

CER Bulletin

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Cameron's deal is more than it seems

By Charles Grant

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By John Springford



The deal on EU reform won by David Cameron on February 19th will not change the fundamentals of how the EU works. So it is not surprising that it has failed to shift British public opinion in favour of EU membership. But this 'decision of the heads of state or government' is far from irrelevant and shows that the EU is changing in at least three ways.

Even if the British vote to leave the EU on June 23rd – thereby rendering the decision void – the thinking behind it will not be forgotten. The least significant change concerns welfare benefits. Cameron won both an 'emergency brake' allowing a government to limit in-work benefits for EU migrants, and new rules on payments to migrants' children living in other member-states. To justify these innovations, the decision extends recent jurisprudence from the European Court of Justice, which had curtailed the access of unemployed migrants to benefits; it implies that the right to free movement within the EU does not mean free access to the welfare systems of host countries. The text says that benefits may be limited if high immigration puts pressure on social security systems, labour markets or public services. In the event of Brexit, such limitations on benefits are likely to continue, since they suit many member-states.

Two other changes are more interesting. The section on sovereignty enhances the special status already enjoyed by Britain. The UK has opt-outs from the Schengen agreement and the euro. It chooses whether to join justice and home affairs measures (and in 2014 withdrew from most of the ones it had previously signed up to). A protocol

of the Lisbon treaty insulates Britain from the effects of the Charter of Fundamental Rights. And February's decision promises a treaty change to state that "the UK...is not committed to further political integration into the EU...The references to ever closer union do not apply to the UK."

But this section affects all the member-states. It says that that ever closer union cannot be used to extend the powers of the EU, or to prevent powers being handed back to member-states. "The references to ever closer union among the peoples are therefore compatible with different paths of integration being available for different member-states and do not compel all member-states to aim for a common destination."

These words merely describe reality; the various members have long had very different ideas of where they want the EU to go. But the text infuriates true believers in a federal EU. Andrew Duff, a former British MEP, responded: "For the rest of the EU, the decision means the end of an implied common goal. Suddenly it has become acceptable if not respectable for states to hold different concepts of the *finalité politique*...The EU is left with its first concrete instance of political

disintegration entrenched at a constitutional level." But however the British vote, the principles enshrined in the decision will surely endure; few European leaders are Duffian federalists.

The other key section covers relations between the euro countries and the others. The British worry that the eurozone may caucus and push through rules that damage the single market in financial services or the City of London. The euro countries are concerned that the British may try to veto financial regulation – or somehow seek to block eurozone integration. The decision defines some sensible principles to govern relations between euro and non-euro countries:

★ Discrimination based on a member's currency is prohibited. Laws concerning the eurozone "shall respect the internal market [and] the competences, rights and obligations of member-states whose currency is not the euro".

★ Members outside the euro "shall not impede the implementation of legal acts directly linked to the functioning of the euro area and shall refrain from measures which could jeopardise the attainment of the objectives of economic and monetary union".

★ Countries outside the euro will not have to contribute to eurozone bail-outs.

★ The Eurogroup (informal meetings of ministers from euro countries) should not intrude on the role of the Council, where the governments co-ordinate economic policy and take decisions, including for the eurozone.

These principles are not particularly controversial (though Sylvie Goulard, a French MEP, found them "seriously imbalanced to the detriment of the eurozone"). They will go into the treaties if the British vote to remain – and the treaties will then recognise, for the first time, that there are two sorts of member, euro and non-euro. Even if the British leave, many governments will want to preserve these ground-rules for relations between euro-ins and euro-outs.

One part of this section was bitterly fought over. The British wanted the right to have financial regulations that differed from those of the eurozone. The French, backed by Germany, many eurozone governments and the European Central Bank, feared that such differentiation could lead to laxly-regulated UK firms undercutting continental ones, or to financial instability.

