Ambitious, but not (very) much needed and poorly equipped: The Lisbon strategy reconsidered

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Introduction

Following the re-launch of the Lisbon strategy/process/agenda in 2005, implementation of reforms in the EU's product, service, financial and labour markets has made further progress, though this may hardly account for the improved economic performance of the EU in 2006 and 2007, the latter being mostly attributed to cyclical factors and much less to the impact of earlier reforms. Still, a reverse causality may actually have taken hold, whereby higher output growth and stronger labour market recovery may have allowed for further structural reforms. Thus far, the contribution of the re-launched Lisbon strategy to structural reform and, especially, economic performance may have been virtually immaterial, whatever (little, if any) relative credit being ascribed to the original Lisbon strategy.

Be that as it may, the re-launch of the Lisbon strategy was meant to provide fresh impetus to the process of economic reform and, for that matter, it entailed modification of those features that had probably weakened the effectiveness of the original approach – at least they had largely been documented as such in the report of the High Level Group on the Lisbon strategy that had been chaired by Wim Kok, in November 2004. Thus, focus was more clearly placed on growth and jobs and emphasis was more explicitly laid to market competition, efficiency-driven public policies, including labour market policies, and innovation-led (sustainable) growth strategies, the latter sometimes, arguably, entailing more than purely efficiency-driven public intervention. Furthermore, two main - headline - targets were chosen, namely the GDP share of investment in R&D and the employment rate, hence, setting aside, or, simply putting in second order those many and disparate targets featuring in the original approach. Besides tighter focusing and parsimonious targeting, streamlining and simplification of the (re-launched) Lisbon strategy was also linked to a clearer allocation of tasks between the Community and member states, consolidation of the strategy's various strands - i.e. the different coordination processes across policy areas - including reporting mechanisms and, supposedly the most important of all, advancing national ownership of the Lisbon agenda.

Nevertheless, the simplified and better focused approach of the revised Lisbon strategy was, soon, partly compromised, perhaps inevitably, in view of changing circumstances, but also owing to political expediency. Thus, following decisions of the European Council, four new priority areas have been added to the 24 integrated guidelines for economic reform, in part addressing social and environmental issues. [1] Also, new coordination processes have been inserted and, accordingly, reporting obligations for member states have increased. Meanwhile, demands for strengthening the social dimension of the revised Lisbon strategy have frequently been made, in practice amounting to calls for enhancing the (relative) institutional status and substantive policy influence of (the open method of) coordination processes in the areas of social protection and social inclusion (for example, Zeitlin, 2008). Yet, as a result of those developments there is a risk that the re-launched Lisbon strategy may end up being too broad to comprehend. To put it otherwise, there is a risk that the revised strategy may, much like the original approach, end up 'being about everything and thus about nothing' - as had aptly been remarked in the report of the High Level Group on the (original) Lisbon strategy. And

[1] These four cutting priority areas are: investing more in knowledge and innovation, creating a more dynamic business environment by unlocking the business potential, in particular for SMEs, investing in people and moving towards an efficient and integrated EU energy policy.

national ownership of the revised Lisbon strategy may, in that case, be costly and virtually out of reach.

Has that partial loss of focus and simplicity been inevitable? How much difference may that really imply for the effectiveness of the revised Lisbon strategy for economic reform? Has the process of economic reform been influenced by the Lisbon growth and jobs agenda thus far? How (and how much) could the effectiveness of the Lisbon process be raised? Should the Lisbon strategy be continued with? Those issues are dealt with in the following sections.

Why caring about an EU agenda for growth and jobs?

The Lisbon strategy was meant to narrate, shape and frame the EU's response to a relatively weakening economic performance that, since the mid-1990s, has put an end to a nearly 25-year long period of almost stable relative per capita output and, thus, has led to a widening of the gap in average living standards between Europe and the US. [2] In particular, the relatively slow output growth in Europe has, evidently, been associated with relatively slow labour productivity growth, which has no longer been sufficient to offset Europe's relatively deficient labour input, that is, its lower rates of employment <u>and</u> shorter work years compared to the US. [3]

