

Workshop on “Developing the Lisbon Agenda at European level”

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Contents

Background paper on Innovation Policy by Maria Joao Rodrigues “On the European Innovation Policy”	I
Key issues on Innovation Policy	13
Reply paper by Luc Soete “Innovation Policy, Some Reflections”	14
Background paper on the European Social Model by Maria Joao Rodrigues “For a Sustainable European Social Model”	26
Key issues on the European Social Model	44
Reply paper by Janine Goetschy “Social Europe in a new context. Policies and debates on the ‘European social model’ and ‘flexicurity’ at EU level	45
Background paper on Macroeconomic policy by Maria Joao Rodrigues “The Economic Governance of the Union and the Quality of Public Finances”	55
Key issues on Macroeconomic policy	63
Reply paper by Pier Carlo Padoan “The Macroeconomic dimension of the Lisbon Agenda. Some Reflections”	64
Synthesis paper by Maria Joao Rodrigues	83

BACKGROUND PAPER ON INNOVATION POLICY

On the European Innovation Policy

Maria Joao RODRIGUES

2006.10.09

The renewed Lisbon agenda aims at preparing Europe for globalisation. The triangle of knowledge, bringing together research, innovation and education is at the heart of this agenda in order to create new competitive advantages which are crucial to sustain the European social model. Innovation turns knowledge into added value, leads to new products and services and should become the main engine for a smarter growth with more and better jobs. Over the recent period, innovation policy has gone through important developments but a new momentum is needed to strengthen this engine.

1. Preparing Europe for Globalisation

The renewed Lisbon agenda aims at preparing Europe for globalisation. The Community Lisbon Programme combined with the National Reform Programmes are now underway, developing the following tools (see Table 1):

- regarding the external action of the Union, trade policy, cooperation policy, the external representation of the Eurozone and the external dimension of the community policies such as research, transports and environment;
- regarding the single market, the opening of markets in energy and services, the integration of financial services, the construction of trans-European networks and the national enforcement of the directives;
- regarding the competition policy, enforcing competition rules and reducing and redirecting State aids;
- regarding research policy, supporting the European research council, networks of excellence, infrastructures, human resources and opening up the national programmes;
- regarding the innovation policy, supporting innovative companies with technical and financial incentives, providing risk capital, developing innovation networks;
- regarding education, promoting a convergence of standards in high level and in vocational education, supporting European mobility and developing lifelong learning strategies;
- regarding employment and social protection policies, enforcing basic standards, raising the employment levels, improving adaptability, managing industrial restructuring and ensuring adequate, adaptable and sustainable social protection.

This is a quite ambitious agenda, but it is important to underline that some important uncertainties are still hindering its full implementation, notably the WTO agreement, the final shape of the services directive, new resources for research, the Community patent or the mix of reforms concerning the labour market. In the meantime, the knowledge triangle is being strengthened by new measures such as (see Table 2):

- in research, the European research council, the technology platforms and the Era-nets;

- in innovation, the European networks of innovation clusters and the reorganisation of the innovation supporting services;
- in education, the European Institute of Technology, the recent developments of the Bologna process and new proposals to reform the universities

2. Building a European innovation policy

More particularly, the innovation policy has gone through quite relevant developments in the European Union with the recent mid-term review of the Lisbon strategy (2005), a stronger focus was put on the central role of the innovation policy in the general structure of this strategy:

- the Lisbon Community Programme, which encompasses all the actions taken at European level, includes not only a more ambitious Framework Programme for RTD but also a Community Programme for Competitiveness and Innovation;
- the European Investment Bank and the European Investment Fund were invited to deploy new instruments to support innovation in the framework of their Initiative *Innovation 2010*;
- the Community Strategic Guidelines for the Cohesion Policy, to shape the regional policy and the next generation of structural funds, are also giving a strong priority to innovation policy;
- the recent reform of the Stability and Growth Pact introduces more concern with the quality of public expenditure and encourages Member States to redirect their public budgets in order to foster public and private investments in key priorities such as R&D, innovation, education and training;
- the Community framework for State aids is being reviewed in order to turn them into a more horizontal approach, focusing on R&D, innovation and human capital;
- last, but not least, the same happens with the integrated guidelines for the Lisbon Strategy, which were discussed by various formations of the Council of Ministers and finally endorsed by the European Council of June 2005 in order to provide the frame for the national reform programmes to be implemented over the next three years.

Taking into account these building blocks, table 3 summarises the state of the art in the building process of the European innovation policy. The need to strengthen this process is confirmed by the common approach on innovation recently adopted by the European Commission (COM (2005)488), as well as by the Spring European Council of March 2006 and its requirement to develop a comprehensive approach on innovation policy.

3. A new momentum for the European innovation policy

Innovation turns knowledge into added value, leads to new products and services and should become the main engine for a smarter growth with more and better jobs. Over the

recent period, innovation policy has gone through important developments but a new momentum is needed to strengthen this engine.

This new momentum should be given by a stronger focus on demand and market opportunities and a more effective connection between innovation, research, education and jobs creation. As the Aho Report suggests and the European Council of March 2006 has pointed out, we need a more comprehensive approach to innovation.

New market opportunities can be better explored and exploited:

- regarding the European internal market, some examples can be given by activities such as: health services, pharmaceuticals, tourism, cultural industries, urban renovation, environmental technologies, urban renovation, food safety, fashion, transports, telecommunications, software, manufacturing systems;
- regarding the external markets, the opportunities are even more diversified but, taking into account the comparative advantages of the European economy, they can be particularly relevant in activities such as: transports, telecommunications, manufacturing systems, pharmaceuticals, environmental technologies, tourism, cultural activities, education and health.

It is up to business to identify and grasp these opportunities, but these initiatives can be supported by a better coordination of trade, cooperation, public procurement and standardisation policies, which can create market opportunities with research, innovation and education, which can enable their full exploitation.

The new market opportunities should be faster translated into new products and services, by more effective innovation mechanisms and more abundant knowledge resources, comprising research capabilities, skilled labour force and specialised management expertise. European networks for growth, innovation and jobs should be encouraged and some leading European initiatives could be launched in some areas such as health, urban renovation or environmental technologies. This process should be particularly followed up by the Competitiveness Council of Ministers and by more permanent strategic platforms in some sectors, in order to build a new competitive capacity of the European economy. Some of the existing mechanisms, such as the technology platforms, the Innova clusters and the sectoral high level groups, already provide some relevant elements in this direction (see Fig. 1, 2 and 3).

4. Developing clusters and partnerships for innovation

Apart from improving the general conditions, the European and the national policy can also focus on special catalysts to speed up the innovation process. For example, the approach based on clusters should aim at developing partnerships for innovation, jobs creation and competence building, involving all the relevant actors: companies, research institutions, education and training institutions and financial bodies.

A cluster can be defined as a set of companies connecting between themselves and with institutions of knowledge production and diffusion in order to build new competitive factors and new competences and to increase the added value. A cluster can be identified and developed at different levels according to the main policy purpose:

- at local/regional level, if the purpose is to strengthen the concrete and personal relationships which underpin all clusters;
- at national level, if the purpose is to improve the framework conditions for clusters which are spread over the national territory;
- at European level, if the purpose is to improve the framework conditions for clusters which are present in various Member states.

The main policy objectives for supporting clusters development are:

- to create a self-sustained process of cooperation for competition, gathering companies, education, research, business support and financial institutions;
- to identify a critical path to develop a network and key-connections in order to add value;
- to speed up the transition to a knowledge intensive economy;
- to improve the comparative advantages in a globalised economy.

The main cluster activities which can be supported as partnerships for innovation are:

- the cooperation between enterprises regarding areas of common interest such as trade, e-business, organisation of the supply chain, diffusion of new technologies and certification;
- the development of joint research programmes;
- the development of joint training programmes;
- the development of joint business support services;
- the support to start-ups.

A critical path to developing a concrete cluster can be discovered by asking how is it possible to add more value building on the already existent competence. For instance, if we take the general human needs as a broad reference for associating clusters of economic activity (see Fig. 1):

- competences in tourism should be combined with the competence in cultural activities, sport and entertainment in order to develop the area of *leisure*;
- competences in construction, furniture, electronics, urban management should be combined in order to develop the area of *habitat*;
- competences in clothing, footwear, new materials and design should be combined in order to develop the *fashion* area;
- competences in car industry, transports and logistics should be combined, in order to develop the area of *mobility*.

In the meantime, other horizontal competences are required to develop all the clusters of activities, such as electro-mechanic equipment, information and communication technologies and biotechnologies. These can also be considered as horizontal clusters.

5. Fostering innovation capacity building at national level

The critical process of building innovation capacity begins at national level. Against the background of these policy developments at European level, it is important to identify the

new possibilities for the innovation policies at national level, taking into account the diversity of national settings.

The National Reform programmes to implement the Lisbon strategy over 2006-2008, complemented by the National Strategic Reference Frameworks can offer a unique opportunity to define national strategies of transition to knowledge-intensive economies with a central role to be given to innovation policy. The key question for each Member State is how to develop this process, adapting the European agenda and, more precisely, the integrated guidelines for growth and jobs and for cohesion to the specificities of its national innovation system. Some of these specificities should be particularly underlined to justify the diversity of national strategies to a knowledge intensive economy:

- the industrial specialisation patterns, the relationship with the global economy and the position in the international division of labour;
- the predominant types of companies and their need “to climb the ladder of innovation”;
- the institutional framework regarding, in particular, the corporate organisation, the education and training system, the research system, the financial system and the labour markets regulations;
- the quality of the infrastructures;
- the educational levels and the specific skills of the labour force;
- the organisation of the civil society and the instruments to manage change.

Recent experiences suggest there is a critical path to develop an innovation policy as a catalyst to the transition to a knowledge intensive economy:

- 1/ to use the European agenda as a leverage to introduce this strategic goal in the national agenda;
- 2/ to spread a richer concept of innovation, taking into account its different dimensions: technological and organisational, in processes or in products and services, based on science or in learning-by-doing, using or interacting;
- 3/ to highlight the implications of the innovation system approach for the coordination of policies;
- 4/ to define the priority areas of an innovation policy and prepare a tool box of operational measures;
- 5/ to open the access to this tool box in order to support innovating projects and companies whatever their sector;
- 6/ to focus on some clusters in order to illustrate the advantages of developing partnerships for innovation, as a good practice which can be followed by other clusters;
- 7/ to dynamise the national innovation system, by focusing on the missions and the interactions among its bodies, including the flexibility of labour markets;
- 8/ to reform public management with implications for innovation;
- 9/ to spread skills for innovation and to train innovation managers;
- 10/ to improve governance for innovation, by improving the internal coordination of the government and the relevant public departments, by creating public

awareness and by developing specific consultation and participation mechanisms with the civil society.

The already very rich comparative analysis on innovation systems, which is available, shows that they operate in quite different ways. Sometimes, the main source of innovation is science and technology but, in other cases, it is learning-by-doing, learning-by-using and learning-by-interacting, leading to less codified kinds of knowledge. The purpose of policy-making should be to improve the mix of these different sources of innovation in each concrete situation, by developing appropriate instruments to foster these different sources. Therefore, the innovation instruments can range from joint research projects between companies and universities to diffusing learning organisations in companies. The tool box of innovation policy instruments should be rich enough to deal with different sources of innovation in order to ensure the appropriate policy-mix for each concrete situation.

Last but certainly not least, the critical problems of improving governance for innovation should also be underlined: the coordination between the different public policies which are involved (enterprise, research, education, employment, regional and macroeconomic policies); the different ways of networking with the civil society; the public-private partnerships; the administrative capacity to foster innovation capacity; the need to build coalitions for innovation.

Table 1 PREPARING EUROPE FOR GLOBALISATION – THE TOOL BOX

POLICY AREAS GOVERNANCE LEVELS	EXTERNAL ACTION	SINGLE MARKET	COMPETITION POLICY	RESEARCH POLICY	INNOVATION POLICY (ENVIRONMENT, ICTS)	EDUCATION TRAINING POLICIES	EMPLOYMENT SOCIAL PROTECTION
INTERNATIONAL	<ul style="list-style-type: none"> - WTO - IMF, WB - UN-Development 	<ul style="list-style-type: none"> - Relationship with third countries 		<ul style="list-style-type: none"> - International Cooperation 	<ul style="list-style-type: none"> - International Cooperation 	<ul style="list-style-type: none"> - International Cooperation 	<ul style="list-style-type: none"> - Common Labour Standards
EUROPEAN	<ul style="list-style-type: none"> - Trade Policy - Cooperation Policy - External dimension of community policies 	<ul style="list-style-type: none"> - Products - Network industries - Services - Financial Markets - Public Procurement - Labour - TENS - ERDF 	<ul style="list-style-type: none"> - State aids - Mergers and acquisitions 	<ul style="list-style-type: none"> - European Research Council - Networks of excellence and integrated projects - Technology platforms - Era-Nets - Infrastructures - Human Resources - Coordination of national research policies - ERDF 	<ul style="list-style-type: none"> - European networks of innovation support services - European networks of clusters - European networks of innovative regions - Coordination of national innovation policies - Community Patent - ERDF 	<ul style="list-style-type: none"> - European mobility and cooperation in high level education, secondary and basic. Training and adult education - Convergence process in high level education and VET - Coordination of national education policies - European Social Fund 	<ul style="list-style-type: none"> - Labour directives - Coordination of national employment policies - Coordination of national social protection policies - European social fund - Globalisation fund
NATIONAL	<ul style="list-style-type: none"> - Bilateral agreements - Cooperation policy 	<ul style="list-style-type: none"> - Enforcement of directives to open the markets - Building transeuropean networks 	<ul style="list-style-type: none"> - Enforcing competition policy 	<ul style="list-style-type: none"> - National research programmes - Reforming research institutions 	<ul style="list-style-type: none"> - Supporting Innovative companies - Developing innovation networks - Providing risk capital - Expanding broad band and e-services - Spreading environmental technologies 	<ul style="list-style-type: none"> - National strategies for life-long learning - Reducing drop-outs - Improving quality standards - Increasing graduates for scientific and technological careers 	<ul style="list-style-type: none"> - Raising employment rates - Adopting employment policies to the life-cycle - Promoting flexicurity - Inclusive labour market - Investing in human capital - Ensuring adequate adaptable and sustainable social protection
REGIONAL				<ul style="list-style-type: none"> - Developing research institutions and networks 	<ul style="list-style-type: none"> - Supporting innovative companies - Developing innovation networks - Providing infrastructures 	<ul style="list-style-type: none"> - Regional strategies for life-long learning - Reducing drop-outs 	<ul style="list-style-type: none"> - Raising employment rates - Adapting employment policies to the life-cycle - Inclusive labour market - Investing in human capital

Table 2 EUROPEAN INSTRUMENTS TO BUILD A KNOWLEDGE SOCIETY

<div> <div>RESEARCH</div> <div>←</div> <div>EDUCATION AND TRAINING</div> <div>→</div> <div>INNOVATION</div> </div>							LEVELS
European Research Agencies	European Research Council	Commission's Advisory Groups FP7		Technology Platforms	European Institute of Technology*	European Foresight on Innovation and Skills	STRATEGIC DIRECTION
Basic Research Projects	Networks of Excellence	Integrated Projects	Marie Curie Fellowships	University* Advanced Projects	Vocational* Education and Training Advanced Projects	Innovation Clusters	EXCELLENCE PROJECTS
MOBILITY INSTRUMENTS							
<div> <div>←</div> <div>STRUCTURAL FUNDS PROJECTS</div> <div>→</div> </div>							CAPACITY BUILDING PROJECTS
Research Systems Reform				Lifelong Learning Systems Reform*		Innovation Systems Reform	NATIONAL REFORM PROGRAMMES

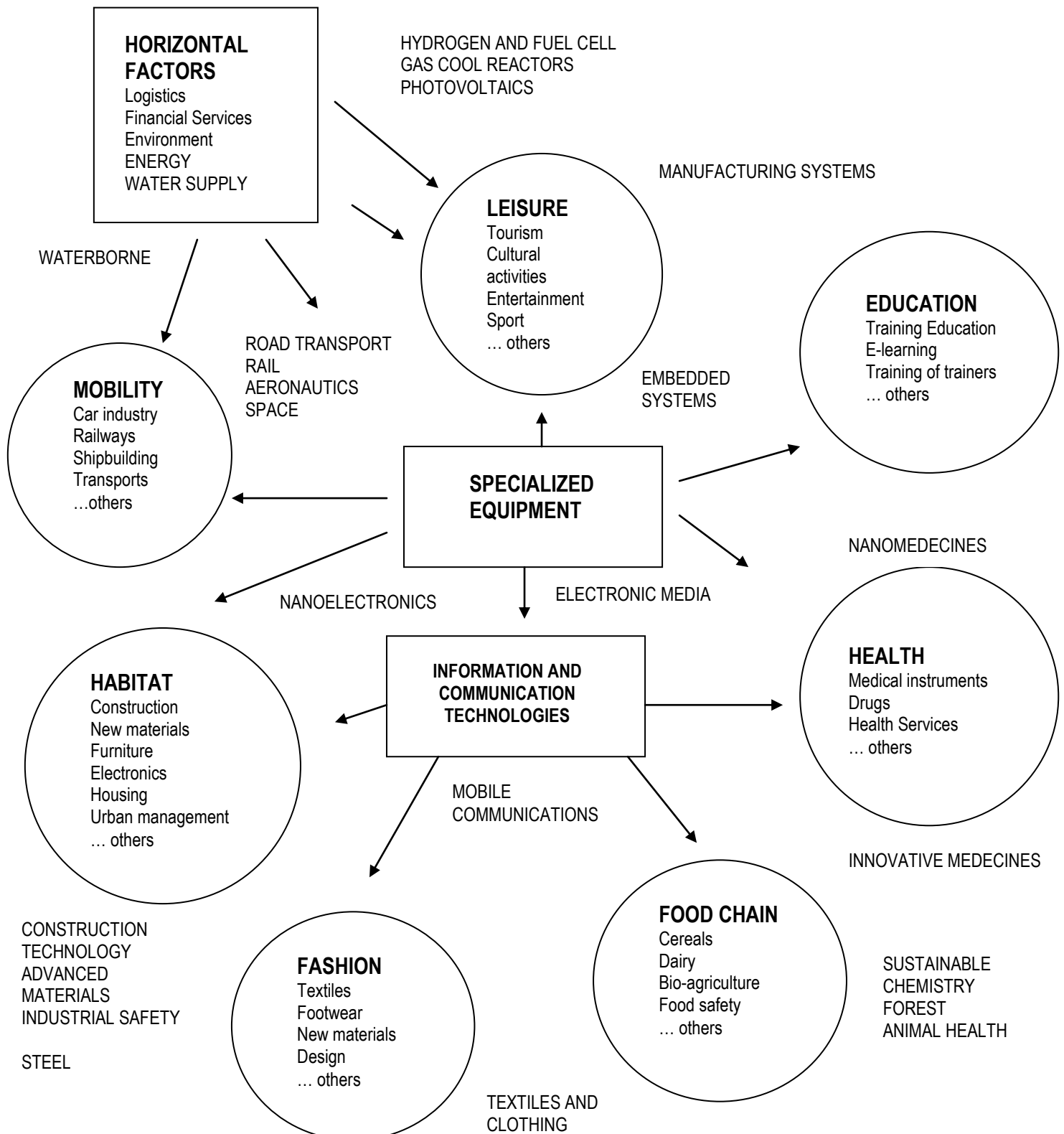
Table 3 BUILDING THE EUROPEAN INNOVATION POLICY

Innovation Policy Components	National Level	European Level
Fostering innovation in companies	<ul style="list-style-type: none"> – Training for innovation management – Business support services for innovation– including support for the modernisation of work organisation at enterprise level – Promoting learning organisations – Support to innovative start-ups 	<ul style="list-style-type: none"> – Training for innovation management (RG, CIP) – Business support services for innovation (RG, CIP, EIB) – Support to innovative SME (EIB, EIF) – Capacity building is required at regional level to provide the organisational infrastructure capable of delivering business support services.
Developing knowledge production	<ul style="list-style-type: none"> – Increasing the private and public investment in R&D – Training and mobility of more researchers – Education and training for innovation (specialised skills and qualifications) – National policies for lifelong learning 	<ul style="list-style-type: none"> – 7th Framework Programme for RTD – Community Programme for Lifelong Learning – EIB actions for human capital – Support to R&D (RG)
Developing networking for innovation	<ul style="list-style-type: none"> – Developing clusters, poles of innovation and partnerships for innovation – Supporting joint research by companies and universities 	<ul style="list-style-type: none"> – Supporting clusters, poles of innovation and partnerships for innovation (RG, CIP) – Supporting international transfer of knowledge and the international cooperation between companies (CIP)
Improving the framework conditions for innovation	<ul style="list-style-type: none"> – Broadband infrastructures – Access to venture and seed capital – Tax incentives for innovation – Intellectual property regime – Innovation in social dialogue. Some really creative thinking is needed at both national and European levels. A strong role exists for action research 	<ul style="list-style-type: none"> – Reform of State Aids – Public incentives for Innovation (RG) – Venture capital schemes (EIF) – Community patent – Innovation in social dialogue
Using demand as a leverage for innovation	<ul style="list-style-type: none"> – Encouraging public procurement of innovative products and services – Improving quality standards and certification 	<ul style="list-style-type: none"> – European competition policy – European trade policy – Setting standards by Single European Market directives
Improving governance for innovation	<ul style="list-style-type: none"> – Council of Ministers for Innovation – Innovation council and board – Lisbon Coordinator 	<ul style="list-style-type: none"> – Council of Ministers for Competitiveness

RG – European Regional Policy
CIP – Competitiveness and Innovation Programme
EIB – European Investment Bank
EIF – European Investment Fund