An early version of the decision pleased the British by saying that "different sets of Union rules may have to be adopted in secondary law". The

French claimed that the wily Sir Jon Cunliffe, a deputy governor of the Bank of England and a former permanent representative to the EU, had 'got at' the Danish and Polish officials drafting the text; since their countries were outside the euro, they (in the French narrative) had an imperfect understanding of the issues at stake.

The wording of the final compromise maintains the status quo, leaving open for future battles the degree to which UK regulation may diverge from that of the eurozone. The text says that all financial institutions must apply the single rulebook. Laws applied by the ECB, the Single Resolution Board or other EU bodies "may need to be conceived in a more uniform manner than corresponding rules to be applied by national authorities" of countries outside the banking union. "To this end, specific provisions within the single rulebook and other relevant instruments may be necessary, while preserving the level playing field and contributing to financial stability." The text also says that unless member-states choose to join common mechanisms, they are responsible for implementing their own measures on supervision, resolution and macro-prudential stability.

Cameron also won a second 'emergency brake': a country outside the banking union may pull the brake if it believes the above-mentioned principles have been breached. The Council and EU institutions would then seek to resolve the matter within a "reasonable time". The European Council may be convened, but the brake is not a veto and ultimately the Council would decide the issue by majority vote.

Some federalists fear that Cameron's renegotiation establishes a dangerous precedent. "By transforming the right of a state to leave the EU into the right to blackmail partners with the threat of leaving, Cameron has opened Pandora's box", wrote Goulard. She worries that other members will now try to pick and choose the bits of the EU they like. Such fears are probably exaggerated. Most other countries enjoy much less leverage than the UK. According to one EU official, "if Hungary held a referendum and threatened to leave, many people would not be that bothered."

In any case, the specifics of Cameron's deal contain much good sense. They recognise the reality that in an EU of 28 plus countries, more differentiated – and complicated – structures will be needed to hold the Union together and enable the very different preferences of the member-states to be reconciled. Federalists do their cause no credit by clinging to conservative and traditional ideas of uniformity.

Charles Grant
Director, CER



Into the bazaar of EU-Turkey relations

by Rem Korteweg

Few of the European Union's foreign relationships are as complex as that with Turkey. It has become the EU's indispensable neighbour, but also a difficult one. Ankara has a role in most of the urgent issues that Europe faces today: the migration crisis, energy security, the Syrian conflict, and relations with Russia. If the EU is to achieve its goals in any of these areas, it needs to find a way to co-operate with Turkey that respects European interests without compromising its values.

On March 18th, the EU agreed a deal with Turkey aimed at arresting the flow of migrants across the Aegean Sea. Under the terms of the agreement Athens can send irregular migrants back, while legitimate refugees will be flown to the EU directly from Turkey. In return, the EU will pay Turkey €6 billion to support the refugee camps, has promised to lift visa restrictions, and will open a new chapter in its talks on EU membership.

Europe's generosity comes from its sense of panic. The migration crisis has strained the EU's cohesion. Borders have been erected across parts of the passport-free Schengen zone and recriminations among European leaders are exposing the limits of EU solidarity. Whether or not the deal holds, it is clear that Turkey is now central to Europe's efforts to prevent the roll-back of European integration. At the press conference after the migration deal was announced, Turkish prime minister Ahmet Davutoğlu boldly said that "there is no EU future without Turkey".

Europe needs Turkey to fulfil two functions: to be a barrier to irregular migration and European jihadists returning from Syria and Iraq; and to be a corridor for Europe's energy supplies as it reduces its dependence on Russia. It would also like Turkey to follow Europe's model of liberal governance and the rule of law, ostensibly with EU membership as its ultimate goal. The EU will only be able to pursue all three goals with better co-ordination and a strategic approach.

Refugees aside, the EU wants Turkey to do more to control the movement of potential terrorists to and from areas controlled by Daesh, the so-called Islamic State. Foreign fighters from Europe – estimated at between four and six thousand in total – mainly travel to and from Syria via Turkey. The attacks in Brussels on March 22nd underline again that the EU and Turkey need to exchange information on the movements of jihadists.

