

Annual Report 2012





About the CER

The Centre for European Reform is a think-tank devoted to making the European Union work better and strengthening its role in the world. The CER is pro-European but not uncritical. We regard European integration as largely beneficial but recognise that in many respects the Union does not work well. We also think that the EU should take on more responsibilities globally, on issues ranging from climate change to security. The CER aims to promote an open, outward-looking and effective European Union.

Through our meetings, seminars and conferences, we bring together people from the worlds of politics and business, as well as other opinion-formers. Most of our events are by invitation only and off the record, to ensure a high level of debate.

The conclusions of our research and seminars are reflected in our publications, as well as in the private papers and briefings that senior officials, ministers and commissioners ask us to provide.

The CER is an independent, private, not-for-profit organisation. We are not affiliated to any government, political party or European institution. Our work is funded mainly by donations from the private sector.

The CER's work programme is centred on eight themes:

- ★ **The euro, economics and finance**
- ★ **Energy and climate**
- ★ **EU foreign policy and defence**
- ★ **Enlargement and neighbourhood**
- ★ **China and Russia**
- ★ **EU institutions and policies**
- ★ **Justice and home affairs**
- ★ **Britain and the EU**

FROM LEFT TO RIGHT,
TOP TO BOTTOM:
Edward Burke
Hugo Brady
Katinka Barysch
Susannah Murray
Simon Tilford
Philip Whyte
Clara Marina O'Donnell
John Springford
Kate Mullineux
Catherine Hoyer
Charles Grant
and Stephen Tindale



Britain's slide towards the EU exit

by **Charles Grant**

The CER has never been a think-tank focused on Britain. Ever since we were conceived in 1995, most of our work has covered the EU as a whole rather than Britain's relationship with it. About half the researchers who have worked at the CER are not British. Many of our seminars and conferences have taken place in other parts of Europe, or further afield in the US, Russia and China. But in 2012, as the possibility of Britain leaving the EU became a serious subject for discussion, we increased our focus on the UK.

"It is quite possible that the debate over whether Britain should remain a member of the EU will shift from the extreme fringes of British politics to centre stage." That is what I wrote in the CER's annual report for 2003. At the time, some of our advisory board dismissed those words as exaggeratedly pessimistic. Unfortunately, that was not the case. Over the past ten years the British public's view of the EU has shifted markedly. Most opinion polls now

show that more Britons want to leave the EU than stay in it.

One big reason for this shift is the eurozone crisis. The EU's management of it – even pro-Europeans must admit – has been, at least some of the time, dreadful. For three years, eurozone leaders have gathered at emergency summits and bickered over the steps required to resolve the euro's problems. Very slowly, they

have made progress, coming up with bail-out funds, new mechanisms to allow the European Central Bank (ECB) to lend to banks and buy government bonds, and plans for common banking supervision. By the end of 2012 they had done just enough to convince financial markets that the euro would probably hold together. But much of Europe remains stuck in recession and unlikely to return to growth any time soon.

European leaders have so far spurned the measures that would put the eurozone on a sustainable footing for the long term, such as EU-wide deposit insurance, write-offs of official debt, the mutualisation of sovereign borrowing or other mechanisms that would effectively transfer money from richer to poorer members. Such policies would evidently be politically unpalatable for Germany and other more prosperous countries. But without them, the eurozone's peripheral economies will continue to labour under a weight of debt that, combined with the stringent austerity that the EU has imposed, stifles economic growth.

The EU's mismanagement of the euro has provided great propaganda for Britain's eurosceptics. They always said that the euro would be a disaster and some of what they predicted has turned out to be true. They intend to use the eurozone crisis as a tool for levering Britain out of the EU.

The euro's problems are changing the EU in ways that make it seem less congenial for the UK. A Union of three concentric circles is emerging. The core consists of the euro countries, which are steadily giving up control of budgetary and other economic policies to EU institutions. The second circle consists of the 'pre-ins' that plan to join the euro. Subscribing to the 'fiscal compact' treaty and the embryonic banking union, they will accept many of the same economic and budgetary disciplines as the core. Finally, the third circle consists of Britain and a few other countries that do not want to join the euro or accept its disciplines – but are still full members of the EU.

This emerging structure creates difficulties for Britain. In theory, outer-circle countries will have just as much say on normal EU business as those in the inner circles. In practice, however, the euro and pre-in countries may caucus on EU business and then impose their views on, say, single market rules. And the more that eurozone leaders centralise economic policy-making for their countries, and the more they talk about 'political union', the more the EU seems to be moving beyond the relatively limited economic

club that Britain joined in 1973 – and the more suspicious the British become of it.

Several other factors have helped to shift British opinion in an EU-hostile direction. The constant talk among EU leaders of treaty-change, institutions and voting rules – at the cost of focusing on issues that voters consider relevant – is off-putting. Many British people also think there are too many immigrants in their country, and they blame the EU for letting them in. Nor should one forget the role that Britain's tabloid press has played in moulding views. The report by Lord Justice Leveson on press standards highlights how newspapers have repeatedly invented horror-stories about what the EU is supposed to have done.

“The European Union's mismanagement of the euro has provided great propaganda for Britain's eurosceptics.”

As a class, Britain's political leaders have followed, rather than sought to influence public opinion. In all the main parties – including the Liberal Democrats, the most pro-European of the three – leaders have consistently, and with very few exceptions, avoided arguing the merits of the EU. Pro-EU politicians have seen the short-term advantages of saying little about an unpopular subject. So they have lost the argument by default.

The Conservative Party, which has led a coalition with the Liberal Democrats since May 2010, plays a particularly important role in Britain's European debate. It divides three ways, between those who want to quit the EU, in any circumstances; those who would like to remain in the EU, but only if Britain can renegotiate its membership so that it opts out of several EU policy areas, including labour market rules; and those who would wish to stay in the EU, even if significant opt-outs cannot be obtained. Most party members and Conservative MPs are in the first two groups; most party leaders are in groups two and three.

Fears of the United Kingdom Independence Party (UKIP) are making Tory leaders ever more eurosceptic. By the end of 2012 this party was scoring better than the Liberal Democrats in opinion polls. In November 2012 it won more votes than the Conservatives in two by-elections, and it could deprive them of victory in the next general election by pulling votes away from them in marginal seats. This fear has encouraged Conservative leaders to accept several demands

from their most eurosceptic backbenchers: in 2011 the government passed the EU Act, which stipulates that Britain cannot accept a new treaty that transfers any power to the EU without a referendum; and in the autumn of 2012 it indicated that it would exercise a provision of the Lisbon treaty that allows Britain to opt out of much police and judicial co-operation.

