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Europe 2020 – A Promising Strategy?

In March, the European Commission released its Europe 2020 strategy proposal, which strives for “smart, sustainable and inclusive growth” and greater policy coordination between the EU and national governments. While the document was greeted with scepticism in some quarters, others believe it lays out the path to continued European prosperity and social cohesion. This Forum examines the strengths and weaknesses of the strategy.

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The Competitiveness Rationale, Sustainable Growth and the Need for Enhanced Economic Coordination

The Europe 2020 Strategy was designed as a European exit strategy from the global economic and financial crisis that started in 2008, but it risks being somewhat overtaken by events in 2010. Before even having enacted the new strategy, the European Union (EU) already faces challenges of a further-reaching nature and different dimension. The economic and financial crisis has transformed into a sovereign debt crisis with the risk of contagion to other eurozone members, calling into question not only the solvency of various member states but also many of the achievements that had already been taken for granted in the EU. It has highlighted the need for increased European economic cooperation in order to deal with the causes of the crisis (competitiveness differentials between member states and budgetary disequilibria) and impede spillovers into the monetary sphere, in particular in the eurozone.

The Europe 2020 Strategy[1], which received the go-ahead from the Spring European Council of 2010, is to reinforce economic policy cooperation with a view to promoting sustainable growth in the EU. It succeeds the Lisbon Strategy (2000-2010) and builds on the objectives and toolbox of the revised Lisbon Strategy of 2005 (focused on growth and jobs). Like the latter, it is driven by international competitiveness concerns and the promotion of productivity, growth and sustainability. It also makes use of the same governance framework.

1 European Commission: Europe 2020. A strategy for smart, sustainable and inclusive growth. COM (2010) 2020 final, Brussels, 3 March 2010.

Over the last decades the competitiveness rationale has been gaining ground in the EU. The Europe 2020 Strategy is one of successive European attempts at improving competitiveness and economic growth. The competitiveness rationale has been an important driver of the European Single Market programme (1986-92), the Lisbon Strategy (2000-10) and the Europe 2020 Strategy. It has given rise to increased coordination needs in the economic sphere. It has become ever more important in an increasingly interrelated and global setting. The competitiveness rationale is currently highlighted in the different national measures and by the European Stabilisation Mechanism (ESM) adopted to deal with the sovereign debt crises in the eurozone context.[2]

Objectives and Priorities

The Europe 2020 Strategy sets out the vision of a social market economy for Europe in the 21st century. It aims at transforming the EU into a smart, sustainable and inclusive economy with high levels of employment, productivity and social cohesion and at reinforcing the EU as an actor in global governance.

2 In this respect, the Europe 2020 Strategy, barely presented, already faces the challenge of catching up with events. Given the urgency of avoiding a default in Greece and later on contagion to other eurozone countries, ad hoc coordination between the Commission, the Eurogroup and even the IMF took place within the ESM.

The Europe 2020 Strategy is therefore based on two strands. First, it identifies three priorities that come to clarify the nature of growth that the EU envisages: smart growth, developing an economy based on knowledge and innovation; sustainable growth, promoting a more efficient economy in terms of resource utilisation that is more ecological and more competitive; and inclusive growth, fostering an economy with high employment levels and which ensures social and territorial cohesion. Second, there are five headline targets that serve as benchmarks for the EU in 2020 on employment, education, social inclusion, research and development, and climate and energy. Combining these two strands leads to a total of seven flagship initiatives that are to promote smart, sustainable and inclusive growth and guide policymaking in the EU and the member states.

Three initiatives, on innovation, education and the digital society, are to promote smart growth. They are to improve the general conditions as well as access to financing of research and innovation so as to strengthen the innovation chain and raise EU investment levels, to improve the results of higher education systems and the international attractiveness of European higher education, and to accelerate the implementation of high-speed internet and a digital single market at the service of families and enterprises. Two initiatives are to promote sustainable growth, one on climate, energy and mobility and another on competitiveness. Resource efficiency is to contribute to decoupling economic growth from resource use, decarbonising the economy, raising the use of renewable energy sources, modernising the transport sector and promoting energy efficiency. The "new" industrial policy aims at improving the firm environment, in particular for small and medium-sized enterprises, and supporting the development of a solid and sustainable industrial base capable of facing up to global competition. Inclusive growth entails initiatives on employment and qualifications and the fight against poverty. Modernising labour markets, facilitating labour mobility and the life-long development of qualifications is to increase labour market participation and achieve a better match between demand and supply. The fight against poverty is to achieve social and territorial cohesion, so as to ensure an ample distribution of the benefits from growth and employment and a dignified life and active participation in society for people living in poverty.

The Treaty on the Functioning of the EU provides for the coordination of member states' economic and employment policies within the Council as matters of common concern.[3] It is the Europe 2020 Integrated Guidelines that set out the framework for the Europe 2020 Strategy and reforms at Member State level.

The first group of Integrated Guidelines (1 to 6) concerns economic policies. The first three guidelines already address some of the preoccupations that had become more urgent and were addressed by the ESM, namely ensuring the quality and the sustainability of public finances, addressing macroeconomic imbalances and reducing imbalances in the euro area. The three remaining guidelines in this first group concern the shift to an information society (guideline 4) and to a competitive and low-carbon economy (guidelines 5 and 6).

3 The Treaty on the Functioning of the EU provides that the Council is to adopt broad economic policy guidelines (Article 121) and employment guidelines (Article 148), specifying that the latter must be consistent with the former. The guidelines for employment and economic policies are therefore presented as two distinct (but intrinsically interconnected) legal instruments: a Council Recommendation on broad guidelines for the economic policies of the member states and of the Union (Part I of the Europe 2020 Integrated Guidelines) and a Council Decision on guidelines for the employment policies of the member states (Part II of the Europe 2020 Integrated Guidelines). Together these guidelines, implemented by the above-mentioned legal instruments, form the integrated guidelines for implementing the Europe 2020 Strategy.

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The second group, on employment and social policies, is composed of four guidelines. They are related to increasing the labour force (guideline 7), improving human resources (guideline 8), the match of supply and demand over time (guideline 9) and bringing people back into the labour market (guideline 10).

Governance

The Europe 2020 Strategy renews the underlying approach of the Lisbon Strategy, based on a partnership for growth and job creation that relies on a mix of the commitment of member states to take action at the national level with making best use of Community instruments at the EU level. Delivery of results is to be ensured by a focus on those policy areas where it is a collaboration between the EU and member states that can deliver the best results and through better use of available instruments. The reduced number of objectives and priorities and the articulation of EU and member states' actions point towards a preoccupation with policy coherence and effectiveness.

As for the general institutional structure, the integrated guidelines define the reach of the EU priorities in political terms, including the headline targets for the EU in 2020, which should be translated into national objectives.

According to the Commission, the Europe 2020 Strategy features reinforced economic governance based on the articulation of the two proposed governance pillars, namely on the basis of thematic priorities and country reports.

The thematic priorities are to implement the EU objectives and priorities through a combination of concrete actions at the EU level and at national level. The seven flagship initiatives are to commit both the EU and the member states. At the EU level, the instruments, i.e. the internal market, the financial instruments and the instruments of external policy, are to be fully employed to eliminate bottlenecks and reach the objectives of the strategy. The Commission's immediate priority is the identification of the necessary actions to define a credible exit strategy from the crisis, carry out reform of the financial system, ensure the necessary budgetary consolidation for long-term growth and reinforce the coordination in the context of the Economic and Monetary Union.

EU objectives are translated into national objectives and trajectories in order to ensure that the member states adapt the Europe 2020 Strategy to their specific situation. The sectoral formations of the Council will have a strategic role in controlling and assessing progress towards the established objectives. The instruments associated with the thematic approach consist of the information that member states provide in their national simplified reform programmes, including detailed information about the bottlenecks that constrain sustainable growth and progress towards the established objectives. Their reform process is followed up by recommendations made within the context of the General Economic Policy guidelines and the Employment Guidelines. In the case of inadequate responses, warnings can be issued.

Country reports are to help member states define and apply their exit strategies from the crisis (restore macroeconomic stability, identify national bottlenecks and ensure that their economies get back onto a sustainable growth and public finance path). Those reports are to feature an in-depth evaluation of the chief macroeconomic challenges facing the member states, taking into account the indirect effects between member states and the different policies. In terms of instruments, country reports will rely on the information provided by member states in their Stability and Convergence programmes. It is to be followed up by specific but synchronised recommendations on budget policy in the Commission opinions on those programmes and about the macroeconomic disequilibria and bottlenecks that affect growth in the context of the General Economic Policy Guidelines.

The Europe 2020 strategy reports and the evaluations of the stability and growth programmes are to be elaborated simultaneously, although they are to remain distinct instruments and respect the integrity of the Stability and Growth Pact (SGP). Drawing on monitoring by the Commission and work done in the Council, the European Council is to assess on a yearly basis the overall progress achieved at both EU and at national level in implementing the Europe 2020 Strategy. Macroeconomic, structural, and competitiveness developments and overall financial stability are to be examined simultaneously.

The Crisis Context

The Europe 2020 Strategy was drawn up by the Commission against the background of the economic and financial crisis and its impact on the European economy, notably a sharp economic contraction and a rise in unemployment rates. The Commission stated that a successful exit from the crisis required shaping the public policies that, taking into account the changed circumstances, would put the EU on a sustainable and high growth path.

The Commission argued that in order to achieve that, the EU needed to act collectively and give a coherent political response so as to come out of the economic and financial crisis stronger than before.[4] The crisis had undone some of the progress achieved over the last decade in the context of the Lisbon Strategy, setting the EU back in terms of a

4 European Commission, op. cit.

number of economic and social indicators and potentially on a lower growth path. Perhaps more importantly, it also exposed persistent structural weaknesses of the European economy. At the same time, pre-existing long-term challenges – globalisation, population ageing and pressure on natural resources – have, if anything, become more pressing.

The European Commission had submitted the Europe 2020 Strategy to the Spring European Council of 2010 and obtained agreement on the global approach and the overall EU objectives in line with the envisaged schedule.[5] At the time, the Council's attention became somewhat diverted from the Europe 2020 Strategy and more focussed on the outbreak of the (Greek) debt crisis, an item not officially on the agenda. With the crisis transforming into a sovereign debt crisis affecting the eurozone in particular, the potential contribution of the Europe 2020 Strategy has to be evaluated beyond its ability to help the EU address and overcome the effects of the 2008 economic and financial crisis. The weaknesses uncovered by the sovereign debt crisis, in particular large differentials in terms of competitiveness, productivity and potential growth of national economies, together with large budget deficits and public and private indebtedness, have put a strain on the euro and even put at stake the survival of the eurozone.

Although the ESM remains for the time being only a "special purpose vehicle", it is expected to evolve into a new EU or at least eurozone institution.[6] It would take responsibility for any rescue package, and it would have to integrate with the SGP or even with a renewed framework of fiscal policy in the eurozone.

From the Lisbon Strategy to Europe 2020: What is New?

Given that the Europe 2020 strategy is as yet at an unfinished stage, it would be early to try to evaluate it. One can, however, compare it in terms of its objectives and underlying social model with the Lisbon Strategy (2000-2010).

The Europe 2020 strategy presents a social market economy model. In comparison with the Lisbon Strategy, the meaning of the European model[7] has been better spelled out, with the already existing social and sustainability concerns now explicitly put at the service of growth as growth-enhancing factors (inclusive and sustainable growth). It is therefore made even clearer that the European model is about modernising social and environmental practices with a view to fostering growth, while adapting to and making the most out of the new economic realities (notably the information society) and thereby addressing the various challenges (globalisation, climate change, ageing population).

The new strategy builds upon the toolbox of the revised Lisbon Strategy of 2005. In 2009 the Commission justified this continuity with its assessment that the Lisbon Strategy, as the EU's reform strategy for the last decade, had helped the EU weather the economic and financial crisis.[8] This assessment extended to the achievements of a coordinated response to the economic and financial crisis (European Economic Recovery Plan).

There are however divergent views on whether the Lisbon Strategy has delivered and on whether it could or should be remedied. The 2009 Swedish presidency had concluded that it was necessary "to further improve competitiveness and increase the EU's sustainable growth potential, refocusing policies towards long-term reforms in an ambitious and revamped new strategy".[9] Tilford and Whyte[10] presented an assessment of member states' progress on the accounts of innovation, liberalisation, entrepreneurship, employment and social inclusion, and sustainable development

5 According to schedule (COM (2010) 2020 final, annex 3), the process in 2010 would then continue with European Commission proposals on the Europe 2020 integrated guidelines, the debate in the European Parliament on the strategy and the integrated guidelines, the definition by the Council of Ministers of the key parameters (EU/national objectives, emblematic initiatives and integrated guidelines). In June the European Council would approve the Europe 2020 strategy, validate the EU and national objectives and adopt the integrated guidelines. Thereafter, the European Commission would present practical guidelines for the subsequent steps of Europe 2020, the Autumn European Council would have an in-depth discussion about a selected topic (for instance research and development and innovation), and the Member States would present their stability and convergence programmes and national reform programmes. In 2011, the European Commission would present its annual report to the Spring European Council, with opinions on the national stability and convergence programmes and proposals for recommendations. The Council of Ministers would analyse the Commission's recommendation proposals in an ECOFIN dedicated to the Stability and Growth Pact. The European Parliament, in a plenary debate, would adopt a resolution. The European Council would evaluate progress and formulate strategic guidelines. The member states, the European Commission and the Council would follow up on the recommendations, implement reforms and elaborate reports. In 2012 there would the same procedure, with particular attention to the follow-up of the process.

6 See for instance D. Gros, T. Mayer: Financial Stability beyond Greece: Making the most out of the European Stabilisation Mechanism, VoxEU.org, 11 May 2010.

7 The meaning and the implications of a "European model" under the Lisbon Strategy are discussed in A. Bongardt, F. Torres: Is the EU Model Viable in a Globalized World?, Ch. 12, in: P. Della Posta, A. Verdun, M. Uvalic (eds.): Globalization, Development and Integration – a European Perspective, Basingstoke 2009, pp. 215-231, Palgrave Macmillan.

8 European Commission: Consultation on the Future "EU 2020" Strategy, COM (2009) 647 final.

9 Council of the European Union, Presidency Conclusions on the Brussels European Council, 10-11 December 2009, http://www.europa-eu-un.org/articles/en/article_9310_en.htm.

10 S. Tilford, P. Whyte: The Lisbon Scorecard X, Brussels 2010, Centre for Economic Reform.

and environment. They concluded that the Lisbon process had prompted some movement in the same direction, but that the EU would not reach any of its objectives from 2000 and that the differences between the best and the worst performing Member States in 2010 had actually increased. The implication is that member states with little progress with respect to the Lisbon objectives were less competitive, with lower innovation and growth potential and lower productivity and employment levels. The large differences in the implementation of goals persist despite the refocus of the Strategy in 2005 on jobs, growth and competitiveness. Wyplosz[11] advocated abolishing the Lisbon Strategy altogether rather than trying to reform and prolong it. This was not because of doubts as to the need for the enhanced coordination of structural reforms but rather its effectiveness, given that the Commission could no longer issue critical reports.

With the Europe 2020 Strategy, however, the Commission is to elaborate, in a synchronised way, reports on member states' progress on augmenting their competitiveness and growth potential with specific recommendations. Specific country reports and recommendations should make member states' non-compliance more visible and make it more difficult for the Council to merely congratulate itself. Still, some member states have (again) expressed reservations on the possibility of warnings to countries that do not comply.

Also, the member states' stability and growth programmes and their national simplified reform programmes are to be evaluated together. This goes towards reinforcing the cohesion of economic policy coordination between the national budgetary policies and growth-relevant policies.

In essence, the Europe 2020 strategy does not entail substantive innovation in terms of instruments. It limits itself to trying to strengthen supervision within the pre-existing framework.

The Europe 2020 Strategy's main innovations with respect to the Lisbon Strategy can be resumed as a stronger recognition of interdependencies between national budgetary policies and national reform programmes (competitiveness and growth potential) and the attempt to increase pressure on bad performers.

Conclusion

The Europe 2020 Strategy is the EU's response to the economic and financial – and, one may add, climate – crisis. The Europe 2020 Strategy is about improving EU competitiveness and achieving sustainable growth. It builds on the revised Lisbon Strategy with some reinforcement of economic policy cooperation but within the same governance framework. Yet the reformed Lisbon Strategy of 2005 did not produce results in terms of undoing the large persisting differences between member states in the implementation of Lisbon goals.[12]

The question is what the added value of the Europe 2020 Strategy is likely to be beyond the Lisbon Strategy.

The economic and financial crisis and the subsequent sovereign debt crisis have exposed some member states' structural weaknesses, that is, low competitiveness of national economies and low growth potentials, and thereby lent urgency to the objectives of the Lisbon Strategy and its successor, the Europe 2020 Strategy (growth, jobs, reestablishing a high potential growth trajectory).

European efforts to counter the sovereign debt crisis have led to urgent coordinated action (e.g. the response by the eurozone to the Greek debt crisis, providing IMF and bilateral credits to Greece, and the subsequent umbrella for other eurozone members that might be in need). In the case of Greece this has meant that financing was made conditional on the implementation of Greek reforms and market liberalisation measures. Reforms and liberalisation have been a precondition for access to rescue package funds by the EU and the IMF in order to counter the causes that led to the situation of insolvency. Progress in terms of reform has been made conditional for freeing more funds in the future for any country in need.

Moreover, a mix of pressure from financial markets (increasing risk premiums) and the eurozone (member states, ECB) has prompted some anticipation of budgetary consolidation in comparison with the stability and growth programmes, with a view to bringing the ballooning deficits and debts back under control after the rescue of national financial systems and/or increased member state spending in the face of the economic and financial crisis. There was therefore increased pressure on potentially insolvent or illiquid member states to cut deficits faster and further than agreed in their stability and growth programmes.

