

Global Europe

Meeting the Economic and Security Challenges

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PREFACE BY THE PRIME MINISTER AND THE FOREIGN SECRETARY

For the first time in its history the European Union has an opportunity to become a genuinely global player.

Enlargement has spread stability and prosperity across Europe. The EU now has 27 members – up from the 6 when Britain joined. The Reform Treaty sets the framework to ensure that an enlarged EU can function well. And it ends the stagnant, decade-long, debate over the false choice between a wider or deeper EU.

We now need to move on from these inward looking institutional questions that have dominated the European debate for too long. The EU has a chance to look up from the detail of its own Treaties and out to the wider world. We now need to focus on the real issues that matter to people in the Member States – competitiveness, jobs, the environment, security.

It also has a chance to start to play its full part in the wider world. Day by day the EU is working to help spread peace and stability beyond its borders, from helping to build a better future in Kosovo, to putting pressure on the regime in Burma, to working for a world trade deal that is in the interests of developed and developing countries alike. Increasingly the EU is making a positive difference in the world. But it can do more.

It is through this positive, pro-European but realistic approach that the EU can realise its full potential in the era of globalisation. Pro-European, because it is only through active engagement that we can meet our common goals, such as tackling climate change. Realistic, because we know that Europe cannot ignore the enormous global changes that affect us all.

This pamphlet, “Global Europe”, is part of our contribution to that debate. It sets out a new direction for Europe in line with the challenges of globalisation and outlines the priorities for action. These include driving forward liberalisation of the telecommunications and energy sectors; leading efforts to secure a breakthrough in the Doha trade round to deliver substantial reductions in tariffs and subsidies; and implementing the climate change measures necessary to meet our ambitious targets for reducing greenhouse gas emissions. Our overall aim, now the institutional debate is over, is to see EU leaders committed to taking the steps that guarantee Europe’s ability to flourish in the globalised world.

Helping people improve their lives and shaping the world for the better. That’s the EU we want. And that’s the EU we now have a chance to build.



Gordon Brown

The Prime Minister,

The Rt Hon Gordon Brown MP



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The Secretary of State for Foreign and Commonwealth Affairs,

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I INTRODUCTION

The challenge for EU leaders

The challenge and opportunity for this generation of European leaders is to move beyond inward-looking institutional debates and set a new direction for the European Union (EU) that focuses on the issues that matter most to our citizens – sustaining growth and jobs, tackling climate change and fighting terrorism. In the 21st century, the most successful countries will be those that are able, not only to adapt to global trends, but also to reach out beyond their borders and engage with other countries. With its shared values, laws and institutions, the EU is uniquely placed to help our countries and our peoples rise to these global challenges. However, it is important to be realistic about the scale of those challenges, and the scale, nature and urgency of the EU response.

The EU has played a vital role in delivering prosperity and security to our continent over the last 50 years: it has met the challenges of building peace from the ruins and devastation of war; of breaking down economic and trade barriers through the creation of the Single Market; of extending a shared commitment to democracy and freedom across a reunited and enlarged EU of 27 Member States; of playing a leading role in the fight against global poverty; and, most recently, showing global leadership with its decisions on climate and energy security at the European Council in March 2007.

Now, at the beginning of the 21st century, the balance of global economic activity is shifting with the rise of China, India and other emerging economies. The transformations in communications and technology have led to the global sourcing of goods, global flows of capital, and to the emergence of new global threats to our security, ranging from terrorism to climate change. These developments create new challenges and new opportunities that the EU's founders could never have foreseen.

As Europe successfully met the challenges of the post-1945 period, so the EU can provide the foundation of our strategy to overcome these new global challenges going forward. But, to do so, we need a more outward-facing Europe, a Global Europe, which can set a new agenda for globalisation that emphasises openness, fairness and the importance of cooperation between nations.

For the context of the European project has changed considerably. In the decades immediately after 1945, the challenge was to rescue Europe from the destruction of the Second World War: to help reconstruct the fabric of our countries, rebuild and strengthen democracy, and link the interests of Western European states by integrating their economies to secure a long-lasting peace. The emphasis was understandably on strengthening internal integration, moving on from the idea that decisions should be taken nationally to the idea that they could be made across the European continent. Many assumed that a common market would become a single market, that the single market would engender a single currency, and ever closer European economic cooperation would progress into political union.

Today, however, it is the far-reaching and fundamental changes of globalisation to which Europe's nations need to respond. The issue now is not just how the enlarged EU of 27 Member States works effectively, but how these Member States reach out to the rest of the world. As José Manuel Barroso, the President of the European Commission, has noted, "...global Europe must be an open Europe. It must be an outward-looking Europe. And it can and must resist those whose response to globalisation is to retreat behind protectionist barricades."

This paper sets out the global challenges that are facing Europe; it discusses how well-placed Europe is to meet and overcome these challenges; and then identifies the key policy priorities for EU leaders and the EU in the decade ahead. Underlying the paper is the belief that Britain and other Member States are stronger by cooperating with one another within the EU to meet the shared challenges of globalisation. It argues that our shared European values should guide our shared approach:

- first, **openness**, embodied in our long-standing commitment to free trade and open markets, and also in our efforts to reach out and extend our values and our framework for cooperation to those outside the EU;

- second, **fairness**, through our desire to ensure that the potential benefits of globalisation are shared by all Europe's citizens and beyond, including through our commitment to competitive markets that reward effort, creativity and entrepreneurship, and by tackling world poverty; and
- third, **cooperation**, working together and sharing our experiences, recognising the vital role that the EU can play, alongside its members, in developing effective international action.

Europe has the opportunity and, more importantly, the responsibility to work to deliver an inclusive globalisation that can be a force for good across the world. A self-confident Europe, sure of the real assets it holds in terms of creativity, skills and stability can play a positive and proactive role, demonstrating global leadership in key areas such as trade and competition policy, development, climate change and energy security.

Priority areas for EU action

At the October 2007 Informal European Council in Lisbon, EU leaders brought to an end a prolonged period of inward-looking institutional debate. The Reform Treaty they agreed sets the framework to ensure that an enlarged EU can function well. They recognised that now is the time to focus our efforts on the issues that matter most to the future well-being of the people of Europe – economic growth, jobs, the environment, and security. They agreed that they must set a new direction for the EU, focussed on meeting the challenges of globalisation. This paper sets out the key issues in meeting these challenges and identifies the priority areas for action:

- a **renewed commitment to high levels of growth and employment** through a new, modern and more flexible approach to Single Market policies that focuses less on legislation and more on promoting competition, reducing the burden of regulation, and encouraging innovation. The immediate priorities for the EU are to move ahead with the proposals for liberalisation of the telecoms and energy sectors; to implement the recently-adopted Services Directive; to deliver EU targets for reducing administrative burdens; to pursue a more risk-based approach to regulation; and to agree further improvements to the European patent system;
- an **effective and well-functioning social dimension** that pursues modern social policies, which combine labour market flexibility with fairness in line with Europe's long-standing social values and its commitment to economic prosperity. To ensure that people can make the most of the opportunities the knowledge economy presents, the EU should launch a European skills review that looks at the EU's long-term skill needs, identifies the areas where skill levels will need to be raised, in order to help Member States address these issues;
- a **commitment to free trade and openness**, with the EU leading by example in breaking down barriers to create a free and fair multilateral trading system, and developing further its partnerships with the US and major emerging economies to foster economic cooperation and free trade. This means that the priorities for the EU now should be to: secure a breakthrough in the Doha trade round by showing as much flexibility as possible and leading by example in offering to reduce subsidies and tariffs; modernise its own trade defence instruments to reflect a more integrated global marketplace; and deliver its pledge to increase aid to developing countries to help them build their own capacity to trade;

