

Where do we think the EU might be going and will Britain go there too?

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17 January 2013

Dissatisfaction with the EU

For those like me who support the EU and British membership of it, the past few years have not been happy ones.

It is not only in the UK that public opinion has become much less enthusiastic about the EU and its institutions. The European Commission regularly takes the temperature of public opinion through a series of polls. The best known asks people whether or not they think the EU is a 'good thing'. It shows that over the last five years average support has declined from 52 per cent to 30 per cent. This has happened in virtually every EU country. In France, for instance, 52 per cent of those polled five years ago said membership of the EU was a good thing: last year that had dropped to 46. In Germany the figures were 65 and 54. In Spain the fall was even more dramatic: from 73 to 55. (No surprise that the corresponding figures for the UK showed only 33 per cent thinking that membership was a good thing 10 years ago, and only 26 per cent last year - but more of that later). No doubt much of this dissatisfaction reflects the general feeling of economic gloom and the perceived failure of governments, both national and European, to rise to the occasion.

Nevertheless, it provides a difficult political backdrop against which governments have to deal with the problems the EU faces. Of these, the biggest is clearly the formidable problems arising from the world wide banking and economic crises for the EU as a whole, but notably for the future, indeed the survival of the EU's single currency, the Eurozone. But first let me say something about another immediate problem for the EU: the fixing of the EU budget for the next few years.

The EU Budget

In purely numerical terms the EU budget is not a big issue: the total EU budget, some £120 billion, is only about 1 per cent of Europe's GDP, whereas total government expenditure in most EU countries amounts to around 40 per cent of GDP. The UK's net contribution to the budget is a mere £7.4 billion, scarcely more than 1 per cent of government expenditure, about half what Germany pays and substantially less than France or Italy.

Nevertheless, in the politics of the EU, it is a regular source of friction. The European Council will shortly lock horns again over the budget arrangements for the next seven years, having failed to reach agreement last autumn. Not surprisingly, those countries which benefit from the budget want an increase and those who are the payers, including the UK, want a reduction or at least no increase; and with all countries obliged to try to rein in public expenditure, they have a point. For the UK, the situation is complicated by the famous, or infamous, rebate. From the time we joined 40 years ago, it was clear that because of the way the finances had been devised before we joined, Britain would find itself making a disproportionate net contribution. As Mrs Thatcher's adviser, I was heavily involved in the tough negotiations in 1979 and 1980 which led to the first British rebate (only finally given permanence in the settlement of 1984). I am not one of those who criticise Mrs Thatcher for the tough stance she took up: she certainly alienated her fellow heads of government, Giscard d'Estaing and Helmut Schmidt, but I am not certain we would have got such a favourable deal had we been less robust. Be that as it may, retention of the rebate has been a key UK objective ever since, and with the Europhobes baying for blood Cameron cannot afford to do even what Blair did - concede a little in order to get an amicable agreement. Remember that when it comes to the rebate, Britain has no allies - it's 26 against 1. So if Cameron succeeds in both retention of the rebate and a freeze on expenditure, he will have done very well - though it will not be seen as such given the House of Commons opportunist vote for an actual reduction in the budget.

The Current Economic Crisis

Of course the biggest issue of all for the EU and in particular the Eurozone is how to get out of the current economic crisis. Without going into detail, this is a world wide problem, triggered initially by excessive private debts and bank failure in the USA and rapidly spreading to Europe. Banks went on a lending spree without adequate risk assessment; governments had to bail them out thus adding to their already inflated levels of borrowing. These debts could be neither repaid nor refinanced without help from outside (debt to GDP ratios: France, Germany and the UK all at roughly 80 per cent, the USA 100, Italy 120 and Greece 160). Over several years now, the EU has sought to remedy the situation through a series of interconnected measures: the creation of enormous funds to assist countries in the greatest difficulty; low interest rates; and loans and financial underwriting by the European Central Bank.

As the EU's largest and most successful economy, Germany is at the heart of the Eurozone debate. For many years Germany, as a strong supporter of the EU, has been content to accept the role of being its largest paymaster. But more recently, sentiment has changed. Germans can't understand, when they

have managed their own affairs rather well, why they should pay for Greek extravagance. Moreover, after the experience of the 1930s, they remain paranoid about the prospect of importing inflation which they fear would be the case if the German government embarked upon an expansionary policy to help the weaker economies. This has left Chancellor Merkel a difficult hand to play. She is popular in Germany for having resisted many of the demands from Brussels for more action to help the weaker economies, but among the debtor countries she is seen as a mean and domineering taskmaster.

