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Realising both economic growth and social protection in Europe in an era of globalisation

Report
Committee on Economic Affairs and Development
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Summary

Globalisation, which can be described as the ever closer economic integration of all the countries of the world, represents both opportunities and risks for the member States of the Council of Europe. The opportunities, which the report urges European countries to seize, include higher growth and prosperity through the expansion of exports, cheaper imports, lower production costs, the attraction of foreign investment and increased benefits from investment abroad. Globalisation provides an opportunity to outsource lower added value activities to the rest of the world, transferring much needed investment and employment especially to the lower-wage emerging economies, while allowing Europe to specialise in higher added value products and services.

Among the risks that have been associated with globalisation are that its benefits are not equally shared in the advanced economies, with losses to labour income, or between countries, with the least gains going to the least developed; that the relocation of production to countries with low standards of social and environmental protection undermines those standards as well as employment in the advanced countries; and that the process of adjustment to globalisation in the latter countries is inadequate.

In order to maximise the benefits in terms of growth while maintaining the high standards of social protection which are among the highest values of the Council of Europe, and with a view to ensuring that benefits of globalisation are widely and equitably shared, the report underlines that governments must closely manage and direct the process of adjustment. The report recommends stimulating employment through greater labour market flexibility while maintaining strong levels of social protection for the individuals affected, and investment in innovation, research and development so as to ensure that Europe stays ahead in the production of high value added goods and services. Investment in social and educational policies should include life-long education and training, support for upward mobility in case of restructuring, and gender equity.

The report calls on European leaders to campaign for a vision that combines economic growth and social protection in the new economic world. Finally, the report notes the essential role of collective bargaining in the adjustment process, with the full involvement of the social partners. Greater efforts should be made to attract foreign investment and to close off opportunities that globalisation offers to criminals, including terrorists, to mask their illegal gains and transactions through money laundering and tax havens.

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A. Draft Resolution

1. Globalisation may be described as the ever closer economic integration of all the countries of the world resulting from the liberalisation and consequent increase in both the volume and the variety of international trade in goods and services, the falling cost of transport, the growing intensity of the international penetration of capital, the immense growth in the global labour force, and the accelerated world-wide diffusion of technology, particularly communications.

2. Globalisation is seen by some as an inevitable and powerful force obeying market principles that is playing the part of Adam Smith's "invisible hand" that will bring about a flat, seamless, integrated world economy characterised by complete freedom in the movement of goods, services, labour, capital and technology to produce growth and prosperity for all.

3. Others see globalisation as a threat that will impoverish Europe in a "race to the bottom" with emerging economies such as China and India, undermining and undercutting its labour force and wages, competing for investment and eroding the high standards of social welfare protection that have become the hallmark of the European social model.

4. For Europe, whose undoubted wealth is already based on the benefits of historic standards of education and training and a successful economic union, the potential of globalisation to stimulate growth and prosperity has been and continues to be realised through greater opportunities for expanding exports and cheaper imports, cutting production costs and attracting foreign investment as well as benefiting from investment opportunities abroad. The Parliamentary Assembly sees the positive side of globalisation as an opportunity to outsource lower added value activities to the rest of the world, especially to the low-wage emerging economies, while allowing Europe to specialise in higher added value products and services. In other words, Europe has a vast opportunity to upgrade its economies in a new international division of labour. In this context, the Assembly recalls and reaffirms its Resolution 1484 (2006) on relocation of economic activities abroad and European economic development.

5. The Parliamentary Assembly believes that the member states of the Council of Europe should seize every possible opportunity offered by globalisation to further stimulate growth, without which job creation to compensate for job loss and maintenance of a high level of social protection are not possible, the more so since providing health care and pensions for Europe's ageing population will make ever greater demands on resources along with other urgent needs such as environmental protection.

6. However, the Assembly cannot accept that free rein be given to a globalisation process that also threatens to undermine the social, cultural and community values that European societies cherish. There is thus a need for governments to guide and regulate this process so as to ensure not only that European economies successfully adjust to the changes brought about by globalisation but also that its benefits are widely and equitably shared, not only within Europe but as between the developed and the developing countries.

7. In particular, the Assembly is concerned by recent findings of the International Monetary Fund (IMF) which show that, although the increase in the global labour force resulting from integration of the emerging countries into the world economy has generally benefited the advanced economies, raising income accruing to labour in all advanced countries since 1980, labour globalisation and technological change together have reduced the proportion of income going to labour, with technological advances having the larger effect. Thus the labour share of Gross Domestic Product (GDP) in the advanced countries declined from 68% in 1980 to 61% in 2005, with unskilled sectors of the economy experiencing the largest declines. Although labour market policies have affected this outcome in different ways, the findings show that countries which have lowered the cost of labour to business, improved labour market flexibility and in particular ensured that unemployment benefits do not deter workers from seeking employment, have generally experienced a smaller decline in labour share.

8. The Assembly is also concerned by the OECD estimate that around 35% of Europeans of working age are economically inactive, compared with some 27% of Americans. Europeans must therefore get more people back to work. Yet the perception exists that Europe's sometimes generous social protection benefits appear to trap some people in inactivity by removing the incentive to seek work. This concerns not only the unemployed but also the much larger numbers of those receiving non-employment benefits such as sickness or disability,those in early retirement or single parents. Secondly, perceived labour market rigidities act to discourage the necessary labour adjustment to the impact of globalisation.

9. The Assembly accordingly believes, with the OECD, that social protection measures should be appropriately designed to support adjustment and minimize the fear of short-term unemployment. Thus, relatively generous unemployment benefits can be paid as long as there are strong and well conceived incentives to seek work along with practical efforts to retrain and upskill. There should be close monitoring and timely support of the unemployed and their search efforts by employment services. Those on non-employment benefits should also be quickly helped to get back into the labour market. In particular, family-friendly policies should target single parents, for example with appropriate tax incentives, optimum parental leave and improved child-care facilities.

10. As for labour market rigidities, the OECD believes that employers will accept regulations as long as their impact is predictable in terms, for example, of the cost of hiring and firing staff. The example of the Netherlands is cited as good practice with regard to dismissal regulations, or that of Austria's individual savings accounts into which employers have to pay a contribution and which employees can carry with them.

11. The Parliamentary Assembly notes the creation of a European Globalisation Adjustment Fund by the European Union in December 2006 which will provide up to €500 million a year to help workers laid off as a result of globalisation to find new jobs. The Fund will be used to help individuals in relation to their job search, personalised retraining, entrepreneurship or self-employment initiatives. The Assembly hopes that such initiatives will help reconcile European citizens with the ongoing process of European construction and commends this model to the wider Europe.

12. The Parliamentary Assembly firmly believes that the governments of the member states must control the nature and pace of the adjustments required to cope successfully with the impact of globalisation, grasping its opportunities and limiting its risks. Besides labour market flexibility, the policy agenda should include investment in innovation, research and development so as to ensure that Europe stays ahead in the production of high value added goods and services and deals successfully with such challenges as environmental protection, climate change and heath care. To promote positive adjustment, investment in social and educational policies should include life-long education and training, support for upward mobility in case of restructuring and gender equity. The social partners must be fully involved; there is an essential role here for collective bargaining. Investment must be the result of a partnership between the public and private sectors so as to ensure adequate and timely provision of resources. More progressive taxation may be required, even on global transactions, not only to raise the necessary funds but also to ensure that the benefits of globalisation are fairly distributed. The gains from outsourcing and offshoring could be taxed to help finance adjustment programmes.

13. Globalisation will increase international competition for investment, notably between the developed countries and the emerging economies like Brazil, the Russian Federation, India, and China. Therefore the European countries must ensure that their strategy to attract foreign investment is effective, not least through appropriate fiscal policies and by providing a highly qualified and motivated labour force.

14. Globalisation also offers opportunities to criminals, including terrorists, to mask their illegal gains and transactions through money laundering and tax havens. The Council of Europe, through its Group of countries against corruption (GRECO) and its work to combat money laundering (Moneyval) is in the forefront of international efforts to fight this scourge, in close co-operation with the OECD, among other organizations. The Parliamentary Assembly calls for this work to be stepped up. The OECD Convention on combating bribery of foreign public officials in international business transactions ("Anti-Corruption Convention") of 1997 was a major achievement, only marred by lack of implementation by certain countries.

15. Dealing with the problems brought about by globalisation requires the building of a political and social consensus based on shared values. There is an urgent need for Europe's leaders to offer a vision that combines prosperity and social protection in the new economic world – it can certainly be done, and the debate should not be left to those who say otherwise. Globalisation offers opportunities to everyone and it can be harnessed to help the next generation of Europeans build on the values that the Council of Europe holds dear. This can only happen through change and adaptation; but Europe's diversity offers many examples of how this can be done successfully with a view to generating the optimism and vitality that today's world economy requires.

B. Explanatory memorandum by Mr Lloyd, Rapporteur

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I. Introduction

1. Globalisation, says economist Anthony Giddens, is a term that has come from nowhere to be almost everywhere. Amazingly, the word did not appear in a dictionary until 1961, and has only come into everyday use during the last ten years. But despite its novelty – or perhaps because of it – globalisation has become the buzzword of our age, seeming to mark a decisive break with the past.

