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Transcript

Counting the Cost: Britain's 40 Years in the EU

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Julie Smith:

Good evening. I'm Julie Smith. I have co-edited with Caroline Soper the special issue of *International Affairs* that is being launched this evening, looking at Britain and Europe, 40 years on. We're slightly in anticipation of 1 January, and I mentioned this to one of the ambassadors to the Court of St James's, who suggested we should ask Her Majesty's Government how it proposes to celebrate the 40th anniversary.

I'm not sure if Dr Cable is going to be able to tell us that. But I'm delighted this evening that we have with us Dr Vincent Cable, who used to be head of the International [Economics] Programme here at Chatham House and needs, I think, no further introduction, as the Secretary of State for Business, Innovation and Skills.

He is going to speak last after Malcolm Levitt, who comes to us having contributed to the special issue an article on the euro and the City. He has previously worked for the UK Treasury, for the OECD and the European Commission, and has been an executive at Barclays, advising on the implications of changing European policy, and a senior fellow at the UK National Institute for Economic and Social Research and the City of London, and is currently advising Kreab Gavin Anderson, a leading communications consultancy.

The third speaker is Dr Kirsty Hughes, who was my predecessor here at Chatham House as head of the European Programme. So she has in the past worked very much on Britain and Europe, dealing with the sort of issues we're discussing this evening, but more recently has worked as Head of Global Public Policy and Advocacy for Oxfam and as a senior associate fellow of the Centre for International Studies at the University of Oxford. And is currently Chief Executive of the Index on Censorship.

And I now hand over to Malcolm Levitt.

Malcolm Levitt:

First, let me say how much I congratulate Chatham House for mounting this event at this time. The themes we will discuss rationally I am sure will become of great prominence in the run up for the next election, where I am afraid I expect a great deal of emotion and misinformation. But Chatham House will ensure that the rational debate continues.

Now, just as the founding fathers, through the creation of the European Community, primarily as a political vision, albeit a strong economic dimension – Prime Ministers Macmillan, Wilson and Heath saw membership as a political imperative and as brought out in Stephen Walls' official history. Politically imperative because they were afraid the marginalization of the UK in European and global affairs if we didn't join.

But of course it was the economic case for membership that they stressed in public. The implications for the City of London were not prominent in the economic assessment made at the time of accession, but the single market was seen and remains crucial for the potential and prosperity of the City. In no small degree, thanks to the single market, the City is now the world's largest financial centre, Europe's largest financial centre. It's where global banks undertake their European business; it's where major European banks undertake their global business.

But of course, its irresponsibility, excesses and lamentable regulation brought the economy to its knees, causing a collapse in tax revenue and an explosion in our public deficit. But, given our economic structure – we are where we are, if you like – it will continue to make a major contribution to our balance of trade, to tax revenue and employment. So, like it or not – maybe it is a regrettable necessity, in the view of some – its competitiveness does matter in the economy as a whole.

Now, I want to make two comments about its relationship with Europe on the single market and European [Economic and] Monetary Union (EMU) before finishing on the current situation. The single market is the arena for jousting between two rival regulatory philosophies. It originally embodied a British liberal concept of a single licence for financial institutions, enabling them to compete throughout Europe on the base of their home country – British – supervision, with very little harmonization of the rules. Now this was anathema in many other members of the European Community. They favoured central supervision and harmonized rules and we are now moving towards that.

The French promptly banned Barclays from its initiative in starting to pay interest on current accounts. They tried to damage if not destroy the international business of the City – of the London stock exchange of the City – through the negotiations, during the negotiations on the Investment Services Directive. The Deutsche Bundesbank tried to exclude the Bank of England from the target system of transmitting liquidity in euros around Europe – I won't get into the technicalities of it, but had they succeeded this

would have had a devastating effect on the City. The German Minister of Finance insisted that the regulation guaranteeing continuity of financial contracts when the euro replaced national currencies would not apply in the UK. Again, this could have been very damaging.

These efforts were defeated with the help of good will from other member states, allies and the force of reasoned argument. It's interesting; both were justified in the German mind, not necessarily as malicious but on the grounds – the logical grounds – that the UK was not part of the monetary union. An omen of things to come, I think.