For Turkey, the priority is its domestic security. Five bombings have taken place in as many

months, striking Ankara and Istanbul. The government has blamed Daesh and the PKK, a Kurdish terrorist group. Spill-over from the war in Syria was to be expected; Turkey hosts more than two million Syrian refugees, putting pressure on local services and increasing the footprint of Daesh in Turkey. But Turkish security priorities do not always coincide with Europe's. Turkey has focused on fighting the PKK at home, and the YPG Kurdish militant group across the border. The Turkish government appears more worried about separatism in its south-east and the possibility that Syria might disintegrate and give birth to a Kurdish state than about the threat from Daesh. By contrast, in European capitals the Kurds are seen as the good guys.

The deteriorating security situation serves as a pretext for President Recep Tayyip Erdoğan to consolidate his power and crack down on domestic opponents, including critical media. Erdoğan's attempts to change the constitution and strengthen the presidency were stalled by November's parliamentary elections, which failed to give him the necessary majority. But in its panic over migration, the EU has allowed Erdoğan to get away with repressive moves. While Europe was considering the details of the migration deal, the government in Ankara replaced the board of opposition newspaper *Zaman*. The timing was no coincidence. Europe's offer of visa liberalisation without democratic reforms now risks rewarding President Erdoğan's authoritarian tendencies. In October, the EU delayed releasing a critical report of the human rights situation in Turkey to avoid scuttling an earlier migration deal.

Turkey's sense of indispensability in the Syrian conflict has complicated the West's already tense relationship with Russia: when Turkey shot down a Russian jet which violated its airspace in November 2015, NATO members fretted that Turkey's rash action could drag them into a conflict with Russia. But Europe cannot ignore Turkey's central role in any settlement of the Syrian conflict, and its aftermath.

Europe also needs Turkey as part of its energy strategy. It wants to diversify away from its dependence on Russian gas imports. Whether it is gas from the Caspian Sea, Kurdish Iraq, Iran, or even from Cyprus's offshore field, the most straightforward route to the European market is through Turkey. The EU started a high-level energy dialogue with Turkey in March 2015; its main agenda item is moving the Southern Gas Corridor – a project to bring gas from Azerbaijan through Turkey, Greece and Albania to Italy by 2019 – to fruition.

Energy co-operation with Europe is of critical importance to Turkey too, as its relationship with its main gas supplier, Russia, has soured. Turkish gas demand is expected to increase from roughly 50 billion cubic metres (bcm) this year to 70 bcm by 2030, and the country lacks domestic sources. It makes sense for it to work with the EU to develop the necessary infrastructure and attract the extra gas.

Historically, one of the EU's strongest levers for change in Turkey has been the carrot of accession. When accession talks started in 2005, it coincided with attempts by Erdoğan's AK Party to weaken the grip of the military on Turkish society; the human rights situation improved for a number of years. But now a weak and divided EU seems to offer little incentive for further reforms. Erdoğan prefers to see himself as a strong regional power, rather than as an EU suitor, and human rights and political freedoms have gone backwards.

One piece of good news is that the Cyprus conflict appears to be inching towards a solution, following a rapprochement between the leaders on the island. The conflict has blocked Turkey's EU accession talks, effective EU-NATO co-operation and eastern Mediterranean energy plans. But Europe's anxious bargaining over the migration deal took little account of the delicate negotiations in Cyprus. The EU must show greater awareness of how the different pieces of its Turkey-puzzle fit together.

The EU acts as though it has little leverage, and will have to sacrifice its values for influence in Ankara. But this is too pessimistic. Turkey's concerns about the potential adverse effects for its economy of the TTIP transatlantic trade talks make it keen to negotiate a free-trade agreement with the US and to update its customs union with the EU. And Russia's economic sanctions leave Turkey with few options but to boost trade and investment with the EU.