Neither measure pacified the eurosceptic right, which is by definition not satisfied unless Britain leaves the EU. So at the end of 2012, David Cameron indicated that a future Conservative government would attempt to renegotiate the terms of Britain's membership, and then ask the people to vote on whether they should stay in the Union. Britain's policy of standing on the margins of many discussions, and the expectation that in the long run it may well leave, are visibly weakening its influence in EU councils.

“The danger of Cameron's referendum strategy is that it assumes Britain's partners will allow it to ‘repatriate’ powers in the areas it dislikes.”

The danger of Cameron's referendum strategy is that it assumes Britain's partners will allow it to ‘repatriate’ powers in areas it dislikes. But they will not do so, because if one country was allowed to pick and choose the bits of the EU it subscribed to, others would demand the same privilege. Italy resents rules that force it to allow foreign academics to work in its universities; Poland bristles against rules that restrain its carbon emissions; and France dislikes limits on subsidies to its car industry. Once countries were allowed to opt out of the rules they dislike, the single market would soon unravel. So a Cameron-led government would risk returning from the renegotiation with a very minimal ‘better deal for Britain’ that many in his own party would oppose in a subsequent referendum.

Ed Miliband, the Labour leader, has so far avoided a precise commitment to an in-out referendum. But if the Conservatives appear to profit from their referendum promise, it will be hard for him to resist a similar pledge, lest his party appear arrogant and out of touch. If Labour won the next election having made such a promise, it could not credibly seek to renegotiate British membership, since it does not want to repatriate powers to the UK. So a Labour government could find it hard to win an in-out referendum with the terms of EU membership unchanged.

A British exit would be hugely damaging to both Britain and the EU. Britain would lose the ability to

shape the rules of the single market and perhaps access to parts of the market. It would therefore lose foreign direct investment (for example, in the car industry and the City of London). And it would lose the ability to steer and benefit from the EU's trade-opening deals with other key economies – such as the South Korean deal recently implemented, or those with Canada, India, Japan, Singapore and the US that are in the pipeline. Britain would also find that on its own it had less ability to influence global diplomacy on issues ranging from climate change to the Iranian nuclear programme to the pacification of Somalia.

Some of the more federalist-minded European leaders would not be sorry to see the UK leave: it has always sought to slow or stop institutional reform and treaty change. But the majority of Europeans would regret a British departure, and rightly so. An EU minus Britain would be more inclined to protectionism and less interested in deepening the single market. Deprived of Britain's diplomatic clout, the Union would have less capacity to influence global security challenges. And any attempt to build an EU defence capacity without the UK would be very limited – as France, the other significant military power in Europe, knows very well.

Britain's pro-Europeans could win a referendum campaign on staying in the EU. But a lot of politicians would have to become much braver than they have been, while business and trade union leaders – who have been extraordinarily silent on the question of EU membership – would have to start speaking out on the benefits.

Pro-Europeans will have to argue convincingly that life in the EU's outer circle need not be uncomfortable for Britain. Many eurosceptics – and some europhiles – assert that so long as Britain is not in the euro, the fiscal union or the banking union, it cannot be influential in the EU as a whole. But that analysis is far too pessimistic. The EU itself will remain an important organisation covering a wide range of policies – such as foreign, defence, energy, climate, trade, farming, transport, regional development, overseas aid, research and the single market. There is no reason why Britain could not have heft in such areas, so long as certain conditions are satisfied:

- ★ The British economy needs to perform better. Governments that manage successful economies are always listened to.
- ★ The EU's institutions, and in particular the European Commission, need to be powerful. The Commission has a strong interest in preventing the fragmentation of the single



market, the emergence of eurozone-specific bodies that are outside the framework of the EU, and the marginalisation of member-states in the outer circle. Though this will be counter-intuitive for many Britons, they need to work hard to preserve the Commission's authority. The alternative is an EU dominated by the big countries in the single currency, and eurozone secretariats that could encourage caucusing, fracture the single market and marginalise the UK.

- ★ The UK needs to behave in a more clubbable manner. Clubs have not only rules but also mores. The EU's mores include a commitment to seek compromises. Members that forget the mores – and threaten to wield a veto, even before a negotiation has begun – are likely to lose the respect of their peers.
- ★ Britain needs to do a better job of winning friends and allies. This sounds obvious, but for many years British ministers and

officials have failed to invest in relationships with like-minded governments, such as the Nordics and the Dutch (exceptionally, Cameron's government has built warm ties with Sweden). When the Central Europeans joined the EU in 2004, many of them saw Britain as a natural friend. But they were subsequently hurt that the British to a large extent ignored them while the French and Germans courted them.

- ★ Britain should take initiatives in areas where it has expertise. It is always in favour of deepening the single market and enlarging the EU further. It also plays a key role in some foreign policy negotiations. But the British have an increasing tendency to sit on the side-lines while others lead. Their partners would be delighted to see a more active UK in areas such as climate, energy, innovation, foreign and defence policy, co-operation on fighting terrorism, or even the reform of the institutions. A Britain that led would have more influence.

ABOVE CENTRE: Michel Barnier

Allianz/CER European forum: Lunch on 'Can the single market move Europe from austerity to growth?', Brussels

Questions for the CER

The uncertainty over Britain's EU membership poses strategic challenges for the CER. If Britain moves towards a referendum campaign, what role should we play? We do not want to become a campaigning organisation. But we cannot remain neutral in a referendum on British membership. We can add value by providing rigorous and sober analysis, and well-informed arguments. During such a campaign, we would become more UK-focused than we normally are.

If Britain were to leave the EU, should the CER close down? We would stay in business, because there would still be an EU in need of reform. The CER has always been 'pro-European but not uncritical' and has a track-record of producing ideas and policies designed to make the EU more effective. Our work on transatlantic relations, Russia and China would also remain relevant. A Britain outside the EU would still have important ties to it, and that relationship would merit our analysis. If we continue to produce good work, people will read it.

The CER's work in 2012: The British problem

In light of all the above, it is not surprising that Britain's relationship with the EU was one of our priorities in 2012. Our most-downloaded report of the year was 'The continent or the open sea: Does Britain have a European future?' by David Rennie of *The Economist*. He analysed the various factions of British euroscepticism, explaining their motivations and ambitions. He highlighted, in particular, a narrative that is increasingly powerful among Conservatives. The problem was no longer that the UK had to battle the encroaching Brussels super-state, but rather that it was tied to an entity in terminal economic decline. David quoted Douglas Carswell MP: "Far from joining a prosperous trading bloc, we shackled ourselves to a corpse." The report argued that the eurozone's centralisation of decision-making could make the EU such an uncomfortable place for the British that they might end up outside it. This was published in May, long before it became commonplace to make such gloomy predictions.