2. The International Monetary Fund (IMF) describes globalisation as *"the economic interdependence of all countries in the world, caused by the increase of the volume and the variety of the international transactions of goods and services, as well as of the international flows of capital, and by the accelerated and generalized diffusion of technology."* And while the nature and implications of this seemingly inevitable process of global economic integration are hotly debated, one thing is clear: in terms of its basic principles, such as expanding communications and trade, globalisation is nothing new.

3. Many economists now see the sixteenth century, when European explorers vied with each other for commercial advantage, as the 'first era' of globalisation – and for the next four hundred years, Europe led the way in creating a global society – particularly during the colonial, free-trading 19th century. In our own times, Europe has been a trailblazer for integration; not only that, but the forces of globalisation have increased the prosperity of today's Europeans, even though the benefits have been uneven and the process has provoked

fears about job losses and a "race to the bottom" as far as wages and social, as well as environmental protection standards are concerned.

Fifty record-breaking years

4. Recent globalisation has been extraordinary, for both the speed and scale of change: since 1950, the world's population has grown from 2.5 billion to 6.3 billion, but the volume of world trade has far outstripped it, growing by more than 20 times, and driven by foreign investment now reaching about $12 billion each week. Meanwhile, foreign exchange transactions reach $1,300 billion daily - up to 65 times the value of world trade. Political stability, low energy costs and galloping technology have helped to bring down barriers and costs; and even in the tighter circumstances of the last few years, low interest rates have maintained demand, while plentiful low-cost labour has restrained prices, so that world trade has continued to grow at annual rates of around 9%, reinforcing the feeling that we live, as Giddens has put it, in a 'runaway world'.

5. Technology has brought a new, informal integration to the world. In the late 1950s, passenger jet travel began and dedicated trans-oceanic cables were laid, while the transistor and integrated circuit revolutionized electronics. Within 10 years, with cold war competition at its height, the first communications satellites were launched. These were crucial steps for globalisation, heralding the advent of systems such as the Internet and GPS positioning, without which the modern economy could not function. Today, there are more than 200 such satellites, and videoconferencing is available to individual consumers (while today's trans-oceanic cables have more than 10,000 times the capacity of their predecessors).

6. Over the last decade, the pace of change has only quickened. The sudden fall of the Berlin Wall is seen by many as the first of a series of events that have triggered a new and accelerated era of globalisation. The decline of ideological conflict brought most of the world into the market economy, at just the moment when technology produced one of its most spectacular creations: the Internet. In late 1992, there were probably no more than 50 Internet servers in the world. By 1999, there were 720,000. Today, there are over 80 million and they are growing at a rate of a million a month.

7. The Internet is the crowning achievement of post-war technology, bringing cheap, instant communication, and information from anywhere in the world, into the hands of anyone who can reach a computer – or, increasingly, a mobile phone. While it has made tyrannies and dictatorships harder to maintain, it has also brought new freedom to individuals and businesses. We have surely only just begun to see its effects.

8. As the largest trading force in the world today, we might expect Europe to be confident. Its people enjoy an unprecedented quality of life, and the vision of the founders of the European Community has been spread throughout the continent. To see this, one need only look at Ireland, now the wealthiest country in the Union after Luxembourg, where income per person was only 62% of the EEC average in 1973. A similar effect can be seen in Spain, now the EU's fifth-largest economy, which has emerged from the poverty and isolation of the Franco era and is one of Europe's most dynamic countries. And that process continues today, with the new entrants from central and eastern Europe already making spectacular progress.

9. Yet a survey conducted for the 2006 World Economic Forum reports that over half of those responding in the EU anticipated a bleak economic future. Indeed, Europe is often portrayed as hostile to globalisation, reluctant to accept the changes going on around it, and defeatist or complacent when thinking about the future. "Europe is bound to stagnate, if not decline," writes Thomas Friedman, a columnist for the New York Times, while another asks: "when will Europe wake up and smell the green tea?"

10. A November 2003 Eurobarometer study of globalisation provides an insight into popular opinion in the then 15 EU member states. Overall, only 29% of respondents were opposed to the development of globalisation, and fewer still believed that Europe's trade policy was too liberal or that their economies were too open. But at the same time, only around 50% thought that its progress would be beneficial for themselves, or for their countries (and in a few countries, a majority believed the contrary).

11. So while Europeans broadly welcome a globalised future, they are not convinced about their prospects in it. And not surprisingly, attitudes to globalisation are most sceptical in the countries where economic performance is poor. This is, fundamentally, a lack of faith in the future, and the threat is that pessimism will become a structural part of European life. This surely lies behind former French President Chirac's call to "make

globalisation an asset for our growth and our jobs". Indeed, as former Belgian Prime Minister Guy Verhofstadt has put it: “If we don't change things, we risk turning Europe into a social and economic museum.”

12. This paper aims to describe, contribute to and stimulate the debate that Europe must carry through, if it is to succeed in the world economy, to protect the values that it cherishes, and continue to play its part in building a better world.

II. Global village, or pillage? A look at the wider world

13. The process of globalisation often seems paradoxical. While growth rates in the developing world now routinely exceed those of developed countries, the world’s rich have become a lot richer. UNDP figures suggest that the 20% of the world’s population living in the wealthiest countries receive at least 75 times more income than the 20% living in the poorest countries, up from a ratio of 30 to 1 in 1960. And the world’s three richest people now have assets that exceed the combined GDP of the poorest 47 countries.

14. But findings from the World Bank and other institutions suggest that, increasingly, the developing countries that have increased their participation in trade and attracted foreign investment have accelerated growth and reduced poverty. A study for the World Bank, "Trade, Growth, and Poverty," shows that the top third of developing countries (the “recent globalisers”, which include 3 billion of the world’s population) has seen an acceleration of its per capita growth rate, reaching a population-weighted average of 5% annually in the 1990s. By contrast, rich countries grew at 2%, and the rest of the developing world (the “non-globalisers”) at 1.4%, down from 3.3% in the 1970s but marginally better than 0.8% in the 1980s.

15. Globalisation, says the report, can support poverty reduction, but it requires international and national actions – particularly enhanced market access and tariff reduction. This needs to be complemented by other factors like a sound investment climate - meaning the environment of regulation, infrastructure, and financial services - and effective provision of basic services, especially for the poor. To reduce poverty, then, countries need more economic development – and the portion of the world that has become poorer in recent years is not getting the infrastructure it needs to take part, while also being burdened by protectionism.

16. So perhaps not surprisingly, research suggests that it is the world’s poorest citizens who are most enthusiastic about globalisation. In 2003, the Pew Center surveyed 38,000 people in 44 nations, with particular coverage of the developing world. And while most people worldwide viewed growing global trade and business ties as good for their country, only 28% of people in the U.S. and Western Europe thought that such integration was "very good," while in developing Asia the figure was 37% and in Sub-Saharan Africa, 56%. In Vietnam and Uganda, the figure stood at 56% and 64%. Similarly, 27% of households in rich countries thought that "globalisation has a bad effect on my country," compared with only 9% in developing Asia, and 10% in Sub-Saharan Africa.

17. Looking specifically at Africa, 75% of households thought that multinational corporations had a positive influence on their country, compared to only 54% in rich countries. And while 72% were positive towards the World Trade Organisation (WTO), World Bank, and IMF, only 28% of African respondents thought that anti-globalisation protestors had a positive effect on their country. It seems that, whatever its inequalities, there is a demand for more trade, not less.

18. This contrasts with the views those who criticise globalisation as nothing but the old imperialism in a new guise. A typical statement is the 1998 Siena Declaration signed by the Directors of the International Forum on Globalisation (IFG), representing over forty non-governmental organisations critical of globalisation and the free market ethos that inspires it: “rather than leading to economic benefits for all people, it (economic globalisation) has brought the planet to the brink of environmental catastrophe, social unrest that is unprecedented, economies of most countries in shambles, an increase in poverty, hunger, landlessness, migration and social dislocation. The experiment may now be called a failure.”

19. In the eyes of the anti-globalists, the role of multi-national companies is particularly abhorrent in seeking to exploit the cheapest resources wherever they may be in order to maximise profits. In particular, they have no compunctions about closing factories in the developed countries where production has become too expensive relative to less developed countries, thus throwing people out of work in the former, but providing employment in the latter. Such closures and relocations are a controversial aspect of globalisation, usually highly visible since they play out on a local or national political and media level. Nevertheless they can bring, besides employment,

much needed investment, technology, trade and growth prospects to the developing countries, raising their welfare and prosperity and hence demand for the developed countries' products.

A multipolar world in the making…

20. Although its economic policies are under attack, China can console itself with the thought that within half a century, its economy is likely to be bigger than any of the post-war democratic establishment, the G7 (the United States of America, Japan, Germany, France, Britain, Italy and Canada). Not only that, but most of the G7 grouping will have ceased to qualify for membership.

21. An October 2003 study by Goldman Sachs focusing on the so-called BRICs (Brazil, Russia, India and China) showed their combined GDP (at market exchange rates) amounting to one-eighth of the output of the G6 (Goldman leaves out Canada, which accounts for only 3% of the G7's GDP). But the study concluded that the total output of the four economies will overtake that of the G6 in less than 40 years. Of today's G6, only the United States and Japan would then still be among the world's six biggest economies.

22. This prediction is not based on a crude extrapolation of growth rates. Instead, the authors made assumptions about population growth, the pace of investment, productivity growth and currency movements. These imply that, even if the BRICs stick with sensible economic policies, their future growth rates will slow significantly.

