CENTRE FOR EUROPEAN REFORM
essays

Britain and Europe: A City minister's perspective

Ed Balls MP

CENTRE FOR EUROPEAN REFORM

about the CER

The Centre for European Reform is a think-tank devoted to improving the quality of the debate on the European Union. It is a forum for people with ideas from Britain and across the continent to discuss the many political, economic and social challenges facing Europe. It seeks to work with similar bodies in other European countries, North America and elsewhere in the world.

The CER is pro-European but not uncritical. It regards European integration as largely beneficial but recognises that in many respects the Union does not work well. The CER therefore aims to promote new ideas for reforming the European Union.

Published by the Centre for European Reform (CER), 14 Great College Street, London, SW1P 3RX
Telephone +44 20 7233 1199, Facsimile +44 20 7233 1117, info@cer.org.uk, www.cer.org.uk
© CER MAY 2007 ★ ISBN 978 1 901229 74 5

Britain and Europe

A City minister's perspective

Ed Balls MP

ABOUT THE AUTHOR

Ed Balls MP was appointed Economic Secretary to the Treasury in May 2006. He has been Member of Parliament for Normanton since 2005. Mr Balls was a teaching fellow at the Department of Economics, Harvard, 1989-1990, and an economics leader writer and columnist for the Financial Times, 1990-1994. He was economic adviser to the then shadow chancellor, the Rt Hon Gordon Brown MP, 1994-1997; economic adviser to the Chancellor of the Exchequer 1997-1999; chief economic adviser to HM Treasury, 1999-2004; and research fellow, Smith Institute, 2004-2005. Ed Balls has published several works including 'Towards a new regional policy', 'Reforming Britain's economic and financial policy: towards greater economic stability', and 'Microeconomic reform in Britain: delivering opportunities for all'.

ACKNOWLEDGEMENTS

The author would like to thank Treasury officials for their assistance. He would also like to thank Simon Tilford and his CER colleagues for their assistance in editing. Thanks also to Kate Meakins for layout and production.

★

Contents

Foreword

Goldman Sachs

Goldman Sachs is delighted to co-sponsor this CER essay. Europe's financial markets have benefited from single market policies to remove cross-border barriers and related policies to integrate European capital markets. For a number of key financial market activities, London, as Europe's main financial centre, now significantly outpaces the US.

Rapid change across the global economy also brings new challenges for Europe. To build Europe successfully, Europe must maintain an outward looking global perspective. As the BRICs (Brazil, Russia, India and China) economies and other emerging markets develop their capital markets, there will be significant opportunities for those involved in the European market to participate in the financial flows that result from stronger global integration.

Financial markets are constantly changing, as they adapt to the needs of savers and investors. Modern techniques and financial instruments offer new ways to hedge and manage risk. To remain globally competitive, Europe must stay at the leading edge of financial innovation and be capable of adapting flexibly to the dynamic needs of firms globally. This poses a special challenge for Europe: how to maintain a framework which is sufficiently flexible to adapt swiftly to new market trends and global realities? Only if Europe maintains a system of financial regulation which is principles-based and risk-focussed will it be able to meet this challenge successfully.

Richard Gnodde

Co-CEO, Goldman Sachs International

Foreword

RBS
The Royal Bank of Scotland Group

RBS is delighted to co-sponsor this CER essay. As the EU develops its policies to enable Europe to flourish in an ever more challenging global market, it is vitally important that it frames those policies in an open and pragmatic fashion. This publication is a timely and welcome contribution to that process.

At the heart of these policy choices lies the future of the single market. The EU faces a fundamental choice between a more outward looking, globally focussed approach, or the more introspective approach of harmonising, 'one size fits all', legislation. As one of Europe's largest companies, RBS's position is clear. We strongly support an effective single market that promotes cross-border expansion, innovation, competitiveness and fairness, and that gives consumers more choice. And it is crucial – as Ed Balls and Internal Market Commissioner Charlie McCreevy recognise – that the EU's single market policy helps business to flourish, by promoting the wider requirements of a globalised market and embracing a strong commitment to better regulation.

Where the EU does decide that regulation is the best way to fix a problem there should, without exception, be clear evidence of market failure. Impact assessments based on robust cost benefit analysis should be mandatory, and undertaken at the consultation stage when formal proposals are still being developed. They should also be obligatory when fundamental changes take place during the legislative process. But the responsibility is not one-sided. Business, too, has its role to play in helping policy-makers to deliver better regulation and in giving the EU an outward looking, globally focussed approach to the key issues which confront it. Industry needs to be an active participant at every stage of the policy-making process. The UK's highly successful financial services sector is an EU asset, and has much to contribute. We should do so in a spirit of committed and constructive engagement.

Sir Tom McKillop

Chairman, RBS

1 Introduction

Returning to the Treasury and the European Union finance ministers' circuit after nearly two years away, I have been struck by how much Europe has changed over the past few years. With 27 ministers around the table, plus their ambassadors or central bank governors, the meetings are now very large. Television screens are usually needed so that we can see the faces of our interlocutors. Genuine debate is hard and drafting discussions over *communiqué* texts are even more protracted than they used to be.

And yet, as the years pass, I am more and more struck by the huge contribution that the European Union has made – and is making – to the prosperity and security of our continent. To be part, as I was recently in Berlin at the informal meeting of the Ecofin Council, of a debate over tax between Germany and Poland, or over the control of public spending with Estonia and Lithuania or the Czech Republic, would have been unthinkable just 20 years ago. So whatever the particular issue we are debating at the time, I always make sure that at any European meeting I attend, I step back and reflect on what a great achievement the Union is.

And Europe is benefiting from these changes. With enlargement from 15 to 27 member-states, and a Commission led by President José Manuel Barroso, the European Union is taking significant strides towards a more open and global view of the world. I have seen how these discussions – like those attended by my colleagues on border controls and immigration, agriculture, transport or international development – are further entrenching the shared commitment to peace and to prosperity across our continent, which has been such a great achievement over the last 60 years.

So my starting point is that we must guard against taking this achievement of economics and politics that is modern Europe for granted. Which is why I agreed wholeheartedly with Chancellor Angela Merkel and the German EU presidency's decision to devote a whole informal European Council on March 25th 2007 to a celebration of the 50th anniversary of the Treaty of Rome.

Of course, we must recognise that for all these achievements, public support for the idea of Europe has ebbed in recent years. Slow growth, high unemployment, EU budget problems and the rejection of the constitutional treaty in France and the Netherlands have all made Europe seem remote and out of touch in the minds of much of the European public. The most recent Eurobarometer survey found that just 54 per cent of EU citizens felt that their country had benefited from membership, and only 46 per cent viewed the EU positively.[1]

[1] *Standard Eurobarometer 66, Autumn 2006. http://ec.europa.eu/public_opinion/archives/eb/eb66/eb66_en.htm.*

As European politicians we have our work cut out to win public support for Europe, both here in Britain and across the continent. To do so, we must show that European co-operation is necessary to meet the new challenges of the future. Indeed, as the leadership of Europe changes, we have a particular opportunity – and responsibility – to make the case for a modern Europe.

