Progress on the Lisbon Agenda

by
John Fitz Gerald. Copyright of the author.

Paper to the Brussels Economic Forum, 21st April 2005
Introduction

In March 2000 the EU-15 leaders made a commitment to a series of reforms and goals that collectively became known as the Lisbon Agenda. The explicit aim of this programme was to make the European Union the most dynamic and competitive economy in the world by 2010. This objectives and the related policy framework has become an importance focus for policy debate within the EU over the last five years. However, while there has been significant political commitment to the objectives of the Strategy at the level of heads of government, in practise there has been limited progress in developing the necessary policy framework within individual members states. As a result, even taking account of the relatively unfavourable economic climate since the Strategy was launched, progress towards meeting the goals has been disappointing.

In order to achieve its aims, the Lisbon Agenda set out a number of targets that should be met by 2010. In November 2004, Wim Kok, the former prime minister of the Netherlands, presented a report to the European Council reviewing the progress made on the aims of the Agenda thus far. Kok cited external events since 2000 as the main contributor to the lack of progress made, as well as a lack of urgency on behalf of the Member States in adopting the proposals. He suggested that the Lisbon Agenda lacked specificity in that while it outlined desirable aims, it neglected to highlight the means of achieving them. Kok concluded that the Agenda was not overambitious and that the 2010 target date should remain.

José Manuel Barroso, the president of the European Commission, announced a new strategy to revitalise the Agenda in February of this year. The new revitalised plan proposes an updating of the Lisbon Agenda, with the main focus now on delivering sustainable growth and better jobs. Success in these two key areas will enable achievement of other economic goals such as progress on social and environmental issues. It involves a streamlining of the original proposals, with an outlining of clearer objectives across ten key policy areas.¹

Intellectual Basis

Unlike the Single European Market programme, which had an intellectual basis in the Cecchini Report, and the creation of a monetary union, which relied on the One Market One Money Report, the Lisbon Agenda was launched without a coherent intellectual basis. This absence of a coherent economic basis to back the launch of the strategy limited its initial appeal. The intellectual excitement and debate that accompanied the previous two major economic reform projects of the EU was very slow to emerge in the case of the Lisbon Strategy. It was only in 2003 that the Sapir Report set out the economic logic behind the Agenda.

The absence of an economic “manifesto” to back up the political agenda might not have been serious if there had been a clear-cut political programme to be

¹ The key policy areas highlighted cover the internal market, competition, regulation, infrastructure, research and development, ICT, the European industrial base, employment, labour markets, and educational attainment
implemented. However, the amorphous nature of the political commitments and the lack of a single focus for policy-makers made mobilisation of effort difficult.

The Agenda also failed to capture the attention or interest of the wider academic community in the way that the previous two initiatives did. The wide range of academic studies debating the crucial mechanisms and issues underlying the single market programme and the EMU project filled academic journals for a number of years. On its own such research need not have had an impact. However, the wide-ranging academic debate interacted with the political process to lend gravitas to what might otherwise have been seen as purely aspirational projects.

Now that the Sapir report has been published it lends significant intellectual coherence to the Lisbon Agenda. However, its late arrival has meant that much of the public debate has taken place in an unfocused manner, either losing the attention of the wider public or even boring them. What is now needed is to build on the intellectual basis for reform and to continue to pursue the important research agenda which the Sapir report initiated.

**Europe’s Utility Function**

One of the key aspirations of the Lisbon Agenda is to raise the level of GDP per head. Particular attention is paid to the US economy as the benchmark against which to measure Europe’s success or failure. Many studies have identified differences in the employment rate and overall hours worked as being crucial in determining the substantial differences between the EU and the US in terms of GDP per head (Blanchard, 2004, Ederveen, van der Horst and Tang, 2004, Denis, McMorrow, Roger and Veugelers, 2005).

In the case of the substantially higher unemployment rate in Europe there is a clear case of “wasted” resources. Any change in the tax-benefit systems or any increase in labour market activation measures that resulted in a movement from unemployment to employment would clearly increase output per head.

However, there is no agreement as to the significance of the differences in hours worked between Europe and the US. Prescott, 2004, argues that it is all due to the high marginal tax rates in Europe. Blanchard, 2004, on the other hand, remarks this seems unlikely.

