

# **Global Europe: full-employment Europe**

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## Introduction

The theme of this pamphlet is global economic change and its impact on Europe; not just on the European economy - our employment levels and standards of living - but on how the European Union now develops.

It is often said that in the new world of global economic change no country or continent, whatever its success now, can take its future prosperity for granted; and that not just nations, but continents, will rise and fall depending upon their ability to adapt to global change.

My argument is that globalisation - the increased global sourcing of goods and services and global flows of capital - poses an even bigger and more profound challenge for Europe: it poses fundamental questions about traditional models of European development.

For decades the assumption has been that Europe's nations would move from economic integration at a national level to economic integration at a European level. Instead of national flows of capital there would be European flows of capital; instead of national companies, European companies; instead of national brands, European brands.

Yet today it is global, not European, flows of capital that we chart every day. We talk of the global company, rather than just the European company. Ambitious businessmen and women aspire to having global and not just European brands. New technologies, if they are successful, quickly become global. So it is the global and not just European sourcing of goods and services - as well as of capital and, importantly, labour - that is now driving economic change. From the era of a European trade bloc, we are moving to the era of a global Europe.

The issue now is not just how Europe integrates as it grows from 15 to 25, but how all 25 - soon to be 27 - reach out to the rest of the world. And in a world where all continents quickly gain access to new technology - from the internet and e-mail to nano-technology and bio-medical advances - the issue now is how Europe best exploits technological advance, and how its global companies can achieve this.

In the old trade bloc Europe, the emphasis was, understandably, on internal integration: breaking down barriers to the movement of capital, labour, goods and services within Europe. The focus was, understandably, inward-looking not outward-looking. The assumption was that a common market would become a single market, and then that single market would engender a single currency, and perhaps even a federal fiscal policy with tax harmonisation and then move to a supra-national state.

But the shifting balance of global economic activity - with the rise of China, India and other rapidly growing emerging economies founded on the global sourcing of goods and global flows of capital - now creates challenges that Europe's founders could never have foreseen.

Although some Member States are performing relatively well, Europe as a whole is losing ground to competitors in five key areas: growth, labour market performance, skills, innovation and enterprise.

This pamphlet's central argument is that the policies relevant to this new Global Europe will be different from those appropriate to the Europe of the trade bloc era. But, just as Europe successfully met the challenges of building a post-war prosperity from the ruins and devastation of war, we believe Europe can now develop the policies necessary for prosperity in the new global era.

We start by showing how Europe changed to meet urgent challenges in the 50 years after 1945. Then we show the scale of the global economic changes to which Europe must now respond - and we suggest the policy agenda most relevant to future success, not least to deliver full employment.

Because it is global change - not least in Asia - that puts Europe under a new, intense and sustained competitive pressure, it is only through policies for mastering the economic challenge from Asia, America and beyond, that Europe can make the most of the opportunities that the new global economy brings. And with 20 million unemployed in Europe, the challenge is now urgent if we are to ensure prosperity not just for some, but for all.

We reject the argument that technological change and globalisation must in themselves bring social fragmentation. Globalisation can be managed well or badly, fairly or unfairly, and we believe that through policies that combine flexibility and fairness, Europe's long-standing social values can be advanced alongside economic prosperity.

So we suggest the policies - economic and social – aimed at achieving flexibility and fairness, and so deliver opportunity for all and full employment in the new global economy.

## Europe adapting to change – two phases of our history

### Phase one: Europe of the late 20th Century

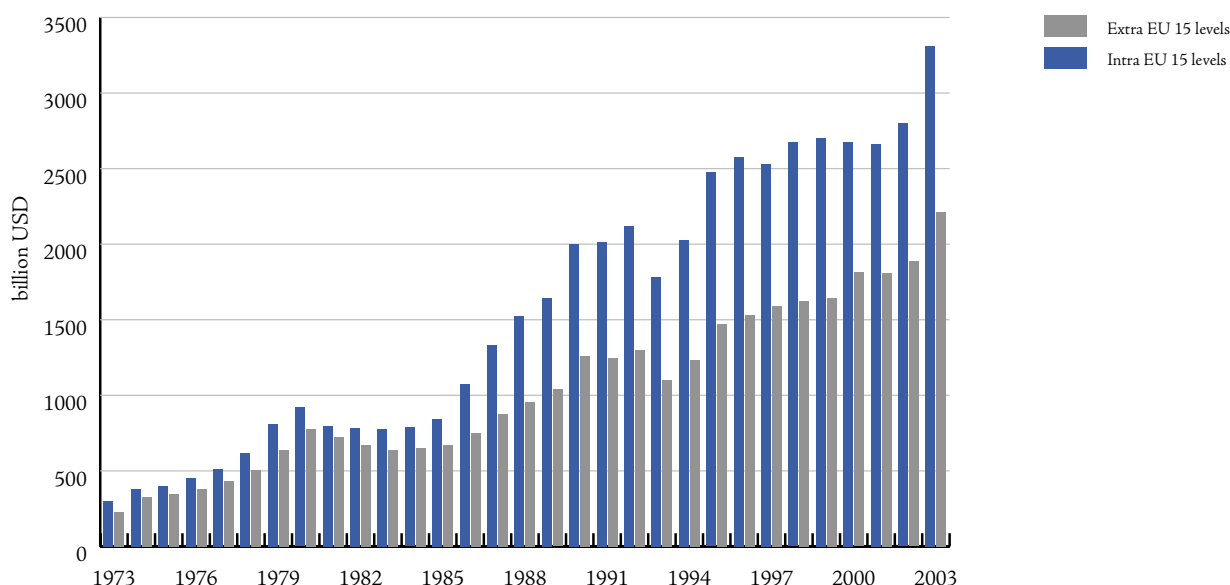
Amid the ruins of the Second World War the first great and powerful arguments for European unity took root, as former combatant nations joined together in the cause of reconstruction. A continent that had seen the origins of two world wars within half a century, and sustained death and destruction on a vast scale as a result, took momentous steps to join its nations together; and rightly the prospect of 'perpetual peace' fired the initial enthusiasm for the European Union. And peace across Europe - now, with an enlarged EU, stretching from the Atlantic Ocean to the Baltic States and soon the Black Sea - is a huge achievement of the European Union.