As a Treasury minister with responsibility for financial services, I have seen at first hand why Europe matters for this critical global industry. Of course, over the past year, I have heard and shared the frustrations of many City practitioners at the detail of some of Europe's directives, not to mention their implementation. But I have also seen how London is strengthened as a global financial centre by Britain's membership of the EU, by the approach taken by the current Commission – and also by our willingness both to fight our corner and to reach agreements when they make sense.

And I have seen that the benefits of this approach stretch beyond the City. For example, as a member of a government determined to tackle climate change, I have also seen that European co-operation is the foundation of any sensible strategy to meet our environmental obligations. As a politician who grew up during the Cold War and then came of age as revolution was taking hold across Eastern Europe, I appreciate the huge contribution that Europe makes to the security of our continent.

In this essay, I want to show why I believe Britain needs the EU. Securing increased employment and sustained economic growth while confronting new challenges such as climate change, protectionism and terrorism, requires effective co-operation with our partners in the European Union as well as reform of Europe's institutions.

I will argue that to meet these challenges Europe must change. We need a new economic focus on job creation and single market reform, a radical reform of the EU budget, and an end to backward-looking attempts at European state-building.

Here in Britain, I want to make the case for a hard-headed pro-Europeanism:

★ pro-European, because we recognise that we are stronger by co-operating with our partners in the European Union to meet the shared challenges of globalisation and climate change;

★ hard-headed because we must have the confidence to put our national interest first and to sometimes say 'no' and to argue our case where we believe Europe risks taking the wrong course.

To win the argument both for reform in Europe and effective British engagement in Europe, I believe that Britain must break out of the outdated debate over Europe which has dogged British policy for decades.

For the last 50 years, Britain's engagement with Europe has been constrained by a sterile debate between two opposing schools of thought. On the one hand, a pro-European movement has traditionally advocated closer union as the sole solution to the perceived problems of Britain's declining influence and wealth, policy paralysis and apparent ungovernability. On the other, anti-Europeans have argued that the very definition of Britishness lies in rejecting anything put forward by the European Union.

To look back at the debate about Britain and Europe in the 1950s and 1960s is to uncover a set of assumptions about what it means to be British among politicians, writers and commentators that seems profoundly limited and constrained. For the pro-Europeans, Europe was advocated as way of avoiding becoming "a sterile...province without a metropolis". Entering the European Economic Community (EEC) offered the chance "to enrich us culturally, restore our rather bruised confidence in ourselves, and make us more politically effective". Because "so much of English life in the past decade has been stale and stagnant," it was claimed, "entering the Market is bound to mean rejoining the European mainstream and adding to it."[2]

[2] *For further examples of this debate, see the 'Going into Europe' symposium in Encounter, 1962-1963.*

So Europe was the alternative, the answer to Britain's inevitable economic and political decline. To the old pro-Europeans, the attraction of Europe was as an antidote to the difficulties surrounding governability and policy paralysis that plagued UK governments in the 1950s, 1960s and 1970s. And the old pro-European argument rested as well on a view, rooted in the Cold War, that to be strong, you had to adopt a continental identity both economically and politically; and that economic integration would lead inexorably to political integration. For this view, British attempts to argue for reform in Europe, to oppose savings tax harmonisation or to stay out of the euro have often been seen as betrayals of the European idea.

The anti-European movement, on the other hand, was forged in opposition to the idea that a European federation was the only and inevitable next step for Britain, and reflected similar assumptions about British weakness. Indeed it is worth noting that anti-Europeanism, which saw any agreement with Europe as a sign of weakness and our isolation as a test of British identity, reached its height in the wake of the economic crisis of the early 1990s.

This ideological fissure has dominated our debate for decades. For successive British prime ministers the negotiating challenge in the run-up to a European Council has been either to agree – and be accused of selling out the national interest in the view of the antis; or to say 'no', often in isolation, and thus, in the view of the pros, to sell out the European ideal.

To me, this old ideological debate about Britain in Europe seems increasingly out of place and time. Take our relative economic performance for a start. Before 1997 Britain was bottom of the G7 in terms of national income per head, behind its European counterparts France, Germany and Italy, as well as the USA, Canada and Japan. Yet now Britain is second only to the USA. In the euro area, average growth in GDP per capita since 1996 has been about 0.5 per cent less than in the UK. The idea that Britain is in inevitable decline and needs Europe as its salvation now looks absurd.

At the same time, the nature of the European project has changed considerably. The EEC of 1973 comprising nine countries has become a European Union of 27 member-states and over 490 million people. Enlargement and globalisation have brought a diversity of culture, tradition and population unforeseen in 1973, changing the dynamics of the European project. The new member-states, often more inter-governmental in their approach and sceptical about the need for new and supranational political structures, have already begun to shift the centre of the European debate. They have brought a liberal approach, which emphasises openness and the importance of co-operation between sovereign countries.

In the past some foreign policy experts confidently asserted that Europe would inevitably progress from economic co-operation to political integration. But profound doubts have now been cast on this assumption, not least by the rejection of the constitutional treaty by the citizens of two founding EU members – France and the Netherlands – and the current desire for an amending treaty rather than a new constitution. The fact is that today the old assumption of an inevitable march from single market to single currency, tax harmonisation and a European state seems very far removed from the reality of modern Europe.

So today we are looking at a new world. Britain is not in decline; Europe is less inward-looking and many of our European partners would join us in pressing for more inter-governmental co-operation and reform of Europe's budget and institutions – rather than centralisation and European state-building.

In this essay, I want to argue that we can break out of this outdated and sterile debate. But this requires a more confident vision of Europe, and a more hard-headed view of the UK's place in it, based squarely on advancing our national interest and the EU public interest together. This involves setting out a clear and principled approach that recognises the critical role the EU can and must play in helping us meet global challenges – where acting together, the 27 member-states of the EU can be more effective and influential than acting separately.

In each of the areas covered in this essay – financial services, the single market, the environment and the EU budget – and also by extension in other areas, such as world trade, security, immigration and enlargement, I argue that we will not promote British interests by leaving the table and withdrawing to the anti-European fringes of the big European debates. Instead I argue that a hard-headed pro-Europeanism demands that we set out three underlying principles that should form the basis of EU action:

★ first, the EU should act only where there are clear additional benefits from collective efforts compared to action solely by individual member-states – rather than 'more EU' for the sake of it;

★ second, where EU-level action is appropriate, it should be proportionate and flexible, using non-legislative solutions wherever possible;

★ third, we need to improve the effectiveness of the EU in those areas where it does act.

The first chapter looks at the UK's engagement with the European Union in the area of financial services. There are those who ask, in light of Britain's success and the increasingly global environment in which financial services operate, whether the City and UK financial services really need Europe any more. While there are real challenges, the chapter gives a clear 'yes'.

The second chapter focuses on the single market more broadly. The single market has been one of Europe's defining achievements, delivering jobs, growth and greater choice for citizens and business. The chapter argues that Europe needs to move beyond the outdated goal of simply 'completing' the single market and must instead focus its approach on the new global challenges we face.

The third chapter focuses on the linked issues of global climate change and energy policy, which are perhaps the most important tests of the EU's capacity to reform and act together successfully in the coming years. The chapter sets out how the UK has taken a lead in arguing that these issues need to be tackled at European level, and how the next challenge for EU environmental policy will be implementation.