So every time there has been a demand to bail out the Greeks, or the Italians, or the Spaniards, Chancellor Merkel has struggled to keep the German Parliament on side and to avoid a further decline in public support for her coalition government. This is chiefly why the EU has in my view made the crisis worse and more prolonged by reacting too little and too late. Each rescue package has bought time but soon the markets have doubted whether enough is being done and the EU has had to come up with yet another package. If the offers of help had been more generous in the first place, the markets would have been satisfied sooner and the cost would have been less. The result has been growing tension between the stronger EU economies, mostly in northern Europe and the weaker economies around the Mediterranean - or to be provocative, a split between a prudent Protestant North and a profligate Catholic South.

The crisis is far from over. The austerity measures demanded of Greece require a degree of sacrifice that the Greek people may just find insupportable. Another 'haircut' (write-down of government debt) will be needed to avoid political chaos. It now seems likely that France and Germany will 'do what it takes' to prevent Greece leaving the Eurozone, more to avoid the risk of the whole of the Eurozone than through any love of Greece. But more short-term help will surely be needed. The reemergence of the mercurial Berlusconi on the Italian scene and the probable withdrawal of the immensely competent Mario Monti cannot be good news. Unemployment in Spain, as in Greece, has reached terrible levels with over 50 per cent of young people unemployed.

The Eurozone

It is now generally acknowledged that in the political enthusiasm to set up the Eurozone, some fundamental issues were overlooked or swept under the carpet. The more percipient economic observers at the time pointed out that currency unions rarely succeeded unless they were part of a fiscal and political union. The Eurozone has a common currency and a European Central Bank but is not a fiscal union nor does it have any system for

transferring resources between the member states to compensate for differing levels of economic progress or competitiveness. It does have rules about the size of budget deficits that countries are supposed to respect but they have been rather inadequately enforced. In the case of Greece, the problem was exacerbated by deliberate concealment of the size of their budget deficit. But the underlying problem is the lack of competitiveness with stronger countries like Germany. In a free market, this would lead to a devaluation of the Greek currency, but for the Eurozone countries this is no longer an option. The result has been growing unemployment, a burgeoning national debt and a steep rise in the cost of borrowing to service the debt. Following Greece, Italy and Spain have found themselves in similar difficulties. Each now has a level of government debt which can only be reduced and serviced by draconian measures to cut public expenditure and raise government revenues - hard in countries where tax avoidance is endemic.

In the longer term it is now recognised that the remedy for these defects can lie only in more economic and political integration among the Eurozone countries. Last year, the Commission came out with an ambitious plan: over the next 18 months the EU would implement reforms on better economic and budgetary governance, and establish common rules for intervening when banks get into financial trouble. Over the next five years, the EU would move further in coordinating tax and employment policies, and a common budget for Eurozone countries would be available to help those whose economies are under pressure backed by a fund to help countries reduce their large public debts and the ability to issue eurobonds on the capital markets. After five years, the EU could take the next steps to full banking, budgetary and economic union, followed by political union. An optimistic plan indeed! This was apparent at the first discussion at last December's meeting of heads of government, when even a less ambitious version put forward by the Council President, Herman van Rompuy - the so-called 'road map' - was given only a very cautious degree of support. Plainly these moves towards greater integration will be contentious and take time, but the direction of travel is clear.

Where does this leave Britain? Given the present government's wish to weaken rather than strengthen EU ties it is clearly a move in exactly the wrong direction. But it is going to happen whether we like it or not. This means that, since there is no foreseeable prospect of the UK joining the euro, Britain will be on the sidelines of what will be the central preoccupation of the EU during the next few years. We will be engaged chiefly in a damage limitation exercise to ensure that as the Eurozone countries plan their future, our interests, notably in the single market, are not prejudiced. Whether we

like it or not we shall be a marginal player, and as they say more brutally in Brussels: 'if you're not at the table, you're part of the menu'!

