

Tracking, analysing and modelling structural reforms

Work underway in the Lisbon Methodology Working Group

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The Lisbon Strategy

In March 2000 the Heads of State or Government of the European Union meeting in Lisbon set for Europe a very ambitious and challenging goal: to become “the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”¹ by 2010. This may appear overoptimistic nowadays, and even somewhat naïve.

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We should not forget however, that in 2000 optimism was not such a rare commodity: economic prospects were still bright, the dot-com bubble had not yet burst, and European leaders were galvanised by the achievement of monetary union. The start of the new millennium, with its symbolic twist, may have also played a role in calling for bold and ambitious goals. Moreover, what was at stake was of the utmost importance: safeguarding the European social model and the living standards of European citizens, threatened by the emerging challenges of globalisation and population ageing and by much more dynamic growth in other parts of the developed world, especially in the US.

Origins of the Lisbon Strategy: a short history

The Lisbon Strategy was developed by improving existing processes and giving them impetus to fulfil the new vision for Europe, namely:

- The Luxembourg process, launched in 1997 with a view to coordinating national employment policies (European Employment

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¹ European Council, Lisbon 23 and 24 March 2000, Presidency conclusions.

Strategy - EES);

- the Cardiff process, started in 1998 to pursue the optimal functioning of product, service and capital markets;
- the Cologne process, that in 1999 established the EU Macroeconomic Dialogue to foster the coordination of fiscal, monetary and wage formation policies.

In June 2001 in Göteborg the European Council adopted the EU Sustainable Development Strategy (SDS), adding the Environment as a third pillar to the economic and social dimensions of the Strategy agreed upon in Lisbon. On that occasion, the Council established “the principle that the economic, social and environmental effects of all policies should be examined in a coordinated way and taken into account in decision-making”².

To pursue the Lisbon targets the European Council adopted the Open Method of Coordination (OMC), a working approach already introduced in 1999 in the context of the Employment Strategy.

Most of the policy areas covered by the Lisbon Strategy fall within the responsibilities of Member States and thus the OMC has the advantage of establishing a common framework for cooperation among Members (common targets, indicators and policy guidelines), and between these and the European Commission, without undermining national ownership. Critics of the OMC maintain that this method is too feeble to be effective in driving reform action at national level, as it does not have binding force and ultimately relies only on the instruments of peer pressure and moral suasion exerted by the Commission and the Council. Conversely, advocates of OMC point out that - soft as it may be - this system offers an opportunity for developing a common understanding of policy issues and the identification of best practices, igniting a dialogue that is eventually bound to influence the national debate in areas from which the European dimension would otherwise have been banned.

Under the OMC the European Council plays both a strategic and a monitoring role, reviewing progress against the agreed priorities in the spring of each year and providing guidance for the way forward. In 2000, a list of targets was drawn up. The overarching goal for the European economy was to become the most dynamic and competitive knowledge-based economy in the world.

The Lisbon strategy relies on three pillars:

- *Economic*
- *Social*
- *Environmental*

The Open Method of Coordination tries to balance the need for common and consistent reform action taken by Member States with the principle of national sovereignty.

² European Council, Göteborg 15 and 16 June 2001 - Presidency Conclusions (SN 200/1/01 REV 1).

Table 1. Key Lisbon targets

Set in	Target	Deadline
2000	Annual economic growth around 3%*	-
2000	An overall employment rate of 70%	2010
2000	An employment rate for women of over 60%	2010
2001	An employment rate of 50% among older workers	2010
2002	Overall spending on R&D and innovation of 3% of GDP, with an adequate split between private and public investment**	2010
2007	A reduction of 20% in greenhouse gas emissions compare to 1990 levels, a 20% share of renewable energies as well as a 20% improvement in energy efficiency by 2020***	2020

* This target, set in 2000 as a yearly objective, was not formally re-endorsed as a key Lisbon target in the 2005 mid-term review.

** Text updated to reflect the new wording used in the 2005 Spring Council.

*** Updated. In 2002 the European Council had established an 8% reduction of greenhouse gas emissions in compliance with the Kyoto Protocol.

However , when the Lisbon Strategy was refocused in 2005, the list of targets boiled down to two emblematic Lisbon goals: investment in research and development equal to 3% of Europe's GDP and a 70% employment rate, both to be attained by 2010.

The 2005 relaunch: a Growth and Job Strategy

In 2004, it was clear that the Lisbon Strategy was not delivering the expected results. Not only had the gap in growth with the US widened since 2000, but Europe was also confronted with the combined challenges of low population growth and ageing.