Detailed growth accounting has revealed that the post-1995 relative slowdown in European productivity growth - resulting from weaker productivity growth in the EU <u>and</u> much stronger productivity growth in the US compared to what they had previously achieved - [4] has been driven less by relatively lower capital deepening in information and communication technology and mostly by relatively (much) slower growth of multifactor productivity. Multifactor productivity being, directly or indirectly, related to the use of information and communication technology (ICT), the total contribution of the so-called knowledge economy to productivity growth has, thus, been (much) lower in Europe compared to the US, thereby resulting to the relatively slower growth of labour productivity in Europe. (Importantly, though, changes in the composition of the labour force in favour of higher skills contributed roughly equally to productivity growth in Europe and the US). Interestingly, Europe's anemic productivity growth relative to the US has been largely linked to the relatively weak contribution of Europe's market services sector, the EU-US differential contribution of the ICT production sector to average productivity growth being comparatively small - still favouring the US. In fact, the main cross-Atlantic differential has arisen in the distributive trade and financial and business services and its major source has been (differential) multifactor productivity growth, Europe lagging far behind the US in both services sub-sectors (this paragraph mostly draws on van Ark *et al*, 2008; also, Crafts and Toniolo, 2008 and Daveri, 2004).

Europe's relative loss of efficiency in the production process - reflected in its relatively slow growth of multifactor productivity - has been largely attributed to overly restrictive regulation of product and labour markets, resulting in lowered entry rates and reduced competitive pressures on incumbent firms, as well as inhibiting industrial restructuring, including internal re-organisation and size adjustment of firms, and labour reallocation, thereby discouraging

[2] For the EU-15 the level of GDP per capita relative to the US has been 76.8 in 1973, 74.9 in 1995 and 74.1 in 2004 (van Ark *et al*, 2008, Table 2, p. 30).

[3] As a matter of fact, over the period 1995-2004, the labour input, i.e. total hours worked, in the EU -15 was growing at an annual rate (0.7%) almost equal to the US rate (0.6%). Yet, during 1980-1995, total hours worked were rapidly falling in the EU (-0.6%), but strongly growing in the US (1.4%). The level of total hours worked per capita in the EU-15 relative to the US has been 101.9 in 1973, 76.2 in 1995 and 82.1 in 2004 (van Ark *et al*, 2008, Table 3, p. 34 and Table 2, p. 30).

[4] For 1995-2004 labour productivity in the EU-15 grew 1.5% annually, whereas in the US it grew 3% annually, compared to 2.4% and 1.5% respectively for 1980-1995 (van Ark *et al*, 2008, Table 3, p. 34).

investment and innovation (for example, Nicoletti and Scarpetta, 2005; Scarpetta *et al*, 2002). Notwithstanding recent positive trends (see footnote 3), Europe's relative shortfall in the labour input, particularly its shorter work year has been related to the distortionary impact of taxation (Prescott, 2004), or to work-sharing practices, mostly induced by trade unions' demands (Alesina *et al,* 2005). However, it has been also suggested that reduced work hours have largely been in line with Europeans' (genuine) preferences for increased leisure time (Blanchard, 2004). Obviously, those explanations bear very different welfare and policy implications, yet the issue has not been settled empirically.

Some academic economists have urged European governments to embrace deep and comprehensive structural reforms, effectively emulating the US model of market flexibility, or, otherwise, risk the economic and political decline of Europe (Alesina and Giavazzi, 2006). In fact, having underpinned economic growth for most of the second half of the twentieth century, European economic and social institutions, particularly of the corporatist variety, may have become less relevant in economies which have reached the technological frontier and, instead of importing technology and accumulating capital, they have now come to increasingly rely on knowledge and innovation. Reform must, then, be encompassing and systemic in character, thus dealing with complementarities and network-type dynamics associated with thick and complex (usually corporatist) institutional structures, whilst, conceivably, aiming at facilitating mobility and change rather than (the once privileged) stability and continuity (Eichengreen, 2007). Yet, this may hardly imply that the European economic and social model should be dismantled. Asymmetric information, coordination failures and, probably above all, preferences for redistribution being stronger in Europe than in the (US) "land of opportunities" (Alesina *et al*, 2001; Alesina and La Ferrara, 2002), may surely cast doubt on the desirability, let alone political viability of radical deregulation, instead calling for 'recalibrating' (including rationalising and updating) the welfare state (see the discussion in Ferrera, 2008). Nevertheless, a bolder reformist line has also been championed by (third-way) advocates of an 'enabling state', that is, a thoroughly transformed version of the post-war institutional model *inter alia* entailing: a keener embrace of economic globalisation and market competition; an emphasis on active policies aiming at the economic empowerment of individuals; and a stronger focus of (fiscal) redistribution on equality of opportunities and prevention of poverty - and social exclusion.

