'best brains' who choose, instead, to favour the other side of the Atlantic. The attractiveness of the EU to key workers in the global economy is an issue that deserves attention, because many of the aims of the Lisbon strategy depend on the enabling influence of such workers. While aggregate measures of human capital based on crude counts of educational attainment tell part of the story, there is a further dimension to do with 'talent'.

Specifically some categories of workers enhance competitiveness and/or growth prospects by having a pivotal or catalytic role in economic activity. An implication is that their role and the barriers to deploying their specific human capital warrant attention. Competition for the best people and ensuring that they are deployed optimally will be increasingly more crucial to success than physical capital or other factors of production in a knowledge dominated economy. This concerns not just the skills and qualities of the current workforce, but the capacity of the EU to retain (avoiding brain *drain*) or attract (securing brain *gain*) the most talented individuals in the global labour market.

A more contentious migration challenge is in filling the jobs - often requiring only basic skills – that EU citizens are either reluctant to fill or for which the aggregate supply of labour is too limited. With an ageing population, care services will need many more employees, yet resistance to immigration of unskilled persons is substantial, and is often portrayed as being about competition for jobs when, in reality, it is more about social conditions or politics. The solution here is to look at the social and economic dimensions of immigration together, and to develop a common EU framework, although policy initiatives will manifestly have to take account of the many national sensitivities in this area.

A second broad orientation for future policy content is the different facets of labour demand.. Although already present in different ways in the existing employment guidelines, these are dispersed and explicit identification of labour demand as a core aim would help to focus attention on the obstacles to increasing labour demand, including the development of new jobs. It would also facilitate closer linkages to macroeconomic variables. Under this heading, areas for attention include wage costs, barriers to hiring disadvantaged segments of the labour force, the promotion of new sectors and of forms of work that are less familiar, including the scope for more self-employment. The bulk of the jobs of today in every Member State are in services that are not, in practice, directly vulnerable to international competition. Many such jobs – the ballast for employment – are in relatively routine personal services. A notable consequence is that the median job may soon have to be thought of as one that is filled by a woman, not necessarily working full-time, in a service industry that may not be greatly exposed to international competition, instead of the male full-time worker in manufacturing. The dichotomy between typical and atypical jobs may not only be harder to maintain, but also increasingly unhelpful as a policy concept, with the implication that a new paradigm for understanding labour demand may be needed to reflect the changes.

Third, there is still a broad agenda in the EU for improving the functioning of labour markets and the public services that promote employment. Such institutional changes are best understood and advanced within a flexicurity framework, but need refinement. Careful examination of the different components of national systems, of the incentives they offer and the ways in which the inevitable trade-offs are managed. Plainly, systems that combine flexibility and security are needed across the EU, but they cannot be imposed from above and there are always sensitive national accommodations that have to be taken into account. It will also be important to avoid the trap of viewing flexibility as mainly about greater freedom in management for employers while security is for the workers. Instead, a modern social agenda should be sensitive to the needs for flexible working arrangements that are attuned to the needs of households.

Although there is some evidence that more heavily regulated labour markets are less successful at integrating marginal groups of potential workers, Employment Protection Legislation (EPL) offers a form of social risk management for workers and can increase the incentives for employers to invest in their workforces. EPL also affects flows into and out of unemployment, with more intensive protection associated with lower turnover. It is a moot point whether this inhibits better allocation of labour or provides a degree of security that could help to boost productivity, although one outcome is to make periods of unemployment longer. A clear message is that the details of EPL matter.

The inter-action between social goals in the labour market (gender equality, quality of jobs) and conventional employment policy certainly deserves more attention, not least because the mainstreaming of issues such as gender equality in the Growth and Jobs strategy since 2005 does not seem to have worked well enough. The social aspects of employment could also be broadened: for example, job quality has previously been seen as being predominantly about raising productivity, but could also be seen from the perspective of what workers want from a job. Wider social inclusion objectives also have to be better connected to the Lisbon strategy which could mean either consolidation of the currently separate EU strategy for Social Protection and Social Inclusion into a more comprehensive EU 2020 strategy or fresh thinking on how to ensure compatibility and cross-fertilisation between these strategies. Doing so calls for a review of the governance mechanisms.