- **tackling climate change and energy security**, where the EU is already playing a truly global leadership role through its commitment to become the world's first competitive, energy-secure, low-carbon economy. This includes a reduction in greenhouse gas emissions (GHGs) of 30 per cent by 2020 as part of a global agreement on climate change. The EU now needs to implement the Climate Change package agreed last Spring and it should look to shape an ambitious global response to climate change at the UN conference in Bali this December;
- **tackling terrorism and organised crime**, where EU action can increase the efficient exchange of information between Member States on criminal activities to enable the pursuit and prosecution of criminals (including terrorists) and the targeting of their financing and assets. The priorities for EU Member States include further improving the exchange of information on criminal convictions and activities; strengthening the capacity of countries outside the EU to fight crime, so tackling those criminals who base their activities beyond the EU's borders; implementing the EU Counter Terrorism Strategy; and improving Member State co-operation on asset recovery procedures;
- **promoting security and stability in neighbouring countries and beyond**, through enlargement, building governance and capacity, through the EU's peace-keeping and peace-building, and through supporting an effective multilateral system. The priority is to maintain the momentum behind the EU's ongoing accession negotiations – crucial for promoting reform and stability – and build peace-keeping and peace-building capability, including in the Balkans and the Middle East;
- **tackling global poverty and development** including through a fresh effort to deliver the Millennium Development Goals (MDGs). The priority for EU Member States is to ensure that they deliver their commitments, which, for the EU15, means increasing collective official development assistance to 0.56 per cent of GNI by 2010, rising to the UN target of 0.7 per cent by 2015; and
- **reforming the EU budget so that the EU is better equipped to meet the challenges of the 21st century**. The priority is to ensure that the forthcoming review of the EU Budget provides the basis for a more effective and efficient Budget, through far-reaching reform of the Common Agricultural Policy (CAP), a significant increase in the percentage of Structural and Cohesion Funds (SCFs) spent on poorer Member States, and reorientation of the budget towards the challenges of globalisation including promoting research and innovation, and addressing climate change.

Through meeting these priorities, we can create an outward-looking, globally-focussed EU that builds on our shared values, laws and institutions to set a new agenda for globalisation and to deliver prosperity, opportunity and security to citizens of all 27 Member States and beyond.

2 GLOBAL CHALLENGES

Global trends are reshaping the EU and its Member States. Greater trade flows and economic growth have increased prosperity, transforming the lifestyles of Europe's citizens and lifting millions around the world out of poverty. Now, global economic integration, and the emergence of China and India as world economic powers, create new opportunities and new challenges for the EU.

Globalisation also presents new security challenges for Member States. The world faces a range of complex and interconnected security risks, including threats from international terrorism, organised crime and inter-state and intra-state instability. Human and resource pressures can impact on stability and development. International efforts to fight poverty have the potential to contribute to global security, but enormous challenges remain to meet the international community's stated ambitions.

INCREASING FLOWS OF TRADE AND INVESTMENT

The world economy is undergoing a period of dramatic change driven by rapid advances in technology, most notably in communications, which are enabling increased specialisation, fragmentation and dispersal of economic activities across continents, and the breaking down of barriers between nations, enabling the freer movement of products, capital and people across borders.

The rise of large, fast-growing emerging economies – particularly in Asia – is transforming the balance of global economic activity. The Asian economies' share of world GDP, which was just 18.5 per cent in 1950, is expected to increase to 30 per cent by 2020. This year China's economy is set to grow at 10 per cent and India's at over 8 per cent. This expansion has the potential to improve living standards and reduce poverty significantly, with the proportion of people in China living on less than a dollar a day projected to decrease from 16 per cent in 2000 to 3 per cent in 2015.

Many goods that used to be sourced in Europe or the US are now increasingly sourced in the emerging world. Twenty years ago just 10 per cent of manufactured goods came from developing and emerging countries, but by 2020 that figure is forecast to be 50 per cent. Trade in services has also intensified. The services sector accounts for over 70 per cent of GDP in advanced economies, but only 23 per cent of global exports. However, recent advances in information and communication technology (ICT) are expanding the range of services, such as computer programming, call-centres and consultancy, which can be easily produced in one country and consumed in another. There appears to be significant scope for trade in services to intensify over the next decade.

The continued growth in the volume and range of goods and services traded presents the EU with opportunities as well as challenges. It generates new and larger markets for EU exports – China, India and Russia alone are set to account for more than half of global trade growth this year – and it intensifies competition, bringing lower prices and more choice to EU citizens. EU Member States have already benefited from the recent period of globalisation. As open economies they have been better able to harness the power of trade to boost competitiveness and productivity, leading to long-term improvements in living standards and sustained economic growth. (See Box 2.1)

Increasing trade flows have been matched by an increase in global capital flows of debt, equity, remittances, and foreign direct investment, spurred by more open global investment conditions. As a result, economies have become increasingly integrated through the cross-border ownership of assets. The stock of financial assets held outside investors' home countries increased from 20 per cent of global GDP in the mid-1970s to 60 per cent in the early-1990s and to around 140 per cent today. This has brought a number of benefits including higher economic growth and better insurance against adverse shocks.

Box 2.1: The benefits of globalisation

Europe is well-placed to take advantage of the opportunities of global economic integration:

- increasing trade and investment flows drive up competitiveness and productivity, while the rapid growth of the emerging economies has the potential to boost global demand and provide new sources of wealth;
- advances in communications technology facilitate the increasing specialisation and internationalisation of production, increasing competition, productivity and also the tradability of services, and delivering more choice and lower prices for consumers.

However, the economic opportunities associated with globalisation are not the only potential benefits:

- globalisation can also be seen as a force for stability. Economic integration can help reduce the possibility of armed conflict and has been central to the peaceful relations in Western Europe witnessed in the second half of the 20th Century;
- the exchange of ideas and people is enriching our culture and society and supporting innovation and scientific breakthroughs. The mapping of the Human Genome is just one example of how the scientific community is using new technology to work across borders;
- globalisation, if managed well, can enable a more efficient and equitable global allocation of growing global wealth, tackling poor living standards, reducing poverty, and providing economic opportunities worldwide. The rapid economic expansion of China and India has the potential to lift millions out of poverty;
- improved governance is another potential benefit of globalisation. Better communications, particularly through the internet, mean that governments can more easily be held to account, allowing greater scrutiny by citizens; and
- civil society groups increasingly communicate and cooperate across borders exerting pressure on policymakers and business. This has enabled environmental, human rights and poverty reduction NGOs to drive the debate on climate change, international development and debt relief.

The integration of capital markets across borders means that financial market events are increasingly global. The recent turbulence in global financial markets, for example, was triggered by problems in the US sub-prime mortgage market. This raises important questions for policymakers. Given the increasingly global nature of financial markets, it is important that any response is international. The IMF and the Financial Stability Forum, which brings together the finance ministries, central banks and regulators of all the major financial centres, should play a leading role in examining the underlying causes and in helping the world to respond to any vulnerabilities in the financial system. Europe should influence this debate, and has agreed a clear set of priority issues that the international community needs to address.

Growing global imbalances and the associated build up of foreign exchange reserves in countries like China, have increased the importance of developing and emerging economies in the international financial system. This has given rise to new financial players, and the rapid expansion of Sovereign Wealth Funds (Box 2.2). However, the challenge to emerging markets to integrate fully into the global financial system remains substantial. The financial crises of the 1990s illustrate vividly the risks from premature or hasty opening of capital accounts in countries that have immature financial sectors and weak legal and regulatory institutions.

Box 2.2: Inward investment and Sovereign Wealth Funds (SWFs)

The European economy has benefited significantly from its openness to foreign investment. Inward investment provides increased competition, greater innovation, access to new technologies, increased productivity and reduced prices for consumers. These benefits can accrue even without the multilateral opening of markets.

It is important to remain committed to maintaining liberal global investment conditions. Where concerns exist about potential competition or strategic issues regarding inward investment, these can and should be addressed by appropriate competition and regulatory regimes to protect the public interest from a lessening of competition and threats to national security. Such regimes should be consistent with the OECD's investment framework of proportionality, transparency & predictability, and accountability. It is important to keep to the minimum restrictions on foreign investment, which should only apply to very limited cases concerning national security.

Sovereign Wealth Funds (SWFs) have been around for many decades, but their recent rapid expansion means that they are increasingly significant investors in the global economy. This has raised two separate concerns:

- first, it has been suggested that SWFs, which have traditionally followed conservative

investment strategies and may therefore have had a stabilising effect on global markets, may now be pursuing more aggressive investment strategies as they seek higher returns. This, combined with the sheer size, concentration and lack of transparency of some SWFs, may cause an increase in volatility in global financial markets. The IMF should examine the possible risks to global financial market stability posed by the growth of SWFs and consider the need for improvements in transparency; and

- second, concerns have been raised about the strategic intentions of some foreign state controlled funds, which could be making inward investment decisions for non-commercial reasons. Any such concerns about national security implications should be tested within proportionate, transparent, predictable and accountable competition regimes.

