

Europe: It's Time to Decide

A Strategy for Deciding the UK's Relationship with the European Union

Introduction

The first of January will mark the 40th anniversary of the UK's entry into the Common Market.

Back in 1973, this was greeted with celebrations in Brussels. At the stroke of midnight a Union Jack was raised at EEC headquarters. The new British Commissioner joined revellers on the streets for a torch-lit procession. Prime Minister Edward Heath predicted Britain would become "more efficient and more competitive in gaining more markets not only in Europe but in the rest of the world."

Four decades on, Britain's future in Europe has never looked so uncertain.

Not so long ago an EU Commission President jetted in to London to warn that Britain must join the single currency or risk losing out. He predicted the spread of the Euro to North Africa and even claimed it would become "very popular" in Britain.

But the intellectual arrogance of the European political elite was not justified. The Euro was no big success even in times of growth. Faced with global financial instability, it has amplified the problem, rather than solving it. Today it remains the single biggest risk to the world financial system.

Worse still, Eurozone leaders have not dealt effectively with the crisis. Faced with the catastrophic consequences of putting federalist fantasy ahead of economic reality, they have dithered and delayed. Faced with a crisis caused by integration, their solution is not less Europe, but more Europe.

Decision Point

The EU began with the best of intentions, but has not achieved the best of outcomes.

It has enjoyed some successes, namely the single market and of course the enlargement which has brought a number of countries with troubled histories into the modern, democratic world, most notably the eastern European nations.

However, I was more than a little sceptical of the decision to award the EU the Nobel Peace Prize. Peace in Europe owes more to NATO and the post-war German constitution than to the Common Agricultural Policy.

Certainly for British voters, the idea of Britain taking her place at the heart of Europe has never held less appeal. We have reached a turning point in our history, and a decision point in our future.

And it is a critical decision we have to make. The pressure for an “In or Out” referendum is building. There is little doubt in my mind that the political elites will be unable to escape holding such a referendum in the next five years or so. I am squarely in favour of such a referendum – but it must be done properly.

Some of you here may be old enough to remember the last Europe referendum – the 1975 vote on Britain’s membership of the Common Market. You may also remember that a year before that referendum, polls showed most people were planning to vote “No”.

But in the intervening twelve months the European Commission, the TUC, the CBI and the government of the day used every scare tactic in the book to secure a “Yes” vote. They claimed leaving the Common Market would mean permanent decline for Britain – less international influence, less work, less trade and less money. As a tactic it was shameless, but it worked. On the day, two thirds of voters backed Britain’s membership of the Common Market.

“Those who cannot learn from history are doomed to repeat it”. We were taught a lesson in 1975. If we were to have a simple In/Out referendum and voters were scared into voting “In”, that would be the worst case scenario for Britain.

It would not reflect voters’ concerns about Britain’s relationship with the EU. And it would render future British governments utterly impotent in European negotiations, undermining their ability to block EU initiatives which threaten British interests. I would not envy the Foreign Secretary his job after that outcome.

So before holding such a referendum, the government needs to have a clear understanding of the visions for Britain’s future relationship with the Europe, whether that relationship is best conducted from within the EU or without. We should structure the decision so that whatever the outcome, we resolve the causes of our troubled relationship with the EU.

The Third Rail – an untenable position

This will require a new approach from the government. For years the Conservative leadership has, understandably, regarded the EU as the third rail of British politics – politically charged, controversial, and too dangerous to touch.

With the continent in the grip of the Eurozone crisis, this has ceased to be a tenable position. Not only does the crisis have direct and potentially devastating consequences for our economy, but the solutions proposed by the Eurozone powers demand further and faster transfer of powers to EU institutions.

But why was Britain’s relationship with Europe treated as a third rail for so long? The answer is simple – fear.

First, fear of splitting the Conservative Party. This is no longer a real threat. The Conservative Party is now over 90% Eurosceptic.

Second, fear of the consequences of leaving the EU. Many greet any such suggestion with warnings of disaster. I was never convinced about this, and today such histrionic scaremongering looks simply antiquated and self-serving.

