REGENT'S
UNIVERSITY LONDON

The UK & Europe: Costs, Benefits, Options.

The Regent's Report 2013

The UK & Europe: Costs, Benefits, Options.

The Regent's Report 2013

Published as part of the Institute of Contemporary European Studies at Regent's University London.

ISSN 2040-6059 (paper)
ISSN 2040-6517 (online)

First published in Great Britain in 2013 as part by Regent's University London, Regent's Park, London, NW1 4NS

Printed by Belmont Press
Typeset in Baskerville / Gill Sans
Design by External Relations at Regent's University London

For more information please contact research@regents.ac.uk

Errata: Any corrections of amendments made after publication can be found at regents.ac.uk/europereport/errata

Vice Chancellor's Foreword

I hope that you find this Report informative and illuminating, and that it helps you to contribute to this important debate over the next few years.

Aldwyn Cooper

Internationalism and global development are at the heart of the mission of Regent's University London. To operate effectively in any field in today's world requires an understanding of the complex international relationships that exist between individual countries and the shifting international groupings of economies and political allegiances.

We have always attempted to shine a light on key issues for our students and to stimulate debate in the wider community. The University's annual Jean Monnet and Europe in the World lectures series and our support of both the European Government – Business Relations Council and the Senior European Experts Group, together with the active work of our International Relations researchers, are a few of our activities in this area.

We believe that universities should be involved and contribute to "big ideas". It is probable that a referendum will take place in Britain on continued membership of the European Union. The issue of what sort of Europe we want, the outcome of the referendum and the impact not only on the UK and Europe as a region but on global trade and partnerships is clearly one of the biggest debates with ramifications for every aspect of society from trade to culture, from education to social responsibility.

This report has been commissioned by the University as its contribution to the debate and is relevant to many of our students from different countries studying international relations and business. We have striven to maintain the necessary academic neutrality in assessing the issues and I am extremely grateful to all the experts who have given their time and knowledge freely in the Report's preparation.

It is, we believe, so far the only independent, wide ranging, professional and non-political contribution to the debate produced by a university. Students from a number of countries studying here helped research it, assisting contributors to assemble facts and figures.

Contributors are all well qualified and eminent experts or academics in their own fields. The views expressed are their own.

This is hopefully the first of a series of Regent's Reports that will address global issues. Relations between the European Union and its "near abroad" to the East, including Russia, may be a future topic for just such a Regent's Report. Likewise the relationship between the EU and the United States, or with the BRICS could well be themes for future years.

I hope that you find this Report informative, illuminating and that it helps you to contribute to this important debate over the next few years.

Professor Aldwyn Cooper
Vice Chancellor
Regent's University London

Editors' Preface

In more than twenty short essays this Report provides tested evidence and clear analysis, outlining the costs and benefits of a changed status in the relationship between the UK and the European Union for specific sectors of our economy and society.

John Drew and Martyn Bond

Much of the growing current discussion of the UK's role in the EU is driven by partisan debate, sometimes based on very selective or no real evidence. At the popular level it often relies on simplistic sound bites and distorted statistics. There appears to be little that is both easily accessible and authoritative about the potential cost of a policy decision that could fundamentally change Britain's relations with our European neighbours. It is surely necessary to give a sense of background and perspective to the European debate which, as Lord Jenkins famously complained some years ago, tends in Britain to be obsessive without being illuminating.

Various Parliamentary Committees have tackled aspects of the issue, notably the House of Commons Foreign Affairs Committee with its Report in June 2013 on the *Future of the European Union: UK Government policy.* The report examined the key overarching principles of the Government's policy for the UK's place in the EU, principally with respect to the Eurozone. The report also started to explore some of the implications of the Prime Minister's January 2013 commitment that a Conservative Government, if elected in the 2015 General Election, would hold an 'in/out' referendum on the UK's continued EU membership by the end of 2017.

The UK Government has itself commissioned an extensive - and expensive - review of all EU legislation having a bearing on the UK. The first volume of its survey has recently appeared, coordinated by the Foreign Office, and covering foreign policy, the single market, taxation, human health, the health and welfare of animals and food safety as well as development co-operation and humanitarian aid. A further twenty-six assessments are to be published before the end of 2014. As *European Voice*, the weekly newspaper in Brussels that closely follows EU matters, commented: "The reports, drafted by civil servants, steer clear of any overt political stand-point or conclusion. Such conclusions would have been highly problematic, because the two parties in the coalition government – the Conservatives and the Liberal Democrats – are not united in their attitude to the EU."

In addition, the House of Commons Library has published a comprehensive research paper (13/42 July 2013) entitled *Leaving the EU*, which explores the political context, the legal process of withdrawal, the question of residual vested rights for individuals or businesses, alternatives to membership and the impact of an EU-exit in different policy areas as well as the implications for Scotland, Wales and Northern Ireland. .

None of these governmental or parliamentary initiatives has as yet received the public attention that they merit. The media, especially at the more popular end of the spectrum, appears content to greet any European news with Pavlovian responses rather than the effort of thinking through what may appear to be new evidence, perhaps for fear of upsetting old prejudices.

This state of affairs led Regent's University London, through its Institute of Contemporary European Studies, its business schools including the European Business School and its international programmes, to try to fill the need for an accessible but also far ranging survey of the European question by commissioning this Regents' Report on *The UK and the EU: Costs, Benefits and Options*.

In more than twenty short essays this report provides tested evidence and clear analysis, outlining the costs and/or benefits of a changed status in the relationship between the UK and the European Union for specific sectors of our economy and society. It has been written for the main part by practitioners, many of them distinguished in their fields, with some additional chapters by academics who have a proven track record of publication on their topic. It is an independent report and does not necessarily reflect the views of the University nor of companies and organisations that may be associated with contributors, who have written as individuals, invited by the editors.

The Report aims to inform the current debate on the UK and the EU, a debate likely to run with increasing intensity until the next General Election and possibly up to the promised – or threatened - referendum. As editors we hope the report will provide useful background reading for others writing about this issue in political, academic and administrative circles, in particular in the UK. We also hope that it will serve a wider audience in the general public, growing daily more aware of its existential interest in this issue.

The broad range and expertise of the contributors has allowed the Report to cover many of the major economic and social sectors affected by any prospective change in the UK's relationship with the EU. Most contributions situate the issue in the context of the author's specialism before focusing on the cost and/or benefits to UK interests of reshaping our relationship with Europe. The contributions supply brief but authoritative statistical evidence as well as informed academic and practitioner analysis. They combine the best of skills from both worlds and offer a stylistic approach that we trust brings together both academic expertise and journalistic accessibility. We appreciate that there are other sectors which we have not covered and hope that others will expand on our list as they see fit.

The editors would like to thank Vice Chancellor, Professor Aldwyn Cooper, without whose enthusiasm and support it would not have been possible to produce the report in such a short period of time, Professor Toni Hilton, Dean of the Faculty of Business and Management, and Professor Judith Ackroyd, Dean of the Faculty of Humanities, Arts and Social Sciences, who not only fully supported the initiative but identified students to work with the contributors.

Students were assigned to various topics to help with research, in particular to provide a short factual summary of the most salient facts, figures and trends relating to the sector in question. At the same time the exercise widened the students' own knowledge both of the subject and of the working methods of the contributors. The Editors would like to thank those who showed particular dedication to this task, among them: Mauria Fransishku, My Öhrn, Paul Cherciu, Alexander Kern, Julia Richter, Brianne Erickson, Goran Akmadzic, Gersson Martell, Binh Tien Kasperzyk, Maximilian Sammer, Nurul Amal Munjiyyatul Athirah, Ena Vukovic, Zhanna Kirienko, Gerhard Odendaal and Achraf Berrissoul.

Finally the Editors offer their sincere thanks to the distinguished contributors who gave freely of their time, energy and expertise to produce what we hope will be a useful contribution over the coming years to the continuing debate about the role of the United Kingdom in the European Union.

John Drew
Jean Monnet Professor of European Business and Management, European Business School and Director, Institute of Contemporary European Studies, Regent's University London.

Dr. Martyn Bond
Visiting Professor of European Politics and Policy, Royal Holloway, University of London.

The Regent's Report
The UK and Europe: Costs, Benefits, Options.

Introduction

Lord Simon of Highbury
Former Chairman of BP

I think the UK electorate should be made more aware of, in business terms, the marginal nature of the EU net contribution.

Lord Simon of Highbury

The Regent's Report

My introduction to the Regent's Report for 2013 on *The UK and Europe: Costs, Benefits and Options* includes my strongly held views on the future of this relationship. I speak from long experience of both the world of business and of politics, of both national and international leadership. I believe the issue of the UK's role in Europe is the salient political issue of our time.

The Report addresses two dozen different aspects of that relationship – from the issue of the UK contribution to the EU budget to the role of our universities in furthering research that relies on EU funding; from the issue of Foreign Direct Investment into the UK to coping with the environmental legislative demands that flow from Brussels. It presents a powerful sweep across many of the important sectors that have real interests in optimising the UK's relationship with the EU. For some that may mean pressing for a reform of existing arrangements, asking for either more Brussels or less Brussels. For others it may show that they are content with the status quo, or even that the relationship with Brussels is marginal for them, since they are engaged internationally on a wider scene. But its importance for the Government is self-evident and it is engaged in a major listing of what competences or powers – and they are many - are currently exercised over various sectors of our national life through Brussels.

Strategy or tactics?

I want to start my personal comments with the much discussed question of the British contribution to the EU budget, not because I think it the most important issue. Far from it. I think it needs to be put in its place which is well down the list of issues we need to discuss and debate. It is for me, with both my business and my political background, an issue of tactical not strategic importance. So we should not spend too much time picking apart the rights and wrongs of the UK net budget contribution.

This expenditure - some £5 to £8 billion depending which source you trust - relates to a total UK annual government spend of £700 billion. In other words, a contribution as a membership fee to the EU of less than one per cent of the Government's annual spend of taxpayers' money. The total gross contribution of the UK, which is about £12 billion out of the £120 billion the EU spends each year, roughly ten per cent of the total, is not out of line for the large countries. The French contribute £18 billion gross and the Germans £19 billion, compared to our £12 billion. Overall the EU spends each year only one-sixth of what we spend in the UK with our £700 billion national budget. So although the EU may be a complex, multi-lingual, international bureaucracy, it is certainly not expensive when compared to national budgets.

So to be frank, the debate on the cash cost - the "what a waste" argument, or the "we want our money back" moan - is out of proportion to the political benefits for the UK of EU membership. As a businessman I was taught to focus on priorities to achieve results. Strategy is long-term, tactics short-term. By all means control budgetary costs with our partners as the Government did very successfully in the recent European budget round. It was a good tactical move as we did it with our partners, and it worked well. But the EU budget contribution is hardly in my view a key question for our political leaders when measured against such real national spending demands in the UK as welfare, health, education and defence.

I think the UK electorate should be made more aware of, in business terms, the marginal nature of the EU net contribution. We should spend our energy on arguing about the right things. It is a question of making sure you see the wood and not just the trees. We need to have a serious debate about strategy, not just tactics, so I want to talk about the wider issues when discussing the UK and Europe, not just the costs in monetary terms.

Confidence and leadership

Cooperation with our EU Partners on such indivisible geographic challenges as climate control, defence, cross border criminality, immigration, jobs and inward investment are all subjects where the balance of benefits to the UK from EU membership can be argued positively. All these are dealt with by practitioners and professionals in this volume, cost/benefit analysis measured just in financial terms is shown to be insufficient when weighed in the scales alongside social perceptions and felt concerns, - the real politics of the case. So what I really want to emphasise in this introduction is the confidence, leadership and cultural contribution which the UK should be bringing to the EU.

Let me start unashamedly with an account which tells of my own experiences in European politics many years ago, looking back from my present standpoint. My memory is now in all probability longer than my future, so I can dispassionately reflect on the coming strategic options for the UK as a positive player in the European community of nations.

Seventeen years ago I slipped out of BP, having served for seven years successively as Chief Operating Officer, Chief Executive and Chairman, and into Government, becoming Minister of State for Trade and Competition for Europe in two departments. I had offices in both the DTI and the Treasury. I was attracted into Tony Blair's new Government in 1997 because he promised to put Britain at the heart of Europe "again." I have added the inverted commas around "again" because I ask myself now, "Were we ever there?"

Successive post-war governments in Britain had blown hot and cold on Europe – Heath, Wilson, Callaghan, Thatcher, Major – but much of my business life was spent winning business and building BP's organisation in Europe with 30,000 people and - in a good year - $300 million of annual profit. So, quite apart from being a child of the "peace dividend generation" – urged by its parents never to let it happen again after two world wars in Europe – I had actually seen and worked in Europe for 30 years and knew the business reality as well as the political challenge of maintaining prosperity and peace across the continent.

As Europe emerged from post-war recovery, the European Community or Common Market - as it was then - was developing an improved economic model. Why? Because the post-war patchwork European economy of separate states with exchange rate competition, border controls, capital controls and very little free movement of goods and people was recognised as a recipe for decline in a globalising world. The 60s and 70s made this conclusion inevitable. It was crystal clear by the 80s. Hence Big Bang in London and a closer step march economically with our European neighbours. That was the Single European Act to boost the Single Market, a move blessed by Thatcher. To compete adequately with the USA in world markets we had to integrate our economies in Europe. By the 90s it was clear that the BRICS would join the globalisation competitive jamboree in the next decade, and the pressure would be even greater for closer economic union in Europe.

I tell this story to stress the repetitive nature of both the economic challenges from global markets to the European venture and to point out how UK reactions have also for this reason had to be repeatedly rethought with governments and parties blowing alternately hot and cold. So in 1997 I joined the political professionals to try to urge and organise closer cooperation in economic and political policy with our EU partners. The DTI and the Treasury were my so called supportive weapons – the latter better described, I think, as a boomerang.

Internationally competitive?

In the period 1997 to 1999 the UK Government fought for a more liberal market structure in the EU. It helped with the launch of the Euro project at the Cardiff summit (during the UK Presidency) and the Treasury and DTI spearheaded much of the early donkey work on the 2000 Lisbon Agreement. This agreement (not to be confused with the Lisbon Treaty) was the first EU-wide plan for supply side reform, covering labour laws, social welfare structures (including pensions), education, and digitisation of the economy. All featured in a wider effort to encourage Europe to liberalise markets further, to grow faster and compete better with the USA. It was a new initiative to supplement what was a pretty repetitive process of budgetary consolidation, then known as the Maastricht Treaty – now called Austerity – new name, same problem. European Governments and Central Bankers have always had such an alternative up their sleeves, they (still do, and perhaps always will) to repair over-borrowing by the public or the private sector - or both - during cyclical surges.

You might read this now and ask, "Was that 1997 to 2000? It seems just like 2010 to 2013!" How right you are. Another Central Bank consolidation for another bubble bursting. Another cry for supply side reform in Europe and, oh yes, another UK devaluation justified politically to "help out our exports, rebalance our deficit economy and save us from losing valuable market share both in the EU (50% nearly of our trade worth - £150 billion a year) and in the BRICS and elsewhere". Unfortunately this is the third time in 20 years that a large sterling devaluation has been needed to help British exports remain competitive. Same problem, same solution that does not work?

So focusing on the key question of future options in Europe for the UK, why is our economic strategy so vulnerable to regular devaluation? If you look at the figures, you see we simply slip a little further each time down the global league. I read recently in the Financial Times that as regards average disposable income we have slipped from fifth to twelfth over the last seven years. By most international comparisons we are just getting poorer. I ask myself, "Why risk inflation and punish savers with higher inflation?" What is Britain's economic strategy for growth? What are the real options for GB to encourage business performance to deliver consistently competitive performance in overseas markets? It certainly can't be devaluation, however much solace that may bring from time to time to weak companies. The so called "blessing" of being outside the Euro is, I fear, a tender trap precisely because it does allow devaluation as the way out of economic difficulties. We still need a competitive cost base and products and services that foreign markets want to buy, without the cheap solution of devaluing the currency.

Politics trumps economics?

If that is the economic issue, what is our political strategy? Is it merely to trumpet our strong national conviction of the importance of our own specific model of Westminster democracy and parliamentary sovereignty? Our neighbours sometimes find it difficult to accommodate British particularism at a time when EU economic performance requires more coherence and more political coordination. We claim repatriation of powers and protection of our own model. But to compete in the free market of today's economic environment, you have to have allies, create larger markets with more level playing fields like the EU – to compete against nations like the USA, China, Brazil and India. Pressures will continue to force all Europeans to become more competitive in global markets. We can no longer do this as one country alone.

In the UK we need all the help we can get to create more employment and competitive companies in foreign markets. Access to new markets is a global struggle, often a bare knuckle fight. As multilateral institutions like the WTO weaken, it becomes even more critical for a medium/small country like the UK to be aligned with the EU. That is why our Prime Minister went recently to the USA to discuss the prospects for an EU-USA trade deal, not just a deal between the UK and the USA. We cannot go it alone in a globalised world, without having employment generators and companies creating goods and services competitive with the best in the world and the EU. Germany is currently the benchmark, so the sooner we are competitive with Germany the better.

Instead of pointing the finger at the weakness of Southern European economies inside the Eurozone, perhaps we should take a little more of the medicine as a preventative ourselves before we need a more drastic cure. The package of growth and austerity – fiscal consolidation of the budgetary side and economic stimulus through supply side reforms – which is good for southern Europe would help the UK too. Our economic options are clear, as they have been since the Lisbon agreement some thirteen years ago, but is our political commitment? Can we compromise enough on our politically specific structure and our financial model – which is so heavily based on the City of London - to help create a more dynamic and effective EU market?

If we really committed ourselves to the EU and further supply side reform, I can assure you that we could take our place as a shaper, not a follower, in the European Club. But I am not convinced that we are on this negotiating course. Not because of what the Prime Minister is saying, because he has said some very simple and clear things, spelling out as few home truths. But Europe has slipped in public perception measured by opinion polls and in the media from positive to negative in the last 10 years. This is in part because the EU has not reformed its financial model as it should have done, and as it will have to do. It is also in part because we have run away from the challenge ourselves, increasingly wrapping ourselves in a cloak of cultural insularity, led – or rather misled - by some of our political classes and our media. "The Euro project is bust", we are told regularly; but the Euro is still here, stronger now against the pound than when it began. "The EU project is a bridge too far; it undermines our democracy and costs too much for what we get from it", the siren voices sing. But more and more states want to join it, and our international influence diminishes the more we question our membership.

Active reform of the EU

We should negotiate more sensible level playing fields in different sectors for all the members of the EU club. That is a very sound economic objective. Negotiating economic exemptions and opt outs for the UK alone – which appears to be a key political objective and a major strand of our economic strategy – is a big mistake. Other Member States will not allow it. Why should they give us such a competitive advantage if we are giving them nothing in return? This is a negative approach and our political exceptions have given the impression that we want economic benefits by exception with less political alignment, and that puzzles and annoys our partners. It alienates the very allies on the continent who would help us negotiate more liberal market structures and supply side reform. We should make sure these nations are on our side when we are negotiating with others who are more difficult on these bigger issues.

The UK should be a more active member of the EU. Of course, the wider benefits outweigh the monetary costs. You only have to think of the environment, defence, cross-border criminality, cultural stimulation, immigration of an educated workforce, the boost to our key universities through research. With a fully committed UK, all these benefits can be enhanced. But political semi-detachment does not help. It is our political culture which holds us back. We will not advance our case by insisting on renegotiating every perceived imbalance - as a largely euro-sceptic press would like. After all, the European Parliament that we elected and our own government in the Council of Ministers agreed these directives. Brussels does not dictate to us; we decide with all the other states together.

The optimistic businessman in me says the UK can, with some effort, reach most European economic benchmarks. It can contribute to a civilised social democracy and create a long-term economic model in Europe that will be competitive worldwide. That is the cultural and leadership option we should choose, leaving the argument over the net £5 billion or so spend in Europe where it belongs, in the tactical column. Alongside the challenging political options open to us as a leading team player in the greater European political structure it is hardly relevant. The fantasy that we can go it alone in economic terms is, I fear, just that. Are we brave enough to stop our slide downhill, to change from passive recipients to active shapers of Europe?

May I recommend you to read the following chapters of the Regent's Report which from many different and professional and expert angles attempt to contribute to what I believe is the salient issue of our time.

Population Change and Migration in Europe and the UK

Professor Ibrahim Sirkeci
Director of the Centre for Transnational Studies, Regent's University London

A key characteristic of human mobility today is that it is transnational and therefore requires transnational treatment in an ever-more connected and globalised context.

Ibrahim Sirkeci

The key issues

Migration is difficult to analyse: the process is complex, the data poor, and the theory unsatisfactory. In addition, it suffers from unpredictable policy changes. But what is clear is that the UK and the other member states of the European Union currently face significant population fluctuations characterised by an ageing population and an increase in migration.

Births and deaths are well-recorded in the industrialised countries and demographic techniques enable reasonably accurate projections. However, migration registers – the number and characteristics of people entering and leaving an area - are not equally good and reliable in all countries.

A key characteristic of human mobility today is that it is transnational and therefore requires transnational treatment in an ever-more connected and globalised context. Europe, economically rich and politically stable, is likely to exert increasing attraction as a destination for migrants in the foreseeable future. The European Union, despite the political and financial troubles of recent years, is a more appropriate body to deal with managing international migration than the individual member states.

Migration is an important factor in a wider complex of issues, characterised by demographic transition on the one hand, and social, political, and economic drivers of human mobility on the other. Debates about migration are – regrettably - often coloured by xenophobic assumptions, and equally often underestimate the issue of population ageing. The European debate also suffers from myopia by focussing too narrowly on the last decade or so.

Population change: ageing and fertility decline

The three components of population change are births, deaths, and migrations, all of which are affected by the socio-economic, political, and cultural environment. Changes in any of these can substantially affect population composition over time.

Recent academic research suggests that economic development and demographic changes empower individuals, weaken family ties, and lead to declining fertility as measured in reproduction rates. Demographic patterns around the world are more or less in line with the demographic transition theory which suggests a development of all societies from a state of high fertility and early mortality, through high fertility and later mortality, to low fertility and late mortality.

Lags between world regions create surplus populations in certain areas (e.g. Asia) while causing demographic deficit in others (e.g. Europe). These surpluses and deficits trigger migration flows, which are encouraged by other environmental and cultural factors as well.

Population projections for the 27 European Union member states show that total population will rise to 520.7 million by 2035 and then will gradually decline to 505.7 million by 2060. However, by that date the median age will have risen from 40.4 years to 47.9 years, and the share of people aged 65 years or over in the total population will have increased from 17.1% to 30.0%. This means over 150 million people over retirement age, and an age dependency ratio (retired to working age) of 53.5% in 2060 as opposed to 25.4 % today. Within this European framework, the UK is expected to see its age dependency ratio rise to just 42%, a less dramatic figure achieved by population growth from around 63 million now to approximately 76 million in 2060.

In the last century dramatic demographic changes occurred across Europe. Not only did people become more mobile, but they also lived longer, got married at a later age, separated and divorced more often. They were likely to have fewer children and, if they did have children, they did so at a later age.

The implications for policy makers are many and various. To take one example, more single parents and more single households means bigger demand for smaller dwellings, such as one bedroom apartments. With a shortage of such accommodation, their price is relatively high, and many more adults are now living longer with their parents in the parental home.

Another example results from the growing elderly population, which brings significant economic costs for pensions and health care. Take the number of patients who fall and break bones. According to the National Joint Registry, the number of hip and knee replacement procedures in England rose from 142,245 in 2007/08 to 172,395 in 2011/12, a 21% increase in just 5 years.

Many governments have responded to the challenge of an ageing population by the simple policy recommendation of increasing the retirement age. However, studies suggest that the advantages initially claimed for this policy are undercut by the decline in efficiency of workers over a certain age, as well as by their declining health. Significant productivity reductions in older age often reduce the economic gains claimed for this policy.

Declining birth rates across Europe over recent decades have been the norm. But there have also been some upsurges in birth rates in countries with higher immigration over the last decade. In the UK, significant increase is seen in the birth rate from 1.65 in 2002 to 1.98 in 2012. Despite this, however, natural population growth (ignoring future migration flows) is estimated to remain negative (i.e. below replacement rate) for the whole of the UK until around 2030.

Immigrant women in Europe have higher fertility rates than indigenous women, in particular at the time of immigration. In the UK total fertility rates (TFR) for immigrant women are much higher than for UK born women. For example, a study in 2005 reported that the TFR in 2001 was 3.9 for women born in Bangladesh and 4.7 for those born in Pakistan, as opposed to 1.6 for those born in the UK.

However, other reports indicate that these rates decline over ten to twenty years residence in the UK. Immigrants' demographic patterns tend to converge with the mainstream in the medium to longer term, reflecting a decline in TFRs of overseas-born women.

While immigration usually reduces the average age of the recipient populations, it cannot 'solve' population ageing, however, except through very high and exponentially increasing inflows. Convergence of behaviour between immigrant and settled populations, including greater longevity, means that immigration is not an effective antidote for an ageing population.

Immigration into the European Union

For some years already migration has been changing the face of European countries and, according to available projections, will continue to do so for several years to come. The proportion of the population of foreign origin in some European countries will increase from 5–15 per cent of the total today to 15–30 per cent by mid-century.

International migration is largely the result of changes in economic and political circumstances, often of dramatic or critical proportions. For example, at the turn of 19th and 20th centuries, many European countries were "source" or "sending" countries, often to America; in the 1950s and 1960s, all Southern European countries were source countries, filling labour gaps in the booming German economy; and at the turn of 20th and 21st centuries, these countries (in particular Spain, Italy and Greece) were major "receiving" countries for immigrants, both retirees from elsewhere in Europe and subsequently third country immigrants from outside Europe in transit towards a richer North.

Dramatic politico-economic events play a role in establishing new migration flows: the fall of the Iron Curtain opened the way for mass migration from Eastern to Western Europe. During the last few decades, migration streams to Northern, Western and Southern Europe have been substantial, and migration is now an important factor determining the size, change, and composition of many member states of the EU. A sizeable proportion of births are attributable to immigrants in Western Europe, and immigration has become the main source of population growth in many European countries, including the UK.

Disparities in wages, living costs and employment opportunities among the EU countries attract migrants to richer states within the EU. Such disparities - skill shortages and labour demand in the UK - are "pull" factors for immigration, added to the universality of English as a common language.

Both push and pull factors are often magnified when comparing states inside the EU with those at its periphery. Economic opportunities and political stability inside the EU compare with lack of opportunity and instability – sometimes even violent conflict – outside. An environment of human insecurity pushes many towards Europe, in particular into the EU, despite the costs of migration and the dangers involved.

International migration is also determined by established cultures of migration: migrant groups go where others have gone before. Their route is coloured by past migration experiences as well as by present conflicts and tensions. Established networks encourage further exchanges and migrations.

Conflicts in former Yugoslavia, Kurdish conflicts in Turkey and Iraq, the Iraq invasion, civil war in Somalia, and the Arab Spring, including the current Syrian crisis, have all contributed to significant migrant inflows to Europe. The unresolved Egyptian crisis is likely to add to this.

These conflict-driven migration flows tend to continue even long after the conflicts cease, often with substantial numbers. EU countries gave protection to 102,700 asylum seekers in 2012, up from 84,300 in 2011. This represents roughly one in four of those who ask for asylum, leaving about 300,000 refused or appealing their rejection, some of whom are likely to remain within the EU – at least for a while - pending a final decision.

Administrative classifications such as labour/work migration, asylum, study or family reunion, even irregular migration, can blur the multiple motives behind population movements. For example, it is difficult to separate economic causes of migration from political causes when considering Turkish migration to Europe, because along with over 3 million labour and family migrants of both Turkish and Kurdish origin already settled, over 1 million more applied for asylum in European countries over the fifty years or so since the bilateral labour exchange agreement between Germany and Turkey. Population movement is neither a new nor a simple phenomenon, and it is clearly here to stay.

Total stock of recent immigrants in the EU was estimated to be about 15 million in the late 1980s. By 2010, the total volume of the foreign-born in the EU is believed to have exceeded 47 million, representing slightly less than 10% of the total population. Turkey, Morocco, Albania, China, Ukraine, Russia, Algeria, and India are the leading source countries among the non-EU immigrant groups in the EU overall.

Immigration into the twenty-seven member states of the EU reached a peak around 2006/2007 when over 3.4 million arrivals were reported. Inflows remained below 3 million in the following five years, and dropped to an estimated 1.7 million people in 2011. Whilst the region saw about 53 per cent rise overall in immigration over the past decade, some countries experienced sharp increases and decreases reflecting various policy changes in certain years. For example, Spain's intake tripled in 2006 and 2007 but then more than halved in 2011. On the other hand, immigration to Germany displayed a stable pattern over the 2000s until it sharply increased in 2011.

Europe is and will remain an immigration destination for third country nationals as long as its economic and political stability remain intact. Job opportunities, quality education, entrepreneurial environment, developed welfare systems as well as political freedoms are major pull factors. Poverty, lack of opportunity, lack of individual freedoms and violations of human rights, environmental crises as well as conflicts in other parts of the world, particularly at the periphery of the EU, are the root causes or push factors for immigration.

There is also another side to the coin of immigration: emigration. They coexist in a fluid and dynamic balance. In the 2000s, the number of migrants who left Europe increased from about 300,000 to over 800,000 annually. Traditional countries of destination such as Australia, New Zealand, Canada and the USA predominate, but during the recent economic crisis, Turkish statistics revealed more immigrants from Germany – many of them returnees - than people moving from Turkey to Germany.

Irregular or illegal migration represents a sub-chapter of immigration into the EU. It is estimated that between 2 million to 4 million unauthorised immigrants reside in the European Union, less than 1% of the EU population. The respective figure for the United States is over 12 million, corresponding to about 3% of the total population. It is commonly assumed that the size of the irregular or illegal migrant population is usually equal to about 15% of the immigrant stock, but over the last decade, the number of irregular immigrants in the EU is thought to have declined by between a quarter and a third. There have been amnesties in Spain and Italy and recently a debate on a possible amnesty or regularisation was opened in the UK. With long and porous land and sea borders, Greece has been a major gateway for unauthorised immigration into the EU, and this will remain the case until Turkey's possible accession moves the external frontier of Europe further eastwards.

Migration within the European Union

Between EU member states the main drivers for migration flows are essentially economic. Movement is becoming easier than ever inside the EU, as national borders become increasingly porous. Metropolitan hubs in Europe and economically stronger areas attract migrants from all around the EU. Sometimes, this flow may be facilitated, prevented or diverted by temporary immigration policies, but the principle of free movement of persons is a core achievement of the EU and is generally respected.

More than a third of immigrant stock in the EU countries taken as a whole is now composed of EU citizens who have moved from another EU member state. About 75% of immigrants in the EU are resident in Western European countries, mostly in Germany, Spain, UK, France, and Italy (see statistical chart). By the end of 2010, about 16 million out of 47 million immigrants in the EU were born in another EU member state. Major countries of origin within the intra-EU immigrant stock (2010 figures) were Romania (2.3 million), Poland (1.9 million), Italy (1.7 million), Germany (1.5 million) and the UK (1.4 million).

As for annual flows, figures leave a tantalising gap. About 1.3 million people previously residing in an EU member state are known to have migrated to another member state in 2011, while at least 2.3 million emigrants were reported to have left an EU-27 member state in the same period. Did a million leave Europe altogether?

The most recent financial crisis has certainly caused drastic changes in the intra-EU migration flows. A report from the Organisation for Economic Co-operation and Development (OECD) noted the volume of southern European migration to other EU states (mainly to Germany and the UK) jumped by about 45% between 2009 and 2011.

This was partly due to the financial crisis and subsequent austerity measures. High unemployment rates and tough government spending cuts triggered a doubling of Greek and Spanish migration to other EU countries. Familiarity with Germany for many Greeks and Spaniards (i.e. an existing culture of migration) added to the attraction of a strong economy. The EU policy of free movement of citizens has removed obstacles to migration and, while not always welcome, such flows are now inevitable.

Between particular European countries there are several well established migration corridors. For example, the three top countries of origin for immigrants in Belgium have for years been Italy, France and the Netherlands. For Norway, it has been Poland, Sweden, Germany, and Denmark. In Ireland, nearly 40% of immigrants are from the UK. Poland has the smallest percentage of foreign-born in the EU, but there are large Polish populations in Germany (about 1.5 million) and the UK (about 0.5 million). These migration routes have been reinforced with Poland's accession to the EU, but they rest on historical links, such as a strong Polish presence in the UK during and after the Second World War.

Immigration into the United Kingdom

According to the 2011 census, the UK population is about 63.2 million. This figure is some 12.5% of the EU total, second only to Germany. The UK is also home to the second largest foreign-born population; Germany's total is larger.

Some 7,625,800 or 11.5% of the UK population are overseas-born and about 8% are foreign nationals. The overseas-born population in the UK increased gradually from around 2.1 million (4.2%) over fifty years from 1951 to reach 4.9 million (8.3%) by 2001. Then came a sharp increase in the first decade of the 21st century as the foreign-born population climbed to 7.3 million (11.5%) by 2011.

Roughly 2,575,700 of this group "born overseas" (33.5%) are from another EU country, the largest subgroup coming from Poland: 579,000 according to the 2011 census.

India, China, Pakistan, Poland, Australia, Germany, USA, France, Spain, Lithuania were the top ten countries of origin in 2011. About 10 million immigrants arrived between 1981 and 2011. In certain periods, immigration flows were dominated by specific groups, such as Iraqis following the invasion, Somalis after their civil war, and Poles after their 2004 accession to the EU.

Despite the volume of migration into the UK having reached historically high levels recently (see statistics), the balance of all migration to and from the UK - for the last hundred years, for instance - shows only a relatively small positive balance of about 170,000. Today's UK exists in an ever more connected world, with large numbers of people travelling more often and many living in other countries for short and long periods. Unsurprisingly the volume of annual migration flows has also increased considerably.

The resulting immigrant stock is summarised in the statistical tables attached. Of the top ten non-UK born populations, only the Irish numbers declined between the two censuses 2001 and 2011, while those born in Poland registered the largest growth. After the upsurge of migration from Poland to the UK between 2004 and 2008, the volume seems now to have stabilised.

Immigration into the UK can largely be traced to the country's historic links. Thus the largest single group of immigrants is from the Commonwealth or former British territories (especially South Asia). They are followed by others linked to historical events such as World War II (e.g. Poles) or regional conflicts in which the UK was involved (e.g. Greek and Turkish Cypriots).

The impact of immigration on UK society is hotly debated. The OECD reports that immigrants tend to make a net positive economic contribution to the countries they move to, which may mean between £7.3 billion and £16.3 billion in terms of nominal GPD in the UK. Migration is age-selective, however, meaning often the younger and healthier move, and after a few decades in employment they will also age and claim their pensions. The full impact of this may not yet show up in the OECD figures.

Many immigrants have higher fertility rates than the host population. About a quarter of babies in the UK were born to foreign-born mothers in 2012. The corresponding figure for London, where a large number of immigrants live, was close to 6 in 10.

Emigration from the UK

Between 1981 and 2011, about 8 million people left the UK. Some well established corridors of emigration can be identified, notably to Australia, New Zealand, Canada and the USA, but also India, Poland, France, Germany, Spain and China (the top ten destinations in 2012). .

A substantial British expat population exists in many countries, but estimates of the total number of Brits living abroad vary wildly. One estimate in 2006 suggested around 5.5 million Brits lived abroad, while others – notably a parliamentary estimate from the previous year - put the figure at over 13 million.

British emigration into the rest of the EU is already large scale. By the end of 2010, out of 4.6 million British expats world-wide, more than 1.1 million of them were resident in the top four British destinations in the EU: Spain (411,074), Ireland (397,465), France (172,836) and Germany (154,826). The UK is one of the top five countries of origin in the intra-EU immigrant stock. While the UK's net EU migrant stock balance with most individual member states is relatively small, Spain and Poland are exceptions. There were over half a million more Polish residents in Britain than British residents in Poland, and Spain was home to nearly half a million Brits as opposed to only about 70,000 Spaniards living in the UK.

Recent international migration statistics for the UK show that the number of asylum applications has declined significantly during the last decade. Compared to an average of 97,000 asylum applications per year at the beginning of the 2000s, by the end of 2011 the total number was down to 27,400. In the meantime, the UK Borders Agency reports that from 2004 to 2012, more than 240,000 individuals were refused entry and deported, over 160,000 failed asylum seekers were forcefully removed and over 160,000 departed voluntarily. However, given the on-going conflicts around the world and the UK's involvement in some of these, there are reasons enough to expect a continuous inflow of people in need of humanitarian protection. This is not a number that can reasonably be expected to shrink to zero.

Irregular or illegal migration is also difficult to assess accurately. The International Organisation for Migration estimates the volume of irregular migrants to be around 10-15% of overall migrant populations. However, the numbers differ considerably between countries. For example in Turkey, official figures of foreign born are about 1.3 million (2000 Census) but total number of apprehended illegal aliens stood around 900,000 between 1995 and 2012. In the UK, government honestly admits that the number of irregular migrants is not known. In 2005, the Home Office, based on 2001 census data, estimated the irregular migrant total at between 310,000 and 570,000. Four years later, another report estimated irregular migrants and their UK-born children at between 417,000 and 863,000. It would be reasonable to imagine that the majority of irregular migrants in the UK are those who have overstayed their visas rather than those who succeeded to immigrate clandestinely. Nevertheless the volume of irregular migration remains uncertain.

Future of migration and population in Europe and the UK

There are already many initiatives across the EU and beyond developing comprehensive regional and even global approaches to migration management. The EU project 'MIEUX' is one such effort, addressing policy needs in managing migration flows in line with the priorities of the EU Global Approach to Migration and Mobility (GAMM). These co-ordinated efforts go well beyond the EU and wider Europe to include partners in Asia, Middle East, North Africa, Sub-Saharan Africa, Latin America and the Pacific.

Such wider collaboration is dictated by the nature of human mobility and the requirements of migration and border management. The 2013 handbook on European law relating to asylum, borders and immigration is a good example of increasing cooperation to ensure a common standard for the practice of freedom of movement within the EU.

The UK has historically been a part of the European social, economic and political sphere for nearly two generations, and there are very similar demographic trends across the UK and neighbouring states. Population trends and immigration into the UK are therefore unlikely to follow very different patterns from those of our comparable continental neighbours. Intra-EU migration is now part of the DNA of the European integration project. Member states would do well to concentrate their efforts jointly on managing flows from outside the EU instead, as they are beginning to do.

According to a recent Gallup World Poll, about 630 million people around the world would like to migrate to another country. This is about 14% of the total adult population. Fortunately not all of them will move at once, and possibly not all of them will ever fulfil this dream. But the figure for those who desire to migrate from Europe to somewhere else stood at 18% overall, with 30% for the UK. In the near future, emigration pressures could pose bigger problems, especially for the UK, than immigration pressure.

Changes in population and immigration flows and their composition will have significant implications for social cohesion and integration as well as for economics and the well-being of populations in Europe. Existing anxieties and hostilities about immigration need to be addressed to avoid further social tensions, and the implications of migration and ageing for health care provision impose challenges at transnational, national, and local levels for governments and planners. Indeed, it is almost impossible to address any migration related policy issues without other EU countries' cooperation, as well as that of neighbouring countries such as Turkey, the countries of the Maghreb and Ukraine. The answers to questions raised by migration policy are likely to be best found in EU-wide collaboration.

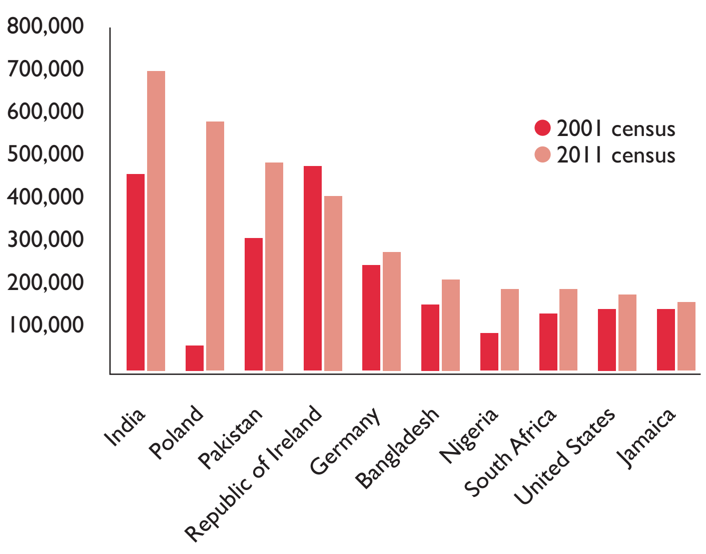
Facts and Figures

Average annual net migration in the UK, 1911-2011

Census year	Average annual net migration
1911	-82,000
1921	-92,000
1931	-67,000
1951	22,000
1961	12,000
1971	-12,000
1981	-27,000
1991	5,000
2001	61,000
2011	197,000

Source: Hawkins (2013), p.27.

Top 10 non-UK born populations in England and Wales, 2001 and 2011



Sources: 2011 Census of England and Wales (table UV08), 2011 Census of England and Wales

UK expats (rounded to nearest 10,000) in selected EU countries

Spain	411,000	Ireland	397,000	France	172,000
Germany	154,000	Netherlands	45,000	Italy	34,000
Cyprus	32,000	Belgium	25,000	Sweden	19,000
Portugal	14,000	Greece	14,000		
Total EU 1,369,000			Total in the world 4,666,000		

Other EU member states citizens (over 20,000, rounded) living in the UK

Poland	521,000	Ireland	422,000	Germany	299,000
France	128,000	Italy	108,000	Portugal	84,000
Spain	70,000	Lithuania	68,000	Cyprus	67,000
Netherlands	56,000	Romania	53,000	Slovakia	49,000
Bulgaria	35,000	Greece	28,000	Latvia	27,000
Malta	26,000	Hungary	24,000	Czech Republic	24,000
Belgium	22,000	Sweden	21,000	Austria	21,000
Total from EU 2,212,000			Total from the world: 6,955,000		

Foreign citizens and foreign born people

In the EU in 2011, the largest numbers of foreign (non-national) citizens were recorded in Germany (7.2 million persons or 9% of the total population), Spain (5.7 million or 12%), Italy (4.6 million or 8%), the United Kingdom (4.5 million or 7%) and France (3.8 million or 6%). In total, more than 75% of the foreign citizens in the EU27 lived in these five Member States.

In 2011, there were 48.9 million foreign-born people living in the EU27 Member States. This figure includes many who were born outside Europe but may have subsequently acquired citizenship in a member state. 16.5 million of this total were born in another Member State than the one in which they live (3.3% of the EU population) and 32.4 million were born in a country outside the EU27 (6.4% of the EU population). In total, foreign-born people accounted for 9.7% of the total population of the EU27. The number of foreign-born people exceeded the number of foreign citizens in almost all Member States.

Source: Eurostat

EU Budgetary Policies

Professor Iain Begg

European Institute, London School of Economics and Political Science

The euro crisis triggered by the implosion of Greek public finances in the autumn of 2009, and its spread to other Member States, exposed a range of shortcomings in the governance not just of the single currency, but also in the management of the EU economy as a whole.

Iain Begg

The Context of the EU Budget

EU public finances, generally, are in a mess. Most Member States (including the UK) are subject to Excessive Deficit Procedures (EDP), public debt is rising in all but a handful of them, and tax revenues are in decline because of economic stagnation. The one glimmer of good news of late has been that the European Council finally succeeded, at its meeting in February 2013, in reaching an agreement on the Multi-annual Financial Framework (MFF) for the period from 2014-2020, then reached a deal with the European Parliament at the end of June that allows the MFF to go ahead

This paper assesses the EU budget in its wider public finance context and considers how the current arrangements affect the UK's relations with the EU. The first section provides a brief overview of the state of public finances across the Union. Section 2 reviews the build-up to the MFF negotiations. Section 3 assesses the deal agreed by the European Council. The chapter then turns to the wider question of the adequacy of EU budgetary policies, looking particularly at calls in the report by the 'Four Presidents' for a euro area fiscal capacity. Conclusions focusing on the UK's options complete the paper.

Budgetary stress across the Union

The severity and duration of what is now becoming known as the Great Recession has had a damaging effect on the budgetary positions of all EU Member States. In the EU27, deficits averaged 2% of GDP between 2004 and 2008, comfortably below the Stability and Growth Pact limit of 3%, but jumped to 6.9% in 2009 – the year which saw a large decline in GDP – and 6.5% in 2010 when there was a tentative recovery. Since then the collective efforts to achieve fiscal consolidation have resulted in lower deficits overall, although the deficits of some Member States are still striking. The most recent forecast from the European Commission foresees no improvement in 2013 with the EU27 average projected to be 3.4% with only a slight fall to 3.1% in 2014. Public debt has ballooned, with the EU average jumping from 62% in the period 2004-08 to a forecast 90% in 2013. It is expected to creep even higher in 2014. For the euro area, the equivalent figures are even higher at 69.1% and 95.2%.

These trends have had knock-on effects. Public investment in the EU is expected to be 2.2% of GDP in 2013, down from averages of around 2.5% in the previous fifteen years. Since many difficult structural reforms that Member States need to implement call for higher public investment, the risk is that the squeeze on public finances will compromise growth prospects. The public sector interest burden has also crept up to 3.0% of GDP in 2012 and 2013 from 2.70% in 2004-08, albeit with big differences among the Member States: forecasts suggest 5.5% of GDP for Italy in 2013, compared to just 0.2% for Estonia. However, the precarity of the fiscal positions of so many Member States is shown by the fact that these relatively moderate interest burdens are still quite a drain on public finances in spite of record low interest rates set by the ECB.

20 out of 27 member states are currently subject to the Excessive Deficit Procedure (EDP). Only Estonia and Sweden have not been in excessive deficit since the onset of the crisis. In May 2010 a Commission report on Luxembourg deemed that country to have a high deficit in 2010/11, but not to be at risk, so that it was spared being made subject to a formal EDP. Finland exited EDP in July 2011, having only narrowly overstepped the limit in 2010, while Bulgaria and Malta exited their EDPs in July 2012 and December 2012, respectively. Germany also exited in July 2012, having spent much of the previous decade in an EDP.

The fiscal vulnerability is reflected in the fact that Greece, Ireland, Portugal and Cyprus had to be rescued through loans from their EU partners, and Spain has only avoided a direct bail-out of its public finances by persuading the EU to underwrite its banking sector rather than lending explicitly to the government. Other Member States, such as Italy, Slovenia and the UK (which is at risk even though it is outside the euro area), are walking a tightrope.

Negotiating the EU budget

Against this backdrop, the septennial ritual of negotiation of the EU budget (the Multiannual Financial Framework or MFF) for the period from 2014 to 2020 was even harder than usual. Even before the Commission put forward its proposals, the UK and four other net contributors to the budget called for a reduction in the overall size of the budget. Since then, a compelling, if not always economically logical, political line has been that, with so many Member States having to make difficult spending cuts, the EU too must rein in its spending.

In June 2011, the Commission published its initial proposals with a headline total of €1025 billion for the seven years. Immediately finance ministers queued up to condemn the profligacy of the Commission, despite the fact that the proposals entailed only a marginal increase in real terms compared with the previous MFF. Most of the planned increase was for the heading of 'competitiveness for growth and employment', the largest share of which is the EU research budget. A new 'Connecting Europe' budget line was proposed to provide for transport, communication and energy networks, with the Commission, rather than the Member States responsible for choosing the projects. The Commission proposals envisaged a gradual erosion of support for agriculture, and keeping funds to support economic and social cohesion - largely through funding for less prosperous regions - broadly unchanged. There was some ambiguity about whether certain large scale items such as the Galileo project (satellites) or ITER (cold nuclear fusion) were best kept within the budget or treated off budget as separate financial deals between the member states.

In discussing the EU budget, the term 'commitments' refers to sums allocated for particular purposes, whereas 'payments' determine what has to be financed from the budget in each particular year. The latter generally undershoot the former for the simple reason that allocated amounts cannot be spent within the time allowed or are clawed back because of irregularities or non-performance of contracts. In presenting the February deal to the European Parliament, Herman van Rompuy pointed out that 'payments' over the 2007-13 period were expected to total €875 billion, more than 10% below the 'commitments' figure in the MFF.

For the UK, the process was less traumatic than it might have been, as the rebate first obtained by Mrs Thatcher in 1984 was (largely) retained. Britain will remain a net contributor, as it has been since joining the EU, although it is important to keep a sense of perspective. On average, over the current MFF period, the UK net contribution as a proportion of GDP has been broadly similar to that of France at about 0.3%, and lower than the biggest net payers such as Germany or the Netherlands. Nevertheless, the size of the UK net contribution can look like a tempting target for euro-sceptics. It fluctuated, and was also expected to do so over the span of the 2007-13 period, reaching a peak in 2011, as can be seen from the atatched table (based on UK Treasury data which tends to present the cost of the EU as higher than alternative calculations). But some of what that net contribution pays for, such as EU external action, would still be a cost to the UK tax-payer. In short, for the UK, the EU budget is a contentious amount of spending, but not something that makes a great difference to UK public finances, as some claim.

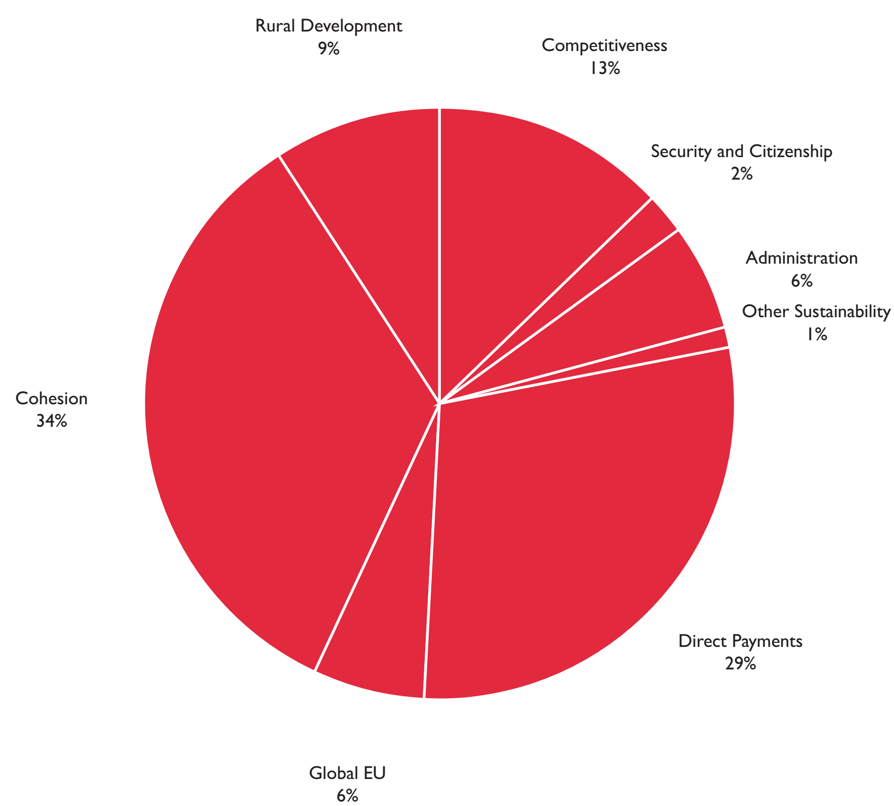
In October 2012, the House of Commons demanded that the Prime Minister veto anything less than a cut in real terms. David Cameron made clear that he would not be bound by the vote, even though the European Council did formally (and just) achieve that outcome. It was clear that Germany, in particular, had chosen not to isolate the UK, and that UK demands – such as for a freeze or reduction in the MFF – had been welcomed in Berlin. The 'friends of cohesion policy', too, largely succeeded in preserving their net inflows, while France led a successful late defence of the CAP.

The budget for 2014-20

The MFF package agreed in February 2013 is, as such agreements always are, a messy compromise. Given the many incompatible demands, it would have been unrealistic to expect the original proposals to have changed more than they did. The mere fact of an agreement should be welcomed, because the alternative would have been highly disruptive.

Despite the increased powers conferred upon it by the Lisbon treaty, the European Parliament did not seek to alter the headline total of the MFF, but concentrated instead on introducing more flexibility into the budget plans. Part of the rationale was to ensure that more of the money allocated is actually spent, in contrast to recent years during which under-spending has meant money being returned to Member States.

