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▶ **To cite this version:**

Eloi Laurent, Jérôme Creel, Jacques Le Cacheux. Delegation in Inconsistency : the 'Lisbon Strategy' Record an an Institutional Failure. 2005. hal-00972772

HAL Id: hal-00972772

https://sciencespo.hal.science/hal-00972772

Preprint submitted on 22 May 2014

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Delegation in Inconsistency:
The « Lisbon strategy » Record as an Institutional Failure[*]

N° 2005-07
June 2005

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Delegation in Inconsistency:
The “Lisbon strategy” Record as an Institutional Failure*

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ABSTRACT

In this paper, we develop an analysis of the reasons for the apparent failure of the “Lisbon strategy” (2000) so far. After having made the general case for a comprehensive “institutionalist perspective” on the European economy, we first try to formalise the objectives of “Lisbon” in order to present a mid-term review of the results attained. Since we find, like many others, that too little has been achieved, we then offer some possible explanations. Apart from an inconsistency problem between the different objectives set, we argue that the major reason for this failure appears to lie in the contradiction between the EU macroeconomic policy framework, based on the logic of delegation of power and control to independent authorities with conservative objectives, and the proactive policies required by the “Lisbon strategy”, which objectives the EU member states eventually find themselves accountable for (not) achieving individually.

JEL Codes: N14, O11.

Keywords: European Union, “Lisbon strategy”, Institutions, Delegation, Inconsistency, Macroeconomic policy, Structural Reform.

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* This paper was prepared for the CONNEX Workshop “Delegation and Multi-level Governance” to be held in Paris, May 11 2005. We are grateful to Benoît Mojon for his comments and remarks. We also thank the participants and, among them, Marco Buti, for helpful discussion. The usual disclaimer applies.

2. Introduction: The case for an institutional perspective on European shortcomings beyond labour markets

Is Europe in decline? Over the recent years, the macroeconomic performance of the European Union has been conspicuously weak, with low growth and high unemployment, in absolute and relatively to the rest of the world. While some of this poor showing may be attributable to cyclical factors, there is clearly a more profound, structural nature of the European lack of economic dynamism, that has so clearly revealed itself in the 1990's. But then what are the major causes of this "structural slump" (Phelps, 1994)?

There seems to be a widely shared consensus on the idea that potential growth is low in Europe, but the reasons why this is so, hence the possible remedies for this European economic disease, are not unanimously agreed upon. However, it is hard to ignore that a "conventional wisdom" has developed on this matter[4]. In brief, goes the argument, Europe would be falling behind mostly because of an archaic hypertrophy of solidarity: the welfare state becoming more and more work-adverse in a globalised economy, the key to a European revival would be its modernisation, as well as the urgent implementation of structural reforms on the market of services, goods and capital. The remainder of this paper is devoted to develop a counter-argumentation to this "conventional wisdom", insisting on the need to adopt an integrated perspective of the role played by institutions in Europe and applying it to the "Lisbon strategy".

Institutions and Growth in Europe

The link between institutions and growth is now an object of wide consent among economists[5]. Moreover, the exploration of this theoretically rich relation has recently given rise to a new wave of comparative economics that takes the form of a "new-new institutionalism"[6] devoted to analytically identify and empirically document the complex interactions between institutions and economic performances[7]. Whatever the fruitful contradictions and refinements, no one would seriously present growth theory today without some solid institutional perspectives[8].

Indeed, on the other theoretical end of the new "comparative growth economics" devoted to shed some light on recent miracles and enduring failures among emerging economies, has stand alone, until recently, a "comparative structuralism" aimed at fundamentally relating economic performance of developed nations to their labour market structures[9]. The "varieties

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[4] See, for instance, Sapir et al (2003), and Kok (2004).

[5] One can think of the quasi-unanimous praise that welcomed the recognition of the work of D. North and R. Fogel, who were awarded the Nobel Prize in 1993 for their analysis of the "role institutions play in economic growth".

[6] In some ways, it resemble the "old" one forged by such founding fathers as Ely, Commons or Veblen.

[7] See, among many others in this fast-growing literature, Hall and Jones (1999); Acemoglu, Johnson and Robinson (2001); and Rodrik et al., (2002).

[8] For a state of the art panorama, see Aghion and Durlauf (2005).

[9] For classic contributions in this field, see Layard, Nickell and Jackman (1991) and Calmfors and Driffill (1988) ; for refutation and counter-argumentation, see Fitoussi and Passet (2000) and Freeman (2000).

of capitalism" literature, focused on the key issues of co-ordination (and the related distinction between "liberal market economies" and "co-ordinated market economies") and "institutional complementarities"[10] is a good example of a fertile new ground for a more integrated perception of dynamic institutional interactions and their economic outcomes in Europe[11].

When considering the classical and rather broad definition of "institutions" given by Douglas North (1994): *"the humanly devised constraints that structure human interaction [...] made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self imposed codes of conduct), and their enforcement characteristics. Together [defining] the incentive structure of societies and specifically economies"* (see North, 1990 for the original formulation), it actually appears problematic, to say the least, not to think of macroeconomic policies, and of the "macro-structural" (policy) mix, as part of the institutional operational system of any given modern economy.

In this regard, the EU looks lopsided. It has developed, for almost two decades since the Single Act in 1986, a growth strategy along a structural pattern, with little consideration for the efficiency of its economic governance. Yet, while the Single Market – although not fully – is largely enforced since 1993 and has also been reinforced, for six years now, by the single currency (the "Euro"), the EU growth performance for the last four years has been repeatedly deceptive and the overall assessment of the last European decade, when compared with the American and Asian performances, is nothing less than dismal (see graph 1). The "juvenile" Asian economies put aside, the EU, not catching-up anymore since the mid-70's, has been lagging behind the US economy for more than two decades by an estimated 30 % gap in GDP per capita (see, among many others, Sapir et al., 2003), this gap possibly amounting, after the Eastward enlargement and the "roaring" American decade of the 90's, to 40%.

The exact nature of the transatlantic gap must here be briefly highlighted and related to the previous institutional considerations. The "American model", made of flexibility, creativity and "risk-loving" culture often seems misunderstood or, better, underestimated in its complexity. While the "structures" of the American economy undeniably played a major role in the phase of innovation and investment acceleration observed after 1995, the sparking and stabilizing effects of both monetary and fiscal policies throughout the decade, fostering in return, in the process of high non-inflationary growth, long-lasting efficient metamorphoses in the economy, must not be neglected (see Solow and Krueger, 2002 for an overview).

Thus, beside the "deepening hypothesis", according to which the EU integration would not yet be sufficient to deliver a durable high level of GDP growth, one of the reasons of the poor economic performance of the region might well be that the EU has not developed the coherent economic policy institutions able to make the most of its potentially powerful economic and monetary integration, in other words: the EU has not developed the coherent economic policy institutions able to foster its potential growth.

The reasons of this failure must be thoroughly assessed. One way to do that is to examine the relevance of the "Lisbon strategy" on the path to growth, jobs, social inclusion and sustainable development. Our conclusion is that the EU is lacking the real means of a proactive macro-structural policy mix (what we propose to call EU's "missing institutions"): the "Lisbon strategy" does not seem equipped with the adequate efficient instruments; implementing "structural reforms" of the kind needed by the EU-25 in 2005 and beyond without a coherent growth-friendly macroeconomic governance is almost an impossible task.