During the first phase of European integration, effort was concentrated on regional economic integration: rebuilding trade and investment links to support post-war reconstruction; developing new policies and institutions as the foundation of a common market; strengthening European integration through the Single Market; and then widening it through enlargement.

In the immediate post-war period, the task of reconstruction led to a broad new commitment to economic cooperation. So, building on the Marshall Plan and the formation in 1948 of the Organisation for European Economic Cooperation (later the OECD), Europe pursued ever-closer economic integration. The Europe that progressed through the creation of the European Coal and Steel Community in 1951, to the Common Market in 1957 and Customs Union completed in 1968, to the Single Market Programme in the 1980s and then in the 1990s to the European Union, led the world with its internal rules, preferential agreements and its openness to trade within its boundaries. And most recently, Europe rose to meet its greatest challenge since the Second World War, with the re-unification of East and West, and the accession of the ten new Member States.

Regional economic integration brought with it strong growth in trade within Europe. Between 1960 and 2003, trade within the EU15 grew by almost double the rate of its trade with countries outside. With the Single Market, trade in goods and services within the EU15 has increased by 40 per cent, and enlargement expanded the internal market further, doubling trade between the EU15 and the new Member States since 1993. The dominance of intra-European trade reflects the fact that European institutions were designed, in the context first of reconstruction and then of growing cold-war tensions, to strengthen economic relations within Western Europe rather than to open up trade links with the rest of the world.

Chart 1: Trade within the EU 15 far exceeds EU 15 trade with the rest of the world



Source: OECD

As with the expansion of internal product markets in the 1950s, Europe took a leading role in the new global expansion of capital markets from the 1970s. The Single Market resulted in increased Foreign Direct Investment (FDI), and investment joined trade as a driver of Europe's economic development. Total European FDI flows grew over twenty-fold between 1970 and 1990, compared to a seventeen-fold global increase and a nine-fold increase in US FDI; and the EU became the most important destination for US overseas investment. Yet even more than with trade flows, Europe's investment flows have been characterised by a high proportion of transactions between Member States. In 2003, 66 per cent of inward and outward FDI came from, and was directed to, other EU15 Member States.

During this first phase, Europe set new standards in international economic cooperation at a time when global markets had all but disintegrated. Yet the inward-looking focus included maintaining external barriers. Through its advanced internal rules and preferential agreements, Europe was able to shelter itself from the rest of the world. And although Europe's founders aimed to remove barriers and reap the benefits of expanded markets internally, they also sought protection and special treatment for particular aspects of their economies such as agriculture. This has brought costs: expensive subsidies still remain in some sectors and it is estimated that barriers to external trade and investment - such as tariffs, quotas and unjustifiably restrictive standards - could cost Europe's consumers up to 7 per cent of EU GDP.

But by the end of the 20th century, an implicit assumption of European development - that what happened within the European Union mattered far more than what was happening outside it - was already becoming out of date.

### Phase Two: Adapting Europe for the 21st century – a new, global Europe

#### Dramatic global change

We are today witnessing a dramatic period of change in the global economy. The rise of large, fast-growing emerging economies – particularly in Asia – is transforming the balance of global

economic activity. Twenty years ago just 10 per cent of manufactured goods came from developing and emerging countries. The challenge from China and India is now such that by 2020 the figure will be 50 per cent. And China's economy has already far outgrown Japan to be the world's second largest economy in purchasing power parity terms, and will soon overtake the Japanese economy as valued by market exchange rates as well. At the same time global economic activity is becoming ever more integrated, with changing patterns of trade, investment, and location of production.

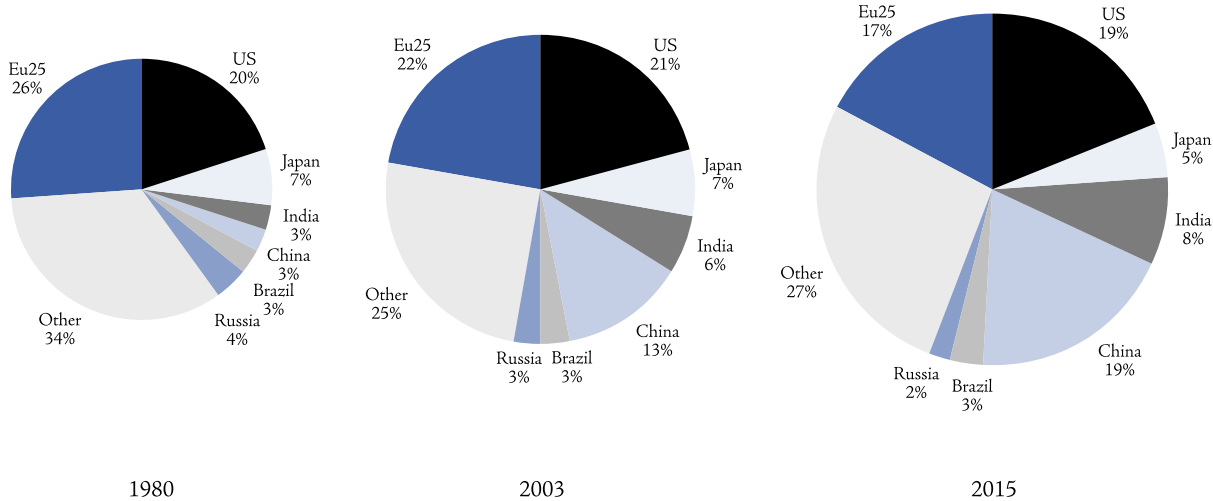
Firstly, global sourcing of goods and services has replaced national sourcing, or even regional sourcing from within a trade bloc. As a result, trade in goods and services is rising dramatically.

World trade in goods is doubling every decade, and last year rose more than twice as fast as world output. And, as an indication of increasing specialisation and global sourcing, trade in intermediate goods is accounting for an increasingly large proportion of total trade.

Trade in services has also intensified and there has been a shift in the composition of global FDI, with the services proportion growing from just a quarter in 1960, to around two-thirds in 2002. And with the services sector accounting for over 70 per cent of GDP in advanced economies but only 20 per cent of global exports, given technological advances, there is clear potential for continued rapid expansion of services trade.

