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The cogs that move the wheel. Seven key messages from Central Europe on the successor to the Lisbon Strategy.

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We care for Europe

Edited by Krzysztof Rybiński
and Paweł Świeboda

The cogs that move the wheel. Seven key messages from Central Europe on the successor to the Lisbon Strategy

Warszawa, 2009

This paper is the result of a series of discussions among officials, opinion-makers and practitioners from Poland, the Czech Republic, Hungary and Slovakia. They included: Miroslav Beblavy, President, Slovak Governance Institute, former Secretary of State for labour and social affairs, Bratislava; Edwin Bendyk, innovation editor, "Polityka" weekly; Krzysztof Blusz, Vice-President, demosEUROPA – Centre for European Strategy; Eliza Durka, Communications Director, Warsaw Stock Exchange, former Member of the Group of Strategic Advisors to the Prime Minister of Poland; Marcin Gomota, Founder, Generation '89; Jan Górski, owner, Plum Web Solutions; Adam Jasser, Director of Programmes, demosEUROPA – Centre for European Strategy; Małgorzata Kałużyńska, Director of the Strategy Department, Polish Europe Ministry; Marcin Kardas, Ministry of Science and Higher Education; Ivan Mikloš, member of parliament and former deputy PM of Slovakia, Bratislava; Professor Krzysztof Rybiński, Director of the Better Government Programme and Partner at Ernst & Young, Professor at the Warsaw School of Economics and former Deputy Governor of the National Bank of Poland, Warsaw; Tomasz Rudolf, President, Innovatika; Piotr Serafin, Junior Europe Minister, Warsaw; Radek Špicar, Director, External Relations, Skoda, former Undersecretary of State for Lisbon Strategy, Prague; Kristian Szabados, Director, Political Capital Institute, Budapest; Paweł Świeboda, President, demosEUROPA – Centre for European Strategy and former EU Director, Polish Foreign Ministry, Warsaw; Andrzej Wodecki, Director of the Polish Virtual Institute.



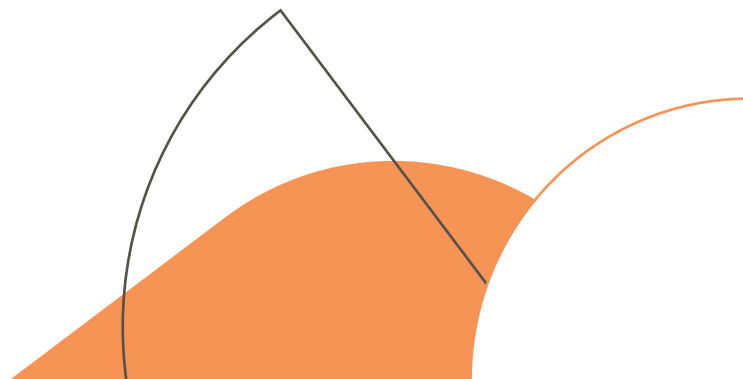
Executive Summary

This paper argues that although the Lisbon Strategy has not been an overwhelming success in the past, it is indispensable in the future as the post-crisis global environment requires determined action to rejuvenate the EU's economic and social model. The successor to the Lisbon Strategy needs to focus on long-term structural challenges such as the building of the low-carbon economy, demography and innovation as the central point of reference for policy-makers and practitioners. It also needs to identify new factors of growth and sectors with highest growth potential in the economy such as the creative industry. The new Strategy needs to protect and enhance the achievements of the Single Market and improve the infrastructural framework of the EU economy.

The report makes seven recommendations for the successor to the Lisbon Strategy to:

- ◆ Empower the individuals to succeed – as entrepreneurs, customers, consumers and citizens,
- ◆ Create a culture of innovation in the EU policy system,
- ◆ Work out an inclusive EU strategy for the building of the low-carbon economy,

- ◆ Focus on public sector performance,
- ◆ Fully use the potential of mini-globalisation by mitigating the fragmentation of the Internal Market,
- ◆ Put in place a new governance mechanism. ▀



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Zooming in on the Lisbon Strategy

The Lisbon Strategy has always been the second best option. It served as the way of advancing structural reform in the European Union in the absence of proper coordination of national economic policies and given the relative lack of interaction between demand and supply side economics in the EU. The Strategy has been **one of the great promises of the EU policy-making in the current decade**. When it was created, it seemed like Europe's "American moment" – full of excitement and expectation of the golden years ahead. The EU was confident it was leading the world into the future. It dreamt about a federation, enlargement and taking on the most important economic competitor, the United States. In the 2000 Lisbon Strategy, it set itself the objective of becoming the most competitive economy in the world.

Although much has changed in the intervening years, the original objective is clearly as much beyond reach as it was at the time. The EU as a whole will not meet the targets which were established in 2000. The income per capita in the EU is 70 percent of that in the United States, the same as 20 years ago. There are 750 scientific articles published in the US per one million inhabitants while it is only 600 in the EU.

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Naturally, such comparisons do not always make sense. For structural reasons, the European firms spend less on research and development because they specialize in sectors which do not always require such investments to grow. **However, today, comparing oneself to the United States is no longer sufficient because the point of reference has changed and there are new economic powers which have taken over as leaders in many areas.** Not long ago Germany was the leader in solar panel production. Now China is firmly ahead. This is just an example of the sort of technological competition taking place in the world.

As this becomes the new trend and dominates the global economic relations, **attention in the EU is very often paid in the first place to protecting manufacturing industries and existing jobs, rather than creating solid ground for jobs of the future.** This solid ground is built upon a sound regulatory framework, predictable economic environment and fair conditions for all companies. Such conditions allow for the natural selection in the market to take its course, which leads to the most competitive and the most adaptable enterprises pushing out the unprofitable ones. This is especially important in the case of small-and-medium sized enterprises whose job-generating role could not be overestimated.

Investments in innovative jobs have a higher risk factor attached to them and often require new skills, which is seen as a complex challenge. The private sector is not always encouraged to undertake such investments by the market and regulatory framework. The EU 2006 Innovation Strategy rightly noted that Europe's ability to compete internationally will not materialize unless "it becomes more inventive, reacts better to consumer needs and preferences, and innovates more".

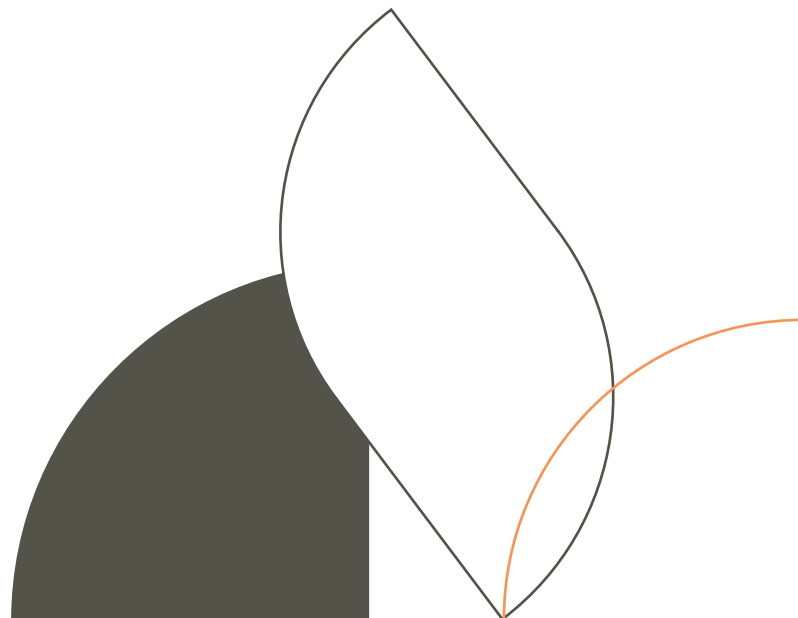
Politically, the European Union has transformed beyond recognition since 2000. It has enlarged to twenty seven members which made the adoption of uniform targets across the EU more questionable. On the other hand, **enlargement has functioned as a microcosm of globalization** allowing the EU to test many of the approaches it had to undertake in the wider global frame-

work. Its potential has not been fully exploited. The opportunities that the accession of new Member States brought (dynamic, mobile and adaptive labour force, fast pace of economic growth, ability to withstand structural change to name but a few) was often stifled by administrative and legal obstacles to economic activity imposed by some of the old Member States.