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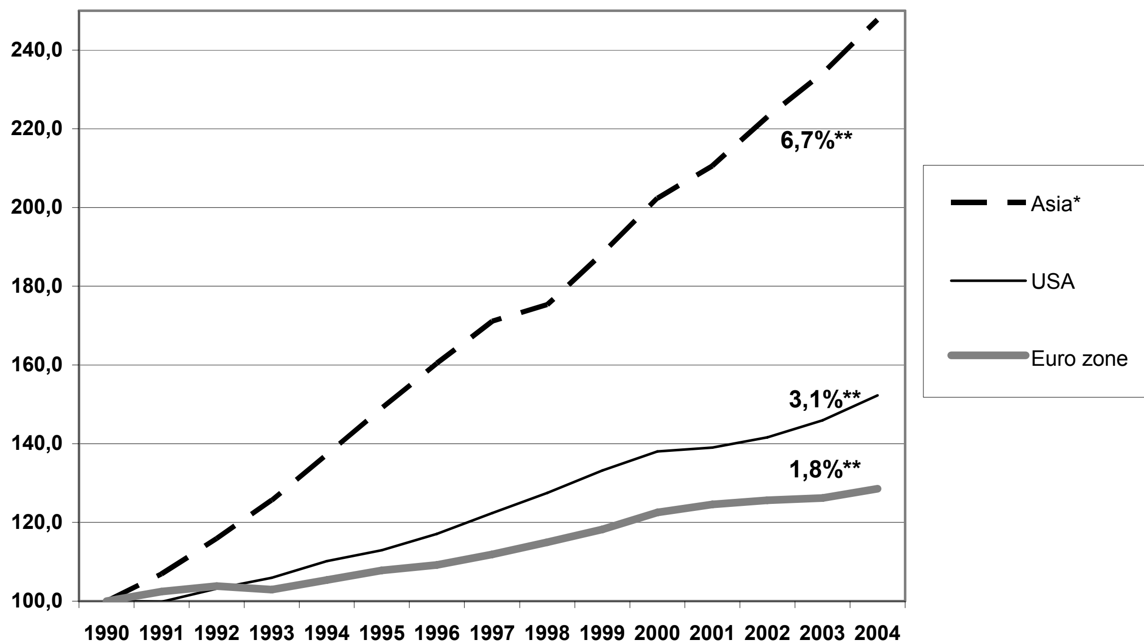
[10] See Amable (2000).

[11] Hall and Soskice (2001) and Gingerich and Hall (2004).

Graph 1: The dismal decade



*: Asia is composed of China, India, South Korea, Hong Kong, Taiwan and Singapore.
**: Mean annual growth rate of real GDP between 1990 (index 100) and 2004.
Source: Fitoussi and Le Cacheux (2005).

3. The Record of "Lisbon"

The overall ambition of the "Lisbon Agenda" or "strategy" is now well known as it is so often quoted in the European Union (EU) literature: "*to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion", " and a sustainable environment."* [12] Actually, it has become so familiar that it seems that no one still cares about its significance, i.e. the accuracy of the economic strategy it stands for. The EU as a whole should just "make Lisbon come true": with what means? for what results?

The "Lisbon strategy", decided at the eponym summit in March 2000, has gone through mid-term review at the Brussels summit last March. The Presidency Conclusions of the summit, that offer a severe assessment of the results so far and propose some ways of improvement (see below), have themselves to be evaluated in the light of the dismal "Lisbon record" of the whole EU. But before possibly formulating any critic regarding, one has first to understand, "Lisbon". But who would not adhere to an economic, social and environmental strategy that allows *simultaneously*, to attain growth, productivity, social inclusion and

[12] This objective was added in the course of the Gothenburg summit in June 2001. The achievement of this objective is set for 2010.

sustainable development? In this respect, “Lisbon” looks like the quintessential contemporary utopia: the end of political trade-offs.

The problem of course, and the key to the understanding of what is wrong with “Lisbon” and went wrong in implementing it, is that such trade-offs are enduring and do not vanish easily. This is why the core problem of “Lisbon” is (in)coherence : (in)coherence of the different objectives ; (in)coherence between the objectives aimed at and the instruments mobilized to achieve them.

What “Lisbon” means

It is quite difficult to capture the meaning of “Lisbon” with the only help of the general motto reproduced above in the first paragraph. The same can be said of the official literature that generally insists on the three pillars –economic, social and environmental– of EU’s millennium strategy. One has first to decipher “Lisbon” to asses its accuracy. Hopefully, the Presidency Conclusions of the 2000 summit give details, and thus offer a second level of understanding. Achieving Lisbon was considered possible in 2000 provided the following actions were taken:

> *"–preparing the transition to a knowledge-based economy and society by better policies for the information society and R&D, as well as by stepping up the process of structural reform for competitiveness and innovation and by completing the internal market;*
>
> *–modernising the European social model, investing in people and combating social exclusion;*
>
> *–sustaining the healthy economic outlook and favourable growth prospects by applying an appropriate macro-economic policy mix."*

Our understanding is that these three objectives, to which one must add that of “sustainable environment”, can be formalised by four “deficits” to be closed by 2010: a “standard of living deficit”, a “productivity deficit”, a “labour deficit” and an “environmental deficit”. It is to be noted that this formalisation goes a long way in simplifying “Lisbon”. The strategy was in the beginning made of 28 main objectives and 120 secondary objectives for a total of 117 indicators, which, to say the least, did not contribute to its visibility. But the Commission has proposed in Spring 2004 a short list of 14 “structural indicators”[13] that it monitors according to the Council demand. These indicators are the “Lisbon road map”: their progress is the reference from which to evaluate the success or failure of the strategy.

[13] These indicators are the GDP per capita in PPS, labour productivity, employment rate, employment rate of older workers, educational attainment (by 20-24 years old), research and development expenditure, comparative price levels, business investment, at risk-of-poverty rate, long-term unemployment rate, dispersion of regional employment rates, greenhouse gas emissions, energy intensity of the economy, volume of freight transport.

Mid-term assessment: Half of...a quarter

We do find in that list, that provides the third level of understanding of "Lisbon", the "four deficits" just mentioned and thus can ventilate most of the structural indicators (9 out of 14) into that four categories:

- The "standard of living deficit" is measured by the GDP per capita in PPS ;
- The "labour deficit" is assessed trough the evolution of employment rate broken down in gender and employment rate of older workers ;
- The "productivity deficit" is apprehended by labour productivity, research and development expenditure and educational attainment (by 20-24 years old) ;
- The "environmental deficit" depends on the progress of greenhouse gas emissions, the energy intensity of the economy and the volume of freight transport.

Before surveying and analysing the available data, the method we use in this paper is to be clarified and justified. As a matter of fact, the "Lisbon strategy" includes very few quantified objectives. The bulk of Eurostat's indicators is indeed used to compare results between countries instead of setting homogeneous targets for them all. This "benchmarking-best practices" method, while usual in the EU since the generalisation of the "open method of co-ordination" (first introduced in 1997) by the Lisbon Council (which conclusions call for a "new method of co-ordination"[14]), seems nevertheless especially unfit in the context of a global strategy supposed to generate positive externalities among member states. Discriminating between "good" and "bad" pupils of the European "class"[15] is of little meaning when the actual point is that the school itself is a bad one compared to others and can only improve its performances through an increased solidarity[16] (see also the last section). Furthermore, one can note that, since the "best" are those whose evolution is labelled "favourable" by EU institutions, this method leaves open the very meaning of the evolution of some indicators[17]. This is why we have chosen to propose an integrated and not fragmented mid-term review of "Lisbon".