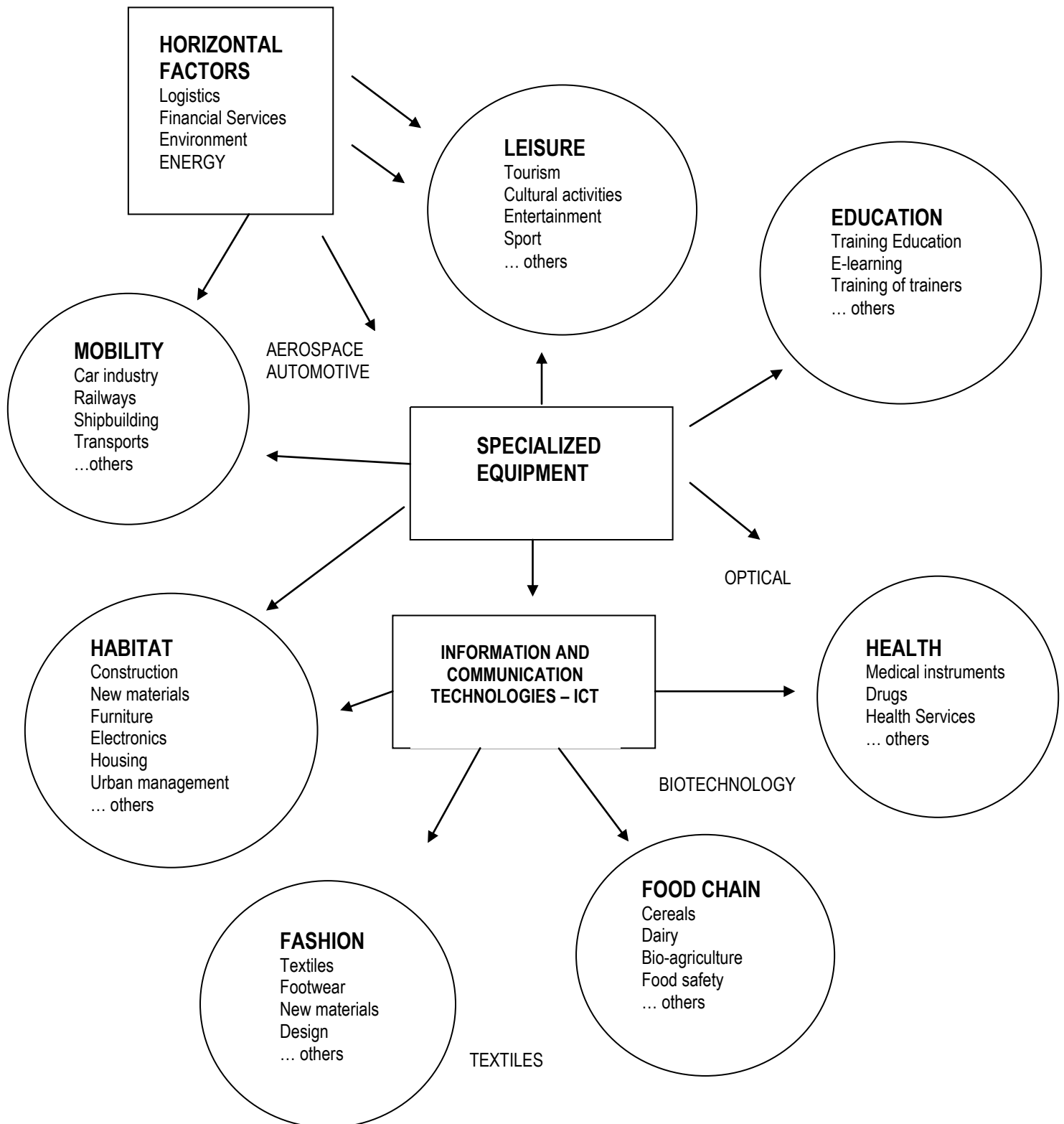
**Figure 1 EUROPEAN UNION
TECHNOLOGY PLATFORMS**

TIPOLOGY OF BASIC ECONOMIC ACTIVITIES



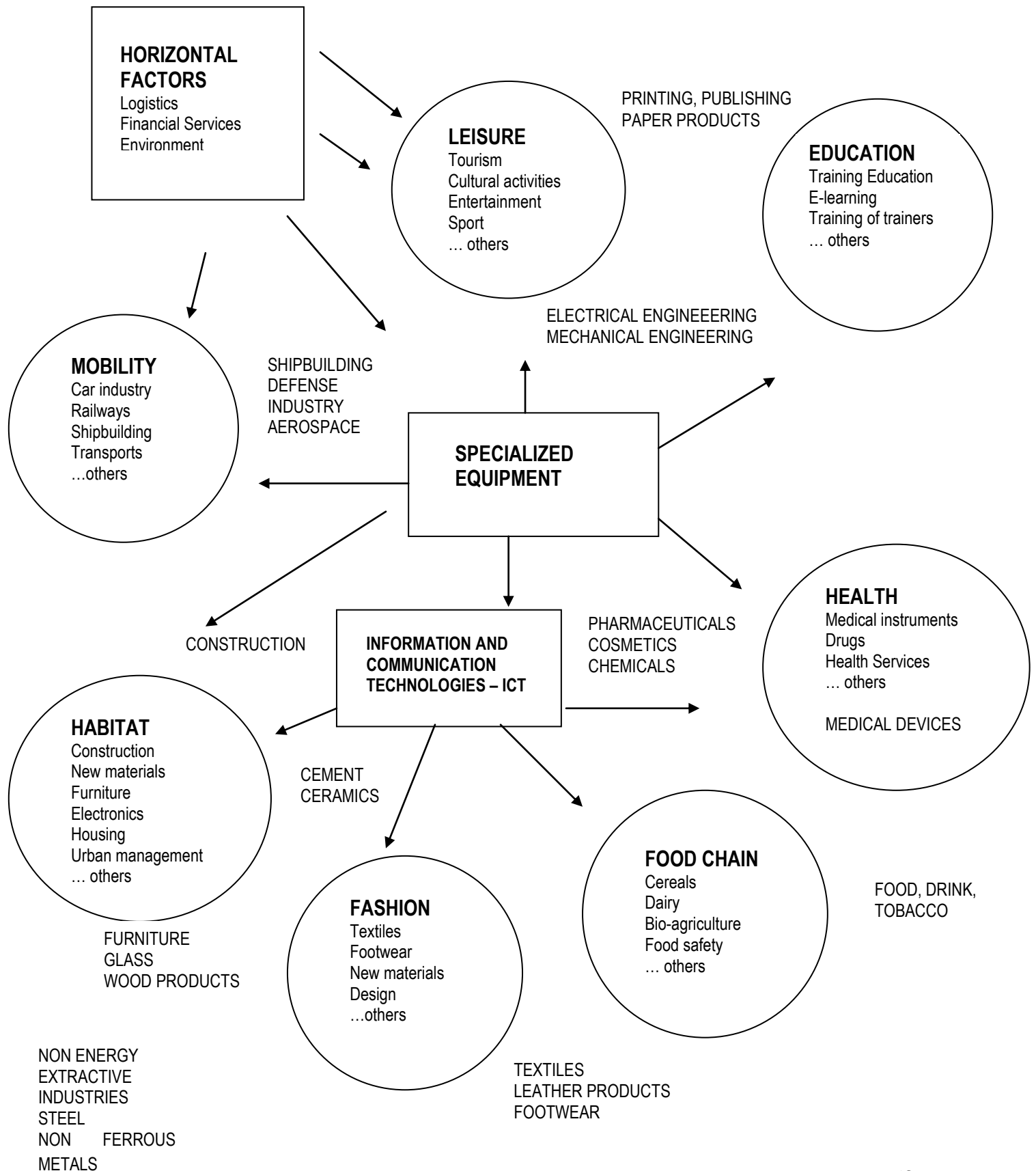
**Figure 2 EUROPEAN UNION
EUROPE INNOVA
INNOVATION CLUSTER NETWORKS**

TIPOLOGY OF BASIC ECONOMIC ACTIVITIES



**Figure 3 EUROPEAN UNION
SECTORAL ACTIONS IN INDUSTRIAL POLICY**

TIPOLOGY OF BASIC ECONOMIC ACTIVITIES



INNOVATION POLICY

Some key-questions:

- 1- What should be the key-components of a comprehensive approach on the innovation policy?
- 2- How can we develop a European dimension of innovation policy?
- 3- What can be the relationships between clusters at regional level and European global networks?
- 4- What should be the European approach on intellectual property rights?
- 5- What are the main conditions to develop venture capital?
- 6- Under which conditions can we have a win-win game between knowledge-intensive economies at international level?
- 7- How should the governance of innovation systems be reformed at national and European level?

LISBON AGENDA GROUP

WORKSHOP Developing the Lisbon Agenda at European level

REPLY PAPER

Luc Soete
November 2006

Innovation Policy, Some Reflections

I have read with great interest Maria João Rodrigues paper *On the European Innovation Policy* which provides a succinct overview of the renewed Lisbon agenda with the view of preparing Europe for globalisation. The **Tool Box Table** gives a good impression on the one hand of the broadness of the various policy areas of relevance to innovation and on the other hand of the need for close interaction between the different levels of governance involved. Let me use that Table 1 to structure my comments and reactions to the paper. I start with topics which are for me on the top of my priority list.

1. The international governance dimension

This dimension appears not surprisingly the least developed one. It undoubtedly reflects the current dominant policy impression that the international governance of innovation is not developed and that there are few tools at the international level. I would tend to disagree. The international governance dimension is taken on growing importance and will take on growing importance within the Lisbon agenda. After all, the Lisbon agenda aims at preparing Europe for globalisation.

The international governance dimension of innovation is primarily driven by business community needs and in particular the large international operating MNCs which have shifted their long term business strategies to the global field.

Three areas seem particularly relevant from this perspective:

a. Why Europe is more dependent on the international exchange level playing field

First, what could be considered to fall under the columns of Single Market and Competition Policy, the inclusion (or rather the subsequent exclusion) under the Doha round trade negotiations of the so-called Singapore “new regulatory” issues: standards for public procurement, competition policy, investment policy and trade facilitation. The inclusion of those issues, which would facilitate the access to emerging markets to European MNCs in some of the most rapid growing high tech markets: telecom services, financial and insurance services, transport and logistics, business services, public utilities had moved the EC to take a positive trade liberalisation stand whereby the Commission was prepared to give in on agriculture tariffs in favour of trade liberalisation in such more dynamic, innovative, service sectors¹.

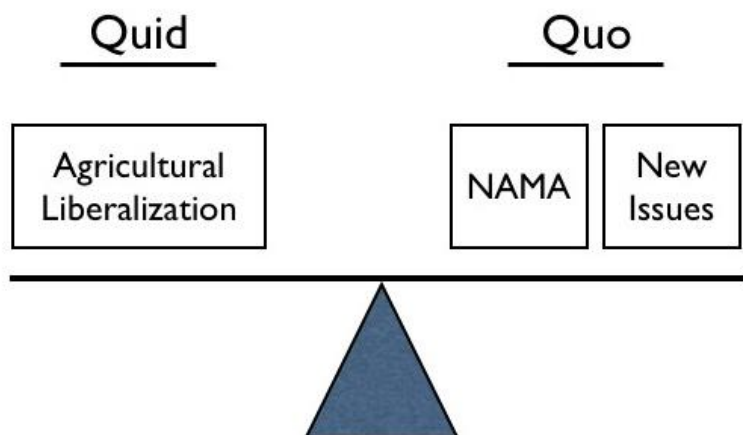
¹ In Multilateral trade negotiations under the reciprocity rule, exporters’ will find that their access to foreign markets depends on the openness of the home market. “Under the reciprocity rule, trade policy formulation appears ultimately a political contest between import competitors and exporters. The central point of Multilateral Trade Negotiations is to create a domestic political constituency in favor of openness where none had existed before by giving exporters a reason to lobby governments in favor of home market liberalization. Hence, in the world of international trade negotiation exporters defend *offensive interests*, import competitors

The central European problem of innovation in each of those sectors, compared to the US is indeed **scale**. The characteristic increasing returns features associated with the delivery of such services (often of a network nature), cannot fully become realized in the European context of 25 member countries each not just with different regulatory regimes, but also different languages, different cultures, different tastes and habits. The slow progress on the internal market front with respect to services is illustrative of the failure of Europe to take advantage of scale. The international dimension and in particular the demands with respect to the “new regulatory issues” did provided a welcome complement for European firms to realize at the international level those increasing returns, scale advantages. The old colonial, language and cultural links of many individual EU member states with many emerging and developing countries, represented for many of those EU member states a sheer natural, more straightforward opportunity for the expansions of such markets in an international global direction. From this perspective one still underestimates dramatically the way historically grown international links between countries on the basis of old established trade and foreign investment relationships have built cultural business and trust relationships (think of Ericsson’s or Saint-Gobain’s, presence in China going back to the 19th Century, or Belgium’s involvement in constructing Chinese railways, or the involvement of French firms in French speaking countries globally, or the merger of British banks with similar Commonwealth banks).

The decision to exclude those Singapore issues from the Doha trade negotiations taken in 2004, has not just shifted the EC’s position into a defensive one, trading tariff reduction in developing countries in NAMA (non-agriculture manufacturing) for tariff reductions in agriculture, it has eliminated in one go, a crucial growth opportunity for sectors at the centre of the Lisbon agenda. It is in my view illustrative of the backward progress made over the last five years on the Lisbon agenda with agriculture coming back into international trade negotiations as the central area for trade liberalisation negotiations.

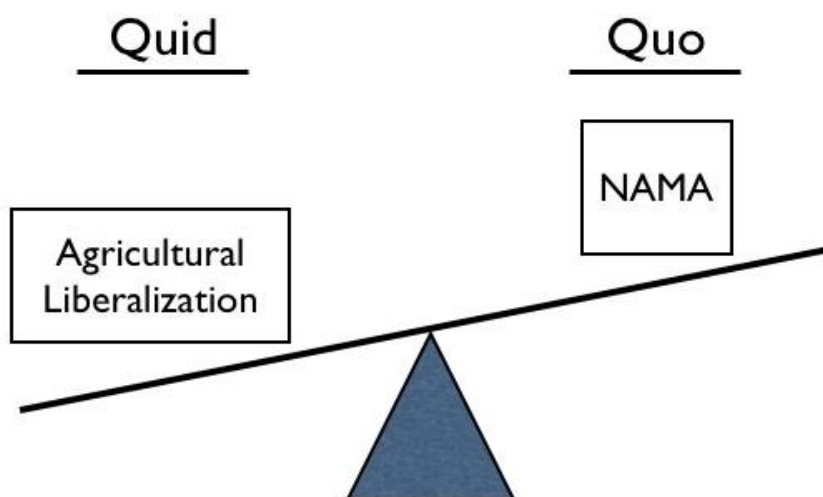
defensive interests.” (Toro, 2006) Under the Doha round which started in 2001, the EC first took an offensive stand in the agenda setting phase and then shifted after the so-called Geneva 2004 meeting towards a blocking stand.

Figure 1: A “Balanced Agreement”? What the EU had envisaged at the start of the Doha round



Source: Toro, 2006

Figure 2: An unbalanced situation: The Negotiation after the Geneva 2004 July Package



Source: Toro, 2006

b. Barcelona as Research and Innovation “fortress Europe”

The second area falling under Research and Innovation policy centres of course on the assumed geographical spill-overs of European, national and regional R&D and Innovation efforts. The national and European focus on the need for investments in knowledge (R&D and innovation) accumulation in the EU and its various member countries as exemplified by the so-called Barcelona 3% target is not just at odds with the global decision making about knowledge investments of multinational firms, it appears also to ignore the increasingly global nature of long term sustainable problems likely to affect directly the future welfare of those developed countries². The European Framework programmes, were really designed at a time when strengthening the international competitiveness of particular European high-tech firms and sectors was considered essential for Europe's long term welfare. It led to the strengthening of a number of industrial firms/sectors some of which became successful at the world level, others that failed dramatically. Today most EU research programmes benefit as much firms of European or foreign origin, as long as they are located in Europe.

As argued elsewhere (Freeman and Soete, 2006) given the much higher risks involved in developing new products for global markets, firms today will often prefer to license such technologies or alternatively outsource the most risky parts to small high tech companies which operate at arms length but can be taken over, once successful. Not surprisingly in most EU countries, the large R&D intensive firms appear today less interested in increasing their R&D investments in Europe than in rationalising them or where possible reducing the risks involved in carrying out R&D by collaboration with others sometimes through publicly sponsored or enabled programmes (SEMATEC and IMEC in micro- and today nano-electronics), or through so-called open innovation collaboration.

Not surprisingly many small, traditionally high R&D intensive EU member countries have witnessed declines in their privately funded R&D intensity over the last years with little or no relationship to their economic performance. The central question appears to be whether the benefits of knowledge investments can be appropriated domestically or will “leak away” globally. In the catching-up growth literature (Fagerberg 1983, Verspagen, 1989), it was emphasized how this phenomenon would be characterized by lagging countries benefiting from the import, transfer of technology and knowledge, formally and particularly informally. As a logical extension, in the current global world economy, it seems obvious that increasing R&D investment is unlikely to benefit only the domestic economy. This holds *a fortiori* for small countries, but is increasingly valid for most countries with only a couple of exceptions left. Thus, as Meister and Verspagen (2003) calculated, achieving the 3% Barcelona target in the EU by 2010 would ultimately not reduce the income gap between the EU and the US, the benefits of the increased R&D efforts not only accruing to Europe but also to the US and the rest of the world. In a similar vain, Griffith, Harrison

² At the same time, and by contrast the national focus on such investments by emerging developing countries, is starting to question the static, “given” nature of their international production and trade specialisation. It is interesting to observe that international trade specialists such as Samuelson have raised questions as to the sustainability of trade welfare gains (for the US economy) given an active, voluntary knowledge accumulation process in emerging economies such as China.

and Van Reenen (2004) illustrated how the US R&D boom of the 90's had major benefits for the UK economy and in particular for UK firms having shifted their R&D to the US. A UK firm e.g. shifting 10% of its R&D activity to the US from the UK while keeping its overall R&D expenditures at the same level, would witness an additional increase in productivity of about 3%, an effect which appeared to be of the same order of magnitude "as that of a doubling in its R&D stock" (Griffith et al. 2004, p.25). In short the link between the location of "national" firms' private R&D activities and national productivity gains appears today increasingly tenuous.

The same holds for universities and other public research institutes. Elsewhere (Soete, 1997), I have pointed to the inherent knowledge "diversion" and European "cocooning" implications of such a European research networking strategy. The broadening of research priorities areas to include both local as well as global long term issues raises increasingly questions about the European territorial nature of the research being carried out and funded through the FPs. In many research areas, European welfare will in the long term be directly influenced not by the development of local knowledge through the FPs, its international commercial exploitation and intellectual appropriation, but by global access to such knowledge, the development of joint global standards and the rapid world-wide diffusion of such new technologies to other, non-EU countries. One may think of energy saving technologies, research on sustainable development and climate change, health and the spreading of diseases, food safety, security, social sciences and humanities, etc. In all these areas, the limitation of the funding of research to academic, public and private research institutes located in Europe appears contrary to the need for global solutions to safeguard in the long term European welfare.

c. Europe's desperate future need for access to brains

The third area deals with the last two columns in the Tool Box table: *Education and training policies* and *Employment social protection*. The international dimension here is absolutely crucial to the Lisbon Agenda. The most fundamental difference between the US and the EU is without any doubt the difference in demographics. Europe can learn in this respect more from countries such as Japan and Russia with similar demographic challenges.

The international dimension of both education and employment policies will have to deal with the growing competition for access to brains. Access to brains should be understood here in its broadest definition: access to talent as an essential ingredient in research, innovation and entrepreneurship; access to more routine technical skills as one element in a broader strategy to tackle growing labour shortages in particular skill categories; and access to more personal skills as Europe's population grows older and the demand for health and care support services will consequently grow dramatically.

Access to brains has of course been an essential feature of development and knowledge transfer within Europe and between Europe and the rest of the world. Many European countries have moved from a situation of emigrating countries to immigrating countries, with Ireland probably as the most extraordinary case. At the same time, the migration of skilled labour from developing countries to developed countries has increased significantly. The issue has been referred as the 'brain drain' as well as brain exchange or brain

circulation. 'Brain circulation' is defined as the cycle of moving abroad to study, then taking a job abroad, and later returning home to take advantage of the skills acquired abroad to enhance domestic job opportunities. "Brain exchange" is defined as a two-way flow of expertise between a sending country and a receiving country. Where the net flow is heavily biased in one direction, the term "brain drain" has been used. The brain drain issue has been analyzed from very different angles such as 'curse or boon' (Commander, Kangasniemi et al. 2002) or 'winners and losers' (Beine et al. 2002). The earlier literature on the brain drain focused on global welfare being raised by the rational choice of highly skilled emigrants to seek improved incomes abroad (Johnson 1967; Berry and Soligo 1969). In later studies, the effects of brain drain for the development of the sending country can be summarized by two viewpoints. On one hand, from an endogenous growth framework perspective, economists believe that the direct impact of brain drain reduces the economic growth of the sending country (Miyagiwa, 1991, Haque and Kim, 1995, Reichlin and Rustichini, 1998, Hague and Aziz 1999; Wong and Yip 1999, Lowell 2002). Furthermore, they have argued that it reduces the wages of the unskilled population, are likely to increase the wages of remaining skilled workers, and hence will increase inequality. Thus, brain drain acts in this view as a double-edged sword on poverty: increasing the inequality and slowing down economic growth. On the other hand the theories of economic growth (Lucas 1988) focusing on "human capital accumulation" as an important source of economic growth, suggest that the effects of migration prospects on human capital formation (Mountford, 1997, Stark et al., 1998, Vidal, 1998, Beine et al., 2001), may actually foster human capital formation and growth in the sending countries. The possibility of emigrating to higher wage countries may stimulate persons to pursue higher education in the hope of improving their expected wages abroad. This causes sending countries to benefit from skilled emigration because it induces the remaining native population to pursue higher education.

From the point of view of receiving countries, and the EU in particular though, skilled migration is always important not just for the growth of the economy but also because of more general benefits like entrepreneurship, the contributions to an increasing demand for goods and services, attraction of new capital, etc. The foreign environment offers new alternative possibilities for initiative taking and entrepreneurship. In short immigration should be fully part of the Lisbon agenda, as should be the challenges it raises in some of the sending countries (think of nurses in South Africa).

d) Where globalization takes over from European harmonization: some other issues

Somewhat at the opposite spectrum of such trends, the global multinational enterprises have been successful in pressurizing both the EU, Japan and the US to strengthen world-wide, the intellectual property regime within which knowledge can now effectively be traded world wide through various so-called TRIPS+ bilaterally enforced trade agreements. This new international IP regime being more or less imposed worldwide by the developed countries will in all likelihood lead to a more rapid international than European harmonization process. The European patent is a case in point. The discussions starting on mutual automatic recognition of US, Japanese and European patents by the patent offices in each of those countries/regions is in all likelihood going to render the further complex discussions on the European patent obsolete.

Conclusions

In my own view the new Lisbon strategy “preparing Europe for Globalisation” will have to recognize much more than acknowledged in Maria João Rodrigues’ paper that Europe is just one region in the world with a number of specific characteristics which render it particularly vulnerable today to emerging global competition. Those characteristics have increasingly become well recognized. They relate to demographic factors such as an ageing population with low fertility; to the systematic failure lack of reaping the scale advantages of European integration; to national governance prerogatives in areas of research and development, innovation, education and employment with many overlapping tools let alone any notion of subsidiarity governing European, national versus regional policy making. As we discussed in previous meetings of our group, the Lisbon initiative six years ago was ultimately a unique attempt to deal with what could be considered an institutional failure in the formation of the European Union. Up to Lisbon there were really only two areas where in institutional terms European power was clearly dominant over national member countries power: competition policy and monetary policy in the case of the euro zone countries. Competition policy has, one could argue, an internal dynamics leading to a continuous broadening of its influence: an enlargement of the sphere of the working of market forces, a further harmonisation of rules such as the services directive or the European patent proposals. While this is likely to bring about a general efficiency enhancing effect across the EU, it has not contributed in any direct sense to knowledge accumulation or innovation improvement within the EU. On the contrary, in areas of research and innovation, competition policy has created growing legal uncertainty in member countries with respect to their own R&D and innovation support policies, explaining the recent Commission efforts in developing a new State Aid Action Plan³. Monetary policy on the other hand as implemented by the European Central Bank has put priority on addressing the regional diversity in the union in growth and inflation pressures. Here too there is a sheer natural broadening of the influence of monetary policy over domestic member countries’ fiscal policies. In principle the Growth and Stability Pact provides Europe with an instrument with which it can determine in purely quantitative terms member countries’ fiscal policies. But here too, there is no inherent incentive to promote knowledge and innovation as engines of sustainable growth.