Member states, to different extents, are starting to implement reforms that may address underlying competitiveness problems and the causes of low growth.

11 C. Wyplosz: The failure of the Lisbon Strategy, VoxEU.org, January 2010.

12 See S. Tilford, P. Whyte, op. cit. Some of the member states most exposed to the sovereign debt crisis (Greece, Portugal, Spain and to a lesser extent Italy) feature a low ranking in the Lisbon Scorecard.

However, this tends to be the result of external pressure. As for budgetary consolidation, it remains to be seen to what extent member states will be able to prioritise spending on those areas that are growth enhancing and put the economy on a sustainable path, according to the priorities spelled out in the Europe 2020 Strategy.

The sovereign debt crisis has also highlighted the interdependencies between economic and monetary policy in the eurozone. It exposed important spillovers between economic policy coordination (under the Lisbon Strategy/ Europe 2020 Strategy and the Stability and Growth Pact) and monetary policy (underlying the need for increased flexibility of wages and sustainable public finances). As a matter of fact, the joint impact of the economic and financial crisis and the sovereign debt crisis has made it plain that member states had insufficiently accounted for negative spillovers from the economic part of the union to the monetary side.

The crises have led to a wider recognition that the causes of the negative externalities should be tackled so as to justify the emergency coordination measures adopted to avoid the insolvency or illiquidity of member states. On that account, the Europe 2020 Strategy looks helpful to the extent that it provides instruments to address competitiveness problems (rooted in factors like inflexible labour markets, uncompetitive wage developments, inflated public sectors, unsustainable social systems) and the consequent low growth potential of certain member states.

The conditions under which the EU and the member states have to address competitiveness issues and low potential growth rates have become much more difficult in the sovereign debt crisis, as the need for budgetary reforms, structural reforms and liberalisation coincides in time. However, such external pressure both from the markets and rating agencies and/or from other member states (either because they want to be in a good position to access funds in case of need or because they want to set an example in order to be able to exert stronger EU conditionality) can certainly help implement those reforms. In this respect, the Europe 2020 Strategy could contribute to a better-structured and more coordinated response.

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What's Wrong with EU2020?

The Commission has issued its strategy document "Europe 2020", covering the next ten years, its purpose being to replace the Lisbon Strategy adopted in 2000. The March European Council held an initial discussion and should adopt the document in June. In parallel, the 2020 Strategy is percolating into all EU Commission documents and particularly the 2020 integrated guidelines (SEC (2010) 488/3 on economic policies and COM (2010) 193/3 on employment policies).

Like the Lisbon 2000 document, "Europe 2020" consists of two parts, the first of which (sections 1 to 4) covers matters of content, with the second (section 5) covering the governance aspect.

In this contribution we will begin with a brief presentation of a few key points covered by the new document. A second section will contain a critique focusing on the four main aspects. The third part will return to the question of the crisis, stressing the real issues at stake and the importance of the choices currently being made in relation to the mid-term strategy for 2020. The last section will propose an alternative approach.

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A Brief Overview of the Contents of 2020

The new document is divided into four sections:

- 5 "headline targets"
- 7 "flagship initiatives" focusing on a) innovation, b) education, c) the digital society, d) climate and energy, e) mobility on the one hand and competitiveness on the other, f) jobs and skills, g) the fight against poverty
- a series of other policies dealing essentially with the internal market (part 3 of the document) and the Stability and Growth Pact (part 4)
- and finally the actual governance of the new strategy.

The main changes, in comparison with Lisbon, are the radical reduction in the number of indicators (which previously numbered 42 so-called "structural indicators") and the incorporation of the environmental dimension with the already accepted targets (20-20-20). It should be noted, however, that the Sustainable Development Strategy continues to coexist in parallel with the 2020 Strategy and that the Commission has published a new communication on the possibility of attaining 30% of GHG in 2030.

The European "headline targets" and "flagship initiatives" are something of a window-dressing exercise, consisting of a few indicators in areas in which the European Union actually has few powers and hence only relative added value. These focus on completion of the internal market in the section entitled "Missing links and bottlenecks" and on implementation of the Stability and Growth Pact in the section entitled "Exit from the crisis". The Commission's proposals fail to incorporate the impact of the short term (see our point "exit from crisis") on the medium term. There is not a word, for example, on the European budget and the level at which it should ideally be set. One positive point, by contrast, is the unblocking of the industrial policy debate but this receives no mention in the European Council's conclusions. In terms of governance, the Stability and Growth Pact constitutes the principal reference and its provisions are intended to structure the member states' action in the short term (exit from the crisis) and hence also the medium term. Unlike the initiatives outlined in the earlier sections of the document, this constitutes a return to the "core business" of Community action, namely the internal market and monetary union.

The last part of the EU2020 document deals with governance. The Commission proposal describes the place of the different actors (Commission, Council, Parliament, civil society etc.) in the new process. The challenge is to persuade the actors to accept ownership of the strategy and to combine the European targets and their implementation at national level, in particular by the definition of national targets. Such implementation is divided between a thematic approach, comprising the seven "flagship initiatives" and five "headline targets", and national reports that seem to focus essentially on public finance. The link between the two is to be achieved insofar as "the Europe 2020 and Stability and Growth Pact (SPG) reporting and evaluation will be done simultaneously to bring the means and the aims together, while keeping the instruments and procedures separate and maintaining the integrity of the SGP".[1] In other words, it is a question of a mix between thematic reports and the Stability Pact with a very clear pre-eminence accorded to the latter.

1 European Commission: Commission staff working document. Europe 2020 – public consultation. First overview of responses, SEC (2010) 116 final, p. 25.

Four Major Points of Criticism

In this section, I should like to consider four problematic aspects: lack of evaluation of the preceding strategy; the absence of any real consideration of the environmental and economic crisis; the tensions/contradictions; and the governance.

a) The first aspect is that no fundamental reflection whatsoever has been given to the question of why Lisbon failed.[2] Assessment of the results of Lisbon emanating from the Community level has been essentially political and has varied depending on the moment and the ongoing momentum: positive from 2000 to 2004; negative with the Kok report from 2004 to 2007; then positive, once more, as a result of growth in 2007 and 2008; finally non-existent (or highly critical) with the advent of the crisis. It is significant that the Commission document evaluating Lisbon[3] was issued after initiation of the consultation.

The simple observation, for example, that not a single target has been achieved – and would doubtless not have been achieved in 2010 even without the crisis[4] – obviously raises the question of the underlying rationale and value of the indicators chosen. It is therefore insufficient to repeat yet again that research and development should be 3% (the same target as at Lisbon). There is a need, rather, to ask why corporate R&D efforts have failed to increase over the last ten years and what measures might be appropriate to improve this situation. Public investment is, in actual fact, exactly the same (around one per cent of GDP) in Europe as in the United States or Japan; the difference is attributable to private investment by businesses. This simple fact is recognised by another Commission document "(…) R&D target might be very challenging if one was to take past trends as a guide for future developments".[5]

Similarly, the increase in the employment rate has been exclusively attributable to atypical contracts.[6] Is it appropriate to adopt a new target (75%) without at least discussing the quality of the jobs created? Indeed, job quality is a term that has completely disappeared from the new strategy in contrast with the "more and better jobs" of the Lisbon strategy.

2 ETUI and ETUC: Benchmarking working Europe 2009, Brussels 2009, ETUI; ETUI and ETUC: Benchmarking working Europe 2010, Brussels 2010, ETUI; P. Pochet, J.Y. Boulin, C. Dufour (eds.): Lisbon: a failed strategy or still relevant for the future, in: Transfer, Vol. 15, No. 1, 2009, pp. 21-31.

3 European Commission: Commission staff working document. Lisbon Strategy evaluation document, SEC (2010) 114 final, 2.2.2010.

4 S. Tilford, P. Whyte: The Lisbon scorecard IX. How to emerge from the wreckage, London 2009, Centre for European Reform.

5 European Commission: The need to ensure coherence and consistency in setting national headline targets. Note for the attention of the Lisbon methodology working group (Lime), Brussels 29.04.2010.

6 P. Pochet, J.Y. Boulin, C. Dufour, op. cit.

b) The second criticism relates to the treatment of the economic and financial crisis on the one hand and of the ecological crisis on the other. Even though both crises are accorded recognition in the document, it would appear, on the basis of the proposals made, that few lessons have been learned. To give a single example: is it possible to continue with a "better regulation" agenda, newly baptised "smart regulation", the underlying purpose of which is, as is well known, to limit the regulatory capacity of the public authorities?[7] The least that might have been expected in the wake of the financial crisis would have been some fundamental rethinking of the role of public regulation. Some Commission documents indicate clearly, what is more, that there were defects in the underlying analysis of Lisbon in relation to the role of financial markets.[8]

All in all, though a few pages of the document are devoted to the crisis, the link between the choices for exiting the crisis and the mid-term targets is not made explicit. Indeed, a closer reading reveals contradictions (see below). In this 30-page document less than half a page is devoted to the issues of regulation of the financial sector.

As for inequalities, they are limited to the questions of health and poverty. Yet the various forms of inequality were among the significant contributory causes of the crisis. What is more, in the absence of a reduction of inequalities, the idea of a green economy is hardly credible, for no one is going to change their behaviour if the most affluent sections of the population continue to enjoy material prosperity such that they can disregard with impunity the constraints imposed by the environmental crisis. Similarly, the Commission had initiated work on an alternative wealth indicator and a reference to the Sen-Stiglitz-Fitoussi report was included as a source of inspiration in an earlier version of the document but has disappeared from the final version. What is missing in reality is any genuine projection of the state of the world in 2020. What are the possible scenarios as viewed from the present time and how, on this basis, can a path be traced? In what is the Commission, as the guardian of the general interest, opening up a way to shaping the future? This is all the more surprising in that the Commission earlier conducted an important exercise designed to consider scenarios for Europe 2025.[9]

c) No reflection is given to the tensions or contradictions between the different aims. The new description of growth as "smart" is quite inadequate as an approach to solving a complex debate between, on the one hand, the need for a return to growth to ensure social stability, social cohesion and a reduction in the level of debt and, on the other hand, the need for a change of paradigm which requires a redefinition of growth (as traditionally understood) to avoid an increase in greenhouse gas emissions. A decoupling of growth and emissions has indeed taken place – such that growth no longer implies an increase in emissions – but the aim is to achieve a *reduction*, not just a *stabilisation* of emissions.

To give another example, how can it be possible to specify the aim of reducing the number of persons living in poverty by an exchange of good practices (*sic*) and by creating a platform for such an exchange? Is such an aim seriously viable and compatible with respect to the criteria of the Stability and Growth Pact in the short term and without any changes in the distribution of income and the mechanisms for redistribution? This is also acknowledged in a technical document by DG Ecfin: "As regards the poverty target, its achievability will crucially depend on its definition. In particular, the relative measures of poverty do not generally change over time significantly and a very important policy shift would be needed in some countries to achieve progress on this target".[10]

The challenges and tensions should not be camouflaged by means of "euro-jargon newspeak" but should allow the conduct of a genuine and open debate. As is underlined by the Gonzalez report, "Instead of focusing on a communication policy which sometimes verges on propaganda, it would be preferable to communicate on policies, explaining frankly what is at stake and the different options available".[11]

d) The fourth aspect is that of governance. The idea, as in Lisbon, is to grant a key role to the European Council which is expected to act as the supreme body entrusted with preservation of the general interest. What is concealed in the text, by contrast, is the central role given to the Ministers of Finance at both national and European level. It is they who are to be the real coordinators of the strategy; for the national reports are to be included in the framework of the provisions of the Stability and Growth Pact. This constitutes a backward step to the extent that one aim of Lisbon was, precisely, to redress the role of the EcoFin Council, which

7 L. Vogel, E. Van den Abeele: Better Regulation: a critical assessment, in: Report, No. 113, Brussels 2010, ETUI; E. van den Abeele: L'agenda mieux légiférer de l'Union Européenne, Courrier hebdomadaire du CRISP: 2028-2029, Brussels 2009, Centre de Recherche et d'information Sociopolitiques.

8 European Commission: Commission staff working document. Lisbon Strategy …, op. cit.

9 European Commission: The world in 2025, Rising Asia and socio-ecological transition, EUR 23921, Luxembourg 2009, Office for Official Publications of the European Communities.

10 European Commission: The need to ensure coherence …, op. cit., p. 8.

11 F. González Márquez: Project Europe 2030. Challenges and opportunities. A report to the European Council by the reflection group on the Future of the EU 2030, Brussels 2010, Council of the European Union, p. 39.

had been strengthened by monetary union, so as to place the other sectoral Councils (Social Affairs, Environment etc.) on the same level as EcoFin.

In part as a response to the criticism of a single target for all, the new indicators are to be formulated in national terms. But the differences between member states are – in some cases – tremendous. For example, in post-secondary education, 12 countries have already reached or are close to the level of 40%. Four countries (Czech Republic, Italy, Romania and Slovakia) have, on the contrary, less than 20% and four others (Austria, Hungary, Malta and Portugal) less than 25%.

Ownership of a text or a strategy has to be achieved by means of broad participation and not, as is the case here, by means of texts prepared in secret by the Commission after consultation with, in the main, the member state governments. Another cause of the feeble legitimacy of Lisbon was the periodic political revaluation conducted in the virtual absence of democratic and open debate. Once again the European Parliament is marginalised in the basic initial choices. The role of the social partners is also very limited (see the criticisms made by ETUI/Business-Europe in their joint document, 2010).

However, the choice of medium-term options will also depend on the choices made for the short term.

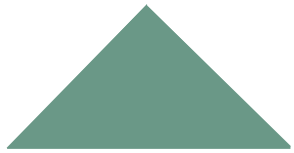
What is Really at Stake: How to Exit the Crisis

A major blind spot in the Commission's proposal relates to the whole question of exit from the crisis, the strategies to be employed to this end, the choices of which, in terms of the budgetary policy choices to be made (deficits, ageing, unemployment, climate etc.; who is going to pay?), will represent a heavy burden throughout the rest of the decade.

Indeed, the crisis is not over yet. Especially thorny is the reduction of deficits at a time when population ageing is beginning to make itself felt: deficits will have to be reduced while increasing expenditure on pensions (and healthcare). In addition, the environmental crisis and climate change call for substantial investment of the order of at least one percentage point of GDP[12] in green infrastructure (transport, intelligent electricity grids, alternative energy etc.) All countries will therefore be faced with a trilemma: reducing the public deficit, investing in going green, and preserving the welfare state and public services (Figure 1). It is unlikely that it will be possible to overcome more than two of these challenges.

12 N. Stern: The economics of climate change: the Stern review, Cambridge 2008, University Press.

Figure 1
The Trilemma Faced Today



It is even more complex due to the need to rethink the model of consumption and production in order to reduce CO2 emissions in line with the 2 degree target (the automotive sector being only the most obvious example).

The Commission clearly indicates the fields to be tackled as a matter of priority: "Fiscal consolidation and long-term financial sustainability will need to go hand in hand with important structural reforms, in particular of pension, health care, social protection and education systems. Public administration should use the situation as an opportunity to enhance efficiency and the quality of service."[13] By contrast "budgetary consolidation programmes should prioritise 'growth-enhancing items' such as education and skills, R&D and innovation and investment in networks".[14] What is at stake here is indeed the conditions of exit from the crisis and the impact on the social institutions and public services including education. For it is all very well to establish targets in terms of education but if the process of exit from the crisis is effected, as is already the case in certain countries, by a reduction of education budgets and particularly post-secondary education (increased privatisation), it seems hardly plausible to achieve the targets regarded as strategic. The same applies to health care where the reference to inequality will carry little weight given the pressures of privatisation. Concealed in the document is the intention of attempting to resolve the trilemma by transferring the costs of education and health to the private sector. Such a step will serve only to increase inequalities, in the absence of compensatory action by the state (in which case there would be no reduction in costs).

It is also interesting to stress that, according to the Commission[15], green taxation should contribute to reduction of the debt and reduction of contributions on labour and not, as one might have expected, to accelerate change by

13 European Commission: Commission staff working document. Europe 2020 …, op. cit., p. 24.
14 Ibid.
15 Ibid.

devoting these new resources to medium and long-term investments (transport networks, intelligent energy grids etc.) The thinking on taxation makes no mention of alternative sources of revenue such as the taxation of financial transactions, dividends, the highest incomes, even though this question has, to varying extents, been tackled in several large European countries including Germany, France and the United Kingdom. On the other hand, the Council conclusions state that the Commission will shortly present a report on possible innovative sources of financing such as a global levy on financial transactions. Meanwhile, a simple idea put forward, namely to exclude green investment from the Stability and Growth Pact, is not taken into account.

Faced with the trilemma, the Commission has clearly chosen the budgetary consolidation corner, with a hint of green but in the absence of any guaranteed financing or ambitious targets.

Totally absent from this document is any deep reflection on how to exit the crisis. Management of the eurozone is mainly regarded as a strengthening of controls and strict application of the Stability and Growth Pact. The Greek case reveals, on the one hand, the institutional shortcomings of the eurozone, a point that has been stressed from its creation by most economists[16], but similar criticism must be levelled at non-cooperative strategy choices, such as that of medium-term pay restraint to foster exports and employment in Germany but which takes place to the detriment of the other countries of the zone. This is now recognised in the new guideline 4, but in an unbalanced approach. It states that pay restraint is needed in the event of current account deficits; in the event of surpluses the sentence is more ambiguous: “remove the structural impediments to private domestic demand”.