Now let's turn to the crisis in EMU. A former very senior treasury official put it to me not long ago, the crisis has given them a once in a lifetime opportunity to rewrite the rules. Now, the crisis – City sceptics writing about EMU said that a monetary union among economies with disparate structures and behaviour was very risky and the UK shouldn't touch it, if it did not have any fiscal underpinning for use in the time of crisis. On the other hand, they argued, if there was a fiscal union that would inevitably lead to political union, and they didn't want any part of that either.

The enthusiasts of British membership were more concerned about the risk of regulatory threats to the city if we were not at the negotiating table through staying outside. So, in a sense, I think both were right: the sceptics to point to the flimsy economic basis for monetary union and the enthusiasts to the threat of not being at the table.

But despite agnosticism and downright scepticism in parts of the city, it made an unsung but crucial professional contribution to the successful technical launch of the single currency, which I describe in my contribution to *International Affairs*.

Now the euro faces an existential crisis, embodying a sovereign bond crisis and a banking crisis. Two initiatives were launched last year to address these issues. One was a proposal to strengthen fiscal discipline, a precondition for any system of financial support for countries and banks in trouble. The other was a banking union, including a single supervisor. Last December, the Prime Minister vetoed the proposed fiscal treaty, opted out of banking union, and demanded a protocol claim to protect the City.

The claim to be protecting the City was praised by some hedge funds in BBC broadcasts, the only people who commented by the BBC. But it caused enormous alarm in other parts of the City, as was eventually revealed in articles in the *Financial Times* last June.

Now since then of course, we've had the sweat of a budget veto, the proposed opt-out from the justice and home affairs legislation, promises to repatriate powers and Eurosceptic speeches from at least two cabinet ministers.

Something like 47 pieces of legislation of concern to the UK financial sector are under negotiation now – and the sector needs allies and goodwill elsewhere in Europe, and that goodwill is being eroded. It's essential that ministers understand why this legislation matters, although it's often very technical and arcane, and it's also essential secondly that they care, despite the unpopularity of the City and the popularity of Eurosceptic declarations.

We face a severe challenge, that of preserving a single market for 27 countries, alongside a banking union of 17, and ensuring that we're not permanently outvoted by the euro bloc. I think some ministers, and I exclude Dr Cable from all the remarks I've made so far, it's also important that some ministers should recognize that aggressive talk about protecting the City could well backfire. That is a concern in the City itself.

Finally, we have the strong possibility of a referendum with the attendant risk of exit from the EU and the single market. Some sort of Norwegian or Swiss arrangement isn't attractive. We'd have to abide by rules we had no hand in determining and we'd need to make a significant budgetary contribution. Norway pays more per head of population to the budget than we do.

But neither the Norwegian nor the Swiss options may be on offer anyway. It could be a case of taking or leaving whatever the EU chooses to offer following a potentially acrimonious exit. Thank you very much.

Kirsty Hughes:

Good evening ladies and gentlemen. It's lovely to be here at this discussion on Europe. It's lovely to be back always at Chatham House. And in fact as Julie said, I actually came here in 1995 to run the European Programme and at that point Vince was in the office next door, upstairs, to me just for a little while. And I actually met Julie for the first time that year and of course it was 1995, you may recall that was a time when there was a lot of Eurosceptic debate about Europe, a Conservative government debating the wisdom of being in the EU and being in the euro.

So we may all be forgiven for thinking this is a rather Groundhog Day kind of experience or certain sense of déjà vu, but I think if I have one main point to make in my short remarks is that I don't think we *are* at Groundhog Day with

Britain and Europe and picking up in a sense where Malcolm finished. I would say that the UK is standing extremely close to the exit door after its 40 years of membership – the closest it has ever stood.

Big questions: Will we actually leave? Does it matter? In the face of the current euro crisis, where is the EU going anyway? It seems to me this evening we're focusing more on the economic aspects of membership, but it's always very hard to disentangle the politics and the economics. In fact I think one recurring thread in British problems with the European Union over the last decades has been precisely the attempt to do just that, to present the EU as only an economic project, as only a trade block.

