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**In Europe, Not Ruled by Europe  
Tough Love between Britain and the EU**

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**Vivien Pertusot**

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# Executive Summary

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Discussions of a potential “Brexit”, the United Kingdom leaving the European Union, have sparked debate in Britain, and also across Europe, intensified by the UK veto of the “fiscal compact” at the European Council in December 2011. What sounded like the absurd pipedream of a few hard-core eurosceptics a couple of years ago has now become a genuine possibility. This study argues that this state of affairs does not originate from a deliberate strategy by the UK or its European partners. Rather they have set themselves on diverging paths, one leading to more integration, the other at best to the status quo – actually a form of relative disintegration – or to less integration. The more the gap widens, the less improbable a “Brexit” appears.

Time is ticking, one might say now that David Cameron has announced that he was in favour of a referendum framed as the choice between staying in the EU on renegotiated terms and leaving. Aside from the need for the Conservatives to win the general election in 2015 and the uncertainty this leaves hanging over the British economy, many other factors may influence how the situation plays out.

This study explores three scenarios: Britain remaining a full member, Britain becoming an associate member, and Britain leaving the EU. The first scenario could occur after a successful referendum to stay but this study predicts that this outcome is only likely if the terms of membership have been revised, or if no referendum takes place. The latter is a possibility if the Labour party wins the election – it has not committed to calling a referendum although it might still do so – or if the Conservatives decide to call it off, if negotiations to revamp the membership have not yet delivered for instance. However, it is very unlikely that member states will offer much leeway to the UK, especially if its demands appear disproportionate, for instance a complete withdrawal from social and employment policy.

The second scenario requires a fundamental change within the EU. The Union has not been designed for differentiation among its members. All developments have been intended to encompass all countries; some have simply chosen not to go along. If this change of conception happened, then an associate membership would be a real option. It would have to be neither too appealing nor too appalling for all parties. That is why it is difficult to imagine an associate membership based on the Single Market, unless the UK decides to set aside its differences on regulation, which is unlikely. It would be a hard sell today, but could become more acceptable if for instance the associate membership status excluded the Single Market and included

all other policies. The UK would lose its global advantage as “a gateway to Europe” – a significant toll for its economy – as well as access to EU’s network of trade agreements, but it could limit the damage by fostering a robust trade deal with the EU and would be free from a large chunk of EU regulation. This path would likely be unattractive for other potentially interested countries, as it would represent a gamble for any economy which is not as well positioned globally as the UK is. This scenario could occur if the government calls a referendum with one of the options being an associate membership, both if the other option is to leave or to remain a full member.

The last scenario is a possible but undesirable outcome. Without some renegotiations and if the Single Market loses its appeal in the UK, an in/out referendum could lead to a “Brexit”.

This study devotes significant attention to the domestic scene and actors. Domestic considerations have been the main drivers of this debate, dominated by actors resisting “more Europe”. This study identifies three main categories of actors: political opponents to the EU; pragmatic eurosceptics challenging the virtue of further integration; and pragmatic reformers who want to implement change in coalition with other member states rather than unilaterally. In other words, pro-integration supporters have lost all influence in the UK.

The strongest common bond for those who do not wish to exit the EU is the Single Market. This study argues that as long as it remains valuable in the eyes of politicians and business leaders, the UK will not seek its future outside the EU. But that may not be enough. The European economies are expected to remain sluggish over the next few years and the UK, like others, is seeking to diversify its export base. Moreover, it has grasped probably quicker than some others the tectonic shift in the global economic balance of power. Its leadership in services – a substantial part of the UK’s economy – is increasingly challenged by emerging players and the competition will become tougher. The triple weight of regulation – national, European, and global – could affect how non-EU investors value doing business in the UK as well as how British firms balance the importance of the Single Market and opportunities within fast growing economies, especially when resources to battle on both fronts are limited. In that respect, British firms often look at Germany to find that balance. This study argues that the capacity for the British government to convince its European counterparts to embrace its preferred reforms on regulation, competitiveness, the Single Market, and trade, will reflect on how the EU is perceived within the UK. All other arguments to promote EU membership hold considerably less sway in the domestic debate.

The UK discussions are interesting for the future of the EU, because more integration might not remain the accepted pathway. Dissatisfaction against the EU is growing and it might translate into growing euroscepticism as well as political reluctance to encourage more integration. Debate in the UK could act as the incubator which spreads such ideas to other parts of the Union.

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# Introduction

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1 January 2013 marked two milestones for the UK: the 40th anniversary of its entry into the European Community and the 20th anniversary of the launching of the Internal Market. The two are intertwined for the UK. The latter is celebrated as a genuine achievement; the former is put under increasing criticism. Britain has often been at odds with its partners regarding the overarching objective of the EU. Most Europeans conceive the EU as a political project, whereas the British now largely view it as an economic arrangement. Against this backdrop, it comes as no surprise that the UK has been adamant against the dilution of national sovereignty.

The change today is that Britain does not consider the Single Market, its core interest within the EU, as strategic as it used to be for its economy. It has made a pragmatic turn toward emerging markets to try to boost its ailing economy. It does not mean that the Single Market is no longer valuable for the UK, but it is investing more resources into diversifying its exports. This relative rebalancing should not be interpreted as a move away from the EU; all member states have engaged on the exact same path. Yet, the UK's domestic context and its inclination to favour "the open sea" over Europe, to paraphrase Winston Churchill, impact the way the British debate is interpreted.

Today, the relations between the UK and Europe are arguably at an all-time low regarding the EU. Many would blame the eurosceptic Conservatives, who share power with the largely pro-European Liberal Democrats in the British government. The same people would pinpoint the infamous European Council meeting in December 2011 as the launching of a negative campaign against the EU in Britain. It is certainly correct that Prime Minister David Cameron's decision to veto an EU treaty, which turned into an intergovernmental treaty now known as the "fiscal compact", heightened existing tensions.

However, the roots of the situation are much deeper and the consequences, especially at the European level, quite intricate to fully appreciate. As Foreign Secretary William Hague, a publicly Eurosceptic, has been saying for over a decade: Britain wants to be 'in Europe, not ruled by Europe'.

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To the surprise of many, the coalition government has been less hostile than it was originally anticipated toward the EU – the Liberal-Democrats have played a role in toning down the Conservatives. But the public, political and media environments the UK government is wrestling with leave little room for manoeuvre on European politics. The Conservative party bears a legacy of tearing itself apart over Europe, and if history teaches any valuable lesson on the matter, it is to keep this issue as secondary as possible for the party in power. This may have been the coalition government's intent, knowing that the two parties clearly differ on this issue.

Unfortunately for the UK government, the European Council meeting in December 2011 brought to light their bold approach to the EU. It felt only natural for the Tories that once back in government they would reverse the EU-friendly trend that dominated the Labour decade. Since David Cameron became Prime Minister, the British debate on the EU has been displaying a coalition government trying to pull itself together and a Conservative Prime Minister increasingly hard-pressed to maintain the leadership of his party as backbenchers in the House of Commons urge him to be more vigorous on the matter. Today, the UK is debating the virtue of its membership of the EU and the kind of ties it wants. Talks of a referendum and of growing euroscepticism should be interpreted through that prism. The main issue for the government is to palliate the uncertainty that this debate fuels at home, but also at the international level, both within the political and business spheres.

In Brussels especially, the focus could not be more different. On the agenda is the deepening of European integration. The Eurozone crisis has laid bare the flaws of the Economic and Monetary Union. Since 2009, political debates have delved into the kind of economic governance to build, and steps to take to stabilise the Eurozone and ensure the viability of the whole of the EU. The trend is clearly toward “more Europe”, something inaudible across the Channel.

Its might grants the UK the authority to differ on integration policies. As much as some would like to twist Britain's arm into accepting more integration, London's voice on the matter is a source of attention and potential concern. The gap between the UK and the EU has kept on widening. It was sustainable as long as the EU had little prerogatives over national monetary, fiscal, and economic policies. The emergence of the EMU partially impaired that shaky balance. Today, the more the Eurozone countries, and most others, get closer together, the more that balance is strained. How long can the EU sustain this widening gap with Britain? Is it conceivable with today's mind-set and structures to have a member state completely disconnected from policies of further integration that the vast majority of member states approve of? These are the core questions this study will strive to address. After setting our framework of analysis, we will analyse the domestic context, fundamental to understand the issue, and how it plays out at the European level. Finally, we will devise some scenarios to look at how the situation can develop.



# A Widening Gap

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Why is the UK deemed an awkward partner? This question is open for interpretation, but two aspects are crucial to understand its scope. First, the UK has always been at odds with the political dimensions of the EU. With the UK, Europe seems in sight but “out of heart”. Still, the UK managed to remain influential even when it shunned the EMU. This may prove more complicated today, since the EU has taken a more integrationist path under German leadership. Second, the relationship between Britain and the EU displays features of the marginalisation – Europe on one path, Britain resisting it.

## ***EU on the way to further integration***

The dynamics of regional integration helps to explain why the EU has been valuing “more Europe” to save the Eurozone from collapse. Two key factors need to be singled out: the path dependence toward more integration as well as Germany’s leadership role in European decision-making. Path dependence is “a way to narrow conceptually the choice set and link decision-making through time”.<sup>1</sup> Taken alone this concept is unsatisfactory; it lacks the root-cause that drives countries to choose a path over another. Pierson shows that path dependence is sustainable as long as actors perceive increasing returns in favouring that option. If further integration is viewed by European leaders as the best way to achieve economic growth and political stability, then all decision-making will value this path over others, which will be considered inadmissible. It is debatable whether this rationale is fully accepted across the EU today, even excluding the UK. Mattli explains that regional integration is sustainable only if an actor takes up the regional leadership.<sup>2</sup> In the EU, Germany plays that role. It may not relish it, in the sense that Berlin does not want to be perceived in that light, but it has the political and economic clout to trump anyone’s voice at the European table. Besides, its European policy overall inclines toward more integration, which explains why there has been a lock on “more Europe”. The EU is on an integration path under the leadership of Germany. All other options are discarded as not fitting the path dependence that prevails. This vision collides with the British vision.

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<sup>1</sup> Paul Pierson, ‘Increasing Returns, Path Dependence, and the Study of Politics’, *The American Political Science Review* 94, no. 2 (June 2000): 264.

<sup>2</sup> Mattli, *The Logic of Regional Integration*, 42–43.

## ***Primacy of the 'no unless' option in Britain***

Euroscepticism seems to pervade all debates on Europe in Britain and is not a new phenomenon.<sup>3</sup> It has been a fixture in British politics even before the country joined the EEC in 1973, but arguably the roots are much older. We will not canvass the entire history of British membership with Europe, but we will look at some recurrent features: instinctive resistance; flexibility; and pragmatism.

We will rely on the works of others who have dissected euroscepticism in the UK.<sup>4</sup> They single out five factors: the roles of geography; history; politics; economics; and the media. *First*, the fact that Britain is an insular territory with a long-lasting maritime tradition cannot be underestimated. *Second*, Britain – arguably primarily England – has always sought to maintain the balance of power in Europe to avoid its security being threatened by the emergence of a hegemon on the continent, which has bred prejudices against the French and the Germans. In contemporary history, Britain did not share a sense of urgency to rebuild a Kantian Europe after the Second World War. It did not lose, did not feel humiliated in any way. British security may not be best served by an alliance with continental Europe, but rather with the United States. *Third*, the UK proudly vouches for its national parliamentary system and is vociferous against supranational attempts to curtail its prerogatives. The British often recall that they founded the principles of the rule of law within the Magna Carta in 1215 and disregard any added value that outside institutions could bring in that realm.<sup>5</sup> *Fourth*, the economy plays a great role. The UK has been an international trading nation and the continent was never its only trading partner. To the contrary, before it joined the EEC, British trade was greater with the rest of the world than with Europe. *Fifth*, the media play an important role. It is an issue of chicken-and-egg, but it is hard to deny that constant negative coverage of the EU feeds euroscepticism.<sup>6</sup>

British attitudes have always been difficult to comprehend for other Europeans. There are still debates today about what motivated Britain to apply for membership in the early 1960s. In any case, it was

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<sup>3</sup> In this study, we refer to Euroscepticism as a phenomenon “attributed to collectively widespread negative evaluations of gains derived from integration and/or costs implied by membership.” See Cécile Leconte, *Understanding Euroscepticism* (New York: Palgrave Macmillan, 2010), 76.

