

# Macroeconomic imbalances: Council conclusions on the 2018 alert mechanism report

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## Council recommendation on the economic policy of the euro area

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 136 in conjunction with Article 121(2) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1], and in particular Article 5(2)

thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances [2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) The economic expansion in the euro area continues and has become increasingly broad-based across countries. The recovery is increasingly driven by domestic demand, with private consumption as the key driver of growth and investment picking up. Employment continued to increase throughout 2016 and the first half of 2017. The unemployment rate has seen a significant reduction, though it is still higher than in 2008. The recovery in the euro area is nonetheless characterised by subdued core inflation and wage growth a large current account surplus and persistently low though improving investment ratios. In particular, subdued wage growth appears to be due to remaining labour market slack in some economies, low inflation expectations feeding in wage negotiations and low productivity growth. Real household income has increased but remains below 2008 levels in many countries. Divergences across euro area countries in terms of GDP per capita and unemployment rates persist. The rates of long-term unemployment and youth unemployment are still high while poverty, social exclusion and inequality remain a serious concern in several Member States.

(2) Overall, on the basis of the reading of the economic indicators for the euro area, there appears to be a case for further supporting demand, investment and wage growth without incurring the risk of triggering inflationary pressures, while fostering internal and external rebalancing and economic and social convergence and increasing potential growth. At the same time, signs of newly emerging imbalances, e.g. in the housing market in some Member States, need to be closely monitored [3].

(3) Significant imbalances persist in the euro area. While much progress has been achieved among net debtor countries in correcting their external imbalances, large current account surpluses remain in some creditor countries, reflecting an overall shortfall in aggregate demand. These generate a surplus for the euro area of 3.3% of GDP in 2016, projected to decline to 2.9% of GDP in 2019. The net international investment positions of the most indebted Member States have been improving at a slow pace and sustained rebalancing efforts are still needed. Countries that had large current account deficits for a long time still have large negative net international investment positions that are generally coupled with large stocks of private or government debt and constitute a vulnerability. At the

same time, efforts are also needed in large current account surplus countries to support domestic demand and potential growth and thereby the rebalancing of the euro area.

(4) Wage growth and job creation contribute to the economic recovery in the euro area by supporting aggregate demand, reduce inequalities and help to ensure high standards of living in the area. Efficient wage setting mechanisms should ensure that wages are differentiated depending on country, sector specific conditions and taking due account of changes in productivity. Implementing structural reforms that increase productivity and improving the quality and composition of public expenditure with a view to supporting investments in all countries, promoting wage growth respecting the role of social partners, and stronger demand dynamics in net creditor countries and implementing measures that contain growth in unit labour costs and aim to improve their competitiveness in net debtor countries would help accelerate the rebalancing process in the euro area.

(5) Consistency and balance in the overall macroeconomic policy mix of the euro area, including monetary, fiscal and structural policies, is crucial to ensure robust and sustainable economic growth. In recent years, monetary policy which resorted to new unconventional tools to achieve the ECB's medium-term inflation objective, thereby also supporting growth and job creation. The monetary policy stance and economic developments call for a focus on fiscal and structural policies. To support the growth potential of our economies, appropriate fiscal policies and focus on structural reforms are needed.

(6) A strong coordination of national fiscal policies, based on common rules, is essential to arrive at an appropriate aggregate fiscal stance for the euro area and for the proper functioning of the monetary union. The common fiscal rules are geared towards pursuing debt sustainability at the national level, while providing room for macroeconomic stabilisation. The fiscal stances for the Member States and at aggregate level for the euro area have hence to balance the objectives of ensuring the long-term sustainability of national public finances and the short-term macroeconomic stabilisation at country and euro area level. In the light of the current, broad-based economic growth in the euro area, albeit with the persistence of crisis legacies in some areas, a broadly neutral fiscal stance at aggregate level for the euro area in 2018 appears still appropriate. An appropriate differentiation of fiscal efforts across euro area Member States, taking into account fiscal space and spillovers across countries, is required. At the same time, the improving economic conditions call for the need to rebuild fiscal buffers, while continuing to strengthen the growth potential of our economies.

(7) A decisive improvement in the composition and management of national budgets, on both the revenue and expenditure sides, including by shifting resources towards tangible and intangible investment, would increase the growth impact of public budgets and raise productivity in the longer term. Improvements in the functioning of national fiscal frameworks and well-managed spending reviews support the pursuit of credible and growth-friendly fiscal policies.

(8) A well-designed structure of taxation is key to promote growth and employment, as well as to contribute to reduce inequalities. Simplifying and modernizing tax systems and addressing tax fraud, evasion and avoidance are essential to make tax systems more efficient and fairer. This can free resources for public investment and, *inter alia*, education and healthcare and contributes to supporting overall investment, quality employment and economic and social convergence. In particular, measures against Aggressive Tax Planning (ATP) are essential to secure government revenues, impede distortions of competition between firms, preserve social cohesion and fight increasing inequalities. The Common Consolidated Corporate Tax Base (CCCTB) would contribute to the fight against tax avoidance, while improving the Single Market for businesses.