Undoubtedly, market policy and institutional reform has dominated - and largely filled - the Lisbon agenda, its rationale being, though, that not only may economic performance thereby improve, but that the European (economic and) social model may also increase its relevance and better withstand the financial pressures mostly emanating from demographic trends. However, this is where the consensus nearly ends. Intense debates about the breadth and depth of institutional reform, largely informed by the variety of national institutional configurations and fed by divergence in economic performance and social welfare have, certainly, precluded the emergence of a (more) concrete policy agenda. And, obviously, too, they have left little, if any, room for binding coordination of (national) market policy and institutional reforms at the EU level, merely allowing for their soft or open, that is, Lisbon-type coordination. Regardless of institutional and other divergence, though, those taking a pessimistic, if cynical, view of government policy, have pinned their hopes for supply-friendly reforms to policy competition amongst national governemnts, in effect thinking of coordination as a means for entrenching institutional inertia - and maintaining meagre economic performance.

Be that as it may, absence of binding coordination at the EU level would have probably hurt the effectiveness - and perhaps implementation itself - of market policy and institutional reforms, had cross-border policy spillovers been important. Theoretically, the effects of supply-side policies and institutional reforms may be transmitted across borders mainly through the trade channel and, for euro area member states, via the monetary policy channel too (but see next section). Besides the extent of economic interdependence, the size and, especially, the sign (positive or negative) of those spillovers may depend upon their sourcing in product or labour market reforms, each case bearing different and, often, contradictory and, at least, partly offsetting implications domestically and across the borders (e.g. stimulating the demand for imports or improving the international competitiveness of the reforming country, or, for euro area member states, allowing for reduced interest rates owing to lower inflation - and lower inflationary expectations). However, empirical estimates of the expected effects from coordinated supply-friendly institutional reforms have been modest, though a bit higher for the euro area, probably implying the incidence of small cross-border policy spillovers. Yet, estimates of the expected gains from joint action have been bigger, when simulated policy coordination at the EU level also entailed budgetary consolidation on top of market policy and institutional reforms (Weyerstrass *et al*, 2006; Commission EC, 2007a). Arguably, then, challenging national policy preferences and institutional heterogeneity might have been little justified - the expected gains would have not been enough to outweigh the costs from imposed homogeneity - let alone politically tolerated.

Therefore, it may be only sensible that the Lisbon process has lacked a strong normative dimension, that is, it has been short of legal obligations and sanctions, having, instead, relied mostly - and typically for the so-called new modes of governance - on a strategic and a cognitive dimension (this 3-dimension approach is applied to the open coordination of social and employment policies in Heidenreich and Bischoff, 2008). Accordingly, the Lisbon-type, soft coordination of institutional reforms at the EU level has been usually justified by way of four main arguments, which may, in turn, interpret the strategic and the cognitive dimension of the coordination process.

Thus, in regard to the strategic dimension, it has been suggested that joint action in the area of market policy and institutional reform may give rise to political economies of scale. For example, a government may appeal to its citizens' (national) 'pride' in order to take measures that bring the (national) economy on an equal footing with the other partners' reformed and revitalised economies; or, it may attempt to give its own reform initiatives a universal, ideologically unbiased quality, drawing attention to the fact that the same, or, at any rate, similar reforms are also implemented by governemnts which hold different ideological convictions (Debrun and Pisani-Ferry, 2006). Also, it has been often said that the existence of a common, if broadly outlined, reform agenda, coupled with (less than fully formal) institutionalization of a procedure for reporting and monitoring national economic reforms, may effectively provide governemnts with a lever to use in order to counter opposition to reforms; that lever arises out of the commitment to (softly) coordinate national policy with policies of other member states, thus, essentially, it takes the form of an external constraint to national policy-making (Begg, 2008). Finally, on the strategic front, it has been argued that the Lisbon reform agenda allows for the realisation of policy complementarities between reforms in product and financial markets, for which the EU often bears responsibility, and labour market reforms, responsibility for which mostly belongs to member states, thereby increasing the gains from (soft) policy coordination at the EU level (Debrun and Pisani-Ferry, 2006). Yet, the case partly rests on an implicit assumption, namely that the appropriate sequence of reforms has been already put in place, whereby deregulation - or, for that matter, re-regulation - in product and financial markets, following the establishment of the internal market, has paved the way for implementing labour market reforms.