This is why the Spring European Council held in Brussels in 2004 commissioned an independent analysis to contribute to the mid-term review of the Strategy. A High Level Group was established, chaired by Wim Kok, former Prime Minister of the Netherlands, and involved representatives of the main stakeholders. The report of the High Level Group, or Kok Report as it is commonly known, concluded that the original priorities of the Lisbon Strategy remain valid and that its “disappointing delivery is due to an overloaded agenda, poor coordination and conflicting priorities. Still, a key issue has been the lack of

In 2004, the Kok Report concluded that the disappointing delivery of the Lisbon strategy was due to an overloaded agenda, poor coordination, conflicting priorities and the lack of determined political action.

determined political action³”.

Taking on board many of the suggestions of the Kok Report⁴, the 2005 Spring Council relaunched the Lisbon Strategy, refocusing its priorities on growth and employment and stating that “Europe must renew the basis of its competitiveness, increase its growth potential and its productivity and strengthen social cohesion, placing the main emphasis on knowledge, innovation and the optimisation of human capital”⁵. A key element of the revised strategy is the idea of a partnership approach, whereby Member States and the Commission, each within their area of responsibility, work together to address common challenges

The mid-term review also improved the governance of the process, with a view to facilitating the identification of priorities, increasing Member States' involvement and streamlining the reporting and monitoring procedure.

The revised Strategy is based on a three-year cycle, which starts with a ‘strategic report’ submitted by the Commission, examined in the relevant Council configurations and then discussed at the Spring European Council meeting, that establishes political guidelines for the economic, social and environmental strands of the strategy.

In order to simplify the entire framework and increase its coherence, the broad economic policy guidelines (BEPGs) and the employment guidelines (EGs), already used as independent tools to coordinate member States' policies, were brought together in a single instrument: the ‘integrated guidelines’ (IGs).

It was also established that, on the basis of the integrated guidelines, Member States would draw up ‘national reform programmes’ (NRPs), reflecting the specific national priorities and situations. The NRPs offered the twofold advantage of reuniting in a single and coherent document the planning and reporting stages of reforms undertaken nationally under the three Lisbon pillars and increasing national ownership. In an effort to enhance internal coordination and process visibility, the Council invited Member States to appoint Lisbon national coordinators (informally known as Ms. or Mr. Lisbon).

As a complement to the national programmes, the European Commission would submit a ‘Community Lisbon programme’ (CLP) covering actions at Community level.

The 2005 relaunch of the Strategy:

- Focus on growth and employment
- National ownership
- Partnership approach
- Improved governance

A partnership approach: Member States and the Commission must coordinate to effectively address the common challenge. The instruments to plan and report on policy measures are the National Reform Programmes, and the Community Lisbon Programme.

³ “Facing the Challenge - The Lisbon strategy for growth and employment”, Report from the High Level Group chaired by Wim Kok, November 2004.

⁴ Not all, however. Especially the idea of publishing yearly league tables that would ‘name and shame’ Member States failing to reform and at the same time ‘fame’ the most successful ones was not endorsed in the mid-term review.

⁵ European Council, Brussels 22 and 23 March 2005 - Presidency Conclusions (7619/1/05 REV 1).

On a yearly basis, the Commission carries out an assessment of progress in the implementation of the three pillars of the Strategy, working together with Member States within technical committees attached to the relevant Council configurations, in line with the new partnership approach. Assessment of macro and microeconomic policies (based on the IGs) is carried out in the Economic Policy Committee, an advisory body to the Ecofin Council, and in particular within the Country Review Working Group. Through a multilateral surveillance process, Member States assess each other's progress in living up to the commitments they undertake in their NRPs. Multilateral surveillance also offers an ideal opportunity to exchange policy experiences, best practices and challenges. A parallel process on the assessment of employment policies, the Cambridge review, is carried out in the Employment Committee (EMCO), attached to the Employment and Social Affairs Council.

Progress on the three Lisbon pillars is reviewed yearly by the Spring European Council that issues country-specific recommendations to Member States in order to stimulate reform action.

Each spring, on the basis of the Commission's assessment, the European Council reviews progress on the Lisbon targets and, if needed, issues policy recommendations to Member States to step up reform efforts in critical areas.

Assessing progress in structural reforms: the Lisbon Methodology Working Group

In September 2006, the EPC considered that: "The main weakness of the Lisbon Strategy in the past has been the gap in the delivery of reforms. Both the scale of structural reforms and the speed with which they have been implemented have been insufficient to meet the Lisbon challenge. Devising a well-focused method for better monitoring of actions and results is therefore a clear priority. Both quantitative and qualitative methods have a role to play"⁶. In considering the Commission's proposal for the development of a methodological framework for assessing progress in the implementation of structural reforms, the EPC added that "a clearly articulated method is vital to the transparency of the Lisbon strategy, while at the same time avoiding a purely formulaic approach and allowing for proper application of intelligent judgement".

