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Speeding up European Reform: A Master Plan for the Lisbon Process - What's wrong with Lisbon?

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Panel 1

SPEEDING UP EUROPEAN REFORM: A MASTER PLAN FOR THE LISBON PROCESS

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What's wrong with Lisbon?

In a democracy, a policy institution acquires and retains legitimacy either through the quality of its decision procedures or because it is able to deliver what the citizens expect. In the recent referenda, the French and Dutch citizens were asked to vote on a new set of rules and procedures. But rather than to give their opinion on the machinery, they chose to express their dissatisfaction with the output.

Together with peace, prosperity remains the Union's premier public good. From the Single Market to the euro, many ambitious projects have been undertaken in the name of it. Expectations have been created, only to be disappointed a few years later – a sure recipe for frustration.

The referenda thus emphasise that Europe's poor economic performance deeply undermines the very legitimacy of the EU – a point rightly emphasised by Prime Minister Tony Blair in a speech to the European Parliament on the eve of the 2005 British presidency.

The need for a growth agenda is thus more pressing than ever. This Spring, the EU announced a revamped version of its growth programme, the so-called Lisbon strategy. Initially launched in 2000, when Europe started to realise that in spite of a favourable environment it had been losing ground vis-à-vis the U.S. for a decade, the Lisbon agenda has not delivered. If anything, the EU's comparative

growth performance has weakened since it was adopted five years ago.

The European institutions cannot be accused of ignoring the evidence. The Kok report commissioned by the European Council and the Commission's own assessment of the economic performance of Europe are unusually frank. President Barroso's intention to give growth an overriding priority is unmistakable. The question, however, is whether the revamped Lisbon strategy is likely to work better than the original one. Lisbon mark 2 essentially boils down to a renewed emphasis on integration, a smaller set of objectives, and a streamlining of the coordination procedures that already exist: "less, but the same", as observed by Collignon (2005). Hardly a revolution.

There is wide agreement that five years after the beginning of the economic slowdown, the EU and especially the Eurozone cannot afford to remain on a sub-par growth track. The question is why the initial strategy has been unsuccessful and why it should now be expected to deliver what it has not delivered in its first five years. On this account, the conventional explanations, which basically put emphasis on the complexity of the initial set of objectives and indicators, are unconvincing. Complexity may account for implementation failures here and there, not for an overall lack of action.

There is thus a need for a deeper investigation into the shortcomings of the Lisbon strategy. What this paper argues is that the reason for those shortcomings is a lack of incentives to coordinate reforms within the EU. It makes the point that the very rationale for undertaking reforms jointly is in fact weak for the EU as a whole while it is stronger *within the Eurozone*.

If this analysis is correct, the conclusion is that the EU must give thoughts to improving the incentive they face, especially within the Eurozone. It must also make better use of its own instruments – the EU legislation, the budget, monetary policy and the Stability pact.

This paper starts with a short assessment of the economic situation in the Union and the degree to



¹ jpf@bruegel.org. This is a revised version of a paper initially prepared for the "Munich Economic Summit", June 2005. Opinions expressed in this paper are those of the author. They do not represent in any way those of the members or the board of Bruegel.

which it explains the result of the referenda. Part 2 is devoted to an evaluation of the Lisbon strategy. Part 3 discusses why this strategy did not deliver. Recommendations for improving it are made in part 4. Part 5 concludes.²

Europe’s economic and political woes

In a recent paper, Olivier Blanchard (2004) challenged the view that Europe is sick, and claimed instead that its relatively low income per head reflects a preference for leisure. This was already a controversial reading of the 1980s and the early 1990s. Turning to the late 1990s and the early 2000s, it can at best be regarded as paradoxical.

Two basic facts illustrate the point. First, the EU’s economic performance has consistently disappointed expectations since 2000. The last five years have been characterised by a persistent lack of economic momentum in the Eurozone and Europe at large and by a widening gap between world and European GDP growth. In comparison, Europe’s relative performance was markedly superior in the early 1990s in spite of the aftershock of German unification (Fig. 1).