Not surprisingly, the new Lisbon area of knowledge and innovation capacity building in Europe was by and large dependent on member countries’ efforts and willingness to give domestic priority to knowledge accumulation in all its facets, including innovation and knowledge diffusion, education and training. This is an area where, contrary to the two areas described above, there is no European power over and above member countries. Furthermore, the relevant policy areas involve a wide spectrum of relevant policy fields ranging from research to education policy, with sometimes little, sometimes growing European involvement (as in the case of the proposed European Research Council). From this perspective it is actually not surprising that little progress has been achieved in bringing forward the Lisbon strategy.

In my view the most appropriate approach to the new Lisbon Agenda, preparing Europe for globalization, should consist of using fully the international challenges with which Europe is likely to be confronted with. View Lisbon as “gate” to the rest of the world

³ See Lars-Hendrik Roller’s recent contribution for the Paris meeting on November 20th, 2006.

which therefore will have to recognize more than ever that innovation and the shifts in global demand taking place today, play increasingly a central role in European and national debates about, and the allocation of resources to, science and technology. The largest part of world wide growth and development over the last ten years has undoubtedly been associated with an acceleration in the diffusion of technological change and with increased world wide access to codified information. The role of information and communication technologies has been instrumental here as has been that of more capital and organisational embedded forms of technology transfer such as foreign direct investment which is today as a percentage of GDP a decimal point greater than what it was fifty years ago, and no longer limited to the old triad world. By contrast, labour markets and with them the knowledge embodied in skills and human capital have barely globalised, with the exception of the mobile top tail of scientists, engineers, managers, actors, football players or other creative talent.

In short, while ICT technologies enable easier diffusion of information, the global knowledge market and with it global access to knowledge – and in particular in its creation – remains highly unequal. There is likely to remain a continuing concentration of innovative activities in a small number of regions in the world which will be matched by persistent international differences in the share of resources devoted to science and technological efforts and R&D in particular. The EU with the US and Japan should undoubtedly attempt to remain part of that region, with China likely to overtake it in the coming decade. Yet, today it is to some extent no longer the concentration of such efforts in a particular region of the world which is key to economic growth and international competitiveness than the broader local organisational, economic and social embedding of new technologies and innovations and the way they unleash or block particular specific development and growth opportunities. As has become recognized in the endogenous growth literature⁴, the innovation policy challenge with its characteristic Schumpeter mark 1 versus mark 2 features appears closely associated with levels of development. In the high income, developed country context the innovation policy challenge seems increasingly directed towards questions about the sustainability of processes of “creative destruction” within environments that give increasingly premiums to insiders, to security and risk aversiveness, and to the maintenance of income and wealth. In an emerging, developing country context, by contrast, the challenge appears directed towards the more traditional, “backing winners”, industrial science and technology policies bringing also to the forefront the importance of engineering and design skills and accumulating “experience” in particular. Finally there are the majority of developing countries characterized by “disarticulated” knowledge systems, well described by many development economists in the area of science and technology and where the endogenous innovation policy challenge is probably most complex of all.

From this perspective, the challenge to Europe and the Lisbon agenda in particular seems fourfold.

First, there is the need for what has been called here the “*Lisbonisation*” of international trade, community budget, macroeconomic policies and in particular Member States’ fiscal

⁴ This view of the philosophy and aims of innovation policies differing amongst countries according to their level of development, reminiscent of many of the arguments of the old infant industry type arguments has now become popular in the endogenous growth literature. See Aghion and Howitt (2005).

policies (see also Pier Carlo Padoan's contribution on M.J. Rodrigues' paper). None of the 6 first guidelines in Table 1 refers to the need to restructure fiscal budgets at the national (or European level) in the direction of knowledge and innovation investments. Worse, the six macroeconomic policy headlines listed appear not even to recognize knowledge and innovation as engines of sustainable growth. Yet it is clear that if a more or less simultaneous alignment between member countries could take place in such a "*Lisbonisation*", quality strategy of public funding, significant growth externalities at the EU level would be realised.

Second, and focusing on the second headline in Table 1, the Lisbon strategy interpretation of "knowledge and innovation as engines of sustainable growth" represents still, I would argue, and despite brave attempts of the Commission to proof the contrary⁵, a very segmented policy approach, addressing first and foremost the traditional R&D and innovation member countries and EC policy constituencies⁶. The proposed guidelines and the further detailed proposals from the Commission (EC, 2005) are from this perspective more reminiscent of the old industrial R&D model than of the emerging knowledge economy paradigm model described in section 1. The only shift in attention paid is with respect to potential regulatory barriers to research and innovation, reflecting the broadening of vision no longer to limit support policies to just R&D but also to include now more systematically innovation, raising new competition policy issues. However, no attention is paid to interactions with Europe's social model, or with education policy buried as guideline 23 under the "more and better jobs" headline in Table 1. The result of this relatively narrow focus is that the proposed integrated guidelines are anything but integrated and convey an impression of "over-structure" with target setting on a multitude of particular aspects of knowledge and innovation which are by and large outside of the control of policy makers.

Third, given the increasingly global nature of the social, economic, environmental, demographic problems Europe is currently, and in the future likely to be confronted with, a unilateral focus on the strengthening of knowledge and innovation activities carried out within Europe with the aim of improving European competitiveness reflects increasingly, I would argue, a rather out-dated "Eurocentric" approach. It certainly does not do justice to the much broader societal and global impact, knowledge accumulation is having on European citizen's welfare. In a growing number of research fields, European welfare will in the long term be directly influenced not so much by the development of local knowledge, its international commercial exploitation and intellectual appropriation, but by global access to such knowledge, the development of joint global standards and the rapid world-wide diffusion of such new technologies to other, non-EU countries. While the shift from the old to the new Lisbon strategy sounds at least less "Eurocentric", the question remains whether it is not time for a different approach in the European Union to

⁵ As in the case of the recent Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on More Research and Innovation - Investing for Growth and Employment: A Common Approach (EC, 2005).

⁶ These range from the Science, Technology or Research ministries and the various advisory committees to the Trade and Industry, Economic Affairs or Innovation ministries and their various advisory committees. Within the EC it is primarily the DG Research and DG Enterprise constituencies.

knowledge appropriation recognizing more explicitly the global nature of knowledge accumulation? It would represent a vision, I would suggest, with more potential political appeal to European citizens than the old Eurocentric perspective of Lisbon.

Fourth, there is a need for a fundamental rethinking of the universality principles of social security systems as they were developed in Europe last Century, in a variety of ways, in broad synergy with the emerging industrial society. Such a rethinking should recognize the duality in the labour force between work involving “*labour*”, i.e. a physical or mental wearing out activity, and work involving “*pleasure*”, i.e. activities providing primarily self-satisfaction in terms of recognition, realisation and creativity. As I argued in section 2 of this paper, workers involved in the first sort of activity are likely to consider the past social achievements of the European social model as important achievements intrinsically associated with their quality of life. They will consider any change of those conditions as a clear deterioration in their quality of life and reject it. Workers, involved in the second sort of activity, call them knowledge workers, are not so much in need of social measures aimed at reducing negative externalities of physical work. Their work involves primarily positive externalities. Obviously they also will appreciate social “security” guarantees to their employment, but these will rather be used as substitute rather than as complement for own life long learning efforts and investments. Effectively, knowledge workers are “free riding” on social “security” guarantees designed in another industrial age and aimed at a different category of workers. The automatic extension of social rights to knowledge workers appears from this perspective not only unjustified, undermining the financial sustainability of the European social model, but could well also explain the lack of dynamism of knowledge workers in Europe.

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BACKGROUN PAPER ON EUROPEAN SOCIAL MODEL

For a Sustainable European Social Model

Maria Joao RODRIGUES

The reform of the European social model is one of the most complex issues to be focused on the general debate over Europe. This model is the outcome of a long and complex historical process trying to combine social justice with high economic performance. This means that the social dimension should be shaped with the purpose of social justice, but also with the purpose of contributing to growth and competitiveness. Conversely, growth and competitiveness are crucial to support the social dimension and should also be shaped to support it. This also means that there are different choices in both economic and social policies which evolve over time and must be permanently under discussion, political debate and social dialogue. This is the European tradition, highly valued inside and outside Europe as an important achievement to ensure prosperity and quality of life.

This tradition was translated into quite different national models and the most renowned typologies distinguish the Scandinavian, the Anglo-Saxon, the Continental and the South-European types (Esping-Andersen in Rodrigues, 2002 and Sakellaropoulos and Berghman, 2004). Nevertheless, in spite of these differences, some key components were put together in order to build this European social model:

- increasing general access to education and training;
- regulated labour contracts;
- general access to social protection and health care;
- active policies for social inclusion;
- social dialogue procedures;
- predominance of public funding via taxes or social contributions, with a redistribution effect.

These components have been shaped in each historic period, depending on the existent institutional frameworks and actors and on their replies to the strategic challenges of their time.

1. Reforming the European social model to face new challenges

Nowadays, it is clear that the European social model is facing new strategic challenges, which seem to be:

- globalisation and the new competitive pressures;
- the transition to a knowledge-intensive economy;

- the ageing trends;
- the new family models;
- the very process of the European integration, in its new stage.

The sustainability of the European social model depends on renewing its economic basis as well as on reforming its main components, in order to cope with these key strategic challenges. Against this background, we will identify some of the main priorities for these structural reforms (see Table 2 in Annex).

Education and Training

The access to new skills will become crucial to get new and better jobs. The education and training systems should be reformed in order to better cope with the challenges of:

- **globalisation and the transition to a knowledge economy**, by a more dynamic identification of the skills needs and by the generalisation of the lifelong learning opportunities in schools, training centres, companies, public administrations and households, which should be underpinned by an universal pre-schooling education and the reduction of early-school leavers. New and more flexible ways to validate competences (such as the Europass) can also play an important role;
- **ageing trends**, by spreading new methods to assess, enhance and use the elderly workers competences;
- **new family models**, by providing equal opportunities to career choices and more flexible access to lifelong learning over the life-course;
- **European integration**, by adopting a common framework for key-competences and facilitating the recognition of qualifications and the labour mobility.

Social Protection

Social protection systems seem to need structural reforms to cope with:

- **the transition to a knowledge economy**, by a more personalised approach in the active labour market policies, by creating learning accounts with drawing rights and by providing more flexibility of personal choices in using the range of social benefits;
- **globalisation and new competitive pressures**, by giving a stronger priority to more effective active labour market policies; by a careful monitoring of the benefits in order to make work pay and to attract more people into the labour

market, reducing unemployment and strengthening the financial basis of the social protection systems. A careful monitoring should also be made about the non-wage labour costs as well as the search of complementary (public and private) financial resources;

- **ageing trends**, by promoting active ageing, reducing early retirement, providing incentives to remain active, introducing more flexibility in the retirement age. Balancing the financial effort to be provided by different generations may also require a careful reconsideration of the balance between the three pillars of the social protection system;
- **new family models**, by spreading family care services and facilitating working time flexibility as important ways to reconcile work and family life;
- **European integration**, with a common legal framework required by the single market concerning minimum standards and portability, to be complemented with the open coordination of the social protection systems reforms.

Social inclusion

The social inclusion policies should also be updated in order to cope with the challenges of:

- **the transition to a knowledge economy**, by putting more focus on developing new social and professional capabilities, beyond the simple income guarantee;
- **globalisation**, by better targeting social inclusion programmes and by strengthening the management of the industrial restructuring;
- **ageing**, by promoting active ageing and by designing target measures for the elderly poor;
- **new family models**, by developing family care services and by designing target measures for single parents;
- **European integration**, by an open coordination of the social inclusion policies complemented with European programmes for social inclusion.

Labour regulations

The labour regulations and the human resources management should also evolve to meet the challenges of:

- **the knowledge economy**, by developing learning organisations in the work place, promoting learning careers and “learning first contracts” for young people, organising learning accounts and improving the working time flexibility for training;

- **globalisation**, by creating more internal labour flexibility (concerning work organisation, working time and wage setting), by combining new forms of external flexibility with security and by strengthening the management of industrial restructuring. The active promotion of better labour standards at international level can also play a crucial role;
- **ageing**, by encouraging new forms of work organisation, working time management and better working conditions;
- **new family models**, by facilitating working time flexibility, parental leave and career breaks;
- **European integration**, by the regular update of the European directives, by removing the obstacles to the mobility of workers at European level and by defining a European frame for economic migration.

Social dialogue

Finally, social dialogue should itself evolve to cope with the same challenges of:

- **the transition to a knowledge economy** by negotiating learning agreements at company, sector and national levels;
- **globalisation**, by negotiating innovation agreements and the social management of the industrial restructurings at company, sector and national levels;
- **ageing**, by negotiating the conditions for active ageing in the collective agreements;
- **new family models**, by systematically introducing equal opportunities in the collective agreements;
- **the European integration**, by upgrading the social dialogue concerning the European strategy for growth and jobs.

The changes which are mentioned above are the outcome of an intensive experimentation, debate and negotiation which is already under way in Europe. Most of these changes are already pointed out by the integrated guidelines of the Lisbon strategy for growth and jobs after a very rich discussion which took place at the European level, involving all the European institutions and committing Prime Ministers and ministers of very different areas. These changes were subject to a larger discussion in Member States during the preparation of their national reform programmes for growth and jobs.

A re-interpretation of the basic values

This larger discussion in the Member States should take into account this more general background of the European social model and the new strategic challenges it is facing

nowadays. Moreover, its underlying basic values seem also to be under re-interpretation, notably when:

- it is said that security should be for change, and not against change;
- in providing security, the focus is put not only in income guarantee but also in enabling and building capabilities;
- the concern with social justice is putting more emphasis in equal opportunities, even if they should be combined with basic solidarity towards the weakest members of society;
- the individual responsibility is also highlighted by this concept of equal opportunities, also leading to more freedom of choice over the life course;
- the principles of sustainable development are taken into consideration in the re-conceptualisation of social justice; hence the contributions and benefits regarding social protection should be balanced across generations.

2. Developing Lifelong Learning

2.1. To define the goals for lifelong learning

The goals of lifelong learning should be defined first of all in terms of education levels and educational attainments. The European Union has recently adopted a short list of common targets, assuming that the upper secondary level seems nowadays the minimal level to provide a solid foundation for lifelong learning. These targets (see Box 1) aim at focusing the investment in education and training in areas with clear value added, in terms of economic growth and employability. This additional effort should combine targeted public investments and higher private contributions.

Box 1

1	By 2010, an EU average rate of no more than 10% of early school leavers should be achieved;
2	The total number of graduates in mathematics, science, technology in the EU should increase by at least 15% by 2010, while at the same time the gender imbalance should decrease;
3	By 2010 at least 85% of 22 years old in the EU should have completed upper secondary education;
4	By 2010, the percentage of low-achieving 15 years old in reading, mathematical and scientific literacy will be at least halved;
5	By 2010, EU average participation in lifelong learning should be at least 12,5% of the adult working population (25 to 64 age group).

Moreover, according to the above presented analysis, two other targets should be added:

- a specific target concerning the education and training of the adult population who only has basic education;

- a general target concerning the pre-schooling education for all children, as it is proved it can play a crucial role in their cognitive development and their subsequent educational and professional performance; this target might be connected with the other already adopted, dealing with the generalisation of child care services.

In the meantime, the EU also agreed on a short list of basic skills which, in addition to literacy and numeracy, should include ICT skills, foreign language, entrepreneurship and social skills.

The goals of lifelong learning should also be defined in terms of occupational profiles and their specific competences. The purpose is not coming back to the traditional models of forecasting, setting a mechanical and unidirectional relationship between the industrial pattern of growth on the one hand and the skills needs on the other. On the contrary, the purpose should be to develop a permanent interaction between skills and the growth pattern at European, national, sectoral and local levels, involving the relevant actors and taking into account both long and short term needs. The recently created *Skillsnet* should be enhanced in order to provide basic references for this process at European level, building on the already very diversified work across Member States, which combines very different techniques: enterprise and labour force surveys, case studies, expert inquiries, analyses of jobs advertisements, forecasting and scenarios, observatories on skills developments.

2.2. For a Strategic Management of Human Resources

The strategic management of human resources becomes an important priority when:

- globalisation and European integration are redeploying investment and jobs creation to new sectors and areas;
- the transition to a knowledge-intensive economy is requiring new kinds of skills;
- the demographic trends is leading to labour shortages;
- increasing migration must be anticipated.

This is exactly the current situation in the European Union. That is why there is a increasing number of companies, regions and countries which are taking initiatives to enhance their instruments for a more strategic management of human resources. These instruments comprise:

- identifying skills needs;
- defining job profiles;
- setting qualification standards;
- developing new training programmes and curricula;
- improving vocational guidance;
- validating individual competences.

A regular foresight on skill needs is critical for a sound development of all other instruments. Specific skills needs can only be identified at company, sector and region levels, but a general and strategic framework can be provided not only at national but at European level, taking into account the global trends of trade, technologies, investment and jobs creation.

In a knowledge-based society, lifelong learning can play a central role in paving the way to new areas of jobs creation. Jobs creation is increasingly intertwined with innovation in all its dimensions: innovations not only in process but in products and services, not only in technologies but in organisation, marketing and design. At the core of innovation there is the capacity to turn knowledge into more added value, and this requires skilled people with specific occupational profiles such as; designers, engineers, different specialists of marketing, management, logistics, telecommunications.

A permanent strategic exercise should be fostered involving the relevant actors at each level, based on partnerships for innovation, jobs creation and competence building. The critical path can be discovered by asking how is it possible to add more value building on the already existent competence. For instance, if we take the general human needs as a reference for associating clusters of economic activity (see Figure 1, p.12):

- competences in construction, furniture, electronics, urban management should be combined in order to develop the area of *habitat*;
- competences in clothing, footwear, new materials and design should be combined in order to develop the *fashion* area;
- competences in car industry, transports and logistics should be combined, in order to develop the area of *mobility*.
- competences in tourism should be combined with the competence in cultural activities, sport and entertainment in order to develop the area of *leisure*;

In the meantime, horizontal competences are required to develop all the clusters of activities: electro-mechanic equipment, information and communication activities and biotechnologies.

2.3.Strategies for Lifelong Learning

The EU Member States are now committed to develop national strategies for lifelong learning. The experience of the most successful cases shows that the following priorities should be taken into account:

- to define the goals for lifelong learning in terms of not only educational levels but also new jobs profiles and competences;
- to develop a new infrastructure for lifelong learning;
- to create a diversified supply of learning opportunities able to provide more customised solutions:
 - to develop the new instruments of e-learning and to explore the potential of the digital TV
 - to turn schools and training centres into open learning centres
 - to encourage companies to adopt learning organisations
 - to shape the appropriate learning mode for each target group
 - to spread new learning solutions for the low skilled workers
- to foster the various demands for learning and to create a demand-led system:
 - to improve the framework conditions for lifelong learning
 - to develop a dynamic guidance system over the life course
 - to renew the validation and recognition system
 - to create compensations for the investment in learning

- to spread new financial arrangements in order to share the costs of lifelong learning;
- to improve governance for lifelong learning, involving all the stakeholders along the following lines (see Table 3 in Annex)

3. Developing flexicurity

Against this background concerning the reform of the European social model and the need to develop lifelong learning, we can now focus on another key issue of this reform which is flexicurity. Flexicurity refers to the different ways of combining flexibility and security, which can be provided by regulations of the labour market, active labour market policies, lifelong learning and social protection.

The method which can be used to deal with this issue is:

1. First, to identify the main types of flexibility in the labour market;
2. Secondly, to specify the measures that can provide security in each one of these kinds of flexibility;
3. Thirdly, to clarify which should be the roles and instruments to be developed at the European level and/or at the national level;
4. Fourthly, to elaborate on the general approach to labour market reforms

We will adopt a comprehensive approach to flexibility in the labour market and we will assume the main types of flexibility are:

- the transition from education to employment;
- the transition from household to employment;
- the transition from unemployment to employment;
- the functional flexibility inside companies;
- the working time flexibility;
- the wage flexibility;
- the transition between different types of labour contract;
- the transition from employment to unemployment;
- the transition from employment to retirement.

3.1. Providing security for flexibility: some key measures

According to this framework, we can specify some measures of security to be combined with the different types of flexibility which were already identified (see Table 4 in Annex).

Regarding the transition from education to employment:

- Financial incentives to the recruitment of young people
- Regional development
- Support to geographical mobility
- Skills needs foresight
- Partnership for innovation and jobs creation
- Vocational guidance

- Internships
- Ensuring the membership to the social protection system

Regarding the transition from household to employment:

- Parental leave
- Part-time parental leave
- Part-time care leave
- Catch-up training
- Progressive individualisation of social contributions and benefits

Regarding the transition from unemployment to employment:

- Decreasing non-wage costs for lower skilled jobs
- Non-discrimination measures
- Vocational and occupational guidance
- Education and training for unemployed people
- Enrolment of non-declared workers in social protection systems
- Universal minimum protection systems
- Adapting social contributions and benefits in order to make work pay
- Social inclusion measures

Regarding functional flexibility:

- Organised internal mobility
- Career and jobs design
- Access to modular lifelong learning
- Learning organisations
- Multiskilling
- Exchange of expertise between generations

Regarding working time flexibility:

- Negotiations on working time flexibility
- Time saving accounts
- Job rotation
- Learning accounts
- Training leave
- Social drawing rights

Regarding wage flexibility:

- Agreements on wages, productivity and jobs
- Agreements on wages and competence building
- Innovation agreements

Regarding the transition between different types of labour contract:

- Ensuring the membership to the social protection system
- Equalising social benefits between these different types of labour contract
- Equalising the access to lifelong learning

Regarding the transition from employment to unemployment:

- Ensuring adequate unemployment insurance
- Re-training during the unemployment period
- Active job search
- Restructuring management
- Regional development
- Partnerships for innovation and jobs creation

Regarding the transition from employment to retirement

- Flexible retirement age
- Part-time jobs
- Adapting working conditions
- New forms of work organisation
- Exchange of expertise between generations
- Reducing early retirements
- Adjusting pension calculation rules

3.2. The paths for reform

As we can see, the instruments which can be used to develop flexicurity are quite diversified. The political instruments range from directives, common guidelines, open method of coordination and social dialogue at European level to law, programmes, partnerships and social dialogue at national level. The financial instruments range from the macro-economic dialogue, the Community programmes and the structural funds at European level to the budgetary, tax and social protection policies at national level.

The paths for reform are to be defined at national level regarding the priorities, the trade-offs and synergies, the sequencing and the packaging of concrete measures. The same applies to the political method to design and implement these measures. Nevertheless, a common ground for reform and social dialogue should be enhanced building on the following principles:

- to put flexicurity mechanisms in the broader framework of the Social model. These mechanisms will be easier to implement if they are complemented by reforms of other components of the social model, notably social protection, active labour market policies and lifelong learning;
- to design the flexicurity mechanisms bearing in mind the transition to a knowledge intensive economy and a framework of sustainable development;
- to put flexicurity mechanisms in the broader context of implementing a strategy for growth jobs; they will be easier to implement if there is a trend for more and better jobs; this synergy between flexicurity and growth should be deepened;
- to make full use of social dialogue at the different levels and to strengthen the conditions to develop a long term partnership for change. A new social contract should be defined.

4. Managing Restructuring Process and Jobs Creation

The restructuring processes underway in Europe should be placed in this broader context of redeploying the European economy to new activities with more added-value and providing new and better jobs. In order to be successful, this redeployment should be underpinned by a more strategic management of human resources, encouraging a more dynamic and future-oriented interaction between labour supply and demand. Otherwise there is the risk that bigger shortages, gaps and mismatches of skills will coexist with structural unemployment.