Some aspects of the governance of employment strategy are worth re-visiting. Procedurally, the present Lisbon strategy works well enough, with policy goals translated into employment guidelines, national responses in the form of comprehensive reform programmes, and a process of scrutiny and recommendations that is now solidly established. Yet it is also clear that the direct impact of the EU level on national policy is muted, because it is often tangential to national policy debates and has only limited resonance for front-line policy actors. One solution would be to make the country-specific recommendations more forthright with the expectation that they might then become an instrument for external pressures on governments (media, national parliaments, public opinion), notwithstanding the consistent opposition of governments to anything that resembles naming and shaming.

A different tack, however, would be to recognise that one of the unsung benefits of policy co-ordination is that it facilitates policy learning and to develop this aspect of governance. Although mutual learning is more systematically organised in the EU's employment and social policy domains than in other dimensions of the Lisbon strategy, it is far from obvious that its potential is sufficiently exploited.

Six main propositions for EU 2020 follow from the foregoing discussion:

1. Flexicurity should remain central to EU employment policy, but needs to be developed to take more account of flexibility from the standpoint of the worker as well as the employer, while also reconciling the redistributive and security-orientated aspects of social protection with flexibility aspirations.
2. There needs to be a balance between short-term measures related to the exit from the crisis and longer-term labour market imperatives in the headline goals.
3. Social and quality of life ambitions should feature alongside the more established competitiveness agenda in the over-arching goals of EU 2020, building on the second
4. National differences in timing and sequencing matter, implying that more attention than in the past should be paid to feasible pathways for each Member State. Possible mechanisms might include using staged targets or benchmarking against comparable Member States, however politically sensitive such measures might be.
5. The importance of a strategic approach to labour supply should be should be stressed, even though short-term considerations might militate against measures that increase the immediate size of the active population, thereby risking higher unemployment rates.
6. The opportunities for learning are a crucial element of policy co-ordination, so that one of the priorities should be to strengthen mutual learning and other approaches to policy learning so that they reach deeper into national policy-making and engage a wider spectrum of actors.

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The macroeconomic dimension and EU global governance

An adverse environment

The outlook of the new decade does not look bright for the European economy. And this for several reasons. First potential output may turn out to be much lower than pre recession levels. There are three main channels through which this could happen. First, a portion of the increase in the number of unemployed during the downturn could become irreversible. This can happen when workers lose attachment to the labor force and their skills atrophy during lengthy spells of inactivity. Consequently, it becomes more difficult for them to find employment once the recovery begins. In the wake of past recessions, labor input has been reduced through a combination of lower labor force participation and higher structural unemployment as negative shocks have interacted with inflexible labor markets. Second, steep reductions in investments by businesses and households are characteristic of most downturns. Investment is also likely to be lower following the crisis to the extent that the cost of using capital is higher, due, for instance, to larger risk premiums. During recessions investment often falls sharply and firms go out of business. This may accelerate the scrapping of capital or lead to its relocation, thus lowering the capital stock and/or its efficiency. Financial crises exacerbate these typical effects of recession by impairing financial intermediation, raising further the cost of capital, and forcing otherwise viable firms out of business. Finally, intangible investments, such as spending on research and development are among the first outlays that businesses cut back during a recession. The resulting impact on growth can be significant, because R&D is needed to sustain the discovery of innovations. In fact, the productivity gains of workers today are often in part the fruits of R&D outlays from a decade or more ago.

The potential impact of the financial crisis on the level and growth rate of total factor productivity is more ambiguous. On the one hand, it may lower total factor productivity by reducing the R&D intensity of the economy as firms reduce such spending. On the other hand, recessions may lead to the closure of the least productive lines of activity and force the least productive firms out of business, thereby increasing average productivity across the economy.

