

Britain must defend the single market

By Jo Johnson MP

If Britain's relations with the EU were ever in stable equilibrium, they are no longer so. The longstanding fault-line separating a sceptical UK from an instinctively more integrationist continental bloc widened into a gulf at the tumultuous European Council summit on December 8th-9th 2011. The decision of the Prime Minister, David Cameron, not to join negotiations to amend or supplement the EU Treaties (after other EU countries refused to include the 'safeguards' he had requested) captured the British public's imagination and provided a substantial domestic political payoff.

Many Conservatives – frustrated by the lack of a referendum on the Lisbon treaty, feeling vindicated in their opposition to British participation in the single currency and eager to claw back powers from Brussels – rallied around a leader who had shown 'bulldog spirit'.¹ Within a fortnight, the Conservatives took a five percentage point lead in the polls, pushing past the psychologically important 40 per cent mark.² (When the lead subsequently subsided in the late spring, the Prime Minister was asked to supply more such "veto moments".)³

¹ <http://www.thesun.co.uk/sol/homepage/news/politics/3988056/David-Cameron-savaged-on-Euro.html>

² According to samples taken by YouGov for *The Sun* on January 20th and by ICM for *The Guardian* on January 22nd 2012.

³ <http://www.telegraph.co.uk/news/politics/9287752/More-EU-veto-moments-please-Prime-Minister-says-Chris-Grayling.html>

In the space of a few weeks, Britain found it had made a profound choice: to stay 'in Europe', but on a more semi-detached basis than ever. At the summit on March 2nd, Britain was one of only two member-states not to sign the new 'fiscal compact' (or Treaty on Stability, Co-ordination and Governance in the Monetary Union).

The ramifications of these decisions will not be clear for some time. But it is premature to assume that just because the UK has not signed up to the fiscal compact that it will not in time be affected by it. Closer economic and fiscal policy co-ordination among members of the eurozone, potentially a solution to the crisis, may result in a gravitational pull of decision-making towards the inner core.

While there is a consensus that Britain wants no part of the fiscal compact, it will need to guard against closer policy co-ordination among the 25 countries that are signatories to it from spilling over into areas properly the preserve of the 27. In particular, it must jealously guard the EU's single market – and, within that, the financial services sector in particular – in the event that eurozone countries proceed towards some form of banking union. It will also need to articulate a vision for how it will continue to shape the evolution of the single market – a vital national interest – and avoid losing influence in the event of caucusing by fiscal compact countries on decisions affecting all EU members.

Britain's contribution to the EU

Following a brief spurt of anti-British rhetoric in the wake of the December summit, a number of EU countries have concluded that their interests are not necessarily best served by Britain's isolation inside the EU – or its eventual withdrawal from it. Although 25 EU countries have now signed a new treaty without the UK, several have made efforts to repair relations across the Channel. Their motives for doing so have differed, but illustrate the various ways in which individual EU member-states value British membership.

Britain has traditionally made a number of important contributions to the European Union:

- ★ First and foremost, the UK has been a strong champion of the single market, of structural reform and of free trade, putting it in a position to provide a counterbalance to French institutional and ideological influence inside the EU. Absent at the creation of the European institutions, the UK initially left France free to shape Europe in its own image. Brussels was in the early years a cold place for the UK. Since 1973, that has gradually changed, with English, for example, displacing French to become the lingua franca of European business as well as of the European institutions, to the benefit of the UK.
- ★ Second, as a military power with a consistently strong relationship with the US, the UK has brought a geo-political heft that other member-states, big and small, have not been able to match.
- ★ Third, as a big country the UK has traditionally provided not just cash (as a net contributor to the EU budget), but also high quality civil servants. All member-states have a few good people, but perhaps only the UK and France can reliably produce first class work across the entire universe of dossiers simultaneously. The UK's technical contribution is a vital part of keeping the EU going. As one Brussels-watcher puts it: "Every EU civil servant knows that a UK submission on any proposal is likely to be (a) correct, (b) coherent, and (c) not a thinly-disguised piece of lobbying. That really matters".
- ★ Fourth, the UK has been an indispensable driving force behind the better regulation agenda. It has played a decisive role in highlighting the unnecessarily burdensome nature of certain EU rules and in changing the climate of opinion on this in the EU.
- ★ Finally, the UK has been the home to the world's pre-eminent global financial services centre, with the City of London representing a significant European, rather than merely British, asset.

This explains why the fall-out from the December summit has been contained. Olive branches have been tendered, bridges (to some extent at least) repaired. The UK has tried to show that it can be a constructive partner, while other member-states have realised that an EU without Britain would look very different, and not necessarily better.