4.1. Improving the management of the restructuring process

Improving the management of the restructuring process requires evolving (see Table 5 in Annex):

- from the traditional passive approach which puts the focus on reducing the social impacts of the restructuring process with social plans in the restructuring companies. This is necessary, but not sufficient;
- to the active approach, which involves various instruments of the active labour market policies and of the regional development policies to move workers to new jobs. This is also necessary, but not sufficient;
- and to a pro-active approach which mobilizes the several instruments of the innovation policy, in a good mix with the trade, competition, employment and training policies, in order to create stronger framework conditions for more and better investments and jobs. Taking into account the current trends for rapid change in the global economy, this approach should be urgently developed because it can prevent the tensions of a restructuring process which tends to be permanent.

4.2. Exploring new opportunities for growth and jobs creation in a globalized economy

Globalisation is changing very fast the specialisation patterns of investment and jobs creation in each country, bringing about a new map of the international division of labour. The European Union should reposition itself into new areas in this map in order to create more and better jobs. For this, it is necessary to develop a more pro-active strategy to benefit from the opportunities of globalization.

The Lisbon Strategy aims at giving a positive answer to globalization by redeploying investment and jobs creation to new areas. Therefore, it is very important to target these new areas and their opportunities by an enhanced coordination of the policies concerning trade, competition, industry, innovation, education, training, and employment.

First of all we have the opportunities created by the **European integration**:

- Enlargement (catching up process, managing real and nominal convergence, inter-sectoral and intra-sectoral specialisation, foreign direct investment, capacity building, the European policies and standards as a leverage);
- Regional development (new priorities for economic and social cohesion policies);
- Internal market (opening the markets for goods and services, integrating the financial markets, managing restructuring process);
- Economic and Monetary Union (coordinating macroeconomic policies to promote sustainable growth and to enhance strategic priorities for public investment);
- European research area (networks for excellence, integrated projects and coordination of national initiatives, creating high skilled jobs).

The **external markets** can also provide a wired range of opportunities:

- the current WTO Round is supposed to create more opportunities for trade and foreign investment, not only among developed countries, but also with the developing countries (i.e. the “Development Round”). The reform of the international financial system can play a key role in order to underpin this process, which will also be shaped by the European capacity to have a more co-ordinated voice in these arenas. In spite of the current difficulties, it remains very important to develop the negotiations in the multilateral framework, overcoming the bottlenecks by negotiating more “win-win” trade-offs.
- with a good combination of the policies for international trade, cooperation and development aid it is possible to foster new opportunities for investment and jobs creation in Europe by exporting products and services to developing countries. This is already the case, for instance, of European companies specialised in providing these countries with tailor-made technologies, services and consultancy for sustainable development, health or telecommunications.

Opportunities are also created by a new economic dynamism based on **innovation** across all sectors in: new products and services, process technologies, business concepts, and management and organisation.

Finally, **societal changes** can also create new opportunities, where a wide range of combinations between private and public initiatives can be used. All these sectors are labour intensive and tend to be knowledge intensive:

- adapting to environmental concerns;
- developing of family care services;
- expanding pre-schooling education;
- spreading lifelong learning services;
- diversifying health services;
- diversifying social integration services;
- developing business services;

- regional development services;
- urban management services;
- cultural management services;
- external cooperation services.

TABLE 1
POLICIES, MODES OF GOVERNANCE AND INSTRUMENTS

<div> <div>Policies</div> <div> <div>Modes of Governance</div> <div>Instruments</div> </div> </div>		Monetary policy	Trade policy	Single market policy	Fiscal policy	Employment Labour Policies	Research Policy	Social Protection and Social Inclusion Policies	Education and training policies	Enterprise and innovation policies
Single policy	Delegation in European bodies, laws	X	X	X						
Harmonisation of national policies	Framework laws			X		X				
Coordination of national policies	Framework laws, decisions				X	X	X		X	X
Open coordination of national policies	Decision on recommendations with monitoring and opinions						X	X	X	X
Cooperation of national policies	Recommendations						X	X	X	X
Supporting national policies	Community programs					X	X	X	X	X

TABLE 2
IDENTIFYING REFORMS FOR THE EUROPEAN SOCIAL MODEL

<div> Main strategic challenges </div> <div> Main components of the European Social Model </div>	Transition to a dynamic knowledge intensive economy	Globalisation and new competitive pressures	Ageing	New family models	European integration
1. Access to Education and Training	<ul style="list-style-type: none"> Anticipating skills needs Generating access to lifelong learning in schools, companies and households Personal competences portfolio (Europass) Universal pre-school education Reduce school leavers 	<ul style="list-style-type: none"> Anticipating skills needs Generating access to lifelong learning in schools, companies and households 	<ul style="list-style-type: none"> New methods of assessing and using competences 	<ul style="list-style-type: none"> Flexible access to lifelong learning Equal opportunities for career choice 	<ul style="list-style-type: none"> European framework for lifelong learning opportunities
2. Social Protection for all	<ul style="list-style-type: none"> Activating social protection Priority to active labour market policies Drawing rights for lifelong learning 	<ul style="list-style-type: none"> Controlling non-wage labour costs Mobilizing new kind of financial resources 	<ul style="list-style-type: none"> Active ageing Incentives to work Reducing early retirements Delay/flexibility in retirement age 3 pillars and inter generations balance 	<ul style="list-style-type: none"> Reconciling work with family life by working time flexibility and family care 	<ul style="list-style-type: none"> Coordinated reforms of social protection systems European directives on social protection
3. Social inclusion	<ul style="list-style-type: none"> More flexibility of choices in the life course Developing capabilities beyond income benefits 	<ul style="list-style-type: none"> To make work pay to increase the employment rates Managing restructuring process Targeted programme for social inclusion 	<ul style="list-style-type: none"> Active ageing Larger measures for elderly poor people 	<ul style="list-style-type: none"> Target measures for single parents Family care services 	<ul style="list-style-type: none"> European coordination for social inclusion European programmes for social inclusion European fund for social costs of restructuring
4. Labour regulations	<ul style="list-style-type: none"> Learning organisations Learning careers Training leave Learning accounts 	<ul style="list-style-type: none"> More internal labour flexibility (work organisation, working time, wage) New forms of external flexibility with security Managing restructuring 	<ul style="list-style-type: none"> New forms of work organisation New working conditions 	<ul style="list-style-type: none"> Working time flexibility Parental leave Career break 	<ul style="list-style-type: none"> European directives on working conditions Removing obstacles for mobility of workers at European level European frame for economic migration
5. Social dialogue	<ul style="list-style-type: none"> Learning agreements 	<ul style="list-style-type: none"> Innovation agreements Social plans in restructuring 	<ul style="list-style-type: none"> Active ageing in collective agreements 	<ul style="list-style-type: none"> Equal opportunities in collective agreements 	<ul style="list-style-type: none"> European social dialogue on the strategy for growth and jobs

TABLE 3
SHARING RESPONSIBILITIES FOR LIFELONG LEARNING

MAIN ACTORS	PUBLIC AUTHORITIES	COMPANIES	INDIVIDUALS	SOCIAL PARTNERS	PUBLIC AND PRIVATE TRAINING SUPPLIERS
PRIORITIES FOR LIFELONG LEARNING DEVELOPMENT					
To define the goals for lifelong learning: new jobs profiles and competences	<ul style="list-style-type: none"> - Forecasting institutions - Partnerships for jobs creation 	<ul style="list-style-type: none"> - Human resources management - Partnerships for jobs creation 		<ul style="list-style-type: none"> - Innovation agreements - Partnerships for jobs creation 	<ul style="list-style-type: none"> - Training development - Partnerships for jobs creation
To develop a new infrastructure for lifelong learning	<ul style="list-style-type: none"> - Telecommunications and TV regulation - Knowledge resource centres 	<ul style="list-style-type: none"> - Digital equipment 	<ul style="list-style-type: none"> - Digital equipment 		<ul style="list-style-type: none"> - Broadband providers - Content providers
To develop e-learning activities					<ul style="list-style-type: none"> - e-learning products and services
To turn schools and training centres into open learning centres	<ul style="list-style-type: none"> - Education and training systems regulations 	<ul style="list-style-type: none"> - New kinds of demand 	<ul style="list-style-type: none"> - New kinds of demand 		<ul style="list-style-type: none"> - Organisational development
To adopt learning organisations		<ul style="list-style-type: none"> - Organisational development 		<ul style="list-style-type: none"> - Innovation agreements 	
To shape the appropriate learning mode for each target group		<ul style="list-style-type: none"> - New kinds of demand 	<ul style="list-style-type: none"> - New kinds of demand 	<ul style="list-style-type: none"> - Negotiation of training in collective agreements 	<ul style="list-style-type: none"> - Product development - Marketing
To spread new learning solutions for the low skilled workers	<ul style="list-style-type: none"> - To support new solutions - To ensure basic education for all 	<ul style="list-style-type: none"> - Organisational development 	<ul style="list-style-type: none"> - Stronger personal commitment 	<ul style="list-style-type: none"> - Special conditions for training 	<ul style="list-style-type: none"> - Specialised courses - Focus on new basic skills
To improve the framework conditions for lifelong learning: time management, care services...	<ul style="list-style-type: none"> - Family care services 	<ul style="list-style-type: none"> - Family care services 		<ul style="list-style-type: none"> - Negotiation of working time management - Time accounts and training leaves 	
To develop a guidance system over the life course	<ul style="list-style-type: none"> - To provide guidance services 		<ul style="list-style-type: none"> - To develop a personal development plan 		<ul style="list-style-type: none"> - To provide guidance services
To renew the validation and recognition system	<ul style="list-style-type: none"> - To create centres of competence validation 	<ul style="list-style-type: none"> - Intellectual capital reports 	<ul style="list-style-type: none"> - To get a personal portfolio - Europass 	<ul style="list-style-type: none"> - To create centres of competence validation 	
To create compensations for investment in learning		<ul style="list-style-type: none"> - Productivity gains - Corporate assets 	<ul style="list-style-type: none"> - Wage increases - Career improvements - Personal development 	<ul style="list-style-type: none"> - Reciprocal compensations in the labour contracts and collective agreements 	
To spread new financial arrangements to share the costs	<ul style="list-style-type: none"> - Basic education for all - Improving education of young people - Supporting target adult people by tax reliefs or direct incentives 	<ul style="list-style-type: none"> - Funding job-related training 	<ul style="list-style-type: none"> - Learning accounts or special entitlements for training 	<ul style="list-style-type: none"> - Sharing costs in labour contracts or collective agreements 	<ul style="list-style-type: none"> - Investment plans

TABLE 4
PROVIDING SECURITY FOR FLEXIBILITY

LEVELS OF GOVERNANCE FORMS OF FLEXIBILITY	EUROPEAN	NATIONAL TO ENFORCE EUROPEAN INSTRUMENTS PLUS
Transition from education to employment	<ul style="list-style-type: none"> • European Employment Guidelines • European Youth Pact • Support to European mobility • Skills needs' foresight • Vocational guidance • Partnership for innovation and jobs • European Social Fund • Labour law for young people 	<ul style="list-style-type: none"> • Education planning • Internships • Financial incentives to recruitment of young people • Membership to social protection system
Transition from household to employment	<ul style="list-style-type: none"> • European Employment Guidelines • Labour law on antidiscrimination, equitable wage and parental leave 	<ul style="list-style-type: none"> • Child and dependants care services • Catch-up training • Progressive individualisation of contributions and benefits
Transition from unemployment to employment	<ul style="list-style-type: none"> • European Employment Guidelines • Broad economic policy guidelines • Labour law on universal minimum protection system 	<ul style="list-style-type: none"> • Strengthening employment services • Vocational and occupational guidance • Education and training • Decrease non-wage costs for lower skilled jobs • Enrolment of non-declared workers in social protection systems • Social inclusion measures • Adapting social contributions and benefits in order to make work pay
Functional flexibility	<ul style="list-style-type: none"> • European Employment Guidelines • European law on health and safety, individual employment conditions, modernisation of work organisation, work councils, information and consultation 	<ul style="list-style-type: none"> • Programmes to spread best practices in work organisation and human resources management (learning organisation, multiskilling, careers and job design, modular lifelong learning)
Working time flexibility	<ul style="list-style-type: none"> • European Employment Guidelines • Labour law on working time and part-time work 	<ul style="list-style-type: none"> • Negotiations on working time • Time saving accounts • Job rotation • Learning accounts • Training leave • Social drawing rights
Wage flexibility	<ul style="list-style-type: none"> • European Employment Guidelines • Broad Economic Policy Guidelines • Macroeconomic dialogue 	<ul style="list-style-type: none"> • Agreements on wages, productivity, competence building and jobs • Innovation agreements
Transition between different types of labour contract	<ul style="list-style-type: none"> • European Employment Guidelines • Labour law on fixed term work • Labour law on part-time work • Labour law on posting of workers • Labour law on temporary workers 	<ul style="list-style-type: none"> • Membership to social protection system • Equalising social benefits • Equalising access to lifelong learning
Transition from employment to unemployment	<ul style="list-style-type: none"> • European Employment Guidelines • Labour law on collective redundancies • Labour law on corporate restructuring • Labour law on transfer of undertakings • Social fund • Globalisation fund • Common objectives for social protection 	<ul style="list-style-type: none"> • Raising unemployment insurance • Restructuring management • Regional development • Partnerships for innovation and jobs creation • Re-training during unemployment period • Active job search
Transition from employment to retirement	<ul style="list-style-type: none"> • European employment guidelines • Common objectives for social protection 	<ul style="list-style-type: none"> • Adapting working conditions • New forms of work organisation Reducing early retirements • Flexible retirement age • Partial retirement • Pension calculation rules • Exchange of expertise between generations

TABLE 5
MANAGING INDUSTRIAL CHANGE – LEVELS AND STAGES

<div>STAGES</div> <div>LEVELS</div>	Passive	Active	Pro-active
Company	<ul style="list-style-type: none"> • Lay-off process • Unemployment insurance • Early retirements 	<ul style="list-style-type: none"> • Corporate social plans for restructuring (CSR) • Competence report (“bilan des competences”) and personal plan • Outplacement services • Training for new jobs in the region • Incentives to geographic and occupational mobility 	<ul style="list-style-type: none"> • Strategic management of innovation • Strategic management of human resources • Competence building • New models of work organisation • Innovation agreements
Sector/Regional	<ul style="list-style-type: none"> • Sectoral programmes of restructuring and downsizing • Social programmes with minimum income 	<ul style="list-style-type: none"> • Rapid Response System and change managers • Sectoral/Regional programmes for labour force transfers between companies and sectors with specific training • Financial incentives for recruitment by new companies • Local employment initiatives • Incentives to new investments, both national and foreign • Local partnerships for growth and employment 	<ul style="list-style-type: none"> • Clusters development • Networks and partnerships for innovation • Innovation poles • Plans for regional development • Learning regions
National	<ul style="list-style-type: none"> • Labour law on lay-off • Social protection regimes for unemployment and retirement 	<ul style="list-style-type: none"> • Active labour market policies • Vocational guidance services • Training programmes to tackle labour market mismatches • Coordination of employment and industrial policies • Labour market regulations: flexibility with security • Social partners consultation • National Employment Observatories • Housing market and geographic mobility 	<ul style="list-style-type: none"> • Coordination of employment, industrial, innovation, education and trade policies • Partnership for change involving social partners • Foresight system for new sources of job creation • Pro-active programmes for education and training • Lifelong learning strategies • Labour market regulations: Transitions and competence building
European	<ul style="list-style-type: none"> • Directives (lay-off, information and consultation) • Social protection guidelines 	<ul style="list-style-type: none"> • Coordination of employment, competition and industrial policies • European Employment Strategy • European Social Fund (ESF) • Directive on works Councils • Directive on portability of pensions 	<ul style="list-style-type: none"> • Lisbon Strategy • Partnership for growth and jobs • European Social Dialogue (sectoral and cross-sectoral) • Community Programmes for R&D, innovation, employment and lifelong learning • ESF+ERDF • European Monitoring Centre for Change • European foresight system for new sources of job creation

EUROPEAN SOCIAL MODEL

Some key-questions:

- 1- What are the critical reforms to be introduced in the European social model?
- 2- How can we analyse the different forms of flexicurity?
- 3- What are the main obstacles to generalise opportunities for lifelong learning?
- 4- How can we develop a more pro-active approach to industrial restructuring?
- 5- What should be the key factors to strengthen the sustainability of the social protection system?
- 6- How should the policy mix in social policies evolve at European level?

LISBON AGENDA GROUP

WORKSHOP Developing the Lisbon Agenda at European level

REPLY PAPER

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Social Europe in a new context. Policies and debates on the ‘European social model’ and ‘flexicurity’ at EU level

Nowadays Social Europe plays essentially two roles: a) it plays a ‘protection function’ vis-à-vis negative consequences of EU economic integration; b) it proposes ‘standards’ for ‘reforming’ European social systems. The flexicurity issue is an interesting case in itself, as it entails both a reforming and protecting function.

Social Europe disposes of three regulatory modes to fulfil both those functions (legislative, contractual, OMCs) and some financial tools.

This reply paper to Maria J. Rodrigues, aims at three objectives: - it intends to show how the debates/issues on the Social Europe agenda (both in its protection and reforming function) have been evolving with the EU institutional crisis; - it opens up the discussion on the role of France and Germany in the Social Europe debate; - it discusses some of the potential and also problematic issues concerning flexicurity.

1. A higher profile for social debates at the EU level after the ‘no’ votes to the Constitutional Treaty

‘A quelque chose malheur est bon’: after the ‘no’ votes in France and the Netherlands on the constitutional Treaty (CT), debates on Social Europe and the European social model (ESM) have been fairly intensive at the EU level between June 2005 and November 2006. It has become clear that social questions have to be deepened before the discussions on the CT can be taken up again (this explains f.i. A. Merkel’s very early suggestion of an annex on social matters).

a) Just a few examples illustrating this new activism. Following Hampton Court Summit discussions (October 2005) under UK presidency, the European Parliament decided to draft an own-initiative report on a ‘European social model for the future’ (July 2006). The report stresses that the ESM is not only a cost, but also a positive factor for the economy, and that it reflects a common set of values - equality, non discrimination, solidarity, redistribution, cheap access to education and healthcare and other public services, care for the young, the old, the sick, the poor. It insists on the fact that urgent action is needed to reform the ESM (its labour market policies and social protection systems) and to make it more efficient if to be preserved. Since many member states cannot reach all the targets of the Lisbon strategy (LS), the report suggests to deepen some of them in priority: employment targets for the young, for women, R&S investment, child care, LLL, reconciliation work-life balance, flexicurity concepts, life-cycle concepts.

Besides, the PES (party of Europeans socialists) has been holding two major conferences in October 2005 and October 2006 where its national leaders have been reflected upon the type of 'new social Europe' which could combine growth and labour market reforms.

The way the EU social agenda presents itself now goes *beyond* what was included in the rolling agenda of the 'pluriannual strategic programme of the Council' (2004-2006) (12/2003) and *beyond* what was planned in the 'EU social agenda' (2006-2010) (2/2005).

Let us recall also that beside its positive elements, the Constitutional treaty presented three shortcomings as to its social dimension: it did not extend EU social competences beyond those of the Nice Treaty (which also reflects that competence transfer has probably reached its limit); its charter of fundamental social rights could only be invoked regarding EU legislation (as demanded by the UK which was supported by DK, IRL, Sweden, NL); it did not suggest urgent solutions in front of an increasing feeling of 'social insecurity' especially in some member states (linked to restructuring and relocation of companies, to steady social protection retrenchment for more than a decade, and to more visible social exclusion situations) .

b) On the Commission side, four major subjects (crucial for the future of social Europe) have been tabled in 2005/ 2006:

* the flexicurity debate , the central issue of the Green Paper on Labour law to be drafted (planned for September 2006, it has been delayed due to social partners conflict over the definition and coverage of flexicurity); the subject is not new on the EU agenda, but now it is more clearly linked to a life cycle approach (see part 3 below);

* The conciliation of work- (family) life balance for which the Commission plans further action at EU level; this subject is not new neither, but gains in salience. Indeed, the recent Commission paper on demography ("Making demographic change an opportunity for Europe" – 10/ 2006) stresses that the economic impact on demographic change will not be able to be compensated by increasing employment rates only. Even with an employment rate of 70%, the number of employed persons should diminish by 30 million by 2050. And the expected migration flow of 40 million by 2050 will not be sufficient to compensate the decrease of the population evaluated to be 48 millions by 2050. Therefore, the conciliation of work-life balance becomes top priority. On gender equality issues, a Gender Pact was adopted in 2006 (initiated by France, Finland, Sweden, Dk, Czech Rep at the spring council) as well as a gender mainstreaming plan (2006-2010) and a framework of actions on gender equality between social partners (2005).

* Company Restructuring (cf. COM, 3/ 2005, Restructuring and employment - Anticipating and accompanying restructuring in order to develop employment: the role of the European Union); this implies better links with industrial, competition and commercial policies, and more immediately the recourse to structural funds and the European Globalisation adjustment Fund (EGF), as well as the development of anticipatory approaches to change: the relative failure of social partners to take up this issue, explains why financial devices such as the EGF have been put to the forth and why the issue is taken up in forum discussions and studies on behalf of the European Monitoring Centre for Change to soften a contentious subject;

* Ongoing actions on education and training (cf. Progress towards the Lisbon objectives in education /training – report 2006 – SEC (16/5/2006). Seen over the *longue durée*, three

remarks can be formulated: a) it is interesting to note that professional training has benefited in the Rome Treaty from a more beneficial legal basis than later on in the Maastricht Treaty where it converged closer towards the situation for education: the Commission had not used very proactively all the potential in the Rome Treaty; b) one observes a rapprochement between education and training policies, not only in prerogatives but also content wise in the way of dealing with them at EU level: the Lisbon strategy pushes further in that direction; c) although those two policies which are support policies to the national level, benefit from fairly low EU regulatory competences, their budgetary means are important: this lies in contrast with EU social/ employment policies with broader regulatory competences but small budgets.

c) On those four social subjects which have gained in salience on the agenda and frame debates for the medium term, flexicurity and restructuring announce themselves as the most conflictual. On the two others, conciliation work-life balance and LLL, more consensus exists among institutions (Commission, EP, MS) and social partners (ETUC, UNICE, CEEP).

d) As regards pending directives, one observes a double trend:

- a *pacification development* and likely successful outcome around a more balanced compromise for the service directive (ex-Bolkenstein); the adoption of the service directive is crucial for the implementation of the LS and the relaunch of the internal market; the Constitutional treaty debate and the pro-active role of the EP have been useful to push for a more balanced directive between social and economic imperatives.

- a *conflictual standstill* for the working time directive (whereas UK and the new member states want to maintain an opt out, France and Spain are for its phasing out; see new Finish presidency proposal) and even more so for the interim work directive (to which Germany, Poland and UK have strong reservations). The working time directive (its revision) is an important test of the survival or not of the principle of the cumulativeness of EU labour law over time: until now the 'acquis communautaire' has been cumulative over time (no deregulation at EU level) and geographically (compulsory to the new joining member states). The cumulativeness of the acquis is according to us a major strength of the Social Europe, a trend which does not exist any longer at member state level.

e) Some conclusions

- In 2005/2006, the social agenda has become higher priority at EU level to ease further discussions on the Constitutional Treaty.