2014 - 20 Multi-annual Financial Framework



The main headlines of the MFF are that:

- For the first time, the new MFF will have a lower expenditure total than its predecessor. It will amount to around 1% of EU Gross National Income (GNI) – broadly the same level as it has been for much of the last decade – although a continuation of economic stagnation could disrupt this arithmetic.
- Spending on 'competitiveness' will increase by around a third compared with the previous MFF. The bulk of it will go to the new research programme known as "Horizon 2020". However, the total expenditure under this sub-heading will still be only 13% of the total MFF.
- Cohesion policy spending will continue at close to the same level as in the previous MFF and will continue to be available to all Member States. Complicated formulae for initial allocations and for performance-related reserves will give preference to those making the best use of the money.
- The slow reduction of direct payments for agriculture will continue. A gentle fall in real terms over the seven years should see these payments fall to 27% of the budget, compared with some three-quarters thirty years ago. There is also to be a 'greening' of agricultural policy and a switch of resources from direct payments to farmers to a marginally increased budget for rural development.
- A new Youth Employment Initiative will be funded from the budget of the European Social Fund.
- To compensate for some lack of flexibility in an MFF set for seven years, several funding pots have been set up or kept outside the Framework. These include the European Union Solidarity Fund, aimed at dealing with major disasters, the European Globalisation Adjustment Fund, and the European Development Fund.
- Together with a 'Contingency Margin' set at a maximum of 0.03% of EU GNI, these off-budget items add a maximum of 0.07% of GNI to the budget.
- In an attempt to improve coherence across spending programmes and to ensure more effective use of money, there will be a Common Strategic Framework for economic development policies, embracing objectives in line with the Europe 2020 strategy. As part of this, macroeconomic conditionality will be imposed, under which Member States risk being penalised financially for breaching commitments, encouraging them to avoid imbalances or risk having to conform with specific recommendations.
- Administration costs, which became a lively issue late in the negotiations under British and German pressure, were shaved a little by altering staff terms and conditions. These changes come on top of an already agreed 5% reduction in staffing programmed for the period 2013-17.
- On the revenue side, the major part of the budget will continue to come from national contributions. However, the existing VAT resource will be replaced by a new VAT resource with a different means of calculation. In addition, those Member States that agree to adopt a common financial transactions tax can earmark some of the proceeds of the tax to their EU budget contribution in place of part of their standard GNI-based contribution.
- There will still be various rebates ('corrections' in the budget jargon), with the UK's special position largely maintained intact. Four other Member States continue to receive 'corrections' (Austria, Germany, the Netherlands and Sweden), and Denmark now joins the list of those receiving some of their money back.

The new MFF is more a recognition of the status quo than a radical change. Over the seven years, the amount going to what can be regarded as redistributive policies (cohesion policy, CAP and rural development) will fall slightly from the 2007-13 share of 77%, but will still account for nearly 72%. The increase in the competitiveness budget to 0.13% of EU GNI (of which the budget for research will be under 0.09%) still barely takes it close to the core Europe 2020 target for total spending on research and development of 3% of GNI. The European Council conclusions refer to mainstreaming of environmental objectives and claim that at least 20% of the spending will contribute to climate action objectives, but there are no really striking new initiatives on major policy concerns such as climate change or ways to exit from the financial crisis. There are proposals for somewhat more flexible management of the budget, and the insistence on macroeconomic conditionality could prove contentious, while placing some of the flexibility instruments "off budget" and outside the MFF could be seen as a sleight of hand to make the latter look more disciplined than it really is. Some of the new ideas, such as the Connecting Europe Fund or the Youth Employment Initiative, may make good sense but are relatively limited in scope,

The UK has always been a net contributor to the EU budget and will remain one over the period of the next MFF. However, the preservation of the rebate should mean that the UK makes proportionally less of a net contribution than some of the other member states. But this depends on Commission data which – like so much in the budget – may be disputed. The gross cost of the EU budget to the UK, though varying year by year, is lower as a proportion of GNI than it would be otherwise because of the way the rebate functions.

EU fiscal and budgetary capacity

The euro crisis triggered by the implosion of Greek public finances in the autumn of 2009, and its spread to other Member States, exposed a range of shortcomings in the governance not just of the single currency, but also in the management of the EU economy as a whole. Because fiscal policy remains a Member State competence, the only policy instrument available at EU level to stabilise the economy when it is hit by a downturn as severe as the current crisis is monetary policy. That represents a crucial governance gap

The Four Presidents' Report (European Council, 2012), together with the Commission's 2012 blueprint for a Genuine Economic and Monetary Union (GEMU), contain a range of proposals for institutional deepening. Prominent among these is a call for a new fiscal capacity for the euro area, but with the presumption that other member states (as with the Fiscal Compact) could join voluntarily. The two documents are explicit in stating that part of their rationale is to contribute to macroeconomic stabilisation, although the language in the two papers is both tentative and circumspect.

In the Commission blueprint, an additional fiscal capacity is justified essentially in terms of supporting economic coordination in the short and medium term. But it does refer for the long-term to supporting 'Member States in the absorption of shocks'. This late mention of asymmetric shocks suggests that the new instrument would not be a powerful tool for everyday use by a single EU (or euro area) finance minister, but rather an instrument for exceptional use in helping individual Member States in occasional difficulty. The 1977 MacDougall report set out long ago what would be needed to run a monetary union effectively, and it suggests that this will not be enough. While the collective fiscal stimulus agreed in 2009 in the wake of the steep recession was a valuable – and necessary – response, it was only ad hoc. The absence of a permanent EU-wide stabilisation capability could be construed as a serious gap in a genuine EMU.

An additional fiscal capacity will require answers to a number of tricky questions, How will the money be raised, how will it be disbursed, and what politically legitimate control will there be on it?. It is likely to need an EU level (or euro area) Treasury and the designation of someone who is, in effect, a finance minister for the EU. Yet unlike foreign affairs, where the High Representative speaks for all member states, the new post would be for an 'incomplete' membership and would be difficult to locate inside the Commission. If new revenue sources are to be tapped, there is a case for an elected European body to choose how, but the European Parliament is also a body representing all member states, and not just those that would be part to the new fiscal capacity. Would the new authority be able to borrow – perhaps opening the door to the issuance of Eurobonds or forms of collective deposit insurance – or would it have to balance the books annually as the EU budget has to currently?

Concluding comments

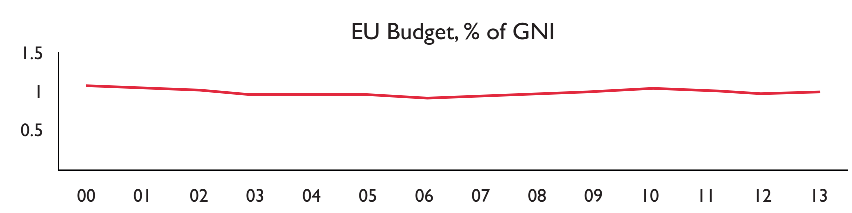
For the UK, the fact that it has emerged from the MFF negotiations without an increased financial burden is a relief for the government. Yet in many respects the outcome fails to meet the UK's long-term goals. The budget continues to be dominated by the CAP and cohesion policy, and the latter will still include money for richer member states, because of the reluctance of many of the net contributors (the UK included) to concentrate cohesion spending on the poorest member states. Nor has there been a rebalancing of spending towards boosting the EU position in the global economy, long a UK objective.

The plans for Genuine Economic and Monetary Union are likely to raise problems for the EU in relation to public finances. Although they skirt cautiously around the question of mutualisation of debt, whether in the form of Eurobonds or common deposit insurance as part of banking union, the likelihood is that a new fiscal capacity will emerge, separate from the EU budget. Indeed, it is hard to see how this issue can be avoided if the flaws in EMU are to be corrected. The EU budget, plainly, is just too trapped in its own past to be the answer. Yet any new fiscal capacity will entail additional sources of revenue and a commitment by those participating to bear the resulting risks. Some states have agreed to more intrusive EU level scrutiny of their public finances already. Will this be the next step?

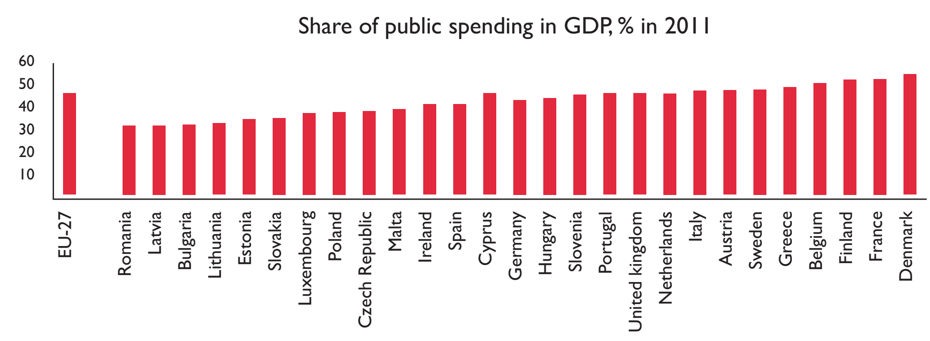
The UK is virtually certain to stand apart from these developments, but a fiscal deepening by others will widen the gap between what the UK wants from the EU and the reality of what its partners are doing in budgetary policy. Their decisions about the future of budgetary policy could, therefore be a trigger for a significant reassessment of where the UK stands in Europe.

Facts and Figures

UK national public expenditure in 2011 (net of EU contribution)	€5,634 billion
Total EU budget (payments) in 2011 (the last year fully reported)	€127 billion
UK national public spending per capita in 2011 (net of EU contrib)	€11,204
EU spending per capita in 2011	€253
Cost of national public spending per citizen per day (net of EU contrib)	€30.70
Cost of EU budget per citizen per day	€0.69
Share of EU spending in total public expenditure	2.2%

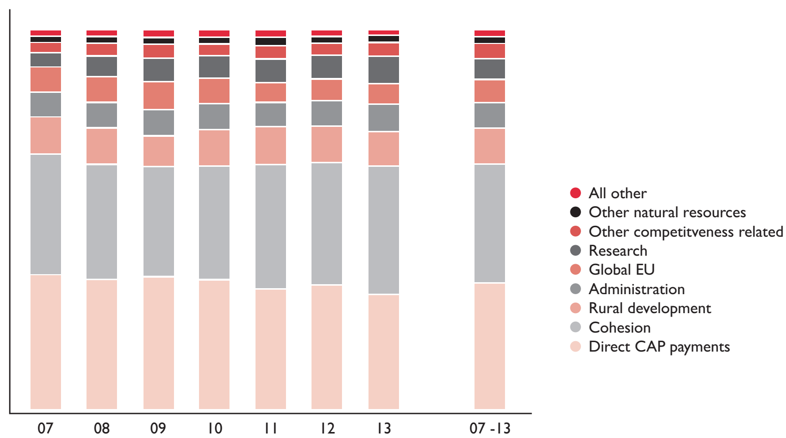


Source: DG Budget, European Commission



Source: AMECO database, DG Ecfin, European Commission

EU Budget 2007-13: How the money was spent



Source: DG Budget, European Commission NB: Implemented budget, 2007-11; voted budget 2012, draft budget 2013

UK Budgetary contribution and rebate

	2006 Outturn	2007 Outturn	2008 Outturn	2009 Outturn	2010 Outturn	2011 Outturn	2012 Estimated Outturn[1]
Gross payments[2]	12,426	12,456	12,653	14,129	15,197	15,357	15,021
Less: UK Abatement	-3,569	-3,523	-4,862	-5,392	-3,047	-3,143	-3,172
Less: Public sector receipts	-4,948	-4,332	-4,497	-4,401	-4,775	-4,112	-4,954
Net contributions to EU Budget[3]	**3,909**	**4,601**	**3,294**	**4,336**	**7,375**	**8,102**	**6,895**

1 the figures for 2012 are forecasts, those for earlier years are outturn
2 gross payment figures include TDR payments at 75 per cent. The remaining 25 per cent is retained by the UK to cover the costs of administering collection on behalf of the EU
3 Due to rounding totals may not exactly correspond to the sum of the individual items
Source: HM treasury

Trade

Dr Nicholas Bowen

President Chartered Institute of Linguists and Principal Lecturer in International Business, European Business School, Regent's University London

One of the attractions of the EU for the UK is the intrinsic nature and strength of its adherence to the theory, principles and practice of free trade.

Nicholas Bowen

Five Questions

The key issues in relation to trade are whether the UK within the European Union has really done well by its membership and, conversely, whether the UK could have done/could do better outside the EU. Much of the debate has centred around highly contested views on five more specific questions:

1. how has membership of the EU hampered the UK's traditional free trade position?
2. would an exit from the EU strengthen or weaken the UK's trading position?
3. would it be easy or difficult for the UK outside the EU to wield as much power in trade negotiations, both in terms of numbers and its world-wide influence?
4. would an exit from the EU relegate the UK to the position of a third-rate economic and trading country?
5. would the energy and enterprise of the UK economy, including the financial services sector of the City, ensure that the UK continues to exercise a role as a major global trading player?

First, the factual position in relation to the trading relationship between the UK and the EU, and the position of the UK within the EU's overall external trade.

Trade between the UK and the other member countries of the EU accounts for about 50% of total UK trade. This figure has been consistently increasing since the UK joined the European Economic Community (forerunner of the EU) in 1973 and allowing for variations in currency values (whether of euro, UK sterling or US dollar) the trend has shown no signs of diminishing. For example, since 2004, the annual average growth in value of general UK trade with the EU has exceeded 4% (4.46% for exports and 4.32% for imports) *(HM Revenue and Customs 2013).* The most recent statistics on UK-EU trade show that, for 2012, UK goods exports to the rest of the EU countries exceeded €187 billion, with imports reaching €257 billion *(Eurostat 2013).* The UK's access to the benefits of the EU single market has enabled total trade in goods with the EU to increase from £96 billion in the first quarter of 2000 to £175 billion in the first quarter of 2013 *(Office for National Statistics 2013).*

Over a third of total world trade originates in Europe, with a worth of about $5.5 trillion annually and the EU is the top trading partner for about 80 countries *(eurobriefing 2013).* Within the overall EU-world trading picture, the UK is second only to Germany among EU members as the largest goods exporter and importer for external trade *(Eurostat 2013).*

Has membership of the EU hampered the UK's traditional free trade position?

The trend towards increasing globalisation, even during the five years of the credit, financial and economic crisis, has often been complemented by developing regional trade agreements. Globalisation has gone hand in hand with regionalisation, both regarded as part of the process of global economic growth through trade. The proponents of regional trade agreements or associations, such as Mercosur, ASEAN, CARICOM or the EU, maintain "that economies that organise their division of labour along regional rather than national lines tend to suffer less protectionism on the part of neighbouring trading partners. They also enjoy higher inwards investment and… generally higher productivity" *(Sitkin and Bowen: International Business – Challenges and Choices. 2013).* The EU, in particular, has demonstrated the benefits of regional arrangements for individual companies and national economies through the economic and political power that it can wield on the international stage: indeed the EU already represents member states' interests in many global forums including the OECD and the WTO.

This link between regional and global arrangements is at the heart of the ideological issue as to whether 'we should go it alone' or whether 'we have to work with others for mutual advantage since world trade is so complex.' The latter view is that there is an economic comparative advantage in being within a number of regional and global frameworks: each country will benefit from concentrating on what it does best and gaining –in the eyes of some - the cost reductions for its consumer population through free trade, and in the eyes of others – defence of indigenous producers through protectionism.

At the same time, the co-operative nature of regional trading arrangements brings the benefits of strength in numbers when operating in the wider world. The arguments in favour of the UK's continued membership of the EU, as well as other international and regional associations, have been very extensively covered by Andrew Hurrell in his work on the 'one world/many worlds relationship' *(Hurrell:International Afairs, vol 83, no.1. 2007).* This suggests that the central question is not an either/or matter; there is no need to posit that the UK has to be either in or out: it can operate in both the regional and the global arenas. Indeed the optimum position for a state such as the UK might be to benefit from acting on three different levels: national, regional and global.

One of the attractions of the EU for the UK is the intrinsic nature and strength of its adherence to the theory, principles and practice of free trade. Historically the UK was at the forefront of intellectual arguments in favour of free trade: at heart this is a belief that trading goods and services should be negotiated in private domestic and foreign markets without government interference. The works of Adam Smith, Richard Cobden, David Ricardo, Alfred Marshall, and even John Maynard Keynes were all part of a tradition that was bound into a conviction that the freer the trade regimes, the more prosperous will be the populace. Even within the EU – and the WTO – the UK has usually resisted unnecessarily complicated procedures and over-bureaucratisation of the economic and trading sphere. The EU gains from the UK's continued advocacy of free trade within its regional framework.

Some of the trade arguments in favour of being out of the EU were made in an article in The Times on 7 May 2013 by former Chancellor of the Exchequer, Nigel Lawson:

"You do not need to be within the single market to be able to export to the European Union, as we see from the wide range of goods on our shelves every day. The statistics are eloquent. Over the past decade, UK exports to the EU have risen in cash terms by some 40%. Over the same period, exports to the EU from those outside it have risen by 75%. The heart of the matter is that the relevant economic context nowadays is not Europe but globalisation, including global free trade, with the World Trade Organisation as its monitor."

The point is well made, but also draws into the argument the question of balanced trade, which is clearly not the same as increased trade.

Would an exit from the EU increase or decrease the UK's trading position?

This question is linked with the third of the opening points: Would it be easy or difficult for UK outside the EU to wield as much trading power, both in terms of numbers and its world-wide influence?

Since the UK is not outside the EU, there is no factual evidence to test whether it would be better off out than in. It is a matter of speculation, occasionally supported by selected statistics and figures. For those, like Lord Lawson, who suggest that the UK would do better outside than inside, there are several key points. One of these is that the EU has become too cosy and too bureaucratic and has thus stifled the UK's inherent free market and entrepreneurial instincts. In his Times article, Lawson noted that:

"Today too much of British business and industry feels…secure in the warm embrace of the European single market and is failing to recognise that today's great export opportunities lie in the developing world, particularly in Asia. Just as entry into the Common Market half a century ago provided a much needed change of focus, so might leaving the EU, an institution that has achieved its historic purpose and is now past its sell-by date, provide a much-needed change of focus today."

A counter argument to this is that the UK has rarely been over-dependent on any single trading partner or region of the world. Even at the height of the UK's focus on the British empire (or its successor, the Commonwealth), the pattern of trade was divided between the older and more economically diversified Dominions, the resource-rich colonies, and the rest of the world. Trade continued with a variety of European countries and the Americas, as well as with areas within Asia and Africa that were outside the imperial reach. Now in the early decades of the 21st century, the distribution of UK imports and exports still has a broad global pattern as is demonstrated at length in an official report on UK trade performance *(BIS Economics Paper No.8 UK Trade Performance: Patterns in UK and Global Trade Growth. November 2010).*

Within this series of arguments in relation to the UK's ability to maintain an equally strong trade position outside the EU, it is essential to discuss two important considerations: (a) the key development of TTIP (Transatlantic Trade and Investment Partnership), and (b) the role of the EU within the WTO (World Trade Organisation).

It is deeply ironic that the UK might consider disengaging from the EU just at the time that there is a prospect of the closest involvement for decades between the member states of the EU and the USA, one of the UK's (and the EU's) major trading partners. Indeed, the UK is the USA's largest trading partner in Europe, and the Transatlantic Trade and Investment Pact (TTIP) is expected to provide a huge boost to UK exports, increasing total exports by 1.3% (£19 billion) with total annual economic gains of up to £10 billion *(UK Trade and Investment 2013).*

Many of the WTO disputes are between the EU and the USA, as the biggest share of world trade is essentially transatlantic trade between the EU and North America. The TTIP negotiations are a crucial step in reducing such trading spats and their costly economic consequences. A successful outcome of the TTIP negotiations would mean that a United States-European Union deal could lay down regulatory markers for the rest of the world. Assuming that this is the case, why would a major trading country like the UK decide to opt out of influencing these discussions and the final pact - which it is hoped can be concluded by the end of 2014? A successful conclusion to TTIP might mean 2 million new jobs in the EU and 80 billion euros worth of trade benefits annually.

The EU and its member states have played a key role in the development of the WTO and of its predecessor, the General Agreement of Trade and Tariffs (GATT). Of their eight Directors-General, six have been European and the increasingly political role of the Director-General has meant considerable prominence for the EU among other leaders of international economic institutions, such as the World Bank, the IMF and the ILO. The first Director-General of GATT was from the UK, and while it may be unlikely that this leadership role will go to a British person again, the influence of Europe within the WTO is clearly very high. The EU is committed to multilateralism and has acknowledged the fundamental importance of WTO in the international trade system. The EU has declared that its "active involvement in multilateral trade means more products on sale at competitive prices, more growth and more jobs" Above all, the EU is "the world's major global player in … international trade". The presence of the UK and its economic, business, financial and trading clout within the EU is of immense importance to the continuing development of world trade and the role of the WTO.

Nigel Lawson argues in his *Times* article - as have others elsewhere - that growth potential for the UK is constrained by being tied to the EU. The UK would be free to expand into the growing markets of the emerging economies if it was outside the EU, he asserts. The pro-EU counter to this is that the aggressive expansion of

Free Trade Agreements by the EU has significantly boosted UK trade already while still within the organisation. The gross value of UK goods exports to non-EU partners has risen 38.8% since 2000 and the gross value of its goods imports from beyond the EU has risen by 39.6% over the same period *(Eurostat 2013)*. The UK can reap the benefits of increased global trade very much better inside than outside the EU.

Would exit from the EU relegate the UK to the position of a third-rate economic and trading country?

The views from advocates of departure from the EU point to three main factors in determining their position: budgetary costs, trade costs and regulatory costs.

The budgetary saving that might be made by leaving the EU is (over)estimated at more than £19 billion by the UK Independence Party (UKIP) on the basis of £53 million per day. This figure is more than double the official Treasury calculation, and it is hard to verify the reality of whatever it may be based on.

UKIP's trade spokesman, William Dartmouth, MEP, has also noted that "the UK as an independent actor will be perfectly able to set up trade deals, with who[m]ever we want to… More important is his [David Cameron's] acceptance that while we are in the EU, trade deals are made in other countries' interests, not our own. Compromises at this level cost billions" (http://www.ukip.org/issues/2013).

But the facts bear out another view entirely. The UK has benefitted considerably already from agreements with third countries negotiated by the EU and stands to gain even more from a successful negotiation of TTIP. The EU has opened up trade with a large number of other markets in the context of regional agreements and associations, and the UK benefits considerably from recent EU trade agreements with, for example, South Korea, Mexico, Chile and South Africa.

In the case of Chile, the UK's exports have nearly tripled since the EU-Chile Association Agreement in 2002, with the UK ranking fourth among the largest foreign investors in the country *(HM Revenue and Customs 2013 and UK Trade and Investment 2013).* For the UK and South Korea, there is evidence that the Free Trade Agreement between the EU and South Korea added £500 million to the UK's gross domestic product, with a growth in total trade from £4.7 billion to £8 billion between 2009 and 2012 *(HM Revenue and Customs 2013 and BIS Economic Paper 17 UK Trade Performance across Markets and Sectors.2012).*

The Euro-sceptic view is that the UK on its own could just as well strike key trading deals with other countries, both outside the EU and inside it. This view is based on a long-held assumption that being free of 'foreign entanglements' might mean that the UK's freedom of manoeuvre would be greater. However, this underestimates the extent to which international trade now depends on a complex set of regional as well as global arrangements, and in negotiating these the EU speaks for all member states collectively.

If your world view is simplistic, then you may resist the conclusions of this assertion. But trade relations are not simplistic, they are extremely complex. Striking out alone in ancient, heroic style is not really possible in either the short- or long-term. It may make popular politics, but it is not intelligent economics. This is partially a debate about globalisation which has been referred to above and is also touched upon in other parts of this Report. For those who might like to explore more deeply the UK-EU trade issue within the discussion of globalization, we would suggest looking at, among many other pieces of expert literature, *Hinsley F.H. Power and the Pursuit of Peace. 1963; Tooze R. and May C. Authority and Markets. 2002; Hoekman B. and Kostecki M. The Political Economy of the World Trading System. 2009: and Mazower M. Governing the World: the History of an Idea. 2012.*

There is no shortage of euro-sceptic views about the UK's trading record or prospects, often compounded by arguments that go well beyond the issue of trade. The anti-EU Bruges Group asserts that European regulation costs the UK £28bn a year. Some Euro-sceptics have also claimed that it has already cost the UK more than £100bn over the last decade.

Both these UKIP propositions about EU regulatory costs are hard to substantiate, as are the Bruges Group and some other euro-sceptic figures for membership costs and trade costs, even if their sources can be traced in an attempt to clarify the reality behind the assertions. This last figure for regulatory costs, for instance, appears to be based on research carried out by Open Europe in 2010 and should be used with some caution. As noted by Katinka Barysch, writing for the Centre for European Reform: "Open Europe looked at the impact assessments attached to 2,000 UK business regulations since 1998. Many national governments, as well as the EU, try to estimate the potential positive and negative impacts of planned pieces of legislation before they enact them. Open Europe's researchers then added up the estimated costs of the proposed regulations as well as the estimated benefits. They found that the 2,000 pieces of regulation could have cost the economy a total of £176bn since 1998, and that £124bn of this could have come from regulation that was in some way related to EU policies. I say 'could have' because the £176bn and £124bn figures are made up of ministerial estimates of potential costs, not actual costs" *(Barysch K. Tilting at European Windmills. Centre for European Reform. 2013).*

There are still complex arguments as to whether the UK could go it alone and whether its departure from the EU would mean that it would weaken or strengthen its generally strong trading position as a world importer and exporter. The UK's trade pattern has changed in recent years while inside the EU with, particularly, some decline in its share of goods exports; however, the UK's share of global services exports remains high at 6.2%, in third place in the world, behind only the USA and Germany. Any future changes will probably be in line with its general economic performance, of which foreign trade is essentially an indicative component.

Would the energy and enterprise of the UK economy, including the financial services sector of the City, ensure that the UK continues to exercise a role as a major global trading player?

Part of the euro-sceptic case is to emphasise that the UK's trading position, especially in relation to financial services, would be improved by releasing the City in particular from the regulatory embrace of Brussels. This argument rests on the historical position of the City as well as the heritage of the UK's industrial revolution. The location of London is seen as crucial for the basing of many international financial institutions, including Lloyds insurance market, stock and commodity exchanges, and a range of international bank headquarters. This advantage is accentuated by its time zone position equidistant between the American and Asian markets *(see Yeandle M, Mainelli M, Berendt A. The Competitive Position of the City of London as a Global Financial Centre, 2005, and Ipsos MORI Understanding Global Networks: Business and Staff Location Decisions 2011).*

Beyond the London location argument and the City's historic and current position as a generator of a significant part of the UK's services sector, there is a view that the bureaucracy of Brussels, combined with too much government from Whitehall, hampers the natural vitality and energy of a free market for UK business. This is a complaint accentuated by small businesses (SMEs) which have fewer resources to cope with the administrative burden of increased regulation.

On the other hand, a 2013 Albion Ventures study suggests that, for some SMEs, there is a strong argument that "continental Europe remains the best export opportunity for many – particularly SMEs that are new to selling overseas" *(Prosser D. The Independent. 15 July 2013).* The Albion study indicates, according to David Prosser in The Independent, "significant numbers of SMEs are still finding export markets harder to crack then they had hoped and expected". Despite these disappointed hopes and expectations, it is suggested that although "the eurozone may indeed be struggling…it's our nearest source of customers, and SMEs need to be given as much encouragement to target these markets as when it comes to more glamorous economies". The focus on the eurozone and the EU for SMEs should be at least of comparable significance to efforts being made in relation to emerging economies such as the BRIC countries or the CIVETS, or any other group of potentially attractive trading and investment markets.

Overall, therefore, it is clear that there is a complex debate about whether the UK's trading position might be better outside the EU rather than inside. On balance, both the figures and the analyses suggest that the advantages lie in remaining within the EU and that the difficulties of extricating the UK would not necessarily bring countervailing benefits. Indeed, the complexities of international trade and economic global arrangements indicate that the UK embedded within the EU can exert greater strength in the increasingly competitive context of world trade than it could do in going it alone.

[with acknowledgements and thanks to Mark Purdy for assistance with preliminary information and analysis]

Facts and Figures

EU trade with the rest of the world

Trade policy is an exclusive power of the EU. The European Commission consults the member states in an advisory committee on all aspects, but it is the EU, not the member states individually, that decides on trade issues and concludes international agreements. That power also reaches into the sphere of trade in services, intellectual property and foreign direct investment.

The EU exported goods to the rest of the world worth 1,553,923 million euros in 2011 and imported goods worth 1,713,544 million euros.

Germany both exports and imports more than any other member state, contributing more than a quarter of the EU's exports and almost a fifth of its imports that year. The UK contributed 11.5% to exports, followed by France (10.7%) and Italy (10.6%). The UK took 14.5% of the imports, followed by The Netherlands (13.4%) and Italy (10.9%).

The US is the main trading partner of the EU. Exports to the US accounted for 16.8% of EU exports that year, while 9.0% went to Switzerland and 8.8% to China., China ranked first, Russia second and the US third among importers to the EU that year. Main export categories were machinery, transport equipment and chemicals, while main imports were fuels and lubricants.

Intra-EU trade

Member states exported and imported to and from each other in 2011 goods worth over 5.500,000 million euros, almost double the value of EU trade with the rest of the world. Intra-EU trade exceeds in value trade with the rest of the world for all the members of the EU, except the UK. For some it accounts for as much as 80% of their overall foreign trade. For the UK, trade with the EU amounted to only 49.4% of UK total foreign trade that year.

UK trade with the EU and the rest of the world

The UK has run a considerable trade deficit for a considerable number of years both with countries outside the EU and with its partners inside the EU. This deficit is most marked in the trade of goods.

Figures from 2005 to 2011 show the net (negative) balance of import and export of goods to and from the UK:

in 2005 minus $ 124,726 million	in 2006 minus $ 140,658 million
in 2007 minus $179,740 million	in 2008 minus $173.457
in 2009 minus $128,558	in 2010 minus $152,449 million
in 2011 minus $160,645 million	

This deficit is largely compensated for by a surplus in trade in services (in particular financial services from the City of London) which on occasion has run close to $ 110,000 million.

Figures from the same range of years show the net (negative) balance of import and export of both goods and services to and from the UK:

in 2005 minus $ 79,882 million	in 2006 minus $ 79.690 million
in 2007 minus $ 94,209 million	in 2008 minus $ 89,309 million
in 2009 minus $ 54,920 million	in 2010 minus $ 64,232 million
in 2011 minus $ 47,704 million	

Foreign Direct Investment

Sacha Zackariya
CEO and Co-founder, the Change Group International plc

Today the UK's situation is very different from the 1970s and 1980s. Britain now boasts some of Europe's most efficient and productive companies in several sectors.

Sacha Zackariya

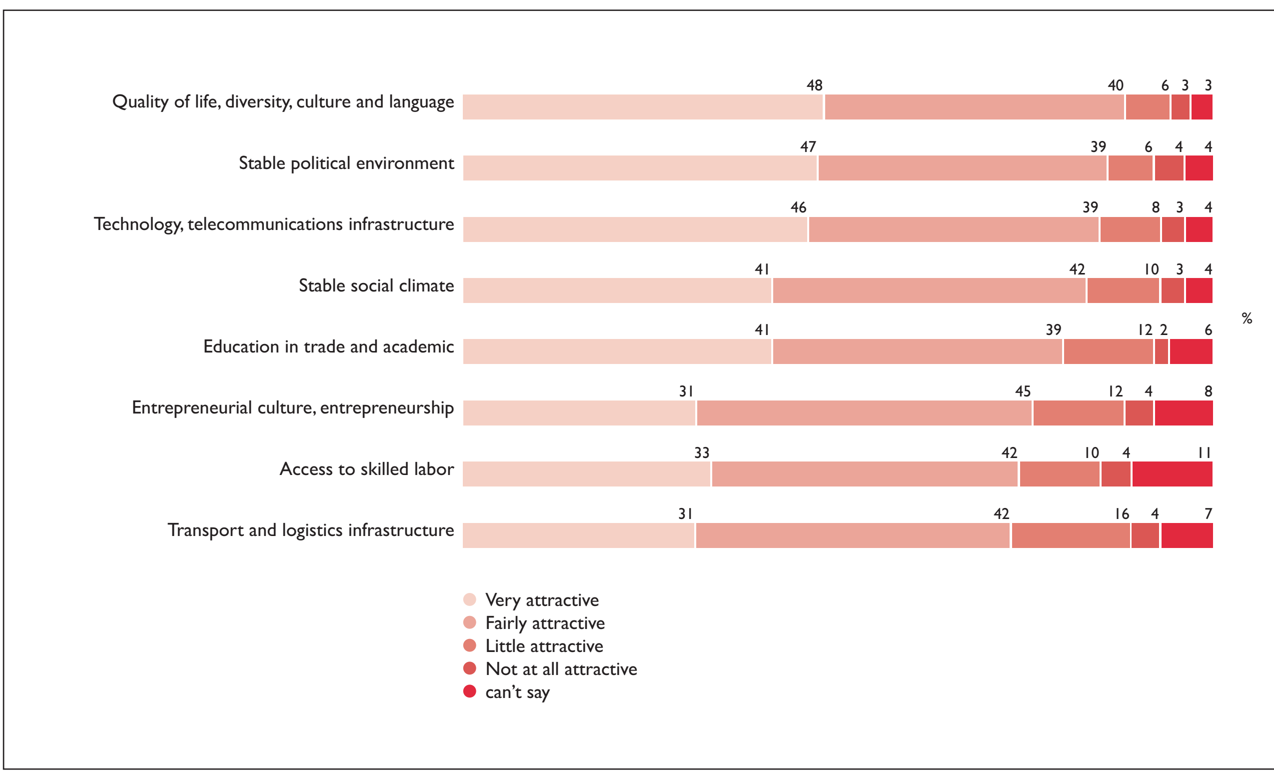
The UK's share of Foreign Direct Investment (FDI) coming to Europe

Of all decisions to invest "abroad" that result in FDI into a European country, approximately one in five choose the UK. An annual survey by Ernst and Young tracks this field, covering nearly 4,000 investment decisions a year. Over the six years from 2006 to 2012 (latest figures), the UK share has remained between 670 and 730 investments, somewhere between 14% and 20% of the total.

In the same period France, the second most popular European destination for FDI, has attracted between 520 and 570 investments each year. But Germany has grown in popularity as a destination for FDI, steadily increasing from 280 to nearly 600 projects. Experts expect Germany, which overtook France for the first time in 2012, to outstrip the UK within two or three years. For investments specifically in the manufacturing sector, it has done so already. When asked which destinations will be most attractive over the next three years, 56% of current investors cited Germany, with only a quarter naming France or the UK.

The reasons why FDI is attracted to the UK

There are many reasons why FDI flows strongly to the UK. The aggregate figures paint one picture, but each of the specific decisions is justified by a multitude of different reasons. The Ernst and Young annual study seeks to tease out some of these reasons through a survey of 500 decision-takers in this field.



64% of all 500 respondents also agreed that the UK's status as an influential member of the EU - but outside the euro - makes it an attractive place to invest. Interestingly, however, the reasons for investing in Germany were not linked to the potential to maintain competitiveness by devaluing against another currency, but rather to inherent strengths of its business model. Ernst and Young found "significant year-on-year rises in Germany's attractiveness on criteria including stability and transparency, internal market and labour costs." The study went on: "Germany's strength in manufacturing and industry is underlined by the three sectors cited as its top three drivers of growth: transportation and automotive, ICT/IT, and energy and utilities. Tellingly, Germany's unique selling point is regarded as being research and innovation."

Where does FDI come from?

The US provides over a quarter of all FDI flowing into Europe. The UK receives slightly more than a quarter (27%) of its FDI from the US, the largest single source for the UK historically and currently. For other European countries, however, the pattern is different. Germany is the main destination for FDI originating in France, The Netherlands and Sweden (all EU member states) and also from Switzerland, Japan and China. German firms repay the compliment by investing in France more than in any other country, as does Italy and the UK. Shares of total FDI each year fluctuate quite widely, but it is clear that UK investments in Europe are relatively evenly spread around the major states, usually making up high single digit or low double digit proportions of the FDI projects announced each year.

In global terms, the UK is currently the world's second biggest recipient of FDI after the US, even if increasingly challenged now by Germany. Reading these headline figures it appears to be an almost unalloyed success story, but to understand the full picture you need to look more closely at the record.

The UK's record with FDI

In the 1970s and 1980s the UK government needed to attract almost any kind of FDI since those companies that invested brought not just financial capital, but were able to force a much needed change in attitudes, management skills, working practices and competitiveness, that UK companies had for the most part been unable or unwilling to achieve on their own.

FDI was heavily promoted in the 1970s and 1980s under Margret Thatcher as a means of transforming moribund sections of the British economy by bringing much needed investment and improved working practices. Greenfield sites such as Nissan's factory in Newcastle could bypass antiquated union relations by negotiating to work with only one union and dramatically simplify working relations. In the 1950s, British car production had been the second highest in the world, yet by the 1980s, it had all but disappeared at the cost of vast numbers of jobs. Nissan imported the latest Just-In-Time (JIT) manufacturing techniques which had been perfected by Toyota in Japan with considerable help from Deming, a statistician from the US. They also invested in the latest tools and equipment and became one of the most productive car plants in the world.

Other parts of the motor industry have been rescued with FDI. Jaguar, Land Rover, Rolls Royce, Bentley and others are now profitable again. Their owners have invested in new factories, new technology and new working practices, producing new models that customers want to buy. There are, however, on-going risks, as with takeovers of any national brand by a foreign owner, that production (and jobs) could always be moved offshore, increasingly so as production lines are globalised. Foreign ownership by definition has weaker local attachment to the location of any business.

In a totally different sector, the Australian publisher Rupert Murdoch was able to transform the newspaper industry after taking over the Sun and the Times. He invested in new state-of-the-art printing processes in Wapping, requiring a fraction of the previous workforce. The print unions went on strike, as they had done each time any UK newspaper had tried to boost productivity. Yet this FDI helped reform the unions and transform the industry for all British newspapers, dramatically driving down costs and enabling advertisers of goods and services to access the British public more effectively and cheaply.

FDI and employment

The Ernst and Young report notes that in recent years Germany has returned to a decentralized, regional approach whereby the Länder compete abroad to attract FDI projects, whereas the UK has closed its Regional Development Agencies in England and Wales and concentrated the recruitment of FDI in Whitehall, a development reflected in the dominance of London and the South East as a destination for FDI projects. Only Scotland has retained Scottish Enterprise as a separate recruiting mechanism for FDI, resulting in Scotland benefitting from greater job creation through FDI than any other region of the UK.

Despite the sometimes dramatic job losses that it may bring, FDI can sometimes help employment. The Ernst and Young survey supplies figures to illustrate this, although based on employment data from slightly less than half the FDI projects recorded. FDI can provide investment that bucks the trend of a declining industry. It can boost productivity and allow the remaining workers to be employed in meaningful jobs. FDI has often invested in new equipment, bringing world class technology and working practices from abroad whilst simultaneously increasing the skill level of British workers and management. The UK has a positive record here, as it has consistently outperformed all other European recipients of FDI in terms of job creation since the start of the Ernst and Young survey in 1997, with the one exception of Poland in 2006.

Alongside capital, labour is the other key factor of production. And one of Britain's major problems is that there is inadequate demand for certain types of labour that it has in abundance, often in the wrong locations. FDI goes some way to compensate for the unwillingness of British companies to invest in those communities or hire those people with their particular skill set.

For many years after the Second World War, the Japanese Ministry of International Trade and Industry (MITI) successfully attracted investment with foreign technology, encouraging manufacture under license, the improvement of technology, and the export of new products. This growth model has been copied by South Korea, China and many other countries. But the UK government has not had a good track record of choosing individual companies or technologies to back. So rather than getting further involved, more recently the UK government has tried not to interfere.

UK newspapers often carry stories of companies being attracted to the UK regions with large incentives, only to abandon them. For example, Siemens abandoning its £1 billion semi conductor plant in 1998, just 1 year after it opened; the LG television monitor plant at Newport in South Wales, abandoned with the loss hundreds of millions in UK grants as well as the thousands of promised jobs in 2003; and Fujitsu's closure of its Newton Aycliffe plant.

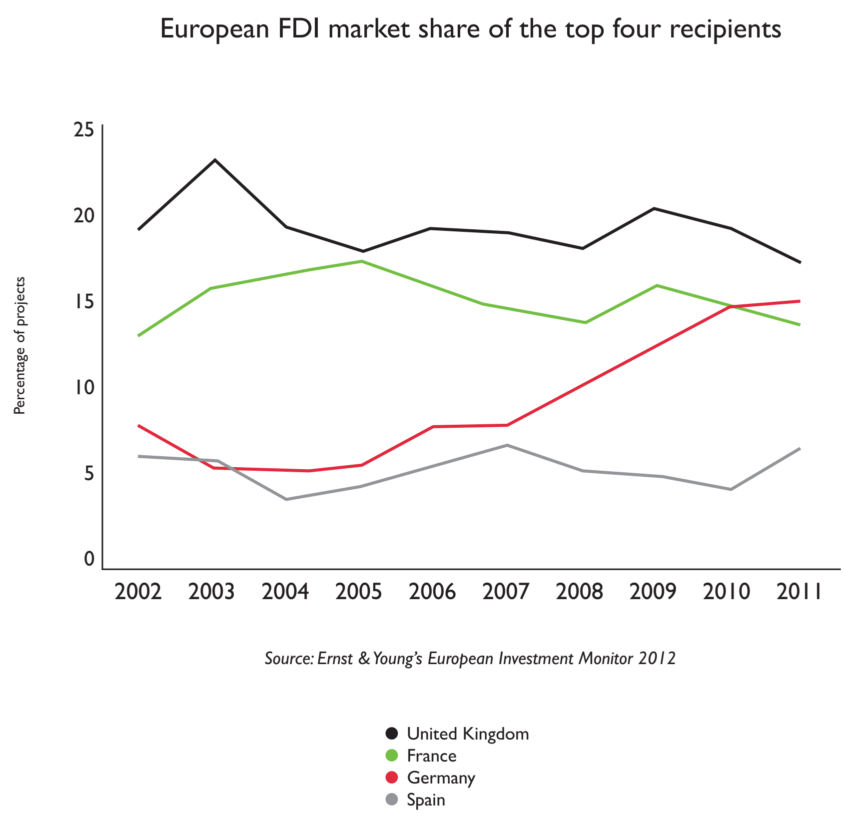
When looking at job creation, perhaps the UK should look beyond the multinationals so often associated with FDI. Net growth of employment in SMEs from 2000-2008 was almost 1% per year, whereas the net job creation of large companies was only 0.5% per year. If SMEs are the future for job creation, if their ability to respond to market changes is quicker, then the UK will need to foster talent in the people that will work in SMEs. How will the UK help to unleash creativity and entrepreneurial activity in that sector with the aid of FDI?

Almost 90% of SMEs do not survive more than 10 years. Inevitably those that work in them have to be adaptable and mobile. Just as large corporations cannot guarantee jobs for life, nor can SMEs. Both workers and entrepreneurs must re-skill themselves every few years. There is no equilibrium model of stable companies; all are in constant flux, growing and declining. Education systems and land law must adapt to suit the changed reality of the modern business world.

Training for skills, technology and investment combined with good business strategy can deliver jobs that do something worthwhile, deliver salaries that rise and deliver a better standard of living year by year, making employees feel valued. Part of that investment can certainly come from abroad, and is certainly to be preferred when it is productively employed as direct investment rather than simply portfolio investment.

FDI today

Today the UK's situation is very different from the 1970s and 1980s. Britain now boasts some of Europe's most efficient and productive companies in several sectors. Britain, the eighth most competitive country globally, has probably the fewest entry barriers to entrepreneurship in the world and is expected to have the lowest corporation tax rate (20%) of all G7 countries by 2015. Furthermore Britain's strong and flexible labor market, top academic institutions - with the highest MBA intake in Europe - contribute to a highly skilled workforce of 30 million people, the second largest in Europe.



Source: Ernst & Young's European Investment Monitor 2012

FDI has typically been focused on attracting large corporations, but recently the picture has become more varied. Clusters such as the science parks at Cambridge and Oxford and the IT hub at Silicon Roundabout in London have attracted start-ups and small companies, both domestic and foreign. A French entrepreneur at Silicon Roundabout commented on the UK's advantages: "There are more resources in London; you feel part of a community, not just a French one".

This may be hard for France to quickly replicate, but Berlin has responded more creatively. Following the collapse of the Berlin Wall a combination of low touch regulation, very low real estate costs, and a special historical ambiance has created an international melting pot of creative, entrepreneurial people potentially rivaling what is happening in London.

Growth in FDI in Germany means that it is likely surpass the UK in the next two to three years. More importantly, the type of FDI that Germany is attracting is arguably of a much higher quality.

What is also needed is to boost investor confidence domestically. UK companies should invest more in themselves, as opposed for instance to paying capital back to shareholders. Just this year a major UK company - BAE Systems – was trying to return over £1 billion to shareholders in a special dividend, because the board and management had no incentive to invest money into R&D or new product launches. BAE hardly lacks areas to grow and develop in, but by returning extra funds to shareholders, the Directors were saying that shareholders could find better areas to invest in than management could, despite historically low deposit interest rates.

What sort of FDI is useful to the country?

FDI is wanted in every country, but it can be more or less useful. Investment should be welcomed from companies if they will create one or more of the following over the medium term:

a net increase in the skills of workers or management;
b net increase in income to the UK Government in tax receipts across the industry sector. (i.e. taking into account the displacement of existing companies);
c net increase in the technological sophistication of the UK company or its suppliers, especially those within the UK.

On this basis, many foreign companies – such as investment banks, retailers or online service companies - who use existing scarce labour in key industries, or do not pay their fair share of taxes, or choose to keep the best technology in their home country, or do not foster creativity or innovation in the UK, should not be especially encouraged to come. Sometimes their investment is given preferential status with the help of their home government - or the UK government - through subsidies or loans. Yet their investments are not particularly helpful to the UK. In many cases their motive is simply to profit short-term from the UK market, or its access to the Single Market. The Government should be more selective about the FDI it attracts, valuing only that which really contributes wider benefits to the UK.

The more contentious part of this argument is that, even where they can bring jobs to impoverished parts of the UK, such investment is not always a good thing. For example, if they simply displace jobs in other parts of the economy – as for example Amazon's UK operation, which displaces more jobs in UK retailers than it creates – they may make on a net basis little or no contribution to the UK exchequer. In this example there is simply a displacement effect on existing UK music, book and hardware resellers, both online and on the high street, and a comprehensive assessment would show that the result is probably lower employment and a lower net tax take. Where foreign companies operate on an unequal tax playing field to UK companies, it gives them an unfair competitive advantage. Under these circumstances it is unsurprising when hard hit UK companies shut down.

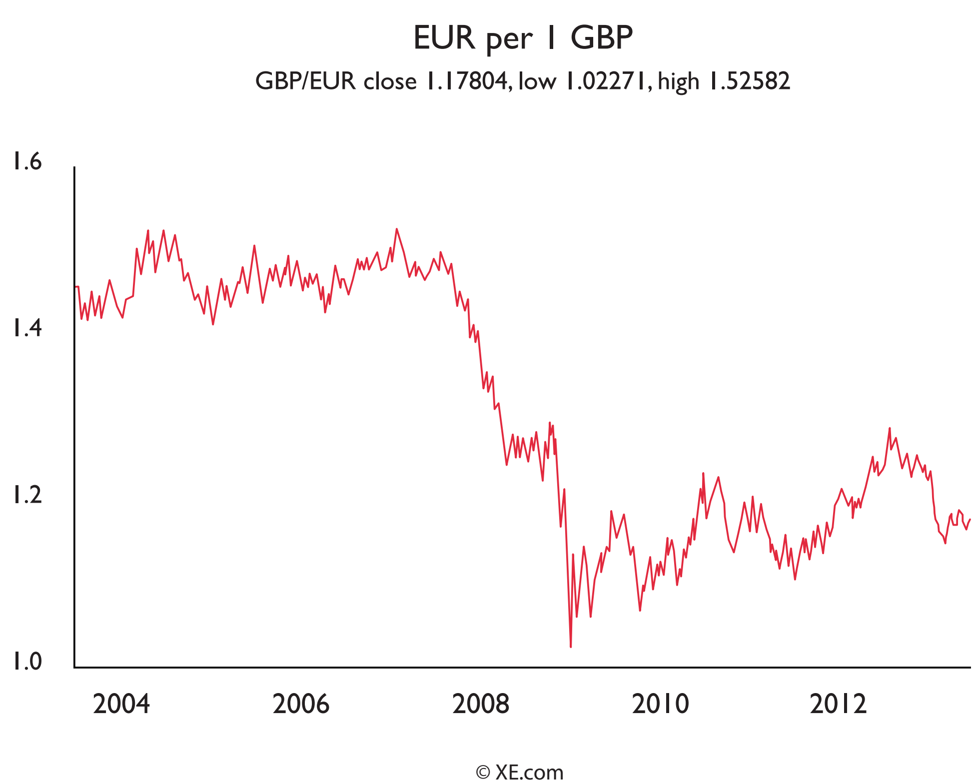
When a foreign owned company in the UK is doing well, its profits typically will go overseas. Yet when it does badly there is little to stop the owners closing it down or transferring production to an alternative low cost country. While inwards FDI is important, and the preservation of UK outwards FDI in third countries as well, so too is the fostering of businesses that are at least potentially more connected to and rooted in the country.

Will leaving the EU affect FDI?

According to the UK Trade and Investments Annual Report 2011/2012, 1406 FDI investments in the UK created or safeguarded more than 120,000 jobs that year. 750 of these were green-field investments which tend to create and sustain secure jobs in the long-run. Technology, knowledge and skill transfer can hardly be quantified, but all commentators agree that they definitely count towards the major direct benefits of FDI in the UK. The EU provides a range of funding for specialist projects and investments, especially to poorer regions of the UK. Foreign investors certainly make use of those funds. Even outside the EU, if considered a high enough priority, it is something that could be provided directly by the UK government, but at a comparable cost to what Brussels provides currently.

Already the UK is at a disadvantage to Germany with regards to direct trade links and direct air transport links to many parts of China and other emerging markets which are currently proving to be a growing source of good quality FDI. More Chinese FDI goes to Germany already than to the UK. Without major investment in UK infrastructure and vocational training to compensate, this trend could also intensify. Hence the UK is likely to slip down European rankings in the amount of FDI it receives, even if it stays inside the EU over the next few decades. The question is whether the situation would be worse still outside.

Some commentators suggest that UK inward investment fell in 1997 partly because of the UK's decision not to join the Euro. Many American and Asian companies felt that with low cost centers elsewhere in Europe, with comparable market access to Europe as the UK had, but without exchange rate volatility, they had on balance more reason to locate there rather than in the UK.



The decision not to enter the Euro has been of fundamental importance for the UK economy. It allowed the Bank of England to set interest rates specifically for the UK, and it enabled changes in the exchange rate to reflect the poorer productivity of UK companies by devaluing, particularly during the 2008 financial crisis. Not joining the Euro has arguably saved many jobs in the UK, but at the cost of less pressure to improve productivity. However, this independence of the Bank of England has enabled historically low interest rates to exist during a time of crisis and help encourage UK businesses, property owners and consumers to continue to borrow money to spend and invest at a time when the European Central Bank was raising rates. Whilst the ECB has helped to curb German inflation, it did much harm to southern European countries whose economies were contracting. More controversially, whilst UK SMEs struggled to access bank funding, much FDI has used UK bank finance at low interest rates to finance takeovers, for example in 2010 Kraft buying Cadbury using billions from the Royal Bank of Scotland.

A scenario where the UK leaves the EU would not change the economic advantages of being a non-member of the eurozone. Leaving would enable greater budgetary and regulatory independence for the UK, but it would close down the advantage of access to the single market that full membership automatically brings with it. That could only be maintained if a position such as Norway, or even Switzerland, currently enjoy could be negotiated for the UK, but that would inevitably have a price. And arguably less certainty about market access than full membership offers would make the UK less attractive for FDI.

