



## ECONOMIC POLICY COMMITTEE

President of the EPC

Brussels, 19 September 2008

### Conference on strengthening delivery of Lisbon reforms

**Rome, 19 September 2008**

*- An EPC perspective for the new cycle -*

Secretary,

Lorenzo,

Friends at the desk and in the audience

Ladies and Gentlemen,

#### Start from Square 1

Do you know this morning whether your Bank or insurance company is still there?

The financial system – optimists say it is just the system of Investment Banking – is in a big squeeze out – Lamborghini, Porsche and Ferrari sales came down sharply in the City. The bubble has indeed reached the core of the system.

It is not the case that no economist, politician or banker has seen or at least felt it. Some 10 years ago I worked close to Horst Köhler, now President of the Federal Republic of Germany. In a speech 1993 he said: “If you put your money in an asset and get continuously more than 8 – 10 %, return on investment this is either highly speculative or even criminal.” Hearing this 10 years ago a lot of people smiled.

Let us be frank: Taking the turmoil today, how can any weird bunch of economists and senior government officials talk about curious things like “LAF” or “LIME”? Ministers today might not care about Lisbon Strategy, Ministers try to save the world right now.

Too bad a picture? But let’s reflect:

When the Lisbon Strategy was launched in 1999 the economic cycle in the EU was doing well. Nevertheless we were lagging behind the US, structurally and cyclically. Soon afterwards the bursting of the dotcom bubble and the terrorist attacks of 2001 brought us all down again, dramatically changing the context of our reform efforts. 2006/2007 European economies did well again cyclically and somewhat better structurally but now the global economic developments are bringing us down again.

We’re facing recession. Do we face a stop of economic reform, too?

What can we learn from that? We need to be realistic and accept that we will have cyclical ups and downs in the future, and most probably in a globalized world we will face tremendous exogeneous shocks.

That basic setting leads to the following issues:

- (1) What do we need most, for our economies, for the industries, for the workers, and for the people as a whole?
- (2) We cannot avoid cycles, we cannot avoid shocks, but we can gain resilience, via rigorously adapting our economies to global challenges. And these gains can also help to smoothe unavoidable distributional conflicts in and between countries (oil! Climate change!).
- (3) Despite the short-term pain of structural reforms that should not distract us from the long-term strategic direction which we will need to follow in Europe. We can help identifying a structural reform agenda and help to implement the reforms; that is what the Lisbon strategy is basically about. And even if we may stand alone a little bit today, the message of EPC and LIME is even more necessary!

- (4) More: A European answer is crucial as integration needs the credibility of EU Institutions. Right now, in economic turmoil we can give a push to Europe. I strongly believe, each of us acting alone could not do better than all together.
- (5) Coming to the point of reflection today, the Lisbon Strategy has two perspectives: (1) One focussing on the current cycle including the question of how to best implement the strategy in national policies – (2) a wider one taking a look at the future and the role of the Strategy after 2010.

The implementation of the current cycle and the tasks ahead

The Economic Policy Committee when preparing the new cycle concluded that the Lisbon Strategy had started to deliver and that therefore no fundamental overhaul would be needed. The core focus of the new cycle is on implementation.

The heads of state at their Spring European Council 2008 shared our view. The Integrated Guidelines for Growth and Jobs and the specific recommendations addressed to each of the 27 Member States would remain unchanged for the 2008-2010 period.

The stability achieved in this process is essential. Even more in a context where we rapidly must accelerate reform efforts and seek structural improvements in all areas where a lack of efficiency has been identified. I refer here also to the current discussion of the EU finance ministers and of the Eurogroup last week in Nice who stressed the need for more structural reform in order to avoid an aggravating of the current economic downturn.

So far, so good: There is just one question: Will this hold?

In all four priority areas – labour markets, innovation, better regulation and energy – there is the need for a greater focus on implementation. EPC is pushing in many areas of structural weaknesses.

Let me mention ageing populations and securing long term sustainability, labour and employment, the quality of public finances, energy and climate change, the internal market, as well as competition research and innovation.

This is a quite broad but urging set of areas for further reform.

The action at community level is also very important here and a framework to channel this work is still to be developed. It should complement, facilitate and strengthen policy action at Member States namely through the implementation of the revised Community Lisbon Programme.

The EPC will use its analytical capacity and country specific experience to serve this agenda, to trigger discussion and to contribute to the Ecofin Council delivery on its goals taking up the following actions.

- The Ageing Working Group is finalising a new set of long-run budgetary projections by early 2009 for all 27 Member States. An agreement on the new Medium Term Objectives to take into account the implicit liabilities and therefore ensure progress towards sustainability should be achieved. This should also contribute to a more quantitative framework for assessing the fiscal impact of policy reforms.
- On labour markets, reforms are needed to make work pay and increase labour participation. Incentives to work should be enhanced and the agreed common principles on flexicurity implemented. We right now work on that, we want to raise interest of ministers and, on an annual basis, we will provide a review of structural reforms on labour markets; assessment of labour market developments; and a discussion of wage developments, e.g. in the context of a deeper and more comprehensive competitiveness review.
- On energy and climate change we try to enhance our understanding of some of the key economic issues regarding EU energy and climate change policies. We will focus on the economic impacts of meeting EU energy and climate change targets and the further development of carbon markets.
- And, in that context, the Committee will be engaged in the work to address high the issue of energy and commodity prices. It is necessary to identify the structural adjustment needs with a view to increase competitiveness, improve energy efficiency and tackle deficiencies on the supply side.

