

# The UK and the EU

Cutting the knot

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## SUMMARY

- The UK must seek a new and different relationship with the EU.
- The UK position on the euro crisis risks being both unprincipled and misguided. It assumes that the policy of endless bail-outs will save the euro, even if Germany can be persuaded to take on this obligation.
- While the damage to the British economy from a euro collapse would of course be considerable, the longer term consequences of the EU becoming a fiscal state would be worse. And it will entail untold hardship to the citizens of the nations involved.
- The alternative is to use the present crisis to construct a radically different relationship between the UK and the EU, which would also serve as a model for the future of the EU itself.
- The long history of opt-outs from EU policy shows that the concept of variable geometry is workable – and could lead to a form of European association whereby self-governing countries come together to pursue common interests.

- However, not least because of the repeated achievements of the ECJ in extending ever closer union, a range of opt-outs no longer gives the UK the protection it needs. An “opt-in principle” is needed, to enable the UK to decide on a case by case basis whether to adopt EU laws, directives and regulations. This principle already applies in the area of Justice and Home Affairs.
- An opt-in principle would extend to every policy area with the single exception of the single market. A single market needs common rules and thus the opt-in principle would not be applicable. It would be necessary to define and limit the rules essential for a single market.
- Financial services would be regulated on the same opt-in basis advocated for other policy areas, but with a core of regulations identified as essential for EU-wide trade in financial services.
- The UK is in a position of strength. Several major EU initiatives need our consent: the extension of the jurisdiction of the ECJ, the European Fiscal Pact; the EU budget and President Barroso’s recent call for substantial Treaty revisions all provide opportunities for renegotiation.
- An EU of opt-ins would be liberating, forward-looking and global. Its achievement requires unflinching political will, and a governing party with a clear electoral mandate, followed by a national referendum. The electorate should be asked whether it accepts or rejects a comprehensive reform treaty which puts the UK-EU relationship on a new footing.
- A Prime Minister and party which rose to this challenge would transcend day-to-day managerial concerns of government and earn a place in history.

## 1. LA COMEDIA E FINITA

The crisis of the euro is also a crisis of the European Union. The currency problem cannot be solved unless equal attention is given to what is wrong with the EU.

The euro was never just a currency. It was the means to secure, irreversibly, the political unification of the EU under a central authority. The euro was planned and introduced despite it being demonstrated, by this author and others, that the EU was not a suitable area for a single currency. The constituent economies were (and still are) too diverse; the equalizing flow of migrant workers too low; and the necessary budgetary transfers too small.

These objections were brushed aside because of the overriding political aim of “unifying Europe” and the perception in Brussels that, since a currency is the attribute of a state, the euro would secure that status for the EU. Never was such a *grand projet* undertaken with so little regard for the facts.

The euro was duly hit by a combination of its own internal contradictions and the 2007/ 08 banking crisis. The weaker economies of the south and west were trapped in a system

which prevented them making the necessary adjustments. Instead, the only alternative policy response was imposed on them: a savage deflation, which still further cut their economic growth, raised unemployment and made them wholly dependent on German hand-outs. Cash bail-outs could disguise the problem but not solve it. At root, the euro crisis is not one of debt but of a misconceived currency.

The euro was launched without public consent and it reinforced all the prevailing weaknesses of the EU – centralizing, unaccountable and technocratic. It ignored the more elevated European traditions of democracy, self-government and respect for diversity.

The United Kingdom has of course escaped the worst consequences of the single currency debacle because of our opt-out. However, the crisis has exposed, beyond doubt, the flaws in EU construction. Efforts to rescue the euro have simply accentuated the negatives – more centralization and contempt for national democracies.

It is not an adequate response for the Coalition, for short-term economic reasons, to urge the Eurozone countries to bind themselves together into an even tighter union than the one which caused the problem in the first place. Such a course has been criticized and opposed by the Conservative Party for many years. It would be truer to Britain's internationalist tradition for us to take a lead for a different form of EU association, based on the principles of popular consent, free trade, political co-operation and parliamentary rights.

If the EU rejects reform and persists along the path of greater power for itself, the UK must disengage from this and form a new and different relationship with the EU. This pamphlet sets

out the case for a radically different relationship based on the “opt-in principle”, whereby Britain would decide on a case by case basis whether to adopt EU laws, while retaining the necessary disciplines for a single market.

This would enjoy widespread public support – a genuine coalition policy; liberating, forward-looking and global. Its achievement requires unflinching political will, and a governing party with a clear electoral mandate, followed by a national referendum. A Prime Minister and Party which rose to this challenge would transcend the day-to-day managerial concerns of government and earn a place in history.

## 2. THE ROAD TO RUIN

*Fanaticism consists in redoubling your effort when you have forgotten your aim.*

George Santayana

Attempts to unify Europe politically have a very long pedigree. They have also usually conflicted with British desire to prevent the continent falling under the control of a single dominant power.