<sup>4</sup> Here we rely heavily on papers by Charles Grant and Stephen George. See Charles Grant, *Why Is Britain Eurosceptic?*, CER Essays (London: CER, December 2008), <<http://bit.ly/11b4N3N>>; Stephen George, ‘Britain: Anatomy of a Eurosceptic State’, *Journal of European Integration* 22, no. 1 (2000): 15–33.

<sup>5</sup> Vivien A. Schmidt, ‘Discourse and (Dis)Integration in Europe: The Cases of France, Germany, and Great Britain’, *Daedalus* 126, no. 3 (Summer 1997): 177; Leconte, *Understanding Euroscepticism*, 85–86.

<sup>6</sup> See recently Benjamin Hawkins, ‘Nation, Separation and Threat: An Analysis of British Media Discourses on the European Union Treaty Reform Process’, *Journal of Common Market Studies* 50, no. 4 (July 2012): 561–577.

never wholeheartedly embraced as the right solution. And ever since instinctive resistance, flexibility, and pragmatism have been features guiding British attitude towards the EU.

Stephen Wall sums up the general approach across Whitehall departments to any new European initiative as “no unless”.<sup>7</sup> Any idea coming out of the European Commission first generates resistance before officials mull over how to protect, or even advance, British national interests. Consider for instance that the British were requesting special membership terms before joining whereas all other applicants have been abiding by the *acquis communautaires* as a normal price to pay to get into the club. One of the leitmotifs that has dominated British politics is to prevent any implicit or explicit references to a European Union as a goal – understood as a super state – rather it is depicted only as a process, something gradual and temporal with no particular integrative objective. This attitude can find roots in the strong opposition against European federalist inclinations.

Going beyond, in the UK, EU membership has been constructed and perceived as a choice: You can be in or you can get out. Building alliances has long been part of UK’s history, but they last as long as they advance national interests.<sup>8</sup> Pragmatism is embedded in the British view. The EU is an object that should help Britain to prosper, nothing less – otherwise what would be the point of being in it? –, nothing more – it could end up jeopardising national sovereignty. That is why the UK views the Single Market as an end in itself rather than the stepping stone to greater integration.<sup>9</sup> Moreover, the British dread no other exercise more than EU institutional debates. As Geoffrey Howe once said during his tenure as Foreign Secretary, “the way forward does not lie across a paper desert of institutional schemes. It is rather through pragmatic, flexible, political cooperation that we shall go forward together”.<sup>10</sup>

Britain’s struggle with the EU has a lot to do with its regulatory agenda. Britain has had difficulty adapting to the EU’s regulatory and legalistic requirements. The European Commission often meets British resistance to replace voluntary rules with statutory ones even when it formalises common practices, despite the fact that the Commission’s economic agenda especially after Jacques Delors’ tenure has been promoting a broadly liberal model.<sup>11</sup> Paradoxically the UK’s awkward attitude may have tweaked the issues in its favour. Schmidt argues that its resistance does not put London in an influential position over the EU’s grand strategy, but it does give it leverage over opt-outs and the

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<sup>7</sup> Stephen Wall, *A Stranger in Europe: Britain and the EU from Thatcher to Blair* (Oxford: Oxford University Press, 2008), 200.

<sup>8</sup> Oliver Daddow, ‘Margaret Thatcher, Tony Blair and the Eurosceptic Tradition in Britain’, *The British Journal of Politics & International Relations* (2012): 5.

<sup>9</sup> George, ‘Anatomy of a Eurosceptic State’, 17.

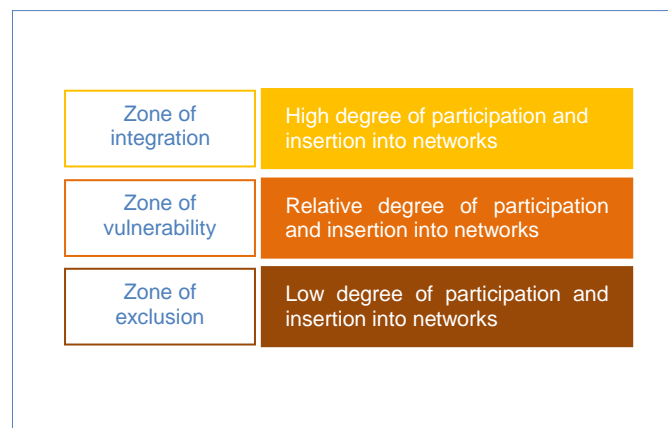
<sup>10</sup> Wall, *A Stranger in Europe*, 46.

<sup>11</sup> Vivien A. Schmidt, ‘Adapting to Europe: Is It Harder for Britain?’, *The British Journal of Politics & International Relations* 8, no. 1 (2006): 23–24.

EU's economic agenda.<sup>12</sup> During the Intergovernmental Conference (IGC) in 1996 for instance, the British regularly played the black sheep in the negotiations, because it could. Arguably it was a relief for some member states to rely on Britain to play the awkward partner they could not afford to be.<sup>13</sup> As Schmidt nicely captured, 'continued support for European integration depends not only on the successful adjustment of the economy but also on the successful adaptation of national political discourse that serves to justify both economic adjustments and institutional adaptations'.<sup>14</sup> This shift in national political discourse has arguably never happened in Britain and is unlikely to in the forthcoming years.

## State of marginalisation

Figure 1 The 3 zones of marginalisation in Castel's model



Events at the European Council in December 2011 led to an old British concept resurfacing: "splendid isolation".<sup>15</sup> News articles and comments used it to qualify the UK's position within the EU after David Cameron walked out of the room vetoing the "fiscal compact". Isolation seems inappropriate to understand Britain's position today. First, it infers withdrawal or nonparticipation. The UK does indeed not participate in some policies, but it is difficult to maintain that it is isolated as a result. The decision making process in the Euro area for instance is in any case limited to its members – the UK is not alone being outside. Second, isolation would rather characterise a final state, withdrawal from the EU for instance, rather than a process. Britain

<sup>12</sup> Schmidt, 'Discourse and (Dis)Integration in Europe', 178.

<sup>13</sup> Stephen George, 'Britain and the ICG', in *Politics of European Treaty Reform: The 1996 Intergovernmental Conference and Beyond*, ed. Geoffrey Edwards and Alfred Pijpers (London: Pinter, 1997).

<sup>14</sup> Schmidt, 'Discourse and (Dis)Integration in Europe', 168.

<sup>15</sup> It was coined to qualify British foreign policy in the 19th century, but has been abandoned in the early 20th century.

remains engaged in all dealings within all institutions and is still subject to EU law and directives. But the more the EU launches new initiatives – the banking union, the fiscal union, etc. – the more Britain will be left out of a greater chunk of policies.

We find it more convincing to look at it from the angle of marginalisation. The integration path the EU has been taking gives little leeway to outliers, and British constant resistance to it has left it at odds with many partners. Castel offers a model that emphasises a gradual process in which both the outcast can easily fall into a slippery slope once the process has started and the group is an active party to the downward spiral.<sup>16</sup> Two aspects are important to understand marginalisation: the participation into the dealings of a group – in our case participation to policies – and the insertion into networks. Looking at the three categories (see Figure 1), Britain would likely appear in the lower part of the zone of vulnerability. In fact, both the UK and leading European countries set themselves apart from each other. This process does not necessarily entail a voluntary strategy. Germany is the leading member state for integration and is among the strongest advocates for keeping Britain engaged. In London, the government has never stopped claiming that the UK is better off in than out.

Britain may slide into a situation where it has little option but to be excluded, because it is too disconnected from the integration path and too resistant to European understandings and networks. We have not yet reached that point, but the risk is genuine. Looking at the dynamics shows that the UK and the EU are on diverging paths, one leading to more integration, the other at best to a status quo – which would actually transcribe into a relative disintegration – or to less integration. Marginalisation plays a key role in this setting Britain apart, and within the current EU structure, it is difficult to halt such a process. This framework will be helpful to shed light on the debates that are taking place today in Britain and how it is affecting its place within the EU.

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<sup>16</sup> Robert Castel, 'La Dynamique des processus de marginalisation : de la vulnérabilité à la désaffiliation', *Cahiers De Recherche Sociologique* no. 22 (1994): 11.

# Europe: A Domestic Affair

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The debate over Europe is raging in the UK. All elements have converged to make it divisive. The government's positions are largely influenced by domestic interests, institutions, and actors rather than strictly foreign policy priorities.<sup>17</sup> Europe is traditionally a hot topic in British politics; some leaders have come under fire, mostly for being too soft. Today, the debate takes place among all parties, associations, and other groups. This domestic context fuels uncertainty to the point that a “Brexit”, a potential British exit, becomes a genuine possibility.

## ***Europe: an ever dividing issue in British politics***

In politics, we can distinguish three main eurosceptic groups.<sup>18</sup> First, there is *political euroscepticism*. They share a principled opposition or defiance towards the EU and the pooling of sovereignties. They are the most favourable to exiting the EU. We find supporters in the UK Independence Party (UKIP), led by Nigel Farage, perhaps ironically a Member of the European Parliament (MEP), and the fringes of the Conservative party. The second group, *utilitarian euroscepticism*, is doubtful about the gains derived from integration and its distributive system. They do not want to exit the EU, but they want to renegotiate some terms of membership, but there is no common agreement on which ones it would include. The vast majority of the Conservative Party adopts this posture – David Cameron and William Hague being prime examples. A significant proportion of Liberal Democrats would also agree, but it is difficult to know whether it is for electoral purposes or an actual change of heart, this party being the most pro-European one in Britain. An important minority in the Labour Party may also accept those principles, especially in the post-Blair era. The last group comprises *pragmatic reformers*. They shy away from desiring more integration as much as they resist calls to repatriate competencies from the EU, especially if it happens unilaterally. They often share a willingness to reform the EU. The Liberal Democrats and Labour belong to this group. Today, there are no more strong supporters for

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<sup>17</sup> Helen V. Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations* (Princeton: Princeton University Press, 1997), 11.

<sup>18</sup> This typology is largely based on Leconte, *Understanding Euroscepticism*, 46–61.

more integration. It was already confined to a small portion of the political elite; it seems to have faded away.

## The Tories and Europe

Let us now look more closely at the Conservative Party – as a party and as part of the coalition government – the Labour Party, and finally the Liberal Democrats.<sup>19</sup> The Tories carry a thorny legacy on the EU issue, which has often hurt their internal cohesion. David Cameron is experiencing one of those episodes of chaotic party cohesion because of Europe, which the Conservatives had managed to avoid for most of the 2000s – an easier endeavour when not in power.

David Cameron had to rise to the challenge of satiating both sides of his party when the Lisbon Treaty was ratified. It was a tricky exercise in 2009, a year before the general election. He offered four guarantees to voters: a “referendum lock” for any additional prerogatives handed to the EU, which was an important commitment in light of the referendum that never took place on the Lisbon Treaty; an opt-out of the “Social Chapter”; a “complete” opt-out from the Charter of Fundamental Rights (CFR); and an opt-out in criminal and justice areas.<sup>20</sup> He had also made the decision earlier in 2009 to fulfil his pledge to withdraw Tory MEPs from the centre-right European People’s Party in the European Parliament to create the British-dominated European Conservatives and Reformists group.