(9) Structural and institutional features of labour and product markets and well-functioning public administrations are important determinants of economic resilience as well as cyclical, real and social convergence across euro area Member States. Resilient economic structures prevent shocks from having significant and long-lasting effects on income and employment within Member States and across the euro area. In this way, they reduce economic fluctuations and provide a favourable environment for sustainable and inclusive growth. Better coordination of the implementation of structural reforms, in particular those prescribed in the country-specific recommendations, can create positive spillovers in the Member States and strengthen their positive effects.

(10) Well-functioning labour markets and social protection systems are important foundations for inclusive economic growth, for reduced inequality and for the resilience of national economies and the euro area as a whole. With the aim to achieve upward convergence in this domain, the *European Pillar of Social Rights* which was proclaimed by the European Parliament, Council, and the Commission on 17 November 2017 sets out 20 key principles, falling into three broad chapters: (i) equal opportunities and access to the labour market; (ii) fair working conditions; and (iii) social protection and inclusion.

(11) Despite progress with reforms to improve the adjustment capacity of labour markets, significant differences persist across the euro area, which continue to challenge its smooth functioning. Well-designed labour market policies that are fully integrated with social protection systems can support labour market transitions and reintegration, reduce labour market segmentation, provide effective automatic stabilisation and promote equal opportunities for all and economic and social convergence. Well-designed working-time arrangements can help mitigate shocks. Effective and timely activation of jobless people who can participate in the labour market can be achieved by providing individualised support for job search, training and re-qualification, while protecting those unable to participate. Emerging new forms of employment and new types of contracts bring along challenges related to job security and social protection. Against this background, employment protection legislation needs to provide for fair and decent working conditions for all workers.

(12) Effective social protection systems are crucial to promote inclusive

labour markets, ensure adequate income support and appropriate social support through access to quality services. Pension reforms and work-life balance policies are also key to foster labour market participation. Unnecessary restrictions to job, sectoral and geographical mobility of workers in employment and social protection systems should be lifted.

(13) Access to high quality education and training is vital to ensure equal opportunities and address skills mismatches. Adequate investments in human capital through education and training systems that improve lifelong learning and ensure that skills levels match present and future labour market needs play a key role in improving the economy's adjustment capacity and real convergence in the longer run. Investment in skills can also drive innovation and increase productivity and competitiveness, in addition to ensuring social inclusion and mobility.

(14) Product market reforms that increase competition and reforms that improve the business environment and the quality of institutions (including an effective justice system that facilitates contract enforcements) foster economic resilience in Member States and the euro area as a whole. Further integration in the Single Market has proven to be the major engine of growth and convergence between Member States. The Single Market still holds considerable unexploited potential and significant progress is needed to complete it. Timely implementation and better enforcement of existing legislation are also key to reaping the benefits of the Single Market. The Single Market for services (including financial, digital, energy and transport) is the pending challenge. Attention should nonetheless also be focused on the goods markets to avoid potential market segmentation. The Digital Single Market should contribute to completing the legal environment to speed up the digitalisation of economic activities as a necessary step to improving the performance of product markets and global competitiveness. Completing and implementing the various Single Market strategies by 2018 therefore remains the shared objective.

(15) While the overall robustness of the euro area banking sector has increased since the crisis and bank lending started to rise again, vulnerabilities remain and need to be addressed. Banks are confronted with low profitability. The need to adapt banks' business models, the low interest rate environment and increasing competition from other forms of finance continue to exert pressure on banks' profitability. Further efforts are therefore needed to ensure their long term sustainability. NPL ratios have stabilised in nearly all more affected euro area Member States or are on a declining trend, but progress remains slow and uneven across banks. High NPL ratios hinder banks' ability to lend, transmission of monetary policy and economic adjustment capacity. They are also a source of vulnerability for the banking system as a whole and need to be addressed at both EU and national levels, as set out in Action Plan that was agreed by the Council in July 2017. As announced in its Communication on Banking Union of 11 October 2017, the Commission is currently working to deliver a comprehensive package of measures to reduce the current stock of NPLs as well as to reduce the risk of future build-up of NPLs.

(16) Strengthening the institutional architecture of EMU requires, as a

matter of priority, completing the Banking Union and further progressing on the Capital Markets Union. The establishment of the Banking Union has made significant advances, but it remains unfinished. In line with the roadmap of June 2016, as set out in the Council Conclusions of 16 June 2016, work is set to continue to complete the Banking Union with regard to risk reduction and risk sharing, including a European Deposit Insurance Scheme and making the common backstop for the Single Resolution Fund operational at the latest by the end of the Fund's transitional period as defined in Regulation (EU) No 806/2014 of the European Parliament and of the Council. The Commission's recent Communication on completing the Banking Union attempts to set out a path on how an agreement on completing the Banking Union can be achieved. The lack of a common deposit insurance scheme and of a common backstop for the Single Resolution Fund hamper the ability of the Banking Union to sever the link from banks to sovereigns. Efforts to further reduce risk and improve risk management in banks must continue. In this context, swift work towards agreement on the regulatory package proposed by the Commission in November 2016 is crucial, as well as further advances in reducing non-performing loans and working towards progress in risk sharing in line with the Ecofin roadmap from June 2016.