After the Second World War, it was understandable that the belligerents should attempt to prevent any reoccurrence by furthering economic co-operation. In a world of high tariffs on manufactured goods, this took the form of a Common Market. The EU's founding father, Jean Monnet, had a much more ambitious, if undeclared, aim: he believed that European unity could only be realized as a technocratic undertaking, with the end disguised from timorous electorates.

British doubts about the political implications of membership were eroded by the comparative weakness of our economic

performance during the 1960s. After two failed applications, Edward Heath took the UK into the Common Market in 1973. If circumstances had delayed British entry for another decade or so, it is unlikely that we would ever have joined. By then, not only was another Prime Minister, Margaret Thatcher, in office, but the terms of world trade had altered. Global tariffs were falling, new economic powers were emerging, and the Common Market was becoming less concerned with trade and more interested in regulations and directives. British self-confidence had returned and it was increasingly clear that the real economic question was not whether this country was competitive in Europe, but whether Europe was competitive in the world. The EU was either irrelevant or unhelpful in rising to that challenge.

Monetary union had long been seen as the motor of political integration. The 1970 Werner Report set out a ten year programme ending with full, irreversible monetary union, but this was derailed by the collapse of the Bretton Woods system which had governed global exchange rates since 1945. A similar fate met the next experiment whereby member states agreed to limit their currency fluctuations inside narrow limits against the dollar, known as the 'snake in the tunnel'. The snake lasted two years, overcome by oil shocks. Next came the European Monetary System, proposed by Roy Jenkins, President of the European Commission. Its central feature was the Exchange Rate Mechanism, which again was supposed to be an irreversible linking together of exchange rates. This lasted 13 years before the UK crashed out in September 1992, together with the Italian lira and others, leading to its general suspension. The European Commission reported that this was due to illogical market reaction and speculators, and the solution was therefore to do away with exchange rates altogether and move to a single European currency, the euro.

Launched in 1999, the euro was similarly built on sand. The variety and diversity of the national economies, with their different trade patterns, structures and growth rates, made it reckless to force them all into a single currency with one universal interest rate and one monetary policy. Like Procrustes, the blacksmith in Greek mythology who forced strangers to fit his iron bed by stretching them or cutting off their legs, the designers of the euro were determined that all must fit one size.

Facile comparisons were made with the US and the success of the US dollar. But labour migration was far too low in the EU to iron out the areas of economic difference; also, the central budget of the EU was much too small to subsidize permanently the weaker countries, even if this had been allowed in the treaties. All this had been pointed out by critics of monetary union; all had been ignored.

The public was suspicious: German public opinion polls showed large majorities against giving up the deutschemark. National referendums on the euro were held in Denmark and Sweden, and they both voted against. No other referendums were allowed.

John Major had secured an opt-out for the UK in the 1992 negotiations on the Maastricht Treaty, but because of divisions in the cabinet, the Government was unable to warn others of the reckless way that the euro was being promoted, and the vacuous intellectual foundations on which it rested. Nor did the opt-out ensure that Britain would remain out, particularly as Tony Blair and most of New Labour were in favour of joining, as were the Liberal Democrats and a number of key Conservatives. The BBC, the CBI, the FT and other establishment organs took up their usual stance of compliance with any supposedly progressive cause. Opponents were dismissed as extremists, when in fact it

was those who wished to give up the national currency who should have been treated as the dangerous radicals.

In the eurozone, the inevitable duly happened. The single interest rate was too low for the countries of the south and west, and engendered an artificial boom in public and corporate borrowing. Nothing was done to correct the growing trade deficits in these countries. It was held that such things did not matter in a single currency area. Within a decade, their unit labour costs rose by some 30% relative to Germany, making them uncompetitive, but the European Central Bank persisted with the pretence that all national debt was the same with no risk attached to the weaker economies. Such a situation could not endure for long. The shock which accelerated the collapse was the credit crunch of 2007/08.

The flaws in the euro project were brutally exposed: the lack of convergence between the participating economies of the EU; and the precarious position of the unfortunately named PIIGS (Portugal, Italy, Ireland, Greece and Spain). Unable to take action appropriate for their national needs, they were subjected to a centrally-directed squeeze which further reduced growth and therefore the ability to pay off debt. The underlying problem was that the PIIGS had become uncompetitive, as measured against the northern Eurozone economies exemplified by Germany. The natural solution, available to every other country in the world outside the eurozone, was a currency devaluation, which would price them back into the market. Since this was impossible, their only hope was an 'internal devaluation', which has meant savage cuts to costs and wages, and higher unemployment. This was naturally resisted by the working population, not least as the architects of the fiasco were often personally except from this treatment.

Meanwhile, the markets were punishing the deficit countries by demanding a substantial premium for continuing to lend them money. Germany was reluctant to take on the role of permanent paymaster, particularly as this was of dubious legality given the 'no bail-out' clause in the EU treaty. Ireland, Portugal, Greece (twice) and Spain received bail-out packages, and in return the German Government demanded a 'fiscal pact' to enforce discipline.