Other EU Activities

Of course there are other EU activities in which we will continue to participate and which are not unimportant - trade policy, the CAP, energy and environmental issues, and development policy (the EU is by far and away the world's largest giver of aid to developing countries). And then there is the whole area of foreign and security policy about which I have said nothing so far. Although the EU proceeds here on the basis of unanimity, and is thus often unable to act collectively, it is an important and growing area of EU activity and one in which the UK, by virtue of its size, history and expertise is a major player. In Cathy Ashton we have the person who heads up this work and, since the Lisbon Treaty, an embryonic European foreign service in the shape of the so-called 'External Action Service' with EU offices in all the major capitals.

It is a shame that, in spite of, or perhaps because of, the prevailing anti-European feeling among the British public, these other activities, which often bring considerable benefit to this country, are not flagged up.

A Referendum?

Anti-EU Sentiment in the UK

If you read the popular press, you would think that, at every turn, the EU is 'out to get us' or engaged in ridiculous legislation to straighten the banana. By and large the media reflect public sentiment, but in the case of Europe, the Murdoch press in particular has a definite anti-Europe agenda. This has undoubtedly contributed to the steadily worsening attitude towards the EU as measured in successive opinion polls. These now show a majority in favour of leaving the EU. Even among LibDems, traditionally strongly pro-Europe, there are significant numbers in favour of leaving. And then there is UKIP, doing well in by-elections and likely to do very well in the European elections in 2014. In Parliament there upwards of 100 Conservative MPs - and probably a few ministers - who might describe themselves as Eurosceptics but whose real objective is to see Britain leave the EU. Their true position is often disguised in the form of wanting unrealistic changes in the way the EU is run. So Cameron is between a rock and a hard place: playing it 'soft' in Brussels means more Tory voters defecting to UKIP and the risk that his backbenchers will turn on him; getting too tough in Brussels alienates the rest of the EU and

points us eventually towards the exit door, a solution which I am sure he does not want.

As we know, the Tory Europhobes are pressing for an early referendum, believing that a 'no' vote is likely if not certain. Cameron and probably even William Hague do not want Britain to leave and nor of course do their LibDem partners (although it is still their official policy to have a referendum to 'clear the air'). Barring some catastrophic miscalculation by the leadership or a spectacularly successful revolt by the backbenchers, there will I suggest be no referendum this side of the general election, but that does not mean avoiding it altogether.

UK Government Strategy

Unfortunately, David Cameron has not honoured us with his long-awaited speech on Europe in time for this meeting. But he has already given indications of its main theme. His plan appears to be to use the occasion of the next treaty change to underpin the new Eurozone arrangements in order to secure changes for Britain and notably the 'repatriation' of certain matters now within the competence of the EU, probably in the field of social and employment laws. I would suggest that this plan is tactically quite clever but strategically flawed. As I have said, the Eurozone countries will not find it easy to agree on the greater integration of monetary and fiscal powers which will be needed: thus by making that link, Cameron has bought time and ensured that any referendum is put off until after the next general election and takes place only on after he has successfully negotiated changes to Britain's position within the EU. Thus the referendum would not be a simple 'in' or 'out, but more like: 'now that I have secured these and these concessions to safeguard British interests, do you want to stay in the EU or leave it?'

There are however, a number of problems with this approach. In the first place, the Eurozone countries may find solutions which do not require treaty change, though this is rather unlikely. More importantly, will this give him the leverage he expects? I doubt it. They will be wary of repatriation of powers to Britain if the result is to give Britain a competitive advantage within the single market. Moreover the prevailing mood among the other member states is not one which is sympathetic to our position. They are in no mood to cave in to British demands. One commentator says the mood among them is 'one of exasperation, regret, rancour and dismay over Britain's special pleading', which may not be too much of an exaggeration. In this respect, an attempted 'renegotiation' this time round will not be the same as the Wilson renegotiation of 1974. Then, although the Six were annoyed (as I saw since I

was working in the Commission at the time), there was sympathy for the position of the Wilson government and a disposition to try to be helpful. In any case, we cleverly did not ask for anything which the others would have found impossible. The danger is that this time we will just ask for too much; and the suggestion that we can veto the proposed treaty if we do not get what we want is fanciful. Cameron tried that in December 2012 and the rest simply found a way round it.

