House of Commons

Foreign Affairs Committee

The future of the European Union: UK Government policy

This is a volume of submissions, relevant to the inquiry The future of the European Union: UK Government policy, which have been reported to the House.

Only those submissions written specifically for the Committee have been included.

List of unprinted written evidence

FEU 01

Written evidence from Dr. Johanna Jonsdottir, Policy Officer, European Free Trade Association Secretariat

Author background

I am currently a policy officer at the European Free Trade Association (EFTA) Secretariat in Brussels, which is responsible for the management of the European Economic Area (EEA) Agreement.

In 2010 I was awarded a PhD in European Studies from the University of Cambridge. My dissertation focused on Iceland's relations with the EU through the EEA Agreement.

My PhD dissertation was awarded the Sir Walter Bagehot Prize by the Political Studies Association for best dissertation in the field of government and public administration.

A revised and updated version of my dissertation is due to be published this year by Routledge.

Foreword

I understand the Committee is starting from the assumption that the UK should and will remain a member of the EU. Nonetheless, as the Committee has expressed a particular interest in submissions from non-member states and in light of increasingly frequent suggestions that the UK should withdraw from the EU, I will reflect on the suitability of an EEA type solution for the UK. This is related mainly to the first two questions posed by the Committee:

- To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?
- Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

Please note that my submission does not in any way represent the official views of EFTA or its member states, but is based on my research and personal observations, which I hope may be of use to the Committee in its inquiry.

Summary of key points

- The EEA Agreement allows Iceland, Liechtenstein and Norway to participate in the EU's internal market while excluding potentially less attractive areas such as the common fisheries policy.
- The EFTA states adopt all EU legislation in relevant areas without participating in the EU's decision-making institutions.
- Although the EEA contains various clauses to formally protect the EFTA

states against loss of sovereignty, there are indications that it functions as a supranational agreement in practice.

- It is unlikely that the UK would find the EEA model in its current form to be a suitable alternative to EU membership.
- The EEA could perhaps provide some lessons for the potential development of a "multi-tier Europe".

Introduction

1. The members of EFTA have a long history of EU rule adoption and close institutional contact with the EU. The current members of EFTA are Iceland, Liechtenstein, Norway and Switzerland. With the exception of Switzerland, the EFTA states are parties to the EEA Agreement and thus participants in the EU's internal market. Indeed, it could be argued that the EEA Agreement entails a form of 'quasi-membership' of the EU. Having been in force since 1994, the EEA Agreement has proved considerably more resilient than was expected at the time of its inception. Furthermore, it appears to have functioned relatively well over the years and in many respects it has benefited its signatory states. Although it is not without its challenges, it is an institutional framework which deserves attention, particularly in light of increasingly louder calls for a multi-tier Europe.

2. In recent years, proposals have been made to expand EEA membership, for example to Western European micro-states such as Andorra, San Marino and Monaco and Eastern giants like the Ukraine. In particular, following the UK's decision in December 2011 to veto the new "fiscal compact" Treaty, suggestions have also been made as to whether the UK might better belong in the EFTA family rather than the EU. In order to evaluate the viability of this course of action, it is necessary to examine how the EEA Agreement works in practice, including its main challenges. In this submission I will explain the content and functioning of the EEA Agreement, before moving on to the recommendations section where I evaluate whether it potentially provides a realistic or suitable alternative to EU membership for the UK or whether it provides any lessons for the development of a multi-tier Europe.

What is the EEA Agreement and how does it work?

3. The history of the EEA Agreement goes hand in hand with the EU's plans to develop an internal market, which gained momentum in the 1980s. At the time, Western Europe was split into two blocks: the EEC and EFTA. The UK was the original driving force behind the establishment of EFTA as a non-supranational counterbalance to the European Economic Community (EEC), as it was called at the time. However, by the time the EEA was being negotiated, the UK had long since left EFTA for the EEC. Nonetheless, EFTA's membership still included some of the Community's most important trading partiers, i.e. Austria, Finland, Sweden, Switzerland, Iceland, Norway and Liechtenstein.[1] The aim of the EEA was to allow them to participate in the internal market.

[1] Liechtenstein became a full member of EFTA in 1991 having previously been linked to EFTA through a special protocol.

4. The EEA Agreement was signed in May 1992 and came into effect on 1 January 1994. However, Switzerland rejected membership of the EEA in a referendum on 6 December 1992. On the other hand, Austria, Finland and Sweden decided to join the EU, becoming full members in 1995, thereby leading to speculation that the EEA Agreement's primary role would be to ease the EFTA states' transition to EU membership. Currently, Iceland, Norway and Liechtenstein are thus the three remaining EFTA parties to the Agreement and there is potential for further dwindling on the EFTA side as Iceland has applied for EU membership.

5. In return for access to the internal market, the EEA Agreement requires a high degree of integration of EU *acquis* into the national legal systems of the participating states. The EFTA states must adopt nearly all provisions relevant to the free movement of goods, services, capital and persons. In addition, the Agreement provides for the adoption of EU legislation in a variety of horizontal areas such as labour law, consumer protection, environmental policy, statistics and company law. As the EU's legal framework is in a state of continuous development, this includes not only legislation that was in place at the time the EEA Agreement came into effect but also all new legal acts that are passed in the relevant areas, which constitutes a large bulk of EU legislation. A number of substantial areas do fall outside the scope of the EEA Agreement (although the EFTA states participate to a certain extent in some of these policy areas through other agreements) including:

   (1) Common Agricultural and Fisheries Policies,
   (2) Economic and Monetary Union,
   (3) Customs Union,
   (4) Common Trade Policy,
   (5) Taxation,
   (6) Common Foreign and Security Policy and
   (7) Freedom, Security and Justice.

6. The exact proportion of the EU legal framework which is covered by the EEA Agreement is difficult to measure. In 2010, the Norwegian Government commissioned a comprehensive review of Norway's agreements with the EU, the EEA Agreement being by far the most extensive. The results of this review, totalling 900 pages, were published in January 2012.[2] The report estimates that through its agreements with the EU, Norway has incorporated approximately three-quarters of all EU legislative acts into Norwegian legislation. Iceland's membership talks with the EU are also sometimes cited as an indicator of the scope of the EEA Agreement. The Commission stated that, prior to commencing negotiations, Iceland had already fully implemented 10 and partially implemented a further 11 chapters out of a total of 33 policy chapters through the EEA Agreement. Figures from the EFTA Secretariat show that at the end of 2010 approximately 8,300 legal acts had been incorporated into the EEA Agreement.

[2]See link to the English translation of the introductory chapter of the review: http://www.regjeringen.no/pages/36798821/PDFS/NOU201220120002000EN_PDFS.pdf

7. Despite the exclusion of certain fields, it is clear that the EEA Agreement is quite extensive. It has enabled Iceland, Norway and Liechtenstein to participate in the internal market while remaining outside of some potentially less attractive areas. However, there is a price to pay for '*à la carte*' relations with the EU, as the EEA Agreement grants the EFTA states very limited access to EU decision-making institutions, while requiring them to adopt all EU legislation in the relevant areas. The EEA Agreement does allow some access to the Commission´s expert groups and comitology committees (Articles 99 and 100 of the Agreement) but no formal access to either the Parliament or the Council. As the EFTA states adopt the majority of EU legislation, they have a clear incentive to make their voices heard and research suggests that they are increasingly making use of more informal lobbying tactics to do so. These may in some cases yield results, though this is difficult to measure. Nonetheless, the fact remains that the EFTA states do not have a seat at the table and their impact is undoubtedly limited. This inherent 'democratic deficit' is indeed one of the main criticisms of the EEA.

8. Unlike the EU member states, the EFTA states have not formally ceded sovereignty to supranational institutions. In order to counter their lack of access to EU decision-making institutions, the EEA Agreement contains various clauses to formally protect them against loss of sovereignty. In the first place, EU acts do not automatically become part of the EFTA states' legal orders. Rather, an agreement has to be reached between the European External Action Service and the EFTA states in the EEA Joint Committee[3] as to their incorporation into the EEA Agreement. All decisions of the Joint Committee are taken by unanimity and, if approved, the acts are listed in the relevant Annexes to the EEA Agreement.

9. If the EFTA states find a piece of EEA relevant legislation unacceptable they have the right to refuse its incorporation into the Agreement. This was considered extremely important when the EEA Agreement was being negotiated. However, it could be argued that in practice it is a mere formality. In fact, it can be said that the EFTA states do not have any 'real veto power' as they do not have the right to refuse without considerable consequences, i.e. the provisional suspension of the relevant part of the EEA Agreement according to Article 102 of the Agreement. As internal market issues are all interlinked, there is also fear that the entire EEA Agreement could be called into question if Article 102 were put into force. Therefore, due to their dependence on access to the internal market, this clause makes it difficult, if not impossible, for the EFTA states to say 'no'. Perhaps not surprisingly, they have never yet refused the incorporation of an act into the EEA Agreement, although the Norwegian government has recently indicated that it intends to veto the incorporation of the third Postal Services Directive, which would mark a historic development in the EEA.

10. In some cases, the EFTA states have been able to negotiate certain exemptions or adaptations prior to incorporating acts into the EEA Agreement. However, they

[3] The EEA Joint Committee provides the forum in which views are exchanged and decisions are taken to incorporate EU legislation into the EEA Agreement. The Joint Committee generally meets about eight times per year and is made up of ambassadors of the EEA EFTA states and representatives from the European External Action Service. Prior to the Lisbon Treaty, the Commission (DG RELEX) was the EFTA states' counterpart in the Joint Committee.

must be able to demonstrate the necessity of such adaptations for example because domestic conditions are entirely different from those in the EU member states. Granting exemptions or adaptations is at the discretion of the EU and they are generally not given because something is 'inconvenient'.

11. Another feature of the EEA Agreement which is aimed at retaining the sovereignty of the EFTA states is that they have not formally transferred binding legislative powers to the EEA Joint Committee. In this way, although an act has been incorporated into the EEA Agreement, one or more EFTA state may have so-called constitutional requirements which means that their respective national parliaments must ratify the act before it can take effect. Thus, unlike in the EU, regulations are not directly applicable and directives do not have direct effect. However, the national parliaments of the EFTA states have never yet rejected an act which has been incorporated into the EEA Agreement. This is perhaps not surprising as refusing to transpose EEA relevant legislation at the national level would have the same effect as refusing to incorporate the act into the EEA Agreement, i.e. the suspension of the relevant part of the Agreement.

12. Once acts have entered into force in the EFTA states, they are not subject to monitoring and surveillance by EU institutions but have their own Surveillance Authority and Court which monitor compliance with EEA law. EFTA infringement procedures are fairly similar to the mechanisms for monitoring compliance in EU member states. The EFTA Court does not, however, have the same authority as the CJEU as it does not have the power to issue binding decisions, only recommendations and advisory opinions. This, coupled with the fact that the EFTA states monitor themselves, means that these mechanisms may appear rather weak at first glance. Nonetheless, research suggests that they function fairly well. This can partly be explained by the fact that having their own institutions increases the legitimacy of the EEA Agreement. Furthermore, each EFTA state is subject to control from its partners, not just its own officials. Finally, the EFTA bodies are in close contact with the EU throughout the monitoring process and so the EFTA states are aware of the potential danger in allowing the EU to perceive that the EEA Agreement is not functioning well. Therefore, in practice, the EFTA states appear to feel strong pressure to adapt to EU requirements.

13. If domestic opposition is very fervent significant delays may be experienced throughout the process of incorporating acts into the EEA Agreement and putting them into practice at the national level. Nonetheless, on the whole the EEA framework appears to be fairly conducive to domestic adaptation to EU requirements due in large part to the asymmetrical nature of the relationship between the EFTA states and the EU and their dependence on participation in the internal market. Taking into consideration lack of access to EU decision-making bodies, it could therefore perhaps be argued that in practice the EEA Agreement involves a greater loss of autonomy than EU membership and there are indications that the EEA Agreement functions as a supranational agreement in practice.

14. In this context it is important to note that the EFTA states have generally found participation in the EEA Agreement to be beneficial. In most cases, EU

legislation corresponds relatively well with pre-existing domestic arrangements in the EFTA states and does not require much change to the national legal framework. State actors may also often feel that EU policy poses an effective solution to domestic needs and challenges. Therefore, the EFTA states willingly adopt the majority of the EU legislation which they are required to take on board through the EEA Agreement. Yet, as in all states adopting EU rules, situations do arise where EU requirements effectively clash with domestic policies or preferences. In these cases, the EFTA states have not had the opportunity to express themselves within EU decision-making institutions and they are not generally able to prevent their incorporation into the EEA Agreement or their implementation at national level.

15. Given that the EFTA states incorporate a large bulk of EU legislation into the Agreement without access to the EU's decision-making institutions, they have been likened to colonies of the EU. This situation has also been described as a 'fax democracy', although perhaps a more apt description today would be an 'email democracy'. The democratic deficit has been a well-known aspect of the EEA Agreement from the start. It is the price which the EFTA states agreed to pay for enjoying many of the benefits of European integration without being full members of the club and without being bound to participate in some of the areas they considered less attractive.

16. In this context it should be noted that the EEA has been slowly extending into new areas. The EU's methods of legislating have evolved over time with more comprehensive acts being adopted which can span over different policy areas. In many cases some elements of an act may be EEA relevant while others are not. As a result, the question of EEA relevance has become increasingly ambiguous. Cases where EEA relevance is controversial can potentially lead to an expansion of the scope of the EEA Agreement into new areas which were not foreseen when it first came into effect, at least when the EU attaches importance to their adoption by the EFTA states. Furthermore, the Parliament and the Council have gained more say in the EU legislative process over the past two decades at the expense of the Commission. Therefore, it could perhaps be argued that the democratic deficit in the EEA has been increasing over time.

Recommendations

17. Having considered the functioning of the EEA Agreement, a question arises as to whether it is, in fact, a viable long-term alternative to EU membership. To date, this has not been a model that has been replicated elsewhere; the closest exception might be Puerto Rico's relations with the United States. As noted by the authors of the Norwegian review, the EEA Agreement has often been considered a second best solution both by those who favour EU membership and those who would prefer looser ties with the EU. By and large other states have not found this to be an attractive model and no other state has so far seriously made an effort to join EFTA and the EEA. Yet the possibility of developments in the membership of EFTA have often been suggested.

18. As a founding member of EFTA, the UK has been frequently named as an EU outsider. Indeed, as previously noted, the UK was instrumental in setting up

EFTA as a counterbalance to the supranational EEC. Although the UK later decided that membership of the Economic Community better served its interests, it has never been a very enthusiastic member of the European project preferring to remain outside of areas of cooperation such as Schengen and the Eurozone. Indeed, some would argue that Euroscepticism and a general distrust of the EU are inherently British.

19. David Cameron's veto of the EU fiscal treaty in December 2011 reopened the debate on the UK's relationship with the EU, with a return to EFTA frequently being named as a potential alternative to EU membership. In the British media a number of reports suggested that the UK might have something to learn from Norway and Switzerland.[4] One article argued that 'switching from the costly and undemocratic European Union and joining the European Free Trade Association would bring many benefits and job creation is one of them'. Slightly ironically, the article further explained that such a move would mean regaining control over democratic law-making processes and being able to choose the best policies in a host of important areas.[5] Another report stated that if Britain were to withdraw from the Union, but remain in the EEA 'it would neither participate in the much maligned Common Agricultural Policy - nor the equally criticized Common Fisheries Policy. It would also fall outside of the common foreign and defense policies so detested by some Eurosceptics'.[6]

20. Many would, however, argue that a return to EFTA would not work for the UK. Not least because the EFTA states are bound by EU rules but lack access to its decision making processes. As noted in one article, in comparison to the EFTA states 'semi-detached status for a larger and more assertive country might well be harder to achieve. And being in with the outs while trading freely in Europe comes at a price. It means paying to administer and police the single market while the in-crowd makes the important decisions about how it works. For a noisy nation accustomed to a place at the table and having its voice heard, that could feel like a very un-splendid isolation'.[7]

21. It is true that the EFTA states have so far been willing to pay the price of non-participation in EU decision-making institutions. However, this would arguably be a much larger price to pay for the UK, particularly due to its size and general international standing. If Iceland and Liechtenstein joined the EU they would be the smallest members of the Union in terms of population. Therefore, even if they did join the Union, they would not receive a large portion of the vote in the Council or a large number of seats in the Parliament. It is also likely that lack of resources would pose a problem for them in terms of active participation. Indeed, questions have even been raised as to whether membership of the EU is possible for a state as small as Liechtenstein. Norway is by far the largest of the EFTA states and therefore membership of the EU might make the biggest difference with respect to increasing influence within the institutions. However, although

[4] For example http://www.economist.com/node/21541863
[5] http://www.publicserviceeurope.com/article/1139/time-to-leave-the-eu-and-stop-exporting-british-jobs-abroad
[6] http://www.publicserviceeurope.com/article/1090/what-exactly-would-the-uk-gain-from-leaving-the-eu
[7] http://www.economist.com/node/21541863

Norway is large in the EFTA context, it would still be a relatively small member state within a growing EU.

22. The UK on the other hand is one of the EU's largest member states. It generally has the resources to participate actively in all policy areas and it is an important actor when it comes to coalition building and Qualified Majority Voting. Losing access to the decision-making institutions would therefore be a substantial blow. Furthermore, the incorporation of EU *acquis* into the EEA Agreement is an inherently asymmetrical process whereby the EFTA states adopt legislation which has been decided without their participation. In the view of the author, taking such a subordinate role would not sit well with the UK's self image. True, the UK´s accession to EFTA would potentially make the relationship between the EU and EFTA pillars slightly less asymmetrical. Nonetheless, the EEA in its current form, is very much a one-way street whereby the EFTA states follow the EU's lead. Therefore, a return to EFTA for the UK might not be such a plausible scenario.

23. Although the EEA Agreement in its current form is not a viable option for the UK, a future scenario of a two or multi-tier Europe in which structure, content and membership of the EEA was substantially revised could potentially be explored further. Forecasts predicting a widening gap between an outer core and an inner core within Europe abound. In his book, The Future of Europe: Towards a Two-Speed EU?, Jean-Claude Piris reaches the conclusion that the solution to the current economic and political climate is to permit 'two-speed' development: allowing an inner core to move towards closer economic and political Union. Michael van Hulten, a former Dutch MEP, has detailed what a two-layer Europe might look like. 'The outer layer would be an overarching, less intrusive and more inclusive framework for European cooperation: a European Area of Freedom, Security and Prosperity (EFSP). This would comprise all EU and EFTA member states, as well as all existing EU candidate countries including Turkey. It could be expanded eastward to all European countries, including Russia, if and when the Copenhagen accession criteria (or similar) were met'.[8]

24. Any such plans could potentially in some ways build on the experience of the EEA, albeit with substantial revisions. For example, changes in the EU's policy making process and recent Treaty revisions should be taken into account. Furthermore, according to the EEA Agreement, Iceland, Norway and Liechtenstein are meant to harmonize their positions internally and then speak with one voice towards the EU. A greater number of diverse states would make this system of unanimity quite difficult and cumbersome. Changes might therefore imply a more supranational structure. However, in return, the members of the outer tier should be allowed further participation in decision-making processes.

25. The economic climate within the EU has perhaps served to decrease the attractiveness of EU membership. The future of the EEA is of course largely dependent on developments within the EU. Whether the EEA Agreement's content, structure and membership are revised or whether it ceases to exist at all

[8] http://www.spectator.co.uk/coffeehouse/7421503/what-kind-of-europe.thtml

are questions which will only be answered in the fullness of time. In general, the EEA in its current form, probably does not provide a viable solution for countries such as the UK. However, this does not mean that the EEA can provide no lessons for the future of Europe. Rather, given that it has generally been found to function well, any deliberations on a multi-tier Europe should take the experience of the EEA into account.

25 April 2012

FEU 02

Written evidence from Mrs Anne Palmer, JP (retired)

I do not belong to, and have never been in any Political Organisation or Political Party. My Faithful and True Allegiance is, as always, to the wearer of the British Crown. Responding to The Foreign Affairs Committee Inquiry into 'The Future of the European Union: UK Government Policy.

1. Question: ***To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU Policy and place in the Union?***
At first glance it looks as if we should and will stand by and watch while a continental system is built. A statement by the Eurogroup made 30th March 2012, states, "The stability and integrity of the Economic and Monetary Union have required swift and vigorous measures that had been implemented recently, together with further qualitative moves towards a genuine Fiscal Stability Union." Etc. To me it is and should be a "wake-up call" for those that want to be further integrated into the European Union rather than be proud to be elected Politicians of what many believe is/was the best free Country and Nation in the World.

2. **Noted that one Gentleman, Mr Ottaway was starting from the assumption that the UK should and will remain an EU Member.** Should the EU progress towards the one State of European Union **will that decision still stand?** The people have recently watched this present Government divide the Nation and Country of England into nine EU Regions through the Localism Bill/Act which is shown quite clearly on the Council of Europe's Website where "ticks" are recorded when action is taken. Is he and the Government concerned at the extra money for and extra layer of Governance this Country has never had before? These REGIONS with elected Mayors, full Cabinets and all the regalia that goes with them? Note also, "T**he Regional Dimension of Development and the UN System". Is this also wanted?**

3. Noted that Mr Hague made quite clear on 8th March 2012 that, the protocol was not agreed, and as a result the agreement among the 25 nations is not part of the Treaties of the European Union, and does not have the force of EU law and that we will have to continue to seek to protect the single market, financial services and our national interests **in other ways** in the absence of having secured a protocol to changes to the Treaties of the European Union. **I would have thought even changing a Protocol to an already ratified Treaty requires a referendum in ALL EU Nation States.**

4. However, on May 31st Ireland is to hold a referendum on the 'Fiscal Compact' which is in fact the "**Treaty on Stability, Coordination and Governance in the Economic and Monetary Union**" an extra Treaty on top of the Treaty of Lisbon, and whether it disturbs or intrudes on the previous Treaty remains to be seen for the original paragraphs relating to the Eurozone Members are in the body of the Lisbon Treaty.

5. I pray that the original intention to alter just the 'Protocol' rather than alter the body of the Treaty, which I believe was/is required for such an important matter, was **not** the intention of being used to prevent or cheat the people of any country out-side the Euro-Zone.

6. "Should the UK Government support the incorporation of the 'fiscal compact' into the EU Treaties?" Without doubt, if the alleged "Fiscal Compact" is included into the Treaty of Lisbon and therefore an alteration to the original Treaty of Lisbon, this Country should-without doubt, have the promised referendum. With a further additional Treaty, which may touch or intrude on the previous Treaty, I leave it to the experts.

7. I do have concerns regarding the recent extra funding to the IMF by the UK Government, which is not in the Euro-zone, yet this extra funding has knowingly been used to 'help out' the Euro area through the IMF. This does raise concerns.

8. Further to Paragraph 2 re Mr Ottaway's remarks regarding remaining in the European Union. That this Country will remain an EU Member. I have noted on more than one occasion that the EU wants to **"use its 'one voice' in all matters and especially in the United Nation Security Council."** In the General Assembly 30th July at the 88th Meeting "General Assembly, in recorded vote, adopts resolution granting European Union, Right of Reply Ability to Present Oral Amendments".

9. In fact I read **Hungary's representative**, submitted the draft resolution **on behalf of the European Union** and reading a number of oral revisions, said it was the product of extensive consultations among a broad spectrum of Member Sates, held following the Assembly's vote on 14th September 2010 to defer consideration of the original text outlining the bloc's expanding rights", **Do you know what those expanding Rights were? Did the people of this Country know? Were they told?** See here GA/10983.

10. UN General Assembly 3rd May 2011. Mr Körösi (Hungary) "***It is an honour for me to appear before the general Assembly, on behalf of the members of the European Union (EU), the draft resolution on the participation of the European Union in the work of the United Nations, contained in document A/65/L.64/Rev.1 I would like in particular to thank the High Representative of the European Union for Foreign Affairs and Security Policy for being here today at a moment of great significance for the European Union".*** Etc.

11. What a great pity the people of this Country did not have the opportunity to celebrate this good news with them-FOR THE PEOPLE OF THIS COUNTRY WERE NOT TOLD. Will the EU soon have "**one Voice**" in the UNSC? Will this Country still need a **British Government or a House of Commons or House of Lords, especially as the EU Regions have been set up here in the once United Kingdom of Great Britain and Northern Ireland** at all, because no one will hear their voices, not even in the United Nation's Security Council if the European Union are going to speak with their one VOICE in all matters and on our behalf.

12. Your questions, 'The Future of the European Union: UK Government Policy.
The future of the European Union as it is at the moment is rather doubtful. Whether we as a country could remain in the EU knowing without doubt that it is to become one European State/Country, not even as once thought a United **States** of Europe rather like the USA, which should, under the circumstances when recent Governments have let the people down, I would have thought should be decided by a Government

of Great Britain that is faithful and true to their solemn Oaths of Allegiance to the British Crown, that **the Oaths they** make before they take their seats in that wonderful and once proud Houses of Parliament, would lift the people into perhaps bringing a little faith and hope of a Government they could be proud of once more. For the only way for this Country and nation to survive, is out of the European Union completely. We truly should never have joined. (See Hansard from the 1960's)

13. If that is rejected, the people of course should be given a referendum on an 'in or out' of the European Union, and surely knowing exactly what the European Union is in reality to become, far better for our Government to tell the people exactly why they are proposing to allow such a referendum and for the people to make a decision. A federal European Union or a Sovereign United Kingdom of Great Britain and Northern Ireland once more? That way, a British Government may win back some credibility and respect which it lacks at present and a chance to really govern this Country according to its long Standing Common Law Constitution. Failing that, in all honesty, if the EU continues as is proposed and encouraged by British Governments to fill the role of a Single State of Europe, I have absolutely no idea what the ending will be, except that there will be in all probability a terrible and tragic ending for all, with no going back.

11 May 2012

FEU 03

Written evidence from Dr. Martyn Bond, Visiting Professor,
Royal Holloway University of London

Please find below my evidence submitted to the Foreign Affairs Committee of the House of Commons concerning the future of the European Union.

The argument of my submission can be summarised as follows:

The UK has lost its way in adapting to the challenges of globalisation. It is heading for an increasingly isolated position, out of sympathy with its regional partners in Europe. It needs to develop a leading role within its regional bloc, co-ordinating its priorities with other leading players there. UK foreign policy should prioritise the EU and project UK power increasingly through this regional organisation.

A note on my background:

I am Visiting Professor of European Politics and Policy at Royal Holloway University of London, a Distinguished Visiting Fellow at the European Business School as well as a Senior Fellow of the Salzburg Global Seminar.

My main career was as a European civil servant, serving eight years from 1974 as press spokesman in Brussels for the Council of Ministers of the EU (then the EEC), a further seven years, first as a senior administrator during the negotiation of the fourth Lomé Convention with the countries of Africa, the Caribbean and the Pacific, and then with responsibility for relations between the Council and the European Parliament. From 1989 until 1999 I worked in London as Director of the UK Office of the European Parliament.

My initial professional training, however, was in the BBC, which I joined on my return from Hamburg in 1966, working there until 1970. I later took leave of absence from my civil service post in Brussels from 1981 to 1983 to work as BBC correspondent in Berlin, broadcasting in German and English about politics, economy and society in West Berlin and East Germany. In 2005 I was invited to become the London Press Correspondent for the Council of Europe, advising on media strategy and promoting the image of the Council in the UK.

I gained a BA in modern languages and literature from Cambridge, followed by further study at Hamburg and Sussex Universities (D.Phil 1971). Between 1970 and 1973 I was lecturer in West European Studies at the New University of Ulster. After retiring from the European civil service I was Director of the Federal Trust for Education and Research from 2000 to 2003, and from 2005 I have been Visiting Professor at Royal Holloway. In 2006 I was invited to become a patron of the University Association for Contemporary European Studies.

I have written and edited several books, including *Eminent Europeans* (Greycoat Press, 1996), *The Treaty of Nice Explained* (Federal Trust, 2001), *Europe's Wider Loyalties: Global Responsibilities for the New Europe* (Kogan Page, 2002), *The European Convention on Human Rights and the Council of Europe* (Council of Europe, 2010), and *The Council of Europe: structure, history and issues in European politics* (Routledge, 2011). I also write for *Public Service Europe* (web only) and for *Parliament Magazine*, a Dods publication in Brussels, and I lecture on European issues both in the UK and abroad. I have contributed to

numerous training courses for UK civil servants, in particular in the context of Dod's programmes *Westminster Explained* and *Brussels Explained.*

The future of the European Union: Implications for UK Government policy

Global framework – Regional priority

1. The power of individual states such as the UK to shape an effective response to global shocks has considerably diminished over the past fifty years. Poor economic performance in relation to other European economies has increased the need for the UK in particular to work with other members of the EU in seeking common solutions for the region. The UK is not as impecunious as Greece, but it is also not as wealthy as Germany.

2. In addition to the shock of the current financial crisis, the member states of the EU now face cultural, social and economic adjustments to an exceptionally strong migratory influx as a result of globalisation. Doubtless other external shocks – possibly ecological or energy-related - will also soon call for a European response.

3. As Chou-en-Lai predicted long ago, at the global level the move to dialogue among several strong regional powers appears unstoppable. The EU represents one such power. The UK individually – despite retaining some elements of power acquired in earlier years (nuclear deterrent, Security Council seat, special relationship, Commonwealth) - does not. Sooner or later it will be the EU and not an individual nation which will answer Kissinger's phone call and speak for Europe. The route to optimising the UK's influence globally lies therefore in strengthening its position inside the EU.

Government influence or Party politics?

4. Many policy initiatives derive from party political discussions at European level. Across the continent, political forces are organised in three main groups, the European Peoples Party, the Socialists and Democrats, and the Alliance of Democrats and Liberals in Europe.

5. The absence of the Conservative Party from the EPP represents a serious weakness for the UK in its efforts to exert influence in the EU at a political level. Without a close alliance with the EPP, the Conservative element of the Coalition government is absent from the dominant circle of those deciding the direction of EU policies in most other states. This is a party political issue that is harming the national interest. It should be remedied as soon as possible.

6. The December fiasco last year was the most recent high-level example of the UK's misjudgement of continental responses because of Conservative political isolation. Absent from the meeting of the EPP in Marseilles just before the Brussels Summit, the Conservative leadership was unable to grasp the importance of other states' political capital invested in the Eurozone.

7. Ideological assumptions increasingly shape member states' political positions at continental level. They influence the European argument well before the Commission puts practical proposals on the table for formal discussion in Brussels. For the UK, the underlying issue is as much a matter of political contacts and ideological affinities as of institutional structures.

8. In this analysis, the fiasco of last December was not a watershed, but one of a series of accidents as these broad political affinities surface from time and time. Until the Conservative Party changes its continental political alignment, the UK under its present leadership will be isolated again and again. In the 2014 European Parliament elections, for instance, the main political groups are all likely to nominate their candidates for the post of President of the Commission well in advance. Conservative absence from the EPP will again isolate the UK Prime Minister when the European Council is subsequently called on to endorse the next President of the Commission.

9. The grand narrative of European unification has little attraction in the UK at the popular level. However, it clearly still has – as it has had since 1945 - considerable strength among European political elites. The assumption of "strength through unity" drives the policy choices of major political parties across the continent. If the alternative is impotent isolation, it also makes more and more sense for the UK.

Maximising UK influence inside the EU

10. It is only within a grand strategy of close co-operation with other like-minded political forces in the EU that the UK government – whichever Party is in power - will achieve its specific foreign policy goals: security of supply for food and raw materials, open markets in third countries, and respect for our values in regard to democracy, human rights and the rule of law. All these objectives are shared with other members of the EU. Only by playing an engaged and proactive role in advancing further integration within the EU will the UK have a powerful voice in deciding how these objectives are to be secured at a global level.

11. Successful opposition to manifestly unfair proposals or specifically detrimental policies at EU level increasingly requires enough allies to form a blocking minority, and preferably a positive majority to press for improvements. This is not achieved from a position of isolation, opposed to the main thrust of integration. Opposition by the UK can be productive – as witness stalling proposals for a financial transaction tax and advancing reforms in agriculture and fisheries – but it is considerably more successful when exercised from within the tent.

12. The UK government should move from a default position of opposition in principle to further European integration to a position that allows it to respond positively to new proposals. The UK administration is still respected for the clarity and consistency of the positions it takes in Council, and a shift of stance in no way detracts from its right to raise objections and call for amendments to proposals as discussions proceed. But to gain a more sympathetic hearing, the UK government needs to signal that Brussels is appreciated more as the solution and criticised less as the problem.

13. In particular the UK government needs to show that it wants to stay as closely associated as possible to initiatives undertaken by groups of other states under "enhanced cooperation". The UK should avoid formalising divisions within the EU, maintaining above all the option to join such initiatives later. It should maintain this option for itself and argue for it as a principle for other states.

14. With specific regard to the "fiscal compact", the UK should rapidly seek allies within the Eurozone prepared to argue its case to keep open the option for the UK a) not to be excluded from the decision-making fora set up for Eurozone countries, and b) to be

able to opt in without onerous conditions if it later decides to. Hence the fiscal compact treaty should be agreed - like other EU treaties – by all member states.

15. Exclusion from the treaty would cause political, moral and economic damage to the UK. It stands to lose its traditional status as a leading member state of the EU if it is forced to position itself outside the mainstream of European integration. This is reflected in exclusion from political decision-making (the top table argument), the absence of British officials in important posts (the engine room reality), and reduced formal and informal influence in Brussels (the everyday experience). The UK stands to lose morally if it is not present alongside its traditional allies in debate, notably states of Scandinavia and central and eastern Europe. In economic terms it stands to lose by being absent from decisions that directly affect the UK's trading interests, notably regarding currency issues and matters relating to the Single Market.

Re-positioning among larger and smaller allies

16. As the EU develops further it will need more than just Franco-German leadership, and the UK should have enough awareness of its own interests to seek a role alongside them in deciding the future of Europe. France and Germany need the UK as a balancing partner in their bi-lateral relationship, if this traditional core of the peace settlement in Western Europe is to develop into a regional force in the world.

17. The reformed voting arrangements of the Lisbon Treaty give the larger states a greater say in the development of EU legislation and policy. The UK should therefore prioritise its efforts, identifying and developing common interests in particular with the big players. The UK's main allies in the EU should be those countries which have the capacity – material and moral – to lead it.

18. At the same time, the UK should not neglect its relations with smaller states in the EU. Many of these - Scandinavia, Ireland, Portugal, Benelux, Malta, Cyprus and the Baltic States - have traditionally had close relations with the UK. As it has done in the past, the UK needs to maintain good relations with the medium and small member states, building up clusters of friends, but in doing so it should not lose sight of the need to identify common interests with the larger leading countries.

Wider responsibilities and the longer view

19. As the UK is increasingly linked with its European neighbours – tourism and residence abroad, trade and aid, finance, military alliance and foreign policy co-ordination, higher education, intermarriage, historical experience and cultural roots - it should strive to maximise its interests in playing a leading role in the new structures of Europe. That cannot be done effectively from the sidelines.

20. The UK government should take measures to stop the drift towards isolation from the continent which has recently marked the country's relations with the EU. A role for the UK comparable to Norway without its oil or Switzerland without its reserves is profoundly unattractive. If the country were reduced to this, the UK would be dominated by an integrated power on the continent and relegated to a subordinate role in both regional and global affairs – an outcome which would realise the worst fears of British foreign policy.

21. As an alternative, the UK should develop its own vision of an EU under conditions acceptable both to this country and to our European allies. It should position itself in

the mainstream of economic and political integration, from which position it would be better able to steer it in the direction and at the speed which optimises British interests.

22. Division among EU states plays into the hands of other powers which are not slow to take advantage of it. Examples include Russia on energy supply, the US on air transport, China on a range of trade issues, and many multinationals (backed by their governments) on conditions for FDI. Temporary advantages won by the UK in competition with other EU states are more than balanced out by benefits won by other members and lost to the UK. Overcoming this zero sum game would benefit all and permit the development of a more coherent foreign policy as a regional bloc.

23. That geopolitical option will involve a considerable revision of recent UK foreign policy aims and means, which have assumed that the UK will continue as a priority to relate bilaterally to the rest of the world. The future will require a perspective looking from London through Brussels out to the wider world. The world by 2020 will be looking first towards the EU and only secondarily towards the individual member states.

24. A view of the UK independent of this perspective is doomed to increasing irrelevance. If the UK does not want to be marginalised in international affairs by positioning itself outside any regional power bloc, it must quickly concert its efforts with other European states to optimise its interests both within and through the EU.

15 May 2012

FEU 04

Written evidence from Sir Colin Budd, KCMG

SUMMARY

- **The December European Council not necessarily a watershed for UK/Europe, but an important wake up call.**
- **For the UK voluntarily to accept demotion from the top European tier would be a huge strategic error. On the contrary, we should wherever possible ensure that we are part of its leadership.**
- **To maximize our leverage in EU policy making, the whole of UK plc must apply itself to that task, with energy, imagination and unceasing effort.**
- **If we fail to wake up, we will increasingly find that we are living in Britzerland.**
- **We can and should do better.**

Introduction

The writer was a member of HM Diplomatic Service from 1967-2005, serving in Warsaw, The Hague, Bonn and Brussels. He was Assistant Private Secretary to Geoffrey Howe, then Foreign and Commonwealth Secretary, from 1984-87; Chef de Cabinet to Leon Brittan, then Vice President of the European Commission, from 1993-95; Director General for Europe in the Foreign and Commonwealth Office from 1997-2001; and Ambassador to the Netherlands from 2001-5.

Background

1. Sir Percy Cradock, who from 1983-1990 was Margaret Thatcher's foreign policy adviser, once observed that the story of British European policy since 1945 had to an alarming extent been one of "mistaken assessments and missed opportunities, a depressing chronicle of delayed awakening to reality, of belated arrival in institutions fashioned by others, of repinings, second and third thoughts, divided counsels and qualified enthusiasms, and a general confusion of policy designed to achieve maximum pain and minimum influence".

2. To ask about the impact of the December 2011 European Council on the UK's policy towards and place in the European Union (EU) is to beg the question: what should that policy and place ideally be? If as a nation we want to avoid simply continuing the lamentable story so pithily summed up by Cradock, we need to think clearly about this.

3. The policy of the present UK government, as laid down in the Coalition Agreement, is that this country should play a leading role in the EU – in order (*inter alia*) to ensure that "all the nations of Europe are equipped to face the challenges of the 21st century".

4. What that, quite rightly, implies is that European countries can meet those challenges more effectively if they stand together than they could on their own. But there is more to the story than that.

5. The underlying logic of EU membership for the UK, for those who support it, has always in essence rested on two perceptions:

(i) the assumption that UK interests are best served by our being inside the EU;

(ii) the view that we are best placed to protect and promote those interests the more influence we can bring to bear on the directions in which the EU is heading.

6. Why is EU membership to our advantage? Partly for economic, and partly for wider reasons.

7. The economic case in favour is very well trodden ground. It rests on full access to the Single Market, with its many implications for profitability and employment; on the magnetism of the EU for foreign direct investment; and on the huge clout the EU has in world trade talks. The UK badly needs Europe to be economically strong, open to free trade, and prosperous. The best way to maximize the chances of that is for the UK to be influential inside the EU.

8. There are also numerous wider benefits – including the ability to travel, live and work anywhere in the EU, the scope the EU affords for action to improve the environment, and the forum it provides for more effective cooperation over crime and justice matters.

9. Above all, there is the wider strategic imperative: the whole question of how in the 21st century to maximize the UK's global influence and authority, in a world in which so many of the key problems cross national borders. As a member state in the EU the UK exercises far greater influence internationally than it could on its own. The more we fall out of the key EU decision-making circle, the more that will undermine our political relationship with the United States and reduce our influence in many international fora.

10. If we want to maximize our prosperity, trade and employment rate, if we want our own continent and the world to be safer and greener, if we want to be as influential as possible in world affairs, there is simply no option but for the UK to be an active and leading member of the EU.

11. It follows that unless there is a compelling case, given the national interest, for standing aside from any particular policy proposal, we should in all circumstances aim to exert as much influence as possible on the decision-making process inside the EU.

12. It was with that analysis in mind that the outcome of the December 2011 European Council left many UK observers with a considerable unease. Far from strengthening the UK's position in Europe, there is accumulating evidence that this has reduced our capacity to influence future EU legislation in the areas it covered – which by common consent are of very great importance for this country. Though there is much left to play for, there must be a strong probability that by the time future policy proposals in the areas in question come to ECOFIN, where the UK will still be present, the outcome of ECOFIN discussion will in effect

have been predetermined - by decisions in the prior caucusing of the member states committed to the fiscal compact.

13. The key dilemma for the UK, when it comes to questions of EU institutional architecture, is that the more we choose to stand aside from the evolving process, the more it will tend to evolve in directions and ways which do not suit our interests, while continuing to impact very directly on those interests. Eurosceptics may want us to roam the globe, untethered by Europe. But whatever their dreams, we will still be 22 miles from the European mainland, and profoundly affected by the way the EU is organized.

Response to the FAC's Questions

14. The FAC asks what institutional architecture the UK should seek for the EU, and whether the UK should embrace the idea of an EU made up of two or more tiers. That directly raises the question of what on any such analysis would be the right tier for the UK to be in. The answer plainly depends on how far we want in future to be counted among the leaders of Europe, rather than the followers.

15. Germany and France will continue to lead, and will tend always to look to each other first – bound as they are by the 1963 Elysée Treaty to arrive, "on all important policy questions, insofar as possible, at a similar position". Along with the leaders of the key EU institutions, they will tend to dominate any European top tier, however much they may disagree on many of the substantive issues.

16. If the UK wishes to maximize its influence in Europe, it has much scope for exercising as much influence as and sometimes more than Germany and France. So long as we remain in the top tier, then in the future as in the past, when either Germany or France disagree with the other, they will often seek support from the UK, thus giving us real scope for influencing the outcome in question. In addition to which, if we cultivate as we should our natural allies on each issue among the other member states, we can in any case often build up a strong bargaining position. But to the extent that we fall, voluntarily or otherwise, outside the top European tier in any given field, there will be an inevitable reduction in UK leverage and influence, often to our disadvantage.

17. We need in this connection to beware of the incremental effect of the widespread and increasing assumption in the rest of the EU that the UK perspective, when it comes to considering the future of Europe, is of less and less importance.

18. The potential danger to which the UK needs to be alert, in assessing the impact of the new 'fiscal compact' treaty, is that in other areas too the notion will take hold that in the construction of the key deal the UK does not have to be involved from the start, but can instead be presented later – as now happens routinely to Switzerland - with a series of *faits accomplis*. Our rights under the Treaty, where unanimity is required, of course still provide us with real protection, but there is nonetheless a clear and significant difference between being one of the prime movers in the power dynamics of the EU, from the beginning of any

discussion, and simply being presented with an already constructed package, which by that stage has become much more difficult to amend.

19. There is little solace to be had, even when we are right, from any situation in which we end up, as most recently in the context of the EU's implementation of the Basel III rules on banking regulation, isolated 26-1. If we find ourselves in that position, the strong likelihood is that we have in one way or another misplayed our hand – especially if it is clear that a number of the 26 in fact share our analysis.

20. Thus at the time of last December's European Council, it was plain that a number of other member states had real sympathy for aspects of our position – but we tabled our proposals and started to look for allies so late in the day that it proved impossible to build the alliance in our favour which would have greatly strengthened our position. The way the UK played its hand, in response to all attempts to agree the fiscal compact unanimously, and within the existing treaties, was in some respects understandable but on any analysis weakened our overall position in the European Union. The outcome of the December European Council, it is increasingly clear, in the eyes of many observers in the rest of Europe as well as in the UK strengthened the perception of a binary division between the UK and the rest, and opened up speculation about the more formal establishment of an explicitly two tier system.

21. It would certainly be better if the fiscal compact could still be incorporated in the treaties - provided the UK position were adequately safeguarded – because the UK would then be able, in an area of such cardinal importance for its interests, to play a full role in all relevant EU discussion. As far as possible, all future framework policy statements should be agreed by all 27 member states.

22. There will always be instances in which the strength of the UK interest in a particular policy line is such that we may prefer isolation to dilution of our own proposals – but there is a strong case for reducing their number to the absolute minimum, to avoid as far as possible our being forced de facto to live with policy outcomes affecting our interests which have been shaped and decided by others. How can we best seek to achieve that?

23. To keep the UK in the forefront of European decision-making will require, in addition to the necessary political commitment, first class planning and a clear and sustained determination to use to the full the networking and other assets we have. What are those assets?

24. We start with the benefit of the growing strength in Europe of the English language. It would be bizarre indeed to accept demotion from the top European tier just when our language is increasingly the lingua franca of our continent.

25. We have, and need to use to the full:

- bilateral links to the 26 other member states of the EU, which need to be nurtured constantly by all Ministers with EU-relevant business;

- and a policy coordination system the envy of our European partners (Jacques Delors, when President of the European Commission, went on record as saying he considered the UK's system to be the best in the EU). If used sufficiently far in advance, that system will tend to maximize our chances of securing, in any given case, at least a significant proportion of our objectives. If we continually reinvest in keeping it well oiled, and in first class working order – which requires (i) optimal coordination between the Cabinet Office, FCO and UKREP Brussels; (ii) effective EU coordination sections in other Whitehall Departments, and (iii) full involvement and use of our Embassies in other EU member states.

26. We also have, but have so far only fitfully chosen to play, a potentially significant role in the developing European polity which is, like it or not, part of the way today's European policy-making game is played.

27. Both Government Departments in London and our political parties need to understand the significance of the evolving pattern of party politics on a European scale. Important in part, clearly, because of the European Parliament's position in the EU, but also because of the prior caucusing of the party leaders before many European Council meetings which has now become a routine part of political life in the EU.

28. Our Government Departments need to make a much greater effort to engage with the MEPs, from all countries, who are active in their policy areas. All our political parties need in the national interest to ensure that they are playing an active role in intra-European dialogue, and in particular that their weight is felt in intra-party debate at the European level in the run up to key meetings of the European Council. In this respect, for instance, the Conservative Party's decision to leave the European People's Party has in effect meant that in recent meetings of the EPP leaders from the EU member states – such as that at Marseilles just before last December's European Council - the UK voice has gone unheard, sometimes at tactically very important moments.

29. Another weakness in our position is the alarming decline in recent years in the number of UK nationals securing posts in the EU institutions: in the most recent EU-wide competition, fewer than 3% of the successful candidates were from the UK (which has some 12% of the EU's population). This needs urgent attention, otherwise 15-30 years from now it will come to haunt us. In the real world, all EU member states rely significantly on the nationals they have in the EU institutions as part of their collective networking strength, and it makes no sense for the UK not to push hard to ensure that the playing field is made level. There is a strong case, which the FAC may wish to consider, for a substantial remedial package – including more training, especially in foreign languages, and agreement across Whitehall that the UK needs to send to Brussels some of its best and brightest civil servants.

30. One obvious test case in the offing for the UK's ability to remain constructively engaged in the EU inner core discussions is the subject of growth, and the issue of a potential growth compact to match the fiscal compact. Here the UK will plainly want an outcome to EU debate which takes the fullest possible account of the UK interest. Equally obviously,

some other participants in the discussion may tend to emphasise questions on which they are not at one with HMG – but there will certainly be some member states in broad agreement with the UK. The question of growth and how best to stimulate it should very clearly not be left solely to the euro area. It is much to be welcomed that the UK has been to the fore in the so-called "Like-Minded" group of member states, which since well before the French Presidential election has been stressing the strength of the case for action to help boost economic growth in the EU.

31. Another test case will be the forthcoming discussion of the EU budget. There we can either establish a purely defensive position, and just sit tight, determined to be inflexible, leaving the shape of the final package to be created by others – or apply ourselves proactively, while still of course pulling no punches about the importance of the UK interest, to the task of working hard at the core of the EU's debate on the subject, using all the arguments we can, to help forge an outcome which can be seen as acceptable to all.

Conclusions

32. Last December's European Council does risk becoming a watershed for the UK's place in the EU, but that is by no means inevitable.

33. To conclude that the UK should now favour a much looser arrangement for the future institutional architecture of the EU, whereby we would take up a position somewhere outside a new core Europe, would be a fundamental misreading of the UK national interest.

34. Certainly the UK must continue to fight its corner in relation to the fiscal compact, but our strategic approach should continue to be to do all we can to shape the evolution of future European policy.

35. In pursuing that strategy we need always to remember that in the modern European Union outcomes are increasingly shaped and predetermined away from the formal negotiating table. The race tends to go to the proactive, well organized alliance-builders, who maintain effective networks and plan their approach to each issue well in advance. Last minute initiatives of the kind the UK tried immediately before last December's European Council are unlikely to prosper. The UK has in ample measure the skills needed to build effective alliances in Europe, but we need to ensure that we both maintain them and use them, early enough in the game to have a chance of achieving our objectives.

16 May 2011

Written evidence from Jean-Claude Piris, former Legal Counsel, European Council and EU Council, and Director General, EU Council Legal Service

Written evidence submitted by Jean-Claude PIRIS (Piris Consulting sprl), Former legal Counsel of the European Council and of the EU Council and Director General of the Legal Service of the EU Council (1988-2010), at the request of the Foreign Affairs Committee of the House of Commons.

SUMMARY

- *The implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ("Fiscal Compact") which was signed on the 2nd March 2012 by 25 Member States of the European Union (EU) will not, in itself, go against the UK's interests.*
- *The conclusion of other intergovernmental agreements or arrangements of a similar kind, binding EU Member States other than the UK, and in particular the members of the eurozone, are not to be excluded in the future.*
- *If this were going to happen, the UK's policy should be to obtain legal guarantees for the protection of its rights and interests.*
- *An intergovernmental agreement or arrangement might be signed, in the period to come, by the members of the eurozone, given the need to increase the convergence of their budgetary and economic policies in order to solve durably the current financial and economic crisis.*
- *Solving this crisis and relaunching economic growth in Europe is a priority aim and an essential interest not only for the eurozone but also for the UK.*
- *It is argued that, if the way of a further integration was chosen by the eurozone to attain this aim, the UK would have no interest, and in any case would have no legal or political means, in trying to oppose or delay this evolution. The UK's aims could be that the provisions of any new intergovernmental arrangement should be fully compatible with the EU Treaties and guarantee openness and transparency. It should as well confirm the legal obligation of the Contracting Parties, under the judicial control of the EU Court of Justice, to comply with the letter and spirit of the EU Treaties, including the rules on the internal market.*

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BRIEF ANSWERS TO THE SPECIFIC QUESTIONS OF THE COMMITTEE ON THE "FISCAL COMPACT"

1) The December 2011 European Council and its outcome, including the signature on the 2nd March 2012 of the Fiscal Compact by 25 EU countries, are a logical consequence both:

   - of the need felt by the eurozone members to go forward in the integration of their policies in order to try and solve the current crisis, and
   - of the policy decided by the UK's Government and Parliament, in particular by the 19 July 2011 EU Act.[1]

1 See the Written Evidence that I submitted on the EU Bill to the House of Commons (European Scrutiny Committee) on November 24, 2010: "*...this might lead to the UK to be sidelined on certain issues. This is because it could trigger a tendency among other Member States to circumvent this*

2) One cannot expect the other EU Member States to remain inactive, if and when they think that they have important interests at stake, in cases when the UK exercises its right of veto within the framework of the EU.

3) If such a case happens, it is argued that the UK's policy should aim at ensuring that any action by the eurozone members shall respect their legal obligations under the EU Treaties. If this condition were fully respected, in letter and in spirit, the place of the UK in the EU and the possibility for the British Government to defend its rights and interests could be safeguarded.

4) The Fiscal Compact will not be legally part of the EU's acquis. Its entry into force will not have any impact on the EU budget, on enlargement, or on the Common Foreign and Security Policy.

5) The rights and interests of the UK might be easier to defend through an incorporation of the Fiscal compact in the EU Treaties. It appears that the Contracting Parties to the Fiscal Compact would not have any obligation or interest to make concessions as a price to pay to the UK for that incorporation. However, the UK could ask that some rules should be formally confirmed (this would in any case follow from the incorporation in the Treaties), such as the possibility to go to Court in case the UK's interests would be put in jeopardy by any decision taken by the Contracting Parties to the Fiscal Compact.

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ON THE POSSIBLE FUTURE EVOLUTION OF THE EU AND ON THE POLICY OF THE UK

6) TO SOLVE DURABLY THE CRISIS OF THE EUROZONE, ITS MEMBERS WILL PROBABLY HAVE TO INCREASE THE CONVERGENCE OF THEIR BUDGETARY AND ECONOMIC POLICIES

7) Most economists argue that it will not be possible to exit the financial (now also economic) crisis without increasing significantly the convergence of the budgetary and economic policies of the members of the eurozone. This has also been acknowledged by British political authorities.

8) This is now becoming more pressing. The high rate of interest which some of the eurozone countries have to pay to borrow money in the markets makes it difficult to encourage investment. Given the present state of affairs, trying to re-launch their economic growth could trigger a further increase in their interest rate. At the same time, it is becoming unsustainable to continue on the road of more austerity. This increases desperation on the part of their population suffering unemployment and fall in revenues and translates into a heavy price to be paid to populist political parties.

9) To be able to use adequate instruments to re-launch economic growth, a protection from possible reactions of the financial markets would be needed. The opportunity to earn money by speculating against individual members of the eurozone should disappear. To reach this aim, the eurozone should move closer to becoming a full economic and monetary union, as this is the only realistic way for the markets to be convinced.