The other important feature of the European situation is that there is a growing gap between the best and the worst performing countries. The impact of the Lisbon Strategy has arguably been less pronounced in the larger countries. "For the UK, it is tempting to claim that Lisbon may as well not have existed", argues one comprehensive study¹. The French labour market and pension reforms have been driven by domestic concerns rather than reference to the Lisbon strategy. National Reform Programmes have received more attention in the smaller member states and have been debated in some of their national parliaments. Measuring the dynamic of progress, one finds, however, that most member states have made some advances on most of the targets with regression taking place on some of them in parallel. **Irrespective of its record of achievement, the objectives of the Lisbon Strategy remain valid.** This is exemplified by the dismal state of economic literacy in the EU. A Danske Bank poll found that 44 percent of Finnish parents do not know the concept of the interest rate² although Finland would be widely considered as one of the member states with the highest human capital. Households all over the Western world have taken adjustable rate mortgages without understanding the financial consequences of what they were doing in the changed economic circumstances. In the post-crisis context, education is the best investment, with highest rate of return. ▀

¹ The Lisbon Scorecard IX. How to emerge from the wreckage. Simon Tilford and Philip Whyte, Centre for European Reform 2009.

² Zapera.com, Market Research Study on Financial Literacy with 18-19 year-olds and their parents (2008) quoted in Ann Mettler, "From Why to How. Reflections on the Lisbon Agenda Post-2010", e-brief, Issue 01/2008, The Lisbon Council



Mixed record so far

The Lisbon Strategy was launched in unique circumstances. It **was focused on one issue – competitiveness**. Subsequently, it had three separate pillars – economic, social and environmental ones, which today should become much more closely integrated as the crisis revealed their correlation. For one, the business community is faced with a concrete challenge to limit greenhouse gas emissions which ten years ago was not the case.

One could argue that **the European Commission did not demonstrate a sufficiently strong sense of leadership on Lisbon during this period**. There was often an expectation, at least in the Central European countries, that the Commission would be far more explicit in pointing out strengths and weaknesses of the individual member states' situation while it instead tended to fear reactions in the member states and opted for not touching any raw nerves in the debate. One important problem, especially visible in the Hungarian discussion, is that **the concept of "reform" gained a completely negative connotation**. Another challenge has to do with the level of intervention dilemma. To quote one high official in a Central European member state, "Lisbon will never be about the member states". The expectation has been that the Lisbon Strategy would primarily focus on the EU level but would not have the ambition of becoming a factor in the equation in the national policy process.

In the Central European region, EU actions are primarily seen as being of regulatory and distributive nature. The Strategy's failure to have a wider impact often has had to do with the fact that **it did not differentiate between countries at different level of development.** The Central European political agenda has been dominated with objectives related to the internal market, better regulation and improvements in basic infrastructure which gradually lost their prominent place at the heart of the Lisbon agenda. **The future edition of the EU economic strategy has to be at the same time all-encompassing, inclusive and responsive, tailored** to individual needs of the different groups of member states.

The methodology did not help either. The EU obsessively followed the approach of designating ambitious targets in 38 areas ranging from the employment level to expenditures on research and development. As many as 195 sub-targets were set. Admittedly, benchmarking has had the advantage of testing a number of economic assumptions, including concerning the impact of liberalization of trade on employment levels.

The Strategy did bring some results. Listing priorities for the European Union has had a bearing in the national debates even if references were not always made to the Strategy itself. It **allowed member states to pursue more strategic objectives** rather than focus on the immediate priorities. Moreover, it has made sense for all member states to decide to move in a certain direction.

At the same time, agreeing the National Reform Programmes with the various stakeholders proved to be a difficult process. Motivating member states to act by means of comparing progress and sharing mutual experience did not work well for everybody. Some preferred to invent everything from scratch. Others, quite on the contrary, wanted to be the best in every area. **Learning from others has spread but not to the point of making a real difference.** The Swedish experts calculated recently that there would be 40 million more jobs in the EU if everybody applied the Dutch employment model. In practice a lot

depended on whether or not the Lisbon Strategy had "an owner" at a reasonably high level in the government of the member state in question.

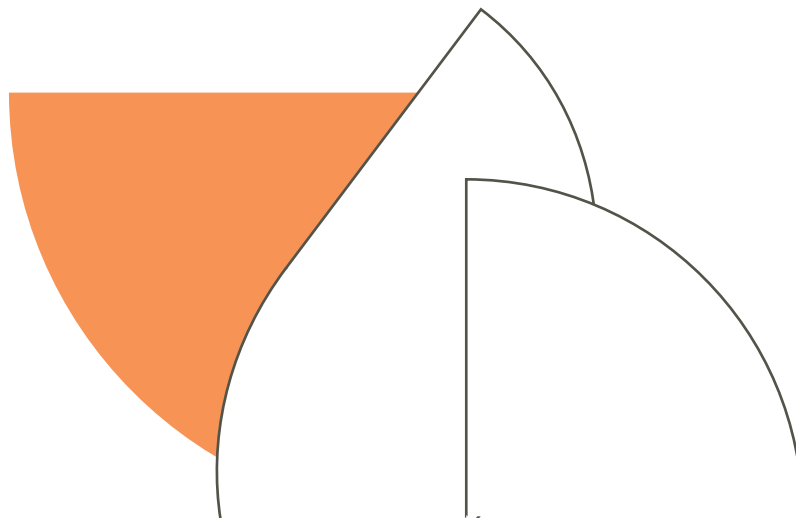
The "open method of coordination" on which the Strategy is based results directly from the division of competence in the EU treaties in which areas such as social policy or education are reserved for the member states. As such **the Strategy often offers not more than an indication of the desired shape of reforms.** What it should put forward as well is a measure of the costs of non-action in crucial areas where the reforms need take place.

The Strategy has been a living organism. Much has changed in the focus it adopted. In March 2005 the emphasis was clearly placed on growth and jobs while more ownership was transferred to the Member States by means of the national Action Plans. Three years later, the environment and citizens became the additional point of reference as concern increased over climate change, ageing and social exclusion. One could speculate that the economic crisis should mean that jobs and competitiveness will again become the priority of the day.

Following the reform of the Lisbon Strategy in 2005, EU governments have been asked to identify their priorities and come up with roadmaps on how to achieve them. Annual assessments of progress on the part of the governments are carried out by the Commission. The latter has done little "naming and shaming" of the best and the worst performers for fear of alienating member states. The method of the Lisbon Strategy has relied on defining guidelines and specific timetables for achieving agreed objectives, establishing quantitative and qualitative indicators of progress, translating European guidelines into national and regional policies and monitoring, evaluating and generating peer review organized as a mutual learning process. **The peer pressure system has been imported from the world of corporate governance. While working quite well at the level of a company with its hierarchical structure, it is more difficult to put into practice in the European environment** with a much flatter system.

The advantage of the Lisbon Strategy lies in its flexibility.