The fourth chapter argues that the EU cannot meet the challenges of the 21st century without reforming its outdated budget. Forty per cent of the total budget is currently spent on the common agricultural policy (CAP) and more than 60 per cent of structural and cohesion fund expenditure is still allocated to the rich member-states. So the final chapter sets out the importance of the fundamental review of the EU budget, announced by EU leaders in December 2005 under the presidency of the UK.

2 Financial services

Let me start with a question which, as City minister, I hear from time to time – do the City and the UK financial services industry really need Europe any more? London is now a global financial centre, the argument goes, and does not need to rely on links to the European market. Others go further and argue that if alternative European financial centres retain their rules and restrictive practices, then London's competitive advantage is enhanced. Just as excessive US regulation in the 1970s led to the Eurobond market developing in London.

I disagree. Since becoming City minister, I have seen how London is strengthened as a global financial centre by Britain's membership of the EU and by our willingness both to fight our corner and to reach agreements when they make sense.

First, London is now established as Europe's wholesale financial services gateway to the world, and the world's financial services gateway to Europe. Key European banks such as Deutsche Bank and Société Générale now choose to locate substantial parts of their wholesale operations in London.

Second, our financial services industry has a great deal to gain – in terms of jobs and new investment – from an enlarged and competitive retail financial services market that allows financial service companies to offer a wider range of competitively-priced products. Of course, to make the most of this opportunity we must implement the single market in the right way – and that is not easy. We do not need a vast programme of harmonisation – the imposition of a one size fits all approach – but rather the removal of barriers to mergers and acquisitions, and a mutual recognition of each others' standards wherever possible. But the idea that London's success depends on other European financial centres lagging behind underestimates the City's strengths and its potential.

Third, because it is by winning arguments for open markets and open trade within Europe that we strengthen our position on the world stage. Through constructive engagement we can ensure that the EU uses its influence well in multilateral trade negotiations; that it develops innovative policies to address climate change, such as markets in carbon trading; and cultivates key bilateral relationships, such as with China, India and the US.

For example, take prudential capital standards. The UK, working within the EU, has been at the forefront of implementing the international Basle II capital standards, and we need all our international partners to work together to meet this challenge.[3] And the same goes for Solvency II – this EU legislation will govern capital requirements for insurance companies. We have the opportunity to create a risk-based prudential framework for insurance at the EU level which will help the sector use capital more efficiently, and contribute to a deeper single market in insurance services. Working with our European partners, we will also continue to support the work of the Transatlantic Business Dialogue aimed at breaking down the regulatory barriers to trade in financial services between the USA and Europe. This is an important opportunity for Europe, working with business, to strengthen transatlantic trade.

[3] *These require banks to set aside more capital for risky investments and demand improved quantification of risk.*

Earlier this year, I invited Commissioners Charlie McCreevy and Neelie Kroes to a meeting of the UK Chancellor's High Level Group on Financial Services. I strongly welcomed their work on developing an approach to financial services integration that is based on the rigorous use of competition policy and non-legislative policy solutions wherever possible. I strongly support both commissioners' championing of the case for a modern, liberal

outward-looking EU, and I know these sentiments are widely shared across the City of London.

This increasingly constructive relationship between the City and the European Commission reflects, I believe, both the City's confidence in its global reach and a more market-orientated approach to the single market in financial services on the part of the Commission.

A few years ago there were many who feared that in not joining the first wave of monetary union, London would be excluded from euro-based financial markets. Yet since the launch of the euro in 1999, London has established a pre-eminent position in euro-denominated international transactions, consolidating its position as Europe's financial gateway to the rest of the world and the world's gateway to Europe. One reason for this is that the UK's proportionate regulatory regime for its wholesale financial markets is widely regarded as the best in the world. The Financial Services Authority's (FSA) principles-based approach to regulation supports innovation by making it easier for firms located in London to trade elsewhere, both in the EU and globally.

There was also a fear that regulation coming from Brussels, in the form of the savings directive or the investment services directive, would lead to inflexible, over-burdensome rules, which would eventually erode London's international competitiveness.

European financial services policy-making has indeed, at times, been excessively influenced by those who see European integration as being about building a legal and institutional edifice. Unfortunately, the voice of those who see integration as a means to dismantle cross-border barriers and improve market efficiency was not always heard. As a result, insufficient attention was sometimes paid to international competitiveness. All too often in the past, Commission thinking was driven by a legal rather than economic approach, resulting in a trend towards legally complex texts that favoured harmonisation of rules over mutual recognition of each others' standards and practices.

But through positive engagement with our European partners, the UK has shown how we can shift the debate and convince others that an inward-facing legislative approach is not the right policy response. For example, on the savings directive we fought and won the argument for a solution to tackling tax avoidance that was workable and took account of global realities. And during some extremely difficult negotiations on the investment services directive (subsequently renamed the markets in financial instruments directive or MiFID) we worked hard to reduce the impact of the pre-transparency rule for share dealing by investment funds, which could have had significant adverse effects. On the prospectus directive, we also won important changes to make it easier for companies to issue shares or bonds across the EU on the basis of a single prospectus. On the transparency directive, we fought and won the battle against quarterly reporting, thereby avoiding the imposition of significant compliance costs on industry. We worked with the European Parliament to ensure that amendments to this directive minimised any adverse impact on bond markets in the UK, made it easier for shareholders to report their shareholdings, and ensured electronic provision of financial information to the markets.

These were all good outcomes for UK-based companies and markets, and, I believe, for the European economy too. However, they did not come about by chance. They required engagement, hard work and patient negotiation. They clearly demonstrate why we must be at the table, making our voice heard, trying to win the argument. The UK can shape the approach taken by Europe in this field from our position of strength as a global leader in financial services. But we need to be proactive, consistent and confident in communicating our vision, so that both the UK and the wider EU interest can be advanced.

This was the case with MiFID – which will mean changes to the established practice in many member-states, including in the UK. In France and Italy, it means abandoning concentration rules that limit competition with their national exchanges. For the UK, home to

many investment banks, it means a new regime governing trades carried out within the banks' own systems. Concerns remain over the operation of certain aspects of MiFID, in particular its application to branches and, in time, how certain aspects will apply to bond and commodity markets. But provided we engage constructively on these issues, I believe we can win the argument and that the UK and Europe stand to gain from the greater competition and openness that MiFID will bring. Indeed we are already seeing increased competition, with the establishment of innovative trading platforms such as Turquoise and Chi-X.

So the evidence thus far does suggest, I believe, that Britain and Europe can develop integrated capital markets and extend choice for our consumers in retail products without stifling innovation or handicapping EU-based firms. But we must work hard to ensure that this is the case.

A global approach

Our starting point has to be the global nature of financial markets. Any newly proposed European regulation must answer the following question: is it neccessary? Will it enhance the competitiveness of London and other EU markets in the face of global challenges? Will it enhance the efficient allocation of capital within the economy and help drive economic growth? Will it allow financial markets to continue to innovate and offer a diverse range of products and services? Will it truly further the integration of the internal market without imposing disproportionate costs?

Our Global Europe approach means recognising that "one size does not necessarily fit all". Differences in legal systems, regulatory approaches and in the composition of retail and wholesale markets across the 27 different markets make a single-sized approach difficult.