The response of the British Government to these moves towards a centrally-directed European state has been steadily more permissive. It started differently. In December 2011, David Cameron vetoed a proposed treaty change which would have allowed the other member states to use the EU institutions to enforce new rules for the single currency. He was particularly worried that the new pact could pass discriminatory rules against the City of London. He also opposed the concept of a, "new treaty within a treaty, a group of countries within the 27 using the institutions, constituting a new legal system and having the institutions serving two masters at the same time within the same statutes".<sup>1</sup>

The veto caught Labour off-guard, and was criticized by Lib Dem members of the Coalition, but was popular with the public. Labour's opinion poll lead, of a steady 5%, disappeared. The Conservatives moved ahead.

But one veto does not make a policy. Three months later, 25 EU countries signed a European Fiscal Union with only the UK and the Czech Republic staying out. This treaty is not formally part of EU law, although it is planned to incorporate it into the EU

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<sup>1</sup> *The Daily Telegraph*, 9 December 2011.

treaties within five years. Due to come into force in January 2013, it sets strict controls on national budgets and borrowings, administered by the European Commission and adjudicated by the European Court of Justice (ECJ). A state which deviates from the deficit reduction programme will be subject to an automatic 'corrective mechanism', and the ECJ will have powers to fine countries in default.

This concentration of powers at the centre, removing yet more powers from national exchequers and parliaments, is contrary to Conservative principles. But the Prime Minister removed his objection to the use of EU institutions to police and enforce the new pact, and allowed it to go ahead. The earlier veto was not part of a plan, but rather an instinctive response to an immediate problem. The leverage that Britain had to obtain reforms or concessions was squandered.

The British Government then joined the chorus of voices urging Germany to fund every variety of bail-out, loan guarantee, write-off and hand-out to the stricken PIIGS. Britain was, rightly, refusing to participate in any such schemes (except via the IMF), but there was an awkward contrast between the Government's policy of financial rigour at home while telling the Germans to pay up abroad.

Nor would such a policy tackle the underlying problem of the Eurozone, which is not one of debt but of a currency and competitiveness. Even if all the debt of the troubled member states were written off, they would still be uncompetitive because of their high unit costs and lack of productivity as measured against the stronger economies of northern Europe. Quite simply, Germany and Greece cannot share a currency. Their differences were always too great to make a shared currency anything other than a politically-inspired fantasy.

The British position on the euro crisis therefore risks being both unprincipled and misguided. It assumes that the policy of endless bail-outs will save the euro, even if Germany can be persuaded to take on this obligation. The damage to the British economy from a euro collapse would of course be considerable, but the longer-term consequences of the EU becoming a fiscal state would be worse, quite apart from the fearful damage it would cause to the livelihoods of millions of Europeans (and therefore our export markets) by entrenching and extending the present policy.

The alternative is to use the present crisis to construct something more enduring: a new and different relationship between Britain and the EU, which would also serve as a model for the future of the EU itself.

### 3. NEITHER DEMOCRATIC NOR EFFICIENT

*Progress occurs not by human design but by human actions.*

F A Hayek

The euro project mirrors the wider failings of the EU: centralizing, technocratic and contemptuous of public opinion. The EU was never designed as a democratic organisation, and rapidly became an exemplar of the Iron Law of Oligarchy.

The executive arm of the EU is the European Commission, which also has some legislative powers. In most areas it has the sole right to initiate new laws and regulations, or their repeal. Although the Commission has the duty to suppress monopolies, this is one they hold on to very determinedly. The Commission is also responsible for the EU budget, which the auditors have refused to sign off for the past 18 years, and it was the driving force behind the euro, with its willful neglect of economic reality. For instance, the early Commission paper making the case for the euro, *One Market, One Money*, emphatically denied that central controls would be needed, and asserted, without evidence, that national adjustments would take place naturally and painlessly.

The democratic yeast was supposed to be provided by the European Parliament (EP), but this assembly has never achieved public recognition. The EP has been given more treaty powers in each treaty change, but turnout has fallen in each and every election since the first in 1979. Few people can name their MEP and fewer still feel represented in any real way in a body they have so little influence over. The record of the EP is almost always to support more EU powers and a bigger budget.

The third corner of this institutional triangle is occupied by the Council of Ministers, representatives of national governments. The spread of majority voting to most policy areas has reduced the power of veto to a few areas like taxation. Successive treaties made the EU into the dominant law-maker, and the principle of subsidiarity – whereby action should be taken at member state level unless it could be shown that EU action was more effective – has never been an effective check on the steady transfer of powers upwards. The arbiter in any dispute is in any case the ECJ, which is an activist court committed to ‘an ever closer union’. For instance, the ECJ asserted the general primacy of EU law over the law of member states, although this was not decided in any treaty and rested only on the court’s own judgment of its own powers.