Since its December veto, the UK has shown its commitment to re-engagement in a number of ways. It has been an active observer to the negotiations over the new fiscal treaty. It has submitted detailed comments on the draft treaty. It has refrained from challenging the eurozone's use of EU institutions. It has played a part in the construction of a eurozone firewall by sanctioning an increase in the resources available to the IMF. And it has openly supported and encouraged further fiscal and economic cooperation among eurozone countries.

Support for the British government's handling of its European policy and for continued engagement with London has come from some unexpected places. At the Franco-British summit in mid-February, for example, France's then president, Nicolas Sarkozy, said that he had "always been of the view that Europe needs Britain", that he had "always been a great believer in the importance of Great Britain" and that he would have acted in the same way at the December summit had he been in the

British prime minister's position in Brussels that night.⁴ For France, one of Britain's key qualities is as an indispensable partner in security and defence policy.

⁴ *UK-France Summit Press Conference, February 17th 2012*
<http://www.number10.gov.uk/news/uk-france-summit-press/>

For most other EU countries, however, Britain's value lies elsewhere. Some of the smaller member-states, fearful of Franco-German domination, see in the UK an important counterweight to the big two. For most member-states, however, the UK's primary value is as a supporter of the single market, open competition and structural reform. It is likely that the arrival of François Hollande in power in France will for these countries underline the importance of keeping a British voice around the European table.

The single market's greatest champion?

It is no coincidence that most of the fence-mending since the December summit has focused on the single market, the area where the UK's contribution is of greatest value for the largest number of countries. For Germany, the Nordics and a number of other EU countries (including the Monti government in Italy), re-creating a unity of purpose around the goal of breathing new life into the single market has been a relatively simple way to repair relations with the UK.

That is because the single market is one of Europe's greatest economic achievements; and there is a general recognition that it owes much of its success to the consistent support of the UK. As a senior British official in Brussels puts it: "The UK often has an inflated view of itself. It is an odd mixture of self-deprecation and self-aggrandisement. But it has played an important role over the years. It has been a consistent champion of the single market and has usually been able to persuade others to follow it – notably the Nordic and eastern and central European states."

In the great game of Brussels horse-trading, the UK has provided inspirational commissioners in key portfolios, including Lord Cockfield and Leon Brittan. It was Cockfield who authored the 1985 White Paper making 300 recommendations on how the single market could be brought into being. This led to the 1986 Single European Act, signed by Mrs Thatcher, which reformed the EU's decision-making mechanisms and paved the way for the completion of the single market. Now uniting 27 countries with a combined GDP of €12 trillion, the single market makes the EU the world's largest integrated trading bloc.

All member-states understand that the single market is good for them, even if some of them do not express much affection for it. Having common rules for the common market should be a huge benefit for businesses, which would otherwise face 27 contradictory and divergent ones. Of course, just like national governments, the EU often gets things wrong, and, despite scrutiny by 27 countries and the European Parliament, manages to adopt too much excessively complicated and redundant legislation. In the countries that have to transpose it into national legislation, EU rules are often and justifiably seen merely as burdensome. Such mistakes must be rectified and the climate of opinion on this in the EU has been moving decisively in Britain's direction.

The UK, for example, has successfully lobbied the EU to exempt micro-businesses (companies with fewer than 10 employees) from the scope of future legislation – unless there is a clear reason not to do so. Britain, with Denmark and the Netherlands, has also been in the forefront of efforts to push the European Commission to reduce the overall EU regulatory burden and to put businesses and citizens at the heart of all European policy-making. This is all the more important as the norms and technical standards laid down for the world's largest single market are often taken as the reference by third countries, not least the emerging markets, for their own legislation.

Given the way the EU works, with its system of qualified majority voting, European Commission proposals to deepen the single market cannot make headway without the support of a large group of member-states, including at least one large member-state. The UK is often one of these states. Acting together with the Commission and in alliance with a floating population of other supporters, the UK

therefore plays an important role in ensuring that the EU continues to produce economic benefits for its citizens.

The UK's role as champion of the single market is all the more valuable right now. Since there is little scope for budgetary stimulus, completing the single market is one of Europe's best hopes for economic growth. Estimates suggest it could make the average European household €4,200 better off each year. The UK's Department for Business, Innovation and Skills estimates that current trade between the UK and the rest of the EU could be as much as 45 per cent higher if current non-tariff trade barriers were eliminated.

At a time when reduced confidence in laissez-faire policies has led to 'market fatigue' and left policy-makers vulnerable to the siren call of economic nationalism, Jacques Delors' complaint that "no one ever fell in love with a single market" has seldom been truer. Today, not only is the single market not loved, it is regarded by many Europeans with suspicion, or outright hostility. It has become a regional scapegoat for the pains of globalisation. While the winners from the single market are many, they are often unaware of the benefits it brings, and are in any case geographically dispersed and not organised. By contrast, those who fear (or have most to lose from) competition and liberalisation are more concentrated and better organised.