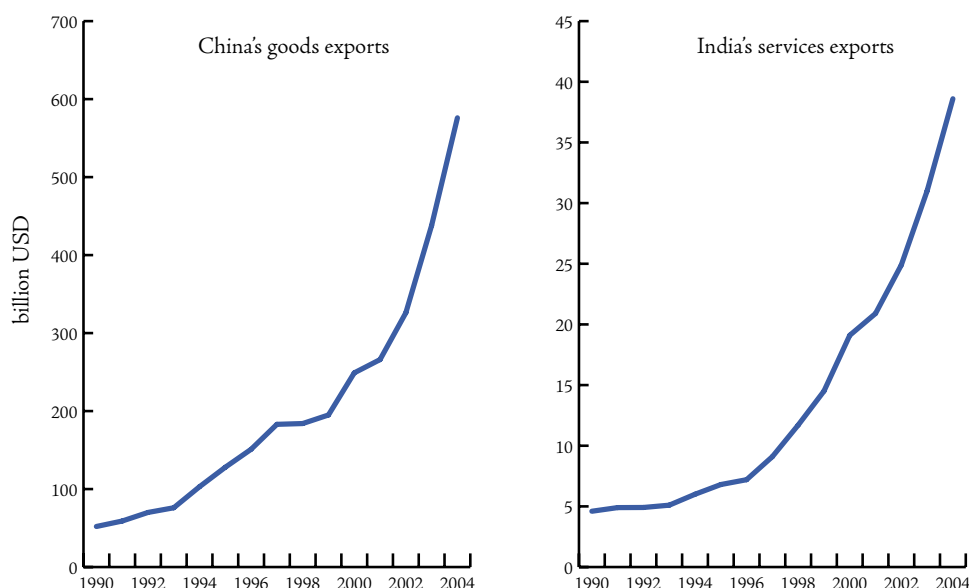
Rapidly growing Asian markets account for a growing proportion of expanding world trade: China's trade is doubling every three years, while India has shown similarly dramatic growth in exports of services.

**Chart 2: Dramatic global change: Europe's declining share of global output (in purchasing power parity terms)**



Source: IMF, Consensus Forecast, HM Treasury.  
 Note: Areas indicate size of global economy

Chart 3: Integration of China and India in the global economy



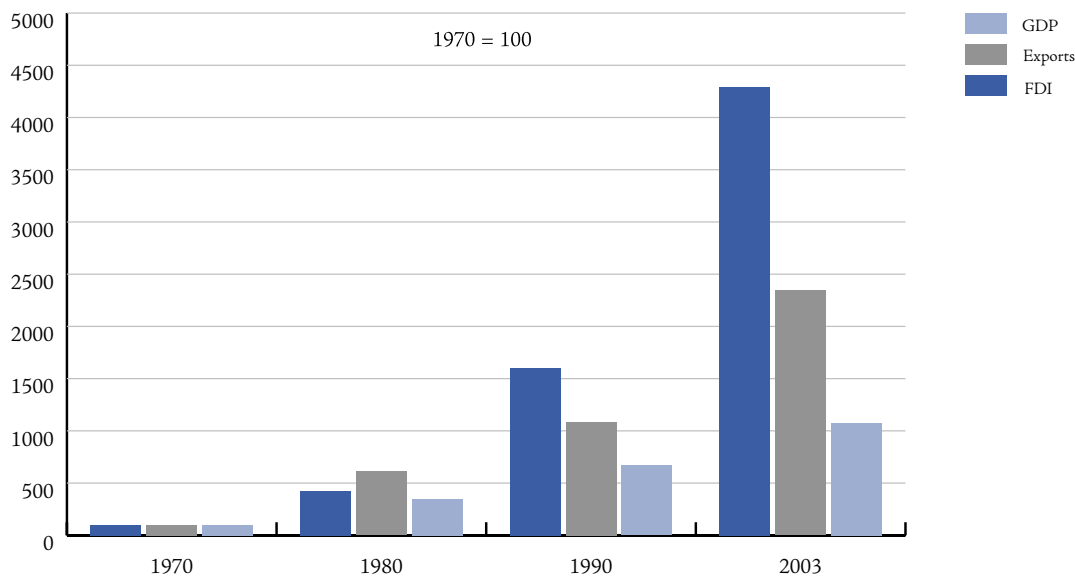
Source: Economist Intelligence Unit

So goods and services that used to be sourced in Europe or America, are now increasingly sourced in Asia, with China alone producing 70 per cent of photocopiers, 50 per cent of cameras, 40 per cent of microwaves and 25 per cent of textiles.

Secondly, flows of capital - including debt, equity, remittances, portfolio investment and FDI - are increasingly global, spurred by a relaxation of capital controls and financial sector liberalisation. This includes a ten-fold rise in capital flows to emerging markets since the 1970s, with private flows replacing official aid as the major source of capital for a number of emerging economies. As a result financial markets have become increasingly integrated - with the stock of financial assets held outside investors' home countries increasing from 20 per cent of global GDP in the mid 1970s to 60 per cent in the early 1990s to around 140 per cent today.

Of these flows, FDI is an indication of the extent to which firms engage internationally. Growth has been dramatic, particularly in the second half of the 1990s, and global FDI flows today are more than five times the average in the first half of the 1980s, even after taking account of inflation. Sustained growth in FDI is likely to continue, as the large emerging markets attract increasing inflows of investment and invest more in other countries. This trend can already be seen: in 1990 China accounted for 1.7 per cent of global FDI inflows but by 2004 it was almost 10 per cent, higher than all EU Member States except the UK. And emerging and developing countries, which together accounted for 18 per cent of total global FDI inflows in 1990, today receive over 30 per cent of inflows.