<table>
<thead>
<tr>
<th></th>
<th>Women</th>
<th></th>
<th>Men</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Childcare</td>
<td>Market work</td>
<td>Total</td>
<td>Childcare</td>
</tr>
<tr>
<td>US</td>
<td>10.8</td>
<td>19.1</td>
<td>29.9</td>
<td>4.2</td>
</tr>
<tr>
<td>UK</td>
<td>18.7</td>
<td>12.1</td>
<td>30.8</td>
<td>10.2</td>
</tr>
<tr>
<td>Germany</td>
<td>18.4</td>
<td>11.9</td>
<td>30.3</td>
<td>6.6</td>
</tr>
<tr>
<td>Europe</td>
<td>17.5</td>
<td>12.8</td>
<td>30.3</td>
<td>7.5</td>
</tr>
</tbody>
</table>


Freeman and Schettkat, 2004, argue that the lower hours worked in the labour market is because of differences in relative prices between Europe and the US. The much
narrower wage dispersion in Europe means that the cost of commercial child-care and of eating out are much higher in Europe than in the US. They argue that this explains the very different pattern of time use. As shown in Table 1, women with children under four years of age in Europe tend to work the same number of hours as women in the US except that more of those hours are worked caring for their own children and less in paid employment. Freeman and Schettkat argue that this is because of lower “marketisation” in Europe due to the high relative price of child-care. They present a similar argument in the case of the higher number of hours spent by Europeans cooking.

However, the data suggest that there is not much difference between the behaviour of women in the UK and the rest of the EU, in spite of the fact that wage dispersion in the UK is closer to that in the US than to the rest of the EU. Also there is considerable difference within Europe in the provision of state-funded child-care which is not reflected in differences in the data.

While the marketisation hypothesis could explain differences in behaviour for those with young children, it cannot do so for those with limited or no child-care responsibilities. In addition, there is a clear pattern for Europeans to choose longer holidays than US workers (Bruyere and Chagny, 2002). All of this suggests that Europeans have a different utility function than workers in the US, preferring to trade off some potential income for more leisure (or time working in the household).

If the European utility function is, in fact, different than that of the US then the success of the Lisbon Agenda must be judged against slightly different criteria than just GDP per head.

**Importance of Micro-Economic Policies**

However, even if the ultimate objective may be slightly different it is clear that the European economy suffers from a number of problems, not least the waste represented by the high level of employment. Policy changes which can bring about a higher employment rate and higher productivity will be welfare improving whatever the precise objectives in terms of output per head.

While much of the attention of governments at the EU level has been devoted to the debate on the Stability and Growth Pact, less attention has been given to the wide range of micro-economic policies that could make a real difference to the productivity of individual EU economies. Fiscal policy rather than micro-economic policy has also tended to attract more media (and hence public) attention at the level of individual economies. This lack of attention is unfortunate, as such policies have the potential to make a much bigger contribution to increasing productivity and the employment rate than any changes in fiscal policy. Essentially government’s can reduce the potential growth rate through “bad” fiscal policy but they cannot increase it through “wise” fiscal policy.

---

2 While it could be argued that workers are “forced” to take longer holidays by the state or by unions, this seems unlikely given the extent of this behaviour across different administrations in Europe.
Part of the reason for the lack of focus on such policies is that it is easy to explain to an electorate why borrowing too much money is a problem. It is much more difficult to explain why globalisation is good for you or why labour market reforms increasing flexibility will increase employment. Thus it has been very difficult to mobilise support on a wide basis for reforms, which in the short term may prove painful. The absence of a coherent intellectual basis for such changes at a European level also did not help.

**Investment in Human Capital**

The importance of investment in human capital in promoting growth has long been recognised in economic theory. However, there remains considerable controversy about its practical significance in explaining differentials in realised growth rates. There are difficulties in measurement of the stock of human capital and there have been a wide range of comparative studies that have tried to quantify its role. Nonetheless there is considerable evidence that it plays a very important role in promoting economic growth and hence in underpinning the process of economic convergence (de la Fuente and Ciccone, 2003).

The investment in human capital can affect the economy through a number of different channels: it can increase the productivity of the work force; it can increase labour-force participation, especially by women; and it can reduce the numbers of unskilled at risk of unemployment. There is extensive data for EU countries showing the return to education for the individual. All of them indicate substantial private gains from education. For Portugal those with a third level education earn around 178% of what someone who has only completed their second level education. For Germany the figure is 145% and for Italy it is a low 127%.

While the returns to human capital for the individual may be substantial at a point in time, theoretically this might not be the case over time as the supply of skilled labour rises. There is the potential for “qualification inflation”, with the increase in the supply of skilled labour driving down the price. However, the evidence from a range of other studies indicates that the private returns to education are substantial. The returns to education for the individual are illustrated in the chart below, which shows the return to education for the individual across different levels of education for selected countries.