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In October 2006, an EPC technical working group was established to work together with the Commission in order to drive forward the development of methodological approaches to track, analyse and model structural reforms

⁶ ECFIN/EPC(2006)REP/54310 final

undertaken as part of the Lisbon strategy⁷: the Lisbon Methodology Working Group (LIME). The LIME Group met for the first time in February 2007 and since then has benefited from close collaboration with the ECB, the OECD and EMCO.

In carrying out its mandate, the LIME Group has kept its focus on the practical application analysis for policy making. Progress has been made in each of the three methodological strands (tracking, analysing and modelling reforms), with a different degree of progress due to the varying degree of complexity of the approaches being developed.

Tracking structural reforms: the reporting table

The LIME Working Group developed a standardised table to report on structural reforms undertaken at national level as part of the Lisbon strategy. The reporting table is submitted yearly by Member States along with their National Reform Programmes and provides a comparable and timely summary of new measures underway as well as of progress in the implementation of measures set out in the NRPs in previous years.

The reporting table rests on three building blocks:

- A description module: describing content, rationale and timing of reform measures.
- A classification module: in which measures are classified against integrated guidelines, national priorities, country-specific and euro-area recommendations and 'points to watch'⁸ issued by the Council.
- An optional impact and follow up module: reporting on national evaluation procedures, direct budget impact and mapping against relevant structural indicators and policy areas.

Work on this strand of the methodology has virtually been completed. A user-friendly web-based application is being developed to enable Member States to fill out the reporting table online, thus streamlining the recording, storing and use of information, both for prompt consultation by the Commission services during the annual evaluation of progress and for completing and maintaining the

⁷ Mandate of the Lisbon Methodology Working Group (ECFIN/EPC(2006)REP/55906 final).

⁸ Similar to country-specific recommendations, but carrying a somewhat minor degree of severity, 'points to watch' are issued by the European Council to Member States to identify areas where reform action is needed.

Commission's databases on structural reforms⁹.

Analysing structural reforms: the Lisbon Assessment Framework

The core task of the LIME Working Group so far has been the development of a methodological framework to identify policy areas, relevant to growth and employment, where Member States are over or underperforming, in order to single out critical areas that are potential candidates for reform. This method is called the Lisbon Assessment Framework (LAF)¹⁰.

The LAF systematically compares the performance of Member States in terms of per capita GDP in twenty policy areas affecting growth, measuring both levels and changes against a benchmark (the EU15 average has been considered as a working assumption, although the LAF allows a flexible choice of benchmarks). It is rooted in an extensive survey of the economic literature and involves a consistent statistical examination of key indicators (mostly structural indicators of Eurostat and EMCO). The LAF is then qualified through additional evidence on country-specific conditions and circumstances¹¹.

The Lisbon Assessment Framework (LAF)

ANALYSIS	GDP	Policy Performance	Screening
	Analyses of 12 GDP components in level and changes	Evidence-based analysis of 20 policy areas affecting GDP. Indicator-based assessment which is then qualified with country-specific information	Examines links (identified in the literature survey) between performance in policy areas and relevant GDP components
OUTPUT	GDP	Policy Performance	Screening
	Relative performance (+ = -) of GDP components	Relative performance (+ = -) of policy areas	Underperforming policy areas qualified with links to GDP components

⁹ In particular: the LABREF database, covering enacted labour market measures, and the MICREF database on microeconomic reforms.

¹⁰ The full fledged documentation on the LAF will be published in September 2008, on the occasion of a conference that will be held in Rome, dedicated to "Strengthening delivery of Lisbon Reform" organised jointly by the European Commission, the Economic Policy Committee and the Italian Ministry of Economy and Finance.

¹¹ The EPC Lisbon Methodology Working Group, *"The LIME assessment framework (LAF): a description of the methodology"*, presented to the June EPC (to be published in September 2008). See also the Commission's notes "A possible approach for identifying the most important growth-enhancing policies in EU Member States" (ECFIN/REP 52368) and *"The Lisbon assessment framework (LAF): possible improvements and next steps"* (ECFIN/ REP 51961).

LAF is structured around three main elements.