However respectable, those arguments may not be very convincing; and the strategic importance of the Lisbon coordination process for the implementation of domestic supply-friendly institutional reforms might have not been adequately argued. Thus, market policy and institutional reforms often having significant redistributive effects, those losing from reforms may obviously be less inclined to appreciate an increase in the average welfare, whatever the implications of that increase may be for the 'national prestige' - and for the their country's place in European and international competitiveness rankings. And, of course, it is hard to believe that 'national prestige' may strengthen the winners' voice, let alone political influence, in supporting reforms. For the same reason, then, 'naming and shaming' would probably have little bearing on the domestic politics of reform, whilst unnecessarily politicising the process of monitoring national action plans; wisely the proposal was never endorsed. Political scale economies may, also, be rendered irrelevant in view of profound differences amongst national political systems, implying *inter alia* different dynamics of policy change and policy inertia, but also in view of asymptotic electoral cycles, implying *inter alia* that chances for electorally unpunished policy changes - when it is possible to stretch changes over longer periods of time - may seldom arise in unison across member states (on the decisive influence of those factors on the politics of welfare reform, see Immergut *et al,* 2007; Armingeon and Giger, 2008).

Furthermore, the Lisbon agenda may hardly serve as a credible external constraint to national policy-making, the reasons being its (entirely reasonable) lack of legally binding sanctions and/or rewards - unlike, say, the convergence criteria for EMU or the Stability and Growth Pact - and, perhaps unsurprisingly, the lack of attention paid to it in national parliaments and, especially, in the media. On the other hand, blame avoidance being an important aspect in the politics of reforms, in particular welfare state reforms (Weaver, 1986; Pierson, 1996), putting the blame on the Lisbon process and, for that matter, scapegoating the EU, may be a convenient choice for national governemnts. Arguably, that choice misrepresents reality and although it may likely fail to have an impact on policy-making, it may probably add to citizens' disillusionment with European integration. All told, one may suggest that the re-launched strategy's focus on advancing national ownership of the Lisbon agenda may partly, at least, imply that the importance of political scale economies and the external constraint for implementing economic reforms has been relatively downgraded. Yet, one may also doubt that national ownership of the Lisbon process may be strengthened by mere procedural changes - as attempted with its 2005 re-launch.

Finally, the issue of policy and institutional complementarities may not be as simple as advocates of the Lisbon strategy are eager to acknowledge. Thus, for all its intricacies, rigorous identification and measurement of complementarities may often run counter to widely received views (Deeg, 2007), whilst empirically strong institutional complementarities may frequently favour resistance to change, as mostly argued in the VoC literature (Hall and Soskice, 2001). Also, the likelihood for complementarity-driven institutional reform may be higher in cases that change has already occurred in a hierarchically dominant institutional domain, within the whole set of complementary institutions, although the direction of that complementarity-driven change, i.e. whether it restores prior complementarities or allows for a shift to a new set of complementary institutions, may be hard to predict. However, changes in subordinate institutional domains may likely have little knock-on effects (Deeg, 2007).

Now, if one subscribes to the view of the VoC literature that product and financial market regulation constitutes a hierarchically dominant institutional domain (but see Schmidt, 2008), one may reasonably expect that, following changes in the EU product and financial markets, reforms of labour market institutions may also be implemented. Nevertheless, one may hardly predict the quality and direction of institutional change in European labour markets. Economists have argued that in a world of lower rents, brought about by product market deregulation and liberalisation of financial markets, resistance of trade unions to labour market reforms may probably diminish (Blanchard and Giavazzi, 2003). However, that may not apply to the whole range of labour market institutions, nor may entail wholesale changes in non-competitive arrangements. In fact, one may contemplate that trade unions or groups of insiders may fight hard to avert institutional reforms that have an effect on rent-seeking activity and a bearing on the security and distribution of even lower rents (insiders-outsiders models would likely make such predictions). [5] The resulting institutional configuration may, thus, be hovering between restoring prior complementarities and shifting to a new set of

[5] As it is said 'half a loaf is better than no bread'.

complementary institutions, albeit at the cost of uncertainty and inefficiency. But that would probably turn the Lisbon process of policy coordination on its head (see next section).