There were actually only five quantified objectives in 2000: the total, women and older workers employment rate, "*an average economic growth rate of around 3%"*, and the reduction by half of the number of youngsters between 18 and 24 who have only accomplished the first cycle of secondary schooling by 2010. The Stockholm European Council in March 2001 has added intermediate targets for employment rates (see below). The Barcelona Council (March 2002) decided to aim for 3% in research and development expenditure. The objectives in greenhouse gas emissions resulted from the Kyoto Protocol (1997). Considering both those quantified and the explicit but informal objectives of "Lisbon", the result is very disappointing.

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[14] *"Implementing this strategy will be achieved by improving the existing processes, introducing a new open method of co-ordination at all levels, coupled with a stronger guiding and co-ordinating role for the European Council to ensure more coherent strategic direction and effective monitoring of progress."*

[15] See for instance the five editions (the most recent in March 2005) of the "Lisbon scorecard" by the London based Centre for European Reform.

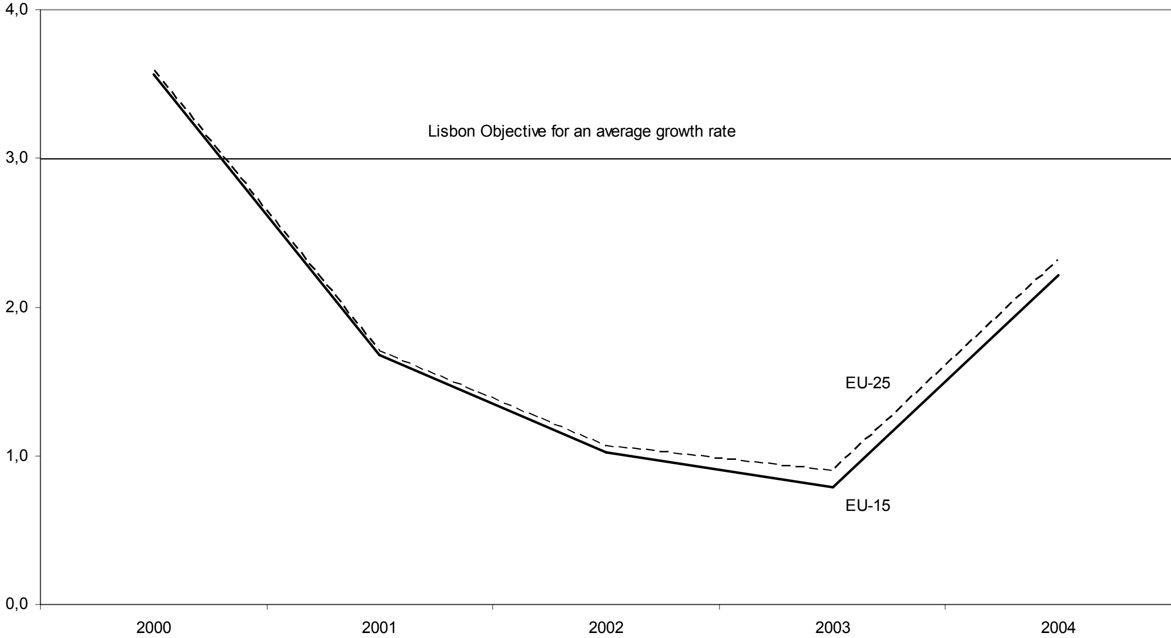
[16] This being, in our view, the fundamental argument for a an Economic and Monetary Union in Europe.

[17] This problem of quality, and thus significance, of the data used by the EU institutions is well reflected for instance in the "volume of freight transport" indicator, of which is nowhere said if it comprises the whole freight (by railway, sea, navigable rivers and road) or only part of it. Therefore, a reduction of this indicator could mean, as well, an environment-friendly substitution between road and railway or a mere reduction in business activity.

First, there is the general growth performance of the EU-15 and the EU-25 since 2000 (graph 2). The average growth rate of real GDP has been of 1.4% in the EU-15 and 1,5% in the EU-25 from 2000 to 2004. The growth rate of GDP per capita in the same period has been of 1.11% in the EU-15 and 1.14% in the EU-25. These numbers indicate that the "standard of living deficit" is not about to be closed, on the contrary.

For the "productivity deficit" –not formally quantified, but even more ambitious than all the others objectives[18] and whose empirical reality is to be discussed (see next section)– the evaluation is even worse. Far from being bridged, the competitive gaps of the EU-15 and the EU-25 have considerably widened since 2001, as shown in graph 3.

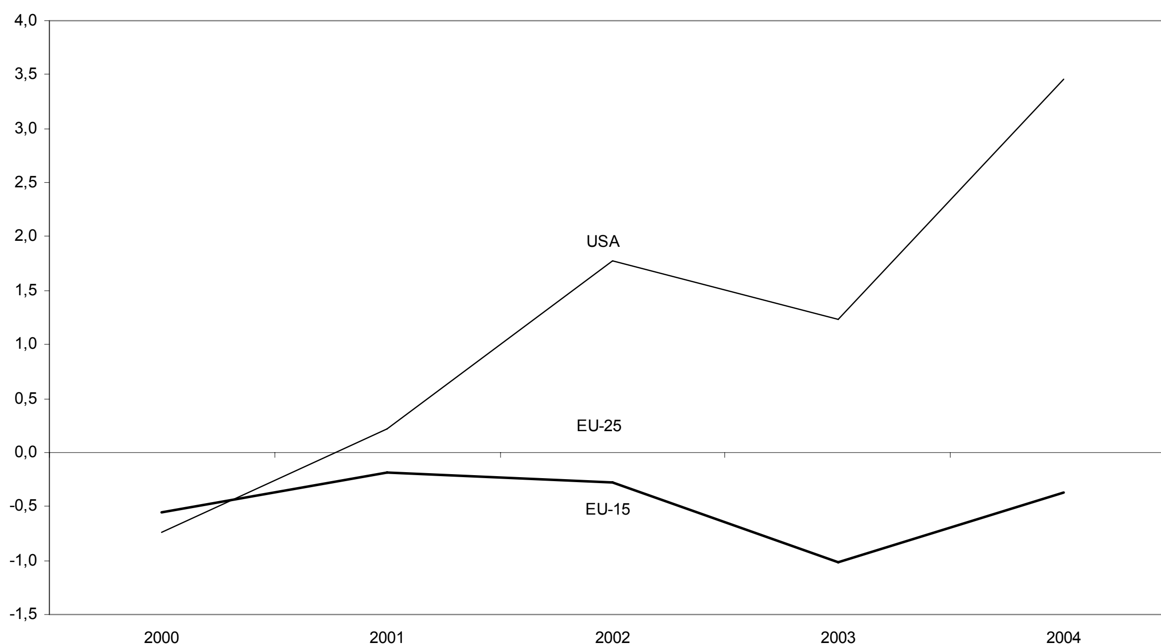
Graph 2: Real GDP growth rate (yoy)



Sources: EUROSTAT, computations by the authors.

[18] To become *"the most competitive economy in the world"*.

Graph 3: Productivity per person (annual growth rate) *vis-à-vis* EU-25



Sources: EUROSTAT, computations by the authors.