As the EU became more powerful, public alarm increased. The 1992 Maastricht Treaty was only just passed by referendum in France – the ‘petit oui’ – and rejected in Denmark. The following year, the Danes voted again and the treaty passed, but the same thing happened in 2001 when the Irish at first rejected the Nice Treaty and were told to try again. It was now clear that the EU was a union of governments rather than people, and the European Summit meeting in Laeken in December 2001 issued a candid assessment that the EU was, ‘behaving too

bureaucratically'. It proposed that, 'the European institutions must be brought closer to the citizens'. A Convention on the Future of Europe was set up under the chairmanship of Valéry Giscard d'Estaing, the former President of France.<sup>2</sup> This could have been an opportunity to modernize the creaking EU machine and confront the realities of world competition. Instead, it quickly fell victim to the requirements of the EU secretariat and the determination of the institutions not to cede any powers.

The Convention's task, to produce a simpler, more democratic Europe, was ignored. Instead, the Convention was presented with a draft European Constitution which was eventually approved 'by consensus'. (This ignored a Minority Report titled *A Europe of Democracies* which was tabled by a multi-national group including this author).

The European Constitution consolidated powers at the centre, set up new unelected posts, moved the EU decisively into the fields of foreign policy and criminal justice, abolished the veto in 38 new areas, and left the accumulated laws and regulations of the EU (the *Acquis Communautaire*) untouched. No powers were returned to Member States, and the European Constitution itself became self-amending so that in future it could be changed without the need for referendums. This defied the instructions given to the Convention in the Laeken Declaration. There was to be no attempt at democracy; only more centralization, with decisions taken even further away from the citizen.

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<sup>2</sup> The author was a member of the Convention as a House of Commons representative.

The designers of the European Constitution paid a heavy price for this betrayal when in 2005 the French electorate voted decisively against it in a referendum, followed immediately by the Dutch with an even more emphatic no. This of course was not the end of the Constitution. Under the German presidency of 2007, it was resurrected as a treaty. As a leaked letter from the German Government explained, it was proposed, 'to use different terminology without changing the legal substance'. The resulting Treaty of Lisbon incorporated virtually all the articles and powers of the rejected European Constitution.

Tony Blair, however, reneged on his promise of a referendum. In only one country was a referendum held, and in 2008 the Irish voted no, but as usual that was not accepted. The following year, a repeat referendum was held, passed, and the Treaty of Lisbon was ratified. It was a shameful end to a process of reform that was supposed to bring democracy to the EU but had only served to undermine it further.

## 4. TOWARDS A NEW EUROPE

*La démocratie se confond exactement avec la souveraineté nationale*

Charles de Gaulle

The search for a different and better form of EU co-operation must start with acceptance of the nation state as the surest way to combine democracy with the requirements of international co-operation.

Democracy requires a “demos”, or unit with which people can identify. Their natural loyalty and allegiance is to their country, not to any supranational organization. Then, by building upwards on the secure foundations of the nation state, it is possible to construct an extensive network of alliances to carry forward common interests.

Most nation states enter into a multitude of such treaties and pacts, covering such matters as security, extradition, tax, financial regulation, standard-setting, trade and the environment. They also join international organisations on which certain specific powers are conferred. It is sometimes claimed that membership of the EU falls into this category and is

therefore no different to belonging to an organisation like NATO. But NATO is not a law-making body and its powers are closely circumscribed. It is a mutual defence pact, but it cannot compel military action, and states can withdraw from it by giving one year's notice.

In contrast, the EU is a law-making body with a parliament, a court, a flag, an anthem, a national day, a currency, a foreign minister and a foreign service. It has accorded itself primacy over national laws, and the accumulated *Acquis Communautaire* is deemed to be irreversible. The great majority of EU laws are passed by majority voting, and many regulations are then directly applicable in member states without any national legislation or parliamentary approval. The EU has therefore acquired an internal dynamic which makes it different in kind from any other international organisation to which the UK belongs.

This top-down structure, whereby the UK is on the receiving end of a stream of EU laws, has long aroused public opposition, magnified by the scandals of the EU budget and the catastrophic mistakes made in planning the euro. People might just be tempted to submit to the rule of unelected technocrats when they display superior knowledge and wisdom, but not when they run a rent-seeking bureaucracy immune to the requirements of good housekeeping or the elementary rules of economics.

The Convention on the Future of Europe failed to challenge this one-way escalator, and more powers were then entrenched in the European Constitution and the Lisbon Treaty, without the referendum promised by all political parties in the 2005 general election. David Cameron's promise to hold a referendum was abandoned when the Lisbon Treaty was ratified. But he did say

that he would not 'let matters rest there'. Further, in March 2007 he said:

*I do not believe it is appropriate for social and employment legislation to be dealt with at European level. It will be a top priority for the next Conservative government to restore social and employment legislation to national control.*

This was widened in the 2010 Conservative election manifesto into a three-part plan:

*A Conservative government will negotiate for three specific guarantees – on the Charter of Fundamental Rights, on criminal justice, and on social and employment legislation – with our European partners to return powers that we believe should reside with the UK not the EU. We seek a mandate to negotiate the return of these powers from the EU to the UK.*

This pledge built on the concept of 'opt-outs', whereby some member states do not participate in EU programmes, at least initially. For instance, the 1985 Schengen Agreement abolished border controls between EU members, but the UK and Ireland remained outside. The euro went ahead without the UK, Denmark or Sweden. Defence policy too does not cover all member states. Similarly, the Social Chapter was included in the Maastricht Treaty but the UK obtained an opt-out, until this was reversed in 1997 by the incoming Labour Government.