What is needed is a completely different perspective. The point of departure must be that of growing inequality and profound environmental challenges (not only climate change).

The social dimension cannot be limited exclusively to the issue of poverty, however important this problem may be, and the solution is much more complex than merely raising educational levels. During these last decades most countries have experienced an increase in wage inequality and labour market fragmentation (most new jobs being fixed-term or part-time). What is more, “pseudo-self-employment” contracts have proliferated, eroding the strength and impact of established labour standards.[17] Although the expressed aim was also to promote a process whereby the new member countries could catch up with the older ones, territorial inequalities have increased with polarisation between capitals and outlying regions. The economic and financial crisis has also impacted particularly strongly upon these countries.[18] It is essential, given these developments, to think in terms of social and territorial cohesion in order to develop a vision of the future. Competition takes place increasingly within national labour markets between workers with differing statuses and different nationalities (posted worker directive, freedom of movement). These trends will be exacerbated by exploding youth unemployment and the risk of a “lost generation” as a result of the crisis. As such, a response in terms of flexicurity is utterly inappropriate. Inequality also has consequences in the area of environmental transition: how to ensure that more environment-friendly consumption becomes affordable? how to convince people of the essential need for change when the richest can continue to waste resources as much as they like?[19]

To tackle this question seriously, it is necessary to return to the role of social rights versus economic rights. The priority accorded to the latter is clearly apparent from judgments issued by the Court of Justice in cases such as Laval, Viking, Ruffert or Luxembourg. The new treaty, containing reference to the fundamental rights included in the charter, is an improvement but it is necessary to take the process even further.[20] A genuine effort to redress the imbalance between the economic and social dimensions is a prerequisite for building a balanced future.[21]

The second aspect is to take seriously the current change of direction towards a low-carbon society. It cannot be a question of “business as usual” with a hint of green and innovation[22], for we are faced with a change of paradigm that requires thinking in depth on the basis of the limits of the current development model (alternatives to GDP growth, environmental justice, changes in social attitudes and

16 D. Gros, N. Thygesen: European Monetary Integration: From the European Monetary System towards Monetary Union, London 1992, Longman.

17 R. Castels: La montée des incertitudes: Travail, protections, statut de l’individu, Paris 2009, Seuil.

18 S. R. Schwenninger: US/Europe: shaping a new model of economic development, in: C. Degryse (ed.): Social development in Europe, ETUI-OSE, 2010; ETUI and ETUC: Benchmarking working Europe 2010, op. cit.

19 H. Kempf: Pour sauver la planète, sortez du capitalisme, Paris 2009, Seuil.

20 I. Schömann: The Lisbon Treaty: a more social Europe at last?, in: ETUI Policy Brief - European Social Policy, Issue 1/2010, Brussels 2010, ETUI.

21 A. Supiot: L’esprit de Philadelphie. La justice sociale face au marché total, Paris 2010, Seuil.

22 On this latter point see P. Aghion, D. Hemous, R. Veugelers: No green growth without innovation, in: Policy Briefs, Brussels 2009, Bruegel.

modes of production etc.) Beyond the climate change debate, the question of energy, and particularly the already apparent or imminent petroleum crisis, indicates that the current model of development is non-sustainable. Major inter-sectoral and intra-sectoral changes will take place with important consequences for employment and national areas of specialisation. This raises questions of transitions within individual sectors and among sectors and also the question of the quality of newly created jobs.

Innovation will indeed be at the centre of the process, giving rise to the issue of patents and intellectual property (transfer prices for less developed countries, see the debate on anti-AIDS drugs). It is therefore a contradiction to seek – as does the document – to strengthen intellectual property rights when the challenge, on the contrary, is to spread innovation as widely as possible.

The changes will also affect modes of consumption (more local and more environment-friendly) and production (regulations to ensure efficient production, ecodesign directive). Other important questions will include relocation (given increasing energy and transport prices and/or consumer preferences) with a debate on levies (carbon compensation) at frontiers. These various elements require a deepening of the definition of a European industrial policy (concerning which the 2020 document – this being one of its positive points – does initiate a debate).

Green development will raise the questions of social justice and redistribution[23] or environmental justice.[24] This will be strengthened by the adoption of new environmental levies intended to alter behaviour[25] and their frequently regressive effects. But beyond behaviour, it is the question of attitudes that is central, in other words, the way in which we perceive problems and formulate the challenges that they pose.[26]

A whole range of policies, accordingly, must be subjected to fundamental discussion and revision. The list includes taxation policies, industrial policies, transport policies, trade policies, employment policies (transition, green jobs).

There is a need for an agenda that focuses on quality jobs, social security, social rights, social dialogue, public services etc., an agenda that has to be debated with the aim of achieving a fair transition through participation of the collective actors in the steps required to achieve this radical change in social model.

23 C. Degryse, P. Pochet: Paradigm shift: social justice as a prerequisite for sustainable development, in: Working paper 2009-2, Brussels 2009, ETUI.

24 E. Laurent: Environmental justice and environmental inequalities: A European perspective, Document de travail, No. 2010-05, Paris 2010, OFCE.

25 E. Laurent, J. Le Cacheux: An ever less carbonated Union? Towards a better European taxation against climate change, Paris 2010, Notre Europe.

26 E. Laurent, op. cit.

Iain Begg

Europe 2020 and Employment

In many of the most fraught periods of the 2008/9 economic crisis, the various EU-level processes for coordinating economic and social policies have seemed to be overwhelmed or irrelevant. The urgency of dealing with the threat of systemic collapse in financial services, of tumbling demand and of rising unemployment saw a series of ad hoc initiatives, with the G20 initially emerging as the forum of choice before losing its visibility. The EU's role was sharply challenged by former Belgian Prime Minster Verhofstadt when he posed the rhetorical question, "Where has Europe been in recent weeks and days? Why the deafening silence from the Berlaymont?"[1] Although the widespread criticism of "Brussels" in the crisis is often unfair, how the exit from crisis is managed and coordinated will provide a stern test of the relevance and potential of EU socio-economic governance.

Clearly, the stakes are high. The crisis has led to a re-assessment of the role of government in economic and social management. Beyond the obvious return of Keynesian demand management, the post-crisis period will be characterised by a more fundamental search for the appropriate role of government and, as the OECD puts it, poses the question, "Should the relationship between government, the private sector, and citizens be redefined?"[2] Much of

1 G. Verhofstadt: The financial crisis: three ways out for Europe, Gütersloh 2008, Bertelsmann Stiftung, p. 9.

2 OECD: Government at a Glance, Paris 2009, p. 33.

the current EU governance machinery is regarded sceptically. Thus, according to its most trenchant critics, the Stability and Growth Pact (SGP) is in tatters; many question whether the Lisbon strategy achieved anything of lasting value, pointing notably to the yawning gap between aspirations and delivery[3]; and even though the coordination of employment policy since 1997 (within the re-launched Lisbon strategy since 2005) receives some praise[4], it is also criticised for having only a limited impact on some of the most intractable labour market problems across the EU, or for being rather tangential to day-to-day policy in certain member states.[5]

More fundamentally, profound reservations have been expressed about the validity of an approach to economic governance that relies so extensively on the "soft law" tools of the open method of coordination. With the Lisbon Treaty finally in force and the need to balance continued nurturing of the recovery with a renewed emphasis on resolving the supply-side shortcomings in so many member states, EU economic governance is, arguably, at a defining moment. This article appraises the Europe 2020 proposals, paying particular attention to their employment dimension and the scope for an approach rooted in flexicurity to be effective.

The Europe 2020 Proposals Appraised

The Commission[6] has set out an ambitious response in its Europe 2020 proposals, comprising seven "flagship initiatives", subsequently endorsed in March 2010 by the European Council. In these proposals, the policy agenda has clearly broadened compared with the Lisbon strategy that is now into its final phase.

The slogan at the core of Europe 2020 – "smart, sustainable and inclusive growth" – encompasses substantially more than the growth and jobs slogan of the Lisbon strategy as recast in 2005, and implies a fusion of three of the overarching coordination strategies currently in place. These are the Lisbon Strategy, the Sustainable Development Strategy and the coordination under the open method of Social Protection and Social Inclusion, as well as the various initiatives concerning energy. It also goes far beyond the four priorities established by Europe's leaders at the 2005 Hampton Court European Council: education and research; unlocking business potential; getting people into work; and efficient, secure and sustainable energy. Moreover, the document proposes a closer linkage between the macroeconomic goals covered by the SGP and the policies to be coordinated under Europe 2020.

Nevertheless, the new strategy appears to be at odds with the message that focus needed to be improved, imparted in 2004 by the Kok Committee.[7] Yet it can also be seen as a valid attempt to clear up the institutional confusion engendered by having overlapping strategies with conflicting timetables and ambiguities around what matters most. In governance terms, the shift to a single reporting cycle should facilitate greater coherence in policymaking, but it is less obvious how the convergence or stability programmes required under the Stability and Growth Pact and the new Europe 2020 programmes will be integrated.

Any coordination process requires a rationale and, for much of the Lisbon/Europe 2020 agenda, it is a mistake to believe that the principal one is to corral member states into a single model backed up by disciplinary mechanisms. Rather, policy learning and innovation is a more compelling rationale. The trouble with this is that it can look amorphous and risks being condemned as rhetoric rather than action. It is therefore a concern that the language in the governance section of the Europe 2020 proposals is predominantly about how surveillance, the taking of ownership, reporting and recommendations can help to keep policies on track, to the neglect of how the exchange of experience, peer review and other lower-key activities can enhance the prospects for mutual learning.

It is important, too, to recall that unity with diversity is not just a rousing political slogan for the EU, but also a stark description of the starting points and perspectives of different member states. There are manifestly different economic, social and employment models in the EU[8], yet many of the challenges that have to be confronted are common to all member states. However, capacities to change, systems of governance and receptiveness to reform differ substantially as a result of how national polities have evolved over many decades.

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3 A recent example is S. Tilford, P. Whyte: The Lisbon Scorecard X. The Road to 2020, London 2010, Centre for European Reform.

4 J. Zeitlin: The open method of coordination and reform of national social and employment policies: influences, mechanisms, effects, in: M. Heidenreich, J. Zeitlin (eds.): Changing European Employment and Welfare Regimes, Abingdon 2009, Routledge.

5 M. Mailand: The uneven impact of the European Employment Strategy on member states' employment policies: a comparative analysis, in: Journal of European Social Policy, Vol. 18, No. 4, 2008, pp. 353-365.

6 European Commission: Europe 2020: A European Strategy for Smart, Sustainable and Inclusive Growth, Communication from the Commission, COM(2010) 2020, Brussels 3.3.2010.

7 European Commission: Facing the Challenge: the Lisbon Strategy for Growth and Employment, Luxembourg 2004, OOPEC, ec.europa.eu/growthandjobs/pdf/kok_report_en.pdf.

8 G. Bosch, J. Rubery, S. Lehndorff: European employment models under pressure to change, in: International Labour Review, Vol. 146, No. 3-4, 2007, provide a valuable overview.

Employment Policy in Europe 2020

Employment policy coordination has been in place since the launch of the Luxembourg process in 1997 and has been influential in re-shaping policy thinking and in pushing governments to implement policy reforms.[9] It has contributed to substantial transformations in the EU labour market, but now faces the more demanding challenges of supporting a convincing and coherent EU strategy for exit from the crisis, while also maintaining the momentum of economic reforms and anticipating emerging influences on the EU economy.

The employment dimension of Europe 2020 is subsumed under "inclusive growth" which emphasises New Skills for New Jobs (NSNJ) as one of its two flagship initiatives and thus draws on the communication and analysis of the same title produced by the Commission.[10] Inclusive growth also embraces the wider social goals of combating poverty, social exclusion, and inequalities in income and access to services. Further refinement of the concept of flexicurity is clearly seen as being necessary to create a convincing approach that can become a model for good socio-economic governance. As set out in the Commission (2010) proposals, the NSNJ flagship initiative embraces a wide range of aims and prospective measures, although the language used leaves much to be fleshed-out and makes it difficult to judge what is likely to emerge in practice.

One of the five targets set for Europe 2020, raising the employment rate of the population aged 20-64 to 75%, is explicitly connected to this initiative. It is open to the criticism that the corresponding target under the Lisbon strategy of a 70% employment rate was missed, so that setting a new, higher target is foolhardy. However, the previous target was for the population aged 16-64, the first age cohort of which comprises a substantial number of persons in secondary or tertiary education, so that the new target is less ambitious than at first sight. Nevertheless, it implies a six point increase in employment, equivalent to around 12 million net new jobs. Given that the early years of Europe 2020 are likely to be vulnerable to the aftermath of the crisis, the latter years will have to see jobs created at a faster rate, despite a backdrop of acute pressures on public finances that will inhibit public sector job growth.

9 I. Begg, C. Erhel, J. Mortensen: Medium term employment challenges, Report to DG Empl., European Commission, Brussels 2010.

10 European Commission: New Skills for New Jobs: Anticipating and matching labour market and skills needs – Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, adopted on 16 December 2008, Luxembourg 2008, OOPEC.

Flexicurity as a Conceptual Basis

Bosch et al. raise the interesting question of whether employment models have cycles and point out that when existing models face a crisis, they can take a long time to resolve – typically much longer than cyclical economic crises – and engender significant distributive conflicts.[11] The resulting reforms may be beneficial, but where some groups face substantial losses, the process of reform is likely to be obstructed. It would be premature to argue that the employment model that has prevailed since the late 1990s is obsolete, but it will have to adapt to the exigencies of climate change, demographic developments and the various influences associated with the term globalisation. This raises the question of whether flexicurity constitutes a sound basis for employment under Europe 2020.

Flexicurity consists of orientations affecting labour market, employment and welfare policies that have evolved from a combination of academic work and innovations attempted by a number of governments in recent years. While it is most often identified with the approaches implemented in Denmark and the Netherlands, especially since the mid-1990s, elements of the approach can be identified in many other countries, and one key component – active labour market policies – dates from the 1930s in Sweden.

The rise of flexicurity coincides with an intellectual debate on the role of welfare systems, with some suggesting that there has been a shift of emphasis from a protective role towards social investment in the functioning of welfare states.[12] The social investment function of social protection has been identified by a number of authors as a novel though increasingly pervasive approach to welfare reform. Indeed, Taylor-Gooby[13] maintains that in its idealised form, the social investment approach to welfare can bring together economic and social objectives in a self-reinforcing manner. However, he also notes that the practice falls short of the rhetoric, implying that rather than social investment, what has happened is "negative activation". He attributes this outcome partly to the weakness of unions and notes that there has been a disjunction between the emphasis on social investment in policy debates and the realities of what has been done within many countries.

11 G. Bosch, J. Rubery, S. Lehndorff, op. cit.

12 See, for example, G. Room: Education and welfare: recalibrating the European debate, in: Policy Studies, Vol. 23, No. 1, 2002, pp. 37-50; J. Hudson, S. Kühner: Towards productive welfare? A comparative analysis of 23 OECD countries, in: Journal of European Social Policy, Vol. 19, No. 1, 2009, pp. 34-46.

13 P. Taylor-Gooby: The new welfare state settlement in Europe, in: European Societies, Vol. 10, No. 1, 2008, pp. 3-24.

From a policy perspective, what is critical is whether the protective and investment roles are in conflict. The glib charge is that, in practice, more flexibility is demanded of workers, but that little security is offered in return, and that although flexicurity was initially advanced at EU level as a more balanced approach than the deregulatory thrust of the OECD (1994) jobs study, still for many the political subtext is that flexicurity is no more than a Trojan horse for neo-liberal policies. For example, Tangian[14] lists some of the ways in which the pursuit of the flexibility component erodes the security elements, and also suggests that the incentives for employers are reinforced by the fact that the state incurs the costs of security while employers benefit from the flexibility. Keune and Jepsen[15] suggest that traditional forms of security (especially of income) have been substituted for different forms of security that are less tangible, such as activation.

Tensions can undoubtedly arise and some will require hard choices, especially in the context of a prolonged recession and limp recovery. However, Bovenberg and Wilthagen assert that "flexibility and security should not be seen as conflicting aspects of labour-market arrangements, but as mutually supportive components of a well-functioning labour market".[16] They reject the notions that flexibility is exclusively in the interests of employers and security is all that concerns workers and that the end product will be a negotiated trade-off between the two. Rather, their approach can be interpreted as being about redefining the contours of the employment and flexicurity models to include income and employment security along with greater flexibility in labour markets, work organisation and industrial relations. Different configurations can achieve similar goals.

Challenges and Dilemmas Confronting Employment Policy

The aftermath of the crisis and longer-term labour market imperatives will have to be reconciled in policy developments bearing on employment over the next decade. The former will have to focus on mitigating many of the known risks of an extended downturn, notably the prospect of hysteresis as a result of a resurgence of long-term unemployment. Yet ensuring that sufficient resources are allocated to prevent adverse labour market outcomes will be difficult against the backdrop of macroeconomic exit strategies that entail budgetary consolidation: active labour market policies are costly.

The EU working-age population is due to peak during the current decade, as early as 2012 according to Eurostat data[17], although increased participation rates (notably of women and "seniors") should mean that the available workforce does not decrease until 2020. Together with the certainty that the ratio of the working-age population to the elderly dependent population will decline from its current level of four to two by 2050, the EU has a medium- to long-term need to bolster the labour supply. This is mentioned in the Europe 2020 proposals, but not elaborated.

Policy Content

While a period of exit from crisis may not seem the most obvious time to fret about increasing labour supply, the long timescales needed to achieve change mean that bold choices will be needed before long. There are essentially three ways of ensuring a higher labour supply: raising the employment rate of the indigenous working population, extending the working life time or increasing the rates of immigration of working-age persons. All have political and social ramifications, yet the main reference in the NSNJ flagship initiative is to "a forward-looking and comprehensive labour migration policy which would respond in a flexible way to the priorities and needs of labour markets". This formulation may have had to be bland for presentational reasons, but it is important to spell out what is at stake.