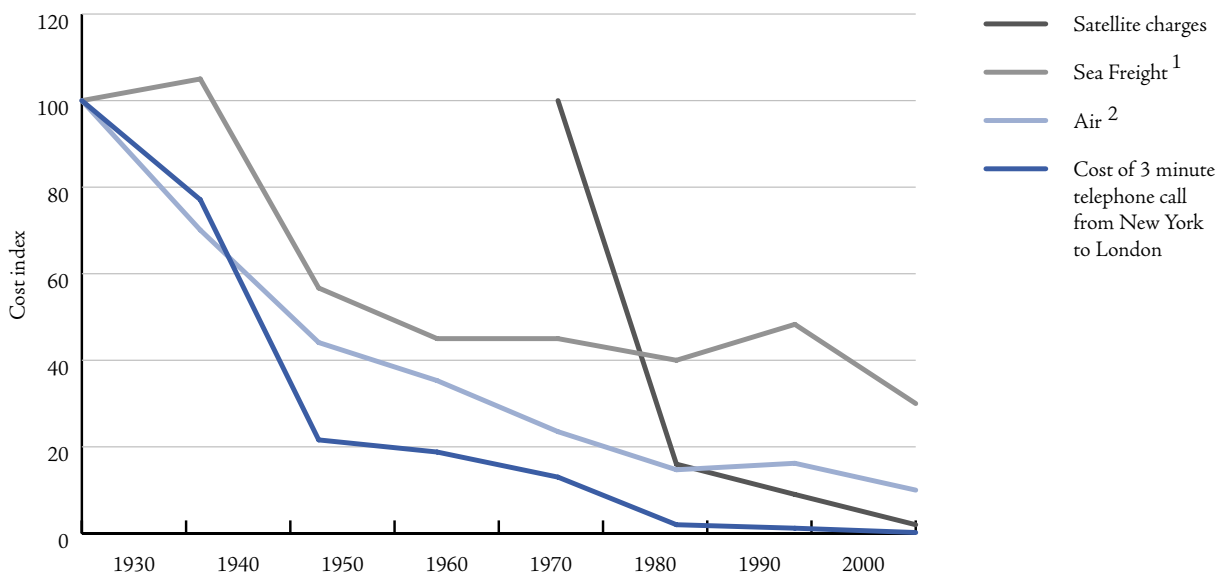
Chart 4: The dramatic growth of world FDI flows and exports



Source: World Investment Report

These trends have been accelerated as rapid technological change has overcome distance and broken down geographical barriers to economic activity, making it far easier for companies to locate activities and source and sell goods and services across the globe. The rise of e-mail and the Internet has made communication across national borders virtually costless. At the same time transporting goods and people has become faster, cheaper and more reliable.

Chart 5: Decreasing costs of transport and communication



<sup>1</sup> Average ocean freight and port charges per short ton of import and export cargo

<sup>2</sup> Average air transport revenue per passenger mile

Source: Busse (2003), also cited in IMF WEO 2005

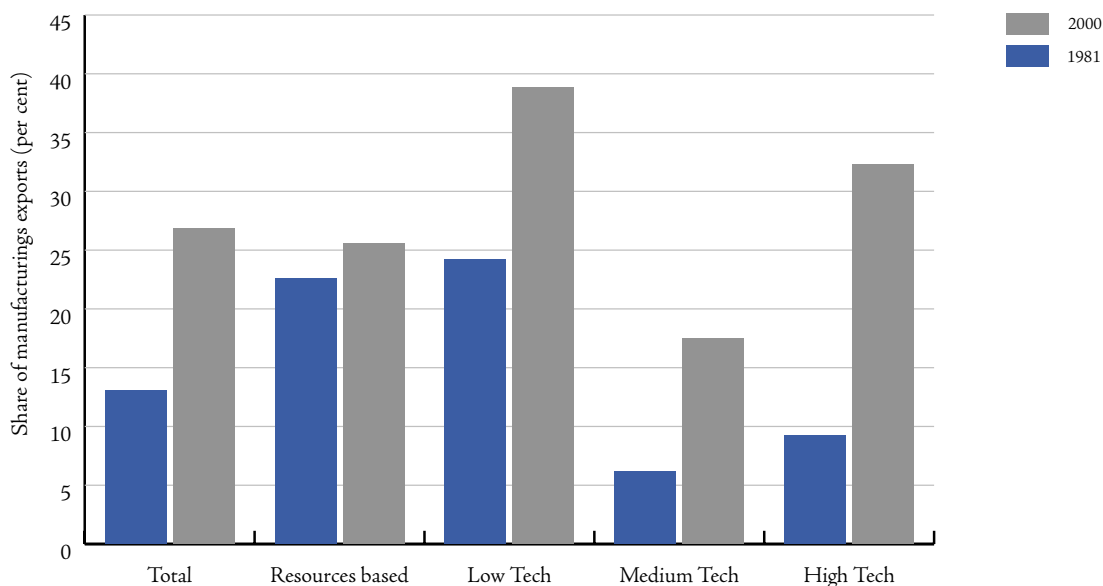


Advances in information and communication technology are not only reducing costs, but also expanding the range of services - such as call-centres, computer programming and consultancy - that can be easily produced in one country and consumed in another. India has demonstrated particularly strong growth in services exports, as highlighted above. But the trade in services works both ways. India is also a high-ranking importer of business and computing services, and some EU Member States are already successfully exploiting new services trade opportunities. The UK, Germany, France and the Netherlands were amongst the top 5 exporters of business services in 2002.

But the face of developing economies is changing. Competition is no longer simply in mass production manufacturing based on low skills, low technology and low wages, but increasingly right across the value chain. With four million graduates a year from China's and India's universities, Asia is now competing on high-tech, high-skilled, high value-added goods. Over the past two decades, Chinese exports have diversified from low cost goods such as textiles and toys to electronics goods, with over 50 per cent of EU imports of computer and office equipment now coming from China.

So China and Asia are not in a race to the bottom but in a race to the top, where we must continuously upgrade skills and technology and raise our game.