23. Even on this basis, China (which has surpassed France and Britain in economic size), is tipped to overtake Germany in 2007, Japan by 2015 and the United States by 2041. India could overtake Japan by 2032. All four BRICs will be bigger than any western European economy by 2036.

24. Such long-term forecasts are almost bound to be wrong, not least because governments may make mistakes or political instability may intervene, but this is, at least, a useful framework for understanding the rise of the emerging giants. The Economist predicts that China will be the world's largest economy in 2026, when using purchasing-power parities, which may be a better measure of an economy's real size than market exchange rates. China would be followed by the US, India, Japan and Germany, in that order, with the UK just scraping in before Russia and Brazil.

25. Many changes in the world's balance follow from this; one striking result of the Goldman Sachs projection is that, for prospective investors, the annual increase in total dollar spending in the BRICs could be greater than that in the G6 by 2009. And by 2025, spending could be increasing twice as fast in the BRICs. This will offer today's rich world many lucrative investment and trade opportunities, but will make it much harder to win investment at home. Hence the pressing need for the European and other advanced countries to ensure that their strategies to attract foreign investment are effective, not least through appropriate fiscal policies and by improving their levels of education and training.

26. Already, the world has begun to feel the change in economic gravity, with energy and commodity prices driven up, costs for materials (such as steel) subject to developing world supply and demand levels, and global interest rates and inflation held down by the lower labour costs prevailing there.

27. China now represents some 25% of world oil demand, with consumption having doubled between 2000 and 2005 – and analysts expect this growth trend to continue. There are obvious implications in geopolitics, where long-standing relationships and economic ties are being replaced by new realities. Asian nations, for instance, are increasingly tied to China for prosperity – for South Korea and Japan, total merchandise volumes with China are approaching 20%, and for Australia and Vietnam they exceed 10%. Moreover, around 40% of recent export growth for a country such as Korea depends on China. And as the emerging powers seek to protect energy supplies and trading interests, new alliances and inter-regional groupings are being formed.

28. In the environmental field, the commitments of the Kyoto Protocol will be even harder to meet given developing world activity. China and India, though parties to the Protocol, are not bound to reduce their carbon emissions during the first target period (to 2008-2012). Indeed, by some estimates, China will overtake the United States (not party to the Protocol and already the largest single emitter of carbon dioxide from the burning of fossil fuels) in total greenhouse gas emissions sometime between late 2007 and 2010. However, with the right environmental protection policies, such trends are surely not inevitable even with growth-intensive economies like China.

29. Without denying the impact of growth on environmental pollution, the World Bank has found that many developing countries have adopted innovative, low-cost pollution control measures in recognition of their cost-benefit ratios, and that openness to trade and production for export often entail the use of newer, cleaner technologies. However, globalisation may also result in more intensive exploitation of natural resources such as forests and fish, requiring suitable tax policies to regulate both international and domestic trade. Finally, it is sometimes argued that international competition will result in a “race to the bottom” as far as environmental standards are concerned. The World Bank, for example, does not believe this to be the case, and its own studies suggest that foreign-owned plants tending to be less polluting than indigenous ones, and multi-national companies adopting virtually uniform standards globally, higher than those set locally.

30. Europe should set the example and is seeking to do so, with varying success. At Kyoto, the then 15 EU members undertook, by 2008-2012, to reduce their carbon dioxide emissions by 8% in comparison to 1990 levels. So far, they have been reduced by 1.5%, according to the European Environment Agency. Even so, the EU has established a new target of a 20% reduction by 2020. However, attempts to persuade the United States, China, and other countries to commit to targetted reductions have so far fallen on deaf ears.

…and that world is on the move

31. Meanwhile, migration is having an ever-increasing effect. Migrants around the world send home at least $167 billion each year, with some $5 billion coming from Britain alone. This capital flow has grown so quickly that, according to the World Bank, it is now more than twice the size of the world's development aid spending. The World Bank calls this migration 'a powerful force for poverty reduction' with an estimated 200 million people now living in countries where they were not born, and more than 2 million crossing the world’s frontiers daily.

32. The World Bank Annual Global Economic Prospects Report of 2006 suggests that remittance inflows into Ghana have helped cut its poverty level by 5%, Bangladesh by 6% and Uganda by 11%. In addition, remittances appear to help households maintain their consumption levels in the face of economic shocks and adversity. Remittances help increase household income, provide investment in education and health and bolster entrepreneurship. It is not surprising to see that two of the biggest recipients of remittances in the world at present are the world's next two economic superpowers, India and China. Both receive over $20 billion annually.

33. For some time, this pattern has been evident at, and within, the frontiers of the EU. It represents a challenge to the concept of the nation state, and the welfare systems defined by them, that Europe is still struggling to address. In some ways, it mirrors the growing importance of transnational corporations, whose freedom – and obligation – to move capital to the most lucrative locations challenges traditional relationships. But migration is a reminder that globalisation offers opportunities for change to ordinary people in the developing world that exceed anything offered by the developed world so far.

34. One of the characteristic features of globalisation, and perhaps one of the most suspect in the eyes of its critics, is the unhindered movement of capital, whether in the form of foreign direct investment (FDI) or in the form of savings instruments and other financial assets that make up the international capital market. While FDI is important in order to stimulate development and growth, the international capital market is subject to volatility and higher economic risk, as demonstration for example by the emerging market crises in East Asia in 1997-98 and Russia in 1998.

35. But the critics of globalisation also point to a further negative aspect: the opportunity that unregulated financial flows gives to criminals, including terrorists, to mask their illegal gains and transactions through money laundering and tax havens. The Council of Europe, through its Group of countries against corruption (GRECO) and its work to combat money laundering (Moneyval) is in the forefront of international efforts to fight this scourge, in close cooperation with OECD, among other organizations. This work should be stepped up. The OECD Convention on combating bribery of foreign public officials in international business transactions (“Anti-corruption Convention”) of 1997 was a major achievement, only marred by lack of implementation by certain countries.

Tackling Poverty

36. According to the UN Millennium Project, economic growth has been the major cause of poverty reduction in the world over the last 30 years. Jeffrey Sachs, the Project Director, says that: “globalisation, more than anything else, has reduced the numbers of extreme poor in India by two hundred million and in China by

three hundred million since 1990. Far from being exploited by multinational companies, these countries and many others like them have achieved unprecedented rates of economic growth on the basis of foreign investment (FDI) and the export led growth that followed". And controversially, he advised developing nations to refuse to settle a new trade liberalization deal, unless agricultural subsidies and tariffs were addressed. Nevertheless, poverty reduction has been uneven, being especially prevalent in East Asia.

37. It is interesting to note that, until 1980, the total number of extreme poor (living on less than $1 per day measured at purchasing power parity) has increased throughout modern history, as world population has increased. But since then the total has declined by 200 million, although the world's population has grown by 1.8 billion. In this context, and whatever its defects and shortcomings, it seems clear that the opportunities of globalisation are not going to be willingly surrendered by developing countries, and this is as much to do with their weaknesses as their potential strengths. China, for instance, desperately needs to maintain growth if it is to cope with its own enormous social challenges.

38. Nor is it clear that Europeans, with their attachment to freedom and social progress, should want them to do so. As WTO Director General Pascal Lamy has said: "we need to remember that trade is only a tool to elevate the human condition." All the same, given Europe's relatively sluggish performance and the need for jobs, how are these values to be maintained at home? To what extent is globalisation impacting upon Europe?

III. Europe's engagement with globalisation

39. Without the export boom that globalisation has offered, things would doubtless be much more difficult for Europe's economies. European exports have grown steadily in the last ten years in comparison to foreign demand for imports, and European export market share has held up well compared to the United States and especially Japan.

40. Germany was still the world's largest exporter of goods in 2006, and has opened up substantial new markets: from 1990 to 1995, its exports to the developing world grew at a rate of 10 percent per year (while its exports to other industrial countries increased by only three percent per year). German companies generate almost a third of their earnings through exports – although it should be said that, while Germany has increased its exports overall, those of other countries have grown faster (its global share of exports declined from 11.8% in 1992 to an estimated 9.1% in 2006).

41. And despite the advances of the developing world's economies, Europeans are likely to remain among the world's most prosperous individuals. It is calculated, for instance, that when China becomes the world's largest economy, the average Chinese citizen will only have the same level of wealth, relative to that of an American citizen, as a South Korean has today.

42. One reason for this is that Europe is a major source of global finance and investment, which provides us with the opportunity to adapt and diversify our sources of income, if we decide to do so. Indeed, it is foreign, rather than domestic, investment that has made China's rise in expertise and capacity possible (which should please those Europeans who believe that globalisation can reduce poverty). In fact, five countries – the US, UK, Germany, Japan and France – account for more than half of China's external investment, with most of the rest coming from its neighbours.

43. This prompts the question: will the economic rise of the developing world necessarily damage Europe's prosperity? A closer look at the relationship with China offers some clues.

44. Europe's trade relationship with China has been remarkably healthy, and increasingly important to both sides. In 2004 China remained the European Union's second biggest trading partner (after the US) and, according to Chinese statistics, the EU has become China's top trading partner (ahead of the US and Japan). But whereas the EU had a trade surplus with China during the 1980s, there is now a widening trade deficit, of some 117 billion Euros in 2006. In fact, this is now the EU's biggest bilateral deficit.