“Norwegians are increasingly unhappy with the arrangement by which they have to adopt single market rules that they cannot vote on.”

William Hague, the foreign secretary, has a reputation as an ardent eurosceptic. But when he spoke at our 14th birthday party, hosted by the Irish ambassador in June, he set out the benefits of EU membership to Britain. One Conservative MP who is not an ardent eurosceptic is Jo Johnson. In 'Britain must defend the single market', an essay that we published in June, he had the courage to spell out some home truths to British eurosceptics. The more that Britain moved towards the exit, the less influence it would have on the single market, the less reliable it would appear as a partner to other EU countries, and the less seriously it would be taken by global powers. Jo warned that any attempt to renegotiate the terms of Britain's membership would achieve very little and create much ill-will.

The fact that Europe's largest financial centre lies outside the eurozone, in London, is a permanent source of tension between Britain and its partners. In an essay published in July, 'Britain, Europe and the City of London: Can the triangle be managed?', Philip Whyte challenged the common view across continental Europe

that the City was a hotbed of speculators bent on destroying the euro, and that the British government was hostile to regulating markets. In many areas of financial regulation, he argued, Britain was more hawkish than other European countries. Philip also described how many international banks thought the prospect of Britain exiting the EU was a major threat to the City's future.

A lot of eurosceptics regard the Swiss or Norwegian models as possible alternatives to EU membership. But in September a policy brief by David Buchan, a former Brussels bureau chief of the *Financial Times*, demonstrated that neither is a viable option for Britain. The Norwegians are increasingly unhappy with the arrangement by which they have to adopt single market rules that they cannot vote on. The Swiss, too, have access to parts of the single market, but their links with the EU have reached an institutional impasse.

Britain has already begun to disengage from the EU in the area of justice and home affairs. The Lisbon treaty says that in 2014 Britain must accept the authority of the European Court of Justice over all existing rules on police and judicial co-operation – or opt out of them as a bloc. It may then seek to opt back into some of them, if the European Commission and its partners agree. Hugo Brady's policy brief of October, 'Cameron's European own goal: Leaving EU police and justice co-operation', sounded the alarm. Hugo, our Brussels-based researcher, argued that opting out of the European Arrest Warrant, Europol, Eurojust and exchanges of information among police forces would endanger national security. Shortly after the policy brief appeared, Prime Minister David Cameron signalled that the government would exercise the opt out. Hugo's paper was more widely quoted in the British and international press than anything else we published in 2012.

Concern about Britain's marginalisation in Europe stretches far beyond that continent. In December we hosted Elizabeth Sherwood-Randall, the senior director for Europe in Barack Obama's National Security Council, who talked about EU-US and UK-US relations. Her remarks were off the record but it is no secret that the administration is very concerned about the adverse impact of a British exit on American interests.

The euro crisis and its institutional consequences

Inevitably, the eurozone crisis continued to loom large in the CER's work. Our researchers

have offered advice as well as analysis and criticism of the eurozone's faltering steps



forward, through longer and shorter CER publications, as well as opinion pieces in many of the world's leading newspapers.

Mario Draghi's announcement in July that the ECB would "do whatever it takes" to save the euro brought a period of welcome respite in financial markets in the second half of 2012. However, the CER has argued that if doubts about the single currency's future are to be dispelled, European leaders must create the institutions needed to make the euro work better and restore the region to economic growth.

In June 2012, European leaders committed themselves to establishing the banking union that the CER had been arguing for since 2011. In December 2012, Philip Whyte's essay, 'What a banking union means for Europe', argued that common eurozone banking supervision on its own would not break the dangerous link between weak sovereigns and weak banks. The eurozone would also need two things that leaders have not yet committed to: a common deposit insurance scheme and a common bank resolution regime. Even an embryonic banking union, however, had the potential to drive a wedge between the eurozone and those outside it such as the UK.

Several CER 'insights' – the shorter pieces that we send out by email – focused on the very low growth that continued to afflict the eurozone. In 'Eurozone: Trouble in the core?', Simon Tilford poured cold water on the widespread belief that problems were confined to the eurozone's 'periphery': Finland and the Netherlands, he

pointed out, were almost as far from pre-crisis levels of output as Spain. And in 'Europe's growth strategy: All supply and no demand', Philip Whyte argued that although the focus on improving long-term economic performance through structural reforms was welcome, in the short term fiscal policy was doing too little to offset the chronic weakness of private sector demand.

The CER's annual economics conference at Ditchley Park in November brought together leading economists, commentators and politicians to discuss 'Europe's future in an age of austerity'. Speakers included Marco Buti, Peter Bofinger, Stephanie Flanders, François Heisbourg, Richard Lambert, George Magnus, Thomas Mayer, David Miliband, Wolfgang Münchau, Stephen Nickell, Philip Stephens, Robert Skidelsky, Paul Tucker, Bart van Ark and Charles Wyplosz. Opinion was divided over whether politicians were doing enough to save the currency, and whether there were alternatives to austerity and structural reform, but the predominant mood was far from optimistic. We also ran a roundtable in February with FTI Consulting on the consequences of the euro crisis for business, with Helen Alexander, Gerard Lyons and Mark Malloch-Brown. And in April we and the London School of Economics organised a conference on the euro with Gavyn Davies, Paul de Grauwe and Adam Posen among the speakers.

Several of our events tackled the political consequences of the eurozone crisis. At a roundtable in January – shortly after the December 2011 summit which had left Britain

ABOVE:

William Hague

Keynote speaker at the CER's 14th birthday party, London

isolated and outside the fiscal compact – Peter Schoof, a senior German official, explained Germany’s view of its misunderstandings with Britain. At a breakfast in the same month, Giuliano Amato reported on Mario Monti’s efforts to restore credibility to Italy’s economic policy. Then at a breakfast in Brussels in May we heard Jean-Claude Piris, former head of the Council of Ministers legal service, explain that a multi-speed Europe was both inevitable and desirable.

“Steps that would be required to stabilise the euro lacked the support of voters and could make them even more hostile to the EU.”

In November, the Allianz-CER forum met in Brussels, to debate the political consequences of the euro crisis and the emerging multi-tier Europe. Speakers included two former prime ministers, Giuliano Amato and Wolfgang Schäussel; serving and past foreign ministers, Miroslav Lajcak and David Miliband, respectively; and the secretary-general of the last Convention on the Future of Europe, John Kerr. The forum focused on the danger that the emergence of a eurozone core could lead to the single market fragmenting. Many speakers worried that the bold and centralising steps that would be required to stabilise the euro lacked the support of voters and could make them even more hostile to the EU. Some thought that a new eurozone parliament with tax-and-spend powers, and the direct election of an EU president, would overcome the democratic deficit. Others thought such steps unrealistic and that modest, incremental reforms would ensure the euro’s survival.