[Insert graph showing UK exports to EU v RoW].

Third, governments are disinclined to enter into negotiations when they appear doomed from the start. Even amongst those who want to take powers back from the EU, there is a fear that other EU Member States would not play nice and that the negotiation would fail. I don't believe this either.

[Table/graph showing Britain's major trading partners – almost all EU countries]

What's next for the Eurozone?

Before we consider our own actions, let us consider the strategic backdrop – in particular, the prospects for the Eurozone.

Austerity

We have become so used to miserable news from the Eurozone that it has numbed our senses. So let us remind ourselves of the facts.

Total Eurozone debt is currently 90% of GDP and will hit 95% next year. In four countries – almost a quarter of the Eurozone - public debt now exceeds national GDP, hitting 120% of GDP in Italy and 165% in Greece by the end of last year.

[Graph to show debt (per household)]

Clearly Eurozone countries must kick their public spending addiction. Excessive borrowing is at the root of the Eurozone crisis. Even more borrowing cannot solve it.

But austerity alone is not enough. To pay down these colossal debts would require spending cuts and/or tax rises of such severity that they would be politically unacceptable.

Indeed, Greek Prime Minister Antonis Samaras only passed his latest austerity budget by promising that these new spending cuts and tax rises are the last the Greeks will have to endure.

The Eurozone needs jobs and it needs growth.

Eurozone unemployment is 11.6% - that's almost 18 million jobless people. In Portugal one in six is out of work. In Greece and Spain the figure is one in four. Amongst young people in those two countries, the employed are now a shrinking minority.

To turn it around, Eurozone countries must become more competitive.

The European Commission predicts just 0.1% growth in the Eurozone next year, and many economists think contraction more likely. The Portuguese government is bracing itself for a third straight year of recession, Greece for a fourth.

Even the eternally optimistic ECB boss Mario Draghi, recently ridiculed for claiming the Eurozone is “poised for recovery”, believes any recovery would “probably be slow”. Without drastic action, Europe risks becoming “the 1% Continent” with low growth in perpetuity.

Take the example of Germany ten years ago. With rising unemployment, soaring debts and overregulated businesses, they were far from being Europe’s dominant economy. But the government of the day took decisive action, implementing extensive deregulation for businesses, along with radical labour market and welfare reforms.

But even the most effective expenditure reduction policy will not deliver jobs, growth and prosperity if the failing economies are locked into an uncompetitive currency. The one measure that offers rapid rescue, exit from the Eurozone, is the one thing the European political elite will not countenance.

So the Eurozone itself has reached a fork in the road.

Break up

One way leads to breakup. The most realistic scenario would be for one or more of the heavily indebted and uncompetitive “peripheral” nations to quit the Eurozone, devaluing their currency and defaulting on their debt.

This would have huge political and legal implications. There is no agreed mechanism to allow a nation to leave the Eurozone, and European leaders refuse to create one. Roger Bootle’s Wolfson Prize winning analysis is the best guide to how it might happen.

Billions of pounds of loans could be written off at a stroke. Banks in other member states could need bailouts. Uncertainty would hang over the exiting country’s EU membership. There would be huge legal and commercial doubt over all euro-denominated contracts to which it was a party. There would inevitably be feverish speculation about which country could (or should) be next to leave.

Holding the Eurozone together

The other way ahead is to try and hold the Eurozone together. This is what its members are trying to achieve. To work, it will require painful action with far-reaching and very long-lasting consequences.

At present, the Eurozone is seventeen economies stuck together with a common interest rate and some ill-observed deficit rules. To stay together, the Eurozone would need to become more like a single economy.

Economic Union

To this end, plans for full fiscal and banking union are on the table. Under these proposals the European Central Bank could get powers to supervise Eurozone banks. EU institutions could be given the power to strike down national budgets, coordinate economic policy, set Eurozone tax rates and harmonise employment and financial regulation law. But it will take much more than that to stabilise the Eurozone.