Among the most sensitive will be how to manage immigration. A narrow view is that the EU should only welcome highly qualified migrants who can fill gaps in very specialised niches. But if these are the only migrants to enter the labour market, the impact on the ratio of working to dependent population will barely be affected and only a sizeable increase in migrants willing to work in more elementary jobs will have much quantitative impact on the ratio. Increasing participation rates is also central to labour supply, implying that the inclusion agenda should be seen not just as being about social justice, but also about labour supply.

The split between new jobs and replacement jobs was projected in 2006 to be roughly 20:80, and 100 million job openings were expected by 2020. Given the effects of the crisis, the latter figure is likely to have fallen, but it is still important to recognise that the inflows into the labour market and outflows from it will be huge. With the working life time typically lasting thirty to forty years, up to a third of the labour force will have been renewed by 2020, and the stock-flow

14 A. Tangian: European flexicurity: concepts, methodology and policies, in: Transfer, Vol. 13, No. 4, 2007, pp. 551-573.

15 M. Keune, M. Jepsen: Not balanced and hardly new: the European Commission's quest for flexicurity, in H. Jørgensen, P. Madsen (eds.): Flexicurity and Beyond, Copenhagen 2007, DJØF Publishing, pp. 189-211.

16 L. Bovenberg, T. Wilthagen: On the Road to Flexicurity, Dutch proposals for a pathway towards better transition security and higher labour market mobility, Tilburg University 2008.

17 Quoted in European Commission: New Skills for New Jobs: Anticipating and matching labour market and skills needs, op. cit.

interactions mean that there will be a marked enhancement of the educational attainment. However, some have argued that the trend in the labour market is towards a hollowing out of the middle-range of skills, notably as a consequence of the inexorable expansion of the share of services in GDP.

The general presumption is that the average skill needs of the jobs of the next decade will increase, but the distribution of skill demands may shift. At the top end of the range, knowledge-related skills will be in high demand, but so too will a large raft of relatively low-skilled jobs in areas such as personal care, security and retailing. Whether this leads to what has been described as an hour-glass shape for the demand for skills – high at the top and bottom ends, but lower in the middle – is a continuing debate, but it does seem likely that labour market policy will have to accommodate a new structure of demand.

The demand for labour cannot be taken for granted, especially in the short term. Job creation will rely partly on a suitable macroeconomic framework, partly on trends in labour costs and partly on the promotion of entrepreneurship. A related issue is how to forestall segmentation of labour demand that exacerbates some of the adverse effects of the downturn on target groups such as youths and older workers. The contribution of education systems is vital, because the evidence is compelling that a better educated workforce has a higher probability of being employed. For Europe 2020, this implies that more attention should be paid to the interactions between policy domains.

Quality of jobs and equality in the labour market were cross-cutting aims of the 2005 Lisbon strategy, but one of the criticisms of national policies in recent years is that both have lost visibility and have been too easily neglected. Job quality has, hitherto, been most directly associated with productivity and, while there is undoubtedly a need to ensure that the competitiveness agenda is supported, it is also important to consider other facets of quality.[18] In particular, the flexibility of working arrangements and associated traps in pension and pay systems for women cannot be overlooked. A longstanding dichotomy has existed between typical and atypical jobs, with the latter seen as inferior and undesirable. Part-time and temporary work have tended to be lumped together as atypical and, by implication, unattractive. What a modernised labour market would do is to find ways of overcoming these barriers such that career choices can reflect more flexible arrangements. In the next decade, transitions within the labour market will become increasingly critical and a key policy question is how to provide the most effective support.

Governance and Implementation

The Europe 2020 proposals outline a beguiling vision of new partnerships, responsibilities and engagements by different actors. However, member states have proved to be very touchy about naming and shaming or any form of league table that would portray them in an unfavourable light. Yet given that it is envisaged that the soft-touch coordination of the Lisbon strategy will remain in Europe 2020, some toughening of the approach could prove worthwhile. Fine words will look empty if they are not complemented by convincing procedures and good incentives for conforming to the commitments set out in reform programmes.

Institutional features and suitable governance mechanisms are never easy to transplant from one setting to another, but where the Europe 2020 approach may have the most to offer is in providing a repository of ideas, methods and tools of implementation. Learning requires investment in capacities[19], whether in developing initiatives, effective implementation or evaluating outcomes. For the EU as a whole, collective learning is important, with refinement of flexicurity, both as a conceptual model for the EU and as a toolkit for reform of social protection and labour market regulation, as an area on which to focus. Although the mutual learning programme as currently conceived in the European Employment Strategy appears to have a valuable impact in facilitating exchanges among officials who attend its meetings, it remains uncertain whether it percolates to front-line departments and has much influence on the wider context of policy development.

Evidence collected by Begg et al.[20] suggests that although member state officials broadly support the mutual learning programme, the impact of the programme could be reinforced by a greater emphasis on the practical side of policy development. Other process reforms should also be countenanced. The country-specific recommendations tend to be rather tame – and certainly rather tamely expressed – and a sense that emerges from the empirical investigation by Begg et al. is that officials often seek to tone down any criticisms, rather than to use the various scrutiny procedures as a means to innovate in policy.

Europe 2020 has to avoid the risk of overloading civil society actors – especially the social partners – and of what the OECD calls "consultation fatigue" in reforms of the governance of policy coordination. Consultations with non-gov-

18 L. Davoine, C. Erhel, M. Guergoat: Monitoring Employment Quality in Europe: European Employment Strategy Indicators and Beyond, in: International Labour Review, September 2008.

19 J. Zeitlin, op. cit.

20 I. Begg, C. Erhel, J. Mortensen, op. cit.

ernmental actors suggest that they have limited capacity to engage in the management of socio-economic policies and that it is not always in their interest to try.[21] Moreover, Gold et al.[22] warn that the expectations placed on social partners can lead to a form of what they call "managerialism" in which social partners (especially) are called on to assist in delivering a policy agenda which they have little opportunity to influence and which may not accord with their priorities. Yet the Commission proposals for Europe 2020 repeatedly refer to the role of social partners.

Ways Forward and Conclusions

Europe 2020 will be a litmus test of the relevance and perspicacity of the EU level in the economic governance of Europe. While it risks being pompous to say so, at stake is the redefinition of European capitalism in the wake of the crisis and of what the European social model can offer. Within the overall strategy, there will be difficult tensions to resolve between social and economic aims, as well as between qualitative progress and quantitative targets. The impact of Europe 2020 on employment and on the labour market will be pivotal, because it is the policy domain that straddles the boundary between the EU as an economic union and its wider social ambitions. Four main issues warrant attention in elaborating the Europe 2020 process.

Despite the widespread moves towards reform of labour markets and the comparative resilience of the labour market in many countries since the onset of recession, there is still unfinished business in consolidating reforms. A template around flexicurity is the likely way forward, but considerable sensitivity is needed in fitting the model to the circumstances of member states. It also needs to be developed to take more account of flexibility from the standpoint of the worker as well as the employer, while also reconciling the redistributive and security-orientated aspects of social protection with the social investment role.

The importance of a strategic approach to labour supply should be stressed, even though short-term considerations might militate against measures that increase the immediate size of the active population, thereby risking higher unemployment rates. The bulk of the jobs of today in every member state are in services that are rarely directly vulnerable to international competition. Many such jobs – the ballast for employment – are in relatively routine personal services, implying that the median job can no longer be understood as that of the male, full-time worker in manufacturing. Similarly, the dichotomy between typical and atypical jobs may not only be harder to maintain, but also increasingly unhelpful as a policy concept, with the implication that a new paradigm for understanding labour demand may be needed to reflect the changes.

In procedures, more forthright country-specific recommendations could prove valuable as they can become an instrument for exerting pressures on governments (through the media, national parliaments or public opinion), notwithstanding the consistent opposition of governments to anything that resembles naming and shaming. More attention than in the past should be paid to feasible pathways for each member state. Possible mechanisms might include using staged targets or benchmarking against comparable member states, however politically sensitive such measures might be.

A last issue is that opportunities for learning are a crucial element of policy coordination. Consequently, a priority for Europe 2020 should be to strengthen mutual learning and other approaches to policy learning so that they reach deeper into national policymaking and engage a wider spectrum of actors.

None of the above will be easily achieved. Perhaps the toughest challenge for Europe 2020 will be to bridge the seemingly inevitable gap between grand visions and aims on the one hand, and the hard grind of implementation on the other.

21 Ibid.

22 M. Gold, P. Cressey, E. Léonard: Whatever happened to social dialogue? From partnership to managerialism in the EU employment agenda, in: European Journal of Industrial Relations, Vol. 13, No. 1, 2007, pp. 7-25.

László Csaba

Green Growth – Mirage or Reality?

Anyone attempting to produce a visionary document in and about the European Union runs the risk of being dismissed by all sides. Some will call him an idealist, others will call it empty talk, still others will miss sectoral or group-specific targets and some will declare that all of the numbers – with the exception of page numbers – are arbitrary, academically unsound and void of any implementation capacity. This has already been the case with the Europe 2020 document published by the Commission in late February 2010[1] and to be finalised by the June Council of the EU. The usual criticisms and counter-criticisms have already been voiced, and anyone reviewing the website euractiv.com can get broad coverage of the endless debate in each of the official EU languages.

This paper attempts to avoid both over- and underestimation of any joint policy document. For one, the Community has always moved ahead in an incrementalist/gradualist manner, relying on a large degree of pragmatism, common sense and compromise. For this reason, the EU has constantly lagged behind in the achievement of its own objectives and ideals. On the other hand, quite unlike many other integrational groupings, the EU has indeed been quite successful in climbing the ladder of various layers of integration. While some of its competitors, like the eastern trade bloc Comecon, have collapsed, and others, like ASEAN, have stagnated after achieving limited trade policy liberalisation, the EU has been singularly successful in deepening its dimensions of integration, from free trade in industrial goods and a bit of joint support for agriculture to a political union. The latter is certainly fragmentary, but the evolution in this direction is undisputable. The Lisbon Treaty, the EMU, the European Court of Justice and an ever larger number of common policies and cooperation forums all reflect the irreversibility of the process of Europeanisation in a variety of areas, from the political to the social, economic and cultural alike. And for any body undergoing change, it is important to have a point of orientation and a set of ideas in order to draft possible trajectories for the future.

On the Use and Misuse of Strategies

Europe 2020 is an immediate follow-up to the Lisbon Agenda, a similarly broad strategy document adopted at the turn of the millennium. Without reiterating the bits and pieces[2], let us recall that the strategy was never meant to be an operational policy document. Both in its original and its revised 2005 versions, the Lisbon Agenda was an attempt to bridge the gap between global competitiveness considerations and broader social and environmental concerns that have been gathering momentum in the European electorate's set of preferences, as reflected in the annual Eurobarometer surveys conducted across the EU. For this reason, it would be hard to subscribe to the frequent claims by policymakers and journalists who consider the Agenda to be a mere talk shop. If for no other reason than practical exigencies, ministries, universities, regulatory agencies and even firms tend to have formal mission statements describing their raison d'être. While the point is well taken that there is no agreement in the EU on a finalité politique, the series of unsuccessful referenda on the Reform Treaty has demonstrated especially well that most of the electorate does not have a clear idea of what the EU is all about, including its institutions, its procedures and the necessity of transferring some sovereignty to its joint bodies.

It is to a large degree reassuring that the Union has come out with a new strategy immediately in the aftermath of a global financial crisis. The crisis has had major repercussions for the global economy[3] and has to a considerable degree modified the modus operandi of European economic policies at both the national and Community levels[4].

Similar to the non-interventionism of the preceding decade, recent EU intervention has not followed any systematic economic logic, whether academic or practical. To a large degree, it has been based on improvisations and panic reactions to the crisis without any preliminary calculation of costs and limits, let alone comprehensive strategies for withdrawal. These improvisations often translate into unintended policy that is neither condoned nor accepted as sustainable.

In such a situation it is necessary, although clearly insufficient, to elaborate what the ECB and others refer to as an exit strategy. In normative terms, this surely covers more than coping with immediate challenges like the Greek debt and should ensure a return to rules-based fiscal policy. Recent evidence from a survey of theories and two centuries of empirical statistics[5] indicates that public debt, especially if it grows exponentially, is not an innocent monetary phenomenon as assumed by much of the mainstream modelling, neo-classical and neo-Keynesian alike. In reality, debt, and by implication deficits, are always a threat. Thus, while allowing for the more flexible interpretation of the deficit criterion, the debt level and especially its medium-run evolution remains a major indicator of the long-run economic health of nations.[6]

It follows from the above considerations that a return to sound public finances in the medium run already is a must. The current financial turmoil indicates once again

1 EU Commission: Europe 2020 – A European Strategy for Smart, Sustainable and Inclusive Growth, 24 February 2010, available on: www.europa.org and www.euractiv.com.

2 M.J. Rodrigues (ed.): Europe, Globalization and the Lisbon Agenda, Cheltenham, UK 2009, Northampton/Md/US, Edward Elgar Publ.Co.

3 J.E. Stiglitz: Freefall: America, Free Markets and the Sinking of the World Economy, New York 2010, W.W.Norton.

4 L. Csaba: Unintended consequences of crisis management, in: Zeitschrift für Staats- und Europawissenschaften, Vol. 7, No. 3-4, 2009, pp. 450-470.

5 C. Reinhart, K. Rogoff: This Time Is Different, Princeton, N.J. 2009, Princeton University Press.

6 O. Blanchard: Rethinking macroeconomic policy, Washington, D.C., IMF Staff Position Note, 03 February 2010, available at: www.imf.org.

that global private markets are unlikely to finance overly large public debts; thus, public authorities need to beware. However, experiences of the 1990s indicate that this is not the whole story. As in that decade, unemployment may be a lasting bedfellow of recovery, even if fiscal policies are sound. Jobless growth, which is a cyclical phenomenon in the USA, can indeed return to much of continental Europe, both old and new. Therefore, the calls for broader policy objectives that go beyond common sense solid economic practices are indeed topical and well established.

By the same token, it is a welcome development that the Europe 2020 strategy strengthens the idea of surveillance over the behaviour of the member states. However, it is important to list some reservations.

- The surveillance issue comes up at a time when decisionmakers are not especially concerned by the long range issues we analyse here, but rather are faced with the panicked reaction of markets to the Greek debt crisis and the default threat.[7] For this reason, their enthusiasm and commitment are less then credible, especially when sunnier days return.

- Non-compliance began neither with Greece nor by the eastward enlargement of the EU. The credibility gap originated with the exemption of France and Germany from the stipulations of the Stability and Growth Pact and has yet to be remedied with procedural and substantive action.

- Reporting, especially on public finance, was thought to have been thoroughly covered by Eurostat and Ecofin reporting and controlling practices. The repeated and recurring mishaps in Greece indicate that the system works much less efficiently in reality than it appears to on paper.

- In the context of the Stability and Growth Pact revision of 2005, a number of suggestions were made to enhance the technocratic nature of surveillance, enhance the credibility and reliability of basic underlying data and cross check forecasts which often serve immediate political purposes. Most of those suggestions, in theoretical and practical terms, are still valid.

However, as demonstrated at the time[8], it was not a lack of cognitive power but rather insufficient political will to resist and limit immediate politicking and interference by governments in the procedures that prevented those propositions from being implemented. Even if we think of simple procedural options such as outsourcing some of the data or decisionmaking to independent bodies such as the European Court of Auditors or even Eurostat, resistance is likely to mount. However, no improvement is realistic without these changes.

Jobs and Growth: Are They Alternatives?

One of the contestable pieces of the Lisbon Agenda was that it put growth ahead of jobs in its original versions. Reflecting the general thinking and social mood of the period, it put the cart before the horse. For this reason, the 2005 revision was a step in the right direction. However, in the contemporary debate, many authors, and not only those in the green camp, consider that growth is no longer an option, or at least should not be a priority. Greening the economy and creating jobs is on the agenda.

At times of soaring unemployment, it goes without saying that growth is the only way to create jobs in a sustainable manner. Recurring attempts by the French and other governments to limit working hours and redistribute jobs proved to be a dead end, since neither the number nor the distribution of jobs are givens that need only to be calculated. In reality, neither of the two can be calculated ex ante, as they evolve through the interplay of a number of factors, including ones usually outside the scope of conventional economic analysis such as societal values, quality of education, health conditions and the quality of the regulatory environment, as well as long-run perspectives of lifestyles by masses of individuals. Perceptional issues seem to rank especially high on this agenda.

For this reason, the goal to enhance the labour market participation rate from 69 to 75 per cent by the end of the decade is ambitious indeed. But as the pension funding shortfall makes clear, this is a must to address the multiple challenges of an ageing society.[9]

There are two basic ways one may approach this goal. First, at the formal level, the Commission has few if any immediate competences over labour markets. Regulation of these and of the educational systems and most of the social transfers also remains firmly in the hand of national authorities. In turn, not only in legal terms but also with regard to the factors forming supply and demand, national arrangements dominate over integrational ones. EU-level discourse on these issues therefore remains at most at the level of declarations of goodwill.

7 EU ministers agree to 750 bn euro package to save currency, BBC World News, 10 May 2010, downloaded the same day.

8 L. Csaba: The New Political Economy of Emerging Europe, 2d, revised and extended edition, Chapter 8, Budapest 2007, Akadémiai Kiadó.