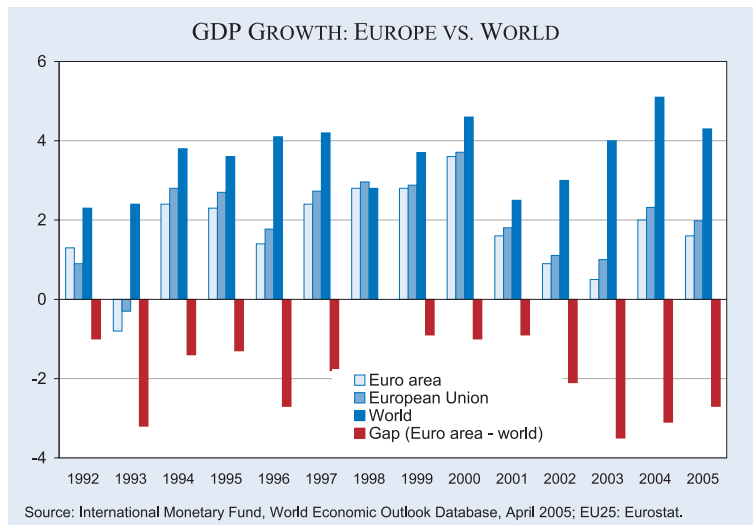
Second, the growth gap between the U.S. and Europe can no longer be ascribed to an inferior mobilisation of labour resources. In the early 1990s, the EU could still be described as a high productivity-low employment economy and it was routinely compared to the low productivity-high employment US economy. But since the mid-1990s, Europe has started to catch up on employment while it has been lagging behind as regards productivity growth. Although the level of labour utilisation remains inferior to that in the U.S., the main factors behind the widening of the income gap are now demographics and productivity (see Table).

Instead of moving towards the frontier by improving its performance on both employment and productiv-

² This paper partially draws on joint work with Philippe Aghion and Elie Cohen (2005).

³ This result consistently emerges from the exit polls of CSA, IPSOS and SOFRES, in spite of varying formulation of the question and of varying alternative answers. It can therefore be considered robust.

Figure 1



ity, the EU thus only seems to be able to trade-off productivity for employment while remaining at a GDP per capita level markedly inferior to that of the U.S. (Sapir et al., 2004). The two macroeconomic goals of Lisbon – employment and productivity – look as being substitutes rather than complements (CEPS, 2003).

It is in the three main economies of the Eurozone – Germany, Italy and France – that those woes are especially apparent. In France, they weighed very significantly in the voters’ decision to reject the draft constitutional treaty: all exit polls indicated that the deteriorated economic and social situation had been the main motive for the no vote, over and above other factors such as the judgement on the constitution itself, disagreement with the prospective enlargement to Turkey or domestic political concerns (Fig. 2).³ The voters’ intention was apparently to sanction the EU for a failure to deliver economic prosperity.⁴ In the Netherlands, the main declared

⁴ Although more detailed analyses indicate that opposition to the treaty among public-sector employees was a significant factor behind the victory of the no, they also confirm that social polarisation among the voters was exceptionally high (Goux and Maurin, 2005).

Table
Relative US/EU15 performance
(EU performance level as a percentage of corresponding US performance)

	1995	2003
Income per head	72.1	70.9
Hourly labour productivity	93.6	88.0
Employment rate	82.9	90.4

Source: Eurostat, structural indicators database.

motives were that the country “pays too much to the EU” and that it would risk having “less control over its own affairs”.⁵ While the difference with French motivation is noticeable, those results can also be regarded as indicating that the EU does not deliver [economic] value for [budgetary] money. Again domestic concerns and Turkey seem to have played a minor role.

One of the messages from the referenda is therefore that citizens are reluctant to approve the rules and procedures of a Union that does not deliver prosperity.

An assessment of the Lisbon strategy

Is Lisbon the remedy? A prerequisite to an answer is to define what Lisbon really means. Putting aside an unfortunate initial hype, it can be summarised in a three-pillars programme⁶:

- *Economic integration.* This is the traditional EU agenda and the one on which its growth strategy rested in the 1980s and the 1990s. Lisbon was a recognition that economic integration was not likely to be sufficient as an engine for growth, but it remains a key component of the approach. Integration today obviously no longer means dismantling border controls, but reforming domestic regulations that obstruct freedom of establishment, hinder cross-border mergers and acquisitions and stifle competition. This requires to combine EU and national policies, albeit in a field where the EU generally has precedence.
- *A soft coordination of domestic labour markets and pension reforms.* This pillar was added in 2000

thanks to the adoption of the “open method of coordination”, a non-binding commitment to reciprocal consultation and benchmarking (Rodrigues, 2002). The goal was to complement the traditional agenda with policies aiming at increasing labour supply and tackling long-term unemployment. However, no legislation could be proposed, as the EU has almost no competence for labour markets, taxation and social security: those areas primarily belong to the remit of the member states. Common targets were set instead, together with supporting league tables and a benchmarking of policies. It was expected that this non-binding coordination would encourage the adoption of best practices. To that end, the Commission had to draw up scoreboards on the basis of commonly agreed targets and indicators.