UK options

The UK appears to have four options in regard to the EU to:

1. keep the status quo as a full EU member, but to negotiate enough changes to the current arrangements to satisfy the UK electorate in the promised referendum in 2017;
2. become a Member of the European Economic Area, similar to Norway, maintaining access to the Single Market at a price and without a seat at the decision-making table in Brussels;
3. negotiate a free trade agreement or customs union with the EU such as Switzerland have done;
4. leave the European Union unilaterally, having failed to negotiate a satisfactory revision of its relationship, relying on WTO rules for regulating trade worldwide.

Option four - a catastrophic break – is not at all likely. The UK is heavily involved in the European market as both an exporter and an importer. Over 1 million jobs in Germany, 500,000 jobs in France and 300,000 jobs in Italy depend on the UK continuing to import. These have annual trade exports to the UK worth 60 billion, 33 billion and 18 billion Euro respectively. Close to 4 million jobs in the UK depend on exports to the EU.

Hence the real choice in any referendum in 2017 is likely between either the status quo as regards the EU (with some minor amendments negotiated in order to keep the support of the UK electorate) or, if that proposition is lost, leaving the EU but remaining part of a wider individually negotiated free trade agreement or as part of the European Economic Area.. Should the UK depart, but still stay involved in the EU, it is unclear to what degree the UK would be able to roll back some of the EU regulations it does not want, and what impact those changes might have on FDI.

However, for the UK to become a member of the European Economic Area and so gain deeper access to the larger market, then it is likely to have to contribute funding to the EU budget just as Norway and Switzerland are required to do and, like them, not have a seat at the decision-making table in Brussels. Currently Treasury figures put the net budgetary payment to the EU at £8.1 billion (2011) having taken account of the rebate negotiated in the 1980s. Judging by GDP equivalents, any British contribution, were it to be in a position similar to Norway or Switzerland, would be likely to be in excess of £2 or possibly even £3 billion.

In relation to total government expenditure or to the flows of FDI, these sums are relatively modest, and should not be the main raison d'être of any serious decision about Britain's future. Maintaining our attractiveness as a destination for FDI, however, most certainly is. Even the uncertainty of the UK's position over recent years and from now until the referendum will not help. Anything that jeopardises that attractiveness in the longer term is to be avoided.

A fifth but even less likely option for the UK would be to deepen the relationship with the EU further by joining the Euro, accepting the goal of political union, and pooling more powers with other European states on defense, foreign policy and even taxation. That would level the playing field with Germany and all other eurozone members in attracting FDI. But that is not currently desired by the UK government or, so it seems, by the majority of the British people or businesses, however much such an embryonic United States of Europe with a strong, fully engaged UK at its heart could be advantageous in the long run both for the UK and for the other member states.

Facts and Figures

FDI flows and stock can vary dramatically from year to year, and variations are often accentuated by major currency adjustments.

The UK share of FDI coming into the EU member states rose dramatically between 2004 and 2005 (from 56 billion to 176 billion $) and fell by half in the financial crisis of 2007 to 2008 (from 196 billion to 91 billion $). Since then it has fallen further to just over 50 billion $ in 2011.

Over the decade to 2011, however, the UK share of FDI flowing into the member states of the EU was higher than that of any other member state, over 20% of the total EU flow: close to 900 billion $ from a total flow into Europe of nearly 4,400 billion $.

Other member states with large shares over the decade were Belgium 16%, France 12%, Germany and Spain 8%, the Netherlands over 6% and Italy nearly 5%. More recently Germany's share of FDI has been growing strongly and it is expected to overtake the UK's share by 2014.

FDI Stock in UK

The cumulative stock of FDI in the UK manufacturing sector is estimated to be £135,065 million, amounting to over 2,200 $ per head of population. It is sourced from the following regions:

EU £66,271 million (49%)	Americas £49,471 million (37%)
Non-EU Europe £9,433 million (8%)	Asia £5,824 million (4%)
Other £2,712 million (2%)	

(ONS.FDI.2011)

Over the past four years the EU share of total manufacturing stock of FDI in the UK has varied from 69% to 49% while the share from the Americas has varied from 22% to 37% and the share from non-EU Europe has risen from 4% to 8%.

International comparisons

Total FDI stock in all countries of the world (in 2010), as calculated by the CIA, is estimated for the "top ten" in billions of $ as follows:

USA 2,581,000 billion	France 1,207,000
UK 1,169,000	Germany 1,057,000
Hong Kong 962,200	Belgium 741,000
The Netherlands 687,800	Spain 668,000
China 574,300	Canada 528,700

Financial Services and the City

John Cooke

Independent Consultant, member of the Senior European Experts Group, Chairman of The City UK's Liberalisation of Trade in Services Committee;

Sir John Gieve

Former Deputy Governor of the Bank of England;

David Green

Former Head of the European Division of the Bank of England and subsequently Head of International Policy and EU Affairs at the FSA.



The growing integration of financial markets across the EU has generated a better allocation of resources and greater efficiency which have been of general benefit to consumers. But it has had special advantages to the UK because it has brought a concentration of high value employment and services in the City and elsewhere.

John Cooke, Sir John Gieve and David Green

Introductory

The UK's EU membership is integral to UK financial services. The forty years since UK accession have seen London renew its pre-eminence as a global financial centre as the Single Market has developed and more recently as the euro has been established. For financial services businesses with a global outlook, the UK's participation in the Single Market is a key factor in the continuing attractiveness of the UK as a destination for investment and as a base for undertaking financial services business, including euro-denominated business. A decision by the UK to leave the EU (even a market expectation of such a decision) would put at risk both London's position and the strength of one of the country's most successful sectors.

In part this simply reflects the UK's wider economic situation within the EU. The rest of the EU is the UK's most significant economic partner. It is the UK's largest export destination and the UK is the single most important market for other EU countries' exports. Similarly, the EU is the biggest single market for UK exports of financial services. About 33% of the UK's total trade surplus in financial services in 2012 came from trade with other EU member-states, compared with 31% from the US.

EU membership has also had more specific effects on the UK's capital markets and international banking and reinsurance. London acts as the main international financial centre for the EU and the EMEA time zone. London also provides easy access to the global capital market both for EU businesses (whether financial or non-financial) from other EU member-states and for savers and investors across the EU. This access brings major business flows through the UK from which UK businesses and the UK economy benefit. Being part of the Single Market enables London to play these roles even though the UK is neither the largest EU economy nor a member of the euro area. UK markets in financial services, and the regulatory structures governing them, are now highly integrated into those of the wider European Union. As TheCityUK has put it in *The UK and The EU: A Mutually Beneficial Relationship (June 2013):*

> "The UK and the EU both benefit greatly from the UK's membership of the Single Market. The EU benefits from having London, one of only a handful of truly global cities, as its hub and entry point for companies based outside Europe wanting to access the Single Market. London helps to create economic growth across the EU and provides access to a global capital market for EU firms. This means that the City is a truly European asset, not just a British one. The Single Market on the other hand gives UK business access to the world's largest market with 500 million people, generating around £10 trillion in gross added value. This is an economic zone larger than that of the US and Japan combined. The financial services sector accounts for around £510 billion of EU gross value, nearly 6% of total EU economic output and employs around 6.6 million people."

Nor do benefits arise only from the Single Market. Other EU policies – notably on trade and investment – also bring gains and attract investment to the UK as an EU member.

Advantages of Integration for the UK

The growing integration of financial markets across the EU has generated a better allocation of resources and greater efficiency which have been of general benefit to consumers. But it has had special advantages to the UK because it has brought a concentration of high value employment and services in the City and elsewhere. This has not just been in finance narrowly construed, but in linked business and professional services which also play a role in supporting other areas of economic and commercial activity. This has benefits both to UK-based providers of financial and professional services over the forty years of EU membership, as well as to end-users of UK markets across the EU (including UK-based final users).

The extent of the benefits for the UK is readily apparent from the charts below (references to "UK banks" means banks in the UK, including all foreign-owned banks with a presence in the UK):

The UK's EU membership brings other, related advantages. A Report by TheCityUK entitled "Driving Competitiveness" recently noted that:

- Access to markets in the EU was the core reason for choosing the UK over other financial centres in over 40% of the UK-positive investment decisions;
- In over 45% of UK-positive investment cases, decision makers cited access to skilled staff, including EU nationals, as one core reason for choosing the UK.

At a non-regulatory level the City is also dependent on other aspects of the Single Market, including notably the free movement of labour, without which many firms in the City would not be able to staff themselves satisfactorily or be able to sell services out of London across the EU to customers in their own language by London-based staff.

The scale of these benefits is linked to two specific features of the UK financial services market:

- Strength of the UK financial services sector: this is one sector in which the UK is a world leader. Financial services account for 8.6% of UK GDP - higher than all other major economies including the US (7.7%), Japan (4.9%), France (4.8%) and Germany (4.0%). All these countries have substantial domestic retail and corporate financial services sectors; but the UK in addition has a very large wholesale international centre for financial business serving global markets. The UK's international strength reflects the growing importance of financial services within the world economy: around 40% of UK financial services activity is accounted for by financial services exports from the UK to the rest of the world.
- International participation in the UK market: UK-owned financial business are strongly matched by non-UK firms established in the UK, which rely on the Single Market and its "four freedoms" as the basis for conducting business across Europe. UK exports of financial services to the EU totalled £20.4 billion in 2012, more than double the £9.8 billion in 2005 (even if down from a peak of £21.8 billion in 2008).
- In 2012, the UK's largest surpluses in financial services trade were with its key EU trading partners (the Netherlands (£2.8 billion), Germany (£2.3 billion), France (£2.0 billion), Ireland (£1.9 billion) and Luxembourg (£1.4 billion)).
- The Single Market, and the UK's position within it, is also a keystone to UK success in attracting foreign firms. A total of 962 foreign-owned financial companies were authorised by the FSA as foreign owned at December 2012. Some 454, nearly half of the total, were from the US and 176 from other EU member-states.

How did such deep integration come about?

The EU Single Market has been the critical factor. It has developed through incremental legislative steps to equalise the terms on which financial services can be provided in different member states. The legislation began by focusing on "freedom of establishment" and "freedom to provide services". It initially concentrated on the least controversial financial services operations, starting with capital transactions and then reinsurance (a financial service required, simply and efficiently, across all six original member-states, whose economies differed in their capacity to provide it). Legislation then expanded to cover a wider range of financial services, introducing steadily more uniform approaches to prudential tests of providers' soundness and to product and price control.

Progress was then driven further forward by the Cockfield Report (1985), which proposed a clear distinction between what had to be harmonised and what could be left to mutual recognition of national regulations and standards. Mutual recognition had come into its own following the European Court of Justice's *Cassis de Dijon* ruling (1979), which effectively laid down that full harmonisation of national laws was not needed for the movement to a single market - all that was required was acceptance (or recognition) of each other's laws. For financial services, this spurred an accelerated incremental legislative process which, by the 1990s, had reached significant critical mass. The Financial Services Action Plan (2000) provided further impetus to a legal framework enabling a firm from one member-state to establish branches in others, conducting business on the balance sheet of the parent company in its "home" member-state, on a basis which both "home" and "host" country authorities could be satisfied was subject to a common regulatory framework. Similarly, non-EU firms were incentivised to establish in one EU member-state on the basis that they could freely provide services across the EU from that base on the same legal basis. The ability to centralise activities in the most efficient locations for each category of business while still accessing markets across the whole EU has provided economic efficiencies benefiting both providers and users of financial services. There have been significant advantages, for instance, in streamlining trading costs, IT, compliance, regulatory and management functions generally. These benefits have also allowed EU-owned firms of whatever national origin to compete on a global scale.

Throughout this process one plank of UK policy has been to ensure that EU financial services regulation follows wider international agreements that the EU adopts – in particular in banking – and does not go beyond the Basel banking framework which covers the G20 and the world's major international finance centres in New York, Tokyo, Singapore and Hong Kong. The aim has been to ensure that the advantages of a level playing field within the EU, which has allowed the single market to develop, are not bought at the expense of disadvantaging the EU, and London in particular, as a global financial centre. This policy has been remarkably successful. The EU has been more assiduous than most (including the US) in transposing into binding laws agreements in the Basel framework and in the equivalent bodies for securities and insurance, all of which are now overseen and coordinated for the G20 by the Financial Stability Board, whose chairman is the newly appointed Governor of the Bank of England. The EU has rarely departed from the substance of these wider international agreements where they have adopted a framework or policy. This has reflected not just the UK's persuasive ability and voting weight, but also a wider recognition among regulators across the EU of the authority and legitimacy of the Basel Committee as the international rule maker. The existence of this wider international framework has helped combat continuing political and populist mistrust and opposition to international financial liberalisation within much of the EU.

Recent Developments

For its first decade, the advent of the euro as a single currency made little difference to the configuration, pace and direction of regulatory integration within the EU as a whole. More recently, however, there has been a changing balance in EU financial services regulation as a result of the financial crisis and consequent stresses, particularly within the euro area. The financial crisis of 2008 and onwards exposed a range of regulatory problems within the EU, many of them common to all member-states with a weaker financial position, whether within or outside the euro area. Analyses in the De Larosière Report and the Turner Review led to similar prescriptions. The Turner Review, published by the Financial Services Authority in 2009, observed that regulatory weaknesses meant that there needed to be either "more Europe" (a deeper level of regulatory integration) or "less Europe" (leaving member state authorities more discretion to take necessary measures). The response has been "more Europe" - a much intensified programme of EU regulatory legislation, binding member-states (including the UK) more closely together. Some has been directed at the Single Market as a whole, while some is more specifically necessary to address euro area integration and the systemic negative feedback which has emerged between the solvency of banks and their sovereigns. The combined effect is to enhance integration in a number of ways: first, decision making in the Council is almost completely by qualified majority voting; second, most legislation is subject to co-decision by the Council and Parliament; third, some important rulemaking powers have been delegated to new European Supervisory Authorities (ESAs) leaving member-states' regulatory bodies a secondary enforcement role; and finally, the euro area has agreed to move to a single Supervisory Mechanism (SSM) for banks with the ECB taking direct supervisory responsibility for the largest banks in each country.

The result is that:

- Regulatory policy and some supervision of financial services are more explicitly shared between the EU and its member-states;
- EU financial services legislation is increasingly being enacted as Regulations rather than Directives, aligning all member-states' implementation much more closely;
- Banking Union, including direct supervision by the ECB of major banks within the euro area, will represent a major step toward the Europeanisation of financial services regulation.

Banking Union – from which the UK has an opt-out - represents a huge leap in the direction of pooling sovereignty. It is sometimes seen as in some sense unrelated to the UK. However, this overlooks the fact that a major proportion of the business of the banks likely to be supervised prudentially through the SSM, and especially their more complex business, is undertaken by the London operations of SSM banks and will remain subject to UK conduct of business supervision. By the same token, UK-based banks, whether UK owned or not, will undertake important business within the SSM countries, sometimes through SSM-supervised subsidiaries.

Implications for the Future

The UK has been an active participant – often a leader – in the integration of Europe's financial markets over the last forty years. Indeed much of the current pattern of EU integration corresponds to a vision put forward under City of London auspices some years ago. The vision, as presented in a paper prepared for the City of London Corporation's City EU Advisory Group in July 2005, was:

> "... an innovative and competitive financial marketplace within which borrowers, issuers of securities and insurance policies, providers of pensions and of financial market services, will interact freely, on a non-discriminatory basis, with lenders, investors and policy holders, and pension plan providers. They will do this on the basis of common and proportionate prudential regulation and investor or customer protection, on a remote, cross border basis if they choose, and have access to all necessary market infrastructure, wherever located, without necessarily requiring a local presence. The market for corporate ownership will safeguard the interests of investors and operate within a framework of sound proportionate corporate governance and takeover arrangements, and be subject to high quality financial reporting and auditing standards"

Much of this vision has now been made a reality to the point that it is largely taken for granted, yet the provision of financial services in the UK by and to non-UK firms on the scale that exists today, together with all the economic benefits this brings, is wholly contingent on the existence of a common EU-wide legal framework in which the UK participates.

The growing integration of the inner tier of the EU in the euro area does bring some risks for the UK. In particular it sharpens the risk that Single Market regulation will in future be dominated by a coordinated block of euro area states (which together can command a qualified majority) and that the loss of UK influence may lead to EU regulation imposing unwarranted restrictions on the activities of UK-based firms inside the EU or disadvantage the UK in the global competition with non-EU centres.

The logical conclusion is that the UK needs to redouble its diplomatic engagement within the EU to mitigate the risks. That approach was successful, for example, in winning agreement to a "double majority" provision in the SSM legislation to give protection to non-euro states to prevent regulation simply being decided in future within a euro area block.

The dangers to UK financial services from moving in the opposite direction and detaching the UK from the EU are clear.

- **Location Decisions** there would be less interest in establishment in the UK by non-UK EU firms, which would no longer have the incentive to establish in the UK as an EU member on the basis that they could freely provide services across the EU from that base on a uniform legal basis. If the UK were to withdraw from parts of the Single Market such business would be likely to try to retain political influence within the EU by increasing its investment in the remaining member-states and relocating some business outside Europe altogether;
- **Loss of Confidence among EU Governments** other EU governments might no longer feel comfortable allowing such a large proportion of the activity of their firms to take place in what could be characterised (more easily than in the past) as an off-shore centre;
- **Greater Distance from euro area Management** the UK is outside the euro area, but UK financial services are vitally concerned with the euro and its successful future management. This is not just because of the

UK's reliance on the economic fortunes of its main trading partners in the EU, but also because the City is the main centre of the more complex segments of the euro-denominated markets. The City is essentially the financial centre of the euro, including housing the more complex operations of the euro area's leading banks, and thus has its own special interest in resolution of the euro's current difficulties. Much of the professional expertise related to complex euro-denominated business is also concentrated in London;

- **Lack of Influence over Single Market/euro area Relationships** the UK has sometimes tried to draw a distinction between the Single Market and the euro, reflecting a concern to be in the one but not the other. But the Single Market (as a whole) is nevertheless integral to the euro project (whatever its current problems). The benefits of the euro project will not be fully achieved for its members and those whose economies depend on them without the efficiencies that the Single Market makes possible. Members of the euro area will therefore always have a particular interest in the functioning of the Single Market, including in financial services. All UK stakeholders need to recognise that it has become a matter of considerable sensitivity that the Euro's main financial centre is offshore to the geographical euro area. UK interests must be ready – and equipped - to take account of concerns, whether well-founded or not, which arise from this. Equally, governments in the euro area and the EU institutions need to continue to recognise that euro-denominated business is conducted on a large scale outside the euro area across the Single Market and that any requirements which might be placed on euro-denominated business (such as location of clearing and settlement, or policies related to the SSM) must acknowledge this interdependence;
- **Wider Losses of Single Market Facilities** free movement of labour is an obvious example. Without it, as has been said, many UK-based businesses would not be able to staff themselves satisfactorily or be able to sell services to customers across the EU in their own language.

As well as these losses, there could be other unknowns, such as the degree of willingness among UK domestic politicians to accommodate the needs of the UK financial services sector. It is easy to assume that the UK political climate would always be benign and more ready to countenance a looser regulatory regime than in the EU. But this is not necessarily so, as recent instances of the UK pressing for tighter standards demonstrate. The recent Report by a Parliamentary Commission on Banking Standards is an example of a UK domestically-driven political viewpoint: its apparently ambivalent attitude to the merits of international regulatory standards (see Volume 2, Chapter 4) illustrates the inherent flux of choices and chances, from which domestic politics is no freer than its intergovernmental counterpart.

The Counterfactual Challenge

The logic of these arguments is that it will remain important for the UK to:

- Continue to participate, as a full EU member, in the framing of the Single Market, both in financial services and more widely;
- Remain engaged effectively with EU Institutions, including the new regulatory bodies and SSM;
- Press the case for better and more uniform enforcement of rules;
- Argue the case, when necessary, for better quality legislation achieved through better processes;
- Proactively participate in the debate over structural reform of the EU (i.e. Banking Union).

There are, however, those who reject any such arguments, preferring to suggest that the UK would be better off if it left the EU or negotiated alternative terms for continuing free trade and market access.

One view is that the UK could secure some alternative half-way-house regime either as a member of the EEA, like Norway, or from outside the EEA, like Switzerland. The suggestion is that the UK would retain most of the advantages of EU membership with fewer of the disadvantages. These so-called Swiss and Norwegian options have been criticised both by the Prime Minister and by the UK Parliament (See Chapter 5 *"The Single Market and the EU: Norwegian and Swiss options"* in the House of Commons Foreign Affairs Committee Report on *"The future of the European Union: UK Government policy"*). First, the UK would not automatically become a member of the EEA, and the terms on which it might do so would depend on its former EU partners. Second, the UK would retain its obligation to abide by most of EU Single Market legislation and, like Norway, contribute financially to its costs, but lose its position as a member to influence its formulation. Whatever the rights of consultation enjoyed by Norway for example, they cannot compare to the influence gained by being represented in the Commission working groups, the Council and the Parliament. Third, the UK would lose the advantages of other aspects of EU membership, notably the market access gained by the EU through trade agreements with third countries.

A more radical view is that the UK would do better to detach itself from the EU and EEA more completely. The proponents of this view put forward three interrelated types of argument in relation to financial services:

a) London has such a lead over other European centres in terms of size and complexity that the UK could leave the EU and retain its predominance in Europe, i.e. the economies of agglomeration are so great that attempts by the Euro area to repatriate business would fail.

It would be reckless to rely on this assumption. True, London has gained a strong critical mass of business within the Single Market. But, if outside the EU, the UK – whatever its advantages in terms of market scale and depth - would lose the key advantages of the Single Market. UK-based businesses would lose their right to branch into the rest of the EU; and EU and EEA businesses might not be permitted to branch into the UK. Facilities for undertaking cross-border business with former EU partners could be curtailed or made subject to conditions. Nor would it be a foregone conclusion that EU regulators would remain content for large EU financial services businesses to continue to maintain present levels of assets and business in London, if UK markets were subject to a different regulatory regime no longer under common EU ownership. The ECB's recent decision on the location of euro market infrastructure (which is being challenged in the courts as a breach of Single Market law by the UK) shows that this is already a concern. In short, the argument that the current economies of agglomeration would be preserved assumes a scenario far more favourable than might actually prevail.

b) The UK would be protected, it left the EU, by the WTO and any future treaties, and so could count on access to the EU in financial services almost as good as at present, i.e. the UK could get the best of both worlds and become an offshore financial centre to the euro area, able to avoid EU over-regulation while still maintaining or growing its share of EU-related financial services business.

This argument relies on some assumptions similar to those at (a) above, plus some others. In terms of market access for financial services, the UK, if outside the EU, might be able to rely on the commitments given by the EU in the General Agreement on Trade in Services (GATS, 1995) and the Fifth Protocol to the GATS (1998); and the UK's trading partners would hope that the UK would confirm its GATS commitments towards them. These steps would probably not be automatic, however, and would require a degree of formalisation. Nor would they necessarily imply that the WTO and the GATS could be the automatic means for the UK to replicate its current trading advantages for financial services within the Single Market: the "prudential carve-out" under the GATS Annex on Financial Services would allow EU regulators to take whatever prudential measures they deemed necessary to intervene in trade in financial services between the UK and the EU so as "to protect investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system". The risk here is both that the EU would limit the access of UK-based companies to the EU market and that, in the absence of the UK's influence, they would more likely to add to and depart from the frameworks established by the G20, the Financial Stability Board, and (for banking) the Basel Committee. The UK has hitherto been very determined in advocating strong adherence to international standards and seeking to ensure that the EU and international positions were closely aligned.

c) The integration of the euro area into a full economic, fiscal and monetary union would anyway leave the UK "in the ante room" to the real discussions and decisions in the EU, so the UK might as well give itself more freedom of manoeuvre by leaving the EU's outer decision-making tier and becoming fully independent.

This too assumes a degree of freedom that would probably prove illusory in practice, given the importance for UK- based firms of retaining access to the EU market as well as the continuing obligation to meet FSB international standards. True, the UK has often been in a minority in EU discussions and decisions; and the risk of minority status could become even greater as the euro area's monetary union progresses. But minority status and minority influence are far preferable to no status and no influence. The UK has been a highly influential voice in the EU on financial matters and can remain so. This reflects London's pre-eminence as a centre of European finance and the quality of the expertise and weight of experience it can bring to bear. There is usually a range of views in each member state on regulation and advocacy by the UK has lent weight to the voices elsewhere in Europe in favour of a free, if regulated, market for finance which can also attract global business. Given the UK's reliance on EU financial services business, it would be disastrous if the EU, absent UK influence, embarked on more protectionist or isolationist courses impeding international transactions. Outside the EU, the UK would have no treaty-based protection against such developments.

The Logic of the UK's Present Position

Taken all in all, the creation of the integrated EU framework for financial services has had a very marked and highly positive effect for those UK-based financial services businesses with an EU-wide or global reach, and an equally positive effect for their clients. Without such a common legal framework and set of legal freedoms, their commercial operations might well not take place at all or else might take place in a non-EU centre. Without it, too, there would be far less interest in establishment in the UK by non-UK EU firms, while their home country authorities might not allow it without additional regulation. The City as it exists today as a market place of firms from across the EU and outside is made possible by the framework of Single Market legislation. The UK, backed by its expertise in financial services, can sustain its influence on the framework, provided it is seen as committed to it. To abandon this for some untried, unknown and unpredictable alternative would be foolhardy.

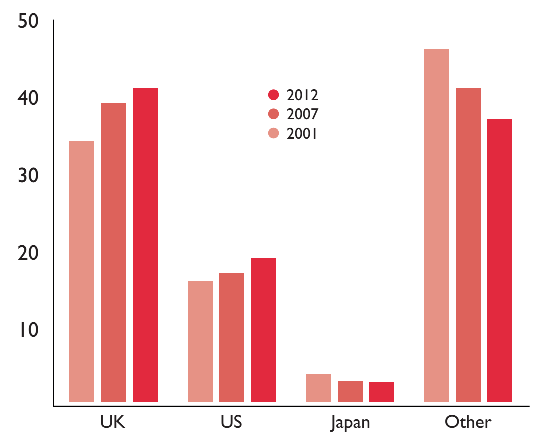
Facts and Figures

The rest of the EU is the UK's most significant economic partner: the UK's largest export destination - and the UK is the single most important market for other EU countries' exports; the biggest single market for UK exports of financial services (33% of the UK's total trade surplus in financial services (2012) came from trade with other EU member-States, compared with 31% from the US).

The extent of EU benefits for the UK stands out from the charts below ("UK banks" means banks in the UK, including all foreign-owned banks with a presence in the UK):

The scale of these benefits is linked to two specific features of the UK financial services market:

Share of global euro-denminated forex trading



% share, April each year

Source:: BIS, Bank of England, TheCityUK estimates

UK Share of financial markets in the EU			
	% share of UK	Date	Source
Interest rate OTC derivatives trading	74	April 2011	BIS
Foreign exchange trading[1]	74	April 2011	BIS
Hedge fund assets[1]	85	2012	Eurohedge
Private equity funds raised[1]	42	2011	EVCA
Marine insurance premiums	51	2011	Int. Union of Marine Insurance
Pension assets	49	2011	OECD
Equity market capitalisation (LSE)	37	2012	World Federation of Exchanges
Financial services GDP	24	2012	Eurostat
Bank lending	17	2011	European Banking Federation
UK bank assets[1]	24	2011/12	The Banker 1000
Insurance premiums	18	2011	Swiss Re
Financial and related professional services employment	19	2012	Eurostat

[1] % share of Europe

Source: Various sources; TheCItyUK estimates

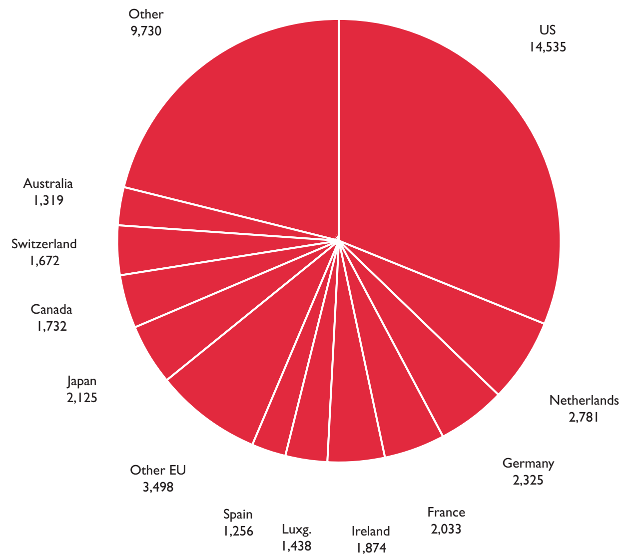
› **Strength of the UK financial services sector** this is one sector in which the UK is a world leader. Financial services account for 8.6% of UK GDP - higher than all other major economies including the US (7.7%), Japan (4.9%), France (4.8%) and Germany (4.0%).

› **International participation in the UK market** UK exports of financial services to the EU totalled £20.4billion in 2012, more than double the £9.8billion in 2005 (even if down from a peak of £21.8billion in 2008). In 2012, the UK's largest surpluses in financial services trade were with its key EU trading partners (the Netherlands (£2.8billion), Germany (£2.3billion), France (£2.0billion), Ireland (£1.9billion) and

Luxembourg (£1.4billion)). The Single Market is also a keystone to UK success in attracting foreign firms. A total of 962 foreign-owned financial companies were authorised by the FSA as foreign owned at December 2012. Some 454, nearly half of the total, were from the US and 176 from other EU member-states.

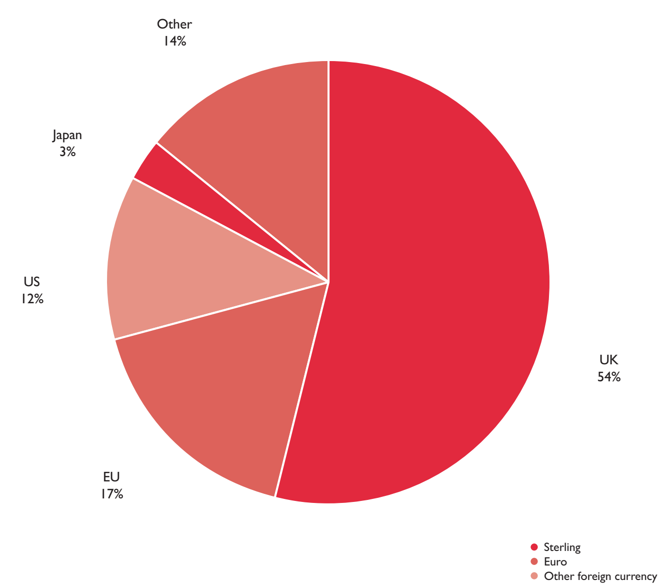
Geographic breakdown of UK trade in financial services

UK trade surplus in financial services with selected countries £m, 2012



UK Trade surplus in financial services: 46.3bn

Ownership/currency breakdown of UK banks' assets



% share of total assets February 2013

Total Assets: 8,164bn

Manufacturing

Stephen Radley
Director of Policy

Lee Hopley
Chief Economist, Engineering Employers Federation

Looking forward, we can never predict the future with complete confidence, but the best analysis suggests that the opportunities for trade will continue to expand.

Stephen Radley and Lee Hopley

Questions on the table

With Britain, like much of the rest of the Europe, still struggling to shake off the shackles of recession, we have seen a growing focus on what being part of the EU means for our economy. Recent events have illustrated how closely our economic fortunes are tied to the rest of Europe, but currently the influence of Europe on our economic performance is widely regarded as negative. The continuing economic weakness and uncertainty in continental markets has had a negative impact on our exports and business investment. It has created the impression that many European economies are uncompetitive and over-regulated, and that our membership of the EU is a drag on growth in Britain. There is also growing speculation that the only way that the EU will deal with the challenges it faces is by initiating some fundamental changes that will leave its individual members much more economically and politically integrated.

This combination of events, impressions and speculation means that questions are increasingly being asked about our future relationship with Europe. For example, would Britain be better off by loosening its links with the EU and developing stronger ones with faster growing parts of the world? Should we be shaping a new relationship with Europe which allows us to escape the constraints on growth that regulation from Brussels imposes on our economy?

These are valid questions and impact on every part of our economy. But they are particularly pertinent for a manufacturing sector whose lifeblood is exporting, which is highly dependent on inward investment, which needs a cost base that is on a par with the rest of the world and a business environment that gives it the flexibility to respond rapidly to constant change in world markets.

Yet it would be a mistake to jump straight from current events, and speculation about what might happen, to prescriptions about what our future relationship with Europe should be. Instead we need to take a longer-term perspective that looks back at what our membership of the EU has meant for British business, and manufacturing in particular, and looks forward to the choices we want to make to shape our economic future.

EU membership has reshaped our economy

Since the UK joined what was called the European Economic Community in 1973, our economy has become two and a half times larger and our living standards have advanced by a similar amount. Productivity growth has also accelerated, while employment is 4.5 million higher. At the same time, however, our manufacturing base is only a little bigger than 40 years ago, numbers employed have fallen sharply and our trade deficit is also significantly larger.

Of course, there is no simple one-to-one relationship between our economic performance and membership of an institution that has changed dramatically not only in name, but in membership and in what it does over the past forty years. But the experience of the past forty years suggests that our membership of a large and growing economic area opened up significant opportunities for our economy and boosted productivity by exposing it to greater competition. At the same time, the performance of manufacturing suggests that it was ill-prepared to adapt to the more intense competition it faced, and that successive governments have lacked the strategy to improve the competitiveness of our industrial sector and to exploit the opportunities that were open to it.

The key questions to answer

Looking forward, we can never predict the future with complete confidence, but the best analysis suggests that the opportunities for trade will continue to expand, while world markets will become ever more competitive as the existing bunch of emerging economies are joined by new and hungry kids on the block.

With the right strategy, a successful manufacturing sector can harness these opportunities to create high quality, well-paid jobs in Britain. The question is whether our future membership of the EU will, on balance, increase the prospects of that strategy being successful. This paper does not offer a definitive answer, but it poses some questions with which both sides of the debate need to engage over the coming months and years. These are whether our membership of the EU will:

- support our ambitions to access new markets;
- develop new industries and expand existing ones by providing solutions to the big challenges facing the world, such as an ageing population, climate change and global security;
- make Britain a cost competitive place to do business;
- ensure we remain a major destination for inward investment.

Accessing new markets

If we are looking to manufacturing to make a greater contribution to a stronger and more balanced economy, a substantial part of this will need to come from faster growth in exports. The scope for significant growth in the domestic market alone will always be limited, and exporting also brings benefits from higher productivity and is a significant driver of investment and innovation. A range of statistics highlights how important access to export markets is for UK manufacturers. These include the fact that:

- 36% of manufacturing companies export compared with 11% in the rest of the economy *(Community Innovation Survey 2011);*
- more than half the UK's exports are manufactured goods *(National Statistics);*
- across EEF's membership, 40% of companies are 'export-intensive' with overseas sales accounting for half or more of turnover;
- between 2009 and 2012 manufacturing accounted for 56% of the total growth in the value of UK exports *(National Statistics).*

There is little argument over these points but substantial disagreement over whether our membership of the EU will continue to support faster growth in exports over the next decade. The EU has been, and will remain, an important source of demand for UK exporters, notwithstanding the current weakness we see across the bloc. Indeed, access to a large and growing single market was one of the reasons for joining the Community initially, with the Prime Minister of the day stating: "This will enable us to be more efficient and more competitive in gaining more markets not only in Europe but in the rest of the world." In the past decade we have seen the EU's economy increase considerably as new members have joined, and this process will continue as enlargement continues and other countries progress towards membership.

For supporters of the UK's continued membership of the EU, market access is most often top of the list of advantages of membership. But the world economy has changed beyond recognition since we joined the EU four decades ago. Indeed, within the past year, goods exports to non-EU markets have overtaken those to our European partners for the first time since we became part of the EU. Economies such as China, India and Brazil are rapidly moving up the global economic rankings, and with growing middle classes and industrial efforts to climb the value chain, there are more and more lucrative opportunities for developed world manufacturers in markets beyond Europe. Although the volume of goods going to the BRICs may not yet be as large as to traditional markets, it is growing more strongly.

While the balance of growth, not just in the next year, but in the next decade, is likely to continue to be tilted towards emerging economies, the UK's relationship with the EU on trade matters does not cease to be relevant. The trend on trade relations in recent years has been away from multilateral negotiations and in favour of regional trading blocs. South American countries have been coming together through Mercosur since 1991, an ASEAN Free Trade Agreement is not far from completion, the Eurasia Economic Union is one of the more ambitious efforts to create a single market across Russia, Belarus and Kazakhstan and the negotiations for an expanded Trans-Pacific Strategic Economic Partnership Agreement are ongoing.

Discussions on a free trade deal with the US are a case in point for the EU, where the eventual benefits for both sides are an estimated additional 0.5% of GDP. Increasingly the focus is not just about reductions in tariffs, which are already low across many markets, but also about reducing non-tariff trade restrictions. A recent EEF survey showed that customs and entry procedures, import licensing requirements and lack of intellectual property protection were seen as major stumbling blocks for manufacturers seeking to enter new markets, particularly in Asia and South America.

UK exporters must also be certain that their interests in these agreements are well served and that the deal is ultimately as good for the UK as a bilateral agreement. The composition of the EU has become more diverse, which increases the complexity of putting together a single negotiation position which seeks to maximise the benefits for the many. This means the UK has to work harder to put itself front and centre in the negotiation process.

While the direction of travel is undoubtedly towards more global cooperation in creating a favourable trading environment across developed and emerging markets, a looser UK-EU relationship would not necessarily exclude the UK from this process. But size does matter when negotiating and defending trade policies, which is why it is one of the competences carried out by the EU for all its member states together. A clear assessment is needed of the UK's position in world trade in all scenarios, including one where UK officials take a more prominent position in EU trade priorities. This will provide certainty for exporters seeking to invest and grow and ensure that there is transparency over how future decisions will impact on the key economic policy priority of rebalancing our economy.

Providing solutions to global challenges

The challenges of tomorrow will not necessarily be addressed with the solutions we have available to us today. And many of the issues that are on the horizon such as shifting demographics, climate change and changing defence and security requirement are global in nature. This means that the size of the prize is significant, but also that accessing it will tend to come from countries working together rather than unilaterally. Many of these challenges are simply too large and complex to be successfully tackled by one country alone, so increasing the scope and scale of international cooperation enhances potential impact, for instance of research activity and public spending.

The UK sees itself as an important part of solution to these challenges, not least because of the strength of our manufacturing sector and the industrial capabilities we have in areas such as defence, aerospace and life sciences.

This is evidenced by the priorities the government has set out as part of its Industrial Strategy. In some of these areas, particularly responses to global climate change, resource efficiency and security, there is a growing trend towards collaboration with international partners, not just in terms of the global policy framework, but also in joint innovation and technology programmes.

The UK research base has strong collaborative partnerships with Canada on health and regenerative medicine and with Japan on space and earth observation technology. The UK, as the world's eighth largest economy, can rightly be seen as an important collaborative partner in pushing for solutions and driving a global agenda, but some emerging markets will rise closer to the top in the coming decades. Therefore, as we consider our future relationship with the EU – which will remain one of the big four trading blocs for the foreseeable future – we must consider whether membership will make a difference to our ability to remain front and centre of the development of global solutions.

The UK academic research base and R&D activity by business is already highly connected with the rest of the global economy. Over a fifth of funding for UK business expenditure in R&D comes from overseas, including from EU sources. And the UK research community is among the most successful in winning support from the EU's Framework Programme for research, including as a key partner for non-European countries participating in the Programme.

We cannot, however, assume that the balance of high value innovation and research activity will remain static over the next decade. In the UK, and indeed in other parts of the developed world, demographic developments and a declining share of graduates in science, technology and engineering subjects may lead to a talent crunch. This might be overcome, in part by working with international partners. But we also need to ensure that we build on our specific capabilities to attract the best researchers to work in the UK.

In addition, the faster growing economies in Asia and South America – including, but not limited to the BRICs – are investing substantially in the research and technological development capacities which are now becoming recognised as meeting high international quality standards. These new entrants into the global research community will significantly increase their bandwidth of expertise to develop solutions to global problems. They will also present competition for resources and talent for economies such as the UK.

Without the collaborative partnerships that we have developed within the EU, the UK would struggle to continue to punch above its weight as part of joint efforts to build large scale international innovation and research infrastructure. A failure to capitalise on these research and industrial opportunities – many of which, such as climate change mitigation and adaptation are likely to be massive in scale – would inevitably weaken our ability to grow our economy and create high quality jobs.

Equally, EU institutions have some significant decisions to make on how and where they deploy their resources to best effect. Pressure on EU budgets will intensify in coming years and the trade-offs on how the EU raises and spends its money will only increase, with agriculture subsidies, regional development and innovation all vying for a larger share of what may be a diminishing cake. We must not miss the opportunity to play a key role in developing the solutions to tomorrow's problems. The debate on our future relationship with the EU must therefore consider whether we will be best placed to capitalise on them in or out of the EU.

A competitive location

While innovation and exporting are increasingly important for many manufacturers, the basic issue of operating from a competitive and flexible location remains central for most of them. The EU is often seen as a source of higher costs, particularly through increased regulation. It is certainly true that the EU has become increasingly active in regulating areas such as employment, health and safety and climate and the environment. In addition, the EU has been estimated to account for more than a third, and possibly a half of the regulation imposed on British business. Advocates of leaving the EU, or at least negotiating a looser relationship with it, would therefore argue that British businesses would benefit from a more flexible and lower cost environment.

However, the reality is more complex. To start with, regulation is just one area of cost for business, and two of the most significant areas – taxation and energy costs – are mainly domestically controlled. Our government's own statistics show that its climate change policies will add some 50% to industry's electricity prices by 2020 with all of this imposed domestically, save for the EU Emissions Trading Scheme. Looking just at regulation, while it may be true that many of the additional measures come from Brussels, our government has discretion over how it is implemented and could learn from the lighter touch approach employed by some our EU competitors. It is also not a given that the direction of travel for the EU will always be towards more regulation. While it would be foolishly optimistic today to imagine the regulatory burden falling, we should acknowledge the growth of an alliance for change amongst some key EU members - including Britain - which is pushing harder on issues such as a meaningful target to reduce the burden of regulation and much greater scrutiny of new proposals.

Looking at the existing stock of regulation, it may be that a decision to leave the EU would open up the opportunity to escape from some of the regulation it imposes, but the extent of the gains may prove to be significantly less than its proponents suggest. For example, the trend towards more family friendly employment regulation is in part driven by the fact that it is electorally popular as households seek to balance out their work and non-work. Similarly, although there are areas of health and safety regulation enacted by the EU which are badly thought through, there will be a public need and popular expectation for the protection it offers. In addition, unless a UK future government was to turn away from demanding goals to reduce carbon emissions, it is hard to see much potential to reduce legislation in this area. We also need to be mindful that, once it is in place, regulation can often be complex and costly to unpick, and that adjusting to any change is often not straightforward for business.

Finally, we also need to factor in the areas where EU membership can reduce costs, For example, the single market in goods has already helped to increase competition and reduce costs, and looking forward there is the potential for greater savings in areas such as energy, telecommunications and insurance.

Given the wide range of issues presented in this section and uncertainty over the future direction of the EU's regulatory effort, it is nigh impossible to put together a convincing estimate of what leaving the EU would mean for the UK's regulatory burden. It is therefore hard to be confident that the size of the deregulatory prize from exit would be that large and this must be weighed against other key areas such as access to markets, participating in international collaborative efforts to address global challenges and the last issue – Britain's future as a destination for investment.

A destination for investment

The UK is a major recipient of foreign direct investment (FDI). The latest statistics from the UN Conference on Trade and Development suggests that the UK accounts for around 6% of the stock of global FDI – more than twice our share of global output.

From a manufacturing perspective, inward investors make an important contribution to industry, accounting for over two-fifths of total output in the sector. These investors tend to be large, committing significant resources to investment in both modern machinery and research and development and are important for anchoring supply chains.

Moreover, the drive to attract inward investment to plug supply chain gaps in key industries remains a priority for policy makers. Our relationship with the EU will have a bearing on our future success for three reasons: EU countries have historically been significant investors in the UK, market size and potential are important factors in FDI decisions, and - as outlined previously - the investment climate for manufacturing.

A range of evidence, including from EEF members and the World Bank, points to market size and potential as a significant factor in inward investment decisions. Statistics from UNCTAD show that the of the world's largest (top ten) non-EU FDI recipients seven are also in the top ten of the world's largest economies. The UK domestic market is not large, but its ties and proximity to Europe for many equate to large market potential. Indeed a 2010 survey of manufacturers by EEF showed that other EU countries were part of the supply chain for the vast majority of UK-based companies: 85% of respondents said that some or most of their customer base was located in Europe and 88% had some or most of their suppliers on the continent. Companies seeking to sell and operate in a pan-European environment can therefore include the UK as a potential destination for this activity.

More focus has turned recently to emerging economies as inward investors in Europe, particularly companies in China and India. Currently investment from these regions is low, but a survey from A CAPITAL points to a growing appetite among Chinese companies to invest and acquire in Europe. However, currently the biggest source of overseas investment in UK manufacturing is from Europe itself. According to National Statistics, the stock of inward FDI in manufacturing from Europe stood at 49% of the total in 2011. While there will be future opportunities to secure new investment in high value manufacturing from faster growing economies seeking a presence in the UK, we are currently strongly linked to investment partners in the EU.

Finally, the EU has a bearing on the investment climate, in terms of how attractive the UK is from a skills, regulation or cost perspective, and the European Commission is also taking a bigger role in developing international investment agreements. Globally there are some moves - sometimes hesitant and subject to stop and start - to create a more liberalised investment environment. And, as is increasingly the case with trade, there are moves towards regional treaty-making rather than bilateral investment treaties. The EU now also negotiates on conditions related to investment protection on behalf of member states. UNCTAD's World Investment Report in 2012 concluded that, as the EU accounts for a quarter of the world's GDP, any agreement concluded with it would have significant economic weight. If, as currently seems to be the case, the balance is shifting towards regional negotiations when it comes to investment, the UK must consider how it maximises the benefits of this process inside the EU.

Conclusion

In this paper we have identified four key economic questions with which the debate on the UK's future relationship with EU must engage and to which it needs to provide some clear answers. What is already clear is that any attempts to unpick or exit from the existing institutional framework which affects our trade and investment position, influences our business environment and will determine the role our industry plays in solving future challenges will not easily be reversed.

The outcome of the potential referendum in 2017 will clearly be decided by the voters of the wider British electorate and not by companies alone. These votes will be shaped by a range of issues that go well beyond the economic ones set out in this paper. However, a key issue for many voters will be whether remaining part of the EU will be good or bad for our future living standards and our ability to create high quality jobs. Currently, the debate on Europe is being conducted at much too low a level and is based more on emotions, suppositions and in some cases misinformation.

We must now raise the quality of the debate. We must provide the British public with much better information on how the relationship that we choose to have with Europe will impact on companies wanting to invest and grow; for entrepreneurs looking to start businesses and sell to a host of export markets and for companies at the cutting edge of technology, seeking to provide solutions to global challenges.

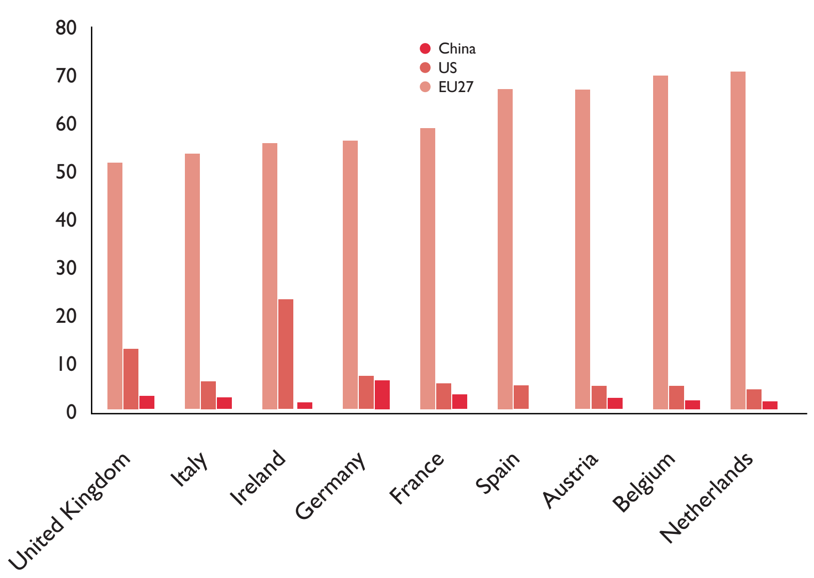
Facts and Figures

1. Manufacturing accounts for over 6% of UK GDP (in 2012 more than £ 140 billion in a total of £ 2,450 billion).
2. Over 2 million workers are employed in manufacturing in the UK, which has a leading position internationally in motor manufacture, aerospace and pharmaceuticals.
3. Manufacturing makes a major contribution to UK exports. Distribution to major destinations is shown below with comparable figures for eight other EU member states.
4. The value trend of manufactured goods exported from the UK has been rising in real terms although its proportion in the total mix of goods and services has fallen from 13.16% to 11.40% between 2005 and 2010. The proportion of services in the export mix has risen, as has the total of foreign trade.

Merchandise Exports: % by destination country

	EU 27	US	China
United Kingdom	53.5	13.2	3
Italy	55.4	6.1	2.6
Ireland	57.6	23.7	1.6
Germany	58.2	7	6.1
France	60.9	5.6	3.2
Spain	65.0	3.7	
Austria	69.1	5.1	2.4
Belgium	72.2	5.1	2.1
Netherlands	73.5	4.4	1.7

Source: WTO



The European Single Market and E-communications

Alfredo Acebal

Head of Telefonica S.A. Brussels Office, Member of the Board and former Chairman of the European Network Operators' Association

The aim of the European Commission has always been to achieve a true single market in all sectors; manufactured goods, energy, transport, services, et al. albeit an aim delivered with varied degrees of success.

Alfredo Acebal

The Fortunes of the Single Market

The EU economy has been in financial and economic turmoil since 2007, with 2012 also marked by very low, even negative, growth rates in many EU Member States. According to the latest European Commission figures, annual GDP in 2013 is forecast to contract 0.1% in the EU and 0.4% in the Euro Zone. Most Member States are burdened with high debt levels and unemployment is at unprecedented highs in many countries, affecting particularly youth segments of the population. The EU's pre-crisis growth performance was disappointing enough and, as highlighted by a study in April 2013 by the Brussels-based think-tank BRUEGEL, "since 2007 EU15 has taken a productivity holiday while productivity has increased rapidly in the US. In terms of total factor productivity, both EU15 & EU12 lag behind Japan. Even economically stronger countries, such as Germany, lag behind the US, and the evolution in the United Kingdom does not differ markedly from that of continental economies". In this difficult economic context, potential sources of growth and employment should be tapped determination by member states including the United Kingdom, what ever its eventual decision is on EU membership

It was not ever thus. The EU's Single Market has been an aim that has very been largely achieved since the much more fragmented state of the Community in the 1980s. During the 1990s and the early 200s the economic situation was generally more positive, with successive enlargements and also steady economic growth increasing the size of the Single Market considerably. It now represents the largest single market in the world with a GDP exceeding that of North America. The financial crisis after 2007 hit it hard.

The aim of the European Commission has always been to achieve a true single market in all sectors; manufactured goods, energy, transport, services, et al. albeit an aim delivered with varied degrees of success. Often referred to as "the EU's jewel in the crown", the Single Market has shown remarkable political resilience despite the economic and financial crisis. Even opponents of UK membership of the EU have tried to defend access to the Single Market as the keystone for future trading success of the UK. They are reluctant to lose the Single Market achievements in trade in goods which have already increased consumer welfare, and they can see the potential gains – especially for the UK – in completing the single market for services.

In the political debate, the European Single Market is a positive point of reference for all member states, a fundamental part of European integration, promoting as it so beneficially does the freedom of movement of goods, services, people and capital. There remains of course much to be completed or improved, particularly in services, with opportunities in a number of other areas such as the telecommunications sector

Information and Communications Technologies

Increased capital investment or greater intensity in the use of capital is a key to economic growth. This is especially relevant in the Information and Communication Technologies (ICTs) sector. Adopting improved ICTs in other sectors across society will deliver similar goals. Investment in ICTs is a powerful lever to increase competitiveness and for this reason is given in this paper as a prime example of important next steps in the development of the Single Market.

The current regulatory framework of the telecommunications sector was primarily developed to liberalise markets from the hold of what were, in many cases, state-owned monopolies. Only secondarily was it concerned to achieve a true single market. It is, therefore, not surprising that a Digital Single Market does not yet exist in the EU today.