The good news is that the world – and the EU – has managed to avoid a 1930s-style protectionist trade war since the start of the financial crisis. But there is no room for complacency. With youth unemployment in peripheral eurozone countries reaching 50 per cent, a political tipping point involving a backlash against the single market cannot be ruled out. The UK has an important role to play in making sure the EU doesn't trigger one in the difficult months to come by Balkanising its own internal market.

That does not mean that the UK should participate in the mooted European banking union. For as long as national taxpayers remain on the hook for bank rescues, the case for preserving the discretion of national, rather than European, supervisors to determine what makes a bank safe for society remains strong. Britain should avoid being co-opted into any schemes to share the burden of insuring deposits. It is bad enough having British taxpayers on the hook for British banks, and politically unsellable to put them on the hook for those of Greece, Spain and other eurozone countries. This would be to ensnare Britain into fiscal union by the back door.

With closer economic and fiscal policy co-ordination among members of the eurozone potentially creating a gravitational pull of decision-making towards an inner core, Britain must ensure that the single market remains the preserve of all 27 EU member-states, not just the 25 signatories to the fiscal compact. Failure to do so would risk pushing the centre of gravity inside the EU towards a view of the world more influenced by France. This might be a Europe with a greater propensity for protectionism and interventionism – a development that could potentially undermine the single market if it were to mean a return to 'picking winners' and supporting national champions (with markets distorted by state aids, government subsidies, concessional credit, privileged access to public tenders or trade protection targeted at particular firms or industries).

In another scenario, a partial fragmentation of the eurozone could also threaten the single market as presently constructed. Technically, a country cannot quit the euro without also exiting the EU. And while Article 50 of the Treaty on European Union does provide for a member-state to leave the EU, the framework for its future relationship with the Union could take time to agree. Furthermore, the single market has, in the minds of many Europeans, always been supported by a system of fixed exchange rates. Many question whether Europe can ever go back to a stable internal market with floating exchange rates between the major countries. They fear that certain countries will always be tempted to introduce import barriers in response to currency depreciations elsewhere.

Whether the single market will be sustainable with fluctuating exchange rates between big member-states ultimately is a judgment call. Although the German Chancellor, Angela Merkel, warns that the end of the euro would be the ‘end of Europe’, it is worth remembering that the single market worked (more or less) before the common currency came into existence in 1999, continues to work today with 10 ‘outs’ and can presumably continue to do the job if Europe goes back to the future in terms of its monetary arrangements, with a larger number of floating currencies. The internal market has, after all, survived substantial recent devaluations by eurozone ‘outs’, such as Britain, the third largest economy in the EU, and Sweden.

Either way, the EU needs a contingency plan to save and re-energise the single market in the event that the eurozone does fragment. Britain would have a critical role to play in defending single market freedoms under such a scenario.

And while Britain works with like-minded liberal countries in defending and completing the single market, it must continue to drive efforts to open Europe to the world. 2011 was meant to be the make or break year for Doha, like 2010 and 2009 before it. It wasn’t. Yet the imperative to connect Europe with faster-growing economies remains. The EU has just signed a free trade agreement with South Korea and aims to finalise ones with India, Canada and Singapore by the end of the year. Completing all the deals now on the table could add €90 billion to Europe’s GDP. Whatever the future of the euro, Britain must keep the single market open to competition and Europe open to the world.

Support for British membership, but not at any price

Although other countries value British membership of the EU, they do not do so at any price. It is important for Britain to realise that it is no longer seen as bringing as much to the European table as it once did.

The UK therefore needs to clarify, both to itself and other EU countries now extending an olive branch, what its vision is for the EU and what sort of a relationship it wants with it. If Germany and the Nordic countries think the UK is heading for the exit or for a form of semi-detached relationship – modeled perhaps on that of Switzerland, which is a member of the European Free Trade Association, or that of Norway, a member both of EFTA and of the European Economic Area – then they will cease to see Britain as a key ally in their attempt to promote a liberal economic agenda inside the EU.

If the UK were to be marginalised within the EU or excluded from its decision-making, London would lose its attraction as a pole in the continent’s economic and political development. The single market would lose one of its strongest and most reliable champions. And the deregulation agenda would suffer. Many member-states (including Germany) would regard this as a regrettable development.

Countries with more protectionist instincts might regard such a development as a positive blessing. But that would be a minority viewpoint, even in Southern Europe.

Lessons for Britain

What lessons, then, should Britain draw from the December summit and its aftermath?