Sir Donald MacDougall

A quarter of a century ago the late Sir Donald MacDougall, former head of the Government Economic Service and chief economic adviser to three British chancellors – and, incidentally, a mentor of mine - identified the difficulties of imposing such economic and fiscal union on different economies.

What he found still rings true today. Sir Donald concluded that per capita incomes are distributed at least as unequally between member states as they are between the various regions of those member states. However, the EU currently has neither the power nor the resources to redistribute wealth to those poorer regions in the way a national government can.

His research showed that full economic union would require Eurozone-wide taxation, a central budget ten times the size of the current one, and a federal treasury with powers to redistribute income between member states on an ongoing basis, just like the US Treasury can redistribute money between the various States.

France and Germany believe this further integration can turn the situation around. But the simple fact is no amount of treaty change will turn Greeks into Germans, either in terms of fiscal responsibility or economic productivity. And whilst some officials might view the Eurozone as one country, ordinary voters will not. It is one thing to see money redistributed from one region to another within a nation. But to ask Germans to hand over their taxes to Greece would be political dynamite.

The leadership of the Eurozone sees its salvation in becoming more like a nation state. But there is a problem. No matter how much integration occurs, no matter how many policies are harmonised, a Eurozone union will never enjoy the democratic legitimacy that is the hallmark of the nation state.

To achieve economic stability the Eurozone would require a budget of up to 10% of its GDP – €940 billion based on 2011 Eurozone GDP figures. That's half the size of the entire UK economy. MacDougall added that, to become a fully fledged federal state akin to the USA, a Eurozone economic union would need a budget equivalent to 25% of GDP – over €2.3 trillion.

To have a central Eurozone budget to redistribute wealth in Europe would be taking away vast sovereign powers from member states, a matter that would surely be disputed and which could require a new treaty.

Of course the €2.3 trillion budget model will not happen tomorrow. There are too many political obstacles, not least the German electorate. But within the EU the political pressure will be permanently in that direction for the next decade or two, acting as an imperative to take more powers from member states year after year.

The reason the EU wins its battles is because it plays the long game, planning what it wants to do years, sometimes decades, in advance. To protect Britain's interests, we must look not only at what Europe does now, but what it wants to do in twenty to thirty years' time.

Balance of power within EU

There are those who argue for European membership on the grounds that a bloc of countries are more powerful than one. They forget that one country only has 1/27th of the say in the decisions of that bloc. But even that is optimistic. All countries may be equal, but in Europe some are more equal than others.

Franco-German axis

Even the humblest student of European affairs knows that Germany and France have long dominated the Eurozone bloc. The prospect of a more integrated Eurozone also raises concerns about the balance of power within the EU.

When I was a Foreign Office Minister negotiating on one of the EU's endless round of Treaties, representatives from three Member States approached me and asked Britain to veto one particular EU proposal. I said if they opposed the plan they should veto it themselves. Their response was telling; only Britain could stand up to the Franco-German axis in Europe.

Over fifteen years later that axis is still strong, and now includes the European Commission and the European Central Bank. And when they are determined on an objective they are powerful enough to bend rules.

Frankfurt Group

Last year this axis was formalised by the founding of the Frankfurt Group – the innermost ring of a series of concentric alliances - in effect a coalition of the architects and paymasters of Europe. Members include the French and German leaders, French IMF chief Christine Lagarde and the heads of the European Commission and European Central Bank.

Meeting in private, away from other Eurozone leaders, this group had soon removed the elected leaders of Greece and Italy, replacing them with unelected, EU-approved technocrats.

Of course it is no novelty that France and Germany meet in private to discuss the fate of the Eurozone. There is nothing secret or sinister about it. They have always been the dominant powers in the European system, together exercising an extraordinary grip on the operation of the Commission, control of finances and the EU's general strategic direction.

In his memoirs Sir John Major, hardly the most ardent Eurosceptic, described how before every summit “...the French and Germans reached an agreed position if at all possible.”

The smaller countries, many of whom receive billions in EU subsidies, do not stand up to them.