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situation, either by engaging in enhanced cooperation among themselves without the participation of the UK, or by concluding intergovernmental agreements outside the framework of the EU".

10) This would demand visible and credible - albeit politically hugely difficult - actions, committing the governments, parliaments and populations of the eurozone countries. This evolution might be accelerated by the current situation in Greece.

11) It is obvious that this would raise huge political problems in the countries concerned, and that it is by no means certain to happen. Would taking such a road be sustainable politically, especially when coupled with budgetary austerity and slow or negative economic growth during a few years? This is a big question mark. However, the economic and political risks of an explosion of the crisis are such that one can bet that the road towards more share of powers within the eurozone has a reasonable chance to be accepted.

12) MAKING THE EUROZONE A FULL ECONOMIC AND MONETARY UNION WOULD INVOLVE ACCEPTING A SUBSTANTIAL SHARING OF POWERS

13) In such a hypothesis, the members of the eurozone would accept not to be the only masters of their budgetary and economic policies.

14) In legal terms, this would translate into a legally binding convergence, ie to go much further than the language used in the 2nd March 2012 "Fiscal Compact", where the Contracting Parties "undertake to work jointly towards...", "stand ready to make active use, whenever appropriate and necessary..." and "ensure that all major economic policy reforms that they plan to undertake will be discussed ex-ante and, where appropriate, coordinated among themselves...".

15) The members of the eurozone would be linked together by a joint responsibility and solidarity.

16) According to the author of this Evidence, "joint responsibility" would mean that each country involved should not finally adopt its national budget before having obtained a green light from "the centre". The choice not to respect a red light would entail the exclusion of financial help from Eurozone Funds. Economic policies might be subject to a convergence mechanism, which would be tighter in cases where a country is receiving financial help. A Eurozone Debt Agency could be created, as well as a Eurozone Banking Supervision Authority, going in the direction of a kind of Banking Union. This might also be accompanied by a minimal harmonisation of national laws concerning taxation (eg a common basis for the assessment of corporate taxes, to be followed eventually by minimal harmonisation) and social policy (such as linking the age and conditions of retirement to current demographic trends, establishing a common minimum guaranteed salary, taking measures to liberalise the labour market and to encourage labour mobility). It is also recalled that Article 138 TFEU might be used to ensure unified representation of the members of the eurozone in the Bretton Woods institutions in Washington, both the International Monetary Fund and the World Bank. These policies and actions would not be detrimental to the rights and interests of the UK or of the other EU States not having the euro as their currency.

17) If such a framework were to be adopted, the other side of the coin, ie "joint solidarity", might trigger a joint answer to a move from the financial markets directed against an individual country in the eurozone.

18) SUCH AN EVOLUTION WOULD TAKE THE FORM OF AN INTERGOVERNMENTAL TREATY OR ARRANGEMENT TO BE CONCLUDED BY THE EUROZONE COUNTRIES

19) A revision of the EU Treaties is politically excluded, especially due to the opposition of the UK and of other EU Member States. The only way forward for the eurozone members would therefore be to negotiate an intergovernmental agreement or arrangement among them. Taking into account its content, the conclusion of a legally binding instrument might involve a referendum, and possibly a change of Constitution, for some countries.

20) It is argued that the UK would not be able, and in any case would have no interest, in trying to oppose such an "Intergovernmental Arrangement" among the countries of the eurozone. However, the UK could and should obviously demand that this arrangement be compatible with the EU Treaties.

21) Besides, the members of the eurozone might, for reasons of coherence and also of political visibility, decide that the Additional Treaty could have other ambitions than in EMU matters *stricto sensu*, for example :

- in the policy of immigration, as linked to the labour market;
- in giving new political rights to the citizens of the countries involved, after a few years of residence;
- in encouraging swift progress in judicial cooperation in civil matters, especially the law of contracts and family law with cross-borders implications, in order to try and make life easier for families of different nationalities;
- in armament industry cooperation, aiming at a common public procurement; moreover, as regards defense policy, it is not excluded that some of the Contracting Parties consider that the time has come for the implementation among them of the "Permanent Structured Cooperation" foreseen in the Lisbon Treaty. If these last issues were to be considered as raising a difficulty for the UK, the British Government might think about launching other ideas in that domain, if that would better suit the UK's interests. This might be welcome by the other EU States, as it is difficult to conceive a group of European countries going ahead on defence matters without the active participation of the UK.

22) ONE OF THE ISSUES CONCERNING THE UK WOULD BE TO KNOW IF A NEW INTERGOVERNMENTAL ARRANGEMENT WOULD ENTAIL A NEW INSTITUTIONAL FRAMEWORK, DISTINCT FROM THE EU'S INSTITUTIONS

23) It would be in the interest of all to avoid the establishment of new organs, in order not to make the picture of Europe more complex than it is already today.

24) In principle, this should not be problematic for some institutions: the EU Court of Justice, the Court of Auditors and the European Central Bank could work, in their present composition and without any change to their status, in the implementation of an " Intergovernmental Arrangement", subject to the acquiescence of all EU Member States. One could hardly see what would be the interest of the UK in opposing this. Actually, British nationals are members of all these institutions. It would look better for the UK (and the other EU Member States non members of the eurozone) to accept that these institutions work for the eurozone as well as for the EU, rather than pushing the Contracting Parties to create new organs, which would appear to be legally feasible, even if politically unadvisable.

25) As for the European Council and the Council, the current situation would not be changed. Meetings of the 17 are already taking place back-to-back with them, both at the level of

Heads of State or Government and at the level of ministers responsible for economic and financial affairs.

26) The issue of the possible role to be conferred on both the European Parliament and the Commission would be more difficult.

27) It is quite obvious that, given its content, the implementation of an Additional Treaty would make it an absolute requirement to have strong, effective and legitimate democratic control. For legal reasons (text of the EU Treaties), it would look a priori impossible to use only the MEPs from the eurozone countries.[2] For political reasons, it would be difficult to use the entire European Parliament which, moreover, would not bring sufficient political legitimacy, especially in these matters, which are in the remit of National Parliaments, which have the power to decide on taxes. It would also be difficult to ask the National Parliaments of the States concerned to accept an important transfer of their powers in such essential domains, without giving them any say when corresponding decisions will be made at the European level. The logical solution would therefore be to establish a Delegation composed of Representatives of the National Parliaments concerned and to confer upon it a real power of co-decision and control.

28) As to the Commission, it would be difficult to imagine the EU Commission, composed of one member for each of the 27 (soon to be 28) EU Member States, taking (at least theoretically) all its decisions by a simple majority, being in charge of monitoring and imposing its decisions in essential matters to a group of them. However, it would be even more difficult to envisage the creation of a new organ with a whole range of similar functions, as well as with the necessary human resources which that would require. A solution might be found through the establishment of a small political organ, exercising limited tasks by itself, and out-sourcing their preparation, as well as other tasks, to other bodies, including to the EU Commission, if this was accepted by all EU Member States.

29) This would look easier if the EU Commission were re-organised, in order to be more efficient, assertive and independent, both from the Member States and from the European Parliament, in particular at a time when more powers are conferred upon it for the governance of the euro. The UK might be interested in such a way out, especially if it helps re-organising the EU Commission, which has been regrettably weakened over the last two decades or so.

30) THE IMPERATIVE FOR THE UK WOULD BE TO REQUEST AND OBTAIN RESPECT AND PROTECTION OF ITS RIGHTS AND INTERESTS

31) The UK will certainly demand that the eurozone should not establish itself as the first class of a permanent two-class or two-tier EU. Any action of what should remain a temporary group should be excluded in areas pertaining to the exclusive competence of the EU, including the areas of shared competence where the EU has already exercised its competences. The group should be forbidden to deal with issues directly linked, inter alia, to the internal market, external trade or foreign policy.

32) It should respect the normal functioning of the EU and of its institutions. Priority should always be given to proposals of the Commission to act or to legislate in the framework of the

[2] This might be seen as going against the letter and the spirit of the provisions of the EU Treaties on the European Parliament. Article 10(2) of the Treaty on European Union provides that "citizens are directly represented at Union level in the European Parliament". The mandate of MEPs is a European and not a national one. Actually, there are numerous acts voted in the EP that do not apply to all twenty-seven EU Member States, for example legal acts concerning fisheries, mountain areas, or specific kinds of industry.

EU. The cohesion of the EU should be preserved, both in the internal market and in foreign policy.

33) An Intergovernmental Arrangement, legally binding or not, should always remain open to accession for the other EU Member States, and foresee means to help those of "the others" willing and able to join. Actually, "the others" include States whose stated policy is to have the euro as their currency as soon as possible. Once these States will have ratified the "Fiscal Compact" and confirmed their policy, they might be offered an "active observer status" in the organs of the eurozone group.

34) As for the others, including the UK, they should insist that their concerns be taken into account and allayed. Provisions ensuring the legal protection of their rights and interests should be included in any new Intergovernmental Agreement. Firstly, openness and transparency should be ensured. Secondly, legal rules, whose respect should be under the judicial control of the Court of Justice of the EU, should guarantee the group's strict compliance with the letter and spirit of the EU Treaties, in particular of the rules on the internal market.

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35) Solving the current crisis of the eurozone would obviously be good for all EU Members, including the UK. It would be in the interest of the UK that the members of the eurozone organise themselves in order to solve durably the crisis, on the condition that the rights and interests of the UK be strictly and legally protected.

15th May 2012

FEU 06

Written evidence from Sir Michael Franklin KCB, CMG

Deputy Director General, European Commission, 1973-77; Head of the European Secretariat, Cabinet Office, 1977-81; subsequently Permanent Secretary, Board of Trade and Ministry of Agriculture, Fisheries & Food

Summary

- the December 2011 European Council did not disrupt business and was not a watershed.
- the EU can accommodate different national needs without the dangers of a 'two-tier' Europe.
- political changes in France and elsewhere open a new debate on how to restore growth in Europe; the UK must play a full part.
- in other important areas of EU activity, the UK has an important contribution to make.
- HMG should see its role in the EU in constructive not defensive terms, and present it in this way to Parliament and the British public.

1. The December 2011 European Council was not, and should not be seen as a watershed. Whatever the arguments for and against the position taken by HMG at the meeting, its effect was not to block progress. With characteristic ingenuity, the EU institutions found a way of dealing with the UK's unwillingness to sign up to the draft fiscal declaration. It is encouraging that, since the meeting, HMG has shown every sign of wishing to proceed with 'business as usual'. The eurozone crisis is too serious to worry too much about legal niceties.

2. Over the years, the EU has shown itself adept at accommodating different requirements of the member states. It abounds in derogations, opt-outs, partial membership, special treatment and other departures from a monolithic structure. I see no need and many dangers in trying to formalise this practice into some kind of two-tier EU.

3. It is now clear, notably with the arrival of a new French President, that a new debate on how to deal with the economic crisis is beginning. It may not reopen the Fiscal Treaty as such but it will certainly lead to a vigorous challenge to its adequacy as a means of solving the many problems of recession, unemployment and banking failures. In one form or another, there will be more emphasis on parallel policies to stimulate growth. This will be an EU-wide debate and it is therefore important that the UK should play its full part in it. It could also provide a convenient opportunity for the Fiscal Treaty to be incorporated into the EU Treaties. Since its contents accord so closely with current UK policy, there seems no reason why HMG should not give its consent, perhaps as part of a package of measures acceptable to the UK resulting from the current debate.

4. I note with satisfaction that the Committee's enquiry is "starting from the assumption that the UK should and will remain an EU Member". This must surely be right. But at present the UK is not getting full value from its membership. The Committee could play a very valuable role in asking, more generally than the particular questions on which the Committee has sought evidence, how the UK Government should play its role as an EU member. All too often in the past, under governments of different persuasions, the UK has put itself on the defensive in Europe. Hence it is often seen by others as a reluctant member, not willing to engage constructively and all too often seeking special treatment for the UK.

5. When we were fighting for a fair UK budgetary contribution such an attitude was inevitable and the legacy is still with us. But that touches only one aspect of EU policy. There are others where the UK can and should have a positive contribution. That has always been true of trade policy where the generally liberal trade policies have owed much to British influence. Even in agriculture, the CAP, albeit still absorbing too large a share of the budget, has changed significantly for the better in ways much closer to UK thinking. In those areas where the EU has still not achieved a single market, there is much for the UK to play for.

6. The EU's Common Foreign and Security Policy is a hugely important and growing part of the EU's activities. Here, surely, with its basis in co-operation rather than majority voting, is a place where the UK by virtue of its history and diplomatic skills can and should play a leading role.

7. If, in these and other areas, the UK Government can be seen actively to serve British and European interests well, it would offer public opinion good news to counterbalance the negative and often misleading accounts currently offered by the media. Its actions and decisions need to be explained to Parliament and to the British public not in confrontational terms but as being the result of honest negotiation and in terms which show where the outcome has been beneficial for Britain and of the EU as a whole. As I wrote in 1990,[1] "by all means let Britain act in the future more as though what is good for Britain is good for the Community, but we need also to believe that what is good for the Community may be good for Britain".

18 May 2012

[1] "Britain's Future in Europe", Michael Franklin with Marc Wilke, Chatham House Papers, RIIA, 1990

Written evidence from The Church of England, The Archbishops' Council

Summary of Main Points

- The Church of England is a Church established by law in the UK but it is also by virtue of its history a European Church. It recognizes that to have any influence in Brussels it needs to work in partnership with others. To this end it has invested time, energy and resources in building appropriate bilateral and multilateral relations with key strategic partners across Europe.

- At the December 2011 European Council, the United Kingdom found itself not only without allies, but without credibility as a negotiating partner as it opposed measures which were intended to achieve broad policy goals which are fully in line with UK national interest. This exposed the domestic constraints on the British government and left its partners with the impression that it was an unreliable partner. An opportunity to show solidarity with partners was missed. The UK must work to rebuild trust with its EU partners.

- Successive British governments have failed to articulate a policy towards the United Kingdom's closest partners that sustains public opinion while enabling it to take a constructive line across the board. Unless future governments develop more constructive and positive conceptions of and commitments to the EU and are able to sell them to an increasingly skeptical domestic audience then Britain could find itself slowly drifting towards the exit. Rather than looking to formalize a two-tier structure the Government should use existing Treaty provisions on enhanced cooperation to press for a more flexible multi-speed Europe with variable membership across different policy spheres.

- By agreeing a legally binding intergovernmental agreement outside the scope of the EU Treaties, signatories to the fiscal compact have marginalised the EU institutions and in so doing weakened their ability to defend the single market. These new arrangements could also have significant implications for the EU's common judicial space and common foreign and security policy. There is a very real worry therefore that the fiscal compact while saving the Euro might over time contribute to the EU's demise.

- It is in the fundamental interests of the UK that the problems of the Eurozone are resolved and it is in the UK's interests that this fiscal compact is folded back into existing EU Treaties as soon as possible. Those wishing to press ahead with a stability union should be able to do so using existing Treaty provisions that allow for enhanced cooperation. The development of a two-tier or even a multi-speed Europe is not without its risks but it is preferable that such a development builds on existing Treaties rather than departing from them.

Introduction

About the Mission and Public Affairs Council

1. The Mission and Public Affairs Council is the body responsible for overseeing research and comment on social and political issues on behalf of the Church. The Council comprises a representative group of bishops, clergy and lay people with interest and expertise in the relevant areas, and reports to the General Synod through the Archbishops' Council.

2. The Church of England, established by law in England, is a European Church active in all the member states of the European Union. It counts among its members nationals of all the member states and many others.

3. The Church of England maintains very close links with the Anglican churches of the rest of the United Kingdom, Ireland, Spain and Portugal. It works in partnership with the Old Catholic churches in Netherlands, Germany, Austria and Switzerland, the Lutheran churches of Iceland, Norway, Denmark, Sweden, Finland, Estonia and Lithuania. Special agreements also exist with the Evangelical Church in Germany and the Roman Catholic Church in France. It maintains 25 companion links with churches in Europe and is active in the Conference of European Churches.

4. It is from this broad base that the Church of England engages with the European Union. The Archbishop of Canterbury has a permanent representative to the EU institutions in Brussels and members of its Europe Bishop's Panel are frequent visitors to Brussels and Strasbourg.

5. The Church of England's policy on Europe has been framed by a succession of papers which have been endorsed by the General Synod, its representative assembly. The Church of England engages with the European Union to ensure a values based approach to Europe's development. It does so in order to build a humane, socially conscious and sustainable Europe at peace with itself and its neighbours.

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

6. The 2011 December European Council was less a watershed in Britain's relationship with the EU as it was the natural and inevitable consequence of decisions taken by successive British governments over the last two decades.

7. The decision not to join the Euro until the economic conditions are right, and only then if approved by referenda, has meant that Britain has always been detached from conversations regarding the governance of the Eurozone. One of the stated reasons why past governments have opposed membership of the Eurozone is that along with monetary union must come closer fiscal integration. There is therefore a 'remorseless logic' of closer integration in-built into the Euro project that Britain has rightly or wrongly decided to exclude itself from.

8. Moving beyond Eurozone specifics, the 2011 European Union Act acts as an emergency brake on Britain's relationship with the EU by requiring any proposed EU Treaty or Treaty change to be subject to a referendum. As a number of Lords Spiritual pointed out at the Second Reading, the Bill ties the government's hands in future Treaty negotiations by delegating authority to the people acting through a referendum. The relatively negative state of public opinion towards the EU (in 2011 opinion polls indicated for the first time a majority in favour of leaving the EU) opens up the prospect of referendum defeat for any future government.

9. The December 2011 European Council showed, however, that the 2011 European Union Act does not serve as an emergency brake on the integrationist tendencies of others**.** That other countries, even non-Eurozone states, are now willing to openly press ahead without Britain, even if that means working outside the formal structures of the EU, is symptomatic of Britain's waning influence in Europe and its declining ability to cultivate allies in Europe.

Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

10. Institutional architecture and membership should be the servants of the issues and priorities that can be anticipated, not goals in themselves. Economic austerity and its consequences are likely to dominate policy, not just in the United Kingdom, but across Europe, well beyond 2020. In these circumstances it will be more than ever necessary for government policy to project hope and to demonstrate solidarity, not just domestically, but with our partners.

11. Against this uncertain background future British governments need to develop constructive and positive conceptions and commitments to the EU, sell these ideas to an increasingly sceptical domestic audience, and find friends in Europe. Unless it does so the UK could find itself slowly drifting towards the exit. That would be a travesty given the positive contribution that Britain has made to the EU since it joined in 1973.

12. Any notion that the UK could somehow turn to 'like-minded' member states to define an alternative to a core of more 'integrationist' member states was shown by events in December to be unrealistic. The problem of the December European Council was not that of two camps, but of a single camp with one major player outside it, despite its vital interest being at stake.

13. The events of December have shown that, despite differences of approach between member states, almost all wish to travel together based on a recognition of continuing shared interests and a desire for solidarity in the face of the most significant policy challenge for the EU since its inception. A two-tier Europe is simply not on the agenda. We suspect Europe's future will be more messy and complex with Europe developing a multi-speed approach with variable membership across more closely coordinated policy spheres.

14. Existing European Treaties provide for enhanced cooperation between member states. Britain should look to use this Treaty provision to develop permanent areas of structured cooperation with like-minded member states on issues of strategic concern across the other two pillars of the EU. An obvious area which would benefit from enhanced cooperation is the field of defence and security and it is an area where Britain can play a leadership role. Such an approach might ensure that Britain is seen as a full and committed EU member, even if it absents itself from the Eurozone and its governance structures.

15. Under this arrangement member states are likely to find themselves operating in different contexts with a different mix of partners and travelling at differing speeds rather than travelling together in convoy at the speed of the slowest. The Europe of tomorrow might therefore more closely mirror the *Europe de Parties* envisaged by Charles de Gaulle than the supranationalism pursued by Jean Monnet.

16. We anticipate that the break with the one-speed model to a multi-speed Europe, could help unpack some of the obstacles that currently impede the future enlargement of the European Union. Enlargement has run into the ground within the current EU. But a messier and more variable multi-speed Europe might prove a vehicle through which to integrate Turkey, Ukraine and others.

17. We accept that there are as yet un-assessed risks with this model of European cooperation. Is enhanced cooperation fragmentation by any other name? Will an *a-la-carte* approach to Europe generate a strong-enough sense of common purpose for Europe to survive? At what point in the process does Europe's policy making become incoherent and ineffective? How might the move to various sub-groups possibly with their own institutions and procedures impact on the EU's institutions and other policy areas? Will smaller member states feel marginalised such that the trust that binds all member states together is eroded?

18. Whatever the answer to these questions, ideas regarding the future of Europe must seek to close the gap between Europe and its citizens. Popular disenchantment with the EU, might be most marked in the UK, but the EU's crisis of legitimacy is a Europe-wide rather than a uniquely UK problem. As suggested by the Lord Bishop of Guildford in the House of Lords debate on the EU on 16 February 2012, Europe needs a revival of the vision of Europe which fired the EU's founders and which is deeply rooted in Europe's many cultures and, now, its many communities of faith.

19. From a UK perspective the Government needs to move beyond the defensive measures provided by the 2011 European Union Act to articulate new channels by which voters can be engaged in the political choices facing the EU. These measures need to be complemented with steps to tackle at both a national and European level some of the issues that fuel populist debates about Europe, some of which are based on miscommunication.

What is the relationship between the new 'fiscal compact' Treaty and the EU's acquis? What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy?

20. As the Lord Bishop of Guildford made clear in the EU debate of 16 February it is to be welcomed that Britain has taken a more pragmatic line when it comes to the use of EU institutions in the workings of the fiscal compact.

21. We remain concerned, however, that the fiscal compact weakens these institutions and makes it harder for them to perform their role of defending the single market and ensuring that all member states are treated fairly. At the very least these institutions will have to try and reconcile two sets of rules and procedures which can only absorb time and resources so making it harder for them to protect and extend the single market. We suspect that over time the relationship between the EU institutions and the fiscal compact will be determined by the European Court of Justice.

22. It was possible that over time the 'Euro core' even without the complication of the fiscal compact would increasingly speak with one voice within the EU as well as outside it. The fiscal compact threatens to accelerate this process. Although history suggests that countries tend not to act as a cohesive caucus there is clearly a risk of signatories to the fiscal compact agreeing a single position and only then negotiating with others. It is important that assurances are in place beyond those set out in the fiscal compact that key policy areas such as the single market, common trade policy and the common budget will be negotiated at the level of all 27 member states rather than being decided by a subset of the EU.

23. Externally, there is a danger that these new arrangements will impair the EU's ability to present a coherent and unified position to others and in international forums with the result that the benefits of a common foreign and security policy remain unrealized. The EU has built a reputation for being fiercely committed to a global order based on strong, multilateral rules and institutions. It supports free trade, the United Nations and global

solutions to challenges such as climate change, economic marginalization, poverty and organized crime.

24. As suggested by the Lord Bishop of Exeter in a supplementary question in the House of Lords on 8 December 2011 the EU's international reputation has already been dented by its handling of the Eurozone crisis, but its soft power could be further eroded if others find the way it organises itself less attractive. We suspect it will be hard for the EU to meet future challenges if an important geopolitical country such as Britain is excluded from its core.

25. We note here the ongoing discussions between France, Germany and Italy as to the possibility of unilaterally establishing their own joint representation at the IMF which might in time provide a core multi-country seat around which all euro area members might be included. We worry that in seeking a solution to the Euro crisis member states might have weakened Europe's ability to play a role in a world which is seeing a significant transition of power from West to East. That is not only regrettable but shortsighted.

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

26. The EU and the Eurozone had various options available to them to resolve the institutional crisis that lies behind the euro crisis. They could have continued with the policy of incremental shifts without treaty change, changed the European treaties to create a stability union or broken free from existing treaties and signed a legally binding agreement amongst themselves.

27. None of these options provide(d) a cast iron solution to the problems affecting the Eurozone, but we consider the third option the most risky and least attractive. It potentially threatens the future of the EU itself by creating over time a tightly integrated core that undermines the single market and prevents Europe from exercising its collective power on the world stage.

28. It is in Britain's interests that this fiscal compact and/or its provisions are folded back into existing EU Treaties as soon as possible. Those wishing to press ahead with a stability union should be allowed to do so using existing Treaty provisions that allow for enhanced cooperation. The development of a two-speed or even a multi-speed Europe is not without its risks, but it is preferable that such a development builds upon the existing Treaties rather than departing from them.

29. In terms of safeguards, the Government should press for a deepening of the single market in order to strengthen the ties that bind all member states together regardless of which lane they are in. This step might be productively linked to pressing for enhanced cooperation in other areas where Britain has a competitive advantage and strategic interest such as foreign and defence policy.

30. Taken together these measures might go some way to dispelling the impression given in December 2011 that Britain was being awkward for the sake of it. We recognise that this strategy is unlikely to find immediate favour with a euro-sceptic electorate, but over time it might help to refute the assertion that the EU works against British interests.

21 May 2012

Written evidence from Professor Clive H. Church, Dr Paolo Dardanelli and Sean Mueller, Centre for Swiss Politics, University of Kent

The 'Swiss Model' of Relations with the EU and its relevance for the UK

Executive Summary

1. The idea that it would be advantageous for the UK to adopt the 'Swiss model' of relations with the EU instead of membership is neither new nor politically neutral.
2. The suggestion is based on a poor understanding of the features of such a 'model' and of the conditions within which it operates.
3. Actual Swiss relations with the EU have disadvantages as well as advantages.
4. A careful examination of the Swiss experience suggests that the Swiss 'model' is inferior to the status quo of UK-EU relations.
5. The UK should try to preserve a unified institutional structure for the EU in the face of pressures for a formalised two-tier architecture.

0. Submitters

Clive H. Church is Emeritus Professor of European Studies, Paolo Dardanelli Lecturer in European and Comparative Politics, and Sean Mueller a doctoral researcher in Comparative Politics, all at the University of Kent's Centre for Swiss Politics. Prof. Church has been working on Switzerland since the 1970s and published three books, notably the edited volume *Switzerland and the European Union* (Routledge 2007). Dr Dardanelli is the author of a series of articles and book chapters on Swiss politics while Mr Mueller, a Swiss national, is completing a PhD on inter-governmental relations in Switzerland.

1. Purpose

It is sometimes claimed that Switzerland's relations with the EU might provide a better model for the UK than membership. The claim is generally based on a limited understanding of the Switzerland-EU 'model' and especially of the conditions within which it operates. The purpose of the present evidence is to outline key features of Switzerland's actual relations with the EU and explore the extent to which these could profitably be adopted by the UK.

I. SWISS RELATIONS WITH THE EU

2. The Idea of a Swiss 'model'

Those who suggest the UK adopts the 'Swiss model' proceed from admiration for Switzerland's economic and political performance. However, the reasons for this are rarely spelled out. They have to be teased out of a series of broad statements about free trade and bilateral cooperation. Critics of UK membership tend to believe the main pillars of the Swiss model to be a popular refusal to join the EU; government intransigence towards 'Brussels'; one-to-one free trade deals with the EU; co-operation in other areas of use to Switzerland; a separate currency; a limited/part time parliament; and referenda. However, whether all this amounts to a 'model', either in the sense of a single, deliberate Swiss creation or a template accepted by all those who urge the UK to follow the Swiss example, is far from certain.

3. Background

Membership of any supranational organisation was long considered incompatible with the country's traditional policy of neutrality. Switzerland did not get involved in the early phases of European integration and stayed outside both the European Coal and Steel Community and the European Economic Community. It joined, however, the European Free Trade Association (EFTA) in 1960 and the Council of Europe in 1963 as these organisations were by then perceived not to encroach on neutrality and sovereignty. In 1972, along with the other EFTA states, it signed a treaty with the EU on free trade of manufactured goods.

4. EEA negotiations and EU application

The emergence after 1989 of a narrower conception of neutrality, and the changing international context led Switzerland to take part in the negotiations to create the European Economic Area (EEA) and to apply for EU membership in May 1992. Ratification of the EEA treaty, however, narrowly failed in a referendum in December 1992. The campaign exposed deep divisions within Swiss society and led to a record high turnout. Subsequent events have confirmed the caution of the Swiss electorate about further integration, although pragmatism has often won out over Europhobia.

5. The bilateral approach

After the EEA vote, the country embarked on a bilateral approach, aiming to sign separate treaties covering a range of policy areas so as to fill the gaps left by being outside the EEA. The first main package of bilateral treaties proved difficult to negotiate and only came into effect, after endorsement in a referendum, in 2002. It contained seven separate agreements on free movement of persons; technical barriers to trade; public procurements; agriculture; research; and overland transport. A second package was signed in October 2004. Its nine separate agreements entered into force at different times, according to different ratification requirements: processed agricultural goods, pensions, and taxation of savings (all three in force since 2005); environment

and media/film industry (both 2006; renewed film agreement signed in 2007 and in force since 2010); statistics (2007); Schengen/Dublin (2008; airports 2009); education (2010), and fight against fraud (not yet ratified by all EU states; applied by Switzerland since 2009 with those that have). In these areas, EU law directly applies to Switzerland. At least 120 other technical agreements are also in place, some dating back to the post war years. Switzerland also contributes financially to EU cohesion and research policies.

6. Informal Integration

The EU's impact on Switzerland goes beyond the effect of formal treaties. In order to make its economy as EU-compatible as possible, the country has adopted a policy of 'voluntary adaptation' whereby Swiss law is aligned with the EU's *acquis communautaire*. A prominent example is the incorporation of the *Cassis de Dijon* principle into domestic law in 2010. Recent research shows that around 55 per cent of the laws passed by the Swiss parliament concern transposition of international, including EU, law. The bilateral treaties and the country's voluntary adaptation have led to Switzerland being much more deeply integrated with the EU than suggested by its formal status as a non-member. Indeed, in certain respects such integration is deeper than that of EU members such as the UK, as the case of Schengen shows.

7. Advantages

7.1 The resulting relationship clearly has many attractions for Switzerland. If initially it was a fallback option in the face of a lack of popular support for membership, it has come to be seen by both the elite and the electorate as the best way of managing the country's relations with the EU.

7.2 The bilateral way essentially enables Switzerland to benefit from access to the single market while retaining a degree of political autonomy in other spheres. Compared to EU membership, such autonomy is particularly significant in monetary, fiscal, trade, and agricultural policy. It also exempts the country from making a contribution to the EU budget commensurate with the size of its economy.

7.3 Symbolically, the bilateral way preserves the formal trappings of state sovereignty and allows the unencumbered exercise of direct democracy. The bilateral way has so far served the country rather well. After a difficult period in the early 1990s, the economy has been highly successful over the last 15 years. At least some of this success can plausibly be attributed to its pragmatic partial integration with the EU.

8. Disadvantages

8.1 The most fundamental disadvantage is that Switzerland finds itself directly or indirectly compelled to adopt much of EU law without having any say in the process of making such law. The EU has made it clear that access to decision-making can only come with membership, so this is unlikely to change. The paradox is thus that an arrangement meant to protect Switzerland's autonomy is actually eroding it. Indeed, some say Switzerland is a vassal or satellite of the EU.

8.2 The legal framework of the bilateral approach is cumbersome, fragmented and static. The linked nature of most of the treaties makes individual agreements potentially hostage to others. This complicates their adaptation to the evolving *acquis communautaire*. A subsequent negative vote in a referendum might endanger the whole initial package. Moreover, while the Swiss government has contemplated negotiating a third set of treaties, the EU has made it plain that it believes the bilateral road has come to an end and that in the future the relationship would have to be based on quasi-automatic acceptance of EU law. The government has aired proposals on the basis of which Switzerland would 'provisionally' adopt the evolving *acquis* under the supervision of a Swiss monitoring agency and subject to direct democracy challenges. But the EU has already signalled its opposition to such an arrangement.

8.3 Some of the advantages also have a negative side to them. Freedom of movement has led to a substantial influx of labour and exacerbated tensions around the high percentage of non-nationals in the country (22 per cent). In April 2012, the Swiss government decided to cap immigration from the post-2004 EU states under a safeguard provision, attracting vocal EU criticism. The rapid appreciation of the Swiss franc in the context of the Eurozone crisis has also created problems. The Swiss National Bank tried to cap the currency's rise by committing itself to maintaining a lower bound of Sfr 1.20 to the euro, a stance now being tested by the markets.

9. Conclusions

9.1 The Swiss 'model' of relations with the EU is one of considerable integration without membership. It would be erroneous to interpret it as 'market access without the burden of regulation' as the impact of EU law on Switzerland is very extensive. Equally, the idealized view of an intransigent and wholly aloof stance is not borne out in practice. Moreover, while bilateralism has served the country well so far, there are serious doubts as to whether it can continue to do so. Switzerland thus finds itself in an impasse, with the bilateral room for manoeuvre increasingly narrow, on the one hand, and severe domestic obstacles in the way of a more comprehensive agreement – or membership – on the other.

9.2 Switzerland has not ruled out membership altogether. Although joining is no longer active government policy, the application submitted in 1992 has not been formally withdrawn despite much pressure for this. A fundamental obstacle is presented by negative public opinion and high constitutional hurdles. Under the country's federal system, membership would have to be approved in a referendum by a double majority of citizens and cantons. As some of the latter are very small and strongly anti-EU, observers estimate that close to a 60 per cent popular majority would be needed to clear the cantonal majority requirement. The present state of public opinion is very far from that: only around 20 per cent favour EU entry, although attempts to insert a ten-year moratorium on entry into the Constitution have recently failed.

9.3 Switzerland thus faces a fundamental trade-off, pitting the autonomy derived in some areas from staying outside the EU against the costs of not having access to EU decision-making. The viability of the bilateral model rests on the former being greater than the latter. While this might have been true in the past, as the country's *de facto* integration continues – hence its autonomy shrinks – there are increasing concerns that costs might soon outweigh benefits.

II. THE MODEL'S RELEVANCE FOR THE UK

10. Origins of the idea

The idea that the UK should adopt the Swiss model of relations with the EU is neither new nor politically neutral. It has its roots in calls for the UK to rejoin EFTA and was advocated in the late 1980s by the Bruges Group. More recently, it has been advanced by Daniel Hannan MEP, Sir Rocco Forte and others. Thus David Campbell Bannerman MEP told the EP that the UK should replace membership by 'a free trade agreement, an arrangement very successfully adopted by Switzerland, saving it CHF 3.4bn.' In other words, the idea has come mainly from critics of the EU. Some have also called for the adoption of features of the Swiss system in the UK, notably direct democracy and decentralisation.

11. Applicability to the UK

However, the model has significant limitations even for Switzerland. Any discussion over its applicability to the UK must also take into account the major differences between the two countries. While some of them would work in favour of the UK, others would make the model even less attractive for the country than it is for Switzerland.

12. Levels of interdependence

A first important aspect is the different level of interdependence with the EU. Because of its size, economic structure, and geographical location, the UK is less dependent on (the rest of) the EU than Switzerland is – the EU buys 60 per cent of Swiss exports. A hypothetical UK-EU bilateral relationship would thus be less asymmetrical than the Switzerland-EU relationship at present. This could mean that the UK would find itself in a stronger bargaining position vis-à-vis the EU and be better able to secure advantageous terms.

13. 'Withdrawal' versus 'rapprochement'

A fundamental difference, however, is that Switzerland has come to the present model through progressive rapprochement to the EU. The UK would have to adopt it after having left the EU. The two dynamics are obviously very different and might produce different attitudes on the part of the EU. While the EU has been more accommodating in its approach to Switzerland than might have been expected, this is now changing, and could rub off on attitudes to the UK after renegotiation or withdrawal.

14. No such thing as 'free trade without regulation'

As outlined, the Swiss model is essentially one of considerable integration without membership, not of rejection of integration. Crucially, it includes acceptance of EU economic regulation without a say in shaping such regulation. If support for the Swiss model in the UK is motivated by a desire to escape EU regulation, then the former certainly is not the way to pursue that objective. If the UK left the EU, it could only retain access to the single market by also accepting

regulation, and would have no influence over the making of such rules – or certainly less than at present.

15. Savings versus influence trade-off

The UK already enjoys a tailor-made, semi-detached form of EU membership – which leaves it outside two of the key areas of integration, monetary union and Schengen, but with the option of joining them any time – while Switzerland has joined Schengen. Hence, the Swiss situation's chief attraction for the UK essentially rests on the savings the country would make if it did not have to pay member-level contributions to the EU budget. While such savings would be substantial, they should be set against the loss of influence the UK would suffer from withdrawing from the EU. In broad, as opposed to narrow accounting, terms, the costs of the latter would almost certainly be greater than the benefits of the former.

16. The impact of possible EU restructuring

It is possible that the EU will restructure in the direction of a two-tier, core and periphery, architecture as a response to the Eurozone crisis. If so, the key question for the UK would be what level of access to institutions and decision-making the 'outer' members would have. Should restructuring go as far as effectively marginalising the non-core countries, membership of such 'periphery' would come to resemble membership of the EEA. This would raise questions in the UK as to whether the terms of the trade-off outlined above would still be in the country's interests. In such a scenario, the Swiss model might become more attractive for the UK. It would be premature, though, to assume a restructuring along these lines. While the 'remorseless logic' of integration, as the Chancellor put it, is certainly at play in the Eurozone, there are powerful obstacles in the way of fundamentally changing EU membership into separate 'classes'.

17. Conclusions

Many of the advocates of the Swiss model in the UK have an imperfect understanding of the features of actual Swiss practice and the challenges it is currently facing. In particular, they fail to appreciate that the model does not deliver free trade without regulation and that it carries high costs in terms of influence. The 'selective' form of membership the UK currently enjoys appears clearly superior to the Swiss model, even from a narrow cost-benefit analysis, let alone from wider considerations such as the UK's place in the world etc. Unless the 'constitutional' architecture of the EU changes dramatically in the wake of the Eurozone crisis, this situation is unlikely to change for the foreseeable future.

III. RECOMMENDATIONS TO THE COMMITTEE

18. Swiss model unsuited to the UK

Our central recommendation is that the Committee should consider the Swiss 'model' of bilateral treaties as unsuited to the UK. It would be an inferior form of pursuing the country's interests in its relations with the rest of Europe compared to the status quo, because it would mean giving up political leverage over fundamental EU decisions.

19. December 2011 European Council and the 'fiscal compact'

We would not over-emphasise the significance of the December 2011 European Council. While the 'fiscal compact' is important, it has not so far greatly impinged on thinking about the Swiss 'model' or on actual Swiss relations with the EU. The latter continue to focus on banking secrecy, tax policy and the question of finding a mutually acceptable form of institutional and policy cooperation. However, in line with much Swiss opinion which sees the history and structure of Swiss nation building as something which the Union should adopt, one think tank has seen it as another potential case where the EU might use Switzerland as a model. This points to the fact that the fiscal compact, assuming it comes into effect in its present form, and especially if it is incorporated into the treaty base, could well introduce a new element of EU-directed control of national economic and financial policies.

20. UK position on a 'two-tier' EU

The UK is already in a *de facto* special form of membership but has full access to the institutions and formal decision-making. A more formalised division into two tiers that would limit institutional access and influence on decision-making would be unlikely to be in the country's interests. The UK should thus try to retain a unified institutional structure for the EU.

21 May 2012

Written evidence from Civitatis International

About Civitatis International

Civitatis International is an independent and supranational think-tank on global governance. Civitatis International is composed of a global network of leading international relations professors and practitioners around the world who research according to the editorial mandate of Civitatis International: Constructive solutions to the common global challenges and crucial issues facing mankind's civilization now and in the future.

Civitatis International works with stakeholders around the world as a supranational research institute independent of any state interest so as to effectively analyse and propose solutions to the interlinked global challenges. Civitatis International publishes its high-level research on global issues to former and serving heads of state and government and global stakeholders.

Policy Seminar: The Future of Europe

Civitatis International convened a policy seminar on "The Future of Europe: Towards the European Dream?" at the Office of the European Parliament in London on April 19th 2012.

Sir Peter Marshall KCMG CVO, Former Deputy Secretary General of the Commonwealth and distinguished British diplomat, chaired the seminar. The discussants included: Mr. Edward Mortimer CMG, Former Chief Programme Officer of the Salzburg Global Seminar and former speechwriter to UN Secretary General Kofi Annan; Mr. Daniel Ottolenghi, Head of the London Office of the European Investment Bank; Mr. Maurice Fraser, Senior Fellow in European Politics at the European Institute, London School of Economics and Associate Fellow at Chatham House and Professor Christopher Coker, Lecturer in International Relations at the London School of Economics and former member of the Council of the Royal United Services Institute.

Taking part in the Civitatis International policy seminar were: Ambassadors to the Court of St James's; First Political Officers and Embassy representatives from key nations; former British Ambassadors and diplomats; representatives from the United Kingdom Foreign and Commonwealth Office; Former Members of the British Parliament; the Atlantic Council and CEOs of City of London companies. Also in attendance were selected young leaders from the British political parties and London's leading universities.

The basis of the seminar was to explore the greater vision for the future of the EU in a broader context and not necessarily for the specific interests of each member state. Therefore our recommendations to the UK Foreign Affairs Committee drawn below are specifically to questions 1 and 2 as submission of evidence.

The below submission of evidence does not necessarily represent the views of the seminar's participants.

Summary to Recommendations

Some of the solutions derived from the seminar included: Retelling the European story in a way that engages and makes sense to all Europeans; emphasizing not what divides us but focusing on what brings us together as Europeans; reaffirming the values on which Europe was built and not allowing politicians to override those values; building a new European economic growth based on an increased European competitiveness in the global market; accepting the new realities of the changing world order towards a more communitarian world and that the European cosmopolitan model may not become universal.

1. Observations and Factual Information Derived from the Civitatis Seminar

1.1. The current pockets of optimism for Europe appear to be, on the surface, more economic, as opposed to political, and in terms of any separation between the two, a 'two-tier' Europe appears to exist. However this is not just simply political versus economic, since there are aspects of economic union which are very important to countries such as Britain, the single market particularly, and equally there are aspects of the political which not all Eurozone members are willing to fully sign up for. 'Variable Geometry' or 'Multi-speed' Europe is the best description of Europe's current state. Phrases like 'two-tier' imply some sort of automatic division. The situation is infinitely complicated and unless there is full political union it is bound to exist. Sovereign states will always want to do different things. How far will it be possible to organise some sort of fiscal union without it drawing in its train everything else? The language of 'two-tiers' is unhelpful. There must be more flexibility than terms of 'two-tiers' or 'two-speed', and so 'Variable Geometry' is a better phrase for the UK government to use.

1.2. It is imperative that Europe overcomes the Eurozone crisis, because apart from the economic damage, it decreases talk of integration and increases the language of break-up; of the Eurozone or perhaps even of the European Union. Average unemployment in Europe was at 10.9 percent in March 2012, according to the Financial Times, and there are nine countries in the European Union with double-digit unemployment rates. In creditor countries there is growing appeal of Eurosceptic populist parties. In debtor countries austerity is perceived as imposed by Brussels or hostile Northern European countries, and Europe-wide there is anti-EU sentiment feeding on the impact of recession. The UK government should look into alternatives to austerity.

1.3. To see growth which might facilitate its aims Europe must achieve an increase in competitiveness. This will require both in-depth structural reforms at the national level and gains in competitiveness that can be achieved by European action, through completing the single market in areas so far untouched, such as many service sectors, and potentially developing common infrastructure in transport and energy. Some countries, such as Germany, have already progressed greatly, but many others still have much to do to improve competitiveness. Here too, there is evidence, including that of Germany, suggesting it will take a long time. Mario Monti, the Italian Prime Minister, has even said that Italy will need eight years of structural reforms. Improving competitiveness will mean reform of labour markets, of pension and welfare systems, investments in physical infrastructure, education, Research & Development, and at the European level, completing the single market. There will be powerful resistance to reform from those who benefit from the

existing system. Current opposition in Greece, or Italy, to structural reforms is because they touch the interests of people who are benefiting from the existing system.

1.4. While Europe needs to increase competitiveness, it does not have a problem of a finance gap in aggregate. Looking at the EU-27 as a whole, the European Union's balance of payments is essentially in equilibrium. The problem of gaps in foreign finance for Europe as a whole would arise if Europe had a balance of payments deficit, and in order to finance that deficit it would need recourse to finance from countries such as China, Japan, and Brazil. Europe, as a whole, also does not have a balance of payments deficit. However there are surplus countries and deficit countries, so the problem is of a flow of funds within Europe. There is a reluctance already within Europe by European investors to invest in countries which currently do not appear to have favourable prospects. Why would Japanese investors, for example, want to invest in projects in countries where there is little confidence of a sufficient return? This reinforces the argument for improving competitiveness in Europe. The moment competitiveness begins to increase private capital will start flowing again. A reform that improves the productivity of a rail transport system, for example, would very much interest private investors globally.

1.5. It may be time to start thinking of a wider Europe, and a looser confederation of countries, perhaps in stark contrast to any protectionist measures, including countries like Turkey. This does not exclude the European project or the European Union continuing to go on its way as a free-market, but it does rule out the idea of a political state in the near term, because a political state would exclude those other European countries that have to be part of the European project. Indeed through a broader lens the EU should welcome the fast growth of new emerging powers as they could power a major engine of growth for Europe through trade, and therefore there needs to be an increasingly open trading system both within the EU and with the rest of the world.

1.6. The emerging economic powers must be factored into European decision-making. Many non-Western people see the European Project as a form of regulatory imperialism, translating Europe's minimal political power into maximal political power by changing the rules of the game. There are also an increasing number of non-Western social advocacy groups and NGOs that do not share the liberal agenda of the 75,000 NGOs Europe is familiar with, in areas such as social planning. Much of the world does not share Europe's vision. For example in Africa the Cotonou agreement has existed since 2008, a tripartite dialogue between the European Union, China and Africa around terms of trade. Europe has tried to use this to influence China away from corrupting local officials or using bribery, and to adhere to International Labour Organization standards regarding labour practices. However those in Africa share the Chinese view not the European view. So perhaps there is a failure by the European Union, despite its commitment in its first security paper of 2003, to underwrite soft power with a military dimension which Solana said was essential for civilian power to mean anything in a 21st Century world.

1.7. There is an emerging common European voice on the world level. It is a voice based on European values that speaks on global issues: on climate change, on human rights, on democracy, on the breakdown of non-proliferation, and on the activities of transnational companies around the world. In terms of trade and climate change, it is evident that there is such a thing as collective preferences based

on a particular culture and originating in a particular set of values. If Europe intends to be serious about multilateralism then it is going to have to develop a new emboldened type of multilateralism and back up its values with a credible peacemaking capability.

2. Civitatis International Recommendations from the Seminar

2.1. Europe must increase its competitiveness. This is imperative if Europe seeks to see growth and is the strongest plan to bring Europe out of the Eurozone crisis. This will allow the flow of private capital to recommence within Europe, both internally and through external investment.

2.2. The European story must be retold in a way that engages and makes sense to all Europeans. The threat of far-right and -left parties in Europe is very real and many people feel disassociated with the European Project. It is important to connect with those living in Europe to make them feel like Europeans and become engaged with the European story.

2.3. Europe should adopt an increased liberal attitude, rejecting insular protectionist measures. The future of Europe is not as predictable as it once was and as it is rewritten, Europe must ensure that this is not at the cost of the project. Europe needs to start rethinking what it should be ultimately by emphasizing not what divides but what unites us.

2.4. Europe should consider a common military policy. Although it looks unlikely at present, if the EU is going to punch at least not under its weight in the future, there will need to be some form of common military and foreign policy with teeth. This could take the form of an integrated EU Army, Navy, and Air Force. Furthermore, Europe should create its own European Security Council, composed solely of EU member states, enabling Europe to speak and act with one voice on security issues.

2.5. There is a need for a real European identity. Having created Europe there is now a need to create Europeans. It may be time to start thinking of a looser confederation of countries as the way forward for Europe and through this establish what a European identity actually means. This is also true for ideas of the West, which must reconsider its own common values and integration, and seek a new model which facilitates these.

2.6. The EU needs one voice on the global stage, and to enable this each EU country should be represented by one voice on the boards of global economic institutions such as the IMF and World Bank. A debate should begin on the merits of a directly elected, through universal suffrage, executive President of the European Union.

2.7. The EU should welcome the growth of the new emerging powers, as they could prove an engine for growth within the EU through trade. To enable this Europe must promote an increasingly open trading system between itself and the rest of the world.

2.8. Erecting protectionist barriers, both within Europe and at its borders, would be a grave mistake as it would deprive Europe of at least half its potential for growth and job creation. Seeking compromise solutions would do a great deal to avoid the break-up of the EU, and encourage further integration, as many past crises have done.

2.9. Europe must achieve gains in competitiveness by completing the single market in areas so far untouched such as many service sectors and developing common infrastructure in areas such as transport and energy. Europe must also recognise and invest sufficiently into key areas where opportunities for future growth lie, such as Research and Development.

2.10. The UK should seek to emulate states such as Denmark, Sweden and Germany in building models of affordable welfare states within stabilised economies. These countries show this existence is not beyond the capabilities of European states such as the UK and on a wider scale suggest that competitiveness can be restored without eliminating the social protection to which Europe has become accustomed.

2.11. If European heads of government do not pull themselves together in matters of solidarity with Greece, consolidating the common European values of human rights, social justice and delivering real democracy, they risk the break up of the EU and the values that it and the broader West stand for. To consolidate the peace of Europe, heads of government must build a common defence and energy security framework for the E-27 and accession states or the European Dream of a cosmopolitan legal and rights based world order risks being eclipsed by one of 'Hybrid free-market communism'. The United Kingdom, more so than others, has a key interest in and therefore responsibility to secure the peace, values and prosperity of the European Union. The British Government, MPs and MEPs should be mindful of this in their statements which are noted as representing our resolve on the world stage.

22 May 2012

FEU 10

Written evidence from Graham Avery, CMG

1. This submission addresses the following questions posed by the Committee:
   - To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?
   - Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

2. In summary, I argue that:
   a) The UK's 'veto' at the European Council, as seen by its partners, illustrated significant aspects of Britain's relationship with the EU
   b) The EU already has the characteristics of a multi-tier system; the UK will face grave risks if it remains in the outer circle
   c) The UK has a strong interest in participating in the main political and economic decisions of the EU, including the shaping of its foreign policy

3. I am a Senior Member of St. Antony's College, Oxford, Senior Adviser at the European Policy Centre, Brussels, and Honorary Director-General of the European Commission. My evidence is based on personal experience of 40 years as a senior adviser and administrator in Whitehall and Brussels (see biographical note at end).

Implications of the December 2011 European Council

4. The British 'veto' at the summit was not, according to commentators, the result of strategic planning on the part of the UK, but a response to the unexpected failure of negotiations in which the UK requested guarantees for Britain's financial sector in return for ratifying amendments to the Treaty. According to sources in diplomatic circles and the EU institutions in Brussels, this incident illustrated a number of aspects of Britain's relationship with the EU:
   a) The partners were unwilling to compensate the UK for ratifying a deal that imposed no new obligations on it. As one diplomat remarked 'we would have liked you to join with us in changing the Treaty, but we didn't see why we should pay you for it'
   b) Although the UK's position was presented as a 'veto', it did not stop 25 other partners from continuing with the process of ratifying the changes in another way. As another diplomat remarked 'we prefer you to join with us in doing things together, but you are not going to stop us from doing things without you if we think it's necessary'

5. These remarks were made – more in sorrow than in anger – by persons friendly to the UK. Others are more critical of British attitudes, for example 'you continually preach

at us, saying that the success of the euro is a priority, but you show little solidarity; as a result, Britain loses influence and credibility'. Others have remarked that the preparation of the December summit on the UK side was below the professional standards expected of British negotiators.

6. The events of December may not represent a watershed in the UK's relationship with the EU, but they did demonstrate that when Britain stands outside important EU policies, it has little leverage with its partners.

Multi-tier membership of the EU

7. The EU already has the characteristics of a multi-tier system: 22 of its 27 member states are in the Schengen zone, and 17 are in the euro-zone. This has not had much impact so far on the EU's institutions, which still operate mainly in a unitary fashion, but the increasing importance of decisions concerning the euro-zone is beginning to create problems and tensions that will be aggravated by the recent compact involving 25 member states.

8. The EU's enlargement from 15 to 27 did not result, as some predicted, in more 'variable geometry'. Although the 12 new members could not join Schengen or the euro on their entry to the EU, they have progressively qualified for membership of the 'inner circles' and continue to do so. The UK thus finds itself in a diminishing minority in the 'outer circle'.

9. The Coalition's Programme for Government stated 'We will ensure that the British Government is a positive participant in the European Union, playing a strong and positive role with our partners'. This declaration sits uncomfortably with the actual situation in which the UK is a commentator, rather than an actor, in current decisions on the euro-zone.

10. Britain's EU policy encourages by default the development of a multi-tier system in which the UK remains in the outer circle. The members of the inner circles will continue to develop common actions and common policies, and take decisions without other members having a vote or being at the table. Whatever assurances may be given, they will naturally tend to ignore the interests of the outer circle.

11. If you are not at the table, your point of view is not likely to be taken into account. Decisions taken without you may not go in the direction that you prefer, and may go in directions that are against your interests. A non-British commentator has expressed it brutally in the following way: 'if you are not at the table, you will be on the menu'.

12. As a matter of national interest, the UK needs to be involved in all the important political and economic decisions concerning Europe. This is a question of realism. If the development of common policies is left to Germany, France, Italy and others, this

may lead to serious economic and political problems for us. The EU poses difficulties and problems for the UK (and for other members) but it remains the most effective system that has been devised of organising Europe in political and economic terms. It is an illusion to think that, if Britain pulls back, the EU will disintegrate, or limit itself to a common market. Without an effective British presence in the balance of power – in the inner circle – the EU may move in directions that are not in our interest.