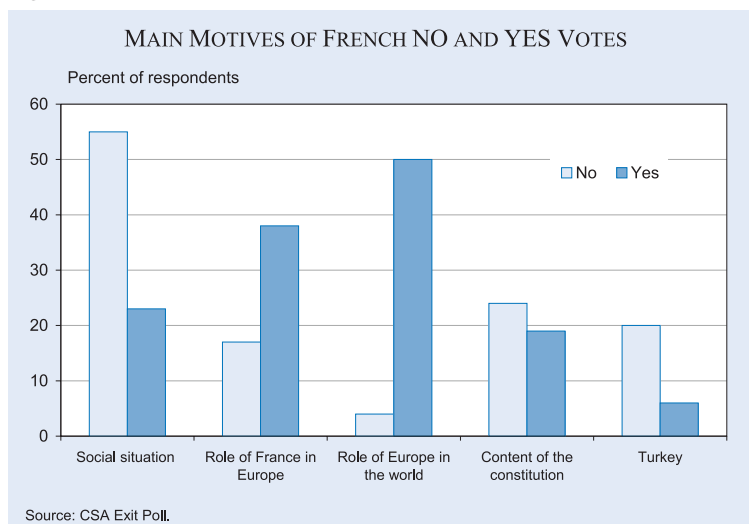
- *A restructuring of public spending* in the direction of R&D and higher education. Here again, most of the means are in the hands of the member states, but the setting up of common objectives was expected to foster additional efforts.

Although in this area the EU is either the player (for Eurozone monetary policy) or can rest on explicit coordination powers (for budgetary policies), macroeconomic policy is not part of the strategy, as it focuses on the structural conditions for growth. Macroeconomic stability, i.e. budgetary discipline and price stability, is regarded as a complement to it.

This is the programme. What are the achievements?

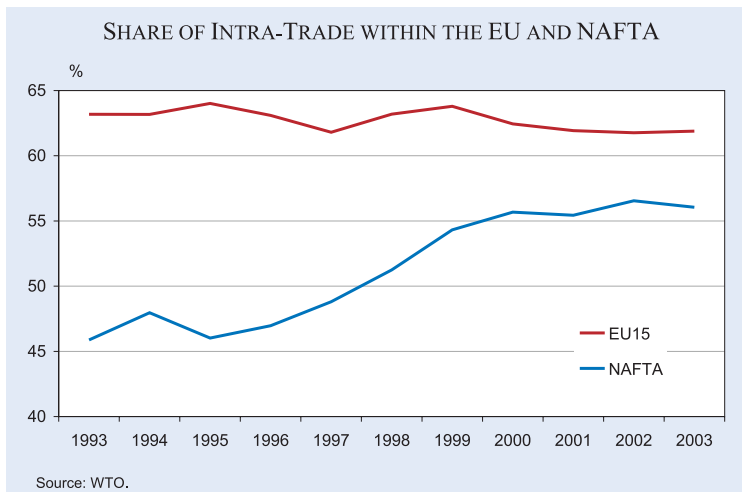
On the integration front, little has changed in recent years. The one advance that can be noted is the implementation of the Lamfalussy programme for financial services. For other policies, no major push has been recorded. Aggregate evidence based on price convergence or trade intensity suggests that after the completion of the Single Market in 1992, integration has somewhat stalled (Fig. 3). Compared to other regional groupings, trade within the EU-25 evidently lacks

Figure 2



⁵ NOS/NSS polls.
⁶ The Sapir report (2004) and the Kok report (2004) provide a more comprehensive overview of the Lisbon strategy. The revised version of the Lisbon strategy is presented in a Commission (2005) communication to the Council and the Parliament as well as in the Integrated Guidelines first adopted in 2005.

Figure 3



momentum. Furthermore, more detailed research (Mayer and Zignago, 2005) indicates that in spite of a much more complete legislative and regulatory apparatus, EU-induced intra-European trade is markedly less important than NAFTA-induced North-American trade. More than ten years after the removal of all border obstacles, the EU is still very far from being an integrated economy.

Another piece of evidence on integration is provided by the OECD (Conway et al., 2005) index of product market regulation (Fig. 4). In spite of the Single Market, there is roughly as much variance in the degree of product market regulation within the EU-15⁷ as among the non-EU OECD countries. Furthermore, the trend towards deregulation is sim-

ilar in the two groups of countries. In short, there is no prima facie evidence that membership in the EU makes a difference as regards the nature or degree of product market regulation.

Turning to labour markets and tax or welfare reforms, the evidence does not suggest tight coordination either. Again, the OECD indicators (Brandt, Burniaux and Duval 2005) can be used to assess the degree to which the regulatory and tax regimes of labour markets have effectively converged within the EU and whether a common European approach emerges from the data.

Only examples can be given here. The most striking regards the degree of employment protection for permanent workers, for which the dispersion among EU-15 members is as wide as within the OECD and remains at the same level as ten years before. Although the issue of employment protection is central in a strategy that intends to equip workers for a transforming economy, there is no evidence whatsoever of European convergence towards a common approach. Some more convergence can be observed

⁷ The new member states of Central and Eastern Europe have been excluded from the sample because their recent transition to the market economy could have affected comparisons over a 10-year period.