The objectives regarding employment ("the labour deficit") that have been the most publicised were the following: in 2005, total employment should have been at 67%, women employment at 57%[19], to reach respectively 70% and 60% in 2010. The older workers employment should reach 50% in 2010. The available data (from 2000 to 2003) and their extrapolation by linear regression until 2010 highlight several key issues.

To start with, the EU is far from the total employment objective it set itself in Lisbon (see graph 4): on the current trend, the employment rate in the EU-15 will fall short by 4 percentage points of the 2010 objective (7 percentage points for the EU-25). This important gap between the EU-15 and the EU-25 reveals one of the "technical" omissions of Lisbon, namely the greater heterogeneity of the EU-25. It is all the more apparent with the women employment performance: the objective could be surpassed in the EU-15, but not even reached in the EU-25 (see graph 5). As for the older workers employment (see graph 6), the trend looks good, but the same discrepancy between the EU-15 and the EU-25 is observed.

The only real, but probably only temporary, success of "Lisbon" so far thus seems to be the closing of the "labour deficit" for women and older workers somewhat at the expense of the other categories of the workforce, whose employment rate, at best, have stagnated since 2000.

The objective regarding the R&D expenditures/GDP ratio (component of the "productivity deficit") is of same nature than the growth performance (see graph 7): it seems out of reach on the current trend, without new means (see following sections).

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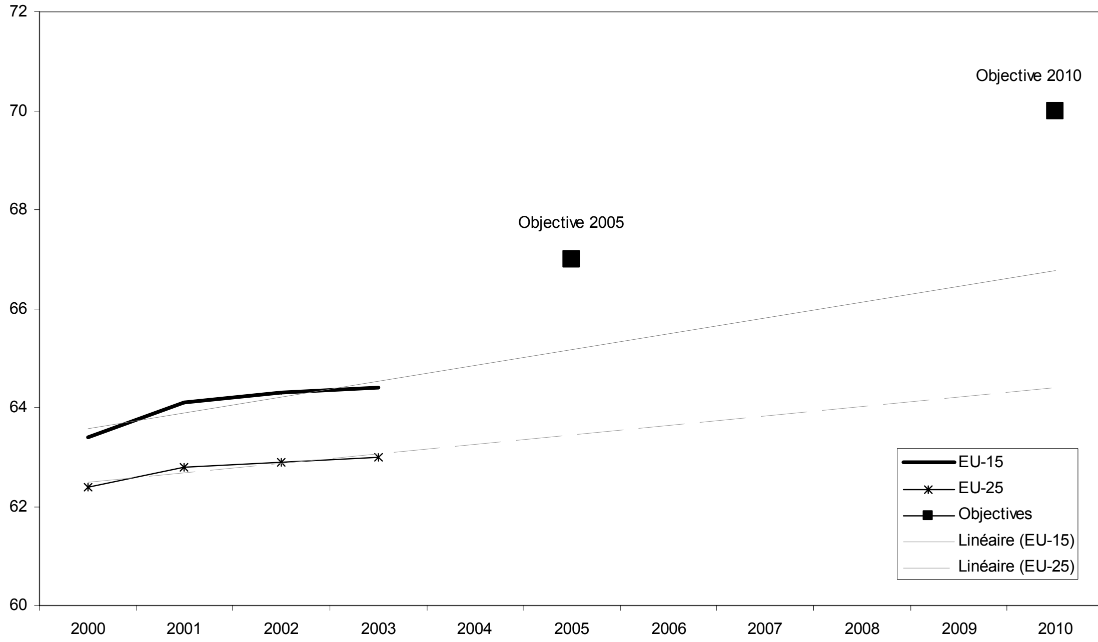
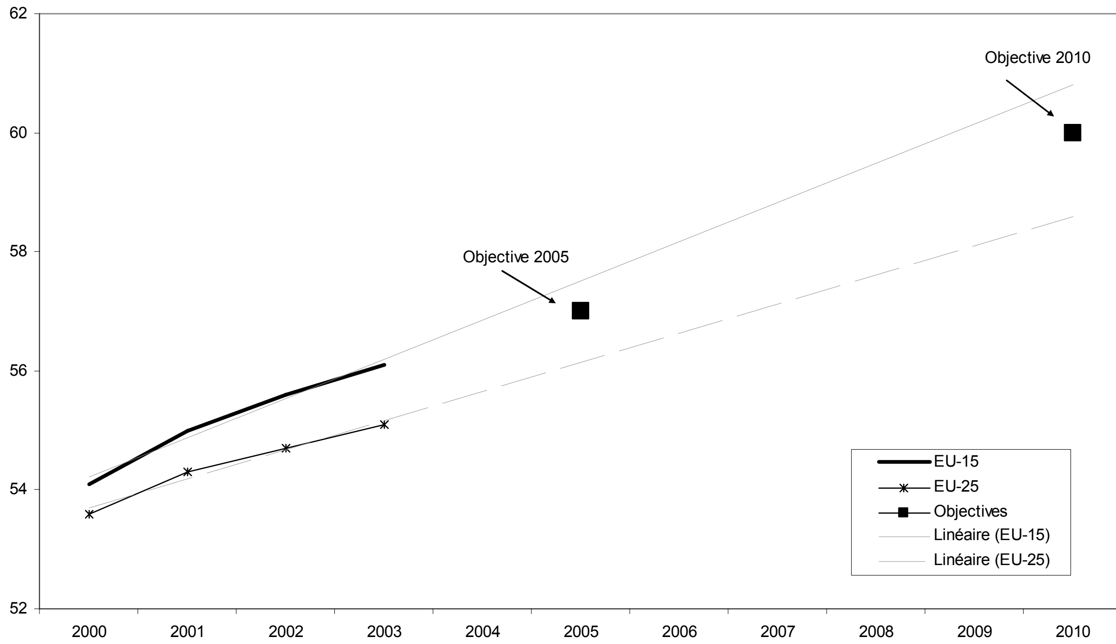
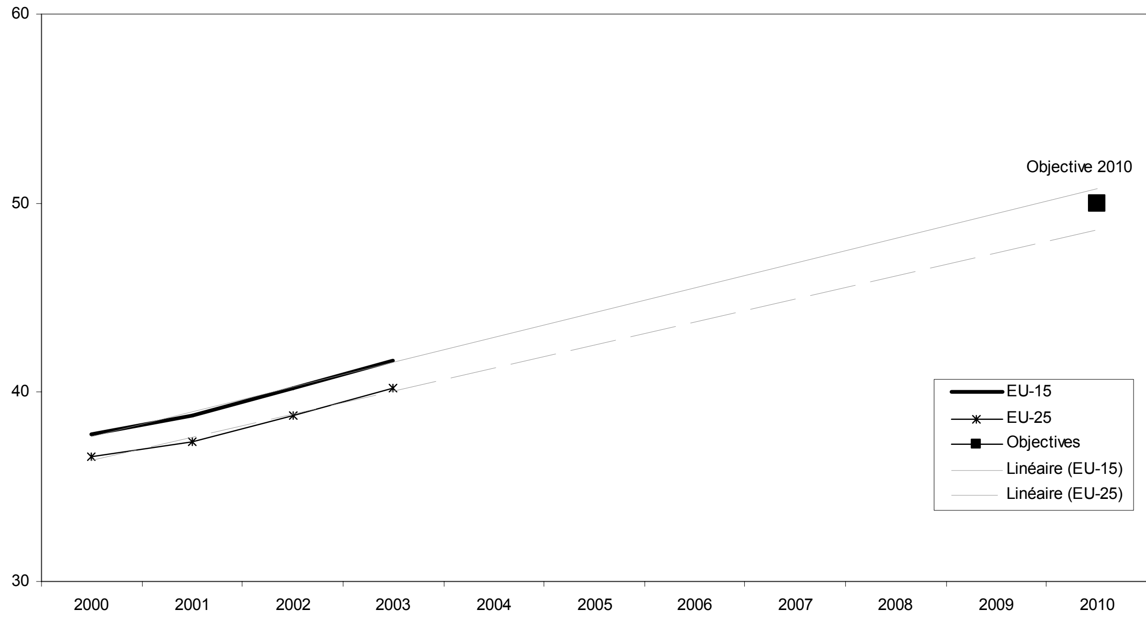
[19] Of the corresponding working-age population.