It is in the interest of all parties to improve standards of governance and transparency, and promote fair investment frameworks. Countries should engage in a constructive dialogue with SWF holding economies, and continue to work through the OECD to look at member countries' current investment frameworks and identify best practices that allow for the free flow of foreign direct investment to continue while at the same time reducing national security concerns.

PRESSURES ON NATURAL RESOURCES AND THE GLOBAL CLIMATE

Energy

As global economic activity has increased, so has the demand for energy, putting pressure on energy supplies, raising concerns about energy security, and causing environmental impacts. Robust global economic growth means that global energy demand is expected to grow strongly over the next two decades. In the absence of policy changes, it is projected to grow by an average of 1.7 per cent per year to 2030. Developing countries are projected to contribute around 70 per cent of the increase in global energy consumption to 2030.

Worldwide fossil fuel resources remain very large, but substantial investment is required in order to turn them into energy supplies for end consumers. However, there is no guarantee that all of the investment needed will be forthcoming. The ability and willingness of major oil and gas producers to invest sufficiently to meet rising global demand is particularly uncertain and the International Energy Agency has already warned that global oil and gas markets could both tighten early next decade. It is clear that energy security will be a significant policy challenge for developed as well as developing economies, including EU Member States.

Climate change

A growing global population and rapid growth in the world economy are placing increasing demands on the environment and there is now strong evidence that climate change will affect the basic elements of life for millions of people. If no action is taken to reduce emissions of greenhouse gases, then global temperatures could rise over 2 degrees celsius from pre-industrial levels by the middle of the century, with the possibility of an increase of up to 6 degrees by the end of the century. In such a scenario, hundreds of millions of people could be affected by hunger, disease, water shortages, environmental degradation and coastal flooding. Developing regions will suffer earliest and most severely. Climate change on this scale will bring substantial risks of instability. If climate change reduces food production, increases water stress and increases the number of droughts and floods, there are clear risks of creating or sustaining existing tensions, which could lead to

conflict and migration. In response to this global challenge, and with the EU as a whole responsible for around 15 per cent of the world's total emissions, the EU has proposed that the world should limit global temperature rise to no more than 2 degrees above pre-industrial levels. This requires emissions to be reduced to less than 50 per cent of 1990 levels by 2050. In leading a global response, the EU is pressing for ambitious commitments in international negotiations, promoting cost-effective abatement through the development of a global carbon market, taking domestic action and encouraging early innovation.

MIGRATION

The movement of people has increased markedly in recent decades, with international migration doubling since 1975. However, migration patterns today are very different to those in previous cycles of globalisation. Temporary migration, which is often work-related, has increased across many OECD countries over the past two decades and migration of highly-skilled people is also much more common. As competitiveness is increasingly shaped by a country's ability to attract and retain a skilled workforce, competition between countries for high-skilled workers is likely to continue to increase.

As the costs of travel have fallen, cross-border movement has become easier not only for those wishing to travel for legal purposes, but also for illegal immigrants. Many countries are facing the challenge of illegal migration. For example, it is estimated that there are over 10 million illegal migrants in the US. Traffickers and smugglers can play a key role in facilitating the movement of illegal migrants and, while estimates of the extent of human trafficking differ, the International Labour Organisation estimated in 2005 that, globally, at least 2.5 million people were the victims of trafficking at any given point in time.

There is also a minority of migrants who have to leave their home countries due to political instability, conflict or natural disasters. Across Europe, there has been a general decline in the number of asylum seekers and in the UK this trend has been particularly sharp: 2006 saw the lowest yearly intake of asylum seekers since 1993.

INTERNATIONAL TERRORISM AND ORGANISED CRIME

International terrorism

International terrorism has been a problem for the international community for many years. However, the nature of the terrorist threat has changed and is more difficult and complex to counter today and, although there are fewer terrorist incidents than in the mid-eighties, terrorist attacks are becoming more lethal.

The terrorist threat today is genuinely international. The largest attack occurred in the United States in September 2001 killing nearly 3000 people. There have also been significant attacks in Europe, notably those on the Madrid train network in March 2004 and attacks in the United Kingdom in July 2005, which killed 52 people and injured over 700 others. Europe and North America are by no means alone in facing this threat; countries across the Middle East, Asia, India and Africa have suffered more deaths from terrorism over the past decades.

The nature of the threat today has changed. It now tends to come from a variety of groups, networks and individuals who are not necessarily confined in their political objectives. These different groups often cooperate and assist each other whilst pursuing separate goals. They intend to cause mass casualties and are indiscriminate, and are often prepared to kill themselves as a means of killing many others.

Terrorists make maximum use of the tools of globalisation to realise their aims, such as the internet, mobile communications and the media. The ease of travel and the ease with which information and money flow across the world mean that the threat has become more difficult to detect and prevent.

International organised crime

Globalisation and technological development now allow criminals to operate outside, as well as within, national borders. The majority of harmful drugs in Europe originate elsewhere, people trafficking occurs around the globe, while organised criminal networks in south-eastern Europe remain a problem for the whole of Europe.

The principal organised crime activities of drugs, illegal arms, human trafficking and money laundering are becoming increasingly prominent risks to international security. A recent UN Report assessed that annual income from international organised crime could be as much as \$2 trillion. These activities pose a major threat to many countries, not only in terms of individual misery and community suffering, but also on account of the associated economic, health, policing and other social costs.

Offences in one country may be planned in another or criminals may use foreign banks to launder their gains. Finance is at the heart of the threats from organised crime and terrorism. Criminals and terrorists use the international financial system to move money, and launder and disguise it in other types of assets. It is estimated that some £3 billion of criminal profits moves out of the UK annually. Criminals and terrorists also increasingly use existing legitimate businesses or set up businesses to hide their criminal activities.

The damage caused to national economies by eCrime is very difficult to estimate, but is thought to be in the region of billions of pounds. The most common eCrimes are identity theft, fraud, extortion, on-line child abuse, intellectual property theft and trade in illegal commodities such as firearms and drugs and narcotics.

GLOBAL SECURITY

The post Cold War world has seen major advances in democracy and a significant reduction in conflict. However, although the number of countries considered to fully respect civil and political rights has risen sharply, a large number remain either undemocratic or have fragile democracies. Repression in Burma, Belarus, Zimbabwe and North Korea are extreme examples of this, but democratisation has slowed in other countries. The consolidation and deepening of democracy across the world to ensure that all people can enjoy the freedoms set out in the Universal Declaration of Human Rights is a major challenge.

Although wars between states are now almost unknown, there are significant conflicts within states or between groups within different states, and failed states or those at risk of failing. Key issues include the long-standing conflict between Israel and Palestine, the tragic civil war in Sudan which has most recently devastated the Darfur region, and the intense armed conflicts in Afghanistan and Iraq. Resolving these conflicts, managing post-conflict reconstruction in a way that breaks the cycle of conflict and deprivation, and tackling proliferation of weapons are of fundamental importance to increased global stability.

Within Europe, the accession of 10 Central and Eastern European countries to the EU in 2004 and 2006 was part of a fundamental transformation that has brought stability and prosperity to most of the continent. Resolution of Kosovo's status is the key remaining issue from the break up of the Former Yugoslavia, but much still needs to be done to consolidate stability in Bosnia and to bring all the countries of the Western Balkans into the EU as prosperous, secure and mature democracies.

GLOBAL POVERTY

Over the past 40 years there has been significant progress in alleviating world poverty. The United Nations Millennium Goals Report 2007 states that the proportion of people living in extreme poverty fell from nearly a third to less than one fifth between 1990 and 2004. In developing countries, enrolment of children in primary school rose from 80 per cent in 1991 to 88 per cent in 2005. Asia has a staggering reduction in poverty, demonstrating the potential of globalisation as a force for good.

Nevertheless, significant challenges remain and progress remains uneven. On current trends, the United Nations Millennium Development Goals Report 2007 estimates that many of the Millennium Development Goals (MDGs) will not be met. AIDs killed 2.9 million people last year, and half a million women died in pregnancy or childbirth. Half of the population of the developing world still lack basic sanitation. And while death rates of children under the age of five have been dropping, progress in southern Asia and sub-Saharan Africa towards halving the proportion of underweight children is moving too slowly.