Figure 4

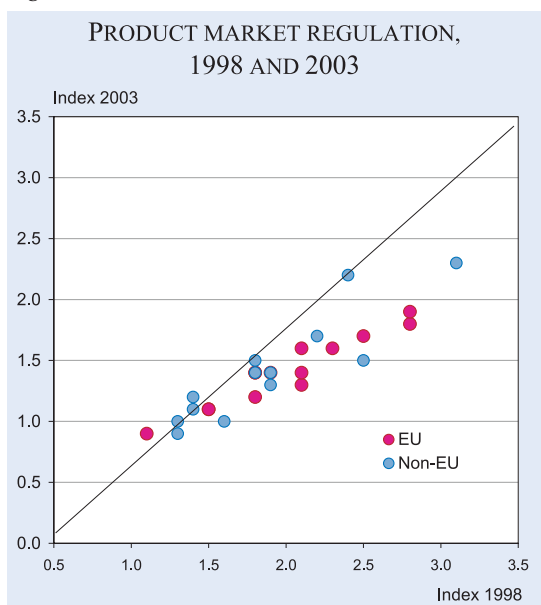


Figure 5

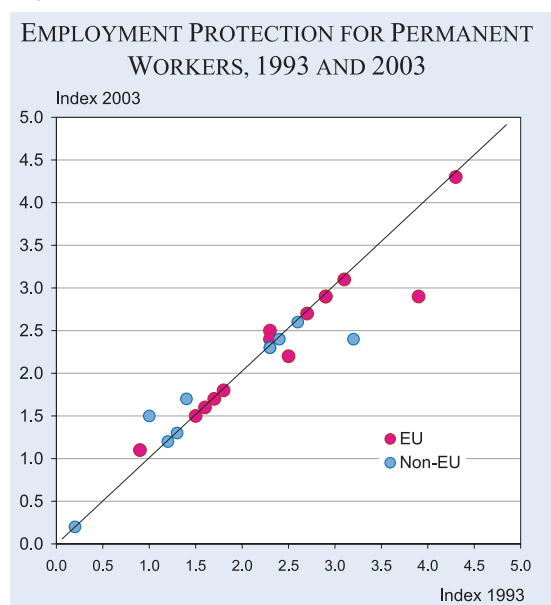
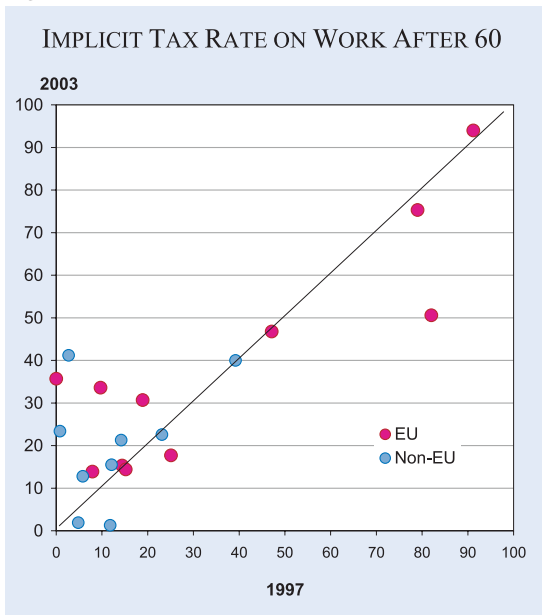


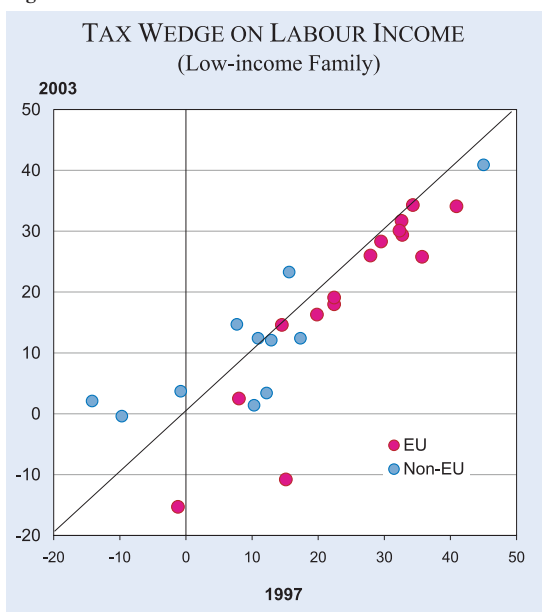
Figure 6



in the protection of temporary workers, as many countries have relaxed provisions regarding temporary workers, but in that case the dispersion regards the frequency with which companies rely on such contracts.