13. Two practical conclusions:
    a) The British government should be more proactive in the development of European policies in areas where we have a decisive contribution to make and much to gain; this is especially true of foreign policy, a field in which the UK has the experience and resources to shape policy in ways that correspond to British interests.
    b) When the sovereign debt crisis is resolved, and the euro-zone is stable, a future British government needs to address the question of joining the euro. In the long term we cannot evade this question if we are to play a decisive role in Europe.

Britain's role in the development of EU foreign policy

14. The most important feature of the Lisbon Treaty was the creation of new structures for foreign policy - the EU's High Representative and the European External Action Service. This reform, which brings together the economic and political instruments of foreign policy, offers the possibility for the EU and its member states to act more effectively to deal with regional and global problems.

15. There are few areas of foreign policy where the UK can be more successful acting on its own than acting together with its European partners. In Beijing, Delhi and Moscow the Europeans exert more influence jointly than individually. As for Washington, an American diplomat with experience in London and Brussels recently told me 'in the State Department we naturally want to cooperate with the Europeans acting together; when they act separately – and particularly without the UK – it's less useful for us'.

16. Although the European External Action Service – the EU's embryonic diplomatic service – has had a difficult birth, it offers a chance to project the interests and values of the EU's member states in a more efficient and cost-effective way. In this, British ideas and British personnel can have a decisive influence. If it's true that the common agricultural policy was fashioned by France, and corresponded largely to France's interests, then surely the future common foreign policy should be shaped by Britain.

Biographical note

Graham Avery is Senior Member of St. Antony's College, Oxford University, Senior Adviser at the European Policy Centre, Brussels, and Honorary Director-General of the European Commission. He has given evidence on a number of occasions to Committees of the House of Commons and the House of Lords

In the Ministry of Agriculture, Fisheries and Food in London (1965-72) he headed the unit responsible for negotiations for accession to the EC, and later (1976) served as Private Secretary to two Ministers.

In the European Commission in Brussels (1973-2006) he worked in agricultural policy, foreign affairs, enlargement policy, and the cabinets of the President and other Commissioners. His last post was as Director for Strategy, Coordination and Analysis in the Directorate General for External Relations.

He has been Fellow at the Center for International Affairs, Harvard University; Fellow at the Robert Schuman Centre for Advanced Studies of the European University Institute, Florence; Visiting Professor at the College of Europe, and Secretary General of the Trans European Policy Studies Association.

In the Queen's New Year Honours 2012 he was appointed Companion of the Order of St. Michael and St. George (CMG) for services to European affairs.

21 May 2012

Written evidence from the Foreign & Commonwealth Office

Letter from Rt Hon David Lidington MP, Minister for Europe

I welcome your Committee's decision to hold an inquiry on the Future of the European Union: UK Government policy.

In providing written evidence I have focused exclusively on addressing the questions posed by the Committee rather than commenting on wider Eurozone issues. However, I appreciate that these issues and broader questions about the Future of the European Union are also of considerable interest to the Committee, and I am willing to discuss these with the Committee at a later stage.

Memorandum

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

1. The December 2011 European Council and its outcome need to be set in context. First, they must be seen in the context of the original decision to set up a single currency within the European Union, which led to the creation of the Eurozone. Greater fiscal cooperation within the Eurozone is a logical consequence of that decision and the December European Council is one moment in this process. As the Chancellor has said, Eurozone states need to accept the remorseless logic of monetary union that leads from a single currency towards greater fiscal integration.[1] However, the UK has been clear that as a Member State not committed to joining the euro, it will not be part of this integration. Second, if integration in the Eurozone deepens, the interests of the UK and other non-Eurozone Member States must be protected. Third, since December, we have continued to engage actively in EU negotiations to shape the debate on a variety of EU issues and promote our national interests.

<u>The logic of greater fiscal cooperation in the Eurozone</u>

2. On the first point, in 1992, the UK Government negotiated the right to remain outside the euro area, even when all convergence criteria are met, and therefore the UK is

[1] Hansard: 6 September 2011, Column 156 (http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110906/debtext/110906-0001.htm)

under no obligation to take part in the euro in the future. The UK's decision to remain outside the euro area has been proved correct. This Government has also enacted legislation (the European Union Act 2011) to ensure that approval in a national referendum would be required by law before the UK could join the euro.

3. Stability and growth in the Eurozone, to which 40% of our exports are sold, matter to our own economic recovery. We have been and will remain a supportive and constructive partner. We have been concerned for some time that certain aspects of the Eurozone arrangements were unbalanced.

4. As the Foreign Secretary outlined in his letter of 15 February 2012 to the Committee,[2] as the Eurozone crisis grew more acute through 2011, it became increasingly clear to us that for the euro to survive, the Eurozone required greater fiscal and economic coordination as well as the implementation of the October 2011 Agreement: a larger firewall, the recapitalisation of the most vulnerable Eurozone banks and a sustainable solution to Greece's debt crisis. Thus this Government has welcomed the greater fiscal and economic co-ordination in the Eurozone required to resolve the crisis, while maintaining the position that it should take place in a way that does not spill over into areas that are properly for the EU at 27, such as the Single Market. We also note that this greater co-ordination does pose questions for Eurozone countries on how it should relate to national democracy and accountability.

5. There is a material difference in terms of the value of and rationale for integration between those Member States in the Eurozone and those outside it. Given the UK's role outside the euro and having not committed to join the euro, it is right and logical that we have said we will not be part of that closer fiscal integration. It is good that we have our own economic policy, our own interest rates and the ability to deal as we deem fit with the problems that face our economy.

Protecting the interests of non-Eurozone Member States

6. The UK considers that under the EU Treaties there is a proper role for the EU Institutions in supporting the Eurozone and strengthening its internal governance, in the way that the European Commission already suggests measures Member States, including Eurozone Member States, should take to correct an excessive deficit. But the interests of non-Eurozone Member States must also be protected and the EU Institutions must not be used in a way that undermines the integrity of the Single Market.

7. We want to ensure that the EU Institutions continue to operate fairly for all Member States and safeguard the Single Market. This is as important for those current and future members of the EU, for whom it will be many years before they join the euro, as it is for those members who have no current intention of joining. In preventing a

[2] http://www.parliament.uk/documents/commons-committees/foreign-affairs/120215-SoS-on-December-European-Council.pdf

proposal to amend the EU Treaties that did not include proper safeguards, the Prime Minister demonstrated how strongly we will defend the Single Market.

UK influence in Europe

8. On the third point, this Coalition Government is committed to playing a leading role in the EU, whilst advancing the UK's national interests and protecting its sovereignty. Over the past two years, Britain has pursued an active and activist policy in Europe, through both the EU itself and through deeper bilateral relationships with European partners. As has long been British policy, this Government has strongly supported the deepening of the Single Market. It has built a coalition of Member States pushing for reform of the EU to deliver economic growth. It has been at the forefront of ensuring that the EU leads on the international stage, delivering a new climate change treaty in Durban and providing support for new democratic regimes in the Arab world.

9. Our approach has not changed since December and we continue to play a full, committed and influential role in the EU. For example, we worked closely with the European Parliament, other Member States and the Danish Presidency to reach agreement earlier this year on the European Markets Infrastructure Regulation (EMIR), which regulates post-trading of derivatives and the operation and governance of Central Counterparties and Trade Repositories. We welcome EMIR as an important element in delivering on our international commitment to reduce systemic risk in derivatives markets, and in negotiations we ensured that the final regulation upheld single market principles.

10. We are also leading a like-minded group on growth which spans both euro-ins and euro-outs. Together we are working to push the Commission to implement various reforms to help stimulate economic growth in the EU.

11. Furthermore, ahead of the March 2012 European Council, the Prime Minister and 11 other EU leaders set out an action plan for jobs and growth in a letter to Mr. Barroso and Mr. van Rompuy. This letter effectively became the agenda for the European Council and our proposals on free trade, deregulation and completion of the Single Market were included in the final communiqué from the summit, agreed by all 27 Member States.

12. In foreign policy, the UK has worked tirelessly to build a solid and coherent EU policy towards Burma and EU sanctions were part of the mix of international pressure which led to the Burmese Government's decision to begin reforms. This is EU external action at its most effective – complementing and supplementing, not replacing, the foreign policies of individual EU Member States. We have also led the way on EU policy towards Syria. Working closely with our European partners, we have agreed 14 rounds of sanctions on Syria which seek to undermine the Syrian regime and deny it access to significant sources of revenue to fund its killing machine. On Iran, we have spearheaded the debate within the EU on the 'twin-track' approach – pressure and engagement. This is now accepted by all EU partners. We have also worked intensively with Baroness Ashton's team to build up the 'engagement' track, for example through

E3+3 meetings with Iran; and have worked extensively with EU partners to build up the 'pressure' track, for example through oil- and other sanctions.

13. We will continue to work alongside our EU partners to tackle climate change building upon December's successful negotiations in Durban, for which Europe has been widely credited. The UK was active in driving high EU ambition during those negotiations and this clearly demonstrated how we can work through the EU to achieve our international objectives as well as the value of a co-ordinated EU approach to climate diplomacy. By settling on a legally binding approach, Durban removed the biggest roadblock to reaching agreement on the measures that will be necessary to tackle the problem.

14. The UK champions the EU's further enlargement, including to the Western Balkans, Iceland and Turkey, based on all countries' continued progress towards meeting the necessary conditions for membership. Croatia's Accession Treaty was signed in December 2011 and it is expected to become a full EU member in July 2013; a Bill to seek Parliamentary approval to enable us to ratify that Treaty was announced in the Queen's Speech on 9 May 2012. Serbia received EU candidate status in March 2012 after progress in meeting conditions related to Kosovo.

15. EU enlargement is a vital strategic goal for all of the countries of the Western Balkans: it creates stability, security and prosperity across Europe on a firm foundation of democracy, freedom, and the rule of law. Through tough accession negotiations designed to ensure that candidate countries fully meet the EU's standards before they join, EU enlargement offers an unparalleled opportunity for these countries to move on from the conflicts of the past.

16. It follows that the Government does not believe that the December 2011 European Council represents a watershed in the UK's EU policy and place in the European Union. The UK was prepared to support EU Treaty change with all 27 Member States in return for safeguards to protect the integrity of the single market. However, without those protections, what was on offer was not in the UK's interests. Therefore the December European Council demonstrated how strongly we are prepared to defend our national interests.

Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

17. We support a multi-faceted EU where Member States with a range of different interests and needs can work together in informal groupings, such as the like-minded groups, or in more formal groups, for example the Schengen countries. Multiple forms of EU membership already exist and it is in both the EU and UK interest that the EU has the flexibility of a network and not the rigidity of a bloc. The EU is not and should not become a matter of everything or nothing.

18. This Government's priority is the delivery of outcomes which are good for Britain and good for the EU. Instead of speculating in this evidence on possible structures,

therefore, we will show how we aim to deliver the FCO's agenda of security and prosperity through the EU and our membership of it as we approach 2020, touching on some key principles which govern our approach to the EU reform agenda, such as accountability and subsidiarity. But of all the institutional issues which others are discussing in more detail, there is one which we think is worth raising here, as it is pertinent on the state of democracy in the EU – the role of national parliaments. In all European countries national parliaments embody national democracy. No other institution matches their legitimacy or their closeness to electorates. They play too small a role in the EU. Part of the answer to the EU's democratic deficit must lie in their playing a larger role.

19. What do we want from the EU and how will we work with the EU to ensure we achieve it? First, we want an outward-looking EU that is more dynamic and competitive on the global stage. The speed and scale at which globalisation is shifting the balance of wealth and political power towards emerging economies poses a challenge to the position of the EU in the world order. This shift reinforces the urgent need for EU countries to reform to stay competitive, generate growth and maintain employment and standards of living. This crisis in the Eurozone has shown the absolute need to ensure that the foundations of Europe's economies are strong.

20. The UK has led the EU debate on reforming the EU economy to deliver growth but we will go further over the remainder of this parliament by looking to keep the immediate need for structural reform at the heart of the debate on growth. We will push for an ambitious programme of deepening the Single Market and reducing the burden of EU legislation. We will also continue to contribute to the EU's prosperity, for example through the City of London, one of the most significant global financial centres. It is in and through the City that many French pensions are managed, German manufacturing companies buy financial services, many energy risks throughout Europe are hedged, and provisions of capital for European infrastructure projects flow.

21. Second, we want an EU that is able to use its collective weight for our common interests, such as trade and security. The UK's ability to influence events abroad is greatly enhanced by our place within the EU. Together we hold more sway than apart and we are stronger in assuring our security when the 27 EU Member States agree. So on issues where there is a common European interest, when the national interests of the 27 EU Member States converge, it makes sense for the EU Members to act together, pool our influence and speak with a united voice.

22. On trade, one voice representing half a billion consumers is heard more loudly in Beijing, Delhi and Moscow, than 27 separate ones. With UK support, the EU has already completed a Free Trade Agreement with Korea worth £500 million to UK exporters. But our ambition does not stop here. We also aim to conclude trade agreements with Canada, India, Singapore and Mercosur, as well as launch a comprehensive package of negotiations with the US, which would tackle the remaining barriers to almost half the world's trade flow.

23. In security and defence policy, as in many other EU policies, there is a need for variable geometry. In Afghanistan, representations from certain Member States are involved in

EU military and civilian missions supporting NATO in building stability and security, with a specific focus on police training. In the Balkans, others are working in EULEX as it seeks to bring justice and stability to Kosovo; and off the Horn of Africa, the EU mission, ATALANTA, is tackling international piracy.

24. The Government will work to make sure that the European External Action Service (EAS) acts to boost UK prosperity and security by complementing and supplementing – not replacing - the work of the FCO. The Lisbon Treaty makes clear that the EAS "shall work in cooperation with the diplomatic services of the Member States". The EAS brings together existing EU external action mechanisms and experts from the Commission and Council.

25. While I did not personally support the EAS's creation, now it is established I believe that our goal should be to ensure that it usefully complements and supplements our national foreign policy but does not in any way replace it. Therefore we believe the EAS can have the most effective impact on UK security and prosperity by focussing on: stability in Europe's neighbourhood - South, East and the Western Balkans; relations with emerging and major powers such as the US and BRIC countries; conflict prevention, development and peace building – especially in Africa; and some key foreign policy challenges such as Iran and the MEPP. We are working at home to promote the EAS as a stepping stone in the career of talented UK officials, so we can ensure that the UK participates fully both in Brussels and in the work of delegations abroad. We remain very clear that the division of competences must be respected, in line with the Treaties; and any changes in representation must be agreed by Member States by consensus. The EAS will only represent the UK where we or the Treaties mandate them to do so - for example, on agreed positions in the CFSP.

26. Third, we want an enlarged EU that helps spread freedom, democracy and the rule of law more effectively in its neighbourhood. Despite the EU's current economic troubles, the extension of European democracy is a success few dared to hope for thirty years ago. Then as now, the prospect of membership of the EU to countries such as Turkey – a key emerging economy – and those of the Western Balkans is providing the incentives to encourage and embed the necessary reforms to enable both the EU and the aspirant countries to benefit from the expansion of stability, security and prosperity across Europe. This is a key part of our vision for the EU.

27. Fourth, we want an EU which faces the challenge of legitimacy. Those within the EU saying that they had a positive image of the EU dropped from 52% in autumn 2007 to 31% in autumn 2011.[3] This is not an isolated trend. The appeal of mainstream politics has weakened in most western democracies in the last thirty years. However, without the roots that sustain national democracies, it is particularly important that the EU addresses demand for greater accountability, transparency, efficiency and probity.

[3] Standard Eurobarometer 76 (http://ec.europa.eu/public_opinion/archives/eb/eb76/eb76_first_en.pdf)

28. This issue of accountability is something we have also sought to address at home. We recognise that many people in Britain feel disconnected from how the EU has developed and the decisions that have been taken in their name on EU matters. To counter this, the Government is committed to ensuring that there is no further transfer of competence or power from the UK to the EU over the course of this Parliament.

29. To help rebuild trust and reconnect people to EU decisions, the European Union Act 2011 has established a referendum lock over any future proposals to transfer further competence or power to the EU, to which only the British people hold the key. It also gives the UK Parliament more control over key EU constitutional decisions taken by the Government.

30. Looking ahead, we will continue to make the case for a Europe which respects and builds on national identities. We will work to improve consultation of national parliaments, advancing transparency, accountability and control over EU spending, and to better assess the regulatory impact of EU legislative proposals before they are voted on. We will look to ensure that principles of localism and subsidiarity are more deeply embedded into EU decision making in line with the approach to decentralisation and flexibility we are seeking to achieve in the UK.

31. In many cases we can in fact achieve "better Europe" by reducing administrative and regulatory burdens at EU level – the UK was instrumental in securing commitments by EU Heads of State and Government (eg at the March European Council) to do just that. The Government is also committed, under the Coalition agreement, to examining the balance of competences between Britain and the EU, on which we will have more to say in due course.

32. In conclusion, under this government, Britain is developing its global role. In 2020 we will be a nation with closer ties to the emerging economies of the world than today. We will have more British companies with a foothold overseas, and exports, manufacturing and investment will make a bigger contribution to our economic growth. This reinvigorated and expanded approach will be built on our strong alliances in the EU and with the United States, building new networks without sacrificing the old. But a strong economy is the bedrock of international influence and the EU's ability to contribute to a secure, peaceful and prosperous world ultimately rests on its economic strength.

What is the relationship between the new 'fiscal compact' Treaty and the EU's acquis? What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy?

33. The Fiscal Compact is not part of the EU Treaties. It is a self-standing international agreement between the signatory States. It is outside the EU Treaties and therefore does not form part of the EU acquis.

34. The Fiscal Compact does not have the force of EU law, for the UK, the EU or for the signatory States. The principle of the primacy of EU law is not affected by the Fiscal

Compact, in fact it is the express intention of the parties to the Treaty that insofar as there may be any conflict or overlap between the Fiscal Compact and the EU Treaties, the EU Treaties shall prevail. Indeed, any other arrangement would be contrary to EU law.

35. The Fiscal Compact deals primarily and in some detail with fiscal discipline for the Eurozone States, and also touches on growth where its provisions are much less specific. The Fiscal Compact does not touch on the EU budget, enlargement, or the Common Foreign and Security Policy. These and all other EU policies will continue to be negotiated under the terms of the EU Treaties.

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

36. Any decision to incorporate the substance of the Fiscal Compact into the framework of the EU Treaties would require the consent of all 27 Member States of the EU. In any negotiation on Treaty change, we would protect and advance our own national interest.

37. The Prime Minister demonstrated this in agreeing to a change to Article 136 of the Treaty on the Functioning of the European Union (TFEU), which recognises that Eurozone Member States can establish a permanent stability mechanism – the European Stability Mechanism (ESM) – to safeguard the financial stability of the eurozone. By agreeing to the Article 136 Treaty change, the Prime Minister secured agreement in both the Council Conclusions and the European Council Decision that the ESM will replace both the euro area-only European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM), for which the UK holds a contingent liability, and that Article 122(2), the basis on which the EFSM was created, will no longer be needed for the purpose of safeguarding the financial stability of the euro area as a whole, and should not be used for those purposes. Consequently, the UK will not be exposed to any future programmes of financial assistance for the eurozone through the EU Budget, specifically the EFSM.

38. In his letter to the Treasury Select Committee on 27 February 2012 the Chancellor outlined the substance of the safeguards proposed at the December 2011 European Council when changes to the EU Treaties were discussed.[4] These safeguards were not UK opt-outs, exemptions or any other kind of special treatment for the UK. What we proposed were safeguards for the whole EU that would have supported open competition for financial services companies across the Single Market, and upheld the existing commitment to ensure the ability of all Member States to supervise their domestic financial sectors, which is particularly important given the scale of the fiscal risks involved.

[4] http://www.parliament.uk/documents/commons-committees/treasury/120228%20-%20LetterfromChxtoChair.pdf

39. In the context of a more integrated euro area, it will be very important to ensure that EU rules respect the Single Market and vital national interests of all Member States whether they happen to be part of the euro area or not. Although it would be premature to outline now what safeguards the UK would propose if there were proposals to amend the EU Treaties in future, we remain concerned to maintain the integrity of the Single Market and vital national interests of all EU Member States.

22 May 2011

Written evidence from Nigel Farage MEP on behalf of the UK Independence Party (UKIP)

SUMMARY

- **What is the relationship between the new 'fiscal compact' Treaty and the EU's *acquis*?**

  The Fiscal Union Treaty stands outside the Treaties and in the absence of agreement by the UK cannot form part of the *acquis* or permit use of EU institutions under it.

- **Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties?**

  No, because the means by which this is to be done sets a dangerous precedent inconsistent with future UK interests.

- **If it should, what demands and safeguards, if any, should it make its condition for doing so?**

  We doubt that any safeguards and conditions would be honoured, given our prior experience of such.

- **Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership.**

  No. We believe that this would still involve an unacceptable loss of sovereignty and would be far too complex to establish and administer.

- **Between now and 2020, what institutional architecture and membership should the UK seek for the EU?**

  If the UK remains a member, then the relationship should be confined to trade and access to the single market with a concomitant architecture. UKIP's policy is clear, however: only withdrawal is the means of securing the exclusive national interests of the UK.

- **What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy?**

  We believe that this will be a signal for the EU to increase its budget, raise more of its own resources and to enforce harmonised tax rates across the Union. Enlargement is on hold. The clamour for an EU foreign policy and defence force will grow.

- **To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?**

With the deft sidestep by the Commission of the "veto", this was no watershed.

In the first instance we feel that a more helpful order for the questions posed in the Committee's rubric is to follow the order we have used below.

What is the relationship between the new 'fiscal compact' Treaty and the EU's *acquis*?

As a matter of international law, the Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union ("The Fiscal Union Treaty" or "FUT") is a Treaty within the meaning of the Vienna Convention on the Law of Treaties and therefore has all the attributes of a Treaty in international law.

It is signed by 25 sovereign nations who are, coincidentally, also members of the European Union. It is not, however, a European Union Treaty. The Treaties - now consolidated as The Treaty on European Union (TEU) and The Treaty on the Functioning of the European Union (TFEU) - are those to which 27 sovereign nations have acceded.

Two sovereign nations which are EU members, The UK and the Czech Republic, having declined to sign this Treaty, the Fiscal Union Treaty has no legal nexus to TEU/TFEU.

Since the EU is not a signatory to the FUT and two of its members have not assented to be bound by it, the EU is not itself bound by the FUT. Nor does the Fiscal Union Treaty have any lawful impact on any Treaty or other agreement which is itself linked to TEU/TFEU.

One should be mindful of Article 5 TEU by which "the limits of Union competences are governed by the principle of conferral". The full 27 member states have not granted to the EU any of the competences which are set out in the FUT.

This has significant consequences. For example, Article 8[1] of the FUT makes provision for use of the ECJ in certain circumstances. Given that the FUT Group legally lies wholly outwith the structures of the EU, it is difficult to see how Article 8 might legally be deployed, given the jurisdiction of the ECJ as set out in Article 19 TEU.

The jurisdiction of the ECJ is the "interpretation and application of the Treaties" [i.e. TEU and TFEU] and, "in accordance with The Treaties", ruling on actions brought by "a member State" or "an institution" (i.e. an institution of the EU as defined by the Treaties) or a natural or legal person; giving preliminary rulings on the interpretation of Union law; ruling on other cases provided for 'in the treaties'. The FUT falls outside that jurisdiction.

We submit that neither the FUT, nor any organization set up thereunder and nor any contracting party has any *locus standi* to bring actions before the ECJ. The contracting parties may say whatever they wish in their own Treaty: the Treaties make it clear that the jurisdiction of the ECJ is limited.

[1] Given the need for brevity we have not set out *in extenso* the text of individual articles on the assumption that this Honourable Committee is fully conversant with them.

Article 8.3 of the FUT pretends to the notion that referring matters to the ECJ under the FUT is a "special agreement" for the purposes of Article 273 TFEU. Yet Article 273 only grants jurisdiction to the ECJ in any dispute between Member States which relates to the subject matter of the Treaties. The FUT is not part of the subject matter of the Treaties.

Nor can this be claimed as an act of enhanced co-operation under Article 20 TEU (which applies to non-exclusive competences) since the subject matter is the Euro, an exclusive competence of the EU.

Notably, The United Kingdom has in no way consented whatsoever to any institution – such as the European Court of Justice (ECJ) – or mechanism of the EU being used by the FUT group or UK Taxpayer's money being thus deployed. UKIP MEP Stuart Agnew, substitute member on the European Parliament's Constitutional Affairs Committee, has repeatedly asked what the legal basis for any such use might be: no satisfactory and compelling answer has been proffered.

Her Majesty's Government has itself no power to permit use of the ECJ by outside organisations or otherwise acquiesce in such use. No such power was granted by The European Communities Act 1972 nor any subsequent Act which makes such permission or acquiescence lawful under UK law. We therefore contend that any expenditure of British Taxpayer's money on such use of the ECJ would quite simply be illegal.

Whilst the 25 may have agreed that as far as this arrangement is concerned, "this Treaty shall be applied and interpreted by the Contracting Parties in conformity with the Treaties on which the European Union is founded", that is entirely a matter for them. Such does not bind the UK.[2]

We also feel it imperative that this Committee considers in this regard two other matters:

- The intimate relationship between the FUT and the Treaty Establishing the European Stability Mechanism (ESM). Implicitly, at the very least, each of the treaties is intimately linked the one with the other. There is an on-going case before the Irish Courts initiated by Independent MEP Thomas Pringle which has this relationship at its heart, challenging the lawfulness under EU law of the ESM and calling for a Referendum on the ESM.

- Continuing developments in Europe. We respectfully suggest that the Committee cannot properly come to any settled conclusion until the issue of further amendments to the FUT is resolved. France's new President Hollande has called for major changes. Greece faces an uncertain future which may have major implications for the FUT. The Netherlands soon has a general election which may produce a call for yet further amendments or even a refusal to ratify. Six months from now the architecture of the EU may look very different.

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties?

For the reasons set out here, we believe that to do so would be wrong and would set a potentially very damaging precedent.

[2] FUT Article 2.1

It will be recalled that very soon after the Prime Minister had indicated Her Majesty's Government's unwillingness to sign this Treaty, the Deputy Prime Minister (DPM) spoke, on 9th. January 2012, of the FUT being "folded into" the existing Treaties:

> *U.K. Deputy Prime Minister Nick Clegg called for changes to the way euro-area countries monitor each other's spending to be "folded into" existing treaties to prevent multiple rulebooks governing members of the 27-nation European Union.*
>
> *"We believe that it should, over time, be folded into existing treaties so that you don't get permanent two parallel treaties working separately from each other," Clegg told reporters in London today following talks with leaders from European liberal parties, which included EU Economic and Monetary Affairs Commission Olli Rehn and Dutch Prime Minister Mark Rutte. "We all see this as a temporary arrangement."* [3]

As an aside, one is bound to wonder who the DPM meant by "we" here.

It is a matter of note that the DPM was speaking of the FUT being "folded into" existing Treaties. One wonders if he had been talking to his erstwhile colleagues at The Commission and had been privately alerted as to how the Commission saw the FUT becoming EU law.

We would point to the observations of a Mr. Romero, a legal expert from the Commission, who spoke to a joint meeting of the Constitutional Affairs Committee and Economic Affairs Committee of the European Parliament on 12th. January 2012 at Strasbourg.

A video of his contribution can be found here: http://youtu.be/WfSvvgCmvbo.

In summary, Mr. Romero was making it plain that making the FUT part of EU Law did not, as far as they were concerned, require a Treaty change of any kind. It would all be done by means of what Mr. Romero calls "secondary legislation" which we take to mean by way of the whole gamut of Directives, Regulations, Delegated acts and implementing acts.

Within about a month of the Prime Minister claiming having to have vetoed the FUT, the Commission had found a way round that little local difficulty and thus rendered the so-called veto nugatory.

One might properly infer that The DPM knew all of this when he spoke. For whom, then, was he speaking? Her Majesty's Government or the Commission?

We strongly submit that this means of eliding external agreements into EU should be fiercely resisted by HMG and that there should be no question of the UK supporting the stealthy insertion of such via the back passage of directives, regulations and the like. Once this exercise has been done once, it will be repeated. British MEPs might in such instances vote against it but the UK stands to be over-ruled at every turn. What is proposed thus represents a serious threat to the UK's interests and must be resisted, involving as it does a considerable further loss of sovereignty, power and influence within the EU.

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[3] E.g. Bloomberg online: http://tinyurl.com/bmofpcp

That is quite apart from our grave concerns that this particular enterprise is both the template for and harbinger of a further strong drive towards Federalism. It contains within it a powerful impulsion towards overall control by the EU of harmonising a wide range of taxes and control over national budgets into which we fear the United Kingdom will be sucked. The degree to which the power of Sovereign States to draw up budgets and set their own tax rates independently is gravely threatened by this Treaty and Her Majesty's Government should have nothing to do with such an anti-democratic step.

This is a major step towards "ever closer union". Whilst the UK remains outside much of this closer integration – for the moment – the United Kingdom remains bound to EU Treaties which call for an ever-closer union whose currency is the Euro. The grave danger is that we shall be pulled headlong into such union by the maelstrom of the collapse of the Euro and its consequences.

We believe that the People of the United Kingdom desire – and demand – that we travel in an entirely opposite direction.

In addition the emergence of a nascent proto-government for the Eurozone is bad for the members of the Eurozone in terms of democracy. This Treaty is profoundly undemocratic, placing as it does so large a degree of control over national budgets in the hands of the EU. Given the ineptitude displayed during the Euro crisis by its leaders at all levels, it is not unreasonable to be pessimistic about Europe's prospects for growth and competitiveness.

That would be deeply damaging to the UK's interests. Having as a major trading partner a sclerotic group of countries becoming ever less competitive by the day - thus inhibiting growth - is hardly likely to enhance the UK's trade. With so many of our eggs in this basket, that can only be against our vital interest.

If it should, what demands and safeguards, if any, should it make its condition for doing so?

We have set out above our view that it should not be supported under any circumstances. If that means we become fully-declared opponents of the great European Project, so be it. We doubt that any safeguards and conditions would be honoured, given our prior experience of such.

Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

The problem we foresee with the suggestion of a two- or multi-tier EU is that it will inevitably involve concession of an unacceptable degree of Sovereignty. More than that it is very difficult to see how such a complex arrangement could be made to work.

We now have forty years' experience of how a single-tier EU is administered and its anti-democratic tendencies, of which the overthrowing of the results of National Referendums and the insertion of EU-approved Technocrats as national leaders are but part. We have also had ample evidence of the poor performance of the unelected and unaccountable officials of the EU who are immune to the norms of democratic life.

Why should a two- or multi-tier EU be any different?

We consider that the notion of a two –speed or multi-speed EU is simply a non-starter. The notion of any significant powers being repatriated – after the EU has spent fifty-five years in the careful and assiduous accretion thereof – is risible. A genuine two-tier relationship is very unlikely to be on offer on any terms that are actually advantageous. The attitude of the new French President to the UK ought to make that abundantly plain.

Between now and 2020, what institutional architecture and membership should the UK seek for the EU?

Whilst the UK remains part of the EU, it should seek the loosest possible architecture for the EU and to be bound by the least political commitments possible. We should take this opportunity to disengage ourselves, above all, from all the non-trading elements (especially the political ones) of the EU and look to concentrate only on our access as a trading nation to the Single Market and our trading relationship with Europe which, we say, is all the People of the UK have ever assented to by way of the 1975 Referendum.

What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy (CFSP)?

As far as enlargement is concerned, we believe that this process will be placed in abeyance for the time being. A new entrant is required to adopt the Euro. The next countries in line, in no particular order, are the likes of Serbia, Albania, Macedonia, Bosnia-Herzegovina and Montenegro. It will be some time before we can assess the impact of Croatia's accession. Given the state of the economies of the prospects, further enlargement is unthinkable for the time being. Greece may yet leave or be ejected from the EU. We could not, with the problems that now face us, contemplate trying to digest Turkey or any of the Balkan states. Enlargement is at best on hold.

The new agreement is highly unlikely, we believe, to promote growth and prosperity for its members.

What it will do is provide the impetus to the EU to introduce new ways of raising EU taxes ("own resources") and harmonising tax rates across the EU. The EU's appetite for spending other people's money will never diminish but will continue to rise. We already know how many of the EU states greatly resent Ireland's low corporation taxes. France calls stridently for a Financial Transaction Tax.

As far as the CFSP is concerned, the diminishing ability of member states to afford proper defence spending will lead to greater efforts to impose the creation of a European defence force, thus further diminishing the UK's independence and ability to protect its own interests.

We believe that this agreement will be a disaster for UK vital interests.

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

It is not the case that the supposed "veto" of the Prime Minister represents a watershed. As we have seen above, the EU plans to sidestep it almost without moving a muscle and the use of secondary legislation to "fold" the FUT into EU law will happen, in a stark demonstration of the impotence and marginality of the UK's MEPs.

In reality it was not a veto at all but simply a spur to the EU to find a way of thwarting UK policy and getting on with the business of integration as fast as possible. Having thus revealed the utter contempt of our so-called partners for the UK's position and interests, it may be thought a watershed in that the UK must now admit to and contemplate the fact of our impotence and lack of influence at the heart of Europe. Those who would claim otherwise must stand adjudged of mere hollow bluster.

If we have no influence, then what is the point of our membership?[4]

22 May 2012

[4] UKIP does not, of course, thereby concede that if we had influence membership has a point.

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Written evidence from the Scotch Whisky Association (SWA)

The Scotch Whisky Association (SWA) is the trade organisation whose main aim is to promote and protect the interests of the Scotch Whisky industry. A key element within that broad remit is to try to ensure that the trade regimes in which our members operate are non-discriminatory and permit fair competition. The EU is the industry's single largest export market and is therefore of vital importance to our sector.

Our member companies, which range from small and medium-sized enterprises to multi-national companies, sold over 500 million bottles of Scotch Whisky in the EU in 2011: over 40% of all Scotch Whisky sales take place in the 27 Member States. Much of this success has been built on the harmonised trade rules in the internal market and the EU's regular phases of enlargement.

We frequently campaign to ensure the internal market's rules are appropriate to our sector and we greatly appreciate the dialogue with, and the support we receive from, UK officials. The EU legislation of greatest interest to our sector often bears the hallmark of UK participation. We only are able to secure rules meeting the needs of our sector through the UK's EU membership and full involvement in its decision making processes.

The SWA therefore welcomes the Foreign Affairs Committee inquiry into the future of the European Union and UK Government policy. The attached submission seeks to highlight the benefits the UK's EU membership has brought our sector within and beyond the EU's borders. We have provided information regarding the internal market, EU enlargement and international trade relations. As a trade association, however, the Committee's questions in relation to e.g. the 'fiscal compact' lie outwith our remit.

Naturally we would be ready to provide further written information if that would be helpful.

1 Executive Summary

1.1 The Scotch Whisky Association welcomes the Foreign Affairs Committee's inquiry into the future of the European Union and UK Government policy. Our sector liaises regularly with UK government departments and greatly appreciates their guidance and support in the effort to improve trading conditions for Scotch Whisky in the EU and in third countries.

1.2 The EU is the industry's single largest export market and is vital to the Scotch Whisky industry. Global exports in 2011 were worth £4.23 billion, of which sales to the 26 other EU Member States accounted for £1.45 billion. Total sales within the EU, i.e. including the UK, amounted to over half a billion bottles, or 42% of the industry's total volumes.

1.3 Scotch Whisky is sold in every EU Member State; our sector benefits greatly from harmonised trading rules in the single market, i.e. as opposed to the 27 sets of national rules that would otherwise apply. These advantages have been extended by EU enlargement. Although the internal market provides a (relatively) barrier-free trading environment, more is required for it to reach its full potential.

1.4 The UK plays a key role in the EU's decision-making processes through the European Council and European Parliament. The Association is extremely grateful for the readiness of UK officials, MPs, MSPs, MEPs and Ministers to raise our sector's concerns and pursue our interests in all relevant fora.

1.5 The UK's EU membership has delivered benefits to Scotch Whisky which would not otherwise have been possible. We very much hope that, whatever decisions are taken regarding the EU's future institutional architecture, and the UK's role therein, these will not jeopardise the benefits of the internal market and the UK's ability to influence and shape EU policies.

2 Introduction

2.1 Scotch Whisky is the world's foremost internationally traded spirit drink. The Scotch Whisky Association (SWA) is the trade organisation which represents the interests of the Scotch Whisky industry. Its main objective is to protect and promote Scotch Whisky at home and in its overseas markets. More than 90% of sales take place outside the UK.

2.2 Despite the current economic difficulties, rising demand in both emerging and mature markets has resulted in export values increasing by an average of 10% a year over the last five years. The government regularly exhorts business to find new opportunities overseas. The Scotch Whisky industry provides an excellent example of the benefits of such trade. Much of the export success could not have been achieved without the UK's EU membership.

2.3 Exports of Scotch Whisky to over 200 countries in 2011 were worth £4.23 billion. This equated to nearly 1.2 billion bottles; or 3.2 million bottles every day. Scotch Whisky alone represents 80% of Scotland's food and drink exports, 23% of the UK's and 7% of the EU's (2010 data, as 2011 figures are not yet available for the whole EU). Scotch Whisky contributes £134 per second to the UK balance of trade.

2.4 The industry employs over 10,000 directly and a further 35,000 jobs across the UK are supported by the industry. Our sector spends £1 billion each year with UK suppliers of goods and services. Prospects for further export-led growth have resulted in the industry investing £1 billion in additional distillation, maturation and bottling capacity over the last 5 years.

2.5 The ability to export is vital to the health of the industry. Our members have been exporting for over a hundred years and are fully familiar with intra-EU and international trade and a wide variety of national trading environments, not all of which are benign. The SWA is an active campaigner against trade barriers and seeks to ensure fair and non-discriminatory trading conditions in all markets.

2.6 Our submission includes an overview of Scotch Whisky in the EU, and highlights some of the benefits it has brought as well as the work that remains to be done. It also looks at international trade aspects, and explains why the UK's EU membership brings benefits within and beyond the EU's borders. We have not sought to address questions in relation to, e.g. the "fiscal compact" since these lie beyond the Association's remit.

3 Scotch Whisky in the European Union

3.1 Exports to the 26 other Member States were worth £1.45 billion in 2011. Total sales within the EU, i.e. also including the UK, amounted to over half a billion bottles. Scotch Whisky is sold in every Member State and our sector enjoys the advantages of the EU's harmonised trading rules, i.e. as opposed to 27 sets of national rules. Our success in the EU is in large part a consequence of the internal market's (relatively) barrier-free trade environment.

3.2 Our sector has long been involved with UK / EU officials and MEPs to try to ensure that EU legislative proposals are appropriate for our sector and enhance trade rules in the internal market. Our involvement is both direct and through our membership of the European Spirits Organisation – CEPS, which represents spirits producers at EU level. In the same way as CEPS relies on its members to determine the best policies for the

industry, so too do the EU decision making processes rely on the active engagement of national governments and MEPs to pursue the interests of their constituents.

3.3 Thanks to the readiness of EU and UK officials to engage with our sector, much useful legislation for the Scotch Whisky industry has been passed. Policy areas where the Association has been actively involved at every stage include VAT and excise taxation, bottle sizes, spirit definitions, holding and movement of excisable products, strip stamps, environment, food labelling and protection schemes for geographical indications.

3.4 The policy work in which SWA and CEPS are engaged requires a constant dialogue with UK and EU officials in national capitals and Brussels, and with MEPs once those dossiers come before the European Parliament. The breadth of issues, and the level of engagement needed, are such that we could not secure trading conditions appropriate to the sector without UK support. Some of the dossiers on which we are engaged affect Scotch Whisky far more than any other spirit drink and the UK's voice is critical in ensuring the enacted measures meet industry needs.

3.5 Among the advantages brought to our sector from the UK's EU membership since 1973 are the following:

- removal of excise tax and VAT discrimination against Scotch Whisky in France, Greece, Italy and Denmark;

- adoption of EU rules to define and protect whisky, and to provide specific protection for geographical indications, such as Scotch Whisky;

- introduction of common rules on labelling requirements and the bottle sizes in which spirits must be sold;

- removal of tariffs, quotas, tax discrimination, national labelling requirements and many other trade barriers in EU accession countries.

4. Single Market - work still in progress

4.1 While we strongly support the principles of the Single Market, as is regularly observed it is far from complete. In our sector difficulties persist, notably on tax issues and inappropriate national rules which prevent free movement or protect domestic interests. Resolving such concerns does not happen overnight; the UK's voice is needed over the long term to try to improve the operation of the single market.

4.2 A key area of concern is the EU's excise tax directives which require Member States to apply minimum rates of tax according to category of alcoholic beverage. On spirits the minimum rate is €1,000 per hectolitre of pure alcohol (hlpa); for beer, it is €127 per hlpa; and on wine, the minimum rate is zero, a level applied by 16 Member States. All alcoholic beverages compete with one another and we believe the tax structure should reflect this situation. Instead the current crisis is being used by some countries to further widen discrimination against spirits; in many cases Scotch Whisky is the main imported spirit.

4.3 In addition, EU structures permit some national derogations from the broad principle that, within each category of alcoholic beverage, everything should be taxed in an identical manner. Thus, for example, there are lower rates of tax in France on rum from its overseas departments and on ouzo in Greece. There are other examples, too numerous to mention, of particular categories of spirit receiving preferential tax treatment sanctioned by the EU.

4.4 These have created the conditions in which some Member States, unilaterally and illegally, have introduced protection for domestic products: Hungary and Romania are

the current worst offenders but Greece too has illegally extended its derogation for ouzo to include other local spirits. While there are means of redress in place, infractions proceedings, designed to enforce compliance with the *acquis*, are often slow and can take over 4 years before being resolved. In the meantime the discrimination continues.

4.5 Although it is usually the Commission that leads in removing such barriers, the UK's involvement, at EU level, and bilaterally with the offending Member State, are extremely helpful in trying to resolve such concerns. We are constantly grateful for the UK's support in this respect.

5. EU Enlargement

5.1 The internal market's benefits have regularly been extended by EU enlargement. In acceding countries this has brought, among other things, the removal of many trade barriers including high tariffs, quotas, preferential tax rates, import permits, inappropriate laws defining whisky and national labelling rules.

5.2 The SWA has been closely involved in each phase of enlargement. Our main aim has been to ensure the EU *acquis* is implemented and enforced in the new Member States at the earliest opportunity, and that any derogations and/or transition periods in our sector are kept to a minimum. We have been helped greatly by the UK administration in this process. Through, e.g. the Enlargement Working Group, and bilaterally with the accession country, the UK has been extremely effective and persuasive in ensuring new EU members accede under the right conditions. Among other things, the UK was influential in securing:

- the introduction of 2 benchmarks in Turkey's accession negotiations which were instrumental in resolving 2 major trade barriers for the Scotch Whisky sector;

- the agreement by Romania that, in advance of its EU accession, the tariff preferences it had negotiated for US whisky should also be extended to EU whiskies;

- the introduction of a review period for certain tax derogations granted to some of the 2004 intake of accession countries;

- the refusal to permit any continuation of the preferential treatment (via excise tax and / or tariffs) of local vodka after Poland joined the EU.

5.3 More recently, we very much appreciate that the UK and others did not accept Croatia's request for a seven year transition period to allow the sale of inappropriately labelled national spirits ('domaci rum' and 'domaci brandy'), against which Scotch Whisky competes. Croatia's accession in 2013 will therefore provide far greater potential for improving Scotch Whisky exports than if the current protection had been maintained.

5.4 EU enlargement has, over the long term, proved to be of massive importance to Scotch Whisky exporters. Some countries that have joined the EU over the last 25 years have been among the industry's most important export destinations:

- Before its 1986 accession, exports to Spain were typically £20 - 30 million a year. 10 years later they averaged over £200 million; between 2003 and 2010 they exceeded £300 million on 4 occasions.

- Exports to Greece were worth £10 - 15 million a year between 1980 and 1985. When barriers were removed upon its 1986 accession, exports rose to £71 million after 5 years. They exceeded £100 million 4 times between 2003 and 2010. Prior to the recent economic difficulties, Greece was often cited as the country with the highest per capita consumption of Scotch Whisky in the world.

5.5 Among more recent accession countries, exports to Poland have increased from £5 million in 2003 to over £42 million in 2011.

6. EU and International Trade

6.1 Europe is the world's largest trading bloc, accounting for one fifth of global trade. EU trade policy promotes the principles of free and fair trade around the world. While the Commission negotiates on behalf of the EU, the active involvement of Member States is critical in ensuring vital national interests are pursued in the negotiations. For example Free Trade Agreements (FTA) between the EU and third countries remove market access barriers, including excessive tariffs, and are an important tool in helping exporters gain better access to markets. In an export dominated industry such as Scotch Whisky, we are very grateful to UK officials and Ministers who regularly seek to ensure our interests are pursued in FTA negotiations.

6.2 The highest priority market for the Scotch Whisky industry is India. There is significant demand for Scotch Whisky in the market, but also major barriers, the most important of which is the excessive 150% tariff; effectively this prices our products out of the range of most consumers. The negotiations on the proposed EU-India FTA offer the only realistic chance of significantly reducing this tariff in the medium to long term. The Association is very grateful to UK officials in Delhi, Brussels and London who put in a considerable amount of time and effort to ensure the interests of the Scotch Whisky sector are taken into account during these complicated negotiations.

6.3 In the case of South Korea, where Scotch Whisky is both the UK's largest export to the country and by far the biggest imported spirit, the entry into force of last year's FTA provided substantial benefits. Not only will the 20% import tariff on spirits be eliminated, but the Agreement provides a mechanism to introduce legal protection for Scotch Whisky as a Geographical Indication. As in India, UK officials in London, Seoul and Brussels played a major part in delivering the successful outcome.

6.4 WTO trade rules have also been very useful in improving trading conditions for Scotch Whisky. For acceding countries, we have been helped enormously by the UK and EU's readiness to ensure, in some cases, that longstanding barriers are resolved as a condition of accession. Elsewhere, WTO rules provide a mechanism for the EU, pressed by the UK, to take action against illegal protectionism in world markets. Our sector has been successful in removing tax discrimination in Japan, Chile, Korea and the Philippines.

6.5 More generally, the EU's trade dialogue with third countries also helps it to promote and 'export' the application of EU rules as best practice, and thereby shape trading conditions around the world. As mentioned earlier, the UK is active in seeking to ensure EU rules are appropriate for the Scotch Whisky sector; such rules can have a positive impact well beyond the EU's borders.

7. Conclusions

7.1 The SWA firmly believes the UK's membership of the European Union has provided significant benefits in improving trading conditions for Scotch Whisky in Europe and beyond. We could not have secured these advantages from outside the EU. And there remains much to be done, in particular to ensure that the proposed FTA with India delivers the tariff reductions that would help unlock this potentially huge export market.

7.2 The UK government has a vital role to play in promoting a level playing field for business in the EU. The EU Single Market and free movement of goods has already delivered huge benefits to Scotch Whisky producers. However, improving the Single Market and removing the remaining barriers to trade should remain a priority UK objective.

7.3 It is therefore critical that the British voice is, and continues to be, heard in Brussels and is successful in shaping EU policies. The UK would lose its current influence if, like EEA members Iceland or Norway, it was not part of the EU decision making process. Moreover, the UK would still be required to implement EU legislation which it had not helped shape.

7.4 We hope any decision regarding the institutional architecture and the UK's EU membership will not jeopardise the advantages membership has brought, or weaken the influence and impact membership brings in the decision-making processes.

We hope the above comments will be helpful. If any further written information or clarification on any aspect would be useful, please do not hesitate to get in touch.

22 May 2012

Written evidence from the Liberal Democrat European Parliamentary Party

Summary: Unless structural problems are tackled, the long-term future of the EU is at risk. UK European policy lacks strategic clarity on this and other matters. Economic recovery is not possible without a stronger Union, where fiscal solidarity supplements fiscal discipline. The fiscal compact treaty is a necessary expedient. Its incorporation in the EU framework will trigger a full-scale revision of the Treaty of Lisbon. The UK will have to decide whether to support further integration of the EU - and, if so, whether to participate. A British referendum on the EU is likely to be necessary.

1. We welcome your important enquiry, and hope it can produce some clear-sighted commentary on and options for the guidance of the United Kingdom's future relationship with the European Union.

2. As Liberal Democrat Members of the European Parliament we are committed to making a success of British membership of the EU and, in particular, to advancing the role, efficiency and legitimacy of the European Parliament in the governance of the Union and in British politics. We sit within the group of the Alliance of Liberals and Democrats for Europe (ALDE).

3. To set a context for our responses to your particular questions, we have some general points to make. First, we firmly believe that Britain's membership of the European Union has been of substantial benefit to the UK and remains fundamentally in the national interest. The UK is clearly more prosperous, more secure and more powerful as a result of being a member of the European Union.

4. Second, no group has produced even a remotely compelling or attractive alternative to full EU membership. The obvious alternative available to the UK is to move to a Norwegian model as a member of the European Economic Area (EEA). But as the recent and thorough report from the Norwegian EEA Review Committee shows,[1] there are serious negative consequences from such a model, not least to national sovereignty since Norway is obliged to implement the vast majority of EU rules without having any voting powers over what those rules actually are. We find this 'fax democracy' option deeply inappropriate for the UK.

5. Third, the protracted liquidity and sovereign debt crises have made the EU more not less necessary. Economic recovery is not possible without deeper European integration, and the Europe 2020 programme sets the appropriate agenda. Recognising the need for a return to fiscal discipline at the national level, it is the obvious role of the EU to provide the platform and instruments for a revival of investment in sustainable growth. Appropriate action at the EU level, both directly through programmes financed by the EU budget, and via the EIB and through the launching of new project bonds, can produce massive cost efficiencies and economies of scale, not least by cutting wasteful duplication and adding value in science and technology (including defence capabilities), as well as by modernising Europe's infrastructure. The transfer of some significant items of public expenditure from national budgets to the EU budget, re-shaped to be more flexible and drive competitiveness, makes every sense. New streams of genuinely autonomous EU revenue will reduce the burden on

[1] http://www.europautredningen.no/english/

national treasuries. We broadly support the Commission's range of proposals on reform of the own resources system.

6. Fourth, we believe that European integration has come almost as far as it can under present constitutional conditions; and that while, after the Treaty of Lisbon, the EU lacks little in terms of statutory authority it is deficient in terms of capacity of government and resources. Unless these structural problems are tackled urgently, the legitimacy and durability of the Union will be at risk.

7. And fifth, we are gravely concerned about the state of British European policy which we find too often to be driven by short-termism and partisan and populist pressures, managed by a declining diplomatic force, and guided by no sense of strategic direction. This may in part be the consequence of having a coalition government composed of contradictory pro-European and eurosceptic tendencies. Yet previous Labour and Conservative governments also signally failed to deepen Britain's engagement with the EU or to enlighten British public opinion about the true nature of the country's deep interdependence with its EU partners and the scale and scope of integration.

The December European Council

8. So, to turn to your questions, we believe that the crisis at the December European Council marks a radical shift both in the UK's policy towards the EU and, more importantly, in its partners' attitude towards the UK. No other prime minister since Anthony Eden has turned his - or her - back on the Brussels negotiating table. We find Mr Cameron's demands of his colleagues in the European Council to be matters of secondary not primary law, largely misguided in content and intemperate in tone. The evidence is that the coalition partnership did not work that day.

9. It is impossible, however, to be surprised by what happened. The European Union Act of July 2011 installed UK referendums on all future important constitutional change in the EU. Although denied by ministers at the time, this unilateral British constitutional innovation was not received elsewhere with equanimity: the EU Act is seen to have side-lined the Westminster parliament, weakened British political parties, and given the populist press a nationalist field day. The result is that the hapless British people have an entrenched veto against the constitutional evolution of the European Union.

10. Treaty change is a normal if complex phenomenon because the European Union is founded on a system of common law. Regular treaty amendment is needed to codify settled jurisprudence of the Court of Justice, to adapt to enlargement, or to adjust the Union's competences and the powers of its institutions to deal with new challenges. Remove the possibility of treaty change, and the Union is paralysed. The fact is that the EU is once again facing a further round of substantial reform with, one way or another, major political consequences for the UK. Therefore the government cannot indefinitely resist a European referendum in Britain.

11. The December European Council was well aware of the threat of a looming British referendum. The main story of that meeting was not so much the attempt by a British prime minister to stymie the efforts to salvage the euro but, rather, the willingness of the other heads of government, under the leadership of President Van Rompuy, to call his bluff. Subsequent events confirm that the rejection of the British was not just a one night stand. There is no attempt made either to reverse the split or even disguise it. Indeed, we detect a palpable sense of relief in some quarters in the EU institutions that the perennially neuralgic

British problem might be about to go away. While the Coalition Government has shown engagement and indeed leadership in some areas – for example by former DECC Secretary of State Chris Huhne on moving to an immediate EU 30% reduction in GHG emissions and at the UNFCCC COP in Durban – the more common perception has unfortunately been that the UK remains uncooperative, notwithstanding the Coalition Agreement commitment to being a positive partner in Europe. The UK maintains a negative attitude across a number of areas of EU policy – including the EU's accession to the ECHR, the negotiation of opt-outs in the field of justice and home affairs, the first shots fired in the battles over the budget rebate and the reform of the own resources system, the continuing debate over the regulation of the financial markets, and a general British refusal to back the development of common foreign, security and defence policies. Good and energetic initiatives from the UK side need to utilise the usual European channels to reach their full potential. For example, the Like Minded Growth Group has successfully brought together 16 member states to focus on deepening the single market, smarter regulation and growth generation, but so far only in a parallel process not cross-referenced to the details of initiatives already underway at a European level.