The challenges facing developing countries are also becoming more complex. International cooperation is needed on trade, instability and climate change as well as the delivery of traditional aid programmes. Trade is often the means by which economic growth takes place, ultimately providing the exit strategy from aid, but at the moment markets in the developed world are not sufficiently open to goods and services from developing countries. Moreover, many poor countries also need assistance in parallel, for example, through aid for trade – to tackle internal constraints that prevent them from taking advantage of more open markets such as poor transport and telecommunications, conflict and corruption.

3 IS THE EU MEETING THE CHALLENGE?

The EU – in its various phases – has played a vital role in delivering prosperity and security to our continent over the past 50 years. Amid the ruins of the Second World War the first impetus for European unity took hold as former combatant nations joined together in the cause of reconstruction. The task of reconstruction led to a broad new commitment to economic cooperation, the breaking down of economic and trade barriers and in the 1980s to the creation of the Single Market. More recently, the EU has extended its shared commitment to democracy and freedom through the re-unification of East and West, and the accession of 12 new Member States. The decisions to write off the debts of developing countries and adopt an ambitious strategy for tackling climate change demonstrate how the EU, through showing global leadership, can also be a progressive force for change beyond its borders.

However, no country or continent can take its long-term prosperity or security for granted. The pace of global change and the scale of the economic and security challenges set out in Chapter 2 mean that the EU must continue and accelerate this process of reform and renewal. With enlargement, and a progressive Commission led by President José Manuel Barroso, the EU and its Member States have taken significant strides in recent years towards adopting a more open and global view of the world, but there is still some way to go before this approach is fully developed and entrenched, and to ensure the EU, its Member States and citizens are fully equipped to meet the economic and security challenges that lie ahead.

THE ECONOMIC CHALLENGE

The Lisbon Strategy

At the Lisbon European Council in March 2000, Europe's leaders committed themselves to an ambitious ten-year strategy for economic reform. The vision agreed at Lisbon was to make the EU “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”. In 2005, following a critical mid-term review led by Wim Kok, EU leaders re-launched the strategy to focus it more sharply on supply-side policies designed to increase jobs and growth and to strengthen the governance arrangements.

However, three years away from the original 2010 deadline, it is clear that the Lisbon vision will not be realised. Living standards still lag behind those in the US and other key advanced economies. In relative terms, Europe is no closer to US income levels than it was thirty years ago. Living standards in the EU15 are around 30 per cent lower than in the US, and 35 per cent lower for the EU25. Although output per worker has picked up somewhat on the back of the current recovery, some sectors of the EU economy, such as services, show particularly low productivity growth. The EU and its Member States still need to implement significant economic reforms to improve the flexibility of product, capital and labour markets and to encourage greater investment in skills and innovation.

Of course, there is a wide variation between Member States. Examples of good performance include Finland and Sweden in innovation and education, and the Netherlands and the Nordic countries for their labour market outcomes. In addition, when compared with some other advanced economies, many Member States exhibit higher levels of social inclusion and lower levels of relative poverty. The share of people living below the poverty line in the EU has been consistently lower than in other advanced economies, and the Nordic countries, in particular, have demonstrated that it is possible to have high average incomes, high employment and flexible labour markets alongside high levels of perceived job security and low levels of inequality.

Employment

The EU employment rate has increased from around 60 per cent in the late 1990s to 65 per cent at the end of 2006 reflecting, in particular, higher levels of employment among women and older workers. In some Member States employment rates exceed 70 per cent, but other countries are fairing less well and overall, despite recent progress, EU employment remains relatively low by international standards. The Lisbon target of an EU employment rate of 70 per cent by 2010 would require the creation of an additional 12 million jobs and looks unattainable. The challenge going forward is to lock-in and accelerate recent improvements so that employment rates increase among all groups, particularly the most vulnerable and marginalised. Increasing labour market flexibility, reducing long-term unemployment and youth unemployment, while raising further the employment rate of older workers should be priorities.

Skills

Intensifying international competition, accelerating technological change and changing patterns of consumer demand increase the demand for higher-level skills. However, education and skills levels vary significantly between Member States and often lag behind our major competitors. Recent trends suggest that many EU Member States are moving in the right direction and most Member States are increasing their levels of tertiary education. However, Member States still lag behind the US, and skills levels are rising much faster, albeit from a lower base, in emerging economies. The proportion of 25-34 year-old South Koreans with an upper secondary education was 97 per cent in 2005, compared with 87 per cent for the equivalent age group in the US and 79 per cent in the EU. Education and skills policies and a commitment to lifelong learning are a crucial part of the response to increasing global competition. But here again performance varies across Member States. The OECD found that 40 per cent of the labour force in Denmark, Sweden and Finland are involved in job-related training each year. This contrasted with fewer than 10 per cent in southern Europe and some of the newer Member States.

Innovation

To meet the economic challenge from emerging economies, EU economies and businesses must become more innovative. Higher levels of competition and reductions in regulatory burdens are essential to creating an environment for enterprise that gives firms the confidence to innovate and invest. Europe as a whole must invest more, and more effectively, in Research and Development (R&D). EU R&D intensity remains at a lower level than that of most other major world economies such as the US and Japan, and its share of global R&D has declined in the last decade. However, the EU has had success in innovating in services and in non-technological innovation for which R&D alone may not tell the whole story and while leading in technology is important, so is the capacity to exploit it.

Single Market

The Single Market has been one of the EU's defining achievements, demonstrating that openness and increased competitive intensity can drive significant economic gains. It has delivered jobs, growth and greater choice and prosperity for Europe's citizens and businesses and demonstrates how EU Member States can benefit from opening themselves up to greater competition and trade.

Box 3.1: The Single Market

By removing cross-border barriers to the free movement of goods, services, capital and people, and strengthening competition, the Single Market has helped deliver considerable benefits for EU Member States, European businesses and citizens:

- boosting prosperity by €225 billion in 2006 and creating an additional 2.75 million jobs;
- a quadrupling of foreign direct investment in the first ten years;
- improving export performance, with EU external trade increasing from 6.9 per cent to 12.3 per cent of EU GDP between 1992 and 2005;
- higher productivity, with evidence that productivity in some sectors of the EU economy has increased by up to 2 per cent;
- lower prices for consumers and increases in the choice and quality of goods and services on offer;
- fewer barriers to trade within the EU, reducing border bureaucracy, cutting delivery times and reducing costs;
- small and medium-sized enterprises (SMEs), for whom previously export costs were prohibitive, have gained access to new exports markets; and
- companies across the EU are now able to bid for contracts from public authorities in other Member States due to the opening up of public procurement.

Trade

Globalisation has already provided substantial benefits for Europe. Increasingly global markets are the destination for European products and also the source of many goods and services we consume. European businesses have done well in the last decade exploiting these new opportunities. Germany in particular has been benefiting from selling exactly the kind of goods that countries such as China, India, Russia and others have been demanding, while the UK, France and the Netherlands are amongst the top global exporters of business services. European firms are also increasingly generating revenues abroad, benefiting domestic investment and jobs. However, although European companies will benefit from the opportunities of a global market for their products they will also face greater competition in Europe and beyond. Inevitably this will lead to restructuring in some sectors. This strengthens the case for EU Member States to implement reforms designed to increase the flexibility of their economies, encourage higher levels of innovation and support individuals in adapting to change, for example through retraining.

THE CLIMATE AND ENERGY CHALLENGE

Energy accounts for 80 per cent of all greenhouse gas (GHG) emissions in the EU and, with global and EU energy demand increasing and sources of fossil fuels becoming more concentrated, it is clear that the challenges of climate change and energy security have to be tackled together. In recognition of this, at the Spring European Council in March 2007 EU leaders signed up to an ambitious package of climate and energy proposals, with the objective of putting the EU on the path to becoming the world's first competitive, energy-secure, low-carbon economy.