These exceptions were not welcomed by the EU, but were tolerated as expedients in order not to hold up the march towards 'ever closer union'. But they do show that a Europe of 'variable geometry' is workable and, developed further, could lead to a form of European association whereby countries come together in varying numbers and patterns to pursue common

interests. It is how international co-operation works everywhere else in the world.

The EU opt-outs that exist were negotiated when the legal instruments or treaties were first being drawn up. There is no treaty provision for opting out of existing laws or treaty articles. The promise in the 2010 Conservative manifesto therefore took British policy into the new and uncharted area of making unilateral demands for treaty change. Having gone through that barrier, it is necessary to widen the areas covered and replace the opt-out concept with something bolder and more radical.

## 5. ACHIEVING A NEW EUROPE

*We have not successfully rolled back the frontiers of the state in Britain, only to see them re-imposed at a European level with a European upper-state exercising a new dominance from Brussels.*

Margaret Thatcher, Bruges Speech

Despite endless re-launches, conventions and treaty revisions, the EU has succeeded only in alienating the public by consolidating its own powers.<sup>3</sup> A project designed to bring people together is now creating division and suspicion. Lasting reform can only come when democracy comes first, in a model of co-operation based on the centrality of the nation state. On this firm foundation, a Europe of Opt-Ins can be built which is flexible, competitive and free, and fitted for the demands of the global economy.

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<sup>3</sup> The EU's most recent Eurobarometer poll shows that popular approval of the EU has fallen from 50% in Spring 2006 to just 31% in Spring 2012. See [http://ec.europa.eu/public\\_opinion/archives/eb/eb77/eb77\\_first\\_en.pdf](http://ec.europa.eu/public_opinion/archives/eb/eb77/eb77_first_en.pdf)

For this to happen, the existing command and control model must be replaced by an EU of Opt-Ins, whereby countries come together on a case-by-case basis to further their common interests. No other system will break the centralizing dynamic of the EU with its entrenched interests and itch to regulate.

The alternative, a system of centrally generated laws from which occasional opt-outs are allowed, is ineffective, and vulnerable to the federalizing bias of the ECJ. This is well illustrated by the history of EU social and employment legislation, and the Working Time Directive in particular. This directive was enacted in 1993 at a time when the Conservative Government had secured an opt-out from the Social Chapter which covered this type of legislation. To get round this, the European Commission brought the measure forward under health and safety provisions, in order to ensure that it was decided by majority voting (and which therefore the British Government was powerless to block). The case went to the ECJ which backed the Commission.

The Working Time Directive caused particular problems for the NHS, made worse by a number of judicial interpretations by the ECJ which widened the scope of the directive beyond what was originally intended by member states. One of these, known as *Jaeger*, redefined junior doctors' on-call time in a way that was virtually unworkable. John Hutton, Labour's Health Minister at the time, said, 'it was certainly not within the intention of the UK government when we signed up to the Directive that time spent asleep would somehow magically count as time spent at work'.

The saga of this directive shows the fragility of opt-out agreements, the ingenuity of the European Commission in circumventing any restriction, and the activism of the ECJ in expanding the remit of the EU. The only defence against this is to replace it with the Opt-In principle, whereby nothing is binding unless explicitly agreed.

There is an area where the UK already participates on this basis: Justice and Home Affairs. The Maastricht Treaty of 1992 set up a 'pillared structure' whereby foreign policy was decided on an intergovernmental basis, not subject to the ECJ. A second pillar dealt with justice, home affairs and immigration on the same basis. The third pillar dealt with everything else, with full involvement of the European Commission, Parliament, Court, and majority voting. This restriction on EU powers was resented, and, sure enough, the next treaty revision moved immigration and asylum out of the intergovernmental pillar and they became subject to routine EU decision-making. However, the UK and Ireland secured a protocol under which they were not bound by such measures unless they exercised their right to opt in. They could negotiate first and then decide.

The Lisbon Treaty, which enacted the European Constitution, collapsed the pillared structure entirely. Now a single EU institutional structure covers everything. However, the UK retained its opt-in concession, which was widened to cover the full range of policing, criminal justice, immigration and asylum measures. We can therefore participate in the discussions and then decide whether to adopt them, without being able to block other countries. It leaves the UK's participation in the European Parliament and the Council of Ministers unchanged. This is the opt-in principle, already at work.

The issue will anyway arise in an acute form in 2014 because, under the Lisbon Treaty, the jurisdiction of the ECJ will then be extended to all measures adopted prior to 2009, including such EU laws as the European Arrest Warrant. The UK will have a choice: we can either accept this or we can opt out entirely from all the pre-2009 home affairs and justice EU laws, which number

about 130. The Government has indicated that there will be a vote on this in both houses of parliament, which will be binding.