Once Prime Minister in May 2010, David Cameron was facing a difficult situation. He had to live up to his pledges, which aside from the “referendum lock”, required negotiations at the EU level. Second, he had to make the Conservative Party bear the Lisbon Treaty as a legacy from the previous government, which was by no means a done deal due to the Party’s bitter opposition to it. Third, his room for manoeuvre was reduced after the Conservatives failed to secure an absolute majority and had to share power with the Liberal Democrats. However, it was a common view in Britain that a treaty revision would not dominate the headlines for years, since it was first necessary to digest the full impact of the Lisbon Treaty.<sup>21</sup> The economic crisis in the Eurozone shredded that expectation. Instead, it rekindled a fierce debate in Britain over the value added of the EU at all levels, a potential hotbed of troubles for the coalition government.

There were concerns that the return of the Tories in government would corrode the UK’s relationship with the EU. But unsuccessful at garnering enough votes, David Cameron had to build a

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<sup>19</sup> In Appendix 1, we draw a comparison between the parties’ policies on the EU.

<sup>20</sup> David Cameron, ‘A Europe Policy That People Can Believe In’ (London, 4 November 2009), <<http://bit.ly/UxNCCw>>.

<sup>21</sup> Philip Lynch, ‘The Con-Lib Agenda for Europe’, in *The Cameron-Clegg Government: Coalition Politics in an Age of Austerity*, ed. Simon Lee and Dr Matt Beech (Basingstoke: Palgrave Macmillan, 2011), 222; Charles Grant, *Cameron’s Europe: Can the Conservatives Achieve Their EU Objectives?*, CER Essays (London: CER, December 2009), <<http://bit.ly/VPT4AN>>.

coalition with the Liberal Democrats and their pro-European leader Nick Clegg. The coalition factor on the UK's European policy has been essential. The coalition program, for instance, did not refer to the opt-out to the CFR, and only mentioned that the government was going to work 'to limit the application of the Working Time Directive'.<sup>22</sup> The coalition factor has had three subsequent effects: It has mostly steered the government away from contentious issues regarding Europe; it has sometimes been difficult to discern whether cabinet ministers were defending the government's policies or party lines; but also, this factor has increased the Conservatives' frustration vis-à-vis the Prime Minister's seemingly 'soft' approach on Europe.

In October 2011, David Cameron came head-to-head with rebel Members of Parliament (MP) during a vote on an EU referendum motion. An overwhelming majority opposed it (483), but 81 Tory MPs voted "aye" making it the strongest rebellion over Europe ever faced by a British government.<sup>23</sup> It became increasingly difficult for the Prime Minister to mitigate internal tensions over Europe. It was again clear in October 2012. The rebellion was less significant than the previous one (53), but Labour joined the Tory rebels to defeat the government to ask a cut in the EU multi-annual budget in a non-binding vote.

The thorniest issue so far has been over that of a referendum on the EU. This issue is testimony to the hardening of Britain's relations with the EU. In 2004, Tony Blair promised a referendum to the British public on the European constitutional treaty. It never took place after negative votes from the French and Dutch. It reinvigorated euroscepticism in the UK. The British felt deceived by the lack of a referendum on the EU or the Lisbon Treaty.

The "referendum lock" in the EU Act of 2011 stems from that episode. Its scope is far-reaching laying out all "trigger events" as tightly as possible – and they are numerous.<sup>24</sup> It may have the counterproductive effect of limiting any UK participation in new EU initiatives, even those that hardly qualify as deepened integration but would trigger a referendum. One issue is still unclear regarding the EU Act, whether it binds future parliaments.<sup>25</sup>

The EU Act requires a referendum only in the case that Britain seeks to transfer powers to the EU. Should this happen, it is possible that the public consultation would transform into a wider referendum, especially if the Conservatives are in power and if the issue at stake is minor. British politicians could also decide never to go down that road, which partly explains why there has still been so much attention

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<sup>22</sup> David Cameron and Nick Clegg, *The Coalition: Our Programme for Government*, May 2010, 19, <[bit.ly/Yf1CHN](http://bit.ly/Yf1CHN)>.

<sup>23</sup> Philip Cowley and Mark Stuart, 'The Conservative Euro Revolt: 10 Points to Note', *Ballots & Bullets*, 25 October 2011, <<http://bit.ly/W6G39f>>.

<sup>24</sup> Michael Gordon and Michael Dougan, 'The United Kingdom's EU Act 2011: Who Won the Bloody War Anyway?', *European Law Review* 36, no. 3 (2012): 3–30.

<sup>25</sup> *Ibid.*, 23–25.



devoted to holding a referendum over the EU. The curiosity of the situation is that the Conservatives may hold one during the next Parliament, but they first need to win the next election – so far, polls suggest a comfortable lead to the Labour Party. The referendum issue has divided the Conservative party and is likely to keep on being contentious. Now that David Cameron has committed to one if he wins in 2015, Tory eurosceptics want a legal guarantee. For the Tories, the core issue is not really whether to hold a referendum, but rather what the question will be. David Cameron said that he would support an in/out referendum after substantial renegotiations.<sup>26</sup> We will devise several other scenarios in the last section. If he manages to secure the repatriation of powers and offers the new terms or withdrawal, voters would likely choose to stay (see below).

It remains unclear which powers he would like to take back, aside from those spelled out in his 2009 speech that were already Conservatives' policy (see [Appendix 1](#)). Overall, David Cameron is keen to inject more flexibility in the UK's dealings with the EU.

Positions may be clearer once the government has completed its Review of the Balance of Competencies. Launched in July 2012 it aims at analysing EU policies in all sectors and determining their impact on British interests. Every six months, until mid-2014, reports will be published.<sup>27</sup> Officially, this Review is an open analytical exercise that will not formulate policy recommendations. The neutral nature of the Review was the only way to accommodate the coalition factor. But its findings are certainly going to be manipulated. Some will want to show how flawed the UK's relationship is with the EU, mostly within UKIP and the Tories. Others, mostly within the Liberal Democrats and Labour, will welcome the opportunity to discuss positive aspects about the EU. What is certain is that it will keep the EU on the agenda, which is not always a positive outlook for a British government.

The attention devoted to Europe in the past few months has accelerated the emergence of new groups that may play an increasing role. Three Tory MPs launched the Fresh Start Project in 2012. It mirrors what the Balance of Competencies aims at achieving. The main difference is that the Fresh Start Project formulates recommendations. They believe that the UK should remain in the EU but should push for a looser membership. Most of their proposals involve some form of repatriation or at least a lesser commitment from the UK. For instance, it promotes a full opt-out from social and employment affairs, but only if the UK government has not managed to convince all other member states to agree on a common repatriation of those competencies to nations. It also advocates for 'emergency brakes' on any new social and employment legislation as well as financial services' regulation. The group promotes a legal safeguard

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<sup>26</sup> 'Britain and Europe' (Speech at the Bloomberg office, London, 23 January 2013), <<http://bit.ly/X4jGyK>>.

<sup>27</sup> A full calendar of the review is available here: <<http://bit.ly/10aLGSw>>.

against the discrimination of non-Eurozone members to protect the integrity of the Single Market.<sup>28</sup> Another group was formed following David Cameron's speech, the Mainstream Conservatives. It published a letter prior to his speech urging him to show leadership in Europe and suggesting should he want renegotiation, that he should try to rally other member states rather than going it alone.<sup>29</sup> The group has sometimes been presented as a counterpoint to the Fresh Start Project's members, but it is not evident how the two really differ. Those groups show a new generation of Conservatives defending EU membership, although the core of their argument is really the belonging to the Single Market.

Against this backdrop, David Cameron will be hard-pressed to maintain the leadership of his own party. His speech may not be enough to keep the party in check on Europe. Despite continuous speculation, the coalition is likely to survive until 2015; on Europe, the two leaders are simply going to agree to disagree. The Europe issue will remain on the political agenda, especially because it permeates other key areas, such as the economy and immigration, two key issues for voters. Moreover, some Tories fear that that UKIP could take votes away from them. Michael Fabricant, MP and Vice-President of the Conservative Party for Parliamentary Campaigning, argued in a strategy paper that the Party needed to contain its rise; an option would be a rapprochement with Nigel Farage's party offering an in/out referendum.<sup>30</sup> Yet UKIP voters are not all Conservatives – 43% of them voted either for Labour or for the Liberal Democrats in 2010. Europe is an important issue, but hardly seems to be the main reason for voters to support UKIP – rather dissatisfaction with mainstream political parties is.<sup>31</sup> Lastly, David Cameron may have to face a leadership challenge from the Mayor of London, Boris Johnson.<sup>32</sup> It may not happen before the next election, but it can be a nuisance to show a united party.

## Labour and Europe

The Labour Party has been pro-European since the mid-1980s and was even pro-integration, especially in the early years of Tony Blair's era. However, the situation has changed. Tony Blair slowly shifted away from his desire to put Britain at the core of Europe, because he did not manage to convince the British of the value of this endeavour. Gordon Brown during its tenure as Prime Minister was always less enthusiastic about the EU and his leadership marked the party on

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<sup>28</sup> *Manifesto for Change: A New Vision for the UK in Europe*, The Fresh Start Project, January 2013, <<http://bit.ly/YmCClg>>.

<sup>29</sup> 'Letter from Eurorealist Tory MPs to the Prime Minister', *Britishinfluence.org*, 15 January 2013, <<http://bit.ly/Xp6Xqp>>.

<sup>30</sup> Michael Fabricant, *The Pact? The Conservative Party, UKIP and the EU*, November 2012, <<http://bit.ly/VBAGyk>>.

<sup>31</sup> Michael Ashcroft, *'They're Thinking What We're Thinking': Understanding the UKIP Temptation* (Lord Ashcroft Polls, December 2012), <<http://bit.ly/WuL4WX>>.

<sup>32</sup> Boris Johnson would need to become a MP first to challenge David Cameron.

Europe to the point that there remains little devoted pro-integration Labourites. We can single out two main trends. Most largely accept the relationship as it is. They agree on the need for reform, but would limit opt-outs and attempt to change the EU from the inside. Party leader Ed Miliband belongs to that group, and he can count on his party's loyalty. But a second group believes that Britain's position in the EU has changed and renegotiating terms could be a viable option. Shadow Chancellor Ed Balls would arguably agree with this position. This trend is likely to shape up more decisively as 2015 approaches.

The Labour Party remained mostly silent for two and a half years over the EU. They knew that it was a sensitive issue and preferred to let the Tories turn fire on each other instead of being caught in the crossfire. More importantly, they lacked a policy on the EU. The more Europe turned into a political issue, the more it became urgent for Labour to define what they stand for (see [Appendix 1](#)). Ed Miliband emphasises three aspects that warrant Britain's membership to the EU: economic interest – notably the Single Market; the leverage it provides in international negotiations on issues such as climate change; and a strategic interest through enlargement. He also said that debating over the virtue of an in/out referendum was only provoking uncertainty, an unnecessary impediment to recovery.

Two elements are notable. First, Ed Miliband argued in favour 'of mak[ing] the case [for Europe] in a new way'. He meant to diverge from the pro-integration inclination that Tony Blair had instilled in the Party. It also serves to reach out to an overall political and public landscape that has become more eurosceptic. This position could be tricky, because it may compel Labour to flirt with euroscepticism as they did during the EU budget vote. In the longer run, it could increase the internal differences hold over Europe.<sup>33</sup> Second, the Labour policy remains difficult to decipher. They seem caught between defining their own positions and countering those of the Tories.

The issue of a referendum is not set in stone. They do not want to commit now, but they do not rule it out in the future either. Until then, Labour are contributing to the uncertainty over Britain's fate within the EU. UK political parties are increasingly expected to take a stand on this issue; the Labour Party has not. That the Prime Minister has done so may foster intense debates among Labourites. Ed Miliband opposes a referendum, but his position is not unanimously shared among the leaders of the Party. Some support a referendum as a way to steal the Tories' momentum in 2015, to hold a genuine debate to settle the Europe issue in Britain. But Labour are not known to rupture over Europe. They believe that David Cameron's speech will not end disputes among the Tories and they will try to incite divisions whenever they can. They may be able to postpone a decision on the referendum until the next general election, but voters will urge them to pick a side.