- Discussions took the form of the unfolding of the European Social Model ('mise à plat'), its 'necessary' reforms and the deepening on crucial issues like flexicurity and restructuring, LLL and work-life conciliation.

- Social matters at EU level have gained in 'encompassingness' by being replaced in a broader debate over the whole ESM (due to globalisation on the one hand - 'Europe in the world' - and to the need for serious reforms on the other hand). Flexicurity has also become a much broader concept encapsulating LLL and conciliation work/life balance issues.

- Besides, employment and social protection policies continue to be more closely articulated at EU and national levels.
- This lies in continuity with the EES and Lisbon strategy logic aiming at putting national priorities (employment, social protection, social exclusion) to the EU agenda in order to facilitate national reforms on the one hand and to avoid increasingly divergent social strategies on behalf of member states on the other hand (this is clearly the risk especially following the last enlargement in 2004 and the next two in 2007).
- But the more national (social/employment) priorities figure at the EU agenda, the more contentious EU discussions will tend to become: as to flexicurity and restructuring issues f.i., conflictual and lengthy negotiations on the social partner side as well as on the Member state side can be foreseen. And the working time and interim work directives difficult discussions already illustrate this.
- However, the variety of existing regulatory modes at EU level for a same topic (legislative, contractual, open method of coordination, financial redistribution) (which are more or less legally binding), the extreme broadness of the EU social agenda by now, the existence of a few consensual subjects, will help obtaining some positive social results despite more conflict prone priorities on the table for the years to come.
- Indeed, open method of coordination processes (policy making; benchmarking; evaluations; peer reviewing) relative to employment policies, social inclusion, pension reforms, health care for the elderly, education/ training, have been following their course (since 1997 for employment and after 2000 for the other subjects). (They stand now in a more or less direct link with the 2005 newly integrated guidelines of the Lisbon strategy).
- In a way, the Lisbon strategy - its content and new governance tools - have been 'preserved' and 'saved' during the constitutional debate and constitutional crisis: the OMC processes went on examining *in depth* issues for reform (on employment and social protection) and more and more along a cost/benefit logic; those OMC processes were somehow 'protected' (relatively isolated) in their civil servants 'expertise driven' committees (EMCO, SPC, EPC) and thanks to their medium term roadmaps (this was the case during the Convention, during the French debate and after the 'no' votes) (and even if the ex-Bolkenstein directive was a key element of the Lisbon strategy, it was not perceived as such by citizens).
- The vivid discussions around the 2007-2013 EU budget concerned both the amount of the budget itself and its qualitative content; they unveiled the double function the EU budget can play: a social redistributive function (structural funds; EGF; CAP etc...) and a more economic function implying more expenses for EU's economic future (R&D investments, infrastructures...). The reopening of discussions on a new balance between those two functions is planned, and more than likely conflict prone. The implementation of the Lisbon agenda on the one hand, and the catching up of the new member states on the other, will count among the major arguments which will be invoked and influence further budgetary reforms.

2. A new chance for a pro-active EU social agenda on behalf of Germany and France

The fact that two of three main EU member states, moreover founding countries with a long partnership in the construction of the EU, France and Germany have shown difficulty both with the implementation of the Growth and Stability Pact (GSP) and with the implementation of the Lisbon Strategy (LS) represents a serious difficulty per se for the future of EU integration. Where do the problems lie? A construction fault in both the GSP and the LS projects vis-à-vis those two countries? A deliberate slowness on their part to implement painful reforms, slowness which they can impose given their size? The existence of more numerous veto points and a more complicated set of internal interests to cope with in those two countries? Idiosyncratic difficulties specific to the so-called 'continental social systems'? Mistaken past reforms as regards their employment policies?

It has often been repeated that the so-called 'continental model', compared to the Nordic and anglo-saxon models (cf. Esping-Andersen classification), presents more difficulties to carry out the required reforms as regards labour markets and social protection in front of the new challenges (globalisation, demography, unemployment stickiness). The 'continental models' which concern France and Germany are said to be very dependent on employment rates to finance their social protection system, and therefore in difficulty when unemployment rates are sticky; in the latter case, they are bound to have recourse to budgetary deficits to finance normal social protection costs as well as increased social protection costs linked to increased unemployment. Moreover, their past labour markets reforms in the 1980s' et 1990s' (early retirement; prolongation of youngsters' years of study; withdrawal of women from the labour market) are said to have been mistaken, as they have diminished even more employment rates and contributed to create a vicious circle between employment policies and social protection financing (Palier; Amable; Sapir).

This might well be the case, but one should not underestimate the series of important reforms which have been introduced in the 1990s and which are still being made since the 2000s' as regards labour market reforms and social protection reforms in both France and Germany. In both countries retrenchment social protection reforms (pensions; health system) took place (reduction of social benefits; benefit targeting; increase of the personal share in reimbursement; private insurances; costs containment...) as well as an increasing contribution of the tax system in financing social protection has taken place. As regard labour markets too, numerous reforms have been achieved or are under way, just to mention the four Hartz reforms in Germany and the profound changes in the practices of employment services in France and deep revision of its industrial relation system. All these reforms which connect more closely employment policies with social policies should correct not only marginally the intrinsic weaknesses of the 'continental social system'.

It has also often been argued that the EU Lisbon agenda and the various OMCs' (especially the EES) are essentially a mixture of Nordic and anglo-saxon devices: if this means that the span of EU guidelines and orientations provided is broad and ample, providing a 'cooking book rather than a recipe', this is correct. But if this means that what is offered at EU level lacks political relevance vis-à-vis France and Germany, it is less correct. What is true is that EU debates on alternatives have been often framed and sometimes simplified around those two ideal type models, Nordic versus anglo-saxon (such simplification explains recurrent UK government's reactions against the caricature of their system). What is also true is that France and Germany, traditionally fairly pro-active as to Social Europe seem to

have kept a fairly low profile in that respect over the last years compared to previous periods in the late 1980s' and early 1990s'.

The temporal proximity of both EU presidencies (Germany in 2007; France in 2008), the fact the social and other constitutional treaty issues have to be linked, the presence of some favourable internal political factors (coalition government in Germany; a slightly different industrial relations scene in France towards more mature and autonomous social dialogue; the particular need in France to provide something to citizens on social Europe whatever the political majority in power; a close proximity between the EU social priorities at present and the national agendas in France and Germany - on flexicurity, conciliation between work/life, restructuring) plead in favour of a more pro-active stance on EU social policy on behalf of those two countries. *Sous réserve*: on flexicurity f.i. the German presidency intends to come with a framework law. *Sous réserve*: France is already busy preparing its social priorities for its EU presidency and reflects upon some ambitious legal EU measures (f.i. on minimum income) and for the social dialogue (on minimum wage levels per country).

3. Flexicurity debates at EU level since 1993: evolution and perspectives

a) *The flexibility-security nexus plays a dominant role in the EU policy discourse and policies since 1993* (1994, White Paper on growth, competitiveness, employment; 1997 Green Paper on Partnership for a new organisation at work; European employment strategy since Essen (1994), Amsterdam treaty and European employment strategy (1997), Lisbon strategy (2000), EU integrated guidelines (2005). Its roots originate from the OECD in the 1980s' and the two successful national cases (Netherlands and Denmark) which have been heavily documented and divulged abroad. The heavy publicity those two national success stories received has certainly had an important cognitive and even political impact in the other EU member states and EU policies, but has probably also contributed to increase feelings of 'social insecurity' in countries where unemployment (especially long term unemployment) problems are sticky.

At a policy level, in all countries the new directions taken include labour market 'activation' policies, individualisation of social protection policies (unemployment benefit system reforms, social assistance reforms, qualitative guidance for job-seekers), pensions reforms, collective bargaining reforms and new legal provisions (new working time arrangements and time saving accounts; parental leaves and better conciliation work-family formula; training schemes – LLL; unemployment protection revisions; reforms in labour contract laws). Altogether a closer articulation between labour market and social protection reforms has been taking place in all EU countries, to different degrees though and at different speeds. France and Germany have been slower in their reforms (due to important veto points, to the specificities of the 'continental system', their large size), however their speed of reforms has been accelerating in the last years.

At a research level, studies on flexibility of the 1980s' (Brunhes; Piore and Sabel; Boyer) have become complemented in the 1990s' with 'flexicurity trade-off issues over a life time', such as the 'transitional labour market approach' (TLM) (Schmid, Gazier) or the notion of 'professional status' and 'social drawing rights' (Supiot). It is interesting to note that scientific inspiration on the prolongation of flexibility debates along a life cycle approach has come from Germany and France inspired though by some of the 'virtuous bridges' of the Danish model.

Though flexibility issues have been on the EU agenda for more than 15 years, they have gained in salience and momentum since 2005 and especially as regards the transitional labour market approach. The latter prefigures now one of the essential components of a possible 'new social pact' at EU and member state level.

b) Definition of flexicurity

Wilthagen and Tros (2004) define flexicurity in the following way: *'it is a policy strategy which attempts, synchronically and in a deliberate way, to enhance the flexibility of labour markets, work organisation and social security on the one hand, and to enhance security – employment security and social security – notably for weaker groups in and outside the labour market on the other hand.*

Further they say 'it is (1) a degree of job, employment and 'combination' security, that facilitates the labour careers and biographies of workers with a relatively weak position and allows for enduring and high quality labour market participation and social inclusion, while at the same time providing (2) a degree of numerical (external and internal) functional and wage flexibility that allows for labour market and company timely and adequate adjustment to changing conditions in order to maintain and enhance competitiveness and productivity'.

c) Advantages of the flexicurity concept (see Keller and Tros, 2004; de Nanteuil, Nachi, 2004)

- it helps linking demands for flexibility with some social security elements and finding solutions between employer flexibility demands and wage earner security demands ;
- it should enable us to come out from the deadlock relative to the ongoing deregulation dispute, and allow some re-regulation as well as new advantages to wage earners (social security; LLL);
- it aims at providing solutions to the increasing social vulnerability and individualisation of social relations;
- it allows for more equity among different groups of wage earners over a life cycle;
- it should help accepting 'temporary' unjust situations over a life cycle;
- it supports the transition between different forms of paid and unpaid employment (sabbaticals; training periods, care for children and the elderly; voluntary work);
- it supports the transition between different types of work (full-time; part-time);
- it should make the individual more active and more mobile;
- it provides a social security compensation for risk taking;
- it improves the 'employability' (qualifications and competences) and 'adaptability' of enterprises;
- it is a multi-level governance project as it requires the negotiation of arrangements among social partners (employment protecting collective bargaining at various levels; work contract arrangements; working time arrangements; life long learning) and the state (framework conditions for labour market issues and social protection issues);
- an adequate transitional labour market policy can increase employment rates, increase wage earner incomes and their competences, reduce unemployment costs; however, increased costs are incurred as regards social protection.

d) Shortcomings of the flexicurity concept (see Keller and Tros, 2004)

The major criticisms addressed to the flexicurity approach (Keller, Seifert, 2004) are the following:

- apart from well studied examples (the Danish and the Dutch cases), its feasibility and implementation in other social systems remains yet vague and unspecified; a variety of institutional preconditions seem to be necessary;
- the TLM approach addresses itself in priority to the weaker groups in society: which relevance for stronger groups ? how to avoid stigmatisation processes between those categories?
- does the TLM approach indicate a standard norm or is it rather a safety net ?
- if the collective bargaining, LLL, pension reform aspects of flexicurity are easier to grasp, the transitional labour market arrangements (TLM) remain less clear;
- in the transitional labour market orientation, the employee perspective seems to prevail over the employer perspective ;
- some quantitative studies of the TLM approach as to their employment potential and their respective cost-benefit aspects, have been carried out (Schmid and Auer, 1998; Schmid, 2000), but remain insufficient;
- the TLM orientation seems to favour external rather than internal forms of flexibility: its should spell out better the links between external and internal forms of flexibility; it should also spell out more clearly its operational character related to the various types of labour contracts (standard labour contract; short term; part-time; interim work etc...);
- the TLM orientation offers two options which are quite different in their consequences as to employment rates, their costs, their societal implications: - an option (Supiot, Gazier, Méda) which includes a broader variety of transition choices for individuals, planning also for transitions from employment to socially useful activities (different forms of voluntary work) whether paid or unpaid; - an option which is more economic.

e) Positive developments

- Efforts have been carried out recently to make the TLM approach more operational, so as:
- To spell out the various transitions phases (see MJ Rodrigues, table 4, paper for the seminar 17/11/2006; see Gazier, 2005): regarding external flexibility, 6 transitions phases have been identified: from education to employment; household to employment; from unemployment to employment; transitions between different labour contracts, from employment to unemployment; from employment to retirement, regarding external forms of flexibility. Regarding internal flexibility, the 3 classical types (functional, working time, wage) have been further included.
- To identify the various instruments and programmes, social rights and negotiations, facilitating each form of flexibility and transition both at EU and national levels (MJ Rodrigues, 17/11/ 2006; Gazier, 2005).
- To evaluate the micro-economic and macro-economic cost dimensions and policy impacts (in term of employment and economic growth) of the TLM approach (Schmid carried out two such evaluation studies for Germany; see M.J Rodrigues and her table on the EU guidelines which identifies the stakeholders who are bearing the costs of each EU guideline: a similar evaluation could be attempted for her table 4 'providing security and flexibility').

f) Flexicurity touches essentially upon five types of policies: a *generic*, transversal and strategic transitional labour market policy (TLM); reformed social protection policies (social inclusion; health; pension schemes; family policies); reformed employment policies; revised collective bargaining patterns; human resource policies and the promotion of strategies for anticipating change on behalf of enterprises.

Flexicurity analyses (and especially its TLM dimension) as well as the identification of EU's major challenges (globalisation; demography; an atonic internal market as stressed by successive Bruegel reports) make it clear that the 3 key horizontal issues which should be given priority in all five types of policies mentioned above are a) life long learning arrangements, b) conciliation between work and family life, c) less inegalitarian developments among generational groups, regions, qualified/unqualified employees.

g) Flexicurity approaches require to be implemented to have recourse to a diversity of modes of regulation at the national/regional but also at EU level:

- a procedural mode of regulation - a fairly flexible method for adapting needs for the market and the individual, based on 'non binding' rules; its should enable evaluation processes and correction mechanisms;
- a substantive mode of regulation - based on a strong 'active social State' which offers the guarantee of various forms of social protection and rights (Castel; Supiot); the EU level could provide some useful framework law and ad hoc directives;
- a contractual mode of regulation based on social partners agreements at all levels. The contractual mode requires to enrich collective bargaining content, to foster social pacts at national level and at the same time to decentralise collective bargaining both at enterprise and at regional level, to open the negotiations to new actors at local level such as associations, municipalities, 'bassins d'emploi', training institutions etc...;
- appropriate financial resources.

h) The various roles the EU can play as to flexicurity are the following:

- it can provide an arena for debates on various flexicurity alternatives and flexicurity institutional dynamics;
- it can spell out some values and principles around the orientation and implementation of a life time perspective (transitional labour market approach) such as fairness, partnership, decentralisation, evaluation, social rights as a safety net, promotion of LLL and the conciliation of work/ family life;
- it can provide minimal social rights (and incomes ?) through ad hoc directives so as to prevent unbridled social developments in some member states;
- it can incite member states to carry out appropriate national reforms (employment policy; social protection; tax policy) and encourage policy coordination;
- it can encourage member states to carry out impact and assessment studies.
- In doing so it can rely on the previous experience of ongoing OMC processes of the Lisbon strategy in the various social/employment/education and LLL fields.

Conclusion

Both the 'ESM' (European social model) concept and the newly enlarged 'flexicurity' concept have in the last years constituted heuristic tools as well as political tools for fostering (as well as legitimising) change and reforms.

Despite the many shortcomings of such 'catch-all' and 'polysemic' concepts, they have proven useful for the following reasons:

- a) be it at national or European level, such concepts enable us to reflect cogently on the workings of a *broader set of economic and social institutions* and the policy crossovers and interlinkages between economic governance, industrial relations, education/training,

social protection and employment;

- b) they enable us furthermore to reflect on *social change* and the variety of forms of social reforms at national and EU level, be they of an incremental nature (resulting often functionally from the constructed 'virtues' of a given social and economic system itself) or of a more radical nature (reforms having to face serious veto points and presenting a serious misfit with the previous situation);
- c) those concepts have lend themselves to *multidisciplinary approaches* and mobilised lawyers, economists, industrial relation experts and political scientists due to their multi-policy relevance;
- d) they have also enabled *researchers and practitioners* (practitioners in enterprises; in political institutions at all levels – world, EU, national, regional, towns) to pool their ideas and facilitated *transfers of knowledge* between these two worlds (research/ practice);
- e) they are serving as 'mediating concepts', *des référenciels*, to business, political and social actors to elaborate and carry out LM (labour market) and SP (social protection) reforms: to what extent deregulate labour markets and which new models and social pacts can be conceived of ? Which degree of retrenchment for social protection policies, and which new models and social pacts can be conceived of?

BACKGROUND PAPER ON MACROECONOMIC POLICY

The Economic Governance of the Union and the Quality of Public Finances

Maria Joao RODRIGUES

1. Improving the economic governance of the Union

1.1. The economic governance of the European Union is facing several overlapping challenges in order to relaunch growth: coping with globalisation, strengthening the euro-zone, fostering structural reforms and supporting internal convergence.

In the period to come, the European Union can make a relevant step forward to improve its economic governance by developing the relationships between central instruments which were recently up-dated:

- the renewed Lisbon strategy and the integrated guidelines for growth and jobs;
- the revised Stability and Growth Pact;
- the guidelines for cohesion policy and the use of the next generation of structural funds.

For each Member State, this means to develop the relationships between the National Reform Programmes, the Stability and Convergence Programmes and the National Strategic Reference Frameworks.

1.2. The main relationships to be developed are the following:

- a/ **structural reforms** are needed to ensure fiscal consolidation and sustainability;
- b/ **structural reforms** are needed to strengthen the long-term growth potential and boost the growth rate; this will make it easier to improve fiscal consolidation and sustainability;
- c/ **macroeconomic policies** should play a role in supporting structural reforms and in strengthening the long-term growth potential, in a framework of fiscal consolidation;
- d/ **structural funds** can play an important role to complement macroeconomic policies in supporting structural reforms and the growth potential.

1.3. Therefore, we are mainly speaking about **synergies which should be fully exploited**, by improving the consistency and the mutual re-enforcement of these three instruments. Nevertheless, there are also **difficulties and trade-offs**, notably because:

- some structural reforms can involve additional expenses, at least in the short term;
- spending of structural funds can be hindered by insufficient absorption capacity;
- there is a structural problem for sustainability, stemming from the ageing trends;
- the conflicting priorities for public spending increase in a framework of fiscal consolidation.

1.4. What can be the solutions to overcome or limit these difficulties and trade-offs? So far, they seem to be the following:

- to assess the synergies between these three instruments in each national case, on a **inter-temporal basis**, in a framework for sustainable growth and fiscal consolidation;
- to foster the structural reforms needed to ensure the **sustainability** of the social protection and health systems;
- to strengthen the mechanisms to improve the **quality of public finances**, “a concept for ensuring the most effective and efficient use of resources with a view to raising the long-term growth potential of the economy¹”.

2. Improving the quality of public finances

2.1. This note will only focus on the third issue, because the others deserve a specialized treatment. According to the above mentioned EPC Report, p.2 “countries that introduced national expenditure rules, within medium-term expenditure frame-works as well as performance budgeting, managed better to **redirect their public expenditure** towards their spending priorities. Effective budgetary institutions in Member States thus seem to be a key-factor facilitating the implementation of medium-term economic policy objectives”.

How can Member States improve their quality of public finances in practical terms, taking as central reference the integrated guidelines for growth and jobs?

2.2. The idea we would like to develop in this note is the following: the integrated guidelines for growth and jobs are a very useful instrument to identify **how structural reforms can contribute for fiscal consolidation and fiscal sustainability** as well as for enhancing the **long-term growth potential**.

Nevertheless, if we want structural reforms interact with macro-economic policies in both ways, **we are missing some instrument to identify more clearly how can macro-economic policies support structural reforms** and what choices can be made with this aim, in a framework of fiscal consolidation.

In an exploratory approach to this problem, we have **prepared a table with this purpose, stemming directly from the current integrated guidelines for growth and jobs**:

- The Table 1 presents the concrete measures which have a possible implication for public finances and identifies what kind of possible implication: public expenditure, tax policy, structural funds, public-private partnerships, public procurement criteria or modernisation of public services. These implications can have a positive or negative impact on public finances, according to national priorities concerning the measures and the financial choices to be made.

The purpose of Table 1 is **to assist each Member State** when answering to the following question: how can a certain measure be supported? What are the choices and the policy mix to be made concerning public finances?

These instruments can also be used in order to assess the internal consistency of the national reform programmes.

Tables 1 is presented in the following pages.

¹ ECFIN/EOC (2005) REP/53776 rev2 *Restructuring Public Expenditure: Challenges and Achievements Progress Report on the Quality of Public Finances*, September 2005.

Annex

Integrated Guidelines for Growth and Jobs and their implications for Public Finances

Table 1

It presents the concrete measures which have a possible implication for public finances and identifies what kind of possible implication: public expenditure, tax policy, structural funds, public-private partnerships, public procurement criteria or modernisation of public services. These implications can have a positive or negative impact on public finances, according to national priorities concerning the measures and the financial choices to be made.

The purpose of Table 1 is **to assist each Member State** when answering to the following question: how can a certain measure be supported? What are the choices and the policy mix to be made concerning public finances?