That is why we strongly believe in, and make the case for, alternative, non-legislative instruments. The Commission's sectoral competition inquiries into financial services are an excellent example of how barriers to the trade in financial services can be tackled through the application of the Commission's existing competition powers, rather than by pursuing legislative solutions. Market-led codes of practice, such as for clearing and settlement, are a good example of the use of a non-legislative solution to tackle obstacles to the integration of financial markets.

At other times, greater co-operation between supervisors through the Lamfalussy arrangements may be the best course of action. These are a series of committees with powers to establish and amend secondary EU financial services legislation. For example, delegating tasks or sharing reporting data more efficiently – may be the most effective way to solve a problem, dismantle a barrier, or strengthen our financial stability architecture. This approach is particularly relevant to the debate about how to further integrate retail financial markets, where barriers such as language, culture or consumer preferences, are likely to result in a legislative solution being less effective or appropriate. The integration of retail markets through removing barriers and obstacles to firms engaging in cross-border mergers and acquisitions, and the development of specific EU-wide products, may provide a more effective way forward than legislation.

As a general approach, it is our view that all non-legislative policy solutions should be thoroughly considered, before the Commission resorts to EU legislation. For example, the case for a directive on mortgages has not been adequately made, and I support the Commission's willingness to explore with the industry the potential of market-led initiatives in this area, for example to improve efficiencies in the EU mortgage funding markets.

Where EU legislation is the appropriate course of action, the UK believes any legislative proposal should be subjected to robust cost-benefit analysis, competitiveness testing and consultation with industry. In each case it must be demonstrated that legislation is

indeed the most appropriate policy response. The UK must also take a hard-headed approach to any negotiations to ensure that our national interest and the wider EU interest are advanced. We must protect the competitiveness of our economy and our principles- and risk-based approach to regulation in the detail of all legislation.

But working for better regulation does not stop once a directive has been agreed. EU legislation must be implemented consistently, proportionately and on a timely basis throughout the Union. Getting implementation right is not always easy, but the UK government is focussed on ensuring that all new regulations are implemented here in a risk-based and proportionate manner. That means no unnecessary and burdensome gold-plating. HM Treasury and the FSA have worked closely with industry to rise to this challenge. The UK's timely transposition of MiFID has provided industry with the maximum time to prepare for the launch in November 2007, enabling UK firms to be at the vanguard of this opportunity. The UK government has also announced measures to ensure that the tax regime supports the competition that MiFID is designed to encourage.

It is vital that member-states transpose and implement MiFID by the agreed deadline. Every day that the EU contains a patchwork of regimes represents a collective failure to reap the benefits of MiFID. That is why I have written to Commissioner McCreevy setting out the urgency of timely implementation, and urging him to take action against those member-states that are undermining the EU's competitiveness by dragging their heels over implementation.

Going forward, Europe must continue to build a globally competitive financial services industry that is the envy of the world. This will increasingly depend on the convergence of practices, standards and rules on a global basis, whether it be in the fields of law-making, supervision of markets and firms, or tackling financial crime. And we must build on the very constructive approach the current Commission has taken in supporting the financial services sector.

There is political momentum, too, behind efforts to break down international regulatory barriers, particularly between the EU and US, with Chancellor Merkel having shown important leadership. The UK government fully support these efforts, and is enthusiastic too about the work underway in the G7 to promote cross-border trading in securities between the world's largest markets.

I welcome, for example, movement by the US Securities and Exchange Commission (SEC) on deregistration to enable many EU-based companies listed in US markets to exit that market, should they choose to. This will enhance, not reduce, the attractiveness of US markets and transatlantic integration. And the roadmap recently agreed between Commissioner McCreevy and Commissioner Cox of the SEC on international accounting standards is an important step forward.

Of course global markets also carry global risks. So the approach we take towards financial stability is also based on international co-operation. In an increasingly integrated European and global financial market, financial sector disruption is highly unlikely to be confined within national boundaries. Robust domestic arrangements for monitoring and managing risks, and responding to shocks and potential crises – as the UK has developed through the Tripartite Standing Committee – are the foundation of effective international co-ordination. However, it is clear that each country will have different structures and processes, reflecting their differing institutions. As a result, there is unlikely to be a single model which can be applied to all. The EU has taken significant steps in this area. It has developed a Memorandum of Understanding on information sharing in financial crises, held an EU-wide financial crisis exercise, and is managing a programme of work to further improve co-ordination between member-states, so they can more effectively manage cross-border crises.

In this context, there has been a recent focus on hedge funds, both in the EU and the G8, recognising the benefits they bring to global

markets, but also the need to understand the potential risks they pose for financial stability at the same time. Here too Europe is demonstrating leadership and influence in the international debate. In May 2007, the Ecofin Council agreed on the need for greater co-operation between the key regulators in monitoring the main counterparties' exposures to hedge funds – and in pooling that information.

Tackling financial crime

Criminal and terrorist finance is also unconstrained by national boundaries. A co-ordinated international response is needed to prevent organised criminals and terrorists from accessing the financial system, and to weaken their networks. The UK's national interest is advanced through engaging with European partners to shape and deliver a robust European response to financial crime that is nevertheless proportionate and ensures a level playing field for firms. For example, the third EU money-laundering directive, which ensures that there is a co-ordinated EU-wide approach to tackling the global problem of money-laundering and terrorist financing, is based upon a risk-based approach. It recognises that whilst we must take tough action where the risks require it, we must also reduce regulatory burdens where possible. The UK successfully made the case for this, working with the financial sector to argue that the directive should allow firms to apply 'know your customer' checks on a risk sensitive basis. The directive will help ensure that a similar approach to that already followed by many UK firms is now adopted across Europe.

So Europe needs to look outwards not inwards, away from creating new single institutional or architectural structures, in favour of enhancing co-operation arrangements with rule-makers and supervisors around the world. Coupled with the rigorous application of non-legislative policy tools like competition policy and robust cost-benefit analysis, this will help ensure that where the EU does act, it does so in a way that will enhance and not impede global competitiveness.

I believe we can best stand up for the City and UK interests by being at the centre of and leading these European debates – and not by leaving the table or withdrawing to the extreme anti-European fringes. That is the clear message I have heard from across the City and the wider financial services community over the past year. Under this government at least, that will be Britain's approach.

3 The single market and beyond

The success of the UK's principles-led approach to financial services in the EU is, I believe, an approach we can apply more widely to the European economy. It can guide our reform of the single market and our drive to deliver rising prosperity and more jobs. This means looking critically at whether EU-level action is necessary, ensuring any such action is proportionate, flexible, and implemented effectively, and confidently making the arguments to our European partners based on these principles.

The single market has been one of Europe's defining achievements and has delivered jobs, growth and greater choice and prosperity for Europe's citizens and businesses. By removing cross-border barriers to the free movement of goods, services, capital and people, and strengthening competition, the single market had by 2006 created an additional 2.8 million jobs across the European Union and boosted its GDP by €225 billion.[4] Europe is now the largest market in the world and accounts for 20 per cent of world trade. Today over half of British trade is within the EU. Our services sector has significantly increased its EU exports since 1992, and this will continue as the services directive opens European markets further to British businesses.