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<sup>33</sup> 'Playing with Fire', *The Economist*, 10 November 2012, <<http://econ.st/10d8aSX>>.

## The Liberal Democrats and Europe

The Liberal Democrats have almost no chance to win the next election, but British politics could welcome another coalition government. The Party would then play an important role. It is by far the most pro-European party in the UK – in 2010, it supported Britain joining the euro. It has played the buffer in the coalition to tone down Tory eurosceptics. It is likely that it will keep playing that role if it joins a coalition in 2015. Nick Clegg, as a former member of cabinet for a European Commissioner as well as former MEP, belongs to the camp of pragmatic reformers, but he has expressed his opposition against a referendum. However, it is difficult to see whether Nick Clegg actually opposed any kind of referendum. His main issues seem to be with committing to hold one so long before it actually happens as well as the very uncertain strategy of renegotiation and repatriation. He has not hidden his disagreements on occasions against David Cameron's decisions, especially after the so-called veto in December 2011. The Liberal Democrats also oppose the opt-out from a chunk of justice and home affairs measures contrary to Tory positions. On Europe, the Deputy Prime Minister and the Prime Minister will agree to disagree. Despite early rumours that the coalition could not sustain some heat, notably on Europe, it has become increasingly likely that it will remain in power until 2015.

However, the potential weight that the Liberal Democrats could have in a new coalition would depend on its electoral results. In 2010, a coalition was the only option for the Conservatives to lead the government, which made Nick Clegg's the kingmaker and offered him incredible leverage. Today, two years before the general election, the Liberal Democrats seem far from able to regain such a coveted position. Its showings in the polls seldom put them above 12% of voting intention – 11% less than in 2010 where the polls often overestimated their score. A first challenge for the Party will be the European election in 2014 where it generally fares well, but the rise of UKIP may damage the Liberal Democrats' results.

Overall on Europe, the Party has sometimes had a difficult time to mark its difference with the Conservatives. Nick Clegg and Business Secretary Vince Cable certainly speak out in favour of the EU, but their distinct positions are often incorporated in the broader government's mix and come out blurred. It has also happened in other policy areas, for instance on the rise of university tuition fees. Moreover, it is not certain that voices among the Liberal Democrats would not rise to be more active to reform the EU, especially if this issue becomes a salient issue for voters closer to the election.

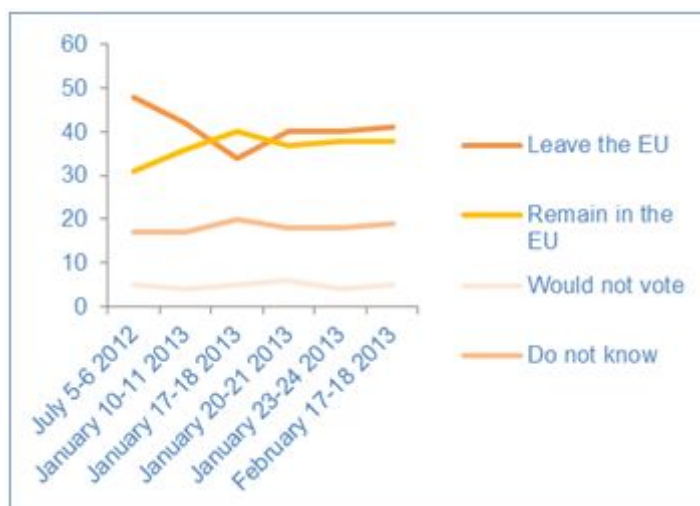
British political parties have all shifted away from pro-European positions – as in favour of more integration. The debate is not whether to condone more EU prerogatives, but rather whether to reduce them. The Europe debate in the UK is also dependable on other influential players.

## A crowded and polarised stage

The weight of external influences is acute. The debates largely mirror those in the political landscape: Few groups are pro-European and most display eurosceptic tendencies. Pro-European groups could rather be defined as “euro-realists”, a term coined by the Centre for British Influence through Europe (CBIE). Broadly, they support continued membership to the EU – the role of the Single Market is prominent – but they may agree on the need for reform or simply resist further integration. The second outcome is that eurosceptic groups display a better record of readiness and resolve to defend their cause. “Euro-realist” groups often step up only when the EU membership appears under threat. The current circumstances have triggered such concerns and there has been a surge of new initiatives defending EU membership. The line often seems blurred regarding the support for a potential renegotiation of the terms of membership.

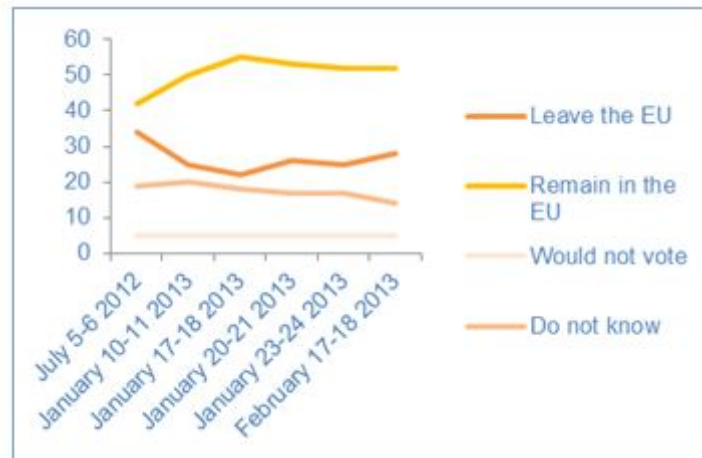
### Public opinion

**Figure 2 Polls on what vote UK voters would cast if there was a referendum with the current terms of membership, in %**  
(Source: YouGov)



Euroscepticism has been a constant feature within the UK public yet its importance is correlated to the saliency of the European issue. That the EU is portrayed negatively or distrusted matters little as long as voters do not consider it one of their top political priorities – that gauges the saliency of an issue. In other words, an issue is not politically important event if the attention is high, until voters rank it as a priority. Typically, Europe attracts disproportionate attention in comparison to voters’ priorities. Moreover, UK public opinion is not hostile to the EU; rather its main characteristic is uncertainty.

**Figure 3 Polls on what vote UK voters would cast if there was a referendum after the government had secured new terms of membership, in % (Source: YouGov)**



The UK public is divided over EU membership, but the most important component is its uncertainty. During the past decade, Eurobarometer polls show that an average of 37.6% have said that membership is neither good nor bad or do not know. Depending on how debate is framed, the undecided vote can move to support membership or to oppose it. If there were an in/out referendum with the current terms of EU membership, over the past seven months, as shown in Figure 2, only once have voters agreed to stay in the EU. However, Figure 3 shows that if the government could secure a renegotiation, then voters would consistently vote to stay in the EU. This illustrates that the main problem for a potential Conservative government in 2015 will be to succeed in negotiating a “fresh settlement.” It does not mean that Britons would necessarily want out otherwise, but the case for continued membership will depend on how the undecided vote. Three elements will play a key role if an in/out referendum takes place with the current membership terms in the balance. Certain arguments could be decisive, such as the importance of the Single Market to the British economy, but its importance could dither (see below). Second, the sway of the marginalisation factor can play a role. If they see an exit as dangerous for the country, they may not choose to withdraw. The situation in the Eurozone may be an important element: If it cannot bounce back, it will be easier to make the case that Britain should not tie its fate to such a fragile enterprise. Third, it will depend how salient the Europe issue becomes. Its saliency could have an impact on how voters behave in a potential referendum, as well as during the 2015 general election. Despite steady attention in the media and politics, it has not featured once in the top 10 of most important issues for Britain in 2012.<sup>34</sup> Britons rank the economy,

<sup>34</sup> IPSOS Mori monitors the most important issues to Britons on a monthly basis. All data are available here: <<http://bit.ly/13chZ52>>.

unemployment, immigration, health, justice and crime as the most important issues facing the country. The EU plays a significant role in all those sectors, but it is debatable whether voters make that connection. An unknown factor is the impact of the Balance of Competencies. Its reports will indeed lay bare how much EU and domestic politics are intertwined; their use by the media, politicians, and interest groups could affect the voters' reactions. Talks of an EU treaty change could also spark a spike of interest among the public, because the lack of referendum on the Lisbon Treaty felt like a political ploy for many Britons.

### The media

Any European reading the UK press will undoubtedly note two traits: how much the media talk about Europe and how negative the tone usually is. It is difficult to quantify how influential the media are in shaping public opinion, but it does not help the cause for Europe that the UK press constantly criticises every nut and bolt in the EU.

In the UK, four media owners are known to hold eurosceptic positions, Rupert Murdoch (*The Times*, *The Sun*), Richard Desmond (*The Express*, *The Star*), the Barclay brothers (*The Daily Telegraph*), and the Daily Mail and General Trust.<sup>35</sup> In September 2012, these titles accounted for the circulation of 74.1%, about 6.4 million copies, of British daily newspapers.

The role of the press is not negligible when explaining euroscepticism, but a study of the media goes beyond our scope. Suffice it to say that the media and the public mutually reinforce each other's perceptions, which are then channelled in politics. The Leveson Inquiry over the press points out that 'factual errors (...) are, in certain respects, trivial. But the cumulative impact can have serious consequences'.<sup>36</sup> In addition, it is generally accepted that taking a pro-European stance is a gamble for UK politicians. During the Inquiry, Tony Blair<sup>37</sup> and John Major<sup>38</sup> testified that they faced pressure from media owners on their positions on Europe.

### Business community

The business community at large agrees on the value of the Single Market, but seems divided on political questions, such as the renegotiation of membership terms. The focus of their attention is on the impact of regulation. There appears to be no real vim to go it alone, at least not for now.

The issue at stake – the EU membership or more accurately retaining an active seat within the Single Market – could see an alliance

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<sup>35</sup> Grant, *Why Is Britain Eurosceptic*, 3.

<sup>36</sup> Brian Leveson, *An Inquiry into the Culture, Practices and Ethics of the Press*, vol. 2, 2012, 688, <<http://bit.ly/Y813ve>>.

<sup>37</sup> *Ibid.*

<sup>38</sup> Brian Leveson, *An Inquiry into the Culture, Practices and Ethics of the Press*, vol. 3, 2012, 1131–1132, <<http://bit.ly/W2wFpO>>.

between the City and large businesses, while the smaller businesses are likely to fall on both sides of the fence. Talks of renegotiation have bolstered calls to alleviate the regulatory regime. The more countries in the Eurozone integrates and the less it seems Britain has leeway to build a new relationship with the EU, the more the business community is likely to shift support away from the Single Market. Another element that holds sway especially among exporting firms is the UK clout in trade negotiations at a time when there is growing calls to lay the ground for a more diversified export base.

Europe remains a sensitive issue for UK businesses. On the one hand, current circumstances have reinvigorated groups such as Business for New Europe (BNE). Created in 2006 as a successor to the 'Britain in Europe' campaign and supported by UK business leaders, BNE has actively been making the case for Europe. On the other hand, it has pushed business organisations and leaders to take a stand. Some like Virgin chairman Richard Branson<sup>39</sup> and BT and easyJet chairman Michael Rake<sup>40</sup> have warned against an exit, and the latter even against renegotiation. Others, such as ASOS chief executive Nick Robertson or AMEC chief executive Samir Brikho, have endorsed David Cameron's call to renegotiate the terms of membership citing the EU's ever-increasing regulation.<sup>41</sup> The broader question is whether there is appetite for reform. According to a survey, just 26% wish to maintain the relationship as it is. The lion share (47%) would prefer a looser one.<sup>42</sup> So far, several business associations, such as the Confederation of Business Industry or the British Chamber of Commerce seem to support that rationale.