A real EU Digital Single Market should unleash a wave of innovation that creates an EU-based digital ecosystem with global implications. It should be achieved with the active participation of EU operators and citizens, and be underpinned by a range of EU public policy and regulatory instruments that foster activity, investment, innovation and inclusion. This can be achieved, in part, by making it easier for operators to add value to society generally, and to consumers and shareholders specifically, through products and services supported by their access networks. In part, it will also be achieved by promoting a European competitive digital ecosystem which enhances European operators' technological and commercial innovation.

Economic facts of the digital world

In 2012 the contribution to global GNP of the ICT sector was 6.0%, down from 6.2% in 2011 according to IDATE'S Digiworld annual fact finding exercise. Taking a closer look at the telecommunications services sector in particular, Eurostat estimates there were 40.2 thousand enterprises operating within the telecoms services sector in 2010 in Europe. Together they employed 1.1 million people, equivalent to 0.8 % of the non-financial business workforce, or almost one in five (18.9 %) of those employed in the wider information services sector.

The e-communications sector is not only an economic factor of growth in its own right, but contributes to growth in almost all other sectors of economic activity as well. This horizontal across-the-board pervasiveness plays a key role at three levels:

Firstly, because it already accounts for almost 3% of EU GDP; secondly, because a 10% increase in broadband penetration an yields increase in annual GDP up to 1.5% whilst raising labour productivity by approximately 1.5% over the subsequent five year period; thirdly, consumers benefit not just in the short-term, but also in the long-term from increased network coverage, faster throughput speeds and pan-European innovation. The Boston Consulting Group estimates that the Internet has a value of Euro 2,500 to 3,000 per user in Europe today. However, totalling € 274.7 billion in 2011, the European telecom services market decreased for the third year in a row, by 1.5% that year, in a context of moderate economic recovery of +4.2% for current GDP in the region. It was a clear demonstration that structural rather than cyclical changes are shaping the sector's performance. Additionally, Europe's share of the global telecoms market has been declining regularly over recent years, from 31% in 2005 to just over 25% in 2011 as the gap between global growth (+3.2% in 2011) and that of Europe is broadening.

The digital ecosystem

Telecom operators are part of the global and complex internet ecosystem, which involves multiple activities and players. Breaking down the Internet value chain, as presented by the consultant AT Kearney in a 2013 study, is helpful to understand the complex interrelationships and market power of the different agents. AT Kearney identifies five main markets in the ecosystem: Content Rights, Online Services, Enabling Technology/Services, Connectivity, and User Interface (devices and applications), as illustrated in the figure overleaf.

The main strategic segments within each market, the different service categories in each of them, together with the names of some of the players, are shown. A number of industry players operate in two or more segments of the value chain. This not only constitutes a powerful tool to enhance a seamless customer experience, but it can also be leveraged to take full advantage of assets such as technology, brands and customer relationships in order to strengthen a competitive position. As the report by AT Kearney put it, "There is a dynamic aspect to the value chain as the different players move relentlessly to adjacent segments of the chain in search of efficiency and market power."

Overview of the internet value chain

Content Rights	Online services	Enabling Technology Services	Connectivity	User interface
Media rights owners Video Audio Books Gaming Adult content Editorial content *Time Warner, EMI* *Harper Collins, Blizzard, BBC*	Communications *Skype, Vantage,* *Hotmail, Facebook*	Support technology Web-hosting Web-design/development Content management *NTT/Verio, Rackspace,* *Limelight Group, Akamai*	Core network *AT&T, NTT, British Telecom,* *France Telecom*	Applications Software Media players Internet browsers *McAfee, RealNetworks,* *Symantec, Firefox*
User-generated content Text Images Voice Video	General / vertical content *Yahoo, Wikipedia,* *Financial Times, match.com*	Billing and payments Online billing and payment system providers *PayPal, First Data, Chase* *Paymentech, Google Checkout*	Interchange *Level 3 Communications,* *XD Communications*	Devices PCs Smartphones Games consoles Other internet access hardware Operating systems *Dell, Nintendo, Microsoft,* *Apple, Nokia*
	Search *Google, Baidu, Bing, Ask.com*	Advertising Online ad agencies Online ad networks/exchanges Third party ad servers Ratings/analytics services *WPP, Razorfish, Double Click,* *Nielsen*		
	Entertainment *YouTube, XboxLive,* *Last.fm, ITunes*			
	Transactions *eBay, Amazon,* *Expedia, Boursorama*			

User

Source A.T. Kearney analysis

An important characteristic of telecommunication services in an Internet Protocol (IP) environment is the separation between telecoms infrastructure (access connectivity) and the actual communication services used by consumers over it. There is a remarkable diversity of agents operating in each category. Voice services can now be purchased from players other than the network operators who provide the physical line connection. As an illustrative example, VoIP (Voice over IP) competes with traditional voice services of telecom operators, but is supplied by service providers such as Skype that do not own telecoms infrastructure. A clear advantage of such VoIP services is that they offer 'fixed-line' phone numbers which can be used in a nomadic way, enabling reach wherever the customer connects to a broadband line. At the same time, network operators are broadening their portfolio in the services segment. Next to voice and broadband, IPTV services are now a standard part of many fixed line telecom product portfolios as these move to "quadruple play" commercial offerings (fixed, mobile, data & IPTV).

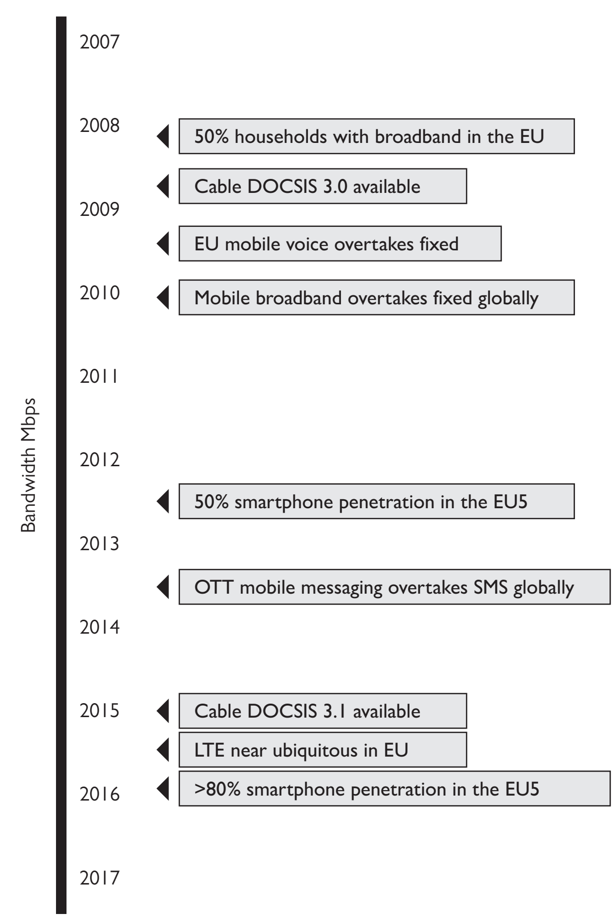
Services		Infrastructure		Device	
Application and online services	Content Distribution	Connectivity Services	Network Operator	Platform Software	OEM
Online services battle			Integration and scale battle	Platform ecosystem battle	OEM innovation battle
Microsoft SAP Rovio Google Facebook Skype Amazon Spotify	Vivendi Disney BBC Sky	Vodafone British Telecom T Mobile Orange UPC		Android Windows iOS	Nokia Samsung

Source A.T. Kearney analysis

The data challenge

A number of fundamental changes to the electronic communications market have taken place in recent years fuelled by rapid technological evolution and consumer behaviour, the latter enthusiastically embracing fixed and mobile broadband and over-the-top (OTT) services. The following chart taken from Plum Consulting's recent publication: *The Times, they are a changin': Relevant markets in the Telecoms Sector*, highlights some of the key market changes due to consumer behaviour and technological evolution.

Adoption of new services is accelerating in all demographic segments. Demand growth is underpinned by rapid technology evolution in network infrastructure (high bandwidth, high-quality access) and in services, and particularly in devices such as smartphones and tablets. These changes have brought about an ever broader and attractive offer of applications, services and connectivity for consumers. At the same time, however, they have confronted network operators with a "data tsunami" that has to be coped with.



Statistics change almost daily, but Nielsen's Law regarding Internet bandwidth is a good reminder of what communications providers are up against to meet consumers' demand and keep them connected. Danish web usability guru, Jakob Nielsen, predicted that bandwidth over the Internet would grow at a compound rate of 57x over a decade. The sheer size of the figures involved helps to understand the huge challenge posed to the industry to guarantee that consumers can continue to enjoy the benefits of using efficient services over their broadband connection. Many other statistics concur in confirming this challenge and thus the need for increased investment and improved network management techniques to face the ever growing "data flood" and guarantee service levels up to the standards expected by consumers.. It is a situation well analysed by the Coalition of an open Internet in their position paper *An Open Internet for Consumers* earlier this year. Some of their conclusions follow for illustration purposes:

- According to Cisco, Global IP traffic has increased eightfold over the past 5 years, and will increase threefold over the next 5 years. Global mobile data grew 70% in 2012 and video traffic exceeded 50% of mobile traffic for the first time;
- Fixed line internet consumer traffic will grow 4-fold from 2011 to 2016 at global level, a compound annual growth rate of 30%, and will reach 74.2 Exabytes (1EB = 10^{18} or 1 quintillion bytes) per month in 2016 (equivalent of 19 billion DVDs per month, or 25 million DVDs per hour).
- The sum of all forms of video (TV, video on demand (VoD), Internet, and peer-to-peer or P2P) will be approximately 86% of global consumer traffic by 2016 and will increase 13-fold between 2012 and 2017, reaching 11.2 Exabytes per month in 2017.
- There were 161 million laptops on the mobile network in 2012, and each laptop generated 7 times more traffic than the average smartphone.
- Between 2015 and 2020, Rand Corporation projects that the Internet economy is projected to grow between 7% annually in the "Slow Motion scenario" and 15% annually in the "Tipping Point scenario".

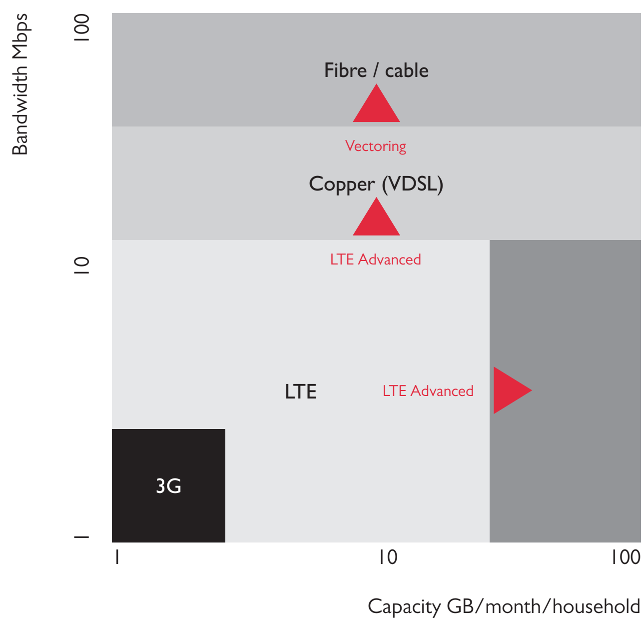
Infrastructure investment gap

In a recent report, Business Europe observed that private investment in Europe is currently stagnating. EU investment as a share of GDP continues to drop. The present rate of 17.5% is well below the 21% observed in the pre-crisis years (before 2008) and continues to decline. In contrast, in the US this rate has started recovering since the end of 2012.

This general investment trend is also apparent in the telecommunications sector, which has suffered from declining revenues in Europe since 2008. This lack of infrastructure investment is creating a worryingly high barrier for growth and innovation in Europe. Despite the urgent need for network investment, dismal telecommunication sector performance has resulted in difficulties in funding investment plans, initially in fixed, and more recently also in mobile. Poor stock market performance of European telecommunication providers over the last few years is keeping investors away: at best they remain very sceptical as regards major investment outlays, since market prospects of achieving required hurdle rates of return are weak. Boston Consulting Group estimates that, absent major changes in policy, telecom industry's revenues will continue to decline, resulting in a €110-170 billion investment gap until 2020. This lack of investment will unfortunately be a lost opportunity for job creation, GDP growth and increased competitiveness across the European continent.

It is both urgent and essential that markets and investors turn their eyes again to European Telecoms and see it as a growth industry. Investment in new networks and services is urgently needed to fill this forecast investment gap.

Regulation



European regulation can improve at least in two vectors. More commercial flexibility, of which pricing is a substantive part, should be restored to industry in order to provide more room for innovation, both at retail and wholesale levels. Secondly, competition analysis should allow for a more efficient market structure to emerge, in which the number of players can decrease to reflect underlying sector economics.

On the service level, regulation and competition analysis should take into account the existing fierce competition in retail markets created by a wide array of voice, messaging and data services provided by global OTT players. On the network level, platform competition is already widespread between different fixed and mobile technologies such as DSL, cable, fibre, and LTE: all are offering ever faster broadband connectivity. Incorporation of these realities into market analyses by EU competition authorities is long overdue. Platform competition between different technologies is already a reality.

Without regulatory distortions, market structure will adjust to the underlying telecoms industry economics, largely driven by economies of scale and scope, along the value chain. There are very large density economies for network infrastructure and IT platforms at the local level (fixed) and national level (mobile). They are sizeable for marketing and advertising at the national level. Scale and scope also come strongly into play for information systems, service design and network operation at the pan-European or even global level.

Political will is required to achieve a Digital Single Market in the EU. New policy approaches should take into account the positive effects of dynamic competition (in particular quality and services performance, service availability and prices) and assess to what extent these offset potential short term and static outcomes of a consolidated market. A new regulatory and competition policy approach will have to deliver simultaneously:

1 *Digital Single Market* What is needed is a single set of rules across the EU providing clarity, predictability and stability over time for all digital services. Rules should be technologically neutral and disregard the nature of the originating agents so as to be able to cope with swift technological evolution and market dynamics.
2 *Investment and innovation* What is needed is a competition model in which a number of agents' business plans cease to be supported by regulation. Low barriers to entry to a capital intensive industry, coupled with regulatory protection, destroy incentives to invest and to innovate technologically and commercially. The telecoms sector investment to revenues ratio is the highest of any sector in the world, a reflection of its high capital intensity and economics. Investments of today deliver tomorrow's operating margins. A new model based on value to allow operators to set prices that respond to market dynamics and economics, i.e. not distorted by regulation, needs to be put in place for players to extract full commercial value from their assets. Competition has to be sustainable over time, independently of the name and provenance of the agents.
3 *Efficient Market structure* What is needed is a regime that does not prevent or interfere with the ability of operators to find more efficient and dynamic balances in terms of market structure and number of operators, including options to consolidate.

An EU regulator?

At present divergent regulatory practices in the different member states hamper the Single Market. It could be a strong argument for creating a European Regulator for Telecommunications, but there are also arguments against this step. Although a centralised regulator could easily oversee the differences existing among telecommunications markets of EU member states, these national markets present local differences (ranging from network topographies through consumer behaviour to market structures) within national borders that can be relatively easily regulated in an efficient manner nationally.

For instance, while traditional copper networks usually have a national scope, in many Member States cable network operators only have partial coverage of the population. Because of these national differences, National Regulatory Authorities (NRAs) are likely to continue to play a substantive role in the future. Nevertheless, there are competences, which today lie entirely in the remit of the member states, where a harmonised or centralised approach might be sensible. This is particularly the case for regulating spectrum.

Spectrum

Spectrum is a key resource for telecommunications market's growth. There is a growing trend towards mobility through an explosion of mobile devices, such as smart phones and tablets, as highlighted by the Ericsson mobility report which pointed to the doubling of global mobile data traffic between the end of 2011 and the end of 2012. Government spectrum licensing policy — supported by a stable, predictable and transparent regulatory regime — has a fundamental impact on the attractiveness of markets for investment. Economies of scale and scope are of particular relevance for mobile devices and mobile networks. Harmonised spectrum availability is therefore paramount. However, there are significant differences of spectrum availability nationally, both in spectrum band allocation and licence terms.

Despite attempts to co-ordinate spectrum release through the Radio Spectrum Policy Programme and other initiatives, there have been delays in the full release of the 800 MHz band for mobile broadband across Member States. This fragmented approach hinders the roll out of new services in Europe and is in sharp contrast with other major global markets such as the U.S.

A more coordinated pan-European approach to spectrum release is necessary to allow operators to capture economies of scale. Furthermore, it would be beneficial for a predictable and stable regime if best practices were harmonized and promoted relating to spectrum licensing, license conditions, renewals and spectrum auction specifications. Europe needs a long-term roadmap to coordinate approaches to the 700 MHz and other bands. While global harmonisation of mobile bands would be ideal, it is rarely possible or practical, so harmonisation at regional level becomes vital. Even small variations on standard band plans can result in device manufacturers having to build market specific devices, with unnecessarily costly consequences for consumers.

Conclusions

The options remain for the United Kingdom to decide to withdraw from the European Union, to remain within it as it is or to remain within it influencing the development, for example, of the European Digital Single Market. A nation so much concerned with market development as is the UK would want to support and decide with its neighbours the required initiatives described here, to ensure an effective and competitive overarching digital regime.

In summary, the main hurdle to achieve a true EU digital single market is investment in networks, as they supply the physical connectivity layer and are the foundation stone for service growth and innovation all along the value chain. The problem is rooted in an outdated competition model imposed by regulation which has been overtaken by market dynamics and technological evolution.

Unsustainable fragmentation is a by-product of this inefficient economic regulation, not the cause. A change of European competition policy and of regulation could restore the right investment climate, create the environment for evolution towards a sustainable and competitive market structure, and tackle current fragmentation in the EU telecoms market.

Due to the separation of local network and global service platform layers, telecom operators can enable Digital services growth on a global scale. However, many services are bound to national obligations and regulations which hamper regional or global development and take-up. The EU´s Digital Single Market concept is ideally equipped to add value in this area. A considerable amount of effort is still necessary to regulate transnational services better in order to seize the benefits of EU scale, but good examples where regulatory reform would contribute most include:

1. Eliminating barriers to content services delivery across the EU and current complexities of Intellectual Property Rights' Management.
2. Eliminating barriers to the portability of Digital Life, enabling customers to port their applications and contents as devices or providers change. The EU needs a common regime that levels the playing field for European operators to compete with other non-European cloud players.
3. Finding a proper equilibrium between innovation and privacy rights to take advantage of services and innovation based on Big Data.
4. Rethinking the current territorial regulatory environment of M2M (Machine to Machine) communications. Operators should face harmonised and user-friendly regulation to help develop this new business, to reshape and improve their business models and keep up network investment levels.
5. Removing the barriers for operators to access the mobile payments and financial services value chain.

Economies of scale and scope are central values in the telecoms sector which potentially has both a global reach and a global vocation. A combination of policies should focus on increasing EU operational density, as argued in this contribution, and other policies such as fiscal policy, consumer protection law, legal interception and data retention, universal service obligations, cyber-security, emergency services, and copyright, to name just a few aimed at growing the market. Removing obstacles to economic progress take us a step further towards the competitive and efficient Digital Single Market to the benefit of all operators, consumers and member states.

I wish to thank my friend & colleague Frederick De Backer for the kind and valuable support and insight supplied to this contribution.

Facts and figures

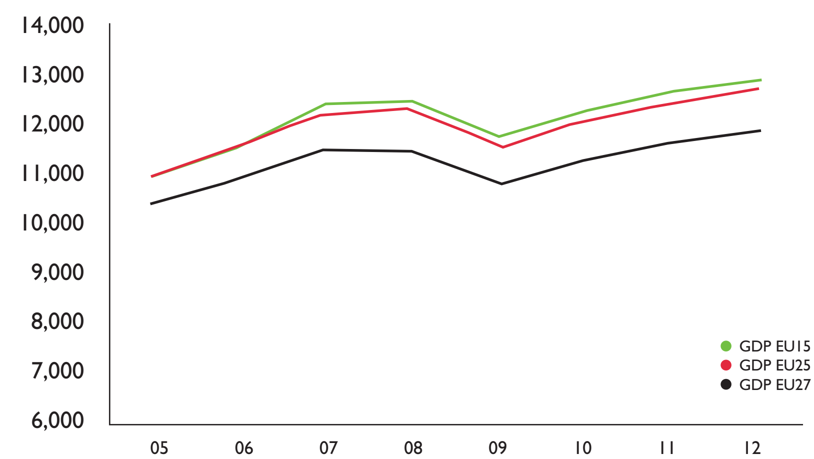
The EU Single Market, often also called the' internal market', involves the free movement of people, goods, services and capital, the four freedom laid down in the 1958 Treaty of Rome

The Customs Union - a common external tariff and the removal of customs duties between member states - forms the core of the Single Market. New states joining the Single Market adapt their legislation to this situation.

In 1987 the Single European Act (SEA) renewed efforts to establish the Single Market by the end of 1992. Close to 90% of the planned legislation (300 Directives) removing non-tariff barriers to trade was in place by that deadline. Substantial changes to services, however, were delayed until the Posting of Workers Directive in 1996 and the Directive on Services in the Internal Market in 2006.

In 2004 the GDP of the EU 15 was approximately 10,400 billion euros. Ten new states added a further 600 billion euros that year. The size of the EU 27 economy measured by GDP is estimated to have grown (at current prices) just under 9% from 2006 to 2012, from 11,576.9 billion euros to 12,900.75 billion euros.

Growth of EU GDP



Source: Eurostat

Single Market legislation in telecoms

Over the past 15 years, EU Single Market legislation has injected competition into telecoms markets. Today, incumbents no longer hold monopolies and must provide wholesale services and network access to alternative operators. However, many ex-monopolists still maintain strong market positions by virtue of their ownership of the fixed networks they rolled out during the monopoly era.

There has been both concentration and fragmentation of the market. As regards mobile networks, four out of five EU citizens possess mobile subscriptions with one of only four major groups. At the same time, many features of the telecoms markets remain predominantly national, such as licensing of operators and the spectrum for mobile services.

The EU Single Market for telecoms is still incomplete: the Commission is confronted with many operators active in 27 separate markets. Furthermore, there are still persistent barriers that limit consumers' ability to take full advantage of market liberalisation. For instance, a recent study on Internet service provision shows that the lack of transparent and comparable information as well as contractual barriers (such as long contract duration and charges for early contract termination) discourage consumers from switching.

UK impact

The UK Department of Business, Innovation and Skills in its 2011 Report states, "The Single Market has been the source of sizable benefits for the EU economy as a whole". EU GDP in 2006 was 2.2% higher than it would have been over the period 1992 to 2006 without the Single Market – an average increase in benefits to consumers of €518 per person; and an additional 2.75 million jobs were created across Europe as a result.

Trademarks and patents no longer need be examined in 28 different jurisdictions, each with its own rules. In 2012, UK firms made 8,791 European Trade Mark applications, pushing the total UK number registered since 1997 close to 100,000. In 2012 UK based firms and individuals contributed 4,757 of the 91,234 patents registered from European sources at the European Patent Office - which received a further 64,282 from America and 85,329 from Asia.

Three out of four European citizens think the Single Market has had a positive impact. Consumer costs have fallen - for example, telephone prices fell by more than 40% on average between 2000 and 2006. British consumers are guaranteed rights similar to their UK statutory rights when shopping in the EU, including internet purchases. EU products carrying the CE mark are safer, and Single Market regulations require food and medicines to be labelled with "best before" dates and a list of ingredients, colourings and additives.

The Working Time Directive confirmed a 48 hour week as the norm, with regular rest breaks and paid leave; part-time and fixed contract workers have comparable rights pro rata to full-time employees, and generalised parental leave is available.

The Single Market stimulated mergers across borders. The EU share of global merger and acquisition activity increased from 10% in 1985-87 to 29% in 1993, attracting extra FDI, in particular from the USA and Japan, much of it flowing into the UK.

Source: Commission Competition Reports

The EU and Small and Medium Enterprises

Karen Clements
EU Consultant, Low Associates

The EU has provided some €100 billion worth of financing for SMEs over the last seven years.

Karen Clements

Basic facts

There are over 20 million small and medium sized enterprises (SMEs) in the European Union, representing over 99% of all businesses. They are responsible for two out of every three private sector jobs, and they generate over half of the EU's GDP. Moreover 85% of new jobs created in the EU between 2002 and 2010 were created by these SMEs.

It is no surprise, then, that national governments refer to them as the lifeblood of the European economy, and that the European Commission has allocated funds and designed a set of specific policies to help improve the business environment in which they typically operate. These policies are designed to add value to, not replace, those being pursued at national level.

How does the EU help SMEs?

Member states remain responsible for the core policy decisions that affect SMEs: their ability to set up, to grow and create jobs through such things as direct taxation, or social security or infrastructure. Nevertheless the Commission has some competence to legislate on aspects of enterprise policy, and has developed over the years extensive networks to support and fund SME growth over and above action at national level.

There are three core strands of activity that drive EU support for SMEs:

› **Policy development** this includes European legislation designed to improve the general business environment, such as outlawing late payment, simplifying VAT rules, and measures to allow venture capital to flow more freely. It also involves specific policies to cut the burden of regulation on SMEs as regards the stock of (existing) rules or the flow of (forthcoming) rules. Within the Commission, DG Enterprise will either lead on a specific dossier or work in tandem with the relevant DGs as the 'champion' of enterprise. In the case of regulation, for example, the Secretariat General is responsible for developing a methodology to assess the impact of new rules, but DG Enterprise plays a key role in spreading best practice ('thinking small first') across the Commission and the member states. It also implements specific policies and initiatives such as the SME test and identifies the Top Ten most burdensome EU rules, through the Small Business Act.

› **Business support** this includes programmes to improve SME access to finance and funding, to markets and to general information on setting up and developing a business. SMEs across the EU benefit from billions of Euros worth of finance each year through Commission programmes such as the Competitiveness and Innovation Programme, the Framework Programme 7, and the ERDF. They also have access to funds from financial institutions such as the European Investment Bank (EIB) and the European Investment Fund (EIF). SMEs across the EU also have access to a growing network of business support centres in key third markets such as China, India and Thailand, as well as trade missions to other developing markets. The Commission's online portal "Your Europe" acts as a signpost for businesses needing information about setting up and trading across borders. This is reinforced by the Enterprise Europe Network of 600 centres across the EU that help SMEs to make the most of the European marketplace. Working through local business organisations, enterprise agencies or universities, they can help SMEs enter new markets, source or license new technologies, or access EU finance and funding. There are 11 centres in the UK located in each of the government regions. In order to deliver this support, the Commission works closely with the individual member states as well as with local public and private operators.

› **Promotion and exchange of best practice** The Commission is also engaged in the 'softer' (but arguably more challenging) aspect of SME policy which is to promote a culture of entrepreneurship.

It facilitates the exchange of best practice, exhorts the member states to act in entrepreneurship education, female entrepreneurship, or young/new entrepreneurship through practical exchange programmes such as the Erasmus for Young Entrepreneurs programme, or awards such as European Enterprise Promotion Awards.

More of the same?

The key framework for delivering the Commission's policy is the Small Business Act (SBA), agreed in 2008 and designed to 'put SMEs at the heart of policy making' not just within the EU institutions but also in the member states. The SBA commits the EU, as well as the member states, to ten key principles as well as to implementing a series of priority actions and policy changes. These include simplifying VAT rules, simplifying access to research and innovation programmes, testing all new proposals against their impact on SMEs, and raising the state aids limits for SMEs.

The Small Business Act demonstrated a growing recognition of the job creation potential of SMEs. Commissioner McCreevy claimed in April 2008 that, if just half the EU's SMEs created just one extra job, there would be full employment. The SBA also set up a network of 'SME Envoys' to ensure the implementation of the SBA in each of the then 27 member states. The network is coordinated by the Commission, and has its own SME Envoy, currently Daniel Calleja, Director General of DG Enterprise. Member states, guided by their respective envoys, are committed to implementing a series of initiatives and to meeting certain targets, with their progress measured each year by the SME Performance Review.

With the economic downturn the Small Business Act became a key instrument for the Commission to provide solutions to some of Europe's problems, even when its competence was in reality somewhat limited. The focus of the Commission (and the member states) narrowed to three key commitments in the Act:

› the need to improve access to finance for SMEs
› the need to cut red tape
› the need to help SMEs access new markets.

The Commission committed billions more in loan guarantees, stepped up its efforts to reduce administrative burdens by 25% (a target that was met in 2012), introduced exemptions for micro businesses (those employing fewer than 10 workers) and agreed to set up SME centres in key emerging markets. That is not to say that the rest of the SBA is redundant, only that access to finance and markets, and better regulation, have become the Commission's flagship policies, and for as long as small business finance remains a serious problem, it is likely to remain at top of the agenda.

Access to finance

SMEs find it difficult enough to access finance in times of plenty, but the recession has seen bank lending drop in all member states. The role of the EU in providing finance to SMEs - directly or though financial intermediaries such as the European Investment Bank - has grown correspondingly. In addition the EU is working to provide integrated and fully functioning pan-European markets in non- bank lending - such as venture capital, micro finance or crowd funding – all of which have potentially significant benefits for UK SMEs.

The EU has provided some €100 billion worth of financing for SMEs over the last seven years. The two biggest financial instruments through which it lends to small business are the European Investment Bank (EIB) and the Competitiveness and Innovation programme (the CIP). EIB loans were worth €12.7billion in 2011 and €13 billion in 2012, with a further €10 billion capital increase announced by Commissioner Tajani for 2014. The CIP has a budget of over €1 billion to facilitate access to loans and equity finance for SMEs where market gaps have been identified, and each euro invested here leverages an average of €6 of risk capital or up to €40 of bank loans. Since 2007, when it was founded, the CIP has generated some €30 billion in new finance and benefitted up to 200,000 SMEs across the EU. Commission statistics show that each SME that gets a guaranteed loan creates 1.2 jobs. Some 90% of beneficiaries are firms with no more than ten employees, a category that has the greatest difficulty obtaining a loan. The average guaranteed loan is around €65,000.

Other financial instruments include microcredit (loans of €25,000 or less) which are available under the Progress Microfinance Facility and JASMINE. Finally there is also finance available through the ERDF (JEREMIE) and Framework Programme 7, some 15% of whose budget is allocated to SMEs.

The Commission is also responding to failures in debt and equity markets by working with member states to create an integrated European venture capital market, as well as preparing proposals to create markets in angel investment and crowd funding.

The impact on UK SMEs specifically?

The UK government and UK financial instruments remain the key generators of finance for SMEs and the scale of government funding alone in the UK dwarfs any EU contribution. The Business Finance Partnership fund worth £1.2 billion has a facility designed for SMEs, for example, worth £100 million, and it is only one of seven different types of loans available to SMEs. In addition the UK government has implemented tax policies to benefit investment in small business: investors in the Seed Enterprise Investment Scheme, for instance, get a 50% capital gains tax break. .

The relative abundance and significance of loan guarantee schemes in the UK might explain why UK SMEs do not take as much out of the EU pot as some of their competitors. There are no UK beneficiaries of the CIP's SME Guarantee facility and under ten UK intermediaries for the High Growth and Innovative SME facility. Applications for CIP loans are perceived as administratively complex; and there is poor communication of the availability of the different facilities.

This should change. The Commission is already simplifying applications for future funding (which will be available from 2014 through Horizon 2020 and the COSME fund) and the UK Government is preparing to rationalise and better signpost business support mechanisms so that more SMEs know where to go for advice.

At a time when national budgets are constrained and bank lending is restricted, the EU offers an additional source of finance that is increasing, not decreasing. Earlier this year EU leaders agreed to prioritise SME financing with billions more Euros and a greater role for the EIB as well as greater securitisation of loans. In its proposal for Horizon 2020, the EC had budgeted €3.5 billion for financial instrument facilities and for research and innovation. At least one-third of this amount should be dedicated to SMEs and small mid-caps.

The EU is also uniquely placed to be able to create the right conditions for cross border lending, thereby increasing further the capital available to UK SMEs from other states across the EU.

Smart Regulation

Complying with EU regulation is an expensive business, more so for SMEs, for whom compliance can cost ten times as much per employee as for a large company. Over the past ten years there have been countless attempts to quantify the cost of regulation to business, and results vary widely, from to 3.7% of GDP to 12% of GDP depending on the point of view of the researcher and whether you measure the administrative burden of EU rules alone, or the full cost of both European and domestic regulation.

When it comes to the impact of EU rules on UK SMEs, the most recent (2010) estimate by Open Europe sets the cost at a colossal £124 billion over 12 years, which would account for 71% of the total burden on business. Nonetheless, this percentage is not far removed from earlier calculations (2009) by the British Chambers of Commerce, but is criticised by the Centre for European Reform as a hypothetical rather than a real burden.

There are also benefits from EU and domestic legislation to offset against these costs. BIS recently calculated that for every £1 spent on EU rules, the UK gets £1.20 back. Open Europe contests that figure, suggesting £1.02 for EU regulation compared to £2.35 for domestic regulation. However, benefits are more difficult to quantify as they tend to be spread more widely across the economy, whereas SMEs in particular shoulder the disproportionate administrative burden of compliance.

Over the past ten years, the EU has tried to simplify the stock of rules and to ensure that any new rules are stripped of unnecessary burdens wherever possible. It recently completed an exercise stripping out over 25% of the administrative burden of the stock of EU rules, worth some €30.8 billion, with a potential of a further €6.2 worth of cuts to be made. Simplifying the rules is a laborious process, requiring consent from the European Parliament and the Council and can take years, but UK SMEs should soon begin to feel the impact of these cuts, such as the exemptions on accounting requirements, which will save each micro in the UK about €1,200 a year.

Thinking small

The Small Business Act differentiates between small and large businesses, allows exemptions from EU rules for micro companies, and introduces an SME test. This is designed to deliver lighter regimes for SMEs - such as those agreed in the legislation dealing with energy audits or construction products, with further changes to be approved by the European Parliament and the Council on public procurement – though this has not yet had much impact on UK SMEs.

Research by Eurochambres in 2011 showed that only one half of all business related Impact Assessments included an SME test, and that only a third of those were of good quality, with half failing to quantify the impact of the proposal on SMEs at all. But there has been progress in a relatively short space of time with changes agreed on accounting requirements and the WEEE Directive (the "take back" obligation for electrical consumer goods) and others waiting in the pipeline, including car emissions; tachographs; data protection; and women on company boards. These measures, along with the Commission's "Top Ten" exercise and SME Scoreboard, show that it takes the issue seriously. It has also made progress in promoting smarter regulation at member state level and, to a lesser extent, in other EU institutions. The European Parliament, for example, has just started measuring the impact of its amendments on SMEs, but the Council has yet to do so.

Do these improvements make a difference for UK SMEs? While the cumulative cost of EU rules continues to rise, that rise may well now be lower from one year to another. But we do not have figures relating to the UK that take the most recent efforts by the Commission into account. What is clear is that action at EU level is absolutely necessary, given that – apart from removing "gold plating" or double regulation - the UK is powerless to amend EU rules on its own.

Moreover the Commission, through its SME Envoy network, is attempting to spread a "light touch" approach to regulation and administration across the EU. Many member states, coming admittedly from a low base, have made progress in cutting red tape or simplifying administrative procedures, which not only benefits domestic business, but also those UK SMEs doing business there.

Promoting Entrepreneurship

The Erasmus for Young Entrepreneurs programme sends new entrepreneurs to work with established SMEs elsewhere in the EU to help develop their business know-how, as well as encouraging them to look beyond the limits of their own borders. After a spell of up to six months outside their home country, young entrepreneurs hopefully return with a better understanding of business, of another culture, of new markets, and with new contacts.

The European Commission funds half of the programme and member states fund the rest. Access is via local contact points in each region of each member state and the programme has to date partnered over one thousand entrepreneurs and SMEs with an average satisfaction rate of 90%. The UK is one of the most popular destinations for entrepreneurs and currently has 373 host and entrepreneurs registered.

By encouraging entrepreneurship and increasing access to markets, the programme meets many of the shared objectives of the EU and the member states; 90% of participants report that the programme has fuelled their ambition to start a business; or encouraged them to develop their business. However its added value has yet to be proved: each visit costs between €8 -10,000 but has yet to yield to sufficient new jobs or new business to make it pay for itself. The EC would do well to investigate streamlining procedures to make the programme more cost effective.

Implications of UK Withdrawal from the EU for UK SMEs

In the event of a UK withdrawal from the EU, UK SMEs would cease to be bound by EU rules. That is not to say, however, that UK SMEs would be free from the costs that they impose.

In the first instance, any UK government would need or want to replace rules that had originated in Brussels in areas such as health and safety. A good example is the Working Time directive: even in the absence of the EU directive, a UK government would want to ensure that UK workers had minimum rest breaks and paid holidays. These two items make up the bulk of the cost of the directive and would continue to be borne by business, even if the rules were domestic in origin. The UK Government might be able to strip out some of the cost, but it could not avoid it altogether.

Second, the UK government would have to negotiate a new trading relationship with the EU. Should the UK opt for membership of the European Economic Area, UK SMEs would continue to be bound by a host of EU rules, such as those regulating the single market, including some social and employment rules that would also bind SMEs that were not trading into the EU. UK SMEs would also still benefit from any EC action to simplify complex rules and ensure that all future rules are fit for purpose. But the UK would not have a voice in determining the content of any new rules, or indeed influence the development of the infrastructure to help policy makers "think small first".

Were the UK to negotiate a free trade agreement along the lines enjoyed by Switzerland, EU regulation would be reduced, and even more so, should it opt for a customs union of the sort enjoyed currently by Turkey. New trading relationships of this kind would, however, bring new costs on those UK SMEs that wanted to continue to export to EU markets; whether in the form of tariff or non-tariff barriers to trade.

Access to Finance

If the UK left the EU, the two would most likely negotiate some kind of a free trade agreement which would almost certainly allow the UK to take part in Horizon 2020 and COSME (the new CIP and FP7) and benefit from EIB loans. UK SMEs could thus continue to have access to EU financial instruments as long as the UK government was prepared to contribute financially. Nevertheless, it would have no influence over the development of a pan-European market in those sources of finance that are particularly attractive to SME growth such as microfinance, venture capital and crowd funding.

Promoting Entrepreneurship

Most of the EU's programmes to promote enterprise whether Erasmus for Young Entrepreneurs, the European Enterprise Promotion Awards, or the Women Ambassadors network, are open to non-EU countries that have a trade agreement with the EU. The Erasmus scheme, for example, is likely to be extended to 'third' countries (outside 'Europe') in the near future. The UK could probably continue to participate. A UK government outside the EU would be free to choose which programme to participate in - and hopefully would make that choice in consultation with UK SMEs.

In general terms, withdrawal from the EU SME policy specifically would not have a devastating impact on UK SMEs. UK SMEs could continue to benefit from EU support and programmes outside the EU, though at a cost and assuming that a future UK government would negotiate access to those programmes. Member states are still largely responsible for providing a supportive environment conducive to enterprise, and the UK tends to score relatively well in its support for SMEs. It is either close to or above the EU average in all SBA indicators, for example, and is rated the seventh easiest country in the world in which to do business.

Options for the UK

For as long as the UK remains a member of the EU (and it is in our view that it is firmly in business' interest, large or small, to remain so), it should work with its EU partners to negotiate changes to EU SME policy that will make it more effective and better able to promote SME growth. There are four key actions that the EU should take that will make a difference:

- › Scrap all rules that where the costs outweigh the benefits for SMEs. This will require consistent application of the SME test by all EU institutions and national governments, and more powers and independence for the body that vets new EU rules, the Commission's Impact Assessment Board.
- › Further expand SME lending. Existing EU financial instruments are an efficient way of spending the EU budget, generate significant returns and need to be expanded. The EU should allocate a greater percentage of the budget to COSME in order to benefit all SMEs, not just innovative, high growth SMEs. Also the Commission needs to intensify its efforts to create a single market in venture capital.
- › Encourage all businesses to access the digital economy. Technology intensive SMEs grow and export twice as much as others, and create twice the number of jobs. The EU must facilitate as a matter of urgency low cost transnational broadband access, as well as a single legal framework for electronic VAT billing, e-payments, e-invoicing, e-procurement, and digital copyright.
- › Encourage SMEs to use existing support networks. Too many SMEs in the UK are unaware of the services available to them, often for free, such as the Enterprise Europe Network, the "Your Europe" portal; or funding for the unemployed to set up businesses. The EU has extensive online and physical support services that can help SMEs set up, access capital, or find new markets, for example. The Commission, member states and SME representative organisations need to work together better to encourage SMEs to take advantage of the help on offer.

Facts and Figures

Definition

A SME in the EU is a company employing fewer than 250 people, with an annual turnover of less than EUR 50 million, or a balance sheet total of no more than EUR 43 million.

The European Commission calculates there are 77,000 large companies in the EU, but approximately 20 million SMEs. SMEs fall into the following categories: Medium 250,000; Small 1,600,000, and Micro 18,700,000.

- › micro enterprises employ fewer than 10 people, with an annual turnover or balance sheet of under €2 million;
- › small enterprises employ 10-49 people, with an annual turnover or balance sheet of no more than €10 million;
- › medium-sized enterprises employ 50-249 people, with an annual turnover of no more than €50 million or balance sheet of no more than €43 million.

Employment

SMEs are responsible for over two thirds of private sector jobs in the EU: 67.4% compared to 32.6% for large companies. Within the SME sector, Micros account for 29.6%; Small companies for 20.6%, Medium-sized companies for 17.2%.

- › SMEs created 85% of new jobs in the EU between 2002 and 2010.
- › Over the same period, SMEs' annual employment growth was 1% compared with 0.5% for large companies.

Private sector employment per member state:

80% plus	Greece, Portugal, Italy and Spain
70 – 79%	Estonia, Latvia, Bulgaria, Lithuania, Hungary, Poland, Czech Republic and the Netherlands
60 – 69%	Belgium, Austria, Denmark, Slovenia, Sweden, Germany, France, Romania and Finland
Less than 60%	Slovakia and United Kingdom (59%)

SME penetration by economic sector in the EU

Construction 81%; Hotels and Restaurants 75%; Business Services 72%; Distribution and Retail 71%; Manufacturing 48%; Mining and Quarrying 30.5%; Transport and Communications 29%; Utilities 21%..

Competition Law and Policy

Tim Cowen

Partner Sidley Austin LLP, former Chief Counsel, Competition Law and Public Policy, BT Group and former General Counsel BT Global Services

Competition law has been central to the single market and is contained in the treaties that have formed the EEC, EC and latterly the EU, for over 50 years.

Tim Cowen

Context and Issues

We live in an increasingly interdependent and globalising world, which is governed by a complex web of trade agreements designed to secure more open and competitive markets. The general trend is towards increasingly open markets and closer integration of economies because that process generates greater opportunity for economic growth, which in turn increases consumer welfare. At their most basic level, competition law and policy in the EU and the UK likewise aim at promoting growth and increasing consumer welfare. A UK withdrawal from the EU would leave the UK in a more isolated position, without the manifest benefits of access to the EU single market or the increased levels of trade, investment, economic growth and consumer welfare that a coherent enforcement of EU and UK competition law seeks to achieve.

Any consideration of the impact on competition law and policy of a potential UK withdrawal from the EU would depend, to an extent, on the precise terms of the withdrawal. At present, the likelihood of any UK withdrawal remains remote and the possible details of implementation are unknown. This makes any detailed analysis of the pros and cons almost impossible. However, one thing is clear. If withdrawal were to mean wholesale re-writing of UK competition law, this would create considerable uncertainty for businesses that had made decisions, investments and contractual arrangements on the basis of assumptions of continuity. 50 years of precedent and case law – on which businesses and investors have based their decisions – would become largely irrelevant overnight. The consequences of deciding to 'start again' and write an entirely new UK competition law would be so obviously undesirable that we believe it unlikely the UK would take such an approach.

Assuming, then, that UK competition law continues to be enforced in broadly the same manner as it is today, we identify below four main competition law and policy issues to which any hypothetical UK withdrawal might give rise.

1. EU competition law promotes the furtherance of the EU's single market objectives in a number of ways. For current purposes, the most important is that it seeks to prohibit suppliers from sub-dividing the overall EU market along national borders (e.g. by giving their appointed retailers 'absolute territorial protection' thereby insulating those retailers from competition from rival retailers in other member states). The EU is at present a market of 28 member states (with Croatia having joined on 1 July 2013) and around 500 million people, whereas the UK is a much smaller economy with a population of just 63 million people. At present, the EU's prohibition on 'absolute territorial protection' allows UK consumers (and business customers) to seek out more competitive prices on offer in other member states and allows UK businesses greater access to other markets. A post-withdrawal version of UK competition law would be unlikely to prohibit such restrictive agreements, and, for its part, EU law post-withdrawal would likewise not prohibit agreements whereby suppliers prevented retailers from exporting from EU member states into the UK. As a result, suppliers would be able to enter into agreements giving their retailers 'absolute territorial protection', meaning that prices in the UK would likely increase.
2. Post-withdrawal enforcement of competition law (in the non-regulated sectors) would be carried out only by the UK's national competition authority, rather than as at present by both the national authority and the European Commission. Lower enforcement activity can be expected, with a consequent impact on the deterrent effect of competition law and, ultimately, negative effects on the dynamism, efficiency and openness of markets in the UK.
3. The EU currently operates a system for regulating state aid. The EU system enforced by the Commission ensures that, in the interests of all in the EU, government aid to industry does not distort competition. Absent EU oversight, UK governments would be free to support national champions or politically expedient causes to a much greater extent. This would be likely to distort competition, undermine incentives for investment, and adversely affect investor confidence. Perhaps

more importantly, UK businesses may no longer have the same ability to complain about aid granted to their competitors by other European countries.

4 Post-withdrawal, greater scope would arise for political intervention in individual cases. The current system allows a degree of flexibility for national policy objectives to be set, provided they are set within a coherent framework and are subject to safeguards that are mandatory under EU law. But withdrawing from the EU would provide significant additional scope for unwelcome political involvement in constantly tinkering with the goals of competition law enforcement, as well as in attempting to influence competition authority decisions regarding individual business practices or particular merger and acquisition (M&A) transactions.

Current EU legal and economic context

In essence, EU competition law is part of a multilateral trade agreement designed to open up national markets and, once opened, to prohibit private agreements or monopolistic practices that restrict competition and re-erect barriers. It is designed to keep markets that have been opened up to competition functioning effectively. Agreements that restrict competition, and engaging in conduct that involves the abuse of monopoly power, are, therefore, prohibited under EU competition law.

Under the current EU system, agreements by which suppliers seek to give retailers 'absolute territorial protection' are generally considered illegal. Such agreements, which prevent retailers from selling outside of their allocated territories and prevent consumers from purchasing from other retailers, serve to sub-divide markets. If, as is often the case, markets are sub-divided along national borders, a consumer in one member state will be prevented from taking advantage of a lower price on offer for the same product in another member state.

In addition, the EU's rules on monopolistic practices have long outlawed the application, by a 'dominant' (i.e. monopoly) supplier, of unjustified price differentials between member states. These rules again seek to ensure that artificially high prices are not charged in a particular member state. The aim – and overall effect – of EU competition law in these areas is to allow goods and services to flow across the internal borders of the EU's single market, to the benefit of consumers.

Competition law has been central to the single market and is contained in the treaties that have formed the EEC, EC and latterly the EU, for over 50 years. Indeed, it has been constantly reviewed and strengthened as the market has grown larger. EU competition law provides the mechanism by which markets are opened and the benefits of a truly EU-wide single market are made available to all. In the relatively recent case of *GlaxoSmithKline,* the Court of Justice of the European Union (CJEU) stressed that integration of the single market is an essential goal of EU competition law *(C-501/06 P GlaxoSmithKline Services and Others v Commission and Others).* If the UK were to leave the EU, it would forego its automatic entitlement to the benefits of the single market.

It is not easy to quantify these benefits of the single market, or the sum attributable specifically to good competition law enforcement, within these overall benefits. But some efforts at quantification have been attempted at various times. Two exercises by the Commission are compared in the table opposite.

Benefits reported in 1997	Benefits reported in 2007
Up to 900,000 more jobs	2.75 million jobs created during 1992-2006
EU absorbed 44% of global foreign investment flows in early 1990s	Trade within the EU rose 30% since 1992
Income is estimated to have been 1.1% to 1.5% higher due to the single market	Lower prices, such the price of telephone calls which reduced on average by 40% over the period 2000-2006.
Inflation rates which seem to be 1.0% to 1.5% lower than they would have been	Over the last 15 years the single market has increased the EU's prosperity by 2.15% of GDP
Intra-EU manufacturing trade was boosted by 20-30%	The average cost for setting up a new company in the former EU-15 has fallen from €813 in 2002 to €554 in 2007
Greater convergence of production structures	73% of EU citizens think the single market has contributed positively to the range of products on offer

In June 2012, Jo Johnson MP, a close advisor to the Prime Minister on European affairs, wrote in an essay for the Centre for European Reform that the single market was one of Europe's greatest achievements, and completing it was "one of Europe's best hopes for economic growth". In a strong defence of the importance of the UK retaining full access to the single market, he cited evidence that suggests it could make the average European household €4,200 (roughly £3,500) better off each year. The effective enforcement of EU competition law plays a crucial role in securing the benefits of the EU single market.

The Treaties' rules on competition and the free movement of goods have together been used to break open markets and create trade opportunities, as well as to prevent anti-competitive practices and outlaw anti-competitive agreements. The Commission has used the competition rules together with its power to impose high fines as a basis for its approach of 'speaking softly while carrying a big stick' and it has been, at least in part, successful in encouraging reluctant member states to open up their previously protected national markets.

Trans-border industries such as telecommunications and energy have been especially dependent on this type of effective liberalisation and enforcement action. The EU's telecommunications and energy markets would not have been opened up to anywhere near their current extent in the absence of such liberalisation, or in the absence of the continued vigilance of the Commission in enforcing the competition rules.

The enforcement of EU and UK competition law

EU competition law is developed and enforced principally by the Commission but operates within an overarching system of EU law overseen by the Court of Justice in Luxemburg. From a policy perspective, Article 3(1)(b) of the Treaty on the Functioning of the European Union (TFEU) gives the EU exclusive competence in "the establishing of the competition rules necessary for the functioning of the internal market".

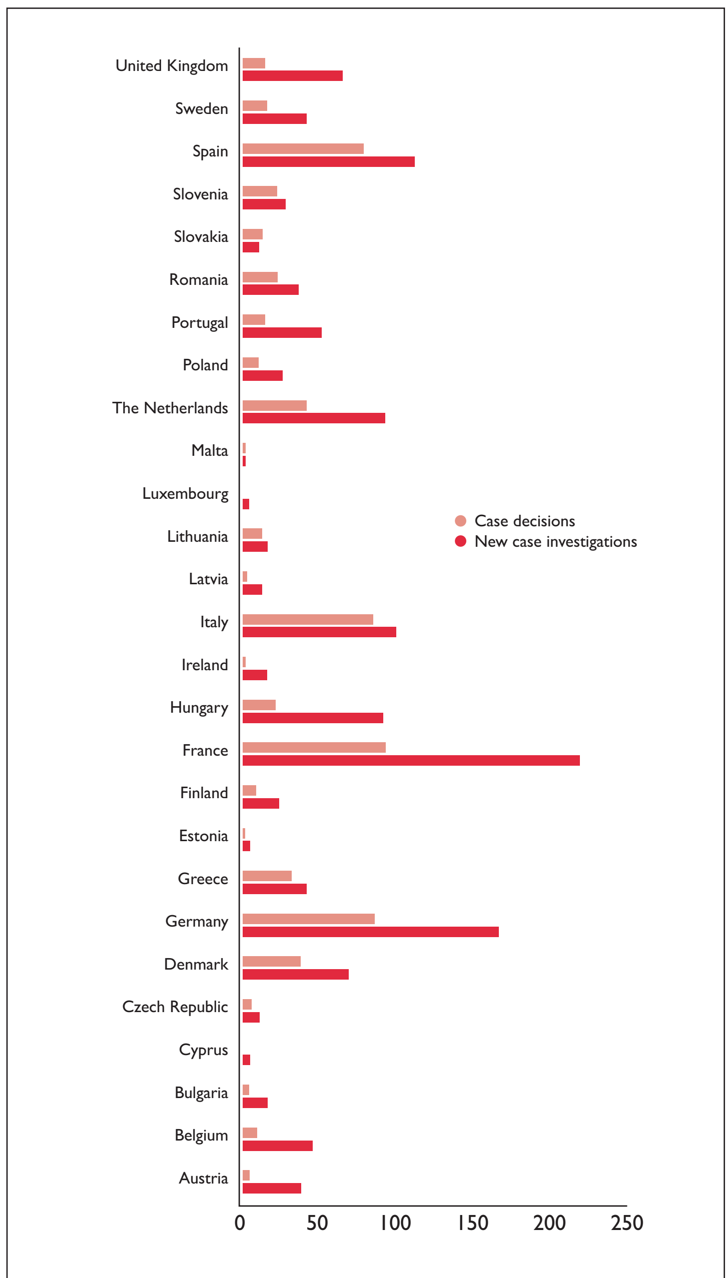
From a practical perspective, the EU system is both integrated, with certain matters dealt with exclusively at

EU level, and decentralised, with certain matters left to the national authorities and national courts.