Of course, he will secure something (assuming he is still Prime Minister). In addition to what can be negotiated, he will for instance be able to point to umpteen justice and home affairs measures from which he has opted out from the 130 measures now under review. It looks as though the reformed Common Fisheries Policy will give member states big responsibilities for managing their own fisheries - a big bit of repatriation - and he will probably be able to say that we have avoided the banking union directives disadvantaging the City. So even though the package may be thin, it can probably be dressed up enough to be presented as a great victory: there is no way a Prime Minister will come back from Brussels and tell the Commons 'I have failed'!

Even with a figleaf, a referendum conducted in the lines I have described would stand a better chance of a 'yes' vote than if it were a straight 'yes or no'. (This is borne out by a recent YouGov poll: given a three-way choice, 15 per cent would stay, 28 would go and 47 would favour renegotiation).

With the government arguing for a yes vote, supported by most of the business community and the bulk of the trade union movement, the referendum is winnable, though by definition it would be on the basis of a Britain which positively wants to remain semi-detached. That is not for me a very engaging prospect. Indeed, as David Hannay writes in his recent book:

The idea that [the Europhobes] can be successfully appeased by concessions often damaging to Britain's chances of playing a full and successful role in EU policy formation is a dangerous illusion.

Nevertheless, it may be the best we can hope for.

And, anyway, there is no guarantee that the vote would be 'yes'. Again, unlike the situation in 1974 when the press was broadly supportive of Britain staying in, this time round we know that most of the British press is hostile to the EU, some viscerally so.

What Happens if the Vote is 'No'?

What would happen if the answer was 'no'? The Lisbon Treaty for the first time contains provisions for a country to leave the EU. There would be a negotiation, and probably not a very amicable one. Various options would be open to us: they would all involve maintaining the single market with a greater or lesser degree of British influence on decisions in Brussels. I do not think therefore that in the end the commercial consequences of leaving would be all that great, although foreign investors might well see Britain as a less attractive entrée into the Continental market. In my view, the most serious consequences would lie externally: on international trade matters we would be negotiating alone instead as part of the world's largest trading bloc. And the same would be true of environmental issues and, most importantly of, foreign affairs. Would our lone voice count for anything when it came to the Middle East, or North Africa, or Afghanistan? As we have been reminded recently, our influence with America would decline because our chief value to Washington is as a voice within Europe. Do we really want to be another Switzerland? I don't think so.

Future Prospects

But what if it is the Labour Party (or a Lab/Lib coalition) rather than the Conservative Party that is in power after 2015? Ed Milliband made a good speech to the last CBI conference and is opposed to any commitment to an early referendum, though it is not clear whether he has yet carried Ed Balls with him. Given the state of public opinion, there will be strong electoral pressure to include a commitment to a referendum in the Labour Party manifesto. If this can be avoided, so much the better. However it works out, there is no doubt that one could say with greater confidence that 'EU membership is safe in our hands' - to coin a phrase - of a future Labour government than one could of a future Conservative government which would have fought the election on a platform designed to minimise the leakage of voters to UKIP. It would however mean that a Labour government trying to play a more positive role in Europe would face relentless cries of betrayal from Europhobes in the Opposition.

Let me try and end on a more optimistic note! Suppose we have a government which is basically in favour of British membership and wants to make a go of it. For reasons that I have explained, we could not be at the centre of the EU's main preoccupation - making the Eurozone secure - but we could get a more sympathetic hearing for our own preoccupations. And, more importantly, we could play a positive role in other areas of EU activity, notably in foreign affairs. This is an area where, for historical and domestic reasons, Germany is incapable of giving a lead, whereas we, for opposite reasons, have the

experience and expertise to lead this important and growing EU role. Under William Hague, the Foreign Office has, I believe, been notably lukewarm towards the setting up of the External Action Service. This is regrettable, because it is here where, pre-eminently, there is an opportunity for Britain to show real leadership. Maybe, as Timothy Garton Ash argued in the *Guardian* some weeks ago, one could envisage a scenario where Germany would be leading Europe on economic matters and Britain would be leading European on foreign and security matters. With Ed Milliband as Prime Minister and David Milliband back at the Foreign Office it might just happen. It's about the best we can hope for, and hope for it we should.

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