9 K. Botos: Europe under double pressure, in: Public Finance Quarterly, Vol. 53, No.1, pp. 43-55.

In a more complex approach, we take it for granted that the process of Europeanisation is more subtle and interactive than the formalistic-legalistic top-down approaches would have it. The EU has often seen the bottom-up evolution of policies in a number of areas, from energy to the environment. This reflects changes in perceptions and priorities of the electorate, which in turn is a fully legitimate way of elaborating new areas of cooperation. Under this second angle, social Europe implies an ever closer intertwining of markets in general and labour markets in particular. In so doing, it is rather straightforward to expect a fair degree of imitation and spontaneous adaptation, learning by doing and thereby a degree of convergence in the areas which look to be entirely in the hands of national regulators.[10] The rulings of the European Court of Justice as well as the broad pan-European discourse over lifestyles, work-family balance, gender issues and the like inevitably shape policies, first in an indirect and later in a more immediate manner. The more pressing we consider the fiscal burden of welfare arrangements that enjoy a very high approval rate across EU states, the more inevitable it becomes that an ever larger part of our fellow citizens will need to be engaged in the workforce for much longer than was perceived as normal just two decades ago. Also, in terms of social integration and curbing health expenditures, countless analyses have shown that lengthening active lives is the way forward towards humane and sustainable solutions.[11]

Since labour market liberalisation is basically a national task which progressed at a snail's pace in most continental countries, and since the employment losses triggered by the financial crisis may well remain for an extended period, it is certainly not trivial to ponder whether, and to what degree, the propensity of firms to apply labour saving technologies can be countered. Moreover, unlike in the USA, non-traditional forms of employment often emerge in the EU only via the active support of public authorities in the form of tax reliefs, benefits or prescriptions. The thick web of regulations and stagnant domestic markets limit the growth potential of small business, which could be one of the major sources of job creation. The difficulties facing startups are well known, but have hardly been remedied by the changes of the past few years. Thus, the drift between frontrunners like Denmark and laggards such as Spain is likely to endure.

It is perhaps of great importance for us to underscore the fundamental difference between the idea of greening growth and halting growth. While environmentalists tend to call for the latter, the EU 2020 document considers sustainable development more in line with traditional thinking in economics, where the continuous expansion – and equitable distribution – of wealth is axiomatic. The more we believe in the relevance of overcoming world poverty[12], which has been exacerbated by the financial crisis, the less we can put up with any version of zero growth.

Moreover, as the strategy also elaborates in some detail, growth nowadays is no longer dependent on the quantitative expansion of industry and the destruction of the natural environment. On the contrary, reliance on computer-based technologies and finance and the introduction of environmentally friendly services have already developed into major industries in Scandinavia and elsewhere. This demonstrates that it is entirely feasible to expand wealth without expanding energy needs – and potentially even diminishing them. In the new member states, the opportunities to become more energy efficient are particularly considerable, given that a unit of GDP is still produced with an input of about twice as much energy as in the advanced western countries.

Smart Growth Is a Must

The preceding ideas have already foreshadowed the imminent need to change the traditional pattern of production and consumption with its wasteful and environmentally deleterious features. The position of the EU, adopted at the Copenhagen Global Climate Summit in December 2009, has indicated that the Community sees no alternative to avoiding its relegation to global irrelevance than by acting as a pioneer in terms of a new, environmentally sustainable model of economic advancement. With the EU's eastward enlargement, the need for convergence has come back to the main stage of policymaking, but this cannot be allowed to compromise its longstanding commitment to environmental sustainability.

The only way of getting both ends to meet is the implementation of a new type of growth, based on innovation. Contrary to the conventional neoclassical simplifications, this can not and should not be restrained to technological progress. Innovations in the organisation of work, for instance[13], can and often do play an even more important role in bringing about more wealth creation and better consumer satisfaction without requiring major investments and certainly without burdening the biosphere of our globe. Meeting the third headline objective of cutting greenhouse

10 For a comparative analysis, cf. R. Bruno, R. Rovelli: Labor market policies and outcomes in the enlarged EU, in: Journal of Common Market Studies, Vol. 48, No. 3, 2008, pp. 661-685.

11 Cf. the Forum discussion on flexicurity in: Interconomics, No. 2, 2008.

12 P. Collier: The Bottom Billion, Oxford-N.Y. 2007, Oxford University Press.

13 CS. Makó et al.: Working It Out? Budapest 2008, Akadémiai Kiadó.

emissions by 20 per cent is thus both attainable and integral to the entire meaning of the new strategy.

Let us be clear: the volatility of commodity, goods, food and financial markets in the 2007-2010 period has clearly indicated, yet again, the limitation of any growth pattern in Europe based on a sheer replication or a mildly modified second edition of the traditional factor-intensive pattern. With that avenue closed, smart growth, i.e. the path based on organisational innovation, social networks and R&D-intensive specialisation, remains the only game in town.

Let us add: while the Europe 2020 headline goal of spending 3 per cent of GDP on R&D, a replication of the 2000 Barcelona target, is somewhat formal and bureaucratic, it does send the message of the need to do more – and perhaps talk less – when it comes to research and its application. The involvement of businesses, both in terms of funding and applications, has become particularly relevant for countries where this lag is the biggest, namely the new member states and the southern cone of the EU, where the corporate-university linkages are perhaps the weakest.

It is important for us to recall that reliance on the big EU-funded mega-projects in this area always tended to be an exception rather than the rule. Furthermore, the economic efficiency of those projects remains questionable, from the Ariane space project to the limited success of the framework programmes in terms of any conventional indicators of research output analysis, such as patents in the hard sciences or the number of independent citations in the social sciences. This sad outcome provides a caution against viewing the return of the old big push approach as the promise for the future. Instead, reliance on a larger number of nationally funded or regionally organised smaller projects – initiated locally and often by industry – may be the key for the future.

Social Europe – But How?

As we have seen above, growth is a necessary but insufficient condition for generating employment and cohesion, the basic constituents of the social dimension of sustainability. Social sustainability is by no means less relevant than the conventionally discussed financial and environmental sustainability, as the recurring violent racial clashes in a number of West European cities from Paris to Amsterdam have amply demonstrated. Therefore it is legitimate for the new strategy to focus on education and poverty reduction. This is in line with the broader approaches in economic sciences that have gained currency over the past few years, especially in terms of broadening the concept of growth to include development. This is reflected in the move away from GDP-based approaches to the HDI and other nonconventional measurements of well-being.

It is one of the most pertinent insights of these broader approaches that the definition of poverty can not and should not be reduced to a lack of income, as neoclassical approaches tend to have it. Poverty, in line with the classic work by Amartya Sen[14], is rightly seen as a lack of capabilities. In other words, no lasting improvement is feasible if it is based on transfers of various sorts. Tackling the fundamental problem of social exclusion, lack of motivation, and the missing capabilities to learn new and socially relevant capabilities such as computer literacy, command of foreign languages and obtaining the social skills needed for labour market performance is only feasible if education is conceived of in a fundamentally different way. Rather than following ideologically set objectives, the mission of schools should be the provision of the above skills that allow young people to be integrated into a competitive society.

From this perspective, it is a welcome development that the Europe 2020 priority no longer focuses on the best and brightest but on the poorest performers, i.e. those that leave school early. Four out of the seven flagship initiatives focus on the areas listed above. This may help create a pool of qualified persons who aim for and are able to pursue lifelong learning, which is no longer a mere slogan in contemporary society. The target of reducing poverty by 25 per cent is intimately related to the educational goals, as missing skills count as one of the major reasons for a notorious lack of competitiveness.

Let us add: contrary to the frequent calls from industrialists, the economics of education does not support an exclusive focus on the vocational training of teenagers or on science education in the college and university levels. Perhaps the most important skills lacking in the marginal groups are perceptional and social in nature, in terms of cooperation, ability and a willingness to tolerate the value system and the discipline required by large scale organisations.

Critical Assessment

As this brief summary of the major features of the new strategy makes clear, Europe 2020 is to a large degree a continuation of the Lisbon Agenda. The good news is that it avoids the "one size fits all" approach which often plagues the bureaucratic interpretations of EU initiatives. Another positive is that there is no attempt to enhance the centralisation of funds and decisionmaking competences, thus taking due account of "unity in diversity". The continued

14 A. Sen: Development as Freedom: Human Capability and Global Need, New York 1999, Alfred Knopf.

reliance on national funding may be sobering for the new member states, but it is a reflection of the realities of the post-crisis period. Finally, it is equally good that we find no equivalent of the 127 detailed targets of the original Lisbon Agenda, since the new objectives are functional, over-arching and socially relevant.

Among the weak points of the strategy, it would be hard to overlook that environmental concerns continue to be relegated to a mere sectoral rather than a formative component. This is a problem insofar as this is the field where the EU should aspire to become a global leader, as appreciated by American authors as well.[15] Second, many of the quantitative targets look quite arbitrary, following political convenience rather than any academic standard. This holds true for emission reductions as well as for R&D spending targets and the objectives to limit the number of students leaving school early. In reality, even if 40 per cent of students graduate with a diploma, this is on its own no entry card to improved job market performance. As we have seen, employability may in some cases require students to leave regular schools even earlier – for vocational training or work – that later may be complemented by on the job and formal training. Likewise, the quality of college and university output leaves much to be desired, since several skills – including entrepreneurial ones – that would directly increase students' employability do not figure into the current curricula. Overall, the social appreciation of work as a major activity is still low in many countries, and lavish transfer schemes contribute to this misperception.

15 D.R. Kelemen: Globalizing EU environmental policy, in: Journal of European Public Policy, Vol. 17, No. 3, 2010, pp. 335-349.

As with the Lisbon Agenda, the Europe 2020 strategy is weakest on the side of implementation. While we welcome the refrainment from the bureaucratic, centralised command methods that still dominate in the CAP and much of cohesion spending, declaring objectives without even hinting at means of attaining them is usually considered to be bad business practice, if for no other reason than because goals and means form a unity, which in an ideal scenario work in a mutually supportive manner via a series of trials, errors, and mutual adjustments. Leaving all means in national hands is of course in line with the tenor of the day, but in the longer run, this may well backfire.

As noted at the outset, a mission statement like Europe 2020 should not be confused with an operational policy document. It is vitally important to have an idea of where the Community is heading and a compendium of the frequently invoked European values in concrete terms. But leaving out all implementation measures is dangerous even if visions return and crisis management is finally replaced by strategic action for global growth. This is the only way for the EU to avoid being relegated to a second-rank global player as soon as the current turbulent decade.

Karel Lannoo

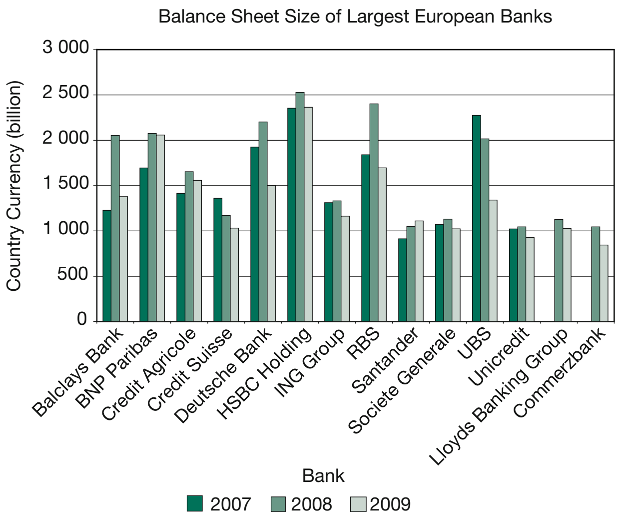
Agenda 2020 and the Financial Crisis

Meeting the Agenda 2020 objectives of smart, sustainable and inclusive growth is even more of a challenge for the financial sector than it is already for the EU as a whole. Smart, sustainable and inclusive growth is just the opposite of what the financial sector stands for and how it continues to be perceived by the public today. The huge regulatory agenda which is on the table should tame the financial sector, but whether it is smart, sustainable and inclusive is an open question.

The Financial Services Action Programme (FSAP) was one of the core pieces of the Lisbon Agenda. Drafted initially in 1999 to secure the full benefits of the single currency, it was merged into the Lisbon Agenda in June 2000 "to foster growth and employment by better allocation of capital and reducing its cost". The benefits of the single financial market were later quantified in several studies to amount to at least 1% of GDP annually. As a result, the Commission proposed to track progress in EU financial integration and to measure financial sector efficiency and set benchmarks. But it also warned that further financial integration may alter the risk profile of the financial system and thus require upgraded financial stability monitoring.[1]

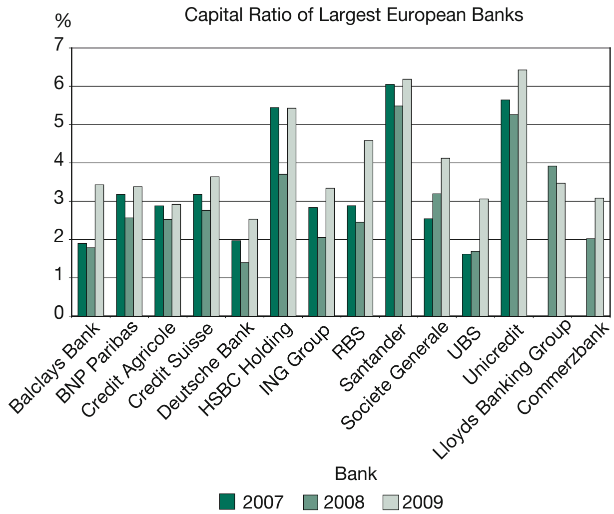
1 European Commission: Tracking EU financial integration, Working Paper, May 2003.

Figure 1
Deleveraging in Europe's 1 Trillion Banks



Note: We kept the balance sheet data in local currency to arrive at a correct comparison of the magnitude of the decline, as the exchange rate movements were substantial. In this case, it is euro, sterling and the Swiss franc. End of year exchange rates £ to the € are 0.73335 (2007) 0.9525 (2008) 0.8881 (2009); CHF 1.6547, 1.485, 1.4836.

Figure 2
Capital Strengthening in Europe's 1 Trillion Banks



Sources: Banks' balance sheets.

As a result of the financial crisis, we are now moving in the opposite direction. Not only is financial integration receding on several indicators, but a vast regulatory plan is being put together where safety and stability take precedence, ultimately over efficiency and profitability. In addition, the combined effect of these measures, developed at global, European and national levels, may create new barriers to market integration.

The objective of this article is to provide an analysis of the impact of the financial crisis from the Agenda 2020 perspective, and to draw certain conclusions. The article starts with an overview of the effect of the financial crisis. It then reviews the key regulatory reform proposals and looks at their impact on bank lending and profitability.

A Financial System under Pressure

Compared to the period of unrestrained credit growth before the crisis, the post-crisis period is marked by cracks and pain all over. The keyword of these times is "deleveraging", or the reduction of the degree of indebtedness in the financial system. Already in early 2008, after the first cracks in the system appeared with the collapse of the securitisation markets, it was expected that the financial system would have to reduce leverage. Back then, however, it was not expected that the process would be so painful and affect the "real" economy to such a degree.

Comparing deleveraging in our sample of 14 "1 trillion" EU banks, it can be noted that banks' balance sheets were reduced by about 3.5 trillion, or 16% from 2008 to 2009 (see Figure 1). This includes occasional drastic deleveraging in banks that were forced to reduce their balance sheets by the authorities, such as Commerzbank, ING, Lloyds, RBS and UBS. Others did it voluntarily, such as Barclays and Deutsche Bank. At the same time, the core capital ratios started to increase, but only modestly, from an average of 2.5% in 2008 to 3.5% in 2009.

For Lloyds and Commerzbank, comparable 2007 data were unavailable, as both banks went through mergers in 2008, in the Commerzbank case with Dresdner, and in the Lloyds case with HBOS.

Seen over a longer period, the deleveraging of these large banks is possibly only the beginning. Size growth and consolidation is a process that has been ongoing at the global level since the early 1990s. The total assets of the global top 25 banks are now six times higher than in 1990. In 1990, none of the largest banks had a balance sheet larger than its home country GDP. In 2008, seven of these top 25 banks had assets greater than the home GDP – all European, by no coincidence. In the US, the largest bank reached 15% of GDP.[2]

At EU level, the process of scale enlargement was stimulated under the single market programme, which wanted to strengthen the global competitiveness of the EU's financial firms. The EU intervened actively to promote cross-border mergers and acquisitions of financial groups (see for example ABN-Amro, Santander, Unicredit), but without having a solid framework in place for the integrated supervision of such groups or for burden-sharing in case of failure. The former is remedied in what is on the table, but the latter has not yet been addressed.

What Is Cooking?

A vast regulatory programme is in the making at global, European and national levels to draw lessons from the financial crisis. At the global level, the G-20 is in the lead, in cooperation with the Financial Stability Board (FSB) and the International Monetary Fund (IMF). Its conclusions set general "de minimis" rules, although so far, the G-20 has gone into considerable detail, and the implementation of its recommendations is advancing smoothly.

The EU is following the G-20 process closely and at the same time improving the regulatory framework for cross-border supervision of EU groups. By early 2011, the new supervisory authorities should be in place, which will participate in the supervisory colleges of pan-European groups and have the authority to delegate supervision and mediate amongst national authorities. On the regulatory side, the harmonisation initiatives can be subdivided into:

- Prudential: Basel III (or CRD III and CRD IV), resolution fund, common rules for central counterparties (CCPs) and central securities depositories (CSDs);
- Product: hedge and other alternative non-regulated funds, rules for standardisation of and central clearing of OTC derivatives;
- Conduct: credit rating agencies, bank remuneration, reinforced rules against market abuse and short selling.