[4] *European Commission, 'Step towards a deeper economic integration: the internal market of the 21st century', 2007.*

But there is more to be done to ensure the single market continues to deliver benefits in the face of new challenges. More than 20 years after its launch, progress is slowing, and the context in which it operates has changed dramatically. The initial success of the single market was due to gains from economies of scale and increasing competition in markets for manufactured goods, but in recent years we have seen a major structural shift in the EU economy towards the provision of services. This is why it was so important to get a good deal on the services directive.

The single market should not be seen as an end in itself, but rather a means of achieving prosperity and higher levels of welfare for Europe's citizens. We need to focus on measures that promote jobs, growth and prosperity. This, as the Commission's own advisers have recently acknowledged, requires a move away from the old integrationist agenda behind the single market, towards a new conception based on ensuring Europe's ability to compete in global markets:

> "In place of a political objective for the single market, to create an integrated Europe based on a homogenous legal order, the single market needs an economic objective, to stimulate competition and encourage innovation."[5]

[5] *Marcel Canoy, Roger Liddle and Peter Smith, 'The single market: yesterday and tomorrow', Bureau of European Policy Advisers, European Commission, 2007.*

We must move beyond the outdated goal of simply 'completing the single market', because in a modern and ever-changing global environment, the single market will never be 'complete'. If Europe's answer to the new challenges it now faces is simply to legislate to fill in all the remaining gaps in the single market, it will always lag behind. Indeed, for Europe to rise to the economic challenges of today and tomorrow and benefit from the opportunities of globalisation and rapid technological change, it needs to adopt a new, modern and more flexible approach. This is particularly true at EU level, where the speed at which proposals can be amended as circumstances change is usually slower than for national policies.

What we need now is an ongoing process of promoting and maintaining a competitive European economy, which can continually develop and respond to the changing global environment. We need an approach that is as flexible as the global markets in which we now operate. It must create and maintain

conditions that allow Europe's firms and citizens to benefit from the new markets, jobs and lower prices offered by the global marketplace. At the same time, this must be accompanied by the pursuit of modern social policies that combine flexibility with fairness. Europe's founders rightly recognised that markets are social structures that work best when there is an explicit social dimension: an effective single market requires an effective and well-functioning social dimension.

The UK's approach to making the single market work better

In a recent document by the Treasury and the Department of Trade and Industry (DTI), we set out the steps Europe needs to take to ensure a more flexible and outward-looking single market.[6] This requires an approach based upon the three principles we have set out to guide the development, implementation and assessment of policies:

[6] *HM Treasury and Department of Trade and Industry, 'The single market: a vision for the 21st century', January 2007.*

★ first, the EU should act only where there are clear additional benefits from collective EU action, rather than 'more EU' for the sake of it;

★ second, where EU-level action is appropriate, it should be proportionate and flexible. A rigorous assessment of all policy proposals is needed, so the EU can ensure that its action is outcome-focussed, effectively prioritised and takes into account all possible tools. Non-legislative solutions, such as competition policy and market-led codes of practice should be used wherever possible;

★ third, we need to improve the effectiveness of the EU in those areas where it does act.

In line with the first principle, the EU should act only where there are clear additional benefits from collective efforts compared to action solely by national governments. An effective single market depends on both the policies and actions agreed at EU level and the policies and actions of individual member-states. At national level, member-states should return to the ambition expressed by the Lisbon Agenda: a commitment to implement structural reforms and to match these reforms with modern social policies that equip people for change by combining flexibility with fairness. In this context, the Commission plays a useful role in facilitating best practice and providing an external appraisal of member-states' performance through the process of National Reform Programmes. However, this process could be strengthened through greater use of clearer benchmarking and ranking of member-states.

But consistent with the subsidiarity principle, action co-ordinated at an EU-level should be focussed on those areas where there are significant cross-border spillovers, or where there are common barriers that cannot be tackled through unilateral action and co-operation alone. This requires an assessment of the importance of particular sectors to the EU economy, an understanding of the nature of the market and the barriers that exist. It also demands the adoption of EU-level action that is proportionate, effective and focussed on those areas where evidence suggests the potential economic benefits are greatest. For example, full liberalisation of network industries, such as telecoms, post and energy, could add €75-€95 billion to EU GDP and create up to 360,000 jobs.

I welcome the analytical, evidence-based approach of the Commission's recent competition sector inquiries into financial services and energy. These have provided a firm base of evidence to inform the Commission's policy-making. The Commission's single market vision paper should also be welcomed for marking a shift away from a regulatory approach, towards a focus on the functioning of markets and the monitoring and measuring of impacts. Indeed, with much of the legislation required to establish the single market already in place, increasing the use of proactive competition policy, rather than relying on regulation, should become a key feature of single market policy.

However, where there is a genuine need for further EU regulation, not only should its design and enforcement be risk-based, but there should be greater use of more flexible forms of regulation. In keeping with better regulation principles, non-legislative measures such as information, guidance or codes of practice should be used wherever possible in order to guarantee a modern and flexible policy framework. Consideration should be given to how the Lamfalussy arrangements could be applied beyond the financial services sector. Improvements in the quality of impact assessments and consultation, along with consistent post-implementation reviews, will also make for better policy. Furthermore, where the EU takes forward regulatory measures such as the development of new standards, it is important to ensure that those standards promote international competitiveness, and do not erect new barriers to global trade. The goal should be to create a single market which is flexible enough to take advantage of regulatory developments across the globe.

The UK is making these arguments consistently. And once the arguments have been won, effective implementation and enforcement are essential to realising the benefits of the single market. Here the Commission has a key role to defend the rules of the EU treaties, and ensure that member-states are competing with each other on a fair and undistorted basis. The reform of the state aid regime and the crackdown on subsidies are good examples of practical action, and should be supplemented by a thorough review of implementation and enforcement. Real benefits would also accrue from giving greater priority to investigations of breaches of EU law, improved access to courts, and wider use of informal problem solving techniques.

Taxation policy in the single market

The principles of our approach to the single market are mirrored in our approach to tax policy in the EU. The EU has already agreed and implemented the tax measures necessary to create an effective and robust single market. And the UK government is working to improve the tax structures we already have in place, in order to drive down costs to business, improve transparency and the exchange of information, and tackle fraud.

In an increasingly global economy, no country will be able to set its tax policy in isolation from other countries. There is a strong economic and social case for co-operation and exchange of information between member-state governments and tax authorities around the globe. Such co-operation can help to meet the challenges posed for national tax systems by globalisation.

But harmonisation is not the answer to these challenges, and neither is isolationism. Rather, we need action at the national level, combined with a renewed agenda of international co-operation. These are the best ways to help countries achieve the fiscal stability that is essential to maximise competitiveness, deliver sustained growth and address the long-term challenges faced by all the nations of the European Union.

That is why the UK has led, and continues to lead, the international community, in promoting the roll-back of harmful tax practices – primarily through the EU Code of Conduct on business taxation, which the Paymaster General to the Treasury chairs, and the OECD. It is not in any country's long-term interests to develop tax structures that promote or enable harmful tax competition or so-called profit shifting – the practice of registering corporate profits in a member-state with low levels of corporate tax in order to minimise a company's overall tax burden. So within the EU and the OECD, we will continue to promote high international standards of exchange of information and transparency, as well as the roll-back of anti-competitive, discriminatory practices.