Therefore, the strategic dimension of the Lisbon process may likely have little impact on the domestic politics of economic reform, or, to put it otherwise, the Lisbon agenda may barely allow for favourable changes in the incentives and constraints, i.e. in the fundamentals of reform strategies, facing policy actors and, particularly, governemnts. Unsurprisingly, several commentators have argued that the impact of the Lisbon agenda and, especially, of the soft (open) policy coordination processes on the national policy field(s) may mostly be felt at the cognitive level, though, perhaps later, that impact may be traced in policy outcomes too (on the social and employment policies, in particular, see Heidenreich and Bischoff, 2008). The cognitive dimension of the Lisbon process has, specifically, entailed mutual learning and exchange of experience amongst member states, associated with benchmarking and comparison of (national) economic performances, and has implied, if anything, a change in national discourses.

Conceivably, though, the alleged importance of the cognitive dimension of the Lisbon agenda may hardly, if ever, be empirically confirmed. Notwithstanding its iterative character, intensity of exchange amongst national officials and between national and European officials and detailed documentation of (national) policy experience, the Lisbon process of mutual learning may claim neither exclusivity, nor unrivaled (cognitive) influence. Besides, there is enough evidence to suggest that informal learning processes have played a (far) bigger role than formal ones in shaping policy-making and institutional reforms (Meseguer, 2003), the best example, most probably, being independent central banking across the globe (McNamara, 2002). Furthermore, formal policy learning processes may, reasonably, not take into consideration informal norms and long established conventions that may crucially impact on policy-making (Algan and Cahuc, 2006; Bovenberg and Teulings, 2008), yet they may not readily be taught, let alone exported. Last - is it least too? - institutionalised policy learning processes, the Lisbon process featuring on top of the list, may often adjust slowly to rapid changes in the broader policy environment, globalisation being their primary source (Baldwin, 2006). In that case, policy advice should favour diagnosis and experimentation over prescription, benchmarking and identification of best practices (Rodrik, 2008). Yet, there is an obvious trade-off between stability of the process (as provided for by the 3-year 'Integrated Guidelines' and associated apparatus for reporting and monitoring national policies) and state-of-the-art policy advice, the former being, though, indispensable for a (coherent) policy strategy, but the latter being readily supplied by other, equally authoritative sources (e.g. OECD).

Admittedly, this paper has, thus far, levied a strong criticism against the Lisbon process and raised major doubts about its effectiveness in facilitating economic reforms. However, those doubts have mostly been linked to the strategic and the cognitive dimension of the Lisbon agenda. The strategic dimension has been found too thin and largely inconsequential. The cognitive dimension has been found lacking in exclusivity, influence and, perhaps, suitability; but that has partly been the price paid for a stable strategy - and policy coordination - framework. On the contrary, the weakness of the normative dimension of the Lisbon agenda has been perceived as both reasonable and inevitable. Are those doubts empirically sustained? How may the effectiveness of the Lisbon strategy be increased? These questions are dealt with in the next section.

Isn't it time we changed course - not merely gear? [6]

Reform of the European economic and social model may, following the Lisbon agenda for growth and jobs, entail no less than a thorough overhaul of the regulatory framework and

[6] This section draws heavily on Koutsiaras 2008a and 2008b

institutional organisation of product, financial and labour markets. It may also involve restructuring of public finances, conditioned on keeping them solvent and sustainable. Those reforms may, arguably, pose a daunting task for democratic – and electorally not suicidal – governments and national political systems, the principal reason being that the benefits and costs form those reforms are unevenly distributed amongst individuals, socio-economic groups, geographical regions and, also, over time, albeit in ways that differ across policy areas. Nevertheless, quite a few analysts and, most certainly, the architects of the Lisbon strategy, have argued that market policy and institutional reforms may be both achievable and sustainable (for example, Blanchard, 2004).

As a matter of fact, the logic underlying the Lisbon strategy has been much inspired by the so-called 'There-Is-No-Alternative' view of market policy and institutional reforms. The TINA view of reforms reflects a certain perception of the dynamics of European economic integration, in conjunction with a systemic view of the European economic and social model, whereby simple linkages and/or complementarities between policy areas are deemed functionally indispensable and politically crucial. Reformist governments may, therefore, mainly need to vigorously confront the regulatory failures and institutional rigidities in one policy area. Reforms in other policy areas may, then, be considerably easier to make and, in some cases, be effectively demanded. In fact, an almost ideal sequence of structural reforms may wisely and, indeed, practically uncontroversially have been put in place, following establishment of the internal market associated with product and financial market deregulation. It has, accordingly, been argued - to repeat discussion in the last section - that in a world of lower rents, related to product market deregulation, and higher elasticity of labour demand, linked to financial market liberalisation and high capital mobility, reform of labour market institutions may, almost inevitably, follow suit, as European trade unions adjust to the changing circumstances.