- The agenda of Quality of Public Finances has been developed further and aims at developing a comprehensive and empirically valid conceptual framework on the links between public finances and economic growth. Further work will be pursued to improve the measurement of public expenditure's efficiency and effectiveness which should lead to solid conclusions by EU finance ministers in the first half of 2009 – the roadmap here is clear and we work very closely together with the Commission and the upcoming Presidency.
- To strengthen the technical underpinnings of the budgetary surveillance, the EPC will carry out further work to improve the assessment of cyclical and structural budgetary positions.
- The Single Market is one of the essential preconditions for EU competitiveness in the global world. Rapid and effective transposition and implementation of the Services Directive is crucial to complete the single market. The Committee will continue to monitor the performance of the single market.
- On surveillance of structural reforms the aim is to strengthen the country review exercise, so that it becomes a more effective instrument of peer review and sharing of best practices. This will help to maintain reform momentum through the assessment of relative performance and to identify common reform priorities. And I see here – in perspective of EMU@10 –also the issue of addressing specific euro area needs.
- The important analytical and hopefully valid empirically valid input is delivered by LIME. The progress made by LIME to date is remarkable. I could not participate in yesterday's meeting which was, thanks to Lorenzo and his team as well as to COM, a success! The Lisbon Assessment Methodology (LAF) will be useful as Member States update key challenges for the 2008-2010 Lisbon cycle
- Of course, we are not at the end of the road! Progress is still necessary!  
On methods first, results to be checked, leading then to consensus and policy conclusions of Member States.

The end of the road is not near yet but we reached some first targets, we can deliver first insights but we have to go further and we have even to step up. Of course, it will not end just by programming policy with data and math. We all know that! Investment Banks just did it and ended at the v. Munchausen dilemma.

Preliminary discussions on the EMU@10 report allowed us to conclude that the reform agenda of the Lisbon Strategy is well specified to address the trends of globalisation, population ageing and climate change.

Again: The Lisbon Strategy should be pursued with vigour, against the background of the external shocks and slowdown facing the economy, there is a need to increase the adjustment capacity of our economies.

Greater focus should be put on reforms that strengthen resilience. More specific and operational country specific recommendations and points to watch should be considered.

But the reform agenda of EMU@10 is also important for EU 27, even if euro area members depend more than other countries on flexible markets to adjust to changes in relative competitiveness as they miss exchange rate mechanisms.

EPC already started work on a key issues paper for Ministers. And as a long-term orientation for the strategy, we see the following issues:

As the fundamental challenges will remain or even increase in the coming decade after the new cycle the future of the Lisbon Strategy post 2010 is posted high on the agenda of the Heads of State and finance ministers in Europe .

Under the Lisbon umbrella core features of a “new” strategy for ECOFIN Ministers should in my preliminary view include:

Feature 1: Economic pillar should retain the key focus

Although the economic pillar derived from the challenges mentioned above is crucial we may think of a sound interpretation of what is the economic pillar, e.g. are is the climate dimension and there are social aspects which have to be taken into account? Or: how is the sustainability and quality dimension to be specified?

There is a need for a rigorous assessment of the necessary economic adjustments and I would see numerical targets for the post-2010 Lisbon strategy as one option for the governance. This, however, makes a sound methodology to measure progress necessary. And we should avoid a too mechanistic approach in dealing with differences between MS.

Needless to say, we see the clear need for reinforcing the role of ECOFIN as a main catalyst for reform.

Feature 2: Improve resilience and reduce imbalances of the EU and of the euro area,

The current developments clearly show that structural reforms should be pursued vigorously since they can strengthen the resilience and adjustment capacity of the economy.

A structural reform agenda to respond to diverging economic performance and macroeconomic imbalances is of particular importance to euro area countries. In this respect emphasis will be put on the competitiveness review already agreed by the ministers of the euro area in July. In that context we need to find a better balance between the MS and the Community/€ area dimensions and take into account even more the structural differences between MS and their implications.

Feature 3: There is a need for a balancing out the needs for sharpness, clarity and ownership.

A key aspect of the renewed Lisbon Strategy is the increase in national ownership. The success of the new cycle depends much on what Member States do domestically. The responsibility for the implementation of most structure reforms remains at national level and

must be assumed there. National ownership of the Strategy should be further enhanced and the different stakeholders should coordinate to facilitate and improve delivery on Lisbon goals.

But, at the same time we do not want white washed declarations which serve as a minimum consensus for a ownership oriented strategy.

Let me be blunt: Full ownership can mean zero message on economic reform! It was, it is, and in the end it will be a bottle of trade-offs. Even if I like the approach from the Swedish Finance Minister Anders Borg advocating that there is still room for a Pareto-hypothesis of consensus on economic reform.

Feature 4: Need for better public awareness

And it all goes with well designed communication to the people, here we also can improve a lot!

Now coming back to Square 1

How can we hold the dam and keep a long-term strategy against short-term turmoil and populist short-term policy measures?

John Maynard Keynes' famous words state "In the long run we are all dead."

However, I do not believe that JMK would be an ultra-short-termist today. On the contrary, he was not only an economist rather than well aware of the society of his times!

Keynes was aware of the Great depression in the 30'ies and wanted to act economically reasonable in dangerous times when economic turmoil jumped onto the entire society.

This is what I would propose: EPC should be part of the answer today, not in an academic tower. What we can do first is to avoid departing from economic reasoning too much and fight for our long-term strategy of structural reform in private and public sector. Thus helping to cope with global challenges of all kind, right in the sense of Adam Smith in his "Wealth of all nations."