---

3 These figures are taken from OECD, 2003, *Education at a Glance.*
of studies suggests that this is not necessarily the case. For the United Kingdom and the United States there is extensive evidence that the returns to education have, if anything, risen over time (Harmon, Walker and Westergaard-Nielsen, 2001). The evidence for Ireland indicates that the returns to education rose markedly between 1987 and 1997 and then fell back somewhat to 2000 with a shortage of unskilled labour and an elastic supply of skilled labour (Barrett, Fitz Gerald and Nolan, 2002). For Poland there was a dramatic increase in the returns to education between 1988 and 1996 (Keane and Prasad, 2002).

Figure 1: EU 15 Unemployment Rate by Level of Education

Technical change means that the world economy is evolving in a way that puts an ever-increasing premium on skilled labour. Modern goods and services that are demanded in the developed world are produced with a high skilled labour content. While there is some possibility to substitute unskilled for skilled labour in the production process this scope is limited. If skilled wage rates were fully flexible then the skilled and unskilled labour markets would clear. However, as shown in Figure 1, there is extensive evidence that the unskilled wage rate in many EU countries is sufficiently high to result in substantial long-term unemployment for those with limited education.

There is clearly a serious problem with the unemployment rate of those with limited education being very high in the EU-15. As outlined in Euroframe, 2005, the ongoing process of globalisation will continue to impact on employment in manufacturing of those with limited education. While one approach, suggested in Sapir, 2003, is to consider policies designed to stimulate employment among this group, there must be serious concerns about the sustainability of such an approach given the nature of technical progress.

In the long term, the answer must lie more in reducing the supply of labour with limited education, to change the relative endowment of skilled and unskilled labour, rather than trying to create employment for this cohort. While investment in education can take considerable time to mature, it will provide the best prospect of dealing with the problem of unemployment in a manner that is consistent with the existing social policy stance of many EU members.
Figure 2: EU-12 Labour Supply

Source: Eurostat Cronos web site

Figure 2 shows the movement in labour supply in the EU-15 over the last decade. The supply of skilled labour rose consistently over that period, reflecting past investment in human capital. While the supply of those with limited education fell, the fall was mirrored by the fall in employment, leaving unemployment rates high. For the future, if the supply of labour with limited education can be brought into balance with the declining demand, the unemployment rate will fall. This can best be achieved by improved investment in human capital, especially through investment in the primary and secondary school systems. This area of investment is purely the responsibility of member governments and the EU Commission can have no role in this task. However, it remains in the interest of those member states with serious problems of unemployment to undertake such investment to enhance their long-term growth potential.

Using data on educational attainment as weights, it is possible to use the data on the returns to education to generate a human capital index for the 25-29 cohort and the 55-59 cohort in a range of different countries. Figure 3 shows the ratio of the index for 25-29 year olds to that for 55-59 year olds, providing a measure of the investment in human capital over the last 30 years in a range of EU countries. This Figure shows that the index for countries like Germany, Denmark, Finland and Hungary, which already had good educational systems 30 years ago, increased little over time. However, for Greece, Spain, Portugal, Ireland, Italy, Poland and the UK, many of which had relatively poor educational systems a generation ago, there has been considerable progress.5

Figure 3: Investment in Human Capital

---

4 With at least a high school education

5 Data on the returns to education are taken from OECD Education at a Glance. For Poland they are taken from Keane and Prasad, 2002 and for Greece from Tsakloglou and Cholezas, 2000.
In spite of the major improvement in educational attainment, Portugal still has a low level of attainment as shown in Figure 4. The very high proportion of the population who have not completed high school in Portugal has serious implications for productivity and, therefore, for convergence in that economy. For Spain, while there has been major progress in the proportion of the population going on to third level, the proportion not completing high school is very high.

While Blanchard, 2004, concentrated on the undoubted problems with third level education in the EU, this analysis points to a possible high long-term return from investment in keeping children in the educational system to complete high school. De la Fuente and Ciccone, 2003, comment that the returns to additional education for those with a very low level of basic attainment are particularly high. A study by Breen and Shortall, 1992, for Ireland, showed that upgrading the educational attainment of those leaving school with no qualifications to at least the most basic level of qualification would greatly reduce the level of unemployment, and of state expenditure on unemployment benefits. This suggests the possibility of significant further gains to investment in education in both Spain and Portugal.