For example, major mergers are dealt with exclusively by the Commission. The Commission takes responsibility when a merger has a "Union Dimension", i.e. where a merger involves two or more undertakings with combined worldwide revenues in excess of €5 billion, and at least two undertakings each with EU revenues of more than €250 million. (The Commission also has exclusive competence to review mergers involving undertakings with lower worldwide and EU-wide revenues, provided, among other things, that each of at least two undertakings has revenues in excess of €25 million in the same three member states. The Commission also has competence to review mergers falling to be notified in three or more member states.) But smaller mergers – or mergers involving companies whose activities are focused in one and the same member state – will fall within the remit of national authorities in the member states concerned.

Equally, pursuant to Article 11(6) of Regulation 1/2003, where the Commission has initiated proceedings in relation to alleged cartels, other anti-competitive agreements or abuses of a dominant position, the competition authorities of the member states are relieved of their competence to act.

In order to ensure efficient cooperation between the Commission on the one hand, and the 28 member state competition authorities on the other hand, the Commission chairs a body called the European Competition Network (ECN), the members of which are the Commission and the member state competition authorities.



The current system of enforcement is therefore highly integrated and entails detailed and systematic cooperation. The leadership of the system is entrusted to the Commission, which benefits from dealing with a high volume of high value matters affecting one of the biggest trading blocs in the world. The Commission's accumulated experience from dealing with high value matters, allied to the input it receives from member state competition authorities dealing with equivalent issues at a national level, means it is uniquely placed and uniquely knowledgeable in the interpretation and application of competition law. In many ways, the system is a model of cooperation and efficiency.

Under EU membership, the UK benefits not only from UK competition law enforcement effected by the Office of Fair Trading (OFT), but also from EU competition law enforcement effected by the Commission and, indirectly, from the intelligence and knowledge shared within the wider ECN.

In recent years, competition authorities have increasingly sought to demonstrate the benefits attributable to their enforcement activities. The OFT has been at the forefront of these efforts but the available statistics do not cast the OFT in a particularly favorable light. Rather, they serve to emphasise the effectiveness of Commission enforcement, and other member states' enforcement as well, from both of which – under EU membership – the UK benefits directly or indirectly.

In the period from 1st May 2004 – 31st May 2013, the OFT opened only 66 new case investigations. Equally, in the same period, the OFT only issued 16 case decisions. By these measures, Member State competition authorities in Denmark, Germany, France, Hungary, Italy, the Netherlands and Spain have all been more effective.

The OFT's level of activity has also been well below that of the Commission. In 2012 alone, the Commission imposed fines of €1.9 billion and addressed decisions to 37 undertakings in relation to alleged participation in cartels. Over the period from 2005-2009, the Commission imposed fines totaling €9.4 billion and addressed decisions to 205 undertakings in relation to alleged participation in cartels. The highest fines for a single cartel case were imposed in 2012, in the TV and computer monitor tubes case, where fines totaling €1,470,515,000 were imposed. Some figures were subject to subsequent reductions following CJEU judgments, but the raw numbers are impressive. When compared on a like-for-like basis, the OFT is clearly operating at a lower level than the Commission, as shown by the table below.

Year	No. of OFT Decisions	Fines in £ millions	No. of Commission Decisions	Fines in € millions
2007	0	0	10	3,500
2008	0	0	7	2,271
2009	2	168	8	3,706
2010	0	0	8	2,873
2011	4	312	4	614
2012	1	58	5	1,875

In that period 2007-12, where the OFT has adopted seven infringement decisions, the Commission has adopted 42. And where the OFT has imposed fines totaling £535 million, the Commission has imposed fines totaling €14.8 billion. The deterrent effect of enforcement by the OFT and the Commission combined is exponentially higher than the deterrent effect of enforcement by the OFT alone.

What would the UK do to ensure equally effective deterrence and enforcement in the event of a UK exit from the EU? No doubt the structural reforms of the OFT, by combining it with the Competition Commission (CC) to form the Competition and Markets Authority (CMA), will provide a new opportunity for more effective national enforcement, but given the scale of the difference in enforcement activity to date, the overall effect of withdrawal from the EU is likely to be a much reduced level of enforcement and deterrence, to the ultimate detriment of UK consumers.

State Aid

Financial or other benefits afforded through governmental bodies to a private undertaking are known as state aid in EU law and are governed by Articles 107-109 TFEU. State aid is often given to promote a particular kind of economic activity, or to protect a national industry, but it can have the effect of distorting competition.

Granting such assistance beyond relatively modest thresholds is considered likely to be harmful to competition and, if these thresholds are crossed, it is incumbent on the member state to notify this aid to the Commission in order to obtain approval. The Commission then reviews the competitive impact of such aid.

Certain exemptions to the obligation to notify aid do exist. Member states are permitted to give very limited direct aid to companies and other undertakings if they can justify it as: (i) regional aid for investment or employment; (ii) aid to small-sized and medium-sized enterprises; (iii) aid for environmental protection; (iv) risk capital aid; and (v) aid for research, development or innovation.

If the UK left the EU, the government of the day would be free to accord aid as it deemed appropriate without external oversight from the Commission. Businesses in receipt of such aid, and the government of the day itself, would doubtless view this as a positive development. However, businesses adversely affected by politically-motivated financial assistance to their competitors would have no established mechanism for holding the government in question to account. Although the absence of state aid rules may be welcomed by the government of the day, the attendant uncertainty is unlikely to be regarded as a positive development by financial markets, overseas investors or successful companies that do not require government assistance.

In addition, post-withdrawal, UK businesses would not necessarily be able to complain to the Commission about state aid granted to a competitor by an EU member state. Even if a complaint were possible, there must be some doubt about the extent to which the Commission could be expected to prioritise a complaint from a UK business in relation to aid granted by, for example, the German government to a German company. Equally, post-withdrawal, in circumstances where there are only two European players on a given market, one of which is in the UK and the other in Germany, aid granted to the German company may not fall within the auspices of the state aid regime at all.

Greater scope for political intervention

The UK being part of the EU, and the OFT being a member of the ECN, does not act as a straitjacket when it comes to improving competition law enforcement in the UK. Rather, the EU legal and institutional framework serves as a useful constraint on political interference in UK competition law.

The fact that the UK currently enjoys a degree of flexibility in determining its national competition law enforcement mechanisms and priorities is evidenced by two recent developments.

First, from an institutional perspective, the UK's new Financial Conduct Authority was formed with a competition objective earlier this year, while the new CMA will shortly succeed the OFT and CC. The UK has been able to craft these institutional reforms within the overall system of EU competition law.

Second, from a policy perspective, in a consultation issued in July 2013, the UK's department for Business Innovation and Skills (BIS) recognised the scope for UK policy goals to be advanced at a national level within the EU framework in its proposals to provide a 'Strategic Steer' for the CMA. This 'Strategic Steer' does not change UK or EU law, but instead outlines possible revised goals for competition policy enforcement in the UK by ensuring that the CMA has appropriate priorities.

If competition policy were to be determined by the UK Government purely at a national level outside the EU, politicians might become much more closely involved in individual cases and decisions. The recent News Corporation/Sky case is an example of some of these concerns. The Commission looked at the purely competition issues raised by the proposed transaction and concluded its apolitical investigation in good time. In contrast, the UK review process (which looked at media plurality issues) resulted in several politicians, including senior ministers in the UK government, coming under considerable pressure to focus on short term issues of political expediency, rather than concentrating on longer-term issues of consumer welfare and free speech. Equally, the somewhat hastily-arranged marriage of Lloyds and HBOS might be seen (by some) as another example of government meddling inappropriately in issues that should have been left to the competition authorities. In that case, the OFT identified potential competition concerns in the markets for personal current accounts, banking services for small and medium sized enterprises (SMEs) and mortgages. But the Secretary of State at the time – Lord Mandelson – intervened to approve the merger unconditionally. At the time of writing, the OFT is seeking views on the scope of a proposed market-wide investigation into competition in banking for SMEs, while in relation to personal current accounts and mortgages, Lloyds is still attempting to finalise the sale of its retail branches that was mandated by the Commission. So the potential competition issues, which were identified back in 2008 but which were suppressed by the UK government at the time, are thought, at least by the relevant authorities, to remain live to this day.

In the event of a UK withdrawal, financial markets could perhaps be expected to assume that political considerations would be brought to bear on individual cases more frequently than they are today. The cases cited demonstrate how the review of potential mergers could be affected by political considerations. Considerable effort may need to be expended for financial markets to be reassured that any post-withdrawal UK decision-making process will be immune from improper influence. This may not be the most significant, or easily quantifiable, of risks, but it nonetheless merits consideration.

Conclusions

Without the combined efforts of the UK's national competition authority, the Commission, and the other member state national competition authorities, there is likely to be a lower level of enforcement and so a lesser incentive for companies to comply with competition law in the UK. The government of the day will also be free to provide aid to individual businesses as it sees fit, with no obvious form of redress for rivals that suffer as a consequence. Equally, UK businesses may be less able to complain about anti-competitive state aid granted to their competitors by other European countries.

Perhaps most importantly, EU competition law plays a key role in ensuring that the EU single market functions effectively. This single market objective does not exist in UK competition law. Absent the application of the EU prohibition on sub-dividing markets along national lines, suppliers may look to isolate the UK market and raise prices. The popular backlash when UK consumers are prevented, in an increasingly online retail environment, from purchasing equivalent goods at lower prices from other countries, should not be underestimated.

The author is grateful for input received from Stephen Kinsella OBE and Patrick Harrison, both of Sidley Austin LLP. The views expressed in this article are exclusively those of the author and do not necessarily reflect those of Sidley Austin LLP, its partners, or clients. This article has been prepared for informational purposes only and does not constitute legal advice.

Facts and figures

EU competition policy has two main instruments to police the Single Market: anti-trust/merger enforcement powers and state aid controls.

Anti-trust and merger powers

The EU shares anti-trust/merger powers with national enforcement agencies, dealing only with the more important cases which potentially distort the market at European level. EU authorities took

40 decisions in 2009, imposing fines totalling 1,540 million euros;

69 decisions in 2010, imposing fines of 2,868 million euros;

14 decisions in 2011, imposing fines of 614 million euros;

37 decisions in 2012, imposing fines of 1,875 million euros.

Among major companies fined by the EU were E.ON and GDF Suez in 2009, Ideal Standard in 2010, and LG Electronics and Philips in 2012.

State aid powers

State aid controls attempt to stop member states distorting competition by favouring national enterprises at the expense of others in the Single Market. Traditionally state aid controls cover non-crisis aid to industry and services, agriculture, fisheries and transport. The Commission can approve state aids within certain limits, and it records aid as a percentage of each member state's GDP, publishing an annual scorecard of aid approved which allows comparisons between member states.

In the period from 1 January 2000 to 30 June 2012, the Commission took 986 decisions on potentially unlawful aid. In 23 % of unlawful aid cases (224 cases) the Commission took a negative decision, finding the aid measure incompatible with the limits. Such negative decisions normally require the member state concerned to recover the illegally awarded aid.

The UK scorecard

The UK scorecard for 2012 shows approximately 10.7 billion euros in approved non-crisis aid, disbursed under criteria relating to research, development and innovation, environmental and regional issues, employment and training, and specific SME concerns. Sectoral aid is also allowed for coal, financial services, manufacturing, and other industrial sectors and services. Overall the UK has, like Italy, a lower recourse to state aids (approx. 0.3% of GDP) than either France or Germany (approx. O.6%).

State aid in the financial crisis

In the recent financial crisis, state aid approvals have been required to permit the restructuring of the banking sector in several member states. In the period from October 2008 to October 2012, the Commission took more than 350 decisions in the financial services sector to remedy serious disturbances in the economies of member states, addressing the situation in over 90 financial institutions. The Commission has so far taken only one prohibition decision. Financial crisis measures have been introduced in all member states, apart from Bulgaria, the Czech Republic, Estonia, Malta and Romania.

In that period the Commission approved aid to the financial sector for an overall amount of €5,058.9 billion (40.3 % of EU GDP). The bulk of the aid was authorised in 2008 when € 3,394 billion (27.7 % of EU GDP) was approved, mainly comprising guarantees for banks' bonds and deposits. After 2008 the aid approved focused more on the recapitalisation of banks and impaired asset relief rather than on guarantees, while more recently a new wave of guarantee measures has been approved, mainly by those countries experiencing an increase in their sovereign spreads, such as Spain and Italy. Between January 2012 and October 2012 further aid totalling € 429.5 billion was approved.

The overall amount of aid used in the period from 1 October 2007 to 31 December 2011 was € 1,615.9 billion (12.8 % of EU GDP). The largest part went on guarantees, which amounted to roughly € 1,085 billion (8.6 % of GDP), followed by recapitalisation (about € 322 billion or 2.6 % of GDP), impaired assets (about € 119.9 billion or 0.9 % of GDP) and liquidity measures (€ 89 billion or 0.7 % of GDP).

The total volume of aid approved by the Commission for the UK to guarantee banks' liabilities and to recapitalise them amounted to € 873.34 billion in the period 2008 to 2012.

Source: Commission report

Environment

Michael J. Lane

Former Secretary General of CONCAWE(Conservation of Clean Air and Water in Europe) and former Global Environment & Health Manager for Exxon Mobil Corporation

Environmental legislation is not only about manufacturing industries improving air and water quality and the protection of ecosystems. Among other areas, it also extends to the energy efficiency of appliances, machinery and vehicles.

Michael J. Lane

The UK Background

David Cameron, in his EU speech in January 2013, explicitly mentioned EU environmental legislation. He used it as an example of an area where power should be returned to member states. He implied that this flexibility could allow the UK to better balance the competitiveness of the economy with environmental improvements. In reality, it is unlikely that a UK outside the EU would significantly relax environmental controls, for two principle reasons: firstly, many of the standards to which the UK are committed do not flow directly from EU legislation; and secondly, a Government which is committed to environmental improvement would neither want to relax rules, nor would civil society accept it.

The United Kingdom's concern for the environment has a long history, starting with sanitation and related health issues and, later, the deterioration of urban air quality following the industrial revolution in the 19th century. In 1863, the Alkali Act was passed to limit industrial air emissions. However, it was not until the late 20th century that a broader awareness of the environment and the need to protect it began to be discussed. The Environmental Agency (EA) was created by the Environment Act 1995, and came into existence on 1 April 1996. It took over the roles and responsibilities of the National Rivers Authority (NRA), Her Majesty's Inspectorate of Pollution (HMIP) and the waste regulation authorities in England and Wales including the London Waste Regulation Authority (LWRA). All of the predecessor bodies were disbanded and the local authorities relinquished their waste regulatory role.

On 1 April 2013, that part of the Environment Agency covering Wales was merged into Natural Resources Wales, a separate body managing the Welsh environment and natural resources.

The Scottish Environment Protection Agency (SEPA) is Scotland's environmental regulator. SEPA is an executive non-departmental public body (Executive NDPB, or "Quango") of the Scottish Government. SEPA was established in 1996 by the Environment Act 1995 and is a member of SEARS (Scotland's Environmental and Rural Services). SEPA carries out its role through the NetRegs environmental guidance service. It protects communities by regulating activities that can cause harmful pollution and by monitoring the quality of Scotland's air, land and water. The regulations it implements also cover the storage, transport and disposal of radioactive materials.

Over the past few decades, the UK has implemented many laws, regulations and created regulatory agencies to control and reduce environmental damage. Some of these pre-date the UK joining the EU. In some cases, these pre-existing laws have either been sufficient, or only in need of minor amendments, to satisfy the requirements of a subsequent EU Directive.

EU Requirements

It is a requirement of EU membership that all EU Directives are transposed into national legislation within a time limit defined in the Directive. Member states are required to implement, as a minimum, the requirements of the Directive, but can choose to go further and specify tougher measures than the Directive itself. Until a member state has enacted its own legislation, any Directive's measures do not become law in that member state.

There are many cases where the UK Government has chosen to go beyond the minimum requirements of a Directive. A recent example is the EU emissions trading scheme (EU ETS) for the market-based allocation of CO_2 allowances. The EU scheme prices CO_2 allowances based on the traded market price, with no floor. The UK has introduced an initial minimum CO_2 price (effectively a floor price) of £16/tonne from April 2013. The aim was to provide clarity on the future cost of carbon and encourage investment in low-carbon technologies. However, with the EU ETS price of CO_2 now (May 2013) below £3/tonne, the effect of the UK floor price is a significant cost penalty to UK energy intensive industries compared with those located elsewhere in Europe.

The UK, like most member states, sometimes fails to meet the deadlines set by a Directive for transposition. Partly due to the slow pace of implementing Directives across Europe, as well as their inconsistent transposition, the European Commission would like to use, more frequently, EU Regulations as the instrument of choice to enact legislation. A Regulation becomes law in each member state at the time it is put into effect at the EU level. No subsequent transposition is necessary in the member states, and the Regulation is the same everywhere. However, the enforcement of Regulations is usually a member state responsibility which can lead to inconsistent enforcement and also to widely different penalties for non-compliance in each country.

EU Principle Directives to protect and improve the Environment

The most important EU environmental legislative instruments are:

- Industrial Emissions Directive (IED)
- Water Framework Directive (WFD)
- Waste Framework (reuse/recycling) Directive (WFDRR)
- Ambient Air Quality Directive (AAQD)
- National Emissions Ceiling Directive (NECD)
- Environmental Liability Directive (ELD)
- Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) Regulation

Industrial Emissions Directive

In 2011 the IED came into force, combining seven previously ratified Directives (including the Large Combustion Plant Directive). The goal is to increase protection of human health and the environment while reducing the administrative difficulties and costs of the previous Directives. It regulates a wide range of industrial activity, including setting emission limit values for large industrial facilities including refineries and chemical plants, power stations and Combined Cycle Gas Turbines.

The Environmental Permitting (England and Wales) Regulations 2010, which covered the requirements of the previous Directives, was adjusted in the light of the EU Directive. In 2013, the Pollution Prevention and Control (Scotland) Regulations 2012 also came into force.

Water Framework Directive

In December 2000 this Directive came into force to protect inland surface water, transitional waters, coastal waters and groundwater. By 2015 'good status' should be reached for all aquatic ecosystems. The Directive requires member states to establish river basin districts and river basin management plans for each of these districts by 2015. These management plans must be reviewed every six years. Their aim is to assess and characterize impacts on the river basin districts, monitor the environment, set objectives and design/implement measures to achieve the objectives. The Directive's overall aim is to ensure sustainable water use and to reduce water pollution. It also sets EQSs (environmental quality standards) which limit the concentration (and total quantity) of contaminants in water discharged from industrial facilities and municipal water treatment plants.

It was transposed into UK law in 2003 via the Water Environment (Water Framework Directive) Regulations 2003 (Statutory Instrument 2003 No. 3242) (England Wales), the Water Environment and Water Services Act 2033 (Scotland) and the Water Environment (Water Framework Directive) Regulations 2003 (Statutory Rule 2003 No. 544 (Northern Ireland).

The timetable imposed by the WFD is very strict, yet resources devoted to improvements are limited, as reflected in the final river basin management plans in 2009. The UK does not plan to go beyond EU requirements with the implementation of the Directive's requirements. The WFD has not really introduced any new requirements to the UK law, its effect was essentially the tightening of existing laws.

Waste Framework Directive

The Directive, passed in 2006, established a framework for the collection, transport, recovery and disposal of waste across Europe. A revised version was adopted in 2008. This Directive also establishes a hierarchy of policies to be applied. Prevention is the most important priority, then reuse, recycling, other recovery (including energy recovery) and finally disposal. Further, specific targets were set, including a target to recycle or reuse 50% of household waste by 2020 and to reuse, recycle or recover 70% of non-hazardous waste by 2020. The member states are also encouraged to make producers responsible of increasing recycling, reuse and waste prevention.

The Directive requires the UK to establish a waste prevention plan by December 2013 and to encourage the separate collection of bio waste.

The UK had until 2010 to adapt its laws to the original Directive, however, the government believed that all required of legislation was already in place. In 2011 the revised WFD was transposed into UK law via the Waste (England and Wales) Regulations 2011. The Waste (England and Wales) (Amendment) Regulations 2012 replaced Regulation 13 and now requires establishments to collect waste paper, metal, plastic and glass separately.

Ambient Air Quality Directive

The 2008 Directive sets limit and target values for individual pollutants that are legally binding for all member states. Protection of human health is the main goal. The Directive sets limits for lead, NO_2, PM10 (particulate matter: soot, dust), PM2.5, SO_2, benzene, CO, some toxic heavy metals, polycyclic aromatic hydrocarbons and ozone. Monitoring takes place by benchmarking values measured over a period of time against EU standards. The AAQD replaced most of the previously established legislation regarding air quality. The new Directive allows member states to apply for extensions to meet their targets, which the UK has done in the case of NO_2 and PM10.

The Directive (as well as a daughter directive, the 4th Air Quality Directive) was incorporated into law through the Air Quality Standards Regulations 2010 (England and Wales), the Air Quality Standards (Scotland) Regulations 2010 and the Air Quality Standards (Northern Ireland) Regulations 2010.

National Emissions Ceiling Directive

The 2001 NECD is similar to the United Nations Economic Commission for Europe (UNECE) Gothenburg Protocol and sets ceilings for certain emissions. It was transposed into UK law through the National Emissions Ceilings Regulation 2002 and came into force in 2003. The National Emissions Ceilings Directive sets total emission limits for the pollutants SO_2, NO_X, volatile organic compounds (VOC) and ammonia, to be reached in 2010 and maintained thereafter. Measures of how to comply with the ceilings were not set. The ceilings set by the Gothenburg Protocol are similar to the NECD ones.

Environmental Liability Directive

In 2004 the ELD established aims to prevent and remedy environmental damage to protected species, nature, water and soil. The Directive is established on the "polluter pays principle", meaning that the legal person occupying the land is the liable party. They are responsible for implementing preventing actions and to remedy any environmental damage that has already occurred.

In the UK, regulations to remedy environmental damage already existed. Previously established legislation (Environmental Protection Act 1990, the Water Resources Act 1991 or the Wildlife and Countryside Act 1981 and the Control of Major Accident Hazards Regulations 1999) still applies and puts additional obligations in the UK. The ELD however, was adopted in the Environmental Damage (Prevention and Remediation) Regulations 2009.

Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH)

The REACH Regulation (EC) No 1907/2006 came into force in June 2007 to better control the manufacture and safe use of chemical substances placed on the market. The definition of "chemicals" is wide, including industrial chemicals, petroleum fuels, many metal compounds, etc. It is the most ambitious, complex piece of legislation the EU has ever implemented; as such compliance is costly and bureaucratic. The European Chemicals Agency (ECHA) was formed to manage the implementation of the Regulation.

It requires all manufacturers and importers of substances covered by the Directive to compile extensive Chemical Safety Reports to show they fully understand the environmental and health impacts of their products, both in manufacture and in end-uses by consumers. All producers and importers are required to register their substances (in 2010 for high volume products; 2013 for lower volumes and 2018 for small volumes).

The UK, if outside the EU, could exempt manufacturing but not exports of such substances to the EU. As most substances covered are, in part, exported to Europe, an exit from the EU would not remove the burden of registration from UK producers. The Classification, Labelling and Packaging (CLP) Regulation (which seeks to harmonise the way hazardous materials are classified and labelled) is the EU instrument to implement the UN Global Harmonized System (GHS) for classifying hazardous substances. As the UK is a member of the UN, nor would an exit from the EU allow the removal of CLP requirements for UK producers.

UK Commitment to non-EU Environmental Protocols

The United Nations, through UNECE, has developed several important protocols, covering environmental protection. The UK is a signatory to these in its own right as a sovereign state. All EU member states are also members of UNECE and, in many cases, the EU itself is also a signatory and has transposed these commitments into EU legislation. However, if the UK was not part of the EU, its commitment to the UN protocols would still continue to determine much UK environmental legislation.

The principle UN protocols for the environment are as follows:

The Gothenburg Protocol

The Gothenburg Protocol was first drafted in 1999 to set emission ceilings for sulphur, NO_X, VOCs and ammonia. It aims to avoid harmful effects on human health, the environment, natural ecosystems, crops and climate. Ceilings were set based on the cost associated with reducing the pollutant level and the severity of its impact on individual's health. The goal was to cut the EU's pollutant emissions before 2010 by:

- Sulphur by 63%; NO_X by 41%; VOC by 40%; ammonia by 17%

Limits were also broken down to sectors, including agriculture and transport. An amendment in 2012 included new emission ceilings for the UNECE region to be achieved by 2020. It also integrated new parties to the Convention and added other emission sources, such as particulate matter (PM) and new mobile sources. Emissions of nitrogen oxides and VOCs are not included in the Gothenburg protocol as they are already regulated by other protocols, adopted in Sofia in 1988 and Geneva in 1991 respectively. Application of the various limits by each party is now related to technical and economical feasibility and flexible transitional arrangements can be made when first implementing the limits.

The UK ratified the Gothenburg Protocol on 8 December 2005. The National Emission Ceilings Directive is the key legislation that transposes these emission obligations into EU law.

The Aarhus Convention

The Convention was drafted in 1998 and came into force in 2001 for the UNECE region. It was amended in 2005. The provisions of the Convention are shared fully by the UK. The amendment was ratified in 2009.

Its aim is to protect future generations, linking environmental rights to human rights by providing the public with rights to access information, public participation in decision-making and access to justice in environmental matters. Transparency and government accountability are key issues, and its terms cover obligations of governmental authorities to the public. They rest on three pillars:

- access to information: parties must create an access-to-environmental-information law or regulation; environmental information must be collected and publicised.
- public participation in decision making: they must establish a transparent and fair framework for public participation in decisions with possible environmental impact, provide opportunities for public participation, and keep the public informed by publishing drafts and outcomes.
- access to justice: they must enforce pillars 1 and 2 by incorporating them into the domestic legal systems and by strengthening environmental legislation, implementing judicial review procedures, and introducing minimum standards for access-to-justice procedures.

The European Pollutant Release Transfer Register (E-PRTR, replacing the European Pollutant Emission Register) was implemented to comply with the Aarhus Convention. The idea is transparency: key environmental data from all EU member states and in Iceland, Liechtenstein, Norway, Serbia and Switzerland can be easily accessed by the public.

The Kiev Protocol

This protocol came into force in 2010 and adopted terms that were first set by the Espoo Convention. It requires Parties to consult each other on all projects that potentially have a significant environmental impact across boundaries. The idea behind the Convention is that environmental threats could have a negative impact beyond national borders. Hence the Protocol requires signatory states to evaluate the environmental (and health) consequences of major projects in the early stages of planning, and to promote public participation. They should underline the importance of sustainable development by incorporating climate change considerations into project planning.

Environmental Standards for Manufactured Goods

Environmental legislation is not only about manufacturing industries improving air and water quality and the protection of ecosystems. Among other areas, it also extends to the energy efficiency of appliances, machinery and vehicles. A significant impact on air quality is caused by car and truck exhaust emissions. EU legislation and voluntary initiatives by both fuel suppliers and the automotive industry have led to reductions for all key pollutants by over 90% since 1995.

The drive to reduce greenhouse gas emissions (GHG) has led to more efficient appliances, whose performance is made clear to consumers through obligatory and standardized eco-labelling. The same principles apply to cars. Regarding vehicle emissions, the progressive implementation of tailpipe emissions limits through a series of EURO standards for vehicle manufacturers – now six in all - has ensured these improvements are delivered. Such is the influence of Europe with regard to these EURO standards (affecting both transport fuel qualities and vehicle design), that much of the rest of the world (especially Asia) is applying the same standards for their own fuel and vehicle specifications.

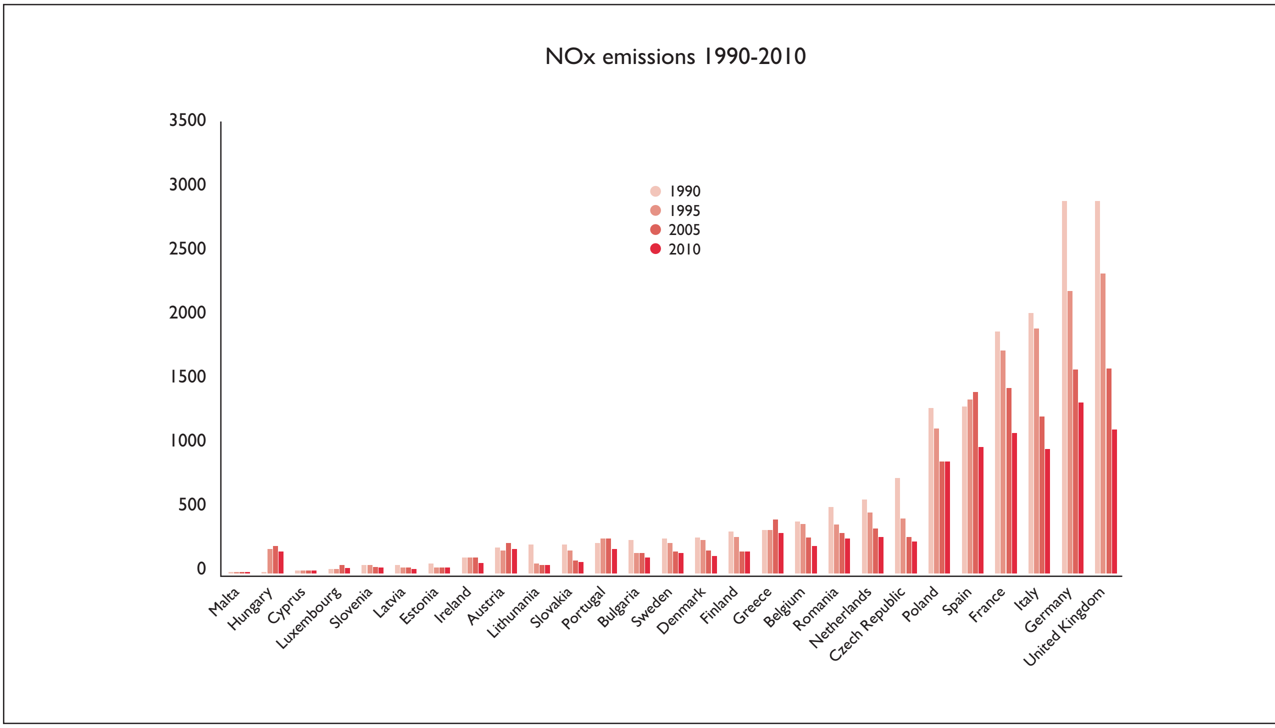
A UK outside of the EU could, in theory, relax these standards for its domestic market. However, given the small size of this national market and the increasing globalisation of production and distribution of goods, UK tailored specifications would be unlikely to be commercially viable for UK manufacturers (e.g. of vehicles), nor for importers of goods just to the UK. In reality, therefore, the UK would still produce and purchase goods which would comply with EU - and increasingly global - standards. Consumers would continue to have the environmental benefits of these products, and also to bear the additional costs involved in manufacturing them, regardless of where they were produced.

The UK Environmental Record

Overall, the UK's performance on the key measures of environmental protection (air quality, water quality (rivers and coastal seas), waste disposal & recycling, etc. are broadly in line with the average performance of EU member states.

For example, the EU has committed itself to a 10% target for renewable energy in all transport fuels. The UK's progress, to date, is slightly behind that of other member states at 3% (2010) compared to an EU average of 4.3%

Environmental taxation, as both an incentive to improve standards and a financial burden on the economy, varies considerably between member states. The UK taxation burden is very close to the EU average.



For air pollution, the UK has made substantial improvements in recent years, as have many other Member States. SO_X has been reduced by 90% (1990 compared to 2010) and the reduction in NO_X emissions, although still among the highest, can be seen in the table above.

The infringement of EU-environmental policies by member states is one indicator of lack of progress and non-compliance with EU environmental legislation. In 2010, the UK accounted for 4% of the environmental infringement cases in the EU, compared with 14% of EU GDP and 9% of the EU population. This suggests the UK is better at achieving compliance with EU environmental laws than some other member states:

In 2010: there were 445 environment-related cases, in total, for all members states;

- In the UK there were 18 infringements of EU environmental legislation (half were related to water pollution);
- In Germany there were 12 infringements of EU environmental legislation (half were related to water pollution);
- In France there were 19 infringements of EU environmental legislation (6 were related to water pollution, 5 to the waste sector);
- In Spain there were 33 cases (10 relating to water, 12 to nature and 5 to air);
- In Italy there were 45 cases of infringements (note though, that the government's cuts did not decrease, but redistribute environment-related budgets).

Conclusions

Overall, it is unlikely that leaving the EU would make much difference to the UK's ability to change (i.e. relax) costly EU environmental legislation:

- › Many commitments do not directly come from the EU (e.g. UN-based agreements).
- › Key environmental Directives are already transposed into UK law. They could be repealed, but this would be unlikely, due to societal and environmental NGO pressure.
- › Changes to some standards (e.g. vehicle fuel consumption & emissions; appliance eco-standards) would require manufacturers to produce special products for the UK market, which is most unlikely.
- › It is possible that the UK could freeze environmental controls at the current level, and not implement the next steps coming from the EU (e.g. IED driven emissions reduction). This would limit the further erosion of industrial competitiveness, compared with other member states, but cut off UK exporters from the EU market.
- › If an UK exit from the EU resulted in a Norway-type arrangement, it would likely contain a commitment to shadow key EU legislation, as does Norway, at some budgetary cost and without a seat at the decision-making table.

It is easy and tempting to identify the EU as the main reason for costly and restrictive environmental legislation in the UK. However, the reality is more complex. If the UK were free from the constraints of EU legislation, it would neither be able to enact any substantial relaxations of these standards, due to wider international standards and commitments, nor would a responsible Government of any political persuasion want to be seen by its citizens as returning to more polluting policies.

Facts and Figures

Key dates

1994	Establishment of the Scottish Environment Protection Agency
1996	Establishment of the Environmental Agency
1998	Aarhus Convention
1999	Gothenburg Protocol
2000	EU Water Framework Directive
2001	EU National Emissions Ceiling Directive
2004	EU Environmental Liability Directive
2005	UK Ratification of the Gothenburg Protocol
2006	EU Waste Framework Directive
2007	EU Registration, Evaluation, Authorisation & Restriction of Chemicals Regulation
2008	EU Ambient Air Quality Directive
2010	UK Air Quality Standards Regulations
	UK Ratification of the Kiev Protocol
2011	EU Industrial Emissions Directive

Emission reduction commitments for 2005- 2020 and beyond

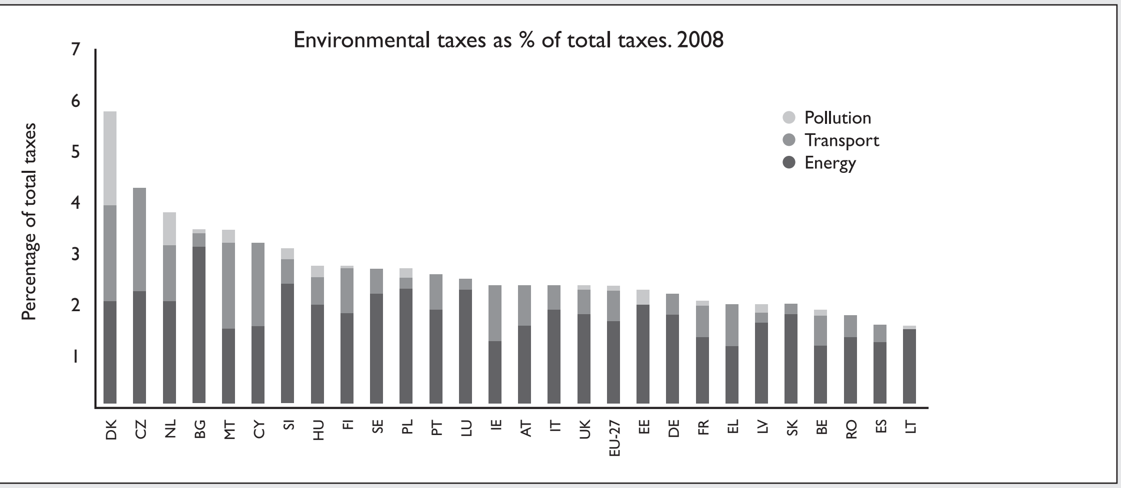
SO2	59%	NO2	55%	NH3	8%
VOC	32%	PM2.5	30%		

Member states' record on Greenhouse Gas Emission 1990-2010

France	-8,6%	Germany	-21,7%	Italy	-8,2%
Spain	+24%	UK	-23,5%		

Total EU-environmental policy infringements in 2010: 445

Only 18 UK cases (9 related to water pollution)
UK represents 4% of total EU infringement cases
Compared with UK's share of 14% of EU GDP and 9% of EU population



Energy policy

David Buchan
Oxford Institute for Energy Studies

While, from the UK viewpoint, there was initially little energy benefit derived from EU membership, there was little cost either.

David Buchan

Costs and benefits over the past 40 years.

For a long time, self-sufficiency in fossil fuels and ignorance about the effect of their combustion on the climate left UK largely uninterested in EU energy policy, either for security of supply or environmental reasons.

When the UK joined the EU in 1973, it was still a major coal producer, and was on the verge of becoming a major oil and gas producer. The first oil was landed from the North Sea in 1975. Thereafter, oil production rose to an all-time high of 2.9m barrels a day in 1999, and gas output to its record annual peak of 108 billion cubic metres in 2000, and the UK remained self-sufficient, if no longer a big exporter, until 2004-5 when it became a net importer of both oil and gas.

On negotiating EU entry, and sometimes subsequently, the UK was fearful that it would lose control of the exploitation of its upstream oil and gas resources to Brussels. Similar fears helped persuade the Norwegian people to vote 'No' in 1972 to joining the EU. In fact, these fears never materialised, and indeed in 2013 the UK was happy to accept an EU directive on offshore rig safety.

While, from the UK viewpoint, there was initially little energy benefit derived from EU membership, there was little cost either. During the 1970s and 1980s, EU energy policy mainly consisted of duplicating the emergency oil-sharing arrangements of the International Energy Agency, and spending money on energy R & D, chiefly nuclear. This left national energy markets, monopolies and policies largely undisturbed.

During the 1990s this changed, as the European Commission began to take action against Europe's historic national energy monopolies, and to open up the market to competition. This posed no inconvenience to the UK. It had already embarked on this route by, for instance, privatising British Gas in 1986 and opening the UK gas market to full competition in 1996, and was by then doing much the same in electricity. To some extent, the Commission was inspired by the UK (and Scandinavian) example of energy liberalisation, but it also had EU anti-trust treaty obligations that would probably have eventually led it to tackle energy market cartelisation anyway.

The UK has generally cheered the Commission on to use its anti-trust powers to liberalise continental energy markets. But, as far as the UK was concerned, the application by Brussels of its merger control power has had a lopsided effect. Most of the takeover bids by big continental companies for UK utilities fell within the remit of EU merger control (because of their cross-border nature) and were nodded through by the Commission (which favours cross-border mergers as adding to competition). By contrast, much of the merger activity on the continent has been between companies of the same nationality (for instance, Eon/Ruhrgas, GDF/Suez) in transactions with a relatively low cross-border element that did not fall within the remit of EU merger control and that were approved by national authorities. The upshot is that four of the UK's big six utilities are foreign-owned, while no UK utility has even a toehold in the continental market. The European Commission shared the frustration of a company like UK-owned Centrica at Brussels' legal inability to prevent companies forming themselves into national champions, thereby effectively blocking any trans-national expansion by UK companies. However, it is also the case that energy privatisation had left the UK with few companies big enough to expand into Europe, while UK governments, as well as the Commission, welcomed the arrival of big European firms in the UK market in the name of competition.

During the 1990s, too, climate change became the other catalyst of EU energy policy. Energy production accounts, on a global average, for around two-thirds of all greenhouse gases in terms of carbon dioxide equivalence. Again, this EU shift to a low carbon energy policy was not a problem for the UK, because it accorded with a similar national shift. The first mark of this was the recommendation, in 2000, by the Royal

Commission on Environmental Pollution that the UK should, by 2050, cut its emissions by 60 per cent below the level of 1990. But the real milestone was the passage in 2008 of the Climate Change Act. This binds UK governments to cutting emissions by 80 per cent by mid-century, and along the way to that 2050 limit requires the setting out of 'carbon budgets' for every period of five years. No other government, in or outside the EU, has bound itself nationally to such goals, which go beyond anything discussed or required in the EU. Hence, in broad terms, Britain's commitment to a low carbon energy policy is a burden that it has imposed on itself, in line with its own 2008 Climate Change Act. Despite this, some aspects of the policy could be cheaper, or simpler to carry out, if the UK were not part of the EU.

The cost/benefit balance today.

The UK debate about the costs and benefits of EU membership has not so far, in the case of energy, raised issues of national sovereignty, EU competence and treaty change. This is surprising, in the sense that energy has only been recognised explicitly as one of the Union's (shared) competences in the 2010 Treaty of Lisbon, which for the first time gives energy a separate treaty article of its own.

The founding treaties setting up the Coal and Steel Community and Euratom give a misleading sense of energy's original importance to the EU, because they were more about politics than economics, more about putting instruments of war - coal, steel and uranium - under common political control than about energy in general.

Therefore, people in the UK could point to energy as an instance in which 'the European Union of 2013 is not the European Community we joined in 1973'. However, this argument is not made in relation to energy, because most people like the way EU energy policy has evolved. Prime Minister David Cameron has highlighted energy as an area of the single market which he would like to see further developed. In energy, the Lisbon treaty article codified what had been happening before 2010 in real life, with EU energy rules being proposed and agreed on other grounds of internal market integration or environmental protection. This organic development of energy policy, running ahead of explicit treaty competences, suggests that ministers and governments have seen an increasing value in a common policy in this area. The Lisbon treaty has a caveat that the various EU competences in energy markets and security of supply, and in promoting energy efficiency and renewable energy, do not affect a member state's right to decide its own energy mix and choice of fuels and sources. Despite this caveat, member states agreed in 2009 to let part of their energy mix be decided at EU level, when they each took on national renewable energy targets.

As it happens, these national renewable targets have assumed unforeseen importance for the UK. This importance partly stems from the fact that the UK accepted the biggest stretch target of any of the EU-27 – an increase of 13.7 percentage points, to take the UK from a 1.3 per cent renewable share in its total 2005 energy consumption to a 15 per cent share by 2020. But renewable targets have also been left as the main prop of low carbon energy, because of the near-collapse of the ETS carbon permit price due to recession-depressed demand and an over-supply of permits.

This near-collapse of the ETS is a particular disappointment to the UK. It faces closure of 12 GW of coal and oil generation and 7GW of ageing nuclear plant by 2020, and had been counting on a high carbon permit price, or carbon penalty, to stimulate the building of low carbon generation to replace this capacity. As a market mechanism, the ETS was a favoured low-carbon instrument in the UK. Along with Denmark, it was the only EU state to start trading carbon emissions on a national level before the ETS was introduced on a European level in 2005. However, the politics of getting any agreement to reduce the structural over-supply of ETS permits is proving very difficult in the face of objections from coal-intensive states like Poland and of competitiveness concerns from countries like Germany with big energy-intensive export sectors.

As a result, the UK is planning several national remedies in a fundamental departure from the market-based principles that have dominated UK energy policy over the past 20 or more years. In order to promote renewables, nuclear and the relatively clean fossil fuel of gas, the UK is introducing a) a separate carbon floor price to increase the cost of carbon permits to UK electricity producers, b) an emissions performance standard that would effectively prohibit coal generation if it were without any capture of carbon emissions, and c) long-term minimum price guarantees for renewables and nuclear. It is possible these price guarantees, especially for nuclear, could fall foul of EU state aid rules.

The competition authorities in Brussels have queried whether in general the UK is not in danger of over-intervening in the marketplace, and in particular over-compensating investors with price guarantees of 30 years or more in established technologies like nuclear. It would be ironic if Brussels were to rap the UK, of all countries, over the knuckles for being too state interventionist. If so, however, Brussels would, in the view of the current UK government, place itself in the infuriating position of failing to solve the problem (the ETS) while also denying member states the right to pursue alternative remedies.

In terms of energy security, the UK, as a net importer of fossil fuels, clearly benefits now from membership of a large bloc of countries with diverse sources of supply and with which it has fixed power links and gas pipelines. Its biggest single source of oil and gas imports is Norway, which is tied in to the EU through the European Economic Area (see below). However, the largest single source of UK coal imports is Russia, Europe's biggest aggregate energy supplier but also from time to time its most problematic. In such circumstances, the UK stands to gain from the ongoing energy dialogue the EU maintains with Russia.

Renegotiation?

The UK appears to have no desire for any treaty change relating to energy, because it has no quarrel with the goal of a low carbon energy system. But because it has some difficulty reaching such a system, it could have an interest in some changes in EU legislation, mostly in order to give it more time to adapt. However, in each case it would have to consider to what extent would change be desirable, and if desirable feasible. EU legislation is always, for the obvious reason of requiring 28 countries' agreement, harder to change than national law.

There are three specific areas worth considering:

a **EU environmental legislation with an impact on energy.** In the first category are the regulations on energy-generated air pollutants, such as sulphur, contained chiefly in two directives, the Large Combustion Plant Directive (in force since 1987) which will be replaced in 2016 by the Industrial Emissions Directive with more stringent requirements. The LCPD gave generators many years to adapt to new pollution limits by installing anti-pollution equipment. However, many UK operators, in contrast to those in Germany, decided not to go to this expense, and chose instead the phase-out option that allowed them to run their dirty plants for a set number of hours from 2008 before closing them down by end-2015. Moreover, some coal plants that do comply with the LCPD may find themselves forced to close by the IED after 2016. In practice, there will be a capacity crunch before 2015, because many operators have been running their plants more than originally planned to take advantage of current low coal prices. The UK's EU partners would not let the UK opt out of the LCPD, or the IED, given the long lead time and flexibility already written into the directives. Unless the UK wanted to abandon its environmental principles, this would be a case where change would be not only not feasible, but also not desirable. The same goes for the EU biodiversity legislation, such as the Habitats Directive, the Natura 2000 network of 26,000 protected sites accounting for 18 per cent of EU territory and significant marine areas, and the Birds

Directive (relevant to wind farm development). This is one of the constraints under which any developer of energy infrastructure has to labour. But opting out of this EU legislation would make no difference to energy infrastructure building, unless the UK at the same time were to scrap most or all of its national bio-diversity protection.

b **Renewable energy targets.** These are national already. They are individually tailored to reflect a combination of each member state's relative GDP and green energy potential, though the national targets are agreed at EU level and designed to produce a European average of a 20 per cent renewable share of total energy by 2020. Almost certainly, the 15 per cent target that UK's Labour government agreed in 2009 will prove too high for the UK, and could be sensibly reduced slightly. The occasion for this could be the general review of the EU renewables directive due to take place in 2014 (though this is expected to focus more on EU targets after 2020 rather than national ones for that date). However, an over-ambitious target would only be a problem for the UK if it were to lead to the country being heavily fined for failing to hit the 2020 goal (and we do not know yet what, if any, the penalties for failure will be), or if it were to panic the UK into over-investing in expensive renewable energy technologies such as offshore wind. In the event, it is primarily the objections to onshore wind by the government's backbenchers that is pushing UK wind investment offshore. The subsidising of renewable energy through levies on electricity users is also organised nationally. Governments, including the UK, want to keep it that way, on the grounds that if they are to have national targets they want to control the means (subsidies) of meeting those targets, as for instance the newly increased incentives to local authorities to develop wind farms. For this reason, the European Commission has no plans to introduce a common EU-wide renewable subsidy system. But, as a country with a high target and middling income, the UK would probably stand to benefit from more harmonisation in the level and structure of national renewable subsidies across Europe, so as not to have to compete for green investment with richer countries like Germany.

c **The Emissions Trading Scheme.** The case for reform, as already set out, is clear, and renegotiation ought to be feasible. The impact of the ETS' failure is not confined to the UK, though it is currently worse there. But the problem of the over-supply of ETS permits is hard to resolve. The Commission is finding it difficult to get approval from the Council of Ministers and the European Parliament to carry out the short-term palliative measure of delaying the auction of some permits, while the longer term reform of cancelling permits will hit the rock of a veto from Poland, whose coal generators want cheap allowances. In theory, it should be possible to change the ETS by qualified majority (as an environmental measure affecting the single market). In practice, it has been agreed that, given the scale of the system and the quasi-tax nature of carbon permits, structural change to the ETS should be by consensus.

Withdrawal?

This could be argued as an option in the energy sector, in two scenarios. The first scenario would see the UK maintaining all the clean energy targets of its current EU membership, but pulling out of the EU in frustration at the EU preventing the UK from effectively meeting those targets. If an unreformed ETS were to remain useless as an incentive for low carbon energy in the UK, and if the European Commission were to prevent the UK from providing necessary subsidies to renewable energy and nuclear power, then the UK might judge it would be better off pursuing purely national policies outside the EU.

However, the UK would lose the chance to argue from within the EU for the Union to maintain an ambitious climate action programme. It would also have no clout, on its own, in international climate negotiations. This might damage UK competitiveness if energy prices were higher in the UK than in remaining EU states.

This competitiveness problem might be solved in the second scenario for withdrawal, which would see the UK abandoning EU-style clean energy targets as well as pulling out of the ETS and pursuing a fossil fuels policy instead. But such a U-turn would reverse decades of UK environmental and climate policy, and is unlikely.

Withdrawal could also pose practical difficulties. In quitting the EU, the UK would be leaving the Northern Ireland part of its UK electricity and gas system closely integrated with an EU state – Ireland. For its part, the English and Welsh electricity and gas system is closely tied into the Scottish network. A Scottish vote in 2014 in favour of independence would seriously disrupt the whole energy sector – oil, gas, nuclear, renewables – on the main island of Britain. But this disruption would be further compounded if an independent Scotland voted to remain in (or as a new state join) the EU, while the rump of England and Wales voted to leave.

Leaving the EU would make no difference to UK ability to import oil and gas, which, like most commodities, is generally traded without tariffs. But the world energy sector is also largely without rules. The World Trade Organisation, like the Gatt before it, has no special rules on energy. The UK would continue to be a member of the International Energy Agency, but apart from the sound policy advice it offers, the practical benefit of IEA membership is limited to the dimension of oil stock sharing in the event of emergencies.

The half-way house of the EEA?

If the UK were to leave the EU, it would almost certainly want to negotiate an energy relationship akin to what Norway has under its membership of the European Economic Area. The parallel of Norway is instructive for the UK. It had the same fears as the UK that Brussels would get its hands on stocks of oil and gas, as well as of fish. These fears helped prevent Norway joining the EU, along with the UK, in 1973. When Norway and others came to negotiate the EEA relationship with Brussels in 1990-92, energy never figured in the negotiations, because the EEA concerned the single market, and there was then no energy dimension to the single market.

Later on, single market legislation expanded into the energy sector, and Norway was obliged to take on, through the EEA, the EU's energy rules, in particularly the three packages of internal energy market legislation of 1996-8, 2003 and 2009. Norway accepted them all, as the UK would have to do if it were an EEA member, without being present to negotiate them inside the Council of Ministers. Like Norway, the UK would probably not have any practical problem, as an EEA member, in accepting EU energy rules. But would it, as an EEA member, be as content as Norway to simply accept the rules agreed in Brussels by the members of the EU, without itself having a seat at the negotiating table and helping to set those rules?