In the field of indirect tax, the UK is pressing the EU to look at how we can improve administrative co-operation and the exchange of information, in particular to combat VAT fraud. This requires international co-operation across the EU and beyond. And the UK is leading work in the EU to modernise the VAT 'place of supply rules' for services and e-commerce, to ensure that tax revenues accrue to the country of consumption. The UK is also playing a leading role in the modernisation of the VAT treatment of financial services.

But since good tax policy responds to country-specific circumstances, there is no good reason to expect countries to have the same tax systems. The key therefore is to preserve national flexibility, rather than creating rigid and harmonised structures that are incapable of adapting to the rapidly evolving demands of globalisation.

A social single market

At the start of this chapter I stressed that an effective and well-functioning single market requires an effective and well-functioning social dimension. By pursuing modern social policies that combine flexibility and fairness, Europe's long-standing social values can be advanced alongside economic prosperity. It is right and welcome that Europe examines the mutually reinforcing relationship between flexibility and security. Anti-globalisation protectionist rhetoric only offers an illusion of safety and long-term security. Europe must offer a legitimate, modern alternative – an inclusive globalisation.

In a rapidly changing world, national governments are best placed to react to changing circumstances – in the context of shared European social values. This allows policies to be tailored to specific demographics, traditions, and labour market institutions. But there is a strong case for EU-level action to address issues that are cross-border in nature. For example, the free movement of labour must be supported by EU-wide agreement on mutual recognition of qualifications and appropriate portability of benefits. The UK has advocated action and modernisation in these fields. The free movement of capital has led to action that ensures employees across Europe have access to information and consultation with their employers. I believe this is the kind of European social dimension which the single market needs. It deals with cross-border issues and it requires both employers and trade unions to accept their responsibilities and work together, in the belief that we achieve more through co-operation than by standing apart.

The existing set of European rights and standards have helped build a common framework that reflects core European social values. In general European legislation is a relatively blunt tool for dealing with social policy in a global economy, because it reduces necessary labour market flexibility and choice for individuals. However, greater co-operation at a European level can add significant value: Europe can act as a catalyst for change, identifying opportunities and common challenges, promoting solutions, exchanging best practice and agreeing strategic objectives.

For example, by raising awareness of successful policies elsewhere in the Union, European co-operation helps member-states devise effective strategies to increase labour participation. Increasing labour participation is crucial to meeting the challenges of the future, including demographic change, and to combating social exclusion. In the modern global economy, security is provided by 'social bridges', which ease the transition from one job to another, and by developing potential for workers and for new jobs. Security is not provided by protecting specific jobs or sectors. By equipping individuals to adapt and master change, governments can empower people to move into new fields of employment. This can be done by providing insurance in the broadest sense – skills and retraining, unemployment benefits and a favourable climate for job creation – but also through policies such as childcare, which make it easier to work.

One of the ways the European Union can help countries is by advancing the skills debate. Education and skills policies, designed and implemented by member-states, are central to meeting the new challenges. An open debate at the European level on skills, their role, and how they interact with employment policy, could help

better exploit the synergies and important links between the two areas. Europe must make globalisation and its technological advances work not just some of the people, but for all of the people – an inclusive globalisation that prioritises the education and the skills of citizens.

Flexibility and fairness must advance together. They do not present a trade-off, but are essential to deliver a Europe of full employment and opportunity for all. Without it, Europe will fail its greatest challenge: making its social values a reality for all in the global economy.

4 Energy, climate change and the single market

Nowhere is the case for a hard-headed pro-Europeanism stronger than in the linked issues of global climate change and energy policy. Indeed this is perhaps the most important test of the EU's capacity to reform and act together successfully in the coming years. On the one hand, European companies and citizens are demanding secure, sustainable and affordable energy supplies; on the other hand, the global challenge we face in dealing with climate change has never been starker, the case for action has never been so overwhelming, and the economic and social costs of doing nothing have never been so high.

The UK has been a strong advocate of a robust European response to these challenges. And as City minister, I have seen first-hand how London has become a centre for global carbon trading, and just how much decisions on energy and the environment have begun to play a central part of decision-making and strategy, not just in government but in businesses as well. It is through continued engagement with other partners – domestically, in Europe and internationally – that we will be able to devise the most efficient and innovative ways of tackling the challenges of global warming.

The Stern Review on the economics of climate change was definitive in its conclusion: unless the world takes urgent action to tackle climate change, not only will the environment suffer, but the global economy and the planet's poorest people will face catastrophe too.

The UK has sought to improve both its own performance and shape an international consensus for change. Domestically, we are on course to meet and go beyond our Kyoto target of reducing UK greenhouse gas emissions by 12.5 per cent from 1990 levels by 2008-2012. In 2005, UK emissions of all greenhouse gases were 18.8 per cent below 1990 levels, while emissions of carbon dioxide declined by 11 per cent over this period.[7] The new system of carbon budgets that will be created by the proposed climate change bill (along with other new measures) is expected to reduce our carbon dioxide emissions to 26-32 per cent below their 1990 levels by 2020.

[7] *The figures regarding UK emissions figures are saying that as a whole in 2005 greenhouse gas emissions fell by 18.8 per cent from 1990 levels, and that CO_2 figures specifically fell by 11 per cent from 1990 level – not connected to JI/CDM. DEFRA. See http://www.defra.gov.uk/news/2007/070131b.htm.*

But such challenges cannot be met by a few countries meeting and acting together in isolation from the rest: the only feasible solutions require multilateral action and global leadership. To make a real impact, we need a global Europe in which member-states work more closely together than ever before. Against a backdrop of increasing global energy consumption and dependence on imported energy, as well as rapid growth in global emissions of greenhouse gases, it is crucial that the EU shows leadership. This means pursuing a strategy that increases the security of our energy supplies, and helps combat climate change, while ensuring the competitiveness of European economies. That is why I warmly welcome the fact that in 2007, the EU has established itself as the global leader in these issues, and adopted the integrated approach to climate and energy policy that the UK has long advocated.

The endorsement of this approach by the 27 member-states of the European Union – including the headline commitment to reduce greenhouse gas emissions by at least 20 per cent by 2020 (as a first step to an internationally negotiated reduction of 30 per cent) – marks an affirmatory moment of genuine global leadership. The headline commitment was accompanied by a range of policies to promote the development of Europe's climate and energy policy. These range from greater co-operation with external countries, to measures to promote the development of renewables and carbon

capture and storage. Made possible by the vision and determination of Chancellor Merkel and President Barroso, this demonstrates to the rest of the world the seriousness of Europe's commitments on climate change and energy security. It is also testament to the UK's leadership within Europe: the mandate to develop this joined-up approach was given to the Commission at Hampton Court in October 2005, under the UK's EU Presidency. It was also the UK which first proposed an ambitious EU-wide 30 per cent target in the government's vision paper for the EU Emissions Trading Scheme (ETS) in October 2006.

The Stern Review emphasised that co-ordinated multilateral action now to avoid the catastrophic consequences of global climate change could cost as little as 1 per cent of global GDP, but that the cost of inaction over the long term would be between 5 per cent and 20 per cent of global GDP. However, to secure action at the lowest possible cost, it is imperative that the right policies are put in place. The EU ETS is the centrepiece of the UK's climate change strategy because it ensures that emissions reductions can be made at the least cost. Greenhouse gases have the same effect wherever they are emitted, and so by allowing participants the flexibility to trade allowances, the overall emissions reductions are achieved in the most cost-effective way possible. Making the carbon market deeper, wider and more liquid will increase its effectiveness in delivering greater emission reductions. It will also help establish the EU ETS as the basis of a global carbon trading market.