45. By itself, a trade deficit with China – now the world's second largest trading country, and the leading supplier of low-cost consumer goods - is hardly surprising; the US deficit with China has now reached epic proportions, of about $232 billion in 2006. In terms of imports, Europe tends to buy from China items where its own manufacturing was in decline, such as toys, or which it had never manufactured in quantity, such as DVD players. It is the switching of capacity from producers such as Taiwan and Japan over recent years that has

aggravated the single headline deficit with China. Meanwhile, EU countries have maintained healthy export levels to China (for instance, Europe sold over 57 billion Euros in goods and services to China in 2006).

46. There are several reasons for this. In general, there remains an enormous productivity gap: according to the International Labour Organisation, a Chinese manufacturing worker supplies only 8% of the added-value that an American worker does. But more specifically, Europe specialises in the sort of high-cost, high-quality goods that are in demand in China. There is, in particular, a huge appetite for infrastructure equipment, a traditional strength for European companies since the days of post-war reconstruction. Siemens, for instance, has been heavily involved in upgrading the Chinese telecommunications system, while selling equipment for dams, power plants, and railways. ABB supplies the Chinese steel and petrochemical industries, while French utility companies Suez and Veolia Environnement have won billions in contracts for water and waste-treatment systems.

47. Given the scale of China's infrastructure challenge, there should be plenty of scope for this type of trade to prosper. Alongside construction and transport, environmental and biotech expertise are likely to be increasingly important, and as Dirk Schumacher, an economist at Goldman Sachs, says: "The demand we're seeing in China is nothing that will fade away immediately."

48. Perhaps the biggest single example of Europe's export success in China is Airbus, despite its recent troubles leading to a re-structuring involving 10 000 job cuts in Europe and repeated strike action. Until the mid-1980s Boeing dominated China's airline market; but today, there are some 300 Airbus planes in service there, around 30% of the entire fleet – and in 2005, two-thirds of the new planes delivered in China came from Airbus. In 2006 Airbus won an order to supply Chinese airlines with 150 A320 jets, and Chinese civil aviation authorities signed a letter of intent to buy 20 A350 planes. China is forecast to be the second largest air market in the world by 2010, and airline spending projected to reach $200 billion over the next 20 years. The A380 super-jumbo has been designed with Chinese passenger volumes in mind, and the company hopes that China will prove to be the plane's top market. To achieve this, Airbus has invested heavily, with a local flight-training school and engineering centre, and awarding local design and sub-contracting work. It has also agreed to build an A320 assembly plant in Tianjin, its first such factory outside Europe.

49. Investing in China is a focus for many European companies. Volkswagen is the country's market leader in cars, and plans to spend $7.6 billion to increase production over the period 2006-2010, while groups such as Mercedes and Peugeot-Citroen are also strongly represented. Meanwhile, Carrefour, Tesco, Accor, and Unilever are building up their position in the local marketplace with local partners, and generally in competition with US companies. Many of Europe's most competitive firms, such as Adidas and Ikea, source substantial production in China – while firms such as Geox and L'Oreal manufacture for the local market. Demand for management and financial services is increasing strongly, and represents a great opportunity for European expertise.

50. With rising affluence, luxury commodities have begun to flourish, too – and the taste for European style and culture is increasingly visible on China's streets. Western brands such as Prada, Louis Vuitton and Ermenegildo Zegna have opened stores across China's cities, although suitable retail sites are hard to find, and European designers and architects are in high demand. While profits for Western firms appear to be elusive and the whole sector may be vulnerable to US trade sanctions, China is now the third largest consumer of luxury goods, with annual sales at over $ 2 billion, and set to become the first by 2015, according to a recent report in the Financial Times.

51. But if all this is true, why should Europeans be so gloomy? Europe is an economic superpower and a major exporter. Europe has developed a relatively energy-efficient economic base, which should help to protect it from rising energy costs. The main cause of despondency is fear about the loss of jobs and income as well as a decline in standards of social protection in a context of already high unemployment in many European countries.

IV. Europe's core challenge

52. According to Eurobarometer, 90% of the public believe that fighting unemployment should be a priority for the EU. And when asked to rate Europe's achievements in the 20th century, respondents rated 'freedom' at the top of the list, and 'employment' at the bottom. The three main reasons are seen to be downsizing, a lack of correct training, and domestic employment policies – with globalisation, the single market and the Euro scoring somewhat lower. And the three most highly rated remedies are to stimulate small businesses, to improve

education and training, and to make it easier to start a business – but, as we'll see, these suggestions are harder to achieve than they should be.

53. The fundamental problem is that high unemployment is a structural feature of many of Europe's main economies – and neighbouring economies suffer its knock-on effects. According to IMF calculations, continental western Europe has a structural unemployment level of around 9%, compared with 6% in the UK and 5% in the US. The challenges are most acute in the large, continental economies that have traditionally driven European growth.

54. And a key to this - as is increasingly, if often only tacitly, accepted - is that labour regulations and costs have risen to levels that appear, at least in some countries, to deter not just the firing of workers, but hiring them, too. This, along with commercial restrictions and a lack of liberalisation in areas such as services, has hindered the growth of flexible employment and the development of new business sectors to replace those in decline. Since the 1980s, a widespread reaction to the growing pressure on wages from global competition has been to fix high minimum wages. And while this can, in a restrictive market, produce an entrenched group of better-paid workers, it will also mean more people without jobs – especially when companies can find cheap labour elsewhere. As the OECD has noted, the empirical evidence points to a clear correlation between high levels of job protection and high levels of unemployment. Which, in turn, restrains growth. In fact, growth in the eurozone fell to 1.4 % in 2005, from 2.1% in 2004. However, job protection is obviously not the whole story, because growth rebounded in 2006 to 2.6% and remains buoyant, whereas labour market reform has been slow.

55. Despite its export prowess, Germany has suffered slow growth since the 1990s, with the economy actually contracting in 2003; for 2005, growth was only 0.9%, although it rose to 2.6% in 2006, boosted by investment and exports. But the US economy is now almost five times as big as the German one, against 3.7 times in 1990. This comparatively poor growth record has gone hand in hand with unemployment levels of around 5 million, around 12% of the workforce, although the rate has improved since mid-2006 to 7% and in eastern Germany the rate is much higher. A particularly serious problem has been the high number of long-term unemployed, and the lack of opportunities for the lower-skilled: almost 40% of those unemployed have no vocational qualification. Reforms introduced in 2003 were designed in part to step up the incentive to work by reducing various elements of unemployment benefit.

56. In France, official unemployment has hovered around 10% for most of the last 20 years, although the rate declined to 9.1% in 2006 and stood in April 2007 at 8.6% (Eurostat) or 8.2% (INSEE). Not surprisingly, it is the number one issue for the electorate. Although growth rates have been reasonable by eurozone standards, with French business operating aggressively in global markets and domestic demand sustained by a boom in property prices, France's admirable productivity figures mask the fact that while fewer people are working for fewer hours, jobs are incredibly hard to find. While those in work are protected, it takes between eight and eleven years for France's young unemployed to find a permanent job, compared with three to five years in most of Europe.

57. A series of measures have been taken in an attempt to lower unemployment, including the early retirement of state employees, public hiring programmes and the introduction of the 35 hour week. In 2005 the French Government introduced the *Contrat nouvelle embauche* (CNE - New Employment Contract) that encourages small firms with fewer than 20 employees to take on more long-term staff by allowing the contract to be ended easily by either party within the first two years, whereas long-term employment contracts can usually only be terminated for a legally justified motive. It has been estimated that some 70 000 new jobs will be created under the scheme in the first two years, net of CNE contracts that would have been signed anyway in other more traditional forms. The attempt in 2006 to extend this principle to employees under the age of 26 and to companies with over 20 employees, in the form of a *Contrat première embauche* (CPE – First Employment Contract), ran into such opposition that it was abandoned. Instead the government is relying on tax incentives.

58. Perhaps because of the marginal impact of these schemes, French voters are some of the most pessimistic in Europe: although 60% are broadly in favour of globalisation, 47% believe that it will not be good for their own circumstances, and 58% believe that it will not be good for the country. The globalisation debate is perhaps at its most intense here. For Nicolas Baverez, one of France's leading 'declinologues,' it is the main issue facing France today. He asks "Will we embrace globalization or will we keep pretending it doesn't exist for another five years?"

59. Perhaps it is Italy, though, that has the most worrying record, with average economic growth over the past 15 years being the slowest in the European Union. Domestic consumption has held up reasonably well, but the country's competitiveness has been sliding, with unit labour costs rising, productivity flat or even declining, and a marked fall in its share of world exports. Meanwhile, membership of the Euro rules out devaluation, which for many years acted as a safety-valve for Italian business.

60. The World Economic Forum in its 2005-2006 annual competitiveness league table ranked Italy 47th, just above Botswana, while the European Commission's 2003 analysis of 88 structural indicators ranked Italy last among the then 15 members of the Union. Its underlying competitiveness was less than that of Spain, Greece or Portugal. A recent study by analysts at HSBC found relative unit labour costs in Spain had fallen by 15% since 1995, while in Italy they had risen by 40%.

61. All this is well understood by Europe's policymakers. A 2003 report commissioned by the EU and led by André Sapir, an economics professor at the Free University of Brussels, concluded that "the current combination of low growth and high public expenditure is not sustainable and will become less so in the future." As the report makes clear, Europe's low growth has led to higher unemployment, which has led to higher social expenditure, which has led to higher taxes and thus to lower growth. It states bleakly that: "The sustainability of the European model(s) of development is increasingly challenged, without a viable alternative in view."