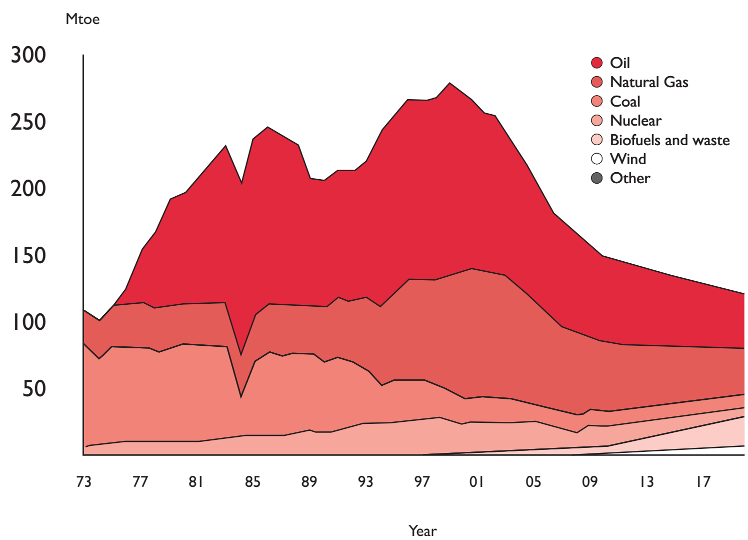
Conclusion

- › At the start of its EU membership, Britain had little interest in any EU energy policy, but has subsequently, for environmental and security of supply reasons, seen increasing value in collective EU energy and climate action.
- › There is little or no demand for any fundamental renegotiation of UK's participation in EU energy policy, because it has evolved under UK influence (market liberalisation) and according to UK concerns (climate change mitigation).
- › The current U-turn in UK policy – to underpin low-carbon energy investment – may raise some competition difficulties with Brussels. But these are minor compared with the major energy and climate goals that the UK shares with the rest of the EU.

Facts and Figures

UK moves from being net exporter to net importer of oil and gas

Energy production by source (million tonnes of oil equivalent) Source IEA 2012



Shutting down dirty coal and ageing nuclear power plants

Closures (megawatt capacity)	2013	2014	2016	2018	2019	2023
Gas	218					
Coal	4,175		2,957			
Nuclear		490	2,335	1,081	2,410	2,418
Oil & gas turbine	1,355		2,281			

Source: National Grid 2012

Carbon price in EU-wide Emission Trading System too low to incentivise low carbon investment, so from 2013 UK sets its own rising price floor

Closures (megawatt capacity)	2011	2012	2013	2014	2015	2016	2020	2025	2030
Projected ETS carbon price if not reformed	12.3	5.8	6.0	6.2	6.4	6.7	8.6	10.3	12.3
Carbon price for UK electricity sector (with price floor)	12.3	5.8	9.6	14.2	19.9	23.6	32.4	54.0	75.6

Source: projections by Department of Energy and Climate Change 2012

The Case for British Agriculture

Peter Kendall
President of the National Farmers' Union

One of the loudest criticisms of the current regulatory system is often not the EU regulation itself but domestic "gold plating" where national regulations go beyond the scope or intent of the European regulation.

Peter Kendall

Unknown territory

With the possibility of the UK leaving the European Union in the next five years now being openly discussed, it is timely to try to evaluate the consequences this might have for British agriculture.

This is difficult for a number of reasons:

- No country has ever left the_European Union.
- As far as agriculture is concerned, there are a number of different scenarios that could be followed.
- A number of European countries have chosen not to be full members of the EU but have obtained some of the benefits of the single market through membership of the European Economic Area, but this arrangement has never operated for agriculture.
- Although the CAP is often cited as one of the major disadvantages of the EU by those who advocate UK withdrawal, there has been no serious attempt to explain what an independent British agricultural policy would look like.

Given the huge number of unknowns that these considerations present, it will probably be helpful to narrow matters down to an investigation of the two main scenarios that could be followed for British agriculture outside the EU:

- What would happen if we leave the EU but remain part of the European Economic Area, including the single market for agricultural goods?
- What would happen if we leave the EU and also do not remain part of the agricultural single market?

Inside the European Economic Area: an untested model.

A number of European countries have sought to gain some of the benefits of the European single market while remaining outside the EU. This is the case for Norway, Lichtenstein and Iceland. Switzerland is a member of EFTA but not of the EEA, having rejected this option in a referendum some years ago. But all these countries have not sought to be part of the single agricultural market for the reason that their own domestic farm support and import protection are significantly higher than that of the EU. Indeed, agricultural lobbies in those countries have been strong opponents of EU membership.

Based on the PSE measure, all these countries enjoy agricultural support far higher than the EU member states. PSE measures the percentage of farm receipts that are a result of transfers from public support policies. It includes implicit transfers to farmers such as income support payments, input and output subsidies as well as explicit price support transfers from consumers. It is a way of expressing the total support afforded agricultural producers and is recorded as a % of farm receipts.

Comparisons show that the EU figure of 18% is very close to the OECD average of 19%, but far lower than Iceland's 44%, Switzerland's 54% or Norway's 58%. Concentrating on the "output based support" – the measure of the most production and trade distorting percentages of PSE - the figures show even more extreme divergences. The EU agricultural subsidy at 13% is considerably less production and trade distorting than the OECD average of 44%, or Iceland's 68%, Switzerland's 42% and Norway's 47%.

In 2011, the UK exported £9.4 billion worth of food and non-alcoholic drink. Despite the Eurozone crisis, exports to the EU grew by 11.3% in 2011.

Our EU partners are the main export market for UK agricultural produce. 77% of the UK's export of food and non-alcoholic drink goes to Europe. For some sectors the EU export market is critical. More than one third of the lamb we produce in the UK is exported to the EU. But the UK still has a negative trade balance with the EU in this sector. We import much more than we export. This deficit has grown by 81% since 2000, despite sterling depreciating significantly in value against the euro over the same period.

If the UK leaves the EU but remains part of the single market

In order to examine the implications of this scenario it is necessary to make a number of assumptions (remembering that this is speculative because, as previously mentioned, no country has ever sought to be part of the agricultural single market but outside the EU).

- The UK would have to continue to observe regulations required for the operation of the single market, but would have no influence over those Regulations, no seat at the Council table.
- It might be possible to avoid some rules and regulations that are not central to the single market (for example, perhaps the Working Time Directive) but this would be subject to detailed negotiation.
- Insofar as the UK would be required to follow common environmental and animal welfare regulations, we would gain some protection from imports produced to different standards.
- The UK would, like current members of the EAA, have to make some contribution to the EU. The contribution is calculated in the same was as EU members on the basis of a proportion of EEA GDP. In 2013 EEA/EFTA contributions to the EU are estimated by HM Treasury to be €641 million.
- Despite this, the UK should make a financial net gain over its current (2011) net contribution of £7.3 billion, again according to HM Treasury figures.
- The UK would have to apply the EU's Common Customs Tariff on goods from third countries. This would be necessary to avoid a "carousel" trade - assuming that the EU would not allow the UK to import more cheaply, for example, meat from South America and then export British beef to higher value European markets.

These assumptions then lead to a number of important questions, to which it is difficult to provide clear and full answers in what remains a hypothetical situation.

- Would the UK in effect have to abide by the Common Agricultural Policy, while having no say in the Council of Ministers or European Parliament? Or would it be free to follow its own policy, provided that was not judged to distort competition? And who would judge that?
- The net financial gain which the UK would make by leaving the EU should, in theory, provide adequate funds for a domestic farm policy. But successive British governments have advocated the abolition of any direct support to farmers and a shift to only paying for "public goods" such as environmental enhancement. Would this policy continue outside the EU?
- In 2005 a joint Treasury/Defra paper called for the abolition of support payments to farmers by 2020. In 2011 the then Farm Minister, Jim Paice, described the coalition government position as abolition, not in 2020 but "as soon as possible afterwards". How would this affect the competitive position of our farmers within a European single market?
- If the UK would be required to maintain the Common Customs Tariff, there would be no possibility of importing cheaper food from the rest of the world, which is often cited by those who oppose EU membership as a major benefit of leaving the EU. Would this consequence be politically acceptable to any government that advocated withdrawal from the EU?

Farmers' views on subsidies

At this point it is worth saying something about British farmers' attitudes to subsidy. British farmers are, by and large, more favourable to the European Union than the generality of the British public. Euro-sceptics often ascribe this, rather cynically, to the fact that they are subsidised by the EU. An historical reminder is required here. The reason that there is a Common Agricultural Policy is that, in order to create a common market in farm goods, it was necessary to harmonise the various national agricultural policies that prevailed in the original six member states (and in the UK before accession in 1973) to avoid trade distortions, real or perceived.

For the National Farmers' Union, it is not the quantity of support that is important, it is equality of treatment with our competitors. Indeed, the NFU has stated that it would be prepared to see support for farmers phased out, provided this happened equally across the European Union. Concerns about the distortions of competition which would occur if levels of support were to be very different are real, and of course would be particularly acute if they occurred on either side of a land border - say Ulster and the Republic of Ireland, or an independent Scotland inside the EU and England outside.

If the UK is outside both the EU and the Single market

Burdensome and unnecessary European regulation is, of course, one of the prime targets of Euro-sceptics. No doubt there would be an opportunity to rid ourselves of some of the most flagrant nonsenses. But there would, of course still need to be national regulations on issues such as food safety, environmental protection, animal welfare, health and safety and so on. One of the loudest criticisms of the current regulatory system is often not the EU regulation itself but domestic "gold plating" where national regulations go beyond the scope or intent of the European regulation.

› We would not be bound by the European Common Customs Tariff but would be free to set our own tariff protection levels against all third countries. Those who advocate withdrawal from the EU very commonly do so on the grounds that we could trade more freely with the rest of the world. In farming terms this would mean cheaper food, and conversely lower farm-gate prices, which could drive some farmers out of business.
› UK trading rules for all imports would be set by the World Trade Organisation (WTO) which would mean we could not prohibit imports on environmental or animal welfare grounds. WTO rules prohibit import restrictions solely on the grounds of the production or processing method (PPM). Restrictions are only allowed on the grounds that a product is objectively different and harmful (for example it contains residues of dangerous chemicals, as in the case of bute in horsemeat). We would not, for example, be able to prohibit imports of battery eggs or pigmeat from stalled sow systems. Within the EU single market PPM restrictions are allowed, providing there is a common European regulation.
› We would make no financial contribution to the EU, and would therefore save our full net contribution of £7.3 bn. But if Government did not want to devastate the UK farming sector by suddenly removing support for UK farmers – as threatened in the statements above – it would need to reinstate a large part of the agricultural subsidies as a national expense to the Exchequer.
› We would risk losing our access to the single market for agricultural goods. The argument is frequently made that because we are net importers from the EU, it would not be in the interest of other members of the EU to see barriers to trade erected between the UK and the EU. From an agricultural point of view, at least, this is dubious. If the UK wishes to lower its tariff barriers with the rest of the world (see previous assumption above) it would not, under WTO rules, be able to apply higher barriers to the EU. So the ability of the EU to export to the UK would be protected; the reverse would not apply.

Again, this scenario throws up a number of difficult questions:

- The net financial gain which the UK would make by leaving the EU should, in theory, provide adequate funds for a domestic farm policy. But successive British governments have advocated the abolition of direct payments and a shift to only paying for public goods. Would this policy continue outside the EU?
- If one of the advantages of leaving the EU is lower consumer food prices, how would the British farming sector be expected to operate profitably?

Conclusions

One of the principal reasons that British farmers have been relatively sympathetic to the European Union in the past has been that the European Commission, under a series of Agriculture Commissioners, notably Ray MacSharry and Franz Fischler, has shown a commitment to a profitable, productive and competitive agricultural sector involving useful and progressive reform of the CAP. The policy line taken by the current Commissioner, Dacian Ciolos, is widely perceived as a backward step, and it is reasonable to suppose that this will have weakened support for the European Union in the farming community.

In addition, the process of legislating a very detailed common policy by 28 governments in co-decision with the European Parliament is extremely cumbersome and often easily open to criticism and even ridicule. The proposition that outside the EU we could devise a policy which was simpler, cleaner, less bureaucratic and more relevant is one that is bound to appear attractive. But that could also lead to negative developments as far as the farming community is concerned, if UK Government support for the sector failed to deliver comparable outcomes for British farmers.

Of the two scenarios described above, the more attractive one for British farmers in economic terms would be to remain inside the single market for agricultural goods. The very significant downside for the agricultural sector would be that this option - the "Norwegian option" – would require us to follow common rules with no role or influence in the process of setting them. And, looked at from the perspective of an anti-European, the scenario would bring few of the vaunted benefits of withdrawal - more open world trade, lower prices or sovereignty in framing regulation.

The alternative scenario of complete withdrawal from the EU and the single market would offer those attractions to the anti-European. But from a farmer's point of view it brings with it huge risks. A combination of lower farm gate prices, loss of our major export market, no support and little or no protection from imports produced to lower than British standards is not a future that farmers would welcome.

In some senses a third option may offer the best solution. Maintaining our current position within the EU and pressing for a continuation of the reforms that have marked the development of the CAP in recent years. If the UK could engineer an alliance of progressively minded member states to press for a continuation of the reforms that Commissioners MacSharry and Fischler pursued, this would seem to offer a better way forward.

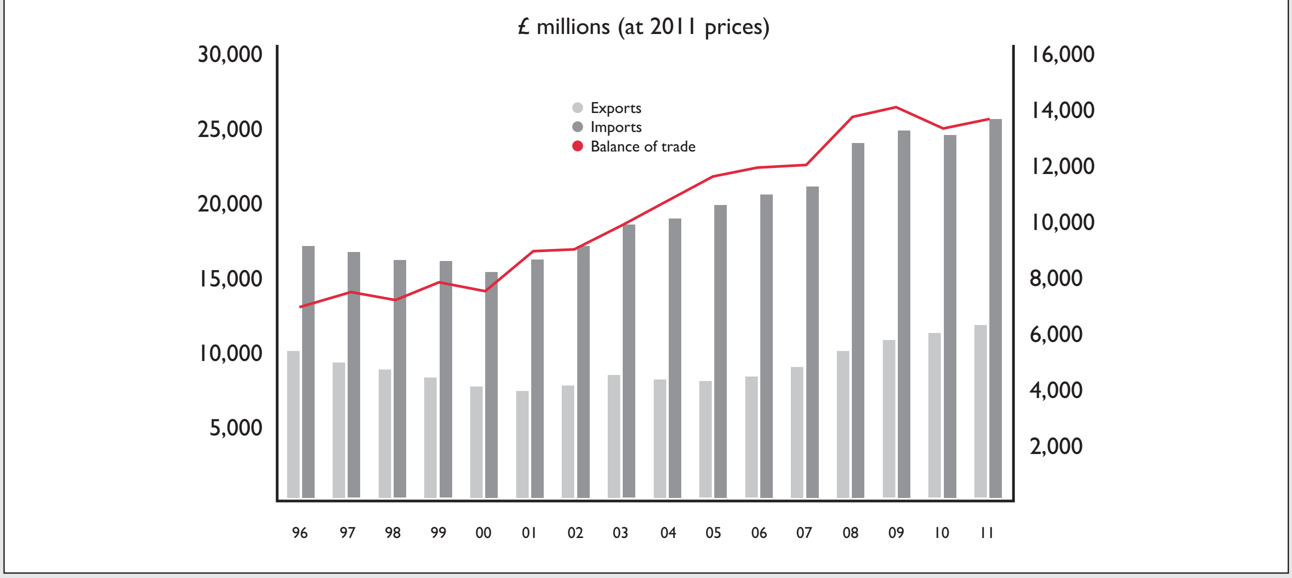
Facts and Figures

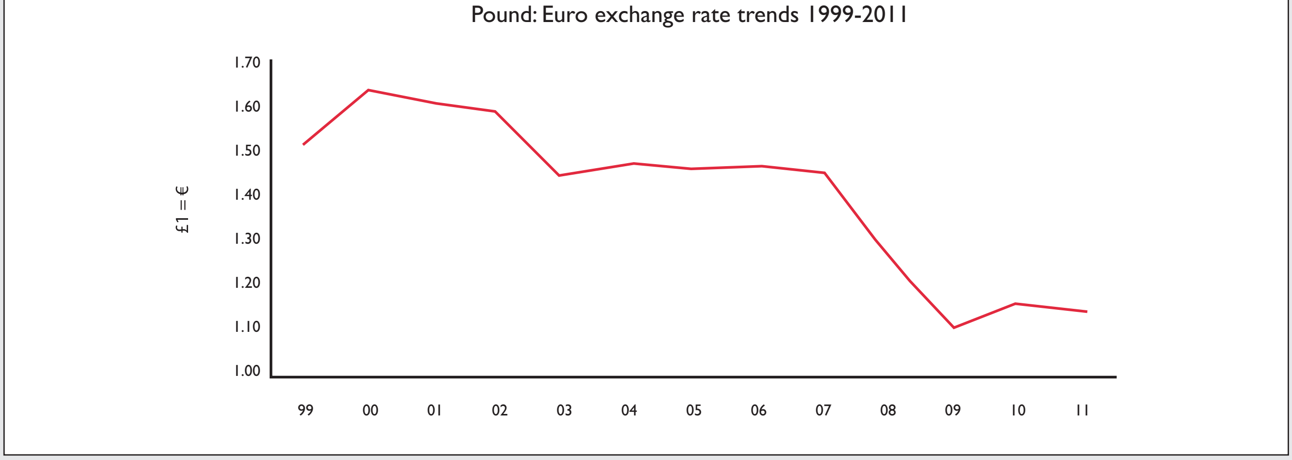
Subsidies from public support policies

	PSE 2011 (as a % of farm receipts)	% PSE classified "output based support" 2011 (considered most production and trade distorting)
EU	18%	13%
OECD	19%	44%
Iceland	44%	68%
Switzerland	54%	42%
Norway	58%	47%

Source: OECD

UK Trade with other EU member states in food, feed and drink





Fisheries

Andy Lebrecht
Former UK Deputy Permanent Representative, Brussels

The main challenge for any marine fisheries conservation policy is to ensure that fishing effort is limited and targeted, so that fish stocks are able to renew themselves, thereby enabling fishing to continue in the future.

Andy Lebrecht

The Essential Issues

For years Europe's Common Fisheries Policy (CFP) did not deliver a sustainable and profitable UK or EU fishing industry, nor did it command the support of stakeholders. In July 2011 European Fisheries Commissioner Maria Damanaki described it as a "failed policy". The same year the Commission proposed a major reform of the policy which the Council and European Parliament have finally decided upon during 2013. As the member state with the second largest fisheries tonnage, the second largest processing industry, and the largest mainland exclusive economic zone (EEZ), the UK has a major stake in securing change. This paper examines the CFP's development and considers whether the UK interest would be better served by securing change via reform or through withdrawal.

The CFP's development

Marine fisheries are by their nature a renewable and a common resource. Ensuring that viable fishing activity is sustainable over time requires active fisheries management to ensure fish stocks and fishing effort are in broad balance. In order to ensure such management is coherent and consistent, the EU member states have agreed in articles 3 and 4 of the Treaty on the Functioning of the EU that conservation of marine biological resources should be an exclusive Union competence. At the same time, competence on other aspects of the CFP is shared between the Union and the member states.

The essential elements of the current CFP were introduced by unanimous decision of the Council in 1983 where the UK negotiating team was led by the late (Lord) Peter Walker. This agreement established the main policy instruments of the CFP and represented the "settlement" in terms of the allocation of fishing quotas between member states in northern waters (excluding the Mediterranean but including certain third country waters in the North Atlantic and the Barents Sea). It also reserved access for national fleets within each member state's 6 and 12 mile coastal zones.

The key balance of that settlement was delivered through the principle of "relative stability". This defines member state shares of catches on fish stocks whatever the size of the Total Allowable Catch (TAC), subject to a small number of exceptions. This has remained the underlying principle to this day, notwithstanding specific challenges following the accession of Spain and Portugal in 1986 and two subsequent major reforms.

Main challenges

The main challenge for any marine fisheries conservation policy is to ensure that fishing effort is limited and targeted, so that fish stocks are able to renew themselves, thereby enabling fishing to continue in the future. Equally, policy will aim to ensure profitable fishing and fish processing sectors, and support social objectives including maintaining employment and small fishing businesses in what are often remote communities. Ideally it should also aim to avoid ancillary damage to the wider marine environment.

Achieving all these goals simultaneously will always be difficult, especially when technological development offers continually increasing efficiency of fishing effort. But the challenge for the CFP is especially strong for a number of reasons:

- The EU's fishing fleets are highly diverse (as shown by figures in the Annex) ranging from a large number of very small (<12 metre) vessels to large and highly efficient trawlers;
- Fisheries in EU waters are similarly diverse. Just in the waters around the UK the annual regulations set TACs for over 80 stocks covering 30 species. Many are complex mixed fisheries, making management especially difficult where the individual species have different size and other natural characteristics;
- The intermingling of fleets from many EU (and non-EU) countries - based on historic fishing patterns - creates fierce competition, between countries as well as fishermen, and has led to increased politicisation of decision making;
- Producing robust and compelling scientific evidence in such a complex fisheries environment can be difficult technically as well as expensive.

The 1983 Settlement

The central conservation policy instruments agreed in 1983 were:

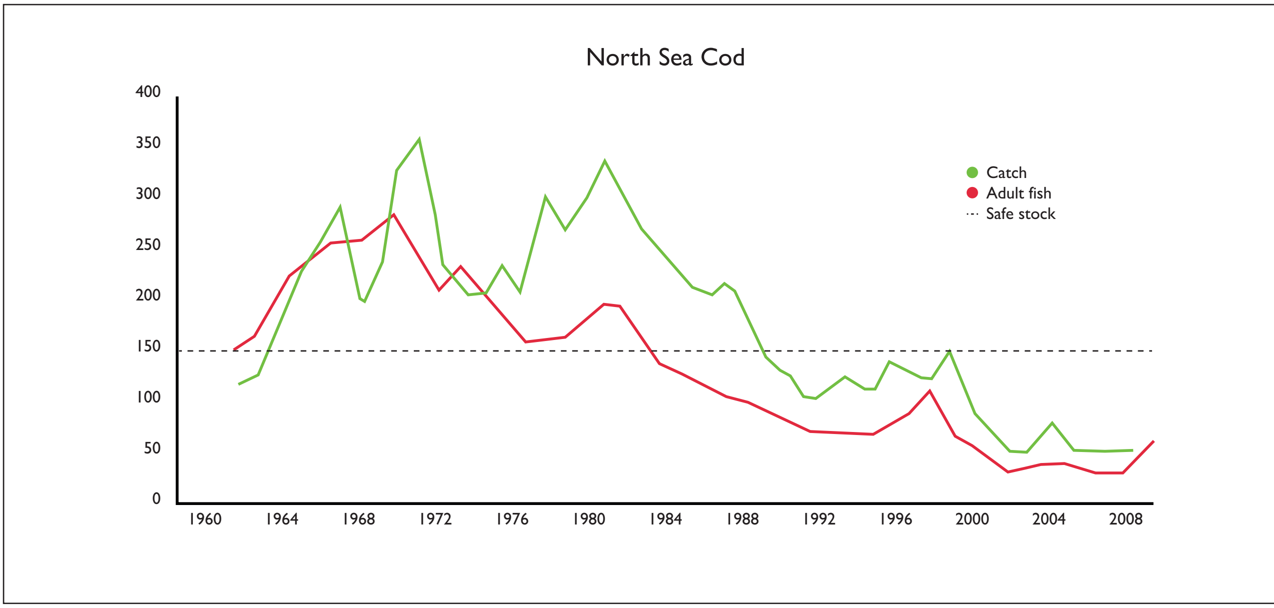
a. TACs and Quotas: Total Allowable Catches of the main stocks that could be landed during the following year were to be decided by Ministers in the Fisheries Council each December following independent scientific advice on the state of the stocks. Each member state would be automatically allocated a quota under the TAC equivalent to its "relative stability" share of the stock;
b. Technical measures: These measures limited fishing effort and improved targeting, e.g. via minimum mesh sizes and temporary closed fishing areas, and imposed minimum landing sizes for the main species to encourage the catching of mature fish only.

Enforcement of the policy was the responsibility of each Member State within its own territory and waters, with a Commission Inspectorate created to oversee the Member States' inspectorates.

In parallel, the Union adopted agreements with certain third countries (most notably Norway) to agree joint management of shared stocks and/or to exchange fishing rights in each others' waters. These "third country agreements" were expanded dramatically after Spanish and Portuguese accession, although the newer "partnership" agreements involved acquiring fishing rights in exchange for monetary payment.

The conservation policy was also supported by a markets policy. This aimed to maintain market prices, by such means as minimum import prices and withdrawing fish from the market, though this support was never so intrusive or costly as the market support practised under the Common Agricultural Policy.

Finally, a "structural policy" was designed to encourage the modernisation of the fleet and its reduction in size, as well as to improve the safety of vessels.



Evolution of the policy to the present day

Since 1983 the CFP has experienced evolution rather than revolution. Successive EU enlargements brought new fleets and new waters into the "Community pond" without significantly changing the policy, except in terms of external agreements. However, it became clear from early days that the Council, under pressure from fishing interests, was unwilling to agree to rigorous annual TACs. Many member states were also not ready to pursue sufficiently large reductions in their fleets. Enforcement by the member states was at best variable. As a result, stocks were overfished, TACs on many stocks declined progressively (see e.g. North Sea cod trends below) and fishermen found themselves subject to increasingly intrusive controls.

Reforms in 1992 and 2002 attempted to restore the balance between capacity and conservation. They introduced measures such as capacity reduction targets at member state level, subsidies for decommissioning fishing boats, tighter rules on aid to fleet "modernisation", restrictions on vessels' "fishing days", multi-annual recovery plans for stocks at risk and tougher enforcement measures. The 2002 reforms also introduced Regional Advisory Committees (RACs) to provide recognised forums for fishermen and other stakeholders to contribute to the management of sea areas.

Beyond the confines of the CFP, two important developments are relevant. First, the Union committed itself in international forums – in particular through the Johannesburg declaration on sustainable development (2002) and the Convention on Biological Diversity (2010) - to implement the principle of Maximum Sustainable Yield (MSY) in the CFP by 2015 if possible, and in any event by 2020. MSY refers to the maximum use that a renewable resource can sustain without impairing its renewability through natural growth or replenishment. Secondly, the Lisbon Treaty extended co-decision rights in fisheries policy to the European Parliament, making it a co-legislator alongside the Council of Ministers.

Present situation

Despite the reforms, the current position, as Commissioner Damanaki has said, is a failing policy. For UK fishermen and environmental NGOs alike, it is not delivering sustainability. Many stocks continue to decline, too many fishermen are chasing too few fish, enforcement is necessarily intrusive and compliance with the rules is variable.

At the heart of this failure is a mix of wrong incentives that encourage counter-productive behaviour, notably:

- Top-down decision making from Brussels, combined with micro-management through detailed technical rules. These disempower the fishermen, set them at odds with the enforcement authorities and remove their incentive to prioritise conservation over short term gains.
- The focus on TACs and quotas in terms of fish landed rather than caught. This encourages fishermen to discard fish, which is both economically wasteful and damaging to stocks. For example, ICES report North Sea cod discards in 2011 comprised 25% of the catch. In 2008 it had been 50%. Most of them were younger fish of pre-spawning age.
- Setting TACs each year has politicised the process and reflects short-term thinking. It encourages Ministers to bid up TACs above levels recommended as safe by scientific advisers.
- Subsidies paid to encourage fleet "modernisation" as part of the structural support policy can actually increase vessels' capacity to catch more fish.

The Way ahead – reform or withdraw?

Reform?

As the above analysis shows, the status quo is damaging to UK interests and, without change, promises to deteriorate. In 2011, the UK Fisheries Minister, Richard Benyon, said:

> "The current CFP has failed. It has not given us healthy fish stocks and it has not delivered a sustainable living for our fishing industry. Only genuine fundamental reform of this broken policy can turn around these failures. We have been making the case for reform for some time and now we have the opportunity to actually make it happen. It is absolutely crucial that we get the detail right, working with the industry, so that fisheries are managed for the long term, and with less top down micro-management from Brussels."

The UK Government, with strong support from the Devolved Administrations, has worked closely with the European Commission, the European Parliament and like-minded countries such as Germany, Sweden, Denmark and the Netherlands to secure such a "fundamental reform". The recently agreed reform seems likely to deliver:

- A ban on discards, with an associated obligation to land all fish caught, to be introduced progressively from 2015;
- The introduction of MSY as the basis for exploiting fisheries, to be achieved by 2015 where possible and by 2020 for all stocks at the latest;
- Future management of main stocks on the basis of multiannual plans, themselves founded on strengthened science and the principle of MSY;
- "Regionalisation" – meaning that member states with an interest in a fishery, after consulting the RAC, can submit joint recommendations on conservation measures to the Commission, with the latter obliged normally to adopt them;
- The introduction of systems of Transferable Fishing Concessions (TFCs), as an option for member states. Those countries not introducing such a system will be required to put in place measures to

adjust the fishing capacity of their fleets to their prospective fishing opportunities, which would in most cases mean reducing them.

Some of these measures will pose significant technical challenges, particularly in mixed fisheries, and the application of the discard ban and conservation based on MSY will require changes in fishing practices. In some cases, MSY will require considerable short term pain (in the form of lower TACs and reductions in fishing effort) to achieve long term gain of restoring fisheries to better health. Innovations such as regionalisation will require constructive engagement by the Commission and real effort by the member states and RACs to make a success of shifting power, and therefore responsibility, from Brussels closer to the fishermen. And the Commission will need to be rigorous in enforcing the necessary cuts in fleet capacity, despite likely resistance from some member states.

Nevertheless, this reform is a genuine attempt to address the central issues of the CFP. It rebalances conservation and fishing effort and delegates responsibility to member states and fishermen through regionalisation. Whilst the shift to MSY inevitably involves some short term pain and the discard ban places new obligations on fishermen, the reforms should result in their actually landing - and selling - more fish. Reliance on long term plans based on MSY will give greater certainty to fishermen about future opportunities. And those member states introducing TFCs will have a proven market-based mechanism for achieving any necessary reduction in fleet capacity.

Withdraw ?

Bearing in mind that fisheries conservation is a matter of exclusive EU competence, the only conceivable way for the UK to withdraw from the CFP would be to leave the EU. The idea that all the other member states except the UK could determine the EU's fisheries policy and then negotiate with the UK while the latter was still a member state is meaningless in legal terms and nonsense as a procedure.

Withdrawing from the EU would leave the UK – as Norway is today – in control of all the waters in its EEZ and, in theory at least, free to exploit the fishery resources in those waters as it thought fit. It could, if so minded, introduce, for example, a discards ban. In principle, the UK would be free to exclude all fishing by foreign vessels in its waters, but it would have to relinquish its fishing rights in other member states' waters as well. It would gain from no longer having to contribute to the EU's external fisheries partnership agreements with African countries and Greenland, for instance, where the total cost was 27 million Euros in 2013. However, it would also lose some fishing opportunities, for instance for Arctic-Norwegian cod which are currently largely compensated for by transfers to Norway from other member states' fishing allocations. And fishery products exports would become subject to the EU's common external tariff.

It is not clear that this gain in "sovereignty" over UK waters would in practice benefit UK fishermen, and it may have the contrary effect. This is because withdrawal from the CFP is not the same as withdrawal from fisheries management, the necessity for which would remain. The overwhelming number of economically important stocks found in UK waters – whether the North Sea, the English Channel, the Celtic Sea or the Irish Sea – also move in and out of the waters of other member states and Norway, as the map of cod spawning grounds in the Annex illustrates. The UK would clearly have a critical interest in ensuring that appropriate conservation policies were applied to those "straddling" stocks in order to avoid their being damaged by overfishing by other countries' vessels. The only way to achieve this would be to enter into formal fisheries agreements with the EU and with Norway to deliver "joint management", along the lines of the current EU-Norway agreement for the North Sea. Indeed, article 63 of the UN Conference of the Law of the Sea requires coastal states to do precisely this.

Any negotiated joint management agreements would of necessity have to specify the share out of the stocks concerned. It is moreover all but certain that the other member states (and Norway) would insist on their current "relative stability" shares of the TACs concerned and access to the UK's Exclusive Economic Zone (as now) as part of any such agreement. Given that the relative stability settlement has endured for 30 years and was itself based on historic fishing patterns, it is difficult to see how the UK could articulate a convincing argument for any alternative allocation of fishing rights.

Failure to reach agreement would effectively result in a free-for-all which would – as with the current failure by coastal states to agree on the western mackerel stock – only result in overfishing and potentially serious damage to the stocks. To avoid this, the UK would almost certainly have to agree an outcome based on "relative stability". It would in any event have demands of its own if it wished to retain the status quo on e.g. Arctic-Norwegian cod or tariff free access to the EU market, for which it would have to pay a negotiating price.

Without the UK at the heart of EU fisheries policy making, the EU's overall policy stance would be less responsible, and therefore less UK-friendly, than currently. Whilst the UK, like Norway, would of course have an influence on management decisions through the joint agreements, this would be as an outsider. Overall, we could expect to see a less UK-friendly conservation regime than if the UK remained in the EU, where its position, close to that of the Commission and certain key member states and supported by some very effective British NGOs, is disproportionately powerful. Even outside the CFP, UK fishing interests would inevitably be affected by its development, but we would have little influence on it.

Conclusion

The conclusion of this paper is that the status quo on fisheries is not an attractive option. As between the alternatives of reform or withdrawal the advantage lies strongly with reform along the lines successfully pursued in recent years by the UK government. In particular reform should deliver:

- Significantly improved conservation of fisheries stocks leading to an improved environment and a more stable, sustainable and profitable fishing industry in the medium term;
- Better returns for fishermen via the discards ban;
- Greater say for UK fishermen in the detailed conservation measures that would affect them (i.e. less Brussels micro-management);
- More stable management through long term plans based on Maximum Sustainable Yield (MSY);
- An opportunity to improve the structure of the fleet through Transferable Fishing Concessions, if the Government and/or devolved administrations choose to adopt them.

Whether these reforms alone will achieve the ideal outcome of balancing stock availability with the capacity to fish those stocks is unknowable. That will depend in part on how all the actors, notably the fishermen, respond. But it will undoubtedly mark a major step in that direction.

In the case of withdrawal, it is unlikely that the outcome will be better for the UK fisheries interests than even the pre-reform status quo and it could prove considerably worse.

- Outside the CFP, the UK authorities would be free to determine fisheries policies specifically suited to UK circumstances and waters. The UK could in theory determine its own Total Allowable Catches (TACs) and also exclude all foreign vessels from fishing in UK waters. But it would effectively lose control over the management of all stocks which straddle UK and EU or Norwegian waters, as it would have no say over what happened outside its own waters. A free-for-all – in the absence of Joint Management agreements – would lead inevitably to overfishing on these stocks.

› UK interests therefore require Joint Management of straddling stocks, so as to regain a degree of control and ensure those stocks are managed effectively in all the waters where they are found.
› The only realistic basis for agreeing such Joint Management agreements is "relative stability", i.e. the current share out of stocks and access rights agreed in 1983 on the basis of historic fishing patterns. UK fishermen would be unwise to expect, in practice, any increase in fishing rights at the expense of other EU member states or Norway.
› The absence of the UK from internal EU fisheries negotiations is likely to lead to the EU to adopt fisheries policies that are less attuned to UK interests. However, the UK would still be affected by such policies and if, as is likely, they are less geared to sustainable development of the stocks, UK fisheries interests would suffer.

Facts and Figures

Value of UK fisheries sector 2011

	£ million
Total seafood consumer purchases (retail and food service)	5,600
Imports	2,547
Exports	1,548
Value of UK vessels' catch	549

Source: Seafish

Employment and vessel numbers

Number of fishermen (2011)	12400
Number of fishermen (FTE 2009)	7000
Seafish processor employment (FTE2012)	11864
Size of UK fishing fleet 2011 (vessels)	6444
Size of UK fishing fleet 2011 (gross tonnage)	202,048
Size of UK fishing fleet 2011 (engine power)	808,887

Sources: MMO, Eurostat (fishermen FTEs), Seafish (processor employment) FTE full-time equivalent

The UK fishing and fish processing industries are not large in terms of global GDP and employment, but they are politically sensitive. The main fishing ports are in Scotland, Yorkshire and Humberside, South West England and Northern Ireland, with the bulk of fish processing located in Humberside, Northern England and North East Scotland. The location of the industry in geographically peripheral and/or low employment areas, plus the socio-cultural and environmental importance of fishing, means that successive UK and devolved Governments have attached a greater significance to this industry than the figures alone merit.

Straddling Cod Stocks around UK coasts

Capacity of the EU fishing fleet

Length	Number of vessels	Gross tonnage	Engine power in kW	Average Age
0-6	26 419	20 808	310 969	30
6-12	43 098	153 215	2 081 137	25
12-18	7 041	161 785	984 899	26
18-24	3 408	254 796	900 202	25
24-30	1 731	243 936	632 593	22
30-36	597	145 177	314 430	24
36-45	441	175 087	411 140	19
45-60	121	105 029	179 123	22
60-75	75	126 553	218 827	19
>75	83	309 790	367 009	22
	83 014	1 696 175	6 400 329	26.6

NB: length refers to total length. Source: EU Fishing Fleet Register

UK fishing fleet trend 2000-2011

Source: from UK Sea Fisheries Statistics 2011. 2000 = base 100. GT gross tonnage.

Structural Funds and Regional Policy

Michael Lloyd

Senior Research Fellow, Global Policy Institute and former Advisor, European Parliament

The problems of achieving regional cohesion in a single country such as the UK are difficult enough. To achieve balanced regional development of the 271 regions of the 27 Member State EU represents a formidable task.

Michael Lloyd

EU Structural Funds; benefits, measurement, options

EU Regional policy (also called 'cohesion policy') has the objective of promoting the Union's *"overall harmonious development"* and in particular *"reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions"* This is done under the general assumption that market forces are unable to deliver such a result.

The problems of achieving regional cohesion in a single country such as the UK are difficult enough. To achieve balanced regional development of the 271 regions of the 27 Member States (plus Croatia now) represents a formidable task. Indeed one of the criticisms of the EU regional policy is that it is an impossible task and that it would be far better to leave regional policy to the Member States under the principle of subsidiarity. Nevertheless, some regional GDP discrepancies are so gross that a transfer from the economically developed to the less-developed countries is seen as a moral obligation and a gesture of solidarity as well as the expression of a rational economic policy. That is particularly the case with new Member States, many of whom have substantial under-development problems. Cohesion policy currently devotes over 80% of the total available funds to regions where the GDP per capita is less than 75% of the EU average.

For the UK, access to the Structural Funds is limited to a share in the approximately 18% of the funding which is allocated to encourage 'regional competitiveness and employment' plus some part of the 4% which goes to 'cross-border integration' projects. The aim here is to improve economic growth in the assisted regions by investment in physical and human capital and in various measures of 'soft' business support.

In looking at UK options, we need to address three questions: What are the attributable benefits of the Structural Funds, particularly in the UK, and how are they best measured? What are the implications for the UK following a possible withdrawal from EU regional programmes? What benefits for the UK may be expected from continued participation in the EU regional policies and use of the Structural Funds?

Methodology

There is a plethora of published research assessing the effectiveness or otherwise of regional policy and the EU structural funds in particular. This article compares three recent (2012) research reports which themselves list earlier research. They review general EU and UK regional-based research and draw conclusions about the impact on regional (and sub-regional) economic growth in the EU and in the UK. Two make positive claims for the policy while one of them goes so far as to suggest UK withdrawal from regional policy and the EU Structural Funds.

The three research papers are: *The Growth Effects of EU Cohesion Policy: A Meta-Analysis* (Benedicto Marzinotto, Breugel Institute, October 2012); *Research to Inform the North West's 2014-2020 EU Funding Strategy: Evaluating the impact of past and current EU programmes* (New Economy, October 2012); and *Off Target: the Case for Bringing Regional Policy Back Home* (Open Europe, January 2012).

Recent History

Within the current financial framework (2007-2013), overall spending on regional policy amounts to an average of almost €50 billion per year, slightly more than one third (35.7%) of the total EU budget and second only to the Common Agricultural Policy expenditure.

Regional policy spending is channelled through three funds – often called Structural Funds. These are the European Regional Development Fund (ERDF), the European Social Fund (ESF), and the Cohesion Fund.

The three main objectives of the EU's cohesion policy are: a) Convergence, b) Regional Competitiveness and Employment, and c) European Territorial Cooperation. However, convergence funding is not available to the UK as none of the UK's regions have a per capita GDP of less than 75% of the EU average, which is the criterion for regions to receive convergence funding. This report concentrates on the remaining two elements of funding.

- Regional Competitiveness and Employment Around 16% of the total funds – or €8 billion per year – is shared among the approximately 170 regions that do not qualify for support under the Convergence objective. European money is used to co-finance projects that contribute to the strengthening of economic competitiveness by promoting innovation and entrepreneurship, protecting the environment, improving transport links, adapting the workforce and investing in human resources.
- European Territorial Cooperation The remaining 2.5% of the cohesion budget – around €1.25 billion per year – is used to promote cooperation among regions in more than one member state by means of joint projects and exchanges of experience. Most of this money is spent on building closer links between border regions in different member states.

The 2007 to 2013 programme is still running in the UK, with disbursements from both the European Regional Development Fund (ERDF) and European Social Fund (ESF). The total amount which the UK receives currently is around £8.7 billion, during the seven year period of the programme (i.e. around £1.25 billion p.a.).

Implications of UK Withdrawal

Superficially, the withdrawal of the UK from the EU and hence from participation in regional funding would appear to have some plausibility and some political support. When at the Treasury in 2003 Gordon Brown is quoted as saying:

> "When the economic and social, as well as democratic, arguments on structural funds now and for the future so clearly favour subsidiarity in action, there is no better place to start than by bringing regional policy back to Britain."

and a Treasury paper in the same year stated that:

> "It cannot be right for richer Member States to continue to receive substantial development funding from the EU budget. Equally, it cannot be assumed that nations and regions of the UK should have to scale down their spending on regional development programmes to accommodate the loss of EU support… We would therefore guarantee that, by increasing UK Government spending on regional policy, UK nations and regions receive a level of resources which ensures they do not lose out from the UK's proposals on Structural Funds reform."

This idea is picked up by Open Europe in their report as a negotiating option for the UK government. They propose that not all member states should benefit from EU regional policy. Structural Fund disbursements should only go to those countries with national income below 90% of the EU average. The UK – among other richer member states - would not then be eligible for any Structural Funds. The loss of this EU support, around £8.7 billion p.a., would be matched by increased expenditure from the UK budget to the regions, as indicated in the 2003 Treasury paper.

Leaving aside the general view on whether to believe Treasury promises, it seems somewhat unlikely that such largesse would currently be forthcoming from a Coalition Government pursuing austerity policies, even in the face of continuing weak national (and regional) economic growth. This possibility seriously undermines the plausibility of such a 'golden scenario'. Equally importantly, it ignores the past and potential benefits of EU regional policy, highlighted in the Breugel research paper and, specifically, in the New Economy empirical study, as indicated below.

There is also a misleading calculation deployed in the Open Europe research paper which vitiates its argument. The calculation relates to net budgetary contributions, but tries to go beyond assessing the UK's overall net contribution on the above scenario, and seeks to identify the net contributions at a UK regional level in relation to the Structural Funds. The calculation of the UK regional division/allocation is made by using regional shares of disposable income *(2007 data taken from Eurostat).*

The calculations made are improper for two reasons. First, because the net figures are irrelevant; it is the impact of the gross amounts actually going into the regions which matters. Second, because it is simply not possible to allocate national budget totals to regions as suggested, given the variety of income flows in and out of regions to the central government. Any such allocation represents a set of arbitrary and, hence, meaningless figures.

Despite these objections, however, there is a general issue of taxation and redistribution thrown up by the operation of regional policy within member states. This point is made in the Breugel research paper.

> "To the extent that the EU should not be concerned with regional disparities in each country (or not all of them), a larger share of the EU budget should go to countries instead of regions at any level of development".

This argument against EU involvement is based on the principle that it is up to national governments to redistribute income within their own countries. The evidence – indicated in the Breugel Paper – is that this initial aim of EU regional policy was abandoned as not being successful in 1988.

Even if desirable, the task of equalising income per head is extremely complicated and, given the paucity of policy instruments available at EU level, likely to be less effective when attempted at a supra-national level than nationally. And yet, ironically, the evidence shows that on the basis of a GDP per capita measure European regions are converging with each other, while – with few exceptions - regions in individual member states are diverging from each other.

The later economic models, used by the Commission, are endogenous growth models which are aimed at using investment in both physical and human capital to stimulate economic growth in the regions supported, rather than attempting to replicate national income redistribution policies. Hence, with refined statistical support, the focus of cohesion/regional policy has, since 1988, been the stimulation of such investment in the lagging regions, via use of EU Structural Funds.

Research Overview

The Breugel research paper provides the latest overview (October 2012) of the various research papers that have been produced over a number of recent years in an attempt to assess the impact of the Structural Funds. It suggests that a number of studies, using both macro-economic models and via empirical research, do not *unequivocally* indicate a positive impact of the Funds. However, to draw an overly pessimistic conclusion from these studies and argue for the complete 're-nationalisation' of regional policy, as does the Open Europe paper, would be an over-reaction and not justified by the evidence.

There is in effect no definitive view among the research community that the EU regional/cohesion policy is an unqualified success, nor that it has failed. The meta-analysis presented in the Breugel paper suggests a consensus around a more positive view, and concludes that:

> "Nevertheless, a few regularities emerge in the literature and partially also in our empirical test. EU funds contribute to growth convergence i) if used in a supportive institutional environment, ii) in the presence of a decent industrial structure and some R&D intensity, and iii) when used for soft and not just hard investment".

The more locally focused empirical research paper by New Economy examines in detail the effects on economic growth of the use of the ERDF and ESF funds which have flowed into the *North-West* Region of the UK in the recent past. This report is concerned to measure the effectiveness of the gross flows of Structural Funding into the region. It assesses the impact on investment and on economic growth over the period from 2000 to 2006, i.e. the gross and net benefits of the financial investment from the ERDF and the ESF. Its research shows net benefits, with North West GVA (Gross Value Added) being increased by at least £2.3bn per annum due to structural funding activity and the creation of 56,800 *additional* jobs within the region.

If the UK government were to aim at eliminating the use of EU regional and structural funds, as set out in the Open Europe paper, what would be the consequences? In practice, given the unlikely disbursement of Treasury funds for an equivalent regional policy investment programme, there would be a substantial likelihood of severe damage to UK regional investment, and hence to the welfare of people living in the less developed UK regions.

The withdrawal of the UK from the EU regional/cohesion policy would mean that the UK regions would lose the positive net benefits available, such as those attributed to the use of the Structural Funds in the North-West Region, and set out in the New Economy empirical research paper. Aside from the *overall* net economic benefits indicted above, there have been a number of specific positive experiences. These have included the establishment of revolving (self-replenishing) investment funds. This is one of the avenues for future wider policy development highlighted in the research paper:

> "The NW has established one of the first JESSICA funds in Europe and has successfully developed two Urban Development Funds (Evergreen and Chrysalis) to deliver £50m of ERDF investment and associated match funding. By creating appropriate legal and governance structures the two Funds have the potential in the medium to long term to significantly grow their scope of investment and the size of the resources under their control – in excess of £350m".

Implications for Continued Membership of the UK in EU Regional Policy

It is not possible to anticipate what might be agreed as a future negotiating position on EU Regional Policy of either a continuing Coalition government, or by an alternative government after 2015. However, some idea of what may be the objective of a radical negotiating position which might be adopted is set out in the Open Europe research paper. Although this approach may have its attractions from an ideological and theoretical point of view, a less extreme position of building on existing structures and flows of funding is more likely in practice. The next Multiannual Financial Framework programme for 2014 to 2020 will provide an opportunity for such a practical approach.

It is probable that the UK Government will decide to opt for the less radical objective of improving the performance of the Structural Funds. Such a negotiating exercise – which is currently taking place on this reform agenda, with inputs from the various UK regions, as well as UK government departments (particularly BIS) and the EU institutions, including the European Parliament and the Committee of the Regions – is more likely to achieve success, and deliver more certain positive benefits for the UK regions, than the superficially radical alternative suggested by the Open Europe research paper.

Practical negotiations such as these, with a likely positive outcome, do not require any 'hard-line' negotiating stance to be adopted by the UK government. They are the bread and butter of daily work in Brussels fora, bringing clearly defined, empirically-based positions to continuing negotiations in an important area of policy. The North-West research paper indicates the type of proposals for improvement which are likely to be adopted in this normal change process. The suggested increase in SME support for investment and for training, also suggested by the Breugel report, is an approach likely to be supported by the European Commission. This so-called, 'soft business support' is also advocated in the North East and in other UK regions.

In delivering Structural Fund support one of the more important side effects is to bring together in close working relationships local private and public agencies and institutions, together with local companies, particularly SMEs. It delivers a multiplier effect for ERDF and ESF projects in the region, and has been the experience in other regions, in particular the North East of England. With the continued absence of regional-level agencies in the UK, this will be of even more value in the future, greatly assisting the more recently established Local Enterprise Partnerships (LEPs) in the UK regions. In the North-East Region, for example, there are two independent LEPS, with the only regional body, the European Enterprise Network (EEN), active in supporting SMEs. The EEN is supported by the EU and the two LEPs in this region, happily, do sit on the Steering Group of the EEN.

Resolving regional growth disparities is not a simple matter. There is no magic bullet. But working in the evolving context of EU regional policy – as indicated in the New Economy and Breugel reports – offers the best hope for a regional strategy which can provide the targeted investment necessary to enable economic growth to be equalised across both EU and UK regions.

Summary and Conclusions

This article has used the latest research on the EU regional/cohesion policy and the use of the Structural Funds to examine the view of the effectiveness of the policy, both generally and in the UK. It has also considered the options: the UK government decides to withdraw from EU regional policy altogether, or to pursue a less radical path of reform, something which is already underway within the EU.

It is clear that there is no definitive view among the research community that the EU regional/cohesion policy is an unqualified success. However, the Breugel Institute research paper suggests a consensus around a more positive view on the potential for the Structural Funds. They can act as a stimulus for economic growth, and, with some modifications in their application, can lead to improved future performance.

This EU-level view is backed up by the New Economy empirical study of the experience of the North-West region of the UK. This report found that there have been substantial benefits from the use of the Structural Funds in the past decade, specifically in this important UK region. Both research papers also indicate that, with a number of suggested reforms, the impact in the future of the Structural Funds in the UK under the 2014-2020 programme should be even greater.

Poorer regions of the UK qualify the UK to receive approximately 4% of the EU total allocated by these funds. For the next funding exercise (2014 – 2020) the UK will receive 9,571 million euros, 457 million for Northern Ireland, 795 million for Scotland, 2,145 million for Wales and 6,174 million for England.

To negotiate away UK involvement, and therefore the UK regions' involvement, in the EU regional/cohesion policy would be unwise and seriously damaging to the future prosperity of UK regions, especially at a time when UK regional disparities are increasing.

There are still reforms of the EU policy, at all levels, which need to be pursued, and from the UK regions' perspective the clearly beneficial way forward is via continued participation in the EU regional/cohesion policy and utilisation of the Structural Funds to even better advantage than in the past.

Facts and Figures

EU member states' GDP per capita

Official statistics across the EU show wide variations in GDP per capita (2012 figures), adjusted for purchasing power parity (ppp).

Eleven states achieved above the average (100%) of 25,600 euros:

An exceptional 271% for Luxembourg, 131% for Austria, 129% for Ireland, 128% for the Netherlands and Sweden, 125% for Denmark, 121% for Germany, 119% for Belgium, 115% for Finland, 110% for the UK and 108% for France.

All others were below the average: Bulgaria 47%, Romania 49%, Latvia 62%, Hungary and Poland 66%, Estonia 68%, Lithuania 70%, Portugal%, Greece and Slovakia 75%, Czech Republic 79%, Slovenia 82%, Malta 86% Cyprus 91%, Spain 97% and Italy 98%.

NUTS divisions for regions

For purposes of regional policy, national territories are sub-divided into NUTS regions (nomenclature of units for territorial statistics). Large regions are NUTS level 1, smaller regions are NUTS 2, and local districts are NUTS 3. The UK is made up of 9 NUTS 1 regions for England plus 1 each for Scotland, Wales and Northern Ireland. These 12 NUTS 1 regions are further subdivided into 37 NUTS 2 regions.