Growth and the single market

Luuk van Middelaar, a writer and adviser to Herman Van Rompuy, has observed that the EU has two separate hearts, the euro and the single market. Recently, the euro has been driving integration more powerfully than the market, and there is a danger that the interests of the two hearts may conflict. The EU’s economic problems stretch far beyond the difficulties of the euro. The single market remains an unfinished project. At a Brussels breakfast in March, Jonathan Faull, the Commission’s director-general for the single market, spoke about how the market can help to raise the continent’s long-term growth potential. But in a policy brief published in September, ‘How to build European services markets’, John Springford argued that integration in services had barely begun. Recent efforts to knit national markets together had been, at best, a partial success.

A more powerful European Parliament would provide greater accountability within the eurozone. At least that was the view of the European Parliament’s president, Martin Schulz, at a CER breakfast in Brussels in June. Many of our breakfast events were euro-focused, such as that in Brussels in March with Commissioner Olli Rehn, and that in London in November with Vicky Pryce, an eminent economist talking about her book on Greece and the euro crisis.

No solution to the eurozone’s problems can be viable unless it wins the approval of national electorates. In 2012 on several occasions electorates voted the ‘right’ way, which is one reason why the euro looked more solid at the end of the year than at the start. The Irish, so often reluctant to approve EU treaties, voted in May to ratify the fiscal compact in a referendum, as predicted in our briefing note by Hugo Brady. The result of Greece’s second general election of the year, in June, was a government committed to staying in the euro. Then the Dutch election of September returned a pro-EU government.

The French presidential election in May gave the socialists their first presidential victory since 1988. President François Hollande has challenged the eurozone’s focus on Germanic austerity. But the structural weaknesses of the French economy limit his ability to shift the EU’s agenda. We hosted his chief economic adviser, Emmanuel Macron, at a CER lunch in March. And at a roundtable in April, between the two rounds of the presidential election, Dominique Moïsi and Christine Ockrent, two eminent commentators, explained that Hollande would find it very hard to reform the French economy.

In March, at a CER dinner, Pascal Lamy, director-general of the World Trade Organisation, defended the multilateral trading order and its relevance for global growth. In November, at a breakfast in Brussels, Mark Vanheukelen, chief of staff to Commissioner Karel de Gucht, explained how the trade deals that the EU was negotiating with countries like Canada, Singapore and Japan should boost European growth.

In May we organised a conference on how to promote growth in Europe with Joaquín Almunia, the competition commissioner, Ed Balls, the Labour Party’s shadow chancellor, Peter Mandelson, the former trade commissioner and Richard Lambert, former editor of the *Financial Times*. The impact of the eurozone crisis and EU financial regulation on UK-EU relations were the subjects of a lunch discussion in Brussels in June with Michel Barnier, the commissioner for the



single market and financial services; a breakfast in Brussels in October with Sir Jon Cunliffe, UK permanent representative to the EU; a breakfast in London in November with Erkki Liikanen, governor of the Bank of Finland; and a dinner in London in November with Paul Tucker, deputy governor of the Bank of England.

The EU's budget, meanwhile, still does too little to improve Europe's growth potential. In 'The European Union budget 2014-20: More boldness needed', John Peet of *The Economist* and our own Stephen Tindale argued that money going into farm subsidies would be better spent on simpler and greener regional funds, and on research and development. Before the EU's November budget summit, John Springford argued in an insight that the UK should push for a pro-growth, reformed budget rather than focus obsessively on its net contribution.

Perhaps our most original paper of the year was 'Economic recovery requires a better deal for labour', an essay by Simon Tilford published in November. He pointed out that the share of national income going to labour had been falling consistently across the developed world for

decades. Stagnant wages and growing inequality were leading to chronic under-consumption and thus hitting growth. Europe's strategy for dealing with the eurozone crisis was exacerbating these trends and thus creating a further obstacle to economic recovery. Simon concluded that EU governments should combine supply-side reforms aimed at boosting competition with policies that prevented any increase of inequality or decline in the share of national income going to labour.

In the autumn, together with Business for New Europe and Open Europe, we held events at each of the three main British political parties' annual conferences. The themes of the meetings were Europe's growth prospects and the UK's place in the EU. At the Liberal Democrats' conference in Brighton, we had David Laws, recently returned to the British government, and Vicky Pryce; at the Conservative conference in Birmingham we had David Lidington, the minister for Europe, and Harriett Baldwin MP; and at the Labour conference in Manchester we had shadow foreign secretary Douglas Alexander and shadow Treasury minister Chris Leslie.

ABOVE:
(L to R)
Wolfgang
Schüssel,
Charles Grant
and Giuliano
Amato

*Allianz-CER forum on
'A Multi-tiered
Europe? The political
consequences of the euro
crisis', Brussels*

Climate, energy and migration

Europe's dearth of economic growth has made it harder for the EU to adopt good policies on climate and energy. Most voters worry more about jobs and income than global warming. Politicians know that measures to curb carbon emissions will make energy more expensive, and few of them see electoral benefits in prioritising

climate change. But climate and energy have not slipped down the CER's agenda. In April, David Buchan's 'How to create a single European electricity market – and subsidise renewables' argued that although renewable energy needed subsidising, differing national subsidy schemes threatened to undermine energy market

integration across the EU. He called for national schemes to be harmonised, even if the amounts of subsidy they provided continued to differ.

The EU's emissions trading scheme is failing to encourage investment in renewables because the price of tradable carbon permits is too low. In 'Saving emissions trading from irrelevance', a policy brief published in June, Stephen Tindale called for the EU to issue fewer permits and set a floor price for carbon. He was also the author of two other policy briefs. 'Connecting Europe's energy systems', published in October, argued that Europe's energy infrastructure needed modernisation, to maximise the use of renewable energy. He urged that the Commission's proposals on infrastructure be adopted speedily. In December, 'How to expand renewable energy after 2020' proposed that the EU should set targets for renewable energy for 2030 and the end of each subsequent decade. That would be the only way to achieve a carbon-free economy by 2060.

“Moscow will not accept a junior position vis à vis Beijing, while the Chinese regard Russia as a fading power.”