Chart 6: Increase in medium and high-tech manufacturing exports from developing and emerging countries



Source: UNIDO

With Chinese spending on research and development (R&D) doubling as a share of GDP between 1996 and 2002, we can expect this shift up the value chain to continue. And as productivity in China and India increases, so wages will increase, progressively closing the wage gap with Europe and America. This will bring new opportunities for Europe through increased demand for goods and services. As noted by the High Level Group chaired by Wim Kok, *“The potential rapid growth of the Chinese economy will create not only a new competitor to Europe, but also a vast and growing market”*. For example, over the past ten years, China's share of EU15 exports has doubled, with particularly impressive growth in recent years. In 2003 alone, China's imports from the EU15 increased by 40 per cent, as China overtook Japan in importance as a destination for European exports. So full

participation in the new global economy will also bring other benefits for Europe. Companies will have the chance to become more efficient and productive; and consumers can benefit from lower prices for the goods and services bought from abroad.

### Is Europe up to the challenge?

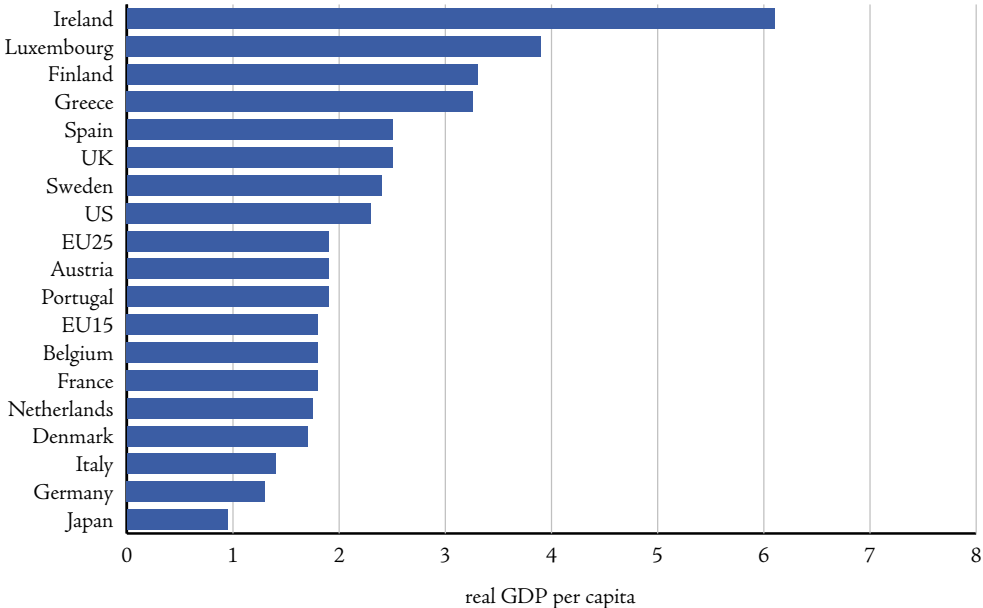
With these dramatic changes taking place in the global economy, no country or continent, however successful today, can take its long-term prosperity for granted. History shows how once confident countries can experience rapid decline, and the risks are all the greater with today’s unprecedented pace of change.

By its very nature, this changes entirely the context for European integration. A Europe whose first goals were internal integration and harmonisation, and whose economic focus has long been inward-looking, now needs to rise to the challenges of the new global economy.

Yet at present, although some Member States are performing relatively well, Europe as a whole is under pressure in comparison with our competitors in five key areas: growth, labour market performance, skills, innovation and enterprise. Is Europe too slow in adapting to change?

Take **growth**. It may not be surprising that Europe grew half as much as America and one quarter the rate of China and India in the last year. But underperformance has been the reality for the last 10 years. While some Member States have achieved high growth rates, since 1996 annual average growth in GDP per capita in the euro area has been about 0.5 per cent less than in the US. And, following a sustained lag in growth, there is now a gap of more than 30 per cent in living standards between the EU15 and the US.

Chart 7: Europe’s mixed growth performance: average annual growth in living standards 1995-2004



Source: Eurostat

It is estimated that Europe's poor **labour market** performance accounts for two thirds of this gap in living standards. Today in the EU, 20 million are unemployed with almost half of them long-term unemployed, and there are 93 million inactive people of working age. The employment rate of older workers (aged 55-64) was 40.2 per cent in 2003, compared to 60 per cent in the US and 62 per cent in Japan. In some Member States unemployment rates are close to 10 per cent. And for the future, it is now estimated that Europe will need to create 22 million more jobs by 2010 to meet our Lisbon targets.

Table 1: Europe's labour market challenge

	Inactivity rate (% of workforce)	Unemployment rate (% of workforce)	Long-term unemployment (% of unemployed out of work more than 12 months)
Spain	31.5	9.4	37.2
Italy	38.4	7.7	51.9
France	31.8	9.6	40.6
Germany	28.7	9.6	51.0
UK	23.4	4.6	21.7
EU 15	29.7	7.9	41.8
EU 25	31.0	8.7	46.0
Euro zone	31.9	8.6	45.3
Canada	21.9	6.8	9.5
Australia	26.4	5.0	20.7
Japan	27.7	4.4	33.7
US	24.2	4.9	12.7
NZ	23.9	3.9	11.7