Establishment of EMU may probably have further reduced trade unions' resistance to labour market reform via, firstly, effectively increasing both market competition and the elasticity of labour demand and, secondly, removing a policy instrument that was meant to withstand country-specific external economic disturbances, thereby putting a premium on swift market adjustment (as pointed out in Sibert and Sutherland, 2000). What is more, product and financial market deregulation and, for that matter, institutional reforms in those areas have often been directly enforced and/or dictated by Brussels, hence allowing national governments to spend most of their precious political capital on labour market and social policy reform. Thus, the Lisbon process may, as discussed in the last section, supposedly assist governemnts to invest their political capital in the most efficient manner.

However, there has been enough evidence to cast doubt on the effectiveness of the Lisbon process for policy coordination in regard to motivating supply-friendly institutional reforms. For example, it has been observed that the pace, intensity and commitment towards reforms have been varying considerably across member states, whilst progress across different policy areas has also been unevenly scattered. It has also been found that implementation of the Lisbon process has barely influenced national attitudes towards reforms or national policy efforts, hence little changing ranking of member states in regard to policy quality – and economic performance. Interestingly, too, a sort of reform – or Lisbon – fatigue has impinged on both the pace and content of Community policies to complete the internal market for services and remove obstacles to labour mobility, but less so in regard to initiatives to simplify regulation and reduce burdens on business (Begg, 2006 and 2007). Thus, in the words of a recent Commission document, the Lisbon policy coordination processes '...have been successful in allowing the Member States and the Commission to define common goals; but less so in stimulating the necessary degree of ambition and policy effort to reach these common goals" (Commission EC, 2007b, p. 10). Nowhere have those observations been more relevant than in field of labour market policy and institutional reform.

European labour market performance has, since the beginning of the present decade, been constantly improving, including a significant reduction in rates of unemployment and a notable increase in employment rates. However, a trade-off between employment and productivity growth has been noteworthy, though it has mostly been pronounced in member states experiencing stronger employment growth and more frequently observed in low-growth "old Europe" than in fast-growing "new Europe". Obviously, those developments have been causally related to reforms that have, especially since the mid-1990s, been implemented in European labour markets (Dew-Becker and Gordon, 2008). Yet, in spite of their increased pace and frequency, those reforms have seldom been deep and/or comprehensive. Instead, they have been mainly marginal in scope and scale and, also, encompassed measures almost equally split between those reducing levels of protection and those providing for increased protection, whilst occasionally comprising contradictory policies undoing one another over a short period of time (stock of reforms is briefly taken in Begg *et al.*, 2007, pp. 94-96).

Marginal reforms, in particular, have often entailed only partial relaxation of employment rules, leaving the entitlements of those already employed under permanent contracts virtually untouched, hence resulting in two-tier labour market institutions – and dual labour markets. Thus, strong rises in the shares of so-called flexible forms of employment, especially fixed-term employment and temporary agency work, have actually been observed in several EU member states. The frequency of low-wage employment has, consequently, increased, along with an increase in volatile employment and lack of training for those working under flexible job contracts, thereby negatively affecting labour productivity (Commission EC, 2006, chapter 2). Furthermore, reforms have also involved changes in active policies, unemployment benefits and labour taxation, whilst having little touched upon early retirement, regular employment protection and wage-setting institutions. (Arpaia *et al,* 2005). Interestingly, implementation of labour market reforms has not proven much easier amidst weak economic conditions associated with a higher risk of job losses, whilst comprehensive supply-friendly labour market reforms have seldom been carried out under unfavourable economic conditions (Begg *et al.*, 2007, p. 97; Boeri, 2000).

The need for comprehensive reform of labour market regulations has, probably, been made clear. It also has formally been acknowledged by national governments. Indeed, the Council of the EU has called for a "sustained reform effort", *inter alia* conceding that only limited progress has been achieved with respect to reform of employment protection legislation and pointing to the need for reforms that improve work incentives in the welfare schemes and allow for increased labour utilisation by raising both employment and the average number of hours worked (Council of the EU, 2007). Yet, no matter what the collective pronouncements of national governments are, comprehensive reform of European labour markets may still be practically unattainable. As a matter of fact, labour market reforms have largely been shaped by political considerations which have, initially, been prompted by the uneven distribution of benefits and costs from reforms and, subsequently, influenced by shared perceptions of fairness and distributive justice (a similar view is argued in Bertola, 2008) and, quite often, by interest group politics (a similar point is raised in Alesina *et al*, 2008; also Saint-Paul, 2000). Arguably, assertions of fairness and equity may occasionally, at least, offer ideological legitimacy to interest group demands and may, even, galvanise the opposition to reform on the part of politically decisive labour market participants. No doubt, though, proliferation of flexible employment contracts may have nothing to do with inclusiveness, employment and income security and fairness in the labour market; but it may effectively reduce competitive pressures on core labour market insiders - whilst increasing the number of employees at the risk of (relative) poverty.