In February, John Mogg, head of the new EU Agency for the Co-operation of Energy Regulators, spoke at a roundtable about ACER's role in bringing about a single energy market. In October, Dieter Helm, one of Britain's leading energy economists, spoke at a CER seminar at which he considered the case for nuclear power,

and then at another – launching his new book – at which he explained why both EU and global efforts to prevent global warming were, so far, failing. But at a breakfast in Brussels in the same month, Connie Hedegaard, the climate change commissioner, defended EU policies and its efforts to lead the world on climate change.

The poor economic climate has also made migration a sensitive political issue. With unemployment rising across the Union, politicians face pressure to amend the Schengen area's rules on free movement. A report in January by Hugo Brady, 'Saving Schengen: How to protect passport-free travel in Europe', proved prescient. He argued that immigration from North Africa following the Arab Spring was not the main threat to well-managed migration. Bigger problems would be the premature accession of Bulgaria and Romania to the Schengen area, the state of Greece's borders and asylum system, and the lack of EU-Turkey co-operation on managing migration.

Since the report's appearance, the admission of Bulgaria and Romania to Schengen, which had been due to take place in 2012, has been postponed; the EU has increased support to Greece for managing its borders and refugees; and Hollande's election in France has enabled the EU and Turkey to open talks on visa liberalisation. The report was launched in Brussels at a seminar with Charles Clarke, former British Home Secretary, Stefano Manservigi, the Commission director-general for home affairs and Antonio Vitorino, former justice and home affairs commissioner.

Russia and China

Much of our work on foreign policy focused on Russia and China. In 2012 both countries appointed new presidents, both became more nationalistic and neither seemed likely to embrace significant political or economic reform (though the prospects of reform look somewhat more promising in China). The CER has made a speciality of studying their relationship and of comparing and contrasting them. In February 2012 we published two heavyweight reports – followed by a couple of *New York Times* opinion pieces – on aspects of Sino-Russian relations.

In 'True partners? How Russia and China see each other', Dmitri Trenin, director of the Carnegie Moscow Centre, analysed the evolution of the Russia-China relationship, and the strains created by China's growing economic preponderance. The two countries share a common interest in preventing US

domination of the international system, and therefore work together at the United Nations. But Dmitri argued that they do not trust each other and so cannot become allies: Moscow will not accept a junior position vis-à-vis Beijing, while the Chinese regard Russia as a fading power.

In 'Russia, China and global governance', I argued that both countries were suspicious of multilateral institutions created by the West, and hostile to anything that could justify external intervention in a sovereign state's affairs. But while Russia takes international security regimes seriously, China does not, and while China is keen to engage on global economic governance, Russia is not. I concluded that if they failed to reform and rebalance their economies they would become more nationalistic and less constructive players in global governance.



These reports – together with a third published at the end of 2011, ‘Russia, China and the geopolitics of energy in Central Asia’, by Alexandros Petersen and our own Katinka Barysch – were translated into Russian and Chinese. Dmitri Trenin and I took all three reports to launch events with scholars and thinkers, in Moscow in March, with Mikhail Krutikin, Vassily Mikheev and Alexey Voskressensky; in Beijing in May, with Huang Ping, Pan Wei and Sun Zhe; and in Brussels in June with Fraser Cameron and Jan Techau. The global governance report received a further outing at the Daiwa Foundation in London in June, at a meeting chaired by Gideon Rachman of the *Financial Times*.

Both countries need to rebalance their economies – in Russia away from natural resource dependency towards manufacturing and services, and in China away from investment in property and infrastructure towards consumption. In both, many vested interests are doing their best to thwart rebalancing, but in both, greater respect for the rule of law would facilitate change. In January we published ‘Three views on modernisation and the rule of law in Russia’, edited by Katinka. The authors of these essays, all noted experts on Russia, considered whether its rulers were serious about reform. Philip Hanson and Alena Ledeneva were pessimistic, but Christopher Granville noted that some commercial courts had become more reliable and independent.

In January the CER and G3 organised a major conference on Russia, featuring Mia Brunell

Livfors, CEO of Kinnevik; Ivo Daalder, US ambassador to NATO; Dmitri Trenin; and Nikolai Tsekhomsky, a senior Russian banker. Then in June we hosted Igor Yurgens, a close adviser of Prime Minister Dmitri Medvedev, at both a dinner in Brussels and a roundtable in London. Liberals such as Yurgens are increasingly gloomy about the situation in Russia. By the time I met President Vladimir Putin in October, as part of the Valdai Club, he seemed to have turned his back on reform – and become markedly more anti-Western than in his early years as president.

Rising nationalism in both countries gives cause for concern. By the end of the year, the dispute over the Senkaku/Diaoyu Islands had made Sino-Japanese relations extremely fraught. In June, when the climate between Beijing and Tokyo was milder, my policy brief ‘Japan’s response to China’s rise’ analysed Japan’s reaction to the growth of Chinese power. Japan is making its defence forces more mobile, strengthening the alliance with the US and building friendships with other countries concerned about China (such as Australia, India, the Philippines and Vietnam). I argued, however, that Japan’s sluggish economy, mountain of public debt and weak political system meant that it could not easily take a tough stance on China.

“Japan’s sluggish economy, mountain of public debt and weak political system meant that it could not easily take a tough stance on China.”

ABOVE:
CER economics
conference
on ‘Europe’s
future in an age
of austerity’,
Ditchley Park

Transatlantic relations, defence and EU foreign policy

This is a difficult period for transatlantic relations. The US is more focused on Asia than Europe, while the Europeans, mainly concerned with their own troubles, are slashing defence budgets. But the CER is unapologetic about continuing to take transatlantic issues very seriously.

“This is a difficult period for transatlantic relations. The US is more focused on Asia than Europe.”

Together with the Brookings Institution and the Stiftung Wissenschaft und Politik we continued to host the Daimler Forum, bringing together key officials and thinkers from both sides of the Atlantic. The meetings in Berlin in May and Washington in November featured US officials such as Deputy Secretary of State Bill Burns, Under Secretary Wendy Sherman and Assistant Secretaries Kurt Campbell and Phil Gordon; and, on the European side, Carl Bildt and Radek Sikorski, the Swedish and Polish foreign ministers, Emily Haber, Germany’s State Secretary, Christoph Heusgen, Chancellor Merkel’s foreign policy adviser and Simon Fraser, Britain’s Permanent Under Secretary. The May meeting focused on Iran’s nuclear programme, and the hope that sanctions and diplomacy would preclude the need for military action. At the November sessions Kurt Campbell explained the rationale of the US ‘pivot’ to Asia and urged the Europeans to think more about Asian security, while the discussion on Syria showed Europeans and Americans both moving towards a greater degree of involvement in the country. In June a CER insight by Edward Burke, arguing that Russia’s policy on Syria was not entirely wrong – and that the West had been too hasty to cut off contact with Bashar Assad – was printed in the *International Herald Tribune*.