That is also why the UK has been a keen advocate of measures in the EU energy efficiency action plan that directly tackle the market failures that prevent consumers making the green choice, even when it can be cost-effective for them to do so. We welcome the European Council's endorsement of the Commission's goal of a 20 per cent improvement in energy efficiency by 2020. Alongside new domestic initiatives – including the announcement on March 12th 2007 of an agreement with retailers and manufacturers to phase out high-energy light bulbs by 2011 – we will work with other member-states to ensure rapid and ambitious action. For example, we support energy performance standards for appliances, vehicle emissions, building standards and labelling. We have also called on European finance ministers and the Commission to recommend the introduction of a reduced rate of VAT to be applied to energy-efficient products.

Improving the functioning of Europe's energy markets

Europe also needs to deliver a fully liberalised European gas and electricity market. This is needed in order to ensure a more efficient use of energy, enable Europe to respond more effectively to the challenges of climate change and energy security, and provide consumers with more competitive pricing and greater choice. The energy industry (gas and electricity) accounts for just 2.1 per cent of total value-added in the EU economy, but it is fundamental to overall economic activity and to Europe's efforts to reduce emissions of greenhouse gases. Electricity and heat production accounted for 24 per cent of total greenhouse gas emissions in the EU-15 in 2004. Despite the clear gains that have been achieved as a result of the liberalisation of the energy sector following the first electricity and gas directives in 1996 and 1998, more must be done to achieve open and effective European energy markets. Full market opening could increase cross-border trade in electricity by 31 per cent and reduce prices in the EU-15 by up to 13 per cent, with total savings across the European Union running to tens of billions of euros.[8]

[8] *Copenhagen Economics, 'The potential gains from full market opening across network industries', January 2007.*

However, achieving this requires us to tackle the problems identified in Europe's energy markets by the Commission's sector inquiry into competition in electricity and gas markets. These include a high degree of market concentration, weak transparency, a lack of cross-border market integration and incomplete unbundling. Where appropriate, the Commission should exercise its competition powers to combat such structural obstacles to market integration, and take action against those member-states that fail to meet their obligations

under the terms of the liberalisation package. The UK therefore welcomes the March 2007 European Council's support for further measures on energy market liberalisation. We will continue our efforts to secure strong implemention and meaningful enforcement, from both member-states and the Commission.

But, on the environment, as I have demonstrated in financial services, the hard work does not stop once the headline targets have been agreed and the framework policies have been put in place. The EU ETS has been in place for two years, but we still need to work together with the other member-states to improve the scheme and make it a model for the world to follow. The March 2007 European Council was a truly momentous occasion, but the next step will now be to focus on putting the right policies in place to deliver the greenhouse gas reductions, and to deliver the investment in new technologies and the improvements in energy efficiency that have been promised. This must be done in the most cost-effective way, with policy proposals subject to cost-benefit analysis and competitiveness testing, as they would be in any other area. The only way that we will be able to influence these policy decisions and be sure that they work for our consumers and our businesses – as well as for Europe as a whole – will be by taking a proactive, hard-headed approach to the negotiations, on every dossier and at every meeting.

In particular, we must strike the right balance between EU-level policies which set an overall framework – with ambitious greenhouse gas targets and action to develop a common carbon price – and flexibility at national level. Member-states must be free to develop their own solutions and employ a range of instruments such as tax, trading and regulation. It will only be through a mixture of domestic, European and international action, under a clear overall policy framework, that we will meet our environmental and energy objectives. And given the clear advantages of Europe acting together to tackle climate change, it is simply not credible both to champion environmental issues, and at the same time be anti-European.

5 Reforming the EU budget

This essay has set out the benefits of an active UK voice within the EU. Not only for the creation of an effective single market in which competitive European companies can thrive, but also to enable the EU to deliver successful outcomes on challenges such as climate change and globalisation. But the EU will be unable to deliver successful outcomes on these challenges without a modern budget that is fit for purpose – and that demands reform.

EU financial management

As an immediate priority, we need to consider what steps are needed to improve the confidence of the taxpayer in EU financial management. Last year, for the twelth successive year, the European Court of Auditors was unable to give a positive statement of assurance on the EU budget. The Court could not confirm that around two-thirds of EU spending was spent in line with the regulations. This is very disappointing. The European Union – both member-states and the Commission – must do better to end this annual embarrassment.

In 2005, under the UK Presidency, we secured agreement for our proposals on how the EU's internal financial control framework could be strengthened. The Commission is now implementing these through its Action Plan towards an Integrated Control Framework, centred on four core themes:

★ establishing simplified, common control principles;

★ greater use of management declarations and audit assurances;

★ introducing a single audit approach;

★ identifying areas of greatest risk and targeting these sector-specific gaps.

The principles of internal control and simplification at the heart of the UK's proposals have been adopted in the new financial regulation, which from 2007 onwards will govern how the budget should be set and implemented.

But if the EU budget is to inspire taxpayer confidence, there is more to be done. We need the highest levels of scrutiny and the most rigorous lines of accountability. Achieving a 'positive statement of assurance' on EU spending will require action by all those involved in the process of EU expenditure. This includes the Commission, the Council of Ministers, each member-state working with its national audit institution, and the European Court of Auditors itself.

Member-states share with the Commission responsibility for around 80 per cent of EU spending: notably agriculture and the structural funds. Getting a positive statement of assurance on the EU budget thus depends in large measure on member-states accepting that they have a shared responsibility for improving the way these funds are controlled and spent.

We know that we have to reform our own systems. This is why I announced to parliament last November that the UK will take a lead in demonstrating how member-states can improve their own management of EU funds by enhancing national level audit and parliamentary scrutiny of EU expenditure in the UK.

By giving national parliaments greater opportunity to scrutinise how EU funds are managed, I believe we can help give taxpayers the reassurance they rightly expect. In taking a lead on this issue the UK can help improve the quality and accuracy of the EU accounts. All

member-states must accept their responsibilities to work together to achieve a clean bill of health for the EU's accounts.

Expenditure reform

Budgetary credibility does not depend only on probity and proper financial management. In the end, it depends on what taxpayers see their money being spent on. Take the 2007 EU budget: 40 per cent of the total expenditure is still allocated to the CAP; while more than 60 per cent of structural and cohesion fund expenditure is still transferred to rich member-states.

This is hardly a budget designed to meet the challenges of the 21st century. The principle of sound financial management must and will be to the fore in our approach to the fundamental review of the EU budget. But building on a base of financial probity we must also ask ourselves: what is the role of the EU in any given policy area? Does it require spending?

The following principles are guiding the UK approach to the budget review:

First, the EU should act only where there are clear additional benefits from collective efforts, compared with action solely by individual member-states – rather than 'more EU' for the sake of it.