At the heart of these proposals are commitments to further liberalise EU gas and electricity markets, improve security of supply, and to cut EU GHG emissions by 30 per cent from 1990 levels by 2020 in the context of a global and comprehensive international agreement, with a firm independent commitment to reduce EU emissions by at least 20 per cent. A range of other policies accompanied these commitments, designed to promote greater cooperation with external countries, improve energy efficiency, increase the use of renewable energy and promote the development of carbon capture and storage. EU leaders also underlined the central role that emissions trading must play in reducing GHG emissions at least cost, both within Europe and as a part of a global carbon market.

With the proportion of EU energy consumption met by imports expected to rise to 65 per cent by 2030 and the majority of these imports coming from a limited number of regions around the world, Europe's leaders also acknowledged the need to act with one voice in dealing with external energy partners. Actions to reduce energy demand and increase low-carbon generation capacity must be complemented by measures to improve the functioning of energy markets within the EU and internationally so the correct incentives are in place to encourage a more diverse range of producers and suppliers, to encourage innovation and investment in infrastructure and to enhance the operation of market mechanisms for tackling climate change. The Commission's competition inquiry into the electricity and gas sectors, which reported in January 2007, found that consumers and businesses are losing out because of inefficient and expensive gas and electricity markets. It noted particular problems associated with high levels of market concentration and the vertical integration of supply, generation and infrastructure.

THE SECURITY CHALLENGE

Primary responsibility for addressing the security challenge must of course lie with individual EU Member States, but the EU also has an important supporting role.

Within the EU, the launch of the Tampere work programme in 1999, replaced by the Hague programme in 2004, saw the development of a legislative and policy framework to combat transnational organised crime and terrorism.

The EU is making the investigation and prosecution of crime and terrorism easier by providing the means for police and judicial authorities to co-operate on all aspects of crime from the very start of an investigation to final sentencing. For example, enforcement authorities can rapidly exchange information on criminals; the European Arrest Warrant ensures that a criminal cannot escape capture by crossing borders; evidence on crime can be provided and used across the EU for prosecutions; and legislation has been introduced to combat money laundering activities and to ensure criminal assets can be recovered no matter where in Europe they are kept.

The creation of Eurojust has also increased the level of judicial co-operation between Member States. The EU, through Europol, is developing its analytical capabilities to identify organised crime threats and inform policy makers.

The EU has provided funding for numerous programmes and operations to combat organised crime and terrorism such as a joint customs operation focused on maritime cocaine smuggling and a multi-agency counter-terrorism operation targeting radiological and other terrorist-related materials transported by sea. Over the next 5 years, the EU's funding programmes have allocated €745 million to ensure effective operational cooperation in the fight against crime and terrorism.

The increasingly global nature of organised crime means that the EU cannot focus solely on its internal activities. It is therefore working with neighbouring countries and beyond to develop their law enforcement capabilities and to improve co-operation and information-sharing. Major projects have been undertaken on police, judiciary and penal reform in addition to projects that support undercover policing, anti-corruption, border management, customs and excise issues and directly tackle organised crime and terrorism.

Counter terrorism

As with security, the EU can also play a supporting role, helping Member States address counter-terrorism. This was demonstrated immediately post 9/11 when the EU elaborated its Counter-Terrorism Action Plan. Subsequently, the EU's Counter Terrorism Strategy - that reflects the changing state of the terrorist threat, which requires co-operation at the national, European and international level - has brought a greater sense of coherence and prioritisation to the rapidly increasing number of work streams contained within the Action Plan. It mirrors the UK's own national counter terrorism strategy. The Strategy sets out the EU's objectives to prevent new recruits to terrorism; better protect potential targets; pursue and investigate members of existing networks and improve the capability to respond to and manage the consequences of terrorist attacks. In addition, an action plan has been developed, reflecting the priority, within the counter-terrorism framework, of countering radicalisation.

Pandemics

Avian and pandemic flu issues cut across national boundaries and represent a many-sided challenge. A pandemic would have not only severe health implications, but would also have an impact on animal health, security, transport, services and the economy. The EU has taken a global leadership role on planning for flu pandemics, working closely with the World Health Organisation (WHO) and actively participating in the Global Health Security Group. Co-operation on reciprocal health arrangements has already resulted in improved systems across the EU to safeguard the health of its citizens which is important as geographical mobility increases. In a pandemic flu scenario the UK would provide emergency medical assistance to EU citizens in the UK and UK citizens would receive treatment in other Member States.

THE CHALLENGE OF MIGRATION

The EU and its Member States need to be able to cope effectively with illegal migrants, and to help combat the traffickers and smugglers who gain from moving people across frontiers, often in dangerous and life-threatening circumstances. The EU seeks to cooperate internally, with neighbouring countries, and internationally, to deal with these flows, including through enhanced FRONTEX border control, targeted information and aid measures, and work with transit countries and countries of origin to tackle the root causes and incentives for illegal migration.

Where migrants leave their home countries due to political instability, conflict or natural disasters, the EU seeks to address the causes of displacement through conflict prevention and resolution, but also to protect those who need help. Refugees should be able to access protection quickly and as close as possible to their countries of origin.

Box 3.2: The EU in Bosnia

The conflict in Bosnia and Hercegovina in the 1990s cost over 100,000 lives and brought the horrors of ethnic cleansing back to Europe. At the time the European response was slow and fragmented, though individual countries worked hard to try to end the conflict. Ten years on, Bosnia is a good example of how the EU can mobilise a range of instruments to anchor peace and stability.

Since 2003, the EU has maintained a military peacekeeping force in Bosnia. Currently 2,500 men strong, its size is being gradually reduced as the security situation improves. It has helped ensure that there have been no significant security incidents in Bosnia since 2001. This force works closely alongside a contingent of European police officers, who are helping the Bosnians to develop the kind of professional and ethnically mixed police forces they need to ensure the rule of law is applied fairly and consistently across the country.

The EU is also the single largest donor to Bosnia, helping to rebuild infrastructure and working with the Bosnian state to build the capacities it needs to meet the aspirations of its people in the future. An EU representative is resident in Sarajevo, double-hatted as the international community's representative and is charged with helping to drive forward reform.

Above all, the EU provides Bosnia with the prospect of eventual membership. This, more than anything, provides an incentive to Bosnians to overcome the divisions of their past and push forward the state building agenda they must pursue to achieve future stability.

THE CHALLENGE OF INSTABILITY

The EU has responded to global instability through a range of policies and instruments. Closest to home, enlargement of the EU itself has fostered the fundamental political and economic reform of the Central and Eastern Europe countries that joined the EU in 2004 and 2006. This echoed earlier political transformations in countries wanting to join the EU such as Spain, Portugal and Greece. EU membership remains a powerful incentive to change. Looking forward enlargement offers the potential to entrench stability and growth in Turkey.

Following recent enlargement of the EU, a new European Neighbourhood Policy was established to help neighbouring countries to the East and South to deepen their relationship with the EU and implement political and economic reforms with significant financial help. This is separate from and does not pre-empt any future decisions on their membership. ENP Action Plans are agreed with each country and are already starting to deliver results for some partners. In Ukraine for example, Action Plan targets such as WTO membership, free and fair parliamentary elections, and unrestricted media are all on their way to being met.

Conflict in the Balkans in the 1990s stimulated development of the EU's Common Foreign and Security Policy and the European Security and Defence Policy. These allow Member States to work closely together on the large number of foreign policy issues on which we share analysis and approaches, combining our diplomatic efforts and deploying armed forces and civilian experts to help prevent or respond to conflict. The EU leads international efforts in the Balkans, and has deployed civilian experts, police and military forces in the Middle East, Afghanistan, the Democratic Republic of Congo and East Timor among other places. Sanctions and other restrictive measures are also used by the EU, often in support of decisions taken by the UN Security Council. Examples include Burma, Iran and North Korea.

Box 3.3: EU enlargement

The European continent has been transformed over the past 50 years by the European Union. Enemies are now partners and divisions between democracy and authoritarianism have now been overcome. The EU has grown from 6 countries in 1957 to 27 today, stretching from Portugal in the west to Cyprus in the East. Europe's appeal, for countries as diverse as the UK, Spain, Cyprus and Lithuania, has been its ability to drive forward change and reform within a framework of shared values, laws and institutions that respect national interests.

Peace and democracy are now taken for granted by all of us in the EU, and the unnatural division of Europe that defined the Cold War has now been consigned to the past. Alongside the security provided by NATO, the EU has provided a framework for cooperation and collaboration, promoting peace and democracy across the Union and beyond.