62. But it's not difficult to see why politicians intoning about the opportunities and challenges of globalisation are often met with cynicism. If you've just received a meagre pay rise when your chief executive has earned a huge bonus, and it's rumoured that your job will soon be outsourced, or if your ability to negotiate a pay rise has been curtailed by cheaper foreign labour, you're not necessarily going to accept that it is illegitimate to defend your job and your living standards. And this is especially true when those in work have been promised security, and see few prospects of finding a new job if they lose the one they have.

Exporting Europe's jobs?

63. In many European economies, job losses due to outsourcing have become an important political issue, and indeed Eurobarometer found a clear majority of respondents believing that globalisation has a negative impact on employment in their country. The European Trade Union Confederation sees this as the negative side of the globalisation coin: undercutting the work force and weakening its bargaining position. To quote its Director General, John Monks, "jobs out, cheap labour in".

64. Of course, outsourcing is hardly a new phenomenon – after all, much of the recent success of countries such as Ireland has depended on it, and in recent years Eastern and Southern Europe have also benefited, though perhaps more slowly than was initially expected. Increasingly, low-cost manufacturing has moved southwards and eastwards: most televisions sold in Europe, for instance, are now made in Turkey, and companies such as Renault and Peugeot have been quietly developing factories in Poland and Hungary. Renault's world car, the cheap Logan which is largely targeted at industrialising nations, is already successful.

65. But to what extent is it true that outsourcing costs jobs? Overall, technological change appears to play a greater role in job losses and wage pressure than relocation – with a significant decline in manufacturing employment over recent years accompanied by an increase in production. And in a regulated employment market, there is an increasing trend toward maintaining old European production facilities, and allowing them to decline by gradual natural wastage, while creating new capacity elsewhere. For employment, this will have a 'time bomb' effect, which can be handled but cannot be avoided. In fact, specific relocation accounted for only 4% of total job losses in France between 2002 and 2004, where, as in Germany and Italy, it represented less than 1% of total employment turnover. For 2004 alone, 11,000 jobs were lost in France by relocation – while 20,000 jobs change hands each day.

66. The IMF has estimated that over the last twenty-five years the global labour force has quadrupled, mainly on account of the integration of China, India, and the former Eastern bloc into the world economy. By 2050, it is expected to double again, swelled mainly by less-educated workers. This globalisation of labour has benefited the advanced economies, although less as a result of offshoring (representing about 5 % of total production in the advanced economies) and immigration than through cheaper imports and expanded export opportunities. Labour compensation has thus risen in all advanced countries since 1980.

67. However, the data suggest that labour globalisation and technological change have reduced the *proportion* of income going to labour, with technological advances having the larger effect. The labour share of

GDP declined from 68 % in 1980 to 61 % in 2005, with unskilled sectors of the economy experiencing the largest declines. Labour market policies have affected this outcome in different ways, but countries that have lowered the cost of labour to business, improved labour market flexibility and in particular ensured that unemployment benefits do not deter workers from seeking employment, have generally experienced a smaller decline in labour share.

68. IMF policy advice emphasises the need for countries to improve the functioning of labour markets; increase access to education and training; and ensure adequate safety nets. Adequate income support should be available to cushion, but not obstruct, the process of adjustment and change.

69. Given Europe's status as a leading recipient of inward investment, and its need to generate healthy markets for its own value-added products, unrestricted investment flows should lead to greater prosperity for all. As the Parliamentary Assembly pointed out in its Resolution 1484 (2006) on relocation of economic activities abroad and European economic development, this should allow countries to "become as much "destinations" as "points of origin" of relocation". Moreover, relocation offers Europe's businesses a vital opportunity to provide improved customer services and remain competitive, and for countries to increase their trade and overseas earnings, reflecting a more complex economic environment where few products or services are created entirely in one location.

70. Again, according to Eurobarometer, most Europeans agree that relocation can be beneficial for their domestic economies, while inevitably regarding it as a threat to their own livelihoods. But the situation is complicated by the special impact that outsourcing has upon more regulated economies. A 2005 McKinsey study suggests that, while US firms generate around 15% additional value for their home economy from shifting investments offshore, German and French firms leave their home economies some 15% poorer. This is partly because of the high-value nature of US investments, and the more efficient, lower cost locations they selected, but crucially because of the ability of the US economy to create new job opportunities. While some 60,000 US jobs are outsourced every 3 months, 70% of the employees had found new jobs within 3 months. In France, only 60% had found work within a year.

71. This poses an immense challenge for Europe's policy makers, since the requirements of the social system are diverging from the imperatives for the country's businesses if they wish to remain successful. And already, wage and skill levels are rising in developing countries, heralding a likely 'second wave' of relocation, that of more skilled activity. A recent survey suggests that almost half of all British manufacturers are considering transferring some capacity to China, while even a luxury brand such as Villeroy & Boch, based in the heart of Europe and with centuries of tradition, is sourcing new production there.

72. Even so, your Rapporteur sees the positive side of the globalisation coin as an opportunity to outsource lower added value activities to the rest of the world, especially to the low-wage emerging economies, while allowing Europe to specialise in higher added value products and services; in other words, Europe has a vast opportunity to upgrade its economies in a new international division of labour.

Shirts and aeroplanes

73. The 2005 furore with China over textiles gives a clear example of Europe's dilemma. Under the regulation of the multi-fibre agreement, Europe had been the world's largest textile exporter. And although the sector has been in long-term decline, with employment falling by 60% in the last decade, it still accounts for two million European jobs. But with the expiration of the agreement, Chinese exports rose sharply. Within weeks, for instance, T-shirt imports rose by more than 150%, while sweater and trouser imports increased by more than 400%.

74. Given the outcry about job losses, Europe's politicians had little choice but to intervene. All the same, the multi-fibre agreement has been in force since the 1970s, and its expiration date was known to all - so how did this panic happen? Europe's breathing space was clearly not embraced by Europe's shoppers: by July, sweater imports had already reached their new quota level, and been suspended.

75. Under its WTO agreement, China in turn had little choice but to agree to limit exports until 2008 – for while it is being driven to liberalise its markets, any other country may restrict Chinese imports, if they have a disruptive effect, until 2013. Whether this sort of action makes strategic sense for Europe is more debatable. Europe's textile industry will inevitably contract – as it was doing in any case - but it is capable of finding new ways to prosper, such as through preparing specialist and premium fabrics, and through value-added production

expertise. As the managing director of Prada, Patrizio Bertelli, has said: 'To attempt to put up tariffs against Chinese imports to Europe would be as useless as building another Great Wall'.

76. In fact, Europe's 3-year reprieve on textile imports may turn out to be as counter-productive to businesses as it has been to consumers. For China's traditionally fragmented industry, having fruitlessly geared up for greater exports, is now being forced to consolidate and try to add more product value, so that European firms will end up facing much stiffer competition.

77. Moreover, as China's commerce minister has pointed out, to buy one Airbus super-jumbo, China needs to sell 800 million shirts. To sell value-added aircraft, we need to keep buying shirts.

78. The impact of the developing world's growth is currently fairly modest, but it may not remain so. Although the developed countries continued to top the league in attracting inward investment during 2005, rising 37% to US$ 542 billion from US$ 380 billion in 2004, inflows to developing countries surged 43% from US$ 233 billion in 2004 to reach US$ 334 billion in 2005 - the highest level ever recorded. In fact, some 36% of all FDI went to developing countries in 2005, while seven of the 10 economies with the largest increases in FDI were developing or transition economies, and the 10 largest declines were in developed countries. Such trends lead economists to suggest that China could overtake Germany to become the world's largest exporter by 2010.

79. All this is certain to cost Europe some of its current jobs, especially where they are low skilled. That was happening anyway, of course – and given its high social costs and its social aspirations this need be no bad thing for our continent. The key, as for any economy in the modern environment, is to replace old jobs with new ones – and to win what will be an increasingly tough battle for investment. And here, it seems that the rigidities and high cost of social protection characteristic of many of Europe's labour markets may be hindering success.

V. Globalisation and Europe's social models

80. Europe has been stunningly successful at rebuilding itself since 1945, and a key ingredient of that success has been its insistence on combining economic prosperity with social protection. Indeed, Europe led the world in addressing hunger and poverty by the creation of over-arching welfare systems that not only provided specific benefits and services, but also aspired to an overall goal of social justice – and the continent's tremendous economic success allowed those systems to expand.

81. Europeans have come to enjoy unprecedented and enduring social protection. In 2006, the UN's Human Development Index ranked all 25 of the EU's member states in the world's top 60, and 18 of them in the top 30. This is something of which Europeans are rightly proud; indeed, Eurobarometer surveys reveal that by a two to one margin, Europeans espouse the value of 'helping others' over 'making a lot of money'.

82. In his study of Europe, 'Postwar', Tony Judt speaks of the development of a common approach, "Europe as a way of life". And, although the mechanisms employed have never been uniform, and cultural emphases still differ widely, it is possible to speak of a shared European ethos, created over the last sixty years – that, for instance, uses redistributive taxation to combine prosperity with social cohesion, and provides comprehensive unemployment and welfare payments, healthcare benefits and pensions. Employment law has become part of social policy, while trades unions maintain an influential voice, particularly via Germany's management boards. And this performance has been combined with a forceful attack on poverty; in France and Germany, for instance, the Economist magazine suggests that the effect of redistributive taxation has been to reduce poverty by around 39%.