The evidence discussed in de la Fuente and Ciccone, 2003, shows that investment in human capital can play an important direct role in raising productivity and hence promoting convergence. It is clear from the data shown above that there has been a very significant upgrading of educational attainment in the cohesion countries over the last 30 years. This investment in human capital is a very important factor in explaining the more rapid growth in productivity that has contributed to the convergence in living standards.

Finally, the investment in human capital also has the effect of raising female labour force participation. This is because the participation rate for women with third level education is much higher than that for women who have completed high school. In turn, participation rates for women who have completed high school are higher than for those with very limited educational attainment. As discussed earlier, the rise in participation rates has played an important role in raising the growth in GDP per head in the cohesion countries. This is an additional channel through which investment in human capital has contributed to the convergence process.
This analysis suggests that investment in human capital has played an important role in promoting convergence by the cohesion countries. For Portugal, in particular, the substantial investment to date still leaves that country with a relatively low stock of human capital. For many of the new member states the stock of human capital is already quite high. However, the experience of the cohesion countries suggests that investment in human capital can play an important role in their convergence process. The dislocation involved in the transition process adversely affected the educational systems in some countries leaving room for further improvement.

**Labour Market Flexibility**

The Sapir Report, among many others, has highlighted the need for labour market reform in the EU. Such reforms are seen as vital if the EU is to raise its employment rate and if the waste of resources represented by unemployment is to be effectively tackled. However, this area of policy is generally the remit of national governments. Each Member State has different labour market institutions and, as a result, very different policy measures may be needed in each State.

Over the period 1999-2003, beginning from a low base, the biggest improvement in the employment rate occurred in Spain and Italy (Kok, 2004). These two countries also saw a significant fall in long-term unemployment. Even though the employment rate was already high in Sweden and the Netherlands, these two countries also saw some increase over the same period.

Over the last year a number of policy innovations have been commenced in major EU Member States. In the case of Germany the *Hartz IV* reforms should have some impact on the German labour market over the coming years (Boss and Elendner, 2005). While initially the numbers registered as unemployed have risen as a result of the reforms, this is due to the way such administrative data are collected. The effect of the reforms should be to encourage more of those currently unemployed to seek employment. The attractiveness of paid employment relative to unemployment benefit payments will increasemarginally. This is because the level and the eligibility criteria of tier II unemployment benefits, payable unconditionally to the long-term unemployed, has been tightened and the duration of short-term pay related unemployment benefits will be gradually reduced starting from next year. Therefore, over time, the reforms should, in combination with improvements in the administrative procedures in the labour office, help reduce the numbers unemployed using a standardised measure (the ILO definition of unemployment).

**Research and Development**

Kok, 2004, shows the performance of EU Member States on some key indicators, two of which relate to R&D. Sweden and Finland already devote a significant share of national output to research and development. Sweden in particular has further increased its national allocation of resources to R&D over the period 1999-2003. A number of other smaller EU States, such as Belgium and Denmark have also increased resources on R&D. In the case of the 10 new member states, the share of resources allocated to R&D is well below the EU 15 average, with Slovenia and the Czech Republic being the leaders.
In 2005, some countries like Italy or France are in the process of introducing or raising fiscal incentives for firms undertaking R&D. The French budget contains a number of measures designed to improve the attractiveness of some French areas (‘competitiveness poles’). The idea is to give fiscal incentives to companies investing in high technology production in specific geographic areas. These “poles” must bring about collaborative work between Universities or training centres, public or private research centres, and small and big firms, to introduce innovative production processes. France has created a new ‘Agence pour la recherche’ to fund applied research conducted by private or public centres. Italy has undertaken similar measures.

However, while economic theory clearly points to the key role of such investment, it does not prescribe how best to deliver such investment. An allocation of funds to R&D does not guarantee that they will be used productively and there is much less evidence on the efficacy of expenditure on R&D across the EU. There remains the danger that investment in R&D could be used as a Trojan horse for the reintroduction of state aids, damaging rather than enhancing growth prospects.

**Competitiveness and the Environment**

The signing of the Kyoto protocol was a major achievement for the EU. The single most important instrument so far implemented to limit emissions is the Emissions Trading Scheme that came into effect in January 2005. This scheme has the potential to ensure that the necessary reduction in emissions is achieved at least cost to the EU economy. However, the details of its implementation over the period 2005-2007 mean that it will be unnecessarily damaging to the competitiveness of the EU, while also being less effective than it should be in limiting emissions.