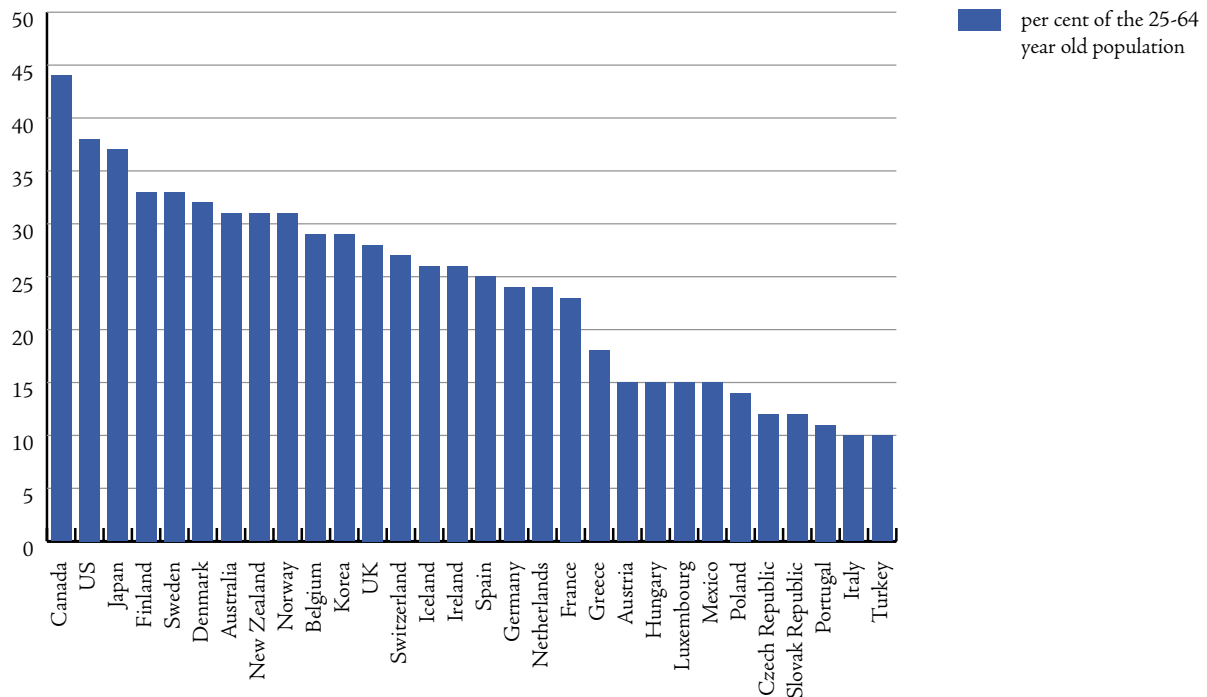
Source: Eurostat and OECD At A Glance

Reflecting Europe's traditional commitment to social cohesion, Europe continues to lead the world in tackling child poverty. The EU15 child poverty rate is at around 20 per cent, compared on a similar measure to 30 per cent in the US. But low growth rates and persistent high levels of unemployment are jeopardising Europe's ability to reduce child poverty further. Some Member States have succeeded in reducing child poverty levels but others have seen rises over the last ten years, with the average level across Europe remaining static.

Higher **skill levels** are essential for Europe to compete in high-tech, high value-added goods and services in an increasingly integrated global economy. Knowledge intensive services are the greatest source of new jobs in the EU - providing over 7 million new jobs between 1997 and 2002. But education and skills levels vary greatly between Member States and often lag behind our competitors. Most Member States are increasing their levels of tertiary education, but all still lag behind the US, Canada and Japan. Meanwhile, skill levels in emerging markets are rising even faster, though from a lower base. The proportion of 25-30 year olds in South Korea with a tertiary level qualification rose from 29 per cent in 1995 to 40 per cent in 2001.

And despite increasing rewards to innovation, it appears the EU has lower levels of **innovation** than major competitors such as the US and Japan. The number of European patent applications per capita filed in 2002 was less than half that filed by US and Japanese inventors. Business R&D in 2002 in the US was nearly 50 per cent higher than in the EU. China and other emerging economies are also rapidly increasing their levels of R&D spend as a share of GDP. The proportion of manufacturing output in China that is high-tech is already similar to that in the EU - around 20 per cent; but both lag far behind the US where 30 per cent of manufacturing output is high-tech.

Chart 8: Varying education and skills levels - tertiary education attainment in OECD countries



Source: OECD At A Glance

Europe is also behind its competitors in levels of **enterprise**. Total entrepreneurial activity in the US, Canada and China is double or treble that in the large EU Member States. Evidence suggests that in many Member States, the framework for supporting entrepreneurial activity may be relatively lacking. For example, the cost in time and money to start a business in the EU can typically be more than ten times that in the US, and on some measures is higher than in China. Public attitudes to entrepreneurial activity are also much more favourable in the US than in the EU. One consequence is that venture capital – the support for risk-based entrepreneurship – is twice as large a part of the US economy as it is of the European economy.

So Europe is doing less well than – or threatens to fall behind - our competitors in terms of growth, labour market, skills, innovation and enterprise. These are issues that we will need to address if we are to improve our economic performance and compete in a rapidly changing global economy – to deliver prosperity, full employment and security for all our citizens.

## Policy priorities for Europe

As the European Union enters this second phase of its history, our success in regional economic integration is no longer sufficient. The challenge is for Europe to move on from the older, inward-looking model to become a more flexible, reforming, open and globally-oriented Europe - able to master the economic challenge from Asia, America and beyond to deliver growth, jobs and social justice. There is therefore a premium on flexibility, dynamism and entrepreneurship supported by an active and responsive labour market policy to ensure Europe can succeed and provide opportunity for all – advancing flexibility and fairness together.

There are some who argue that the only way Europe can retain its unique balance of prosperity and fairness is to retreat from globalisation into a new protectionism and act at the EU level to erect

new barriers to global trade and investment. Others look at the rapid pace of change and argue that nothing can be done in the face of globalisation and technological advance, that it is impossible in the modern world to sustain prosperity and fairness together, and that individuals must be left alone to adapt to far-reaching change.

We reject both. Protectionism cannot work in a global economy where production processes are increasingly spread across continents, and businesses and consumers depend on international trade and investment links. In a world of global capital flows, protectionism can only bring about higher unemployment and higher prices. At the same time a laissez-faire approach leaves people defenceless against change when we should be enabling them to master that change.

Instead, we need a strategy that delivers a full-employment Global Europe. The answer is not to restrict or retreat from global competition, but to meet and master global change through policies that promote openness and opportunity for all. This calls for greater flexibility in product markets, labour markets and capital markets to ensure that Europe's businesses and individuals are equipped to take advantage of new opportunities; and ensuring fairness through policies that expand opportunity and choice, provide security for the vulnerable, and help people adapt to change. Structural reform that promotes flexibility and fairness together is the key to success in the modern global economy. There can be no security without change.

So it is essential that Europe's leaders take the difficult long-term decisions to achieve flexibility and fairness, and so deliver opportunity for all and full-employment in the new global economy.

In today's global economy the foundation of economic success must be a framework for macroeconomic policy that supports stability and growth. As the debate on this framework evolves in Europe, it is important that we learn from international practice: a pro-active, forward-looking and transparent approach to deliver clear objectives on monetary policy, including a symmetric inflation target; and a prudent interpretation of the stability pact that recognises the economic cycle, national debt and the important role of public investment.