It has also strengthened Members' economies, offering businesses and citizens the full benefits of a competitive market – built on the principles of free movement of goods, services, workers and capital – which following the most recent round of enlargement totals 450 million people. For the ten newer Member States of Central and Eastern Europe the accession process provided incentives for reform in a number of areas including economic and monetary policy, while the economic growth in these newer Member States has also proved to be a new source of dynamism for existing EU Member States.

Going forward, enlargement remains the EU's most effective soft power to foster political and economic reform in candidate countries (Croatia, Macedonia and Turkey) and the pre-candidate countries in the Western Balkans. Accession related reforms are improving the lives of citizens in these countries and helping realise our vision of a European future for the region.

GLOBAL POVERTY

Europe is the world's biggest aid donor, providing 55 per cent of total aid to more than 160 countries. In recent years, the EU and its Member States have taken a leading role in the fight against global poverty and the promotion of growth and development internationally. One example of the EU's global reach in supporting third countries' efforts is in the field of education. With a budget of €4,500m, disbursed in 100 countries and financing over 400 bilateral and regional projects, it aims to ensure that 250,000 children from poorer countries successfully complete their primary education.

The European Commission is improving its own aid effectiveness and providing support to EU donors to help them fulfil their commitments. New financial instruments have been introduced that are better tailored to respond to the needs of developing countries and the speed of aid disbursement has increased. In addition, in 2005, following increasing recognition that aid transfers alone would not be sufficient to help developing country partners reach the Millennium Development Goals (MDGs), Member States committed the EU to using a much wider range of policy instruments, including trade, climate change, migration and security, to pursue development goals.

The EU has worked in the WTO to promote successive rounds of trade liberalisation, although urgent progress is now needed in the Doha Development Round. 'Aid for trade', which focuses aid on measures designed to ensure developing countries have the capacity to benefit from trade, will reach €2 billion a year from 2010. In addition, the EU is negotiating pro-development Economic Partnership Agreements (EPAs) with countries in Africa, the Caribbean and the Pacific (ACP). The EU must ensure that these are appropriately designed and implemented to bring new trade and development opportunities to ACP countries.

4 POLICY PRIORITIES

The EU and Member States have the opportunity and the responsibility to work together to deliver an inclusive globalisation that benefits all Europe's citizens and can be a force for good across the world. To meet the challenges ahead, the EU will need to demonstrate further its global leadership in key areas such as trade and competition policy, development and tackling climate and energy security.

With its shared values, laws and institutions, the EU is uniquely placed to help Member States rise to these global challenges. However, it is important to be realistic about their scale, and the nature, scale and urgency of the European response. Where the response is at EU level, we should ensure that action is focussed on areas where there are clear additional benefits from collective action, so maximising the EU's added value and respecting the principle of subsidiarity.

Where the EU acts, its actions must be rooted in our shared European values:

- first, **openness**, embodied in our long-standing commitment to free trade and open markets, and also in our efforts to reach out and extend our democratic values, and our framework for cooperation, to those outside the EU;
- second, **fairness**, through our desire to ensure that the potential benefits of globalisation are shared by all Europe's citizens and beyond, including through our commitment to competitive markets that reward effort, creativity and entrepreneurship, and by tackling world poverty; and
- third, **cooperation**, working together and sharing our experiences, recognising the vital role that the European Union and its Member States can play in developing effective international action and showing global leadership in responding to new challenges.

PROMOTING PRODUCTIVITY AND COMPETITIVENESS

Strengthened commitment to the Lisbon Strategy

Europe's policy makers have a crucial role to play in responding to and addressing the economic challenges of globalisation. Member States need to accelerate domestic reforms to enhance their competitiveness and increase productivity, based on a strengthened commitment to the Lisbon Strategy. The key priorities for EU Member States should be:

- a stable macroeconomic environment that promotes growth, investment and fiscal sustainability in the face of demographic and global economic challenges;
- to improve the underlying conditions for innovation and entrepreneurship including by increasing competition, stimulating private R&D, education and training, and improving the access to capital, especially for SMEs;
- embedding better regulation at the national level, for example by screening new regulatory proposals and simplifying existing regulations; and
- reforming labour markets by introducing active labour market policies which protect employability rather than specific jobs.

Box 4.1: Making the most of globalisation

Recent studies by Goldman Sachs and the OECD show that some European countries have already benefited significantly from the integration of Brazil, Russia India and China (BRICs) into the global economy and that Europe is, on balance, well placed to prosper from globalisation. However, some countries are experiencing a much more competitive environment, given their particular trade specialisation patterns. For example, the EU15 is strong on engineering, pharmaceuticals and services, which at present face relatively little competition from the BRICs, while the newer Member States tend to concentrate on medium and lower-technology manufactures, where BRICs and other emerging economies are stronger. Several EU15 countries also fall in this category due to their reliance on more traditional industries such as textile and clothing. In order to compete, these countries may need to move into higher-value added industries or become niche players.

As the emerging economies move up the value chain other countries, including those within the EU15, will face increasing competition. Structural reform therefore remains a priority for all EU Member States. Reforms to encourage greater flexibility, particularly labour market flexibility, will be a priority, as will policies to support individuals in adapting to change.

A new approach to the Single Market

At EU level, a rapidly changing global environment puts a greater premium on flexibility, where the speed at which measures can be implemented – or amended as circumstances change – is slower than at national level. In the Single Market context, the importance of flexibility means that legislative proposals should no longer be our first response: consideration should also be given to alternatives to regulation and there should be a greater focus on more effective enforcement and implementation of existing legislation. We need a new approach to the Single Market that focuses on outcomes – jobs, growth and prosperity – and that prioritises action to where the economic benefits are greatest, for example, by pushing ahead with:

- **liberalisation of network industries** such as telecoms, post and energy where market opening could generate between €75-95 billion of potential extra economic benefits and create up to 360,000 new jobs. These sectors represent 7 per cent of EU GDP and 5 per cent of total EU employment. They also provide inputs to a large number of other economic activities and affect the competitiveness of the economy as a whole; and
- **rapid and effective implementation of the Services Directive.** Services now account for 70 per cent of Europe's output, but still just 20 per cent of European trade. In part this reflects the lower tradability of services (which are often consumed near to where they are produced), but also illustrates the existence of barriers to trade in services. The ECB estimates that there is scope to increase service sector output by 12 per cent through raising competition in the euro area to US levels. The recently adopted Services Directive can, properly implemented, deliver up to €30 billion of new wealth to the EU and create up to 600,000 new jobs.

Proactive use of competition policy

Competition is key to stimulating the higher levels of market dynamism and productivity that the EU needs. Greater competition is vital to help EU businesses prepare to meet the competitive challenge from the emerging economic powers, promoting productivity and growth, creating incentives for innovation, and ensuring that resources are allocated swiftly towards more

productive uses. Competition also drives down prices and increases choice for consumers, bringing the benefits of open markets to Europe's citizens. With much of the legislation required to establish the Single Market in place, pro-active competition policy should become the centrepiece of Single Market policy at EU-level. It is important for the European Commission to entrench and develop its robust stance on competition matters, for example, by promoting greater use of sector inquiries and using market monitoring to identify sectors with inadequate levels of competition.

Better regulation

An enterprising and innovative Europe requires a sustained commitment to regulatory reform. Europe needs to improve the regulatory framework and lessen the burden of regulation, while ensuring the standards of protection that society demands. Europe is beginning to meet this challenge. If the EU target of reducing administrative burdens arising from EU legislation by 25 per cent by 2012 is achieved, it will boost the competitiveness of European businesses, especially SMEs. However, it is important that the EU and its Member States continue to take tough action to tackle unnecessary bureaucracy and red tape. Moreover, where there is a genuine need for new regulation, we should make use of more flexible forms of regulation and apply a risk-based approach to improve its rationale, design and enforcement.

Encouraging innovation

Reform is also needed of Europe's system of intellectual property rights to improve incentives to innovate. The cost of applying for and maintaining a patent in seven Member States is between three and five times higher than the comparable costs of patenting in Japan and the US. To allow the EU to develop its patent regime, all options for improving European patents should be considered, whether Community or non-EC proposals. Recent developments in the ratification process of the London Agreement are welcome here, potentially saving business, in particular SMEs, hundreds of millions of euros. Similar achievements in relation to a European Patent Court and the Community Patent would deliver even more substantial savings.