83. Europe risks falling living standards, not because of a concern for social justice, but because in the context of globalisation, the social models in some countries are structured in such a way that they may tend to perpetuate unemployment (and thereby, lead to social exclusion), and are made unaffordable by it. Too little has been done to cope with the impact of Europe's aging population profile and declining competitive advantage, which will make these spending levels even more unaffordable than they are today. As we will see, welfare systems do not need to be abandoned, so long as they can be reformed and adapted.

84. Spiralling social costs have become a key reason for structurally high unemployment. For instance, while German productivity advantage has declined, the hourly cost of labour in manufacturing industry in western Germany, including wages, social-security (including health) and pension contributions, is 13% more than in the United States, 43% more than in Britain and 59% more than in Spain. With national provisions costing 12% of GDP, compulsory contributions (paid jointly by employees and employers), take up nearly 20%

of gross wages, and amount to around 70% of the net average national wage. There are other heavy costs, too, notably applying to the health-care system.

85. And while official unemployment figures are bad enough, they do not show the general reduction of working hours amongst those employed and, even more importantly, the number of working-age Europeans who are inactive or relying on welfare. Across Europe, large numbers of potentially working-age people are not at work but have taken early retirement or are drawing some sort of welfare benefit. In the Netherlands, for example, around 1 million out of a working-age population of less than 9 million are now classified as disabled.

86. The OECD reckons that around 35% of Europeans of working age are economically inactive, compared with some 27% of Americans. Europeans must therefore get more people back to work. How best to do this was the subject of a recent reassessment by the OECD of its recommended strategy for boosting employment and growth.

87. If Europe is to derive maximum benefit from globalisation in terms, for example, of higher growth, it must be ready rapidly to adjust to changing needs, to shift resources from one sector in which comparative advantage has dwindled to other sectors where higher value-added can be achieved. This is all the more important when rapidly emerging countries with large and competitive labour forces like China and India are increasingly integrated into the world economy.

88. Yet Europe's perceived over-generous social protection benefits appear to trap people in inactivity by removing the incentive to seek work. This concerns not only the unemployed, but also the much larger numbers of those receiving non-employment benefits such as sickness or disability, those in early retirement, single parents and so on. Indeed, evidence shows that some 66% of the inactive would like to work, given the right conditions. Secondly, perceived labour market rigidities, which make it difficult to reduce unemployment levels, act to discourage the necessary labour adjustment to the impact of globalisation.

89. According to the OECD, what matters above all is that social protection measures should be appropriately *designed* to support adjustment. First of all, relatively generous unemployment benefits can be paid as long as there are strong and well conceived incentives to seek work, including disincentives to remain unemployed where work is a practical option. There should be close monitoring and support of the unemployed and their search efforts by employment services. Those on non-employment benefits should also be helped to get back into the labour market. In particular, family-friendly policies should target single parents, for example, with appropriate tax incentives, optimum parental leave, and improved child-care facilities.

90. As for labour market rigidities, it is again the *design* of regulations that is important. Thus the OECD believes that employers will accept regulations as long as their impact is predictable in terms, for example, of the cost of hiring and firing staff. The example of the Netherlands is cited as good practice with regard to dismissal regulations, or that of Austria's individual savings accounts into which employers have to pay a contribution and which employees can carry with them. What worries the OECD is that some countries, faced with the political difficulty of introducing greater labour market flexibility, which is seen by many voters as undermining traditional job security, has led these countries to ease only temporary employment conditions. This leads to greater duality in the labour market and hinders both investment in training and growth in productivity.

91. Finally, the OECD emphasises the importance of appropriate stability-oriented macro-economic policies to reduce cyclical and hence employment fluctuations, that of policies to stimulate product market competition so as to open up new jobs, and that of effective life-long learning to help workers acquire new skills as necessary.

92. There is, moreover, more than one model of success in terms of raising the employment rate. The best performers, which have not all shared the same strategy, are in general the Nordic countries, and include Switzerland, the Netherlands, the United States and the United Kingdom.

Social insecurity?

93. European welfare systems are of course also threatened by the fact that Europe's population is ageing. Within a decade there will be only two Europeans of working age for every elderly citizen, compared with just under four to one today. And by 2050, according to a Deutsche Bank study, the figure is likely to be one and a

half to one. This problem has not been caused by globalisation; but, when it comes to balancing economic prosperity and social protection, it is Europe's greatest impending challenge, for many of the present spending models – particularly related to pensions – become overtly unsustainable.

94. There are few short-term solutions; some countries have made efforts to encourage fertility via the tax and welfare system, and although France, for instance, has had notable success with this approach, it cannot be enough to reverse the overall trend. Additional immigration might ease the problem, too, but the numbers needed to offset the effect of ageing would probably be politically unacceptable – even at current levels (and despite the associated benefits to poorer countries), migration and immigration are sources of huge controversy. Interestingly, the European Commission has recently reported that the three countries to allow unrestricted access to workers from the EU's new members – that is the UK, Ireland and Sweden - have gained economic benefits without increasing unemployment. But the prospects of such citizens achieving full labour rights in the near future are remote.

95. So, since state pensions in the EU are mostly paid for out of current tax revenues, either taxes or national debt levels, or both, may have to rise steeply. In a recent report on the fiscal implications of ageing in Europe, Standard & Poor's predicts that the EU countries with the most serious pension problems - including France and Germany - could see their public debt grow to more than 200% of GDP by 2050. For comparison, countries that want to join the euro are supposed to keep their public debt below 60% of GDP.

96. Italy has one of the lowest birth rates in Europe, with an average of 1.3 children per woman, and the population is now shrinking; but with Italians enjoying longer lives, it is also ageing rapidly. The economic consequences - too many pensioners, not enough workers to maintain them - are worrying enough on their own. What makes them worse is Italians' low rate of participation in work. Only 57% of those in the 15-64 age range are in employment, the smallest proportion in western Europe.

97. In France, a commission appointed by the finance minister reported that if the country fails to tackle funding deficits, there will be a €20 billion annual shortfall of funds to pay state pensions by the year 2020. With public debt now officially equal to two-thirds of gross domestic product, France has seen its borrowings increase faster than any other European country over the past decade – and the commission even suggests that the true level of indebtedness would reflect off-balance sheet pension liabilities, which would double the official figure.

98. Further, the commission points out that debt levels have risen inexorably over the last 25 years, that the state payroll has expanded by 14% over the last 20 years, that state spending has exceeded receipts by 18% over the last 10 years, and that by 2050 France's public debt could be five times higher than the country's GDP. Accordingly, they called for an end to "the easy option of public borrowing to reinforce economic growth and social cohesion".

99. In the past, higher inflation levels would have helped to mask the problem. But in an era of low interest rates, and with the Euro preventing devaluation, public spending commitments will have to be adjusted.

100. Some wonder, though, if Europe has the will to do it. Despite formidable political skills and an explicit platform of retaining Germany's social cohesion, Chancellor Schroeder's tenure proved an arduous battle over reform, that saw the first cuts in the level of unemployment benefits in Germany since 1945, but left voters divided over whether he had gone too far, or not far enough. Across the continent, it has been a familiar story – with only those reforms too modest to make much difference being enacted without crisis. In Italy, the government of Silvio Berlusconi was forced to call a vote of confidence so as to force through a reform to raise the country's retirement age. And in France, nobody has attempted a bold pension reform since the government of Alain Juppé was brought down by street demonstrations in 1995.

101. But at individual company level, there are some signs of change: big German employers such as Bosch, Siemens and DaimlerChrysler have recently negotiated agreements to extend working hours without increasing pay, which should sharply increase productivity, while several groups operating in France have been able to reach agreements with the government that allow them to maintain employment and remain competitive. To reform working life in Europe without industrial strife will be a challenge, but the spectre of globalisation may help to get it done – and given the lack of other jobs on offer, employers have a negotiating advantage. All the same, Europe's governments know that they must take a lead, and increasingly, as we shall see, there are signals that this is happening, too.

VI. Renewing the good society

102. When it comes to social and economic reform, it may well be that the strength of Europe is precisely its diversity. With so many different cultures, and such a wide range of different practices and systems in place, there clearly is no single, universal solution, whether it be labelled "social" or "liberal". Some countries, like Sweden, do well with a high tax burden and public spending; others do badly. Some, like Estonia, flourish with flat taxes and neo-liberal economic policies; that doesn't mean they'd be good for everyone.

103. Europe’s differing conditions and experience can act as a great experimental laboratory, with countries learning, borrowing and adapting from each other, so that common ideals can continue to be delivered, even as circumstances change. Historically, this was the method by which Europeans charted the world and rose to economic eminence – and it is exactly the process being applied by the developing world and multinational companies in modern globalisation. If we are agreed on our goals - higher growth and productivity, more innovation, less unemployment and reduced poverty - we don't all need to get there by the same means. Nevertheless, some models have been singled out for their apparent success.

Looking north…

104. In 2005 the World Economic Forum rated Finland as the world's most competitive economy, with Sweden coming third, and Denmark fourth (they were the only EU countries to make the top ten). Meanwhile, an Economist Intelligence Unit survey in 2006 on the best places to do business ranked Finland third, Denmark seventh and Sweden eleventh.