Europe's market power gives it leverage if it chooses to use it. But it needs to pull together all the strands of its relationship with Turkey. At least six Commissioners and High Representative Federica Mogherini currently cover Turkey policy, with no-one in overall charge. Mogherini should oversee a co-ordination process. As in a bazaar, the EU must know what it wants from Ankara and understand the art of haggling; otherwise, it risks overpaying.

Rem Korteweg
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Why the EU's market matters to Britain

by John Springford

Brexit would free Britain to sign bilateral free trade agreements with the 'BRICS' emerging economies, the Anglosphere and Japan without having to reach a consensus with 27 other EU member-states. The rest of the world is growing faster than the EU, and it offers opportunities that would make up for any forgone trade with Europe. This means that Brexit would boost the economy in the long term, especially if you throw in some deregulation to boot.

This commonplace view is wrong. There are three reasons why. The first is distance. If Britain were to start its trade negotiations from scratch, its first priority should be to reduce the cost of trade with big, nearby economies. Trade diminishes quite rapidly with distance. Half of Britain's exports go to the EU, which makes up a fifth of the world economy. Meanwhile, the non-European members of the OECD – although they comprise a third of the global economy – only buy a quarter of Britain's exports, because on average, they are seven times further away.

The second reason is that trade with the BRICS is not the unalloyed good that many disciples of free trade imagine. After he came to power in 1978, Deng Xiaoping's pro-market reforms allowed China to make use of its comparative advantage in low-value added manufacturing. Other developing economies followed. This process enriched Britain's consumers: electronic goods, toys, clothes and steel became much cheaper in real terms. And over time, labour and capital were redeployed to more productive sectors of the

British economy, raising incomes further. Together, these two effects made Britain richer on average.

However, those last two words matter. Trade with poorer countries is not without cost. The scars of deindustrialisation are still visible in Britain's unbalanced economy, with higher unemployment rates and lower productivity continuing to blight the UK's northern cities. As manufacturing and industrial work dried up, many low-skilled people moved into poorly paid services jobs. Productivity growth in low value-added services sectors has been slower than in manufacturing. These trends have contributed to the 'hollowing out' of the British labour market, with more low- and high-paid jobs being created than those which provide middling earnings. That does not mean that an 'independent' Britain should avoid a trade agreement with China – but it does suggest that agreements with richer countries should be its priority.

After the 2008 crash, Britain's productivity plunged and then stagnated. It had been catching up with US levels over the preceding decades, but after six

years of weak growth, the UK's output per worker is now a quarter lower than the US. Thus Britain's trade strategy should make productivity growth its ultimate aim. This points us to the third reason why Britain needs untrammelled trade with the EU: imports, especially from rich countries, are more valuable than exports, because they help to boost productivity. In the long run, economic growth is determined by productivity growth – wringing more output from workers and machinery.

Imports boost competition in the domestic economy, which raises the incentive for domestic firms to make productivity-enhancing investments and to invent new technology. This process is known as the 'dynamic' gains from trade. The constant pressure of competition from more productive overseas companies raises productivity growth.

Outside the EU, Britain could unilaterally and fully open its markets to the US, Japan, Australia and the EU in order to take advantage of those dynamic gains. But without unimpeded access to the EU market, foreign direct investment to the UK would be lower. Such investment is a big source of dynamic gains. The UK has been the largest recipient of FDI in the EU because it offers a bridgehead to European markets, with a labour force that speaks English and low taxes and regulatory costs. And, since the UK cannot control what tariff and other barriers the rest of the EU

would impose on the country after withdrawal, foreign investment would be at risk: Nissan, whose Sunderland factory now produces more cars per year than Italy, has plants elsewhere in the EU, and higher trade costs would prompt it to expand production inside the single market.