A second, equally striking example is given by the implicit taxation on work after 60. A major objective of the Lisbon programme is to increase the labour force participation and employment rates of persons between 60 and 65 years old. A major obstacle in higher senior participation comes from provisions in the pension and tax regimes that effectively discourage work after 55 or 60, frequently because addition-

Figure 7



al pension contributions do not increase the future benefits. Reducing this implicit taxation of work should thus be a common objective of the EU member states. Yet the dispersion of implicit taxation rates remains wider within the EU than among non-EU OECD countries.

Finally, I look at the tax wedge on labour income at the bottom end of the wage distribution (data are again from the OECD). A number of European countries have recently introduced targeted cuts of social security contributions in order to “price in” unskilled labour. Figure 7 does confirm that there is an observable tendency toward a lower tax wedge among EU members. However it has taken place at a very uneven pace and the dispersion has in fact increased rather than decreased over the 1997 to 2003 period.

Although the evidence presented remains somewhat sketchy, it tends to confirm that the Lisbon coordination of labour market policies has not strongly affected national policies.

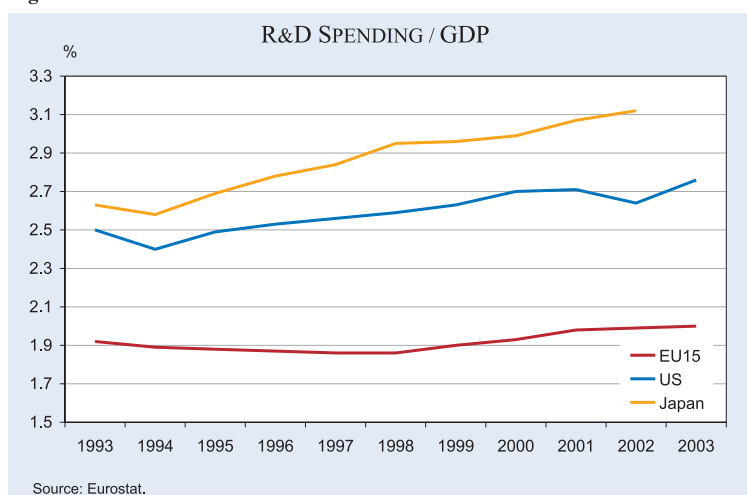
Finally, the restructuring of public spending is not taking place, at least it has not yet occurred. Aggregate figures indicate that the share of R&D in GDP has increased in Japan and the U.S., but not in Europe (Fig. 8). The commitment to increase this spending to 3 percent of GDP has failed to materialise.

Evidence thus supports the view that Lisbon has not fulfilled its promises. The question is, first, why it has not delivered, second, what can be done to make it effective.

Why is Lisbon not effective?

It is hard to challenge the Lisbon goals. In fact, they command virtually universal support. Governments are committed to them. The European parliament supports them quasi-unanimously. Both the employers federation, UNICE, and the European Trade Unions Congress, ETUC, strongly endorse them. But action does not follow words. So why is the EU unable to deliver on such a seemingly uncontroversial reform agenda? Why have integration and reform stalled? Why, finally, is Lisbon the least effective in the large Eurozone countries, where reform is the most pressing?

Figure 8



Conventional wisdom puts the blame on complexity, i.e. on the multiplication of detailed targets, objectives and reporting procedures. Yet the argument places much too much faith in the Lisbon process. Beyond the technicalities, the gist of the Lisbon agenda is clear and simple – as previously emphasised. To claim that its failure stems from the complexity of the procedures amounts to assuming that governments have behaved in an excessively myopic way.

The deeper issue is of a different nature. Rather than with complexity, the problem has to do with the lack of incentives to behave in accordance with the prescriptions of the Lisbon strategy.

Lisbon rests on the belief that member countries have a common interest in coordinating structural reform policies. The underlying rationale draws on two series of arguments. First, it is assumed that countries may gain from undertaking reforms jointly. Second, it is expected that they may learn from the experience of each other and that the EU may help in providing an assessment of what works and what does not.

The first argument rests on the existence of positive cross-border externalities from supply-side policies. As always in the presence of such externalities, coordination should help internalising the benefits of reform policies and thereby lead governments to move away from an inefficient no-reform equilibrium to an efficiency-enhancing reform equilibrium. The problem, however, is that externalities arising from supply-side policies are less evident than those from demand-side policies. Absent labour mobility, a

country that lowers its structural unemployment rate does not significantly impact its neighbours. Its success fundamentally benefits its own citizens. Similarly, a country which succeeds in improving its productivity performance essentially boosts its own growth. Its neighbours may benefit from resulting price cuts and corresponding purchasing power increases, but this effect normally results from the move to a new price equilibrium and, absent market failures, there is no reason to suspect that this cross-border spill-over reduces

the incentive to improve productivity. In other words, externalities are pecuniary ones and are normally dealt with by the market (Tabellini and Wyplosz, 2004).