And in two years the voting system will change to give a qualified majority to the Eurozone countries.

The Frankfurt Group is a precursor of how we can expect major decisions to be taken in the Eurozone bloc and the EU as a whole. What is more, the powers driving these decisions are convinced of what they see as the remorseless logic of integration for EU member states.

Britain has been on the receiving end of the Franco-German axis’ determined federalism before.

Working Time Directive

For example, when the Working Time Directive was first proposed, the UK said they could not support it. Since working hours are a question of employment law, the harmonisation of which requires approval by all member states, that should have been the end of the matter.

But it wasn’t. The Working Time Directive was not dropped. It was not even amended to allow a compromise. Instead it was reclassified. Suddenly the proposal was back on the table, presented not as a matter of employment law but instead as a health and safety measure.

The difference? Whilst changes to employment law used to require unanimity, health and safety legislation could be passed by a qualified majority. This rendered Britain’s objections futile, and the Franco-German axis got what it wanted.

More recently, we have seen this pattern repeated.

Fiscal Pact

Last December, David Cameron rightly vetoed attempts to restructure the Eurozone because the plans threatened British interests – particularly those of our financial sector. The point of giving member states a veto is to allow them to stop something happening. If a member state feels strongly enough to exercise its veto – something only ever done as a last resort - then fellow member states should at least seek some sort of compromise.

But the Franco-German axis does not see it that way. Faced with a British veto of their far-reaching reforms, they brushed aside the government’s perfectly valid concerns, and pushed ahead with the plans. The veto didn’t stop anything – it has ended up as a sort of pre-emptive opt-out.

New EU Budget

The same will happen with the EU Budget when it is discussed in three days' time. The Prime Minister has threatened to veto the Commission's demand for an inflation-busting 5% rise.

Of course he must veto such an extravagant proposal. But it will not achieve any cuts in the EU's budget. EU rules mean that if agreement is not reached, the budget will be approved annually by Qualified Majority Voting. This will allow the EU to increase its budget in line with inflation, shielding it from the austerity the taxpayers who fund it must face.

This threatens Britain's national interests. A more integrated Eurozone will vote as a united bloc within the EU. With Germany and France at its heart, it will be a powerful force for further EU integration and the transfer of powers from national governments to EU institutions.

Critical decisions and missed opportunities

It is clear that Europe is changing. The Eurozone nations are intent on further integration and will achieve this through Eurozone-only agreements if they cannot do so through the EU Treaties.

But just because we do not know what shape the post-crisis EU will take does not mean Britain should adopt a "wait and see" approach. The government needs to be clear (both in its own mind and with European partners) about how the new EU should function.

The government has launched a review of the balance of competences between the UK and EU. That is all very well, but how can you assess whether or not there is an imbalance unless you have first determined exactly what powers should lie where? It is also not due to conclude until 2014, which is too slow.

Delay is unlikely to improve our negotiating position. Before we can know if, and in what areas, the EU has too much power, we must decide what should be done at the EU level, and what should be left to nation states. This is a decision we can make now.

Shopping List: Repatriation of Powers

As Europe's powers go up, its popularity in Britain goes down. It now has powers on huge areas of public policy, from home affairs to health and safety, from tourism to tax, from national security to social security.

The Commission can tell us how many hours a week we can work, or even how long a bus route can be. And the European Court of Justice can tell our law makers and our law givers, our parliamentarians and our judges exactly what they should and shouldn't do.

This intrusive legislation, and this intrusive control, now grows at a rate of 3000 regulations a year. The European Commission admits that EU regulation costs businesses at least £110bn every year, and even accepts that much of this regulation is “unnecessary”. The previous government’s own regulatory impact assessments estimated that EU regulations cost Britain’s private and public sectors £140bn between 1998 and 2010.

[Graph]

Ratchet clauses

That is bad enough, but since the Lisbon treaty, which gave the European Union 40 more areas of control, the Commission can now use ratchet clauses to extend its power without rewriting a treaty.