Guidelines are meant to be translated into each member state's specific context and action plans. There is absence of formal constraints with the reviews and assessment aimed at encouraging the learning process. The Strategy lacks a sanction system which would be enforceable and credible. It aims to facilitate progress at the European level in areas which tend to remain the domain of national political systems. This aspect of the situation needs to be kept in mind. The Lisbon Strategy ventured into a territory where the EU has had a relatively weak competence. As a result, its ambitious targets such as the three percent of the GDP to be spent on research and development were bound to be affected by the fact that the EU's Framework Programme accounts for not more than five percent of public funding for research in the EU budget, which constitutes a little more than 1 percent of the cumulated GDP of Member States. ▀



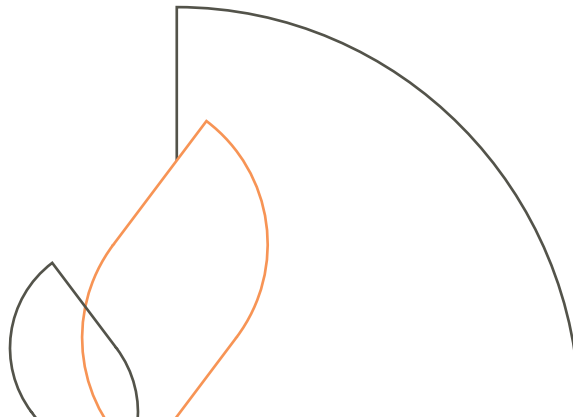
Looking ahead

The discussion is now entering a new phase. The Lisbon Strategy needs to be either concluded or re-launched for the next period of up to 10 years. The European Commission is preparing a new proposal for the forthcoming period, together with an assessment of the efficiency of the Strategy so far and an analysis of the actions undertaken as part of the recovery package. Adoption of the new Strategy is planned for the first half of 2010. The context is determined primarily by the reshaping of the global economy following the economic crisis as well as the demands of the low carbon economy which needs to be built to prevent negative effects of climate change.

There is no doubt that **if the EU wants to successfully emerge from the crisis, it needs more rather than less of Lisbon**. It means that rather than drop the Strategy altogether, the EU needs to change it and adapt it to the new circumstances. It should become a "strategy of strategies" – a type of guide to specific actions in the key areas of economic life. **The pressures of the crisis will point to a greater need for structural reforms, including reform of product and labour markets**, particularly given the likely more limited role of the financial institutions in fuelling the markets.

The current recession provides both opportunities and risks when it comes to enhancing competitiveness of the European

economy. The opportunity lies in a rational allocation of resources while the down-sides have to do with unwillingness to accept risks which are the condition of innovation or lower volumes of capital available for investment in research and development. Recession could also be challenging in terms of maintaining the level of human capital. ▀

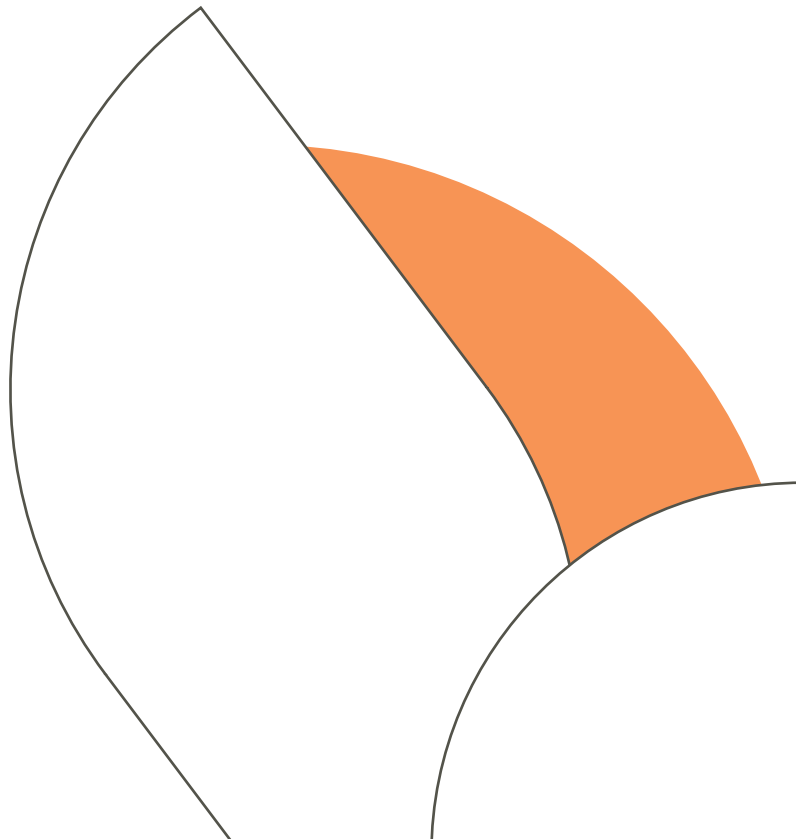


The global context

The Lisbon Strategy has progressively become the European way of adapting to globalization. Adaptation is obviously not everything and, as Laurent Cohen-Tanugi has argued, **the EU also needs to shape globalization in the way it considers desirable.** This means that it should be much more effective in what it does. It needs to react faster and focus on integrating change into its own blood stream. Ann Mettler, co-founder of the Lisbon Council points out rightly that arguments for reform cannot be defensive and concentrate on China, India or Eastern Europe scare stories. **“Europeans need to know where the journey is going”³.**

The **new Strategy has to develop further an external dimension** and address the question of how the European countries can remain competitive with regard to the emerging economies which have divergent views of environment, climate, property rights and even rule of law. Instruments like the European Neighbourhood policy should be explored in this direction. ▀

³ Ann Mettler, “From Why to How. Reflections on the Lisbon Agenda Post-2010”, e-brief, Issue 01/2008, The Lisbon Council



Factors of growth in the European economy

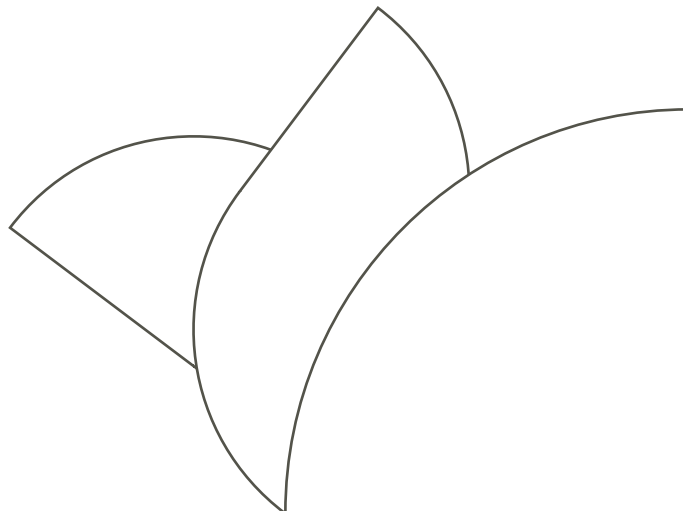
The successor to the Lisbon Strategy will need to recognize **the way in which the character of the European economy is changing**. Europe will need to take care of the fundamentals and improve conditions for long-term growth including by means of better labour force participation, enhancing total factor productivity and creating better business environment. However, it will also have to look beyond the classical economics.

Žiga Turk, the former Slovenian minister for Lisbon and the current Secretary General of the Reflection Group on the future of Europe, rightly says that we are dealing with an “aspirational” economy, in which expectations have to be created and then fulfilled⁴. Industry will remain in Europe but as a result of the current crisis, it will be a much more productive industry. **More jobs will be created in the high quality services market than in industry**. Design will become more important, even in the area of medical products, where at first sight it is not the most critical matter. The entire strategy of Philips in the area is aimed at improving the design of medical devices. The creative sector is already bigger than the agricultural sector in the Netherlands and in the United Kingdom it is meant to be bigger than the financial sector before 2013, which speaks for itself. The Vice-

President of the outcoming Commission Günter Verheugen is right in saying that the high growth areas will be about everything that has to do with health, mobility and communication.