There are obviously exceptions, as some policies such as spending on research and higher education, which involve non-pecuniary externalities, gain from being coordinated. There are also counter-arguments⁸, but on the whole, a fair assumption is that the case for coordinating supply-side policies must be assessed on a case-by-case basis.

The second argument is based on the so-called theory of “yardstick competition”, initially developed in a regulatory context (Shleifer, 1985) and later extended to analyse the behaviour of decentralised governments (Besley and Smart, 2001). By providing an independent assessment, the EU could help governments to sort good from bad policies and voters to sort good from bad governments. In this way, the “open method of coordination” should trigger competition and foster reform.

The problem with this argument is that, in the European context, yardstick competition is a rather weak force. Voters may compare the overall performance of the respective EU countries – for example their relative unemployment rates – but comparing policies and reforms is much less straightforward, as the impact of any given reform depends on a host of other factors, from existing institutions to complementary policies and the macroeconomic context. A recurring theme of the literature on economic

⁸ See Pisani-Ferry (2004) for a discussion of Tabellini and Wyplosz.

reforms is that, in the presence of policy complementarity, their effectiveness heavily depends on these context factors. Furthermore, voters face difficulties in appreciating the trade-offs involved (for example between efficiency and equity or employment and job security), as, again, this requires more information than the mere observation of economic results.

Lisbon may be regarded as a supporting device to make yardstick competition more effective. The provision of harmonised data and comparative assessments may trigger a kind of performance transparency and help determining what works best – without infringing on the member states' policy autonomy.

However, anecdotal evidence suggests that the adoption of the Lisbon programme has not significantly affected the reform debate in the larger member states such as Germany (where the discussion on Agenda 2010 was mostly conducted without reference to it) or France (where politicians routinely warn against the devilish character of the Anglo-Saxon model). The paradox of Lisbon is thus that it tends to be a reference in smaller, more open and reform-minded economies – exactly where it is hardly needed.

Furthermore, the Commission is visibly in an uncomfortable position vis-à-vis the member states. It has no power to enforce the Lisbon agenda and hesitates between the role of a schoolmaster and that of a coach. The Barroso Commission recently took some distance with the former role, indicating that its intention was not to designate good and bad pupils, but rather to support the efforts of all of them.

Against this background, the decision by the European Council of March 2005 to base the monitoring on “national reform programmes” geared to the member states’ “own needs and specific situations” (and whose preparation is the responsibility of the member states) risks watering down the whole exercise and may weaken even further the incentive to conform to the commonly agreed agenda.

There is, however, another potential motive for coordinating reforms, this time within the Eurozone. In a monetary union, countries that reform and, as a result, lower their structural unemployment rate or increase their trend productivity growth rate exert a medium-term externality on their neighbours. Think,

for example, of a monetary union composed of two countries, A that reforms and B that does not. Both obviously share the same nominal interest rate. Suppose that as a consequence of reforms in A, the aggregate structural unemployment rate goes down while aggregate productivity goes up – in both cases lowering inflation until a new steady-state equilibrium has been reached. The central bank can thus lower interest rates, thereby boosting domestic demand in both A and B. However, for A the interest rate reduction is less than it would have been with currency autonomy, while for B it entirely results from the partner's policies (and can therefore result in inflationary pressures). The key here is that the externality is entirely attributable to the fact that the two countries share the same currency.