The reasons for this are twofold: Firstly, the lack of an emissions permit auction system will increase the cost of emissions trading (Parry, Williams and Boulder, 1999, Congressional Budget Office, 2000). Secondly, the second round allocation of free permits for the 2008-2012 period means that many of the bigger polluting firms that are covered by the scheme and have market power (e.g. electricity generation) are incentivised to remain in business to receive a further free allocation of permits for the next round, further raising the costs of compliance with Kyoto for the EU (Fitz Gerald, 2004).

Over the coming year, in reviewing how this scheme will operate between 2008-2012 governments should reconsider their approach. A move to increase the share of permits that are auctioned in the period 2008-2012 offers the best opportunity to remove the distortions in the present scheme. The revenue from the auctions would permit governments to reduce taxes elsewhere in their economies. Such a reform would reduce the overall cost to the EU economy of complying with the Kyoto protocol, resulting in improved competitiveness and an increase in sustainable employment.

**The Services Directive**

While the Single Market reforms of the early 1990s dealt with the barriers to goods trade and achieved much in the services area, there still exist significant barriers to
services trade. The EU Commission draft directive, proposed last year, envisaged the abolition of many of the remaining internal barriers to services trade within the EU. Unfortunately agreement has not been reached on the directive and it seems likely that there will be significant changes made that would see some barriers remaining in place for the foreseeable future. In the end the progress of the Single Market may best be protected by the European Court acting on the basis of legislation already in place.

**International Relocation**

Europe is both a beneficiary and a source of foreign investment. Visible disadvantages and less visible gains characterize the impact of international relocation of production on the EU economy. In times of low growth, when the job losses are not counterbalanced by immediate increases in employment in growing sectors, the disadvantages of the process may be more apparent than the advantages. The process of reorganisation of the world’s economy, often referred to as globalisation, of which international relocation of economic activity is but a small factor, has led to enhanced output and productivity in the European economy.

Most of EU countries’ trade and capital flows take place with the US or other European countries. Hence, job losses due to relocation are relatively small. Relocation can initially weaken the position of low-skilled workers, which in times of low growth manifests itself in unemployment or growing wage differentials with high-skilled workers. However, technological change is more important for the disparity between low-skilled and high-skilled workers. Moreover, a part of relocation is not motivated by low-cost competition, but by access to foreign markets or foreign suppliers.

Gains from relocation countervail the disadvantages (EUROFRAME, 2005). Larger international trade and capital flows reduce import prices, create opportunities for productive companies, expand product variety and foster international learning. Relocation also enables companies to increase their productivity. More productive companies reduce their prices or pay higher wages, thus benefitting customers and workers. These advantages spread out across the economy and are less visible than direct disadvantages.

Policy makers can facilitate sectoral shifts and skill upgrading to enhance Europe’s comparative advantage in high-skilled activities. As indicated above, the position of workers with limited education can best be protected by reducing their numbers through investment in education. R&D warrants special attention because relocation of R&D entails the risk of a loss of associated knowledge spillovers. To prevent tax competition, policy coordination on corporate taxes seems desirable. Last and somewhat least from the perspective of relocation, but certainly not least from the perspective of technological change: in their design of social security provisions policy makers face an awkward dilemma between greater income inequality and higher unemployment of low-skilled workers. This dilemma can be avoided if the fall in the supply of unskilled labour takes place at least as rapidly as the fall in unskilled employment within the EU.
Promoting Convergence

The process of EU integration on its own has played an important role in promoting convergence between the four existing cohesion countries, Ireland, Spain, Portugal and Greece, and the EU average level of output per head. In the case of Ireland and Portugal the higher rate of growth in productivity has been particularly important in bringing about convergence. This has implications for the new member states: it is important to concentrate on policies that will enhance the growth of productivity in the longer term (Fitz Gerald, 2004).

The way the labour market interacts with the convergence process is important. If wage rates converge to the EU standard of living more rapidly than the rate of productivity, then the convergence process will be interrupted or halted. This suggests the importance of developing flexible labour markets in the new member states, as is suggested by the Lisbon agenda. In addition, because increases in the tax wedge affecting earnings impacts on wage formation, an unduly rapid rise in the standard of public services (and hence taxation) could also adversely impact on the convergence process.

A major factor underlying the high rate of unemployment in the EU and in the new member states is the size of the unskilled labour force relative to demand for unskilled labour.

The stock of physical infrastructure in the four existing cohesion countries and in the new member states is significantly lower than in the rest of the EU. The shortage of physical infrastructure is a significant constraint on future growth and convergence.