In that context, the new Lisbon Strategy needs to have **two objectives – to address the structural challenges for the European economy such as its demographic situation while identifying new factors of growth and creating a culture of innovation** which can help to sustain the new economic model. ▀

⁴⁾ At a brainstorming organized jointly by the European Commission and the Lisbon Council, Brussels, 20 July 2009



Recommendations

1 Empowering individuals to succeed. New philosophy of economic policy.

Removing barriers has been one of the most important tasks in the previous years. While the goal of barrier-elimination remains valid, today it is also about encouraging people to be active and change. The Lisbon Strategy concentrated in its initial period on research and development as well as reducing business barriers. Today entire groups of people create new ideas outside of business (eg. Wikipedia) while business integrates them and puts them to use. But different incentives are needed for these processes to run their course. **Consumers** have been rightly elevated to the position of important actors in the system by virtue of the choices they make and expectations they formulate with respect to future goods and services, the latter being an important source of innovation. Innovations are increasingly consumer or customer driven. Growth in the future will depend more and more on the **ability to create demand** by influencing consumer preferences. Consumer policy will be an important focal point of that process but **effort needs to be undertaken across the spectrum of EU policy, including in such fields as information society and media as well as competition.** The potential which is at stake here is well illustrated by the phenomenon of reverse innovation taking place in the US where a lot of inspiration is sought in countries like India where entrepreneurs test solutions that could work more cheaply and be easier to commercialise. Recent analysis suggests that if you are able to achieve market success in China, you can achieve similar success in the developed world as well⁵.

Lessons should also be drawn from “Freedom Incorporated” type of organisations which succeed in freeing initiative in areas which have often been stifled by bureaucratic constraints for decades. The key to their success lies in liberating leadership which transforms firms and entire industries by creating an intrinsic equality among employees, encouraging them to adopt a higher level of ambition, building an environment for self-motivation and becoming freedom culture keepers⁶. It is also the question of **intellectual property rights** which in the US are at the same level as real estate ownership rights. There should be a real and enforceable regime of intellectual property rights in place. Lesson should also be learnt from the less developed countries – for example the Brazilian Development Bank, BNDES, measures company intellectual capital when deciding about company financing. In a 21st century company intellectual capital could prove to be a stronger loan collateral than bricks.

2 Creating a culture of innovation

Innovation is a cultural phenomenon which has to become a systemic characteristic of the European economy. This is about forming conducive environment for people to be creative, to take the risk and reward unorthodox ideas rather than imitation. There has to be an intrinsic openness for new ideas and solutions within the European economy. One could spend a lot on research but still fail to score economically without a proper level of innovation. Sweden was once the leading country in the world on research and development of radios based on vacuum tubes. But all the resources that went into the process became useless when the Americans invented the transistor radio. Applied research matters just as much as the basic research does⁷. Innovation systems need to be tailored towards making the most out of European research but **outcome rather than inputs** should be the main focus of attention.

Naturally, **different types of innovation need to be distinguished**, from new products and technological advances to ways of bringing goods and services to the market. Successful

innovation often takes place at the low or mid-levels of technological advancement or concerns areas which are entirely outside of the scope of technological change. In fact, emphasis on “hi-tech” innovation may lead to the crowding out of resources and support for innovators in the area of services.

Expenditure on R&D is an unsatisfactory indicator of innovation but there is a correlation between R&D and competitiveness with the caveat that levels of spending will depend on structural factors and countries’ level of economic development. The EU has paid a lot of attention to innovation, starting with the Commission’s Green Paper in 1995 and leading up to the Year of Creativity and Innovation this year. Creation of lead markets, enhancing R&D expenditure, increasing structural mobility and fostering an innovation culture are key components of EU policy.

The EU cannot take up the overall responsibility for the flourishing of innovation in the member states but it **needs to act to stimulate markets for innovative products and services and improve on its 2008 Lead Market Initiative**, the results of which have been mixed. The Initiative aims to use legislation, public procurement, standardization, labeling and certification as well as financial incentives to create conducive environment for potential new markets. The six sectors identified in 2007 as having the potential to become lead markets are: e-health, protective textiles, sustainable construction, recycling, bio-based products and renewable energies. However, it is not clear how the evolution of the sectors is meant to be monitored and assessed.

Public procurement can contribute to creating demand but on the assumption that the market environment is transparent and competitive. Public authorities are encouraged to be demanding first-buyers in the 2007 Communication on the Pre-commercial procurement aims. The objective also remains to **dismantle barriers** hindering the free movement of knowledge, hence creating the **fifth freedom** and a cross-border European Research Area with the planned European “passport” for researchers. **Taxation policy** has a role to play in encouraging risk-taking.

One particularly important feature is the continued **support for creative small firms** which have a strong record in coming up with path-blazing inventions. SMEs are successful in creating jobs and their international exposure and export-orientation helps to increase productivity. Globalisation has often induced the governments to support medium-sized companies which can be more visibly successful on the international market. Therefore SMEs will require more specific attention in the future as they tend to be great innovators.

The **collaboration between business and research communities** should be strengthened by means of public-private partnerships such as the Technology Platforms, Joint Technology Initiative and the European Institute of Technology, meant to encourage cross-border innovation clusters and bring together research, education and innovation. The European Research Council in its 2009 review process supports risk-taking in research and hence ties in with the innovation agenda. The least that the EU can do is to complete the internal market so that investors can capitalize on investments and strengthen the legal framework to protect intellectual property rights, including by means of finally agreeing on the European Community Patent backed by a patent investigation system. Smaller companies should be offered insurance to protect them against infringements by larger enterprises.

The EU is committing **substantial funds** to research and innovation in the current financial perspective – 86 billion euro between 2007 and 2013 apart from the resources of the Seventh Framework Programme. Funding for innovation is provided through Structural Funds which are used to shape regional innovation strategies and Competitiveness and Innovation Framework Programme. The different funding streams should be better coordinated in order to maximize impact and existing programmes simplified to allow for greater support of SMEs. The latter would also benefit from advice and guidance in the area of innovation as well as improved access to technologies. There should be **better access to venture capital for Europe's entrepreneurs**, as envisaged in the recent EIB initiatives.

Discussion needs to be launched on **the leverage that EU funds could provide** in the next financial perspective, primarily stimulating growth of lead markets in the situation in which private investors are often unwilling to take the risk which is an intrinsic feature of an environment conducive to innovation. The findings of the Esko Aho report on innovation in the EU remain valid on this issue although more stress needs to be placed on low carbon energy solutions and security as potential growth areas where innovation is most needed.