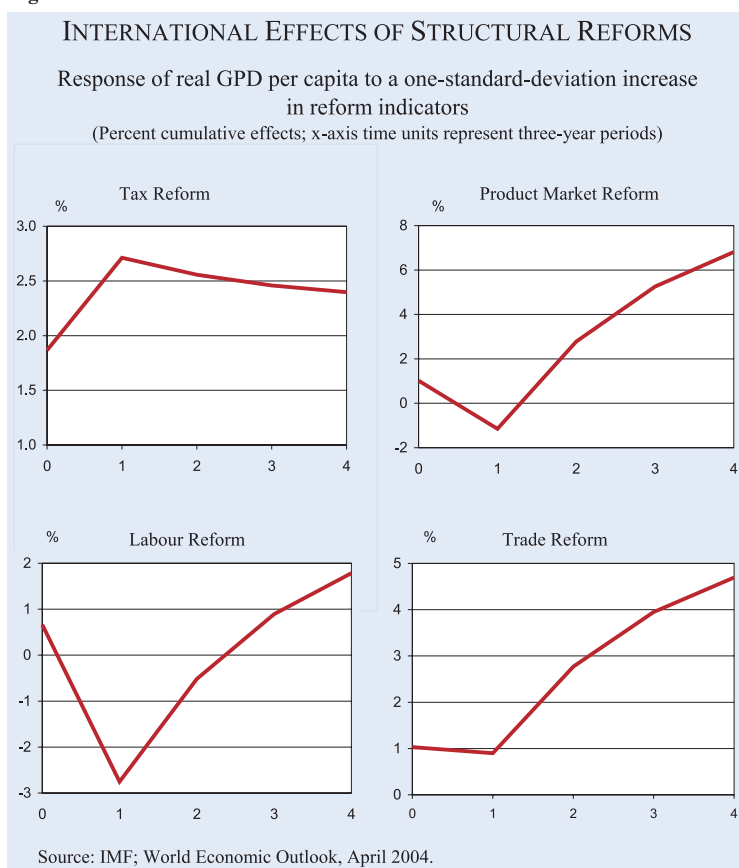
Assume now that governments face a political economy constraint and therefore hesitate to undertake reforms. Structural reforms, which increase potential output in the medium term, frequently cause output losses in the short term because they involve adjustment costs, create uncertainty and affect consumer behaviour (as illustrated by the current situation in Germany).⁹ A recent IMF (2004) study suggests that this kind of inter-temporal distribution may in fact characterise a wide array of labour market and product market reforms (Fig. 9). In such situations, the inter-temporal gain from introducing a reform can be low or even negative if governments have a strong preference for the present.

More generally, reforms frequently amount to trading short-term (economic and political) costs for long-term (economic) gains. For that reason, politically motivated governments may hesitate to undertake welfare-improving reforms. This is where macroeconomic policy comes in. What it can do is to change the inter-temporal distribution of costs and benefits through speeding up convergence to the new, higher equilibrium. By taking advantage of the structural improvement before spontaneous convergence has taken place, it can make reforms less costly in the short term and thus more attractive for politicians. In other words, macroeconomic accommodation can be an incentive to structural reform.

In a monetary union, however, monetary policy can only support the reform efforts of any given government to the extent it contributes to improving the

⁹ Reforming employment protection can, for example, imply more unemployment in the short term (as firms dispose of redundant workers) but less in the long term (as flows increase and the market for labour becomes more fluid).

Figure 9



aggregate performance. For a government acting in isolation, the incentive to overcome political economy constraints is reduced accordingly. Absent a coordination of structural reform efforts, this may result in a reform deadlock in which no government undertakes the necessary reforms.¹⁰

This reasoning has relevance in the Eurozone. Reform-minded governments can only rely on fiscal policy to the extent this does not conflict with the Stability and Growth Pact. They can only rely on monetary policy to the extent their reforms result in lowering the aggregate inflation rate. On both accounts, the macroeconomic framework does not help to overcome the reform deadlock.

Summing up, the problem with structural reform coordination at the EU level is that the rationale for it is relatively weak and that the incentive to coordinate hardly exists. The problem with coordinating

¹⁰ Other Eurozone-specific externalities exist. Another important one regards pensions. The case for coordinating pension reforms within the EU as a whole is not a very strong one, but it is much more compelling within the Eurozone because of their impact on public finance. Long-term sustainability essentially depends on the implicit liabilities created by the pay-as-you-go systems and for that reason, budgetary surveillance necessarily encompasses the issue of pension reform.

structural reforms among Eurozone members is that they face a collective action problem that the macroeconomic framework does not help to overcome.

This Eurozone dimension was until very recently not taken into account in the EU policy framework, as the Lisbon agenda entirely focuses on reform coordination among the 25 and completely overlooks the Eurozone dimension, while the Stability Pact ignored the issue of structural reform until its recent reformulation and monetary policy was not geared to supporting structural reform.

What can be done?

To return on a higher growth path, the EU first needs to concentrate efforts and political energy where they can be expected to deliver growth dividends. Second, it needs to remedy the lack of incentives in the Lisbon programme. Third, the Eurozone needs to better combine structural and macroeconomic policies in a way that builds on their complementarities.

Economic integration within the EU should be pushed further, but as a growth-enhancing programme rather than as an end in itself. In an environment characterised by rising reluctance to governance from Brussels and a tendency to revert to the nation-state as the ultimate shelter against the pressures from globalisation, it is important not to confuse means and ends. Recent reactions to the outcome of the referenda indicate that the two major achievements of the last decades, the Single Market and the euro, can be openly challenged by senior mainstream politicians. The mere preservation of what has been achieved can therefore not be taken for granted.