These rules of trade economics give trade negotiators a clear order of priorities. First, seek to open markets with more productive, rich countries. Second, seek to open markets with countries that are nearby. Measures to boost exports with distant emerging economies come third. If Britain votes to leave the EU, it might be possible to negotiate continued market access – with a ban on any behind-the-scenes discrimination against British companies in EU member-states. But this would be difficult politically. The EU would demand that Britain sign up to all single market legislation – so Westminster would not be allowed to repeal unwanted EU regulation. And the UK would have less sovereignty, not more, because we would lose our vote on new EU rules. The UK would also have to continue paying budget contributions and accept unrestricted immigration from the EU. Since those divorce terms would be hard for the UK to accept, Brexit would be likely to raise trade barriers with the EU. We would be poorer for it.

John Springford
 Senior research fellow, CER

CER in the press

The New York Times

17th March 2016

But as [John Springford] said in a study last year, "The regions that have most to lose tend to be the most eurosceptic." In the northeast, he said, exports to Continental Europe "are far higher than other regions – yet its residents consistently favour withdrawal."

The Economist

12th March 2016

Many are shocked that the EU has made such a lavish offer when Mr Erdoğan has nothing but contempt for Europe's values... Some EU members, particularly those with strong right-wing parties, regard visa-free travel as "very sensitive and problematic", said Camino Mortera-Martinez of the CER.

Bloomberg Business

8th March 2016

Christian Odendahl, chief economist at the CER said, "what markets need to know is that the ECB is willing to let inflation overshoot for a while until the recovery is completed before it starts normalising rates. More of the same in terms of forward guidance is not going to achieve that."

Vogue

29th February 2015

The role she played in that historic deal, which has resulted in Iran dismantling large parts of its nuclear program, is widely considered Federica Mogherini's biggest achievement, [says] foreign-policy expert Rem Korteweg of the CER.

The Washington Post

20th February 2016

The CER concluded that Cameron's "package of reforms will sway few voters, so he must now make the case for the EU itself." "Cameron's best chance of success, is to shift the debate onto more lofty terrain, away from arguments about banking safeguards and migrants' benefits towards a contest over how to secure Britain's interests in Europe and the rest of the world."

Die Welt

15th February 2016

"Contrary to others we have never seen integration as an aim in itself but as a means to an end – the furtherance of our own interests", said Simon Tilford of the CER. Precisely because it doggedly

questioned the belief in the merits of ever closer integration, the UK was a valuable partner, he said.

The Economist

12th February 2016

"He [Cameron] got diplomacy pretty late in the day, but better late than never," agrees Charles Grant of the CER.

The Financial Times

2nd February 2016

Agata Gostyńska-Jakubowska of the CER, said Poland had to show resistance as being seen as too accommodating risked backfiring with domestic opinion. "For the moment it seems there is enough flexibility in the text for both to claim some victories. But the devil is in the details, and what Cameron and Szydło will be discussing."

Recent events



David Mundell

22 March 2016

Speech on 'Scotland, the UK and a reformed European Union', London
With David Mundell

9 March 2016

CER/Kreab breakfast on 'Can Schengen survive without a common migration and asylum policy?', Brussels
With Laurent Muschel



Laurent Muschel



Jeppe Tranholm-Mikkelsen

1 March 2016

CER/Kreab breakfast on 'The challenges facing the EU: A Council perspective', Brussels
With Jeppe Tranholm-Mikkelsen

23 February 2016

CER/Kreab breakfast on 'Brexit: A business perspective', Brussels
With Matthew Baldwin



Matthew Baldwin



Julie Smith

4 February 2016

CER/Pro Europa panel on 'Fog in the Channel: Clarifying the UK referendum debate', Brussels
With Tom Nuttall and Julie Smith

18 January 2016

CER/Istituto Affari Internazionali seminar on 'Between power and rules: The geopolitics of TTIP', Rome
With Sandro Gozi and Marietje Schaake



Sandro Gozi