(17) The Commission's White Paper on the future of Europe outlined possible scenarios for the future of the Union. The Commission further contributed with a series of reflection papers, among which the Reflection Paper on the Deepening of EMU, building on the Five Presidents' Report, which proposed an overall vision and sequencing of steps for the completion of the EMU architecture. The Commission made additional proposals in autumn 2017.

(18) The Employment Committee and the Social Protection Committee have been consulted on the employment and social aspects of this recommendation.

HEREBY RECOMMENDS that euro area Member States take action, individually and collectively, within the Eurogroup in the period 2018–2019 to:

1. Pursue policies that support sustainable and inclusive growth and improve resilience, rebalancing and convergence. Make significant progress towards completing the Single Market, particularly in services, including financial, digital, energy and transport, and by implementing relevant product market reforms at national level. Given the positive cyclical conditions, all Member States should prioritise reforms that increase productivity and growth potential, improve the institutional and business environment, remove bottlenecks to investment and foster innovation, support the creation of quality jobs and reduce inequality. Member States with current account deficits or high external debt should additionally aim at containing growth in unit labour costs and seek to improve their competitiveness. Member States with large current account surpluses should additionally create the conditions to promote wage growth respecting the role of social partners and implement as a priority measures that foster investment, support domestic demand and growth potential, thereby also facilitating rebalancing.
2. Deliver the planned, broadly neutral overall fiscal stance for the Euro Area, contributing to a balanced policy mix. Strike an appropriate balance between ensuring the sustainability of public finances, in

particular where debt ratios are high, and supporting the economy, in full respect of the Stability and Growth Pact and taking into account fiscal space and spillovers across Member States. Use the improving economic conditions to rebuild fiscal buffers, while continuing to strengthen economic growth potential. Ensure the effective functioning of national fiscal frameworks. Member States should pursue policies which support investment and improve the quality and composition of public finances, also by making use of spending reviews and adopting growth-friendly and fair tax structures. Member States should take and implement measures to reduce debt bias in taxation and fight aggressive tax planning to ensure a level playing field, provide fair treatment of taxpayers and safeguard public finances and stability within the euro area. This includes continuing work on the Common Consolidated Corporate Tax Base (CCCTB).

3. Implement reforms that promote quality job creation, equal opportunities and access to labour market, fair working conditions, and support social protection and inclusion. Reforms should aim at: (i) reliable labour contracts, which provide flexibility and security for employees and employers, combined with adequate support during transitions and avoiding labour market segmentation; (ii) quality, efficient and inclusive life-long education and training systems, which aim at matching skills with labour market needs; (iii) effective active labour market policies that foster labour market participation; (iv) sustainable and adequate social protection systems that contribute throughout the life cycle to social inclusion and labour market integration and are responsive to new types of employment and employment relationships; (v) smooth labour mobility across jobs, sectors and locations; (vi) effective social dialogue and wage bargaining at the appropriate level according to national specificities; (vii) shifting taxes away from labour, particularly for low-income and second earners.
4. In line with the Council (ECOFIN) roadmap of June 2016, continue work to complete the Banking Union with regard to risk reduction and risk sharing, including a European Deposit Insurance Scheme, making the common backstop for the Single Resolution Fund operational as agreed. Further strengthen the European regulatory and supervisory framework to prevent the accumulation of risks. Take measures to tangibly accelerate reduction of the levels of non-performing loans on the basis of the agreed Council (ECOFIN) Action Plan and promote orderly deleveraging in Member States with large stocks of private debt. Further develop the Capital Markets Union to support growth in the real economy while safeguarding financial market stability.
5. Make swift progress on completing the economic and monetary union, taking into account the Commission initiatives launched in autumn 2017, in full respect of the Union's internal market and in an open and transparent manner towards non-euro area Member States.

[1] OJ L 209, 2.8.1997, p. 1.

[2] OJ L 306, 23.11.2011, p. 25.

[3] See Alert Mechanism Report 2018.

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## **Council conclusions on macroeconomic and fiscal guidance to the member states (annual growth survey)**

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## **Press release: Crackdown on illegal waste and fishing activities**

During 2017 the Environment Agency successfully prosecuted 108 individuals and companies for flouting waste and fishing laws in the North East resulting in almost £170,000 in fines and costs.

There were 16 prosecutions of individuals or companies for waste offences, amounting to total fines of £62,763 and costs of £40,493.