105. Nordic people were among the poorest in Europe less than 150 years ago, and are now among the richest in the world. While the Nordic countries (like the Netherlands) have tended to spend the most money on poverty reduction and on comprehensive services, job protection laws are relatively weak – and while there are generous unemployment benefits, there tends to be a cultural emphasis on ensuring that people work when they can.

106. These countries have shown that deregulating labour markets need not mean sacrificing all the protections of Europe's social model, and that a strong safety net can be preserved even while allowing market forces to play more freely in the demand and supply of labour. But it is interesting to note that this strong position has come from systematic reform, and that the Nordic countries continue to face the same sorts of pressures as the rest of Europe.

107. Much attention has been paid to the success of the Danish model termed “flexicurity”, which however was not introduced as a specific reform but resulted from a long process of historical development. Its basic features are that it provides security through relatively high unemployment benefits, together with flexibility through liberal dismissal regulations, including firing at short notice. This results in high job mobility, to which is added an active labour market policy that includes extensive provision for education and training. The success of this model depends essentially on involvement and cooperation of all the relevant social partners and a high tax burden to finance the benefits and other aspects. This has led OECD to suggest that this Danish model cannot be exported without acceptance of significantly higher tax rates in many European countries (the Nordic average is 53%). Instead, the OECD recommends focusing on strengthening education and training systems, leading to higher productivity, innovation and growth. Moreover, the Danish model has changed. To retain their benefits, those seeking employment must accept a job offer or training, and the maximum period for receiving benefits has been reduced from five years to four.

108. Finland had to overcome a painful banking crisis after the collapse of the Soviet Union, and continues to suffer from high structural unemployment, but with the help of investments in export industries and high technology, exports as a share of GDP doubled to 40% in the ten years to 2001. The most obvious symbol of Finland's success is Nokia, now a household name in mobile phones. Esko Aho, a former Finnish prime minister who brought in liberalisation and tax reforms, says: “We were lucky to have problems in the early 1990s; we had to reform our economy and society.”

109. Sweden, too, has faced challenges – although it seems a showcase for the potential of European social models. In the 19th century, the country was so poor that a million Swedes emigrated to the US. Now it has the highest life expectancy outside Japan, and an infant mortality rate twice as low as in the US. There is generous paid parental leave and free childcare is offered to everyone until the child reaches the age of five. This has

allowed women to work in record numbers, making them the most empowered in the world, according to the World Economic Forum.

110. Although Sweden now enjoys one of the highest growth rates in Europe, it had gradually been slipping behind its Nordic neighbours in terms of income per person, with ‘hidden unemployment’ levels approaching 20%. And in the early 1990s, with public spending reaching 67.5% of GDP and the economy shrinking by 5.2% in 3 years, public service reforms were begun. In particular, Sweden has attempted to make the welfare system less cumbersome, and to offer more choice.

111. Some hospitals are now privately managed, though state-funded, and users are free to choose which clinic to attend. Meanwhile, about 6% of younger Swedish students, and 8% of older ones, now go to independent schools that are privately run and allowed to select students according to criteria they set themselves, for example by academic ability. All the schools continue to be state-funded and free to users and must meet national education standards, but anyone can start a school if it meets the right conditions. While not a voucher system, with schools receiving more money for students who need extra support, there is freedom of choice, with resources following the choice. But Sweden’s education minister maintains that, even so, ‘the most important thing is equality’.

112. And change must continue, for the tax base in Nordic countries is constantly threatened by international competition. Economists suggest that Swedes increasingly move money offshore to avoid paying tax, perhaps to a level of around $65 billion, and that many use unofficial labour to look after their children and old people, and in construction and farming. In fact, outside influences (not least EU legislation), and mobility of people and capital are seen as challenges for the future. Many highly-qualified Nordic youngsters go to work overseas – and while high taxation may be only one reason for this, there is little traffic in the opposite direction. Accordingly, Sweden now offers special tax exemptions for the richest individuals, and Finland taxes foreigners less for a period. Meanwhile some Nordic companies, such as IKEA and Tetra Pak, have based themselves wholly or partly abroad. Given all this, and the rise of low-cost, low-tax economies across the Baltic, Finland and Sweden have paid particular attention to encouraging research and investment in high-technology, value-added businesses.

113. The emphasis in Sweden is now on labour market reform, getting people back to work by reducing disincentives and increasing incentives, for example by lowering taxes for the lowest paid. This policy has been very successful in getting men back into employment, whereas many women remain on sick leave. The problem of the integration of refugees and asylum seekers has also to be solved. Sweden has already completed a thorough reform of the pension system, and is now engaged on reforming other aspects of social security.

114. As in much of Europe, Nordic countries face an acute problem with ageing populations. By 2050, says the UN, pensioners will equal 45% of the working-age population in Norway, 49% in Finland and 54% in Sweden. Privately funded pensions are being introduced in all the Nordic countries to reduce the huge liabilities being piled up by public pensions. An official Finnish study has proposed measures to increase employment by moving students more quickly from school or university into jobs, and by raising the age at which people actually retire, while Denmark's government has announced a scheme to let workers postpone drawing their pensions in return for improved benefits later, and others in the region are likely to follow suit.

115. One solution has been to allow more foreigners to come in to take jobs, and therefore to pay taxes. But this may create its own problems, with some economists saying that a more ethnically mixed society could make the idea of a traditional welfare ethos, the *folkhemmet,* more difficult to sustain, so lessening the general willingness to pay taxes. As immigration progresses, that debate goes on.

116. Joakim Palme, who wrote a paper on the region for the 2005 Hampton Court EU summit, comments: "I do not say the Nordic model should be copied. But if you are serious about combating poverty and inequality and want to combine that with growth and employment, it is difficult to discard the way the Scandinavians have organised the system of social protection."

117. And indeed, the Nordic model is no simple solution; it is changing too. But alongside its blend of technology and tradition, perhaps it is continuous experimentation, self-examination and adaptation to changing circumstances that is the central lesson of the Nordic experience.

And east – and west…

118. The accession to the EU of new members from central and eastern Europe has been highly successful for their economies, and focused the minds of many in the west. In 2005, even the slowest-growing country, Hungary, achieved a rate more than twice as fast as the eurozone, while the Baltic countries did far better. These countries are understandably anxious to preserve their competitive advantages, such as flexible labour, low taxes and light regulation. They have relatively low ratios of tax to GDP, with Lithuania and Latvia maintaining the lowest ratios in the EU, at just over 30% - while just across the Baltic, Sweden's ratio of just over 50% is the highest in the EU.

119. For these countries to grow their economies, it is important that this continues. Not only do they need to secure inward investment from western Europe, but they also face a direct threat from low-cost Asian production – and it is notable that the region has, in fact, begun to secure direct investment from Chinese manufacturers seeking production sites within Europe.

120. With the right approach, these countries have exciting prospects; for instance, while Latvian incomes are currently the lowest in the EU, if the Latvian and the German economies were to go on growing at their 2004 rates of 8% and 1.6%, Latvian incomes would overtake German ones in 2032 - which is to say, within the working lifetime of a young adult. And while that would be good news for Latvia, it would also be good news for Germany, which would have a prosperous nearby market that no longer offered low-wage competition.

121. Ireland is another European success story in which low taxation has played a part. In the late 1980s - during a time of economic crisis - the government, the main trade unions, farmers and industrialists came together and agreed on an austerity programme, lowering corporate taxes to 12.5%, moderating wages and prices, and aggressively seeking foreign investment. In 1996, Ireland made college education basically free, creating a highly educated work force.

122. Today, 9 out of 10 of the world's top pharmaceutical companies have operations there, as do 16 of the top 20 medical device companies and 7 of the top 10 software designers. Ireland has recently won more foreign direct investment from the USA than has China, and the country's top exporter is Dell Computers. The result is that government tax receipts have increased.

123. Moreover, while Ireland's total work force was 1.1 million in 1990, it has now reached two million, with very low unemployment and 200,000 foreign workers (including 50,000 Chinese). "It wasn't a miracle, we didn't find gold," said Mary Harney, formerly Ireland's Deputy Prime Minister, now Minister for Health and Children. "It was the right domestic policies and embracing globalisation."

124. Of course, Ireland's experience is specific – no other country could do exactly the same thing with exactly the same effect. As with all such examples, the secret is in adapting sound mechanisms to suit local conditions; Spain, for instance, has had great success in building a reputation as a Mecca for international culture and leisure, and this relies very much on the country's unique identity. This is true within Europe, and elsewhere too: there is much to learn from Japan's successful response to its demographic challenges, which are similar to those looming in Europe, and that have enabled the country to bounce from a decade of semi-recession. One can also look at the completely different approach of the United States, which has tackled demography and maintained productivity by continuing its high levels of selective immigration.

Investing in the future

125. In many ways, the best measure of an economy's performance and prospects is the productivity of its workforce - the efficiency with which they work or the amount an individual can produce in a given time. By this key measure, Europe remains strong, but its advantage is diminishing. The roots of this problem can be seen in an OECD study of skills in 16 developed countries, where the countries that came top, with less than 5% 'low-skilled' workers were Japan and Korea, while Britain was second from bottom. With an exceptionally high share of British pupils leaving school without qualifications, the OECD says that productivity in the United States and Germany is 20 % higher than it is in Britain. In France it is nearly 33 % higher. The OECD has recently decided to launch a major, multi-faceted 'Innovation Strategy" designed to yield policy recommendations.