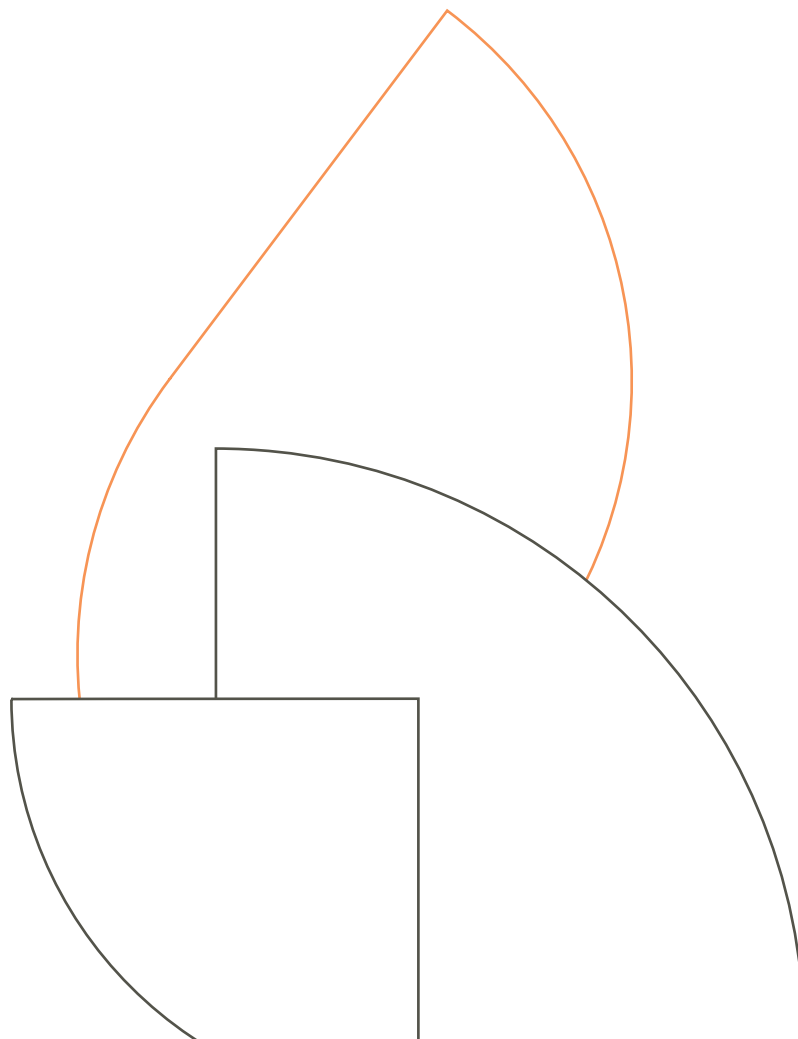
It would be another important objective to **ensure that every quantity of public knowledge is available around the world**. What is more, knowledge should not be a restricted good but must be disbursed extensively in society, ensuring that people have the instruments to improve the way they implement their initiatives and operate businesses. Creating a **European knowledge repository** could be an important project to be undertaken as part of the implementation of the Lisbon Strategy.

Innovation culture should receive more attention in the future. There have been EU guidelines on fostering an innovation culture at the national, regional and local level but incentives to take action have been weak, producing mixed results. The latter should receive more funding in the future throughout the education system, including in schools, training and skills organizations. ▀

⁵¹ See Hexter J., Woetzel J. (2007) "Bringing best practice to China", The McKinsey Quarterly, number 4, 2007; Radzikowski M., Rybinski K. "Achieving Sustainable Growth. Will New Europe Fly or Crawl in the 21st Century Global Economy", in "The Future of Europe" Proceeding of the Club of Rome International Symposium, Vienna, September 12–13 2007

⁶¹ Brian M. Carney, Isaac Getz, "Freedom Incorporated. Free Your Employees and Let Them Lead Your Business to Higher Productivity, Profits and Growth", Random House, 2009.

⁷¹ Speech by Tobias Krantz, Swedish Minister for Higher Education and Research, Lund University, 12 August 2009



Challenge of a demographically viable, low carbon, innovative European economy

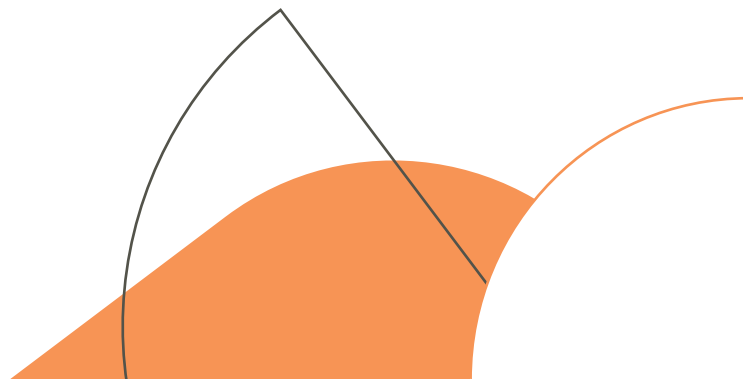
The scale of necessary changes in the European economy today is bigger than in 2000. It is not only about the way to emerge from the current recession. There are more **systemic challenges** which need to form the basis of any future EU economic strategy. They result in the imperatives of **building a low emission economy, addressing the demographic problem and making innovation a systemic feature in the European Union.** To be relevant, the new Lisbon Strategy needs to tackle what really needs to be done. A horizontal focus on improving competitiveness across the board will no longer be sufficient on its own although it should remain a focal point of all the efforts addressing the above-mentioned challenges.

Achieving a stable climate will certainly be difficult to achieve. Emissions need to peak in 6 years for us to prevent the negative impact of climate change. This means a reconfiguration of the entire global economy, where efforts of all the stakeholders are needed. Innovation has to drive that process. At the EU level, creating a low carbon economy would have to mean adopting the EU-wide internal burden sharing system of emissions

reduction, removing market barriers in low carbon sectors, encouraging greater resource efficiency and energy savings, transformation of infrastructure, investing in skills, developing rules for low carbon procurement, encouraging consumer and business demand for low carbon goods and services, encouraging low carbon innovation, identifying areas where the EU has the potential to play a leading global role and supporting innovative start-ups and growing low carbon projects.

When it comes to demography, there are hard facts to face.

If we want to maintain today's balance between the working and not working groups in the society in 2040, we will need to work 10 years longer and bring in 40 million immigrants. Ageing will also contribute significantly to the accumulation of public debt which is already high as a result of the economic crisis. Sustainable growth will be needed to manage the implications of the demographic trends for social security systems. Bismarck's pension system was created with the intention of catering for up to three final years of peoples' lives and it was seen by some as a populist device aimed at generating political support. Today, the economy must become flatter and take better into account the intergenerational solidarity. People should work longer but also get more out of their older age. Solutions on demography need to be short-term and long-term at the same time. ▀



Recommendations

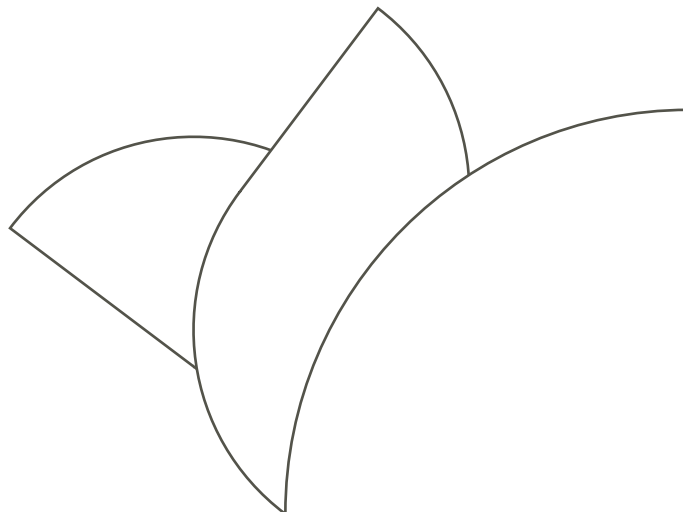
3 Working out an inclusive EU strategy to build the low-carbon economy

Transformation towards low-carbon economy will require a **comprehensive effort** of forging **a new sector of the economy** based on the demand for low carbon goods and services, investments in new green technologies as well as improving resource efficiency. Key role will have to be played by better environmental regulation and reducing barriers to bringing low-carbon products and services to the market. Low-carbon economy will require specialist skills, relevant infrastructure and support for innovation. Business strategies and consumer choices will be the drivers of this process. **Government intervention will be necessary** in creating lead markets to launch the emerging innovations and ensure the required level of funding as well as to provide clarity on the context in which businesses will operate.