PE	Public expenditure
TI	Tax policy
SF	Structural funds
PPP	Public-private partnerships
PP	Public procurement criteria
M	Modernisation of public services

MICROECONOMIC REFORMS TO RAISE EUROPE'S GROWTH POTENTIAL

B.1 Knowledge and innovation – engines of sustainable growth

Guideline No.7. To increase and improve investment in R&D, in particular by private business, the overall objective for 2010 of 3% of GDP is confirmed with an adequate split between private and public investment, Member States will define specific intermediate levels. Member States should further develop a mix of measures appropriate to foster R&D, in particular business R&D, through:

- more effective and efficient public expenditure on R&D and developing PPPs; **PE, PP, SF, PPP**
- developing and strengthening centres of excellence of educational and research institutions in Member States, as well as creating new ones where appropriate, and improving the cooperation and transfer of technologies between public research institute and private enterprises; **PE, PPP, SF**
- developing and making better use of incentives to leverage private R&D; **TI**
- modernising the management of research institutions and universities; **M**
- ensuring a sufficient supply of qualified researchers by attracting more students into scientific, technical and engineering disciplines and enhancing the career development and the European, international as well as intersectoral mobility of researchers and development personnel. **PE, M, SF**

Guideline No.8. To facilitate all forms of innovation, Member States should focus on:

- improvements in innovation support services, in particular for dissemination and technology transfer; **PE, SF**
- the creation and development of innovation poles, networks and incubators bringing together universities, research institution and enterprises, including at regional and local level, helping to bridge the technology gap between regions; **PE, SF, M**
- the encouragement of cross-border knowledge transfer, including from foreign direct investment; **TI, SF**
- encouraging public procurement of innovative products and services; **PP**
- better access to domestic and international finance; **M**
- efficient and affordable means to enforce intellectual property rights. **M**

Guideline No.9. To facilitate the spread and effective use of ICT and build a fully inclusive information society, Member States should:

- encourage the widespread use of ICT in public services, SMEs and households; **PE, TI, PP, SF, M**
- fix the necessary framework for the related changes in the organisation of work in the economy; **M**
- promote a strong European industrial presence in the key segments of ICT; **TI, PP, SF**

- encourage the development of strong ICT and content industries, and well functioning markets; **M, PP**
- ensure the security of networks and information, as well as convergence and interoperability in order to establish an information area without frontiers; **M**
- encourage the deployment of broad band networks, including for the poorly served regions, in order to develop the knowledge economy. **PE, PPP, SF**

Guideline No.10. To strengthen the competitive advantages of its industrial base, Europe needs a solid industrial fabric throughout its territory. The necessary pursuit of a modern and active industrial policy means strengthening the competitive advantages of the industrial base, including by contributing to attractive framework conditions for both manufacturing and services, while ensuring the complementarity of the action at national, transnational and European level. Member States should:

- focus on the development of new technologies and markets:
 - This implies in particular commitment to promote new technological initiatives based on public-private partnerships and cooperation between Member States, that help tackle genuine market failures; **PP, PPP**
 - This also implies the creation and development of networks of regional or local clusters across the EU with greater involvement of SMEs. **SF**

Guideline No.11. To encourage the sustainable use of resources and strengthen the synergies between environmental protection and growth, Member States should:

- give priority to energy efficiency and co-generation, the development of sustainable, including renewable, energies and the rapid spread of environmentally friendly and eco-efficient technologies:
 - inside the internal market on the one hand particularly in transport and energy, inter alia in order to reduce the vulnerability of the European economy to oil price variations, **PE, TI, PPP, PP, SF**
- promote the development of means of internalisation of external environmental costs and decoupling of economic growth from environmental degradations. The implementation of these priorities should be in line with existing Community legislation and with the actions and instruments proposed in the Environmental Technologies Action Plan (ETAP), inter alia, through:
 - a/ the use of market-based instruments;
 - b/ risk funds and R&D funding; **PE**
 - c/ the promotion of sustainable production and consumption patterns including the greening of public procurement; **TI, PP**
 - d/ paying a particular attention to SME;
 - e/ a reform of subsidies that have considerable negative effects on the environment and are incompatible with sustainable development, with a view to eliminating them gradually. **TI**

B.2 MAKING EUROPE A MORE ATTRACTIVE PLACE TO INVEST AND WORK

Guideline No.12. To extend and deepen the Internal Market, Member States should:

- apply EU public procurement rules effectively; **PP**

- promote a fully operational internal market of services, while preserving the European social model; **PE**

Guideline No.13. To ensure open and competitive markets inside and outside Europe and to reap the benefits of globalisation, Member States should give priority to:

- a reduction in State aid that distorts competition; **TI**
- in line with the upcoming Community Framework, a redeployment of aid in favour of support for certain horizontal objectives such as research, innovation and the optimisation of human capital and for well-identified market failures; **TI**

Guideline No.14. To create a more competitive business environment and encourage private initiative through better regulation, Member States should:

- reduce the administrative burden that bears upon enterprises, particularly on SMEs and start-ups; **M**

Guideline No.15. To promote a more entrepreneurial culture and create a supportive environment for SMEs, Member States should:

- improve access to finance, in order to favour their creation and growth, in particular micro-loans and other forms of risk capital; **TI, PP**
- strengthen economic incentives, including by simplifying tax systems and reducing non-wage labour costs; **TI**
- strengthen the innovative potential of SMEs; **M**
- provide relevant support services, like the creation of one-stop contact points and the stimulation of national support networks for enterprises, in order to favour their creation and growth in line with Small firms' Charter. In addition, Member States should reinforce entrepreneurship education and training for SMEs. They should also facilitate the transfer of ownership, modernise where necessary their bankruptcy laws, and improve their rescue and restructuring proceedings. **M**

Guideline No.16. To expand, improve and link up European infrastructure and complete priority cross-border projects with the particular aim of achieving a greater integration of national markets within the enlarged EU. Member States should:

- develop adequate conditions for resource efficient transport, energy and ICT infrastructures – in priority, those included in the TEN networks - by complementing Community mechanisms, notably including in cross-border sections and peripheral regions, as an essential condition to achieve a successful opening up of the network industries to competition; **PE, PPP, SF**

The Employment Guidelines

(Integrated Guidelines Nos 17-24)

Guideline No.17: Implement employment policies aiming at achieving full employment, improving quality and productivity at work, and strengthening social and territorial cohesion.

Policies should contribute to achieving an average employment rate for the European Union (EU) of 70% overall, of at least 60% for women and of 50% for older workers (55 to 64) by 2010, and to reduce unemployment and inactivity. Member States should consider setting national employment rate targets.

Guideline No.18: Promote a lifecycle approach to work through:

- a renewed endeavour to build employment pathways for young people and reduce youth unemployment, as called for in the European Youth Pact; **PE**
- resolute action to increase female participation and reduce gender gaps in employment, unemployment and pay; **TI**
- better reconciliation of work and private life and the provision of accessible and affordable childcare facilities and care for other dependants; **PE, PPP, TI, SF**
- support for active ageing, including appropriate working conditions, improved (occupational) health status and adequate incentives to work and discouragement of early retirement; **TI**
- modern social protection systems, including pensions and healthcare, ensuring their social adequacy, financial sustainability and responsiveness to changing needs, so as to support participation and better retention in employment and longer working lives. **PE, TI**

Guideline No.19: Ensure inclusive labour markets, enhance work attractiveness, and make work pay for job-seekers, including disadvantaged people, and the inactive through:

- active and preventive labour market measures including early identification of needs, job search assistance, guidance and training as part of personalised action plans, provision of necessary social services to support the inclusion of those furthest away from the labour market and contribute to the eradication of poverty; **PE, SF**
- continual review of the incentives and disincentives resulting from the tax and benefit systems, including the management and conditionality of benefits and a significant reduction of high marginal effective tax rates, notably for those with low incomes, whilst ensuring adequate levels of social protection; **TI**
- development of new sources of jobs in services for individuals and businesses, notably at local level. **SF**

Guideline No.20: Improve matching of labour market needs through:

- the modernisation and strengthening of labour market institutions, notably employment services, also with a view to ensuring greater transparency of employment and training opportunities at national and European level; **PE, SF, M**
- better anticipation of skill needs, labour market shortages and bottlenecks; **M**

Guideline No.21: Promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners, through:

- the adaptation of employment legislation, reviewing where necessary the different contractual and working time arrangements; **TI**
- addressing the issue of undeclared work; **TI**
- better anticipation and positive management of change, including economic restructuring, notably changes linked to trade opening, so as to minimise their social costs and facilitate adaptation; **SF**
- support for transitions in occupational status, including training, self-employment, business creation and geographic mobility. **TI**

Guideline No.22: Ensure employment-friendly labour cost developments and wage-setting mechanisms by:

- reviewing the impact on employment of non-wage labour costs and where appropriate adjust their structure and level, especially to reduce the tax burden on the low-paid. **TI**

Guideline No.23: Expand and improve investment in human capital through:

- inclusive education and training policies and action to facilitate significantly access to initial vocational, secondary and higher education, including apprenticeships and entrepreneurship training; **PE**
- significantly reducing the number of early school leavers; **PE, SF, M**
- efficient lifelong learning strategies open to all in schools, businesses, public authorities and households according to European agreements, including appropriate incentives and cost-sharing mechanisms, with a view to enhancing participation in continuous and workplace training throughout the life-cycle, especially for the low-skilled and older workers. **PE, TI, PPP, SF**

Guideline No.24: Adapt education and training systems in response to new competence requirements by:

- easing and diversifying access for all to education and training and to knowledge by means of working time organisation, family support services, vocational guidance and, if appropriate, new forms of cost sharing; **PE, TI, PPP, SF**
- responding to new occupational needs, key competences and future skill requirements by improving the definition and transparency of qualifications, their effective recognition and the validation of non-formal and informal learning.” **SF, M**

In: Council of the European Union, Guidelines for the employment policies of the Member States, 10205/05, 2005.07.05.

MACROECONOMIC POLICY

Some key-questions:

- 1- What should be the terms of a regular dialogue between the Eurogroup and the ECB on the interest rate and on the exchange rate?
- 2- How can the macroeconomic dialogue improve the follow-up of the unit labour costs and their implications for wages and productivity?
- 3- To what extent is it possible to converge to some common principles in tax policy, notably in corporate taxes or in the financial basis of social protection?
- 4- How can we assess the recent review of the Stability and Growth Pact and notably its refocusing on the long term sustainability of social protection and its new margin of manoeuvre to reduce public deficit, taking time and some relevant factors into account?
- 5- What are the main relationships between structural reforms and macroeconomic policies? More specifically, how can we analyse the budgetary implications of the Lisbon agenda? How can expenditure and taxes be redirected towards the Lisbon goals? How should State aids be reformed?
- 6- What can be said about emerging proposals to go further in the demand side, notably:
 - the coordination of national public investments at European level?
 - a more active use of public procurement to implement the Lisbon goals?
 - the need of a “growth spurt”(growth above the growth potential)?
 - the advantage of setting an aggregate fiscal position at European level, to be broken down by “tradable deficits” between Member States?
- 7- How can the European budget be redesigned (in expenditure structure and new resources) in order to be more in line with the Lisbon goals?

LISBON AGENDA GROUP

WORKSHOP Developing the Lisbon Agenda at European level

REPLY PAPER

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The Macroeconomic dimension of the Lisbon Agenda. Some reflections

The interactions between the LA and the macroeconomic dimension are many and complex to say the least. In this short paper I will offer some reflections on what, in my view, are the crucial points to be taken into account in discussing the issue. I will touch upon the following points: 1) The interaction between the macroeconomic environment and the LA. 2) Institutional and operational modifications to strengthen the EU macroeconomic framework. 3) The Stability and Growth pact and the LA. 4) Other policy instruments in support of the LA. 5) The external dimension.

1) An appropriate macroeconomic environment is a necessary condition for the success of the LA. But without a successful LA the European macroeconomic environment, and the euro area in particular, could face significant risks.

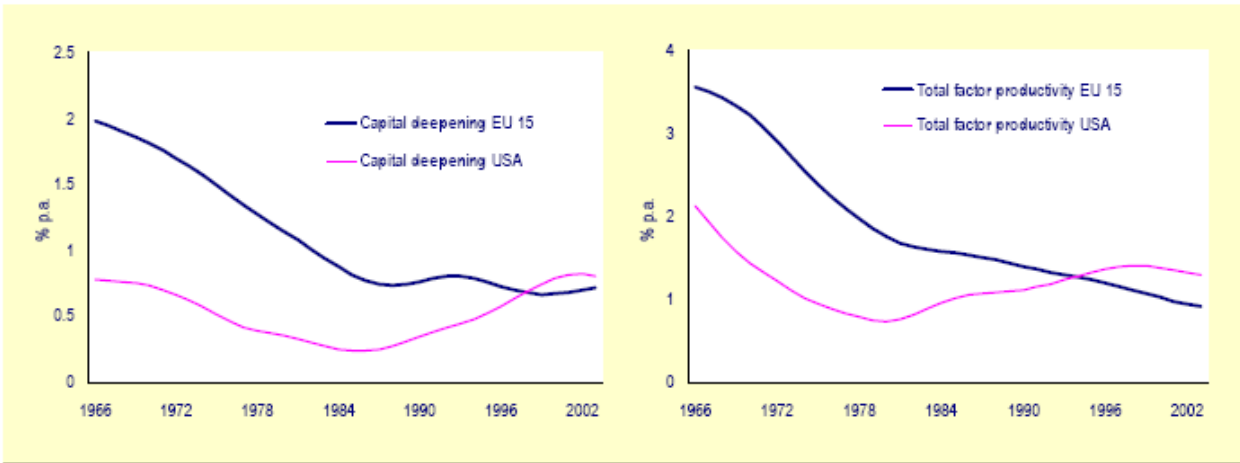
LA needs more investment in physical and knowledge capital

Knowledge based growth requires a stable macroeconomic environment. This point is generally accepted when discussing the relationship between macroeconomic policy and growth. Low and stable inflation provide a pro growth environment in the medium to long run. While some short term costs to macroeconomic stabilization may materialize they tend to be negligible. This common wisdom however, needs to be qualified.

LA driven growth in Europe needs more investment in physical and knowledge capital. Hence most of all, the macro environment must provide incentives for investment. Graph 1 shows that both physical capital and TFP growth have been declining in EU 15 while they have been on the rise in the US.

Graph 1

Graph 3: Breakdown of trend labour productivity into capital deepening and TFP

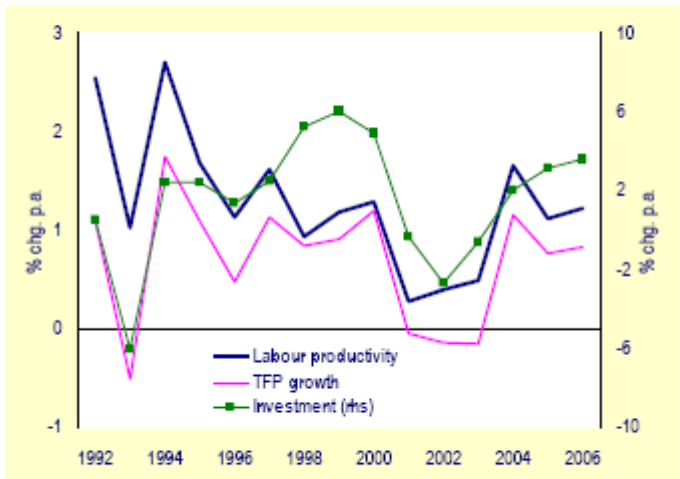


Source: Commission services.

Graph 2 shows that, in the euro area, disappointing productivity is driven mainly by investment and TFP. Table 1 offers a more disaggregated analysis. Growth rates of capital deepening and TFP have been declining over time, contrary to what has happened in the US.

Graph 2

Graph 27: Investment and productivity growth, euro area



Source: Commission services.

**TABLE 1 : DECOMPOSITION OF US AND EU15 HOURLY LABOUR PRODUCTIVITY
GROWTH RATES INTO CAPITAL DEEPENING AND TFP (PERIOD AVERAGES)**

	1966- 1970	1971- 1980	1981- 1990	1991- 1995	1996- 2000	1996- 2003
US						
LABOUR PRODUCTIVITY (HOURLY)	2.2	1.6	1.3	1.5	2.4	2.4
<i>(TFP)</i>	<i>(1.4)</i>	<i>(1.1)</i>	<i>(1.0)</i>	<i>(1.0)</i>	<i>(1.7)</i>	<i>(1.5)</i>
<i>(CAPITAL DEEPENING)</i>	<i>(0.8)</i>	<i>(0.5)</i>	<i>(0.3)</i>	<i>(0.5)</i>	<i>(0.7)</i>	<i>(0.9)</i>
EU15						
LABOUR PRODUCTIVITY (HOURLY)	5.4	3.7	2.3	2.5	1.8	1.5
<i>(TFP)</i>	<i>(3.6)</i>	<i>(2.3)</i>	<i>(1.5)</i>	<i>(1.4)</i>	<i>(1.3)</i>	<i>(0.9)</i>
<i>(CAPITAL DEEPENING)</i>	<i>(1.8)</i>	<i>(1.4)</i>	<i>(0.8)</i>	<i>(1.1)</i>	<i>(0.5)</i>	<i>(0.6)</i>

Source : EU Commission, own calculations.

A less procyclical macroeconomic stance supports investment

In the EU, and in the euro area in particular, success of the LA which requires more investment in physical and knowledge capital, macroeconomic and financial market conditions must be such as to avoid that cyclical factors inhibit investment. Such a result is largely the consequence of the interaction of the policy stance and of the degree of financial market development and integration.

As Philippe Aghion (2006) states

“...structural budget deficits and short-term interest rates fluctuate much less over the cycle in the EMU zone than in the US and UK, and ...this in turn may inhibit growth in the euro area. ...This depends on whether firms can borrow enough funds to maintain their R&D investments during bad times and, therefore, throughout the cycle. If they can, the best would be, at least from a growth perspective, to recommend that governments do not intervene over the business cycle, and instead let markets operate. However, the prescription might be quite different when credit market imperfections prevent firms from borrowing enough in recessions. For example, suppose that the borrowing capacity of firms is proportional to their current earnings. In a recession, current earnings are reduced and so therefore is firms' ability to borrow in order to maintain R&D investments. In this case, a countercyclical policy will foster innovation and growth by reducing the negative consequences of a recession (or a bad aggregate shock) on firms' innovative investments”

In sum, if the EU macroeconomic policy stance were to become less procyclical investment and growth could be significantly enhanced.

Coping with increasing divergence in the euro area requires more LA

A related aspect is that recent macroeconomic trends in the EU, and especially in the Euro area, point at increasing divergences which, if unchallenged, may put the functioning of the euro zone at risk. Divergences can be identified in a number of ways. One way is by looking at real exchange rates which (see graph 3) show increasing divergences among the major EU economies

Real exchange rates divergences reflect the dynamics of wages and productivity. The evolution of the latter is particularly worrying. Not only euro area productivity has been rising less than US productivity, but productivity growth rates in the EU have diverged substantially between the euro and non euro area, within the euro area between the large and small countries, but also among the large euro area members. See tables 2 and 3.

The differences in national labor productivity are mostly due to differences in TFP. Graph 4 (averages 1996-2003) shows that the EU, and the euro area have a double problem. They need to increase aggregate productivity growth and they also need to close the gap between national productivity trends. This, in turn, requires both EU aggregate and national efforts in the direction of a knowledge based economy. In other words LA is needed to ensure macroeconomic sustainability.

This evidence also suggest that a macroeconomic environment supportive of LA requires action at both EU/euro level and national level.

Graph 3

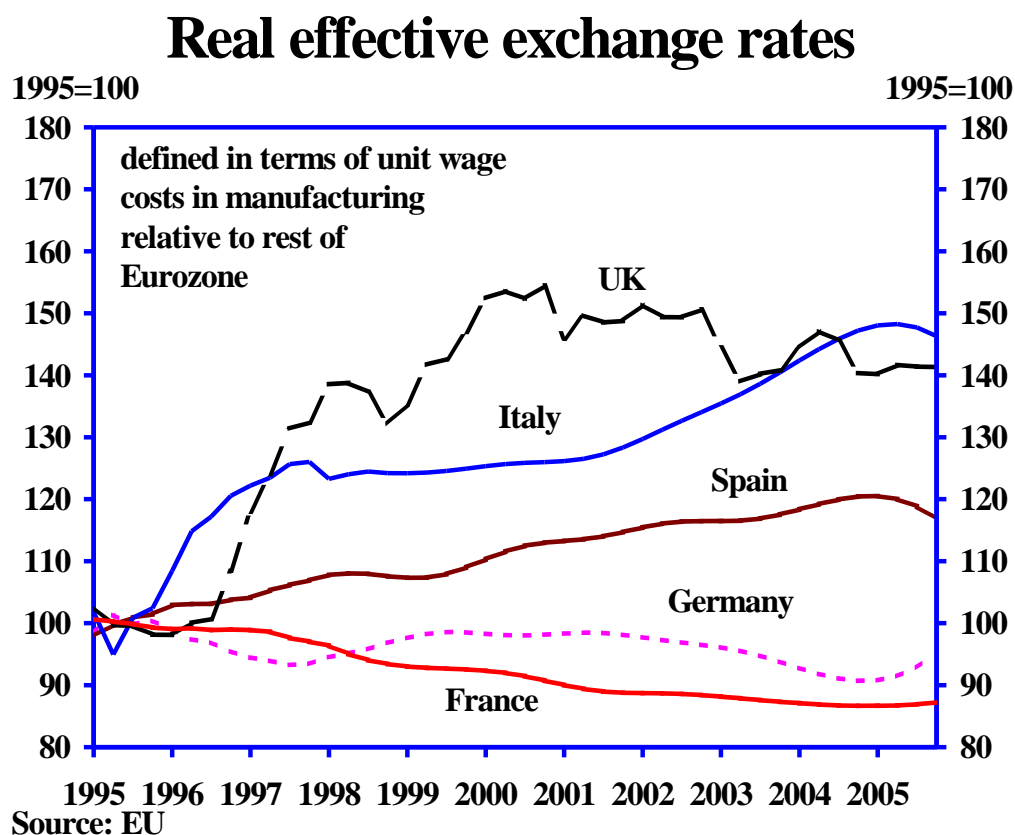


TABLE 2: LABOUR PRODUCTIVITY (PERIOD AVERAGES -PER PERSON EMPLOYED)

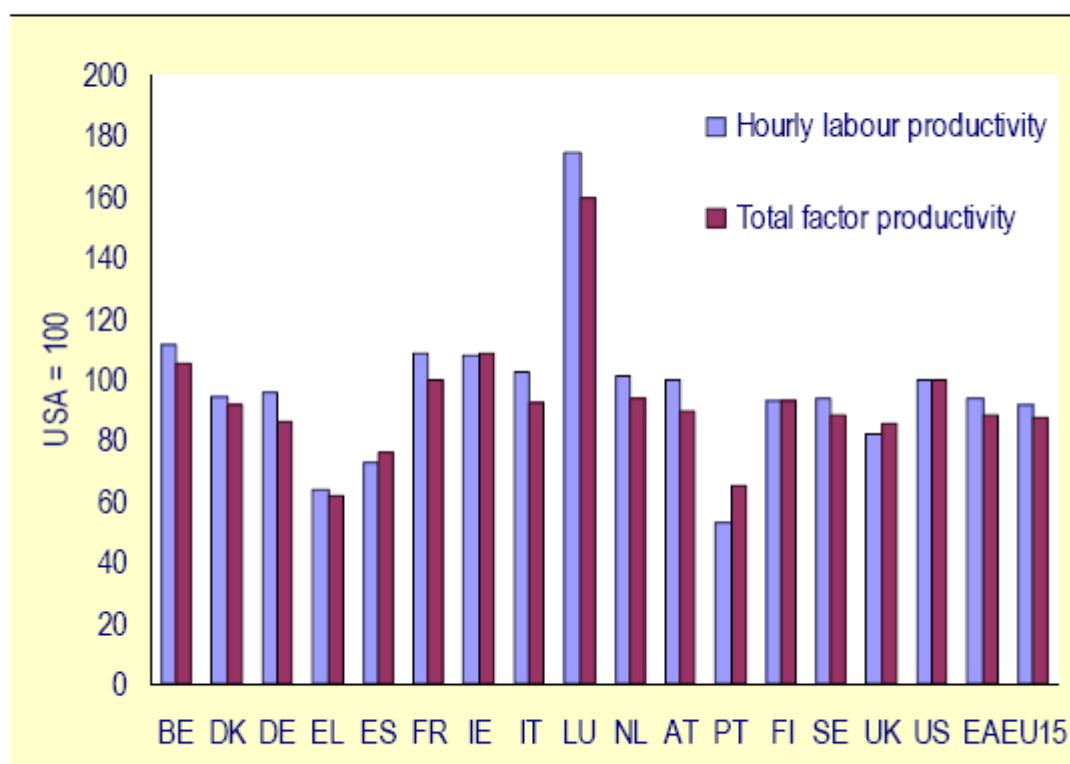
	1981-1990	1991-1995	1996-2000	2001-2003
WORLD		5.0	3.3	3.1
CHINA		10.1	13.0	8.0
INDIA		7.6	5.4	4.4
JAPAN		2.7	0.8	1.4
US		1.3	1.4	2.2
EU25		NA	NA	1.5
FURTHER BREAKDOWN OF EU25				
NEW MEMBER STATES (EU10)		NA	NA	3.6
EXISTING MEMBER STATES (EU15)		1.8	2.0	1.2
NON-EURO AREA		1.8	2.4	1.7
EURO AREA		1.8	1.8	1.0
FURTHER BREAKDOWN OF EURO AREA				
BIG FOUR		1.9	2.0	0.8
SMALL EIGHT		1.4	1.3	2.0

Table 3

		1992-1995	1996-1999	2000-2004
Unit labor cost	Italy	1.3	2.1	3.0
	France	-1.2	-1.4	-0.6
	Germany	2.9	0.6	-0.6
	Euro area		0.2	0.4
Labor cost per employee	Italy	5.1	2.7	2.9
	France	2.7	2.3	2.5
	Germany	6.7	2.0	2.3
	Euro area		2.2	2.7
Labor productivity	Italy	3.8	0.6	-0.1
	France	3.9	3.6	3.1
	Germany	3.7	1.4	2.8
	Euro area		2.0	2.3

Graph 4

Graph 3: TFP and labour productivity gap



Source: Commission services.