126. For Europe as a whole, the problem is less a decline in standards, and more a dramatic rise in standards elsewhere. Especially in Asia, manufacturing and production continue to be revolutionized as the

quality of the labour force improves. And although European value-added products remain in demand across the developing world, we cannot rely on a continued advantage in the future. Indian universities already produce more than a quarter of a million engineers each year, and outstrip Europe in science studies; accordingly, it plans to expand its biotechnology sector fivefold in the next five years.

127. Of the top 20 universities in the world today, only two are now in Europe. "The US has most of the world's top universities, and spending per student is two to three times higher than in the EU", says Carl Bildt, the former prime minister of Sweden. "We have a better level of basic education here, but by losing out to the US in higher education it means that they can attract all the best talent, and it's mainly down to money." Given the link between universities and cutting-edge research and development, it is no surprise that nearly three out of four of the world's top IT companies created over the last generation, and almost half the top 300 firms ranked by R & D spending, are American.

128. Overall trends in research and development are plain to see, and worrying. At the 2002 European Council meeting in Barcelona, Europe's leaders agreed that research and development spending should rise to 3% of the continent's GDP by 2010 – but Eurostat figures show that from 1.9% when the objective was set, the level has actually fallen slightly to reach 1.86% (2004). This compares with levels of 2.66% (2004) in the US and 3.2% (2003) in Japan. And while the 2002 declaration agreed that some two-thirds of this should be funded by the private sector, the latest figure is only 54.3% (a significantly lower share than in the US, Japan, or China). China, incidentally, has trebled its R & D spending over the last five years, and is on course to overtake the EU in this area by 2010.

129. While some of Europe's large companies are well represented in the EU's scoreboard rankings (and Daimler Chrysler is the world's largest investor), the top 20 European companies account for more than 55 % of the total R & D spend by the region's top 500 companies. Recent EU reports make clear that while established companies such as Nokia and Volkswagen perform as well as non-EU companies such as Microsoft and Toyota, Europe is failing to match its competitors in generating the smaller and medium sized businesses that will grow into large R & D investors – and this is particularly in emerging, R & D intensive sectors**.** EU companies are relatively less present in sectors such as biotechnology**,** health and information technology and invest more in older, medium-intensity sectors such as cars and transportation.

130. There are bright spots: investment in R & D in Sweden and Finland, for instance, surpasses 3.5% of GDP. But when one looks at absolute spending (rather than a measure against GDP), EU firms were found to have increased their research spending by 1% in 2005, while those in the rest of the world grew by 7%. This trend has been broadly similar since the scoreboards were introduced, and is in line with Europe's declining share of scientific publications and patents, particularly in emerging technologies. Overall, it must surely suggest that Europe stands to lose competitive positioning, and may struggle to compete in important new sectors, in the next generation.

131. What should be done? To raise the number of European "industrial R & D champions we need to create an environment that supports such investment", says Janez Potočnik, the EU commissioner for science and research. And the Commission underlines this, pointing out the need for tax breaks, simplified bureaucracy, and improved access to venture capital. A range of EU-wide schemes have also been proposed, including a European Centre for innovation. As Jean Philippe Courtois, the President of Microsoft International, says: "the potential benefits are considerable if all sides are willing to commit to creating a knowledge-based society in Europe." But the Pew Center survey quoted previously shows that personal computer use is higher in Korea than any of the major European economies – and that China and Ivory Coast have higher levels of use than a G8 member like Italy.

Making the most of unity

132. Clearly, there are some areas where we need the strength and the economies of scale that unity – and specifically the EU - can provide. The coordination of scientific research and development is an obvious case, for if we are to compete with the United States, China and India, we will need to maximise our resources. Indeed, there is a growing consensus that spending priorities should shift towards this effort, and France – long seen as the prime defender of agriculture spending – has suggested that the European Investment Bank should be used to leverage an extra 30 billion Euros for research and innovation projects. Trade and competition policy is another example – and surveys show that European citizens are happy to be represented by a supra-national body in these areas.

133. But attention needs also to be paid to achieving the ideals of Europe's single market. The adoption of the long-delayed services directive in December 2006 will allow the single market to apply to a sector which accounts for half of Europe's output, and more than two-thirds of its employment. Liberalisation should help to develop Europe's position in a sector where it should have a global advantage, and which will be even more important, as it has become in Britain, with the decline of manufacturing employment. The European Commission believes that implementation could bring 600,000 jobs, and as Commission President Jose Manuel Barroso said to MEPs: "I can't see anything more social than creating quality jobs."

134. The European Union took an important step forward in December 2006 with the creation of a European Globalisation Adjustment Fund which will provide up to €500 million a year to help workers laid off as a result of globalisation to find new jobs. The Fund will be used to help individuals in relation to their job search, personalised retraining, entrepreneurship or self-employment initiatives.

135. Such measures are necessary to face the crisis of confidence affecting the European Union. Although it is often blamed for things beyond its control, there is no doubt that its credibility has recently been battered, and this cannot be tolerated at a time when the continent faces enormous challenges. In 2003, André Sapir's report for the EU joined the call for a radical shift away from farm spending and towards investment to promote greater competitiveness, in areas such as research and development. Regional and social spending should be concentrated on the new member states, it said. At the same time, the report called for a dedicated tax that would finance the European budget, saying that otherwise no reform would be politically possible.

136. Whether or not this is the right way forward, the EU needs to decide on its course and explain it effectively to Europeans. The review of EU budget spending to be carried out by the Commission in 2008 provides a forum for this, if it cannot be done before. Time and again in recent years, the EU has seemed at odds with itself – and sometimes, as with the services directive, it seems that the Commission is pitted against the Parliament, with member nations formed up into factions. What should voters make of it, when they are worried about their futures?

137. If Europe's leaders are going to revive faith in the Union, they must give a much clearer sense of direction and relevance for the future. If they don't, they must expect that voters will fail to see the point in it. And once that new direction is set, teamwork is needed. The more 'Europe' is blamed for domestic difficulties, the weaker will the ideal of European unity becomes.

VII. Concluding Remarks

138. In itself, globalisation is nothing new, but the scale and the pace of change is unprecedented. And while this phenomenon is by no means entirely responsible for the challenges that Europe faces, it makes addressing them imperative. Given our recent history, we have to do this together. For very good reasons, and with very positive effects, the nations of Europe have become interlinked by a dense network of economic and social policies. And so, when it comes to facing the challenges of globalisation, Europeans must work together.

139. Contrary to the impression sometimes created, Europeans are not broadly hostile to globalisation. But they are concerned about their economic prospects, and where those concerns are strongest, there is the also the greatest scepticism about the effect that globalisation will have.

140. Globalisation is seen by some as an inevitable and powerful force that will play the part of Adam Smith's "invisible hand" in bringing about a flat and seamless, integrated world economy characterised by complete freedom in the movement of goods, services, labour, capital and technology to produce prosperity for all. Others see it as a threat that will impoverish Europe in a "race to the bottom" with emerging economies such as China and India, undermining and undercutting its labour force and wages, competing for investment and eroding the high standards of social protection that have become the hallmark of the European social model.

141. One of the main conclusions to be drawn, a point strongly made by the European Trade Union Confederation and many others, is that policy will make a difference: the opportunities should be grasped and the risks limited. The policy agenda should include investment in research and development, innovation (new sectors of activities), and ensuring flexibility on the labour market. Social Europe must be part of the solution through investment in social policy to promote positive adjustment: life-long education and training, support for upward mobility in case of restructuring, gender equity. There is an essential role here for collective bargaining. Investment must be the result of a partnership between the public and private sectors so as to ensure adequate

and timely provision of resources. It may be that more progressive taxation is required. Globalisation must be seen as a challenge and an opportunity to upgrade our economies and this opportunity must be seized.

142. In fact Europe has benefited, as has much of the rest of the world, by the spread of global trade and investment. There is no doubt that the increasing integration of the world economy offers potential major benefits in terms of wealth creation. The question then becomes, like all questions about wealth, how should it be managed and distributed? Again, to the question whether we can allow free rein to a process that also threatens to undermine the social, cultural and community values that European societies cherish, the answer must be a firm no. There is thus a need for government to guide and regulate the globalisation process so as to ensure not only that our European economies successfully adjust to the changes brought about by globalisation but also that its benefits are widely shared.

143. As the Chairman of the United States Federal Reserve Board, Ben Bernancke, has said, “as in the past, the social and political opposition to openness can be strong. Although this opposition has many sources, ...much of it arises because changes in the patterns of production are likely to threaten the livelihoods of some workers and the profits of some firms, even when these changes lead to greater productivity and output overall. …The challenge … is to ensure that the benefits of global economic integration are sufficiently widely shared…”

144. We must also think carefully about the pace of change that we are prepared to accept, bearing in mind the need to put on the brakes before reaching the inevitable sharp bends.

145. Dealing with the problems brought about by globalisation requires the building of a political and social consensus based on shared values. There is an urgent need for Europe’s leaders to offer a vision that combines prosperity and social protection in the new economic world – it can certainly be done, and the debate should not be left to those who say otherwise. Globalisation offers opportunities to everyone, and it can be harnessed to help the next generation of Europeans build on the values that continent holds dear. This can only happen through change, and adaptation; but Europe’s diversity offers us the chance to learn from each other, to experiment, and to generate the optimism and vitality that today’s world economy requires.

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N.B: The names of the members who took part in the meeting are **printed in bold**

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