And whenever the politics of integration have appeared on the agenda, as of course they have repeatedly – in ways that they can't be denied – those proponents have often been derided by sections of the British media and political establishment as mad integrationists or madder federalists.

I think we also can't, and shouldn't, disentangle the politics and economics because again as Malcolm was just discussing, the economic decisions taken in the EU depend very, very much on political power. They depend on also diplomatic and political skills, how you play your cards. In the EU there are always cross deals being made. You bet me on this one and I'll back you on that one.

That's a little bit difficult to do if the rest of the EU is heading for integration with their own police and criminal cooperation or economic policy on increasing the powers of the European Parliament. If the UK is continually opting out, even wisely with hindsight of the euro, it's not going to have the same political clout.

I think that's what's happened over the last 10–15 years, or certainly what's happened since the mid-90s. The UK now has much less weight, much less political weight, in the European Union. It may have the same number of votes in the Council of Ministers, but in terms of political influence, leadership, ability to build coalitions, drive the direction of a summit – I would say even more than back in 2004, when the EU was deeply split over the Iraq War and France and Germany were on one side and the UK was on the other side, even back then the UK had a lot more influence.

I was looking back yesterday at some of the articles I've written on the EU over the last few years and back in 2004 we were, a lot of us, still talking about the 'big three' in the EU. The big three being France, Germany, and the UK and that was still at a time when obviously we weren't in the euro, we

weren't Schengen after the Iraq War, but compared to today we were still a major player in Europe.

Today I would say we're not only on a second tier. We're out on an outer tier. Obviously, we've got a quite extraordinary situation, the worst economic crisis in 80 years or more, but we've got a euro group that are responding to that by integrating more. We've got then the eight around them who are going along with that in the terms of the fiscal compact and then we've got just Britain and the Czech Republic in that outer tier. And, certainly in the UK case, talking and discussing about referenda and about possibly leaving.

If you look at what happened almost a year ago when David Cameron wielded his veto in a way that seemed to shock not only the leaders around him but Cameron himself when he came to give his dawn press conference and found he hadn't actually got his way by wielding the veto, I think you have, however, a fairly clear picture of what the problem is.

I wanted to say something very briefly too, as Malcolm did, about the Norway option. Is this a real option? Would it matter if the UK finally stepped back and said, 'Okay, we only want to engage on the economics. We really don't want to engage on the politics.' Well anyone interested in that question, I recommend you look at a report that came out at the start of this year looking at 20 years – in Norway's case – 20 years of membership in the European Economic Area and interestingly it was called 'Outside and Inside'.

It pointed out that Norway has taken on three-quarters of EU legislation. It's signed up to a plethora of other agreements on borders, on immigration, on foreign policy. But I think for tonight's discussion what's very interesting is the conclusions of that report. The conclusion was Norway's done very well economically in the last 20 years. Some of that is certainly due, they said, to the European Union but politically and democratically there was a rather serious problem.

The report's author said there was a great democratic deficit. Said that could have been chosen in a sense by the Norwegian people because they'd rejected twice joining the EU in referenda – it was a national compromise, but nonetheless it was a democratic deficit and it had a very peculiar and interesting outcome. Although there was and is this extraordinary mesh of interconnections and ways Norway is effectively part of the European Union, nobody in the country, the authors felt, had an overview, a sense of the whole relationship. Lots of experts on their individual areas. I'm just going to read you one quote from it. It said, 'There are few areas of Norwegian democracy today where so many know so little about so much as is the case with

Norwegian European policy.' I think that's something the UK really needs to think about.

To end where I began, in a sense, with the Groundhog Day point, I've been struck in the last few weeks and months at how much the debate sounds like a debate we might have been having on Britain and Europe 10 or 15 years ago, but we're absolutely not in the same place. Clearly the EU is in crisis. It's not out of that crisis yet. It's very hard to see where it's going, but it is clearly moving for the moment in the direction of deeper integration, though with a questionable degree of popular support for that.

And as I said, the UK is not only on the margins in this third tier but what I see – perhaps contradicted via many of the people in this room tonight – but what I see compared again to 10 to 15 years ago is British pro-European elites, experts and enthusiasts in many ways much reduced in number.