Tomas Valasek edited a report – ‘All alone? What US retrenchment means for Europe and NATO’ – to which four CER board members contributed: François Heisbourg, Wolfgang Ischinger, George Robertson and Kori Schake. They argued that unless Europeans assumed greater responsibility for their own security, NATO risked drifting into irrelevance. Kori predicted that the US would cut back its commitment to European security, François wrote that on current trends Europeans would soon be unable to act outside their neighbourhood, Wolfgang warned that Germany was not going to take defence more seriously, and George urged Europeans to do more pooling and sharing with their limited resources.

The authors launched the report at a roundtable in March with Espen Barth Eide, Norway’s defence minister.

One of that report’s themes, the need for more pooling and sharing of defence capabilities, was discussed in more detail in a policy brief published in May, ‘Smart but too cautious: How NATO can improve its fight against austerity’, by Claudia Major, Christian Mölling and Tomas Valasek. Poland, which once had a NATO-centric view of defence, is now in the vanguard of proposing a stronger EU defence policy. In a policy brief, ‘Poland’s U-turn on European defence: A missed opportunity?’, Clara Marina O’Donnell argued that Britain and other EU countries should have responded more enthusiastically to Poland’s proposals.

In January, we hosted a dinner with Ivo Daalder on the future of NATO. In February, we held a breakfast with Gerald Howarth, a British defence minister, on whether international collaboration was the answer to defence austerity. In May, a brainstorming with King’s College London looked at the impact of the euro crisis on EU foreign and defence policy. And in December, we organised a roundtable in Brussels on Franco-British defence co-operation, and its relevance for NATO and EU defence, with Julian Braithwaite, Britain’s ambassador to the EU’s Political and Security Committee, Philippe Errera, France’s ambassador to NATO and General Ton Van Osch, head of the EU military staff.

Clara is now the CER’s Washington representative. In October, her policy brief ‘US foreign policy after the presidential election: What should Europeans expect?’ argued that there would not be much difference between the foreign policies of Barack Obama and Mitt Romney, given the constraints of congressional politics, the US budget and the emerging multipolar world. She predicted that neither candidate would be able to do much to restart peace talks between Israelis and Palestinians. But she wrote that the Europeans would find Obama easier to deal with on Russia than the hawkish Romney.

Every year we bring a group of officials and thinkers to Stockholm, where the Swedish parliament hosts our discussions on how to make EU foreign policy more effective. When this group met in May, speakers included Patricia Flor, EU special representative to Central Asia, Carl Hallergard, Lady Ashton’s adviser on Russia and Jakub Wisniewski, head of policy planning in the Polish foreign ministry.



The EU's new foreign policy machinery has been much criticised since it started work at the end of 2010. 'In Europe's External Action Service: Ten steps towards a credible EU foreign policy', Edward Burke argued that the Commission had to take some responsibility for the new body's problems, since it treated the service as an interloper. He suggested that the EEAS should focus its limited resources on bringing a political perspective to trade policy and on strengthening the EU's neighbourhood policy.

Turkey is a neighbour whose candidacy for EU membership is no longer taken very seriously

in the country itself, where there is growing hostility to accession, or in the EU, where several governments and many voters oppose the idea. But Turkey is far too important a country to ignore, so we continue to organise (together with EDAM, a Turkish think-tank) the Bodrum Conference every October. In 2012 we focused on the responses of Turkey and the EU to the Arab spring. Speakers included Carl Bildt, Egeman Bagis, Turkey's Europe minister, Thomas Carothers, an authority on democracy-promotion, Kemal Derviş, a former Turkish economy minister, David Miliband and Nicky Mladenov, Bulgaria's foreign minister.

ABOVE:
 (L to R)
 Lieutenant
 General Ton Van
 Osch, Charles
 Grant and Julian
 Braithwaite

*FR-UK defence forum
 roundtable on 'The
 European dimensions of
 Franco-British defence
 co-operation', Brussels*

Changes at the CER

One reason why CER publications are often read is that they are rigorously argued and clearly written. But we have recently paid greater attention to promotion and dissemination, so that even more people read our papers. At the end of 2011 we launched a completely new website, which has proved to be a success, doubling the number of visitors. We have also put video interviews of our researchers on the website. We are using social media to publicise our work – and have made it easy for visitors to the site to share our publications on Twitter. In September 2012, guided by Kate Mullineux, our publications manager and website editor, we redesigned our reports, essays and policy briefs so that they are lighter on the eye. And the CER bulletin – which has appeared every two months since 1998 – is now produced in full colour.

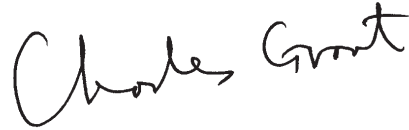
Although we published 26 longer papers in 2012, many people know us primarily through the shorter insights that we send out by email, most of which are not mentioned in this report. Our 41 insights in 2012 covered topics ranging from a proposal for a European Civil Liberties Union to the EU's achievements in Burma to the growth of regionalism in Catalonia, Scotland and elsewhere.

We are also known through opinion pieces written by our researchers – there were 48 in 2012 – in the world's leading newspapers and journals including in *Cumhuriyet*, *Les Echos*, *The Financial Times*, *Financial Times Deutschland*, *Foreign Policy*, *Gazeta Wyborcza*, *The Guardian*, *La Vanguardia*, *The Wall Street Journal* and *Die Zeit*. No fewer than eight pieces appeared in the *International Herald Tribune*.

In our offices in Great College St, Westminster, we have taken on an extra floor. This has given us a new meeting room with plenty of natural light, a good view of Westminster Abbey and an area for people to enjoy refreshments before or after events. Attending CER roundtables is now a more comfortable experience than it was.

We lost two researchers on 2012. Edward Burke, who had not been with us for long, left in July to pursue a doctorate at St Andrews University. In September Tomas Valasek, our director of foreign policy and defence, returned to Slovakia after more than five years at the CER. He became president of a new think-tank, the Central European Policy Institute. Soon afterwards he was appointed Slovakia's ambassador to

NATO. He joins other CER alumni in Brussels: Edward Bannerman, in Catherine Ashton's cabinet, Stephen Everts, a special adviser on Asia in the EEAS, Heather Grabbe, director of the Open Society European Policy Institute's office, and Daniel Keohane, FRIDE's head of strategic affairs. The CER's advisory board gained one new member: Sir Nigel Sheinwald, former ambassador to the EU and the US.