Inner London is the richest NUTS 2 region in Europe with a GDP per capita adjusted for ppp at 328% of the EU average. Luxembourg, Brussels and Hamburg all average over 200%, and Paris, Groningen, Bratislava, Prague, Stockholm and Vienna range down to 164%.

Two UK regions – Northern Ireland and Wales – are among the 68 NUTS 2 regions with a GDP below 75% of the EU average. 22 of these - located in Bulgaria, Hungary, Poland, Romania and Slovakia - have a GDP per capital below 50% and account for over 38 million people, or approx. 7.7% of the EU population.

UK figures

The UK average gross domestic household income per head was £16,034 in 2011.

London with 127.9%, the South East with 112.8% and the East of England with 103.6% were the only NUTS 1 regions with GDHI above the UK average.

Other English regions recorded below average GDHI: 99.9% in the South West, 90.8% in the East Midlands, 90.3% in the North West, 89.6% in the West Midlands, 86.2% in Yorkshire/Humberside and 84.6% in the North East. Scotland, Wales and Northern Ireland recorded 97.6%, 88.1% and 87.1% respectively (2011 figures).

London is the only NUTS 1 region in the UK where every NUTS 3 (smallest) sub-region had a GDHI per head above average. In Northern Ireland and Wales every local NUTS 3 area had a GDHI per head below the national average.

Across the NUTS level 3 regions of the EU in 2010, GDP per inhabitant ranged from 5 000 PPS (20 % of the EU-27 average) in Vaslui in Romania to 143 800 PPS (587 %) in the capital city region of Inner London-West in the United Kingdom: a distribution of 1 to 28.8. (PPS is a theoretical unit allowing comparisons of GDP per capita at ppp.)

Transport Issues

Handley M.G. Stevens

Former Under-Secretary, Ministry of Transport, and author of "Transport Policy in the EU"

As an EU Member State, the UK is not free to negotiate international agreements on its own account in areas where there are EU policies.

Handley M. G. Stevens

An international Island

There are two major factors which limit the impact of EU membership on transport for the UK.

The first is that most of the journeys that begin in the UK also end within the UK. The only land border we share is with the Republic of Ireland; our only international rail connections are between Belfast and Dublin and through the Channel Tunnel; otherwise all traffic between the UK and the EU has to move by sea or by air, even if the rest of the journey is on road or rail.

For that reason British citizens might prefer the laws which govern transport (for example, the regulations governing product safety or acceptable levels of pollution) to be fashioned in Westminster rather than in Brussels. On the other hand, companies located in the UK which build or make parts for a car or plane might be more inclined to see the benefits of a single set of regulations applying throughout the European Union.

The second major factor which would have a bearing on any judgment about the costs and benefits of EU membership is the web of international organisations reaching far beyond the European Union, both at the level of governments and transport operators. The United Kingdom and/or British transport operators currently belong to many of these, and would continue to do so, alongside the relevant institutions of the EU. In some of these organisations the UK would have greater freedom to express its own point of view, particularly where it might disagree with its EU partners. On the other hand, in the light of the negotiating constraints applying to the EU and its member states, the UK might very well have less influence over the outcome as a lone voice outside the EU than it does as an important member state influencing EU policy from within.

Negotiating with the EU

It was the final stages of the 1969 negotiations for the European Agreement concerning the Work of Crews of Vehicles Engaged in International Transport (AETR) which gave rise to a judgment in the European Court of Justice (Case 22/70) which had far-reaching implications for the freedom of EU member states to negotiate international agreements independently in areas of common policy. The Commission challenged the right of the member states to negotiate the agreement on their own account, and the Court ruled that 'each time the Community, with a view to implementing a common policy envisaged in the Treaty, adopts provisions laying down common rules, whatever form they may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules or alter their scope. With regard to the implementation of the provisions of the Treaty, the system of internal Community measures may not be separated from that of external relations … With regard to agreements in the sphere of transport policy, the Commission is entitled to make proposals and negotiate, whilst it is for the Council to conclude the agreement.'

The significance of this judgment was not lost on the UK department of Trade and Industry, which was then preparing for British membership, nor on the secretariat of the European Conference of Ministers of Transport which, from that time and as a direct consequence of the AETR judgment, recognised that any policies they might negotiate for Europe as a whole had to be compatible with those adopted by the European Community.

Not only does it mean that as an EU Member State the UK is not free to negotiate international agreements on its own account in areas where there are EU policies; it also means that its neighbours in the EU would not be free to negotiate independently with the UK in the event of a British withdrawal. In all areas of transport policy the UK would have to negotiate with the EU, represented by the Commission.

On the benefit side of that equation, the UK would continue to benefit from the more or less uniform and more or less immediate implementation of agreements enshrined in Community law. This has considerable advantages over the long delays and varied interpretations that may afflict the implementation of an intergovernmental agreement in the national law of many different signatories.

On the negative side, if the UK wished to follow a policy that differed from that adopted by international agreement, including agreement with the EU, it could prove extremely difficult to negotiate change with a partner whose mandate had already been the object of difficult negotiations and compromise among 27 or more member states. Indeed, the EU actively uses its membership of international organisations to promote its policies in neighbouring countries, and is proud of the fact that the AETR, for example, has aligned its provisions for driving time, breaks and rest periods with EU law, and followed the EU in introducing the digital tachograph.

Recent History

The importance of transport to the establishment of the common market was recognised from the outset by the inclusion of a chapter on transport policy in the Treaty of Rome, but the text was so ambiguous - as a result of fundamental disagreements between the negotiating partners - that very little progress was made, even on land transport which was subject to qualified majority voting rules from as early as 1965.

However, the situation changed radically following the adoption of the Single European Act in 1986, which not only extended qualified majority voting to air and sea transport, but gave a major political impetus to the establishment by 1992 of single markets for transport by road, sea and air, and since 1991 to the more gradual development of a single market for rail transport.

From 1992 the Treaty on European Union added powers to legislate in relation to transport safety and to create transport infrastructure. Since then the establishment of the European Aviation Safety Agency (2002), the European Maritime Safety Agency (2002), the European Railway Agency (2006) and the Trans-European Networks – Transport Executive Agency (2006) have all endowed the Commission, which oversees them, with substantial additional resources and expertise to monitor and develop the single market.

Road Transport

The EU has adopted regulations governing the licensing of companies to operate passenger or freight services, the initial qualification and training of drivers, working hours and rest periods of coach and truck drivers, maximum weights and dimensions of road vehicles, the carriage of dangerous goods, minimum rates of vehicle taxation and fuel duty, and maximum rates for road user charges. In addition the manufacture of road vehicles has to comply with EU standards.

As well as seeking to ensure a level playing field for the safe and efficient operation of the single market, the purpose of these regulations is often to give the effect of Community law to agreements reached in intergovernmental organisations. Whatever the outcome of any renegotiation of the terms of our EU membership, the UK would remain bound by the international agreements it had signed for itself, alongside the EU, to implement UNECE (United Nations Economic Commission for Europe) agreements on the conditions governing the carriage of dangerous goods, as well as the AETR agreement on the working conditions of coach and truck drivers.

There are some regulations that apply only as part of EU law. In road transport, the regulations governing access to the single market, the maximum weights and dimensions of road vehicles, minimum rates of fuel duty and maximum levels for road user charges, as well as the rights to compensation of passengers using bus and coach services, are not covered by wider international agreements. The UK is not therefore doubly bound to these rules by our membership of any wider international organisation.

On the other hand, the UK could not reasonably expect to negotiate access for its hauliers and coach drivers to the single European market if it were not prepared to accept for them the same conditions as would apply to their European competitors. EU rules do not apply to vehicles weighing less than 3.5 tonnes (or to certain other categories, including emergency vehicles), but it would be difficult to make a case for wider exemptions. Within the European Free Trade Area (EFTA), Norway, Iceland and Liechtenstein participate fully in the internal transport market, accepting all its rules; only Switzerland has a special relationship, and the need for road and rail transit through the Alps to link Italy with the rest of the EU gives them a stronger negotiating hand than the English Channel offers the UK.

Rail transport

Under the Berne Convention there are uniform systems of law to facilitate the international carriage of goods (since 1890) and passengers (since 1924). 47 States, including the United Kingdom, are now members of the Convention Relative aux Transports Internationaux Ferroviaires (COTIF), which was established in 1980 in succession to the Berne Convention, to oversee the continuing development of these arrangements. The EU acceded to COTIF on 1 July 2011. Since 1996, EU directives have also applied the UNECE rules on the carriage of dangerous goods by rail. Alongside these intergovernmental organisations, there is extensive co-operation among the railway companies themselves under the aegis of UIC (Union Internationale des Chemins de Fer) and CER (Community of European Railway and Infrastructure Companies), as well as among the European standards bodies (CEN, CENELEC, ETSI) whose technical work is essential to the interoperability of railway products and systems.

As noted above in relation to road transport, a British renegotiation or even withdrawal from the EU would not affect the application of internationally agreed rules and standards, since the UK is independently committed to their application through national membership of both COTIF and UNECE, industry membership of CER and UIC, and BSI membership of the European standards bodies. Once again however, as an independent national signatory, we would have more freedom to express our own views about any future amendments, but probably less influence over the outcome than we might have as a significant member state within the EU.

The UK has only two direct rail links with other member states of the EU, across the land border to Eire and via the Channel Tunnel to France. There is no reason to suppose that either of these links would be affected by renegotiation or withdrawal, and co-operation would doubtless continue through the industry and standards organisations mentioned above. Railway infrastructure has a long life, so that the effect of any erosion of common standards would in any case be slow.

The main risk would be to railway industry supply companies based in Britain, which might lose their access to the single European market unless the UK agreed to follow EU rules, and might prefer in the longer term to be located within the EU; and to British railway operating companies who would have even less chance than they do now to compete for the provision of railway services elsewhere in Europe. In statements as recently as 2011 the Commission has made no secret of its ambition to 'extend internal market rules through work in international organisations' and to 'promote European safety, security, privacy and environmental standards through bilateral and multilateral cooperation'. If the UK government considered it important that British companies in the railway industry should retain access to the European market for their goods and services, the UK would have little choice but to adopt EU standards and submit to the oversight of the EU's European Railway Agency, which polices adherence to them. Insofar as EU standards were the same as those adopted by the relevant European bodies with wider membership including the UK, British companies would probably be bound to adopt them anyway, but the collective view of the EU would carry more weight than the lone voice of the UK when such standards were being debated.

Sea transport

Sea transport accounts for approximately 37% of all intra-EU freight transport, and the internal market has been substantially opened up to EU competition since 1992 under Regulation 3577 of that year. However, sea transport is a global industry which is exceptionally mobile, since ship owners can register their vessels wherever they choose. In 1997 almost 50% of the world's merchant shipping was registered under flags of convenience such as Panama and Liberia, which apply less onerous conditions than most European states. Since it is not practical to exclude such shipping from European ports, or even from intra-European trade, it is difficult for the EU to impose regulations which go beyond incorporation into EU law of the norms accepted internationally, under agreements negotiated within the International Maritime Organisation (IMO) and the International Labour Organisation (ILO).

These include notably the IMO Convention on Prevention of Pollution from Ships (MARPOL), the IMO Convention on Safety of Life at Sea (SOLAS), the IMO Convention on Standards of Training, Certification and Watch-keeping, as well as a wide range of ILO conventions and recommendations governing the working conditions of seafarers, including the Maritime Labour Convention. Although the Commission coordinates EU policy on these matters, it does not have observer status at the IMO itself, and has to rely on the member state holding the Presidency of the Council of Ministers to speak for the EU.

A key issue in maritime law is how to enforce its application to vessels flying foreign flags, particularly flags of convenience. To some extent this can be addressed by port state control, a procedure under which compliance with internationally agreed standards can be monitored when a vessel calls at a port; the vessel can if necessary be detained until any breach is remedied, or even banned from European coastal waters. Following the grounding of a Liberian-registered oil tanker, the Amoco Cadiz, off the coast of Brittany in 1978, a group of European states adopted the Paris Memorandum of Understanding (1982), setting a target for 25% of vessels operating under the flags of non-participating states to be subject to port state control. However, further accidents resulting in serious pollution continued to occur, and by 1995 the signatories were ready to agree that an EU directive on port state control would be more effective than an intergovernmental agreement. Two subsequent directives, in 2001 and 2009 have imposed tighter standards, and oil spills have declined dramatically over the past thirty years.

Since 1994 EU Regulations have also provided for the mutual recognition of the Classification Societies that carry out statutory surveys and certification tasks, ensuring that they maintain high professional standards, and since 2002 the Commission has been assisted in its oversight of these responsibilities by the European Maritime Safety Agency. However, since the IMO remains the key forum for the regulation of international shipping, the direct consequences of any renegotiation of the terms of British membership of the EU, or even withdrawal, would be minimal.

Air transport

The situation is very different when considering air transport. Since 1986, when the Single European Act applied qualified majority voting to air (and sea) transport, the EU has developed a comprehensive set of policies for air transport. Liberal access to a single European market for air services was established by a succession of three package deals negotiated between 1987 and 1992, and by 1997 EU airlines could even operate internal services within another member state.

The structure of the industry has been utterly transformed by the absorption of national airlines into three major global alliances – the Star Alliance which includes Lufthansa and SAS, the International Airlines Group comprising BA, Iberia and others, and Sky Team which includes Air France/KLM. In addition, low-cost competitors such as Ryanair and Easyjet have established extensive European networks that would have been unthinkable thirty years ago, with hubs in several countries. Ancillary functions, such as airline licensing, computer reservation systems, airport slot allocation, airport ground handling, air traffic control and safety certification have all been brought within the ambit of EU law.

Moreover, the network of bilateral air service agreements between EU member states and third countries is gradually being complemented and in some cases superseded by EU agreements, including a ground-breaking agreement between the EU and the USA. Even where member states continue to negotiate bilaterally, they are required to make provision for all EU airlines to have equal opportunities to access the available rights.

In the event of a British withdrawal from the EU, it would be extremely difficult and potentially costly to unwind this situation. If the UK was willing to accept every aspect of the single aviation market, it would presumably be possible to negotiate reciprocal access. However, air service negotiations are famous for hard bargaining, and European airlines which had lost market share to UK airlines (notably to Easyjet) might well look for ways to restore their competitive edge, for example by insisting that UK airlines could only fly to and from the UK. The renegotiation of bilateral rights with third countries such as the USA could be even more difficult. The rights of UK airlines under EU agreements would expire if not with immediate effect from the date of withdrawal, when BA and Virgin Atlantic would cease to be EU airlines, then at best after the usual period of twelve months notice.

Moreover, in any renegotiations arising from such a disengagement, against a tight deadline which might apply to a large number of simultaneous negotiations, it cannot be assumed that the third countries concerned would necessarily be prepared to grant unchanged rights to UK airlines under a new bilateral Treaty without demanding significant additional benefits for their own airlines in exchange.

Costs and Benefits

Since 1985 the EU has developed extensive common transport policies. Where these do little more than implement in EU law the terms of international agreements and conventions which the UK has signed as an independent sovereign state (e.g. in road and sea transport), the costs arising from any renegotiation or even withdrawal from the EU would be minimal. The consequences for rail transport would be particularly small, since EU policy is less developed, and there are so few direct rail links. On the other hand, the consequences for air transport are potentially more costly, since the European aviation market is now so closely integrated both internally and externally. Unless the UK remained part of the European Aviation Area, the rights of UK airlines to operate freely between and within the member states of the EU would be put at risk. Even with membership of the EEA, the rights to serve third countries (including the USA) which derive from EU agreements granting rights to EU airlines, would have to be renegotiated.

It is difficult to see what benefits the UK would derive from disengagement. In particular the UK would almost certainly find that any freedom it might gain from the application of EU law was heavily constrained by the agreements it would need to negotiate with the EU in order to retain access to the EU market. If UK-based manufacturers of transport equipment as well as transport operators wished to retain such access, the UK would almost certainly have to continue to implement under UK law most if not all the existing regulations and directives which are designed to ensure fair, safe and equal competition, and the UK would have little or no influence over future changes.

Facts and Figures

Transport activity shadows developments in GDP.

Between 1995 and 2010 GDP in the EU grew by 1.4% p.a. Passenger transport measured by passenger kilometres travelled (pkm) grew by 0.9%, and a similar measure for freight (tkm) also by 0.9%.

EU transport modal split

In 2010 passenger carriage by different modes of transport aggregated at EU level was as follows: Cars: 73.7%; M'bikes: 1.9%; Bus/coach: 7.9%; Rail: 6.3%; Tram/metro: 1.4%; Air: 8.2%; Sea: 0.6%

European Airports

In 2010 London Heathrow was the busiest European airport with 65.74 million passengers, followed by Paris Charles de Gaulle with 57.95 million, and Frankfurt with 52.65 million.

UK Links to the continent

Each year through trains carry close to 9 million passengers to and from the continent via the Channel Tunnel. Through freight trains carry over 1.325 million tonnes of freight. The shuttle train also carries a further 2.263 million cars, 56,100 coaches and 1.263 million tonnes of freight.

Railway infrastructure

The UK has approx. 16,000 km of rail track, 32% electrified. Comparable figures for Germany are 33,000 and 58.8%; for France 20,000 and 52.4%; for Italy 17,000 and 70.7%; for Spain 15,000 and 59.2%.

The UK has only 113 km of high speed track (capable of trains over 250 kph). Comparable figures for Germany are 1285 km; for France 2036 km; for Italy 923 km; for Spain 2144 km. The EU has overall 6,830 km of high speed track.

Ports

Dover is the busiest passenger port in the EU, with 13.5 million embarkations and disembarkations per year. Felixstowe is the seventh busiest container port with over 3.4 million TEU, and Southampton is the eleventh busiest with over 1 million TEU per year. Immingham is the eighth busiest general freight port with over 54 million tonnes, and London is the tenth busiest with over 45 million tonnes per year. (TEU = standard container size: twenty-foot equivalent units.)

Motorways

Of a total length of EU motorways of 68,242 km in 2009, 12,813 km were in Germany, 14,021 were in Spain, 11,163 were in France, 6,661 were in Italy and 3,674 were in the UK.

Social and Employment Dimensions

Lord Monks of Blackley

Former General Secretary of the TUC and of the European Trade Union Confederation

If the Prime Minister renegotiates us out of Social Europe, many gains are at risk. You only have to look at what the present Government is doing to rights which derive solely from UK legislation.

Lord Monks of Blackley

The heart of the matter

Under pressure from a large part of the Conservative Party and from the surge in support for UKIP, the Prime Minster has recently announced that, if the Conservatives were to win the next General Election, there will be an 'in/out' referendum on Britain's membership of the EU. His plan is to negotiate a looser relationship with the EU in some important areas, then to claim that the UK can be comfortable with this relationship; and encourage the nation to vote 'Yes'. This plan has already been rubbished by some leading members of his own political party, among them Lord Lawson and Michael Portillo, who go further and call for the UK's exit from the EU as soon as possible.

The Prime Minister has not yet been specific about what form of new relationship the UK should negotiate with the EU. A Foreign Office-led review of UK/EU competencies is in train at the moment. But in one area – social and employment competencies – the Government's intentions are already clear. They want an opt out from EU employment rules. Whether this opt out should be general, as was a previous one negotiated by John Major at Maastricht in 1992, or whether it will relate to specific measures like the Working Time Directive or the Agency Workers' Directive, is not yet clear.

Social and employment issues are at the heart of many of the controversies of the UK's continued troubled relationship with the EU. I make no claims to be dispassionate. I believe in the UK's membership of the EU and also in a strong European social model. This article highlights the value of the EU's social dimension to British workers specifically and to the nation generally.

What is Social Europe?

For Europe's trade unions, if the EU is to enjoy popular support, it cannot just be a single market in which member states compete on lower and lower labour standards. From the outset, from the Treaty of Rome, this principle was at least in part conceded by the member states. And in the Single European Act – which set out the ground rules for the single market – Europe's leaders agreed that the single market should not allow competition on the basis of one country using low health and safety standards to gain an advantage. Mrs Thatcher signed up to that principle. As a result, EU legislation on health and safety has spread good UK rules throughout the EU. In this field, at least, the UK has been the country which took the lead.

Social Europe has evolved through successive treaties over the past 50 years or so. The main landmarks are as follows:

The Treaty of Rome (1957), the founding treaty of the EU, included a provision for equal pay between men and women. Any social policy initiatives needed to be adopted by unanimity.

The Single European Act (1987) included for the first time a provision for qualified majority voting on social policy relating to health and safety. This also provided the detailed legal basis for free movement of labour among EU member states, along with the other freedoms of movement of capital, goods and services.

The Maastricht Treaty (1992) went further and included the Social Chapter whereby the social partners (employers' associations and trade unions) could negotiate Europe-wide collective agreements, and that social provisions in some areas could be adopted by qualified majority voting among member states..

The Lisbon Treaty (2009) incorporated the Charter of Fundamental Rights into the EU treaties, including key provisions on the right to collective bargaining and the right to strike.

On the basis of these treaties around 60 directives have been agreed by the Council of Ministers and the European Parliament on social and labour market issues. These can be grouped as follows:

- Health and safety (including the controversial Working Time Directive). These account for over 40 directives.
- Equality on gender, race, religion, and sexual orientation.
- Specific provisions on equal treatment for part-time workers, fixed-term workers and agency workers, maternity provisions and the right to parental leave.
- A general framework on information and consultation of the workforce, as well as on mass redundancies, transfer of undertakings and European works councils.
- Miscellaneous laws – in particular the Posted Workers' Directive which aims to extend entitlements to workers sent by their employer from one country to another, entitling them to at least the minimum conditions available in the host country.

This is an impressive list, but many of the core issues of industrial relations are still dealt with at national level. This includes collective bargaining on pay, strikes, job security and employment protection, restructuring, pensions, sick pay, social security and dismissals and work discipline. Yet despite this clearly agreed division of competences between Brussels and the nation states, with key issues being reserved for national determination, the question of whether there should be any European-wide labour standards at all continues to be hotly debated in the UK.

Social Europe and the Economic Crisis

The whole of the EU is beset to varying degrees with serious economic problems. Many member state governments, with the UK in the vanguard, indulged in an explosion in bank lending, inflating their balance sheets, accompanied by declining levels of equity and by massive borrowing. This created a long boom which was always fragile and ultimately unsustainable. Bankers claimed that they had invented new tools to handle what previous generations would have regarded as impossible risks. Even governments claimed to have ended the cycle of boom and bust. They were wrong. The banks' debts have now largely been transferred to the sovereign states, wrecking nations' balance sheets. Now we have austerity imposed on reluctant electorates and a long depression. As Will Hutton wrote recently in the New Statesman: "Never have so few lent so much to so many so recklessly, escaping the consequences while imposing hardship on others."

The result in blighted lives is evident from the table at the end of this article. Unemployment stands at nearly 11% across the EU with Spain having over 26% jobless. Youth unemployment is even worse – close to 50% in Spain.

Four countries are currently in receipt of EU multi-billion euro support packages – Greece, Ireland, Portugal and Cyprus. The terms of these packages have been very tough, imposing austerity on the populations of these countries through cuts in wages, especially public sector and minimum pay, social security; and public spending. The policy has also included privatisations. For pro-Europeans, the doctrinaire handling of the current crisis by Europe's leaders is causing both alarm and dismay.

This approach, driven primarily by Germany, is massively counterproductive. It is based, Old Testament style, on punishing sinners against the existing EU rules. At best it will impede and delay recovery; at worst, it will kill it stone dead.

Not only are policies of austerity being forced on Greece, Portugal, Ireland and Cyprus, they are being enshrined in a new treaty covering 25 EU countries, all except the UK and the Czech Republic. Never was an EU treaty less needed. There were already strict rules for countries in the Eurozone covering levels of debt and deficits, but they were broken. The size of the economic crisis has made them irrelevant. More rules are not the answer. They will not power Europe out of its difficulties.

Historical lessons

Solidarity has been largely absent in the EU member states' response to the sovereign debt crisis and, where support has been offered, the terms of European support have been so draconian that EU 'help' has felt more like a punch in the stomach. That was the case in Greece initially, but also in the other distressed countries.

Just when the EU needed to rise to the challenge of handling its worst economic crisis since 1945, it adopted the misguided approach of President Hoover to the Great Depression in the early 1930s and intensified austerity at a time of economic collapse. It is as though John Maynard Keynes, the great economist, had never analysed what went wrong, nor that President Roosevelt had then correctly tackled the 1930s crisis by the New Deal policies of public expenditure to stimulate growth and employment.

If the lessons of the 1930s are being forgotten, so are the lessons of the post- war period of the late 1940s. Then General Marshall correctly saw that Europe was broke and needed dollars to re-equip itself and start to grow. The USA stepped forward to help the other countries of Western Europe. The policy was both generous and self-interested. It was also far sighted.

The contrast with the period after the First World War could not be more stark. Then heavy reparations were charged, by France and Belgium in particular, on the defeated countries, especially Germany. The burden of repayment made Germany's economic and political recovery very slow and difficult, encouraged rampant inflation, and ultimately paved the way for the rise of the Third Reich. Today, Greece feels a bit like Germany did after 1919.

Recent action by the European Central Bank has been successful in calming markets and stabilising the current position, but there are few signs of growth, or any convincing indications in Europe that the lessons of the 1930s and 1940s have been fully learned.

Contemporary alternatives

By contrast, the USA is showing the way. Its economy is recovering more quickly, partly because it did not apply austerity policies. In Europe, including the UK, it is vital that similar policies of growth take precedence over the drive to repay debt. In the long run, of course, debts must be repaid, but the distressed countries need time as well as help, with the stronger nations carrying more of the burden. This can be done in various ways, especially by pooling debt and issuing Eurobonds; or by the European Central Bank acting as a lender of last resort; or by special measures to tackle in particular youth unemployment.

Not everyone will agree with me, but I think that the EU has been a considerable success until this recent crisis. Since then, however, the EU has barely put a foot right. It needs now to listen to the trade union voices of the ETUC and put its faith in a new approach, like a European Marshall Plan It needs to learn from that post-war experience.

We should also learn from the experiences of the Nordic countries, Finland, in particular, which, after the collapse of the Soviet Union and the resulting loss of 15% of GDP, pursued approaches based on solidarity and common purpose. The Finns rejected right wing solutions which would have promoted social division and soon their economy resumed growth. That should be Europe's road to growth, mobilising the best of Social Europe to fight the crisis.

Instead, moves in the Eurozone towards greater economic convergence are centring on stricter rules to control and reduce unit labour costs and social costs. These have the effect of eroding nationally-based wage formation and collective bargaining, weakening the voice of labour. This approach that entrenches austerity is disheartening for Europeans. The ETUC is leading calls for a change to a Keynsian-based policy of expansion. As Joseph Stiglitz, the renowned social economist, has written, "The deeper the austerity, the deeper the downturn….The cure is not working, and there is no hope that it will….It will take 10 years or more to recover the losses incurred in this austerity process".

At long last the EU may be waking up to the risks of pursuing the wrong policy. Recent statements by the French President, the Italian Prime Minister and President Barroso give some indication of a will for a change of course. But there are no signs yet of the German government contemplating a change. The European Commission does what it can to promote specific measures to combat unemployment, using what funds it has at its disposal for job creation. But these funds do not address the central problem of low demand and low growth.

Sadly, the crisis is benefiting those who believe that Europe must become more free market, and that labour costs must fall in order to compete with emerging economies like China. These free market fanatics – and the eurosceptics and the nationalists – are the ones who have seized the initiative. UKIP is a very British development, but it has its eurosceptic and nationalist counterparts across the EU. Trade unionists should be their main opponents, and galvanise the currently ill-equipped centre left political parties to promote their responses to the current crisis of financial capitalism.

Free Movement of Labour

In 2004 eight former communist countries from Eastern Europe with relatively low levels of GDP joined the club. This made the EU's single market a much larger reality than it was before and In particular brought in its wake a surge in migrant workers from East to West across the continent.

The ETUC has long favoured the free movement of labour but on the basis that employment and other social standards applied are those of the host country, not of the country of origin.

Yet in recent decisions – Lavel, Viking, Rueffert, for instance – the European Court of Justice has taken the view that applying host country labour standards is a barrier to free movement. In effect the ECJ's view is that it is acceptable that only minimum conditions need apply to posted and perhaps to other categories of migrant workers such as seasonal workers and intra-corporate transfers. These judgments are having the effect of undercutting the terms of collective agreements, and producing an increase of protectionist feeling among some workers.

The ETUC is attempting to address these problems by calling for a Social Progress Protocol in EU treaties, for a revised Posted Workers' Directive based on equal, not minimum pay, and a regulation in the proposed new Single Market Act which would emphasise that the single market does not overrule fundamental rights, like the right to strike. These ETUC proposals would protect established workers against being undercut by some categories of migrant workers, while providing that migrants are not regarded as second class, subordinate workers to be treated in an inferior way.

Wider questions of standards

But they do not provide a complete answer to growing inequality nor to social dumping, nor to the need to build a robust trade union movement across all member states of the EU, more capable than currently of formulating common demands and actions.

Is there scope for a more ambitious approach for debate, starting with asking some hard questions? How realistic is it to try to insulate national systems against pressures from the EU's single market? Would a Social Progress Protocol and a revised Posted Workers' Directive be enough? Can these measures be complemented by a more European-wide approach to establishing a range of common and minimum standards, drawing on ILO standards and the standards of the most advanced EU states?

If that route is followed, should there be a universal right to negotiate and to collective bargaining both within a member state and at European level? A framework directive might require member states to build collective bargaining systems which:

› Establish minimum rates of pay in all sectors of the economy;
› Ensure that productivity gains are fairly distributed;
› Regulate hours of work;
› Ensure equality on a gender basis, for all categories of migrants, and on a pro rata basis for all 'precariously' employed workers;
› Provide for information and consultation of the workforce before all decisions affecting employment security.

Next, among trade union key concerns is the need for a framework for democracy at work on other matters. We need to establish union/worker influence at the level of the board of directors, or at the equivalent top level of private companies and private equity held companies. The aim is to ensure there is a regular dialogue about creating growth and sharing its proceeds; about reducing carbon emissions; about any implications for employment; and about skills and training. It would be an important step in putting the brake on growing inequality, the widening gap between rewards for top executives and other employees that is evident across European business.

An additional step might be for each member state to establish social dialogue machinery to implement the suggestions outlined in this article in a manner appropriate to that member state. These initiatives could be reported annually to a European Conference on labour standards in which the social partners play a prominent part. This way, economic governance at European level could be matched by increased social governance.

The UK Debate

The British debate is, of course, on a different plane entirely. The Prime Minister is but the latest UK politician to regard the EU social dimension with suspicion and hostility. Margaret Thatcher did so, regarding it as an attempt to revive trade unionism whose teeth she had extracted in the UK in the 1980s. John Major continued that policy and negotiated an opt out from the Social Chapter in the Maastricht Treaty. It was a regrettable development, as the Social Chapter was a major advance, allowing the social partners to negotiate Europe-wide agreements and extending majority voting into social matters.

Even the Labour Government was sometimes hesitant on social matters at EU level. It did not wish to alienate British employers, and believed that a 'flexible' labour market with weaker unions was the way the rest of the EU should go. But its general hostility did not prevent some specific progress. It was the Labour Government that ended the opt out from the Social Chapter, and since then two important directives have been introduced – the Information and Consultation Directive and the Agency Workers' Directive.

The Working Time Directive, however, is the particular bugbear for those who oppose the development of a European social model in the UK. British Eurosceptics claim that it puts a big burden on the UK economy and even puts patients' safety at risk in hospitals. Let's look at the facts. The Directive aims to provide a minimum entitlement to four weeks' holiday, rest breaks, and an upper limit to the normal hours of work per week. Six million UK workers have benefited from improved holiday entitlements arising from the Directive. Another area where its impact has been substantial affects the hours worked by junior hospital doctors. Their previously excessive hours have now been controlled. Who wants to be treated by a trainee doctor who has been on duty nearly 100 hours, as was the case before the Directive changed working practices in the NHS? But the impact of the 48-hour rule for normal working hours has been limited in the UK as the Government secured an opt out which – naturally - employers use widely.

It seems odd that the Prime Minister is attaching so much importance to maintaining this opt out. He will be opposed strongly by European Trade Unions and by other member governments. The Working Time Directive has weaknesses – many other EU governments have problems with it and there are numerous opt outs for health service workers in particular. But, as a recent pamphlet from the Centre for European Reform *(The Working Time Directive – What is all the fuss about?)* shows, these problems can be tackled by action in the framework of social dialogue between Employers organisations and the trade unions at EU level or by decisions in the Council of Ministers. They do not warrant the Prime Minister raising the stakes by making changes in the Directive a condition of the UK's continuing membership of the EU.

The EU's employment laws are bulwarks defending workers' rights against raids by owners of capital or business friendly governments. The standards achieved by past generations of workers and their representatives should be defended. They are not designed to make the UK less competitive. In fact, by raising standards, they are a spur to higher productivity, investment and skills. Without them, our future could be a race to the bottom, to ever poorer social protection in the single market. If the Prime Minister renegotiates us out of Social Europe, many gains are at risk. You only have to look at what the present Government is doing to rights which derive solely from UK legislation.

UK laws have introduced new restrictions on access to employment tribunals by requiring cash deposits and raising qualifying conditions; they have made cuts in legal aid and available compensation; they have reduced periods of notice of redundancies; and encouraged workers to sell their rights for potentially worthless shares. Already three million workers have been taken out of unfair dismissal protection. It is much harder to unpick EU-derived rights that have required the agreement of all the member states, so right-wing attacks on them are less successful.

EU social rights, like the EU itself, with all its flaws, deserve the determined support of British working people. They are a cause worth fighting for. Realising the Prime Minister's vision of a UK without significant protections for employees, competing on cheapness and vulnerability, would be a disaster.

Conclusion

Social Europe has been a political battlefield and will remain so. It is for many of us at the heart of what the EU should be – whether it develops as a 'North Sea' economy with high productivity, high social standards, and constraints on inequality, or whether we slide further towards the 'Atlantic' model of monetising as many aspects of public life as possible. It is vital that the 'North Sea' vision wins.

Facts and Figures

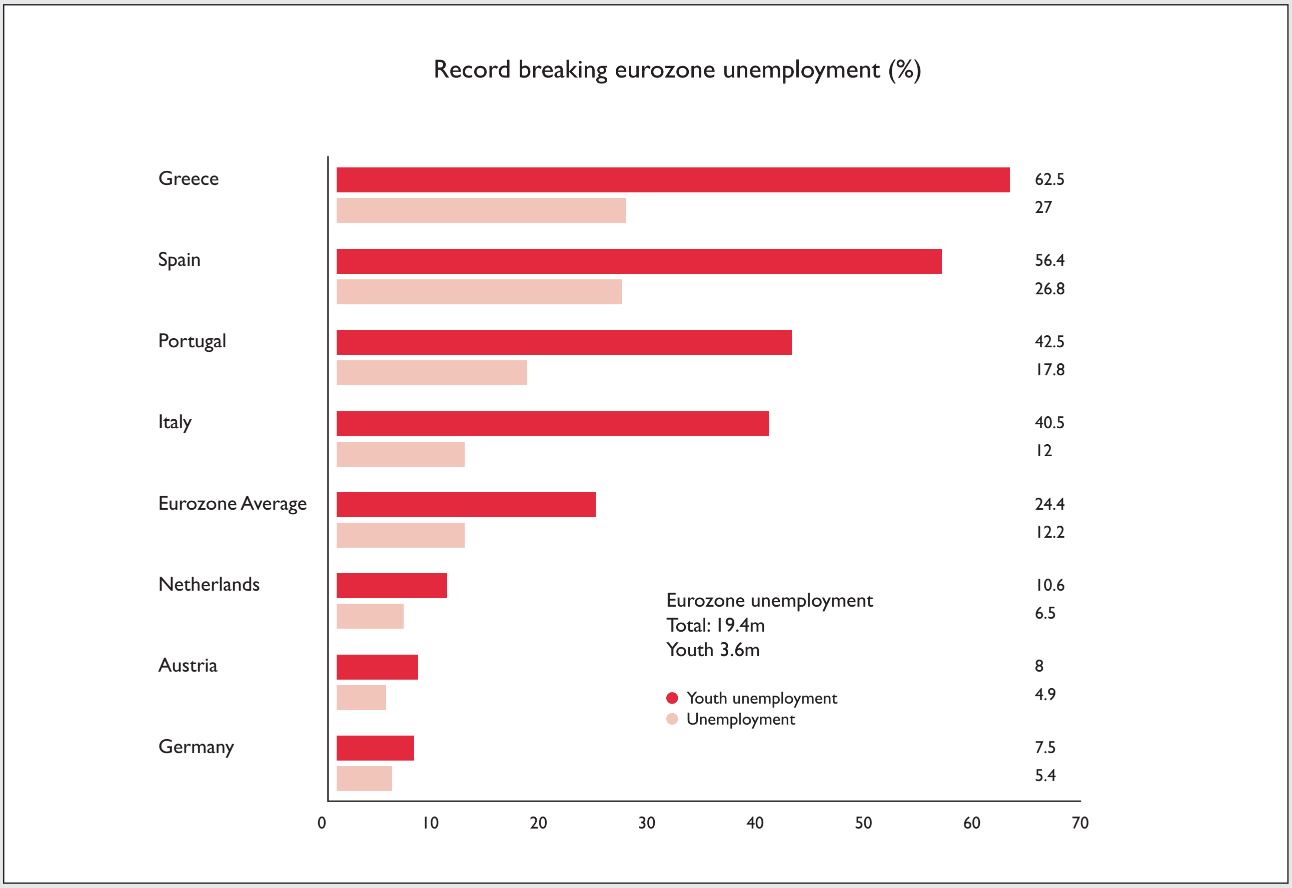
The EU has set a target rate of employment of 75% as a proportion of the adult population within the age range 20 to 64. Statistics for 2012 suggest that the actual rate is 68.6%. The figure for the UK is 74.2%. Only six other member states have a higher proportion of their population actively engaged in employment: Sweden with 79.4%, The Netherlands with 77.2%, Germany with 76.7%, Austria with 75.6%, Denmark with 75.4% and Finland with 74.0%. *(Source: Eurostat)*

The UK workforce numbered 32,112,390 in 2011. Women made up 46.97%. Agriculture, fisheries and forestry employed only 1.2% of the total workforce; 19.1% worked in industrial production and 79.0% in services. *(Source: Index Mundi)*

The unemployment rate in the UK is currently (mid-2013) 7.8% with 2.51 million people out of work.

Unemployment in the EU as a whole is currently 11%. Unemployment in the Eurozone of 17 member states is higher at 12.2%. It shows wide variations across different countries. In Austria it is lowest at 4.9%, in Germany 5.4%, but in Portugal it is 17.8%, in Spain 26.8% and in Greece 27%.

Youth unemployment in the eurozone is significantly higher still, now reaching 3.6 million young people, or 24.4% of the young workforce. In several badly affected countries it is higher still: over 60% in Greece and close to 40% for instance in Italy. *(Source: BBC)*



Source: Eurostat

European Research Funding and the UK Research Landscape

Dr. Joanna Newman

Director, UK Higher Education International Unit

The benefits of international collaboration in research projects are profound and wide-ranging. They encourage excellence by bringing together the most outstanding researchers in the field.

Joanna Newman

Introduction

EU Research and Innovation (R&I) funding is of critical importance for Europe: it is the main EU driver ensuring Europe's competitiveness in an ever-increasing globalised world economy. The European Union's primary funding instrument for supporting collaborative, transnational research and development is the Framework Programme, currently in its seventh phase (Framework Programme 7 or FP7 for 2007-2013).The next programme, called Horizon 2020, will start in January 2014.

EU R&I is especially important for the UK. In the current programme, the UK is numbered amongst the top three participant countries, with UK higher education institutions (HEIs) being the UK's most significant participants. For UK institutions, the Framework Programme is an increasingly significant source of funds: it provides an additional 15% on top of the UK Government's own science and research budget, a sum greater than that of all but two of the UK Research Councils. More importantly, it is also a growing source of income with funds for research projects requested by UK HEIs from the European Commission rising from €508.6m in 2008 to €856.3m in 2012. The cash-terms freeze of the UK domestic science budget, re-confirmed in the UK 2013 Spending Review, enhances the vital importance of EU funding for the UK research base even further.

In addition to funding, the Framework Programme also delivers another key benefit for UK researchers: collaboration across Europe and beyond. Collaborations are increasingly essential to research excellence: 46% of UK research articles published in 2010 were co-authored internationally. According to a recent BIS study, internationally co-authored research is more highly cited than nationally co-authored publications – even when the country of the co-author is itself of lower citation impact. The significance of funding collaborations lies in attracting excellent researchers, giving experience of mobility to the next generation of researchers, building teams to address grand challenges with more expertise than any nation alone could provide, and opening up new partnerships across the EU. Through collaborations, the UK benefits from access to excellent research all across Europe, participating in projects with a growing range of businesses and academics across many member states.

Horizon 2020 offers an increase in the Framework Programme budget, mirroring the EU's commitment to investment in R&I. This positive trend means that European research funding will become even more important to the UK in the future. Simplified application procedures for funding under Horizon 2020 will ensure more stress on excellence and closer linking of research to innovation than in previous programmes – both areas in which UK universities have a strong track record.

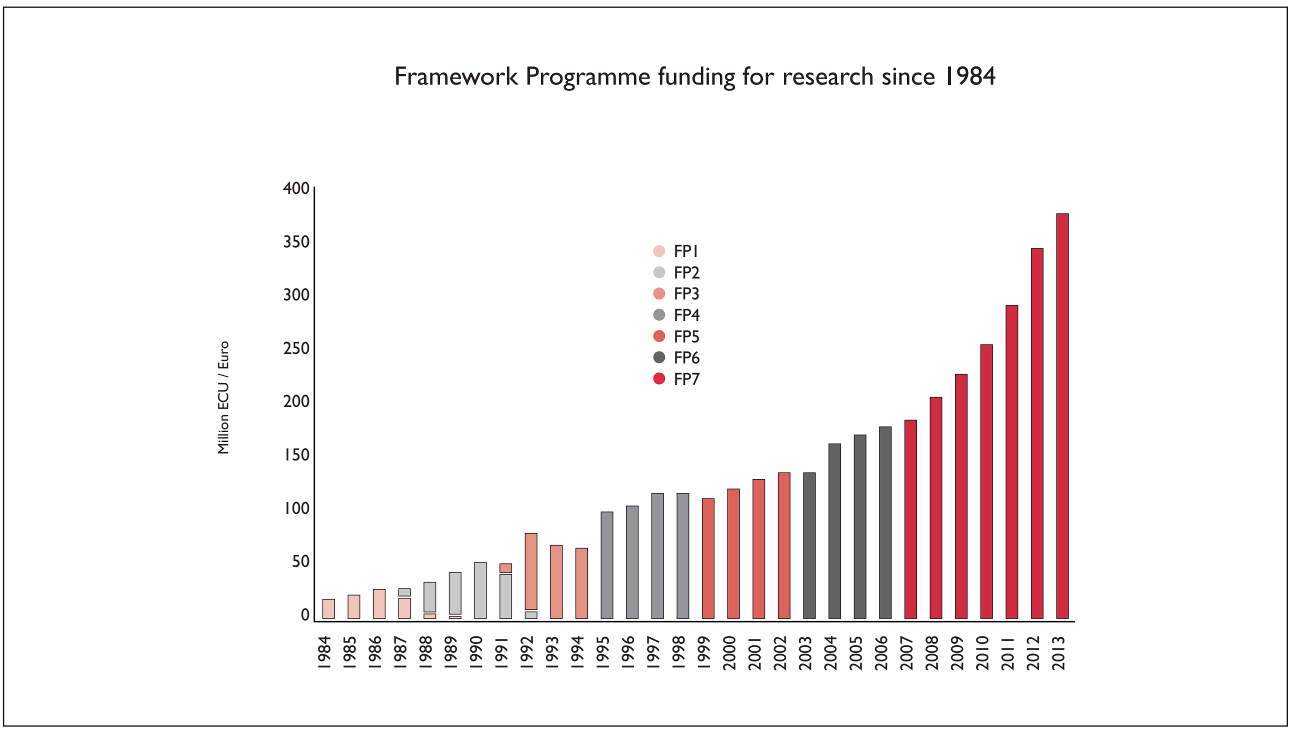
The European Framework Programme

The Framework Programme was established in 1984 and is the European Union's primary funding instrument for supporting science and innovation through collaborative, transnational research and development. During its seventh phase from 2007 to 2013, the FP7 will distribute over €53.2 billion (£45.5 billion) to as many as 10,000 research projects.

The primary aims of the Framework Programme are to:

› strengthen the EU's science and technology base
› improve the EU's competitiveness
› support policy development in the EU

Framework Programme funding for research since 1984



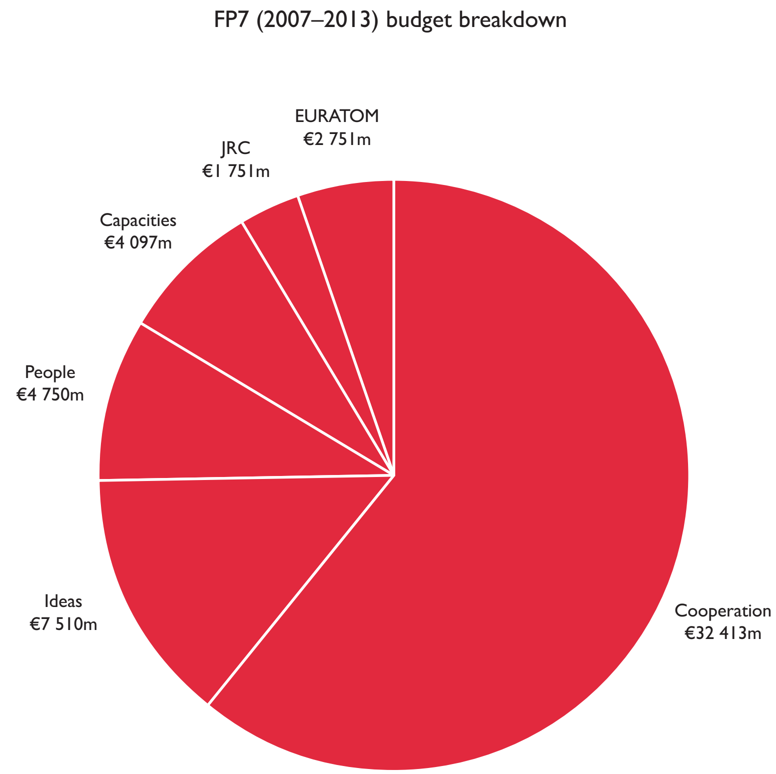
Source: ec.europa.eu website: http://tinyurl.com/7wxl9an. ECUs changed to Euros from 1999.

FP7 Specific Programmes

The FP7 funds four 'specific programmes', plus a fifth focusing exclusively on nuclear research (EURATOM, and the Joint Research Centre which undertakes research to support European policy). The four specific programmes are:

› Cooperation – funds research involving international collaborative projects across ten research areas.
› Ideas – funds investigator-driven research projects across all fields carried out by individual teams. Managed by the European Research Council (ERC).
› People – funds individual researcher mobility, provided through 'Marie Curie Actions' *(See http://ec.europa.eu/research/mariecurieactions/)*
› Capacities – provides funding to build European research and innovation capacities.

FP7 (2007–2013) budget breakdown

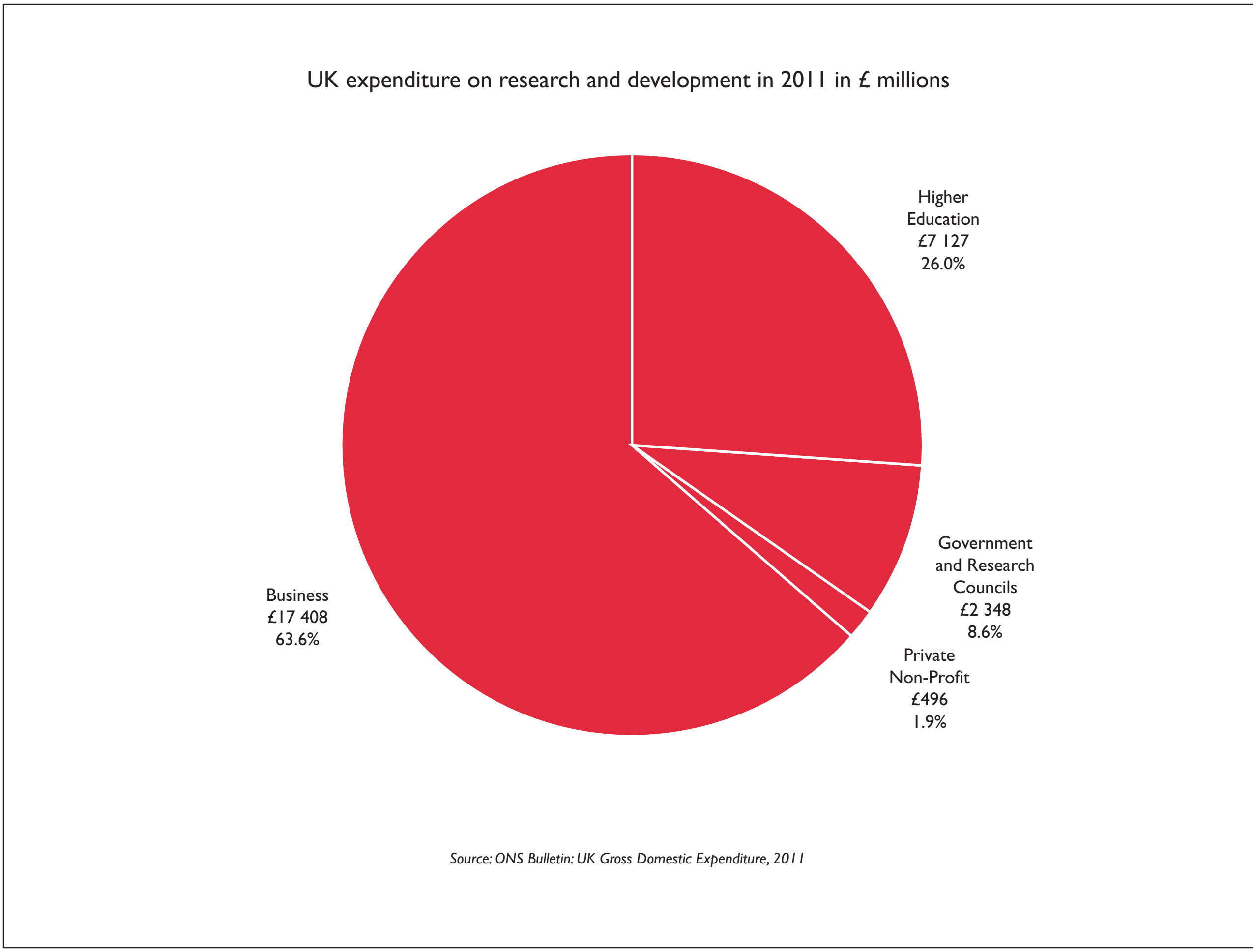


Source: European Commission Fifth FP7 monitoring report (2011):ttp://ec.europa.eu/research/evaluations/pdf/archive/fp7

Research funding in UK higher education institutions

In 2011, the UK's gross domestic expenditure on research and development was £27.4 billion, which represents 1.79% of its gross domestic product. The higher education sector accounted for £7.1 billion (26%) of this total expenditure.

Within the higher education sector the Research Councils are the main public funders of specific research projects and individuals in the UK, funded by the Government's Science and Research (S&R) Budget, via the Department for Business, Innovation and Skills (BIS). Each Research Council funds basic and strategic research and postgraduate training activities across the whole of the UK. Research funds are awarded to individual grantees in universities research centres according to competitive peer review.



The seven Research Councils are:

- **Arts and Humanities Research Council (AHRC)** – budget ≈ £100m per year
- **Biotechnology and Biological Sciences Research Council (BBSRC)** ≈ £445m per year
- **Economic and Social Research Council (ESRC)** ≈ £203m per year
- **Engineering and Physical Sciences Research Council (EPSRC)** ≈ £800m per year
- **Medical Research Council (MRC)** ≈ £760m per year
- **Natural Environment Research Council (NERC)** ≈ £400m per year
- **Science and Technology Facilities Council (STFC)** ≈ £500m per year

Other bodies also provide finance to this sector:

The **Higher Education Funding Council for England** (HEFCE, also funded through BIS) and its devolved counterparts in Scotland, Wales and Northern Ireland provide block grant funding to universities on the basis of a periodic assessment of recent research performance, formerly known as the Research Assessment Exercise (RAE), currently the Research Excellence Framework (REF).