A MODERN EUROPEAN SOCIAL DIMENSION

The benefits of globalisation for both businesses and consumers are large, but they are widely spread, whereas the costs, though smaller, can be very visible when they hit specific sectors or regions hard. This can create feelings of insecurity that governments need to recognise and act on. By pursuing modern social policies that combine flexibility with fairness, Europe's long-standing social values can be advanced alongside economic prosperity.

It is right and welcome that the EU Member States examine the mutually-reinforcing relationship between flexibility and security: 'flexicurity'. Several Member States have already demonstrated through their policies that countries can benefit greatly from globalisation, while still preserving and advancing social inclusion. We must offer a legitimate, modern alternative – an inclusive globalisation.

Social policies should be active, not passive, and should help individuals adapt to change. By protecting employability rather than specific jobs, governments can support people to move into and progress in work. This can be achieved by providing insurance in the broadest sense, through skills and retraining; unemployment benefits; maintaining the conditions suitable for high job creation; policies such as childcare, which make it easier for parents to work; and help for those who cannot work.

The existing set of European rights and standards have helped build a common framework that reflects core European social values. However, in general EU legislation is a relatively blunt tool for dealing with social policy. In a rapidly changing world, national governments are best placed to react to changing circumstances. This allows policies to be tailored to specific demographics, traditions, and labour market institutions.

However, there is a strong case for EU-level cooperation to address issues that are cross-border in nature: for example, the free movement of labour must be supported by EU-wide agreement on mutual recognition of qualifications. Europe can also act as a catalyst for change: identifying opportunities and common challenges; promoting solutions; exchanging best practice and agreeing strategic objectives; and providing analysis and evidence to inform reform programmes in Member States that increase labour participation.

A new debate on skills

The knowledge-based economy favours labour market entrants with higher skills, while technological and structural change mean people may require new and different skills throughout their working lives. If the EU is going to achieve sustainable growth and retain its competitive edge, while ensuring social justice for all, Member States must redouble their efforts to modernise education and training policies, in line with the goals of the Lisbon strategy. Although education and skills policies are the responsibility of Member States, one way in which the EU can add value is through a European skills review that assesses the skills challenge, and examines long-term skills needs and priorities.

PROMOTING EXTERNAL OPENNESS

At the heart of moving to a more outward-looking Global Europe should be a long-term commitment to reducing trade and investment barriers with the rest of the world. Successive reductions in trade barriers in the post-war period have helped drive productivity and growth, while investment into the EU has boosted jobs and enhanced the efficiency of European economies. Today, when adapting to changing patterns of global trade and investment is the key to future prosperity, a sustained commitment to openness across the whole EU economy is vital and the EU cannot afford to retreat behind protectionist policies. As an example of that commitment we must ensure, therefore, that EU trade defence rules are responsive to the global market place in which business now operates and are equitable in their operation.

The EU's dialogues with its major trading partners, including the US, China and India, offer the opportunity to develop stronger economic partnerships and break down barriers in regulation, competition and investment. In this respect, the launch of the Transatlantic Economic Council to address the remaining EU-US barriers to trade, investment and growth is a welcome development. With a new, more outward-looking 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 areas to reduce insecurities and share the benefits of global change.

The most urgent priority, if we are to secure the benefits of increased global trade for the world economy is to make progress and secure a breakthrough in the Doha Development Agenda (DDA) trade talks. An ambitious, pro-development outcome has the potential to deliver global growth worth tens of billions of dollars. A real opportunity exists to do this, and it is vital that the EU, US, and key emerging economies demonstrate the necessary political will, and show flexibility in their negotiating positions to secure an ambitious outcome that substantially reduces tariffs and trade-distorting subsidies. The EU should also continue to play a leading role in building the capacity of developing countries to respond to new market opportunities. It has pledged to increase its aid for trade to €2 billion a year from 2010 for all developing countries and is monitoring progress on the pledges of Member States.

REFORMING THE EU BUDGET

The current EU budget does not equip the EU to meet the challenges of globalisation. For example, in 2007, 40 per cent of total expenditure is still allocated to the Common Agricultural Policy (CAP). Similarly, with Structural and Cohesion Funds (SCFs), current spending requires reform. In 2007, 60 per cent of SCF spending is going to richer Member States.

An effective EU must be equipped with a budget that enables it to properly address the challenges, and benefit from the opportunities, of globalisation, and that represents good value for the EU's citizens. It is clear that the EU budget needs radical reform. The commitment by the European Commission and Member States to a fundamental review of the current budget in 2008-09 – beginning with the publication of the Commission's budget review green paper in September 2007 – is therefore a welcome first step.

The budget has an important role in supporting a number of collective EU priorities, but it is essential that resources are used more effectively. A principled approach can guide this:

- first, the EU should only act where there are clear additional benefits from collective efforts, or ‘EU added value’, compared with action by individual Member States;
- second, where EU-level action is appropriate, it should be proportionate and flexible. We must recognise the limits to EU budgetary intervention. Expenditure is just one of a number of policy levers, alongside coordination, sharing best practice, and legislation or regulation. In addition, the full range of financing options should be considered, for example, a loan from the European Investment Bank may in some instances be a more appropriate form of financing than a grant from the EU budget; and
- third, sound financial management, including the highest standards of financial control and independent audit is necessary, alongside continuing budget discipline.

It will also be important to pursue far-reaching reform of the CAP. Evidence suggests that the goals of a competitive, sustainable EU farming industry can be achieved more effectively and at a significantly lower cost. Similarly, the EU must focus better its budgetary support for structural and cohesion policy on the less prosperous Member States. The budget must be oriented to meet the challenges of globalisation, for example, in areas such as international development, migration, innovation and some measures to combat climate change, such as support for the development of clean energy technologies. In all these areas, significant benefits could accrue to all EU citizens.

The 2008-09 EU Budget Review offers an important opportunity to progress towards a reformed EU, one better able to deliver for the benefit of all its citizens. It must be genuinely fundamental, strategic and ambitious, and conducted openly, creatively and from first principles, in order that it achieves proper and effective reform.

Box 4.2: The EU’s Common Agricultural Policy (CAP)

The CAP remains the most visible and expensive common policy of the EU, but it distorts the Single Market, hampers innovation, and is increasingly out of step with the need for Europe to respond to the challenges of globalisation. Internationally, it continues to attract criticism, creates tensions in the EU’s relations with trading partners, and imposes significant costs on developing countries. Domestically, it imposes substantial costs on consumers and taxpayers and is inefficient in delivering support to farmers and promoting an attractive rural environment. Indeed much of the CAP still has a negative impact on the environment. The UK’s vision for EU agriculture by 2015-2020 is for an industry that is genuinely sustainable. It should be an integral part of the European economy, and internationally competitive without reliance on subsidy or protection. This means phasing out market price support and all direct payments to EU farmers by 2020.

MIGRATION

The UK retains responsibility for its borders, including visa arrangements with non-EU countries. Furthermore we have strengthened border control at ports of entry from the EU and from outside. However, clearly it is in the UK's interest to participate in EU cooperation to tackle illegal migration into Europe, and people trafficking and smuggling; and in initiatives to strengthen the EU's external land border, where, for example, UK expertise in document security is highly valued. Along with other Member States and the European Commission, the UK is participating in the delivery of a comprehensive external migration strategy, in line with the December 2005 European Council's Global Approach to Migration. The strategy is intended to offer a balanced, far-reaching and coherent approach to migration that, in cooperation with third countries, both tackles illegal migration and better manages legal migration.

The EU and Member States need to work together to take this forward including by: strengthening controls at the EU's external borders; through greater cooperation on tracking and tackling human smuggling and trafficking; and by working with third countries to remove some of the incentives for migrants to undertake hazardous and expensive journeys to enter the EU. In addition, Member States must take action to stamp out exploitation of migrants.

TACKLING CLIMATE CHANGE AND ENERGY SECURITY

The EU has a crucial leadership role to play in securing a global and comprehensive post-2012 agreement that will bring about emissions reductions, while supporting sustainable development and poverty reduction. The commitment by EU leaders to ambitious GHG emissions targets at the Spring 2007 European Council provides a clear statement of their intention to tackle climate change within the EU and an opportunity for the EU to lead the global debate. It is now imperative that the EU and its Member States follow up these commitments with effective action.