There were also two custodial sentences, three suspended sentences, two community orders and two rehabilitation orders. The courts also awarded a total of £14,735 in compensation to those affected by the crimes, which included a landowner left with costs of £100,000 to remove 585 tonnes of waste dumped on their land.

In addition, the Environment Agency revoked two environmental permits from waste companies who continually failed to meet their permit conditions.



Courts imposed a further £19,162 in fines and costs on an individual and company for twice polluting a protected water course.

In fisheries enforcement, there were three serious offences resulting in £1115 in fines, costs and victim surcharge, plus two 12 month conditional discharges.

There were a further 87 offenders prosecuted for 119 rod licence offences, including 77 offences for fishing without a licence. This resulted in total fines, costs and victim surcharge of £29,461, with three offenders also given conditional discharges.

Enforcement activity has taken place right across the North East in Teesside, Tyne and Wear, County Durham and Northumberland.

The Environment Agency's enforcement teams work alongside other specialist teams to support businesses in abiding by their permit conditions, but take tough action against those who deliberately flout regulations.

Fisheries enforcement officers carry out regular patrols and act on information and intelligence to target illegal activity on our rivers.

Jamie Fletcher, Environment Manager at the Environment Agency in the North East, said:

We take illegal waste and fishing activity very seriously. We have had some excellent results in court over the last year and will continue to work hard in the coming year to ensure enforcement action is taken against those who flout the law.

Waste crime can cause serious pollution to the environment, puts communities at risk and undermines legitimate businesses, impacting on investment and economic growth.

Similarly those fishing illegally are cheating other anglers and putting the future of the sport and quality of our rivers in jeopardy.

We have specialist teams that work hard to target those suspected of being involved in illegal activity and to ensure any necessary action is taken against them.

We work closely with a wide range of partners including local authorities, police and the fire service, and I'd like to thank them for their continued support.

To report information about illegal activity contact Crimestoppers on 0800 555 111. To report a crime ongoing dial 999.

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## Speech: Dynamic security threats and the British Army: Chief of the General Staff General Sir Nicholas Carter KCB CBE DSO ADC Gen

Malcolm, thank you for those kind words of introduction and good evening everybody, it's good to be with you and it's particularly good to see so many friendly faces in the audience.

In Parliament last week the Defence Secretary explained that the analysis of threats in the 2015 Strategic Defence and Security Review remained sound, but he did observe that these threats have diversified and become more serious, and at a faster pace than we expected.

Hence the Government initiated the National Security Capability Review last July – which for Defence, remains ongoing, and contrary to speculation, no decisions have yet been made.

I am very grateful, therefore, to be given the chance this evening to elaborate on the threats and what I believe we should be doing about it, and hopefully to create some debate. And a particular thanks to RUSI for hosting us this evening.

Now in terms of threats, I shall start with international terrorism. It seems to me that significant progress has been made against Daesh in Iraq and Syria, and the prospects of a Caliphate on the ground have been defeated. The threat from international terrorism though has diversified and is more dispersed, and we see the phenomenon that Daesh represents emerging in other parts of the world. And of course we've learned, sadly, over the last few years, that anyone can become a terrorist these days simply by renting a vehicle or wielding a machete.

Terrorism is clearly a very significant threat to our country. In the short term it is vital that we protect our population, while recognising that the long-term solution is to fix the causes of it – which are invariably a lack of education, a lack of opportunity and a growing feeling of exclusion and isolation often, I suspect, coupled with a lack of opportunity and therefore a sense of impotence. This is a worry in many European countries, but in the Middle East and North Africa, when local politics, regional dynamics and the geopolitical situation are overlaid, it becomes a wicked problem.

Resulting, I suspect, in a complicated tapestry of factors with extremist groups exploiting the chaos to seize territory and carve out an even larger foothold for themselves whence to launch attacks, including recruiting and inspiring our own citizens to acts of terror.

The next threat I would touch on, I think, are the longer-term implications of population movement and how that might affect the stability and the cohesion of our society.

Looking specifically at Africa; according to the United Nations, Africa is expected to account for more than half the world's population growth between 2015 and 2050. Nearly all of this growth will be among the 49 countries of sub-Saharan Africa – some 2 billion people by 2045. By then more than half of Africans will be living in cities – and this group will be mostly young people connected through mobile devices. Without economic growth matching population growth it is inevitable that we will see more movement.

But, I think it is the rising threat from states and the consequences that stem from this for the military that is of most immediate concern. And particularly to me as the head of the Army.