12. It is extremely difficult to identify any benefit to the UK from the outcome of the December European Council, a view echoed in private by many in the British financial services industry which the Prime Minister's actions were apparently seeking to protect. Meanwhile the costs to British reputation and relationships have been significant, with potential knock-on consequences for our negotiating clout, including, ironically, on financial services dossiers. Moreover, the potential for caucusing among Eurozone or Eurozone Plus countries on EU matters, including the single market, is now more real than before December.

13. We note with deep regret the tendency in London to proceed to debate EU affairs as if 'Europe' were a far off country of which nothing much needs to be known. The narrow nationalistic tone of the domestic debate does great harm to the image of the UK in the rest of Europe. The argument over the future of Britain's treaty commitment to the ECHR and the Charter of Fundamental Rights is being closely scrutinised, as will be any official discussion of 'repatriation' of EU competences. The behaviour of British right-wing MEPs who work merely to undermine the institution to which they are elected to serve is universally ridiculed, but the relative influence of all British MEPs is affected adversely by the belligerence of the few. In short, we deplore the fact that conclusions are now being drawn in Brussels, across Europe and in the wider world about Britain's fitness and trustworthiness as an EU partner.

The fiscal compact treaty

14. The new treaty is unprecedented.[2] It works by explicit analogy with the EU treaties, respects the competences conferred under the EU treaties, seeks to deploy the institutions which are empowered by the EU treaties, commits to its own eventual incorporation within the EU treaties, but is not itself of them. It is an archetypal confederal treaty, committing the governments of signatory states to a course of action which if in the event they choose not to pursue there is no enforceable legal sanction against them. The European Commission may help to implement the fiscal compact treaty, but it is unable to use the fullness of its powers vested under the EU treaties to do so. The European Court of Justice is enjoined to act at the behest of one member state against another according to Article 273 of the Treaty

[2] The Schengen Agreement, by contrast, concerned an area of policy (passport controls) which the EU itself had not at that stage (1985) embraced and was crafted with the consent of all EU member states even though only some were to be bound by it.

on the Functioning of the EU in a dispute 'which relates to the subject matter of the [EU] Treaties'. Here the vessel of the fiscal compact sails into uncharted seas: Article 273 has never been used in litigation, not least because of what its use would imply for the elevation of the ECJ into a federal supreme court. At the very least, as the UK government has already made clear, the EU institutions will only be able to act in the context of the fiscal compact treaty under the threat of court action from another EU institution or a member state if a provision of the EU treaties is breached or the integrity of EU law abused.[3] The principle of sincere cooperation among member states and between the institutions is here a very relevant and important general principle of EU law.[4] It is difficult not to conclude that the relationship between the fiscal compact treaty and the formal EU treaties is highly ambiguous.

15. Despite its portentous title, the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* does not go all the way to remedy the flawed structure of EMU as handed down by the Treaty of Maastricht. Nor does it comprise more than one element in establishing the reign of austerity: indeed, most of its provisions are already enshrined (with the full support of the ALDE Group in the European Parliament) in the 'Six Pack' of EU laws which re-tightened the nuts and bolts of the Stability and Growth Pact and has made it more difficult for states, even large ones, to evade their mutualised responsibilities to observe fiscal rectitude.

16. An important innovation of the fiscal compact treaty is that the signatory states commit to passing cardinal laws at home in order to install a debt brake on national budgets where structural deficits rise above 0.5% of GDP. The confederal nature of the treaty means, of course, that there is no mechanism for enforcing the implementation of such rules. The contracting parties also agree to use reverse qualified majority in the Council of Ministers when it acts in the excessive deficit procedure – a principled code of conduct whose practical operation will be under close observation. The effect of the corrective provisions of the new treaty will only be felt in a number of years once the outcome of the present austerity regime is known. The immediate impact of the treaty falls on those eurozone states which will be unable to access bail-out funding from the European Stability Mechanism unless and until they agree to ratify both the fiscal compact and ESM treaties. For that reason alone, the substantive importance of the fiscal compact should not be underestimated. Its symbolic importance lies in its exclusion of the British.

17. Two other features are notable. First, the treaty commits its signatories to using the enhanced cooperation provisions of the Treaty of Lisbon to go further and faster in matters of social and economic integration. And, second, like all good confederal pacts, the treaty will come into force before all signatory states have completed their ratification process - indeed, when only 12 of the 17 eurozone states have done so. One would hope that such flexibility will influence the debate which the Union is bound to have at its next Convention on how to modify the entry into force provisions of its own treaties.

18. In any case, the fiscal compact treaty, if not an entirely good thing, is a necessary expedient, and adds to the pressure of market discipline and continual peer assessment to which all member states are now subjected to a greater or lesser extent. What is needed now, however, is faster economic growth to make palatable to a sceptical democracy the inevitably painful process of structural reform.

[3] See the letter from the UK Permanent Representative to the Secretary-General of the Council, 22 February 2012.
[4] Article 4(3) Treaty on European Union.

Incorporation of the fiscal compact treaty

19. Article 16 of the new treaty foresees its substantive incorporation within the EU legal framework 'within five years at most' following entry into force. It also predicates a situation five years hence in which the United Kingdom (and the Czech Republic) have changed their mind about the business and are prepared to concede what in 2012 they blocked. We support such incorporation. The UK's interests are not served well in the current set up. We must ensure that a rigid two-tier Europe, with the UK as a second rank junior partner, does not develop.

20. We would draw the Committee's attention to the likely significance of the institutional innovation of twice yearly summit meetings of the eurozone. Under Article 12(3) of the fiscal compact treaty these summits will discuss Europe's competitiveness, the modification of the global architecture of the euro and its fundamental rules - that is, the convergence criteria and the Stability and Growth Pact. Unless and until the UK agrees to the incorporation of the substance of the fiscal compact treaty into the EU framework its prime minister will be excluded from such important negotiations. British self-exclusion from such a forum would not serve the national interest.

Fiscal union and beyond

21. The integration of the fiscal compact treaty into the EU framework will not be the only item of constitutional business which the Union will need to address over the next few years. For a start, in addition to the new treaty, the rigid fiscal discipline enshrined in the current austerity programmes, the stronger regulatory framework for the financial sector, the creation of the EFSF and ESM and the revision of Article 136 TFEU, the Euro Plus Pact proposals on the supply side, the Six Pack (and other) EU legislation - all need now to be followed through by a decisive move towards fiscal solidarity. The debate about stability eurobonds takes the Union in that direction, as does the election of President Hollande in France. We believe that it is in everybody's interests that the euro is consolidated through the building of a fiscal union in which joint and several liability for sovereign debt is admitted. Such a fiscal union will need effective economic governance to make common economic policy.[5] The shape and size of this government have yet to be determined, but its powers and instruments are becoming increasingly well defined - including, for example, the creation of a proper treasury facility at the EU level. We have discussed above the need for a rebalanced EU budget with its own sources of revenue.

22. The creation of a fiscal union requires a radical overhaul of the Economic and Monetary Union chapters of Maastricht, including the granting of new powers to the Commission and Court, adjustment to the statute of the European Central Bank, changes to the decision-making procedures in the Council of Ministers, and modification of the 'no bail out' rules. Moreover, in addition to fiscal union, the next opportunity to revise the EU treaties will surely be minded to rectify some of the less good features of the Lisbon treaty. There will also be moves to reform the electoral procedure of the European Parliament and, possibly, to address the issue of its seat. In any case, it is already some ten years after the start of the last constitutional Convention whose work culminated in the Treaty of Lisbon: another general revision of the treaties cannot reasonably be long avoided - with its inevitable climax in a British referendum.

[5] We note that Mr Cameron appears to agree with this. He told the *Daily Mail* on 8 May 2012: 'We think that single currencies really require single governments if they are going to work properly'. Mr Osborne speaks of the 'remorseless logic' of fiscal union.

23. For the United Kingdom, therefore, and for other member states frustrated by the British problem, there will be one unavoidable topic at the next Convention. This is nothing less than the continuing status of the UK as a member state. Will the UK wish to stay a member of a more federal union or not? If not, will the UK have either the moral authority or the political will to block its partners from proceeding where they deem it necessary and desirable to go? Alternatives to EU membership should be properly assessed. Would a form of associate membership be more convenient for the UK? If so, what shape could that association take? Would other countries, either currently full member states of the Union or actual or probable candidate states, prefer to be more or less closely associated with the federal core but not to be a full part of it? These questions will be divisive. Their answers will be complex. Any outcome of a re-ordering of membership of the European Union will be controversial both for those who stay and for those who go. But the future of Europe will not be secure unless the European Union reaches a higher stage of integration than it has at present or one it can hope to reach under the treaties currently in force.

22 May 2012

FEU 15

Written evidence from Professor Michael Dougan, Chair in European Law, and Dr Michael Gordon, Lecturer in Public Law, Liverpool Law School, University of Liverpool

1. The main points substantiated in this evidence may be summarised as follows:

   - The December European Council veto will only be treated as a watershed if the UK opts to view it as such.
   - The TSCG[1] is separate from and subordinate to the EU Treaties. One should be wary of dressing political reservations about the TSCG in the language of illegality.
   - There are several different scenarios in which UK policy towards the TSCG will be conditioned by the legal and political environment created by the European Union Act 2011 (EUA).
   - Flexible membership of the EU already exists. The benefits of further reform must be balanced against the corresponding costs of greater flexibility.

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

2. There is no necessary reason that the "veto" exercised by the Prime Minister at the December 2011 Brussels summit should be treated as a watershed moment in UK Government policy towards the EU. The exercise and consequences of the veto were significant, yet we believe its implications can be construed in two ways. We suggest that the veto will only be treated as a watershed if the UK opts to view it as such.

3. First, the 2011 veto could be understood "narrowly", as an exercise in the protection of specific UK national interests which has had a minimal impact on its broader position in the EU. Indeed, this would seem to reflect the view of the Prime Minister, who in a statement to the House of Commons on 12th December 2011 maintained that the veto was necessary in the absence of "relatively modest" safeguards "on the single market and on financial services". Disagreement about the fiscal compact might thus be seen as effectively severable from other EU policy issues, and not necessarily inhibiting constructive engagement by the UK with fellow Member States.

4. Further, the UK, as a non-Contracting Party to the TSCG, actually remains in substantially the same position with respect to the provisions of the fiscal compact as non-eurozone Contracting Parties. The new obligations set out in the fiscal compact, and in particular the balanced budget rule, will only be applicable to such non-eurozone Contracting Parties if they declare an intention to be bound by these provisions. Further, the UK may decide at any point to accede to the TSCG, thereby placing itself in an identical position to any other non-eurozone Contracting Party. The UK may not then in practice be isolated on the margins of

[1] TSCG – The Treaty on Stability, Coordination and Governance

the EU simply because it has declined to participate in a compact designed principally to regulate fiscal policy among Euro-members.

5. Secondly, however, the Brussels veto might in contrast be viewed more "broadly", as expressive of a more fundamental shift in UK Government policy towards the EU. The UK Government's attempts to obtain concessions in exchange for consenting to an amendment of the existing EU Treaties demonstrates a lack of solidarity with fellow Member States during the ongoing financial crisis, especially since the most controversial provisions contained in the fiscal compact would not have been automatically applicable to the UK. Nor was the Prime Minister's veto necessary to avoid a national referendum in accordance with the EUA, because the "referendum locks" contained in that Act would not have been triggered by the provisions of the fiscal compact. Indeed, it is difficult to see the Brussels veto as necessary or effective in any real sense, given the Prime Minister's negotiating strategy failed to secure any of the safeguards sought, while the provisions of the fiscal compact objected to by the UK Government were still enacted by alternative means.

6. Perhaps the UK veto might then be emblematic of a shift in Government policy towards the EU, rather than a statement of dissatisfaction with the notion and/or terms of the fiscal compact itself. If this is the case, the 2011 veto may ultimately come to be seen as a watershed moment: the diplomatic manifestation of the UK's retrenchment from Europe. Yet the fact that such an understanding of the veto *may* be adopted does not mean that it *ought* to be adopted. Whether viewed narrowly or broadly, the Brussels veto will have implications for the UK's future within the EU. The two contrasting understandings discerned here will, however, afford different priority to the questions raised in this inquiry. If the impact of the veto is to be understood narrowly, attention should be directed to the Committee's questions concerning the relationship between the fiscal compact and the existing EU architecture. If the impact of the veto is to be understood broadly, then one should concentrate rather upon the Committee's questions concerning the UK's vision for future EU membership.

Narrow focus:

What is the relationship between the TSCG and the EU acquis?

7. The formal relationship between the TSCG and the EU Treaties is very straightforward. The TSCG is an international agreement entirely separate from and constituting no part of the EU legal order. Moreover, the TSCG must be interpreted and applied in conformity with EU law, the latter taking precedence in the event of any conflict between the two regimes.

8. Despite that formal separation, there is a significant overlap between the subject matter of the TSCG and EU law. The TSCG contains certain obligations for Contracting Parties which go beyond those already laid down under EU law: e.g. the "balanced budget" rule in Arts.3 and 4 TSCG commits the Contracting Parties to a higher standard of fiscal discipline than that imposed under existing EU law (while Art.8 establishes a specific enforcement mechanism in respect of limited aspects of that commitment); the "reversed qualified majority voting" rule in Art.7

TSCG commits the Contracting Parties to a particular course of conduct within the Council (though there is no effective way to enforce that commitment, should a Member State behave otherwise in accordance with EU law).

9. Otherwise, however, the TSCG does little which can be considered genuinely novel. Various provisions merely anticipate obligations which are possible and indeed imminent under the EU Treaties, e.g. Art.5 budgetary and economic partnership programmes; Art.6 public debt issuance plans; Art.11 major economic policy reform plans. Similarly, several provisions do no more than express aspirations about the future use of powers/procedures already provided for under the EU Treaties, e.g. Art.10 enhanced cooperation; Art.13 parliamentary cooperation. Meanwhile, other provisions refer to informal programmes/activities already established before the TSCG, e.g. Art.9 enhanced convergence and competitiveness; Art.12 Eurosummit meetings.

10. We do not share the analysis expressed by certain commentators, and partially endorsed by the recent report of the European Scrutiny Committee, concerning three important issues of compatibility between the TSCG and EU law.

11. First, there is the idea that recourse to an international treaty is somehow improper, as a matter of principle, whenever a Member State(s) tries and fails to persuade its partners to amend the EU Treaties themselves. That is quite a remarkable proposition – amounting to a virtual denial of state sovereignty. It cannot be seriously argued that the failed or indeed hypothetical possibility for the EU to have assumed responsibility over a given matter thereby precludes the Member States from pursuing the same or similar objectives under ordinary international law.

12. Secondly, there is the argument that Art.273 TFEU[2] is an improper legal basis for the jurisdiction conferred upon the ECJ pursuant to Art.8 TSCG. There is little direct judicial authority exploring the detailed conditions governing resort to Art.273 TFEU, though there is much historical precedent to support the view that the Member States enjoy a wide margin of appreciation when it comes to voluntarily submitting disputes to the ECJ. To reject the lawfulness of Art.8 TSCG implies adopting a systematically restrictive interpretation of Art.273 TFEU without any real legal authority and despite the evidence of past practice.

13. Thirdly, there is the argument that it is impermissible for Member States to entrust limited tasks to the Union institutions outside the framework of the EU Treaties. There is direct authority from the ECJ to support the lawfulness of such delegated functions as a matter of constitutional principle. However, the conditions governing such delegated functions in practice remain unclear – especially whether delegation requires the express consent of all Member States. There are solid legal arguments on both sides of that debate – which should caution against adopting a strong critical stance based on the alleged unlawfulness of the TSCG, as opposed to holding an opinion about its political desirability.

[2] TFEU – The Treaty on the Functioning of the European Union

Should the UK Government support the incorporation of the TSCG into the EU Treaties?

14. Adopting a narrow understanding of the implications of the UK veto, and accepting that the TSCG contains little which can be considered genuinely novel, the possibility of the fiscal compact's future incorporation into the existing EU Treaties will need to be considered. We focus here on the legal issues arising in relation to the UK Government supporting incorporation of the fiscal compact into EU law, as envisaged by Art.16 TSCG.

15. There is no compelling political reason that the Government should not support incorporation, especially since the provisions of the fiscal compact do not bind the UK. There is also no domestic legal impediment to the Government supporting incorporation, for, as noted above, the referendum locks contained in the EUA would not be triggered by such a development. Although an amendment of the existing EU Treaties to include the balanced budget rule set out in Art.3 TSCG would appear to be caught by s.4(1)(f)(i) EUA, which provides that an extension of EU competence in relation to economic policy will attract a referendum, the exemption in s.4(4)(b) would serve to obviate this requirement. By this exemption, while the provisions of the fiscal compact remain inapplicable to the UK, it would not be necessary for a national referendum to be held before an amending Treaty could be lawfully ratified by the Government.

16. This basic position should be qualified by noting three potential legal problems in relation to future incorporation attempts. First, if an amending Treaty went beyond the simple incorporation of the fiscal compact provisions into EU law, and purported to make other changes which extended the competence of the EU in any of the ways specified in s.4 EUA, unless those changes were exempt under s.4(4), a referendum would be necessary. If the UK were to make its acceptance of an amendment of the existing EU Treaties conditional upon certain demands being satisfied, and other Member States were to counter with competing demands, it is conceivable that the exercise could expand beyond the mere incorporation of the fiscal compact into EU law, with the consequence that a broader amending Treaty might engage the EUA's referendum locks.

17. The remaining problems expose inconsistencies in the EUA itself. The second problem is a gap in the scheme of referendum locks. If the UK were to support the incorporation of the fiscal compact into EU law, and *subsequently* opted to be bound by these provisions, the competence of the EU with respect to UK economic policy would have been extended, and yet a referendum would not have been required lawfully to ratify this extension of competence. A referendum lock would only be engaged if the rules contained in the fiscal compact were to be applicable to the UK from the time of their incorporation. Otherwise, a national referendum could be readily avoided, and while this may appear politically convenient, given the controversial content of the fiscal compact, it might also be difficult to justify.

18. The third problem is, in contrast, one of overprovision. If the UK were to accede to the TSCG in accordance with Art.15, and declare an intention to be bound by the fiscal compact *prior* to supporting its incorporation into EU law, a referendum

would be required at the moment of incorporation notwithstanding the fact that the UK would already have put in place a domestic mechanism to implement the balanced budget rule. In such circumstances, the formal extension of EU competence would trigger a referendum essentially to approve what had already been done, with the corollary that a failure to obtain the requisite popular approval would produce significant legal and political uncertainty.

19. In essence, the EUA adds a further layer of legal and political complexity to any UK Government decision to support the incorporation of the fiscal compact into the existing EU Treaties. In so far as it has transformed the domestic procedure for approving an amendment of the EU Treaties, and dramatically reconfigured prior assumptions about the role played by national referendums in this process, we contend that, if a watershed moment in UK Government policy towards the EU is sought, it should be found not in the Brussels veto, but in the enactment of the European Union Act 2011.

Broader focus:

Between now and 2020, what institutional architecture and membership should the UK seek for the EU?

20. It is worth recalling that, despite its controversial evolution, the final Lisbon Treaty was widely seen across Europe as a triumph for the UK's vision of European integration. Lisbon clearly affirms that the EU is merely the creation of its Member States, the latter remaining sovereign states under international law, and that the EU lacks any claim to statehood of its own. Lisbon reinforces fundamental characteristics such as the principle of attributed EU powers and a system of differentiated EU competences. It redraws the EU's institutional balance by strengthening the influence of national governments. It also includes specific provisions for the UK, such as extending the opt-out across all of justice and home affairs. Against that background, we should ask: if the British vision for Europe triumphed at Lisbon, what is it that remains "wrong" with the UK-EU relationship?

21. For some, the problem is a relatively narrow one: it relates to the fact that one government objects to being bound by particular EU reforms or policies (in fields such as employment rights) that were agreed to by or under a previous administration. If that diagnosis is correct, there seems little that can be done to remedy it: there is no unilateral capacity to undo EU treaty reforms; the right to repudiate existing EU secondary obligations is very rare. Perhaps the major political parties need to reconcile themselves to a system in which certain policy choices are indeed a collective responsibility of the Member States and as such difficult to reverse unilaterally even after a change of domestic government.

22. For others, however, the real difficulties are significantly more far-reaching. Perhaps the British vision for Europe has changed since Lisbon, even among those actors who are not opposed as such to UK membership: there is certainly a strong political constituency which argues that the extent of our participation in European integration now needs positively to be rolled back. Or perhaps the fallout from the ongoing Eurozone crisis will see other Member States pushing for a renegotiation

of the Lisbon settlement, so as to strengthen considerably the foundations of European economic and political integration – a project in which the present or a future Government decides the UK should not fully participate. In either case, the FAC's terms of enquiry suggest that one potential solution lies in developing multiple forms of EU membership.

23. In that regard, it is worth recalling that "flexible integration" already exists under the current Treaties. The range of policy opt-outs provided for directly under the Treaties themselves, together with the system for engaging in enhanced cooperation within the EU framework, mean that there are myriad constellations of (actual and potential) national participation in various fields of EU activity. Moreover, such flexibility already carries clear institutional (as well as substantive) consequences, e.g. as when the Council acts in restricted formations, taking into account only the votes of participating Member States.

24. Against that background, one should ask: how much further might the UK want such flexibility to go? E.g. would it be sufficient to encourage more frequent/extensive resort to enhanced cooperation within the framework of the existing Treaties? If so, that would permit the UK to opt into or stay outside given EU measures or policy sectors as the national interest required – but would require building consensus within the EU that enhanced cooperation should be exploited to its full potential (and possibly also a Treaty amendment to remove the requirement that enhanced cooperation may only be used as a "last resort"). Or would the UK wish to negotiate amendments to the Treaties themselves, extending its existing opt-out rights beyond the single currency or justice and home affairs, to cover additional policy fields? If so, that would require the UK to persuade its European partners of the need for potentially far-reaching revisions to its EU membership, potentially including making the difficult case for special treatment within the single market, or a second-rate status for UK workers/consumers.

25. In any event, it is worth recalling that flexibility has costs as well as benefits. Flexibility can involve a tangible loss of policy leadership and influence – especially if it involves institutional arrangements which exclude a Member State even from being present around the negotiating table. Depending on the relative sizes of the core/periphery, and the importance of the subject matter, flexibility might risk non-participating states being *de facto* obliged to follow, or work around, the policy agenda agreed by others. Flexibility can also exacerbate concerns about the complexity, transparency and legitimacy of EU decision-making – though such concerns pale when compared to the limitations of more traditional intergovernmental bargaining conducted outside the EU framework. Seeking to negotiate "country specific" Treaty amendments obviously still requires unanimity among the Member States, and opens the door for other countries to bring their own demands to the table, some of which may not serve the UK national interest.

22 May 2012

Written evidence from Open Europe

Open Europe is an independent think tank, with offices in London and Brussels, set up to contribute positive new thinking to the debate about the future direction of the European Union and Britain's role within it.

THE UK MUST REVISE ITS EU MEMBERSHIP TO SAVE IT

Summary:

- The institutional and political status quo in Europe is not an option for the UK. The UK public and political class are growing more sceptical of the European Union at exactly the same point as the Eurozone is set for more integration: the final destination points for the UK and the Eurozone are inevitably different.

- Without a revision of the UK's EU membership terms and if the EU is left to become simply an extension of the euro, Britain may be forced to leave altogether.

- Based on these changed circumstances, the UK should set out a new, firm and positive vision for its place in the EU, based on the following principles:

  - Powers can flow back from the EU – it should not be a one-way street;
  - Countries must be free to integrate with each other to different degrees;
  - No EU interference in areas that can be better – or equally well – handled locally or nationally;
  - A far greater role for national parliaments.

- This agenda should be pursued with a concerted and thought-through drive by the UK government aimed at:

  - Formalising an EU structure based on different – but equally legitimate – circles of membership;
  - Seeking safeguards to counterbalance the risk that a more tightly knit Eurozone could dictate terms to non-euro members;
  - Starting a process of devolving powers back from the EU when the political and economic circumstances present themselves.

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1. To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

1.1. The December veto was a reflection of the multi-tier Europe inherent in the creation of the euro, not the cause of it. It was a watershed moment in as much as it could signal the start of a new political settlement in Europe in the wake of the Eurozone crisis, a process which could last for a number of years – perhaps more than a decade. Furthermore, no matter what we think of the diplomatic efforts and the preparatory work that preceded the veto,[1] so far there is no evidence that the UK has lost influence in Europe as a result of it – as some

[1] For a broader discussion, see *Open Europe*, 'Cameron's EU veto: Ten lessons that need to be learnt', December 2011, http://www.openeurope.org.uk/Content/Documents/PDFs/10lessons.pdf

warned, in very stark language, following the December Council.[2] On the crucial Capital Requirements Directive, for example, the UK managed to largely achieve its objectives, despite being in a minority position at the outset.

1.2. What is clear is that the status quo is not an option. The euro crisis will inevitably force EU member states to develop a more variable approach to European cooperation. Though not of the UK's making, the rules of EU cooperation are changing – Britain's role in Europe must change with it. This presents opportunities as well as challenges.

Challenges:

1.3. ***If the EU becomes a political extension of the Eurozone, then the UK may well be forced to leave the EU:*** The December veto did remind us that the end points for the Eurozone and the UK are now, inevitably, different if the UK remains outside the euro. The British public and political class is becoming increasingly sceptical of the EU at exactly the same point that the Eurozone is set for further integration. Therefore, if the Eurozone continues to insist on more political integration, including those EU member states that are not euro members – such as was the case with the fiscal treaty – then the UK will become increasingly uncomfortable within the EU and could well slowly move towards the exit. The question is whether this is what the UK and the rest of the EU really wants and if it is inevitable (see 'Opportunities' below)?

1.4. ***Eurozone caucusing:*** A well-documented risk is that Eurozone states start to act and vote as a 'caucus' – not only in areas of direct concern to the running of the Eurozone but also, for example, in single market legislation, social policy or financial services regulation.[3] It is hard to envision how 'Eurobonds' or other forms of shared eurozone government borrowing could work without some sort of banking resolution fund at the eurozone level to underpin the financial system or potentially even a shared finance minister, as proposed by former ECB President Jean-Claude Trichet.[4] This would clearly have major implications for the UK's financial services industry.

1.5. So far, there has been limited evidence that Eurozone caucusing is taking place, but it remains a clear risk – this is particularly true if the EU grows more protectionist in services (including financial), on which the UK is heavily dependent.[5]

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[2] See, for instance, Charles Grant, 'Britain on the edge of Europe', 9 December 2011, http://www.opendemocracy.net/ourkingdom/charles-grant/britain-on-edge-of-europe; Charles Grant is Director of the Centre for European Reform (CER)

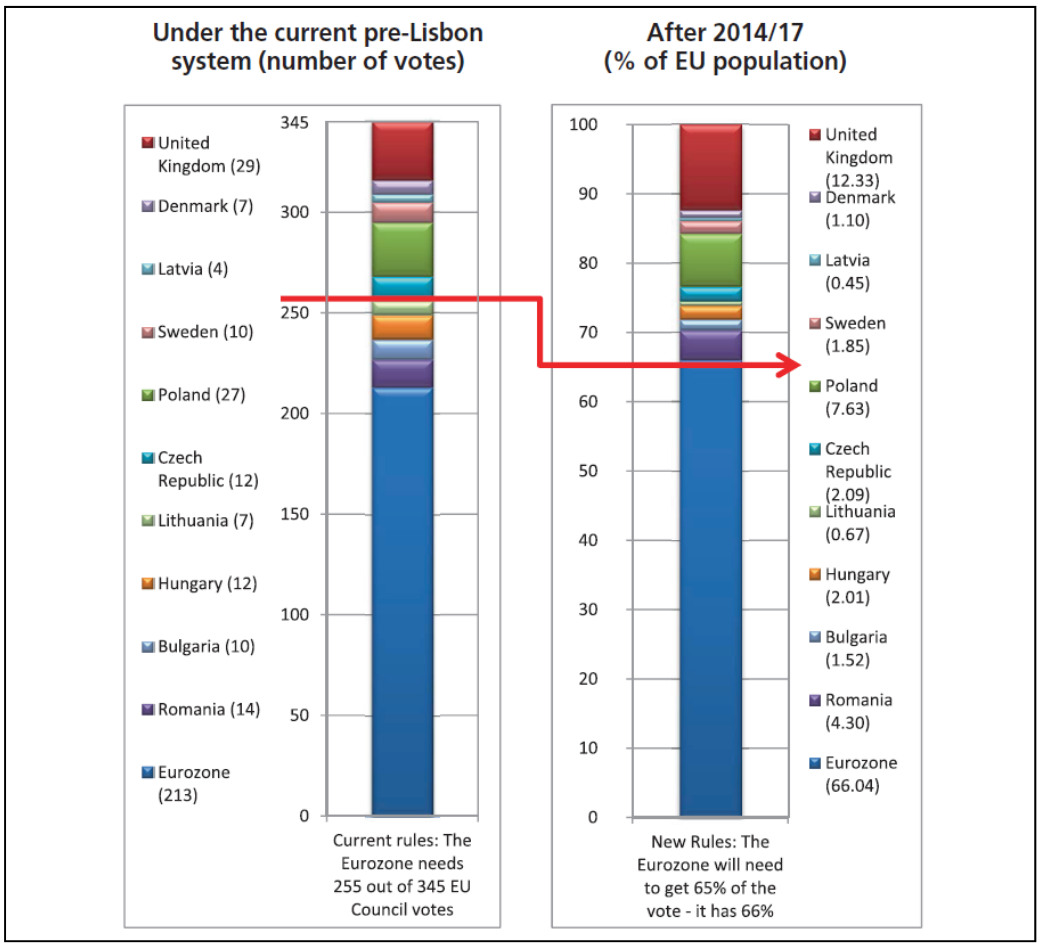
[3] We discussed the issue thoroughly in *Open Europe*, 'Continental shift: Safeguarding the UK's financial trade in a changing Europe', December 2011, http://www.openeurope.org.uk/Content/Documents/PDFs/continentalshift.pdf

[4] See the *FT*, 'Trichet seeks single EU finance ministry', 2 June 2011, http://www.ft.com/cms/s/0/e0bd4e7a-8d15-11e0-815d-00144feab49a.html#axzz1vUPlj1IT

[5] An early example of the potential for eurozone dominance was the decision leading to the creation of the EU's European Financial Stabilisation Mechanism (EFSM) bailout fund, used to aid Ireland and Portugal. Unlike the European Financial Stability Facility, which is guaranteed solely by eurozone states (EFSF), the EFSM is jointly guaranteed by all 27 EU member states via the EU budget. The decision, in May 2010, to create this fund was hugely controversial because it used Article 122 of the EU Treaties, previously reserved for providing financial assistance only in times of natural disaster, to overrule the Treaties' 'no bailout clause'. Although the decision was formally approved under QMV at a meeting of the EU-27 finance ministers on 9 May 2010, eurozone leaders had already outlined the creation of the EFSM at their own meeting two days earlier. The statement of the heads of state or Government of the euro area (from 7 May 2010) is available here, http://in.mobile.reuters.com/article/businessNews/idINIndia-48328620100507

1.6. Future changes to qualified majority voting weight in the Council of Ministers (under the Lisbon Treaty) could potentially exacerbate this risk. In 2014 or 2017 (if a country requests it), Eurozone countries, if they vote as a bloc, will for the first time have a qualified majority in the Council of Ministers, meaning that they can outvote non-euro members on issues decided by QMV.

Changes to qualified majority voting under the Lisbon Treaty



1.7. ***The colonisation of the EU institutions:*** Linked to the above is the risk of the European institutions being used to pursue policies that are designed for the specific needs and concerns of the Eurozone as opposed to the EU as a whole. There is some, albeit limited, evidence that the EU institutions are already starting to act as facilitator of a Eurozone agenda. As has been widely noted, without the specific approval of the UK, and despite it not being incorporated in the EU treaties, the fiscal treaty makes some use of the EU institutions to enforce Eurozone budget rules (the ECJ is meant to police whether the new rule on 'balanced budgets' is implemented into national law, but cannot impose penalties if a signatory country breaks the rule).[6] Likewise, the European Commission has tabled a proposal for a financial transaction tax, following pressure from within the Eurozone (the proposal is protected by a veto so will not be adopted at the EU-level as long as the UK objects).[7]

[6] See *Open Europe*'s blog, 'Fifth time lucky?', 30 January 2012, http://openeuropeblog.blogspot.co.uk/2012/01/fifth-time-lucky.html
[7] See *Open Europe*'s blog, 'Taxing unicorns', 23 March 2012, http://www.openeuropeblog.blogspot.co.uk/2012/03/ftt-rears-its-ugly-head-once-again.html

1.8. These risks are linked to the possible 'fragmentation' of the single market, i.e. the single market gets divided between those inside the euro and those outside, which would represent a step backwards for intra-EU trade. However, the UK could have allies in seeking to prevent this. The European Commission and smaller member states want to avoid it, as it would tip the balance of power further towards the Franco-German axis.

Opportunities:

1.9. ***A new vision and model for European integration:*** The Eurozone crisis marks a clear setback to the original founding principle of "ever closer union". First, the principle has led directly to financial and political turmoil; Greece should clearly not have joined the euro, but there was so much political momentum for closer union that it signed up, which is now threatening to cause major political and economic fallout in Europe.

1.10. Second, as noted, it cannot accommodate for the different end points for the UK and euro countries. It follows that the UK now has a unique opportunity to take the initiative, stating clearly and firmly an alternative principle of European cooperation, which allows for different circles of membership of the EU, and which would be based on the following principles:

- Powers can flow back from the EU – it should not be a one-way street;
- Countries must be free to integrate with each other to different degrees;
- No EU interference in areas better – or equally well – handled locally or nationally (the current concept of 'subsidiarity' is so vague that it can mean anything, elsewhere we have instead proposed a 'European localism' agenda, i.e. taking the principle of localism endorsed at the national level and applying it to the European level);[8]
- A far greater role for national parliaments.

1.11. The UK government has consistently suffered from a poverty of vision for its role in Europe, which has left it without an overall strategy.[9] The euro crisis, and its potential aftermath, means this must change. The alternative vision it now has the opportunity to set out needs to be positive, stressing a new, economically flexible model, growth opportunities across the globe and the need to reconcile EU membership with national democracy. David Cameron came close to spelling out such a vision last year when he said that the EU should take on "the flexibility of a network, not the rigidity of a bloc – whose institutions help by connecting and strengthening its members to thrive in a vibrant world, rather than holding them back."[10] Having a clear vision of where the UK should be in Europe – and setting out an alternative vision for European cooperation – will also help to focus diplomatic efforts and make it easier for EU partners to know what, exactly, the UK wants to achieve (and therefore easier for them to lend support or at least reach a position of compromise based on mutual interests).

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[8] See *Open Europe*, 'The case for European localism', September 2011, http://www.openeurope.org.uk/Content/Documents/PDFs/EUlocalism.pdf

[9] See, for instance, Open Europe Senior Analyst Christopher Howarth's article on *Conservative Home*, 'If he wants Britain to have a vision for Europe, David Cameron should appoint a European Secretary', 17 April 2012, http://conservativehome.blogs.com/platform/2012/04/christopher-howarth-if-he-wants-britain-to-have-a-vision-for-europe-david-cameron-should-appoint-a-e.html

[10] From David Cameron's speech at the Lord Mayor's Banquet, 14 November 2011, http://www.number10.gov.uk/news/lord-mayors-banquet/

1.12. ***Pushing for redistribution of powers:*** As the Eurozone will continue to need the UK's approval to pursue further integration via the EU institutions, and as Germany and other member states have a strong incentive to keep the UK inside the EU, the UK should accompany its drive for an alternative model for European integration which includes bringing specific powers back to the UK (see below).

1.13. ***Reorientation of the UK economy away from the eurozone:*** The EU will remain an important destination for UK trade but the short and long-term economic challenges Europe faces warrant a rethinking of the UK's economic interests. Currently, only 1.4% of UK exports go to India forecasted to grow on average by 8.1% a year up to 2050 and only 2.35% to China forecast to grow at 5.9%.[11] Although trade negotiation remains an exclusive EU competence, the UK retains the power to promote UK business and exports to non-EU countries, something which the current Government has correctly made a priority. This is an important exercise for two reasons. Firstly, boosting UK trade with emerging and fast-growing economies is clearly beneficial in its own right but, secondly, the less the UK depends on the EU/eurozone for trade, the stronger Britain's negotiating position when it comes to arguing for reform.

2. Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

2.1. Talk of a "multi-speed Europe" – implying that all EU member states are religiously heading in the same direction – must stop. Instead, the UK should fully embrace a formalised EU structure based on different modes of membership, based on the principles set out above and the understanding that Britain will not join the euro.

2.2. The notion that such a multi-facetted EU structure would leave the UK on the side-lines is misplaced: the UK is one of EU's 'big three' economies; it is a large export market; remains a genuine global player; a big net contributor to the EU budget; is home to Europe's financial centre and a nuclear power. The rest of the EU will listen to the UK if it comes up with a constructive agenda. In the EU debate, "influence" is a term too often used – particularly by those who favour the status quo – in a rather lazy and undefined way. Those who worry about loss of influence must give concrete examples of where this is happening and, crucially, *what* the UK should be influencing.

2.3. In terms of an EU institutional framework, the UK has three basic options:

- Status quo;
- Changing the institutional framework from within, i.e. seeking new membership terms;
- Seeking a new institutional arrangement with Europe altogether, which most likely would involve withdrawal.

2.4. We believe the status quo is not an option, while withdrawing from the EU altogether would raise more questions than it would answer (the alternative trading arrangements with Europe, i.e. the European Economic Area or a free trade agreement, would also require the 'approval' of EU partners and therefore

[11] *ONS*, 'Pink Book' and *Open Europe*, 'Continental shift: Safeguarding the UK's financial trade in a changing Europe', p25

raise many of the same issues as renegotiation from within). Therefore, creating a new institutional arrangement from within is the UK's best option. Concretely, the new institutional architecture that the UK should push for could include:

2.5. **The devolution of powers from EU – at least for the UK:** David Cameron has labelled the current crisis "An opportunity, in Britain's case, for powers to ebb back instead of flow away and for the European Union to focus on what really matters."[12] This is the right thinking. Substantially reforming the institutional division of labour between the UK and the EU may be necessary to reconcile public opinion to EU membership. The pursuit of returning powers to the UK and further Eurozone integration is not mutually exclusive – on the contrary.

2.6. The priorities should be areas that have an everyday impact, for example:

- Devolving EU regional spending to richer member states, including the UK, which would save Britain billions and allow it to run a far more effective regional policy (no treaty change);[13]
- The UK should exercise its 'block opt-out' from around 130 EU laws in justice and home affairs, which it could do unilaterally under the Lisbon Treaty (by 2014 – no treaty change);[14]
- As noted below, there needs to be a better balance between European market access and control over vital national economic interests, for example via a veto over disproportionate financial services law (treaty change);[15]
- At least part of the CAP should be re-nationalised (no treaty change);[16]
- A UK long-term objective should be to devolve social and employment law (treaty change). A short-term, intermediate objective should be to minimise the impact of the working time directive (no treaty change);[17]
- EU environmental legislation should be far less prescriptive. A compromise may involve overall targets set at the EU-level but member states free to meet them in whatever way they deem the most cost-effective (no treaty change).

2.7. **Far stronger roles for national parliaments:** This should include far greater scrutiny powers for MPs (for example a mandate-based system based around the Danish model, which could be achieved unilaterally) and pushing for parliaments to be given a "red card" option which would enable them to veto Commission legislation if there was a significant majority opposed (requiring Treaty change).[18]

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[12] From David Cameron's speech at the Lord Mayor's Banquet, 14 November 2011
[13] See *Open Europe*, 'Off target: The case for bringing regional policy back home', January 2012, http://www.openeurope.org.uk/Content/Documents/PDFs/2012EUstructuralfunds.pdf
[14] See *Open Europe*, 'An unavoidable choice: More or less EU control over UK policing and crime law', January 2012, http://www.openeurope.org.uk/Content/Documents/PDFs/JHA2014choice.pdf
[15] See *Open Europe*, 'Continental shift: Safeguarding the UK's financial trade in a changing Europe'
[16] See *Open Europe*, 'More for less: Making the EU's farm policy work for growth and the environment', February 2012, http://www.openeurope.org.uk/Content/Documents/Pdfs/CAP_2012.pdf
[17] See *Open Europe*, 'Repatriating EU social policy: The best choice for jobs and growth?', November 2011, http://www.openeurope.org.uk/Content/Documents/PDFs/2011EUsocialpolicy.pdf
[18] *Open Europe*, 'The case for European localism'

2.8. **European cooperation must be a two-way street:** As noted above, it simply has to be possible under the Treaties for powers to flow back to member states. There are a number of ways in which this could be formalised. For example, the Lisbon Treaty already allows for so-called "enhanced cooperation", whereby a group of member states are free to pursue a policy separately if not all 27 are able to agree. This has already happened in areas such as family law and an EU patent. However, there is no reason why this cannot also work in reverse, with a group of countries deciding to repatriate powers or EU laws, even though it may not be politically possible for all 27 countries to do so.

3. Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

3.1. Yes, subject to safeguards or powers back. These safeguards need to be better thought-through, prepared and communicated than the UK's demands ahead of the December summit. The safeguards could include:

1) Formal safeguards for the non-euro group. For example, 'double QMV' to give the non-euro group a veto or a non-euro red card allowing non-euro members to block a Eurozone 'caucus' in the Council.

2) A new 'single market protocol', which could commit the EU to a pro-growth, outward looking and proportionate regulatory regime while safeguarding the UK from decisions taken solely by the eurozone for all 27 member states.[19]

3) UK-specific, legally watertight safeguards that will ensure that the UK is not overruled on a vital financial measure and cement London's ability to do business and compete in global markets. Though it will be resisted by EU partners, this could include a 'double lock', acknowledging the UK's prominence in this sector and giving the Government the right to refer any disproportionate or discriminatory laws to the European Council, where it has an effective veto over regulatory proposals.[20]

3.2. We have recommended that the UK focus first and foremost on financial services as it is a policy area where we can already see the potential friction that can occur between Eurozone integration and UK interests (as a fiscal union could well spill over to financial supervision and regulation) – therefore options two and/or three are our preferred ones.

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[19] For a broader discussion, see *Open Europe*, 'Continental shift: Safeguarding the UK's financial trade in a changing Europe'
[20] *Ibid.*

ANNEX: Potential wording of the protocols

Wording of a potential single market protocol

PROTOCOL ON THE SINGLE MARKET

THE HIGH CONTRACTING PARTIES,

RECOGNISING the importance of maintaining the single market for the prosperity of the Union;

DESIRING to reduce barriers to trade in areas such as the digital economy, services, telecoms and energy by 20XX;

DESIRING to allow for a competitive flexible and responsive labour market;

HAVE AGREED upon the following provision, which shall be annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union:

Article 1

So as to ensure that competition in the internal market is not distorted, all decisions relating to the internal market are to be decided by the Council of Ministers by the ordinary legislative procedure and that all decisions relating to the operation of the euro-area are compatible with the internal market of all member states.

Article 2

No provision will be introduced unless it has been subject to a rigorous impact assessment, is matched by the cancellation of a current measure, is proportional, consistent with the principle of subsidiarity and is demonstrably related to a known risk.

Article 3

No provision relating financial services will be introduced unless it is proportional, related to and seeks to remedy a known and demonstrated risk, and does not impose maximum standards on the sector, if a member state demonstrates the need to safeguard its own industry.

Article 4

That a Code on Better Regulation will be considered before any proposal is brought forward and an assessment made as to whether measures will improve growth and competitiveness of the Union economy.

Wording of a potential UK Protocol:

PROTOCOL ON THE FINANCIAL SERVICES INDUSTRY IN THE UNITED KINGDOM

THE HIGH CONTRACTING PARTIES,

RECOGNISING the importance of the financial services industry to the United Kingdom;

DESIRING to allow the United Kingdom to maintain control over the regulation of its financial services industry;

WHILST wishing to allow the United Kingdom to retain the ability to participate in regulations and measures;

ACKNOWLEDGING the United Kingdom’s responsibility to act responsibly and preserve the Single Market;

HAVE AGREED upon the following provision, which shall be annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union:

Article 1

Notwithstanding the provisions of the Treaties, where the United Kingdom indicates to the Council that it believes that a proposed regulation or directive or an amendment to an existing regulation or directive is or would in its judgement adversely and disproportionately affect its financial services industry it may request that the proposal is referred back to the European Commission, that additional assessments are made of the proposal and that suggested amendments are considered.

Article 2

Notwithstanding the provisions of the Treaties, where the United Kingdom indicates to the Council that it believes that an existing directive or regulation, a proposed regulation or directive or an amendment to an existing regulation or directive is or would in its judgement adversely affect its financial services industry it may request that the proposal is suspended and referred back to the Council. In that case, the ordinary legislative procedure shall be suspended and the validity of such a request shall not be called into question whether by the ECJ or in any other way.

Written evidence from Ruth Lea, Economic Adviser, Arbuthnot Banking Group

Summary

- The December 2011 European Council and the subsequent signing of the "Fiscal Compact Treaty" by 25 EU Member States (excluding the UK and the Czech Republic) would at face value seem to have little impact on the UK's EU policy and place in the Union. After all the British Government remains firmly committed to EU membership, which is not, in my judgement, in the country's best interests.
- But perhaps the December Summit will be seen by future historians of the EU as a watershed event for the UK and the EU, when the UK's isolation was obvious, at last, for all to see. Moreover, despite the PM's veto, the European Council has simply pushed ahead with the Treaty, which will probably be incorporated into the EU Treaties sooner rather than later. One can only conclude that Britain's influence on EU events, as crisis engulfs the Eurozone, is minimal.
- Given the lack of UK influence in the EU, we are in the weakest possible position to drive forward institutional or policy developments in the EU. Whilst we remain a member, the best we can do is respond to decisions made by the Franco-German axis and EU institutions and attempt to obtain the best deal for us. This may seem like a counsel of despair, but it is a realistic one.
- In any case, any major near-term to medium-term developments in the EU will almost certainly concern the Eurozone as EU institutions and the EU17 Member States struggle with the existential threat to the currency. Britain, thankfully outside the euro, is inevitably at the periphery of events, a bystander.
- Moreover, any notion that the British Government could use the Eurozone crisis to negotiate any repatriation of powers, and develop a different form of membership, is a chimera. There is absolutely no evidence that our EU partners would accept such a move.
- It is not clear that the Treaty will have any direct impact on other aspects of the EU and its policies. But the indirect impacts of its implementation must not be underestimated. The Treaty is part of the on-going centralisation of EU policy-making. Under these circumstances, I would expect the EU's institutions to push ahead with the further centralisation of policy-making, some of which is intended, at least putatively, to "save the euro".
- Having vetoed the incorporation of the Fiscal Compact Treaty into the EU Treaties in December 2011, the UK Government should continue to reject any such move for the sake of consistency, at the very least. If the Government is prepared to agree to the incorporation they should at the least get guarantees that the EU-wide Financial Transactions Tax will remain subject to veto in order to support the City. They can, after all, do little to protect the City from the flood of EU Single Market financial regulations which are subject to QMV.

Submitter of evidence

Ruth Lea has worked in the Civil Service (the Treasury, the Civil Service College, the CSO and DTI (1970-88), with a short break lecturing in economics); the City (Mitsubishi Bank (1988-93), Lehman Brothers (1993-94), Arbuthnot Banking Group (since 2007)); ITN (1994-95) and the Institute of Directors (1995-2003). She was Director of the Centre for Policy Studies (2003-07) and Director of Global Vision (2007-10).

I would be happy to give oral evidence to the Committee.

Submission

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

1. A brief analysis of the background to the "Treaty on Stability, Coordination and Governance of the Economic and Monetary Union", otherwise known as the "Fiscal Compact Treaty",[1] is required in order to assess the significance of the December 2011 European Council meeting for Britain.

2. The Treaty is intended to strengthen the Eurozone's Stability and Growth Pact (SGP), whereby general government deficits should not exceed 3% of GDP and general government debt should not exceed (or is "sufficiently declining towards") 60% of GDP, by introducing a new range of medium-term objectives, including a "balanced budget rule" and an automatic mechanism to take corrective action. The former states that budgets must be balanced, with "a lower limit of a structural deficit of 0.5% of GDP", or in surplus. Concerning the corrective action, if the European Court of Justice judges that a member has failed to comply with the "balanced budget rule", it can impose a fine, a sum "that shall not exceed 0.1% of GDP". It should be noted that there is some flexibility in the "balanced budget rule" in that "exceptional circumstances" are allowed for. In addition, the target is expressed in terms of the "structural" (i.e. the cyclically-adjusted) balance, not the actual recorded balance, which can allow for large deficits if the economy in question is performing well below potential. Note also that, because the Treaty is exclusively about the Eurozone, it does not directly affect the UK.

3. Putting aside the feebleness of the SGP to impose fiscal discipline on the Eurozone's members in the first decade of the euro's existence, there are significant doubts about the Treaty's potential success, given the horrendous and deep-seated structural problems faced by the Eurozone in its current dysfunctional configuration. The Treaty is, significantly, only concerned with fiscal discipline in the Eurozone and should be seen in the general context of the EU's endeavours to tighten economic governance procedures.[2] It is not, as sometimes reported, concerned with the development of an EU fiscal union, broadly defined as comprising a common Ministry of Finance, common sovereign debt (the mutualisation of debt) and substantial financial transfers from the rich, highly competitive northern economies (principally Germany) to the less competitive peripheral economies. Such a fiscal union is arguably necessary to save the currency area in its current configuration. There are moreover few signs that the Eurozone is moving towards such a union. It should also be noted that the Treaty does nothing to address the fundamental structural fissure at the heart of the Eurozone crisis, namely the competiveness mismatch between the northern and the peripheral economies, which is tearing the currency union apart. It can be argued that the

[1] European Council, "Treaty on Stability, Coordination and Governance in the Economic and Monetary Union", signed on 2 March 2012. Subject to ratification by at least 12 Eurozone members, the Treaty enters into force on 1 January 2013. Available on www.european-council.europa.eu.

[2] Council of the European Union, "Council confirms agreement on economic governance", press release, 4 October 2011. This press release for example outlines the "Six Pack", the six legislative proposals on economic governance in the EU (though more specifically in the EU17), agreed by the Council of the European Union (the Council) in October 2011. The proposals related to a reformed SGP, reducing macro-economic imbalances and promoting competition. The press release is available on www.consilium.europa.eu.

Treaty, by focussing on fiscal discipline, has simply side-stepped or chosen to ignore the causes of crisis engulfing the euro.

4. 25 out of the 27 Member States signed the Treaty in March 2012, with the UK and the Czech Republic the only two dissenting members. The Czech Republic may yet sign, leaving the UK completely isolated. December's Summit was, of course, noted for the British Prime Minister's veto of the EU's plans to incorporate the proposed Fiscal Compact Treaty into the current EU Treaties when his stipulations for relatively modest safeguards for the City of London were refused. His veto forced the separate Treaty but the EU clearly intends to push ahead and incorporate the Treaty into the EU Treaties "as soon as possible".[3] The likelihood is that this will happen sooner rather than later.

5. So to what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union, given this background? The short answer appears to be "very little" at face value. After all the UK's EU policy remains committed to membership of the EU, which is not, in my judgement, in the country's best interests.[4]

6. But developments since the PM's veto have merely served to underline our lack of influence in EU affairs, implying our place in the Union is firmly at the periphery. The Fiscal Compact Treaty has gone ahead essentially as planned by the European Council, even if it remains outside the main EU Treaties. Because the UK is (rightly) outside the Eurozone, which is understandably focussing on trying to hold the currency union together, the UK is inevitably increasingly peripheral. Our influence diminishes as crisis engulfs the Continent, even though the future of the Eurozone has major implications for the country. If the Eurozone pushes ahead towards full fiscal union the UK's influence in EU affairs will diminish even further. Perhaps the December Summit will be seen by future historians of the EU as a watershed event – an event when the UK's isolation was obvious, at last, for all to see.

<u>Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?</u>

7. Given my earlier comments on the lack of UK influence in the EU, I believe we are in the weakest possible position to drive forward developments in the EU. Whilst we remain a member, the best we can do is respond to decisions made by the Franco-German axis and the institutions of the EU and attempt to obtain the best deal for us. This may seem like a counsel of despair, but it is a realistic one.

8. More specifically, any debate on the future of the EU and its institutional architecture is inevitably dominated by the possible resolution of the existential Eurozone crisis. It is worth speculating as to how the UK should respond, given possible Eurozone resolution scenarios.

[3] The precise words in the Treaty are "…bearing in mind that the objective of the Heads of State and Government of the euro area Member States and of the other Member States of the European Union is to incorporate the provisions of this Treaty as soon as possible into the Treaties on which the European Union is founded."

[4] See Ruth Lea and Brian Binley MP, *Britain and the EU: a new relationship*, Global Vision, May 2012, for wide-ranging discussion of the options open to the UK.