In the coming years, the question will become how much the Single Market holds its value in the eyes of British business leaders. UK firms consider economic developments in the Eurozone to be the primary factor influencing their businesses. Therefore, continued sluggishness in the EU may affect how they perceive the Single Market, especially if the Eurozone is deepening its integration, leaving little margin for a looser relationship to develop. The more export-driven companies will also consider the impact of trade negotiations. The EU has embarked on an ambitious campaign to conclude free trade agreements (FTA) with several countries and regions – from a UK perspective, the U.S.-EU FTA will be closely monitored.

In the City, the issue also remains sensitive. An essential tenet is the City's access to the Single Market. Without it, its attractiveness for non-EU investors would likely diminish despite unparalleled assets.

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<sup>39</sup> Richard Branson, 'Why an Exit from EU Would Be Bad for British Business', *Virgin.com*, 3 January 2013, <<http://bit.ly/XLFEpx>>.

<sup>40</sup> George Parker and Peter Spiegel, 'Business Leaders Warn Cameron on EU Terms', *Financial Times*, 8 January 2013, <<http://on.ft.com/ZeQKX7>>.

<sup>41</sup> Roland Watson and Charles Bremmer, 'Business Backs PM's Call for Mandate on Europe', *The Times*, 24 January 2013.

<sup>42</sup> 'Britain's Businesses Say No to Further EU Integration', *British Chamber of Commerce*, 19 July 2012, <<http://bit.ly/Xtuoky>>.



The City was not wholeheartedly in synch with David Cameron's decision to walk out of the European Council in December 2011. It put the City in the spotlight, a position which it did not relish, at a time when it had to face increasing criticism. However, a poll conducted among UK financial services professionals shows clear-cut support for a looser relationship with the EU even if it leads to more difficult access to European markets. A strong majority agrees that EU regulation outweighs the benefits of the Single Market, and expects that it will worsen in the next five years.<sup>43</sup>

### Interest groups and think tanks

The UK landscape is variegated in the field of interest groups and think tanks. Many of them are experiencing a new momentum or have emerged as result of the current situation. They are likely to contribute more and more to and take a greater place in the debates.

Among advocacy groups, the Bruges group has been a historical megaphone for strong euroscepticism. It used to be quite influential, especially among Tories. Its rhetoric is one of the toughest – leaving the EU is certainly an option. But its aura has waned, as it got outpaced by the emergence of the think tank Open Europe. Launched in 2005, the latter's influence really took off after the Tories came to power. It is eurosceptic, but preaches for continued though looser membership. Its influence stems in part from its links with the political sphere; it acted as secretariat for the All-Party Parliamentary Group on European Reform, which served as bedrock for the Fresh Start Project. In addition, it has been a powerhouse of recommendations for the government's European policy.

At the other end of the spectrum, the Centre for European Reform acts as the most pro-European think tank of the batch. Launched in 1996 by Charles Grant, its reputation and presence has grown throughout the years. It deems that the benefits of membership outweigh the costs. In comparison to other European-focused think tanks in the UK, it also expresses a clear interest for foreign and security affairs supporting a greater role for Europe in the world.

Interest and grassroots groups have contributed to the debate on both sides of the fence. Some, eurosceptic, have been focusing on the issue of a referendum, such as the People's Pledge, which has gathered more than 130 000 signatories. Some are fiercely anti-EU, such as the Surrey Democracy Movement, which advocates for an exit. Others have taken a "euro-realist" lens, as the CBIE likes to refer to its point of view. Formerly called Nucleus, its goal is to take a UK perspective show what is being achieved in the EU. It is not advocating for more integration, but it is dismissing calls for an exit.

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<sup>43</sup> 'ComRes Poll of Financial Services Professionals', *Open Europe*, 14 December 2011, <<http://bit.ly/VuvNYF>>.

## The devolution of Britishness?

A last factor could be the re-emergence of national identities in the UK.<sup>44</sup> Some in Scotland are supporting for independence from the UK – and to move into the EU and NATO afterwards. A renewed sense of Englishness is surfacing as result of perceived imbalances in the devolution's agreements.<sup>45</sup> It may not be far-fetched to say that the more disgruntled the English feel about devolution the more eurosceptic they become. For now, this feeling is more prominent among English nationalists. Some argue that this is likely to change. The compound effects of a politically motivated English national identity, the Scottish referendum, and the consequences of devolved power in the social and economic environment may affect the functioning of the UK.<sup>46</sup> It is difficult to predict how strong this influence will be in debates over Europe, especially since nationalist arguments remain on the margin of mainstream politics.

It goes beyond our scope to focus on the Scottish referendum. It will take place in 2014 and its outcome is quite unclear. The Scots are characterised as pro-European, but in fairness, they may simply be less eurosceptic – euro-realist would fit well. There may indeed be a strong appetite to become independent, but it is also likely that the consequences of a break away from the UK could entice voters to remain part of it. On Europe for instance, Scotland would need to apply for membership to the EU and to NATO. There would be no automatic membership.<sup>47</sup> In the meantime, it could foster deep economic uncertainty and a sense of isolation. In any case, this episode may impair the UK itself and breed nationalist discourses.

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The landscape on Europe is extremely crowded in the UK. Very few actors are pro-integration; most would at best prefer the status quo. The majority across the board wish for a looser relationship with the EU. A rush toward the exit does not seem a tangible option for now. But, a lot depends on negotiations to repatriate powers or at least limit the UK's involvement in some areas being successful. If they were to fail, it could result in the Single Market being the last beacon of hope as an engine to restore growth in the UK – not a done deal. Notwithstanding the authority of other arguments in favour of the EU, such as its capacity to act as a force multiplier on the world stage, they are not as important as the Single Market.

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<sup>44</sup> David Rennie, *The Continent or the Open Sea: Does Britain Have a European Future?*, CER Report (London: CER, May 2012), 40–41, <<http://bit.ly/10bgfGF>>.

<sup>45</sup> Richard Wyn Jones et al., *The Dog That Finally Barked: England as an Emerging Political Community*, IPPR Report (London: IPPR, January 2012), <<http://bit.ly/YacfHT>>.

<sup>46</sup> Andrew Mycock, 'The Politics of Englishness', *Policy Network*, 4 July 2012, <<http://bit.ly/Vw06hy>>.

<sup>47</sup> Daniel Furby, *In Depth: Scottish Independence and EU Accession* (London: Business for New Europe, March 2012), <<http://bit.ly/WauV8H>>.

# Single Market: Is It Still Enough?

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The UK has been suffering from the fallouts of the Eurozone crisis. If there was a temptation at first to throw the responsibility of Britain's economic turmoil on the Eurozone crisis, the government dampened them. The economic crisis has had two important impacts on the UK's dealings with the EU. First, the slowdown of economies in Europe puts the value of the Single Market under scrutiny and coincidentally the efforts that the government is undertaking to diversify its export base. Second, Britain had to handle a tightening of EU's regulatory regime in financial services and banking. Those effects have touched a sensitive chord in the UK. The argument goes that if the Single Market is not as beneficial as it was and if the UK's economy misses the chance to tap into emerging markets, the chances of bouncing back quickly from the crisis will decrease. It has also bolstered talks of EU over-regulation, which for some led to accepting a potential EU exit to free British businesses from this burden.

The UK adopts a bold approach to reform the EU, by buttressing trade deals with rising economies, in addition to those with long-time allies like the United States, the completion of the Single Market, and measures to reduce regulation on businesses. It remains a land of opportunities for foreign investors although Germany is clouding a bit of the UK's prestige. Emerging markets are obvious targets to diversify export bases, but akin to most EU countries, the UK has yet to anchor a sustainable presence. UK firms may be tempted to venture into new markets, but the Single Market remains their "natural backyard". In addition, the government is taking a leap of faith by putting all its eggs in the same basket within the EU to support the City against all odds. The UK is striving to maintain its leading profile in financial and business services, financial as well as business ones. Yet other centres, notably Singapore, are putting the City's competitiveness and attractiveness under increasing pressure.

## ***The Single Market: the "natural backyard"?***

The UK's economy differs from most of its neighbours: It looks at international markets more than most of them and services account for a large share of the UK economy. They have been playing an

increasing role in the British economy compared to goods. In export, the UK ranks third in the world in services and only tenth in goods.<sup>48</sup>

The UK is striving to maintain a competitive profile. It worries that it could lose out in the mid- to long-term. Some predict that it could fall from 9<sup>th</sup> to 11<sup>th</sup> in GDP terms by 2050. Only France and Germany would remain within the top 10 by 2050.<sup>49</sup> In manufacturing, the UK's competitiveness would also drop. According to a survey, it could slide from 15<sup>th</sup> in 2012 to 19<sup>th</sup> in 2017. In Europe, only Germany would appear in the top 15 by 2017.<sup>50</sup> The UK is concerned that EU member states do not fathom this global shift hence the British government is pushing the EU to reform. In 2011, the government published a pamphlet laying out four domains where the EU should be more active: complete the Single Market; conclude more trade agreements with fast-growing economies; reduce the cost of doing business, i.e. less regulation; and focus on innovation, which for instance involved setting a European patent regime.<sup>51</sup>

The British economy is so intertwined with developments in the EU that it cannot go it alone. The UK envies Germany's prowess to maintain a high profile in Europe and across the globe. Increasingly, Germany's attractiveness is upstaging the UK's. Britain still hosts almost one in five new foreign projects across Europe, but its lead has experienced a 7-point decline since 2004 and Germany now accounts for 15% of all new projects. Moreover, it is extremely reliant on U.S. foreign direct investments (FDI). The UK is not the leading recipient of FDI projects from any of Europe's other top 10 countries of origin – Germany is in six cases out of ten.<sup>52</sup>

The UK is facing daunting challenges. Similar to many European countries, growth is lacking, its competitiveness and its attractiveness are being challenged, and the government's strategy to rebalance the economy to strengthen advanced manufacturing has yet to bear fruits. The GDP contracted in three out of four quarters in 2012. The European Commission predicts a slow return to growth with an increase of GDP by 0.9% in 2013 and then by 1.4% in 2014.<sup>53</sup>

The internal market remains the UK's main trade platform. From 2008 to 2011, 48% of total exports took place within the EU. In

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<sup>48</sup> Department for Business, Innovation and Skills, *UK Trade Performance Across Markets and Sectors*, BIS Economics Paper (London: Department for BIS, February 2012), <<http://bit.ly/W3qKLT>>.

<sup>49</sup> PwC, *World in 2050: The BRICs and Beyond* (London: PwC, January 2013), <<http://pwc.to/VR6Yly>>.

<sup>50</sup> Deloitte and U.S. Council on Competitiveness, *2013 Global Manufacturing Competitiveness Index* (London: Deloitte, November 2012), <<http://bit.ly/WiEDrq>>.

<sup>51</sup> HM Government, *Let's Choose Growth: Why We Need Reform to Unlock Europe's Potential*, 2011, <<http://bit.ly/X5szlm>>.

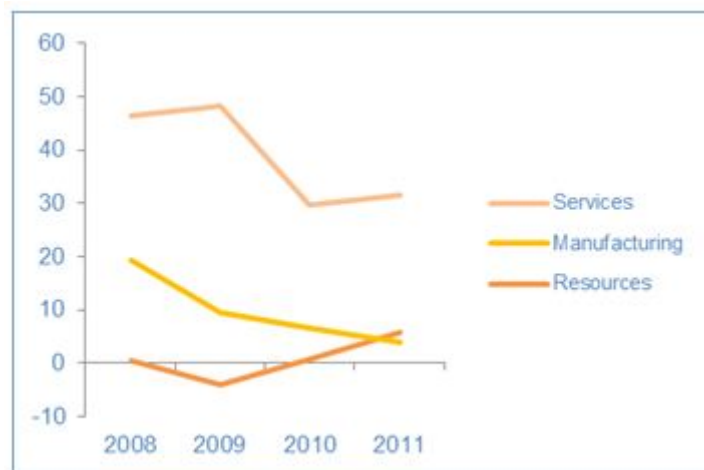
<sup>52</sup> Ernst & Young, *Staying Ahead of the Game: UK's 2012 Attractiveness Survey* (London: Ernst & Young, 2012), 7–8, <<http://bit.ly/VoOWen>>.