Parliament must take that opportunity to take back full powers in this central area of policy. If any of the measures are deemed essential there is provision to opt back in on a case-by-case basis. As the Council must seek the 'widest possible measure of participation' by the UK, that should be entirely feasible.

This process of collective discussion and negotiation, followed by a national decision on whether to participate, is the right model for EU engagement. It is different to a veto because countries choosing not to join would not prevent others doing so. It brings national parliaments back from the sidelines to the centre of law-making. It is easy to explain and understand. It is how the rest of the world conducts itself.

The same procedure should apply in every other area of policy. For instance, social and employment legislation is another area which the Conservative Party is committed to returning to national control. The economic case for doing so is strong because of the enormous cost of the accumulated layers of business regulations, which act as a drag-anchor on the ability of European countries to grow their way out of recession. By the European Commission's own calculations, the economic cost of these regulations frequently outweighs the benefits. But they are very seldom repealed.

Social policy should in any case be a matter for national electorates to decide, and a legitimate subject of debate between political parties. The German Constitutional Court, in its 2009 ruling on the Lisbon Treaty, identified social policy, along with criminal justice, as 'especially sensitive for the ability of a constitutional state to democratically shape itself', and noted

that, 'The essential decisions on social policy must be made by the German legislative bodies on their own responsibility'.

There are no safeguards that this will happen. The division of responsibility between the EU and member states is ambiguous. The Convention on the Future of Europe was supposed to draw a clear line and decide 'who does what', but only confused the matter further. It proposed a category of 'shared competences', which was defined to mean that member states could only act in those areas if the EU decided not to, which is a strange definition of sharing.

Nor is it easy to identify those articles in the EU treaties on which social and employment is based. As already noted, the Working Time Directive was brought forward as a health and safety measure to evade the British opt-out, and was then the subject of endless extensions by the ECJ.

Any workable and secure repatriation of social and employment legislation must therefore go beyond the occasional opt-out from new measures and switch to the opt-in principle identified for justice and home affairs. This would not be the end of such legislation, or to the principle of worker protection. British Governments could still decide to opt in to EU-wide laws, and any that were repatriated would still have to be repealed by parliament. But instead of being the result of a distant and opaque EU law-making factory, these measures would be the subject of debate between parties, when the interests of small businesses, large corporations, trade unions, consumers, and the needs of the national economy could all be considered.

The opt-in principle should extend across the board to every policy area, including the environment, energy and transport. In each case, the same procedure would apply as for Justice and

Home Affairs; that is, not only would future EU laws be subject to an opt-in choice, but existing laws would be reviewed as well. And if the UK did not participate in programmes such as EU foreign aid, that part of our budgetary contributions would be repatriated too.

Are there exceptions to this? Is there an area where compulsory rules are necessary and all joining states must comply? Yes, and it covers the basic requirements for free trade.

## 6. KEEPING THE SINGLE MARKET

*Do you think the UK should stay in the European Community (Common Market)?*

Referendum question, 1975

Most people who voted yes in the 1975 UK referendum thought they were endorsing membership of an area of trade and free movement. Most people who became disillusioned with the way it subsequently morphed into a proto-state still believe in a European area of unrestricted trade. 'Staying in Europe for trade' is a common response from the public when asked what relationship they want with the EU.

The advantage of tariff-free trade in Europe is today much less than it was when Britain joined in 1973. Then, the average industrial tariff on world-traded goods was over 10%; it is now less than 3% because of the reductions achieved in a succession of WTO trade rounds.

46% of total exports go to the EU, a figure much lower than for most other member states. The UK relies heavily on the export of services, mainly to non-EU countries. This earns a healthy surplus which helps to off-set the large deficit in manufactured goods that we run with EU countries.

All this makes the EU single market a declining asset, particularly as the fastest-growing markets for British goods and services are all outside Europe. In addition, the share of world trade taken by the EU will continue its relentless decline. It is an irony that the perceived failure of our relationship with the Commonwealth was a potent argument in the 1975 referendum campaign, but today the economy of the Commonwealth has overtaken that of the Eurozone. While the EU suffers the torments of a euro-induced recession, many Commonwealth countries are surging ahead.

Nevertheless, if we were outside the EU single market, and relied entirely on WTO agreements for trade access, we would face steep tariffs on some exports. For instance, UK-based car manufacturers would pay the same 10% duty on their exports to the EU as those from America and Japan. The UK chemicals and food processing industries would face EU tariffs of over 5%.

It would be possible for the UK to negotiate a free trade agreement with the EU, similar to that enjoyed by Norway or Switzerland. After all, the UK runs a large balance of payments deficit with the EU and therefore any new tariffs would be even more inhibiting for continental exports to the UK. But, as the Trade Policy Research Centre has shown, free trade agreements only provide for duty-free trade in products which are largely manufactured in the area it covers. If, for instance, Britain was to export cars to the EU containing parts made in China, they would face the 10% tariff unless they complied with complex 'rules of origin' tests. These apply in free trade areas but not within customs unions such as the EU single market. The existence of a common external tariff round the EU ensures free movement of goods without any rules of origin tests.