Very broadly three such scenarios can be identified. The first scenario is that the EU17 members push ahead with full fiscal union and the Eurozone bloc survives broadly as currently configured. The EU is already a two-tier organisation comprising the EU17 (and arguably the pre-in aspirants) and the "outs" the UK, Denmark and possibly Sweden.[5] With fiscal union, or political union, a two-tier structure would be formalised and the UK's peripheral position would be reinforced. The second scenario is a possible major reconfiguration of the currency union with either the weaker countries returning to their own currencies or, more fundamentally, a split into a northern Eurozone and a southern Eurozone to reflect the competitiveness gap between these two blocs. The power would indubitably be with the northern Eurozone bloc. Britain should, of course, stay clear of both blocs, but with the Eurozone split Britain would look less isolated from mainstream affairs than with full fiscal union. The third scenario is a complete collapse of the bloc which would shake the EU to its very foundations and could possibly present the UK with an opportunity to remodel, or reform, the EU as a looser trading relationship. But I regard this scenario as highly unlikely with the chances that the UK could drive forward a major reform of the EU as vanishingly small. There is simply no stomach for such a "reformed" EU in the other EU Member States.

9. There are, of course, non-currency "multi-tier" aspects to the EU already (Schengen springs to mind) but these are of minor significance compared with the currency and will almost certainly remain so. On a slightly related issue, there is much speculation that the UK Government could negotiate the repatriation of certain powers thus creating a different class, or form, of EU membership. But there is absolutely no evidence that our EU partners would accept such a move and plenty of evidence to show they would block it totally. For example, German Minister of Finance Wolfgang Schäuble said last October that Britain should forget any attempts to use the Eurozone crisis to repatriate EU social and employment laws.[6] The repatriation of powers is a chimera.

What is the relationship between the new 'fiscal compact' Treaty and the EU's *acquis*? What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy?

10. I assume for all practical purposes that the Treaty is already part of the *acquis* and if/when it becomes part of the EU Treaties then it will formally become part of the *acquis*.

11. It is not clear that the Treaty will have any direct impact on other aspects of the EU and its policies. But the indirect impacts of its implementation must not be underestimated. The Treaty is part of the on-going centralisation of EU policy-making. The history of the EU tells us that its proponents only have forward gears and the EU's institutions cumulatively accrue competencies and influence. They do not divest power. Under these circumstances, I would expect the institutions to push ahead with further control over policies, possibly including budgetary issues or matters relating to the CFSP. Where there is a possible link between an EU policy (say budgetary control or promoting an EU-wide Financial Transactions Tax) and "saving the euro", I would expect "saving the euro" to be invoked frequently in support of increased EU activism. Concerning the implications for

[5] Only Britain and Denmark have formal opt-outs whilst Sweden has decided to stay out of the euro for the time being. The other seven, however, are legally bound to join and wish to do so except, perhaps, the Czech Republic.

[6] "David Cameron told by Berlin: drop demands for repatriation of powers", *Guardian*, 19 October.

enlargement, I would speculate that successful countries on the EU's periphery, Turkey springs to mind, would have even less interest in joining the EU if it means an EU-grip on its economic policies.

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

12. Having vetoed the incorporation of the Fiscal Compact Treaty into the EU Treaties in December 2011, the UK Government should reject any such move for the sake of consistency, if nothing else. But, as already commented, the Treaty states clearly that the European Council wishes to proceed with its incorporation "as soon as possible" and I expect the UK Government to agree to this.

13. The Government should revisit the Prime Minister's demands for some relatively modest safeguards for the City of London and insist they are enshrined in the Treaty. Specifically, any proposals for an EU-wide Financial Transactions Tax should strictly remain subject to veto. But there is little that the UK can do about the EU's heavy programme of financial regulations because they are part of the Single Market and subject to QMV where we have just 8½% of the vote in the Council of the European Union. As such the UK has little influence over the legislation relating to one of its major businesses, arguably one of its most successful businesses, some of which has been described as "harmful".[7] Membership of the Single Market is increasingly disadvantageous for this country. But this is a different issue.

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[7] *The Economist*, "Save the City", 7 January 2012.

Written evidence from TheCityUK

1. Preliminary

1.1 This Note sets out views on behalf of TheCityUK in response to the Select Committee's Inquiry into the future of the European Union and UK government policy. TheCityUK is a membership body representing UK-based financial and related professional services businesses competing in global markets, both developed and emerging. It coordinates its work through its Advisory Council, its Board, and various Groups and Committees on which its member-businesses are represented.

1.2 In this evidence, TheCityUK will take all four principal Inquiry Questions together, and seek to give a combined response. Given TheCityUK's remit, the evidence will focus on financial and related professional services and will be cross-sectoral in its approach.

2. Short Summary of main points of Submission

2.1 Service businesses including financial and related professional services play a key role in the UK economy, the UK's international competitive advantage and in meeting the saving, protection and investment needs of its citizens. Financial services account for 8.9% of UK GDP - higher than all other major economies including the US (8.4%), Japan (5.8%), Germany (5.3%) and France (5.1%). A significant portion of this is made up from the contribution of financial services exports (2.9%). To safeguard this key economic interest, the UK must be fully engaged in EU financial services policymaking.

2.2 UK businesses and non-UK firms established in the UK rely on the Single Market. They take its "four freedoms" (free movement of goods, persons, services and capital) as the basis for conducting business in Europe. UK exports of financial services to the EU totalled £17.8bn in 2010, 80% up on the £9.8bn in 2005, although down from a peak of £21.8bn in 2008. Main destination centres in the EU for UK exports of financial services in 2010 were the Netherlands £3.4bn, Germany £3.4bn, France £2.9bn, Ireland £1.7bn, Luxembourg £1.2bn and Spain £829m. The existence of the Single Market also partly explains the UK's success in attracting foreign firms. A total of 1,442 financial companies were authorised by the FSA as foreign owned at end-2011 including 634 US companies and 78 Swiss companies.

2.3 The new UK regulatory authorities succeeding the FSA will need to remain engaged with the EU Institutions and European Supervisory Authorities (ESAs). Indeed we would argue that even greater focus and resources are needed today than before. First, UK participation in the staff of the EU Institutions and ESAs needs to be enhanced. Rulemaking powers will reside with the EU authorities. The new UK regulatory bodies will have a secondary supervision and enforcement role. This change in the balance of decision-making necessitates the establishment of a UK secondment/placement scheme for filling senior roles. Senior vacancies in EU Institutions and ESAs need to be mapped out, followed by an identification of suitable candidates whose candidacy can then be promoted. TheCityUK is keen to support this effort. Secondly, the UK authorities will need to co-ordinate their activities to ensure that UK interests continue to be seamlessly promoted in discussions with the EU Institutions and ESAs.

2.4 Financial services regulation and trade liberalisation both have key implications for EU economic growth. An over-emphasis on regulation is likely to act as a brake on jobs and growth-oriented policies. Regulatory policy should prize stability but not at the expense of

economic growth, while trade policy should be a spur to business expansion and lasting job creation.

3. Breadth of TheCityUK's Interest in EU Issues

3.1 TheCityUK's member-businesses exist to service their customers' needs in the UK and globally; and TheCityUK has an interest in those EU policies that impact on their ability to do so. The areas of EU policymaking with which TheCityUK is particularly concerned include EU regulation of financial services and related professional services, EU proposals for taxing financial services, the EU's strategy for regulatory convergence with other global markets, and the EU's trade and investment policy for market opening; as well as an interest in such other areas of EU policy as encouraging Small and Medium Enterprises (SMEs); finance for business including promoting alternative sources of finance; trade finance; corporate governance, competitiveness and innovation.

3.2 Services including financial and related professional services are integral to the UK economy. UK private-sector businesses in the services sector contribute around 60% of UK GDP and employment. The UK is the largest exporter and importer of services in the EU, with a third of total EU trade in services. More than 60% of all outward foreign direct investment (FDI) by UK business and around 70% of FDI coming into the UK is invested into the service sectors. Financial services account for 8.9% of UK GDP higher than all other major economies including the US (8.4%), Japan (5.8%), Germany (5.3%) and France (5.1%). A significant portion of this is made up from the contribution of financial services exports (2.9%). Consequently, UK engagement in EU policymaking lies at the heart of safeguarding these UK interests.

4. Promoting an active EU Engagement Strategy

4.1 The UK benefits from being within the EU Single Market in goods (the stock-in-trade of many of TheCityUK's members' clients) and services (the business of TheCityUK's members); UK businesses and non-UK firms established in the UK rely on the UK presence within the Single Market and the "four freedoms" inherent in the Single Market (free movement of goods, persons, services and capital) as the basis for conducting business in Europe. The UK also derives benefit from participating in the formulation of such EU policies as the Common Commercial Policy – the basis for the EU's trade relations with third countries. UK exports of financial services to the EU totalled £17.8bn in 2010, 80% up on £9.8bn in 2005, although down from a peak of £21.8bn in 2008. Main destination centres in the EU for UK exports of financial services in 2010 were the Netherlands £3.4bn, Germany £3.4bn, France £2.9bn, Ireland £1.7bn, Luxembourg £1.2bn and Spain £829m. The existence of the Single Market also underlies the UK's success in attracting foreign firms. A total of 1,442 financial companies were authorised by the FSA as foreign owned at end-2011 including 634 US companies and 78 Swiss companies.

4.2 The UK seeks to shape EU policies in line with the principles of open and competitive markets. For financial and related professional services, this needs to be backed by a reinforced system of financial regulation which promotes financial stability and high levels of consumer protection and unlocks capital which is vital to economic growth.

4.3 It is also clear that many other EU Member States wish to work alongside the UK for policies that will promote the EU's growth and global competitiveness. UK policymakers should use the UK's resources across government, regulatory bodies and in financial and professional services firms themselves to champion the UK's interests with other Member States.

5. Enhancing UK engagement on EU financial regulation and EU trade policy

5.1 This part of TheCityUK's response will not attempt a comprehensive itemisation of the details of every policy area in which the UK has an interest in full participation in EU policymaking. Instead two policy areas are highlighted as examples, namely financial regulation and trade policy.

Financial Regulation

5.2 Changes to financial regulation are clearly required to address failures highlighted by the financial crisis. Protecting consumers, businesses and taxpayers from the costs of failures in financial firms is rightly the priority. A significant programme of change is already underway including via the Financial Services Bill, and TheCityUK's members are willing partners to complete this programme of reform.

5.3 In EU terminology, financial regulation is not an EU "common policy" established under the Treaties (i.e. it differs from the EU's Common Commercial Policy, Common Agricultural Policy or Competition Policy). It comprises a developing body of legislation and institutions. These have evolved to a point where the EU's common legal framework for much of financial services is now a "given" in the international business of the UK as a global financial centre: indeed the provision of financial services in the UK by non-UK firms has become to a large degree dependent on the maintenance of that common EU legal framework and the UK's part in devising it and operating within it. The evolutionary character of this common legal framework means that the UK must be engaged at all levels of policy development.

5.4 Nor is the process of widening and deepening EU engagement only a matter for Government. Financial institutions also have a role to play. TheCityUK and its membership in conjunction with the City of London Corporation have decided to promote a dialogue with other Member States. It is envisaged that this dialogue will encompass policymakers and regulatory authorities as well as business and trade associations, think-tanks and civil society. We believe this effort can complement UK diplomatic engagement with other Member States.

5.5 Nonetheless the main burden of maintaining constructive engagement with the European Institutions and international bodies will inevitably fall on the FSA and its successor bodies and other UK regulatory authorities. Further, we would argue that greater resources and attention are now required given the changing political and regulatory environment. The developing role of the ESAs mean that greater focus is required from the UK. This was highlighted by FSA CEO Hector Sants in February 2012 when he said "it needs to be recognised that currently in respect of prudential regulation, and increasingly in the future in respect of conduct, the rules will be made by the European Supervisory Authorities and the role of PRA and FCA will primarily be one of supervision and enforcement." The example of the European Securities and Markets Authority (ESMA) emphasises the scale of the challenge for UK representation. The UK market accounts for between 60 to 80 per cent of all EU securities trading, yet the UK has only 8 per cent of the vote.

5.6 TheCityUK welcomes the Government's commitment to establish an international co-ordination committee for the Treasury, the Bank of England, the FCA and the PRA ("the UK authorities"): its mandate should be to lead and co-ordinate UK engagement on European financial services policy issues and to:

- establish clear ownership and responsibility for each European policy dossier: overlap or worse 'underlap' is undesirable in the UK's international representation;

- enable strategic objectives and the full extent of "the UK position" to be agreed in advance of EU negotiations and during their progress;

- harness the expertise and contacts of UK Government officials in Member States so that engagement on European dossiers is not seen through a narrow Brussels prism but takes into account the realities that views promoted in Brussels are determined in Member State capitals; the efforts of FCO officials in Member States to complement Brussels engagement are to be welcomed, and

- harness the views, knowledge and skills of financial industry practitioners in the UK.

5.7 Two specific issues should be highlighted. Firstly, UK staffing of European Institutions, European Supervisory Authorities (ESAs) and international authorities: the UK needs to play a full role in the governance of the ESAs and other bodies, whose importance is forecast to grow. There is high level UK staff participation in ESMA, EIOPA[1] and ESRB.[2] Whilst these developments are helpful, greater depth of resource is needed. This necessitates the putting in place of a dedicated UK secondment/placement scheme for filling senior roles both in the European Institutions and the ESAs. TheCityUK is willing to support HMG in the establishment and promotion of this scheme.

5.8 Secondly, interaction of the new UK regulatory regime with EU Institutions and European Supervisory Authorities: the transition to a new UK financial regulatory regime will change responsibilities for representing the UK in European and international bodies. It is already clear that there will not be a perfect match between the responsibilities of the new UK bodies and those of the European Supervisory Authorities (ESMA, EIOPA and the EBA[3] which are set up along sectoral lines). The Financial Services Bill should therefore make full provision for coordination between different UK bodies to ensure that the UK's interests continue to be seamlessly represented. The Bill requires the preparation of a Memorandum of Understanding between the Treasury, the Bank of England, the FCA and the PRA ("the UK authorities") and the establishment of a committee for the purposes of co-ordination. The Government should make it clear that the UK authorities have an equal voice and parity of status in agreeing the UK position. The Financial Services Bill, as currently drafted, lacks any requirement for UK financial regulators to have regard to the impact of their actions in an international context: TheCityUK considers that this requirement (which previously existed) should be reinstated.

5.9 TheCityUK believes that taking a holistic approach to engagement with the EU agencies and with other Member States should yield dividends over the medium term making it more likely that the UK achieves understanding and support for its views and positions when policy issues reach Heads of State and Government in bodies such as the European Council. We commend the work of UK Ministers in seeking to explain and develop support for the UK's positions in the Council.

Trade regulation

[1] EIOPA - European Insurance and Occupational Pensions Authority

[2] ESRB – European Systemic Risk Board

[3] EBA – European Banking Authority

5.10 Trade policy is different in character from EU financial regulation. It is a "common policy" whose ambit is set under the Treaties. The demands placed upon trade policy are now changing. Until recently, the policy focused on long-term, multilateral trade liberalisation. This has now changed. First, under the Lisbon Treaty, the EU trade policy now includes investment and investment protection (previously the province of Member States). Secondly, the focus is now on shorter-term bilateral approaches, reflecting both the global trend towards preferential trade and investment agreements between a limited number of parties and the EU's own policy enshrined in the Commission's "Global Europe" initiative (2006). This provides opportunities for the EU to engage with emerging economies.

5.11 This change in policy has had several important effects. First, EU trade policy, by focusing more bilaterally, involves prioritisation of markets to a greater extent than before. Secondly, the types of trade agreement being entered into (bilateral Free Trade Agreements (FTAs) for instance), are narrower and deeper agreements than before, embracing such matters as regulation and consultation mechanisms for resolving regulatory conflicts. Third, there are more linkages between trade policy and regulatory policy. Fourth, the importance of the EU's trade policy for services in general, and highly regulated services in particular, is heightened as services liberalisation requires regulatory barriers to be tackled.

5.12 For all these reasons, the interplay of different Member States' choices and priorities in policy-formation is even more marked than before. The UK has a well-respected position in the EU Trade Policy Committee, supported by the government's wider commercial diplomacy initiative (which TheCityUK welcomes). It will be important for the UK to continue to have an influential voice. Trade policy is changing its nature, and the UK will need to see that its interests continue to be recognised and that the EU retains an outward-looking perspective drawing in emerging economies.

6. Financial Regulation, Trade Policy, and Growth

6.1 In developing its views on both regulation and trade policy, a particular feature of TheCityUK's approach has been to emphasise the potential implications of both for EU economic growth. In the case of EU financial regulation, TheCityUK has consistently stressed that regulatory reform cannot be viewed in isolation from wider economic policies. True, sound regulation of financial services is important in itself. But financial services facilitate the functioning of the economy as a whole by channelling savings towards productive investments.

6.2 An over-emphasis on regulation is likely to act as a brake on growth-orientated policies. The EU's current Proposals on CRD[4] IV and Solvency II need to be carefully calibrated to ensure that they do not restrict lending to the real economy and investment in corporate bonds and infrastructure. Other Proposals such as MiFID[5] II need to ensure the EU remains open to business with third countries. TheCityUK welcomes the Government's efforts to reorient EU policy towards growth, modernisation and competitiveness exemplified in the Prime Minister's recent letter (with eleven other EU Prime Ministers) to President Barroso calling for fresh initiatives in the interests of trade and growth.

7. The EU's Institutional Architecture

[4] CRD – Capital Requirements Directive

[5] MiFID – Markets in Financial Instruments Directive

7.1 Even a cursory review of some of the EU's economic, commercial and regulatory policies suggests that the UK ought to be wary of any new institutional architecture in which the UK's influence is reduced, whether this be through new formal or informal structures. Fiscal integration within the Eurozone is likely to lead to further changes in architecture and an EU policymaker presumption that the needs of the Eurozone and of the Single Market are the same. UK policy will need to be alive to these trends and assumptions, working with the grain of other Member States' perceptions while countering or rebutting them as necessary. To be effective, UK policy will need to operate within an institutional framework that accords the UK a full voice in representing UK, and full equality of treatment in securing them.

8. Conclusion

8.1 TheCityUK's evidence does not seek to cover the entire policy field. However, by taking two key policy areas bearing on its members' business, and by bringing out how both relate to growth, TheCityUK seeks to illustrate two essential points: first, that the EU policies in question are themselves evolving and, secondly, that the UK needs to be a continuing force in contributing to their evolution in ways consistent with UK interests. The European Union has reached a sudden and unanticipated phase in its development. These changes are taking place against a global backdrop of great changes in traditional patterns of economic comparative and competitive advantage between trading blocs. For TheCityUK and its members it is vital that the UK retains and enhances its influence over the development of EU policy and practice at a moment of change.

22 May 2012

FEU 20

Written evidence from Professor Richard G. Whitman, University of Kent and Associate Fellow, Chatham House, and Thomas Raines, Chatham House

The submitters of evidence are the authors of a recent Chatham House report evaluating the performance of EU foreign policy and the EU European External Action Service. Thomas Raines is Programme Coordinator for Europe and North America at Chatham House. Professor Whitman is an academic and commentator working on the EU's foreign, security and defence policy and has previously presented written and oral evidence to the *Foreign Affairs Committee* on EU matters.

Summary of evidence

The evidence submission argues that Stability and Governance Treaty (SCG) sets a precedent that could be exported to other EU policy domains. This is illustrated by reference to the EU's foreign, security and defence policies. The evidence outlines areas where an approach drawing on the SCG might be devised by other EU member states may be seeking to develop policy beyond consensus at 27 and to the detriment of the UK.

Evidence

1. The Stability Coordination and Governance Treaty (SCG) raises important questions about the UK's future place in the EU. This is primarily because the Treaty represents an approach towards setting near-term objectives for the European Union without any formal UK participation.

2. A key concern for the UK must be the precedent that it sets as an arrangement for future collaboration and agenda setting between Member States based on an agreement to which the United Kingdom is not a party. Of crucial significance for the UK is the principle that is established to use the EU institutions outside of the provisions of the EU Treaties. These policies could be styled 'sub-EU 27' policies as they do not contain the participation of all the member states but will carry the imprimatur of the EU.

3. The UK's future European policy could be affected by the precedent that has been set to operate on this basis. Consequently a broader discussion of the possible implications of the SCG for other policy areas is important. This submission will deal principally with the potential knock-on effects of the SCG on the EU's foreign relations and the UK's capacity to play a lead role in collective European foreign and defence policy.

4. The Foreign Secretary (in his letter to the Committee of February 2012 final paragraph) was sanguine about the implications of the SCG for other policy domains and specifically referred to the leading role that the UK continues to play in foreign, security and defence policy. However, foreign, security and defence policies are areas in which the SCG model [of cooperation] might well be replicated.

5. A sub-27 member state arrangement already operates in the area of EU defence policy with the government of Denmark not participating. The remaining 26 member states fully utilise the EU foreign, security and defence policy institutions for defence matters.

6. In addition, the innovations introduced by the Lisbon Treaty can be viewed as facilitating an approach similar to the SCG. The Lisbon Treaty represented a departure from the EU's previous foreign and security policy arrangements, with the intention to bring greater coherence and impact to the EU's international relations. Implicit in the design of foreign, security and defence policy post-Lisbon is an innate capacity for the creation of 'sub-27 EU' policies.

7. The Lisbon Treaty has diminished the international profile of the EU's 27 member states in its elimination of the rotating six-monthly Presidency of the Foreign Affairs Council (formerly the General Affairs and External Relations Council). This was intended to ensure a greater degree of continuity in EU policy-making and in the representation of EU foreign policy to third countries. However, the opprobrium attached to Baroness Ashton from some member states for her reluctance to proactively lead a more ambitious European foreign policy (rather than just be a servant of the EU's Foreign Ministers) may encourage her successor to seek a more independent line on foreign policy issues. Such an approach to the role of High Representative might encourage a 'sub-27-EU' tendency within the foreign policy domain amongst member states that are receptive to a more developed approach [supported by the majority] which overrides the objections of some member states. Some member states may even wish to collectively grant the High Representative representation for their national foreign policy to third parties and in international fora.

8. In establishing the European External Action Service (EEAS) as an institution separate from the main institutions of the EU there has already been institutional innovation in the foreign and security policy domain. As we have noted in a recent report written for Chatham House (Chatham House, 2012) the EEAS will need to establish a reputation for independent action if it is to carve out a distinctive role for itself. In order to make the most of its role and its capabilities, the EEAS needs to cultivate the virtues of entrepreneurship: seeking to be ahead of the market by emphasizing intellectual leadership and innovative policy development; utilizing resources most effectively through a clear strategy; seeking new opportunities to advance the EU's common agenda and be prepared to take calculated risks for that purpose; and building the confidence of its 'shareholders' – the EU's 27 member governments and the EU institutions – through creative diplomacy that takes advantage of the leverage that comes with the EU's unity while exploring the opportunities that lie in its diversity.

9. If considered as 'shareholders' in the EEAS it is possible to envisage a majority group of member states seeking to steer the service in directions that may not represent the unanimous view of all 27. Further, the EEAS is already actively operating on a foreign policy issue (Kosovo) where there are cleavages between the 27 on the issue

of recognition and so is pursuing a policy which, in effect, represents a 'sub-27 EU' position. It is difficult to envisage how the UK might resist moves to further task the High Representative and the EEAS with a collective policy agreed by a 'sub-27 EU' group of states if this was presented as offering a boost for EU foreign policy.

10. Another area in which 'sub-27 EU' practices can be considered is a decision by a group of member states to 'sub-contract' their consular work or political representation in third countries to Union delegations. Under such an arrangement the member state(s) concerned would sign an agreement that allows for their consular activities or diplomatic representation to be conducted on their behalf by the Union delegation. This arrangement is likely to appeal to states that face resource constraints in running an extensive embassy network in third countries and/or take the view that they do not have foreign policy interests that extend beyond those already pursued collectively through Union foreign policy and which may be more effectively conveyed through collective negotiation. Agreement by a 'sub-27 EU' group of countries to sub-contract representation may be difficult to resist in principle by other EU member states if it is presented as a more efficient use of national foreign policy budgets.

11. The Common Security and Defence Policy (CSDP) is an area in which 'sub-27 EU' policies could be contemplated. This is also an area in which the UK currently finds itself in opposition to majority member state support for increasing the European Defence Agency (EDA) budget and setting up an EU operational headquarters. An SCG-type arrangement in defence may become an attractive option to other member states if the UK is considered to be the primary obstacle to greater EU defence integration.

12. The Lisbon Treaty created the Permanent Structured Cooperation arrangements of the CSDP that allow for 'cooperation between member states whose military capabilities fulfil higher criteria and which have made more binding commitments to one another in this area'. The participating member states are expected to 'bring their defence apparatus into line with each other as far as possible, particularly by harmonising the identification of their military needs, by pooling and, where appropriate, specialising their defence means and capabilities, and by encouraging cooperation in the fields of training and logistics' (Art. 2(b), Protocol 10). Although it is not envisaged as a procedure for the deployment of EU missions, this mechanism should facilitate capability development and the pooling of assets, in turn increasing CSDP operational capabilities. The Treaty defines membership as voluntary: there is no obligation for the member states to join a Permanent Structured Cooperation. Further, the decision for the establishment of a Permanent Structured Cooperation is to be adopted by the Council on the basis of qualified majority voting. The existing un-utilised voting provisions of the CFSP suggest that recourse to voting in the face of member states opposing a policy innovation in this area in unlikely and the SCG provides an alternative model to provide for such an arrangement.

13. The Treaty also foresees the possibility of entrusting CSDP operations to a group of member states 'which are willing and have the necessary capability for such a task'.

The procedure to establish a 'coalition of the willing and able' is much less convoluted than in the case of Permanent Structured Cooperation. The Council authorizes the decision and, thus, the mission is launched in the name of the EU, but run by the 'coalition of the willing'. The coalition will agree on the details of the implementation of the task, in association with the High Representative. The rest of the member states have the right to be kept regularly informed of its progress. Again the SCG-type agreement provides an alternative governing arrangement for such an undertaking.

14. The precedent setting consequences of the Intergovernmental Treaty on Stability Coordination and Governance in the Economic and Monetary Union should be considered. A broader discussion of the possible implications of the SCG for other policy areas is important. As indicated, EU foreign, security and defence policies are policy domains which could see the evolution of comparative arrangements of collective action by smaller constellations of states within the 27. This could place the UK in a position of future disadvantage, reducing UK leadership in these fields and limiting HMG's influence and capacity to set the EU's agenda.

22 May 2012

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FEU 21

Written evidence from Professor René Schwok and Cenni Najy, University of Geneva

UK returning to EFTA : Divorce at 40 and going back to Mom and Dad?

Summary

Our objective is to assess the proposal that the United Kingdom (UK) leave the European Union and return to the European Free Trade Association (EFTA) in order to get deals such as the European Economic Area (EEA) or even simple bilateral agreements such as Switzerland enjoys for a couple of years.

In the first part, we analyse the relationship between EFTA states and the EU through the EEA. This mechanism is based on a certain number of complex features that offer a high level of integration to three EFTA countries.

Second, we address the Swiss case, an active member in EFTA, who maintains close relations with the EU despite its rejection of EEA membership. *Prima facie*, the example of Switzerland supports many British eurosceptics because it provides an example of flexible arrangement.

Third, we assess the likelihood of the UK joining either the EEA/EFTA or instead adopting the EFTA/Switzerland approach as a sustainable and realistic choice.

Biography

René Schwok is professor of political science at the University of Geneva, specializing in European integration.

He is the holder of the Jean Monnet Chair, and Director of the Master programme in international and European security studies.

He has published 20 books and authored many journal articles and book chapters. They are available at http://unige.academia.edu/RenéSCHWOK/

René Schwok was born in Geneva and is Swiss. He has been a consultant for various Swiss and European agencies and governments, comments frequently on European issues for the media and speaks regularly at conferences.

Cenni Najy is a Master student at College of Bruges and holder of a Master from the European Institute of the University of Geneva.

Introduction

1. There has been increased domestic pressure demanding that the United Kingdom (UK) leave the European Union.

2. Some of them also propose to return to the European Free Trade Association (EFTA) and to get a "more advantageous integration" through deals such as the European Economic Area (EEA) or even simple bilateral agreements such as Switzerland enjoys for a couple of years.[1]

3. Advocates of this EFTA option expect major positive effects following a UK withdrawal from the EU.

4. Economically, they foresee greater prosperity and growth due to the removal of the British contribution to the EU budget, the phasing out of the common agricultural and fishery policy, a lowering of VAT, a reduction of European workers from Eastern Europe, a decrease of bureaucratic norms that constitute barriers to trade and the possibility of concluding independently free trade agreements with other countries in the rest of the world.

5. They also argue that EFTA states (especially Norway and Switzerland which are the two biggest members) are more prospering economically than the EU countries and, consequently, that their levels of unemployment and debts are much lower.[2] Note also that the combined GDP of Norway and Switzerland is nearly half of the UK![3]

6. They also anticipate political benefits including greater independence and increased democracy. In addition, it is argued that by abandoning the EU's foreign, security and defence policy, the UK will benefit from a rapprochement to United States' external policies.

7. On the other hand, advocates of maintaining UK membership to the EU do not take into serious consideration the EFTA option, which they consider as a regressive proposal, comparing this to divorcing at 40 and "going back to mom and dad".

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[1] Van Randwyck, H. (2011) "EFTA or The EU?", *The Bruges Group*, 21 March. Available at: <http://www.brugesgroup.com/EFTAorTheEU.pdf>.
Ould, R. (2011) "Time To Leave The EU And Stop Exporting British Jobs Abroad", *Public Service Europe*, 17 November. Available at: <http://www.publicserviceeurope.com/article/1139/time-to-leave-the-eu-and-stop-exporting-british-jobs-abroad>;
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[2] See for instance Van Randwyck, H. (2011), op. cit., pp. 5.

[3] GDP of Norway = billions 480 $, GDP of Switzerland = billions 666 $. Total = billions 1,146 $.
GDP of the UK= billions 2,481 $. Source: IMF. GDP at current prices in USD (2011). Available at: <http://www.imf.org/external/pubs/ft/weo/2011/02/>.

8. Overall, the objective of this paper is to consider the essence of EFTA and to try to analyse it as objectively as possible.

9. In the first part, we analyse the relation between EFTA states and the EU through the EEA. This mechanism is based on a certain number of complex features that offer a high level of integration to three EFTA countries.

10. Second, we address the Swiss case, an active member in EFTA, who maintains close relations with the EU despite its rejection of EEA membership. *Prima facie*, the example of Switzerland supports many British eurosceptics because it provides us with an example of flexible arrangement.

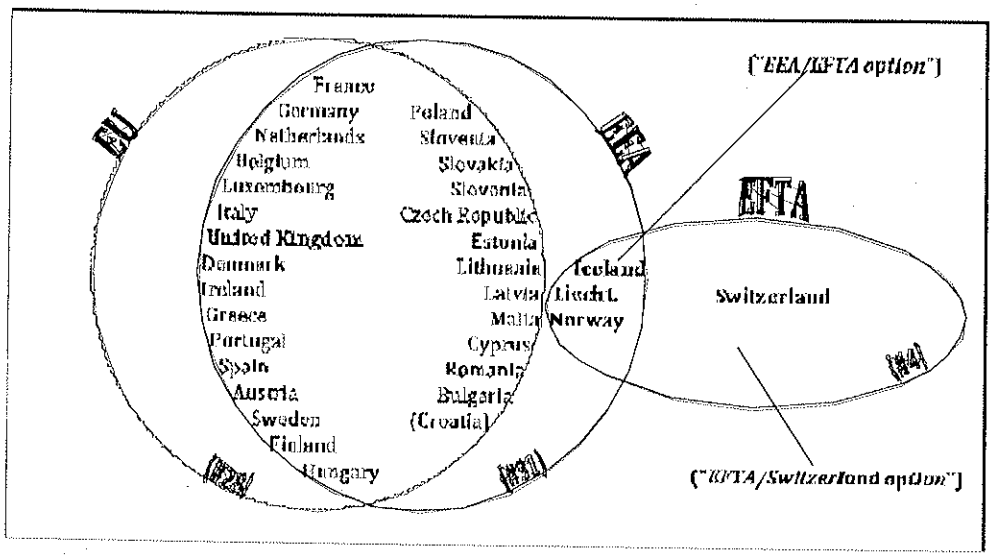
11. Third, we will assess the likelihood of the UK of joining either the EEA/EFTA or instead adopting the EFTA/Switzerland approach as a sustainable and realistic choice.

A- The EFTA/EEA model

12. The European Economic Area was established on 1 January 1994 following an agreement between the European Union and the member States of the European Free Trade Association.

13. By July 2013, its total membership could reach 31 states included in two pillars: the 28 EU member states (including Croatia) as well as 3 EFTA countries (Norway, Iceland, Liechtenstein).

Figure 1: the three circles



14. Materially, the EEA is an association based on primary EU law and treaties, in addition to secondary law such as regulations and directives commonly referred to as the *acquis communautaire*. It mainly contains the so-called EU "four freedoms": free-circulation of persons, goods, services and capital.

15. The EEA agreement also include issues pertaining to several horizontal provisions relevant to the four freedoms, such as competition law (i.e. the abuse of dominant position, cartels, merger control, state aid and state monopolies), minimum social standards as well as consumer and environmental protection.

16. The EEA does not eliminate however border controls for rules of origins and indirect taxation. Indeed, the free movement of goods is only established in respect of products originating from the contracting parties. Otherwise put, this agreement does not establish a customs union as it is the case in the EU.

17. Consequently, EEA/EFTA countries retain their full sovereignty over their trade policies in addition to the capacity of establishing their own different level of value added tax (VAT).

18. Similarly, the EEA is not related to the Economic and Monetary Union (EMU), the Common Agriculture Policy (CAP), the Common Foreign and Security Policy (CFSP) as well as the Justice and Home Affairs policies.

19. Finally, the EEA agreement provides a cooperation framework between EU and EEA/EFTA states in matters concerning research, development, tourism and civil protection.

EEA institutions

20. In exchange for internal market access, the European Commission imposed from the beginning a rigid institutional arrangement with the concept of the European Economic Area based on two pillars: EC and EFTA.

21. As a result, the Oporto agreement established four different institutions: the EEA Council, the EEA Joint Committee, the EFTA surveillance authority and the EFTA court. Let us briefly introduce them hereafter.

22. The *EEA Council* is composed of members of the Council of the EU, members of the EU Commission and of one of the government members of the participating EFTA states. According to Article 89 of the treaty, it "is responsible for giving the political impetus in the implementation" of the agreement. Furthermore, it may decide to amend the agreement.

23. Daily tasks are left over to the *EEA Joint Committee*. This body ensures that, "the implementation and operation" of the agreement is carried out on a monthly basis. In practice, it is responsible for adopting the decisions extending the evolution of the *acquis* to the EEA/EFTA members.

24. Taking a step back the Committee's composition and functioning appear to be quite interesting as well. Since the EU is represented by the Commission and faces EEA/EFTA states representatives, it can be argued that this committee is an interesting example of both a supranational/intergovernmental mixed institution.

25. The *EFTA surveillance authority*, which is a technical and supranational institution by nature, ensures that the EEA/EFTA member states respect their legal obligations. Hence, as the EU Commission, it may initiate proceedings against one of these states (for instance in case of development of unlawful burdens on commercial activity).

26. *Parliamentary cooperation* is also provided through the EEA Joint Parliamentary Committee. Interestingly enough, this institution has a special composition, as it includes members of the EU Parliament and of the EFTA states. However, it does not carry out important political tasks.

27. Finally, a *Court of Justice*, also referred to as the "EFTA Court", has been created in order to ensure a single interpretation of the treaty. Generally, this Court aims at ensuring a strict homogeneity of interpretation with the Court of Justice of the EU (CJEU). That being said, it has no legal monopoly as rulings of the CJEU falling within the EEA scope are also bound to produce effects for EEA/EFTA participants.

The EEA as an asymmetric market-association

28. Despite this seemingly balanced institutional architecture, the EEA agreement prevents significant political participation of EEA/EFTA member states in the EU decision-making process.

29. As we have seen, these States must comply with the obligations imposed by most of the *acquis,* in addition to the adoption of Community law and the interpretations made by the ECJ existing prior to their EEA accession.

30. Although, they have been granted a right of consultation and association during the early stage of the legislative procedure, the so-called "decision shaping", no possibilities of participation to the voting procedure in the EU Council or the European Parliament are provided.

31. Admittedly, an opting-out instrument exists but it is politically unusable and has never been used until now. Like in the case of the decision shaping clause, this opt-out instrument has to be agreed upon by the entirety of the EEA/EFTA pillar members.

32. In principle, any of these three countries may refuse to take on new EU legislation. However, this would drag into the same opt-out position the other EEA/EFTA countries, regardless of their particular position on the matter. Indeed, the EEA agreement clearly stipulates that EFTA participants are not entitled to take the decision to adopt EU legislation on an individual basis (see art. 93).

33. An additional deterrent is also the understanding that failure to adopt an act after the end of the time-limit, may lead to the partial or even total suspension of the EEA agreement (see art. 102). Consequently, these conditions make any rejection less likely to occur.

B- The EFTA/Switzerland's model

34. Following the rejection of the EEA agreement in a popular referendum on 6 December 1992, the Swiss Federal Council engaged in long negotiations which led to the conclusion of a first package of bilateral agreements, hereafter "Bilateral Agreements I". Signed on June 21, 1999 in Luxembourg, these agreements were adopted by the Swiss electorate on May 21, 2000 and entered into force on June 1, 2002.[4]

35. Five of the agreements posed no difficulty and concerned relatively secondary matters. The most important two – free movement of persons and overland transport – on the contrary, were the object of intense debate.

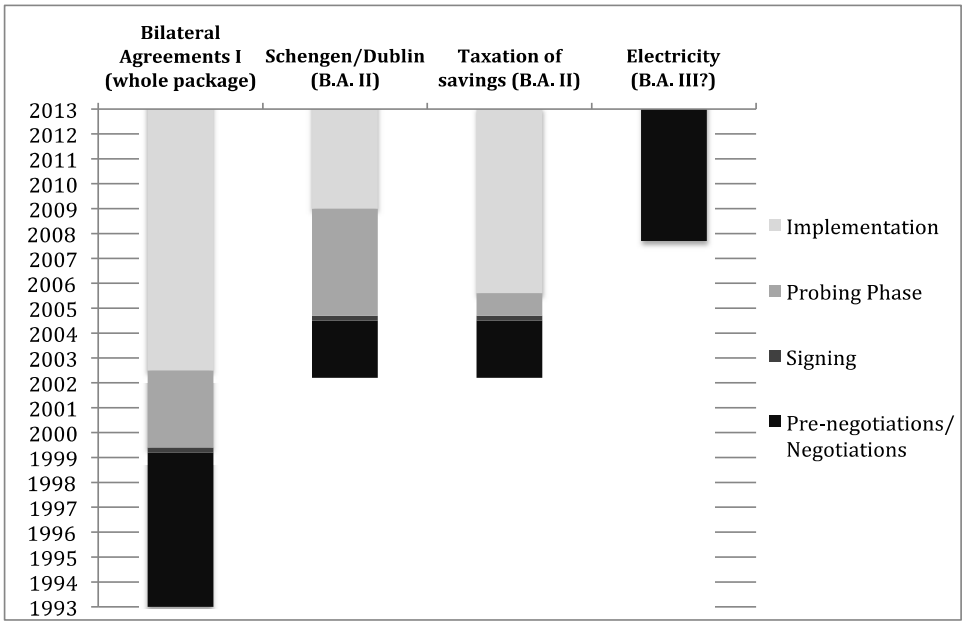
36. The EU and Switzerland also signed a second series of Bilateral Agreements (BA II) on October 26, 2004. These agreements cover nine dossiers each of which took effect on different dates. The most important concern the participation of Switzerland into the Schengen area and a withholding tax on taxation of savings in place of the lifting of bank secrecy originally demanded by the European Union.

37. From a legal perspective, these agreements are not interlinked, unlike the Bilateral Agreements I, and thus do not include a "guillotine clause". Switzerland could have rejected any one of them without the others being called into question.

38. Seven of these agreements posed no problems and concerned secondary issues. Once again, the two most important ones, Schengen/Dublin and the taxation of savings, were the subject of a heated internal debate. As a result, the Agreement on Schengen/Dublin was subject to a referendum in June 2005 but was accepted by about 54.5%.

[4] More details on the Bilateral Agreement I and II in Schwok, R. (2009) *Switzerland-European Union. An Impossible Membership?*, Brussels, PIE Peter Lang, pp. 37-78.

Figure 2: The Swiss-EU Bilateral Agreements or a time-consuming process



Differences between the Bilateral Agreements and the EEA

39. In comparison with the EEA, the Bilateral Agreements enable a third-party country (in this case Switzerland) to negotiate on an individual basis.

40. This freedom of action is in part limited by the multilateral structure of the EEA, which obliges EFTA countries to speak with a single voice. Here, Switzerland has never been obliged to harmonise its position with its EFTA partners before or during its dealings with the European Union.

Differences in terms of structures

41. The structure of the Bilateral Agreements I and II is light and does not create any new institutions. This distinguishes it from the EEA which was more unwieldy and based on a two-pillar system relying on a galaxy of institutions.

42. In principle, the Bilateral Agreements I and II do not function through a literal and all-inclusive application of Community law as is the case in the EEA: they are not governed by a Community or para-Community justice mechanism akin to the European Communities Court of Justice or the EEA/EFTA Court, but rather by a political mechanism (the Joint Committees).

43. The Bilateral Agreements I and II, therefore, radically differ from the EEA agreement, under which the EFTA-pillar states were obliged to adopt the relevant Community law together with its interpretations by the European Communities' Court of Justice pre-existent to the date of the signature of the agreement.

No automatic acceptance of new relevant Community legislations

44. The Bilateral Agreements I and II do not include an automatic adoption of new relevant Community legislations but instead, allow for the renegotiation on a case-by-case basis. There are, however, exceptions concerning Schengen legislation and air transport competition.

45. Thus, these Bilateral Agreements I and II differ from the EEA, where the EEA/EFTA countries are almost obliged to integrate developments of the relevant *acquis*.

46. Nonetheless, the Bilateral Agreements should not be over idealized. Switzerland is not immune to outside developments and the processes of "EU-isation". Since 1988, with every new federal legislation considered, it is mandatory for the Swiss parliament to include a paragraph summarising the EU position on the relevant matter. As a result, this has led to indirect adaptation in that Switzerland adopts numerous legislation of the European Union without conducting formal agreements.

Differences in terms of content

47. The EEA includes important sectors not covered by the Bilateral Agreements I and II, mainly concerning the free movement of services (i.e. financial, telecommunications and postal services), the free movement of capital, company law and intellectual property.

48. Additionally, the EU rules of competition for the four types of free movement were transposed into the EEA treaty. Regarding the monitoring of competition rule compliance is carried out, on the one hand, by the European Commission and, on the other hand, by the EFTA Surveillance Authority.

49. Conversely, the Bilateral Agreements I and II do not make provision for rules of competition. The only exception is in the domain of air transport where the European Commission and the European Community Court of Justice obtained exclusive jurisdiction over compliance with competition rules provided for in the agreement.

Differences in terms of horizontal and flanking policies

50. In comparison with the bilateral path, the EEA also added horizontal and flanking policies. This included concepts such as equal treatment between men and women, labour rights, participation in enterprises, consumer or environmental protection, and some social policy, education and youth, tourism, civil protection together with European economic and social cohesion.

51. The financial solidarity towards less affluent countries and regions of the EU that would have been asked from Switzerland as a member of the EEA would be greater than that required under the Bilateral Agreements I and II.

Figure 3: Overview of the scope and depth of the EEA/EFTA and Swiss options

	European Economic Area (EEA/EFTA)	Bilateral agreements (Switzerland)
Free trade area in industrial goods	Yes	Yes
Free trade area in agricultural goods	No	No (in negotiation)
Free Movement of workers	Yes	Yes
Free movement of capital	Yes	Yes
Free Movement of services	Yes	No
Common External Tariff	No	No
Absence of border control (mutual recognition)	Yes	No
Absence of border control (VAT/indirect taxation)	No	No
Value added tax harmonization	No	No
Absence of border control (rules of origins)	No	No
Common integrated institutions	Yes	No
Decision Shaping	Yes	No (mostly)
Recognition of the CJEU's judicial supervision	Yes	No (mostly)
Participation to EU agencies	Membership/observer status	Selective membership/ observer status
Participation to Comitology for experts	Yes (informal)	No
Adoption of the *acquis* (amount / method)	"Nearly full" / automatic	Partial / in a case- by-case basis

See Schwok, R. (2009) and Lavenex, S. (2011)

The bilateral approach is largely deadlocked since 2007

52. Since 2007, no more significant agreements were signed. This can be attributed to the EU dissatisfaction regarding the continuous Swiss' strategy aiming at concluding rigid "tailor-made agreements".

53. Recently, the European Union demanded that Switzerland adopt the evolution of the relevant EU *acquis* and called for a uniform interpretation in its application.

54. For its part, the Swiss Confederation does not want to lose its autonomy of decision and to accept the rulings of foreign judges. In fact, Bern would prefer as a model for future agreements the 2009 Switzerland-EU bilateral agreement on "the simplification of inspections and formalities in respect of the carriage of goods and on customs security measures" (also known as the "24 hours" agreement).

55. This technical agreement offers interesting institutional components.

56. First, it provides a participation in the early stage of the legislative process.

57. Second, Switzerland does not adopt automatically the evolution of the relevant EU *acquis*. Although it declares itself in principle ready to adopt the new EU legislation, the internal approval processes are respected.

58. Third, if Switzerland were not able to adapt to the evolution of the relevant EU *acquis*, the whole agreement would not become automatically terminated (there could be however proportionate "rebalancing measures" decided by the EU).

59. Fourth, the settlement of dispute about the interpretation or application of the agreement is also very creative because it is not let to the EU Court of Justice but to the Joint Committee or to an ad hoc arbitration.

60. This contrasts sharply with the EEA agreement since there are no such possibilities of independent arbitration on the proportionality of the EU rebalancing measures.

61. That being said, the European Union has constantly repeated that the 24 hours agreement will not serve as a framework model for the future of the Swiss-EU relations.

C- Advantages and disadvantages of the two options

62. Within the following analysis, our goal is not to argue for or against the UK leaving the EU. This is a political decision to be taken by the British themselves.

63. Besides, we are also aware that the circumstances of a return of the UK into EFTA are not comparable to the situation of EEA/EFTA countries as well as Switzerland.

64. Finally, although not addressed within this text, we acknowledge that a withdrawal of the UK from the EU itself would likely result in an avalanche of consequences that are difficult to assess.

Advantages of joining EFTA

65. First, EFTA membership would imply a far lower British financial contribution. Costly EU policies are not included, especially the ones related to the onerous CAP.

66. Nevertheless, one should also keep in mind that EEA/EFTA membership is not free of costs. These three countries have to pay for policies in which they are included. Their most important financial contribution is related to their participation in EU structural funds (1.8 billion Euros allocated to 13 EU member states for the 2009-2013 period). Similarly, Switzerland, which is not even part of the EEA, had to disburse significant amounts to secure its relationship with the EU. Indeed, through its bilateral agreements, Bern is also obliged to contribute, though far less than EEA/EFTA states, to the "reduction of socio-economic disparities" in the Union.

67. Thus, it is plausible that a country with a larger GDP such as the UK would have to disburse much more than the above-mentioned amount if it was to join the EEA/EFTA pillar or even to adopt a Swiss approach through the use of bilateral relations.

68. In terms of the total financial cost, it is possible, by extrapolation, to provide the following figures for both potential EEA/EFTA pillar membership and the Swiss-type bilateral approach (all-included): EUR 2.54 billions and EUR 1.62 billions per annum, respectively. However, it is also important to note that the UK would have to negotiate the exact amount of its contribution in both cases. Hence, these figures are only intended to be indicative as they assume that the UK would get the same treatment as EEA/EFTA states or Switzerland.

69. In addition to the above mentioned elements, the UK government would also be free to set its VAT level. That being said current British VAT level is 20% for most of their products, which is much higher than the 15% required by EU legislation. Therefore, it is unlikely that a withdrawal from the EU would change immediately anything in this regard.

70. Another advantage of EFTA membership is that States within this organisation have demonstrated their capacity to ratify free-trade agreements faster and with more partners than the EU.[5] As of 2012, EFTA member states have implemented 24 free trade agreements (covering as much as 33 countries).

71. It should be noted that the EFTA countries negotiated agreements with all States, which have concluded a Free Trade Agreement with the EU.

72. Additionally, it is interesting to observe that the EFTA States preceded the EU in their free-trade agreements with Canada, Columbia, the Gulf Cooperation Council, Ukraine and South Korea. Moreover, they are also well advanced in their negotiations with India, Indonesia, Thailand, Russia, Belarus and Kazakhstan.

73. It can be argued that Switzerland and Norway have been more efficient in terms of developing their free trade network than the EU. Indeed, the Union is often mired with internal disagreements as well as its institutional constraints in matters of trade policies (mainly related to the existence of divergent interests and views regarding agriculture and conditionality).

74. Finally, it is also important to underline that EFTA member states are free to enter into trade agreements independently. Thus, if the UK would join the EFTA, it would certainly benefit from a greater freedom of manoeuvre to sign free trade agreements with other countries in the world.

75. Concerning dimensions of foreign policy, security and defence, bilateral agreements between the UK and the EU, based on the Norwegian model, would undeniably better protect British sovereignty. It would come however at the expense of a loss of influence, particularly on CSDP. This would also mean that it would be more difficult for the UK to control or even to slow down the development of a more integrated EU defence "from the inside".

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[5] Schwok, R. (2010) "Specificities of Switzerland's Relations with EFTA", in Bryn, K. & Einarsson, G. (eds.) *EFTA 1960-2010, Elements of 50 Years of European History*, Reykjavik, University of Iceland Press, pp. 117.

76. While it can be argued that a withdrawal from the EU would imply a decrease of adaptation to new norms the Norwegian and even the Swiss cases show that these two "outsider" countries have still adopted directly or indirectly a certain number of EU laws.

Challenges of EFTA and EEA membership

77. In order to accede to EFTA or to the EEA/EFTA pillar, the UK would have to follow a potentially difficult path.

78. First, the UK would have to submit an application to EFTA. Unlike the EU, this organization does not pursue an active enlargement policy and, according to a well-informed source: "Feasibility and desirability of a possible EFTA enlargement would have to be assessed on a case-by-case basis for each possible applicant".

79. As a matter of fact, there is no guarantee that EFTA States would welcome any new member or simply not veto its application (as the EFTA convention specifies that unanimity is needed in case of enlargement). Indeed, this organization represents a quite homogenous bloc in terms of countries' size, economic development and trade preferences. Hence, the accession of big countries such as the UK would certainly shake the established bases of the whole organization. Besides, it is also questionable if the British would accept to deal on a one to one basis with small countries such as Liechtenstein.

80. Furthermore, even if London secured an EFTA membership, it is not guaranteed that the three EEA/EFTA States would welcome the UK in "their" pillar. As we have seen, these countries would have to adopt a common position during the joint decision making procedure. While this has not proven to be a problem until now, it could very well change with the arrival of a new member. These three countries would be laying at the mercy of any kind of British opt-out, leading potentially to a partial or even the total suspension of the EEA agreement.

Swiss or EEA option?

81. Arguably, the Swiss option can be seen as relatively favourable when compared to the EEA option as a way to formally maintain its sovereignty. That being said, the EU is clearly against the perpetuation of this *sui generis* bilateral relation mechanism, which is a case resulting from the several economic and political particularities of Switzerland.

82. In contrast, the EEA option could result in the support of the European Commission and of its member States. There is also the advantage of providing full access to the EU internal market. Given EEA's evolutionary nature, this allows for easy and rapid adaptation to the developments of EU legislation, while also offering strong legal certainty, and therefore predictability.

83. The main challenge of the EEA option is related to the undermining of UK sovereignty. If the UK withdraws from the EU, it may very well end up becoming a sort of "satellite" of the European Union if it joins the EEA/EFTA pillar. Indeed, its government would be

obliged to automatically adopt certain legislation within important policy areas, while being unable to take part in the making of decisions.

84. In 2012, Norwegian experts mandated by the government went as far as relating these sovereignty problems to a more general question of democratic deficit. In their view, the Norwegian government cannot be held accountable for most of its European policy.[6] Thus, one has to seriously question the argument that the EEA would be a better deal for the UK because it would restore important parts of the British national sovereignty.

6 June 2012

[6] EEA Review Committee (2012) "Outside and Inside: Norway's Agreement With The European Union", *Official Norwegian Reports (NOU 2012:2)*, Oslo, 17 January, pp. 7.

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Written evidence from the Liberal Democrat parliamentary party committee on international affairs

Executive summary

- British membership of a European Union of peaceful, free democracies has brought us a huge range of benefits including jobs and prosperity both through free access to the EU's internal market and through the EU's collective weight in international trade negotiations. It has brought robust consumer rights and protections, justice and home affairs measures which help our police and security services to keep British people safer and more secure and greater environmental protection and it has generally magnified UK influence in the world. But EU institutions are not perfect and should be subjected to challenge and review.

- The obsessive focus by some on the worst aspects of the EU gives the British public a grotesquely distorted view of Europe. But British parliamentary scrutiny of EU affairs is itself inadequate and needs to be mainstreamed across departmental select committees. Ministers need to be questioned *ahead* of sectoral council meetings. More also needs to be done to increase British representation within the commission and across the EU institutions.

