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Keynote Address by

WIM KOK,

Minister of State and former Prime Minister of the Netherlands;

Chairman of the High-Level Group on the Lisbon Strategy

Mr. Chairman, ladies and gentlemen,

First of all I would like to thank the organisers of this economic summit for their invitation to be with you today and for the kind words of welcome that were addressed to me.

It is a pleasure indeed for me to make a few introductory remarks at this opening session about the competitiveness of the European Union in a globalising and challenging world and the future perspectives for the European economy: the central theme of the so called Lisbon Strategy that was adopted by the governments of the EU member states five years ago.

The goal of this Lisbon Strategy was to make the European Union stronger, both in terms of economic performance and in terms of social cohesion and sustainability.

Its targets included, just to mention a few examples:

- increasing average labour participation to 70 per cent,
- reducing the school drop-out rate by half and
- raising public and private spending on innovation to 3 percent of GDP, all by the year 2010.

All together, the strategy contained over one hundred targets, sub-targets and indicators, really a kind of “Christmas tree”.

The strategy agreed for achieving these targets was to use the Community Method – the traditional European legislative process – combined with setting common goals and comparing national performance, including best practices. The latter is known as the Open Method of Coordination.

As you all know, the results since 2000 have been mixed. Some countries have managed and are still managing very well, whereas most others are lagging behind.

Because this has been a matter of growing concern, a high level group – which I chaired – was set up last year by the European Commission and the European Council in order to prepare a mid-term review of the Lisbon Strategy. This mid-term review was on the agenda of the European Spring Council in March this year.

The conclusions of this high level group were – briefly stated – the following:

We prefer Europe to be economically strong and competitive, but also responsible and sustainable – in terms of social cohesion, environmental protection and economic policies. In other words, the Lisbon three-pillar strategy has not lost its validity. If we want, however, to do our utmost to sustain our model of social cohesion and environmental sustainability, we must focus much more strongly on Europe’s growth and employment performance – and therefore improve Europe’s competitiveness. National and European politicians, entrepreneurs and all other stakeholders must urgently revitalise the Lisbon process. Focussed and comprehensive national and European policy actions are required to improve our overall performance.

To ensure a better performance by member states, the Lisbon process needs to be improved, too. In order to make the common European strategy more effective, the national component – “ownership” – must be made more visible and has to be strengthened. The process must better engage and involve citizens, social partners and parliaments.

Above all, however, common political will and determination are strongly required.

Both strong global competition and radical demographic changes are main causes why action must be taken now. Frankly speaking, not with the unrealistic

ambition of becoming the world's number one economy by 2010 because that will prove to be absolutely impossible. No, urgent action is first of all required to maintain (and possibly strengthen) our position in the economic league we are currently in.

Let's not be afraid to look squarely at how things now stand. Over the last several decades, Europe has not succeeded in closing the economic gap with the U.S. – a gap which, since the 1970s, has remained at about 30 percent of GDP per capita.

An even greater cause for concern is the fact that, since the mid-1990s, annual labour productivity growth in the U.S. has outstripped that of the European Union.

International competition is intensifying, and Europe is facing a twin challenge from Asia and the U.S. Of course: the potential rapid growth of the Chinese economy will create not only a new competitor to Europe, but also a vast and growing market. For Europe to take advantage of that opportunity, it needs to have an appropriate economic base, recognising that over the decades ahead competition in manufacturing goods at home and abroad, especially those with a high wage content and stable technologies, is going to be formidable.

Indeed China, industrialising with a large and growing stock of foreign direct investment together with its own scientific base, has begun to compete not only in low-value, but also in high value-added goods.

Although Chinese wages are a fraction of those in Europe, it is clear that the difference in duality of a growing number of products and goods produced in China or the EU is already small or non-existent.

India's challenge is no less real – notably in the service sector where it is the single biggest beneficiary of the “offshoring” or “outsourcing” of service sector functions with an enormous pool of educated, cheap, English speaking workers.

In short, Asia's collective presence in the world trading system is going to be much more marked.

Europe, therefore, has to develop its own area of specialisation, excellence and comparative advantage which inevitably must lie in a commitment to the knowledge economy in its widest sense – but here it is confronted by the dominance of the U.S.

The U.S. accounts for 74 percent of the top 300 IT companies and 46 percent of the top 300 firms ranked by R&D spending.

The EU's world share of exports of high-tech products is lower than that of the U.S.; the share of high-tech manufacturing in total value added and numbers employed in high-tech manufacturing are also lower.

In a global economy, Europe has no option but radically to improve its knowledge economy and its underlying economic performance if it is to respond adequately to the challenges of Asia and the U.S.

Europe must also face a second challenge – the problems arising from its ageing population. Two forces – declining birth rates and rising life expectancies – are interacting to produce a dramatic change in the size and age structure of Europe's population. These are two separate but interconnected problems.