Charles Grant, Director

CER publications 2012

Saving Schengen: How to protect passport-free travel in Europe

report by Hugo Brady
January 2012

Three views on modernisation and the rule of law in Russia

essays by Christopher Granville,
Philip Hanson and Alena Ledeneva
January 2012

True partners? How Russia and China see each other

report by Dmitri Trenin
February 2012

Russia, China and global governance

report by Charles Grant
February 2012

All alone? What US retrenchment means for Europe and NATO

report by François Heisbourg, Wolfgang Ischinger, George Robertson, Kori Schake and Tomas Valasek
March 2012

Poland's U-turn on European defence: A missed opportunity?

policy brief by Clara Marina O'Donnell
March 2012

The European Union budget 2014-20: More boldness needed

policy brief by John Peet and Stephen Tindale
April 2012

How to create a single European electricity market - and subsidise renewables

policy brief by David Buchan
April 2012

Ireland's fiscal treaty referendum: (More) fear and loathing in the eurozone?

briefing note by Hugo Brady
May 2012

Smart but too cautious: How NATO can improve its fight against austerity

policy brief by Claudia Major, Christian Mölling and Tomas Valasek
May 2012

The continent or the open sea: Does Britain have a European future?

report by David Rennie
May 2012

Japan's response to China's rise

policy brief by Charles Grant
June 2012

Britain must defend the single market

essay by Jo Johnson MP
June 2012

Saving emissions trading from irrelevance

policy brief by Stephen Tindale
June 2012

Europe's External Action Service: Ten steps towards a credible EU foreign policy

policy brief by Edward Burke
July 2012

Britain, Europe and the City of London: Can the triangle be managed?

essay by Philip Whyte
July 2012

Outsiders on the inside: Swiss and Norwegian lessons for the UK

policy brief by David Buchan
September 2012

How to build European services markets

policy brief by John Springford
September 2012

Connecting Europe's energy systems

policy brief by Stephen Tindale
October 2012

Cameron's European 'own goal': Leaving EU police and justice co-operation

policy brief by Hugo Brady
October 2012

US foreign policy after the presidential election: What should Europeans expect?

policy brief by Clara Marina O'Donnell
October 2012

Economic recovery requires a better deal for labour

policy brief by Simon Tilford
November 2012

What a banking union means for Europe

essay by Philip Whyte
December 2012

How to expand renewable energy after 2020

policy brief by Stephen Tindale
December 2012



CER events 2012



17 January
 Roundtable on 'After the summit: German & British perspectives on fiscal union'
with Peter Schoof, London

France, NATO and the EU'
with Gerald Howarth MP, London

20 January
 Seminar on 'Schengen & EU migration policy'
with Antonio Vitorino, Hugo Brady, Charles Clarke and Stefano Manservigi, Brussels

20 March
 CER/Kreab Gavin Anderson breakfast on 'The future of economic and monetary union'
with Olli Rehn, Brussels

23 January
 Dinner on 'NATO, defence austerity & the US'
with Ambassador Ivo Daalder, London

23 March
 Lunch debate on 'François Hollande's economic policy'
with Emmanuel Macron, London



23 January
 Seminar on 'The impact of the Russian elections on the rule of law, the economy & foreign policy'
with Mia Brunell Livfors, Ivo Daalder, Dmitri Trenin and Nikolai Tsekhomsky, London

17 April
 CER/LSE economics conference on 'Institutions of economic governance for an incomplete union'
with Gavyn Davies, Paul de Grauwe and Adam Posen, London

24 January
 Breakfast on 'Europe's future, and Italy's role in it'
with Giuliano Amato, London

27 April
 Roundtable on 'France after the presidential election'
with Dominique Moïsi and Christine Ockrent, London



22 February
 Breakfast on 'The role of ACER in European energy markets'
with Lord Mogg, London

3-4 May
 CER/SWP/Brookings Daimler US-European forum on global issues
participants included Carl Bildt, Ivo Daalder, Simon Fraser, Philip Gordon, Emily Haber, Christoph Heusgen, Wendy Sherman and Puneet Talwar, Berlin

22 February
 CER/FTI roundtable on 'Will the euro survive? What does the crisis mean for business?'
with Lord Malloch-Brown, Gerard Lyons and Helen Alexander, London

14 May
 Seminar on 'What can Britain and Europe do to promote growth?'
with Joaquín Almunia, Ed Balls MP, Lord Mandelson and Richard Lambert, London



1 March
 CER/Kreab Gavin Anderson breakfast on 'Can the single market rescue the European economy?'
with Jonathan Faull, Brussels

28 May
 Launch of 'Russia, China and global governance' and 'True partners? How Russia and China see each other',
with Huang Ping, Dmitri Trenin, Pan Wei and Zun Zhe, Beijing

6 March
 Launch of 'All alone? What US retrenchment means for Europe and NATO'
with Espen Barth Eide, François Heisbourg, Wolfgang Ischinger and Kori Schake, London

29 May
 CER/Kreab Gavin Anderson breakfast on 'Is a two-speed Europe inevitable? And is it desirable?'
with Jean-Claude Piris, Brussels



7 March
 Dinner on 'Trade multilateralism: To be or not to be'
with Pascal Lamy, London

31 May
 CER/King's College London brainstorming on 'The economic crisis and its effect on EU foreign policy'
with Sir Lawrence Freedman and Sir Nigel Sheinwald, London

14 March
 Breakfast on 'Is collaboration the answer to defence austerity? Perspectives on the UK,

8 June
 Allianz/CER European forum:
 Lunch on 'Can the single market move

Europe from austerity to growth?'
with Michel Barnier, Brussels

18-19 June

CER/Demos Europa/The Swedish Parliament seminar on 'The future of European foreign policy'
with Patricia Flor, Carl Hallergard and Jakub Wisniewski, Stockholm

20 June

CER/Kreab Gavin Anderson breakfast on 'Democracy and the eurozone crisis'
with Martin Schulz MEP, Brussels

21 June

Launch of 'Russia, China and global governance'
with Akira Imamura, Gideon Rachman and Urs Matthias Zachmann, London

22 June

Launch of 'Russia, China and global governance' and 'True partners? How Russia and China see each other',
with Dmitri Trenin and Fraser Cameron, Brussels

26 June

CER 14th birthday party
with a keynote speech by William Hague MP, hosted by the Irish ambassador, London

12 July

Allianz/CER European forum: Dinner on 'Can Russia reform, and what are the implications for the EU?'
with Igor Yurgens, Brussels

13 July

Roundtable on 'Russia in Putin's third term'
with Igor Yurgens, London

24 September

CER/BNE/Open Europe fringe event at the Liberal Democrats' party conference: 'Europe, from crisis to growth'
with David Laws MP and Vicky Pryce, Brighton