- ★ First, context matters. To be seen as unconstructive at a moment of existential crisis is very different from defending a national interest on a single policy issue in a more humdrum setting.
- ★ Second, alliance-building is essential, particularly with Germany, but also with other like-minded liberal countries. Britain will have little influence on the development of the single market if it sticks to a failed strategy of trying to be the leader of the group of ten eurozone ‘outs’. That grouping patently no longer exists as a viable potential vehicle for British diplomatic influence.

- ★ Third, Germany’s attitude to Britain has changed. In the past, Germany always tried to keep the UK inside the tent. If there was a possibility of an opt-out or a compromise, it would be offered. At the Brussels summit, the decision to proceed without the UK was taken quickly. What Germany was really saying, according to one German official in Brussels, was: “If you’re not helping us solve this crisis, then we don’t want you round the table”.
- ★ Fourth, since the European Union Act 2011, British governments are legally required to hold a referendum before any treaty changes transferring powers from Westminster to the EU can be ratified. This obviously limits what governments in the UK can sign up to at EU level and limits their options in bargaining.
- ★ Fifth, the European Union Act 2011 has equally obvious repercussions on how other EU countries see Britain as a negotiating partner. The new legal constraints in the UK limit the willingness of other countries, particularly those inside the eurozone, to expose themselves to political risk in Britain. At the December summit, other countries took the view that if Britain could not sign or ratify the fiscal compact, then the agreement should proceed without Britain.
- ★ Sixth, while Britain’s stance at the December summit angered many other EU countries, it has not resulted in a clamour in other European capitals for the UK to leave the EU. Many EU member-states feel that Europe needs the UK in the role that it currently plays and would regret the UK’s marginalisation and (worse) its exit from the EU.
- ★ Seventh, patience with Britain is not unlimited. Britain may be seen as an important ally by economically liberal member-states in areas like the single market. But even these countries do not always see the UK as a reliable partner, and are unlikely to see Britain as an ally inside the EU if they think that the country is heading for the exit.
- ★ Eighth, if the eurozone is to survive and prosper, deeper fiscal and institutional integration will be necessary. If there is a gravitational pull of decision-making towards the inner eurozone core, Britain will need to guard against such policy co-ordination spilling over into areas properly the preserve of the 27, particularly the EU’s single market. The bulk of EU decision taking must remain where it rightfully belongs, at the level of the 27, not the 17, so that Britain does not find itself an associate member of a two-tier club, with a much more limited ability to shape decisions before they are taken than it enjoys at present.
- ★ Ninth, continued British membership of the EU is no longer taken for granted. An EU without Britain is now discussed as a real possibility, both in the UK and in continental Europe, in a manner that would have been unthinkable 10 years ago. This is undoubtedly weakening Britain’s influence, not just in Europe, but also in the capitals of the fast growing emerging powers. A visiting Indian diplomat recently noted that the “changes in Europe had left Germany as the big kid on the block” and was triggering a re-evaluation of the UK’s ability to play its traditional role as an interlocutor and point of entry.
- ★ Finally, and most importantly, there is a risk inherent in what some see as ‘premature *schadenfreude*’ over the future of the eurozone. In the present climate of euro-pessimism, it may seem hard to imagine the EU transforming itself overnight into a dynamic high growth area and easy to believe it will remain dysfunctional, sluggish and sclerotic for years, hobbled by baroque internal decision-making processes.

Such a gloomy vision for Europe may well encourage the UK to seek a Europe that is ever more *à la carte*, in which Britain somehow retains all of its trade privileges within the world’s biggest commercial bloc, while opting out of the burdensome social and employment laws that come with it. Even if such an option exists – and the experience of countries such as Norway makes that a highly questionable assumption – unilateral renegotiation is likely to be limited in scope and to frustrate more people than it satisfies.

Yet, in the medium term, the situation is far from hopeless. Current events are clearly highlighting the failure of the “European Model” of high taxes and even higher government spending. Behind the scenes, more or less everybody acknowledges that excessive government spending across Europe was used to cover up relative economic underperformance, and no matter how dismissive neo-Keynesians may be about austerity, there is a general consensus that there is only one direction in which government spending can now go, as the result of the Irish referendum on the fiscal compact in June clearly demonstrated.

What this means is that Europe as a whole knows that it needs to reform the old model of *l'Europe sociale* and to build a new one, for which Germany's Agenda 2010 reforms represent a decent blueprint.⁵ Indeed, there has never been a more propitious moment for Britain to work with Germany and other like-minded countries to promote the reforms that will fend off sclerosis and ensure that the EU continues in aggregate to produce sustainable economic benefits for all its citizens.

⁵ <http://www.dw.de/dw/article/0,,988374,00.html>

I am grateful to Philip Whyte at the Centre for European Reform for his patient editing and numerous insights, as well as to Simon Gleeson of Clifford Chance for his comments and ideas. All errors are mine.

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June 2012

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