A second source of concern will be fiscal sustainability. Debt levels will rise significantly over the next few years, in Europe and elsewhere in the OECD area, as a consequence of the massive fiscal support measures that have been taken to face the recession. These will build on the already high debt levels related to the cost of ageing.

Historical evidence shows that the huge debt build-up in the aftermath of crises is the consequence of both recession-led falling revenues and the spending increases introduced to counter the recession. This seems to be the case this time too. Tithe average debt level in OECD countries has risen sharply and significantly since the outbreak of the crisis and is expected to peak at 100% by 2010, with some countries moving well beyond this figure.

Such a steep rise in debt has a significant impact on the size of fiscal adjustment that will be needed to ensure debt sustainability. According to the standard debt dynamics formula, for a given primary balance, the debt to GDP ratio declines as long as nominal gdp growth is higher than the nominal interest rate. For given growth and interest rates the primary surplus needed to stabilize debt rises significantly in almost all countries. Such increases, coupled with the fiscal deficits generated in response to the crisis, significantly increase the fiscal gaps.

The risks associated with rising government debt burdens could be further aggravated by lower potential output growth and higher interest rates. The effects of this reduced potential output might then have more serious fiscal implications if associated with a permanent decline in employment, rather than a decline in productivity if this calls for an increased use of employment support measures. Further, the risks associated with rising interest rates will be higher, and the consequences more serious, for those countries where debt burdens are already very high. These risks could become even higher for those countries tempted to inflate away debt.

All this will take place in an environment of rising competition among sovereign borrowers that will have to place on the markets increasing amounts of debt. As experience shows countries with higher debt levels and or poor fiscal credibility will be requested higher risk premia in the markets.

The possibility of a vicious circle-rising debt restraining growth and pushing interest rates up-developing over the medium term cannot be ruled out. Once the recession is behind us the global economy could well face a prolonged period of lower growth and rising (or at least not declining) debt. In some cases debt burdens could become unsustainable, opening the way to possible defaults and/or rising inflation.

This overall picture is further deteriorated if we take into consideration that the global environment may less conducive to demand growth in the medium term. We can expect the US and other advanced economies to grow less strongly as households increase their savings to recover wealth losses. This negative effect is likely to be offset only partially by the sustained demand growth in emerging economies, China in the first place, which is largely policy driven.

The global demand environment could also be weakened by the resistance of global payment imbalances. These have recently narrowed as a consequence of the recession but their underlying causes are still intact and, absent major policy adjustments, they will start to widen as global growth resumes.

One negative implication for Europe is that as the exchange rate between the dollar and the renmimbi is not significantly modified the euro will continue to face an appreciation vis a vis both currencies and therefore a loss of competitiveness.

Internal divergences and the policy dilemma of the euro area

The adverse macroeconomic environment for Europe could be aggravated by increasing divergence within the EU and especially the euro area.

Global imbalances are present within the euro area as well with on the one hand countries with current account surpluses, relatively sustained growth and sustainable fiscal positions and on the other hand countries with current account deficits, weaker growth and unsustainable fiscal positions. Markets have already begun to price sovereign risks selectively. This poses a serious policy dilemma not only to such countries but to the euro area as a whole. Fiscal sustainability requires that countries with rising debt and weak fiscal record take prompt and vigorous action to stabilize public finances. If this policy action is taken by several countries a negative impact for the euro area as whole will result, adding to the weak global environment scenario. On the other hand if such action is not taken the credibility of the euro as an area of monetary and fiscal stability may be at risk.

There are two, mutually reinforcing, strategies to deal with this dilemma. To try to strike a better balance between fiscal sustainability and growth within the euro area, and hence improve the functioning of the Stability and Growth Pact. To develop and implement an affective growth strategy at the global level.

On the first point one can reiterate the issues raised by Maria Joao Rodrigues and myself on the need to take into account the quality of public finances in assessing fiscal sustainability within the SGP. This approach is even more needed now as the state of fiscal sustainability in a number of countries will requires action both on the spending and on the revenue side to achieve the primary surpluses needed to maintain debt sustainability. And indeed in the response to the recession many countries, most notably outside the EU have taken this approach.