We now live in a much more competitive, multi-polar world and the complex nature of the global system has created the conditions in which states are able to compete in new ways short of what we would have defined as 'war' in the past. It is what US Defense Secretary Mattis described last week as 'great power competition.' I quote:

"We will continue to prosecute the campaign against terrorists that we're engaged in today, but great-power competition – not terrorism – is now the primary focus of US national security"

And I think, viewed from this perspective: with increasing competition in the South China Sea; the potential grave consequences of North Korea's nuclear programme; the arms race and proxy wars that you see playing out in Yemen and Syria, that perhaps stem from Iran's regional aspirations. With Russia the most complex and capable security challenge we have faced since the Cold War superimposed on much of this, it would be difficult I think, on that basis, not to agree with Jim Mattis's assessment.

Worrying though, all of these states have become masters at exploiting the seams between peace and war. What constitutes a weapon in this grey area no longer has to go 'bang'. Energy, cash – as bribes – corrupt business practices, cyber-attacks, assassination, fake news, propaganda and indeed military intimidation are all examples of the weapons used to gain advantage in this era of 'constant competition,' And the rules-based international architecture that has assured our stability and prosperity since 1945 is, I suggest therefore, threatened.

Now this is not a crisis, or series of crises, which we face. Rather it is a strategic challenge. And I think it requires a strategic response.

The deduction we should draw from this is that there is no longer two clear and distinct states of 'peace' and 'war'; we now have several forms. Indeed the character of war and peace is different for each of the contexts in which these 'weapon systems' are applied. And the risk we run in not defining this clearly, and acting accordingly, is that rather like a chronic contagious disease, it will creep up on us, and our ability to act will be markedly constrained; and we'll be the losers of this competition.

The arch exponent of this is Russia, as described by the Prime Minister in her Mansion House speech last autumn. I said earlier I believe it represents the most complex and capable state-based threat to our country since the end of the Cold War. And my fellow Chiefs of Staff from the United States, France and Germany shared this view at last year's RUSI Land Warfare Conference.

In the military we analyse threats on the basis of capability and intent. So let us just examine Russian capability at the moment and how they are applying it. Of course we must not interpret what we see as a revival of Russian Cold War practice, nor look at the Crimean operation alone.

They have no single model for conflict with NATO, they use a multi-model approach utilising conventional, unconventional and nuclear domains. A hybrid version that might involve little green men, big green tanks and huge green missiles. Their thinking is very flexible. Their General Staff is able to change, evolve, and learn lessons with agility. For example: they know that demography is not on their side, so they are developing capability that needs fewer men – for example missiles, drones and two man tanks.

They have developed coherent concepts for equipment and training that are focused on our vulnerabilities, for example: our dependency on communications and IT; our lack of massed fires; and, perhaps, our lack of investment in air defence. They apply a ruthless focus on defeating their opponents – not seizing ground for the sake of it – but making sure that our vital ground is denied to us. I shall return to missile capability in a moment.

Since 2016 we have seen a marked shift to cyber, to subversion and to coercion as well as sophisticated use of smear campaigns and fake news. Whether you believe in interference in the US democratic process, or the attempted coup in Montenegro, they are very easily examples of this.

Chris Donnelly at the Institute for Statecraft suggests that they are creating new strategic conditions. Their current influence and disinformation campaign is a form of 'system' warfare that seeks to de-legitimise the political and social system on which our military strength is based. And this undermines our centre of gravity which they rightly assess as our political cohesion; and Russian overtures to Turkey are a clear indication of this.

Now this 'system warfare' has to be defeated. One has to recognise the importance of messaging one's intent; and the importance of deterrence. Their doctrine for war utilises all of the instruments of national power – not just the military. They believe that any shooting war must be finished quickly if it is to be successful. Their instinct will be to escalate and to speed up the tempo of operations.

To avoid being surprised, they believe in pre-emption without long mobilization, and they will do something that their opponent least expects. They have used Syria to develop an expeditionary capability, to give very large numbers of their officers the high-end war-fighting experience they had not been able to get in Ukraine; and to combat-test their long range strike missiles and over 150 different new weapons and items of equipment.

Their conventional military posture gives them a calculable military advantage. They operate on interior lines with a very capable rail and transportation network. We saw that during last year's ZAPAD exercise and how effective it is. They believe in connecting their strategic zones – the West, the Arctic, the Black Sea and the Far East – and rapidly switching forces between them.

In the last five years the number of air, maritime and land based platforms for long range missiles has increased by a factor of twelve. That's in the last five years. And Gerasimov spoke last November about how they had increased the number of missiles with a range of up to 4,000 km by a factor of thirty.

This gives them the capability to create mobile 'missile domes' – shields in which they can assure their freedom to manoeuvre and deny us the ability to act. This is what we call Anti Access Area Denial and we have seen this in Syria with their capacity to seal airspace over significant distances. They use electronic warfare at scale to cue precise targeting by large numbers of drones that enable very accurate and instantaneous fires – including thermobaric warheads – to destroy an opponent's forces; and we have seen this in Ukraine. During last year's ZAPAD exercises they used the opportunity to suppress and, more worryingly, to distort, the GPS signal across much of Scandinavia.