Individual national low-carbon economy strategies should be combined to form **an EU low-carbon strategy** which would focus on the creation of lead markets, support for technological innovation and consumer demand. It would propose a set of priorities, both common to all member states such as greater energy and resource efficiency, smarter low carbon procurement and the construction or retrofit of low carbon buildings. It would also identify possible geographical specializations depending on the particular strengths and attributes of the member states and regions and highlight barriers to the development of low carbon economy including level of uncertainty about the results of investment in research and development and the resulting funding gaps as well as regulatory, infrastructural and planning requirements.

The Strategy should lead to the creation of a **Clean Energy Institute as a private/public partnership** to invest in strategic low carbon energy technologies and solutions. There should be taxation policy measures suggested to incentivize growth of demand for low carbon goods and services.

The European Union will need to make a big push to maintain its position as a leader in building the low-carbon economy. **The greening of the energy mix should start with greening electricity, to be followed by heat and transportation.** A master plan is needed to make sure that all the elements of that process fall in place. In parallel, the EU will need to learn to exploit the web 2.0 services and ICT-based innovations for greening the economy. Innovation will play decisive role as new methods of storing electricity transform the way networks operate and integrate them with storage. There are initiatives taken in Asian countries and in the US (Smart Grids) which have a more thorough transformational potential. Monitoring, accounting and labeling of carbon emission will need to become a norm with the relevant institutions in place and common standards to ensure the functioning of the single market. Carbon monitoring will also have to become part of the public procurement system in the EU. ▀



ICT-based growth

The ICT sector is responsible for much of innovation taking place in Europe. It contributes over 6 percent of GDP but over 40 percent of productivity growth and 30 percent of investment in research & development in the last decade. It is also a key force for the dissemination of knowledge. We are still at the threshold of the real technological revolution. The latter takes place much faster than our ability to govern it and affects all areas of social life. The Google search engine is used 20 billion times a day. Every year we register more information than has ever been registered in the history of humankind. This translates into a growing sense of interdependence. **ICT innovations will further transform the existing mode of provision of services and business models.** Their potential has been recognized in the Lisbon Strategy and i2010 initiatives. The EU still needs to recognize fully the role that ICT innovations will play in the transition towards low carbon economy.

The European Commission drew attention to the role of smarter homes and offices, smarter logistics and electrical power grids in its May 2008 Communication but delayed filing recommendations in order to carry out stakeholder consultations. The role of financial incentives was demonstrated by inclusion of a “factory of the future” project in the Recovery Programme as well as investments in broadband infrastructure. A number of sectoral

initiatives refer to the role of ICT, including the Directive on the Energy-Performance of Buildings which promotes intelligent sensors and efficient lighting control systems and which will need to be further revised to meet the 2020 targets. However, they have not been integrated into a strategy of ICT-led low carbon economy. Coordination will be of pivotal importance for this project, linking up RTD, innovation, the functioning of the market and the different tiers of the governance structure, including public procurement and the regional and city level.

The key elements of the ICT-based transformation are:

- ◆ **Broadband networks** which are crucial for the availability of information and services. The EU needs to do more to accelerate the next generations of fibre and wireless access and substantial investments will be needed in the forthcoming years.
- ◆ **Smart grids** which would lead to more effective demand management across the network and by end-consumers.
- ◆ **Smart buildings** allowing for the control of energy use by consumers and hence active energy management, extensive application of smart meters and efficient lighting and climate controls as well as feeding in surplus energy to the network (buildings use 40 percent of energy supplies).
- ◆ **Efficient logistics for transport** (26 percent of end-use of energy in the EU), enabling the tracking of freight containers, rationalizing routes and encouraging intermodality.

Decentralisation of power distribution to enable local and regional power generators to access the grid will be a key part of that transformation. ▀

Recommendations

4 Making investment in education and skills a flagship issue

Improving education and skills will remain fundamental for raising productivity and employment. Demand for skilled labour will grow with the advancing globalization and technological change. Educational standards are rising around the world. **In the multipolar world the competition for talent has gone global.** The nature of work is being transformed by new technologies, there are new skills demanded and different ways in which workforce is sourced globally. Talent has become one of the key competitive advantages. Industry, infrastructure, innovation all contribute to the economic growth and power. But the key role is attributed to those who are behind these factors – people. It is already the case that nations with the best pool of talent pool, best skilled, educated and trained workforce have a distinct advantage.

Not long ago the Western countries had assumed they would be attracting high-skilled jobs from developing countries and exporting in exchange low-skilled low-wage workplaces there. In reality, however, **the new players have invested heavily in education.** As a result, the share of the US in the global enrollments has fallen from 30 percent in 1970 to 14 percent in 2000. The level of doctorates is expected to fall from 50 percent in 1970 to a projected 15 percent in 2010. **The emerging economies have more than doubled university enrollments between the late 1980s and 1990s.** China is expected to produce more graduates in science and engineering than the US by 2010. Clearly, **the new chapter of globalization will be about a battle of the high skilled and a rivalry for top technological innovations.** Winners in the global market are skilled workers in the developed countries and unskilled workers in the developing countries. **There may be an unprecedented migration of labour and jobs between countries and continents in the 21st century.**

Education is no longer simply the process of learning at school or at university. The quantity of new technology information doubles every year. Half the knowledge of a polytechnic student will become outdated by the time he or she starts the third grade. Richard Riley, the US education secretary stated in 2004 that “none of the 10 top jobs in 2010 exists today”. **Modern education systems should empower people to be flexible, to learn new things, to be able to change professions several times in a lifetime.**

Public finances in Europe will soon be under severe stress given the pressures of the ageing problem. **Education policies will have to be designed in such a fashion so as to make people work longer and enjoy staying active into the old age.** Incomes, employment, activity ration increase with the level of education. Mentoring younger knowledge workers is one obvious idea on how to take advantage of the more experienced labour.

Successful workers are not necessarily the most intelligent ones. **They are the ones who are in the right place at the right time. Governments, universities and companies should use their collective wisdom to determine what will be the next big challenge and focus the resources there.** In 2000, Singapore launched its vision of becoming one of the world’s leaders in biomedical sciences called “Biopolis Asia”. As part of this project, Singapore has pursued an ambitious programme of increasing the number of PhD students and post-doctoral fellows. Students have received hundreds of scholarships to pursue biomedical science studies. This is about using the education expenditure in an optimal way. We need to define key competencies leading to the future success in Europe. One of the key competencies is the ability to learn throughout the career.

Economic and social returns from public investments are higher in the early years of everyone’s life. **The future Lisbon strategy will need to show ways of integrating the objectives of innovation, education and skills and low carbon economy.** The “New Skills, New Jobs” strategy is an important instrument for improving the way that the provision of skills responds to

the needs of the markets and it should be strengthened. Mutual learning process is key in stimulating innovation and the EU should encourage cooperation between entrepreneurs. The European Commission promotes entrepreneurship through education and learning with a range of proposals in the 2006 “Oslo Agenda for Entrepreneurship Education”.

The EU’s challenge is two-fold. It has to do with the fact that it invests too little in education at all levels and has a poor record on skills and lifelong learning. Excellent data on skills forecasts is compiled by the European Centre for the Development of Vocational Training in Thessaloniki although it has failed as a communication initiative. Research shows that there is rise in jobs that require “complex communication” and “expert thinking” while demand for routine jobs declines⁸. Governments can provide incentives to pursue education and training by means of tax systems and funding, help to communicate the importance of a learning society and investment in skills.

The challenge for Europe has to do with financing – investment in education is too low at all levels – and limited opportunities for life-long learning. The policy framework can generally have influence by means of incentives (making it worthwhile to pursue education and training), pressure (wide-spread knowledge and acceptance of the benefits of becoming a genuine learning society) and persuasion.