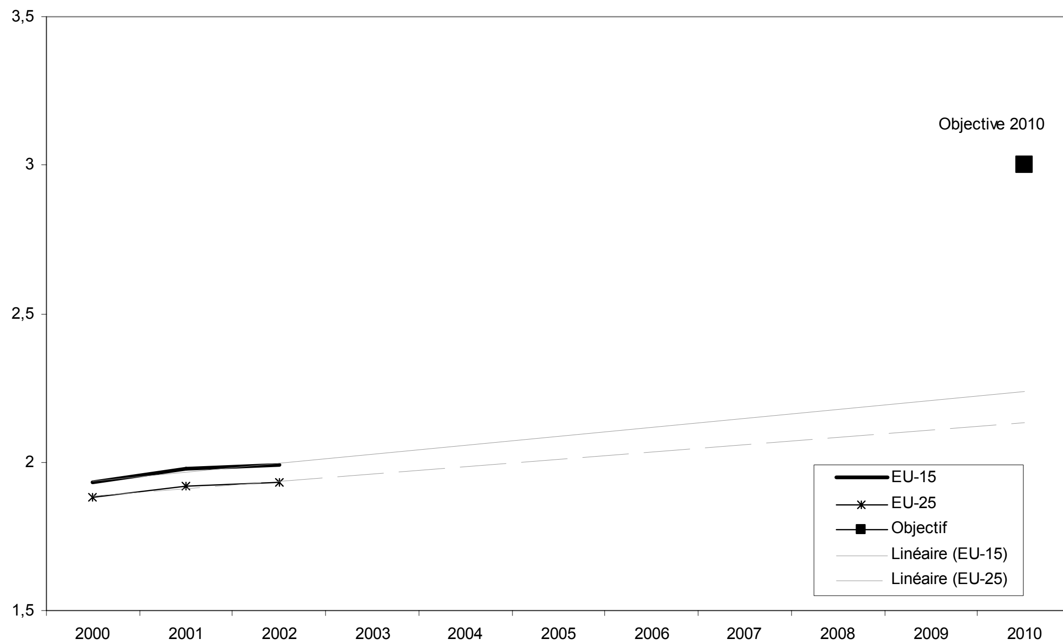
Sources: EUROSTAT, computations by the authors.



Sources: EUROSTAT, computations by the authors.



Sources: EUROSTAT, computations by the authors.



Sources: EUROSTAT, computations by the authors.

Lastly, the future evolution of greenhouse gas emissions (partially responsible for the "environmental deficit") is very uncertain: data are only available for the years 2000 and 2001 and show that the progress toward sustainable development is much too slow and unstable to achieve the Kyoto objectives, that many already consider outdated. From 2000 to 2001, the greenhouse gas emission has actually increased in the EU-15 and EU-25: the evolution in percentage from the reference year indicates a progress from 96% to almost 98% in the EU-15, and from 92% to 94% in the EU-25[20]. The evolution from 2001 to 2002 is reversed, the figures decreasing to return to their initial level.

Notwithstanding the shortness of these series, the picture is not encouraging for two reasons: the first one is, once again, the gap between the EU-15, well above the 92% objective of Kyoto, and the EU-25, that seems on a much sounder environmental path. The second one is the possible correlation, in the EU-15, between the deceleration of growth and the improvement of environmental performance since 2001 that casts doubt on the quality of the EU development.

From our examination, we conclude that, halfway to 2010, half...of a quarter of the Lisbon strategy has been achieved: the "standard of living", the "productivity" and the "environmental" deficits are not closing, and some are, in a concerning way, widening. The "labour deficit" has been, at best, halved, thanks to women and older workers better employment.

This "unpleasant arithmetic" has been acknowledged, although in a different way than above, by EU and Member officials gathered in Brussels on March 22 and 23 2005. While The President of the Commission severely labelled the EU performance "*lamentable*", the Presidency Conclusions diplomatically remarked: *"Five years after the launch of the Lisbon Strategy, the results are mixed. Alongside undeniable progress, there are shortcomings and obvious delays. It is essential to re-launch the Lisbon Strategy, to re-focus priorities on growth and employment",* adding a new motto for the "new Lisbon": *"Europe must renew the basis of its competitiveness, increase its growth potential and its productivity and strengthen social cohesion, placing the main emphasis on knowledge, innovation and the optimisation of human capital."*

The problem is that the exact same conclusions, in the exact same city, had been drawn one year before, at the 25 and 26 March 2004 Council: *"The Union set itself ambitious goals in March 2000. Four years later, the picture is a mixed one. Considerable progress has been made and the European Council reaffirms that the process and goals remain valid. However, the pace of reform needs to be significantly stepped up if the 2010 targets are to be achieved. The European Council is committed to demonstrating the political will to make this happen."* The other problem is that the 2005 motto does not differ very much from the original one, except maybe for the "re-focus on growth and jobs"...at the expense of environmental sustainability (see next section). Our view is that neither are good news for the "Lisbon strategy". In the remainder of this paper, we will try to analyse more thoroughly what is wrong with Lisbon, so as to propose new means of action and ultimately contemplate significant progress.

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[20] Eurostat data.

3. What is wrong with "Lisbon"? The objectives incompatibility

First of all, one has to wonder if the objectives set in Lisbon –ambitious but vague– are really accurate in the contemporary economic European context. Following the formalisation proposed, we will present successively three issues of internal compatibility.

1) Is it possible to close simultaneously, in order to bridge the "standard of living gap", the "deficit of labour" and the "deficit of productivity"?

Reading the Brussels Council Conclusions, there does not seem to be any contradiction between increasing simultaneously employment and productivity to raise EU's standards of living, notably to the US level. In our view, there is. This issue is far from being straightforward and needs to be considered with great care in order to formulate an accurate analysis and policy recommendation.

To begin with, recent studies (see Table I & II) show that if the evolution of the contribution to growth of the number of hours worked is globally more favourable in Europe than in the USA, this diagnosis does not hold for such big countries as France and Germany, which performance in terms of employment are respectively worse and just equal to that of the US. Secondly, the major difference between Europe and the US seems to reside much more in the quantities of inputs (labour and capital) incorporated in the production than in the performance in terms of GFP: among the four countries in Table II, the input quantity is 30% inferior to that of the US, while the GFP is only 2% less. According to other studies, the "quantity of labour" alone would provide much of the explanation for the "standard of living deficit", the European situation being explained alternatively by a "constraint" or a "preference hypothesis"[21].