Against this background, the EU should neither promote further market integration in an indiscriminate way nor stop pushing for it. It should consciously devise a strategy to rebuild legitimacy through concrete achievements. This implies to focus on areas where integration has the potential of decisively con-

tributing to aggregate growth and better take into account the balance between political costs and economic benefits.

In other words, the EU should primarily focus on “making the Single Market more dynamic” as proposed by the Sapir report (2004). This means less insistence on liberalisation across the board and stronger priority on areas such as competition, the long-awaited community patent, the completion of the single market for financial services or the free cross-border provision of high-productivity services. This also means lifting the bottlenecks that prevent the effective integration of the new member states, which has the potential of contributing to a renewal of European growth and competitiveness.

Reform coordination should not be abandoned, but efforts should focus on areas where it is justified by cross-border externalities. The European Commission should continue to provide an uncompromising comparative assessment of performance and efforts that can be used in domestic policy debates and thereby trigger an informed discussion on what works and what does not. But it should focus its positive coordination efforts in areas where significant externalities exist, such as migration or research and higher education. In those areas, policy effectiveness requires joint action and EU intervention is more than legitimate.

However, reform coordination cannot only take the form of exhortations or encouragements. To ensure effective coordination, words need to be substantiated with deeds. This is why the Sapir report (2004) had proposed to use the EU budget as an incentive device to support national efforts in areas of common interest and encourage member states to undertake them (A good testing ground could be higher education, where member states share a common interest in upgrading their research universities to retain students and professors and make them contribute to the development of a knowledge-based economy: EU money could be used to elicit national efforts). The initial Commission proposal for the 2007 to 2013 financial perspectives had partially taken this proposal on board, but further negotiations in the run-up to the June European Council led to reverting to a more traditional approach. An unambitious budget that neither restructured spending nor increased it in a significant way would have deprived the EU of a potentially powerful device to trigger coordination and increase incentives to pur-

sue growth-enhancing policies. The debate over the financial perspectives that has started creates an opportunity for discussing options.

Finally, the Eurozone should take into account complementarity between structural and macroeconomic policies and adapt its policy framework accordingly. The principles governing macroeconomic policy in EMU are certainly not compatible with the explicit “two-handed approach” advocated two decades ago by economists (Blanchard and al., 1985). However, more can be done within the current framework to help overcoming the political economy obstacle to growth and reform.

First, overall stabilisation can significantly be improved. Over the last cycle, the Eurozone has been characterised by a lack of responsiveness of monetary policy (combined with comparatively weak transmission mechanisms) and an inappropriate stance of aggregate fiscal policy in the upswing. Improving stabilisation through better responsiveness would benefit in the short run and might even improve long-term growth (Aghion, Cohen and Pisani-Ferry 2005). Some progress, albeit without much result so far, has been made in this direction through the redefinition of the ECB target and the reform of the Stability Pact.

Second, the fiscal policy framework must encourage reforms that are conducive to growth and may improve the intertemporal budget balance. The agreement of March 2005 on reforming the Stability and Growth Pact includes a commitment to take structural reforms into account “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”. The devil, however, is in implementation, especially as the reformed Stability and Growth Pact has moved away from rules to rely more on discretion (Pisani-Ferry 2004b, 2005). Furthermore, the countries in the most urgent need for reform are also those in which the budgetary margins allowed by the Stability Pact are exhausted.

Third, the ECB should explicitly let it be known that, without prejudice to price stability, it stands ready to back reforms that lower structural unemployment and put the Eurozone on a higher growth path. It has already recognised the existence of complementarities between macroeconomic policies and structural

reforms and hinted at the additional room for manoeuvre that the latter would create for the single monetary policy (Papademos, 2004). Time has come to go further and more unequivocally recognise that, provided the governments act, monetary policy would support their action. Such a commitment would certainly involve taking a risk. The question, however, is whether it is preferable to take the alternative risk of remaining in a deadlock that would ultimately undermine the sustainability of monetary union.

Conclusions

Two decades of sub-par performance and four years of near-stagnation have resulted in a situation where the very legitimacy of the European Union is at stake. Failure to deliver growth and prosperity has already undermined support for the common institutions. It could tomorrow trigger a backlash against economic integration and the very achievements of the last twenty years, the Single Market and the euro. It could turn the potentially highly beneficial integration of the new member states into a zero-sum game and spark off a range of intra-EU controversies.

This paper has argued that the Lisbon programme has not delivered on its promises and that Lisbon mark 2, its revamped version, is unlikely to succeed either, because it fails to recognise the shortcomings of its predecessor. What the EU needs is to focus integration efforts, to use the EU budget to support reform efforts with effective incentives rather than just words, and to make the macroeconomic framework more conducive to reforms.

A more effective growth programme has for a long time already been an economic imperative. After the referenda, it has also become an even more pressing political imperative.

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