<sup>53</sup> European Commission, *European Economic Forecast: Winter 2013* (Brussels: European Commission, February 2013), 86–87, <<http://bit.ly/131YYXy>>.

this same period, the contrast between exports in goods and services is revealing (see [Appendix 2](#)). Exports in goods and services to the BRICS only amounted to 15.4% of the UK's total exports.

Moreover, Europe is the natural trade area for UK firms. 86% of UK exporting firms have done business in Europe in the last five years – the second area is North America at 47%.<sup>54</sup> It translates in outward FDI to Europe, which is by far the first destination. Conversely, the UK has been able to attract foreign investment both from within and outside the EU. Unsurprisingly, as shown in Figure 4, services account for the greatest flows of FDI despite a clear decrease due to the financial crisis. Perhaps more worrying is the fact that FDIs in manufacturing have been going down since 2009 despite a few bits of good news, such as Toyota's decision to locate the European production of its new generation hatchback cars in the UK.

**Figure 4 Net FDI flows into the UK by industry type, 2008 to 2011, in %**  
(Source: Pink Book 2012).



It has greatly taken advantage of the Single Market. It has been able to specialise in what it does best, notably business and financial services, which has been profitable beyond the EU – services have globally become a major source of revenue in trade. Thanks to the free movement of people, it can attract a skilled European labour force and the 500 million-people market that the Single Market offers also facilitates economies of scale.

The UK realises that EU countries are evident trade partners, but it has also been pressing to improve and complete the Single Market. Some 44% of UK exporting firms have reported facing at least one significant barrier to trade in Europe. The most common one involves regulatory and legal barriers.<sup>55</sup> One reason is that the UK is the most compliant countries to enforce directives among the bigger

<sup>54</sup> OMB Research, *International Business Strategies, Barriers & Awareness Monitoring Survey 2012* (Kent: OMB Research, August 2012), <<http://bit.ly/12WMII0>>.

<sup>55</sup> *Ibid.*

economies in Europe – in February 2013 it had 36 pending infringement cases compared to 52 for France and 46 for Germany. Arguably, it results from the UK having less of a tradition of social partners than many countries in the EU.

Additionally, the UK is a strong promoter of the completion of the Single Market and the conclusion of trade agreements. Ten years after the Single Market was launched, there have been tremendous efforts to liberalise the economy and remove obstacles, but some areas remain excluded. The UK government recommended progressing on the liberalisation of sectors that are 'sources of growth'. It identified services (not fully liberalised), energy and digital economy. Unsurprisingly, those are sectors in which the UK would have a head start. It also pushed to remove some regulations, or at least a lightening of the regulatory regime, for SMEs.<sup>56</sup> It is estimated that a full liberalisation of the Single Market, an ideal scenario, would result in a 7% bump in the UK's GDP. It is less than for others, because it is already quite liberal in services and trade with non-EU countries, but it would still represent a substantial achievement.<sup>57</sup>

Trade also ranks high on the list of priorities for the government. David Cameron is taking the opportunity of the UK's G8 presidency this year to stress the importance of trade to boost growth with a particular focus on EU FTAs, including a potential EU-U.S. FTA. According to the European Commission, concluding all FTA negotiations could bolster the EU GDP by 2%.<sup>58</sup>

The British government knows that remedies to the economic crisis will not come solely from national efforts. Economic integration in the EU has deeply involved the UK and it needs to negotiate with its partners if it wants to fulfil its objectives. The UK approaches the situation via the lens of further liberalisation both within the Single Market as well as within trade. In both cases, it knows its comparative advantage. British influence has largely shaped the Single Market adopting the UK-favoured path of increasing liberalisation sometimes at the expense of a greater social dimension. The UK has taken advantage of it: The Single Market represents its first destination for exports and FDI and the UK has managed to become a gateway to Europe for non-EU investors. Were the UK to leave the Single Market, it may strike a blow on this coveted position. Diversification of exports to fast-growing markets will take years to develop. The two are not mutually exclusive, but there seems to be a tendency to focus on one or the other. In addition, the UK is facing increasing pressure to

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<sup>56</sup> Department for Business, Innovation and Skills, *UK Government Response to the European Commission Consultation on the Single Market Act* (London: Department for BIS, February 2011), <<http://bit.ly/Xgs7KD>>.

<sup>57</sup> Vincent Aussilloux et al., *The Economic Consequences for the UK and the EU of Completing the Single Market*, BIS Economics Paper (London: Department for BIS, February 2011), <<http://bit.ly/12xDnG8>>.

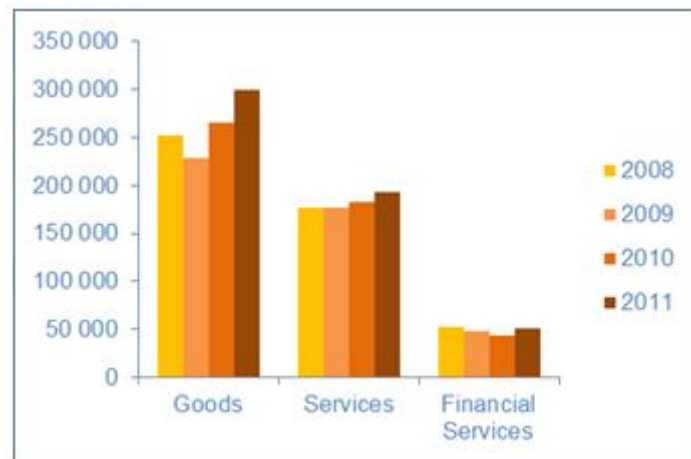
<sup>58</sup> European Commission, 'Concluding Trade Deals Could Boost EU's GDP by 2 Per Cent', 20 July 2012, <<http://bit.ly/VABNI8>>.

maintain its competitiveness in the world and in Europe. It has been capable until now to play on both stages as a global leading service provider, but it needs to tread carefully to keep playing on all fronts.

### ***Financial services: the jewel of the crown***

In December 2011, when David Cameron left the European Council, he argued that the City's interests would have been threatened had he agreed to the terms on the table. The government is anxious to protect a clear asset. No other member state possesses such a strong financial sector, which accounts for 9% of the UK's GDP. As shown in Figure 5, from 2008 to 2011, financial services amounted to 26% of exports in services and 10% of total exports. Its regulatory framework displays differences to what many countries in Europe do, but regulation has become, perhaps reluctantly, the most obvious approach. In some cases, European regulation proposals are already on the agenda in the UK, such as the separation between retail and investment branches in the banking sector, which the EU has only recently discussed in the Liikanen Group on Banking Reform.

**Figure 5 Total export of goods, services, and trades, in billion pounds, from 2008 to 2011 (Source: Pink Book 2012)**



The financial crisis has altered the environment both in Britain and in Europe. In the UK, the government's "light touch" approach hit the wall. It had to bail out Lloyds, the Royal Bank of Scotland and Northern Rock. Those interventions had a traumatic effect on the Treasury Department and all actions taken to prevent similar scenarios have been animated by a "never again" attitude. Moreover, the City's image plummeted in the public opinion when the LIBOR scandal broke out in 2012. Those episodes have impacted how politicians and

professionals alike see regulation in the UK.<sup>59</sup> Two issues dominated the attention in the banking sector. One focused on ‘ring fencing’ retail from investment branches to make sure that commercial activities are immune from the more volatile financial ones. Some even argued that the regulator should have the power to declare a structural separation between the two branches if the ring-fenced activities are considered threatened. The other issue was to increase the capital requirement even beyond what the EU Capital Requirement Directive IV provides for.<sup>60</sup> Most of those concerns have been echoed in the Financial Services (Banking Reform) Bill introduced in early February 2013.

This Bill will complement the Financial Services Act. Its objective is far-reaching: Grant a macro-prudential power to the Bank of England to monitor the UK’s entire economic policy. Previously, no entity had the responsibility to monitor the overall economic system. The Act also toughens and expands the scope of criminal offences against wrongful practices in financial services.

The financial crisis as well as the LIBOR scandal heightened the scrutiny the UK has been putting over banks and financial firms. Old habits die hard, some would say, and all the adjustment made may be loosened once the dust settles. At this stage, this is mere speculation. However, it is interesting to note how regulation comes off in the UK.<sup>61</sup> In many European countries, regulatory authorities try to set the rules for how the market should operate. In the UK, the regulation focuses on how actors – both firms and individuals – should operate. Moreover, the mentality differs: In the UK, everything is allowed unless forbidden. In Europe, you only do what is permitted. The financial crisis may have mitigated some perennial disagreements which divided the UK and other member states, mainly France and Germany, on regulation. Yet, the crux of the issue is now about regulating the market, not just its actors.

On regulation, EU member states find themselves in two camps. “Market shaping” countries, such as France and Germany, promote prescriptive rule-based regulation with a strong steering action from public authorities. “Market making” countries, such as the UK, prefer a light touch, principle-based regulation, and private sector governance.<sup>62</sup> The latter had managed to keep the EU little involved in legislation over financial services. Yet, the crisis steered the momentum in favour of more action in that realm and the UK even agreed to some greater EU supervisory power. The EU set up a new

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<sup>59</sup> Philip Whyte, Britain, Europe and the City of London: Can the Triangle Be Managed?, CER Essays (London: CER, July 2012), <<http://bit.ly/11b5aLB>>.

<sup>60</sup> See for instance Independent Commission on Banking, *Final report: Recommendations* (London: Independent Commission on Banking, 2011), <<http://bit.ly/13Nrh80>>; Parliamentary Commission on Banking Standards, *First Report*, HL 98, HC 848, 21 December 2012, <<http://bit.ly/14Po4ah>>.

<sup>61</sup> I am indebted to two interviewees for highlighting that point.

<sup>62</sup> Lucia Quaglia, ‘The “Old” and “New” Politics of Financial Services Regulation in the European Union’, *New Political Economy* 17, no. 4 (2012): 520.



financial supervision architecture in 2010. In this system for instance, the European Banking Authority (EBA) is in charge of drafting the Single Rulebook, which will establish a single set of harmonised prudential rules for banks throughout the EU.

The UK may have become more accommodating in terms of regulation at the European level as long as it does not see its room to manoeuvre is too impinged. It is clear in negotiations over the Banking Union. The UK wanted to ensure that this new initiative, especially the Single Supervisory Mechanism (SSM) devolved to the ECB, would not cover its banks – its perimeter will be limited to the Eurozone. It also sought to avoid the creation of a Eurozone caucus within the EBA that could coalesce against non-Eurozone members.<sup>63</sup> Decisions on technical standards, such as those inscribed in the Single Rulebook, for instance are binding. The EBA's voting system applies either qualified majority vote (QMV) or simple majority vote, which means that the UK does not hold a veto. In December 2012, the Council adjusted the EBA's voting procedure requiring a "double majority" (of those participating to the SSM and those who do not) for most decisions. This mechanism gives greater power to the UK than in any other. The majority of non-Eurozone member states is bound to join the single currency – hence the Banking Union – at some point; the UK is not. But member states provided a renegotiation of those procedures once all but four countries will have joined the SSM.

There has been a rebalancing between "market shaping" and "market making" countries in the EU, but it is debatable how much influence the UK has lost. The EU's regulatory agenda largely overlays the UK's – it is not surprising considering the importance of the banking and financial services sector in the British economy and the clear need to reform it. It infers that the EU's agenda has so far focused on the actors rather than the system, but that trend is unlikely to change because of contrasted views across Europe.