2) Institutional and operational modifications are needed to strengthen the EU and euro area macroeconomic framework

Macroeconomic institutions. The European dimension

There are ways, short of setting up a single EU fiscal authority, to improve the degree of fiscal coordination in Europe so as to obtain a less procyclical policy stance.

The procyclicality of national fiscal policies could be decreased by giving more room to automatic stabilizers and set expenditure targets over the medium term (on the issue of the composition of spending see below).

Given national fiscal policy programmes (on which see below in the paragraph devoted to SGP) macroeconomic coordination can be strengthened.

National budgetary processes could be aligned. This would allow national programmes to be based on consistent assumptions of other member states policies and eventual spill-overs. As suggested in the Sapir report (2004) the Commission could define the external framework to be used when preparing national Stability and Convergence Programmes taking into account both national and euro-area conditions.

National programmes of the euro-area Member States could be consolidated into an aggregate “European Stability Programme” which would serve to assess the overall fiscal policy stance within the area and help to determine whether adjustments to national programmes would be desirable. This step could also help to better assess the impact of structural reforms on potential growth on a EU wide scale and the possible spillovers of reform from one country to another.

A euro-area Council should be entrusted with all policy decisions pertaining to the operation of the euro area (with the exception of issues under the jurisdiction of the Ecb) and be given the right to adapt rules that are relevant only for euro-area members, while preserving the rights of Member States not participating in the single currency. Regular informal meetings between the president of the euro-area Council, the relevant Commissioner and the President of the ECB would reinforce the process.

Such a framework (the European Stability Programme and the euro area Council) would also help to formulate and implement a common external policy of the EU and euro area vis-à-vis other countries and in the international institutions. This would strengthen the role of Europe in addressing global policy management (see below).

Other measures include the possibility of tradable fiscal deficits. It is a good idea in principle but in practice it should be accompanied by an assessment of the quality of the deficit in terms of structural vs cyclical components as well as the spending and taxation items. In order to strengthen the quality of public finances tradable deficits could be limited to LA relevant items (see below).

Strengthening the macroeconomic dialogue.

Macroeconomic issues to be discussed jointly by the euro area Council and the Ecb would be the appropriateness of the monetary and fiscal policy stance, which should include the degree of monetary tightness as determined jointly by interest rate and exchange rate developments. The assessment of the fiscal policy stance would be made easier by the definition of an aggregate European Stability Programme. Dialogue with trade unions and social partners at the EU level should deal with general reform issues, including ways to use EU budget resources in the restructuring fund (see below). More ownership of the NRP at the national levels should include a systematic dialogue with social partners on the reform process. Given the wide dispersion of productivity trends at the national (and possibly even more so local level) it is difficult to envisage a EU wide “income policy” discussion.

3) The Stability and Growth pact and the Lisbon Agenda are the two pillars of the Eu economic policy framework and need to be better integrated.

There are (at least) three reasons why the SGP and the LA should be better integrated to form a unified a single economic strategy of the EU and the euro area: a) incentives for policy action would be strengthened, b) the reforms process would be accelerated, c) the overall quality of public finances would be improved.

The SGP and the LA face symmetrical incentive problems

The SGP is based on a clearly defined incentive set, itself underpinned by behavioral rules which, however, have produced only a limited boost to growth. Conversely, the LS would significantly boost growth if it could rely on stronger incentives.

As a consequence, the overall EU strategy has been weakly oriented to growth, if at all. Eliminating or limiting such a bias is imperative. To do so the SGP and the LA, while clearly representing two separate pillars of the EU model, should be much better connected by allowing the two channels through which public finances influence growth –factor accumulation and provision of the right incentives- (in addition to setting an appropriate and stable macroeconomic environment) to operate fully.

A reformed SGP would also better interact with the NRP also by lengthening the relevant policy time horizon. The SGP has been reformed lately, but more needs to be done. It would also help to overcome the “reform fatigue” which is present in several EU countries given the priority assigned to fiscal adjustment.

Implementing reforms could have significant impact of the budget which need to be taken into account. This is necessary also to overcome reform fatigue

The SGP has been reformed in the direction of avoiding procyclicality, especially to encourage adjustment in good times. But the most important change is the possibility to consider deviations from the adjustment path to take into account the consequences of the implementation of structural reforms. In the reformed SGP the impact of reforms on the budget are taken into consideration according to a number of conditions.

- i. Only major reforms that have a verifiable positive impact on the long-term sustainability of public finances are taken into account.
- ii. Only adopted reforms are considered.
- iii. A safety margin to ensure the respect of the 3 percent of GDP reference value for the deficit needs to be guaranteed.
- iv. The budgetary position is expected to reach the medium term objectives within four years following the year of presentation of the programme.
- v. A detailed cost-benefit analysis of the reforms from the budgetary point of view would need to be provided in the Stability and Convergence Programmes.

The modifications introduced can help improve the incentives to undertake reform programs. The criteria set out above remain however subject to a high degree of uncertainty especially about the magnitude of the impact. Some initial evidence on the impact of reform on the budget does not lead to compelling results

Evidence of the impact of reforms on the budget and on the influence of the budget on propensity to undertake reforms

Servaas Deroose, Alessandro Turrini (2005) find that, in the aftermath of reforms, budgets do not worsen significantly compared with cases where no reforms occur. However, when the short-term budgetary impact of reforms is evaluated, there is evidence that product and market reforms and pension reforms are associated with a deterioration in budgets. The impact appears rather weak (a primary CAB reduced by few decimal GDP points depending on the specific reform considered) and not always statistically significant.

Overall, there is a strong indication that generalizations are not easy to make for what concerns the link between structural reforms and budgets in the short-run. Results differ depending on the specific type of reforms considered. Also within a given type of reforms (e.g., pension reforms) the fiscal implications are likely to differ considerably depending on the main elements of the reform and on how reforms are designed. These results point to some lessons for policy. In the implementation of the EU fiscal framework there are reasons for taking better into account the role of economic reforms, especially when there is a strong ex-ante expectations that reforms may have a positive impact on public finances in the long run coupled with budgetary costs in the short term. However, a mechanistic, one-size-fits-all approach whereby all reforms, or all reforms belonging to some broad categories, are judged the same way should be avoided. Judgement should be used on a case-by-case basis.

Friedrich Heinemann (2005) does not find a general short-run trade-off between Maastricht and Lisbon since the link between budgetary phenomena and structural reforms is rather weak. While Maastricht and Lisbon tend to be mutually reinforcing for the liberalization of financial and product markets, there can be short-term conflicts for tax and labour market reforms. In addition, expectation effects may be a more important part of the link between reforms and the budget. The perception of reforms can be a crucial driver of any short-term consequences for employment, growth and the budget. The finding of negative expectation effects associated with labour market reforms is likely to be one of the explanations that these reforms are particularly slow to materialize. Finally he finds that an unfavourable deficit situation makes it very unlikely that certain reforms are initiated in the first place.

Romain Duval (2005) finds that the descriptive evidence on recent reform patterns suggests that EU (including euro area) countries typically have undertaken more comprehensive and far-reaching labour market reforms than other OECD countries over the past decade. However, he also finds different reform intensities between EU and non-EU countries and within EU countries. Large EU countries have shown no particular ability to carry out reforms in areas where political resistance is normally strong (with the exception of retirement schemes where impending fiscal pressures are particularly large in EU countries). Furthermore, in the more specific case of EMU countries, there appears to have been a slowdown in the reform process after the formal advent of the euro – though this could reflect the prior race to qualify for EMU. There is some evidence that top reformers (Denmark, Finland, or the Netherlands) started their reform programmes with relatively favourable fiscal positions and made only limited efforts to improve them during their reform years. Conversely, in a number of EU countries where only few reforms have been implemented during the past decade, the state of public finances was initially poor and major fiscal adjustment efforts were made, especially during the run-up to EMU (Greece, Italy, Spain). The propensity to undertake reforms depends on a number of variables. These are: an economic crisis and more broadly high unemployment. Small countries are also found to have a greater propensity to undertake reforms, possibly reflecting lower risks of short run economic slack and/or lower product market rents and thus lower public support for existing institutions aimed at capturing them. There is also evidence that a sound fiscal balance helps. Conversely, fiscal adjustment is found to hinder the structural reform process. There is also more tentative evidence that the latter effect may be greater for countries that pursue fixed exchange rate regimes or participate in a monetary union such as EMU, and therefore have little or no monetary autonomy.

The evidence above highlights two important aspects: a) the impact of reforms on the budget is there but it tends to disappear in the long run so at least in the long run there is no contradiction between reforms and fiscal adjustment, however b) countries with a bad fiscal position tend to postpone reforms or avoid them in order to pursue fiscal consolidation. A tentative conclusion is that the reform of the SGP, in spite of being effectively implemented or not, does not provide sufficient incentives to carry out growth enhancing reforms and, especially for countries with a difficult public finance condition they do not provide sufficient incentives for a strong contribution of public finances to LA. Hence further incentives to direct the budget toward LA targets should be considered.

Exploiting in full the contribution of public finances to growth, by changing their composition².

Individual items in the government budget, be they expenditure or taxes, have different impacts on growth. For example, spending on education and research, by increasing factor accumulation, and providing fiscal incentives to innovation, increase growth potential. Some of the LA targets such as devoting 3% of Gdp for R&D have a direct impact on budget allocation measures.

On the other hand, one-off measures, such as tax amnesties, hinder growth by decreasing long run tax certainty and depressing the propensity to invest, generating the wrong

² This section is based on Padoan, Rodrigues (2004)

incentives for the private sector. In other words for given size of the budget and of the deficit, its composition will have a different impact on sustainable growth.

It should be possible to use the discipline element of the SGP, its incentive structure, in order to redirect resources towards more sustained growth and reinforce the implementation of the LA.

This would reinforce EU potential output growth and strengthen its sustainability by putting more emphasis on the intertemporal dimension of financial equilibrium.

To this purpose a Good Quality Finance Rule (GQFR) should be introduced to complement the rules already underpinning the SGP. The GQFR is based on two pillars: a budget pillar, and a debt pillar.

The budget pillar

While maintaining the 3% deficit limit and the commitment to reach a budget position in surplus or close to balance in the medium term according to the revised version of the SGP the budget items would count differently towards the respect of such requirements as it is in the case of the budget costs of structural reforms.

Factor accumulation measures should be excluded, totally or partially, towards the computation of the SGP deficit definition. (For example the increase in the deficit resulting from expenditure for research or education, tax incentives to innovation, would be excluded or counted only partially towards the SGP requirements). Conversely, measures that depress long run growth, such as tax amnesties whose revenue reduces the deficit, would not be admitted towards meeting the SGP requirements. Both sets of measures would enhance growth through, respectively, their support to factor accumulation, and the suppression of negative incentives.

This requires a careful identification of those budget items that should be considered as supporting factor accumulation, i.e. physical, human, and knowledge capital. The transparency of the process is to be guaranteed through an accurate and independent assessment of the specific budget items by Eurostat and by strengthened surveillance by the Commission. It remains a controversial issue whether an independent audit agency could increase transparency and efficiency of the budget process in this respect. The annex includes a list of measures enhancing the growth potential with possible budgetary implications.

The debt pillar

Reinforcing the role of public finances to support growth should not go to the detriment of debt sustainability. Long term sustainability requires a decline of the debt to Gdp ratio which should be as rapid as possible, especially for high debt countries.

The measures suggested under the budget pillar should be implemented subject to the conditions of a sufficiently rapid decline of the debt to Gdp ratio (for countries whose debt/Gdp is above 60%) or, in any case, that debt should not go above 60% (for countries whose debt/Gdp is below 60%).

Both pillars would have to be put in an appropriate time frame, taking into account the inter-temporal dimension and avoiding pro-cyclical effects. Several proposals have already been put forward. (For example, setting aside resources for “rainy days”, adoption of indicators to assess long term debt sustainability, including the implications of implicit liabilities related to pension systems, the adoption of an explicit minimum debt reduction requirement, etc).

4) Further policy instruments in support of the LA

We discuss in this section further instruments which can complement the implementation of the LA at the EU level: the EU Budget, tax base harmonization, EU growth initiatives, public private partnerships (ppp).

The EU Budget

The issue of the reform of the EU budget, while complex in practice, can be summarized in a few points. On the ***spending side*** a) for a given size of the budget resources should be significantly redirected from agriculture and traditional structural fund allocation towards knowledge driven growth. One can think of several ways of achieving these targets. As a way of example we can recall the suggestions included in the Sapir report. The Sapir report suggests to concentrate budget resources into three separate funds. The allocation of resources should respect the principle of “one fund for one goal”. Growth and solidarity goals should be clearly divided across the different funds.

1) A fund for economic growth within the EU area. It should cover three areas of spending: R&D and innovation, education and training, and infrastructures connecting national markets. Through such a fund, by acting as a catalyst for national expenditure, the EU budget can also provide an incentive to governments to improve the quality of national public finances.

2) A convergence fund aimed at helping low-income countries in need of above-average growth in order to converge towards the rest of the EU. It could be used for two purposes: institution-building and investment in physical and human capital.

3) A restructuring fund aimed at facilitating the process of resource reallocation that would be required as a result of deeper and wider economic integration. It should be available, with no restrictions, to all workers adversely affected by change, irrespective of their country of residence or their sector of activity. Affected workers could use the restructuring fund to cover three main needs: (i) re-training; (ii) compensation for relocation costs; (iii) setting up a new business. Eligibility for the restructuring fund should be limited in time with the possibility for renewal. This fund would cover persons occupied either in manufacturing and services or in the agricultural sector.

On ***the revenue side***, changes should be significant too, moving away from a predominant role of national contributions towards a EU-wide tax base and related to EU wide projects and or funds such as those mentioned above

EU networks

Macroeconomic benefits of knowledge driven growth require not only more knowledge accumulation in terms of R&D, human capital, but also a greater emphasis on innovation diffusion to fully exploit the advantages of ICT. This requires, among other things, the development of Europe wide infrastructure networks (see e.g. Guerrieri et al. 2005). The issue arises of the financing and development of such networks. Such networks, while clearly of EU interest, can be financed by national (private and public) expenditure with the renewed EU budget playing a catalyst role.

A complementary way of addressing the financing needs of large infrastructure projects is through public private partnerships. In cases of EU wide infrastructure projects financed through national public funds it could be considered to separate these items from the spending items that determine the definition of national deficits relevant for the SGP procedures.

Tax harmonization

Should tax rates be harmonized to enhance knowledge driven growth in Europe while avoiding social and fiscal dumping? As financial markets become more integrated coordination of tax rates risks becoming ineffective, if not counterproductive, given the high risks of free riding. A more effective way to proceed is to obtain a EU wide set of accounting rules aimed at determining a common tax base for firms operating in the EU.

5) The external dimension. Europe needs to speak with one voice to better manage the global system.

Increased coordination between the euro area and the Ecb as suggested in section 2 is relevant also for the external dimension of macroeconomic policy. The key issue here is not so much agreeing on the exchange rate stance but to speak with one European voice in the management of the global economy. This is particularly relevant in the medium to long term which, given current trends, will see a decline in the share of world GDP for the euro area and the EU in general (see figure 1)

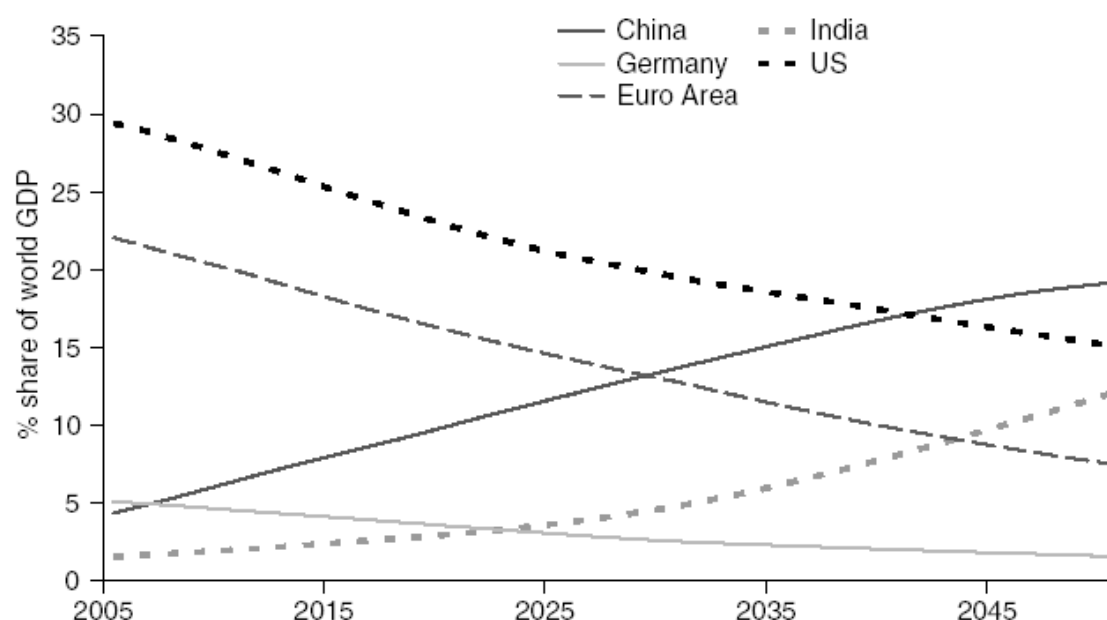
The issue of global exchange rate arrangements is becoming increasingly urgent given that the quasi fixed exchange rate regime between the dollar and several Asian currencies (the Chinese renminbi first of all) is generating an appreciation of the euro in real affective terms hurting euro area competitiveness. Also, given the tendency to establish regional monetary agreements in Asia, this pressure could increase in the future. It is in the interest of Europe, and of an effective governance of the global system that, Europe identifies a long term strategy in this respect and speaks with a single voice. This requires a strong European economy as well as appropriate institutional arrangements.

A successful implementation of the LA, by generating stronger growth, would reinforce the voice of Europe in global issues and would also respond to the calls coming from the international community about the contribution of Europe to addressing global imbalances (to implement structural reforms so as to enhance the contribution of the EU to global growth). Conversely, a strong European voice in the global arena would allow to establish a system of governance which would support EU interest while strengthening a multilateral approach to global governance.

An obvious step in this direction is to move from national to euro area representation in international institutions such as the IMF. Tables 4 and 5, taken from Bini Smaghi (2005), illustrate the implications in terms of voting power and blocking power of a single euro area chair. This would be clearly larger than any of the current national chairs.

As for the long term objectives the guiding strategy should be one of reinforcing the formation of open regional monetary blocs that interact cooperatively for the management of global imbalances, strengthening the multilateral approach as well as multilateral institutions.

Figure 1



Graph 1: Shares of key emerging economies in world GDP in % (in PPP).

Sources: IMF, European Commission, Goldman Sachs.

Table 4

Table 1: Current voting shares and voting powers in the IMF

Constituencies ^a	Voting share	50% majority threshold		70% majority threshold		85% majority threshold	
		Voting power	Blocking power	Voting power	Blocking power	Voting power	Blocking power
United States	17.08	21.48	65.46	11.12	98.85	6.65	100.00
Japan	6.13	5.81	17.71	6.46	57.38	5.84	87.87
Germany	5.99	5.68	17.31	6.32	56.17	5.79	87.02
Belgium	5.14	4.87	14.84	5.47	48.64	5.36	80.67
France	4.95	4.69	14.29	5.28	46.92	5.25	78.97
United Kingdom	4.95	4.69	14.29	5.28	46.92	5.25	78.97
Netherlands	4.84	4.59	13.97	5.17	45.92	5.18	77.93
Mexico	4.27	4.04	12.32	4.58	40.68	4.78	71.92
Italy	4.18	3.96	12.06	4.49	39.88	4.65	69.93
Canada	3.73	3.53	10.76	4.01	35.67	4.30	64.60
Norway	3.51	3.32	10.12	3.78	33.60	4.10	61.72
Korea	3.32	3.14	9.57	3.58	31.81	3.93	59.10
Egypt	3.26	3.08	9.40	3.51	31.24	3.87	58.24
Saudi Arabia	3.22	3.05	9.28	3.47	30.86	3.83	57.67
Malaysia	3.17	3.00	9.14	3.42	30.39	3.79	56.94
Tanzania	2.99	2.83	8.62	3.23	28.69	3.61	54.27
China	2.94	2.78	8.47	3.17	28.21	3.56	53.50
Switzerland	2.85	2.70	8.21	3.08	27.36	3.47	52.12
Russia	2.74	2.59	7.89	2.96	26.31	3.35	50.39
Iran	2.47	2.34	7.12	2.67	23.74	3.06	46.01
Brazil	2.47	2.34	7.12	2.67	23.74	3.06	46.01
India	2.39	2.26	6.88	2.58	22.98	2.97	44.68
Argentina	1.98	1.87	5.70	2.14	19.06	2.50	37.61
Equatorial Guinea	1.44	1.36	4.15	1.56	13.88	1.85	27.81

^a *Current Executive director.*

Source: Bini Smaghi 2005

*Table 5***Table 9: An euro area countries' coalition**

Constituencies	Voting share	50% majority threshold		70% majority threshold		85% majority threshold	
		Voting power	Blocking power	Voting power	Blocking power	Voting power	Blocking power
Euro area (12)	22.91	25.36	88.06	18.06	99.86	8.04	100.00
United States	17.08	13.17	45.73	17.60	97.35	8.04	100.00
Japan	6.13	6.52	22.64	6.85	37.86	7.07	88.01
United Kingdom	4.95	5.15	17.88	5.39	29.79	6.32	78.61
Ex-Canada	3.33	3.40	11.81	3.56	19.68	4.70	58.49
Korea	3.32	3.39	11.78	3.55	19.62	4.69	58.34
Egypt	3.26	3.33	11.56	3.48	19.26	4.62	57.45
Saudi Arabia	3.22	3.29	11.41	3.44	19.00	4.57	56.91
Malaysia	3.16	3.22	11.19	3.37	18.64	4.50	55.99
Tanzania	2.99	3.05	10.58	3.19	17.62	4.29	53.35
China	2.94	2.99	10.40	3.13	17.32	4.22	52.57
Ex-Denmark	2.92	2.97	10.32	3.11	17.20	4.20	52.25
Ex-Mexico	2.86	2.91	10.11	3.05	16.84	4.12	51.29
Switzerland	2.85	2.90	10.07	3.03	16.78	4.11	51.13
Russia	2.74	2.79	9.68	2.92	16.13	3.97	49.36
Iran	2.47	2.51	8.71	2.62	14.52	3.61	44.91
Brazil	2.47	2.51	8.71	2.62	14.52	3.61	44.91
Ex-Netherlands	2.46	2.50	8.67	2.61	14.46	3.60	44.74
India	2.39	2.43	8.42	2.54	14.04	3.50	43.57
Ex-Belgium & Italy	2.13	2.16	7.50	2.26	12.50	3.14	39.12
Argentina	1.98	2.01	6.97	2.10	11.61	2.93	36.51
Equatorial Guinea	1.44	1.46	5.06	1.52	8.43	2.16	26.87

Source: Bini Smaghi 2005

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Annex

Measures enhancing the growth potential and with possible budgetary implications

These examples are included in the common objectives or guidelines adopted by the Member States in the framework of the open method of coordination.