- No compelling case has been made for any alternative to full EU membership. Norway and Switzerland, by their own admission, have to comply with EU rules but are unable to shape those rules. This would be a bizarre way to try to defend British sovereignty.

- Rather than the exercise of a British veto, the December council was a decision by the rest of the EU to walk away from the UK and carry on with their negotiation in a different room. The key danger now is that the questionmark over Britain's future place in Europe becomes a self-fulfilling prophecy as other member states start to overlook UK interests. But the government has rightly worked hard to rebuild key relationships and this must continue.

- A formalised two-tier model could relegate the UK to permanent second class citizen status in the EU with all the consequences this implies for British influence over the shape and fortunes of our continent and the seriousness with which we would be taken as a global player. We should retain top table status within the EU.

- The fiscal compact treaty should be incorporated eventually into the EU treaties along with safeguards and access guarantees for non-Eurozone countries like the UK but without those countries having to sign up to any aspect of the treaty itself.

Introduction

1. The Liberal Democrat parliamentary party committee on international affairs is a sub-committee of the Liberal Democrat parliamentary party. The committee is chaired by Martin Horwood MP with co-chairs Baroness Kishwer Falkner, Lord David Chidgey and Lord John Lee.

2. The Liberal Democrats believe that the UK belongs firmly at the heart of Europe. This political stance is built on our long tradition of internationalism and our clear belief that UK membership of a

European Union of peaceful, free democracies is in the British national interest. Our membership of the EU has brought huge benefits in terms of jobs and prosperity through free access to the EU's internal market and a uniform regulatory environment for EU-wide business, and through the EU's collective weight in international trade negotiations, whether via the WTO or EU free trade agreement negotiations.

3. Membership of the European Union allows us extraordinary freedom to live, work, study and retire anywhere in the Union. It makes life cheaper and easier by, for example, driving down flight costs through competition, cutting phone and data charges, providing free access to EU-wide health insurance and putting in place robust consumer rights and protections. EU justice and home affairs instruments and minimum standards help our police and security services to keep British people safer and more secure from security threats and serious organised criminal gangs operating across borders, whilst also raising the standards of justice, and the protection of civil liberties and rights for our citizens wherever they are across the Union.

4. Collective European action enables the UK to pursue credible policies on cross-border matters of vital importance, whether it is energy security, combating climate change, boosting environmental protection or developing joined-up infrastructure networks. Collective EU action in foreign, development and defence matters can be an extraordinary magnifier of British influence in the world. We have included in the Annex to our submission a range of facts, figures and examples to illustrate some of these points.

5. The UK has driven forward an open, outward looking and liberalising agenda to improve the Union and increase the benefits it delivers for the British people and all Europeans. In an increasingly interconnected global economic and political system with shifting patterns of power and influence, EU membership has helped successive British governments to shape our own future direction and fortunes by actively helping to shape the future direction and fortunes of the continent of which we are a major part. In the process, the UK has been able to retain global player status, taken seriously in Washington, Beijing, Moscow, Delhi and Brasilia, in large part because we hold influence in Brussels, Paris and Berlin, the world's largest single market and biggest trading bloc.

6. The EU is not perfect. Liberal Democrats believe as passionately in reform of the European Union as we do in reform of the UK's political system. We want the EU to work and to work better. And as with any set of political institutions, the EU structures, systems and processes are in need of constant attention, regular challenge and review. We are convinced that there is considerable scope for cutting waste, achieving greater cost efficiencies and refocusing EU level spending on areas where it will add greater value to spending at a national level.

Public perception and scrutiny of European affairs

7. We want a more efficient, effective, transparent and accountable European Union helping to deliver a prosperous, progressive, liberal and outward looking Europe. But there is a tendency, sometimes an obsession, in many parts of British political and public life to focus on the worst of the EU. Too often, a picture is painted that is grotesquely distorted, riddled with myths and peppered with untruths. If our picture of British public life was equally distorted – if all the British public knew about the UK government, parliament and British politics was MPs' expenses, party funding scandals, media scandals, and failed big budget projects - it would hardly be surprising if people questioned the value and purpose of the whole British political system.

8. We do want to see a more responsive, transparent and accountable Union, and we believe that some of the reforms necessary to achieve this need to occur at home. For instance, it is painfully clear to us that the Commons European scrutiny system needs urgent reform. In a post-Lisbon world, it is simply unacceptable for the Commons to rely on a single Scrutiny Committee and a system of ad hoc Standing Committees to scrutinise EU affairs. Such a setup is symptomatic of the widely held and misplaced view that Europe is a niche foreign policy issue and only of general interest when framed in terms of in/out or the future of UK-EU relations. While we welcome the Foreign Affairs Committee's inquiry, it is in danger of falling into this trap as well, unless it is accompanied by a mainstreaming of EU foreign policy matters within the work of the committee.

9. The vast majority of MPs have little or no engagement with substantive EU matters at all. The level of understanding of how the EU operates and Britain's role within it is staggeringly low and the awareness of EU policy developments practically non-existent. The European Commission's 2011 Work Programme - the European equivalent of the Queen's Speech - was given less than an hour's debating time in an ad hoc standing committee some six months after it was published and when the bulk of the planned measures had already been introduced. If MPs handled the Queen's Speech in this way, there would be outrage. EU matters need to be mainstreamed across the departmental select committees so that they can consider them early enough to influence government and commission thinking, question ministers representing Britain's interests *ahead* of sectoral councils and focus on policy direction and how it relates to domestic policy and British interests, not just constitutional questions.

10. Equally, we are extremely concerned at the UK civil service's capacity on EU matters and the long-term decline of British personnel in the EU institutions and the numbers successfully passing through the Commission *concours*. We understand that EU units across Departments have been among the first to see cut-backs, that the UK has never before been so under-represented amongst commission personnel and that only eight British nationals successfully passed through the concours in 2011. The lack of focus on this crucial area by successive governments needs to be urgently addressed. The British civil service and UK representation (UKRep) have some incredibly good people working on EU matters, and many talented British nationals work in the EU institutions. But we need to drastically increase Whitehall capacity and British representation across the EU institutions.

There is no realistic alternative

11. In the absence of any clear and compelling alternative vision to Britain's full membership of the European Union, the only option for Britain is to remain at the heart of the European Union. Within the EU, we will retain the economic benefits, individual freedoms and advantages for British citizens, the enhanced ability to manage major cross-border issues and the geo-strategic advantages of increased global influence in an increasingly interconnected and competitive world.

12. There is no compelling case for an alternative relationship between the UK and the EU. The only realistic alternative to full EU membership is membership of the European Economic Area (EEA) along the lines of Norway or Switzerland. But this would clearly be detrimental to UK national interests.

13. In order to gain access to the single market as a member of the EEA, the Norwegian government has to implement the vast majority of the EU's rules but has no say in deciding those rules. This 'fax democracy' represents a huge democratic deficit for the people of Norway. As a Norwegian

Committee set up to consider the impact of EEA membership recently reported,[1] Norway is as 'Europeanised' as the UK despite not being a member of the EU yet there is an enormous democratic cost to not having votes in the Council, MEPs in the European Parliament or a commissioner in the commission as the UK and all other member states do.

14. In our view, this would not enhance British sovereignty. It would leave the UK sitting on the sidelines as others went ahead and shaped the future of the continent without us. Without a British voice pushing for open markets, green governance and an outward-facing Europe, the EU could turn in ways that would damage all our collective interests. As the Prime Minister put it: "Leaving the EU is not in our national interest. Outside, we would end up like Norway, subject to every rule for the single market made in Brussels but unable to shape those rules. And believe me: if we weren't in there helping write the rules they would be written without us – the biggest supporter of open markets and free trade – and we wouldn't like the outcome."[2]

15. The case of Switzerland is very similar. Though the Swiss have tried to resist the rigid application of EU rules under the EEA and other agreements with the Union, the trend is very clear as the country has increasingly accepted that it is in its interests to apply EU rules given the importance of the Union for its own trade. Bern, by its own admission, has increasingly deferred to Brussels in the key areas of banking and trade. New hedge fund rules proposed in Switzerland are explicitly based on EU rules with additional Swiss rules - a Swiss form of gold-plating. And negotiations between the Swiss and the EU aimed at encouraging the Swiss to conform to "all the criteria" of the EU Code for Business Taxation are due to start imminently.

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU Policy and place in the Union?

16. Prior to the December European Council, the major concern in Britain was that a caucus of Eurozone countries might stray into EU-27 matters, most importantly over the single market. This is a legitimate concern. But the outcome of the December council increased the risk of such caucusing rather than reduced it.

17. The UK was not asked to pool any additional sovereignty or power within the EU architecture. What we were being asked was to allow the Eurozone countries to enhance the debt rules that apply to them by amending the EU Treaties accordingly. Worryingly, and for the first time in our membership of the Union, all the other member states decided that they could not work with the UK in this regard. They had to find an alternative arrangement outside the EU Treaties and without the UK. Rather than being a British veto, this was a decision by the rest of the EU to walk away from the UK and carry on with their negotiation in a different room.

18. This broke the number one rule that has guided British policy on Europe for decades: that we should always seek to exert maximum British influence on decision-making inside the Union. And, far from protecting the City of London, it actually put the City's interests, and broader British interests, more at risk not less. The outcome of the Council was a plan for a Fiscal Compact signed by 25 out of 27 member states (and we expect the Czech Republic to sign before long). Provisions for discussions and initiatives among the signatories are dangerously close to single market matters under Title IV of the Treaty and regular meetings among Eurozone and Eurozone Plus members will take place

[1] http://www.europautredningen.no/english/
[2] PM's Lord Mayor's Banquet Speech, 2011

around European Council meetings. Unless the Treaty is embedded into the institutional architecture of the EU, the UK cannot fully rely on the protections and rights afforded to member states under the Treaties. The potential for caucusing among Eurozone or Eurozone Plus countries, and without the UK, on single market matters, especially financial services, remains clearer than ever with vehicles and legal scope for this to occur.

19. This risk is reinforced by the political impact of the December council, with British relations with our partners strained at a time of extreme anxiety for the Eurozone and broader EU. The UK's reputation as a fully committed, reliable and trustworthy member of the EU has been questioned. It is far from rare to hear people openly speculate about Britain's future in the EU, or about whether EEA membership may be a better model for us. The key danger in the short/medium-term is that the questionmark over Britain's future place in Europe becomes a self-fulfilling prophecy as other member states start to overlook UK arguments and interests (regardless of their merits), and make other alliances over matters of core interest to the UK. The recent negotiations over the CRDIV Directive, a piece of legislation of crucial importance to us, saw the UK dangerously close to a position of 1 against 26, despite the merits of our argument. A by-product, perhaps, of the December council. And there are plenty more difficult negotiations to come.

20. All is not lost - far from it. The use of our observer status in the negotiations following the December council was wise, as was our decision to allow the use of the EU institutions which themselves are bound to protect the EU Treaties in full and thereby British rights and responsibilities. The UK is a highly valued member of the Union in many ways, not least for our free trade and liberalising instincts which chime with many other member states and the natural disposition of the European Commission. But also for our leadership in foreign and security policy matters, our excellent reputation on police and judicial co-operation, our strong climate change credentials and our rigorous scrutiny of EU proposals at a technical level to ensure they are workable.

21. The UK has rightly fought hard to rebuild key relationships and alliances on matters such as the European growth agenda, climate change and EU foreign policy matters. We need to redouble our efforts, maintain a flexible approach, generate new initiatives and ideas, deepen existing alliances and build new ones - especially with Euro "ins" - and maximise our influence while taking opportunities for good deals and trade-offs for the UK.

Between now and 2020, what institutional architecture should the UK seek for the EU? Should the UK embrace a formalised two (or more) –tier EU and start to develop ideas for multiple forms of EU membership?

22. A multi-speed Europe already exists. The UK is not a member of the Euro or of Schengen (though we participate in police and judicial cooperation aspects in the latter) and we have an opt-in on all justice and home affairs matters. The treaties also offer considerable safeguards for the UK and other member states on sensitive matters such as the emergency brake clauses, safeguards on the single market and new powers for national parliaments over subsidiarity matters. This flexibility has worked well for Britain and many other countries within the overall framework of the EU, while they retain the option of altering these arrangements according to their own interests. Denmark, for example, is considering moving from an opt-out on JHA matters towards a UK opt-in model, and many non-Eurozone states are committed to joining the Euro in the future.

23. The treaties' enhanced co-operation mechanisms (the first use of which the UK pushed for in relation to the EU patent and patent court) was one amongst other innovations in the treaties.

These offer a vehicle to preserve the rights and responsibilities of non-participants in specific areas of deepened integration.

24. However, a formalised two-tier model is not in the British national interest. It could relegate the UK to permanent second class citizen status in the EU with all the consequences this implies for British influence over the shape and fortunes of our continent and ability to project power and influence internationally. The non-Euro block is likely to decline in size so the idea of forming a non-Euro group to balance a Euro-grouping is fanciful. If the UK wishes to maximise its influence in the EU and retain global player status in world affairs, it is fundamentally in the national interest to ensure we retain top table status within the EU. We see grave risks of the 'self-fulfilling prophecy' if the UK openly starts to explore different forms of membership with the EU. The reality is that, in such circumstances, others might take that decision for us.

What is the relationship between the new 'fiscal compact' Treaty and the EU's acquis? What impact might the conclusion of the Fiscal Compact Treaty have on other aspects of the EU and its policies such as the budget, enlargement, or CFSP?

25. The fiscal compact Treaty lies outside of the EU treaties, but is linked via the EU institutions and sets out political commitments among the signatories over the use of EU Treaty tools, such as enhanced co-operation, and positions such as on the enforcement of the new 'six pack' rules. Our primary concern over this structure is the potential for caucusing over EU-27 matters, most notably on the single market. Within the Fiscal Compact Treaty, this could occur through actions taken under Title IV of the Treaty. More broadly, the new opportunities for Eurozone and Eurozone Plus groupings of member states to meet to discuss matters under the Fiscal Compact Treaty could directly or indirectly impact the interests of the EU-27 or the single market. The prospect of this materialising depends to a large extent on the 27's ability to find solutions to problems with the EU's main architecture, and thereby on the attitude and approach of the UK and other member states.

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

26. The 'fiscal compact' Treaty envisages its own incorporation into the main EU Treaties within five years. This would be far more satisfactory than the current situation and clearly in line with British national interests. It would not mean that the UK itself would need to sign up to the debt rules included in the Treaty or to any other aspects of the Treaty itself. Rather it would, as was the original intention, enable Eurozone countries to tighten and apply greater discipline to their own debt rules by amending them within the EU Treaties. The UK and other non-Eurozone countries would be well within their rights to ask for a generic safeguard on single market matters (that is that they remain the exclusive preserve of the EU-27 and that the Compact will honour and not undermine existing single market rules), as well as access to future Eurozone and/ or Eurozone Plus meetings.

Annex

1. Creating British jobs and prosperity through the single market:

- The UK economy benefits from the single market alone (not including EU external free trade deals) to the tune of up to £90bn annually, or £3,300 per household every year (27m households in UK).[3]
- The EU's single market gives British companies free trade access to the world's biggest single market worth nearly £12tn in GDP and over 500 million consumers.[4]
- 3.5 million British jobs are reliant on the EU's single market. That's one in every 10 British jobs.[5]
- 50% of British trade, worth £450bn a year, is with other EU member states.[6]
- Over 100,000 British firms export to other EU countries, 94,000 of which are SMEs. 80% of all UK businesses think the Single Market delivers concrete benefits to them.[7] Over 200,000 UK companies trade with the EU every year.[8]
- The growth in free trade within the EU has generated up to £3,300 in extra income per British household per year over the last 30 years.[9]
- Over 50% of foreign direct investment to the UK comes from other EU member states, and is worth £351bn a year.[10]
- Over 50% of companies investing in the UK cite the UK's membership of the Single Market as a core reason for investing in the UK.[11]
- Full access to the EU's single market makes the UK a magnet for foreign companies locating in the UK: Between 1998 and 2011, 603 major foreign companies chose to locate their European Headquarters in the UK.[12]
- An OECD and Bank of England study suggest that UK withdrawal from the EU would cut FDI into the UK by over a third and damage household incomes.[13]
- The UK is pushing to liberalise trade within the EU in new growth areas such as energy, digital, services and green tech. sectors. This could add over £650 billion to the EU economy, making the average UK household almost £3,500 better off each year.[14]
- EU enlargement is hugely economically beneficial for the UK by expanding the EU's single market. The enlargement of 10 central and eastern European countries has seen UK exports to those countries treble over the last ten years to almost £12bn.
- The City of London and Edinburgh are the leading financial centres in Europe. Ensuring the UK retains its influence over financial services regulation is vital.
- The level of trade liberalisation in the EU is unparalleled anywhere in the world.

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[3] http://www.theyworkforyou.com/wrans/?id=2011-09-06c.67079.h&s=section%3Awrans+speaker%3A11494#g67079.q0
[4] http://www.bis.gov.uk/policies/europe/eu-single-market-introduction
[5] http://www.theyworkforyou.com/wrans/?id=2011-09-06c.66959.h&s=section%3Awrans+speaker%3A11494#g66959.q0
[6] http://www.bis.gov.uk/policies/europe/eu-single-market-introduction and http://www.theyworkforyou.com/wrans/?id=2012-03-27a.101662.h&s=section%3Awrans+speaker%3A11823#g101662.q0
[7] 2006MORI Poll
[8] http://www.theyworkforyou.com/wrans/?id=2012-03-27a.101662.h&s=section%3Awrans+speaker%3A11823#g101662.q0
[9] http://www.theyworkforyou.com/wrans/?id=2011-09-06c.67079.h&s=section%3Awrans+speaker%3A11494#g67079.q0
[10] http://www.theyworkforyou.com/wrans/?id=2011-09-05a.66958.h&s=section%3Awrans+speaker%3A11494#g66958.q0
[11] UKTI, OMB Research, (2010) UKTI Performance and Impact Monitoring Survey (PIMS) Inward Investment.
[12] Calculated taking 2010/11 figure from: http://www.theyworkforyou.com/wrans/?id=2012-03-27a.101660.h&s=section%3Awrans+speaker%3A11823#g101660.q0 and 1998-2009 figure from http://www.ukti.gov.uk/uktihome/item/113922.html
[13] Pain and Young, (2004) Macroeconomic Impact of the UK Withdrawal from the EU.
[14] http://www.bis.gov.uk/news/topstories/2011/Mar/eugrowth

2. New opportunities, making life cheaper & easier for British citizens:

- Our membership provides UK nationals freedom of movement across the entire EU.
- Today, around 2.2 million British nationals are living in another EU member state – either working, studying, or in retirement. Around 50% live in Spain.[15]
- EU free movement rules allow British families to travel freely on holiday throughout the EU at any time in the year - some 25m Brits go on holiday to other EU countries every year.[16]
- EU rules allow for Brits to live and work anywhere else in the EU too. Some 260,000 Brits work in another EU country, an increase of more than 40,000 since 2005.[17]
- Under current and emerging EU rules, British nationals will be guaranteed to have their rights and protections respected in all other EU member states.
    - E.g. the European Protection Order will ensure that British victims of violence who have a UK protection order will receive the same protections anywhere in the EU.
    - E.g. the EU is in the process of passing a package of measures that will ensure that any British citizen arrested on the continent will have their basic rights guaranteed including the right to be fully informed at all stages of the process, access to a lawyer and translation rights.
- The European Health Insurance Card (EHIC) enables UK travellers to receive free or reduced cost healthcare when on a temporary visit to another member state. There are around 30.5 million UK-issued EHICs in circulation.
- EU competition and consumer rights laws have driven down prices, opened up markets for smaller businesses and boosted consumer protections.
- The average British UK consumer saves around £480 per person per year as a result of EU single market competition driving down price of goods and services.[18] For example, British families and businesses now enjoy vastly reduced mobile phone roaming charges, cheaper flights and proper compensation when flights are delayed or cancelled.

3. Opening up markets for British businesses around the world:

- The EU is vital to opening up new trading opportunities for the UK around the world.
- By negotiating as part of the world's biggest single market bloc, the UK is able to get much better terms and access than it would if it were negotiating by itself.
- For example, a recently signed EU Free Trade Agreement (FTA) with South Korea (a bigger market than Turkey or Indonesia) has virtually eradicated all tariffs barriers for EU exporters. It will bring £500m a year of benefits to British businesses.[19]
- The EU is in the process of negotiating a series of new FTAs including with India, Canada, Ukraine and South America which will deliver enormous economic benefits to British households and businesses. Completing all ongoing EU FTA negotiations would generate over £50bn for the economy.[20] There are many others in the pipeline, including with Japan and the US which could bring enormous economic benefits to the UK and broader European economy.

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[15] http://www.theyworkforyou.com/wrans/?id=2011-09-06c.68474.h&s=section%3Awrans+speaker%3A24928#g68474.q0
[16] http://www.theyworkforyou.com/wrans/?id=2011-11-24b.82499.h&s=section%3Awrans+speaker%3A11494#g82499.q0
[17] http://www.theyworkforyou.com/wrans/?id=2011-11-24b.82500.h&s=section%3Awrans+speaker%3A11494#g82500.q0
[18] http://www.theyworkforyou.com/wrans/?id=2012-04-16b.102035.h&s=section%3Awrans+speaker%3A11823#g102035.q0
[19] http://www.bis.gov.uk/news/topstories/2010/Oct/davey-free-trade-agreement
[20] http://www.number10.gov.uk/wp-content/uploads/EU_growth.pdf

- Below is a snapshot of some of the benefits from some of individual FTAs under negotiation:[21]
    - EU-Canada: The benefits of this agreement to the UK could be approximately £423 million per annum in the short term;
    - EU-India FTA: This agreement could produce benefits to the UK of approximately £2 billion over ten years;
    - EU-Mercosur FTA: The Commission has conducted some research but there is not yet a published SIA;
    - The EU-Malaysia FTA and EU-Singapore FTA are important building blocks towards an EU-ASEAN FTA, which could bring benefits of up to £3 billion per annum to the UK in the long term.

4. Helping the UK combat climate change, deliver energy security & generate a low carbon economy:

- The EU is vital to delivering British objectives on climate change, energy security and generating a low carbon economy.
- The EU is a world leader in combating climate change. Collective EU action was crucial for establishing the Kyoto protocol. Strong leadership by the UK and the European Commission helped to keep a strong and united 'Team EU' position at the UNFCCC CoP in Durban in 2011 and secured a remarkable global commitment including all major emitters.
- The EU's collective position to deliver a 20% reduction in emissions by 2020 is essential for securing a global deal on climate change. The UK is pushing for a 30% EU climate change target.
- The EU's Emissions Trading Scheme is the biggest of its kind in the world and vital for combating climate change and generating low carbon growth.
- The EU's new Energy Strategy is essential in delivering UK energy security by diversifying energy generation and supplies, driving through reductions in consumption, creating a fully functioning internal energy market and investing in an efficient European Supergrid.
- EU targets and actions stimulate investment in UK renewables and low carbon technologies, and generate British low carbon export markets across the EU.
- For example, a European Supergrid could generate tens of thousands of new British jobs in the offshore renewable industry, turn the UK into a net exporter of energy again and reduce the costs of investing in new offshore wind and marine energy by 25%.[22]

5. Helping to combat criminal & security threats facing the UK & protecting rights:

EU-wide action is essential to tackle cross-border security threats to Britain like terrorism, human trafficking, drug smuggling, illegal immigration and money laundering. Some examples:

- A 3-year Europol investigation, Operation Rescue, broke the world's largest online child pornography network making 184 arrests (121 in Britain) and rescuing 230 children (60 in the UK) 2011.[23]
- Operation Golf, a joint operation between Europol, the Met and Romanian Police, broke up an organised criminal operating a child trafficking network in the UK and across the EU. In 2010, this

[21] http://www.theyworkforyou.com/wrans/?id=2012-04-16b.102034.h&s=section%3Awrans+speaker%3A11823#g102034.q0
[22] http://www.parliament.uk/business/committees/committees-a-z/commons-select/energy-and-climate-change-committee/news/esg-publication/
[23] http://www.guardian.co.uk/society/2011/mar/16/global-paedophile-ring-smashed and http://www.build.co.uk/national_news.asp?newsid=124346

saw 7 individuals arrested in the UK and the release of 28 children. In total, some 121 individuals were arrested under the Operation.[24]

- Through the European Arrest Warrant (EAW), in 2010 the UK extradited over 145 individuals from other EU member states to the UK to face criminal prosecutions for crimes they had committed here.[25]
- Over the last two years, the UK has used the EAW to extradite at least 71 non-UK nationals suspected of committing serious crimes in the UK. This includes 4 thefts, 4 robberies, 5 murders, 5 rapes, 6 child sexual offences, 9 cases of GBH and 14 cases of fraud.[26]
- This, of course, excludes British national extradited back to the UK for crimes committed in the UK. We note, for example, the extraordinary success of the Crimestoppers' Operation Captura which has successfully seen the arrest and return under the EAW of 49 out 65 most wanted British nationals on the run in Spain.[27]
- Through EU action to enable transfers of data on convictions, the UK is now aware (previously unaware) of 276 British nationals who have committed offences against children across the EU.
- The Eurodac System helps the UK cross reference thousands of asylum claims in the UK with those in other member states.[28] Since 2003, the EU's 'Dublin System' has enabled the UK to remove over 12,000 asylum applicants to member states that are responsible for deciding their claims.[29]
- EU action via 'Frontex' at Europe's external borders helps to combat illegal migrant flows into the Union, many of whom intend to travel to the UK.
- The EU's Joint Investigation Team (JIT) has become a key vehicle for the British Police to operate smoothly with other national forces in pursuing lengthy and complex cross-border investigations. Since 2009, British Police have been involved in at least 15 JITs.[30]
- The recently operational EU Council Framework Decision 2005/214/JHA should enable the UK to ensure that hundreds of thousands of pounds worth of financial penalties issued for offences committed in the UK can be claimed back from individuals in other EU member states.[31]
- The EU's Prisoner Transfer Framework decision, which recently came into force, should allow the UK to both improve rehabilitation outcomes and reduce the size of the British prison population by returning foreign national prisoners to the home EU member state. The transfer of the first batch of prisoners is currently in the pipeline.[32]
- The ongoing package of legislation to put in place minimum standards for victims rights, heavily inspired by UK best practice, will help to ensure that British victims of crime in other member states have their rights properly protected. The parallel package on procedural rights in criminal justice, also heavily inspired by UK best practice, are crucial for ensuring that the more than 3,000 British nationals arrested and tried in other member states every year are subject to high standards of criminal justice.[33]

[24] https://www.europol.europa.eu/content/page/operational-successes-127
[25] SOCA Annual Report 2010-11 page 93
[26] http://www.theyworkforyou.com/wrans/?id=2011-11-28c.81230.h&s=section%3Awrans+speaker%3A11494#g81230.q0
[27] http://www.crimestoppers-uk.org/most-wanted/catching-criminals-in-spain/arrests-to-date-operation-captura
[28] http://www.theyworkforyou.com/wrans/?id=2011-11-15c.81155.h&s=section%3Awrans+speaker%3A11494#g81155.q0
[29] Ibid
[30] http://www.theyworkforyou.com/wrans/?id=2012-04-16b.103060.h&s=section%3Awrans+speaker%3A11494#g103060.q0
[31] http://www.theyworkforyou.com/wrans/?id=2012-05-01b.106071.h&s=section%3Awrans+speaker%3A11494#g106071.q0
[32] http://www.theyworkforyou.com/wrans/?id=2012-03-07a.98443.h&s=section%3Awrans+speaker%3A11494#g98443.q0
[33] http://www.theyworkforyou.com/wrans/?id=2011-11-15c.81154.h&s=section%3Awrans+speaker%3A11494#g81154.q0

6. Helping deliver British foreign policy: global security, stability & combating poverty:

Acting as part of a 27 nation bloc, representing the largest single market in the world, is a huge magnifier of Britain's voice and influence in the world. Some examples:

- The EU's biggest foreign policy success is spreading European values, peace, security and prosperity across the continent, most recently through enlargement in 2005 to include 10 new EU member states. The UK remains a leading proponent of further enlargement to the Western Balkans, Iceland and Turkey.
- The EU's Neighbourhood Policy is essential to delivering UK objectives of stability and prosperity to countries on the Eastern-edge of the EU, and in supporting the transitions underway across much of North Africa and the Middle East.
- EU sanctions have a much greater impact than UK-only sanctions. The EU, urged on by the UK and others, recently agreed sanctions on all oil exports from Syria to help put pressure on the regime there. Syrian oil exports to the EU are 95% of their total oil exports and reports suggest that the impact of the sanctions is already being felt by the regime and the ruling elite.[34] The EU has also enacted a robust sanctions package on Iran and Zimbabwe.
- Equally, removing EU sanctions, opening up normal diplomatic channels and relaunching aid flows are a huge incentive to positive reforms. Indeed, we saw this and the benefits it brings to UK influence overseas very neatly in Burma with the PM's initiative to urge the suspension of sanction on Burma, this position being approved by EU Foreign Ministers, the EAS opening up a new office in Burma and the reopening of EU aid flows to the country.
- The EU remains the world's biggest aid donor and will be crucial for delivering on the UK's objectives of combating global poverty.[35].
- The EU's trading power is vital for supporting poorer countries growth and stability. The EU, under a UK initiative, agreed an ambitious emergency trade relief package for Pakistan in the wake of the devastating floods in the country last year.
- The EU's Common Security & Defence Policy (CSDP) is delivering in a variety of important areas to the UK and broader EU such as:
    - The large-scale rule of law mission in Kosovo to combat organised crime, corruption and deliver stability in the country;[36]
    - Operation ATALANTA, a UK-led (commanded from Northwood) EU naval mission to counter-piracy off the coast of Somalia which has reduced the number of successful pirate attacks and protected over 500,000 tonnes of food aid.[37]

[34] http://www.bbc.co.uk/news/world-middle-east-14759416
[35] http://development.donoratlas.eu/home.html
[36] http://www.eulex-kosovo.eu/en/front/
[37] http://www.eunavfor.eu/ and http://www.publications.parliament.uk/pa/ld200910/ldselect/ldeucom/103/10302.htm

FEU 23

Written evidence from Professor Richard Rose, FBA, University of Strathclyde and European University Institute

DISTINCTIVE UK PRIORITIES FOR THE EU'S FUTURE

1.1 The December 2011 European Council is a challenge, not a watershed, because it is unclear how eurozone members of the EU will react to future events. The German Chancellor is calling for changes in EU rules that could trigger a British referendum under terms of the 2011 European Union Act. To avoid misunderstandings and possible isolation, HMG should start preparing for such developments.

1.2 The European Union notionally endorses diversity as well as Union, but the predominant position favours all member states advancing in unison toward an ever closer union. Thus, the UK's repeated challenges to further European integration are widely perceived as negative. This submission recommends that, consistent with HMG's distinctive position, it should promote institutional diversity as a positive means of managing differences within an EU that has 27 or more member states.

- 1.2a Pragmatic experimentation. EU procedures for enhanced cooperation enable willing countries to adopt policies and countries with doubts to observe the experiment before deciding whether to join in. This has been Britain's stance on the euro and the Stability Treaty can go into effect after ratification by 12 countries.

- 1.2b Give European citizens a say on major increases in EU powers. HMG should promote its 2011 EU Referendum Act as a positive step to address the EU's democratic deficit by testing the commitment of Europe's citizens to further expansions of the EU's powers.

- 1.2c Link enhanced cooperation and referendum endorsement. A coalition of the willing implies that the unwilling should satisfy themselves by opting out. Therefore, future agreements on the expansion of EU powers should have complementary and contingent provisions for enhanced cooperation by countries that favour further integration and opt out clauses for countries that may not do so, e.g. Britain after a national referendum.

1.3 The above recommendations are based on an ESRC-funded study to be

published by Oxford U. Press next spring, *Representing Europeans: a Pragmatic Approach*, and related publications. Both projects reflect my long-term interest in how growing cross-national interdependence can be managed by governments accountable to a national parliament and electorate. See for example, *The Prime Minister in a Shrinking World* and *The Post-Modern Presidency*.

2.1 Experimenting through enhanced cooperation occurs when some EU member states adopt a policy and others do not. This has been happening for decades in different policy sectors and institutional forms. For example, the Schengen agreement promoting easy movement across national boundaries started in 1985 and Britain and Ireland continue to opt out. Pragmatic experimentation enables governments that consider a policy in their national interest to cooperate with other member states and promptly learn how it works. Simultaneously, it allows governments that think a measure not in their interest to avoid being forced to join and, even worse, being forced to pay the costs of doing so if the experiment is unsuccessful.

2.2 Title IV of the Treaty on European Union and the Treaty on the Future of the European Union Article VI. Title III contain detailed rules for the use of enhanced co-operation to maintain momentum toward an ever closer Union when unanimity is lacking about what the EU should do. Hence, the practice is sometimes described by the term 'differentiated integration'. The eurozone crisis pushes EU countries into uncharted waters. In conditions of high uncertainty, trial-and-error policies are being adopted in an experimental search for measures that will work. Since eurozone countries fall into three different groups--members; non-members with a commitment to join at some unspecified future date; and countries not expected to join--it is possible that different policies may be suited to each group. By allowing for differentiation, enhanced cooperation increases the number of countries satisfied with their EU obligations.

2.3 Enhanced cooperation can avoid the extremes of Britain vetoing an EU measure favoured by a substantial majority or Britain being compelled to adopt a policy unacceptable to the UK Parliament and citizens. In a 27-country European Union it is unlikely that Britain would be alone in hesitating about being in the vanguard of moves toward closer integration. However, in the absence of leadership from a major country, small states lack the political will and clout to secure major changes in what a predominant majority agrees.

2.4 The convention of the *acquis communautaire* prevents "retro-fitting" enhanced co-operation to established measures. Hence, it is rhetorical overkill to suggest that it would cause the EU to disintegrate. Where uniformity is required, for example, the admission of new member states or basic principles of the single Europe market,

enhanced cooperation is not feasible. However, existing EU policies show that the case for uniformity tends to be exaggerated. Key measures affecting the three pillars of the EU are not uniformly applicable across EU member states, e.g., border controls (Schengen); monetary policy (the euro); and defence (NAT0).

2.5 HMG should promote enhanced cooperation as desirable in principle and invoke it when issues emerge where there are pressures to act but no agreement about what is to be done. Ideally, these issues would include policies where Britain can lead in cooperation, as it did in air support for Libya, as well as those where its distinctive priorities recommend opting out.

2.6 Pragmatic experimentation through enhanced cooperation is not a commitment to a two-speed Europe. The dynamic consequence depends on its success. If an initiative is successful, laggards (that is, those who do not initially join) can catch up with leaders subsequently. This is the process by which the UK entered the European Union two decades after refusing to be a founder member. It also provides a firm institutional foundation for flexible integration, in which the member states that join together can differ from one policy to another. This is the basis on which Britain participates in the chief institution for European defence, NATO, while remaining outside the chief institution for European monetary policy, the ECB.

3.1 Giving European citizens a say through referendums. While the European Parliament has gained in powers vis a vis other EU institutions, its claim to represent EU citizens has fallen as turnout has settled below half the electorate. Moreover, key decisions in the EP are made by multi-national party groups, which research shows are much more in favour of an ever closer Union than are Europe's citizens. Moreover, irreversible decisions on treaties expanding the EU's powers can be agreed in the European Council by national governments representing less than half their country's voters and binding future national governments. This is less than the super-majority normally required to endorse changes in national constitutions; ten member states require referendums on major changes in their national constitution.

3.2 Consistent with the EU principle of subsidiarity, it is open to the government of any EU country to call a referendum on an EU issue. At different times over the years 22 countries have called a national referendum on an EU issue on grounds of political principle, political prudence or for domestic political reasons. The conduct of a referendum campaign focuses attention on whether citizens want to be committed to further integration. Turnout at EU referendums is normally significantly higher than national participation in a European Parliament election. In three-quarters of the cases, the result of a referendum is popular endorsement of an EU measure. Public opinion in every EU member state favours a referendum vote on any new EU treaty

(Annex 1).

3.3 The current practice of referendums on expanding EU powers has major flaws. National referendums have excluded between 72 and 99 percent of EU citizens from voting (Annex 2) and a single EU country can veto the adoption of an important measure supported by a preponderant majority of countries. Because a free and fair referendum vote risks the rejection of an EU agreement, current EU policy is to expand its powers by adopting "treaty-like" agreements through novel procedures. The new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union is a prime example. It confers new powers on the European Commission and European Court of Justice and national governments are expected to get their parliaments to adopt fiscal measures prescribed therein without further reference to their national electorate.

3.4 The UK is now one of three member states with a legal requirement to hold a national referendum on treaties transferring powers to the EU. The Irish court has ruled that the Stability agreement is a Treaty subject to a national ballot. Danish lawyers have been able to finesse referendum requirements. National elections in member states, occurring at the rate of seven a year, present further challenges, as Greece most vividly demonstrates. In addition, the German Federal Court is now prepared to examine cases challenging whether EU measures are consistent with the democratic principles of the German Constitution.

3.5 HMG should call for European citizens to be given a bigger voice on major EU decisions through simultaneously held national referendums. This is a practical means of reducing the EU's democratic deficit and increasing popular commitment to EU measures that national majorities endorse. Moreover, it does not require a new Treaty to be enacted. National governments that decide to hold a referendum need only co-ordinate the date and wording of a ballot. National governments hesitant about doing so would be under pressure to follow where others lead.

3.6 The prospect of a referendum on the transfer of powers to the EU should have a significant influence on discussions in Brussels about whether and how integration should be increased. It should encourage the pro-integration majorities in the Commission and Parliament to pay more attention to securing the commitment of their citizens. It would also remind national governments meeting in the European Council that British concerns with ambitious transfers of power are not a peculiarly insular fixation but one that a significant number of their own citizens may share.

4.1 Linking enhanced cooperation with popular support through referendums. Any treaty approved by all national governments in the European Council is likely to be endorsed by a majority of national referendums. But since all referendums raise the

possibility of defeat, a treaty proposal should include clauses for opting out by countries rejecting a treaty and also clauses allowing countries to join subsequently if a new policy is successful.

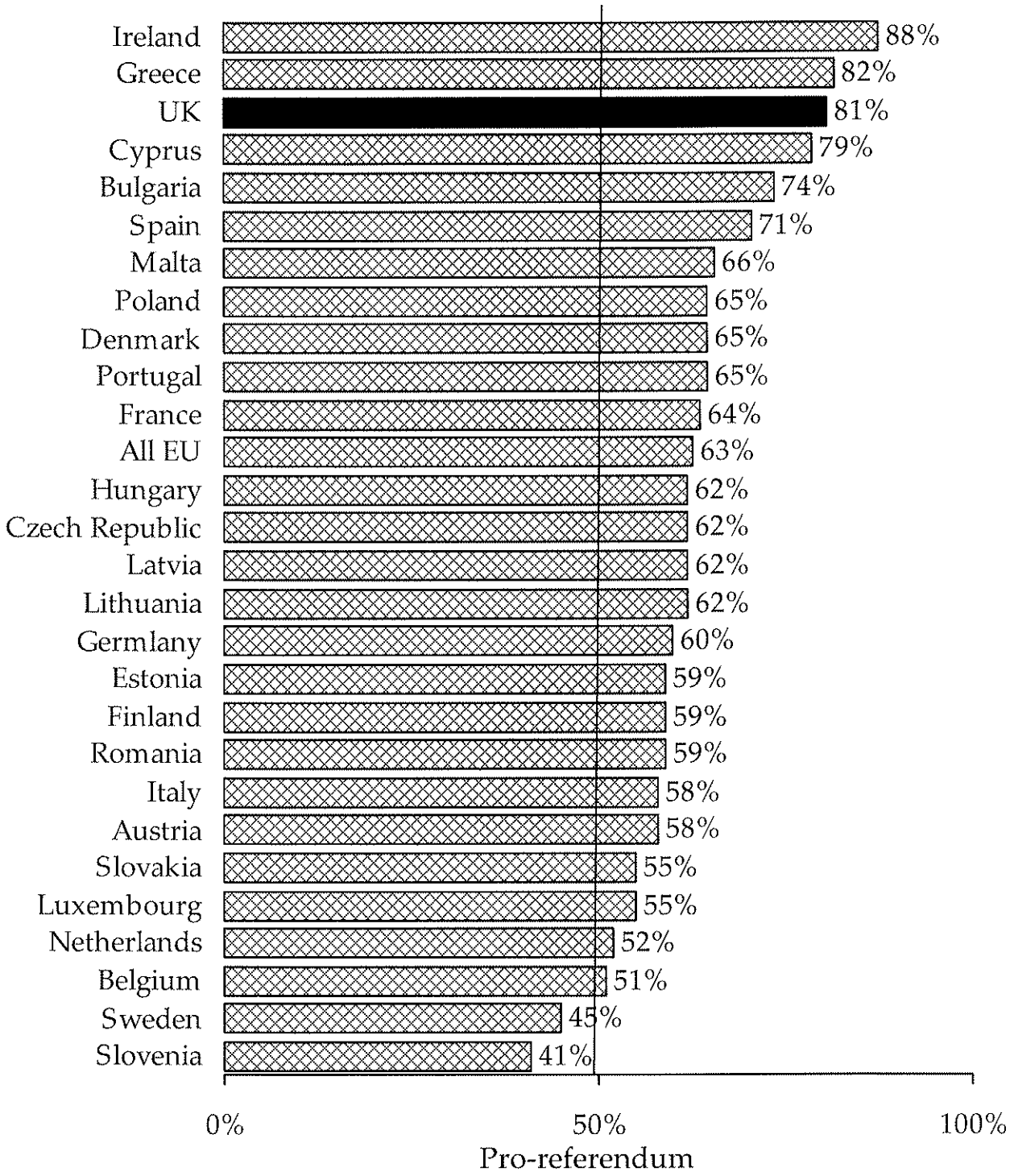
4.2 HMG should have a two-pronged strategy for proposals to expand EU powers. It can seek support to modify proposals to make them acceptable in Britain. If this is not practical, it should emphasis including enhanced cooperation clauses that allow member states to co-operate and allow Britain to opt out. Such a strategy can be justified as consistent with the EU principle of diversity, authorized by the Treaty on European Union. It will also avoid conflict between the UK's 2011 EU Act and commitments that majorities endorse.

22 May 2012

Annex 1 National demand for referendums on EU treaties
Annex 2 Exclusion of Europe's citizens by national referendums

Annex 1. NATIONAL ENDORSEMENT OF EU REFERENDUMS

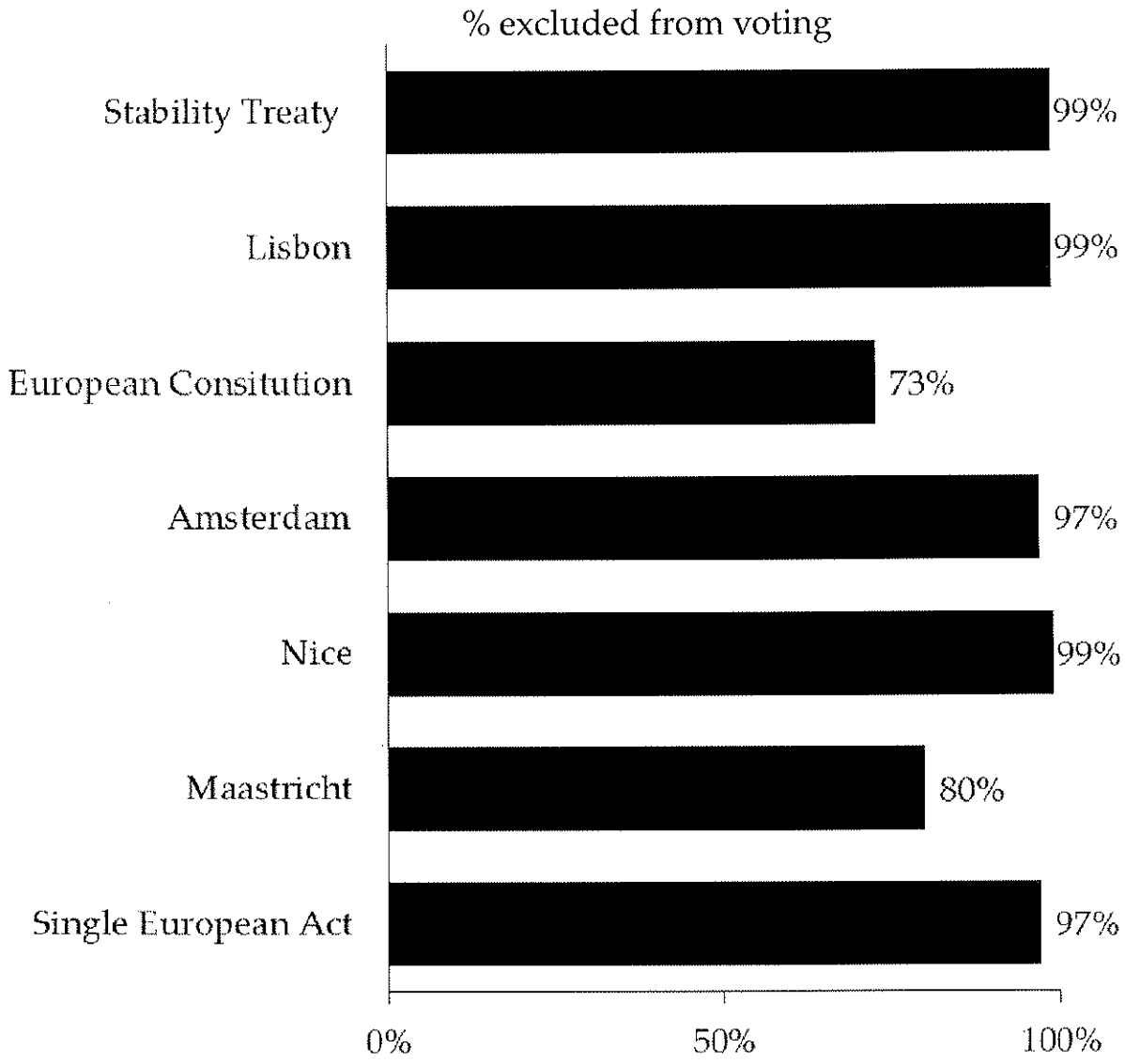
Q. *Do you agree or disagree that EU treaty changes should be decided by referendum?*



Source: European Election Study, 2009. A survey of 27,069 respondents across all EU member states. For details, see www.piredeu.eu.

Annex 2. EXCLUSION OF EUROPE'S CITIZENS BY NATIONAL REFERENDUMS

(Percent of citizens in member states not holding Treaty referendum)



Notes: Stability Treaty and Lisbon: Ireland voted; 26 countries did not. European Constitution: France, Spain, Luxembourg and Netherlands voted, 21 countries did not. Amsterdam: Ireland and Denmark voted, 13 countries did not. Nice: Ireland voted, 14 countries did not. Maastricht: France, Ireland and Denmark voted, 9 countries did not. Single European Act: Denmark and Ireland voted, 10 countries did not.

FEU 24

Written evidence from Professor David Phinnemore, Queen's University Belfast

The Future of the European Union: Forms of Membership

Executive summary

- A UK referendum on the EU is now highly likely and will, irrespective of the wording, most likely be treated as a vote on whether to stay in the EU or not
- Any renegotiation of the terms of UK membership will need to address the individual and collective interests and preferences of all member states and not just those of the United Kingdom
- Any renegotiation could result in a demand from 'full' members that the United Kingdom's institutional representation and role in decision-making be reduced
- Any renegotiation would set precedents for and challenge the EU's approach to enlargement
- The United Kingdom already benefits from a specially tailored form of membership that other member states may be willing to see refined in the context of a further round of wider treaty reform but this refinement may not be sufficient to meet popular and political demands for a renegotiation
- For a range of reasons relating primarily to maintaining the existing balance of rights and obligations of member states and to enlargement the EU is unlikely to agree formalized tiers of membership

Prof. Phinnemore is an expert on the politics of the European Union and specifically its treaties and enlargement. He is Visiting Professor at the College of Europe where he teaches on EU enlargement. He has published widely on successive rounds of EU treaty reform as well as on enlargement and forms of association with the EU. During 2010-11 he was seconded as a Senior Research Analyst to the Foreign and Commonwealth Office during the passage through parliament of the EU Act 2011. He is currently completing a book on the negotiation of the Treaty of Lisbon

1. Whether or not the December 2011 European Council and its outcome can or should be seen as a watershed in the United Kingdom's EU policy and place in the Union is open to question. Current debates on how the United Kingdom should respond to calls for further integration, particularly within the Eurozone, on whether the UK government should seek to alter the terms of its membership, and on whether there should be a referendum on remaining in the EU all predate the eurozone crisis. Rather they are the symptoms of the United Kingdom's uneasy and unenthusiastic participation in a process of European integration which is poorly understood and which successive governments and oppostions have shown a tendency to portray as alien and threatening.

Towards a renegotiation of the United Kingdom's EU membership

2. Although support for the United Kingdom's continued membership is regularly re-affirmed by governments and most political parties, there can be no question that the current inquiry is taking place at a point when the desirability of this membership is being most openly and forcefully questioned among voters, campaigners and politicians. The political saliency of the issue has not been so great since the early 1980s. With public opinion remaining for the most part unenthusiastic about European integration – whether the status quo or further integration – and increasingly inclined to express a view on the United Kingdom's position within the EU,

debate on alternatives appears set to remain a feature of UK politics until such time as a referendum is held and its outcome addressed.

3. The likelihood of a referendum is high and not simply because of the political saliency of the continued membership issues. The EU Act (2011), irrespective of whether it requires or not a referendum for a treaty change, has heightened expectations of a referendum being held. In the current political climate, it is extremely difficult to envisage a future government being able to resist popular and parliamentary calls for a referendum even if it can provide a completely water-tight legal case for ratification of a treaty change being exempted from referendum requirement under the EU Act (2011). Irrespective of the formal focus of the referendum, the vote would be treated by many campaigners and voters as a question of whether the United Kingdom should remain in or alter its relationship with the EU.

4. Many opponents of the United Kingdom's continued membership of the EU advocate withdrawal and the establishment of an alternative relationship, often along the lines of the European Economic Area or the complex, multi-agreement bilateral relationship that Switzerland has with the EU. These are dynamic forms of relations in which the non-member state takes on a substantial proportion of the obligations of EU membership without a formal role in their adoption, an important point often overlooked by supporters of such relations for the United Kingdom.

5. A key feature of the emerging debate is, however, the preference to consider 'renegotiation of membership' as some form of middle way between the status quo and withdrawal.

6. Assuming such a focus is maintained, it raises the question of what alternative forms of EU membership are possible and which would suit UK interests best. However, and importantly, consideration of options cannot be undertaken simply from a UK perspective of what would be desirable. EU membership, it cannot be forgotten, is regulated by unanimous agreement among the member states as contracting parties to the EU's constitutive treaties – the Treaty on European Union and the Treaty on the Functioning of the European Union – and so renegotiation would have to take place with their active consent and potentially be ratified by them.

7. It is not the case that the United Kingdom could dictate the terms of any renegotiated form of membership. The interests of the other member states both individually and collectively would have to be addressed. It is to be expected that the EU's institutions will also seek to influence the substance of any renegotiations with the European Parliament likely to demand a role in the formal approval of any change. As regards the collective interest, any renegotiated form of membership would set precedents for other actual and would-be members as well as the terms of accession governing enlargement. Renegotiation would have implications well beyond the narrow terms of the UK's continued membership.

<u>One membership, but degrees of membership</u>

8. Formally, there is only one form of EU membership: membership. Other forms of membership have been proposed (e.g. affiliate membership) but no treaty provision has ever been drafted to enable them. If a state wishes to become a member of the EU, it has one option: membership. Established practice is that it assumes all existing treaties as well as all other primary and secondary legislation – the *acquis*. Opt-outs are exceedingly rare and highly specific. Moreover,

acceding states are obliged to subscribe to the *acquis politique* of the EU, i.e. its often loosely worded political ambitions, including 'ever closer Union'.[1]

9. In practice, certain forms of contractual relationships have been presented as a form of (e.g. 'associate') membership. Legally speaking, however, these are not a form of membership of the EU, but a form of relationship with the EU. This is irrespective of the fact that the intensity of the contractual commitments in some relationships is so great (e.g. the European Economic Area) that the non-member state assumes many of the obligations and receives many of the benefits of membership and in some cases, notably where Schengen participation is concerned, is actually more of a member than certain member states (e.g. the United Kingdom). However, one important and highly sought benefit of membership that has never been granted to a non-member state has been representation in the EU's institutions and therefore participation in EU decision-making.

10. Although legally there is only one form of EU membership, in practice various degrees of membership exist. On the one hand, not all member states are members of the eurozone. Member states can be divided into three categories: eurozone members – 'ins'; member states that have not yet met the criteria to become part of the eurozone – 'pre-ins'; member states – 'outs' – that have either previously signed up to economic and monetary union and subsequently decided not to join the eurozone (Sweden, Denmark) or have always had an opt out (United Kingdom). On the other hand, not all member states participate fully in Schengen activities or the area of freedom, security and justice: the United Kingdom, Ireland and Denmark have a partial membership of these areas due to various opt-out/opt-in arrangements. Furthermore, the United Kingdom and Poland have a special status vis-à-vis the Charter of Fundamental Rights,[2] and Denmark has a politial opt-out from defence cooperation. And then we have the recently established forms of enhanced cooperation (i.e. on cross-border divorce, an EU patent).