In other words, the major issue regarding "standard of living deficit" is the trade-off between productivity and input incorporated, or even between "quantity" and "quality" of labour. Trying to increase at the same time productivity and employment without a heavy strategy of qualification of the workforce might merely lead to a neutral operation in the EU.

[21] See respectively Prescott (2004) and Blanchard (2004).

Table I: Real GDP growth rate and average contributions of hours worked and of labour productivity

	Real GDP		**Hours worked**		**Labour productivity**	
	1995-00	2000-02	1995-00	2000-02	1995-00	2000-02
France	2.7	1.4	1.4	-0.2	1.3	1.7
Germany	1.8	0.4	-0.3	-0.9	2.2	1.3
Italy	1.9	1.1	1.0	1.2	1.0	-0.1
UK	2.9	1.7	1.0	0.7	1.8	1.1
EU-15	2.7	1.3	1.1	0.4	1.5	0.8
USA	4.0	1.3	2.0	-0.4	2.0	1.7

NB: 'EU-15' excludes Luxemburg.
Sources: O'Mahony – van Ark (2003), also taken from Baudchon et al. (2005).

Table II: Levels of Output and Input Per Capita and Total Factor Productivity
(US = 100 in 2000)

Year	USA	RU	France	Germany	Italy
	Output Per Capita				
1995	85.6	61.4	57.0	65.0	62.1
2001	100.3	71.3	64.0	69.2	68.8
	Input Per Capita				
1995	88.8	67.0	57.0	73.7	58.8
2001	100.8	73.6	61.7	79.0	67.2
	Total Factor Productivity				
1995	96.4	91.7	99.9	88.1	105.6
2001	99.5	96.9	103.6	87.6	102.5

Sources: Jorgenson (2004), also taken from Baudchon et al. (2005).

2) Is it possible to reduce the "standard of living" and the "labour" deficits at once?

At the heart of this question lies in our view a strong contradiction between the Lisbon objective to "modernise the European social model" and the European growth crisis, due to the lack of active macroeconomic management of the EU since 2001. Can one reform to grow

without first growing to reform? The idea of "time inconsistency" takes all of its (unintended) significance here[22].

It allows indeed to understand why Europe's societies –at least in France, Germany and Italy that make up respectively for 75% of the Euro area and 50% of the EU GDP– are very reluctant to decrease the degree of solidarity in hard economic times and how, following from that, they "strategically" reject the welfare system reforms advocated by the Member State governments gathered in Lisbon.

In times of sluggish growth and soaring unemployment, social and economic insecurities are on the rise. The threat of a weakening of the degree of solidarity in this context logically results in a rise in the rate of household savings and not consumption, that could trigger a proper recovery through investment and employment. In other words, mounting insecurities lead to rational anxiety and precautionary behaviour.

In this deadlock situation, only the belief that decision-makers will commit to a growth and full-employment oriented macroeconomic policies could modify the anticipations and incentives of European agents. Maybe then, they could accept the reforms they are now, once again logically, refusing. The pursuit of non-cooperative strategies of tax and social competition –i.e. of public and institutional competition– would only aggravate the situation, by threatening to make the future more structurally unstable, as nobody would know what pillars of the welfare state would risk to fall apart.

3) Is it possible to close the "standard of living" deficit while reducing the "environmental deficit"?

Our last interrogation on the internal coherence of the "Lisbon strategy" regards the genuine integration, as opposed to cosmetic addition, of an environmental dimension in EU's grand plan. As already mentioned, great concerns have been expressed in the European community that the Brussels summit may mark a turning point in deciding to favour "growth and jobs" over sustainable development for the remaining time before 2010.

This highlights the idea, shared by many, that there is indeed a contradiction between the "Lisbon" and the "Gothenburg strategy" (see note 1)[23]. Insisting, as the EU institutions do, on the development of "win-win" strategies is necessary but not sufficient to guide the path for the urgent inevitable trade-offs, which represent most of the actual situations today, between growth stimulation and environment preservation.

Furthermore, while the Kyoto Protocol is finally coming to reality, it is of primary importance to offer EU citizens ambitious perspectives in terms of sustainable development. Not the Malthusian strategy that echo the famous "Limits to growth" (or even zero-economic growth) advocated by the Club of Rome some thirty years ago. Not even the perspective of a protectionist EU that would have chosen to be environment-friendly rather than competitive against fast-growing "irresponsible" economies like China or the US. But a resolute choice of a "European model of development", encouraging resources-saving technologies and destined to build new international specialisation and new comparative advantages in an ever-

[22] See Fitoussi and Laurent (2005).

[23] See for instance From Here to Sustainability–Is the Lisbon/Göteborg agenda delivering ?, European Panel on Sustainable Development, Report n°1, 2004-12-01, accessed at www.gmv.chalmers.se/epsd

integrating world. The implementation of such a demanding strategy would necessitate the efficient use of EU instruments and possibly the creation of new ones, both perspectives which are even more uncertain after the Brussels Council.

4. Is anybody in charge of "Lisbon"? The objectives/instruments incoherence

Indeed, an obvious perspective on the "Lisbon strategy" is that it does not have the means of its ambitions. More precisely, there is in our view a major contradiction between the economic policy framework of the EU, relying on the delegation of macroeconomic power to independent authorities whose mandate, as stated in Article III-177 of the EUCT, is to guarantee "*stable prices, sound public finances and monetary conditions and a stable balance of payments"* and the objectives of Lisbon, which Member states are accountable for achieving.

At first, the Brussels Presidency Conclusions do not seem to propose anything new to put the EU powerful instruments in coherence with "Lisbon": *"To achieve these objectives, the Union must mobilise all appropriate national and Community resources – including the cohesion policy – in the Strategy's three dimensions (economic, social and environmental) so as better to tap into their synergies in a general context of sustainable development."* But that first look is misguiding. Actually, beside the traditional calls for the completion of the single market and the modernisation of the European social model[24] (see above for the analysis of this objective), the Brussels Council puts forward two instruments to "re-launch Lisbon". The first one is a reformed Stability Pact, which new features are included in the text of the conclusions, and the second one is the financial perspectives for 2007-2013.

Our view, expressed in the next two points, is that both will do little to put the EU back on the track of "Lisbon". The reform of the Pact is ambiguous and can even be seen as a move toward more rigor and fiscal discipline. The simple invocation of the financial perspectives for 2007-2013 lacks a methodological federal framework. But we first start with a brief examination of the role of the exchange-rate policy in the Lisbon strategy.

What the Euro can do for "Lisbon"[25]

It doesn't really matter if the Euro is "weak" or "strong," as economic analysis in principle does not consider this aspect to be relevant in absolute terms. Europe's problem is that the euro is, for Europe itself, instable, or more precisely, a cause of instability. In the 1980s, even if the range of variations seemed to be excessive, the trend made perfect sense: the euro would depreciate during a slowdown and appreciate during an upswing. In the 1990s, the opposite took place: the euro appreciated from 1991 to 1996 – in times of sluggish growth - depreciated until 2000 when growth accelerated, and has been appreciating since then, while economic growth has been faltering. In other words, external demand is declining in Europe while domestic demand is down and, conversely, external demand is rising when domestic demand is up. But the most serious consequence of this destabilisation is of dynamic nature.