The core measures of the package are the new prudential rules for banks. One part, covering higher capital requirements for trading books, the remuneration in banks and rules on securitisation (the 5% retention), has almost been adopted, but the most substantial part is still in the making: the rules on minimum capital ratios, buffers, dynamic provisioning and liquidity ratios.

So far, only one new post-crisis measure has been effectively adopted in the EU: the credit rating agencies regulation (although the debate about their role seems to be far from over). Meanwhile, most others are awaiting adoption by the European Parliament and EU Council.

Also at the national level, initiatives are being implemented to adapt the institutional and regulatory frameworks. In several EU member states, the institutional framework for supervision is changing, with more powers for the central bank in general and a curtailing of the financial supervisory authorities. Some member states have also unilaterally adopted new laws which may impact the free provision of financial services (such as rules on liquidity regulation and living wills in the UK).

Other measures are still in the pipeline. Over the last few months, the momentum behind a transaction or bank balance sheet tax has grown. Initially proposed by Gordon Brown in November 2009, it gained significant weight in January 2010 with the Obama proposal of a Financial Crisis Responsibility Fee. It is now commonly expected that there will be a form of bank activity tax to constrain the activities of the banks and reinforce financial stability. The proceeds of such a tax could go into national resolution funds. A second measure, still pending, concerns the structure of banking. The "Volcker rule", which forbids banks from engaging in proprietary trading and having interests in hedge and private equity funds, was adopted in the US Senate Bill on 20 May 2010.[3] Although the EU has so far indicated that it will not adopt anything similar, the new UK coalition agreement states that it will examine a possible separation of investment from commercial banking.

Which New Brave New World for Banking?

The combined effect of global, EU and national rules means that regulation will stem even more from the centre in banks' business models than has been the case so far. It will lead to much lower profitability for global universal banks and will represent a strong incentive to

2 JP Morgan: Global Banks – Too Big to Fail. Big can also be beautiful, February 2010, pp. 5-7.

3 The "Volcker rule" is reminiscent of the 1933 US Glass-Steagal Act, but it does not propose a formal separation of investment and commercial banking,

re-consider the universal model in favour of a segmentation of the financial system in niches to benefit from the lower capital charges for specialist players and reduce complexity. This will be accelerated by the possible introduction of a bank tax.

JP Morgan has calculated that the capital needs of global banks would be an additional 19% of tangible equity as a result of the new measures. The profitability of global banks would decline from 13.3% in 2007 to 5.4% in 2011 due to the different proposals now on the table. At these levels, it would be difficult to attract private capital; hence, the pricing of financial products would have to increase substantially, by about 33%.[4] Rating agents also see a huge need for additional capital in the banking sector. As governments progressively retrieve the guarantees and support schemes, downgrades will follow, leading to additional capital and refinancing needs peaking in 2012.[5]

The question is whether it remains interesting to be a global universal bank under these circumstances. According to the JP Morgan report cited above, scale continues to offer an advantage of serving a larger and more complex client base. Economies of scale emerge from spreading fixed costs over a larger revenue base and lower funding costs. The difference is that in the Basel II framework, capital needs were declining with size or barely existing at all for SPVs and OTC derivatives trading, for example. Now the opposite will be true. The new Basel framework adopts tougher standards for Systemically Important Financial Institutions, requiring them to internalise the risks they create for the public at large. It sets higher capital requirements for trading book activities, counterparty credit risk, complex securitisations and re-securitisations, and OTC derivative activities. Normal capital requirement will be allowed for centrally cleared derivatives, but this will require banks to participate in the capital of these CCPs. Before, these banks could propose their own risk models for these activities. As authorities will be extremely wary of having too-big-to-fail banks under their supervision, certainly within the EU as long as fiscal policy remains local, enforcement will be guaranteed.

In addition, the new bank tax that is in the making will tax a certain part of a bank's liabilities, less the capital, or tax the sum of profits and remuneration in the financial sector. Such a tax would tend to reduce the size of the financial sector, as it would tax above level profits and remuneration.[6] This will again hit the larger banks hardest. Moreover, in the EU this tax will be raised at the local level to fund a national resolution fund, which will disadvantage cross-border banks that have expanded through acquisitions (as most have in the EU).

Segmenting a financial group according to its business lines may, from a regulatory capital and supervisory perspective, become a more advantageous model. At its core, a financial group would be focused on commercial and consumer lending but split all of its specialised activities into separate entities. Asset management would fall under the UCITS directive and be subject to a much lower capital charge[7]; money transmission (and short-term credit) would fall under the Payment Services directive; and investment services would fall under MiFID and be subject to the trading book capital requirements. OTC derivatives could be executed through a hedge fund, and non-banking activities would not be subject to the bank tax. Such segmentation would also be in line with the demand for living wills or the "contingency plan".

In fact, the segmentation process has already begun. Bank insurance is out. The ING Group, the prime example of bank insurance in the EU, will sell its insurance activities and return to basic banking.[8] As large banks discover the burden of the new Basel III package, they will start to consider other options.

In this sense, the new regulatory framework could contribute to meeting the Agenda 2020 objective of smart and sustainable growth, but as an indirect rather than a direct effect of regulation. The tendency on all sides to penalise size and complexity in the financial system will lead large banks to downsize and examine smarter structures. It will most likely significantly reduce the profitability of the financial system, as scale effects will be reduced. This process may also contribute to increasing the sustainability of the system, as the too-big-too-fail syndrome will decline, and groups, or parts thereof, will be allowed to fail. But it should be remembered that this goal will not have been achieved as a result of careful policy planning, but because of an extremely costly financial crisis. It is also the antithesis of the Lisbon Agenda goal.

4 JP Morgan, op. cit.

5 Fitch: The Outlook for European Bank Lending in 2010, Special Report, February 2010.

6 IMF: A fair and substantial contribution by the financial sector, Interim report for the G-20.

7 See Karel Lannoo: Challenges to the EU Asset Management Industry, ECMI Policy Brief No. 16, April 2010, for a comparison of capital requirements in the asset management industry.

8 ING 2009 Annual Report.

Luc Soete

Towards a Sustainable Knowledge-based Economy in Europe: from the Costs of "Non-Europe" to the Costs of Europe?

The financial crisis has hit Europe particularly hard. According to the Europe 2020 strategy[1], it has wiped out many years of progress, both social and economic. In addition, the euro crisis has brought to the forefront the fragility of the growth and stability pact as a credible basis for the monetary union of eurozone countries. With the mounting pressures for fiscal austerity and structural reform across the board and affecting all EU countries, the recovery growth forecast for the coming years remains precarious.[2] While the first decade of the 21st Century – the decade of the Lisbon strategy – appears in retrospect to be a lost decade for Europe, the second one looks like the decade of the decline of Europe; Europe no longer appearing capable of generating additional new wealth with growth forecasts now dropping below population growth rates; no longer capable of maintaining past achievements such as a more or less universal welfare system (or the creation of a common currency?); and confronted with a rapidly growing older part of population likely to be confronted with declining purchasing power and wealth.

The hypothesis we would put forward here is that the current European financial crisis is illustrative of the failure to integrate across Europe the core production factors behind economic growth: in brief, of having addressed in an effective manner the so-called costs of "non-Europe".

- With the Single Market, and broadly in line with the origins of the Economic Commission for Coal and Steel, the basis of European integration was the common economic aim of reducing barriers to trade and in particular of gaining access to energy (coal) and capital, considered certainly in the 1950s and 1960s as strategic production factors. At the same time, consumers benefited from cheaper prices and from enlarged product choices. The large Single Market became the economic foundation for the European Union, laying the basis for reaping the economic scale advantages of the growing size of the EU. At the same time, the various enlargement waves provided the EU with more or less continuous, new opportunities for catching-up growth, increasing its overall growth and productivity performance.

- With respect to labour mobility, migration played a much less significant role. In some countries, such as the UK, immigrants from new member states provided a major impulse to economic growth in the 1990s, but the effect faded away as the catching-up growth of new members states started to run into critical labour shortages resulting from their own even more rapidly ageing population trend.

- The factor, and admittedly the most important input factor, behind economic growth where the least progress was made at the level of European integration was knowledge in its different forms. National policies with respect to R&D, patents and licensing, attracting foreign direct investment, telecoms, Internet and more broadly the use of ICT, all remained first and foremost governed by national member states' policies and concerns. In R&D, EU policies became focused on the 5% or so funding the EC was entitled to distribute through its various research network policies (FPs, etc.) At the same time the execution of the structural, so-called cohesion funds which the EC could grant to backward and peripheral regions in the Union became the sole prerogative of national and/or regional governments. The Commission's role was limited to control and accounting. The result has been that contrary to the Lisbon growth strategy, technology, ICT, innovation and more broadly knowledge did not ultimately play any role at the European level in enhancing European growth. National policies, national and regional prerogatives by and large remained dominant.

As in other cases, a crisis brings diagnostic clarity. It often highlights already well-known and well studied existing weaknesses. In this case, the crisis raises some fundamental issues with respect to the future of Europe's long-term knowledge-based growth strategy. In its immediate impact, the crisis has resulted in reductions in the private funding of research and in the near future it is likely also to be reflected in reductions in the national public funding of R&D, particularly in those countries most directly confronted with major fiscal cuts. The long-term result will be a further widening of the gap in productivity growth levels between rich and poor member states, exacerbating the fiscal pressures within the eurozone member states.

1 European Commission: Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth, Brussels 3.3.2010, EC, COM(2010)2020. Available at: http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf.

2 See http://ec.europa.eu/economy_finance/eu/forecasts/2010_spring_forecast_en.htm.

From this perspective the current financial crisis points to the need to re-address the Lisbon strategy in a much more radical fashion than the Europe 2020 strategy is currently proposing. The Europe 2020 Strategy highlights three mutually reinforcing internal EU priorities: the development of a pattern of so-called *smart growth* to develop an economy based on knowledge and innovation, a focus on *sustainable growth* to promote a resource-efficient and greener economy, and a Lisbon repeat of the desire to achieve *inclusive growth* fostering high employment and social cohesion. In line with the old Lisbon strategy all three priorities are primarily inward-looking, based on the old national industrial policy approach characteristic of European integration.[3]

It was this industrial policy which focused on what was perceived after the second world war as Western and Eastern Europe's central problem compared with the USA or the Soviet Union, namely that of scale: scale in production as in the case of the European Community on Steel and Coal Mining or in agricultural production as in the case of the proposals to come to a Community Agricultural Policy. Later on, with the Delors initiative on the Single Market, it shifted to concerns about scale in trade integration and harmonisation amongst the member countries of the enlarged EU. As in the USA and, particularly, Japan the focus of industrial policy shifted away from rust-belt sectors towards sunrise industries such as the semiconductors industry. It led to the formal acknowledgement of the strategic importance of European R&D collaboration, networking and alliances. It is also within this context that the notion of a European Research Area took form early this century at a time when the argument about scale as the basis of European integration had already become gradually eroded: international knowledge diffusion and world-wide mobility of researchers had become the norm in many scientific fields. Also at the industrial level, as in the case of the semi-conductor industry, the sector which had been at the centre of many of the European research framework programmes, the growing competition from Asian countries such as China with even bigger scale advantages than the USA, challenged the European integration focus on scale. The semiconductors scale advantage, which had been greatly enhanced by GSM mobile phone demand, effectively the killer applications for the semiconductor producing firms in Europe, was gradually challenged. Similarly, in the case of services, Europe appeared confronted with major difficulties in reaping scale gains of harmonisation and integration. The final consensus agreement on a revised and limited services directive was only achieved in 2006, its implementation only finalised at the end of December 2009. Actually in service sectors most strongly characterised by the increasing network advantages associated with the delivery of services, reaping European scale advantages appeared difficult if not impossible in the context of 27 member countries with differences not just in regulatory regimes, but also in languages, cultures, tastes and habits.

As in research, these challenges questioned the geographical nature of European economic integration. Suddenly, Europe appeared to have become much more borderless, its growth and dynamics becoming more dependent on external forces and growth opportunities than on unrealised internal scale dynamic advantages.

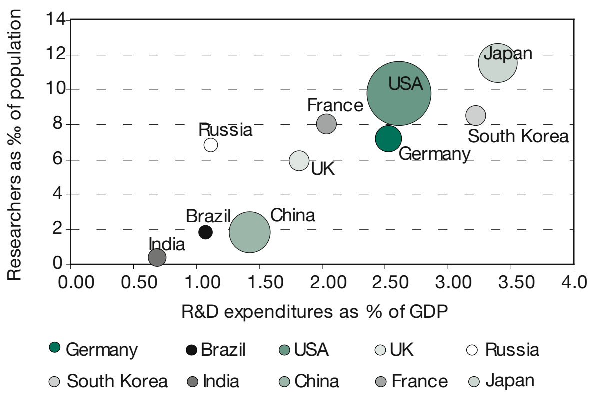
In the remaining part of this paper we focus on some of those challenges for the new Europe 2020 strategy. Clearly a future vision of Europe can no longer be confined just to reaping scale advantages in new areas. While the scale logic still offers some opportunities for reaping efficiency gains at the European level from further integration, there are increasing trade-offs with respect to loss in diversity – in language, in culture but also in macro-economic adjustment and local growth dynamics. The costs of non-Europe have become increasingly less identifiable; by contrast with the financial crisis the costs of Europe have suddenly become highly visible. The Europe 2020 undoubtedly addresses the right issue – achieving over this decade a process of smart, sustainable and inclusive growth in Europe – but it appears to provide poor insights into how such a process could possibly be achieved over the next ten years.

Globalisation, the Financial Crisis and the Funding of Knowledge Investments

Achieving smart growth depends crucially on a better use of knowledge whatever its origin and whatever its form: new product and process technologies developed in Europe as well as the systematic re-use and new combinations of knowledge developed elsewhere, across both public and private sectors, in manufacturing, agriculture and services, and across borders. Smart growth will have to take fully into account the rapidly globalising nature of knowledge accumulation and knowledge diffusion. Globalisation includes the entry of new players in new countries into knowledge production as well as an increase in the circulation of knowledge and the mobility of skilled people at the international level among existing and new players. In this sense globalisation refers to an increasing multiplicity of global linkages and interconnections between companies, research organisations, universities and countries, which today make up the globalised R&D system.

3 For a critical assessment see L. Soete: The European Research Area as industrial policy tool, in: H. Delanghe, U. Muldur, L. Soete (eds.): European Science and Technology Policy. Towards Integration or Fragmentation?, Cheltenham 2009, Edward Elgar, pp. 312-327.

Figure 1
R&D Expenditures (in absolute and relative terms)



At the same time, and despite such global linkages, there is evidence of the persistence of an uneven spatial distribution of research and innovative activities, where research investments appear to remain concentrated in a relatively small number of locations. The globalisation of R&D has undoubtedly led to a reduction in the concentration of R&D and innovative capabilities *amongst countries* at the world level, with new players such as China and India entering the global research world. However, at the same time the trend towards the physical and spatial agglomeration of research activities within countries has been further accentuated, even in new areas such as green technologies. Figure 1 illustrates the geographical concentration of R&D expenditures in the largest countries in the world.

These globalisation and agglomeration trends represent a major challenge for public policies, exacerbating some of the classical tensions and trade-offs that policymakers have traditionally been able to manage. The following list summarises the major characteristics:

- Research and innovation policies are still developed within a national context, and in the case of the EU, a European context, while knowledge and investment flows are driven by firms' and individuals' motives which increasingly take place at a global level.

- In so far as Lisbon was rooted in the idea that the EU's productivity problems were of an internal structural nature[4], this European competitiveness vision is being challenged by the way in which new pervasive technologies such as Information and Communication Technologies have broken down the distinctions between high and low tech sectors.[5] The new challenge is how to deal with the increasing fragmentation of value chains and the increasing heterogeneity of required knowledge inputs. This requires stronger cooperation in R&D with third countries and a stronger focus on the deployment of ICT based technologies.

- Within Europe the drive towards excellence in research has benefited from Europe's regional cultural diversity and autonomy. At the same time, though, the drive towards excellence demands that no consideration is given to maintaining such diversity in terms e.g. of the country or region of origin of the researcher. For countries and regions that are in need of qualified human capital for their own catching-up effort and which are in no position to match the working conditions and real income levels of richer countries or regions, this might represent a major problem.

- The financial and economic crisis is likely to further exacerbate some of the structural problems the globalisation and spatial agglomeration of research raise with respect to Europe. Compared with other regions in the world, the remaining fragmentation of European national markets, e.g. in high-tech services, is likely to increase the uncertainty of the expected rate of return to R&D investments in Europe, and represents today an impediment to the increase of private investment in R&D in Europe.

Because of these growing tensions, it is important that European research and innovation policies fully take on board the implications of globalisation and spatial agglomeration, and develop institutional solutions addressing some of those tensions. I would strongly subscribe to a recent Expert Group's Report[6] that a renewed commitment to knowledge investments from all EU member states in the years to come is required today. Contrary to the Europe 2020 strategy which still focuses on the old Barcelona 3% R&D target, such a commitment should address not just basic or business R&D but all components of knowledge investments including higher education and lifelong learning, and the deployment of ICT-based innovations and applications in services.[7] While public com-

4 In short: the EU was lagging behind in R&D because of the failure to strongly develop high-tech sectors and knowledge-intensive services.