- First, there is an examination of the sources of per capita GDP differentials and the main components of growth. A statistical analysis is carried out on twelve GDP components (3 demographic, 6 labour utilisation, and 3 labour productivity components), measuring both levels (2006) and changes (2000-06) against a benchmark (EU15).
- Second, an evidence-based analysis of performance is carried out in 20 policy areas relevant to growth and employment. This consists of an indicator-based assessment, the results of which are then qualified on the basis of pre-determined criteria by country-specific information¹². The outcome is an assessment of the relative performance (+ = -) in all policy areas.
- Finally, for the policy areas identified as being underperforming (-), a screening exercise examines whether there is a coincident underperformance in GDP components that the literature survey suggested as being related to the areas under consideration.

The outcome of the LAF is a list of critical areas for each Member State, where underperformance has been identified both in terms of policies and relevant GDP components. In its first application, the analysis has been carried out in the form of individual "country studies", specific for each of the 27 Member States.

It must be noted that the LAF is not meant to be a ready-to-use and automatic device for producing policy recommendations. Rather, it is intended to be a useful tool - among others - to help reach a common understanding of important economic issues affecting EU countries and the progress made in these areas.

There are, indeed, important limitations to the LAF that should be borne in mind. A non-exhaustive overview of the main issues, with the usual caveats

The LAF is not a ready-to-use device for producing policy recommendations. It is not meant to be a rule, but is an analytical tool that can help underpin the assessment of policy challenges facing Member States in raising growth potential.

¹² The LIME Working Group has discussed at length the need to balance the important country-specific qualitative information with the need to ensure sufficient transparency and consistency. For the methodology to maintain credibility it is essential that the reasons for qualifying indicator-based results are expressed in a clear, consistent and transparent manner.

associated with growth accounting applying, includes:

- LAF results can be affected by the business cycle
- The analysis of labour inputs has been developed more extensively than the breakdown of labour productivity.
- LAF results are backward looking by definition.
- Time lags: many of the indicators used in LAF may not reflect the latest economic developments and impact of reforms recently adopted by Member States.
- Data and theoretical limitations: they still exist in a number of policy areas, which is why extra caution is needed in interpreting results in these areas.
- No indication of causality: the screening exercise provides no compelling indication that underperformance in a policy area has affected outcomes in a relevant GDP component, it merely provides an additional input when considering growth priorities.

It should also be considered that, even if the LAF has a broad coverage and captures most drivers of growth, it does not address all areas and dimensions falling under the Lisbon Strategy (e.g. environment, physical infrastructure, climate change and the most qualitative aspects of employment¹³).

Nevertheless, despite its caveats and limitations, the LAF can bring great value added to the more general effort of developing sound methodological approaches for evaluating progress in the implementation of the Lisbon targets. First and foremost the LAF stems from a joint effort carried out by the European Commission and the Member States, in line with the partnership approach called for under the relaunched Strategy. In practical terms, the LAF provides a consistent analytical framework for identifying Member States' specific strengths and weaknesses, it is transparent with regard to the ways in which policies affect growth and jobs and the criteria for the selection and interpretation of quantitative indicators. LAF is not a blind benchmarking exercise; rather, it is an attempt to get a better understanding of key growth channels. In measuring both levels and changes, the LAF takes into account the different starting conditions, while the possibility of adding country-specific evidence to qualify indicator-based findings balances the requirement for transparency and consistency with the need to take

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¹³ Such as quality at work and fostering the creation of better jobs, comprehensive strategy for youth, work organisation, quality of and access to education, etc.

into account differences in country-specific institutional settings and circumstances.

The LAF can thus provide useful input to a structured dialogue between Member States and the Commission for identifying policy priorities. The LAF could also help identify best practices and support peer review of progress in implementing structural reforms through the multilateral surveillance process.

In order to overcome part of the above-mentioned limitations, the LAF should be improved dynamically (e.g. it should be updated with better indicators as they become available). As to the scope of the analysis, my opinion is that its focus should remain on the policy areas already considered, whereas complementary methodological work to cover missing areas or dimensions could be done in other relevant committees and working groups.

The modelling of structural reforms

The LIME Working Group established a modelling forum, providing a platform for national experts and the Commission to undertake model comparison exercises and exchange experiences and best practises.

The main objectives of the forum so far have been to enhance mutual learning and foster greater transparency on available modelling tools and their use to assess the impact of structural reforms.

Experts from twenty different countries participated in the meetings, together with experts from Commission services, the ECB, the OECD, the Joint Research Centre, the Dutch Central Planning Bureau (CPB) and EMCO. The workshops carried out a comparative analysis of standard reform shocks as well as specific 'reform shocks', such as R&D, administrative burdens, migration and venture capital. Special focus was placed on examining the existing models used by the European Commission, such as QUEST III and WORLDSCAN.