The total population size in the European Union is projected to fall by 2020. By 2050, the working-age population (15 to 64 years) is projected to be 18 percent smaller than at present and the numbers of those aged over 65 years will have increased by 60 percent.

As a result, the average ratio of persons in retirement compared with those of the present working age in Europe will double from 24 percent today to almost 50 percent in 2050.

This development is already at work, and by 2015 the EU average dependency ratio will have increased already to 30 percent. The impact is then compounded by the low employment rate of older workers.

All this will have serious repercussions on public finances. Ageing will raise the demand for pensions and healthcare assistance at the same time as it reduces the number of people of working age, to produce the necessary wealth.

In case the present utilisation of the labour potential would remain unchanged, European Commission projections estimate that the pure impact of ageing populations will be to reduce the potential growth rate of the EU from the present rate of 2 to 2.25 percent to around 1.5 percent from 2015.

A conclusion we must draw from all this is the following. If we want our social systems, including our

pension systems, to be financially sustainable, a better utilisation of labour is desperately needed, both by increasing employment and by working more hours on a life-time basis. In other words, people will inevitably have to work longer before they retire.

In order to enable people to do so, they will have to be provided with up-to-date skills which are in demand. A modern, properly functioning education system, including life-long learning, must ensure that this is possible.

Europe must pay attention to these two challenges – all the more so because it has just seen its biggest enlargement since the creation of the European Community.

It must be said – while this enlargement in itself is most important and welcome of course – that this has not made reaching the Lisbon targets any easier. Enlargement has made inequality and the problems of EU cohesion more pronounced. The new Member States are characterised by strong regional disparities with wealth only concentrated in a small number of regions.

Equally, quite understandably, the EU-25 will find some of the Lisbon targets even more challenging than the EU-15.

The positive aspect of enlargement is that it offers the prospect of the new Member States achieving rapid rates of growth in GDP and productivity as they catch up with the European average, so creating an area of economic dynamism in Central and Eastern Europe.

There is already evidence that this is happening. Output and productivity growth in most new Member States have been above that of the U.S. over the last five years. As they replace redundant ageing technology with state-of-the-art processes they will jump a generation in terms of their technological capacity. There is every prospect of their growth in output and productivity continuing.

Nonetheless, their relatively low tax and wage rates attracting inward investment from the rest of the EU are likely to be a source of continuing friction. The present restrictions within the EU on free labour movement from new Member States as well as sensitivities in “old Europe” related to the current debate on the Services Directive clearly illustrate

this. Unless there is some prospect of convergence, these tensions will probably not disappear.

In this respect meeting the Lisbon goals to promote growth and employment in all parts of the European Union is vital for its future internal cohesion.

Ladies and gentlemen,

Europe needs to face these three challenges – with much greater political will and resolve than we have seen up to now.

If Europe wishes to uphold its distinctive choices in respect of its social model, if Europe wishes to increase its living standards, it needs to accelerate employment and productivity growth via a wide range of reform policies, including a better utilisation of labour both by increasing employment and by working more hours on a life-time basis, and via a set of interconnected initiatives and structural changes releasing Europe’s potential.

This demands priority action across five policy areas:

- **The knowledge economy**

Making Europe much more attractive to researchers and scientists by competing for the best brains in the world; at the same time, making R&D and innovation top priorities; strengthening Europe’s industrial basis and promoting the use of information and communication technologies (ICTs), including the recommendation on adopting a Community patent at short notice.

- **The internal market**

Completing the internal market for the free movement of goods and capital and urgent action to create a single market in services, including financial services (EU Member States can simply not afford the luxury of not making the best possible use of the benefits of the single market for services, eventually with some exemptions and/or transitional periods). Reaping the full benefits of a single market by appropriate and timely implementation of agreed EU legislation by member states.

- **The business climate**

Enacting measures to reduce the administrative burden; improving the quality of legislation; improving the availability of and access to risk capital; facilitating the rapid start-up of new

enterprises; creating an environment which is more business-friendly and finally less and better regulation at all levels.

- **The labour market**

Increasing the adaptability of workers and enterprises; creating an inclusive labour market by striking the right balance between flexibility and security and by moving away from job-security to employment- security; developing strategies for life-long learning and active ageing through more effective investment in human capital; the participation rate of female and older workers is essential to Europe's labour markets.

- **Environmental sustainability**

Spreading eco-innovations and building leadership in eco-industry; pursuing policies which lead to long-term, sustained improvements in productivity through eco-efficiency; special attention is needed in order to avoid the risk that the competitive position of European industries is endangered by the application of unilateral EU environmental regulation; instead, synergies must be developed between a strong economic performance and sustainability.

Last but not least however, a wider macroeconomic framework is required which is, as much as possible, supportive of growth, demand and employment.

For that reason, the high level group supported the moderate reform proposals for the Stability and Growth Pact that were presented by the European Commission in September last year.