Paul Hofheinz argues for making skills and human capital a policy priority to “help reposition the globalization debate in a way that will allow us to make more progress in the effort to reform”. He has in mind launching a broad-based and sustained debate on skills and human capital to raise the profile of the dossier and lay down institutional reforms that will ensure the agenda remains at the forefront for years to come. Paul argues for devoting a European Council meeting to skills and human capital to “send a strong signal to citizens, media and organized stakeholders” and set clear targets. He also suggests initiating a yearly stocktaking on skills development, developing new targets and indicators such as the 40 percent tertiary educa-


tional attainment target and initiate dialogue with stakeholders by means of a major presidency-led conference.

Europe's higher education spending is much lower than that in the US (1.3 percent of GDP as compared to 2.9 percent) and the continent is characterized by poor research performance and relative lack of attractiveness of European universities to students from emerging countries⁹. The **national education systems differ strongly in spite of the Bologna process aiming at increased coordination**. There continue to be numerous administrative and legal obstacles to mobility within the EU which have to do with the difficulties in transfers of social security and research funding. **Promotion of academic staff continues to be network-based rather than excellence-based**. There is also lack of managerial autonomy of universities in several member states. The European Commission has in the past few years focused on putting in place the European Research Area to extend the single European market to the world of research and technological development. Six fields of action were identified in the 2007 Green Book, including a single labour market for researchers and developing world-class research infrastructure. They remain valid but need to be achieved faster by a combination of measures from a European ranking of universities and research institutions on the basis of their contribution to academic excellence, policies aimed at making the EU attractive to foreign researchers and creation of a pension scheme for researchers encouraging their cross-border mobility.

The EU needs to attract creative people, ideally those with proven innovation record, create pro-innovative context by means of putting in place attractive incentives such as innovation-related remuneration and social safety framework, create a network of creative people and markets for innovation, introduce innovation in the curricula of all levels of education, make sure that government is a source of innovation (e-government), adjust the accounting of GDP to start treating wages and bonuses as well as R&D outlays as investments, not costs. Rules should be introduced to incentivize innovative thinking in the course of the

education process – distinction should be granted to students who come up with an innovation or new idea with extra points for intercontinental/multinational teams. In principle every student has to spend one year outside the country to build the European network of ideas.

What is also needed is for the **human capital agenda to be made pro-active and high-profile** based on a broad social consensus around embracing globalization, open markets and skilling up. A broad-based programme should be adopted to facilitate better access to training and skills and an effort to raise awareness of this issue in a long-term, sustainable way.

Last but not least, we should operationalize the research findings showing that the highest return to education investment is in early years: kindergarten and primary school. EU top priority should be to make European primary school-leavers achieving world class level of competence, to be proven by top PISA scores. 

⁸ Skills and Human Capital: Towards a 21st Century Agenda for Europe, Paul Hofheinz, the Lisbon Council.

⁹ More on this in André Sapir (ed.), "Europe's economic priorities 2010–2015. Memos to the new Commission", Bruegel Institute 2009.

5 Focusing on public sector performance

The requirements of the post-crisis economy and demographic pressures will lead to major strains for health and social welfare services across the EU. This means that the **efficiency of the public sector and public expenditure should become a major priority** of the new Lisbon Strategy. The main features of that process will have to do with increasing productivity in the public sector and promoting a culture of innovation inside the sector. In the health area itself, there has to be more focus on improving the health condition of the ageing population which is key to increasing the working age. Pension reform is a must.

What is more, **governments need to be ever more open to the world outside as factors shaping the future are more and more beyond their control.** They should define problems but let others work out the solutions. The new Lisbon Strategy should mean a government which is pro-active, dynamic, integrated and committed to ongoing assessment of services. Listening to citizens and responding to their needs (services online) as well as transparency will be key to achieving that objective, just as incentivizing people to change. **Support for innovation may have to originate outside the existing institutional structures in order to overcome the bureaucratic legacies and inertia**¹⁰. The successful new actors such as Vinnova in Sweden or Sitra and Tekes in Finland have shown that fostering innovation can often be most successful if it is done by a new institution acting with a good degree of independence. Progress could be achieved in areas such as innovation, human capital and skills by empowering small and safe-financing new institutions acting outside the remit of the traditional line ministries. ▀

¹⁰ See Ann Mettler, "A New Dawn. Ten Recommendations for the New European Commission", Lisbon Council e-brief, 02/2009.



Objectives of the new strategy and EU budget

EU budget is not of the size that would make a difference to Europe's performance in the area of competitiveness and innovation but it is an important lever and an even better indication of political priorities in the EU. Existing policies will need to transform. As for cohesion policy, the old paradigm of income convergence between regions will not be sufficient. **New measures of cohesion should be created such as those relating to intellectual capital.** This would mean that more resources would be devoted to pre-school education of children rather than to instruments of active employment policy. In his recent report prepared for the European Commission on "Agenda for a reformed cohesion policy", Fabrizio Barca argued that 55–65 percent of expenditure in the policy should be dedicated to 3–4 priorities such as innovation and climate change, migration and children, skills and ageing of societies.

The effectiveness of EU spending should be subject of separate attention. The burden of red tape, the required geographical spread of partnering institutions and a complex fund-allocation mechanism lead to a limited interest on the part of the business sector in participating in the EU Framework Programme projects. Accessibility and effectiveness of EU spending on re-

search must be improved urgently. Performance-driven criteria of allocation as well as simple administrative procedures have to be introduced in the next financial perspective to make the EU research funding for projects more open, independent and transparent. ▀



Recommendations

6 Fully use the potential of mini-globalisation by mitigating fragmentation of the Internal Market

It is often forgotten that the Internal Market has been the single most successful component of European integration. Falling costs of air travel, better consumer choice, higher quality of products – these are all consequences of steps taken under the Single Market framework, enhanced and strengthened by the initial Lisbon Strategy. **European companies are increasingly able to face up to their global competitors thanks to the discipline that the Single Market imposes upon them.** Cheaper labour force from Central Europe helped the Western European companies to stave off competition from low-cost, labour-intensive manufacturing industries in the developing countries. Europe needs to build further upon this success. **The administrative (EURES, Solvit) and legal (quicker transposition of *acquis communautaire*) and political (supervisory role of the Commission) mechanisms that serve to protect the four freedoms need to be buttressed.** National governments should be prevented from pursuing beggar-thy-neighbour policies and no protectionist policy should be allowed.

For the Internal Market to function properly, it is also required to ensure that there is an adequate system of legislative monitoring and implementation of relevant legislation into national environment, not only through strengthened cooperation between Member States and the Community institutions but also first and foremost by means of a streamlining of the process by which the impact of planned legislative solutions is assessed.

Transport, energy and ICT infrastructure is the condition sine qua non of a well-functioning Internal Market. In this respect the contribution of the EU cohesion policy cannot be overemphasised. Further development of the Trans-European Transport Network linked to an effective network of Member States' national infrastructures is a way to strengthen Europe's competitiveness. The Trans-European Transport Network will ensure a sustainable development and do away with barriers in access to the transport infrastructure throughout the EU. Similarly, the development of the European energy market requires national and cross-border infrastructural investments to be supported by the EU budget.

7 Putting a new governance mechanism in place

The post-2010 Lisbon Strategy needs to be based on policy outcomes rather than benchmarks as in the initial version. This means a radically new logic of generating the momentum for reform. Processes need to be initiated by reference to a new and complete vision of the economy that needs to emerge rather than a series of detailed targets which stand no chance of adding up to a potent political proposition.