The new member states have similar needs for accelerated investment to those of the four existing cohesion countries and will benefit by a continuation of the EU support for cohesion. The substantial returns to infrastructure investment in the cohesion countries, when properly managed, suggests a significant payback to such investment in the new member states. Each country will have to determine its own priorities for public investment. There is a danger that the key role of human capital may be undervalued in planning future investment. In addition, the experience of the CSF in Ireland suggests that less emphasis should be put on direct aid to the private sector and a higher proportion of the available resources should be devoted to investment in physical infrastructure and human capital.

Finally, experience in the cohesion countries suggests that the structural funds process brings administrative benefits over and above the direct financial aid. Its emphasis on medium-term planning, consistency between different forms of investment, and evaluation of results can benefit the process of public investment, not just where that investment is funded as part of the EU CSF, but also where it is funded out of domestic taxation.

Implementation

Whether or not the Stability and Growth Pact is to be reformed, it can be argued that by focusing undue attention on itself, it has distracted attention from consideration of the best economic approach to the difficulties of many Euro area economies. An extensive economic literature has developed considering fiscal adjustments around the
world over the last thirty years. Alesina and Perotti (1995) after reviewing the available literature, including the evidence from Ireland in the 1980s, drew conclusions as to the best approach to dealing with such problems. They concluded that when countries get into fiscal difficulties, urgent action, involving significant cuts in public expenditure, offers the best prospect of a return to growth. While tough action would undoubtedly deflate the relevant economy in the year it took place, the damage might be much less than would result from a fiscal war of attrition. The Irish experience of the 1980s would tend to confirm this; so too would the dramatic turnaround in the Finnish economy in the early 1990s, following on an immediate and strong fiscal response to major shocks that hit that economy in 1989-1990.

Eichengreen, 1998, emphasises that the effects of a fiscal tightening will depend very much on the context in which the tightening takes place. In the current Euro area context fiscal attrition leaves consumers and investors uncertain about the future, resulting in depressed consumption and investment levels. While a short sharp shock would undoubtedly depress demand even more in the year it took place, it would hold out the prospect that from that point onwards things will continuously get better. Once consumers and investors responded, the public finances would improve further and unemployment would begin to fall. Ireland experienced such a “virtuous circle” in the 1990s after a decade of wasted opportunities.

In the light of this literature it might be in the best interests of some key Euro area governments if they took urgent action to reduce their fiscal imbalances through cutting expenditure. The desirability of this course has nothing to do with the SGP, but stems rather from the depressing effect on private sector expectations of the continuing focus on fiscal problems and the continuing ineffectiveness of governments in dealing with them. As in the Irish case in the 1980s, such a course of action could also mobilise a sense of urgency as part of the Lisbon Agenda to deal with the wider problems affecting competitiveness in these economies. While the short-term cost, both economic and political, could be significant, it would probably hold out the best prospect for a rapid return to future growth. The effect of the debate on the SGP is to promote the belief among consumers and investors that prospects are truly gloomy.

Temporary economic difficulties can often lead to an overreaction by the wider public and the underlying prospects for the European economy are probably somewhat better than this popular perception. Blanchard, 2004, in considering, in particular, the French economy reaches such a conclusion. The household sectors in France, and to a lesser extent in Germany, are in quite a strong position. If they saw signs that a recovery was under way, so that they raised their level of consumption (and investment in housing), this could bring about a virtuous circle: rising consumption and output would help solve the problems of the government sector. In turn, this would allow governments to reduce the burden of taxation – further adding to a sense of well-being.

Making difficult decisions on micro-economic issues can best be done either gradually during good times, or else when things are so desperate that the electorate accepts their inevitability. The latter was the case in the new member states in the early 1990s, in the Netherlands in the mid-1980s, in Ireland in the late 1980s and in Finland in the early 1990s.
However, for most of the major European economies of the EU 15 circumstances are not sufficiently difficult that hard decisions are inevitable. The labour market reforms in Germany do show significant movement but they have taken much political effort to bring into effect. Reforms which will have an upfront cost are more likely to be made by member governments when there are real signs that their economies are genuinely “turning the corner”, with real prospects of a fall in unemployment.

Some of the changes that governments need to make to speed up the “Lisbon agenda” will take significant time before they produce a real pay-off. This is certainly true for investment in infrastructure in the new member states. It is also true for investment in human capital, especially investment in education. Investment in Research and Development, even if undertaken effectively, will produce a payback in the long term. In the short term it will represent an increase in costs. The fact that many of the policies that member states need to implement have long payback periods certainly complicates the implementation of the Lisbon Agenda.

References