Formalizing tiers of membership

11. Each of these arrangements alters the degree of a state's membership and has been developed following negotiation between the member states. Each – with the exception of the eurozone opt-outs – also remains rather fuzzy, the boundaries shifting as the relevant *acquis* evolves and opt-ins are exercised. None has been formalized through the creation of a particular form of named membership that is made available – explicitly or implicitly – to others, whether current or would-be members. Only at the time that the relevant treaty change was agreed (e.g. Maastricht, Amsterdam, and Lisbon) was the variable degree of membership established.

12. The unscripted emergence of the variable degrees of membership and the fact that they have remained *ad hoc* arrangements reflects a widespread reluctance to formalize tiers of membership. At least five reasons can be advanced:

    - securing agreement on what constitutes a second or third etc. tier of membership would be exceptionally difficult given the integrated nature of the *acquis* and the fact that unanimous agreement among the member states would be required;

[1] It can and should be expected therefore that states acceding to the EU in the future will be expected to commit in principle at least to acceding to the extra-EU Fiscal Compact Treaty even if becoming a signatory is not a pre-requisite for membership. In any case, with the 'six-pack' legislation on economic governance part of the *acquis*, acceding states would be committed to most of the requirements of Fiscal Compact Treaty albeit with the obvious exception of the debt brake.

[2] This is due to be extended to the Czech Republic.

- member states have studiously avoided any situation where they might be classified as a second-class member as with all certainty would be the case if tiers of membership were established;
- formalizing tiers of membership would necessitate a debate on the balance of rights and obligations associated with each tier leading potentially to differentiated levels of institutional representation and decision-making involvement;
- the existence of formalized tiers of membership could, and potentially would, necessitate a fundamental re-working of how the EU enlarges (e.g. regarding which tier should be the basis for negotiation) and oblige the EU to admit applicant states to some form of membership earlier than would normally be the case;
- if certain rights of membership (e.g. relating to institutional representation or decision-making) were clearly associated with only specific obligations being undertaken, a non-member state meeting such obligations under a contractual arrangement with the EU could legitimately claim such rights.

13. While the possibility of EU member states formalizing tiers of membership – whether via political agreement or formal treaty change – cannot be ruled out, precedent suggests there would be little appetite to do so. The default option of the EU and its member states has always been for any deviations from 'full' membership to be negotiated on an *ad hoc* basis and only when absolutely necessary to secure agreement on a wider set of treaty reforms. The preference for flexibility is also reflected in the decision not to specify the minimum content of any agreement governing relations with a member state that decides to leave the EU through the withdrawal clause in Article 50 TEU introduced by the Treaty of Lisbon.

14. Moreover, the question should be asked as to whether other member states actually support the idea of formalized tiers of membership. Past proposals for differentiated forms of integration and of establishing an 'avant garde' of member states have generally attracted little support beyond the most integrationist member states. Most member states have feared relegation to a second or potentially lower tier. Among those member states has been the United Kingdom. There is currently little, if any evidence, to suggest that member states would be receptive to any formalization of tiers. Reaching unanimous agreement among the current 27 member states would be a major challenge.

<u>Obstacles to Renegotiation</u>

15. The history of the European integration has been long been characterised by flexibility with *ad hoc* solutions often being generated to address the particular concerns of individual member states. This helps explain the unique nature of the United Kingdom's formal participation as a member in the EU. Whether there is scope to secure a renogotiation or further refinement of that relationship is unclear. Precedent would suggest that the latter – refinement – may be possible, although media and academic accounts of successive rounds of treaty reforms reveal a persistent frustration with UK demands for exceptions, exemptions and other special treatment. It may be that the United Kingdom has at last exhausted the patience of other member states.

16. If a further refinement of the United Kingdom's EU membership were possible, the question still remains whether the result would satisfy domestic demand for a more substantial renegotiation such that a UK government could win a referendum which in all likelihood would be perceived by many as a vote on whether the United Kingdom should remain in the EU or not.

17. How member states would respond to a UK demand for a more substantial renegotiation is unclear. It is likely that they would baulk at the prospect, not least because membership has

always been – at least for member states – a carefully negotiated balance between rights and obligations in which all member states have had to compromise. If renegotiation were possible, it can be expected that it would only be possible in the context of a wider, possibly major, treaty reform process, during which the United Kingdom would be expected to make concessions to the other member states allowing them to pursue further integration. If so, the United Kingdom's renegotiated – and reduced – form of membership would be accompanied by further integration among the remaining member states thus increasing the gap between 'UK' and 'full' membership.

18. As the gap – which already exists – widens, attention will undoubtedly shift to whether with reduced commitments and obligations the United Kingdom should retain the same level of membership benefits, notably regarding institutional representation and decision-making. The EU would be faced with its own West Lothian question, most obviously within the Council and European Parliament, but also potentially within other institutions (e.g. the Court of Justice) and the EU's advisory bodies, the Economic and Social Committee and the Committee of the Regions. Existing practice means that MEPs are not excluded from debates and decisions relating to areas of EU activity from which the United Kingdom has opted out. In the Council, however, the United Kingdom does not have a vote in such situations.

19. A consideration that will undoubtedly influence the willingness of the other member states to consider a renegotiation is the fact that the result would further expose the inconsistency between the requirement the EU makes of acceding states to accept as a prerequisite of membership the *acquis* in full and the fact that a member state can negotiate down various, possible many of its, obligations while retaining the benefits of membership. The EU will undoubtedly want to avoid accusations of double-standards; it will also want to maintain at least a semblance of consistency in its approach to enlargement and the terms of accession. A UK government will also presumably wish to avoid accusations of double-standards. Could though a UK government, with its strong advocacy of Turkish membership, insist that Turkey only be admitted if it meets the criteria for membership in full when the United Kingdom is seeking to reduce its commitments and exempt itself from elements of the *acquis* which it finds incovenient and undesireable?

22 May 2012

Written evidence from Dr Robin Niblett, Director, Chatham House

Dr Robin Niblett is Director of Chatham House. He also contributes to the institute's work on Europe and UK foreign policy. His recent publications include *The Chatham House-YouGov Survey 2011: British Attitudes Towards the UK's International Priorities* (Chatham House, 2011) and *Playing to its Strengths: Rethinking the UK's Role in a Changing World* (Chatham House, 2010).

Summary of evidence

The December 2011 European Council meeting was a watershed for the UK's relationship with the European Union (EU). It exposed the growing divergence between the UK's approach to its membership of the EU and that of the overwhelming majority of other member states. Britain's position outside the eurozone means that it will have minimal influence over near-term changes to the EU's institutional architecture, which are being organised around the need to stabilise the monetary union and may include building a fiscal union. The risk has grown, therefore, that the UK will be pushed to the margins of European integration and that this will undercut its influence and interests within the EU overall.

The UK has three options. It can take the radical step of withdrawing from full EU membership. It can sit on the sidelines of the EU while other member states focus their energies on saving the single currency. Or it can make the most of its EU membership. Either of the first two options would demonstrate a serious misreading of the UK's national interests at the start of the 21st century. These interests are best served through active UK participation in the EU.

Stepping back or sitting aside from the EU would also reveal a misreading of the process of European integration. Even a fiscally united eurozone will be divided between the more and less competitive, between those who favour a more federal or a more intergovernmental Europe, and between the smaller and the bigger states. Britain will continue to be an important player in this multi-tiered Europe.

Rather than holding the EU at arm's length at this critical juncture, the government should be more proactive than it has been in its approach towards the large realm of EU policy outside European Monetary Union (EMU). For example, it should lay the groundwork for a deepening of the Single Market in the services sector, drive the agenda on collective approaches to energy, trade and climate change, and build more coordinated European foreign policies towards the Middle East and the Asia-Pacific region.

Evidence

The logic of EMU

1. The December 2011 European Council was a watershed for the UK's relationship with the EU. It exposed the growing divergence between the UK's approach to its membership of the EU and that of the overwhelming majority of other EU member states. Since December, the divergence has widened rather than narrowed. Eurozone members and those EU member states that hope to join the single currency area (and even countries such as Sweden and Denmark which currently do not) are working together to create new structures of financial and political integration that they hope will put the euro on a more stable footing for the future.

2. There are some in the UK and beyond who expect the current crisis to be the beginning of the end of the single currency. Others expect it to retreat into a core group of North European countries clustered around (and sharing some of the same competitive advantages as) Germany. These expectations ignore the political thinking on continental Europe that launched the euro and the economic drivers that created a large rather than 'core' eurozone in the first place.

3. The decision in 1992 to create the euro was not driven by economic logic. Principally it reflected the determination of the French government of President François Mitterrand to contain the economic power of a unified Germany. The creation of the euro also reflected Chancellor Kohl's desire to bind a unified Germany irreversibly into an integrated Europe with France and Germany at its core. This fundamental Franco-German political pact at the heart of the eurozone remains intact.

4. With France and Germany locked into a single currency, there was economic logic (as well as political pressure) to launch the euro with a larger rather than smaller number of members. If Italy had remained outside the euro, German companies would have faced stiff competition in their domestic market and internationally from companies based in Italy's dynamic north pricing their goods in cheap lira. If Spain had remained outside the euro, German companies would have been tempted to shift more of their production to its relatively cheaper labour market. In either case, prospects for German domestic growth and job creation would have been affected. This economic dynamic remains in place today; as such, Germany and other northern states have a powerful economic incentive to keep the eurozone together.

5. Most eurozone members also see membership of the single currency as part of their defence against the growing might of China and other emerging economies, as well as a counterbalance to the economic power of the United States. Despite the current turmoil, being inside the euro offers EU members greater long-term stability in terms of interest rates, inflation and exchanges and some prospects for solidarity (in terms of the role of the European Central Bank and other mechanisms of intra-eurozone financial support). Carrying out painful structural reforms to their welfare systems is likely to be easier inside the eurozone than if each country had to manage its own currency. This is a principal reason why other EU members are still queuing to join the euro.

6. Certainly, there is a growing risk that Greece will leave the euro. The contagion effects of such an event could force out vulnerable countries such as Portugal or even Spain. But the pressures and incentives to avoid this outcome are enormous. Even if it happens, the impetus to sustain the euro in some form, covering as many EU members as possible, would be powerful. If it did have to be re-fashioned, it would likely be with the political dimensions of a fiscal union debated and approved from the outset.

The UK and the single currency – divided we stand

7. Given its geography and its history, the UK has never shared the same political commitment to European integration as other European countries. This means that not only the British public, but also the two major political parties have viewed the single currency with considerable scepticism. No UK government, either at the time of its launch or since, has been a strong and consistent advocate of membership, doubting the economic benefits and fearing the domestic political consequences.

8. The divide between British and continental European perspectives concerning the relative merits and risks of joining the single currency has not abated. Today, with the euro crisis in full flow and with British public opinion as eurosceptic as ever, there are no prospects of the UK joining the euro at any point in the near- to medium-term (indeed, remaining outside the eurozone is even written into the 'Coalition Agreement'). There is also little prospect that the UK will join the fiscal compact any time soon, as other non-euro and 'pre-in' governments have chosen to do.

9. For their part, eurozone members have drawn the opposite lesson from the crisis. They now recognise the insufficiency of the political mechanisms in place to manage the single currency during periods of stress. They have committed, therefore, to deepen their fiscal coordination and have embedded national commitments to fiscal discipline in a treaty that requires a dilution of legislative sovereignty and a commensurate increase in the power of EU institutions.

10. The UK must recognize that, absent a sudden implosion of the entire single currency, building this fiscal union and resolving the euro crisis in a sustainable manner will be the overriding objective of most EU member states for the next few years.

11. The UK will be on the margins of this process, and its absence could affect its political relations with other EU member states. The attitudes of the Netherlands and of Poland are a case in point. Both countries have traditionally been close bilateral allies of the UK within the EU: the former as one of the main advocates of an open EU Single Market, like the UK; and the latter as a sovereignty-minded late-comer to EU integration with strong Atlanticist instincts, also like the UK. Today, however, the governments of both countries have thrown in their hand with the logic of deeper European integration. And their officials are deprecating in private about the UK's stance.

12. It is true that deeper political integration within the eurozone should not imply material changes to the overall EU *acquis*, whether in the management of the Single Market or negotiation of the budget, nor in more intergovernmental areas such as EU enlargement or foreign policy. And, while the UK may end up as the only EU member state outside the fiscal compact (or one of a very few), it has been in this sort of position before (as the only EU member state not to adopt the 'Social Chapter' initially) while remaining a full participant in other areas of EU competence.

13. On the other hand, close and regular cooperation between EU members on an issue as fundamental as fiscal policy will change the dynamics of EU integration and the UK's place in Europe in ways that are hard to predict. There is a risk that 'package deals' of demands and concessions among euro members over issues that begin in the fiscal realm will then spread into other aspects of EU policy-making. This was partly the concern of the UK government in the lead-up to the December 2011 summit; the fear was that new regulations governing EU financial services – a Single Market issue in which the UK has a full vote – might be driven by concerns over the stability of the euro rather than by the need to sustain market openness and stability.

Options for the UK

14. Faced with a structural transformation of the EU in which it does not want to share, the UK has three options. It can take the radical step of withdrawing from full membership of what looks likely to be an even closer Union. It can sit on the sidelines while other EU member states focus their energies on saving the single currency. Or it can make the most of its EU membership. I argue in this evidence for the third option.

15. The first option, **reconsidering full EU membership,** presupposes that UK leverage within the EU will inevitably decline as the euro crisis deepens. By this logic, the UK might as well get out before it is pushed into a second tier of membership from which it is increasingly difficult to shape an EU that best fits UK interests. Is this likely to be the case?

16. On the contrary, there is every possibility that an integrating eurozone will contain the same tensions and inconsistencies that the EU as a whole has carried since its inception: between big and small states; between those that favour a more federal future and those that want to preserve as much national sovereignty as possible; between those that are already competitive and those that are struggling to become so; and between those who foresee the eurozone becoming a genuine transfer union and those, such as Germany, which currently remain committed more to the principle of 'collective responsibility rather than solidarity'.[1]

17. These cleavages within the eurozone mean that the UK will continue to find receptive partners to promote a range of its EU priorities, whether in the Single Market, on the budget, on energy policy, or on priorities for EU foreign and security policy. In

[1] Philip Whyte, 'Governance reforms have left the euro's flawed structure intact', Centre for European Reform, 18 April 2012, http://centreforeuropeanreform.blogspot.co.uk/2012/04/governance-reforms-have-left-euros.html.

contrast, stepping out of the EU but remaining inside the European Economic Area would turn the UK into a consumer rather than a co-designer of the Single Market and into an observer rather than a leader of its more intergovernmental policies.

18. The second option, **sitting on the side lines**, fails to recognise the enormous value that the UK gains from its membership of the EU and the importance of the UK's voice in shaping the future evolution of the Union in ways that reflect the best of British ideas as well as national interests.

19. The UK's membership of the EU already gives it (almost) barrier-free access to a single market of 500 million of the world's wealthiest consumers; estimates suggest that trade between EU countries is twice as high as it would be without the Single Market. It is a key reason that the UK continues to attract some of the largest inflows of foreign direct investment (FDI) and sends the lion's share of its own FDI into the EU. Government estimates suggest that 3.5 million jobs in the UK are linked to exports to the EU, and the income gains for UK households from the Single Market are in the region of £1,100–£3,300 per year.[2]

20. Even if the UK adjusts its patterns of trade to take better advantage of emerging markets, Europe is likely to remain by far its dominant market. At the end of 2011, eight of the UK's top ten trading partners were in the European Economic Area.[3] And, if the UK were to double its exports to China, these would still only match the volume the UK currently exports to the Republic of Ireland.[4]

21. In addition, at a broader political and geopolitical level, the UK's attachment to Europe is likely to increase rather than decline in the coming years. As a medium-sized power in a world of increasingly large players, and at a time when the United States is spending more of its time and energy in Asia, being part of a unified European market and of a coordinated diplomatic entity enhances rather than diminishes UK international influence. This applies as much to negotiations with third parties over UK trade interests, energy security and climate policy as it does over preventing nuclear proliferation or the spread of instability in the Middle East.

22. The third option, **making the most of its EU membership**, represents the best choice for the UK, in light of both the compelling economic case and the strategic realities inside and outside the EU.

23. Moreover, as a major player in a multi-tiered Europe, the UK government has every opportunity to build alliances with other EU members and within EU institutions on

[2] These figures are taken from the Department for Business, Innovation and Skills. For more information, see Department for Business, Innovation and Skills, *The UK and the Single Market*, 2011, http://www.bis.gov.uk/assets/biscore/international-trade-investment-and-development/docs/u/11-719-uk-and-single-market, p. 3. According to BIS, in 2008, 49% of total inward FDI originated from EU member states.
[3] Office for National Statistics, 'Trade in goods – one month geographical analysis', 9 February 2012, http://www.ons.gov.uk/ons/rel/uktrade/uk-trade/december-2011/stb-uk-trade-december-2011.html#tab-Trade-in-goods---one-month-geographical-analysis--seasonally-adjusted-.
[4] *The Guardian*, 'UK export and import in 2011: top products and trading partners', 10 January 2012, http://www.guardian.co.uk/news/datablog/2010/feb/24/uk-trade-exports-imports#.

EU policies that do not form part of eurozone competence, but that continue to be of direct interest to the UK. These include:

- Liberalising further the Single Market by opening up the EU market in services, a key element of a European 'growth strategy' that is supported both by northern EU governments such as the Netherlands and Denmark and southern governments in Italy, Spain and Portugal. A 2005 study examining the economic gains for the EU of integrating services into the Single Market, undertaken by the Dutch Planning Bureau, suggested this could yield growth benefits of 0.6–1.5% of GDP;[5]
- Energy policy, where the European Commission's emphasis on building a more inter-connected and open energy market plays directly to UK strategic and economic interests;
- Re-designing the EU budget, where Germany shares many of the UK's interests in re-balancing funds towards new drivers of economic growth;
- International climate negotiations, where UK and EU leadership and leverage were instrumental in the breakthroughs made at the Durban summit in November 2011;
- Trade policy, where the UK, EU Commission and a number of member states see the completion of new free trade agreements or economic partnership agreements as critical to the much-needed European growth strategy;
- Designing and conducting more coherent EU foreign and security policies in targeted areas where the common interests of all EU member states are clear, such as the sanctions regimes against Damascus and Tehran or joint operations to combat piracy off the Horn of Africa.

Conclusion

24. The UK's national interests are best served by active participation in the European Union. But, given eurozone members' rush to build a fiscal union, the government will need to be more proactive than it has been in the past in its approach towards EU policy. It cannot afford to hold the EU at arm's length.

25. In order to overcome the growing suspicions of their EU counterparts about UK objectives and motivations, the Prime Minister and his senior ministers will also need to engage consistently, not spasmodically, in EU policy debates.

26. And they will need to work as collaboratively as possible with EU institutions such as the European Commission, the increasingly powerful European Parliament and the European External Action Service, rather than treating them instinctively as obstacles to progress or threats to national sovereignty.

[5] See European Commission, 'Economic Benefits of the Services Directive', 20 May 2009, http://ec.europa.eu/internal_market/services/docs/services-dir/explanatory/economic_benefits_en.pdf. The case for expanding the Single Market was made by Prime Minister David Cameron and other EU leaders in two letters to Herman Van Rompuy and José Manuel Barroso in February and March 2012, http://www.number10.gov.uk/news/joint-letter-to-president-van-rompuy-and-president-barroso/; http://www.number10.gov.uk/news/letter-to-european-council-on-european-growth/.

27. The euro crisis will change the EU. The UK's psychological detachment from the process of deepening European integration will be more apparent than before. But the contributions that it can offer and the benefits that it can obtain from active EU membership will continue to make the EU one of the cornerstones of Britain's place in the world.

24 May 2012

FEU 26

Written evidence from Brendan Donnelly, Director, Federal Trust

1. This submission addresses all the four questions posed by the Committee in its call for evidence. In summary, I argue that as a result of decisions by successive British governments the United Kingdom is likely to be for the foreseeable future a spectator rather than a shaper of the most important developments in the European Union. The events of the European Council in December 2011 were in my view a clear illustration of this reality.

2. I am the Director of the Federal Trust, a research institute concerned with subnational and supranational political structures. From 1994 to 1999 I was a Conservative Member of the European Parliament. My submission is offered in a personal capacity.

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

1. At one level, the European Council of December 2011 can be regarded as a simple failure of British negotiating tactics. The British position was not that of refusing to join the proposed Fiscal Compact act as a matter of principle, but rather of being willing to do so if certain changes were made in the Union's decision-making procedures in order to "renationalize" the regulation of financial services. The European Council's consideration of this proposal had not been well prepared, nor was it well conducted during the meeting of the Council by the British side. With better preparation and presentation, it might have been possible to secure a more sympathetic consideration or at least a less brusque rejection of this British proposal.

2. Beyond the immediate issue of questionable negotiating tactics, however, the events of December2011 mark the unsurprising culmination of a series of events and decisions by successive British governments which have weakened British influence and standing within the European Union. The continuing refusal to join the euro; the continuing refusal to participate in passport-free travel in the Schengen area; the passage of the EU Bill in 2011; the commitment of the Coalition government to stand aside from any further European sovereignty-pooling over the five years of its existence; and finally the perceived attempt of Prime Minister David Cameron to unpick in December 2011 central elements of the European single market—all these steps have cumulatively led Britain's partners in the European Union to the conclusion that the political trajectory of the United Kingdom within the European Union is likely over the coming years to be at best one of semi-detachment and at worst eventual total withdrawal. This has fundamentally changed the political "terms of trade" between the United Kingdom and the rest of the Union. Britain's partners in the Union emphatically do not think today that the British government believes "we are all in this together."

3. It would have been surprising indeed if this growing perception on the part of Britain's partners had not led eventually to a diminution of British negotiating capacity within the Union. The enormous fund of good will towards the United Kingdom from its European

partners and clever diplomacy by British officials and ministers have to some extent postponed this day of reckoning. But the increasing centrality of the Eurozone and its structures to the future evolution of the European Union has inevitably hastened the process of British marginalization. The Coalition agreement stipulates that during its five years of office the United Kingdom will not join or make any preparations to join the euro. The larger party of government has as its established policy not to join the euro in any circumstances. Against this background, the British government cannot reasonably expect to play any significant role in the European Union's current defining debates, those about the future of the Eurozone and about the implications of that future for the wider structures of the Union. There will no doubt continue to be some areas of the European Union's activities where the United Kingdom will be able to make a constructive contribution. But the crucial question of the euro is not one of them. That fact has the profoundest consequences for Britain's position within the European Union.

Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

4. Over recent months, the British government has found itself in the unexpected position of urging upon its partners in the Eurozone a quicker and deeper process of integration than some of them might wish. Britain's position outside the Eurozone deprives these calls of political authority or significance. The fact that they are being made highlights however the uncomfortable alternatives with which a United Kingdom semi-detached from the European Union finds itself confronted. The success or failure of the Eurozone is a matter of central economic importance to the United Kingdom, not least in view of the British economy's current fragility. There is a more than plausible case to be made for arguing that the success of the Eurozone can only be achieved by greater political and economic integration among its members. Yet when the current British government calls upon its neighbours to pursue more vigorously such integration, it is spectacularly reversing centuries of British foreign and European policy, central to which was the avoidance of united European structures potentially hostile to the United Kingdom. While a more deeply integrated Eurozone will no doubt be a more positive factor for the British economy than one which has disintegrated, its successful integration may well pose in the medium term a new set of political and economic problems for the United Kingdom. There could be no guarantee, or even likelihood that the approach of this integrated Eurozone to such questions as macro-economic policy, financial regulation, trade and competition would always be congenial to the United Kingdom.

5. Ironically, its very semi-detachment within the European Union dispenses the present British government from needing to form any very precise view of the appropriate future structures for the Eurozone and of the European Union in general. Unless the single European currency ceases to exist, or its membership is radically reduced, decisions on these matters will overwhelmingly be taken by others, and it will be up to Britain to make what it sees as being the best of the situation with which it is confronted. In the chaos that would follow the collapse of the single currency, Britain's voice might (but not necessarily) be a determining one in the reconstruction of European co-operative and integrative structures. Otherwise, its role will predominantly be that of a spectator. Even on the question of how many other countries from within the Union will wish to share Britain's role as spectator, and to what extent, the British capacity to shape events should not be over-estimated. Before the European Council of last December, there were well-publicized calls in this country for the United Kingdom to play a role of leadership for the member states of the Union not in the

Eurozone. The outcome of the European Council clearly suggests that these calls are unrealistic.

What is the relationship between the new 'fiscal compact' Treaty and the EU's *acquis*? What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy?

6. The "Fiscal Compact" is unlikely of itself to compromise the present *acquis* of the European Union. On the other hand, the Compact is unlikely to be the final building-block of the greater economic, fiscal and political integration emerging from the present difficulties of the Eurozone. If this integration continues on its present path, the current *acquis* of the Union will inevitably come to form an ever smaller proportion of the Union's legal instruments and structures. The members of the integrated Eurozone will be well placed to shape the new elements of the *acquis* and in some instances to revise the existing *acquis*, according to the Union's established decision-making procedures. Fear of this latter prospect may well have weighed with Mr. Cameron in his abortive attempt to change some of the Union's decision-making procedures at the European Council last December.

7. The Fiscal Compact is equally unlikely to affect directly the three mentioned policy areas of the European budget, enlargement and the Common Foreign and Security Policy. The Eurozone countries are clearly unwilling to use the European budget as a major instrument of macro-economic or fiscal adjustment; if they had wished to do so, that would inevitably have created controversy with member states outside the Eurozone. The terms of the debate surrounding the continuation of the British rebate/abatement in the next Financial Perspective for the European budget are long familiar to all involved. The Fiscal Compact will neither exacerbate nor mitigate this probable confrontation. The debate about the further enlargement of the Union in general and specific candidate countries in particular is already a complex one, and the Fiscal Compact will not simplify it. The Common Foreign and Security Policy is a predominantly intergovernmental arrangement with its own specific decision-making procedures, in which Britain plays and is likely to continue to play a significant role. If the countries of the Eurozone were willing to adopt between themselves decision-making procedures for their contribution to the Common Foreign and Security Policy more akin to those of the Union's other policy areas, then that would of itself be a radical innovation. No such change however seems in immediate prospect.

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

8. Paragraph 6 above sketched out the possible implications of the increasing integration of the Eurozone for the evolution of the Union's *acquis*. These implications are not greatly affected by whether the Fiscal Compact is incorporated into the EU Treaties or not. If a future British government were able to secure some "renationalization" of decision-making in return for accepting the Compact's incorporation into the Treaties, then it might regard itself as having achieved some desirable measure of "protection" against future developments of the *acquis* driven primarily by the member states of the Eurozone. To judge from the events of December 2012, it seems unlikely that any such *quid pro quo* would be on offer. It would of course be open to a future British government to acquiesce in incorporation of the Pact into the European Treaties as a simple gesture of goodwill to its partners, which will avoid legal

complications for them and make no objective difference to the United Kingdom. Whether it will wish or be politically able to make this gesture cannot be predicted today.

Final Comment

9. The Committee's Chairman, Mr Ottaway, remarked in connection with the proposed report that he was "starting from the assumption that the UK should and will remain an EU Member." A recurrent theme of this submission is that Britain's present capacity to influence the Union's decision-making is small and likely to become smaller. When Britain joined the European Community in 1973, a central reason why it did so was in order to influence European decisions that, for better or worse, would crucially affect British interests. Policies pursued by successive British governments which put that influence at risk cannot but undermine the political rationale for British membership of the European Union.

28 May 2012

FEU 27

Written evidence from the European Movement

Summary

1. This submission argues that the European Union represents the best way for European countries to cooperate on matters of mutual interest whilst respecting the political rights of their citizens. The increasing trend towards opt-outs and integration at different levels is a reflection of the different state of public opinion in different parts of Europe, but nevertheless there are some core principles which must be observed by all EU member states. The several opt-outs that apply to the UK will not necessarily deprive it of influence in Europe's future direction, as long as the government acts positively towards the rest of the EU. This is not obviously the position of the government at present.

About the European Movement

2. The European Movement is a independent, not-for-profit and all party organisation that calls for closer integration at the EU level, with more powers for the democratically elected institutions of the EU and more popular involvement in its intergovernmental decision-making structures. It was founded in 1948 by Sir Winston Churchill, and its president is Rt Hon Charles Kennedy MP.

Introduction

3. The case for the European Union is made stronger by the recent developments in the eurozone and around the world. That individual countries are no longer able to safeguard their own interests acting independently becomes clearer and clearer every day. To enable European countries to take care of their own interests and those of their citizens is the purpose of the European Union. This is true when considering the current economic crisis, the developing social and environmental challenges, or the growing change in the global balance of power.

4. We recognise that, for the time being, public opinion in some countries means that not every country can take part in every aspect of European integration. We regret the fact that public opinion feels this way, but the fact that the EU is a union of consent means that this must be respected.

5. It is therefore necessary to design the future European Union taking into account these variations in public opinion in different member states. This is a process that started in fact in the Maastricht Treaty with the opt-outs for the UK and Denmark from the euro, and has acquired many new dimensions since then. The notion of a *finalité politique* that was perhaps in the minds of some of the founders of the EU has been replaced by a more varied picture. Public opinion can change, meaning that the opt-outs that were once necessary might someday be relinquished, so the picture we paint here is not necessarily permanent. However, it may be said to be more than strictly temporary.

Core principles of the European Union

6. The design of the European Union under this approach, recognising opt-outs, must also specify those aspects of EU membership from which no opt-out may be permitted in order to ensure that the EU is not hollowed out into nothingness. There are some core principles to which all EU members must subscribe, and we list them here:

6.1 The rule of law – decisions taken through the European institutions must have the force of law, which citizens can see enforced through the courts, and not be merely political declarations to be made or dropped for political convenience. Both market credibility and public trust must be earned and cannot simply be taken for granted.

6.2 The supremacy of EU law over national law in those areas specified in the treaties – this is a long-standing principle of the EU that ensures that its decisions have meaning and that the member states can rely on each other to keep to the commitments they have made.

6.3 The role of the European Parliament and the Council of Ministers as the two chambers of the legislature – the directly elected European Parliament performs a vital role in representing the interests of the citizens in the European decision-making process, and the Council represents the interests of the member states. Both are important; neither should have supremacy over the other.

6.4 The role of the European Commission as the executive of the EU – there must be a part of the institutional system that represents the common European interest rather than the interests of any particular member state. Among other things, this is a protection for those member states not participating in any particular European initiative.

6.5 Transparency – the EU institutions may have been created as a diplomatic initiative but are now better understood as an expression of democracy. The standards of openness and transparency observed by the institutions should reflect their democratic role rather than their origins in diplomacy and international relations.

6.6 Minimal use of the veto power – it is for the time being unrealistic to propose that the veto power should be relinquished by the member states altogether, but its use should be absolutely a last resort. The threat of the veto creates uncertainty and discontinuity in policy – one country's "red line" is another country's "unreasonable veto" – which qualified majority voting does not. The academic literature shows that QMV encourages member states to join successful coalitions rather than to hold out in lonely opposition.

6.7 Subsidiarity – the idea that there should be no more centralisation than necessary and as much decentralisation as possible is another foundation of the European idea. Changes in technology and markets will lead to a reassessment from time to time of what is the appropriate level for each policy, or for different aspects of the implementation of each policy. Debate between the member states and the European institutions over the appropriate level is an expression of the success of this policy and not its failure.

6.8 Contributions to the EU budget – to be able to act effectively, the EU needs reliable and sufficient financial resources. The original vision that the EU should be financed wholly from own resources has been lost in a complex web of political compromises between the member states, made up of rebates, exceptions and correction mechanisms. It is imperative we replace this opaque system with something that resembles what the treaty originally intended, to function in a more transparent, simpler and above all fairer way. A more direct form of EU funding would signal an end to the clientelistic relationship between the union and its member states and at the same time strengthen the direct connection with citizens, by making clearer how much the EU costs and how it is being paid for.

Core powers of the European Union

7. Those principles of decision-making must apply to a minimum core set of powers, including:

7.1 The single market, with its implications for issues such as environment, social policy and international trade

7.2 The fight against international terrorism and cross-border crime

7.3 Human rights

7.4 Foreign policy, to the extent that EU member states have foreign policy interests in common

8. Opt-outs currently exist inter alia from the euro (the UK, Denmark and Sweden), defence cooperation (Denmark), Schengen (the UK and Ireland), the European patent (Italy and Spain), the euro-plus pact (Hungary, Czech Republic, Sweden and the UK). These and future opt-outs have to be reconciled with the organising principles of the EU (paragraph 6) and the essential powers of the EU (paragraph 7).

Britain and the EU

9. Britain belongs in the European Union. The principles outlined in paragraph 6 above are entirely consistent with the view of EU and of democratic politics as understood in Britain over many years. They imply that the EU is effective in the policy areas granted to it by the treaties but not beyond those areas. They grant citizens legal rights within the political process, in a way that no other international organisation can do.

10. That Britain is currently not a member of the euro nor of the Schengen area is a matter of regret. Nor was the UK an active participant in drafting the fiscal compact treaty. However, these exclusions do not have to imply a termination of British participation in the European Union.

11. There is still plenty of opportunity for a positive attitude on the part of the British government to exert a positive influence on the European Union, even given the exclusions mentioned above. However, that influence has got to be earned and cannot simply be assumed. The European Movement remains concerned that the current

government is not doing nearly enough to earn that influence in the EU, a trend which if taken to its logical conclusion would render redundant the speculation by this and other parliamentary committees about the future of the European Union. It is necessary to act before it is too late.

28 May 2012

Written evidence from Maurice Fraser, Senior Fellow in European Politics, London School of Economics and Political Science and Associate Fellow (Europe), Chatham House

Biographical note

Maurice Fraser was Special Adviser to three UK Foreign Secretaries, 1989-95: Sir Geoffrey Howe, John Major and Douglas Hurd. He is Director of the LSE-Sciences Po European Double Master's Degree programme and Director of the LSE European Public Lectures Series. He is a trustee and council member of several European think tanks and policy networks and is a regular commentator on European affairs in the international news media. He has recently conducted master classes on French politics for Whitehall departments and the BBC. He was made *Chevalier de la Legion d' honneur* in 2008.

Key propositions

1. The EU needs an institutional framework which enables it to improve the quality of its outputs and genuinely to add value.

2. The UK's national interest remains in the promotion of a unitary model of European integration, with a complementary rather than an alternative role for 'variable geometry'.

3. The UK has an interest in a strong European Commission that upholds the interests of the Union as a whole.

4. Whilst the assumption continues to take hold that monetary union requires fiscal union if it is to be sustainable, the appetite for far-reaching economic union in the eurozone is at present limited. The UK's role should be to inject clarity and realism into such a discussion, in the interests of the EU as a whole.

5. Those who argue for political union to underpin economic union have yet to demonstrate how their proposed solutions would command legitimacy.

6. Institutional reform and public consent need to be pursued in tandem and not left entirely to *post facto* legitimation in the form of parliamentary ratification or a referendum.

7. The momentum behind EU enlargement has faltered, potentially irreversibly. Real effort will be needed just to keep the option on the table.

Argument

1. The EU needs an institutional framework which enables it to improve the quality of its outputs and genuinely to add value.

This should be obvious but urgently needs restating. For all the soaring rhetoric of European construction, the fact is that the founding rationale of the EEC/EU was a practical and unsentimental one: it was to be an instrument for addressing collective action problems in those areas where solutions were beyond the reach of nation states acting on their own - principally cross-border issues

such as the movement of people, goods, services and capital, but also those areas where collective action can yield significant economies of scale. On the whole there were few arguments about such public goods: the customs union, the common commercial policy, the competition policy and, later, the single market were win-win projects. To be sure, they produced negative externalities which required regulation. But the only losers were inefficient producers who had grown used to national protection.

This mission for the European Union is one which successive UK governments have sought to promote, with the accent on ' outputs' and 'deliverables' – the goods which make a real difference to the lives of Europe's citizens. Far from being a minimalist 'anglo-saxon' idea of Europe (mistakenly characterised as a glorified free trade area by some of Europe's political and intellectual elites), this instrumental conception of the EU generates a rather long list of strategies requiring close cooperation, some best pursued intergovernmentally, others lending themselves to the Community Method. The list includes not only the dismantling of trade barriers but concerted action for dealing with cross-border crime, terrorism, migration flows, energy security, pollution and climate change.

This mission for the EU finds its legitimacy in the effectiveness of its *outputs*. But there are other lenses through which we look at the EU, and some of these are more problematic. One such lens is that of *values*, because the EU is a community not only of law but of values such as freedom (in the form of civil liberties) and democracy, originally enshrined not in the EEC/EU but in the Council of Europe – specifically in the European Convention on European Rights, though such rights now form part of the *acquis communautaire.* As with the original economic goods, these too were not zero-sum games: everybody could enjoy them. They are at the heart of Europe's identity and are a key element of its attractiveness to others – its 'soft power'. But, as a rationale for the EU's institutional architecture, the 'values vision' is deeply problematic, because, in its relentless attempts to lever up standards to a level which (to the minds of some at least) adequately expresses what it means to be a European, it falls foul of the decentralising principle of subsidiarity.

This has been most apparent under the heading of 'Social Europe' and the recent concept of socio-economic rights. The UK's objection to the Working Hours Directive is an example, as are some recent controversial rulings of the European Court of Human Rights. At best the ' values' rationale of the EU is a distraction (no EU member state sends its young boys up chimneys); at worst, it takes the EU into unnecessarily contentious territory, alienating public opinion in some member states.

This is why the UK should press the case for an institutional architecture for the EU which enables it to realise its *instrumental* mission, concentrating on those (mostly cross-border) challenges of the 21st century which are evidently beyond the reach of nation states acting alone.

2. The UK's national interest remains in the promotion of a unitary model of European integration, with a complementary rather than an alternative role for 'variable geometry'.

Successive British arguments have put the case for both unitary and flexible models simultaneously (and somewhat uneasily). While the flexible, decentralised and non-coercive character of variable geometry most closely reflects traditional UK concerns about sovereignty, concerns about marginalisation, loss of influence or potential vulnerability to caucusing by other member states has often impelled British governments to caution against fragmentation and the idea of a 'hard core' Europe.

From a UK perspective, the most prudent course is to insist on the integrity of the *acquis* and the primacy of EU obligations over other political or legal instruments amongst Europeans, on the basis that the liberal economic character of the *acquis*, and the level playing-field it provides, serves the

UK's interests well. The demonstrable utility and moral capital which the EU has built over more than half a century should help ensure that Britain will find many allies for this argument. What is more, the unitary model has proven its ability to accommodate multiple forms of integration (Schengen, EMU, CFSP, aspects of JHA) outside its 'core' competences and indeed has formalised arrangements for pioneer groups through the 'enhanced cooperation' provisions of the Treaties. The UK needs to take care, however, to give convincing reasons when it calls for the exclusion of new areas of integration (such as those defined in the Fiscal Compact) from the EU treaties, and to learn better how to use the communautaire language of solidarity in the service of its national interests.

3. The UK has an interest in a strong European Commission that upholds the interests of the Union as a whole.

Even before the economic crisis, it had become apparent that the power and influence of the European Commission had been waning. From a UK perspective as well as a European one, this is regrettable.

First, the Commission has responsibility for ensuring that the writ of EU law runs through the EU. (It was precisely to bolster the rule of law that the UK successfully proposed at Maastricht the power for the ECJ to impose fines.)

Second, the Commission has responsibility for safeguarding the interests of all the EU27. In any new institutional architecture for the EU, it will continue to perform this role, thereby helping to ensure that the UK's keen interest in, for example, the single market and an effective competition policy, are safeguarded.

Third, the Commission has been a powerful force and ally for economic liberalism, structural reform and free trade. This is not widely understood by the British public; in the printed media at least, memories of the Delors Commission's activist approach to social legislation die hard. But that chapter is closed and is likely to remain so, barring a seismic shift to the left in the Commission's complexion over the next few years, which is improbable.

After a short-lived and unhappy flirtation in the early 2000s with a UK- France-Germany *directoire* - no longer an option in an EU of 27 - the UK is now in a better position to understand, following its self-exclusion from the Fiscal Compact and the fears about marginalisation which this has raised, the need for allies in upholding the interests of the 27 and the integrity of an *acquis* which is broadly liberal in complexion.

4. Whilst the assumption continues to take hold that monetary union requires fiscal union if it is to be sustainable, the appetite for far-reaching economic union in the eurozone is at present limited. The UK's role should be to inject clarity and realism into such a discussion, in the interests of the EU as a whole.

Among many supporters of the 'European project', and indeed numerous 'neutral' commentators, it has become a commonplace that, beyond the present eurozone crisis, a new system of economic governance going beyond the Fiscal Compact requirement of balanced national budgets, tight surveillance and automatic sanctions for excessive deficits, will be required. At present, however, against the background of painful fiscal retrenchment across the EU member states, there is little support for more ambitious ideas such as fiscal federalism in the form of a new dedicated budget for economic transfers, or for the mutualisation of existing debt in the form of Eurobonds (though the limited use of such bonds for new debt may yet prove acceptable to Germany).

We are still in an EU of nation states and, for as long as this remains the case, it would seem unlikely that the member states would fail to draw from the eurozone crisis the obvious conclusion that countries should in future avoid moral hazard and take full responsibility for their own economic management. As for the more radical ideas for European economic governance intermittently advanced by France (such as harmonisation of company taxes or of labour market regulations), these have attracted little support across eurozone members, given their potential to undermine the comparative advantage of many member states. Nor, crucially, are such ideas likely to be acceptable to Germany.

The UK's role – from its position as a non-member of the eurozone but a significant economic and financial actor – should not only be to urge clarity in the Europe-wide debate about further economic integration but also to caution against a rush to political union which is not, of itself, required by the degree of economic integration which seems likely, in light of the limited provisions of the Fiscal Compact. (The legitimacy of such a political union is discussed at para 5, below.)

It would not be in the UK's interest to absent itself from such a debate, given its degree of economic interdependence with its eurozone and fiscal compact partners. But, to be effective, the UK's contribution to the debate (however intergovernmentalist or 'eurosceptic') should be presented in a way which does not call into question its *bona fides* or its commitment to secure and build on the demonstrable achievements of the EU to date.

5. Those who argue for political union to underpin economic union have yet to demonstrate how their proposed solutions would command legitimacy.

After decades of a progressive pooling of sovereignty through the extension of community competences, of the co-decision procedure for EU legislation, and of qualified majority voting (QMV) – developments which were widely taken as presaging a fuller 'political union' - it now seems clear that policy integration in the EU has reached a plateau. Key areas of policymaking, such as health, education, welfare, pensions, law and order and defence, along with most areas of taxation, will remain matters of national competence, and there is no serious suggestion, even from federalists, that these should be revisited. (N.B. Whilst the communitisation in recent years of much EU activity under the heading of Justice and Home Affairs would appear to contradict the 'plateau' theory, in fact this is one of the areas where the particular logic of collective action applies, consistent with the founding rationale of the EEC/EU – see para 1, above.)

The absence from the European public space of most of the 'high-salience' policy areas which touch directly on the lives of the citizen, with all the opportunities for political contestation and mobilisation which these present, is of major significance: it constitutes a potentially insurmountable obstacle to the ambition of building a legitimate political union on the foundations of a European 'demos'. And it is by no means clear that proud and ancient nation states (with the possible exception of Germany) are yet ready to endorse the establishment of potentially competitive institutions with an equal claim to democratic legitimacy.

There are further reasons why a top-down or mechanistic pursuit of a European demos is likely to remain counter-productive. Ideas such as the direct election of the president of the European Commission by European voters, or even of the president of the European Council, run straight into a number of difficulties.

First, their adoption would require treaty change - a fraught and uncertain process, as European leaders have learned to their cost on many occasions over the last twenty years.

Second, the assumption that a democratically elected Commission or Council president would command functional (as opposed to titular) legitimacy rests on the heroic assumption that levels of allegiance and consent are unaffected by the geographical remoteness or cultural 'otherness' of those who wield authority, even where democratically endorsed. It is asking a lot of people's sense of European identity to suppose that a left-wing voter at one end of the European continent would comfortably accept decisions taken by a right-wing leader from the other end of the continent, and vice versa. There is a real risk here of jeopardising the cornerstone principle of democracy, namely, the willingness of a minority to be bound by the decisions of the majority.

Third, the well-documented and much-analysed decline in voter turnout at European Parliament elections reminds us of the inherent difficulty in building the legitimacy and credibility of a majoritarian institution which handles predominantly low-salience issues (even when its powers have steadily increased under successive treaties). It also illustrates the difficulties already experienced by the main actors and channels of contestation in any putative European demos: the pan-European party groups. Whilst the European People's Party, the Party of European Socialists and the Alliance of Liberals and Democrats for Europe are able to agree broad statements of principles and values, they find it much harder to achieve internal consensus around concrete policies from which European voters can be invited to make a clear and decisive choice. Furthermore, party labels can be misleading: it could be more logical for a supporter of free trade to vote for a Scandinavian social democratic MP than for a French centre-right MEP.

So it is by no means clear that European political parties are yet in a position to upload to the European level their national function of articulating clear policy options and aggregating voters' choices. This is to say nothing of the lack of interest in politics shown by most citizens, most of the time, in well-ordered polities - let alone in European Parliament elections. And even if the political parties were more effective actors on the European stage, we are drawn inexorably to the conclusion that whilst the continuation, *de minimis*, of the present 'passive consensus' within a full-fledged economic union looks very precarious, most of the innovations now being canvassed for addressing the even larger democratic deficit which would be opened up by full economic union risk disappointing expectations and alienating public opinion – thereby encouraging the centrifugal forces which such innovations were designed to reverse.

6. Institutional reform and public consent need to be pursued in tandem and not left entirely to *post facto* legitimation in the form of parliamentary ratification or a referendum.

It is unrealistic and ultimately futile to posit any set of institutional arrangements as being appropriate for the UK independently of the likelihood of these securing public endorsement. For any new set of EU institutional arrangements to command public consent across the European Union and, more particularly, in the UK, with its particular concerns about sovereignty, the rationale of institutional reforms needs to be explained and set out in advance of the 'end game' of treaty negotiations in an Inter-Governmental Conference (IGC). In the UK, this will require a degree of public information which successive governments have shirked, on the grounds that such activity could be seen as 'propaganda'. This has led to the curious and regrettable situation in which one of the two central planks of UK foreign policy - membership of the EU (alongside membership of NATO) - has never been properly explained to British citizens – and this in spite of the fact that EU membership not only provides benefits for UK consumers but also creates rights for UK citizens.

To succeed in its objective, any public information campaign about the EU should explain the centrality of institutions and law in the European project, given the need to lock in the commitments of the member states and to prevent free-riding and cheating. Such an explanation should be intelligible and persuasive for British public opinion. Until now, however, the impression has been

given that the customs union and single market provided by the EU can be guaranteed through self-policing. This is evidentially not the case – as the regular use of infringement procedures by the EU Commission and ECJ testifies. It needs to be explained.

7. The momentum behind EU enlargement has faltered, potentially irreversibly. Real effort will be needed just to keep the option on the table.

A combination of enlargement fatigue, the distractions of the eurozone, concerns about uncontrolled migration and the social integration of minorities, and more general fears about the sustainability of the whole European project has chipped away at the EU's most compelling narrative since the Single Market programme and risks undermining its international profile as an effective normative power. This presents a real obstacle to continued enlargement beyond Croatia and, possibly, Iceland.

For the Western Balkans, the accession process will be kept alive procedurally by the European Commission, which remains a committed but increasingly low-profile supporter of enlargement. If substantive progress is to be made, there is no substitute for high-level support from the member states and the public articulation of the case for a widening, outward-looking and inclusive EU, consistent with the principles of openness which historically have underpinned its success. But the reality is that none of the EU's leaders now see any benefit in such an investment of political capital; indeed, it is striking how even the most enthusiastic supporters of EU enlargement, notably the UK, have largely dropped EU widening from their public discourse.

In order merely to retain a realistic medium-to-long term prospect of membership for aspirant countries, the UK government needs to explain why EU enlargement is a win-win scenario, not a zero-sum game; how the EU has built its success on an open and outward-looking mindset; how transitional arrangements can be put in place to ease problems of absorption and adaptation (as in Germany and Austria after 2004); and how stability and prosperity in the western Balkans, on the EU's doorstep, is of vital interest to the EU's existing members.

The case of Turkey, historically part of Europe's 'Other', was more problematic even before EU accession negotiations stalled over Cyprus, European concerns about civil liberties and the treatment of journalists in Turkey intensified, and Turkey's commitment to a western orientation began to look equivocal. The question of Turkey's ultimate geopolitical choice (western, middle eastern, or eurasian/pan-turkic) is unlikely to be resolved definitively and is in any case simplistic: there is no reason why Turkey should not pursue several strategic vocations, whilst privileging its western one. But if Turkey's EU accession is not to wither on the vine, the present stand-off will need to be overcome before its exclusion from the EU becomes a self-fulfilling prophecy.

The case for Turkey's EU membership remains compelling: it is in the EU's interest that as important an economic player and commercial partner should join the EU (for the same reason it joined the customs union in 1995); that as influential and increasingly important a geopolitical player should join the EU (for the same reason it joined NATO in 1952); and that the EU should succeed in its mission of extending its norms and values beyond its present territorial confines.

29 May 2012

FEU 29

Written evidence from Nucleus

Summary of submission:

- The events of the December 2011 European Council meeting were not so much a 'watershed' as a missed opportunity, emblematic of the long-term approach of the UK to EU-level policy.
- Whilst the UK has increasingly isolated itself from key EU decisions, there are plenty of reasons to be optimistic that the UK can still play a vital, and leading role in shaping the outcome of the eurozone crisis.
- The UK's current approach to EU-level policy-making has negative consequences for both the UK and the EU itself.
- It is the approach, not the policy detail, of the UK Government, that has done most to isolate it from its European allies.
- An informal two-tier EU already exists. This flexibility is part of its strength.
- A formalised two-tier EU – with the eurozone 17 at the heart of decision making, with the 10 euro 'outs' excluded – would dramatically alter the focus of the EU, and have disastrous consequences for the UK.
- The euro is a key priority of the EU, and it is extremely unlikely that it would be allowed to fail.
- Before the sovereign debt crisis in Greece and the burst of asset bubbles in Ireland and Spain the euro had reportedly become the most widely held currency and the *de facto* second reserve currency.
- The US and China have continually shown their support for the euro, both verbally and practically.
- The UK Government's outright rejection of the fiscal compact was unwise, given its effect on those outside the common currency as well as within.
- The uncertainty over ratification of the fiscal compact by its signatories may present an opportunity for the UK to re-involve itself in negotiations.

About the submitter:

Nucleus is a euro-realist campaign organisation that seeks to promote a positive and pragmatic approach by the UK towards membership of the EU, other European institutions and diplomatic relations with key member states. Nucleus brings together various euro-realist voices, and provides a platform for figures from business, media, academia and politics. Nucleus is an independent, private not-for-profit organisation. We are not affiliated with, nor do we receive any funding from, any Government, political party, or European institution. Our activities are funded entirely by donations from the private sector.

Our team includes senior figures from Westminster, think-tanks, media, and business.

Recommendations for action by the Government or others which the submitter would like the Committee to consider for inclusion in its report to the House:

The Eurozone crisis has brought fresh focus on the entire EU project and reopened questions about the role of national parliaments - indeed, the role of citizens - in European policy-making. These questions are, naturally, most urgent for countries like Italy and Greece. For Britain, however, the situation provides an opportunity to promote a new understanding of what the EU does, how Parliament can influence it and how Britain can enhance her role in the process.

The Conservative Party's position is clear: we seek a changed relationship with a reformed EU, but at present we have an important and influential role inside the Union and wish to remain full-fledged members. However, such is the mistrust of "Brussels" and everything to do with the EU today, that there is little appetite amongst Tory MPs to fully understand how the EU actually works - and how to use parliamentary power to change it. Indeed few MPs seem even to be aware of the power Parliament now yields, following enactment of the Lisbon Treaty, in influencing or even blocking EU legislation particularly if it joins forces with just nine other EU countries. If we are honest, UK MPs are generally not interested in EU details. Few visit Brussels, few speak European languages well and few bother to exploit networking opportunities in other capital cities with like-minded politicians. Consequently we do our citizens a disservice by providing inadequate oversight and influence over what the EU does.

Consequently the party is not as good at changing EU policy upstream as it should be, but excels at complaining about the same policy when it becomes law. Such a "complain-but-don't-change" policy is clearly not in Britain's interests considering that around 10% of all UK law determined along with 50% of all business legislation is decided in Brussels.

A new approach is now needed. If we are to fully master all the EU mechanisms at our disposal then a clear strategy must be given, which allows Government Ministers, the civil service and Parliament to contribute towards shaping, tempering or indeed rejecting proposed EU legislation emanating from Brussels.

This means, firstly, improving the current (underpowered) system of EU scrutiny; and, secondly, a cultural shift towards engagement, which will assist in projecting Britain's national interests in EU decision-making and encouraging other member states to support us in the process.

