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Secretary of State for Work and Pensions**

**The Foreign Policy Centre
Reviving the European economic reform agenda**

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I'm grateful to Stephen and the Foreign Policy Centre for the opportunity to join you today. The Foreign Policy Centre has established itself at the leading edge of the debate on the future of Europe – so it's very fitting that they should be hosting this event.

The EU is a union of values, of solidarity between nations and people. It's a common market in which we trade – but it's also a common political space in which we live together as citizens.

After the destruction of two World Wars, Europe has enjoyed 60 years of peace, prosperity and progress. A remarkable achievement and one of which it should be justifiably proud. Throughout this - reconstruction and economic growth have gone hand-in-hand with a strong and caring social dimension. And rightly so.

Economic growth and social justice are mutually reinforcing. A fair society and a strong economy are not opposites but outcomes that are inextricably linked together.

But today demographic change and globalisation present Europe with new social and economic challenges.

Rapid demographic change – fuelled by modern advances in healthcare and rising life expectancy - means that the demands on the EU's welfare systems will be greater than ever before. All of this at a time when the number of people of working age able to support the dependent population will continue to decline.

Over the first 50 years of the 21st Century the dependency ratio in the old EU15 will nearly double – while the average increase in public expenditure on pensions will be 30%. And similar trends will apply to the now enlarged EU25.

Indeed, over the next 25 years the working age population of the EU will fall by 7% while the population aged 65 and over will increase by over 50%. And it is not just our society that is changing. Our economies are changing too.

Globalisation is irrevocably changing the international marketplace. World trade in goods is doubling every decade – and China's exports to Europe doubling every three years. Twenty years ago just 10% of manufactured goods came from developing and emerging countries – by 2020 it will be 50%.

China's growth has averaged 9.5% over the past two decades and its wage costs are still just 5% of those of the European Union. But we are not simply competing in low skilled low wage mass production manufacturing.

India's biotechnology sector will increase fivefold in just the next five years. And China has trebled its spending on research and development in the last five. With 4 million graduates a year from China's and India's universities – global competition means high skilled, value added goods too.

Europe's future success will therefore hinge on its ability to develop policies and institutions that embrace this change, but which are also underpinned by the enduring values that have shaped the union.

We used the UK's Presidency of the EU last year –to stress that we had to move beyond the old arguments that you were either in favour of the Social Model in its entirety or against it altogether. These were false choices that had bedevilled the debate about the future of the EU.

When European Heads of State met at Hampton Court they agreed that Europe must reform and modernise its policies in order to preserve its values.

And it is only by remarrying these values of our Social Europe with the economic realities of the modern world that we can achieve a modern knowledge-based economy. One that's underpinned by greater social inclusion – so that the poorest do not once again lose out in the face of social and economic change.

The Lisbon Agenda was launched in 2000 with the 10 year objective of "making Europe the most competitive place to do business in the world." At its heart was an employment target of 70%. Its achievement will be critical – for individuals; for families and communities; for wealth creation; for economic competitiveness and social justice; for both the Social and the Economic Europe.

But at 63.3%, the EU employment rate increased only half a per cent in the first five years of the Lisbon timeframe. And with 18 million Europeans unemployed and one in every three of working age deemed economically inactive – Europe must reform and reform quickly.

To turn this around, in a climate of ever greater global competition, I believe that Europe needs to address three critical issues. First – improving the skills of its workforce; Second being more supportive to entrepreneurship and innovation as the engines of growth in a global market; and third, achieving greater flexibility – stripping away unnecessary centrist regulation and enabling member states to adopt tailored flexible welfare policies that focus on the specific needs of individuals and which provide the kind of security that enables active inclusion, with work for those who can and security for those who can't.

I'd like to say just a few words about each.

Firstly skills.

Employment is the key to social protection. But skills are the way to unlock social progression.

In today's labour market the acquisition and updating of skills are the absolute essential pre-requisites for success.

Skills drive economic growth by improving both productivity and employment. They determine our capacity to innovate and they hold the key to reducing social disparities.

By 2015, China is likely to have become the third largest economy in the world –contributing nearly a fifth of global output. In order to maintain and improve its growth, Europe will need to manage the resulting structural change effectively, allowing workers to shift to more productive and profitable sectors.