Now, a vivid indication of the scale of their modernization is clear from the three minute video clip I am now going to show you. This was run on Russian TV a couple of years ago. You don't need to understand the Russian, just simply listen to the tone of the commentary. But the key point is that what you will see is all new stuff, and the 2017 State Armaments Plan shows that even more has followed since this.

Now of course we have to accept that this is information warfare at its best, but I think you would agree it's an eye-watering quantity of capability. Now, the other part of the threat is how one assesses intent. Now I am not in any way going to suggest that Russia wants to go to war in the traditional definition of the term, but there are factors that bear on the question of intent and one needs to understand Russian psyche, their culture and their philosophy of pre-emption.

Russia, I think, could initiate hostilities sooner than we expect, and a lot earlier than we would in similar circumstances. Most likely they will use nefarious sub-NATO Article 5 Treaty actions to erode the capability of NATO and threaten the very structure that provides our own defence and security. This is the divide and rule which the international order is designed to prevent.

I don't think it will start with little green men. It will start with something we don't expect. We should not take what we've seen so far as a template for the future. And there will be some who might ask if Russia sees itself in decline, and more able now to go to war than in the future, does this encourage them to think of war?

Perhaps compare the situation today to 1912 when the Russian Imperial Cabinet assessed that it would be better to fight now, because by 1925 Russia would be too weak in comparison to a modernised Germany; and Japan, of course, drew similar conclusions in 1941. And Russia worries, I think, that the West will achieve a technological offset in the next decade.

I suspect, though, the greatest risk is the risk of miscalculation. The recent false alert in Hawaii that warned of an incoming missile is an indication of how easy it would be to miscalculate; particularly when the level of militarization is significant. And we saw this only too vividly with the downing of Flight MH17 over Ukraine in 2014.

Speaking recently, William Perry, Secretary of Defense under Bill Clinton, who is all too familiar with false alerts, having been awakened by a call from a night watch officer in 1979 and thought he was "about to experience the holocaust". And, of course, he also presided over the dismantlement of nuclear weapons in the 1990s. He warned that the threat is back. I quote:

"Because the US and Russia today are confronting each other with a hostility that's recreating the geopolitical dangers of the Cold War ... and because the US and Russia are rebuilding their nuclear arsenals that's recreating the military dangers of the Cold War."

Now you can argue about the extent to which the Kremlin's disinformation efforts have influenced various western countries. But the main impact has been to convince ordinary Russians that the West is a threat. We have been made to appear as the enemy, whether we like it or not, and whatever the real situation.

Moreover, we, on our side, don't have the same level of understanding that we had of each other in the Cold War, and the tried and tested systems and diplomatic instruments are not what they once were – confidence building measures, arms reduction negotiations, public monitoring and inspection of each other's military activity etc. So when the ante was upped following the Russian intervention in Ukraine, conversation became difficult. Now of course it does not have to be like that.

We now have to worry, not about a symmetric playing field as one saw in the Cold War, but an asymmetric one in which there are far more players. So we should not assume that events in the Pacific wouldn't draw more US attention than those in Europe, and we, I think, should be careful of complacency. The parallels with 1914 are stark. Our generation has become used to wars of choice since the end of the Cold War – but we may not have a choice about conflict with Russia – and we should remember Trotsky's dictum, that: "you may not be interested in war but war is interested in you."

So, what should we be doing differently? First of all, I think we should recognize that Russia respects strength and people who stand up to them. The original plan for Ukraine had been to acquire significantly more terrain. However, Russia was surprised by Ukrainian resistance and had to settle for less.

We should Identify Russian weaknesses and then manoeuvre asymmetrically against them. First and foremost, perhaps we should be in the business of building real institutional capacity in neighbouring states so that they have the strength and confidence to stand up to Russia and the internal resilience to withstand pressures designed to bring them down from within.

We should be making more progress on reducing energy dependency on Russia. We should be telling the Russian population what's really going on. We should be protecting our critical capabilities; hence the importance of cyber. And we should be looking to identify our own vulnerabilities to Russian malign influence and disinformation, and act to reduce them.

Next, I think, we need to demonstrate our preparedness to commit. 'Boots on ground' is not a positive term at the moment, but our allies on NATO's eastern flank absolutely appreciate that a platoon of infantry is worth a squadron of F-16s when it comes to commitment.

The importance we attach to alliance cohesion – that is vital to us – that is our centre of gravity. And hence, I think, the words that were in SDSR 15 about 'international by design' are absolutely right. And everything the British Army is doing at the moment is to work out how it can implement 'international by design'. We recognise that our communication systems have to be extrovert so that our allies can plug in to them; hence the vital importance of interoperability.

And by interoperability our priorities are to be able to communicate securely, but at a NATO Mission Secret level, not at UK [Eyes] only level. It's important to have shared situational awareness and to be able to control fires digitally in support of each other. For me, therefore, the ability to bring into service a new form of Land Environment tactical communications is vital. And our relationship with the UK IT sector to deliver this is also vital.