Can stimulus packages also raise potential growth? In addition to the tax structure, fiscal stimulus could have a positive impact on long-term growth beyond the multiplier effect to the extent that public investment, in both physical and immaterial infrastructure, affects long-term growth. The impact of infrastructure on output is difficult to pin down and the direction of causality hard to determine empirically. Nevertheless, there is some evidence from annual and multi-year growth regressions that infrastructure investment has positive effects that go beyond the impact expected from an increase in capital stock. Furthermore, infrastructure investment appears to have a nonlinear effect with, on average, a stronger long-term effect on growth at lower levels of provision. These effects were not commonly shared across OECD economies, where there was some evidence of both under- and over-provision and of both efficient and inefficient use of investment.

The SGP mechanism could also be reinforced by further strengthening the lines of reforms taken a few years back which have introduced some flexibility in the time needed to maintain fiscal sustainability especially in the case of measures related to the implementation of structural reforms and growth enhancing actions.

In addition more coordination among the national budget processes, at least in terms of timing and disclosure could help exploit positive externalities and/or avoid negative externalities which could lead to compounded recessionary impacts.

Dealing with scenario such as this calls for a serious discussion of the adequacy of the global policy framework both within and outside Europe, not simply the measures taken in direct response to the crisis. Within Europe a new policy framework should be based on three pillars: (i) an integrated approach targeted at reinforcing and possibly increasing potential growth by better connecting macroeconomic, structural, and regulatory policies, (ii) strong institutional frameworks to ensure fiscal sustainability, and (iii) enhanced international cooperation in formulating and implementing macroeconomic, structural, and regulatory policies targeted at preventing unsustainable imbalances from developing. I briefly develop this last point below.

EU and global governance

The global crisis has put an end to the so called Bretton Woods II system that in spite of several shortcomings has been able to provide sustained demand growth for the global economy for a prolonged period of time. The Bretton Woods II system is also exemplifying well the attitude that Europe has taken over the years vis a vis these issues. In a nutshell this attitude could be termed as one of reactive adaptation rather than proactive modification. Europe has been quite active in building a very specific European macromonetary system, and it has followed this strategy also in response to external developments in the international monetary system. It has been much less proactive in shaping the international monetary system itself.

Such a reactive-adaptive attitude vis a vis the issue of shaping the international monetary system is not sustainable any more. This is one of the lessons of the crisis that needs to be understood. The Bretton Woods II system needs to be replaced with a different mechanism that could desirably generate a distribution of world demand without building global imbalances and avoiding prolonged misalignments of exchange rates. More specifically a new system should: 1) provide a credible and robust multilateral insurance system so as to avoid building up of massive stocks of reserves in surplus countries. Such a multilateral system would have to rely on international financial institutions that are financially stronger and with a better and more balanced governance. 2) allow for a gradual and smooth unwinding of the exchange rate misalignments, most notably the dollar/yuan exchange rate both through increased flexibility and through the introduction of new currency agreements (such as currency baskets). 3) promote the development of a long term approach to international investment through the introduction of financial market reforms as well as market friendly regulation in both investing and receiving countries.

Such a reconstruction of the international system will require the active participation of all relevant actors. The G20 is the new body that should deal with these issues. The Framework for Sustainable and Balanced Growth launched by the G20 will be the instrument that should facilitate coordination of national policies first of all by assessing to what extent such policies are mutually consistent or are bound to generate unsustainable imbalances like in the past. The G20 itself as well as its agenda is a golden opportunity for Europe to step up its role and relevance on global governance. In addition to implementing the Framework the G20 agenda includes the reform of the international financial institutions. In both cases Europe could play a key role provided it speaks with one voice. As a player in the Framework it is almost natural that Europe should take one unified view as what matters here are the external implications of domestic economic policies and, in the case of Europe, domestic cannot mean anything but European. In addition this is the time for Europe to take up a single seat in the IFI, starting from the IMF as part of a major governance reform which would allow emerging economies to hold a voice more appropriate to their economic weight.