That is one of the reasons the government’s current policy of “we’ll have a referendum if we have a new treaty” is simply not good enough. It’s not good enough because it is a reversal actually from the position before, which was if more powers go to the European Union we’ll have a referendum. It’s actually now possible for those powers to go without them asking the people.

We should seek the repatriation of a whole range of powers to create a new relationship between Britain and the EU.

We should take back all of our justice and home affairs powers.

We should take back immigration powers.

We should take back control of social and employment legislation.

We should give our government the final say on health and safety legislation.

And we should protect Britain from financial regulation designed to punish the UK’s success.

We should take back all of these things and more, and take them back permanently.

If we achieve this we would return Britain to a relationship with Europe which is similar to what the British people thought they were voting for in 1975 namely a Common Market which delivered economic benefits for the whole Continent without impinging on the democracies of the nations on that continent.

But this of itself is not enough. It is no good simply negotiating away the things we do not like about Europe only to face a future in which EU institutions, backed up by ever more prevalent qualified majority voting, continues to erode our national interest.

In democratic nations we hold regular meaningful elections where voters can stick with what they have got or wipe the slate clean. Crucial to this principle of people power is the rule that a government cannot bind its successors.

For example, if a party won an election promising to cut taxes, then it would have a mandate to do so. But if that party could then pass a law saying no government could ever raise taxes again, it would undermine the right of the electorate to change its mind in future.

However, the EU has no such concept. What it has is the *acquis communautaire*, a doctrine which states that the powers the EU has acquired belong to the EU forever. This is not just undemocratic, it is anti-democratic. Anti-democratic because through this doctrine the EU specifically seeks to bypass the views of voters. If a democracy cannot change its mind, it ceases to be a democracy.

Nation state as a moral concept

I'm an old fashioned Tory in that I believe the nation state is a moral concept.

By that I mean that, with its common laws, its common tradition, its common conventions, its common beliefs, and its common understandings, the nation state is actually the highest manifestation of democracy.

Democracy is not just about casting a vote. Democracy is about being willing to make sacrifices for each other, to allow taxes to be used to support those who cannot support themselves. Democracy means letting our sons and daughters put their lives on the line to defend us.

The EU, though, is run by the Commission, a group of people – all unelected and mostly unheard of – appointed to represent their nations' citizens around the top table. It is they who propose new laws, control the budget, implement decisions and manage its day-to-day running.

In 2009 the European Commission was responsible for 72% of new EU law. That is fundamentally undemocratic. It is a remarkable and unacceptable state of affairs that these 27 Commissioners can be handed so much power without ordinary voters having any say.

In the last four decades we have seen European institutions extract power from national parliaments - which you elect and you control - and hand it to people you probably wouldn't recognise and can't get anywhere near.

That is why we need a fundamental constitutional change in the relationship between the British Parliament and the European Union.

We need a permanent, universal opt-out that allows us to escape the damaging effects of costly and unnecessary EU laws. If we do not like a new law, Parliament should be able to reject it.

Some will say this is impossible. Certainly negotiations will be difficult, but EU arrangements already allow something similar regarding justice and home affairs law.

Because even the Commission recognised that it was highly controversial to bring crime, justice and immigration within the scope of EU law, it allowed an opt out.

Justice and Home Affairs

Britain has been signed up to 135 of the EU's justice and home affairs laws for a number of years. In that time we have found that some work well and others do not.

For instance, the European Arrest Warrant was established to help fight terrorism and organised crime. However its flaws have led to multiple miscarriages of justice and we should not opt back in to it in its current form.

By exercising the opt out, which government plans to do, we can repatriate significant powers and refuse to allow the European Court of Justice to override British courts on criminal law matters, whilst still cooperating with our European partners. This arrangement is a blueprint for what our relationship with the EU should be.

Transformation of Europe 1975-2012

This leaves us with two issues to resolve. How to negotiate such a change, and how to obtain the approval of the British people for attempting such a historic grand bargain, one which will affect the future not just for them, but for their children and grandchildren.