Spillover effects and complementarities of the modelling exercise, were considered, particularly on R&D but also in the areas of employment, skills and administrative burdens. There are still significant uncertainties as to the quantification and analysis of these effects¹⁴, but since the idea of an integrated approach (across policy areas and Member States, but also between community

The LIME modelling forum has been a useful experience that enhanced mutual learning and fostered greater transparency on available modelling tools and their use to assess the impact of structural reforms.

¹⁴ R&D spillovers seem to carry the highest positive impact. See Barrell, Kirby, Lejour and Rojas-Romagosa, "International Spillovers of Domestic Reforms - Background Study for the 2007 European Competitiveness Report", May 2007: "Spillovers associated with R&D expenditures are the key factor behind the joint implementation of EU policies. When the R&D target is jointly reached in the EU, output almost doubles and consumption experiences an even greater increase".

and national level) is a key element of the relaunched Lisbon Strategy, it would be worth investing in this field of analysis to better underpin the call for policy coordination.

The modelling forum, which is expected to deliver its results in the next autumn, has proved to be a useful experience¹⁵. The challenge now is to make use of the lessons learned within the broader context of the analytical framework developed by the LIME Working Group.

The way forward

The time has now come for a review of the mandate of the Lisbon Methodology Working Group. Potential areas for further work as well as priorities will be defined by the Economic Policy Committee in the autumn.

The 2008 Spring Council urged the European Commission “to continue working with Member States to further develop a clear and transparent methodology for the monitoring and evaluation of Lisbon reforms”¹⁶. In my view, and following the Council's recommendation, the LIME Group should now concentrate on bringing together the different work streams developed so far, so that they can feed more effectively into the Lisbon process. More specifically, the LIME Group should work on developing transparent analytical frameworks to evaluate the impact of structural reforms, both in terms of the adequacy of policy action taken at national and EU level (as set out in the national Reform Programmes and the Community Lisbon Programme) and, in broader terms, with regard to quantifying the macroeconomic implications of microeconomic reforms. Efforts should also be made to contribute to the ongoing debate on a post-2010 Lisbon strategy, i.e. to provide evidence on the ex-post impact of Lisbon reforms on growth and jobs since the launch of the strategy in 2000, and the ex-ante potential impact of future reform measures.

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The future of the Lisbon Strategy: to 2010 and beyond

After the conclusion of the first three-year cycle following the re-launch of the Strategy in 2005, we can say that the Lisbon Strategy is finally starting to deliver. Member States have improved their economic and budgetary conditions and, although most of the EU economic upturn is due to cyclical factors, it is also clear

The Lisbon Strategy is starting to deliver. In the next cycle the focus should firmly remain on the implementation of reforms and the delivery of results.

¹⁵ The main findings of the forum will be published in a forthcoming DG ECFIN Working Paper.

¹⁶ European Council, Brussels 13 and 14 March 2008 - Presidency Conclusions (7652/1/08 REV 1).

that Member States have stepped up the implementation of structural reforms. The pace and intensity of reforms, however, has not been homogenous, with the larger continental economies still failing to commit to a sometimes difficult, yet necessary, sustained reform effort.

The new governance of the Lisbon Strategy, with its emphasis on partnership between Member States and the European Commission, has proved to be the right approach - although greater coordination would be useful.

An independent evaluation of the integrated guidelines¹⁷ concluded that, while formalised co-ordination procedures and recommendation play an important role, the greatest success in overcoming obstacles to structural reforms has occurred in areas where there have been sustained efforts to frame a policy debate among relevant stakeholders, thus facilitating the emergence of a consensus for reforms that are sustainable and with lower risks of subsequent policy reversals.

In launching the new 2008-2010 three-year cycle, the European Council confirmed the current set of integrated guidelines, while at the same time calling for a stronger focus on implementation and delivery.

The route set out in Lisbon in 2000 was – and still is – the right one. The challenges of globalisation and ageing population we faced then, are still here today and they are all the more urgent against a backdrop of economic slowdown, rising inflation and scarcity of natural resources.

We need to hold the helm firmly on course and speed up the delivery of results, including the delivery of tangible benefits to European citizens in order to regain credibility and support.

The LIME Working Group could contribute to the development of the analytical toolbox needed to inform and sustain the political debate, evaluating progress, identifying useful benchmarks of good practice and contributing to the definition of priorities. Ultimately, the key factor is the political commitment to act.

The key factor is the political commitment to act. The LIME WG can help develop the analytical instruments to inform and contribute to the political debate.

¹⁷ Euréval and Rambøll Management, "Evaluation of the Integrated Guideline Package (IGP) for Growth and Jobs", Final Report January 2008 (ECFIN/R/3/2007/004-IGP).