The EU supports the launch of comprehensive negotiations to agree a framework for action at the Conference of the Parties to the UN Framework Convention on Climate Change in Bali in December 2007. The key elements of this framework should

include: a long-term goal of reducing emissions to less than 50 per cent of 1990 levels by 2050; the strengthening and extension of global carbon markets; financial support for the development, deployment and transfer of clean technology and adaptation; and action on deforestation. The target should be to complete these negotiations completed by 2009.

Emissions trading is central to the delivery of EU objectives and the EU Emissions Trading Scheme (ETS) must become a more effective mechanism for driving change. This will require a more predictable, top-down approach to setting the overall caps for emissions, in line with the EU's ambitious overall GHG targets, higher levels of auctioning of allowances, and clear long-term signals about future requirements to drive low-carbon investment and innovation. The EU should also seek links with schemes in other economies to develop a truly global carbon market, capable of turning international agreement on targets into rapid, cost-effective action.

EU action is also necessary to set technology standards, which can encourage innovation and investment in energy-efficient products. They can take the form of legislation to require the phasing out of high-energy products, such as traditional light bulbs, or binding targets, for example, for the average energy efficiency of new cars, which would provide incentives for the development of new low-carbon models. EU rules on VAT should provide Member States with the flexibility to change VAT rates to encourage energy-efficient products.

Greater use of biofuels can have real carbon benefits, but their production can also be inefficient and may pose risks to sustainability, through the impact on land-use and food prices. Another priority will be to ensure that the EU fully considers the cost-effectiveness of biofuels, as well as effective sustainability standards to be developed and implemented, at EU level and beyond.

The Spring Council agreement marked an important stage in delivering greater EU security of supply by calling for the development of a common approach to external energy policy. EU leaders agreed on the need for effective diversification of energy sources and transport routes, for a common EU voice in pursuit of energy objectives, particularly when seeking to influence third countries, and for effective

use of the EU's network of energy security correspondents to anticipate and mitigate supply disruptions. However, the establishment of more competitive, transparent and liquid energy markets based on a stable, predictable and transparent regulatory framework is essential to enhancing energy security and ensuring that market-based instruments to tackle climate change, such as the EU ETS, are effective. Liberalisation of EU energy markets and, in particular, action to implement proposals to unbundle energy supply from energy transmission should therefore be a priority.

TACKLING TERRORISM AND ORGANISED CRIME

Primary responsibility for combating terrorism lies with individual EU Member States, but the EU has an important supporting role. The increasingly globalised nature of organised crime and terrorism has meant that the EU has developed structures to enable law enforcement authorities to work across national boundaries. But the focus has to shift to engaging more with the wider world so that we can, for example, stop the flow of drugs and people at source.

The ability to share information quickly and efficiently between law enforcement authorities both within the EU and internationally is a key priority. Some mechanisms have already been agreed, such as the Schengen Information System, the Prüm Treaty – which will allow the more effective sharing of DNA and fingerprint data for law enforcement – and the EU/US Agreement to share passenger information, while maintaining adequate protections. These should be fully implemented, while new work should also be taken forward, for example, on the exchange of criminal convictions information, and further enhancement of data sharing capabilities.

Organised criminals and terrorists are able to adapt rapidly to new measures and identify new opportunities, particularly by exploiting advances in technology. Our approach must therefore remain flexible, looking to practical responses and projects and move the focus beyond legislation. Criminals will also continue to base activities beyond the EU's borders to evade prosecution. The EU should continue its efforts to strengthen the capabilities of other countries to fight these threats.

Much remains to be done to deliver the EU Counter-Terrorism Strategy, both through delivering on the priorities and through effective implementation of existing arrangements. Work on asset recovery across EU borders should also be strengthened, supported by bilateral agreements or an EU agreement on asset sharing. This would enable one country to enforce another's orders, liquidate assets and split them with the country in whose courts the original order was made. This would provide incentives on both sides to ensure cross border assets are tracked down and seized.

STABILITY IN EUROPE'S NEIGHBOURHOOD AND BEYOND

Embedding democracy and economic development in neighbouring countries, both prospective EU members and others is a key priority for the EU. Enlargement – one of the EU's biggest success stories – has proved to be a powerful incentive for candidate countries to implement political and economic reform and also benefits existing Member States. Threats such as drugs smuggling, illegal immigration, organised crime and the fight against terrorism cannot be fought by erecting a notional wall around the EU, they can only be challenged through international cooperation, and crucially with our immediate neighbours.

The EU's existing commitments to accession for Turkey, Croatia and other countries of the Western Balkans are crucial for reforms and stability. The accession negotiations, and negotiations on Stability and Association Agreements in those countries, must be continued and tackle rigorously the range of issues identified to bring those countries up to European standards.

Accession-related reforms are already improving the lives of citizens in candidate countries and pre-candidate countries, helping us realise our vision of a democratic, European future for the region. This makes it all the more important to maintain our commitments to candidate countries such as Turkey and to keep the door open for those countries who have the right to apply. The EU must show that it is ready to respect fully its commitments to candidate countries, and take account of the potential damage to the EU's overall interests which a disillusionment in those countries with EU accession might create, both in terms of stability and progress towards political and economic reforms.

Set up in 2004, some Action Plans within the European Neighbourhood Policy have yet to be agreed and implemented. ENP is still developing and facing challenges, including on how to offer sufficient incentives for the Euromed and Eastern neighbouring regions to reform. Given the myriad of existing regional initiatives and other overlapping fora, we need to develop a more coherent policy tailored to meet each individual partner's needs and circumstances while at the same time prioritising common challenges to the EU and neighbours, such as terrorism, climate and energy security, and energy efficiency. There should also be greater ownership of the policy by partners at government and civil society levels. As a first step in developing the ENP, the proposals from the Commission's December 2006 Communication should continue to be taken forward and implemented.

Foreign policy remains a matter for Member States, but the more we work together, the more effective we can be. Recent efforts to improve the effectiveness of Europe's Foreign and Security Policy should continue, focusing on effective crisis management and our ability to deploy military and police forces and civilian expertise quickly and effectively.

Box 4.3: The Middle East Peace Process (MEPP)

The EU plays an active and increasingly significant role in efforts to achieve lasting peace in the Middle East. Its extensive political involvement in the Middle East Peace Process (MEPP) is demonstrated by its role in the Middle East Quartet. Membership of the Quartet has enabled the EU to extend its access and influence to policy-makers in the region and more widely. The High Representative for EU foreign policy, Javier Solana, is seen as an important interlocutor in the Middle East. An EU Special Representative represents the EU in the region and actively promotes EU policies in relation to the MEPP. Already in 2007, the EU and its Member States have committed over 800 million euros of humanitarian and other forms of assistance to the Palestinians.

The EU operates two European Security and Defence Policy (ESDP) missions in the region: a border assistance mission to monitor the Rafah crossing point between Gaza and Egypt, and a police support mission to deliver training and develop the capacity of the Palestinian Civil Police. Both missions contribute to confidence-building and the implementation of agreements between the Israelis and the Palestinians, and build the capacity of the Palestinian administration to manage its own security challenges.

TACKLING GLOBAL POVERTY

The EU has a leading role to play in the fight against global poverty, and the promotion of growth and development internationally. To achieve this, we must ensure that EU development policy remains focused on the immense task of eradicating global poverty, including by meeting our commitments under the Millennium Development Goals (MDGs), continuing to improve aid effectiveness and speed of delivery and ensuring development objectives are fully taken into account in other EU policies such as trade, climate change, security and migration.

The EU15 are committed to spending collectively 0.56 per cent of GNI on official development assistance by 2010, rising to 0.7 per cent by 2015 (0.33 per cent for the Newer Member States). This aid will be delivered both bilaterally and through other multilateral channels, as well as through resources channelled through the EU's European Development Fund and from the EC budget. This will represent a substantial contribution towards tackling global poverty. However, Member States must work together to ensure that these resources are increasingly well-coordinated and efficiently targeted so as to provide effective, predictable and long-term funding to promote the attainment of the MDGs in developing countries.



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