The chances of comprehensive labour market reforms being implemented may, thus, largely depend upon improving their distributive effects, particularly increasing the benefits from reforms and bringing them forward, whilst also discounting their costs and providing for adequate compensation to those bearing most of the burden. Comprehensive labour market reforms may, though, put an end to the proliferation of flexible job contracts, thereby also disassociating employment growth from low-productivity, low-wage jobs. Moreover, comprehensive labour market reforms may also reduce the influence of - and principally the incentives for - rent-seeking interest group politics in the labour market, thereby allowing for bolder and faster rent-reducing, productivity enhancing product market reforms. A higher employment and productivity growth path for Europe may, thus, be within reach. The crucial issue, then, becomes how to attain a better, fairer and politically sustainable distribution of benefits and costs from market policy and institutional reforms, especially reforms of labour market institutions.

Macroeconomic policy may practically be of little help. Fiscal policy may be cushioning temporary increases in the output gap associated with institutional reforms, thereby averting short-term, yet politically undesirable increases in unemployment. The budget may be bearing the direct cost of certain reforms (Razin and Sadka, 2002), whilst also footing the bill of compensation packages granted to reform losers so that they stop resisting policy change and/or funding policies to bring employment gains forward. Although the reformed Stability and Growth Pact may, in principle, allow for temporarily conditioning fiscal consolidation on practicing market policy and institutional reforms, much depends on its implementation. Yet, a loose implementation of the Pact may arguably jeopardise the credibility of its fiscal rules and, hence, put in danger financial stability. On the other hand, an accommodating monetary policy stance may, in principle, be conducive to labour market reforms, by bringing employment gains forward and, also, allowing for short-term budget improvements. Yet, in practice - both for Euro-area member states and, effectively, for EU member states which have adopted some form of currency board - a monetary stimulus to labour market reforms may only be in short supply, as it would take a great and, perhaps, inflationary deal of monetary easing, on the part of the ECB, to cater for divergent equilibrium and actual rates of unemployment and levels of potential and actual output.

Thus, contrary to the often espoused TINA argument, European monetary unification may actually weaken the incentives for labour market reform, for the simple reason that, having lost (full) control of policy instruments to stabilise the economy, national authorities have less to gain from reform, be it in terms of a looser monetary policy or, perhaps, increased fiscal discretion, compared to what would have been the case had they opted out from monetary union. Unsurprisingly, governments have, thus far, mostly followed the convenient route of marginal and/or selective reforms that have provided for some improvement in employment performance and have allowed for some increase in labour market flexibility, as it certainly is required for EMU members' adjustment to (asymmetric) economic shocks, albeit - to repeat it once more - at the cost of lower productivity and higher incidence of low-wage employment.

It, thus, appears that comprehensive labour market reform has probably been entrapped within a governance system that falls short of producing adequate incentives for that purpose, most probably carrots, sticks being institutionally - and indeed reasonably - precluded. Obviously, that goes to the heart of an effective reform strategy. And, arguably, it should be partly addressed by a strategically vibrant Lisbon process - in particular an active strategic dimension of the Lisbon agenda - that may favourably impinge on the domestic political economy of labour market reform. As it is argued here, that goal may better be achieved via a system of financial incentives, in effect transfers of EU funds aiming at rewarding implementation of comprehensive labour market reforms, whilst alleviating domestic political economic constraints. In particular, EU financial support may, largely, entail backing national government policies and supplementing national budgetary resources in order to attain a socially tolerable and politically acceptable distribution of gains and losses from labour market reform, which might often imply compensating those incurring most of the burden.