30 September

CER/BNE/Open Europe fringe event at the Labour party's conference: 'Europe, from crisis to growth'
with Douglas Alexander MP and Chris Leslie MP, Manchester

9 October

CER/BNE/Open Europe fringe event at the Conservative party's conference: 'Europe, from crisis to growth'
with Harriett Baldwin MP and David Lidington MP, Birmingham

12-14 October

CER/EDAM - The 8th Bodrum roundtable
participants included Egemen Bağış, Carl

Bildt, Thomas Carothers, Kemal Derviş, David Miliband MP and Nickolay Mladenov, Bodrum

17 October

Roundtable on state aid and nuclear power
with Dieter Helm, London

18 October

CER/Kreab Gavin Anderson breakfast on 'Strengthening Europe's economy through climate policies'
with Connie Hedegaard, Brussels

22 October

Breakfast meeting on 'The future structure of EU banking'
with Erkki Liikanen, London

30 October

CER/Kreab Gavin Anderson breakfast on 'Britain and the EU: Future direction'
with Sir Jon Cunliffe, Brussels

9-10 November

CER economics conference on 'Europe's future in an age of austerity'
with Marco Buti, Richard Lambert, David Miliband MP, Robert Skidelsky and Paul Tucker, Ditchley Park

20 November

Breakfast on 'Has Europe learnt anything from the Greek crisis?'
with Vicky Pryce and Sony Kapoor, London

21 November

Allianz/CER European forum on 'A multi-tiered Europe? The political consequences of the euro crisis'
speakers included Giuliano Amato, Miroslav Lajcak, Lord Kerr, David Miliband MP and Wolfgang Schäussel, Brussels

27 November

CER/Kreab Gavin Anderson breakfast on 'How can EU trade policy contribute to economic growth?'
with Marc Vanheukelen, Brussels

29-30 November

CER/SWP/Brookings Daimler US-European forum on global issues
speakers included Bill Burns, Radek Sikorski and Kurt Campbell, Washington

17 December

Defence roundtable on 'The EU dimensions of Franco-British defence co-operation'
speakers included Julian Braithwaite, Philippe Errera and Lieutenant General Ton Van Osch, Brussels

18 December

Roundtable on 'The US and Europe in President Obama's second term'
with Elizabeth Sherwood-Randall, London



Advisory board

Esko Aho

Senior Fellow, Harvard University, Consultative Partner for Nokia and former Finnish Prime Minister

Giuliano Amato

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Timothy Garton Ash

Professor, European Studies, University of Oxford

Heather Grabbe

Director, Open Society European Policy Institute, Brussels and Director of EU affairs, Soros Network

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Igor Yurgens

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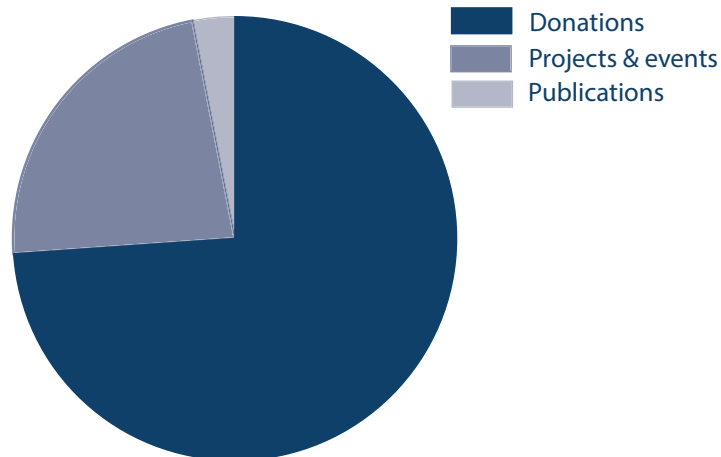
In addition to our corporate members, numerous other companies have supported specific publications, projects and events.

Financial information

Audited accounts for year ending 31.12.2011

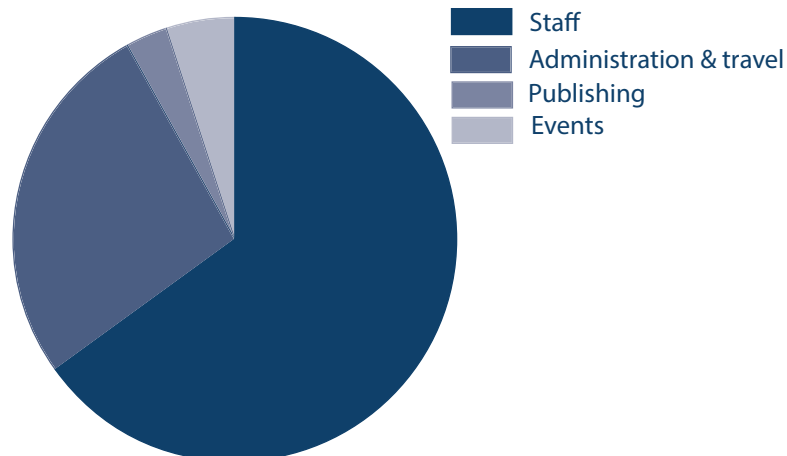
Income for 2011:

Total £1,234,849



Expenditure for 2011:

Total £1,185,999



CER staff 2012

Charles Grant is the director. His interests include the euro, European foreign and defence policy, Russia and China.



Katinka Barysch is the deputy director. Her areas of expertise are Russia, energy, the European economy, globalisation, EU enlargement and Turkey.



Simon Tilford is the chief economist. He focuses mainly on competitiveness, macro-economics, economic reform, the euro and the environment.



Philip Whyte is a senior research fellow. He specialises in fiscal and monetary policy, micro-economic reform and financial regulation



Tomas Valasek was director of foreign policy & defence. He specialised in EU foreign & security policy, European neighbourhood policy, transatlantic relations and the defence industry.



Hugo Brady is a senior research fellow. He specialises in justice and home affairs as well as the reform of EU institutions.



Stephen Tindale is an associate fellow. He specialises in climate and energy policy, as well as agricultural policy and the EU budget.



Clara Marina O'Donnell is a senior research fellow. She specialises in European foreign policy, defence and the Middle East.



John Springford is a research fellow. He specialises in the single market, labour markets, international trade, the euro and fiscal and monetary policy.



Edward Burke was a research fellow. He specialised in EU foreign and security policy and the Middle East.



Catherine Hoye is the director of operations and finance. She is also PA to Charles Grant.



Kate Mullineux is publications manager and website editor. She designs all CER publications and organises their production.



Susannah Murray is the events co-ordinator. She also provides administrative support to the researchers and manages the CER's database.