While the EU still exists politically and economically, I think it's a loss to Britain if it doesn't remain a member. We lose a voice on all the sorts of areas, whether politics or economics, that the EU will still act on, even in the recurring attempts at common foreign policy, both in the neighbourhood and in the wider world.

But to have that influence, to stay part of the EU, would require very different policies from today. At the moment, we're standing by the exit door. We're complaining very loudly, and I suspect we're probably about to step through it soon to the other side. Thank you.

Vince Cable:

Well thank you for inviting me. I was almost a contributor to this collection. Indeed I spent part of my summer holidays writing it. And then somebody in the system discovered that the cabinet minister was skiing off-piste and thinking creative things about the European Union and this really wouldn't do. I don't quite know what's happened to my article but I think there's a lead case somewhere deep underground where these embarrassing thoughts are hidden.

But nonetheless I wanted to contribute to the debate for several reasons. First of all, one of my monikers is President of the Board of Trade. I'm interested in trade policy; it's part of my job. So anything that affects half of British exports is of professional and immediate interest for me.

I think also there's a historical interest. I was reflecting slightly wistfully that I first made a political speech as an undergraduate on the European Union almost exactly half a century ago. Some of you may remember that the debate on British membership first surfaced in 1962, [Charles] de Gaulle and all of that. My interests in this subject go back a long time.

I've changed my views on many things over this period, including my political party. But I've nonetheless remained convinced about the merits of British membership throughout that time, though it's not as a Euro-fanatic. In fact if you go back to the things I wrote here in the mid-1990s, they were often aggressively critical of aspects of European policy, particularly on agriculture in relation to the budget.

But today I have an immediate reason for wanting to speak about this subject, because I've launched a call for evidence on the single market, which is part of a broader review of balance of competencies as we call it which the government is undertaking. It's one of a series of calls for evidence on what impact the European Union has on the UK, different areas of policy, what it means in terms of our national interest and how we can perhaps redefine and reform it. We're inviting submissions from NGOs, think tanks, business, from our European and G20 partners on what the single market means, how it could be reformed and how we progress.

Now of course we're not starting with a blank sheet of paper; the single market's there. Arguably, it's one of the main UK contributions to the European Union. Mrs [Margaret] Thatcher, Lord Cofield and others created this structure with Jacques Delors and others two decades ago. And what we have is a product of that initiative.

And I think probably, arguably, even among people who argue for withdrawal from the European Union, even right on the fringes, would argue that if somehow one could preserve the single market then this would be a good outcome. So it's one of those areas on which views coalesce.

But can I just sort of step back a little bit and ask actually what it is? The jargon is – we describe it as the 'four freedoms'. That's freedom of trade in goods and services, free movement of capital, free movement of labour. Of course the single market isn't by any means quite that. I mean, there are major exceptions.

The free trade and services is pretty rudimentary. The single market in energy has never actually happened. There are serious practical limitations on the movement of people and there is ongoing controversy about the rules which stand behind the four freedoms, which we'll come onto later.

I think – getting past definitions – I think there is a sort of broad understanding among economic analysis and also at sort of a public level that the single market has had very real tangible economic benefits. If you go back to the inception, there were economic studies by Cuccini and others which showed a certain percentage of GDP growth would result from the single market. Now I think looking back ex post, most people would agree that that has been realized, though it's difficult to quantify and separate it out from many other things.

But if you took one concrete area – let's say the car industry – you can look at the benefits that it enjoys from tariff free trade which is something on the order of £1 billion for the UK car industry. There's a freedom from quota restrictions, there is a set of common industry standards and there are state aid rules which protect us from what we would regard as unfair competition in countries like France, which would otherwise perhaps be tempted – still are tempted – to intervene through subsidization of their domestic industries.

So, when I isolate a particular area that benefits are very easy to identify. I would add another, and that particular industry is a good example, that overseas investors will often argue that one of the reasons that they wish to invest in the UK is because of access to the European Union market as well as whatever attractions the UK has for them.