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[24] I.e. *"making work a real option for everyone, attracting more people into the labour market, improving adaptability, investing in human capital, modernising social protection, promoting equal opportunities inter alia between men and women, and fostering social inclusion."*

[25] This section draws heavily on Fitoussi and Laurent (2005).

It must be indeed emphasised that an overvalued currency, as the Euro is since the launching of “Lisbon”, reinforces the damaging effects of the transitions caused by the loss of a comparative advantage instead of smoothing them out. Even worse: it can stifle future comparative advantages before they arise, since nascent industries need dynamic markets to develop. In that regard, it should be mentioned that the United States developed its comparative advantage in information and telecommunication technologies essentially in the 1990s (roughly from the end of the 1980s to 1996), i.e. in a period when the dollar was “weak.”

It illustrates the way an exchange rate policy can sustain a growth strategy, giving an emerging industry a competitive edge that will allow it to reach the maturity phase faster. In this strategy, economic policy uses the exchange-rate in the pursuit and attainment of an objective of social and economic improvement. Instead of entering a fruitless relationship of substitution, public and private goods then become complementary to one another. This point must be made: The exchange rate policy is also, and perhaps primarily, an industrial policy and it plays an adverse role in the implementation of the Lisbon strategy. What can be said in this regard of budgetary policy?

A more intelligent Stability Pact?

The Stability and Growth Pact (SGP), although widely and, at times, officially criticized for its weak theoretical rationale and poor record (see Fitoussi and Le Cacheux, 2005), is still in place. While not discriminating, as the “golden rule” for public finances for instance would do, between consumption and investment governmental spending, the SGP harms the potential growth of each Member State and thus finds itself to be an obstacle to the closing of the “productive deficit” in the EU. This fact has been acknowledged at the Brussels summit as a reform of the SGP has been proposed.

But while many have hailed the agreement on the Stability and Growth Pact inscribed in the Brussels Council Conclusions as a welcomed effort to increase its flexibility, some even lamenting that it had been denatured, a careful reading of the text reveals otherwise and incite to prudence, to say the least, concerning its possible contribution to the achievement of “Lisbon”.

While the Conclusions optimistically state that: *“The amendments to the Stability and Growth Pact will (...) enable Member States to play a full role in re-launching long-term growth”,* one should refer to the content of the Brussels agreement, very close to the line defended in the European Commission’s Communication of 3 September 2004 "Strengthening economic governance and clarifying the implementation of the Stability and Growth Pact". The agreement relies on four major points, the balance of which leans more toward a renewed rigidity than true flexibility:

- *“A strengthening of the preventive arm of the Stability and Growth Pact*” trough the development of *“medium-term objectives, between -1% of GDP for low debt/high potential growth countries and balance or surplus for high debt/low potential growth countries.”*
- *“A more symmetrical approach to fiscal policy”*, Member States being invited to *“commit at a European level to actively consolidate public finances in good times”* and *to “pursue an annual adjustment in cyclically adjusted terms, net of one-offs and other temporary measures, of 0.5% of GDP as a benchmark.”*

- A consideration *"in order to enhance the growth oriented nature of the Pact",* for *"structural reforms" (...)"when defining the adjustment path to the medium-term objective for countries that have not yet reached this objective and in allowing a temporary deviation from this objective for countries that have already reached it."*
- A tolerance, *"for other relevant factors in the steps leading to the decision on the existence of an excessive deficit", "fully conditional on the overarching principle that the excess over the reference value is temporary and the deficit remains close to the reference value"* and provided that *"no redefinition of the Maastricht reference value for the deficit via the exclusion of particular budgetary items should be pursued."*

This last point in particular is crucial in ruling out the possibility of regulating public finances in the EU by introducing a "golden rule". Hence, it appears problematic to argue that the reform aims at putting the SGP in line with "Lisbon", by giving the member states the means of their ambitions. Rather, the new flexibility of the SGP seems to aim at temporarily relieving the burden on the euro area member states that don't abide by the Pact in the context of the European "soft growth" since 2001 (they from a majority in 2005) at the cost of higher rigidity in the future, especially during economic booms.

The financial perspectives for 2007-2013: From confrontation to co-operation?

The Brussels Council Conclusions state: *"At the same time, the financial perspective for 2007-2013 will have to provide the Union with adequate funds to carry through the Union's policies in general, including the policies that contribute to the achievement of the Lisbon priorities."*

Unfortunately, the EU budget is, at the same time, quite small (1% of the EU GNI) and almost fully devoted to agricultural and regional aides (80% of total spending)[26]. As recently documented by the "Sapir Report" (Sapir et al., 2003), the amount left to "growth spending" at the EU level is almost negligible. This situation is likely to worsen in the EU-25, with new members planned to receive only 40 billions Euros in the next 3 years from the EU budget and old members willing to reduce their own contributions (strong claims to keep the EU budget at 1% the EU GNI have been made by EU founding members). As is well known, new members are markedly less developed than the 15 older members; and this makes the negotiations over the future EU budget more difficult, especially in times of bad overall economic performance and very tight budget conditions in most member states.

Instead of reasoning on common goals and appropriate tools to reach them, the new negotiations over the size and structure of the EU budget for the next decade are dominated by a petty accounting logic and by the concern of major current contributors to minimize their net financial "burdens" and get closer to the "*juste retour*" once advocated by former British Prime Minister Margaret Thatcher in the early 1980s.

Amounting to a little less than €100 billion in 2003 and due to rise to only €115 billion in 2006, the European budget is both small, relative to national or even, some local budgets, and highly tilted towards two major expenditure items: the Common agricultural policy (CAP) eats up about €45 billion, and structural and regional policies about €33 billion. While the former has been considerably trimmed over the past ten years, in the process of adapting EU

[26] These developments on the EU budget hinge extensively on Le Cacheux (2004).

agriculture to the rules of world trade and of reducing public support to production prices and farmers' incomes, structural policies have progressively emerged as the major financial instrument for promoting economic convergence and social and spatial cohesion amongst EU countries and regions. With their low income per capita and, for many of them, relatively large and backward agricultural sectors, the new member states would, in the absence of any change in the rules for distributing EU funds, have been important beneficiaries on both accounts.

Although the mere idea of calculating net gains and losses may seem contrary to the spirit of European integration and the notion of financial solidarity that goes with it, it has become a habit to start all budgetary negotiations in the EU with an assessment of net financial gains and losses of each member state, and indeed to reason almost exclusively in these terms even in the course of the negotiation. In an effort to curb the opposition of net contributors *vis-à-vis* the extreme polarization of net benefits and contributions, which the new enlargement to relatively poor, and in some cases, agricultural countries, reinforces, the EU Commission has recently proposed a generalized correction formula for net budgetary balances of member states, that would leave no country with a net contribution larger than what all would regard as "fair". Although such an approach may be necessary to win the support of major net contributors to a larger EU budget, it also tends to postpone the reflection on better sources of financing and to institutionalize the notion of "*juste retour*", with all the theoretical objections and practical problems of assessment that may be raised against it.

Rather than focusing the debates on the overall size of the EU budget or on net contributions of member states, a more constructive and potentially more fruitful approach would emphasize the common objectives and possible collective goods that European countries recognize are willing to provide, either jointly through the direct intervention of the EU level via its budget, or indirectly, by inducing national governments to provide them. The way the EU Commission has tried to reformulate common policies and recast the various spending items in terms of major objectives (essentially competitiveness, cohesion and external actions, see table III) is an interesting attempt in this direction, although it appears quite artificial and mostly cosmetic.