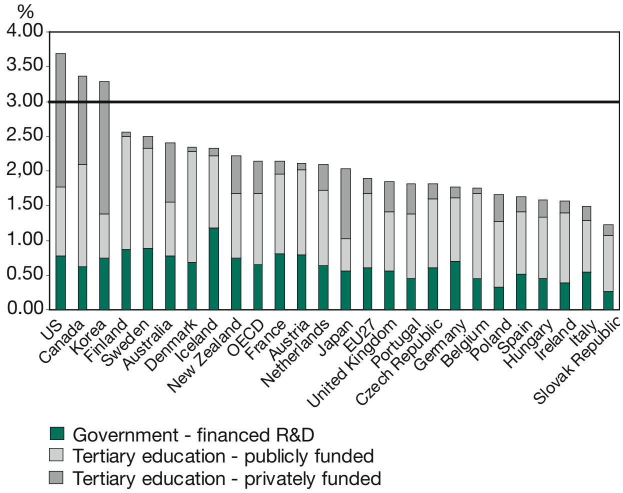
5 See D. Snower, A. Brown, C. Merkel: Globalization and the Welfare State: A Review of Hans Werner Sinn's "Can Germany be Saved?", in: Journal of Economic Literature, Vol. 47, No. 1, 2009, pp. 136-158.

6 See http://ec.europa.eu/research/era/pdf/community_research_policy_role.pdf.

7 While US and European firms are more or less similar in R&D intensity "within sectors", they are not similar in the service sector. In services European firms appear particularly R&D adverse.

Figure 2

Higher Education and Public Knowledge Investments as a % of GDP



mitment and financial efforts can indeed be translated into clear targets, such as the 2010 Barcelona 1% public R&D funding target or the 2% higher education target[8], business investment should, rather, be considered as the result of such efforts: ultimately the reflection of the success of a persistent public effort that makes the country or region attractive (and visible) to private knowledge investment. The proposed new 3% investment target has two clear policy advantages over the previous Barcelona 3% target.

First, it focuses directly on that for which governments and policymakers are directly responsible. The proposed new 3% knowledge investment target is directly under the control of governments, whether in terms of funding or setting funding rules such as in the case of tuition fees with respect to higher education. It is a target for which governments and policymakers in member states can hence be held both responsible and accountable. Secondly, and as illustrated in Figure 2, none of the EU member states is near, or likely to come near, this target in the years to come.

In political terms the new target thus offers credibility. All countries are being challenged to either find their own public resources to increase such knowledge investments, or alternatively to call upon private resources to invest in individuals' future human capital. By leaving the latter to the individual choices of member states, the target also provides sufficient political freedom to member states to decide how they intend to try to achieve the target by 2020.

8 In the latter case based on public or private contributions.

Sustainable Growth – Influencing the Direction of Technological Change

As the Europe 2020 Strategy acknowledges, there is little doubt that measures that enhance the effectiveness of both public and private research investments and technology transfers in a wide array of "green technologies", also facilitating knowledge-sharing, adaptation and diffusion of innovations, are urgently needed. In line with the arguments about the need for a new, credible 3% knowledge investment target, publicly funded R&D is necessary to share the risks of developing new technologies: this would provide the private sector with the opportunity to build on these technologies through less risky, applied R&D. One tends to forget that exploratory research is particularly uncertain; an early start with a diversified research portfolio from which the more promising lines can subsequently be selected for further development is particularly welcome. At the same time R&D diversification is essential so as to ensure that other potential technology options are either in the pipeline, or can be quickly scaled up if so required. To make such a broad R&D portfolio strategy work, a European policy commitment in a wide array of "green technologies" is needed. As David et al. put it, "This also implies a critical rethinking of ways to mitigate the inhibiting effects upon R&D of excessive protection of intellectual property rights. Targeted domains for research exemptions, liability approaches to IPR infringement and competition policy adjustments to permit efficient pooling of patent, copyright and database rights, all come under this heading."[9]

The scope and scale of the sustainability challenge demand the rapid mobilisation of considerable human and financial resources across many fields in order to confront them and resolve the problems they pose to mankind. There is no doubt that science and technology, research and innovation, can contribute greatly not only to the mitigation of existing problems but also to their prevention in the future. Tools and techniques needed to mitigate their impacts and to underpin the subsequent development and widespread deployment and diffusion of the innovative technologies and approaches needed to prevent their reoccurrence will have to be developed.

The urgency and importance of these issues is the strongest argument for investing in the research needed to confront the sustainability growth challenge. However, there are others that complement the primary argument and make the case for greater investment in research and

9 P. David, C. Huang, L. Soete, A. van Zon: Toward a Global Science and Technology Policy Agenda for Sustainable Development, United Nations University Policy Brief, No. 4, 2009.

innovation irresistible. The first of these concerns the size of the latent demand for innovative goods and services. If this demand can be successfully stimulated, the potential returns on investment in research – both commercial and societal – are likely to be huge as the resolution of the sustainability challenge could well provide a new dynamic for innovation and become a new motor for economic growth and prosperity in a classic win-win situation. A green economy without innovation is not feasible. But a green economy with innovation will require a major private sector commitment to creating more efficient green technology options. Yet private sector investment is unlikely to be forthcoming as long as there is no commitment to setting an effective price on greenhouse gas (GHG) emissions – by setting tight caps that will not be quietly loosened by the issuance of additional emissions permits to alleviate industrial "distress". The danger, dramatically accentuated by the current private and public debt crises, is one of an "inadequate-effort level equilibrium trap" as exemplified by the case of carbon-capture technologies. Because current costs of carbon-capture pilot operations are too high to make it believable that firms facing CO2 emissions limits would adopt these methods, many countries with coal deposits resist tight caps on CO2 emissions – in the absence of affordable carbon capture they would lose access to that source of energy, and profits, respectively. But since they will not agree on effective caps, the necessary investment in R&D (required to create the expectation that those caps would turn out to be tolerable) simply is not forthcoming.

Quite strikingly, China has recently embarked on a course that points the way out of this dismal scenario. By adding major stimulus funds to ongoing programmes of focused investments in a range of GHG emissions-reducing technologies – from nuclear power plants to wind-turbines and low-cost carbon-capture and sequestration techniques – China is opening a path which will eventually permit greater exploitation of its abundant coal resources without further degrading its own environment. More striking still is the recent report of the International Energy Agency that these efforts have yielded such rapid advances that China could be in the forefront of the world's green technology movement by 2020, providing methods that would permit carbon capture at commercially affordable costs in other similarly endowed regions, including the USA.

In a certain sense the international financial crisis and the looming crisis of climate change have brought to the forefront an understanding that the realistic solution to a truly global sustainable development strategy is not simply to provide the world's investors with global financial access. Having access to the fruits of expanded public and private investments in science and technology at the global level is no less, and probably more, critical in the long run. What makes the "climate crisis" a unique green growth opportunity, if a perilous one, is that citizens in Europe, the USA or Japan are crucially dependent for their sustainable future on the speed of (green) knowledge diffusion throughout the rest of the world as well as in their own countries. In short, a Europe 2020 sustainable growth strategy would better be called a global world 2020 strategy.

Safeguarding Social Cohesion

It was noted above that globalisation is having a clear impact on the way (especially private) R&D occurs and where it occurs. It was highlighted that there is a geographic pattern of concentration of R&D. Within the EU, a challenge along the same lines is that posed by the increasing gap between those countries involved in research and innovation at the knowledge frontier and the laggards that are some way behind. Despite social cohesion policies, this gap is increasing, and has been spurred by the financial crisis.

The influential Barca report[10] saw innovation as one of the core priorities within a "place-based approach" to EU cohesion: selecting in each region a limited number of sectors in which innovation could most readily occur and a knowledge base built up. The Report argued that policy effectiveness would be achieved "when cohesion policy has been implemented as a coherent part of a national development strategy".[11] At the same time, the report recognised the limits of an endogenous only approach to development: massive injections of EU funds in regional knowledge economies are not nearly enough by themselves; on the contrary they might well have been detrimental. Instead, Barca pleaded for a combined exogenous and endogenous push: the main purpose of cohesion policy is not in redistribution but in triggering institutional change and breaking inefficiencies and social exclusion traps through the provision of public goods and services.[12] This triggering of institutional change can come only through "an exogenous public intervention (which) can improve things by upsetting the existing balance. But for this intervention to be effective, it needs to be accompanied by increased local involvement."[13] The importance of local involvement points to a second major problem in cohesion policies: the lack of knowledge

10 F. Barca: An Agenda for a Reformed Cohesion Policy: A place-based approach to meeting European Union challenges and expectations, Independent Report prepared at the request of Danuta Hübner, Commissioner for Regional Policy. Brussels 2009, DG Regio.

11 Ibid, p. 106.

12 Ibid.

13 Ibid, p. 40.

specialisation at national and regional level. The argument goes as follows: if all countries and regions in Europe fight to reach the frontier of science and innovation, the majority will miss the goal. To reach the frontier there are extremely severe conditions in terms of scale, scope and critical mass. As an example, only four US universities account for 15% of the overall career mobility of the worldwide top 1000 scientists in computer science.

For countries, regions and institutions that cannot play this game, it would be better to search for a suitable specialisation in the global competitive landscape. It is most likely that this specialisation will take place along applications, exploiting business segments, niches or markets that require the adaptation of general technologies to specific user needs, so-called "smart specialisation".[14] This framework suggests strategies that can be pursued with advantage both by regions that are at the scientific and technological frontier and by those that are less advanced. While the *leader regions* invest in the invention of a general purpose technology (GPT) or the combination of different GPTs (e.g. bioinformatics), *follower regions* are often better advised to invest in the "co-invention of applications", i.e. the development of the application of a GPT in one or several important domains of the regional economy. Some examples would be biotechnology applied to the exploitation of maritime resources; nanotechnology applied to the quality control of the wine, fishing, cheese and olive oil industries; information technology applied to the management of knowledge about, and the maintenance of, archaeological and historical patrimonies. By so doing, the follower regions and the firms within them become part of a realistic and practicable competitive environment – defining an arena of competition in which the players are more symmetrically endowed, and a viable market niche can be created that will not be quickly exposed to the entry of larger external competitors. The human capacities and resources formed by the region, thanks in particular to its higher education, professional training and research programmes, will constitute "co-specialised assets" – in other words the regions and their assets have mutual needs and attraction for one other, which accordingly reduces the risk of seeing these resources go elsewhere.

Smart specialisation should not be associated with a strategy of specialisation by, say, Greece, for instance in tourism. What smart specialisation suggests is specialisation in the co-invention of ICT applications in the tourism sector.

14 D. Foray, B. van Ark: Smart specialisation in a truly integrated research area is the key to attracting more R&D to Europe, Knowledge Economists Policy Brief, No. 1, Brussels 2007, Expert Group "Knowledge for Growth"; D. Foray, P. David, B. Hall: Smart Specialisation – The Concept, Knowledge Economists Policy Brief, No. 9, Brussels 2009, Expert Group "Knowledge for Growth".

Smart specialisation deals with R&D and innovation specialisation. The current financial crisis, certainly in the eurozone countries, brings to the forefront the question of "how to specialise or what specialisation to go for" in regions/countries that are not leading in any science and technology fields. These regions/countries have to increase the intensity of knowledge investments and intangible capital in the form of higher education and vocational training, public and private R&D, and other innovation activities assets. The question is whether there is anything better to do than investing a little in biotechnology, in information technology, in nanotechnology. Is there a better strategy than being subcritical and inefficient in allocating resources to fields in which one will always be laggard? How should one position oneself in the knowledge economy?

For a eurozone Europe, with its multitude of still highly fragmented layers of governance and sub-critical institutions, it is actually essential that the ongoing process of knowledge accumulation leads to regional smart specialisation, a process which avoids the problems of "locational tournament" competition amongst regions in developing many similar knowledge peaks. The basis of such regional peaks should be sufficiently large and locally "deeply" integrated.[15] There is a great deal of differentiation amongst the EU countries in terms of R&D specialisation profiles; typically countries tend to be more specialised in terms of technology than in terms of science. The most striking pattern is often the lack of parallelism between the public and private sectors as far as the structure of the respective knowledge bases are concerned. There is a need for mechanisms creating new networks opportunities – private-public partnerships and programmes that bring together the better performing segments of the public sector in an attempt to relax and unblock binding constraints on regional growth. The focus will be on missing connections which, once established, are likely to have synergistic and increasing effects.

This new perspective recognises that growth constraints are never general and generic, but are most often locally specific: in Barca's words, "... design of integrated interventions must be tailored to places, since it largely depends on the knowledge and preferences of people living in it".[16] If binding constraints are local and require a specific approach, the policy must focus on local knowledge. The policy process becomes a learning activity in itself.[17]

15 R. Veugelers, M. Mrak: The Knowledge Economy and Catching-up Member States of the European Union, Knowledge for Growth Report No. 5, 2009.

16 F. Barca, op. cit. p. 6.

17 S. Radosevic: Strategic Policies for Growth in Post-Socialism: Theory and Evidence based on Baltic States, in: Economic Systems, Vol. 21, No. 2, 1997, p. 192.

Such policy goals are in any case better implemented if the principle of conditionality is adopted on a large scale. By conditionality is meant introducing a policy framework that makes financial support from the European Union conditional on a number of achievements on the part of those receiving the resources.[18] The basic idea is that, in order to build on learning about local conditions for growth, it is essential that actors share the risk of policies. Research and innovation policies are by nature subject to uncertainty and risk. By doing this, a policymaker provides strong incentives to those actors that have the best available knowledge on how to reach results, while discouraging opportunism and rent-seeking. In this way the burden of risk is placed on the shoulders of those that have the best local knowledge, combined with the best global or "engineering" knowledge on implementation of policies.

In more practical terms, I would propose making the provision of structural funds conditional upon the development of local, smart and open specialisation strategies. An interesting notion here might be to grant EC structural funds as a form of regional Risk-Sharing Financial Facility (RSFF) in collaboration with the EIB. Since 2007, the EIB, with the support of DG Research (FPs), has been running a debt-financed financing instrument to support private and public investment in research, development and demonstration as well as innovation across Europe. The RSFF is managed by the EIB (standard rules, regulations, and procedures), and aims at adding value in areas where the financial market cannot provide the required funding while the EIB can leverage private funds. The amount of support is significant: the contribution of EIB and EC is 2 billion euro, providing loan finance and/or guarantees in the order of 10 billion euro to eligible RDI investments for the period 2007-2013. The RSFF provides an interesting innovative approach to public-private partnerships in risk-sharing within the present private and public debt crisis situation: it creates positive feedbacks in markets at a difficult time for companies; it combines budgetary European FP7 resources with loan resources creating at the same time a new revolving funding basis for research and innovation.

The notion of RSFF can be expanded in different directions: e.g. the RSFF is currently being expanded into risky climate change projects: carbon capture storage and innovation renewal technology projects. In this case the EIB will be combining grant funding from the monetisation of CO2 allowances (some 300 million of the new entrants' reserve will be sold for cash on secondary markets) with its own loan provision system under RSFF. One might consider a similar scheme in relation to structural funds, increasing the leverage on local public and private funding. Furthermore, the EIB expertise in selecting projects is likely to add a crucial additional feature to the economic impact of structural funds.

By linking European structural grant funds with an EIB debt-loan facility, a specific economic prioritisation – the capacity for generating an income revenue stream in the long term – would be added to the submitted projects for structural funds, bringing to the forefront in a more explicit way the growth and competitiveness potential of such cohesion support. There is now a limited window of opportunity of only three years to address the competitiveness gaps across EU countries and regions within a eurozone confronted with large public deficits. Addressing those competitiveness gaps will need to recognise the under-exploited opportunities for smart, local knowledge specialisation as opposed to just aiming for the Barcelona targets.

Conclusions

There is little doubt that a strong concentration of knowledge creation activities in a small number of regions in the world is likely to remain. The EU should undoubtedly attempt to remain part of that region, with China and possibly some of the other BRIC countries likely to overtake it in the coming decade.

Yet today, and given the increasingly global nature of the financial, environmental and demographic problems with which Europe is currently confronted, a unilateral focus on the strengthening of knowledge and innovation activities carried out within Europe with the aim of improving European competitiveness increasingly reflects an out-dated "Eurocentric" approach to knowledge creation. It does not do justice to the broader global impact which knowledge accumulation activities, wherever they are carried out, are having on European citizens' welfare. In a growing number of research fields, European welfare will be directly influenced in the long term not so much by the development of local knowledge and its international commercial exploitation and intellectual appropriation, as by global access to this knowledge, the development of joint global standards and the rapid worldwide diffusion of such new technologies to other, non-EU countries.

18 The idea of conditionality traces its origin to the idea of performance requirements as exemplified in development economics through the analysis amongst others of Korea's industrial policy by Chang and by the World Bank in its East Asian Miracle study. At the European level it has been taken on board by the Barca Report on the basis of a contribution by Bonaccorsi. See H.J. Chang: The Political Economy of Industrial Policy in Korea, in: Cambridge Journal of Economics, Vol. 17, No. 2, 1993, pp. 131-157; World Bank: The East Asian Miracle: Economic Growth and Public Policy, Oxford 1993, Oxford University Press; F. Barca, op. cit.; A. Bonaccorsi: Towards Better Use of Conditionality in Policies for Research and Innovation under Structural Funds: The Intelligent Policy Challenge, Report Working Paper, 2009, available at http://ec.europa.eu/regional_policy/policy/.../3_bonnacorsi_final-formatted.pdf.

Christian Egenhofer

A Closer Look at EU Climate Change Leadership

"Promoting a more resource efficient, greener and more competitive economy" under the heading of sustainable growth is one of the three European Commission priorities on the road to European transformation in the Europe 2020 Strategy. This was predictable, given Europe's record in domestic and international climate change policy and its self-declared leadership on climate change. The underpinning strategy, however, lacks any serious ambition. It also misses the opportunity to bring the EU climate change policy back on track after the failure of Copenhagen and the effects of the economic crisis.