Under the reformed Stability and Growth Pact, however, that was agreed recently, governments seem to be allowed to run budget deficits of more than 3 percent of GDP for several years as long as they are of the opinion that relevant factors are justifying this. It all depends upon the wisdom of respective governments, but this potential lack of sufficient checks and balances at EU level worries me seriously.

So far my brief remarks, ladies and gentlemen, on the five priority areas on which the high level group recommended comprehensive actions. Each of these areas was already part of the original Lisbon Strategy, but implementing the recommendations now is even more urgent than it was five years ago. Time is running out.

Europe formulated the right strategy in 2000, but now words need to be followed by action. To that purpose we made a number of additional suggestions on how to improve the process and thus improve the performance of the EU.

The essence of these proposals is more coherence and consistency between policies and participants; improving the process for delivery by involving national parliaments and social partners; and clearer communication on objectives and achievements, because the necessity of structural social and economic reforms in order to raise productivity, economic growth and employment is to a large extent a communication project.

It is clear that until now the progress of the Lisbon strategy has suffered from lack of ownership and from lack of coherence and consistency, both between participants and between policies.

Policies pulling in contradictory directions must be realigned so that they become mutually reinforcing, including the European budget.

Whatever decisions are finally reached about the absolute level of the budget, the High Level Group believes that the structure of the European budget must reflect the Lisbon priorities of growth and employment – as should national budgets.

On top of that also a clear alignment between participants is needed.

Member States play a crucial role in creating the right conditions for more growth and employment. Up until now national parliaments and citizens have not been sufficiently associated with the process. The same applies to social partners and other stakeholders.

Therefore, the High Level Group proposed – and the European Council followed that proposal – that from now on each member state will formulate its national action programme.

In order to ensure coherence between the national and European levels, these national programmes need to have a clear link with the Broad Economic Policy Guidelines and Employment Guidelines, but also with the legislative process in the member states.

In addition, the Open Method of Co-ordination can be improved. It has fallen far short of expectations.

The central elements of this method – peer pressure and benchmarking – are clear incentives for the Member States to deliver on their commitments by measuring and comparing their respective performances and facilitating the exchange of best practice.

And finally, a stronger focus on a limited number of top priorities is absolutely necessary.

Ladies and gentlemen, let me now turn to my concluding remarks.

The challenges facing Europe – why policies are developing as they are and the importance of acting together – need to be understood much better by the European public.

Understanding this requires clear and vigorous communication. All involved, including European and national politicians, and especially the European Commission, have an important role to play in delivering the message. Europe's leaders need to instil the hope that tomorrow will be better than today.

Europe has considerable economic and social strengths. The programme of reform outlined in our report is eminently deliverable and will bring improvement. It needs to be clearly explained, understood and delivered.

Citizens are not always sufficiently aware of the urgency and scale of the challenges we are facing. Citizens are not always sufficiently aware of the high price they or their children will have to pay if the Lisbon Strategy is not going to succeed.

In the present circumstances, the clear message must be: if we want to preserve and strengthen our social model we have to act and adapt.

In any event the status quo is not an option.

The High Level Group did not call for indiscriminate action; reform packages should, of course, be balanced, well thought through and properly designed. Equally, there should be a strengthening and modernisation of the distinctive European approach to organising the economy and society, so embedding core European values that all Europeans care about. Social partners should be fully involved at all levels.

The issue is delivering on the promises and undertakings that have been made, and that will entail significant change.

As I said earlier: at the end of the day, achieving higher growth and increased employment depends highly on the political will and determination of Europe's leaders.

The outcome of the European Spring Council meeting in March this year was not very encouraging, I must say. My general impression is that the meeting was too much dominated by the controversy on the Stability and Growth Pact and the bitter dispute on the Services Directive.

Certainly, reading the conclusions of the meeting I do recognise a large number of analytical remarks and recommendations the High Level Group put forward.

But in my view the European Council missed to seize the momentum, to express a real sense of urgency, to send a clear signal to governments, parliaments, stakeholders and citizens in Europe that in order to revive the European economy a narrow focus on growth, employment and competitiveness is urgently needed.

Only a few weeks ago a majority of the French and the Dutch electorate rejected the constitutional treaty.

I fully recognise that this is not the most appropriate occasion for me to try and analyse the main reasons for this. The European Council will meet one week from now to discuss the current situation and possibly to decide about the future roadmap.

Potentially Europe is running the risk now of entering a period of stagnation and standstill. Of course, solutions will have to be found in order to overcome the present institutional and political deadlock. But we cannot afford to become an inward looking continent. The world will not be waiting for us. External and internal realities cannot be ignored.

A new constitutional treaty or not, a considerable recovery of our European competitive performance is absolutely indispensable in order to raise current employment levels as well as our living standards and to sustain Europe's social model – in whatever form. Therefore Europe has to act now.

Thank you for your attention.