Maintaining an influence over the evolution of the EU regulatory agenda will be essential for the UK government. The City remains a leading global financial centre, but it faces increasing competition. The UK will likely see its share of activities diminish in the long term, because of the rise of centres in emerging markets, such as Singapore as well as the increased interconnectedness between emerging markets, cutting Western financial markets out of the loop. This trend has yet to prove sustainable because most centres are a long way to rival what that the UK offers.<sup>64</sup> To overcome this phenomenon and tap into Chinese growth, George Osborne has for instance been working to make the City the main offshore trading centre for renminbi.<sup>65</sup> Yet,

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<sup>63</sup> See for instance House of Lords, *European Banking Union: Key Issues and Challenges*, HL Paper 88, 12 December 2012, <<http://bit.ly/WgX4wB>>.

<sup>64</sup> PwC, *Project Blue: Capitalising on the Rise and Interconnectivity of the Emerging Markets* (London: PwC, 2012), <<http://pwc.to/12aadgc>>.

<sup>65</sup> George Parker, 'Renminbi Deal Aims to Boost City Trade', *Financial Times*, 16 January 2012, <<http://on.ft.com/13ciGv7>>.

some indicators suggest that the City is not immune. Moreover, CityUK analysed the location decisions of 147 financial services firms between 2006 and 2012: 83 of them decided not to go to the UK; 37 opted for the UK; and 27 put their decision on hold.<sup>66</sup> Negative decisions happened when the firms were seeking macroeconomic growth and access to new customers. Moreover, those deciding against the UK or having put their decision on hold pointed to perceived added cost of regulation.<sup>67</sup> One of the key reasons for firms to be in the UK is the access to the Single Market. It appeals to new firms who want to set foot in Europe and to those who want to use the UK as a hub for regional operations.

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On the one hand, being part of the Single Market remains an essential asset for the UK to attract foreign firms. On the other, the EU's economies are sluggish and the UK's regulatory architecture seems to curtail Britain's appeal. The UK is battling on two fronts and may exaggerate its safety net. It is trying to maintain its lead in services on the global scale in the face of increasingly strong competition. It seeks to alleviate concerns over regulation, strengthen its core assets, and retain its seat within the global networks. In the long run, it may not be enough; the City's relative appeal is likely to decrease, because other non-European financial centres will grow. This challenge will also prove difficult for the diversification of its export base. Tapping into emerging markets is attractive, but the UK will be facing tough competition from many countries, including European neighbours. Those countries are growing rapidly, but many variables (decrease of domestic consumption, decrease of imports in favour of national firms, political stability, increasing global competition in services etc.) could affect how the UK performs.

Simultaneously, it needs to keep its access to the Single Market. This foot in Europe will remain essential for EU and non-EU investors. When the UK did not join the Euro, some speculated that it would impact the City's business. It did not. Today, the situation is different. Leaving the EU would kick the UK out of the Single Market, a far more consequential decision. Being outside the EU, but within Single Market as a silent partner obliged to implement EU regulation hardly seems a realistic option for the UK. Despite slower economic growth, Europe is likely to remain appealing for foreign investors, especially if the movement toward greater economic integration strengthens the Eurozone. The UK is well inspired to stir other member states that have been slow to comprehend the global tectonic shifts. The Single Market may indeed need to adapt to a world whose rules are not set only by Western powers. It is far cry to envisage other cities in the Eurozone take over the City, but it might be imprudent to wish to

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<sup>66</sup> CityUK, *Driving Competitiveness: Securing the UK's Position as the Location of Choice for Financial and Related Professional Services* (London: CityUK, November 2012), 19.

<sup>67</sup> *Ibid.*, 21–22.

distance from the Eurozone core. It would be wrong to put the Single Market against the rest of the world; Germany's example proves that it is possible to succeed in both. But the UK is not Germany. Part of its success on all fronts is that it does not see Europe as its "natural backyard"; it is in the midst of it.

It is a source of concern that the Single Market does not represent a sufficient argument to convince the business community across the board of the value of membership. It is debatable whether talks of renegotiation and repatriation have initiated that shift, but they certainly have nurtured it. The more Europe is bogged down in economic torpor, the more UK businesses may feel EU regulation as a hurdle to exploit opportunities where they are, that is not in Europe.

# Scenarios

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Our study leads to the conclusion that a British exit is a plausible option, but not a desired outcome. Reactions to David Cameron's speech in January were clear. No member state has endorsed a potential "Brexit". And there are genuine reasons to keep the UK in. Although a difficult partner, Britain is an active contributor to debates on foreign affairs, environmental and development policy for instance. Moreover, the UK brings to the table its international proclivity. While many European countries seldom look beyond Europe, the UK pushes its partners to look outside their comfort zones, a key attitude in a world undergoing a change in the balance of power. Lastly – and probably more difficult to publicise – some member states do appreciate the UK playing the black sheep, something they cannot afford to.

Yet most member states are denying Britain room to negotiate, which could lead the UK to exit the EU. It is possible that David Cameron's vision will attract supporters if EU member states cannot move forward together to get out of the crisis. More and more people may turn their back on the European project as an 'ever closer Union', and could endorse a flexible EU. Some countries, such as the Netherlands, have already displayed interest for the balance of competencies and a potential "referendum lock". Yet as long as Germany remains the leading EU member, the integration path is likely to carry on. We contemplate three scenarios: Britain as a full member, Britain as an associate member, and Britain as no longer a member.

Our predictions are based on a set of assumptions. First, the Tories and the Labour Party will commit to holding a referendum in the next Parliament. It is becoming increasingly likely. Second, there will likely be some form of treaty change in the next five to ten years. It is not an option favoured by member states today and they would prefer to avoid a new IGC, but the likelihood will increase as the Eurozone integrates further. Third, it seems very plausible that EU growth will remain limited in the next five years.

Two variables can alter those scenarios. The UK government could decide not to live up to its promise to hold a referendum for fear of a negative outcome. It would imply a repeal of the EU Act or the government would hope that there would be no new treaty. The second variable is a fundamental shift in the EU. The vision that David Cameron provided could serve as basis for a new kind of Union. Schematically, there could be a highly integrated core group and an orbit of permanently less integrated members. It appears unlikely today, but we cannot rule out that integration and its consequences

may become difficult to accept or to defend for some national politicians before their electorate, especially if the disconnect between the European project and citizens widens.

## ***Britain as a full member***

### **If a referendum is called with or without significant renegotiations**

In 2015, the Tory Party wins the general election with a mandate to renegotiate the terms of membership to the EU. David Cameron would have put on the agenda of the European Council his terms of negotiations. They include repatriating all social and employment policies and ensuring a legal safeguard to protect the Single Market. Both require the unanimous agreement of all other 27 countries (Croatia will have joined by then). An IGC would have been launched. After tough negotiations especially with the French and the Germans, he would manage to get some of his demands, such as a full opt-out of social and employment policy, in exchange for a ratification of the treaty. Member states would deem it in the EU's and their own interests to make concessions to keep Britain in. His government would organise an in/out referendum before the end of his mandate with the renewed terms of membership and a ratification of the new treaty. Despite fierce debates with his eurosceptic backbenchers, David Cameron would win the referendum and the UK would technically remain a full member.

If the Labour Party wins the elections, some aspects could change. They may not want to renegotiate the same policies, such as the social and employment policies. However, it is likely that a referendum without any room for the UK to review those policies could be harder to win, so Labour could be tempted to seek at least some minor changes or some flexibility to implement those policies. An in/out referendum would have been accepted as a smart political way to cast a shadow over the Tories' tactic, although Labour would promise it only if they manage to get some reforms through, such as more powers for national parliaments and more flexibility in European policies. Their approach would differ from the Tories in the sense that they would try to gain support from other countries so that the UK would not be alone trying to repatriate powers, seeking some kind of "collective cherry-picking". By then, some other member states may have elected governments unconvinced by the virtues of the "ever closer Union". The Tories may also want to find allies, especially after David Cameron gave his vision for Europe, which he was careful to frame as universal as possible. It has been the case before that other member states waited for the UK to play the black sheep to follow suit. The difference between the two parties is that the Tories would not feel at odds if the UK would remain in a "club of one", being the only member state eventually outside the Eurozone for instance. This situation would feel awkward to Labour.

This scenario implies that member states would accede to British demands, especially in terms of social and employment policy – at this stage, it is highly unlikely. Many countries would see it as social dumping, which in times of economic hardship would be unacceptable to them. Second, it could open a Pandora's Box with countries requiring their own demands to be accepted in exchange. We could end up with specific sectors protected from the Single Market in some countries. Such a situation would be resisted if an IGC is not launched or if no new protocol can be added to the accession treaty of a new member. Even if member states decide to re-open the treaties, it is not even certain that they would let Britain adjust its participation to the EU.

We cannot rule out that an in/out referendum takes place without much or any renegotiation. It seems a risky gamble for all parties, since the possibility for a majority vote to leave the EU increases. The British economy would play a role. The more fragile it is, the more the Single Market as a safe base for business would hold some sway despite its imperfections. It would also depend on European economies. The more sluggish they remain, the less appealing it would seem to British voters to stay in the EU. That also takes into account the importance of the marginalisation factor. The UK may feel more confident outside the EU if it is strong and if the EU is still flagging.

### **If no referendum is called**

Labour may decide not to commit to a referendum and still win the 2015 general election. After all, the European issue may not turn out to be as salient as some expect. Another option is that neither the Tories nor Labour manage to get an absolute majority in the next election and either one decides to coalesce with the Liberal Democrats. So far, Nick Clegg has opposed the referendum, but it is difficult to anticipate how much a red line it would be. If Labour win, then it is likely that they could agree not to hold a referendum for the sake of the coalition even if they had committed to holding one. If the Tories win, it may be more difficult for the Liberal Democrats to eschew a referendum, but they would want to have their say on which powers to repatriate. With a Tory government, it is possible that the referendum could be called off. That could occur if they have committed to an in/out referendum with significant reforms but have failed to secure them. Instead of running the risk to call an absolute in/out referendum after failed negotiations, they would rather postpone until they can offer meaningful something to British voters.

If the government does not call a referendum on its own, it would need to hope that no IGC is convened, because a new treaty would require a referendum.

## ***Britain as an associate member***

### **If an in/out referendum is called**

The next government could decide to seek a new kind of membership, “an associate membership.” There have already been several arguments to provide the UK such a status, but it does not exist and would require a treaty change. In essence, it would involve a shift in philosophy. The EU has not been built to differentiate between members. Differentiation does take place, by default – a country not participating to some policies –, not by design – the euro was not launched to exclude some countries.

Eurozone countries and member states bound to join the single currency would consider that it would be a tremendous loss to see the UK withdraw from the EU. The EU would need to define what an associate membership is, and what it entails in terms of obligations and concessions. The template could be modular, but its shape would require the unanimity of member states. Should the UK want this new status, it is likely that it would not partake in some decisions which could affect its own policies, perhaps on the Single Market. For that scenario to work out, the UK and the other member states would need to negotiate a package that is not appealing yet not appalling to all parties. Some have imagined that an associate membership could include participation in the Single Market as a basis and then offer a choice to contribute to other fields. But the UK’s major quarrel with the EU is the social dimension of the Single Market, especially among Tories and the business community. As in the previous scenario, it is unlikely that the EU would offer the UK the chance to stay out of all social and employment policies while remaining a member of the Single Market. An associate membership based on the Single Market seems a false good idea.

Another option could be an associate membership without participation in the Single Market. The UK would consider that it could manage to negotiate a trade deal with the EU that would allow both sides to import, export, and invest without major barriers. It would also imply that the UK would not benefit from the network of EU trade deals any longer. Meanwhile, Britain could remain involved in other policies, such as environmental, development, and foreign policy.

An associate membership excluding participating to the Single Market could represent a viable option. The UK and the EU could negotiate a trade deal afterwards. However, the impact on the UK economy would be significant since it would lose its status as gateway to Europe. This would still require a treaty change – on top of a deep philosophical shift – which is not evident as expressed in the previous scenario, but could be more acceptable.