I believe that we can achieve both of these aims with a single strategy, the so-called double referendum strategy. This is less complex than it sounds.

First it requires us to decide very clearly what our negotiating aims are – really what I have just laid out – during the course of the next year. The details may be complex, but the primary aim is clear – to get as close as possible to the trading alliance, the common market we all voted for in 1975.

Then we present that negotiating package to the British people, and seek their approval for it in a referendum. We would be looking for a clear mandate. And I would be very surprised if the proposal I have described does not obtain a 70% voting majority – greater than we got in '75, and greater than any modern political party has ever achieved.

In the same Act of Parliament that establishes the Mandate referendum, we also commit the country to a decision referendum, to be held when the EU negotiation is concluded. In essence, in that referendum the British people would either approve the new negotiated relationship, or if it was not good enough, it would trigger the negotiation to leave the Union.

This approach has a number of advantages: the Mandate referendum would stiffen the spines of our negotiators, and undermine the legitimacy of the European resistance to change.

One of the characteristics of the EU is that it never backs down in the face of national demands except when they are backed up by a referendum. When Ireland rejected the Nice Treaty because it threatened their military neutrality, the EU gave formal undertakings that they would not be forced into a common EU defence policy. When French and Dutch voters rejected the Constitutional Treaty, it was also rewritten.

The legal certainty of a decision referendum would also signal to the EU that we are serious – that this negotiation was not sabre rattling, and that a failure to conclude an agreement that recognised Britain’s democratic right to make its own decisions in areas of critical national importance would lead to a parting of the ways.

This in turn would mean that British citizens would be offered the best possible circumstances for staying in, as well as a real alternative in pulling out.

The purpose of this strategy is to maximise both the democratic legitimacy and the negotiating leverage to achieve our policy aims. But there is a domestic political side effect. The optimal timing for this is to decide the policy in 12 months and hold the mandate referendum in late 2013 or very early 2014. Before the European Parliamentary elections.

There has been much talk of Labour outflanking the Conservatives on a referendum. That timing would pose some difficult questions for all the parties to answer. And I am not at all sure how UKIP would do in the European Election once the government had faced up to this policy properly.

To make this work we have also to be clear what our position would be if the European Union did not deliver a package that appealed to the British people. As I said, this is much less scary in the current world of 2% trade tariffs than it was in the 1975 world of 10% tariffs.

We have a range of options, from European Economic Area and European Free Trade Agreement membership with Norway, through the series of bilateral arrangements that Switzerland has, to a World Trade Organisation-based minimalist relationship.

But we are the United Kingdom, a significant power on the international stage, and I see no reason why we should not forge our own relationship. My preference would be that we should remain within the Customs Union of the EU.

What this means is that we would have to maintain a common external tariff barrier (only about 2.7% on manufactured goods) and give up some freedoms in terms of negotiating our trading arrangements with third countries.

The advantage would be that our manufacturers would not face complex and punitive “rules of origin” tariffs if parts of their products were made in, say, China. That would also be the arrangement that would allow true free trade in both directions across the Channel, so Continental manufacturers would prefer it.

But, frankly, if the EU did not want to do that, the other options are pretty attractive too. The Swiss free trade area approach would allow us to negotiate advantageous trade deals with non-EU countries. It is this sort of option that offers Britain the “European Hong Kong” strategy. So UK negotiators would have the luxury of negotiating for one of several options, all better than our current status.

Paradoxically, the fact that the radical, out-of-Europe options are growing more attractive as the years pass, means that the deal that we can strike with Europe is likely to be much stronger.

Tony Blair recently called for a “Grand Bargain” to save the Eurozone. But as ever his words were not backed by detailed plans. Now is the time for big actions, not just big rhetoric. We need a new deal with Europe. One which keeps the trade and keeps the cooperation with our European partners, but which also keeps law-making powers in Westminster, not Brussels.

Both Britain and Europe have reached a decision point. The federalist course the Eurozone powers have chosen is not one Britain should follow. So the time to strike that deal is now.

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