From such a foundation of stability we need new commitments to create opportunity and security in the labour market, to promote productivity and competition; and to promote a new, more outward-looking relationship with the rest of the world.

### Opportunity and security in the labour market: skills and employability

In a world of rapid change, technologies arrive and quickly become out of date. Companies rise and fall. Jobs and occupations become redundant far more quickly than before. European governments must ensure that their citizens are able to adapt to this new environment, to ensure opportunity for all, protect people from poverty and achieve a full employment Europe.

Global economic restructuring - international competition, accelerating technological change and changing patterns of consumer demand - is increasingly focusing advanced industrial nations away from low-skill, low-tech products and processes to the technology driven and high value-added. In the United Kingdom, for example, it is estimated that by 2010, 80 per cent of new jobs will be higher-level occupations. Unless European governments rise to this challenge, European growth and jobs will suffer. As we have already seen, Canada, the USA and Japan have higher tertiary skills attainment than any EU country. China may often be associated with low-value added, labour-intensive industry, but already produces 2 million university graduates a year, including 270,000 in science and engineering.

These developments provide opportunities for all EU economies, but mean there is an urgent need for modern social and labour market policies geared towards promoting opportunity and

employability, through the provision of skills and steps to promote workforce flexibility. European national governments have the primary role – in partnership with stakeholders across society – in developing and implementing this approach.

Central to this ambitious challenge is the need for national education and skills policies, designed and implemented by Member States, and built on the foundation of investment in education and lifelong learning to equip people to adapt to change and to new areas of comparative advantage. The UK, for example, has sought to tackle its historically poor skills mix by introducing a series of policies to promote education and skills attainment and setting a target to ensure that more young people participate in higher education. And in Sweden, the country with the highest participation rates in lifelong learning in the EU, citizens have legal rights to take study leave, increasing incentives to learn.

National governments also have primary responsibility for wider measures needed to increase employability and must look for better ways of re-employing the unemployed - active labour market policies to help those without work find new jobs; childcare to help parents overcome the specific barriers to work they can face; and reform of tax and benefits to make work pay and increase the income of those earning least. And again there is much we can learn from one another - Britain, for example, has led the way in one aspect of labour market reform with the tax credits system, while the Scandinavian countries – as part of what they call ‘flexisecurity’ - have pioneered childcare support and parenting services.

These policies must reflect national traditions and electoral preferences. National governments rightly have the lead in developing skills and labour market policies that match their own domestic contexts and there is no single “right” model. Different institutional, economic and social contexts mean that the appropriate response will vary across each Member State, while citizens will also have different preferences for the level of service that their governments provide. All this means that the key instruments of labour market and skills policy must remain the responsibility of Member States.

But we must also recognise that the Single Market is a social structure, and as such there is an important role too for EU-level action which responds to opportunities and challenges that are cross-border in nature. For example, the free movement of goods and services brings with it a responsibility to ensure the availability of transparent consumer information and protection not just in individual countries but right across the Single Market. The free movement of labour must be supported by the mutual recognition of qualifications, and the portability of benefits. And the free movement of capital suggests European action to ensure that employees across Europe have rights to information and consultation.

But flexibility and fairness must advance together. We should look to learn from one another, through the open method of coordination, in developing policies to suit national circumstances. And instead of viewing flexibility as the enemy of social justice, we must recognise that flexibility matched by fairness is essential to deliver a Europe of full employment and opportunity for all. Without it, Europe will fail its greatest challenge: making its social values a reality for all in the global economy.

## Productivity and competitiveness in Europe: enterprise and innovation

As global competition and the speed of technological change increase, so there will be increasing rewards from enterprise and innovation. The challenge for Europe is therefore to ensure that the right conditions are in place to allow enterprise and innovation to flourish and to increase the attractiveness of the EU as global destination for economic activity. This requires a new commitment to reform - to complete the Single Market, promote better regulation, encourage innovation, and refocus the EU budget.

The creation of the Single Market was one of the defining economic achievements of the EU. By removing cross-border barriers to trade, it has helped to strengthen competitive pressure in Europe, putting downward pressure on prices, promoting enterprise and growth, and ensuring that resources are moved quickly towards the most productive uses. Yet while completing the Single Market is a shared ambition it is not yet a shared achievement. Price convergence in the EU falls far short of that in the US and ECB estimates suggest that increasing competition within the euro area to US levels could boost output by over 12 per cent.

So we should start with a political commitment to completing the Single Market:

- first, we must speed up the process of opening up key utility sectors, holding to the timetables we have set. Having agreed each nation would legislate to open up telecommunications by July 2003, in 2005 over a third of the EU15 have not done so. And full market opening in the crucial electricity and gas sectors has been delivered in only a small minority of Member States;
- second, we must open up the hugely important market for services in Europe. Services constitute some 70 per cent of EU output but only 20 per cent of EU trade. Estimates suggest that the removal of national regulatory barriers in this area could increase trade in commercial services by up to 30 per cent, delivering substantial economic rewards;
- third, we should pledge together to eliminate inefficient state subsidies that prevent full and fair competition in Europe - businesses that are sheltered from competition in their domestic markets are unlikely to cope with the rigours of international competition; and
- fourth, we must implement an independent and pro-active competition policy, extending the use of market investigations, such as those currently planned in the energy and financial services sectors, to open up all markets that remain sheltered and improve competition in the Single Market.

And we should recognise that in tax policy we can best meet the challenges of an increasingly global marketplace by delivering open, flexible and competitive tax systems across the EU. Neither the demands of the modern global economy, nor the principles of subsidiarity and political legitimacy can justify harmonisation of tax rates or bases at an EU level. So, just as we have recently welcomed the introduction of an alternative to the harmonisation of savings tax, based on exchange of information on savings income, so we must agree that fair tax competition is the right approach across the board, reflecting the realities of the global economy and respecting the fundamentally national nature of public services needs and economic management challenges that governments face.