Essentially we must understand the (EU) beast in order to better tame it and improve its 'democratic deficit'. MPs must be encouraged and rewarded for developing a specialism and building influence in European capitals. We must get away from reducing every debate on EU legislation to the broken record of quibbling about our fundamental relationship with the EU. This rhetoric undermines progress made by the Conservative-led government in enhancing our influence in Brussels through UKREP, the influence of British EU officials and ad hoc alliance building with other member states. It also overshadows the critical role we play as one of the three big

players in the EU. Germany and France need us. In a whole variety of areas from security to climate change we are the "lead" nation. The Lisbon Treaty also fully recognizes the case for so called 'European Localism'[1] the antidote to centralization. But to date there has been no voice providing a constructive plan to maximize British interests and influence with the Europe we have today, not the Europe some might want to have in the future.

If we are in it – then we must be committed to deliver on our priorities and aims. If we are committed we can lead. If we lead we project influence. This paper considers how that enhanced commitment might start.

Questions:

To what extent should the December 2011 European Council and its outcome be seen as a watershed in the UK's EU policy and place in the Union?

The 'veto' of December last year, ought not to be considered a "watershed", as the outcome of the European Council was emblematic of the UK's approach to European-level politics under this Government. Rather, this should be seen as a missed opportunity for the UK to exert its influence in any meaningful sense, and a dangerous step towards self-propelled isolation on the sidelines.

Prime Minister David Cameron issued a rallying cry for a "time for boldness",[2] then meekly retreated. Despite what the UK media overwhelmingly presented, the UK Government was not alone in its reservations; but what is striking is that when it could have indeed spoken for a large number of fellow member states, and provided leadership in an obvious vacuum, the government failed to rise to the occasion.

It was this approach, especially the failure to seek out and win allies in advance and during the negotiations and the last-minute nature of the UK's demands, rather than the substance of the UK views, which cast Britain into self-imposed exile from the negotiating table.

However, whilst the UK has increasingly isolated itself from key EU decisions, there are plenty of reasons to be optimistic that the UK can still play a vital, and leading role in shaping the outcome of the eurozone crisis. There has been (often justified) criticism among its partners that the UK government is carping and lecturing from the sidelines but these partners remain anxious for Britain to offer its wisdom and expertise – in financial services above all - in a co-operative spirit. This was true, particularly of Berlin and other capitals, in the run-up to and even during the December 2011 'summit'. Since then too, there was the single market letter, signed by David Cameron and eleven fellow European Prime Ministers. However, so far, the UK's approach to EU-level policy-making has had and continues to have negative consequences for both the UK and the EU itself. 'Annoyance' has become the oft-repeated way to describe the feelings of our EU partners towards the UK.

[1] Open Europe: The Case for European Localism: Anthony Brown and Mats Persson

2 http://www.nucleus.uk.net/home/item/a-time-for-boldness

Between now and 2020, what institutional architecture and membership should the UK seek for the EU? Should the UK embrace a formalised two (or more)-tier EU and start to develop ideas for multiple forms of EU membership?

The FAC is correct to use the term "formalised", as a two-tier – also referred to as a multi-speed – EU already exists in many senses. The most obvious example of this is the division between the 17 members of the eurozone and the ten non-members or "outs". But there are others such as membership of NATO or the Schengen 'passport-free' area.

Bence Nemeth, of the Defence Planning Department of the Hungarian Ministry of Defence, has argued that the Anglo-French military co-operation treaty has created a 'two-tier Europe' insofar as foreign and security policy is concerned.[3] Tracing the development of a two-tier structure back further, Dr Michael J. Geary, (lecturer in history of European integration at Maastricht University), and Kevin A. Lees, (Associate, Latham and Watkins LLP in Washington, D.C), have written:

> By the 1990s, a two-tier EU was already emerging, which became an enshrined reality by the early 2000s when it became clear that Britain had not only firmly opted out of not just the single currency, but also rejected the Schengen Agreement on the removal of border controls within the EU and had scoffed at a Europe-wide foreign policy.[4]

This might also be applied to other countries such as Denmark, Sweden in the case of the euro – or Ireland regarding NATO.

It is our opinion, however, that a two-speed EU, based around those embracing closer fiscal union, and those who do not, would formalise a two-tier structure. This would undoubtedly have strongly negative consequences for the UK – we would likely see the 17 eurozone countries driving decision-making, while the 10 euro "outs", of which we are one, are not even in the room, let alone at the table. This is already happening to a large extent – much to the consternation of "outs" such as Poland, which are bound to join the EZ sooner or later.

The centre of gravity of the EU has – since the onset of the eurozone crisis – moved away from the leaders of the 27 member states in the European Council towards what are now known as the EZ-17. The agreement amongst those eurozone states over ten steps to formalise how the EZ should be run, and a decision that EZ summits will take place at least twice a year separately and not necessarily concurrently with European Council meetings, based on agendas encompassing key economic and financial

[3] http://www.nucleus.uk.net/diary/ideas-on-europe/item/pesco-and-british-french-military-co-operation
[4] http://www.nucleus.uk.net/diary/item/britain-and-the-european-union-continuity-or-rupture

policies, including on growth and competitiveness, has dramatically shifted the centre of power within the EU to an organ in which the UK has no place and no voice.

For an image of what this would be like, we need only look to history, and the founding of the European Free Trade Area (EFTA) as an alternative to membership of the then EEC. The UK quickly realised that influence and opportunity for growth were limited by being outside the core EU decision-making process, and began to pursue membership. Britain would be in danger of becoming "Greater Switzerland": bound by the rules of the EU and, indeed, the EZ but having no influence over the latter and, increasingly, over even those of the former.

What is the relationship between the new 'fiscal compact' Treaty and the EU's acquis? What impact might the conclusion of the 'fiscal compact' Treaty have on other aspects of the EU and its policies, such as the EU budget, enlargement, or the Common Foreign and Security Policy?

The 'fiscal compact's' effect is to politicise the single market. Clearly, the fiscal compact draws upon and enhances previous EU policies and treaty provisions such as the Maastricht criteria, the Stability & Growth Pact and the recently adopted "Six Pack" (already in the process of being amplified). The "European Semester" hands extensive powers to Brussels to oversee and influence the budget process in member states. These powers are even more extensive in the case of Greece and other Member States subject to the "bailout/rescue" programmes, including those of the EFSF and soon-to-be ESM.

Arguably, they prefigure a fully-fledged EU federal state. The EU – including many of the current "outs", future members and actual or potential applicants who are all treaty-bound to join - is engaged in a process of monetary integration which might soon be coupled with fiscal and political union. No matter what the immediate and short term problems of the eurozone (and its institutional architecture) are, the EZ and its single currency are so systemically important for the EU (and global) economy that it is a matter of when rather than whether the zone will sort itself out and continue its path towards becoming a global reserve currency. (More than a quarter of reserves are already in euro-denominated assets.)

Before the sovereign debt crisis in Greece and the burst of asset bubbles in Ireland and Spain the euro had reportedly become the most widely held currency and the *de facto* second reserve currency. It has maintained that status throughout the financial and debt crisis of 2008 and 2010 and it has also kept its value, while global powers like the US and China have verbally and practically shown their confidence in the euro.

As a result we will soon find ourselves in a world where the global economy will be dominated by two, maybe three, currencies: the US dollar, the euro and the Chinese renminbi/yuan. This would be a situation that could contribute to the re-balancing of the global economy, away from the current uni-polar and destabilising system towards a more sustainable multi-polar system.

The question is what happens to relatively declining economies like Britain's, with a freely floating currency, when they get caught up in the headwinds of those three global reserve currencies and the enormous economies that underpin them.[5]

Lord Hannay of Chiswick has written:

> The global financial and economic crisis which engulfed the world in 2008 would have tested the European Union severely whether or not the single currency had by that time been established. So it makes no sense to blame the euro for everything that has happened. Nor can any of the European Union's twenty seven governments afford to neglect that it is in our collective interest that the Eurozone should survive and prosper and avoid a chaotic collapse which would damage all of us. The hard fact nevertheless remains that, for the foreseeable future, the European Union is going to consist of member states within the Eurozone and member states outside it; and, since it is unlikely that the errors of premature admission to the Eurozone will be repeated, that foreseeable future could be a long time indeed, so we had better get used to that and learn to live with it to our mutual benefit, minimising the differences between the two groups. In that context the British coalition government's decision to reject the fiscal union treaty was unwise, given that the different obligations on the two groups are clearly spelled out in it. And we do all share the view that fiscal austerity, which is proving every bit as painful in this country as elsewhere in Europe, must not be regarded as an end in itself but rather as part of a concerted growth strategy.[6]

There remains some uncertainty over the fiscal compact. Germany has sought a delay on a vote, and cannot now say when it will ratify – possibly in June, maybe July. The new French President has clearly signalled his intention to amend or, at least, amplify the treaty; the ratification process is incomplete. A compact will be agreed though, whether in its current form or otherwise. Any delay presents an opportunity for the UK to return to the negotiating table and, this time, help shape the outcome in a more constructive manner.

However, it is also clear that the closer union of those signed up to the fiscal compact will have a growing influence on the future direction of the EU's organs and policy-making. The budget will largely be decided within its framework, future enlargement will require new member states to meet stricter financial criteria from the very beginning, even long before entry, and, by its very nature, this "inner club" will begin to dominate all areas of EU policy and decision-making. The question then arises whether the UK should actively support and participate in this integration process or, as in the last 40 years, with exceptions such as the Single European Act, continue to "sit it out".

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[5] http://www.nucleus.uk.net/diary/item/the-european-view

[6] http://www.nucleus.uk.net/diary/item/britain-in-europe-a-tragedy-in-the-making-or-just-another-episode-in-a-long-running-soap-opera

Should the UK Government support the incorporation of the 'fiscal compact' Treaty into the EU Treaties? If it should, what demands and safeguards, if any, should it make its condition for doing so?

Nucleus firmly believes that the UK should play a positive but not uncritical role within the current – and future – EU. This requires a substantial shift from the position adopted at the December 8-9 2011 "summit": Britain should now support the inclusion of the compact within the existing treaty framework. The compact's provisions will provide greater stability to the EZ and that, as the Prime Minister and Chancellor constantly remind us, is in the UK's vital interests.

However, certain safeguards – notably over parliamentary control over the budget process – must be retained. In the absence of a full fiscal and indeed political union the old adage of no taxation without representation applies to no small degree. We do not share the view that – in a multipolar, highly complex globalised world – national sovereignty is an absolute. But the British legislature and executive must retain control over the national budgetary process and influence monetary policy while we remain outside the EZ/euro. There can be no question of the European Commission holding a veto on that process. The same holds true, obviously, for the decision to go to war or engage in peace-keeping operations with partners.

29 May 2012

FEU 30

Written evidence from Sir Peter Marshall KCMG, CVO

I hope you will permit me, as someone who has followed with great enthusiasm the work of the Committee, to express to you my delight at your decision to launch this inquiry into *The future of the European Union*: *UK Government policy*.

First, its timing: "by conducting an inquiry at this stage, we hope to contribute to public debate by airing some of the options that might be available to UK policy-makers". That is of particular relevance in the light of the inquiry into the Lisbon Treaty undertaken by the previous Committee, and of their clear dissatisfaction at the lateness of the stage at which they were able to express an opinion. Anyone familiar with the work of the Select Committees readily understands their key importance, not only in the service which they render directly to the House of Commons, but also more widely in enlightening and shaping public opinion in matters of great weight and complexity. Timing is of the essence.

Secondly, the background. You call attention to "a widespread sense that the Eurozone crisis and the December 2011 European Council have raised fundamental questions about the future of the EU and the UK's place in it". The causes of the disquiet now so generally felt are manifold. They also go back a long way: 2013 will mark the fortieth anniversary of UK accession to the EEC, an appropriate juncture at which to make a general assessment. More fundamentally, 2014 will be the poignant centenary of the outbreak of the Great War, with all its disastrous consequences. It cannot fail to sharpen memories of the upheavals and the suffering endured by the peoples of Europe during so much of the twentieth century, and cast fresh inquiring light on the relevance to our own day of the pressures which ensued for European integration. It is a sombre thought that disaffection in a minor part of the Austro-Hungarian Empire led to much of Europe going up in flames. It is a no less sombre thought that Greece, a mere 2% of the Eurozone GDP, has the G8 by the ears.

Thirdly, while attention to the historical perspective does not reduce their urgency, it would nonetheless suggest that the four questions on which in particular, the Announcement notes, evidence would be welcome represent in a very real sense the tip of the iceberg. That helps to explain the extraordinary way in which the Eurozone crisis has developed, or has been allowed to develop. Such have been the scale and rapidity of the crisis, any answer to the four questions must inevitably involve a measure of second-guessing of governments or even of electorates.

Fourthly, you speak, Mr Chairman, for the vast majority of our compatriots in stating that you were starting from the assumption that the UK should and will remain an EU Member. That is a broad judgement, not a narrow one. To approach the question of member ship of the EU as if it was only a matter of whether we should, or should not, be part of the Brussels institutions, or of whether we should, or should not, acquiesce in any particular amendment of them, is to adopt an essentially two-dimensional approach to a three-dimensional problem. There is more to our stake in Europe than the EU. There is likewise far more to the EU than *l'acquis communautaire.*

Fifthly, by virtue of their mandate, and of the skilled and imaginative way in which they are discharging it, the Committee under your leadership have acquired a unique understanding of the interplay between ends, ways and means in British diplomacy,

and of the broad political and social context, both national and international, which modern world wide interdependence demands of the conduct of foreign policy. These are factors which have in the past too often been ignored or underestimated in the conduct of our European policy.

These considerations prompt the submission to you of two lines of thought. First, while concentration on the policy options that might be available to UK policy-makers has great practical value, are the Committee not ideally placed at the same time to contribute to public debate on the wider issues involved in the future of the EU and Britain's place in it?

Secondly, could that contribution with advantage extend not only to the *substance* of our relations with our European partners, but also to the *management* of them? It is clear that the over-polarised and divisive debate on the issues which has largely prevailed in this country has weakened the influence which we can exert in Europe. Why is it, we should ask ourselves, that we have so far failed to achieve in our dealings with our European partners the same type of broad *ad hoc, ex post/ex ante, de facto/de jure* consensus which we have managed in virtually every other major aspect of our international involvement?

These lines of thought in their turn point to a yet more basic consideration. We may have reached a stage in the debate on our European involvement at which it is appropriate to seek the expert impartial assessment and advice which only an authoritative high level body set up exclusively for that purpose, and with adequate resources and time at its disposal, is in a position to furnish?

A study of the appointment over the years of Royal Commissions in the UK and elsewhere in the Commonwealth suggests that the criteria for the utilisation of this eminent vehicle are less than clear cut. The principal factor seems to be the perception that a particular situation requires the response that only a body of the consequence of a Royal Commission can provide, or help to provide. The present state of our relations with our European Partners can be a case in point. The publication of the findings of a Royal Commission during the lifetime of this Parliament would be an enormous help in the next general election.

I am acutely aware that, for all the effort to make it both brief and self-contained, a submission of this kind to the Committee cannot but rest on a wide and detailed analysis of the relevant factors, which of necessity would be of a length putting it beyond the normal compass. I have therefore offered to the most admirable staff of the Committee a memorandum, prepared in the first instance for my fellow members of the FCO Association, that is to say, the Diplomatic Service *alumni*, addressing the issues in greater detail. A copy of this memorandum is enclosed with this letter.

Memorandum for the FCO Association on the inquiry launched by the House of Commons Foreign Affairs Committee into the future of the European Union: UK Government policy

As our Chairman noted in his report to the AGM, the House of Commons Foreign Affairs Committee have launched an inquiry into the future of the European Union and UK government policy. The brief text of the Select Committee Announcement, dated March 28, 2012, repays close attention. The timing is significant. The

Committee's hope is that by conducting an inquiry at this stage they may be able "to contribute to public debate by airing some of the options that might be available to UK policy-makers".

The Committee have invited the submission of written evidence by May 22. Although time is limited, the case is a strong one for responses where possible from members of the Association. But that of course is by no means the end of the matter. The subject as a whole is on-going. It is as massive as it is complex. Boredom will not be a problem in the foreseeable future. We are under the ancient Chinese curse "may you live in interesting times".

The background, as it would seem to affect the membership of the Association in particular, is explored in this memorandum under three headings: Opportunity; Context; and the Image of the Diplomatic Service and its *Alumni*.

I Opportunity

(a) One of the many respects in which we are fortunate indeed to have William Hague as Foreign Secretary is that he is the first holder of that office to make a strong positive point about the value of the *alumni*. The strong historical sense which pervades his speeches is not only greatly reassuring in itself, but also gives added weight to the practical steps, in pursuit of clearly articulated objectives and priorities, which he outlines in them. He and his Ministerial colleagues are a team for which anyone who values the work of the Diplomatic Service should be profoundly grateful. Never before has a chairman of the House of Commons Foreign Affairs Committee subsequently become an FCO Minister, as is the case with David Howell.

(b) The present Foreign Affairs Committee is likewise unprecedented in its expert, detailed and supportive scrutiny of the work of the Diplomatic Service in the pursuit of UK international priorities, which are advisedly extensive, despite the financial exigencies which are likely to beset us for years to come. The Committee's work testifies to a precious ability to look simultaneously at the ends, ways and means of diplomacy in the broad political and social context, both national and international, which world interdependence demands. We should be much encouraged that the Committee set store by the experience and the opinions of the *alumni,* and have promised to let the Association know about future inquiries.

(c) Past experience of discussion of the UK role in the EU suggest that it can easily generate more heat than light. However after years of polarisation and a dialogue virtually of the deaf, there is a great deal of constructive thinking and discussion. I make no apology for referring in particular to the recent seminar at Europe House, organised by Civitatis International, on the theme "The Future of Europe: towards the European Dream?", which I had the honour of chairing. The contributions of the four main speakers – Edward Mortimer, Daniel Ottolenghi, Maurice Fraser and Christopher Coker - taken individually and collectively, were outstanding. Still less do I apologise for drawing attention to the "Eurogazing" missives circulated to members of the Wyndham Place Charlemagne Trust by its indefatigable Secretary, Win Burton. All in all, one is conscious of a hint of consensus in the air. It should be inhaled deeply.

II Context: (i) political and diplomatic

(a) In the announcement of the inquiry, the Chairman of the Foreign Affairs Committee, Richard Ottaway, observed that "there is a widespread sense that the Eurozone crisis and the December 2011 European Council have raised fundamental questions about the EU and the UK's place in it". That observation becomes more pertinent day by day.

(b) Next year we shall mark the fortieth anniversary of UK accession to the EEC. The anniversary will stimulate much further analysis. 2014 will be the centenary of the outbreak of the Great War, which will prompt even more profound questions about our European involvement. Have Sir Edward Grey's lamps, which went out all over Europe in 1914, been lit again? What would Eyre Crowe have to say now for our guidance? It is a sobering thought that disaffection in a minor part of the Austro-Hungarian Empire led to much of Europe going up in flames. Today Greece, which accounts for some 2% of Eurozone GDP, has the G8 by the ears. There must be better ways of running the railroad.

(c) In the meantime let us go back fifty years. On December 5, 1962, in a speech at West Point, Dean Acheson waspishly remarked that "Britain had lost an Empire and not yet found a role". His comment was ill-received in this country at the time, not least because it was uncomfortably near the truth. There seemed to be no let-up in our post-war adversities. The Plowden Committee to examine our future overseas representation had just been appointed. Our standing aside from the EEC and the creation of EFTA meant that Europe could be said literally to be at Sixes and Sevens. De Gaulle's veto of our first application to join the EEC was only a month away.

(d) Matters are somewhat better now. We have a perception, both realistic and responsible, of the scale and nature of our international involvement in a world of growing interdependence, or, to put it more picturesquely, in the Global Village. Our perception of course has its continuities with the past. But it is in the main very different from our prevailing notions of a century ago.

(e) The best measure in the twenty-first century of this transformation is to be found in the ground-breaking White Paper on UK international priorities published by Jack Straw, one of our patrons, during his Foreign Secretaryship, in December, 2003 (in which our present Permanent Under-Secretary had a noteworthy part) and its sequel in March, 2006. Detailed study of both these wide-ranging texts continues to be rewarding. The policy of the Coalition, comprehensively outlined in 2010, has a good deal in common with them. The same overall approach is convincingly endorsed in the lecture delivered at Ditchley last year by Sir John Major, another of our patrons. In all these documents our relations with our European partners are seen as integral to our international involvement as a whole, and not as some external, unwelcome, yet overriding, priority.

(f) The FAC Chairman speaks for the overwhelming majority of our compatriots in stating that he was "starting from the assumption that the UK should and will remain an EU member". Exactly what this implies must be approached from a number of different standpoints. It certainly does not suggest that there can or should be a single view on the major issues of the day The Committee's announcement lists at the outset four burning questions on which in particular evidence would be welcome. The rapidity and invasiveness of developments even since March 28 are such that any

reply to these questions could not but be highly speculative, and require a measure of second-guessing of governments, or even of electorates. No two members of our association would be likely to come up with exactly the same answers. The idea of a collective Association view is fanciful.

(g) We need surely to give more attention to the shortcomings of discussion in this country of European issues. Historians surveying our record on the fortieth anniversary of our accession to the EEC are unlikely to shower us with compliments on our handling of business. They would be bound to draw attention instead to the divisiveness, the sterility even, of much of the debate, when the commonality of interest is so great and so promising. Sir Edward Heath said at the outset that he would not wish to take Britain into the EEC without the "full-hearted consent of the British parliament and people" . He soon changed his tune, averring that a single vote was enough.

(h) The requirement has in reality always been to nurture an approach to the EU embodying the same *ad hoc, de facto/de jure, ex post/ex ante* broad consensus we have achieved in almost every other major aspect of our international involvement. Within such a compass, there will inevitably be considerable differences of analysis and a plethora of prescriptions. Once again, the idea of a single view on such a massive array of interrelated topics is fanciful. It is however the overall consensus which is crucial. Without it, our impact on European counsels is much more limited. With it, we can be more confident that what we have to say will receive greater attention. Failure so far to achieve such a consensus has cost us dear.

III Context: (ii) public and social

(a) Reaching a consensus on how best to involve ourselves in the EU is not the elitist preserve of policy-makers. Public opinion and the public mood are becoming an increasingly important factor in virtually every aspect of foreign policy-making. Yet failure to carry people with you, and indeed the deliberate riding roughshod over the views of voters and what are firmly seen as their democratic rights, have in recent years been the besetting sins of the EU.

(b) In the 21st century we are hearing more than ever before about national solidarity, the maintenance of which is indispensable for security as well as prosperity. There is increased willingness to examine our EU policy, not only in the context of Britain's international involvement generally, but also in the light of the necessity of fostering national values and the social cohesion essential to the discharge of our international responsibilities. It is a far cry from classical diplomacy.

(c) In EU terminology this is a matter of *l'esprit communautaire* in dialogue with *l' acquis communautaire* . We have heard little or nothing in recent years about the former: the latter, principally in the shape of a raft of treaties and their ensuing regulatory moves – the Single European Act, followed by the Treaties of Maastricht, of Amsterdam, of Nice, of Lisbon and the current fiscal compact - has squeezed it out. That is the antithesis of the creation step-by-step of a *de facto* solidarity envisaged by Schuman in the 1950 Declaration.

(d) EU Heads of Government fully recognised the importance of securing public support or acquiescence for this *fuite en avant,* inspired and engineered by Jacques Delors in his long tenure of the office of President of the European Commission.

(e) The European Council Declarations of Nice (December, 2000) and Laeken (January, 2002), on the eve of major enlargement to the East, followed up by the Declaration of Berlin on the occasion of the 50th anniversary of the signature of the Treaty of Rome (March, 2007), dwelt on the twin necessities of fulfilling our international responsibilities abroad and of bringing the EU institutions nearer the people at home. The outcome is distressingly different. Inward-looking institution-mongering, eventually enshrined in the Lisbon treaty, itself stubbornly adhering to the precepts of the Constitutional Treaty spectacularly rejected by the voters of France and the Netherlands, has absorbed an inordinate amount of time and attention. The Eurozone is now, and is likely for some time to come to remain, the major headache of the international financial and business community. The EU institutions, very largely by their own fault, have never been further than they now are from the public in the member countries.

(f) Developing within the UK a broad *ad hoc, de facto/de jure, ex post/ex ante* national consensus on EU matters will be a mighty multi-faceted task. But we have a no less mighty weapon available to help meet it in the shape of the richness of our heritage, of our creativity, of our adaptability and of our diversity. We are a happy breed. In recent years we have had limited success in expressing that noble truth in our European involvement.

(g) Co-operation among the major faiths has an important part to play in this quest, especially as regards the role of Christianity, and historically, of Christendom. On February 18 the Archbishop of Canterbury brought together at Lambeth Palace representatives of the nine major faiths on the occasion of a visit by The Queen and the Duke of Edinburgh as part of the Diamond Jubilee celebrations. As Dr Rowan Williams observed,

> it was an unprecedented gathering here within these walls, but it was one which certainly revealed the degree to which our society has changed quite radically in terms of its religious composition, just within the last 60 years. It was an event which highlighted both the religious diversity of our society and the willingness to integrate, represented by the elements within that diversity".

The text of The Queen's short address to the gathering is highly satisfying food for thought.

(h) In November, 2009, *Notre Europe,* a think-tank of which Jacques Delors is the Founding President, issued a Declaration which can be regarded as an authoritative orthodox formulation of the post-Lisbon mission of the EU in the 21st century. It asserts that "the condition for success is to rediscover ... the Community method, a virtuous and dynamic counterpoint between the three institutions responsible for the well-being of the Union and its people", a triangle formed by the Council, the Parliament and the Commission, each body "newly strengthened ... and led by men and women freshly summoned for the task".

(j) Matters have not worked out that way. The thesis itself is seriously flawed in at least two respects. First, the Declaration makes no mention of the European Court

of Justice. The Court's powers, enhanced by the wide extra discretion conferred on it in the Treaty of Lisbon, constitute probably the greatest stumbling block to the willing public acceptance of the Union's institutions as a whole.

(k) Second, there is no hint of a popular dimension to the problem. We are concerned not with a virtuous and dynamic triangle, but with an irregular quadrilateral, the fourth side being composed of the people of the Union in numerous configurations, Europe-wide, national, regional and local, and with interests and preoccupations far removed from institutional fine-tuning in Brussels.

(l) In our own country the establishment of the Supreme Court in the old Middlesex Guildhall offers us a lively example of the quadrilateral in what can be called *the Allegory of Parliament Square.* To the East is the Legislature; to the North, the Executive; to the West, the Judiciary; and to the South, Westminster Abbey. It comprises, in what many people think of as the Parish Church of the Nation, a Royal Peculiar, the Seat of Monarchy, the chief National Shrine, homage to excellence and sacrifice, and a beacon in modern society.

(m) In her message on Accession Day, The Queen expressed the hope that "this Jubilee year will be a time to give thanks for the great advances that have been made since 1952 and to look forward to the future with clear head and warm heart as we join together in our celebrations". That surely applies as much to our involvement in the EU as to any other aspect of our national life.

IV The Image of the Diplomatic Service and its *Alumni*: three FAC Inquiries

Thirdly, a word about our own concerns as a Diplomatic Service. The Foreign Affairs Committee has, within a relatively short span, launched three related inquiries into policy matters which, though by no means the sole concern to the FCO/Diplomatic Service, are very much in our bailiwick: the first was concerned with the role of the FCO in UK government; the second is considering the role and future of the Commonwealth; the third is the present EU inquiry. They need of course to be looked at synoptically.

(a) Until recently the FCO was not so much getting a bad press on account of its shortcomings as being the subject of concern on account of the difficulties created for it by No 10 and the Treasury. In evidence submitted to the Committee, I listed three in particular of what I described as the "present discontents": sofa diplomacy in No 10, managerialism and what Douglas Hurd, yet another patron, called "the hollowing out of the FCO". One of the last recommendations made by the FAC in the previous Parliament was that the new government should "carry out a comprehensive foreign policy-led review of the structures, functions and priorities of the FCO, MOD and DFID".

(b) I am not aware that the new government responded directly to this recommendation. But William Hague and his ministerial colleagues at once grasped all the main nettles. The discontents were rapidly remedied. A new atmosphere prevailed.

(c) The new Foreign Affairs Committee, for their part, sprang early into action. They immediately launched an inquiry into the Role of the FCO in UK Government.

The Committee's report was published a year ago, actually on the day of our last AGM. The directness of the report is refreshing. Its main conclusions were that there was indeed a significant role for the FCO/Diplomatic Service and that we were significantly underfunded for its adequate fulfilment.

(d) The moment however was hardly propitious for demanding an immediate large increase in the FCO budget. But the question remained whether the FCO/Diplomatic Service had been sufficiently robust in recent years in defending our legitimate interests, or sufficiently comprehensive in the discharge of our responsibilities.

(e) In this context it is relevant to recall the point noted by the previous Foreign Affairs Committee that "among the 30 Member States of the OECD only one other – Germany - has a fully-fledged ministry of international development, with all the others maintaining agencies or departments that in one way or another fall under the authority of the foreign ministry".

(f) The reasons for this state of affairs may be numerous. But chief among them is undoubtedly the failure of the FCO adequately to understand either the emergence of what was aptly termed "the third world coalition" - the collective actions and the pressures of the countries newly acquiring their independence and eager to join others, similarly desirous of expressing their sovereignty and of securing a "level playing field" internationally - or the ever-widening concept of "development". The chief consequence in practical terms of this failure is the grotesque discrepancy between the expanded funding lavished on the DFID on the one hand, and the penury visited on the Diplomatic Service on the other.

(g) The second of the three inquiries directly affecting us was launched by the FAC on December 8. It addresses the role and future of the Commonwealth, and was prompted by what was widely thought of as the disappointing outcome of the biennial Commonwealth Heads of Government Meeting in Perth (Western Australia) last October. The Committee will take its time about reporting, not least because of what may emerge in this Diamond Jubilee Year.

(h) Although they will deservedly commend Ministers for their stance on the Commonwealth putting the "C" back into the FCO, the Committee are likely to be unenthusiastic about the performance as a whole of the FCO over the years. The Commonwealth has been seriously neglected. In one halcyon year – I name no names, nor date no dates – the word "Commonwealth" did not appear in the Annual Departmental Report except in the term "Foreign and Commonwealth Office".

(j) The third is the EU inquiry, launched on March 28. The particular context is the outcome of the December EU Council meeting and the consequences of the British "veto". It must be said that the Committee can hardly ignore the general public perception in this country of the FCO as having been unduly influenced by, and ready to endorse, the actions and ambitions of Brussels. Former members of the Diplomatic Service, especially those who have served in UKREP, have been vociferous in their collective advocacy in particular of the euro and the Lisbon Treaty.

Envoi

This brief survey of the issues involved in the Foreign Affairs Committee EU inquiry suggests a number of areas in which we as *alumni* are well placed to make a contribution, individually if not collectively, to the on-going debate. And let us not feel inhibited about discussing these matters among ourselves. How about, for example, a laid-back exchange of views on some low-key question such as "will future historians cast Jacques Delors in the role of Pied Piper of Brussels?"

Finally, what of the Diplomatic Service itself? Perhaps Hollywood mogul Sam Goldwyn sums up our position: "the last thing I think about is money - pause - before I fall asleep".

21 May 2012

Written evidence from Professor Pauline Schnapper, Sorbonne Nouvelle University, Paris

Pauline SCHNAPPER, Professor of British Studies at the Sorbonne Nouvelle University, Paris. I have been doing research on the UK and the EU since I completed a PhD in International Relations at the Institut d'Etudes Politiques (Sciences Po Paris) in 1997, having spent two years at St Antony's College, Oxford. I published among other books and articles: *La Grande-Bretagne et l'Europe: le grand malentendu* (Paris, Presses de Sciences Po, 2000) and *British Political Parties and National Identity: A Changing Discourse* (Newcastle: Cambridge Scholars, 2011).

Summary

- The decision of the present government to reject the fiscal stability pact signed by the other 26 EU members in December 2011 was unprecedented.

- It has led to Britain being isolated in the EU, which cannot be in its long-term interest.

- The EU has actually evolved in a 'British' direction in the last 15 years, a fact often overlooked in the public debate.

- The UK government should not let itself be drawn, for party political reasons, into an even more remote corner but play a full part in EU developments which are clearly in the national interest, such as CFSP, the single market, the future EU budget, etc.

1. The refusal of the coalition government to sign the fiscal stability pact agreed by the other 26 European Union member-states in the midst of a major economic crisis during the December 2011 European Council marks a turning point in the British engagement in Europe, with potentially long-lasting consequences. The obvious risk is that Britain will find itself isolated and incapable of exercising influence in an organisation which weighs heavily on its economy and provides it with an opportunity to increase its clout on the world scene.

2. It was the first time that a British government chose not to opt out from some aspects of a treaty but completely withdraw from a negotiation since it joined the EC in 1973. Neither Margaret Thatcher nor John Major had in effect adopted such an empty chair policy in spite of their reservations, to say the least, towards plans for further integration in the 1980s and early 1990s. They always chose, whatever the rethoric, to try to influence negotiations from the inside, hoping thus to advance what were defined as British interests - the single market, deregulation, reform of the CAP, etc.

3. Arguably, David Cameron was in a different situation last December since the UK is not part of the eurozone and therefore not as directly affected by measures destined to help resolve the crisis as eurozone members. In theory it also pursues an independent monetary and budgetary policy, with no obligation to follow rules that apply to others. The well-known truth is, as acknowledged by David Cameron and William Hague themselves, that the British economy is totally interdependent with that of the eurozone countries and that it is definitely not in the British interest to see the eurozone collapse - whatever the gleeful predictions of some eurosceptics. It could therefore have been argued that the national interest made it imperative to sign the treaty. The other argument used, that the treaty failed to protect the interests of the City of London, 'threatened' by new regulations, was also debatable. On the one hand it is not obvious that the interests of the City totally overlap with the interests of the British economy as a whole, as underlined at the time by some British business worried about British isolation in Europe. Secondly, it is not certain either that EU plans for financial regulation are contrary to British consumers' interests. There should at least have been a debate on whether obsession with the protection of interests of the City can become counter productive.

4. It is clear therefore that the decision to stay out of the treaty was taken not so much for economic reasons as for party political ones, which raises once again the issue of British euroscepticism, in its different guises, and the constraints it imposes on governments. There is still a widely shared perception in the UK that membership of the EU is a pragmatic adaptation to international economic pressures but that it fundamentally undermines the sovereignty of Westminster and the identity of Britain. In this view membership offers some advantages, such as access to a wide and expanding market conducive to growth, but the scope of the EU, or at least of Britain's involvement to it, should be curtailed. The EU is seen as an obstacle to the UK's full enjoyment of the benefits of globalisation and open markets. The Conservative party has entrenched this 'soft' euroscepticism in its DNA since the late 1990s, while some in the party as well as its direct competitor in the electoral field, UKIP, campaign for a complete withdrawal from the EU. I do not believe that it is a reasonable reflection of the situation Britain finds itself in as a member of the EU.

5. The reality of the EU is much more complex than this vision suggests. Eurosceptics ignore the fact that the EU has actually become much closer to the model that they favour than it was twenty years ago and that the federal dream is to a large extent dead. The European Union is now much more intergovernmental, in spite of or thanks to enlargement, than federalists hoped for. In institutional terms, this evolution can be traced back to the Nice treaty (2000), when big EU countries, including Britain, secured a majority of votes in the European Council, thus preventing a coalition of small countries from potentially outvoting them in the future. Voters throughout Europe have become much more wary of European integration, for both good and bad reasons, as illustrated in opinion polls, European Parliament elections and referendum results, which imposes heavy constraints on what all governments are ready to accept in the EU. Britain is not alone in resisting moves towards more integration – France under Presidents Chirac and especially Sarkozy has reasserted the importance of intergovernmentalism in the EU, contributing to a weakening of the Commission. Britain is therefore less 'different' than its politicians think from a new mainstream Europe.

6. In the midst of the sovereign debt crisis, it is difficult to assess the future for Britain in the EU. Provided the whole euro project does not collapse, more budgetary and tax integration is likely in

the eurozone. This deepening of integration among some member states should not push Britain even further to the margins than it already dangerously is. In a European Union which would become *de facto* multi-tier, Britain should remain a central player in all the other crucial sectors dealt with at the EU level. This includes the Common Foreign and Security Policy, where the UK is a crucial player and has a vital interest in improving the efficiency of the current system, if only for economic reasons. Bilateral cooperation with France, however positive, will not be enough to reduce costs and improve European defence within NATO. The CFSP offers an opportunity to encourage other EU members, notably Germany, to improve burden-sharing. It also includes cooperation in the former 'third pillar', home and justice affairs, where Britain has enjoyed the 'best of both worlds' (to use Andrew Geddes' phrase) in being able to opt in or out of EU directives. British input into the EU will also be necessary in decision-making about the budget and single market issues in general if the government is to push the EU towards Britain-friendly policies.

7. The long-term economic and political interests of Britain and Europe in general require continued engagement in the EU, not the dogmatic opposition to anything European, based on an outdated vision of an illusionary 'superstate', which is too often heard in the British media and on some Parliamentary benches. The British government should acknowledge how much the EU has changed since the 1990s and the extent to which the debate about sovereignty is out of step with a globalised world in which individual European nations are not major players. The debate about organising a referendum on whether to stay in the EU is equally surreal – leaving aside the debate about the merits of referenda in general in solving complex issues - when considered within the global environment. This is marked by the relative decline of 'the West', the rise of emerging countries and an economic crisis unprecedented since the 1930s. In this context Britain's active participation in the EU is more necessary than ever.

30 May 2012

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Written evidence from Business for New Europe (BNE)

Business for New Europe (BNE) welcomes the opportunity to make a submission as part of the consideration by the Foreign Affairs Select Committee for their Inquiry into 'The Future of the EU: UK Government Policy'. This evidence outlines what BNE views as the key priorities.

1. Executive Summary

The UK government should seek the following goals for the UK's relationship with the European Union:

- Seek to **retain the UK's seat at the EU table** and have a voice in all negotiations.
- **Boost jobs and strengthen growth** by pushing for reform at the EU-level.
- Recognise and **advocate the benefits of UK's full access to the single market** more clearly.
- Push for greater liberalisation and **completion of the single market.**
- **Prioritise digital and energy markets** in the pursuit of a more liberal European market.
- **Foster and encourage EU external trade** policy.
- Push for **Common Agricultural Policy reform.**
- Support measures to solve eurozone crisis and **protect the UK's financial services** sector.
- Continue **to fight against a rise in the EU budget** for 2014–2020.
- Proactively **address the diminishing UK numbers in the EU** institutions at both UK and EU levels.

2. Introductory Comments

2.1 BNE is an independent coalition of business leaders advocating a positive case for reform in Europe. We are an independent not-for-profit organisation funded by donations from the private sector with offices in London and Brussels.

2.2 Our Advisory Council consists of Chairmen and CEOs of FTSE 100 companies and our Executive consists of experts in foreign and economic policy.

2.3 We are involved in a wide range of advocacy activities to provide a platform for debate on European issues to business leaders and policy makers. We publish research, hold seminars and conferences, and contribute in the media. We seek to ensure that a reasoned, pro-European voice is heard in the UK.

2.4 The author of this evidence, Ariane Poulain, Head of Research at BNE, specialises in quantitative and qualitative analysis, EU and UK affairs, immigration, international development and economics. The editor of this evidence, Phillip Souta, Director of BNE, is an expert on the eurozone, international trade, Britain's relationship with the EU, European foreign affairs and comments on these issues regularly in the media. Phillip Souta would be happy to appear before the Select Committee and provide oral evidence on this submission.

2.5 BNE appreciates the opportunity to put forward evidence and will focus on advocating: (a) positive and engaged approach to the UK government's relationship with the EU; (b) specific policy areas that the UK government should prioritise as critical to the future of the EU: the Single Market, EU external trade policy, reform of the Common Agricultural Policy, the Multiannual Financial Framework 2014–20 and financial services; and (c) British representation in the EU institutions.

3. Recommendations

3.1. The UK should pursue a realistic, pragmatic and positive approach to the EU. We advocate that the UK government's approach to its future relationship with the EU should be characterised, overall, by the following two prerogatives:

3.1.1 The importance of the UK having a seat at the negotiating table must not be underestimated.

- Britain must remain engaged across all relevant policy areas. The view that the UK would be in a better position if it left the EU and instead took part in an EEA-style agreement, similar to that of Norway, is not in the UK's best interests.

- A January 2012 report commissioned by the Norwegian government[1] highlighted major drawbacks of their agreement with the EU stemming from not having a seat at the table during negotiations. Norway is 'bound to adopt EU policies and rules on a broad range of issues without being a member and without voting rights' and as a result, for example, has actually implemented more EU regulations than the UK.

- Norway's 'association without membership' relationship with the EU provides access to the single market but at the cost of contributing to the EU budget and not having a voice at the negotiating table. An EEA-style arrangement, if it were even available to Britain on equivalent terms to Norway, would in practice do little to enhance British sovereignty, and would mean that the UK would be obliged to implement EU legislation without having any say in its formation.

3.1.2 The pursuit of opt outs is a red herring and the UK government must shift the current debate towards a more constructive agenda, primarily focused on achieving better growth.

- According to the Office for National Statistics, the UK's real GDP has stagnated for nearly two years and is currently in a 'double dip' recession with a second successive quarter of economic contraction—real GDP declined by 0.3% in Q1 2012.

[1] "Outside and Inside: Norway's agreements with the European Union", Report by the EEA Review Committee submitted to the Ministry of Foreign Affairs on 17 January 2012, Official Norwegian Reports NOU 2012: 2, Chapter 1 [in English], at http://www.europautredningen.no/wp-content/uploads/2011/12/NOU201220120002000EN_PDFS.pdf

- At present, the EU has not implemented the necessary reforms sufficient to boost jobs and growth—this is damaging the EU and in the process, the UK.

- Thus, the UK's future relationship with the EU must be based upon pushing for reform that is in the UK's interests. With this in mind, the future of UK government policy on our membership of the EU should not be about renegotiation, it should be about reform.

- As 3.2 notes in greater detail, the EU is the UK's largest trading partner and the single market adds over €600 billion to the UK economy annually. It is in the UK's best interests that the EU overcomes the crisis and regains competitiveness in the global economy.

3.2 The European single market is vital to the UK economy and plays a major role in the importance of the UK's relationship with the EU. We advocate that the UK government should build a stronger agenda on the following:

3.2.1. Seek to more clearly recognize and build upon the key benefits of the European single market. The following identifies why—despite the current financial crisis—the UK's full access to the EU single market remains highly attractive and lucrative in the global political economy.

3.2.1.1. The single market is the world's largest trading area with almost 500 million consumers and worth €12.6 trillion, compared to €12 trillion and €3.5 trillion in the US and Japan respectively.

3.2.1.2. Over 50% of foreign direct investment to the UK comes from EU member states; the UK attracts global FDI primarily because of its full access to the EU single market. An example of this is the recent decision by the leading Japanese pharmaceuticals giant, Shionogi, which is currently rolling out a five-year global expansion plan. In July 2012, Shionogi announced that they would set up their European headquarters in London because of London's strong infrastructure, outstanding talent and "easy access to the rest of Europe"; this creates 50 new jobs and Shionogi are now also considering moving part of their manufacturing operations to the UK.

3.2.1.3 The single market adds €600bn a year to the UK economy, accounts for over 50% of all UK trade in goods and services, and 3 million jobs are directly or indirectly linked to it.

3.2.2. Full completion would add a further €200bn to the EU's GDP. We advocate that the UK government prioritise the following two policy areas in the push for greater liberalisation and completion of the European single market: the digital single market and the energy market.

3.2.2.1 The Digital Single Market

- The failure to complete a digital single market in the EU has the potential—under cautious assumptions—to cost Europe at least 4.1% of GDP by 2020 due to the lack of coherence and fragmentation across EU member states which present significant barriers to growth in a swiftly growing market.

- In the UK alone, it is estimated that the digital market will grow by 10% in 2012 and by the end of 2015, the Minister for Media, Culture and Communication, Ed Vaizey, predicts that it will represent 20% of the UK's total GDP.

- We strongly encourage the UK government to fully support the goals of the 'Digital Agenda for Europe',[2] from improving cross-border online transactions to the implementation of pan-European licensing for online content such as music, photography and film.

3.2.2.2. The Energy Market

- Like the digital market, the EU's member states are operating in a highly fragmented European energy market and at present, EU 2020 targets in the area of energy will not be achieved. For example, in energy efficiency alone, the EU is forecasted to improve its energy efficiency by 9% which is less than half of the EU 2020 target.

- In May 2012, European Commission president, Jose Manuel Barroso, stated that the EU energy market was worth €620 billion in itself.[3] This clearly underlines the importance of the Commission's communication 'Energy 2020: A Strategy for Competitive, Sustainable and Secure Energy ' goals which comprehensively set out the requirements for a stronger and more productive EU energy market, such as energy efficiency and infrastructure.

- We strongly encourage the UK government to actively support and push forward the EU 2020 goals in energy for the benefit of the wider EU economy as well as domestically. Furthermore, the UK does not have the capacity to independently meet national energy demands and is currently falling behind other EU countries in its ability to maintain important environmental priorities such as reducing greenhouse gas emissions and increasing the amount of energy produced from renewables.

3.3. As a member of the EU, the UK trade sector is in a much stronger position and it is in the UK's best interest to foster and encourage the EU's external trade policy.

3.3.1 The EU is a significant force multiplier for UK trade. There are three main reasons for this:

3.3.1.1 The UK trade sector has the support of the EU if external trade partners contravene WTO rules.

3.3.1.2 As part of the EU27, the UK is in a more influential and attractive position to secure Free Trade Agreements (FTAs). The following examples demonstrate a benefit already achieved and the potential for future UK opportunities in EU external trade policy:

3.3.1.2.1 In July 2011, an FTA between the EU and South Korea came into force. The deal is estimated to eliminate over 99% of duties on EU goods and in the UK specifically, the Department for Business, Innovation and Skills estimates that the

[2] See http://ec.europa.eu/information_society/newsroom/cf/pillar.cfm?pillar_id=43&pillar=Digital%20Single%20Market

[3] "Deepening EU China co-operation on energy: Working together to meet global challenges", speech by European Commission President Barroso, EU-China High Level Meeting on Energy, Brussels, 3 May 2012, press release available via http://europa.eu/rapid

deal will bring £500 million of annual benefits to the UK and create an additional £2 billion in export opportunities for UK business.
3.3.1.2.2 We advocate that the UK should continue to encourage the EU's external trade policy because of the vast potential opportunities for the UK trade sector. According to the European Commission's comprehensive sustainability impact assessments for FTAs, the following benefits to the UK of completed EU FTAs would be, for example:

- EU/Canada: Around £423 million per annum in the short term.
- EU/ASEAN: Up to £3bn per annum in the long term.
- EU/India: Approximately £2 billion over ten years.

3.3.1.3 The UK's EU membership places the UK in the strongest position to push for a more liberal trade agenda at the global level. This influence is two-fold. Firstly, the UK has a significant role to play in shaping the EU trade policy agenda which—considering that the EU is the world's largest trading area—allows the UK to push forward its open market philosophy and encourage greater liberalisation in the single market. Secondly, as an individual voice on the global level the UK is more powerful as part of the EU27; if the UK was outside of the EU, for example, it would have little ability to influence and shape the WTO agenda.

3.4 The UK government should call for reform of the Common Agricultural Policy (CAP) to ensure CAP spending is conducive to long-term growth and better aligned with the UK's best interests alongside providing more effective support to the EU's agricultural sectors.

3.4.1 The main issues surrounding negative CAP spending are:

3.4.1.1 The allocation of direct payments are highly unequal: (a) over 50% of CAP goes to the top 16% of farmers; (b) direct payments per hectare vary significantly across EU member states, from €462 to €190; this primarily disadvantages the Central and East European (CEE) member states and the CEEs are most in need of support to strengthen their agricultural sectors.

3.4.1.2 Subsidising the EU agricultural sector goes against the values of the single market: it is (a) highly protectionist, and (b) distorts regional and global markets.

3.4.1.3 CAP is currently allocated over 40% of total MFF spending and of this amount, only 25% goes towards rural development. Rural development spending is more sustainable and effective than direct payments in the long-term.

3.4.2 We consider that the above issues should be addressed in the next MFF and as a result, an 8% reduction would be made to overall CAP spending but alongside efficiency gains and an increase in positive spending. We advocate that the UK government should consider the following reforms to CAP:

3.4.2.1 Introduction of means testing for individual beneficiaries of CAP.

3.4.2.2 A 50% reduction in direct payments to the top eleven EU member states with a GDP above the EU average, with the aim to phase out post-2020.

3.4.2.3 Increase direct payments by 26% to the four EU member states with the lowest GDP below the EU average.

3.4.2.4 An increase in rural development spending by over €4 billion.

3.5 The euro area summit conclusions dated 29 June 2012 provide for the creation of a "single supervisory mechanism" by the end of 2012. This mechanism will be vested in the European Central Bank (ECB) and once established will allow for the European Stability Mechanism (ESM) to recapitalise banks directly. It is in the UK's interests that the eurozone crisis be resolved. It is reasonable to talk about common resolution, depositor protection at a eurozone or EU level. We submit that the UK government should strongly support the creation of such a "European Banking Union," whilst bearing in mind the following:

3.5.1 Financial services are of considerable importance to the UK economy, accounting for 9% of UK GDP, and £63 billion in UK tax revenues in 2010/11 accounting for 12% of total UK tax receipts. Financial services employ 2 million people in the UK—7% of UK employment.

3.5.2 The UK accounts for 36% of the EU's wholesale finance industry and 75% of European financial transactions take place in London.

3.5.3 The European Council conclusions dated 29 July 2012 state that proposals to be prepared on a European Banking Union, *"will include concrete proposals on preserving the unity and integrity of the Single Market in financial services and which will take account of the Euro Area statement and, inter alia, of the intention of the Commission to bring forward proposals […]"*

3.5.4 It should be remembered that the proposals referred to in 3.5.3, above, will not change fundamental treaty freedoms. At this stage, it is also impossible to give a detailed analysis as there is no detail on the proposals.

3.5.5 In order for the Single Market in financial services to be properly maintained and protected, the government should maintain that:

- Regulation of eurozone banks should remain fully within the scope of the EU's existing EU treaty structure, where both the European Commission and the European Court of Justice are bound to maintain a level playing field.

- The UK should remain fully engaged in the operation of the European Banking Authority, which works with the national regulators of all the EU's 27 member states to prevent regulatory arbitrage and help maintain a level playing field.

- The UK should seek to establish whether there is any risk of a European Banking Union creating barriers to eurozone banks which currently have operations in the UK.

3.6 Negotiations on the next long-term EU budget 'The Multiannual Financial Framework 2014–2020 (MFF)' are ongoing. We encourage the UK government to push for the EU to avoid raising the size of the MFF to reflect the impact of the current fiscal pressures on member states.

- This submission recognizes that areas such as energy, the digital agenda, innovation and research play a significant role in the success of productivity, growth and unemployment levels in the EU and individual member states alike.

- However, future EU spending must offset the current times of austerity and policies, such as CAP, that are not conducive to long-term prosperity should be reduced.

3.7 In order to pursue this realistic, pragmatic and positive approach to the UK's membership in the EU, British influence towards and within the EU institutions is paramount. We strongly encourage the Government to proactively push for greater UK representation at the EU level alongside building a better platform to encourage the importance of this domestically.

3.7.1 Whilst a European Commission official is of course required to act on behalf of the interest of the EU as a whole, rather than that of his/her member state, the official naturally reflects his/her national perspective and culture in his/her daily interactions. Without national perspectives represented in each institution, the institution would not act on behalf of the Union as a whole. Regrettably, the number of British officials within the institutions, namely the European Commission, is dwindling at an astonishing pace.

- The UK represents 12% of the population of the EU but holds only 5% of posts within the institutions.

- These figures are only deteriorating and UK representation in new EU institutions, namely the European Financial Supervisory Authorities, is also a worry to the British business community.

3.7.2 The main issues behind this lack of overall representation include the following and all of these reasons fall on a background of an overall national negative perception of the EU:

3.7.2.1 The 1972 intake of British citizens is close to retirement.

3.7.2.2 The *Concours* examination must be taken in French or German.

3.7.2.3 The awareness of career opportunities at universities is poor and secondments within the Civil Service to Brussels are not encouraged.

3.7.3 BNE has worked with the UK Government, both in London and Brussels, on this issue for the past two years. We will continue to push this agenda and encourage continued government support.

- We applaud the Foreign and Commonwealth Office and the UK Permanent Representation to the EU in placing such a priority and resources to achieving the objective of greater UK representation in the EU.

- Following representations made by our members, we welcome the introduction of mandatory foreign language learning in the English Baccalaureate and we support the government's drive to work with universities, including the College of Europe, to create awareness of the many EU career possibilities open to UK graduates.

- We also welcome the support given in the establishment of the *British Brussels Network*. This network seeks to provide a platform for debate on EU issues from a British perspective in Brussels and has been successful in doing so over the past year.

3.7.4 Whilst the Foreign and Commonwealth Office has made noticeable progress in highlighting the need to address this subject, BNE seeks to ensure that this priority is heard across Government. We strongly recommend that further action be taken as follows:

3.7.4.1 The Civil Service should explore the possibility of requiring civil servants to work on EU issues at some point during his/her career development, whether it is through secondment or training.

3.7.4.2 The Government must seek to ensure that the new financial supervisory authorities are staffed appropriately. This is of upmost importance because without the continuation and strengthening of this drive, British influence within Europe is bound to diminish.

10 July 2012