The UK government would call an in/out referendum with the choice to stay as an associate member or to leave altogether. It would be dangerous for the British economy that the government offers this alternative without having set the ground for the kind of

trade negotiations the UK would have with the EU if the associate membership excludes the Single Market. But if it has been anticipated, then such a referendum would likely result in a landslide vote to stay.

### **If an in/in referendum is called**

The other possibility for the government could be an in/in referendum with the choice to stay as a full member – without any renegotiations – or as an associate member. It is doubtful that other member states would give the UK the flexibility between a revised membership and an associate membership. This scenario seems unlikely with a Conservative government but could appeal to Labour or to a coalition government. Once again, if the associate membership excludes the Single Market, it would be crucial to have paved the way for a trade deal. This option offers benefits in the sense that it automatically excludes a “Brexit”, but many actors may reject it. A way to appease the tensions could be to set a minimum participation rate for the referendum to be valid – this could enhance its legitimacy.

## ***Britain outside the EU***

In 2015, the UK government is elected with the mandate to hold an in/out referendum on the EU membership. If it does not manage to revise some significant terms to the membership, a negative outcome is more likely. The European economic landscape would be slightly revitalised but the benefit of the Single Market would have diminished in the eyes of British businesses.

The government would offer to renegotiate some terms that require treaty change in addition to some more cosmetic adjustments. Despite some pressures from UK allies, such as Sweden and the Netherlands, the European Council would oppose to reopen the treaties lest other member states put in their own demands. In this case, even if British demands would intervene during an IGC, member states could refuse that the UK dictates its own terms and call London’s bluff: Accept the new treaty or leave. The government would inevitably call for a referendum under to the EU Act. The question would likely be expanded to an in/out referendum, and not simply a consultation on the treaty, especially if the Tories are in government. British voters would likely vote to withdraw in spite of strong campaigning by an overwhelmingly “euro-realist” political elite to stay in. Then, under Article 50 of the Treaty of the EU, the UK would initiate the process at the European Council and all other member states would decide by QMV the new relationship between the EU and the UK.<sup>68</sup>

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<sup>68</sup> *Consolidated Version of the Treaty on European Union*, vol. 53, 2010, sec. 2010/C 83/01, <<http://bit.ly/127tkbM>>.



The chances of other member states turning down Britain's demands are very real especially if they consider that it threatens the very foundations of the European project. Member states would defend their own interests and recognise that it would become unsustainable to have all member states largely on the same path and another – a very prominent one – remaining on the side-lines. The rest of the EU would integrate more and more creating a wider and unbridgeable gap between them and Britain. This scenario is the least desirable, but the track has already been built.

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By and large, the UK is closer to the exit than is often realised. A simple in/out referendum could very much end up with a majority to withdraw. Despite a strong case against it, the British people would not accept to partake in a project they feel is more and more pushed upon them. It would be especially salient if the Single Market is not a good enough argument anymore to maintain the UK engaged. It appears unlikely that member states would accede to British demands, whether there is an IGC or not.

An option could be an associate membership. Then, there are two broad options: either to include the Single Market or not. An associate membership that includes participation to the internal market is plausible only if the UK is a full member to both its economic and social dimensions. From a European perspective, this may represent the least unfavourable option. From the UK perspective, some would certainly complain, but it may be the price of staying in the EU. It begs the question of the impact of further integration in the longer term on the UK membership. As seen with the SSM, the UK has been adamant about protecting its interests. If we consider that the vast majority of countries will join the Euro at some stage and consequently all the instruments that have been created to sustain the single currency, we would need to find a mechanism that allows the UK to participate but not to obstruct the way forward.

If it does not include participation to the internal market, which implies relinquishing all EU trade deals, an associate membership would represent a tremendous loss for the UK even if it can negotiate a robust trade deal with the EU afterwards. However, it would mean that it could maintain close ties to the EU. It would also allow the UK to set its own regulatory framework – in the end a lot is likely to resemble how it is done in the EU. From a European perspective, this kind of status would appear unattractive enough – it would be an enormous gamble for smaller economies to venture into such uncertain waters – however, this solution could be an affordable lose-lose option if it is not possible to bring the UK closer to the continent.

# Appendix

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## ***Appendix 1: Comparison between the positions of Labour and the Tories on Europe***

The two parties agree that the EU needs reform, but they disagree on how to go about it. We will strive to demonstrate that both parties share many positions regarding the needed reforms to the point that it may appear debatable whether Labour have fully appreciated the extent of their proposals. However, talks of renegotiation and repatriation are not common among Labour's leaders. Two caveats are important to note. First, Conservative Cabinet members are limited in their capacity to lay out a definitive list of reforms due to the coalition factor. Relatedly, Labour have not devised a fully-fledged plan either, which is understandable two years before a general election. We will rely on five speeches to consider the positions the two parties hold on Europe.<sup>69</sup> They are generally considered as blueprints for policies vis-à-vis Europe.

As shown in Table 1, Tories and Labour share common ground on what EU reforms should look like. For instance, they support the completion of the Single Market, in existing domains like energy, and in newer ones, such as digital economy. They both realise that any new mechanism designed for the Eurozone, most recently the Banking Union, should not impinge on the prerogatives of those outside of it.

They agree that the EU should work to boost economies, but they differ in their approach. The Conservatives promote more competitiveness and the signing of free trade agreements (FTAs). The Labour Party is more hesitant to encourage this path. Competitiveness and FTAs can lead to less regard for social and working conditions, hence Labour's opposition to opt-out of the Social Chapter, which includes the Working Time Directive for instance. Labour stress the

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<sup>69</sup> 'Britain and Europe - Speech at the Bloomberg Office'; Douglas Alexander, 'Britain's Future in Europe' (presented at the Chatham House, London, 17 January 2013), <<http://bit.ly/UZF8UY>>; Ed Miliband, 'One Nation in Europe' (Speech at the Confederation of British Industry, London, 19 November 2012), <<http://bit.ly/UFJOAz>>; William Hague, 'Europe at a Crossroads: What Kind of Europe Do We Want?' (Speech at the Körber Foundation, Berlin, 23 October 2012), <<http://bit.ly/12a9Mma>>; Cameron, 'A Europe Policy That People Can Believe In'.

\* We use the term 'Social Chapter', but it has institutionally changed. Now social and employment affairs are incorporated with the treaties. It means that a unilateral opt-out is not possible.

need to back growth measures, such as to reform of the EU Structural funds to guarantee they benefit growth-oriented programs, and to create a mechanism to assess the growth potential of every new piece of EU legislation. Some of those measures will find positive echo among Tories.

On some aspects, they clearly disagree. Labour think that the opt-out on justice and home affairs measures is dubious, especially if the objective is to opt-back in sometime afterwards. Rather, the core of the debate surprisingly revolves around institutional frameworks. Both parties favour more flexibility within the EU. David Cameron openly supports treaty change, because he knows that there is no other option for the UK to renegotiate its membership terms. Labour have not made up their mind; they seem to have adopted a wait-and-see approach. Yet, they do support institutional reform, for instance for the strengthening of national parliaments in EU law making.

**Table 1 Tories and Labour positions on the EU**

Conservative Party	Labour Party
<b>Economy</b>	
Europe needs to boost its competitiveness	Not expressed in the speeches selected
The Single Market should be completed	The Single Market should be completed
The EU should sign more free trade agreements	Not expressed in the speeches selected
Not expressed in the speeches selected, but Conservatives share this view	There needs to be deep reforms to the EU budget and the EU structural funds
<b>Politics</b>	
The EU should pursue enlargement	The EU should pursue enlargement
EU foreign policy helps strengthen our voice on international issues	EU foreign policy helps strengthen our voice on international issues
Britain should maintain its opt-out on the Justice and Home Affairs measures	Britain should <i>not</i> opt-out of the Justice and Home Affairs measures
Europe lacks democratic accountability, so more national Parliaments should have more powers	Europe lacks democratic accountability, so more national Parliaments should have more powers
Britain should opt out of the Social Chapter*	Britain should <i>not</i> opt out of the Social Chapter*
Britain should opt out from the Charter of Fundamental Rights	Not expressed in the speeches but unlikely to favour an opt-out
<b>Institutional change</b>	
There should be a treaty change and we should negotiate a better deal	No clear position on treaty change, but it is not in Britain's interest to demand 'unilateral repatriation'
Flexibility is required because not all member states are ready to integrate further	Flexibility is required because not all member states are ready to integrate further

There should be mechanisms to take powers back when competencies can be better managed at the national level	Maybe in some areas we will do less together and also in others we will do more together
New arrangements for the Eurozone must work fairly for those outside	New arrangements for the Eurozone must work fairly for those outside
Not expressed in the speeches selected but Conservatives share this view	The EU should be more flexible in transitional arrangements
Not expressed in the speeches selected	There should be a mechanism to assess the impact of every new piece of legislation on its potential to promote growth
EU institutions (Parliament and Commission) should be reformed to enhance their efficiency.	EU institutions (Parliament and Commission) should be reformed to enhance their efficiency.
Not expressed in the speeches selected	There should be a Growth Commissioner

It is doubtful that those changes could occur without re-opening the treaty. Labour’s position appears weaker regarding the issue of the repatriation of powers. They oppose “unilateral repatriation”, but they could foresee that some policies will not be carried out at the EU level any longer. In other words, they do not seem to close the door on some form of repatriation, but were it to happen, they would try to find a collective agreement – a rationale that could lead to backing treaty reform. Moreover, Labour do not rule out transferring more competencies to the EU in some areas, contrary to the Conservatives. It is not part of their policy options and the EU Act is making this option unattractive, begging the question how Labour would deal with this Act if the time comes. This part of uncertainty relates to the issue of referendum. Labourites do not seem all in synch over this issue; they seem to oppose a referendum *now* – which was never really a serious option – but they may agree to one in a few years.

In fact, the extent of their differences is fundamental and goes back to the baseline of each party: Labour are rooted in the trade union movement and the Tories are more comfortable in pro-business attire. They agree on the Single Market being the bedrock of the EU, but they differ on its social dimension. Labour could not envisage dissociating the Single Market and its social dimension – this linkage is precisely what made them rally to the pro-European cause in the first place. Inversely, it seems implausible for the Conservatives to spare social aspects associated to the Single Market – this dimension is what led them to back away from the pro-European front in the 1980s. That fundamental divide that exists on the social dimension of the Single Market has been quiescent so far and it is plausible that Labour will not push this agenda forward as they need to gather the support of the business community.

## Appendix 2: Exports of goods and services to selected countries

**Table 2 Total of exports in goods from 2008 to 2011, in billion pounds**  
(Source: ONS, Pink Book 2012)

Countries of export	2008	2009	2010	2011
EU27	142 055	124 879	142 009	159 024
USA	35 262	33 896	37 985	39 853
China (including Hong Kong)	8 713	9 121	12 086	14 670
India	4 116	2 941	4 074	5 695
Brazil	1 693	1 785	2 219	2 466
South Africa	2 649	2 250	2 894	3 462
Russia	4 266	2 398	3 602	5 008
BRICS	21 437	18 495	24 875	31 301
Rest of the world (excluding EU27)	110 233	103 361	123 798	140 088

**Table 3 Total of exports in services from 2008 to 2011, in billion pounds**  
(Source: ONS, Pink Book 2012)

Countries of export	2008	2009	2010	2011
EU27	70 947	69 315	69 472	74 777
USA	38 036	37 303	39 124	40 035
China (including Hong Kong)	4 814	4 049	4 421	5 267
India	1 818	1 737	2 134	2 637
Brazil	644	755	915	1 229
South Africa	1 692	1 660	1 851	1 950
Russia	2 237	1 897	1 683	2 278
BRICS	11 205	10 098	11 004	13 361
Rest of the world (excluding EU27)	106 466	106 711	112 705	118 882