Once the policy outcomes are defined, **a mix of EU and Member State level action has to be determined. Better coordination** of activities leading to the implementation of the new Lisbon Strategy is a must, as is **more effective surveillance**, especially given the failures exposed by the crisis. Spending on Lisbon-related objectives will be more important than in the initial version of the Strategy, also requiring a financial engineering with both EU and national funds committed. Just as the overall objective of the Lisbon Strategy should be to focus on policy outcomes, funding should concentrate on achievement in key areas.

Financial allocations need to go hand-in-hand with **improving systems to distribute them efficiently and perform proper**

quality assessments. EU regulation has to be more evidence-based and drawing on stakeholder consultation. Coalitions for change going beyond business and academia need to be established to inspire responsibility and expertise to engage in broad issues. **Enforcement** may have to be stronger within the context of the post-Lisbon strategy although it has to be remembered that the legally enforceable rules such as the Maastricht criteria are not always widely respected.

The new post-Lisbon strategy has to be firmly anchored in the new institutional system created by the Lisbon treaty. The European Commission must demonstrate leadership on the issue with a clear chain of command inside the college, starting with President Barroso himself but cascading down to a competent Vice-President who should chair the post-Lisbon caucus of commissioners. There should also be a separate commissioner for innovation, lending a face to Europe's much wanted cultural characteristic. This should be **the best communicator in the Commission** since the task at hand will very much depend on spreading the gospel of innovation, including by means of sharing of best practices. The new permanent President of the European Council would also be well-positioned to provide leadership on innovation as should the rotating presidency through its chairmanship of the Competitiveness Council and the strengthened European Parliament. What we should see emerging is **not a single source of leadership on the issue but a system in which innovation remains on top of the agenda of all the key actors in the process.**

The **structure of the new European Commission** should reflect the priority given to themes such as innovation. Currently, in the words of President Verheugen, innovation falls within the portfolio of at least 12 different DGs¹¹. Responsibility in areas such as ICT-based innovations spreads across several Directorates-General and agencies dealing with energy, climate, environment, enterprise and innovation, research and the information society. In the future, a comprehensive Innovation Strategy will be needed with leadership coming directly from the Commission President. Better coordination will also be necessary lead-

ing to initiatives which are jointly taken by two or more Commission directorates and more task forces which cut across the different services.

The European Commission needs to revolutionize the way it communicates with citizens. Web 2.0 and social networking may not be to everybody's liking but it does enrich the way public authorities can interact with individuals and answer their needs and preferences. The Commission should use the multimedia capability and community driven internet platform combining wiki, blog and knowledge-sharing functionalities to engage citizens in policy debate.

For the post-Lisbon Strategy to have more clout, **European Commission needs** to have a stronger position vis-à-vis the member states. This requires that changes are made inside the Commission in the way in which Lisbon Strategy issues are handled. The President of the Commission should remain in charge of the work on Lisbon Strategy, chairing the caucus of commissioners dealing with the issue. Better coordination of work between National Lisbon Coordinators would help as would the creation of an internet platform for the exchange of good practices.

There should be **departure from the emphasis on numerical targets and move towards an approach focused on policy outcomes and impact on the economy**, especially in areas such as innovation where the R&D indicator is not a useful measurement and should be substituted by more thorough ways to include improved business performance, more efficient public services, innovative human capital development, new business processes and organisational change. Long-term, individualised action plans in the key areas are needed with benchmarks comparing member states at a similar level of economic development and with a similar economic structure. Action plans should contain recommendations on meeting the objectives.

A new governance structure must bridge the existing gap between the goals set at the community level and the follow up re-

maintaining mainly in the hands of national governments. This deficit can be addressed by **defining a set of key policies and goals which have to be and can be addressed at the community level** with the European Commission and the Council being equipped with tools to enforce these policies effectively. The policies in question would be those dealing with advancing or completing EU-wide markets in strategic areas such as research & development, innovation and services. They should be closely linked to the EU-level spending by means of aligning the objectives of structural funds with the Lisbon goals.

A mechanism would also be needed to push the member states much more effectively to address their key weaknesses. In the present situation, the member states are left to identify these issues and appropriate policies to address them. In the future, there should be a strong mechanism at the community level to assess the performance of the member states and recommend ways of addressing key challenges with adequate enforcement measures. **More effort should also be invested in collecting best practices in each key area** within the EU and providing them as inspiration for countries which are underperforming and need to address their key deficiencies. ▀

¹¹⁾ EU innovation policy: time to step on the gas, Event Report, European Policy Centre, 22 September 2009

Appendix

The position of the three largest EU economies vis-à-vis the United States, Japan, China and South Korea in the area of knowledge and innovation.

Table 1. Number of patent applications.

Number of patents applications (residents & non-residents)	1995	2000	2007
United States	228 142	295 895	456 154
European Patent Office	60 559	100 692	140 763
Japan	368 831	419 543	396 291
China	18 699	51 906	245 161
United Kingdom	27 521	32 747	24 999
Germany	46 158	62 142	60 992
France	15 896	17 353	17 109
South Korea	78 499	102 010	172 469

Source: WIPO

Patent applications are applications filed with a national patent office for exclusive rights for an invention – a product or process that provides a new way of doing something or offers a new technical solution to a problem.

Table 2. Capacity to commercialise innovation.

High-technology exports (% of manufactured exports)	1995	2000	2007
United States	30,8	33,5	30,1
Eurozone	14,7	19,4	15,6
Japan	26,1	28,3	21,6
China	10,0	18,6	30,3
United Kingdom	27,3	30,0	33,6
Germany	12,9	18,0	16,6
France	18,7	23,8	21,2
South Korea	25,9	34,8	32,0

Source: World Bank, World Development Indicators

High-technology exports are products with high R&D intensity, such as in aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery.

Table 3. Number of scientific publications.

Scientific and technical journal articles	1995	2000	2007
United States	193 337	192 743	205 320
Eurozone	125 240	145 763	158 066
Japan	47 068	57 101	55 471
China	9 061	18 479	41 596
United Kingdom	45 498	48 216	45 572
Germany	37 645	43 509	44 145
France	28 847	31 427	30 309
South Korea	3 803	9 572	16 396

Source: World Bank, World Development Indicators

Scientific and technical journal articles refer to the number of scientific and engineering articles published in the following fields: physics, biology, chemistry, mathematics, clinical medicine, biomedical research, engineering and technology, and earth and space sciences.

Table 4. Spending on R&D.

Spending on R&D as a percentage of GDP	1995	2000	2007
United States	2,5	2,7	2,6
European Union	1,8	1,9	2,0
Japan	2,8	3,0	3,4
China	0,6	0,9	1,4
United Kingdom	1,9	1,9	1,8
Germany	2,2	2,5	2,5
France	2,3	2,1	2,1
South Korea	2,4	2,4	3,2

Source: World Bank, World Development Indicators

Expenditures for research and development are current and capital expenditures (both public and private) on creative, systematic activity that increases the stock of knowledge. Included are fundamental and applied research and experimental development work leading to new devices, products, or processes

Table 5. Spending on Information and Communication Technology.

ICT expenditure (% of GDP)	2000	2007
United States	2,7	2,6
European Union	1,9	2,0
Japan	3,0	3,4
China	0,9	1,4
United Kingdom	1,9	1,8
Germany	2,5	2,5
France	2,1	2,1
South Korea	2,4	3,2

Source: World Bank, World Development Indicators

Information and communications technology expenditures include computer hardware (computers, storage devices, printers, and other peripherals); computer software (operating systems, programming tools, utilities, applications, and internal software development); computer services (information technology consulting, computer and network systems integration, Web hosting, data processing services, and other services); and communications services (voice and data communications services) and wired and wireless communications equipment. 🍌



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