It is therefore desirable for the UK to remain in the EU single market, which would minimize disruption to trade, reassure foreign manufacturers based here (and those considering investing here), and give the public what it thought it was voting for in 1975.

The EU single market, or indeed a free trade area, needs common rules. The opt-in principle advocated in this paper is therefore not appropriate here. However, the articles in the EU treaties which were designed to create a single market have been used far more widely and have spawned a net of regulations and peripheral rules which are not essential for free exchange. The Brussels approach is that free exchange of goods and services only happens in a heavily regulated context, when in fact the essential requirement is the removal of barriers, duties and restrictions.

The European Commission has often used the single market as an excuse to regulate on a far wider basis. In particular, Article 114 (ex article 95 TEC) allows majority voting to harmonize laws in member states, 'which have as their object the establishment and functioning of the internal market'. This is the notorious 'rubber article' which has been used to promote directives on such diverse subjects as money-laundering, art market levies, balance of payments support, data retention, mobile phone charges, food additives and public health. The ECJ has been a poor check on this 'competence creep' and has normally sided with the EU against member states.

During the Convention on the Future of Europe, this matter was studied by a Working Group, on which the author sat. The group recommended some safeguards, and proposed that Article 95 (as it was then) should only be used where it was shown to be specifically and directly necessary for liberalizing trade. The

recommendation was ignored and the European Constitution (now the Lisbon Treaty) made no reference to it.

It is therefore essential to define and limit the measures essential for the single market. This is particularly important in the regulation of financial services. Open Europe has calculated that the UK accounts for 36% of the EU financial wholesale market and 61% of the EU's net export of financial services. But our power to block unwelcome measures is declining. The UK only has 72 out of 734 members of the European Parliament. From 2014 the British Government will possess 12.3% of votes in the Council of Ministers, and new rules will make it harder to block proposals as the threshold for passing a new law will be lowered. If, for instance, the Eurozone states start to act and vote as a 'caucus', the UK could be consistently outvoted on measures affecting a vital section of the economy.

As the 2007/08 banking collapse showed, financial services need better regulation. But this is unlikely to be achieved by the EU, whose own accounts have been persistently rejected by the auditors, and whose expert opinions about the euro have been so spectacularly wrong. Already, the focus of EU financial directives has shifted, from liberalizing markets and promoting cross-border trade, towards more centralization and control. Dozens of such financial directives are in the pipeline and many of them take little account of the specifics of London-based trade.

The idea is prevalent in the EU that the answer to every problem is a new tax. In this vein, the Commission has published proposals for a Financial Transactions Tax, which, being a fiscal measure, the British Government can at least veto. The other proposals will be decided by qualified majority voting and, because of the size and uniqueness of the City of London, the

UK has few allies. There is also a bloc of 17 eurozone countries, which will shortly have its own Fiscal Union: this will have no interest whatever in maintaining London's pre-eminent position and is behind a recent draft directive to control short-selling, and another to insist that transactions in euro-denominated financial products are cleared within the Eurozone rather than in London. The UK Government has issued a legal challenge to the latter, but this is not a certain or secure way to protect an industry which pays 11.2% of the UK's total tax receipts, and which earns an enormous trade surplus for the country (to offset the equally enormous trade deficit which the UK runs with the EU).

The only real safeguard is for the regulation of financial services to be done on the same opt-in basis advocated for other policy areas, but with a core of regulations identified as essential for EU-wide trade in financial services. A distinction would therefore be made between prudential regulation for the protection of consumers and the wider economy, and the regulations required for the single market. Only the latter would be subject to the existing EU procedure of majority voting and supervision by the ECJ, but of course the UK Government would be free to opt in to any other such directives on a case by case basis.

This model for a new relationship with the EU, based on trade plus co-operation, would require a huge diplomatic effort, persistence and political will. The question is, does that will exist?

## 7. ARE THEY UP FOR IT?

Public opinion polls on the EU show a long-term, deepening dissatisfaction with its performance, and the terms of our membership. The most recent Eurobarometer poll showed that only 1% of the British population have a very positive opinion of the EU with a further 15% having a somewhat positive opinion (15% had “a very negative opinion”, and 30% “a negative opinion”). Polls asking the in-out question indicate a majority for complete withdrawal, although this is sensitive to how the question is phrased. When given more options, this usually breaks down into a preference for some kind of negotiated return of powers, and what might be described as, ‘staying in the EU for trade’. As noted above, the same trend can be seen in other member states (according to Eurobarometer trust in the EU stood at an all-time low of 31% in May 2012).

These attitudes are sometimes dismissed on the grounds that the EU is an unimportant issue for most people, and that they seldom suggest it as their top concern (which is usually living standards or unemployment). Other political subjects such as the environment also feature low down on the list but are not dismissed in this way.

The EU is an issue which can lie low for a few months and then suddenly become prominent under some provocation or challenge. In elections to the European Parliament, voters regularly show their preference for less Europe, or none at all. In the 2009 elections, UKIP outpolled both the Labour and Liberal Democrat parties in its share of the popular vote.