There is a strong case for budgetary assistance to less well off member-states, to help them make the infrastructure and institutional investments needed to support their economic growth. This, in turn, will help to develop the wider European economy. A case can also be made for expenditure in areas as diverse as international development, migration, and measures to combat climate change, such as support for the development of clean energy technologies. In all these areas significant benefits would accrue to all EU citizens. The same case cannot be made for the current level and form of spending on the CAP. Radical reform to modernise the EU budget and meet the demands of all European citizens – rather than just defending the old way of doing things – is exactly what pro-Europeanism is all about.

Secondly, where EU-level action is appropriate, it should be proportionate and flexible. Just as we acknowledge there is a clear case for European spending on some objectives, so we must recognise the very real limits to European budgetary intervention. Indeed, expenditure is only one of a range of policy levers, alongside co-ordination through peer review and shared best practice, such as in aspects of social policy; competition policy and liberalisation, such as in the single market; and legislation or regulation, such as the setting of environmental emission levels. Where expenditure is appropriate, Europe must be prepared to consider a wide range of financial sources. The European Investment Bank, for example, is pioneering the use of loan support to support the development of climate change financial instruments, such as the climate change finance facility.

Thirdly, and as I have already outlined above, we need the highest standards of financial control and independent audit – alongside continuing budget discipline.

These three principles – a clear understanding of how we advance our national interest and the European interest; proportionality; and sound financial management – can help guide us towards a modern EU budget. I believe that this vision is increasingly widely shared – and over the coming months and years, the UK government will work in partnership with President Barroso, his Commission and other member-states to achieve this.

Applying these principles properly is essential if we are to achieve our shared objective of a modern, outward-looking EU, which enables member-states to respond to the challenges of globalisation and delivers opportunity, fairness and prosperity for all our citizens.

6 Conclusion

In conclusion, I believe our approach should be to engage to advance the British and European public interest where we can – while standing firm where our national interests would be damaged. That is what I mean by a hard-headed pro-Europeanism.

On financial services, on competition policy, on environment, the CAP and the EU budget – our challenge is the same. We need to create an outward-facing, flexible Europe that can meet the fundamental challenges of a global economy, and deliver opportunity, fairness and prosperity for its citizens. We need an EU budget, which recognises and equips Europe to meet the challenges of the 21st century. The fundamental review of the EU budget will be key to achieving this.

And in the debate on the European constitution, it is essential that we also take a hard-headed approach. We must not return to the old ideological assumption that being pro-European means moving inevitably towards European political integration, regardless of the opposition of national populations across Europe. Rather, the test for European co-operation is whether the national interests of member-states are advanced together.

But we are confident also that we are stronger by co-operating with our partners within the European Union to address the global challenges we will face in the decades ahead. So the challenge for this generation of European leaders is to shift the terms of the debate onto the practical and tangible outcomes that Europe's citizens demand. Public support for the idea of Europe has ebbed, with slow economic growth, high unemployment, budget problems and the rejection of the 2004 constitutional treaty making Europe seem stagnant, remote and out of touch. It is clear that a European state is not the answer. We do not need a constitutional treaty that fundamentally changes the relationship between member-states and the European Union.

The challenge for Europe in the 21st century is whether we can co-operate successfully and rise to the task of delivering opportunity, fairness and prosperity to all our citizens. And so in the discussion on institutional reforms in the weeks ahead we should always start with this test – will reform help us make sensible decisions that address these fundamental challenges?

Here in Britain we can only make progress if we break out of the old caricatured debate about Europe. We know that the only way to get the best deal for Britain is by working together with our partners in the European Union, and by not being afraid to stand up for Britain's interests. But we can only do so if we re-frame the British debate – and are more confident in setting out when co-operation is both good for Britain and good for Europe. Defending our wider national interest means being at the table and winning the arguments. We will not succeed by withdrawing to the extreme and anti-European fringe.

As I have set out, over past decades we were too often presented with only two schools of thought. On the one hand, an anti-Europeanism that believed the definition of Britishness lay in rejecting anything from the EU. On the other, a pro-European view borne of the belief that Europe was the sole solution to the problems of decline, policy paralysis and apparent un-governability. Sensible people of our generation reject this false choice. Instead, in 2007 the sensible mainstream view is pro-British and pro-European.

So we should reject ideological approaches to Europe, in favour of a pragmatic and hard-headed approach that reflects the reality of Britain, Europe and the world in the 21st century: a successful

Britain strengthened by its membership of the EU, and an outward-looking globally-focussed EU strengthened by the UK's active engagement.

★

CENTRE FOR EUROPEAN REFORM *publications*

- ★ **Why treaty change matters for business and for Britain**
  Policy brief by Hugo Brady and Charles Grant (May 2007)
- ★ **What future for EU development policy?**
  Working paper by Aurore Wanlin (May 2007)
- ★ **The EU should not ignore the Shanghai Co-operation Organisation**
  Policy brief by Oksana Antonenko (May 2007)
- ★ **The EU and the fight against organised crime**
  Working paper by Hugo Brady (April 2007)
- ★ **The Lisbon scorecard VII: Will globalisation leave Europe stranded?**
  Pamphlet by Katinka Barysch, Simon Tilford and Aurore Wanlin (February 2007)
- ★ **Divided world: The struggle for primacy in 2020**
  Essay by Mark Leonard (January 2007)
- ★ **Turkish business and EU accession**
  Essay by Sinan Ülgen (December 2006)
- ★ **The EU and Russia: From principle to pragmatism**
  Policy brief by Katinka Barysch (November 2006)
- ★ **Europe's blurred boundaries: Rethinking enlargement and neighbourhood policy**
  Pamphlet by Charles Grant (October 2006)
- ★ **Will the eurozone crack?**
  Pamphlet by Simon Tilford (September 2006)
- ★ **The EU must keep its promise to the Western Balkans**
  Essay by Tim Judah (July 2006)
- ★ **Cyprus, Turkey and the EU: Time for a sense of proportion and compromise**
  Policy brief by David Hannay (July 2006)
- ★ **How to strengthen EU foreign policy**
  Policy brief by Charles Grant and Mark Leonard (July 2006)
- ★ **The future of European universities: Renaissance or decay?**
  Pamphlet by Richard Lambert and Nick Butler (June 2006)
- ★ **Let justice be done: Punishing crime in the EU**
  Policy brief by Hugo Brady and Mónica Roma (April 2006)

Available from the Centre for European Reform (CER), 14 Great College Street, London, SW1P 3RX
Telephone +44 20 7233 1199, Facsimile +44 20 7233 1117, kate@cer.org.uk, www.cer.org.uk

CENTRE FOR EUROPEAN REFORM
NEW IDEAS FOR A NEW EUROPE

Britain and Europe

A City minister's perspective

Ed Balls MP

Britain's membership of the EU strengthens London as a global financial centre, argues City minister, Ed Balls. The UK should engage actively with the EU, to ensure that its financial regulation is proportionate, flexible, and implemented effectively. Similar principles should apply to European action in other areas, such as the single market, climate change and the EU budget. Ed Balls argues for a 'hard-headed pro-Europeanism'. This means recognising that Britain is stronger by co-operating with partners in the EU to meet shared challenges, but having the confidence to stand firm where UK national interests would be damaged, and argue the case where Europe risks taking the wrong course.

Ed Balls, the MP for Normanton, is Economic Secretary to the Treasury. His ministerial responsibilities include the financial services sector.

ISBN 978 1 901229 74 5 ★ £8