Higher skills levels are essential to achieve this overall shift to a modern knowledge-based economy. Here in the UK, it is already estimated that by 2012 over two-thirds of all new jobs will require qualifications at or above level 3.

Most occupations already require higher levels of skills than in the past. Once, IT skills were a specialism – today they are increasingly a core requirement for many jobs.

It means there's a high premium on transferable skills – the tools that will, for example, enable people to respond to new opportunities by changing career mid-way through their life.

But even if we achieve this shift in skills – Europe can not sit back. Global competition is not going to be a race to the bottom - far from it. India now produces more science graduates than Europe. And only yesterday, the front page of the Financial Times reported the Chancellor of Oxford University planning the first of several recruitment drives to India and China.

So to compete in the global market-place and harness the opportunities that this presents – Europe must build a world class skills base. But skills, while essential, will not be enough on their own. We must also create the right conditions for innovation and entrepreneurship.

India and China are crucibles of innovation - unconstrained by legacy practices and able to introduce new technologies and systems relatively easily.

China has already established itself as a pre-eminent manufacturer of standards based products. And with, for example, the EVD (Enhanced Versatile Disc) as a potential successor to the DVD, China is driving standards and innovation in a highly skilled technology market.

It's also drawing in global capital with over \$1.2 billion invested into Chinese ventures in 2004. 11% of today's world stock of foreign direct investment is now located in China. Venture capital and private equity firms are helping Chinese enterprises tap into innovative practices, global commercial and capital markets.

But whereas much of China's success has been driven by foreign direct investment – India has focused on providing a more nurturing environment for its own home-grown entrepreneurs.

In contrast to China, India has begun to back away from micro-managing its economy – ceding its monopoly over long-distance phone services for example, cutting some tariffs and opening a number of industries to private investment, including investment from abroad.

As a consequence, entrepreneurship and free enterprise are flourishing. In a recent survey of leading Asian companies, India registered a higher average score than any other country in the region, including China.

If Europe is to renew itself in this age of global competition, we too must nurture the spirit of entrepreneurship from the classroom to the boardroom. We must support innovation with investment in science and infrastructure; and provide the right incentives to make Europe a centre of excellence for research and development.

Europe needs a dynamic and competitive economy based on open markets. The EU must combine the economic strength of the Member States in a single open European market for the benefit of all of us – to allow us to trade freely with each other – and to ensure the European business is well placed to compete in the rest of the world.

So it is by embracing global market forces and product market competition that we can combine economic efficiency with the delivery of our social justice goals. But here too, flexibility is going to be key.

For all China's rapid growth it is still in the process of freeing itself from substantial legal and regulatory constraints. It was only at the turn of the century that domestic companies were finally granted the same constitutional protections that foreign businesses have enjoyed since the early 1980s.

Currently, although there are already over 60 foreign banks operating in China, they only hold 1.4% of banking assets. Next year, the financial sector will be opened to the full participation of foreign banks.

China will need to manage its own transition as it moves towards greater liberalisation. To manage the transition of workers from state-owned companies in a flexible labour market where there are almost no restrictions on hiring and firing and no major mandatory benefits. And to manage an urban-rural divide that sees for example, per capita GDP in Shanghai at roughly eight times that of some of the provinces.

As China develops greater flexibility – Europe must be careful not to move in the opposite direction.

More than 50% of significant new regulations that impact on UK business now emanate from the EU. Too often in the past, I think the EU has given the impression of regulating first and asking about the impact later. Better regulation does not mean dismantling social standards or cutting health and safety in the workplace. It does mean finding more effective ways to deliver those standards so that they do not place unnecessary burdens on business. So that they don't drag as an anchor on innovation and productivity.

In all of these areas there has been some progress, with important steps forward during the UK Presidency, when – as Chancellor of the Duchy of Lancaster – I had the pleasure of being the Minister charged with overseeing the better regulation drive. The European Commission under the leadership of President Barosso has shown a genuine determination to change the regulatory culture in Europe, with the decision announced in September to withdraw 68 legislative proposals under its broader initiative to cut red tape. And last October a new Communication on Simplification, repealing, codifying, recasting or modifying up to 1400 legal Acts – a clear signal of intent.