Information Society Policy

- Cheaper and faster Internet access
- Faster Internet for researchers and students
- Participation for all in the knowledge-based economy
- Government online: electronic access to public services
- Health online

Research and Development Policy

- Networking of existing centers of excellence in Europe and the creation of virtual centres through new interactive communication tools
- A common approach to creating and financing large research facilities
- More abundant and more mobile human resources
- Improving Europe's attraction for researchers from the rest of the world
- Enhancing European cohesion in research by fostering the exchange and the transfer of knowledge among regions
- Putting in place fiscal incentives to private investment in research and innovation as well as employment of researchers

Innovation Policy

- Improve the environment for innovative enterprises
- Developing support services including incubators and by spreading educational and training schemes in entrepreneurship and innovation
- Improving the key interfaces in the innovation system, namely by:
 - stimulating regional initiatives for networking the innovation system;
 - developing education and training programmes addressing the skill gaps;
 - encouraging universities to promote the diffusion of knowledge and technologies; and
 - stimulating large public research facilities to improve their partnerships with enterprises.

Education policy

- Improving the education and training for teachers and trainers; providing an adequate supply of qualified entrants in the profession and making it more attractive;
- Ensuring access to ICT for everyone. Widening the range of equipment and educational software so that ICT can be best applied in teaching and training practices;
- Increasing recruitment to scientific and technical studies, in particular research careers and scientific disciplines;
- Developing an open learning environment. Providing education and training so that adults can effectively participate and so that people can combine their participation in learning with other family and professional activities;

- Increasing mobility and exchanges. Ensuring that less privileged establishments and individuals take part in mobility programmes. Certifying the skills acquired through mobility.

Employment Policy

- Implementing active and preventive measures for the unemployed and the inactive
- Fostering entrepreneurship to create more and better jobs
- Promoting active ageing
- Investing in human capital and strategies for lifelong learning
- Promoting gender equality and combining working life and family life
- Supporting integration and combating discrimination in the labor market
- Preventing the risks of social exclusion

Sustainable Development

- Address threats to public health
- Manage natural resources more responsibly

LISBON AGENDA GROUP

Workshop on “Developing the Lisbon Agenda at European level”

Institute for European Studies, ULB - Free University of Brussels

Brussels, 17 November 2006

SYNTHESIS REPORT *

by Maria João RODRIGUES

A. EUROPE IN A GLOBALISED KNOWLEDGE ECONOMY – THE WAY FORWARD

The point of departure for strategic thinking on Europe should always be the globalised world. More particularly, when reconsidering the Lisbon agenda, we should take into account that the process of knowledge accumulation and diffusion is speeding up at world level by increasing investments in research, innovation and education and by the impact of ICTS. This process is also being deeply restructured by the organisation of the global production chains led by multinational companies as well as by competition among countries to attract international investment. The Silicon Valley may remain unique, but innovation poles trying to replicate it in a way or another are now spreading all over the world. More specifically, the emergence of large scale competitors, such as China and India, is changing dramatically the global landscape.

In this new context, the key questions for Europe seem to be the following:

1. How can the multiplication of knowledge intensive economies lead to a win-win game?
2. How can European companies develop at global level?
3. How can Europe remain attractive for world wide investment?

Before addressing these questions, we should assess the comparative advantages of Europe in a medium-long term perspective. From this view point, advantages such as the market size, the research capabilities and the education levels will remain important features but no longer distinctive ones. The distinctive advantages of Europe may rather be the overall quality of life, the sophistication of the consumers, the creativity of the workers, the capability to run sophisticated services and production systems, the quality of public services, the environmental balance, the single currency and the political capability to manage diversity. Against this background, let us now address the three above mentioned questions.

* This synthesis report is based on the following papers prepared for this Workshop:

- “Key issues paper” by Maria João Rodrigues
 - “Social Europe in a new context. Policies and debates on the ‘European social model’ and ‘flexicurity’ at EU level” by Janine Goetschy
 - “The Macroeconomic dimension of the Lisbon Agenda. Some reflections” by Pier Carlo Padoan
 - “Developing the Lisbon Agenda at European Level, redesigning the innovation policy” by Luc Soete
- It was also based on the debate involving all the other participants: Jos Berghman, Iain Begg, Benjamin Coriat, Wolfgang Drechsler, Mario Telò and Ádám Török.

1. How can the multiplication of knowledge intensive economies lead to a win-win game in the international scene?

- Some common global standards concerning the social, environmental and economic dimensions as well as the intellectual property rights should be developed with the purpose of creating a level playing field. For Europe, it is not possible to succeed in a very ambitious agenda comprising all these dimensions, if its main international partners do not move in the same direction.
Therefore, the EU should strongly develop its external action to improve global governance notably in the WTO, in the Bretton Woods institutions as well as in the coordination of the UN agencies for development in order to promote these global standards.
- More specifically, the EU should move quicker in the WTO from a defensive approach concerning agriculture towards a proactive approach concerning the Singapore issues, using trade as leverage for a more forward looking international division of labour.
- Beyond this larger multilateral negotiation, the bilateral agreements under discussion should also be used as a tool to encourage some processes of regional integration underway.

2. How can European companies develop at global level?

While keeping their home base in Europe, European companies, big or small, should be encouraged to go global for new markets or new productive factors.

- The first condition to be fulfilled is to create scale, by making better use of the European single market, by avoiding protectionism of national champions, by supporting the dynamic SMEs in reaching a critical size.
- The size of this market can be increased not only by competition policy, but also by setting common standards and using public procurement.
- Finally, the integration of financial markets can also play a very important role in reorganising the business models at European scale.
- The critical mass for global competition should also be developed by organising European wide strategic platforms, mobilising companies, research, education and financial institutions and able to identify priorities for research, innovation and education in a coherent way, aiming at building capacity to explore new markets. The concept of “lead markets” building on the technology platforms and the European clusters can go in this direction.

3. How can Europe remain attractive for world wide investment?

- The first condition to be fulfilled is to enhance the above mentioned distinctive advantages of Europe in a sustainable way.
- The second one is to step up the knowledge accumulation and diffusion process in Europe. What is at stake is not only investing in research but also in innovation and in education. Therefore, it would be useful to complement the largely publicised indicator on research investment with a more comprehensive indicator on knowledge accumulation.

- The shortages of human resources should deserve a special attention in their broader sense: not only highly skilled people, but also creative professionals, professional of technical routines as well as professionals of personal services. The European policy for immigration should also be reconsidered against this background, leading to new models which go beyond brain drain to brain circulation and to brain exchange.
- The restructuring of the labour market regarding skills which is underway has also implications for the reform of the social protection systems. A more personalised approach is needed, to support not only cases of redundancies and job losses but also more dynamic careers among the so-called knowledge workers.

More fundamentally, what seems to be at stake is to create a model of creative destruction speeding up the transition to a knowledge intensive economy, which should be supported not only by the financial markets but also by the European social model according to its values. This leads us to the next theme dealing with the reform of the European social model and the role of the European social policy.

B. UPDATING THE POLICY-MIX OF THE EUROPEAN SOCIAL POLICY

We should first recall that the purpose of the European social policy has been to keep social cohesion and to support change throughout the different stages of the European integration: building the common and single market, creating a monetary zone, facing the common challenges of globalisation and demographic trends. The specificity of the Lisbon agenda is that, after a shift previously occurred in 1997 with the European Employment Strategy, Member States accept not only to adopt European measures but also to coordinate their national social policies, comprising employment, social protection, social inclusion, education and more recently, health. The main argument for this development is that they are facing common challenges and common needs for reform because, in spite of the differences of their social systems, they are identified with a common European model.

The approach developed by the Lisbon agenda comprises some typical features:

- social policy has a value in itself, but should also be envisaged as a productive factor;
- social policy should be renewed to support the current transition to a knowledge intensive economy. The role of education, training, learning organisations or restructuring management become outstanding from this view point;
- the concern with sustainability enlarges the concept of social justice to take into account the relationship between generations; it also leads to put emphasis not only on reducing unemployment but also on raising the employment rate, as a crucial factor to sustain the social protection systems;
- the analysis of the labour market is based on more dynamic approaches, taking into consideration the transitions over the life-cycle which should inspired the redesign of social policies;

Where are we now concerning the policy-mix and the instrument mix of the European social policy? The *acquis communautaire* of directives comprising labour, employment and social protection issues was built on or complemented by the outcomes of the social dialogue at European level. This one, in spite of being supported by bilateral work programme and by a regular Tripartite Summit, seems quite weakened in its capacity to update the legal framework of the European social policy. On the other hand, a new phase of the European Social Fund is now being launched to cover the period of 2007-13, expected to be more in line with the Lisbon goals, and complemented by a new instrument, the Globalisation Fund.

Finally, the Employment guidelines are now included together with the broad economic policy guidelines in the integrated guidelines for growth and jobs, defining the current version the Lisbon agenda by using these Treaty-based instruments. As the references to social protection and social inclusion were clearly reduced regarding the previous version of the Lisbon agenda, a parallel process covering these policies and based on the open method of coordination was created, supposed to “feed-in” the main Lisbon central process.

A central question which should now be addressed is if the current state of the European social policy is enough to support the European citizens and companies in adapting to globalisation. Some possible new developments of the European social policy were then identified, concerning the policy mix as well as the mix of instruments to be used.

1. Improving the policy-mix of the European Social policy

- As a major improvement, social protection and social inclusion should be included in the integrated guidelines defining the Lisbon agenda, which should be streamlined and reduced in their overall number. This can have the advantage of considering the social dimension in a more consistent way, avoiding parallel processes.
- It will then be easier to draw all the implications of the life-cycle approach, by designing a consistent combination of employment, lifelong learning and social protection measures for each phase: integration of young people into the labour market, conciliation of family and working life, active ageing, mobility and immigration.
- In this framework, it will also be easier to identify the kind of securities which should be provided in order to facilitate the flexibility in the labour markets, designing more tailored instruments of flexicurity.
- Lifelong learning should be developed as a much more central policy in a policy-mix according to the Lisbon agenda. This requires more political effort in addressing the problems of both demand and supply. On the demand side, generalised and up-dated vocational guidance, validation and recognition of training, working time flexibility, child care and new financial facilities, such as learning accounts, are crucial to encourage citizens to participate in lifelong learning. On the supply side, companies' investment in training can be fostered by a stronger influence of their human assets on their financial value and by new funding arrangements for training by companies, including labour contract arrangements where training costs should be taken into account in cases of professional mobility.
- In restructuring management, the traditional instruments for a passive and cushioning approach should be increasingly complemented by an active approach based in regional and industrial policy and, furthermore, by a pro-active approach based on innovation policy.
- In social protection policies, beyond the general re-calibration of benefits/contributions to take into account the new social risks and the balance between generations, a more personalised approach creating some room for personal choices should be developed precisely to take into account the various stages of the life-cycle as well as the need of spreading lifelong learning.
- In social inclusion, better combinations between minimum income and activation should be developed for a new social contract. A composite indicator of social inclusion should be considered in the political assessment of the Lisbon agenda, in parallel with the composite indicator on knowledge accumulation which was suggested in section A.1.
- Finally, in any case, the European social standards will not be sustainable without a stronger international action of the European Union for an improvement of the social standards of other international partners. This action can take place via international regulations, such as the ILO conventions, as well as via trade negotiations or cooperation programmes.

2. Improving the instruments of the European Social Policy

This policy mix should have several implications for the mix of instruments to be used:

- the next generation of integrated guidelines to define the Lisbon agenda should also comprise social protection and social inclusion, avoiding parallel processes;
- some tools of the open method of coordination should be used in the implementation of these guidelines, notably concerning the regular monitoring, the peer learning and the participation by the stakeholders;
- the scope of restructuring problems covered by the Globalisation Fund should be enlarged;
- beyond a stronger enforcement of the current directives, some new legislative initiatives could be considered, notably regarding re-training opportunities and the general principle of minimum income with activation.

C. STRONGER SYNERGIES BETWEEN THE MACROECONOMIC POLICY AND THE LISBON AGENDA

Quotations on the paper by Pier Carlo Padoan “The Macroeconomic dimension of the Lisbon Agenda. Some reflections.”

Against this background, the macroeconomic dimension of the Lisbon Agenda should also require some new developments. The interactions between the Lisbon agenda and the macroeconomic dimension are many and complex. The following key-issues should be reconsidered:

1. The interaction between the macroeconomic environment and the Lisbon Agenda.
2. Institutional and operational modifications to strengthen the EU macroeconomic framework.
3. The Stability and Growth pact and the Lisbon Agenda.
4. Other policy instruments in support of the Lisbon Agenda.
5. The external dimension.

1. An appropriate macroeconomic environment is a necessary condition for the success of the Lisbon Agenda. But without a successful Lisbon Agenda, the European macroeconomic environment and the Euro area in particular could face significant risks.

1.1. The Lisbon Agenda needs more investment in physical and knowledge capital

Knowledge based growth requires a stable macroeconomic environment. This point is generally accepted when discussing the relationship between macroeconomic policy and growth. Low and stable inflation provide a pro-growth environment in the medium to the long run. This common wisdom however, needs to be qualified. Lisbon Agenda driven growth in Europe needs more investment in physical and knowledge capital. Hence, most of all, the macro environment must provide incentives for investment.

1.2. A less procyclical macroeconomic stance supports investment

In the EU and in the Euro area in particular, macroeconomic and financial market conditions must be such as to avoid that cyclical factors inhibit investment. Such a result is largely the consequence of the interaction of the policy stance and of the degree of financial market development and integration.

“In a recession, current earnings are reduced and so therefore is firms’ ability to borrow in order to maintain R&D investments. In this case, a countercyclical policy will foster innovation and growth by reducing the negative consequences of a recession (or a bad aggregate shock) on firms’ innovative investments.” in Philippe Aghion (2006)

In sum, if the EU macroeconomic policy stance was to become less procyclical, investment and growth could be significantly enhanced.

1.3. Coping with increasing divergence in the Euro area requires more Lisbon Agenda

A related aspect is that recent macroeconomic trends in the EU, and especially in the Euro area, point at increasing divergences which, if unchallenged, may put the functioning of the Euro zone at risk. The differences in national labour productivity show that the EU, and the Euro area have a double problem. They need to increase aggregate productivity growth and they also need to close the gap between national productivity trends. This, in turn, requires both EU aggregate and national efforts in the direction of a knowledge based economy. In other words the Lisbon Agenda is needed to ensure macroeconomic sustainability.

This evidence also suggests that a macroeconomic environment supportive of the Lisbon Agenda requires action at both EU/Euro level and national level.

2. Institutional and operational modifications are needed to strengthen the EU and Euro area macroeconomic framework

2.1. Macroeconomic institutions. The European dimension

There are ways, short of setting up a single EU fiscal authority, to improve the degree of fiscal coordination in Europe so as to obtain a less procyclical policy stance:

- The procyclicality of national fiscal policies could be decreased by giving more room to automatic stabilizers and set expenditure targets over the medium term (on the issue of the composition of spending see below).
- National budgetary processes could be aligned. This would allow national programmes to be based on consistent assumptions of other member states policies and eventual spill-overs.
- National programmes of the Euro-area Member States could be consolidated into an aggregate “European Stability Programme” which would serve to assess the overall fiscal policy stance within the Euro-area and help to determine whether adjustments to national programmes would be desirable. This step could also help to better assess the impact of structural reforms on potential growth on a EU wide scale and the possible spill-overs of reform from one country to another.
- A Euro-area Council should be entrusted with all the policy decisions pertaining to the operation of the Euro area (with the exception of issues under the jurisdiction of the ECB) and be given the right to adapt rules that are relevant only for Euro-area members, while preserving the rights of Member States not participating in the single currency. Regular informal meetings between the President of the Euro-area Council, the relevant Commissioner and the President of the ECB would reinforce the process.
- Such a framework (the European Stability Programme and the euro area Council) would also help to formulate and implement a common external policy of the EU and Euro area *vis-à-vis* other countries and in the international institutions. This

would strengthen the role of Europe in addressing global policy management (see below).

- Other measures include the possibility of tradable fiscal deficits. It is a good idea in principle but in practice it should be accompanied by an assessment of the quality of the deficit in terms of structural *vs* cyclical components as well as the spending and taxation items. In order to strengthen the quality of public finances, tradable deficits could be limited to Lisbon Agenda relevant items (see below).

2.2. Strengthening the macroeconomic dialogue

- Macroeconomic issues to be discussed jointly by the Euro area Council and the ECB would be the appropriateness of the monetary and fiscal policy stance, which should include the degree of monetary tightness as determined jointly by interest rate and exchange rate developments. The assessment of the fiscal policy stance would be made easier by the definition of an aggregate European Stability Programme.
- Dialogue with trade unions and social partners at the EU level should deal with general reform issues, including ways to use EU budget resources in the restructuring fund (see below). More ownership of the NRP at the national levels should include a systematic dialogue with social partners on the reform process.

3. The Stability and Growth Pact (SGP) and the Lisbon Agenda are the two pillars of the EU economic policy framework and need to be better integrated.

There are three reasons why the SGP and the Lisbon Agenda should be better integrated to form a unified single economic strategy of the EU and the Euro area: a) incentives for policy action would be strengthened; b) the reforms process would be accelerated; c) the overall quality of public finances would be improved.

3.1. The SGP and the Lisbon Agenda face symmetrical incentive problems

The SGP is based on a clearly defined incentive set, itself underpinned by behavioral rules which, however, have produced only a limited boost to growth. Conversely, the Lisbon Strategy would significantly boost growth if it could rely on stronger incentives.

A reformed SGP would also better interact with the NRP by lengthening the relevant policy time horizon. The SGP has been reformed lately, but more needs to be done. The SGP has been reformed in the direction of avoiding procyclicality, especially to encourage adjustment in good times. But the most important change is the possibility to consider deviations from the adjustment path to take into account the consequences of the implementation of structural reforms. In the reformed SGP the impact of reforms on the budget are taken into consideration according to a number of conditions.

However, this reform of the SGP, in spite of being effectively implemented or not, does not provide sufficient incentives to carry out growth enhancing reforms and, especially for countries with a difficult public finance condition, they do not provide sufficient incentives for a strong contribution of public finances to the Lisbon Agenda. Hence, further incentives to direct the budget towards Lisbon Agenda targets should be considered.

3.2. Exploiting in full the contribution of public finances to growth, by changing their composition.

It should be possible to use the discipline element of the SGP, its incentive structure, in order to redirect resources towards more sustained growth and reinforce the implementation of the Lisbon Agenda.

This would reinforce EU potential output growth and strengthen its sustainability by putting more emphasis on the intertemporal dimension of financial equilibrium.

To this purpose, a Good Quality Finance Rule (GQFR) should be introduced to complement the rules already underpinning the SGP. The GQFR is based on two pillars: a budget pillar, and a debt pillar.

3.3. The budget pillar

- While maintaining the 3% deficit limit and the commitment to reach a budget position in surplus or close to balance in the medium term, according to the revised version of the SGP, the budget items would count differently towards the respect of such requirements as it is in the case of the budget costs of structural reforms.

This requires a careful identification of those budget items that should be considered as supporting factor accumulation, i.e. physical, human, and knowledge capital. The transparency of the process is to be guaranteed through an accurate and independent assessment of the specific budget items by Eurostat and by strengthened surveillance by the Commission.

3.4. The debt pillar

- Reinforcing the role of public finances to support growth should not go to the detriment of debt sustainability. Long term sustainability requires a decline of the debt to GDP ratio which should be as rapid as possible, especially for high debt countries.

The measures suggested under the budget pillar should be implemented, subject to the conditions of a sufficiently rapid decline of the debt to GDP ratio (for countries whose debt/GDP is above 60%) or, in any case, that debt should not go above 60% (for countries whose debt/GDP is below 60%).

Both pillars would have to be put in an appropriate time frame, taking into account the inter-temporal dimension and avoiding pro-cyclical effects.

4. Further policy instruments in support of the Lisbon Agenda

4.1. The EU Budget

- The issue of the reform of the EU budget, while complex in practice, can be summarized in few points. On the *spending side*, for a given size of the budget, resources should be significantly redirected from agriculture and traditional structural fund allocation towards knowledge driven growth.

- On *the revenue side*, changes should be significant too, moving away from a predominant role of national contributions towards a EU-wide tax base and related to EU wide projects and/or European Structural funds.

4.2. EU networks

- Macroeconomic benefits of knowledge driven growth require not only more knowledge accumulation in terms of R&D, human capital, but also a greater emphasis on innovation diffusion to fully exploit the advantages of ICT. This requires, among other things, the development of Europe wide infrastructure networks. The issue arises of the financing and development of such networks. Such networks, while clearly of EU interest, can be financed by national (private and public) expenditure with the renewed EU budget playing a catalyst role.
- A complementary way of addressing the financing needs of large infrastructure projects is through public private partnerships. In cases of EU wide infrastructure projects financed through national public funds it could be considered to separate these items from the spending items that determine the definition of national deficits relevant for the SGP procedures.

4.3. Tax harmonization

Should tax rates be harmonized to enhance knowledge driven growth in Europe while avoiding social and fiscal dumping? As financial markets become more integrated, coordination of tax rates risks becoming ineffective, if not counterproductive, given the high risks of free riding. A more effective way to proceed is to obtain a EU wide set of accounting rules aimed at determining a common tax base for firms operating in the EU.

5. The external dimension. Europe needs to speak with one voice to better manage the global system.

Increased coordination between the Euro area and the ECB as suggested in point 2 is also relevant for the external dimension of macroeconomic policy. The key issue here is not so much agreeing on the exchange rate stance, but to speak with one European voice in the management of the global economy. This is particularly relevant in the medium to the long term which, given current trends, will see a decline in the share of world GDP for the Euro area and the EU in general.

A successful implementation of the Lisbon Agenda, by generating stronger growth, would reinforce the voice of Europe in global issues and would also respond to the calls coming from the international community about the contribution of Europe to addressing global imbalances. Conversely, a strong European voice in the global arena would allow establishing a system of governance which would support EU interest while strengthening a multilateral approach to global governance.

- An obvious step in this direction is to move from national to Euro area representation in international institutions such as the IMF. The voting power and blocking power of a single Euro area chair would be clearly larger than any of the current national chairs.

- As for the long term objectives the guiding strategy should be one of reinforcing the formation of open regional monetary blocs that interact cooperatively for the management of global imbalances, strengthening the multilateral approach as well as multilateral institutions.