An enterprising and innovative Europe also requires a sustained commitment to regulatory reform that lessens the burden of regulation while ensuring the standards of protection that society demands. Poorly-designed or badly-targetted regulation benefits no one and costs us all. Research by the OECD and the IMF has shown that the regulatory framework in Europe inhibits the performance of EU economies - according to the OECD, better regulation in Europe could raise levels of productivity by up to 6 per cent in many EU economies.

So further action is needed to reduce the burden of regulation on European companies in order to boost growth and jobs. The Six Presidency Better Regulation initiative set out a number of proposals to improve the EU business environment, including a competitiveness test for all new regulations and a common approach to measuring and reducing the administrative cost of regulation. It also called for swift and comprehensive action to simplify the Union's enormous and unwieldy rulebook, sweeping away redundant rules that are no longer needed and reducing the economic cost of others. In all of these areas, we need to see concrete progress by the end of this year and a clear agenda for action going forward.

Further progress in this area requires that inspection and enforcement efforts are focused where they are needed most, by adopting a risk based approach to regulation - no inspection without justification, no form-filling without justification and no information requirements without justification. And because it is business that is often most affected by legislative proposals, we must also establish an advisory group that is business-led and will give those in the front line a stronger voice in the process of regulatory design and reform in Europe.

It is those sectors where the impact of globalisation is most clearly felt where better regulation needs to be made a top priority. Financial services are one such area, where capital - and high-skilled jobs - are at risk if we do not modernise our regulatory environment to recognise the new realities. And because a thriving financial services marketplace underpins the rest of our economy the effects of over-regulation are widely felt. So further action is needed to explore ways of reducing the burdens of regulation on the financial services industry. And we should work with the Lamfalussy committees on banking, insurance and pensions and securities to implement and enforce the European Financial Services Action Plan. And we need in-depth competition investigations into why some financial services markets are working better than others, and the commitment to act on the results.

Better regulation is key to reducing the burdens on creative and innovative businesses. But if Europe is to respond effectively to the challenge of global competition it must also invest more, and more effectively, in research and development and take further steps to establish the conditions needed to stimulate private investment and innovation. So we must embrace too a comprehensive strategy for promoting R&D:

- first, by ensuring that the EU budget supports the knowledge-based growth industries of the future, raising Europe's capacity to conduct and compete in the very best basic research, strengthening the links between science and industry, and improving industrial competitiveness;
- second, by ensuring that national education and skills strategies address the needs of innovative and high-tech businesses, and encourage the take up of science careers; and
- third, through comprehensive and long overdue reform of Europe's costly and inefficient system of intellectual property rights to improve incentives to innovate, create market opportunities for science-based firms and promote technology diffusion.

Reform of the EU budget is also key. The priority should be to create a budget fit for purpose in the 21st Century - a budget that meets the science, skills and infrastructure challenges of global change. Yet in 2013 Europe could be spending almost 55 per cent of its total budget either on protecting agriculture or supporting regional development in the richest member states. The failure to reform the budget impedes the very economic changes we need if we are to meet the competitive challenges of globalisation: if we continue to fail it will become the most visible symbol of Europe's failure to face up to the future.

## External openness

At the heart of moving from an inward-looking Europe to a Global Europe is a long-term commitment to a new, more outward-looking relationship with the rest of the world.

In the old inward-looking Europe there was always a risk that while internal trade would be seen as a benefit, trade with the rest of the world would be seen as a threat. Fortunately, Europe has tended to oppose protectionism. And today with trade and investment exchanges now the key to future prosperity, we cannot afford to retreat behind protectionist policies.



With Asia now a major driver for the global economy, we welcome the agreement at the recent Asia-Europe Meeting (ASEM) of finance ministers' meeting to strengthen our economic and financial cooperation. We also welcome the EU-China financial markets dialogue that began earlier this year and which will enhance Europe's influence in global markets; and we strongly support the establishment of an EU-India dialogue along similar lines, with the support of industry, as soon as possible. The Prime Minister, in our EU Presidency role, has been advancing our co-operation through the EU-China and EU-India Summits last month.

And, taking forward the remit of the June EU-US Summit, we are seeking to make progress in our Presidency in developing a stronger transatlantic economic partnership. This is already the largest bilateral trade and investment relationship in the world - accounting for up to \$2.5 trillions of commercial transactions each year and supporting 14 million jobs on both sides of the Atlantic. But removing the remaining transatlantic barriers could generate one million more jobs and, according to a recent study by the OECD, bring permanent increases in per capita GDP of up to 3 per cent.

Because of these huge potential benefits for European jobs and prosperity, engaging in a more regular transatlantic economic dialogue would help us to break down old barriers and to discuss common approaches to regulation, competition and transatlantic commerce. Having already established the EU-US financial markets regulatory dialogue, we should now agree a more forward-looking agenda, with as objective a barrier-free transatlantic financial market. And we should expand our dialogue on regulation to other areas including pharmaceuticals, IT, chemicals and energy efficiency, bringing European and US regulators together to set priorities for closer cooperation.

With a new, more outward-looking global Europe, we should see America, Asia and the rest of the world as partners not rivals – working together in trade policy but also in far wider policy areas to reduce insecurities and enable global change to be of benefit to all.

So, only eight working weeks away from the world trade talks in Hong Kong, the right action needs to be taken. If we are to avoid the disappointments of Cancun, Europe and America must agree to move together. Europe should lead the way in rejecting agricultural protectionism, responding to the US offer to abolish export subsidies and cut tariffs, and reforming the Common Agricultural Policy. Our test at Hong Kong will be to press for the conclusion of an ambitious trade deal that will completely open markets to exports from poorer countries.

## Conclusion

This pamphlet has shown how rapid transformation of the global economy brings new pressures and new opportunities for Europe, to which we must respond in order to deliver both peace and prosperity for all our 450 million citizens in the future.

Across Europe, we are recognising that to make this move, we need to adapt our policies and priorities to fit the new global era. With performance in many countries in key areas such as skills and innovation falling behind, our task now and in the years to come is to equip Europe for the 21st century through structural and budgetary reform, social reform, regulatory reform and trade reform – creating a Global Europe that becomes more competitive as the route to delivering full employment.

It is on this long-term programme of economic reform that we will seek to make progress in our European Presidency and beyond.

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