But we shouldn't pretend that we are there yet – in truth, we've got a very long way still to go. We must do more to modernise our internal institutions. To have the confidence to remove unnecessary regulation, to peel back bureaucracy and champion a global, outward-looking, competitive Europe.

But above all, a modern flexible welfare state is crucial in progressing economic reform in Europe.

A Government's duty to its citizens used to be seen as compensating them through state hand-outs – to lift their incomes above a poverty level. That was perhaps the original deal between Government and individuals – and at the time, a major social advance. Government offered blanket benefit payments

to those out of work. There was an understanding and an expectation that those unemployed would try to get back to work but there was limited support or incentives to do so. We must carry on providing this support – but we need to go very much further.

Since 1997, through record investment in the New Deal and Jobcentre Plus – the Labour Government has sought to move the welfare state here in Britain from a passive one-size fits all model to a more pro-active service which tailors support more to the specific needs of each individual.

We have sought to open the door to greater social mobility. Through the National Minimum Wage and tax credits, we created clear incentives to work by making work pay. And by creating an active, enabling welfare state that matched rights with responsibilities, we offered people the opportunity to help lift themselves out of poverty for good, rather than merely trying to ameliorate their condition from within the benefits system.

There are now 2.3 million more people in work; 1 million fewer people on benefits. And 2 million children and almost 2 million pensioners have been helped to escape from living on the poverty line.

The flexibility which has underpinned this approach is central to the reforms of Incapacity Benefit set out in last month's Green Paper. As well as benefit reform, this included a more flexible tailored approach to welfare delivery - focused on harnessing the resources and expertise of the public, private and voluntary sectors in waging a war on the now remaining pockets of deprivation – areas of the country heavily correlated with the largest numbers on benefit.

Across the EU, each Member State is unique – with its own traditions, institutions and practices. But all are underpinned by shared values – solidarity, mutuality and the ambition to allow everyone to develop their true potential and make their full contribution to society.

We must all find our own way to make this transition in welfare support from the original State benefit hand-out to this new flexible approach where communities are empowered to develop local solutions to address the impact of global change on their own local areas.

But in the years ahead all the nations of Europe must ensure that rights-based and equality-driven European laws and directives do not impede this flexibility needed to achieve our social justice goals.

Too often in the past, Europe has seen labour market flexibility as being somehow the enemy of social justice. It is not.

Modern social policy is not about regulation and job protection in a way that may save some jobs today at the expense of many jobs tomorrow.

Today flexibility can promote a progressive agenda. It can provide the means by which people move between jobs rather than into unemployment or inactivity. It provides the mechanism by which people can receive tailored help to acquire new skills as the fastest route back into employment. And it can provide the opportunity for new and previously excluded groups to enter the workplace and make their full contribution to society.

Today's labour market – with its flexible hours and part-time options means that working mothers and single parents can now find a way to work whilst meeting their family commitments. Europe must have the resilience not to be tempted into shaping, for example, a Working Time Directive around the old outdated stereotypes of white, male industrial workers. Removing the opt-out would be a truly regressive step. An old-style inflexible policy, stifling opportunity and widening social injustice rather than tackling it.

And neither should we be fooled into thinking that an inflexible Working Time Directive is about ensuring safety in the workplace. Because if that were true, you would expect nations like Britain, which remains committed to the opt-out, to have amongst the worst health and safety records in the European Union. In fact we have the best.

Europe will be left behind if it insists on maintaining rigid labour markets and one-size-fits-all regulations. Uniformity is now the enemy of progress; Flexibility the key to achieving true equality of opportunity - enabling people to make the best of their lives by offering them tailored choices rather than imposing rigid one-size-fits-all solutions.

As in the past – a successful Economic Europe will depend on a successful Social Europe. A Europe that balances rapid change with proper support for people through the State and together in wider society. A Europe which doesn't just provide hand-outs but a hand-up to enable people to lift themselves out of dependency and not to fall back. A Europe which invests in skills, rewards innovation and balances regulation with flexibility.

I'm an optimist – I believe we can achieve this. And in doing so, we can harness the opportunities presented to us by the advances in technology and healthcare that underpin the challenges of globalisation and demographic change. Challenges now that offer the chance not just to revive our economic performance – but actually to achieve our ultimate social policy goal; the eradication of poverty and the creation of true equality of opportunity for all citizens within the European Union.