Doubtless, the sort of labour market policies eligible for EU financial support may closely reflect or directly follow the Lisbon 'Integrated Guidelines', particularly the guidelines for the employment policies of the member states. However, those EU transfers may not apply to policies eligible for assistance from the European Social Fund. Instead, they may support reforms seeking to stiffen competition in the labour market and remove or, in some cases, offset distortions, including compressed wage distribution, which reduce effective labour supply and make the search and matching processes lengthier and costlier than would otherwise be. They may, also, be granted to institutional reforms which cater for asymmetric information in the labour market and lack of access to financial and credit markets, thereby providing for better quality of jobs and increased labour productivity, as well as income security, yet at a lower cost (e.g. in terms of unemployment) than would have been obtained, had the reform at hand not been implemented. However, EU financial support may not be given for policies which may likely increase labour market segmentation and, possibly, put long-term labour market performance at risk. Thus, in general, EU financial aid may be granted to labour market policy and institutional reforms which may allow for an improvement in the terms of relevant trade-offs, or, to put it otherwise, may provide for a movement towards 'efficient redistribution' - and away from inefficiency - in the labour market.

For instance, EU financial support may be granted to reforms aiming at substituting higher unemployment insurance for stricter employment protection legislation, thereby increasing flexicurity in the labour market - and, probably, allowing for an increase in the level of employment and a reduction in the rate of unemployment, especially amongst certain groups of workers. EU financial transfers may, also, be awarded to - and reward - policies aiming at making work pay, or increasing job search incentives for disadvantaged groups, or simplifying and transforming employment protection legislation in accordance, say, with experience-rating principles. For those purposes, then, EU financial resources may directly contribute to the national budget, thereby allowing for lower spending cuts and/or tax increases than would otherwise be; or, they may be added to national resources to finance targeted wage subsidies in order to increase employment of less employable workers; or, they may be allocated to social protection systems, thereby helping to provide for compensatory measures for those left worse-off following reform (for a much detailed analysis of how that scheme would practically work, Koutsiaras, 2008a).

Obviously, while drawing on the experience of the recently established European Globalisation Adjustment Fund, the scheme proposed here goes many steps further and, even, gets into the sacred area of redistribution, albeit not unconditionally. As a matter of fact, this scheme could take both the place and the dowry of the Globalisation Adjustment Fund, which may be barely thought of as a (very) successful policy (Begg, 2007; Koutsiaras, 2008a; see also Commission EC, 2008), although its detailed scrutiny, assessment and funding may be part of the debate on the mid-term review of the Community budget. Be that as it may, the strategic dimension of the Lisbon process may thus be considerably strengthened and its national ownership may accordingly be substantially increased, thereby raising expectations for comprehensive market policy and institutional reforms, whilst also addressing social anxieties and equity concerns associated with economic reforms. That would certainly remove pressures for 'social modifications' of the Lisbon strategy, which may add little real value and may only lead to unnecessary complications in policy coordination processes. And it would probably weaken the politics of blaming the EU for domestic economic ills and policy failures.

Conclusions

In the introductory section of this paper a number of questions were raised, the answers to which may now be summarised. Thus, it has been argued that the revised Lisbon strategy may not improve on the original strategy's low effectiveness in stimulating market policy and institutional reform, in particular reform of labour market policies and institutions. Although simplification, including clearer focusing, of policy coordination processes may, in principle, be welcome, its contribution to policy-making - and to the domestic political economy of economic reform - may hardly be traced, partly because it may only be insignificant; and it may prove unsustainable too. It has further been argued that an effective Lisbon agenda may principally rely on a strengthened strategic dimension, as long as its normative dimension may both reasonably and inevitably be weak, whilst its cognitive one may not really make a difference. Thus, it has been suggested that a system of financial incentives aiming at rewarding labour market reforms may be strategically important. That scheme may, in particular, assist national governemnts to alleviate domestic political economic constraints to reform and, for that matter, attain a socially tolerable and politically acceptable distribution of gains and costs over time and amongst labour market participants. It may, thus, finance policies aiming at removing inefficiency in labour markets and moving towards 'efficient redistribution'. The Lisbon agenda may, in that way, be strategically strengthened and its national ownership considerably increased, raising the prospects for economic reform and addressing issues of fairness and equity.

A final remark may now be raised. No matter what the future holds for that proposal - and my rational modesty may only allow for 'diminished expectations' (a very big cheer for Paul Krugman!) - the Lisbon agenda should not be dismissed. If anything, the Lisbon strategy has been symbolically important; it has manifestly displayed the collective commitment of EU member states to revitalising the European economies and reforming the European economic and social model. Doubtless, the symbolic value of the Lisbon agenda may only increase and, even, spread across the European borders; indeed, the message of sound economics - and economic policy - may need to get louder and clearer in the turbulent months and (maybe) years to come.

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