EU Leadership

One can make a reasonable case that the EU has been the driving force behind other, notably developed countries' domestic climate policy formulation. In some cases, EU policy innovation has been able to pull, or has at least been helpful in pulling along, other – often reluctant – developed countries, including the USA. A few examples illustrate this. The most obvious one is the EU Emissions Trading System (ETS). While the concept and practice of emissions trading stems largely from the USA, it was the EU that implemented the first large-scale carbon trading scheme. Both the mistakes and successes of the ETS have provided valuable input for the development of similar programmes in other parts of the OECD. The EU ETS has at the same time remained the principal pillar for the global carbon market, including credits from the Clean Development Mechanism (CDM). The EU also adopted unilateral absolute reduction commitments in 2007, which ultimately triggered a series of so-called national "mid-term" targets. It developed a methodology for sharing the efforts between rich and poor EU member states, proving that effort-sharing is possible in practice, even among countries that are at very different stages of their economic development.[1] In 1996, the EU had already adopted the (political) objective of limiting warming to 2°C on average – until very recently a highly contentious issue.

1 Comparable to the international situation, GDP per capita differences (in PPP) between EU member states are significant. In 2008 differences ranged from 41% to more than 270% of the EU-27 per capita average of roughly €25,000 (the richest member state, Luxembourg, is however an outlier with a per capita GDP of €69,300, which is more than twice as high as the second richest member state). Source: Eurostat: Gross domestic product at market prices - [tec00001]; Purchasing Power Standard per inhabitant, Eurostat online database (retrieved from http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tec00001 on 17 May 2010).

It was the EU that was the first to accept the need for major international financial transfers, pushing as it did for an agreement on a headline figure and burden-sharing. The agenda of Copenhagen was to a significant extent of the EU's making.

The contrast of this past leadership with the lack of real ambition in the Europe 2020 Strategy could not be starker. The climate change related headline target of Europe 2020 – discussed and approved by the March 2010 European Council – merely requires that the "20/20/20 climate/energy targets should be met" although it adds in parentheses the vague possibility of "an increase to 30% of emissions reduction if the conditions are right".

Legally speaking, the headline target that the "20/20/20 climate/energy targets should be met" merely repeats a legal obligation by member states which they undertook by adopting the amendments to the EU Emissions Trading and the Renewables Directives in 2009. One would expect that in a mature legal system such as the EU, laws will be implemented. Where is the target then? Only the energy efficiency commitment, a 20% reduction of primary energy consumption by 2020 compared to projections to date, remains non-binding and merely a political commitment, which legally speaking cannot be enforced by the European Commission. Why not make the energy efficiency target legally binding?

Implications of the Economic Crisis

While the absence of a real target may be seen as a formality, far more important is the absence of any material ambition regarding EU and global climate change objectives. Sticking to the pre-crisis 20% target ignores the impact of the economic crisis, which "ensures" that the required reductions will largely be achieved by the accumulated output losses as a result of the crisis. Some go so far as to argue that a 30% post-crisis reduction target would be less costly than the pre-crisis 20% commitment.[2] Based on International Energy Agency (IEA) energy-related emissions projections from 2008 and 2009, the International Institute for Applied Systems Analysis (IIASA)

2 See M. Amann, J. Cofala, P. Rafaj, F. Wagner: The Impact of the Economic Crisis on GHG Mitigation Potentials and Costs in Annex I Countries, GAINS report, International Institute for Applied Systems Analysis, Laxenburg, November 2009.

estimated in 2009 that, as a result of the economic crisis, total GHG emissions by industrialised countries including the EU would fall 6% by 2020. This compares to a projected 2% increase before the economic crisis. Considering that the EU-27 had registered a total reduction of 10.7% compared to 1990 in the pre-crisis year of 2008, the effect of the economic crisis could mean that the EU's 20% target has nearly been achieved already.[3]

According to the IEA World Energy Outlook 2009, the economic crisis has reduced GHG in OECD countries by 3%. Thus the EU-15, bound by a collective reduction commitment of 8%, improved its reductions from roughly 6% in 2008 to around 9% today (compared to the 1990 benchmark), thereby surpassing its Kyoto Protocol commitment. For the EU-27, the IEA concluded that the business as usual development of the EU's emissions, i.e. under the current 20% reduction pathway, would see them fall to 16% below 1990 levels by 2020. The European Environment Agency (EEA) greenhouse gas emissions figures for 2009 reveal a reduction by 14% compared to 1990. Taking into account the potential of CDM and JI credits, the ETS sector, for example, would meet its emissions cap for 2020 without additional reduction policies.[4]

When measured against 2007 levels, the EU's current pledge of 20% also compares poorly with the pledges of other industrialised countries. The 20% pledge is inferior to the US or Canadian pledges in terms of the effort required, while a 30% reduction pledge would still be weaker than the upper-end pledges of Australia and Japan.[5] Translated into CO_2 intensity improvements, the EU's target of reducing emissions[6] by about 13% over the period 2005-2020 – taking into account the reduction prior to 2005[7] – translates into an implied reduction of CO_2 intensity of roughly 2.4% per annum (or a 30.7% decrease over the whole period).[8] For comparison, the pledge submitted by the US in the context of the Copenhagen Accord (emissions reduction "in the range of" 17% in 2020 from 2005 levels[9]) would amount to a CO_2 intensity reduction of about 3.2% per annum on average (or a 38.3% decrease for the period)[10]. As a result, the US effort (going forward from 2005) is more ambitious than that of the EU – at least in the sense that the improvement in intensity terms would be about 0.8 percentage points higher, compensating for the slightly steeper improvement by the EU since 1990. Figure 1 sheds some light on EU CO_2 intensity trends in comparison.

True, using 2005 or a later base year does not take into account the EU's previous efforts and obfuscates progress compared to 1990, the Kyoto Protocol base year and global yardstick, yet it is a very useful indicator of the level of effort required.

This has become even more important after the failure of Copenhagen. Since then, one of the main (if not the most) important drivers of climate change policy has become domestic progress toward a low-carbon economy, which is also one of the essential narratives in the Europe 2020 strategy and the 26 May European Commission climate change communication.[11] The European Commission itself makes the case that the economic crisis has made a 30% reduction target more affordable. According to this analysis, the additional total costs for the EU to step up from 20% to 30% are estimated to be around €33 billion in 2020, or 0.2% of GDP, although with slightly different figures.[12]

3 See M. Amann et al., op. cit.

4 See IEA : World Energy Outlook 2009. OECD/IEA, Paris 2009, pp. 182 ff.

5 See T. Spencer, K. Tangen, A. Korppoo: The EU and the Global Climate Regime: Getting back into the game, The Finnish Institute of International Affairs, Briefing Paper No. 55, February 2010; Michel Den Elzen, M.A. Mendoza Beltran, J. van Vliet, S.J.A. Bakker, T. Bole: Pledges and Actions, The Netherlands Environmental Assessment Agency, Report No. 500102 032 2009, 2009.

6 We assume a constant portion of CO_2 emissions in total absolute GHG emissions. In this case, the percentage changes presented in this section are valid for both total GHG emissions (absolute targets are announced in this metric) and for the CO_2 emissions (intensity targets have been announced in terms of CO_2).

7 The target of -20% from 1990 levels corresponds to -13.1% from 2005 levels (own calculations) due to the 7.9% reduction based on 2009 data from the European Environment Agency EEA achieved by the EU by 2005; see: European Environment Agency: Annual European Community greenhouse gas inventory 1990–2007 and inventory report 2009: Submission to the UNFCCC Secretariat, EEA Technical Report No 4/2009, Copenhagen 2009.

8 This is the result of combining the drop in emissions (-0.9% p.a.) with a potential GDP growth rate of around 1.5% per annum on average. Note that per annum averages are compound annual growth rates. GDP growth rates are author's estimates based on the data and projections by the IMF through 2014; see International Monetary Fund: World Economic Outlook Database, October 2009.

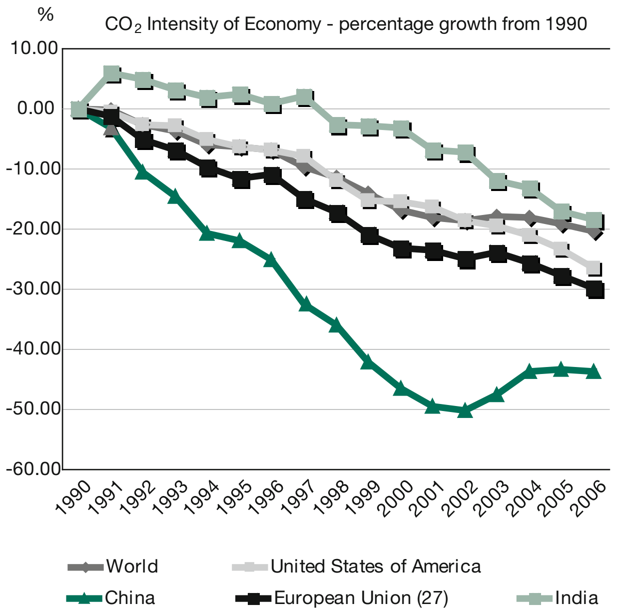
9 The US letter to the UNFCCC Secretariat can be found on the UNFCCC website (see "Appendix I - Quantified economy-wide emissions targets for 2020" at http://unfccc.int).

10 This is because the potential GDP growth rate of the USA is estimated to be about 0.5% higher than that of the EU, i.e. at 2% per annum on average. Higher US growth rates would of course have to result in higher reductions of US CO_2 intensity if the USA is to attain its target. If both the EU and the USA were to attain their targets, the outcome would probably be quite comparable (in terms of intensity changes), using 1990 as the base year, because over that longer 30-year period, the difference in the change in emission levels (-20% for the EU versus only -3% for the USA) would be offset by higher US growth. For comparison, see the corresponding World Resources Institute estimate of US (-37%) and EU (-30%) efforts in terms of GHG intensity improvement (including LULUCF) from a 2005 base year under slow growth, see: K. Levin, R. Bradley: Comparability of Annex I Emission Reduction Pledges, WRI Working Paper, World Resources Institute, Washington, February 2010.

11 European Commission: Analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage, Communication from the Commission COM(2010) 265/3 (Unofficial version).

12 European Commission, op cit.

Figure 1
CO_2 Intensity Trends in Selected Economies
1990-2006



Source: Daniel Gros, Christian Egenhofer: Taxing Carbon at the Border? Centre for European Policy Studies (CEPS), Brussels 2010, based on data from Climate Analysis Indicators Tool (CAIT) Version 7.0., World Resources Institute, Washington, DC 2010.

The implication of the lack of ambition goes beyond the EU's domestic decarbonisation strategy.

The EU's minimum target is likely to lay above the trajectory implied by a linear reduction from current levels towards a long-term 2050 target of reducing "emissions by 80-95% by 2050 compared to 1990 levels", the EU's politically accepted objective. An EU reduction target of 20% would not seem to allow the world to reach its envisaged objective under reasonable assumptions[13]. This has been indirectly acknowledged by the European Commission in the Staff Working Paper accompanying the 26 May Communication which states that "internal reductions by 2020 at a higher level than the reference case (which achieves the -20% target internally) is more in line with a 2°C compatible scenario".[14]

A low level of ambition in the EU is unlikely to facilitate an ambitious international agreement consistent with long-term objectives and economic efficiency. The European Commission's own analysis in 2009[15] noted that a 30% reduction target combined with a carbon market for the group of developed countries would cut global mitigation costs by about a quarter. Sticking to a 20% target would forego these potential benefits.

Finally, a lack of ambition is in gross contradiction to the EU's rhetoric on how to generate financing for mitigation and adaptation to climate change in developing countries. The EU envisages the majority of these financial flows coming though the carbon market. Under a 20% reduction pathway and with the possibility to import credits through the Kyoto Protocol flexible mechanisms, the resulting EU carbon price is likely to be too low to generate a significant portion of the $100 billion p.a. post-2012 that has been agreed to in Copenhagen.[16] To date the effects of the economic crisis are not yet fully reflected in the ETS allowance price, which currently stands somewhere between €12 and €15. This is still surprisingly high, given that all industries are long, but reflects the fact that most industries prefer to bank allowances rather than selling them. This means, however, that the EU allowance price is unlikely to increase much even if the economy picks up again.

Hostage to International Negotiations

In the past, stringent emissions and renewable targets have been justified by a mixture of domestic and international benefits. Typically they have included security of energy supply benefits (i.e. lower import dependency on Russia), less local pollution and the associated health benefits, technological leadership, the creation of green jobs as well as global climate leadership, thereby strengthening the EU externally. Over the years, the EU has made itself hostage to international negotiations by making the "successful" outcome of Copenhagen conditional to deepening EU climate change policy.

Returning to the Europe 2020 Strategy, a successful low-carbon strategy cannot depend on international nego-

13 See, for example, M. Ward, M. Grubb: Comparability of Effort by Annex 1 Parties: An Overview of Issues, London 2009, Climate Strategies.

14 Commission Staff Working Document, accompanying the European Commission Communication: Analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage, Communication from the Commission, SEC(2010) 650/2; Background information and analysis Part II (Unofficial version), p. 40.

15 European Commission: Stepping up international climate finance: A European blueprint for the Copenhagen deal, Communication from the Commission COM(2009) 475/3.

16 The 26 May 2010 European Communication estimates the ETS price of €16 in 2020 (European Commission, op. cit., footnote 2 on p. 48). Assuming an average annual emissions cap of around 1.8 billion tonnes of CO_2 for the years 2013 until 2020 and that around 60% of total allowances would be auctioned (i.e. all allowances in the power sector), member states would auction 1.1 billion allowances. At a price of €16 per tonne, this would amount to €17.6 billion per annum. Note that member states have "politically" at best committed to use half of these revenues for global transfers.

tiations, which seem to go in endless cycles at a snail's pace. Instead, this requires predictable long-term objectives and policies, including significant long-term innovation support. This seems to have been understood by the European Commission and heads of governments when agreeing on the climate and energy package, including the 20-20 targets. The EU's 20-20 targets have also been intended as a means to ensure that – in the absence of a global agreement – there is some kind of "minimum" carbon constraint that allows decarbonisation to continue. The economic crisis has eroded this minimum constraint. The Europe 2020 Strategy risks burying this approach.

Increasing the EU Target

If low-carbon growth is to become a priority for the European transformation in the Europe 2020 Strategy, it is difficult to see how the EU can avoid moving – relatively swiftly – to a 2020 target higher than the current 20% goal. This unfortunately appears to be in contrast to governments' reflexes to avoid "additional burdens" in times of economic crisis. True, tinkering with the legally enshrined linear reduction factor of 1.74%[17] may indeed reduce the credibility of the EU's long-term cap. Yet, on the other hand the Directive has explicitly foreseen the possibility to move to a higher target than 20%. The EU will also need to ask itself how credible a target is that represents little of a constraint for another decade. Even if one agrees that the linear reduction factor creates sufficient incentives to the ETS sector already now, the non-ETS sector offers potential for additional measures such as for transport, buildings, agriculture etc. as suggested by the European Commission to move to a somewhat higher target as the current 20%.

Judging from the initial Europe 2020 Strategy, the European Commission and member states seem to be looking for an easy way out. This might favour a policy to postpone action until later in the hope that new back-stop technologies such as Carbon Capture and Storage (CCS) will reduce costs for climate change mitigation. Relying primarily on such a technology push is a convenient short-term policy but might ultimately increase costs and risk that Europe misses out on broad-based incremental technology improvement.

Getting Back into the Game

If the Europe 2020 Strategy is to have meaning in the area of climate change and help trigger EU transformation, the EU will need to do better than simply implement the already agreed to and now unambitious targets. In addition, it is not credible that anything less than an EU 30% reduction target (or possibly even more) by 2020 can realistically render the envisaged 80-95% reduction for developed economies by 2050 possible, as the European Council has re-confirmed as recently as October 2009. Meeting such targets, however, will require an efficient economic framework, including undistorted price signals both in the ETS and non-ETS sectors alike, i.e. 100% auctioning of the allowances under the EU ETS and the implementation of co-ordinated, EU-wide national carbon taxes or a blanket EU carbon tax for the non-trading sector.

Under such a scenario, the EU could exercise leadership in future climate talks by pursuing a global "level" pricing of carbon. There are two ways of doing this. One route would be to scale up and reform existing flexible mechanisms such as the CDM and create new ones that would allow the establishment of a global carbon price. However, this would require the cooperation of other countries, notably developing countries, and such co-operation is highly unlikely.

Another – more promising – route would be for the EU to impose an import tax on the CO_2 content (including the embedded carbon) of all goods imported into the EU from countries that do not have their own cap-and-trade system or equivalent measures. Such an import tariff would improve global welfare by at least partially transferring carbon pricing via trade flows even to those parts of the world where governments have so far refrained from imposing domestic measures of any magnitude. In other words, it would create a mechanism to enforce the pass-through of carbon costs across the globe, therefore making domestic consumers pay the full cost of carbon. A key effect of such a tariff is that it would always lower global emissions. There are solutions to issues such as WTO compatibility and equity, the latter for example through rebating.[18] The latter move would have potential implications for the world trade regime and international relations.

Currently, import taxes on CO_2 content are still highly controversial, not only between but also within member states and within the Commission, because of the potential implications for the EU's relations with China and India, the world trade regime, and international relations, as well as for European businesses operating internationally. From a purely economic perspective, however, this would be a straightforward means of moving towards a global "shadow" carbon price and thereby towards an efficient climate change policy.

17 The Directive mandates an annual reduction of 1.74% of total EUAs even beyond 2020, which creates a very high level of certainty and thereby is seen as being credible with investors.

18 For an up to date analysis and overview, see: D. Gros, C. Egenhofer, Taxing Carbon at the Border? Brussels: Centre for European Policy Studies (CEPS), CEPS Paperback 2010.