But it's also vital that our human relationships are maximised. And, for example, the combined engineering regiment that we share with the Bundeswehr, based in Minden in Germany, is a very good example of how you can burden share and deliver more capability through a pairing and a partnership like that. As indeed we do with our French allies through the CJEF

Next, I think, we've got to continue to work at improving NATO. We have to recognise that readiness is about speed of recognition, speed of decision making and speed of assembly. I'll say that again: it's about speed of recognition, it's about speed of decision making and it's about speed of assembly. Now, our contributions to the Very High Readiness Joint Task Force (Land) in NATO and the enhanced Forward Presence deployed, in our case partly in Poland but more in Estonia, are starting points. And they are good ways, also, of multinational development in terms of our French and Danish involvement.

Now, they are a starting point because I would suggest that we need the ability to reinforce them rapidly and, to be able to outmanoeuvre the potential Anti Access Area Denial 'missile dome' that will be put in place as

we seek to reinforce them. We therefore need, I would suggest, to be able to deploy overland by road and by rail. And our Strike concept seeks to project land capability over distances of up to some 2,000 km. It brings with it good questions about logistic sustainability and communications, as well as combat and combat service support.

However, we are testing it at the moment through a programme of experimentation and we are learning very good lessons. For example, we are copying what the Germans did very well in 1940 when all of their prime movers, in terms of their tanks and armoured vehicles, had trailers; and by doing that, it reduces your logistic tail. Those sorts of old-fashioned lessons, brought forward, are definitely improving our ability to deploy. And we will test this concept by driving to the NATO Exercise Trident Juncture which is taking place in Norway this autumn.

It's also important, I think, to stress the needs for a forward mounting base and, therefore, we are actively examining the retention of: our infrastructure in Germany where we store our vehicles in Ayrshire Barracks in Rheindahlen; and our training facilities in Sennelager. As well as our Heavy Equipment Transporters that are based there and our stock-piling and ammunition storage.

Next, I think, it's important – go back to my point on speed of recognition and speed of decision making – that we give policy makers the opportunity to exercise with military leaders, as we did during the Cold War. This goes to the heart of speed of recognition. It goes back to the point about it won't be 'little green men' next time. And when you think about how difficult it is, in this era of constant competition, where there is this grey area between peace and war, the first hostile act is going to be very difficult to recognise. And when as a young officer, I sat in my trench on the West German plain, it was very clear to me what that first hostile act would have looked like and I always imagined a soldier from the Soviet Union with wire cutters, cutting the fence before his tank drove through it. It's not going to be like that next time, so how we educate and train our policy makers in making the decision that they might need to make is vital.

And I think, to do all of this, we need to return to an annual or biennial NATO exercise rhythm in which all levels play from the grand strategic level to the tactical level. This would allow for our resources to be properly targeted and for front line countries to practice mobilization and, indeed, allow us to exercise and train on private land, and understand some of the constraints associated with choke points and bridges and railway traffic and all that goes with it.

Next, I think, we need to prepare ourselves to fight the war we might have to fight. I think it's an important point. Because in being prepared to fight the war we might have to fight, there's a sporting chance that we will prevent it from happening. And I think the hundredth anniversary of World War One gives us a great chance to actually think about what that war might look like.

Therefore in the Army, at the moment, we have a project underway styled as



'Project Henry Wilson'. For the historians amongst you, you will know that Henry Wilson was the Major General who was the Director of Military Operations in 1914, who was able to pull a mobilization plan off the shelf and send the British Expeditionary Force to Flanders. Now, being able to do that again, I think, is important.

It's important so that we understand what our equipment can do and it's important to understand where we maximize the potential of all of our manpower. And that's why we have invested significant effort in the Reserve component, but increasingly, also, in a Regular Reserve component. Now I hasten to add that our Reserve component is not a substitute for the Regular component, but it's the means to augment it with, particularly specialists, and there is much that we're doing in drawing that talent from the medical area, from cyber, and from information warfare. But it's also, of course, about augmenting with mass; and that recognises that the Regular component has never been as small as this, probably since Napoleonic times. And what it also does for us, is to provide the basis for regeneration and reconstitution.

I've been very impressed with the talent that's come forward to join the Army Reserve, particularly on what we call 'Group B' terms of service. In our 77 Brigade, which I shall come back to, we have got some remarkable talent when it comes to social media, production design, and indeed Arabic poetry. Those sorts of skills we can't afford to retain in the Regular component but they are the means of us delivering capability in a much more imaginative way than we might have been able to do in the past.