Of course there is a flip side to that: that any decision on contraction is equally well made from the European standpoint. But I think if we put these different elements together, there is a broad consensus at both at the technical level and the popular level that this is something that has been beneficial to the UK.

The question then is if we wanted to improve it, how would we do it? What are the kind of questions we would need to ask? First of all, there is this sort of basic issue about should integration in Europe through the single market take the form of harmonization or mutual recognition? This is sort of Euro-speak but it's quite an important issue.

Principle liberal economists tend to argue for a fairly low level of integration, of mutual recognition, and that works well if you're talking about something like professional qualifications. But there is a popular scepticism about the kind of extreme harmonization that people believe that the European Union has produced. All the caricatures about square tomatoes and straight bananas comes from this belief that the single market is about harmonization rather than mutual recognition.

But, there are clearly areas where harmonization is sensible. I mean, if you're talking about physical connectivity or if you want major economies from standardization, then a process of harmonization makes a certain amount of sense.

What is more difficult to agree on, and there are lots of controversies that continue to rage about this, is how far a single market needs common health and safety standards, common working conditions, common environmental standards, common systems of consumer protection or common banking standards or common tax rates or common tax bases. These all become interwoven with the arguments about a single market. It's often not very clear that they'd been undertaken in order to deepen the single market or because of some other consideration.

There are often arguments about so-called level playing fields. Social dumping is an awful, non-economic idea which is often brought in to justify having common social standards as part of the single market, though actually you don't need them for a single market. But I would argue politically, they're important in other ways. So, there is set of unresolved controversies about how much harmonization, how much subsidiarization or mutual recognition should one have?

Another big debate that continues to rage and it's highly relevant to the continuing debate on services: are we doing this for the benefit of consumers or are we doing it for the benefits of companies or producers? I mean, they may have very different interests that point opposite directions. There are very mercantilist voices in the European Union who promote the single market from the interests of their domestic companies. A broader economic standpoint looks at it from the standpoint of consumers. These are not the same. And in assessing the evidence, we've got to look at both standpoints.

But let's assume for the moment that we're all agreed that this is a beneficial undertaking, and that we've got an agreed way of approaching it. What should we be doing next? I mean, what are the priorities for the single market?

I think there is, certainly amongst the main governments, an agreement about what we do have to do next. I think the most important area is the services sector. There is agreement, in principle, there are services directives which have not yet been implemented, and if they were implemented in full the economic analysis tends to suggest you could add about 2.5 per cent of GDP. There are complex arguments about methodology, but certainly big gains would come if you had a fully-integrated services market.

Another area of priority is a digital single market. We estimate that there's something in view of €175 billion now in digital trade. The UK's digital shopping sector is one of the biggest in the world – I think it's second to the Swedish. Potentially enormous benefits from having common standards across the European Union. Again, estimates have been made of a potential gain of about four per cent of GDP from opening up digital rules.

And then finally, there's the energy sector, about which there's been endless discussion over the last 20 years or so and very little, so far, has happened. There is a provisional energy package that could be brought into effect if we agreed to progress with the single market.

Now just to conclude: I think most of us would accept whatever degree of enthusiasm they have for the European project in general that the single market has been a success story. And indeed, as Kirsty implied, even those countries which are not part of the European Union seek to have some of the benefits of it. There are people in the UK who want us to leave the European Union, and argue that we should be more like Norway, which as Kirsty pointed out, has to accept the rules as part of the European Economic Area without having any participation in creating them.

Another option often advanced is the Swiss version, which is not part of the Economic Area, but part of a free trading arrangement. The Swiss, of course, align their own domestic laws with those of the single market in order to ensure that they can trade freely. So in both cases, there's what Kirsty called an 'issue of democratic accountability'. So, democratic deficit. They are part of the single market in fact, but have no role in shaping.

So, I just want to leave you with the thought that the study, the Balance of Competence Review, which we're launching in government today around the single market, gives an opportunity for informed groups – you're obviously one – to raise again many of the issues about the single market, contribute to a debate, hopefully helping us to make decisions on our participation in Europe that are based on evidence and careful thought, rather than on emotion and prejudice. Thank you.