Table III: EU Planned expenditures under the 2007-2013 financial perspective

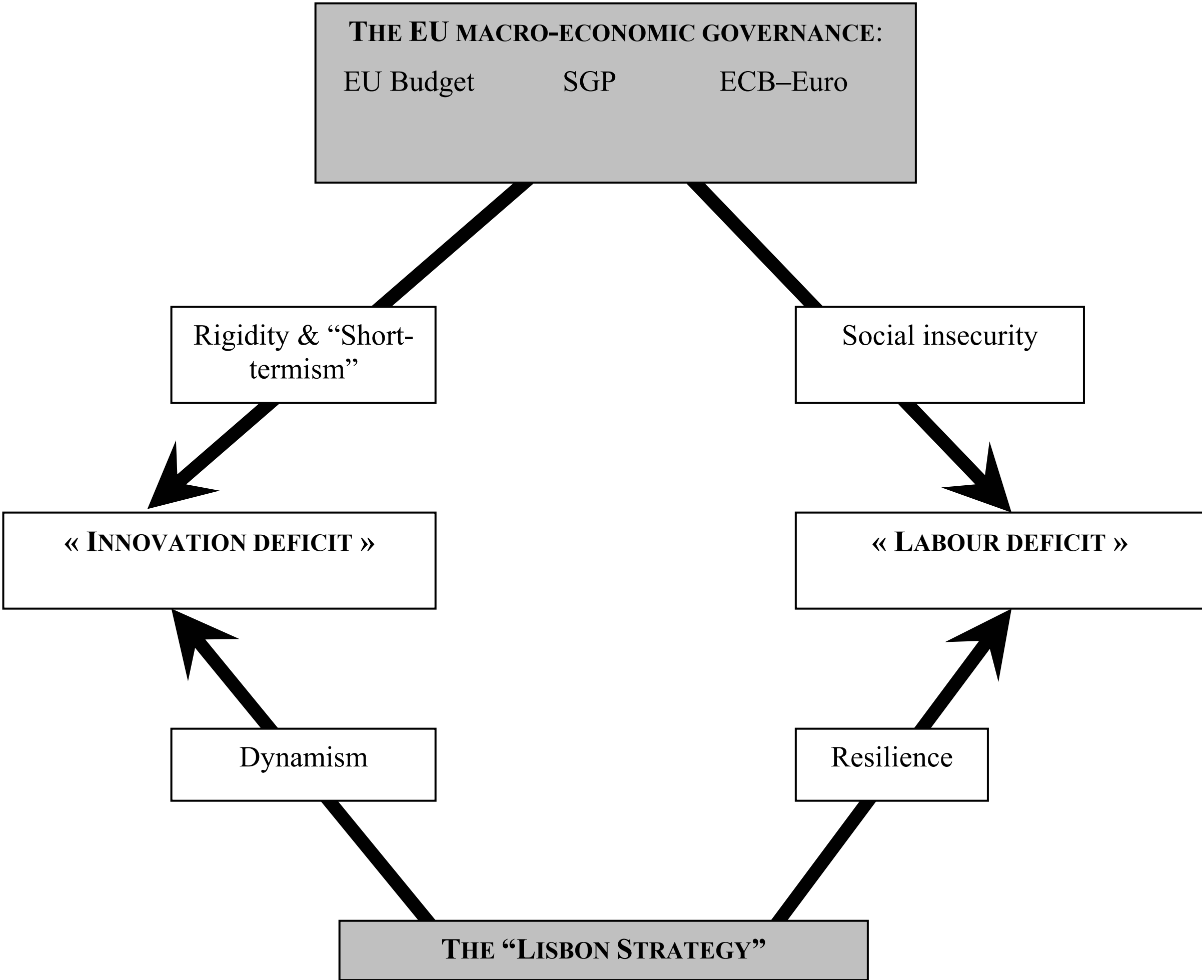
(% of total budget)

Policy heading	2006*	2007	2008	2009	2010	2011	2012	2013
1a. Competitiveness	7.3	9.1	10.4	11.7	12.0	14.1	15.3	16.3
1b. Cohesion	32.1	35.6	34.9	34.3	33.6	32.9	32.5	32.2
2a. Agriculture	36.2	32.6	41.7	40.6	39.5	38.5	37.5	36.5
2b. Other "sustainable management"	10.2	10.2	10.3	10.3	10.2	10.1	9.9	9.8
3. Citizenship, security, etc.	1.1	1.2	1.5	1.6	1.8	2.0	2.1	2.3
4. EU as global partner	9.3	8.5	8.8	9.0	9.4	9.7	9.8	9.9
5. Administration	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8

NB: Due to a one-off adjustment made by the Commission in the current structure to make it comparable to the planned one, this column adds up to a little less than 100%.
Sources: EU Commission, 2004, calculations by Begg (2004).
The EU's "incoherence diamond"

One can represent the contradiction between Lisbon's objectives and the EU instruments, or between the "Lisbon strategy" and the "Brussels tactics" in the form of an "incoherence diamond" (see Figure I). Notwithstanding the contradiction between the two objectives (see above), the dynamism and flexibility aimed at by "Lisbon" in order to close the "labour" and "productivity deficit" are contradicted in reality by the short-termism and social insecurity created by the mis-macroeconomic management of the EU.

Figure I : The EU's "incoherence diamond"



5. Conclusion: Naming, blaming, shaming...growing?

This paper has attempted to develop a comprehensive institutional perspective aimed at shedding some light on the reasons why "Lisbon" is not working. In order to understand the theoretical scheme assumed here, a central reference is the thinking of probably the greatest institutional economist, Ronald Coase: "*"The key to the development of a sensible analysis [of the working of the economic system] is the comparison between the additional production resulting from the rearrangement of activities and the cost of the transactions needed to bring the rearrangement about. If you can get extra production, a higher standard of living by rearranging activities, you will do so if the costs of transactions are less than the value of what is gained. Therefore it follows that if you can lower transaction costs, there'll be more rearrangements, and the economic system will become more productive. Transaction costs, in my view, become the factor upon which the productivity of the economic system depends."*[27] The function of institutions in the economic system must accordingly be understood as essentially to lower transaction costs in order to allow productive structural change. Macroeconomic policy in the EU must thus be devoted to ease the change called upon at the Lisbon Council, not to harden it.

Furthermore, it appears especially counter-productive, to implement "Lisbon", to advocate a punishment-reward method with the member states taken individually, as the "Kok Report"[28], the key document to the re-launch of Lisbon decided in Brussels, for instance does : "*The European Commission should deliver, to the Spring European Council in the most public manner possible, an annual league table of Member State progress towards achieving the 14 key indicators and targets. Countries that have performed well should be praised, those that have done badly castigated."*

To put our view in a more provocative way, a global strategy for the EU can not have for principle to reward the virtuous and blame the vicious. This method of "governance by morality" has proven a failure many times in the EU history: The powerful instruments at EU disposal should not be used (and wasted) to divide and rank member states by order of merit, but to unite them in a mutually beneficial strategy. "Lisbon" has first to be understood in its true finality to be successively achieved.

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[27] See Coase (2002).

[28] *"Facing the Challenge" The Lisbon strategy for growth and employment* (Report from the High Level Group chaired by Wim Kok), November 2004.

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