We now have over 30,000 on the books in terms of the Reserve and they are available to deploy with the Regular Component, if they have got the time and if their employers can release them, whenever they want to. Now turning to the Regular Reserve; potentially, we have some 25,000 to 30,000 who would make up the Regular Reserve. This recognises that 50% of the Army leaves before age of 30; hence, much of them are young and well qualified with, of course, a statutory liability to be available for mobilization. The trick is in retaining contact with this force and we are working, at the moment, through the Data Protection issues, to make sure that we reinforce that. The goal, I think, will be to build on a pilot that we ran last year and to conduct a full-blown mobilization exercise, for all of the Reserve, and the Regular Reserve, just like we used to do in the Cold War, sometime in the middle of next year.

Now, as part of this, we will clearly place a priority in the Regular Reserve on scarce capabilities like, for example, attack helicopter pilots. But it is definitely a means of maximising the potential of all of the manpower that we have and it would, potentially, deliver a total armed force of nearer 140,000 post-mobilization. Now quite clearly if we're going to do this we need to have support from the policy level, through employers, to the general public as a whole. But I think people can understand that, perhaps for a day a year, it is logical to be able to retain this capability.

The next observation I'd make is that we need to be able to fight differently against the sorts of threats I've set out there. First of all, we need

reversionary skills to counter the threat against our software and our communication systems; and, potentially, having the GPS system taken down. Good old night navigation and map reading that I was brought up doing should clearly be a feature of what we are talking about here.

Next, we've got to be able to fight more dispersed with the ability to concentrate rapidly to achieve the mass you need. Next, we've got to invest in junior leadership; hence I talk much about maximising talent. I talk about our command philosophy that enables initiative and tactical adaptation at the lowest levels and, absent further orders, enables people to seize the initiative. It's why we are investing in a brains-based General Staff to challenge, to think flexibly, and to place a premium on adaptability. Recognising, of course, that when we go to war, we definitely won't get it right on day one and it is that sense of adaptability and agility which will give us the chance to prevail.

And finally in terms of fighting differently, we need to recognise that how and where we train, and who we train with, should be a surrogate for warfare as well, given the nature of messaging that comes in this era of constant competition that I described.

And then last, in terms of how we do things differently, we need to acknowledge that we have some capability issues that have to be addressed. I think first that we have to recognise that deterrence needs a set of graduated responses to enable escalation. And that means that for me as the CGS it's important that I recapitalise much of the Army's equipment. You have to go back to 1985 and the era of General Bagnall for the last time that we had a major recapitalisation programme. And the capabilities that we see now: the Challenger tank, the Warrior armoured fighting vehicle, the attack helicopter, multi-launch rocket systems, the AS90 self-propelled artillery system were all systems that came in under him and under his thinking, with his concepts at the front end of it.

And of course what has happened over the last fifteen years is we've been focused on counter-insurgency and stabilisation. And by the end of the Afghan campaign of combat operations we were a very well equipped army for that particular task. Our challenge now is to leap forward to what we need, given the threats that I have described.

Now I sense that involves upgrading our armoured infantry capability. We are looking at active protection, more lethality, and greater range for our Challenger tank. We are looking at upgrading our Warrior armoured fighting vehicle. We are looking at maximizing the potential of the Ajax vehicle – it looks like a medium tank that's entering service at the moment; and, in due course, bringing into service a mechanised infantry vehicle to complement it. This will be transformational for the British Army and will get us to manoeuvre in a very different way and to project power over land in a different way.

We need to improve our ISTAR capability – Intelligence, Surveillance, Target Acquisition and Reconnaissance – to be able to target deep fires. Because we have got to revert to an era where we are able to focus on the enemy's

uncommitted forces; the so-called 'deep battle', that we soldiers talk about. But whilst we are doing that, to protect ourselves from the air and from inbound missiles. And I touched on connectivity. We must invest in our ability to communicate and to share information through a new Land Environment Tactical CIS system.

We also, though, need to continue to improve our ability to fight on this new battlefield, and I think it's important that we build on the excellent foundation we've created for Information Warfare through our 77 Brigade which is now giving us the capability to compete in the war of narratives at the tactical level. And as David Patrikarakos put it in his recently published book 'War in 140 Characters', in which he observes on the war in Ukraine:

"... I was caught up in two wars: one fought on the ground with tanks and artillery, and an information war fought largely, though not exclusively, through social media. And counter intuitively, it mattered more who won the war of words and narratives than who had the most potent weaponry."

He also observed that: "social media is throwing up digital supermen: hyper-connected and hyper-empowered online individuals" and I'd like a few of those in 77 Brigade, please.

So, in sum, I have inevitably looked at this through a Land prism, but you should recognise that what I am describing is part of a Joint Force. So to conclude, I believe that our ability to pre-empt or respond to these threats will be eroded if we don't match up to them now. They represent a clear and present danger. They are not thousands of miles away, they are now on Europe's doorstep. And the character of warfare is making it much harder for us to recognise true intentions and thus distinguish between what is peace and what is war.

Of course, it doesn't have to be like this, but we cannot afford to sit back. We need to recognise that credible deterrence must be underpinned by genuine capability and genuine commitment that earns the respect of potential opponents.

Thank you very much.