However this is interpreted, there is an unambiguous public dissatisfaction with the EU and how it has undermined British self-government and the ability of electors to make changes to their lives through a political system they feel part of. Despite promises of reform and referendums, nothing has been done. This has contributed to a wider disillusionment with the political system. It is a foremost duty of elected politicians to defend the rights of the people they represent and to resist the transfer of their powers to other jurisdictions without their consent.

The matter can only be settled by a mainstream party of government obtaining an electoral mandate and taking the matter to a conclusion, with the endorsement of the people in a referendum. The Conservative Party's 2010 manifesto promise to repatriate powers in three important areas was a significant step towards this. UKIP's policy of standing against Eurosceptic Conservative MPs, and aiming for a hung parliament, contributed to the outcome of a coalition in which the Conservative Party dropped its European policy. It is a feature of coalitions that they give all participants an excuse not to deliver on their promises.

The Government has legislated to assert the sovereignty of parliament, and to provide for a national referendum if more powers are transferred to the EU. Although welcome, these measures do not begin to tackle the underlying malaise. The Lisbon Treaty remains an illicit treaty, ratified without the

promised referendum. The euro fiasco threatens the economy, and the ability of the Coalition to promote growth is undermined by the number of job-destroying business regulations, which are entrenched in EU directives and therefore impossible to repeal.

There are always arguments for drift, and one of these supposes that the fragile state of the British economy requires the Government to support any euro rescue plan, however dangerous the consequences, and to back the European Fiscal Pact, however contrary to longer term British interests. A truer policy would recognize the opportunity to resolve the longest standing impasse in British politics, and show the same leadership in Europe that we have supplied in the past.

There is no easy or painless solution to the euro mess, which has already ruined the lives of millions through lost jobs, failed businesses and recession. As explained, this is fundamentally a political crisis of the EU: therefore the British Government should not be afraid to propose a political solution, ideally for the EU as a whole, and, if not, for Britain's relationship with it.

The European Fiscal Pact requires UK consent to the use of EU institutions, and although the Prime Minister appears to have abandoned his opposition to this, it is not irretrievable. The EU is also currently negotiating the size of its budget for 2014-20, and this requires unanimity. The size of Britain's annual net contributions, and the poor controls over how they are spent, make this a potent lever.

And another opportunity to renegotiate from strength may well be emerging. On 12 September, in his "State of the Union" address to the European Parliament, President Barroso stated that he will:

*Before the next European Parliament elections in 2014, the Commission will present its outline for the shape of the future European Union. And we will put forward explicit ideas for Treaty change in time for a debate.*

This will require changes to the Lisbon Treaty. It is surely unthinkable that a British Government could agree to any amendments without at the very least putting the issue before the people in a referendum.

The Conservative Party is already committed to a policy of repatriating powers in a way that requires treaty change. But the proposals are partial and incomplete. It would be better to finish the task and put our relationship onto an entirely new, intellectually coherent basis.

This would not be a retreat from modernization or the wider world. On the contrary, it is the EU which is old-fashioned, unpopular, incapable of reform and visibly failing as an influence in the world. It would be a liberating experience for Britain to once again take up the cause of democracy and freedom in Europe.

The choice between in or out of Europe is a false one. Britain will always have a close relationship with our continental neighbours, through trade and co-operation, even if this has been eroded by the influence of global expansion and the rise of new powers. But the present relationship is doomed, causing resentment on both sides of the Channel and making the UK a reluctant partner in most area of EU activity.

The opt-in model offers a decisive change. It builds on the system already used in the field of criminal law. It repatriates all powers, and then uses them selectively to advance common

interests. It offers full engagement while ensuring national parliamentary control. It makes provision for free trade in Europe, preferably through continuing membership of the customs union. It is simple in concept, easy to understand, democratic, forward-looking, and how the rest of the world conducts its affairs.

Yes, it will also be fanatically resisted by the EU establishment. Yes, it will require huge determination and the expenditure of massive diplomatic and political effort. But the Prime Minister must decide if he wants to be a manager of decline, or in the warrior tradition of some of his predecessors who moved forward to solve problems, took on the opponents of reform, and always put the rights of parliament and people first. If the Conservative Party wants to recover its sense of purpose and mission, this is the issue and here are the means.

The final arbiters must be the people in a referendum. They should be asked to accept or reject a comprehensive reform treaty which put the UK-EU relationship on to a new footing. Those who deliver this would earn the gratitude of the country and a permanent place in the history of the nation.

The UK must seek a new and different relationship with the EU.

Now is the time to construct a radically different relationship between the UK and the EU, a relationship based on the concept of variable geometry.

An “opt-in principle” is needed, to enable the UK to decide on a case by case basis whether to adopt EU laws, directives and regulations. This would extend to every policy area with the single exception of the single market (which needs common rules and thus the opt-in principle would not be applicable).

The electorate should be asked whether it accepts or rejects a comprehensive reform treaty which puts the UK-EU relationship on a new footing. The UK would then be in a position of strength to create a EU of opt-ins – an EU which would be liberating, forward-looking and global.

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