In addition to the FP7 funding UK HEIs also receive funding from other **EU based funding sources** as well as EU-based industry, commerce, public corporations, charities and other sources.

The Royal Society, Royal Academy, British Academy, Royal Academy of Engineering and Royal Society of Edinburgh are independent institutions supporting science, engineering, the arts, and the cultural, economic and social well-being of Scotland and its people respectively. They also receive funding from BIS.

The Technology Strategy Board invests in collaborative research to encourage university and business interactions and the exploitation of emerging technologies. Funding (provided by BIS) is awarded on the basis of competitive peer review.

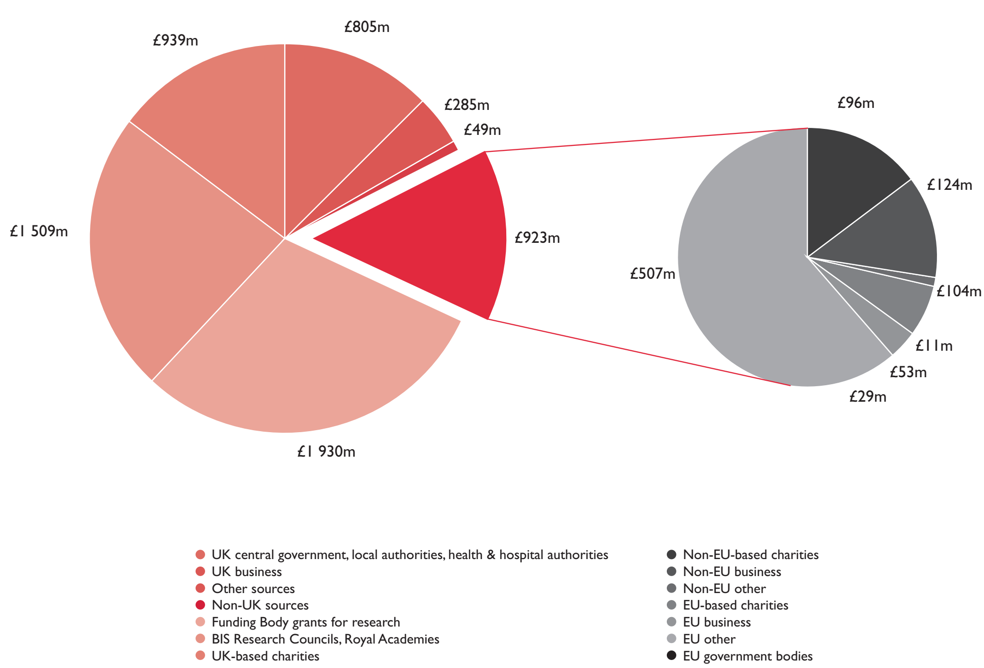
The UK charitable sector invests upwards of £939m per annum in research. The most significant UK research charity is the Wellcome Trust, an independent body funding research to improve human and animal health.

64% of overall research expenditure in the UK is from **industry,** and includes an increasing flow of investment from foreign companies. Much of this research is collaborative, bringing together university researchers and those from the private sector.

UK HEIs receive funding from various **non-EU-based business, charitable and other sources.**

As can be seen from the chart below, over half (55%) of all non-UK funding to universities comes from EU governmental bodies, primarily support provided through the Framework Programme.

UK HEI income from research grants, contracts and funding body awards in 2011-12



Source: HESA Finance return 2011-12, Tables 5b and 6b via HEIDI database.

Roughly half of UK HEIs are members of Mission Groups, which represent institutions with common interests and approaches, distinguishing primarily between research-intensive institutions and those with a more teaching-based, vocational outlook. The main five mission groups are:

- › **Russell Group** an association of 24 research-intensive universities, including Oxford and Cambridge Universities, Imperial College and University College London. Generally considered the most elite of the mission groups, members nevertheless have a similar profile and reputation to those in the 1994 Group;
- › **1994 Group** an association of 11 smaller research-intensive universities;
- › **University Alliance** an association of 23 universities with a professional-/business-focused ethos;
- › **Million +** an association of 19 universities, so called because students of its member institutions number over 1 million;
- › **Guild HE** an association of 27 universities representing institutional diversity and distinctiveness within the UK higher education sector.

Research income in UK HEIs 2011-12, disaggregated by Mission Group

	Research grants and contracts (£m)	Funding Council grants for research (£m)	Total research income (£m)	Number of institutions in mission group (2012 definitions)
Russell group	3,302.3	1,294.8	4,597.1	24
1994 Group	274.9	163.4	438.3	12
University Alliance	140.2	96.9	237.2	24
Million +	54.5	35.4	89.9	22
Guild HE	6.2	4.5	10.7	25
Other/ Unaffiliated	731.6	335.0	1,066.6	94
All institutions	4,509.7	1,930.1	6,439.8	201

Source: HESA (Higher Education Statistical Authority) Financial Return 2011-12, tables 5b and 6b, via HEIDI database. Figures disaggregated according to HESA's 2012 definitions of Mission Group membership.

As can be seen in the table above, Russell Group universities attract by far the largest share of research funding.

UK participation in the Framework Programme

The UK has been a consistently strong player in the Framework Programme, securing a disproportionately large share of available funding, and increasing year on year. The UK Government's national grant funding for science and research (S&R) is £4.6 billion a year and FP7 provides an average additional 15% funding annually.

Funding allocations to the UK: The UK overall received €4,915m (£4,188m) in funding through the first six years of FP7 (2007-2012) an average of €819m (£698m) per year, which is greater than the spending power of five of the seven UK Research Councils. Given that Framework Programme spending has and will continue to increase each year, whilst the UK's S&R budget has remained frozen at £4.6bn and decreasing in real terms with inflation, the Framework Programme represents an increasingly important component of research funding in the UK.

Compared to other EU states, the UK receives 15.1% of the total FP7 funding; only Germany has received more funding overall, and UK HEIs receive more funding than those in any other country.

FP7 requested financial contribution (€ millions)

	Higher or Secondary Education	Research Organisations	Private Commercial	Public Bodies	Other	Total	% share
UK	3,482	451	845	99	38	4,915	15.1
Germany	2,004	1,796	1,381	64	40	5,285	16.2
France	545	1,869	997	58	271	3740	11.5
All Countries	14,323	9,064	7,680	839	732	32,638	

Source: e-CORDA FP7 grant agreements and participants database, Vs 13.0, released March 2013

UK institutions have participated in more FP7-funded projects than any other EU member state. Due to these very high levels of participation, the UK is likely to continue to retain a significant share of Framework Programme funding.

Proportion of projects with UK involvement in FP4, FP5, FP6 and FP7

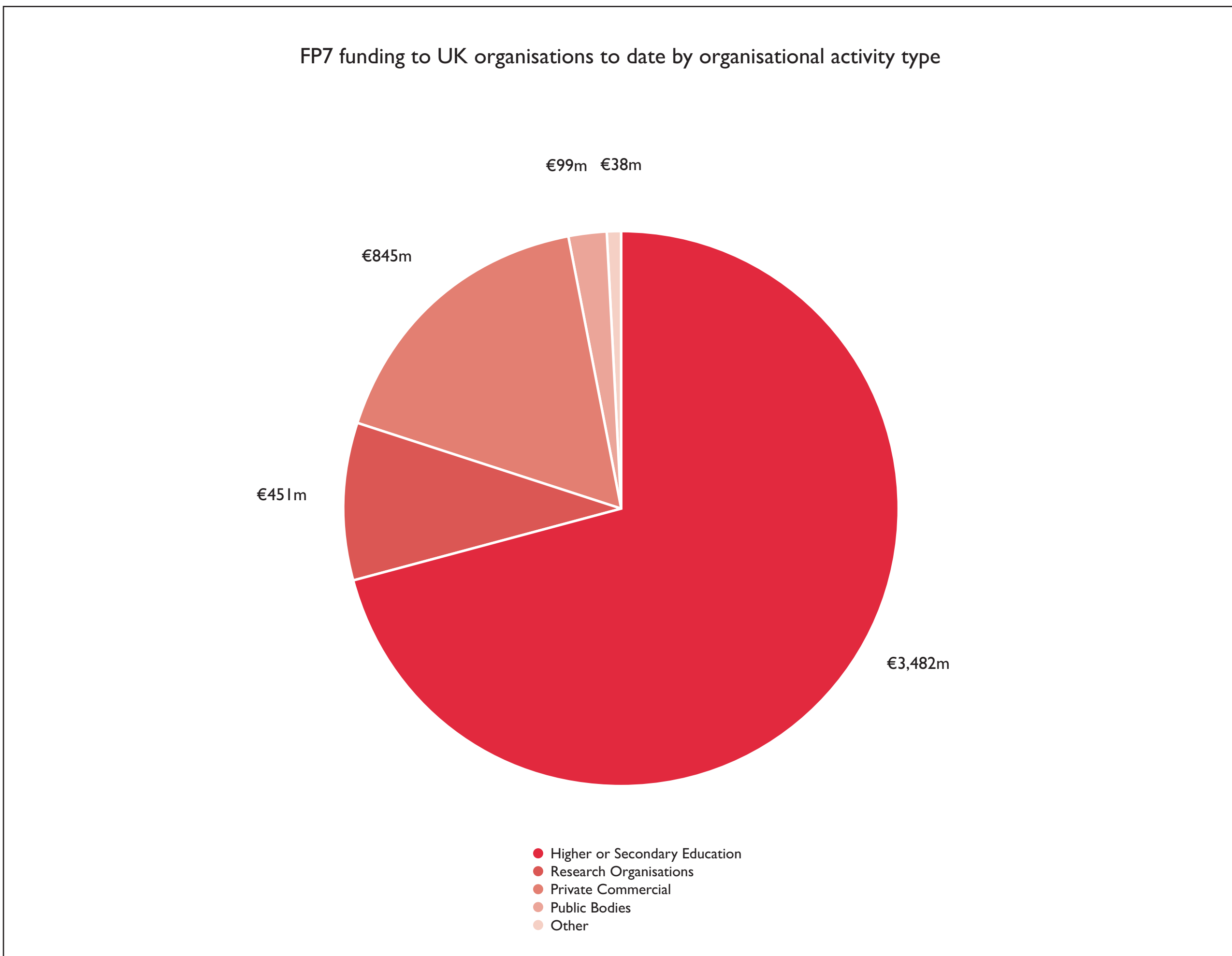
	FP4 (1994-1998)	FP5 (1998-2002)	FP6 (2002-2006)	FP7 to date (2007- March 2013)
Number of projects	15 457	16 251	10 058	18 507
Number of projects with UK partners	7,276	6,613	4,459	7 591
Proportion of projects with UK partners	47.1%	40.7%	45.3%	41.0%
UK rank amongst all EU member states	Not available	1	1	1

The actual number of UK 'participations' in Framework Programme projects is also very high, second only to Germany in the current funding round.

Number of UK participations in FP5, FP6 and FP7

	FP5 (1998-2002)	FP6 (2002-2006)	FP7 to date (2007- March 2013)
Number of participations overall	80 086	74 400	99 625
Number of UK participations	10 905	8 792	12 817
Share of all FP participations	13.6%	11.8%	12.9%
UK rank amongst all EU member states	1	2	2

Sources: Tables above updated from 'The impact of the EU RTD Framework Programme on the UK' (2010)



Source: Chart above from e-CORDA FP7 grant agreements and participants database, Vs 13.0, March 2013

There are five UK institutions in the top 20 participant organisations according to funding received, compared to three each from both France and Germany. Amongst the top ten higher education participant institutions, five are from the UK, increasing to 14 in the top 50. This is also reflected in terms of actual funding, where 70.8% of the UK's FP7 share goes to academia.

Amongst UK HEIs, there is a high degree of correlation between the proportion of research income from all sources and funding received from the Framework Programmes, This partly reflects the high cost of research in science, technology and medicine; the research intensive universities have a well-established infrastructure for cutting edge research in such subjects compared to social sciences and smaller applied research projects.

Future developments - Horizon 2020

At the time of writing, Horizon 2020 has been politically agreed, but the legislative approval is pending. The headline changes in comparison to FP7 will be

- Streamlining the Framework Programme funding with other EU innovation-related funding pots, creating a single programme with a three pillar structure, as illustrated by the diagram below;
- An increase in overall funding, in particular a significant increase for the European Research Council;
- Simplifying the participation process for companies, universities, and other institutes;
- More co-ordination of access to large research infrastructures;
- More emphasis on research excellence and linking research to innovation;
- A dedicated instrument to 'widen participation' of a wider range of partners in the programme.

Excellent Science	Industrial Leadership	Societal Challenges
European Research Council (ERC)	Leadership in enabling and industrial technologies	Health, demographic change and wellbeing
Future and Emerging Technologies (FET)	Access to Risk Finance	Food security, sustainable agriculture, forestry, marine, maritime, inland water and bio-economy
Marie Skiodowska Curie	innovation in SMEs	Secure, clean and efficient energy
Research infrastructures		Smart, green and integrated transport
		Climate action, environment, resource efficiency and raw materials
		Inclusive, innovative and reflective societies
		Secure societies - protecting freedom and security of Europe and its citizens

Spreading excellence and widening participation	EIT	JRC

The Societal Challenges reflect policy priorities of the Europe 2020-strategy and should address major concerns shared by citizens in Europe and elsewhere. They aim to bring together resources and knowledge across different fields, technologies and disciplines, including social sciences and the humanities.

Benefits of the UK's involvement in the Framework Programmes

As an EU-wide funding scheme, the Framework Programme brings a number of opportunities and positive outcomes, which amplify and in some cases differ from those provided by national sources of funding. In particular they foster economic growth and employment and encourage international and cross-institutional collaboration.

Investment in science and research offers substantial returns in terms of economic growth. According to the Horizon 2020 Impact Assessment Report, the rate of return for publicly funded research usually exceeds 30%.

Framework Programme funding has had a significant impact on the economy and employment: the long-term impact of FP7 is estimated at 900,000 additional jobs and a growth in GDP of nearly 1%. Across all member states, every €1 of FP7 funding has been calculated – again in the Horizon 2020 Impact Assessment Report - to lead to an increase in industry added value (contribution to growth) of €13 on average.

Although direct comparisons between Horizon 2020 and FP7 are complicated by the inclusion of additional innovation-related activities in Horizon 2020, an increase of approximately €9bn in research and innovation funding for the period 2014-2020 may be assumed (based on the June 2013 informal political agreement between the European Council and European Parliament setting the overall Horizon 2020 budget at €70.2bn,compared to the FP7 total budget of €55bn - adjusted for inflation).

Should the UK continue to secure its current share of around 15% throughout Horizon 2020, then it could attract an additional €1.3bn across the lifetime of the programme due to the increase, along with the wider-reaching long term economic and social benefits this funding brings.

Additional income for science funding filling gaps in national provision

The €9bn increase in research funding that will be made available through Horizon 2020 is likely to be particularly significant if national science budgets are frozen or decline. If the UK continues to be successful in attracting EU funding, it will represent an increase in science and research funding whilst the national science budget remains frozen.FP7 funding has the potential to fund projects which struggle to find funds from UK sources. The IDEAL consortium researches the role of early life environment on ageing with an international consortium of sixteen institutions across eight countries. Project Leader Professor Mark Hanson, Director of the Academic Unit of Human Development and Health at the University of Southampton, states that:"The consortium has allowed a large study which has an element of 'Blue Sky' speculative research… that would otherwise be unlikely to be supported by conventional UK funding streams… IDEAL makes possible the integration of diverse data sets and expertise in a manner that no single member state would be able to support. This strength is of critical importance if the health challenges of global importance are to be met."

Leveraging further funding from non-EU sources

The award of large grants also attracts further funding from other sources, such as matching funds. The 'Marie Curie Actions' leverage additional regional, national and international funds through the co-funding mechanism of individual fellowships such as COFUND. The total budget of 81 selected COFUND programmes amounts to €528 million, of which – according to the Horizon 2020 Impact Assessment Report - only €211 million is contributed by the EU.'

The benefits of international collaboration in research projects are profound and wide-ranging. They encourage excellence by bringing together the most outstanding researchers in the field, provide opportunities to share best practice across partner institutions, provide access to huge international datasets and tend to result in high publication and citation rates.

Bringing together world-leading expertise: In many cases, the broad range of expertise required for major interdisciplinary projects is simply not available within a single country The HSusBuild Project aimed at developing hydrogen storage for energy-efficient, self-sustaining zero-CO2-emission buildings, involved 18 industrial, academic and research institute partners from eight EU member states and Norway, including the University of St Andrews. According to an EC case study on the project, the objectives of H2SusBuild could only have been met at a European level due to the wide variety of knowledge and skills required. Furthermore, no single Member State could have come up with the necessary financial and personnel resources with the same level of scientific-technological excellence and engineering skills.

Tackling global challenges through global cooperation

For science research tackling global challenges such as health issues or climate change, international collaboration is essential. Access to large research infrastructures and large datasets, for example public health statistics, are one key advantage. The EARLYNUTRITION project involved 36 universities, research institutes and industry partners in studying the long-term effect of early nutrition on later health. Project Leader Professor Keith Godfrey (University of Southampton) explains: "EARLYNUTRITION, has provided a significant expansion in the scope of expertise, disciplines and unique resources/data sets available to the Southampton Team…. The ability to bring together international academic, commercial, clinical and NGO players under a common project is significant for addressing the key research issues and seeing our work translated into public benefit."

Generating global impact

International collaborative projects have a greater impact at a global level. The Royal Society in its 2011 report *'Knowledge, networks and nations: Global scientific collaboration in the 21st century'* states that citation rates tend to be significantly higher for papers published with multiple international authors compared to those with only domestic authors. A paper in Nature in May 2013 by Jonathan Adams used citation rates to calculate 'normalised citation impact': where 1.0 is the global average, it has been shown that in the UK, international collaborative papers have an impact of 1.72, compared with 1.21 for papers with only domestic authors. BIS reports that 46% of UK-authored papers in 2010 had at least one international co-author. The high level of international collaboration may be one important reason why, according to a BIS study in 2011 of the 'International Comparative Performance of the UK Research Base, the UK, which produces 6% of the world's articles, manages to earn 11% of global citations.

Facilitating researcher mobility and the exchange of ideas

Through providing funding for international research mobility, the Framework Programme facilitates the development of partnerships overseas, making a substantial contribution to the UK's ability to attract Europe's best talent to its labs, with all that this means for scientific excellence and productivity, and to the country's reputation as a preferred international partner. It also provides UK researchers with the opportunity to work abroad, enhancing careers and building networks for future joint projects. BIS reports that researchers who have spent time abroad tend to be significantly more productive in terms of articles published than those who have remained in the UK.

The Marie Curie Actions which provide funding for research mobility are one key instrument for achieving this. For example, the BIOPTRAIN project, which looked at ways to interpret the vast amounts genetic data generated by the decoding of genomes, seeking to unlock the information coded into DNA for use in clinical science, received €2.1m from the Marie Curie Actions. According to Project Coordinator, Professor Jon Garibaldi (University of Nottingham), the most important result was that it helped build a multidisciplinary knowledge base in the emerging bioinformatics field. "We brought together researchers from different backgrounds and perspectives and started to form a European approach to the problem, gaining new insights and spreading good practises," he says. "This is the new breed of scientist comfortable in different domains and with a new way of looking at problems that straddle different domains." In 2012, the UK was the most successful country for all Marie Curie Individual Fellowships and top or second country for all Marie Curie host schemes, receiving €207.56 million under this programme.

Supporting researchers early in their careers

Another important FP7 instrument is the European Research Council's Starting Grant, a 'fellowship' fund for early-career researchers which is a highly effective alternative to smaller and more fiercely competitive national schemes, allowing HEIs to retain a larger proportion of the most talented academic researchers. UK Research offices in Brussels report that the UK was the top country for the ERC's Starting and Advanced grants in 2012 receiving €244.42 million from this programme.

Fostering relationships between academic and business communities

Public investment in R&D encourages private investment. An important study in 1989 by Jaffe on *Universities and Regional Patterns of Commercial Innovation,* and another in 2002 in conjunction with Trajtenberg entitled *Patents, Citations, and Innovations: A Window on the Knowledge Economy,* has shown that a 10% increase in university research increases private R&D by 7%. BIS publications confirm that Framework Programme funding has "a positive impact on the nature and extent of collaboration between the UK academic and industrial communities and their counterparts abroad."

The University of Southampton's involvement in developing the RODIN – an open source software toolset which helps to prevent errors in safety critical systems in the automotive and aerospace domains - strengthened the institution's connections to industry, according to Professor Michael Butler: "The University's involvement has led to the international (academic and industrial) recognition of Southampton as one of the main centres supporting and promoting the Rodin technology, and the receipt of further funding from a UK company to adopt the technology for their purposes. The projects also led to the establishment of collaborations between the University of Southampton and companies in Brazil and India."

Large-scale, international projects enabled by the Framework Programme/ Horizon 2020 are an essential contribution to the creation of a world class European Research Area, which reduces the fragmentation of research infrastructure, allowing the region to compete with major economies such as the US and, increasingly, China.

Conclusions

European research funding is an area where the UK does particularly well and receives considerable funds from Brussels. Given that Framework Programme spending has increased and is likely to continue to do so over the course of the next funding programmes, whilst the UK's S&R budget is decreasing in real terms with inflation, the Framework Programme represents an increasingly important component of research funding in the UK.

Framework Programme funding also has had a significant impact on the economy and employment: the long-term impact of FP7 throughout the EU is estimated at 900,000 additional jobs and a growth in GDP of nearly 1%. The Horizon 2020 Impact Assessment Report calculates that, across all member states, every €1 of FP7 funding leads to an increase in industry added value (contribution to growth) of €13 on average.

The political agreement of Horizon 2020 indicates a trend of growing EU R&I funding, increased emphasis on connecting research and innovation, attempting to simplify and lower the administrative burden, and maintaining a focus on the very best research – not least through the growing budget of the European Research Council. Based on their track record, UK universities seem likely to not only retain but to grow their already sizeable level of European research funding.

In addition to the financial aspects, European research programmes contribute a myriad of benefits to UK institutions that are of considerable importance in maintaining the UK's competitiveness. By fostering international collaboration and researcher mobility, the Framework Programme provides benefits which differ from those provided by national sources of funding. It brings together leading academics to undertake world-class research, tackling global challenges on a larger scale than any single nation state could achieve. It addresses gaps in national funding for large-scale and blue sky projects, facilitates access to large datasets and facilities, enables the sharing of expertise and best-practice across institutions, provides opportunities for researchers to work abroad and advances the careers of those involved in its highly regarded projects. By doing so, it has become a vital part of the UK research landscape.

With research assistance by members of the H.E. International Unit

Facts and Figures

1. The European Research Council in the period 2007 to 2013 administered approximately 7.5 billion euros in grants. This represented close to 15% of the entire funding of the Framework Programme 7 (FP7) from 2009 to 2013 which amounted to 50.5 billion euros.
2. Associated and Candidate Countries participate on a par with the EU's 28 member states in Horizon 2020, the next Framework Programme. In the case of Switzerland, Norway, Turkey and Israel, and any candidates for future accession, their science and technology co-operation agreements involve contributing to the budget.
3. Third countries can participate in projects only alongside member states, candidate or associated countries, not as sole participants. Specific conditions apply to collaboration with third countries which include the USA, Russia, China, India, South Africa, Australia and Canada.
4. Application success rates are similar amongst EU member states, associated, candidate and third countries, but contributions to candidates and third countries are far lower. In 2007-2011, there were a similar number of successful applications from associated and third countries, yet third countries received approximately a fifth of the funding that flowed to associated countries:

FP7 participation figures by country types for 2007-2011

	Average success rates for applications	Applicants in retained proposals (counts)	Granted EC funding (€m)	Average EC contribution per grant holder (€000)
EU member states	22.0%	72,355	22,565	330
Associated countries	23.3%	5,816	2,105	380
Candidate countries	17.6%	1,321	202	160
Third countries	23.3%	5,756	448	120

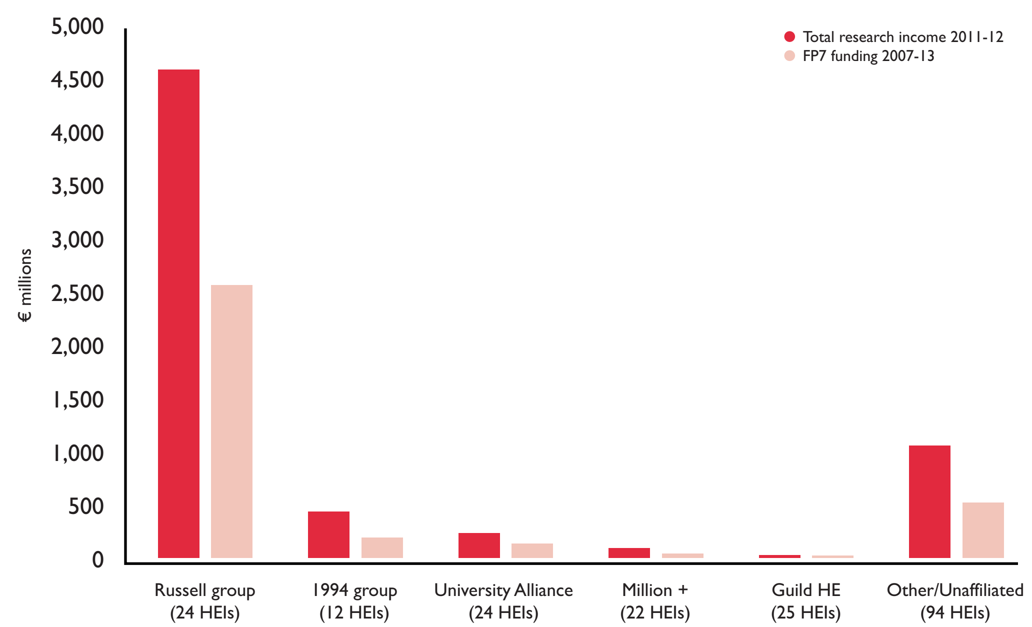
Source: European Commission: Fifth FP7 Monitoring Report (2011)

5. While Third and Associate countries have limited access to funding, they do not have any influence in shaping Framework Programme rules and budgets. This remains the prerogative of member states.
6. The Interim Evaluation of the Seventh Framework Programme shows that Cambridge and Oxford Universities, Imperial College, University College London and Edinburgh University all feature in the top 20 recipients of FP7 funding with sums ranging from 97.8 million euros to 59.3 million.
7. UK industry also benefits considerably. Businesses make up the majority of participating organisations, with 1,742 companies involved in FP7and representing 76.3% of total UK participant organisations.
8. UK Higher and Secondary Education Institutions perform particularly well compared their counterparts in other states. Amongst the 50 top HEIs, measured by number of participations, 14 are from the UK, including the three top institutions. However, this strong performance from the UK higher education sector must be

balanced against the fact that much research taking place in UK universities would be undertaken in non-teaching research institutes in other countries such as Germany and France.

9 Amongst UK Higher Education Institutions there is a high degree of correlation between the proportion of research income from all sources and funding received from the EU Research & Technological Development Framework Programmes. Russell Group institutions dominate the field, followed by 1994 group members. Note the following graph does not compare identical accounting periods, but merely illustrates the similar distribution of FP7 funding and that from other sources:

FP7 funding allocations (2007–2013) compared to research income from all sources (2011-12) by mission group



A 2010 EU study on the UK impact of the EU RTD Framework Programme confirms the correlation between institutions' Research Assessment Exercise 2008 scores and participation in FP6. Framework Programme funding reflects - even emphasises - the existing pattern of mission groups as the EU's Framework Programmes primarily support science, technology and medicine and Russell Group universities have a well-established infrastructure for cutting edge research in such subjects.

Common Foreign and Security Policy

Anthony Cary, CMG

Former UK Ambassador to Sweden and High Commissioner to Canada and former chef de cabinet to Chris Patten, European Commissioner for External Affairs

The most significant single foreign policy success of the EU over the past half century has been its stabilising influence on the continent, and not least on its own periphery as it has enlarged.

Anthony Cary

The Essential Issues

The EU remains weak – and often finds itself divided – as an international actor, despite the changes introduced in the Lisbon Treaty to develop the role of the High Representative and to create a European External Action Service. Though even the largest member states recognise that common EU external action can be the most effective way to advance their own interests, they have been reluctant fully to commit to a dimension of European policy that could so directly challenge national profile and prerogatives.

The UK, for its part, wants to see the CFSP prosper as an adjunct to national capacity, but only as one option among others. It emphatically does not want CFSP to cut across Britain's many other networks of influence or threaten its independence of action. HMG has therefore supported the latest institutional changes while joining with others to deny the material and political support that might enable the EU to pursue a more active and effective foreign policy.

The most significant single foreign policy success of the EU over the past half century has been its stabilising influence on the continent, and not least on its own periphery as it has enlarged. It helped democracy to take root in Spain, Greece and Portugal after their dictatorships and provided a focus for their economic modernisation. It gave the countries of Central and Eastern Europe a docking-point after the collapse of the USSR, and provided not just a blueprint but extensive programmes of support for their economic and political transformation. It has been hugely important to the modernisation of Turkey since 1963. It remains the single most important factor keeping a lid on further unrest in the Balkans, where hostilities are kept within bounds because countries are anxious not to jeopardise their EU membership aspirations.

In *The Sleepwalkers,* a recent history of how Europe went to war in 1914, Christopher Clark observes that while the jockeying nations "were aware that there was a possible outcome that would be generally catastrophic" their policy was to exploit that possibility as leverage in securing their separate objectives. Furthermore "the powerful supranational institutions that today provide a framework for defining tasks, mediating conflicts and identifying remedies were conspicuously absent." Tragically, the protagonists saw the pursuit of national interest as the sole and self-evident purpose of foreign policy. They had no sense of an overarching shared interest. The development of that shared interest, with structures to support it, might be said to be the real ambition of the EU. The steps already taken to that end have served to promote peace and prevent conflict – which is what won the EU the Nobel Peace prize in 2012. National approaches to the embryonic CFSP may still do a great deal either to strengthen or to undermine the fuller realisation of the goal.

The origins of a common European foreign policy

Foreign policy illustrates one essential difference between the USA and the European Union. In America, united action against a common external threat was what drove the (sub-national) colonies together and eventually achieved the birth of a nation. A common foreign policy was at the heart of the project from the beginning. The EU, by contrast, is composed of separate nations determined to maintain their independence of external action. After the failure of the European Defence Community in 1954, the European integration project was driven by economic rather than security or defence co-operation.

Political Cooperation, as foreign policy coordination was then called, was launched in 1970. The UK, joining the Community in 1973, was keen to capitalise on its own strength in this field and strongly supported the initiative. But for many years, and with some notable exceptions such as the negotiation of the Helsinki Final Act in 1975, the policy remained essentially declaratory. Member States would meet to discuss international developments.

After much deliberation they might issue a statement – as they did, for example, some months after the invasion of Afghanistan in 1979, to condemn the Soviet action – but they rarely aspired to common action.

The Maastricht Treaty

The determination to step up a gear was dictated in part by the rate at which Europe was developing along other axes – with the 1992 Single Market programme and plans to become a fully-fledged Union sharing a single currency. CFSP came into being in 1993 with the entry into force of the Maastricht Treaty.

But what really drove the project over the subsequent decade was the brutal exposure of European weakness in the Balkan crisis that followed the collapse of the Soviet Union. EC member states, and not least the UK, had wanted to help avert the unfolding tragedy. Finding themselves powerless as separate actors they had tried to operate together. The Luxembourg Foreign Minister (holding the rotating EC Presidency) grandiloquently announced "the hour of Europe" in 1991. But the Carrington-Cutileiro plan of March 1992 was never credible because the warring factions knew that the EC had no means to enforce its decisions. Where, they asked, was the US? The Vance-Owen peace plan of early 1993 carried a UN as well as an EC imprimatur, but got nowhere either, for much the same reason. Not until the US chose to engage was it possible to make real headway. Though the Dayton Accords echoed much that the Europeans had proposed, they were an American achievement. All this reinforced the EU's ambition to become a more credible international actor.

The version of CFSP created at Maastricht remained a 'common' policy primarily in name. It was bedevilled by institutional and legal difficulties, and four in particular.

1. The Council had a rotating Presidency. At the time of Maastricht this included the Foreign Minister representing the EU, who would change every six months to the bewilderment of foreign interlocutors.
2. The external representations of the EU were "Offices of the European Commission" answering only to the Commission and without responsibility for CFSP.
3. While it was the Council (i.e. the member states) that was responsible for CFSP, it was the Commission that had sole right of initiative in proposing and then implementing most of the instruments required to give effect to common external action. This inevitably generated friction. There was a similar lack of co-ordination with other European institutions. CFSP policies did not require the consent of the European Parliament and largely escaped the purview of the European Court of Justice. Yet the Parliament was coming to play a greater and greater role in the instruments of external action such as trade, development, energy, agriculture, fisheries, environmental policy and so on. The Court, too, helped to see fair play in the execution of foreign policy decisions. This institutional disconnect did not arise to the same extent in the Common Security and Defence Policy (CSDP) where the instruments for execution of policy lay with the member states themselves.
4. CFSP policy was determined by consensus in the Council of Ministers. Any single dissenter could block a decision. When member states disagreed, it followed that there could be no policy. The Maastricht Treaty tried to mitigate this problem by introducing the concept of "Common Strategies" to be agreed unanimously but within which decisions could be taken by majority vote. In practice, however, this failed to move things forward: the only Common Strategies that could be agreed were too vague and all-encompassing to permit of consequential decisions.

The Amsterdam and Lisbon Treaties

The Amsterdam Treaty, which came into force in 1999, tried to overcome the disconnect between Council and Commission by creating a High Representative for CFSP to assist the rotating Presidency in close co-ordination with the Commissioner for External Relations – operating "as lips and teeth", as Chris Patten put it. Yet despite the best efforts of Javier Solana (the former Secretary General of NATO who served as High Representative for the entire time that the post existed independently of the Commission) and of successive Commissioners for External Relations, CFSP remained underpowered. There were endless turf-wars and a simple lack of communication between the Commission, the Secretariat serving the Council of Ministers and the rotating Presidency.

The Lisbon Treaty of 2007 went further still to improve co-ordination by the bold expedient of combining the roles of High Representative and Commission Vice President for External Relations in a single figure (the 'HR/VP') who would also replace the rotating Presidency in external relations. To support this figure, it created an External Action Service (EEAS) staffed by Commission, Council Secretariat and diplomats seconded from Member States. The EEAS, with a headquarters staff in Brussels, inherited the network of Commission Offices which have now become full EU Delegations.

This was a genuinely innovative approach which shocked the institutional purists. It was deplored by those on the Council side who worried about Commission 'competence creep' into intergovernmental decision-making By the same token some on the Commission side feared encroachment by the Council: *"This is what we have decided in the Foreign Affairs Council"* the new HR/VP might say in Commission. *"I am now here to instruct my fellow Commissioners about the consequent action required in the fields of trade, development, agriculture, energy, transport…"* Given the steady drift towards inter-governmentalism in the EU over the past 20 years, with a strengthened Council and a correspondingly weakened Commission, the Commission perhaps had more reason to be concerned.

Achievements and deficiencies of CFSP within the new architecture

The first HR/VP, Baroness Ashton, has had some notable successes. The landmark deal between Serbia and Kosovo in April 2013 was the culmination of a long EU-mediated dialogue, and reflected how much the EU's role in this region has grown since the humiliations of the 1990s. The EU has been at the forefront of the Balkan reconstruction effort since 1999, and is by far the largest single donor in the region. The success also reflected the stabilising influence of membership aspirations, especially for Serbia. Within days of the agreement the Commission recommended to member states that negotiations be opened with Serbia on EU accession, and with Kosovo on a Stabilisation and Association Agreement.

Burma is another success. After the concerted and sustained application of economic sanctions, the EU has begun a calibrated readjustment of its policy with the objective of strengthening the reform process. The visit of President U Thein Sein to Brussels early in 2013 suggests that this policy is bearing fruit.

Many other instances might be cited. The EU can be justly proud of its contribution to the Atalanta naval operation to contain piracy off the coast of Somalia, for example, and of its more recent supporting role following the French initiative in Mali.

The truth, however, is that CFSP remains somewhat anaemic. As a senior official from the Commission commented in evidence to the House of Lords in December 2012, "The EEAS is still far from what was imagined around 10 years ago when such a service was first mooted. While HR/VP may formally conduct the Union's CFSP….Baroness Ashton and the EEAS are nowhere close to actually driving the EU's foreign policy towards a stronger global role."

That partly reflects inevitable teething troubles in establishing the new machinery. It is taking time to weld Commission officials, seconded national diplomats and Council Secretariat staff into one seamless organisation. The problem is exacerbated by the fact that the central role of many EU Delegations abroad is to manage large and complex programmes (often of development aid) which remain the responsibility of the Commission. Few seconded national diplomats or Council Secretariat staff are trained for such work.

But the under-performance of the EEAS so far also reflects a (perhaps unconscious) choice by the member states, especially by the larger ones, including Britain, that have serious national foreign policy capacity and pretensions.

- First, it should be noted that there was no attempt in the Lisbon Treaty to overcome the consensus requirement in CFSP which remains a serious European weakness. The EU had no position throughout the Iraq conflict, for example, nor on Libya in 2011 – though in both cases it was involved at the margin, especially in work to relieve the humanitarian consequences of the crises.
- In Baroness Ashton the Member States picked a relative unknown as the first HP/VP rather than an established international figure who might develop a serious public profile and challenge national prerogatives. It is no criticism of Baroness Ashton's achievements that the HR/VP is still what has been called a "High Representative for the Lowest Common Denominator" with absurd demands upon her time and no deputies to stand in for her.
- Member states have starved the EEAS of funds; even now, in mid-2013, the new service is not fully operational. Figure 1 in the annex illustrates the state of play, while figure 2 shows the relative scale of European and national diplomatic efforts.
- Equally, the larger member states are reluctant to invest political capital in CFSP. British embassies abroad co-operate politely with EU posts – drawing a careful line, however, at joint work in the consular area or on visa issues where HMG is vigilant in guarding against 'competence creep' by the Commission. Like other large states, the UK is jealous of its own networks of influence – as a member of the UN Security Council, for example; as a nuclear power; and as a member state with considerable diplomatic assets of its own.
- The FCO has not really factored the EEAS into its manpower planning, though the German Foreign Ministry has said that it expects one third of new recruits to spend at least part of their career on secondment to EEAS. HMG sees the EU as a useful additional foreign policy resource in some fields of endeavour rather than as reason to re-frame its approach. Foreign policy is still conceived essentially in terms of British interests, for which the UK hopes to secure support from partners whenever possible, rather than the pursuit of a wider common good. Yet – paradoxically – the conscious promotion of a wider interest, and the political articulation of that wider interest in public dialogue, would be in Britain's own interest.

Winston Churchill commented in 1930 in an article in the Saturday Evening Post on *"The United States of Europe"* that as international structures became more complex, overlapping loyalties would become not just possible but necessary. 'From every man,' Churchill suggested, 'will someday be required not the merging or discarding of various loyalties, but their simultaneous reconciliation in a complete or larger synthesis.' Britain has attempted no such reconciliation. It is less interested in developing CFSP as an expression of Europe's international personality than in deciding on a case by case basis where and when national interests might be served by working through the EU - or around it.

Options

CFSP could be strengthened by:

- appointing a high-profile political figure to the post of HR/VP and providing more support for that office, including deputies;
- increasing the powers and responsibilities of HR/VP. In the Council, HR/VP might be given more authority to force decisions within parameters unanimously agreed by the member states. In the Commission, HR/VP might be given more power to coordinate the work of other Commissioners with responsibility for aspects of external action. There also needs to be a stronger internal coordination structure (equivalent to the UK Cabinet Office) to reconcile conflicting policies;
- more generous funding of CFSP, accepting that over time this would require comparable cuts in funding for national foreign affairs activities, since it is unlikely that national Treasuries would accept an overall growth in the resources devoted to foreign policy. Less resort, too, to ad hoc funding of CFSP initiatives, developing in its place a stronger framework for common funding, with appropriate supervision;
- clarification and codification regarding the appointment of 'EU Special Representatives' covering, for example, their appointment, their powers, their relationship to other EU and member state actors, and the support given to their work;
- agreement that the EEAS should play a stronger co-ordinating role between member state missions in third countries, presenting a more unified EU public profile. Over time, consular and visa operations overseas might also be streamlined;
- more examples of member states choosing to be represented through EU Delegations. This would represent a saving where member states could thereby cut back or even close their own separate missions in some parts of the world. Some member states might make the choice for political as well as economic reasons. In many parts of the world the EU Delegation has better political access and more clout than all but the largest member states;
- EU representation in international organisations – such as the Security Council, to take the most sensitive example – in place of separate national ones.

Not all of these options are desirable or even practicable, at least in the short term. Member States are competitors (e.g. for trade and investment) as well as partners. But over time it is in Britain's national interest that CFSP should gain in strength and credibility.

CFSP is not conducted, like most European policy, with strict neutrality between the member states. On the contrary, it is often the case that the large member states take a lead because of their greater military and diplomatic capacity. As a large member state with a big international profile (including its membership of the Security Council) Britain has disproportionate influence in CFSP. On Iran, for example, European policy is driven by Britain, France and Germany in the so-called "EU3+3" framework. Baroness Ashton is working as much as the servant of three member states as the embodiment of a European consensus policy. In Mali, the EU established its military training mission in the wake of a French national operation in which the EU as such had no say. Rather than stifling national potential CFSP often serves to promote it, especially through supporting action using European programmes and resources.

Take the decision of 27 May 2013 to threaten an end to the EU arms embargo against Syria. In a typical expression of British disdain, Con Coughlan wrote in the Daily Telegraph that "Yesterday's tortuous summit in Brussels of EU foreign ministers was yet another classic example of Europe's institutional inability to reach consensus on vital issues of global security", threatening to make the EU "an international laughing stock". This was doubly ironic. First, insofar as such indecision is 'institutional' this mainly reflects the consensus requirement of which the Daily Telegraph is one of the fiercest defenders. Second, the Syrian decision was an example of big member states (in this case Britain and France) driving the whole Union to adopt a policy against the better judgement of several member states. In this case European foreign policy served to amplify British influence, first through the EU arms embargo (which Britain could not have negotiated alone) and then through the threat to lift it.

Conclusion

For all its successes – which are not insignificant – CFSP still under-performs. It can be at once an embarrassment to the EU and a source of weakness, especially when it serves mainly to advertise European differences, encouraging others to divide and rule. Russia and China have both done that with considerable success over the years. What policy conclusion should Britain draw from this under-performance?

Some would see it as one argument among many for British withdrawal from the EU. Yet, as the US has repeatedly made clear, Britain would be seriously diminished as an international actor if it took that course. Lack of involvement in the EU's external policies and international agreements would further reduce Britain's (and the EU's) influence in a world of rising powers such as China, India and Brazil, where size counts. Britain would lose influence over the terms of its European trade. Above all, it would have chosen to break with what is overwhelmingly the most significant European political and economic institution, which also exerts real influence internationally through trade policy, standard-setting, and so on. For the first time in centuries, the UK would have abandoned the aspiration to be a leading European power.

If the weakness of CFSP is not an argument for withdrawal from the EU, might it be an argument for clawing back powers from Brussels, restoring autonomy in foreign policy? This, too, is hard to sustain, since no substantive powers have been ceded in the area of CFSP.

The present British policy, rather, is that European weakness in external affairs reinforces the case for prioritising national policy, piggy-backing on CFSP only where this happens to serve Britain's immediate interests in a given case.

The national interest would be better served by seeking to engage in CFSP with more enthusiasm and imagination, trying to rise above a mechanical and mercenary computation of national interest in favour of a more strategic conception of Britain's long-term interest in playing a leading role within an EU that carries more international weight. We should be making fuller use of CFSP, exploiting the fact that Britain plays a particularly influential role within the system.

Facts and Figures

The EEAS and the High Representative have a network of over 140 Delegations and Offices – European embassies - around the world responsible for promoting and protecting Europe's interests. The role of the EU's CFSP is to preserve peace and strengthen international security; to promote international cooperation; and to develop and consolidate democracy, the rule of law and respect for human rights and fundamental freedoms. The CFSP is based on diplomacy – backed where necessary by trade, aid, security and defence – to resolve conflicts and bring about international understanding.

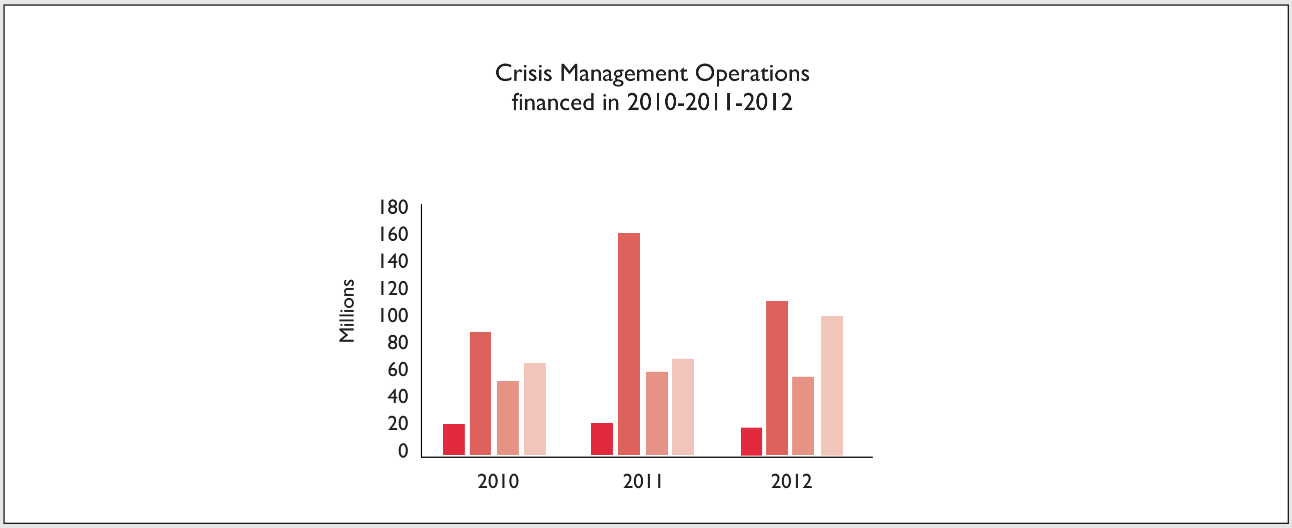
The EEAS coordinates a range of instruments with considerable budgetary resources to pursue its policies. The instrument for nuclear safety cooperation (INSC) has a budget of half a billion euros for the next seven years; another for promoting democracy and human rights (EIDHR) has a budget of well over a billion euros, complementing the Instrument for Stability (IfS with over 2 billion euros), the Development Co-operation Instrument (DCI) and the European Neighbourhood and Partnership Instrument (ENPI), both with smaller budgets. It can also call on the Industrial Countries Instrument (ICI) with approx. 170 million euros; the Instrument for Pre-Accession Assistance (IPA) with approx. 11.5 billion euros covering Iceland, Montenegro, FYROM, Serbia and Turkey; the Instrument for Humanitarian Aid, delivered in part by the EC Humanitarian Office (ECHO) and in part by the Commission; the Development Co-operation Instrument (DCI) with approx 10 billion earmarked for 47 partner countries in the developing world, a further 5.5 billion euros for food security, migration and asylum issues, environment problems, etc. and another 1.2 billion for the 18 African, Caribbean and Pacific countries of the sugar protocol. In addition the EEAS can help coordinate EC guarantees for lending operations which had an allocation of 1.75 billion euros for the past seven years and a fund for Macro-Financial Assistance (MFA) to support third countries with balance of payments problems, similar to the IMF reform programme. This has been called on to assist Georgia, the Kyrgyz Republic, Egypt, Kosovo, Armenia, Moldova, Serbia, Ukraine and Bosnia Herzegovina with grants of approx. 100 million euros each year and loans of c. 125 million in 2011 and c. 750 million in 2012.

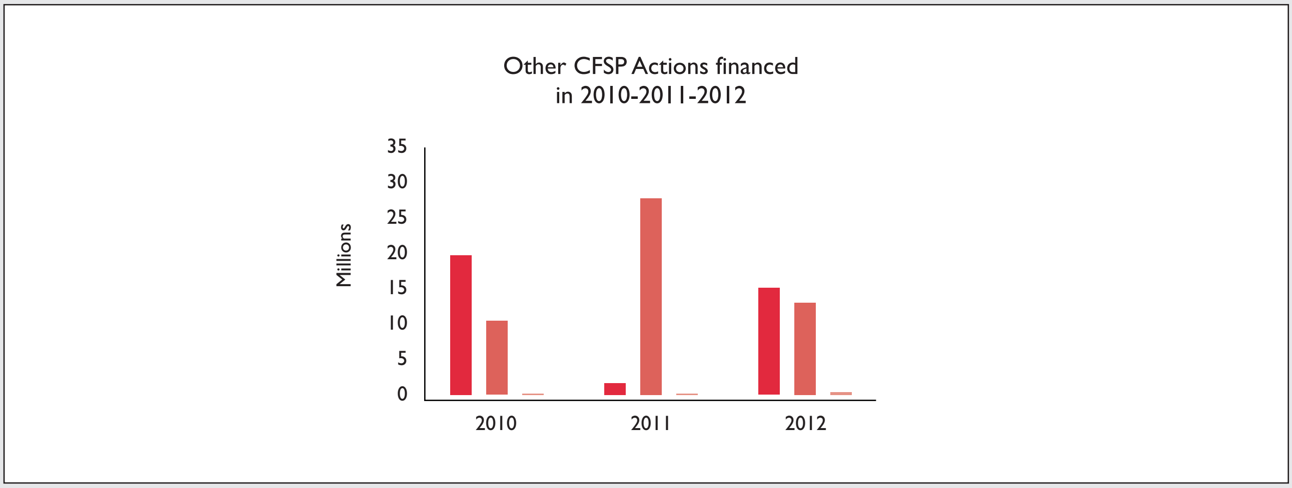
The EU has no standing army. It relies on ad hoc forces contributed by EU countries for joint disarmament operations, humanitarian and rescue tasks, military advice and assistance, conflict prevention, peace-keeping, peace-making and post-conflict stabilisation.

CFSP crisis interventions, both civilian and military, attract most public attention. Over the last decade, the EU has launched 23 civilian missions and military operations on 3 continents in response to crises – post-tsunami peace building in Aceh, protecting refugees in Chad, fighting piracy off Somalia and the Horn of Africa. The EU's role as a security player is expanding.

Since January 2007, the EU has been able to undertake rapid-response operations with two concurrent 1500-strong battle groups. Deployment decisions are taken by national ministers from EU countries meeting in the Council. The EU has sent peace-keeping missions to several of the world's trouble spots, including the Western Balkans where it is funding assistance projects in seven countries.

The following charts show the distribution of costs for civilian crisis management in 2010, 2011 and 2012, by operation and by theme (non-proliferation, Special Representatives, etc.) followed by the common costs of the four military operations in the same period.





Common costs cover an agreed list of standard support costs but exclude the cost of military personnel and directly associated costs. Source: Yearbook of European Security 2013.

Operation	Amount of common cost (m EUR)	Regions
EUFOR Althea	71,700,000	Wider Europe
EU Atlanta	8,300,000	Africa
EUTM Somalia	4,800,000	Africa
EUTM Mali	12,300,000	Africa

Security and Defence Co-operation

Professor Jolyon Howorth

Visiting Professor of Political Science and International Affairs, Yale University and Jean Monnet Professor of European Politics, the University of Bath

The United Kingdom has been an active participant in the majority of the almost thirty overseas missions launched under the CSDP badge since 2003.

Jolyon Howorth

In at the beginning

The United Kingdom played a crucial role in the launch of what has become known as the European Union's Common Security and Defence Policy (CSDP). After fifty years of refusing to entertain any direct EU involvement in European security and defence policy, Prime Minister Tony Blair signed the Saint-Malo Declaration with France's President Jacques Chirac in December 1998, asserting that the EU "must have the capacity for autonomous action, backed up by credible military forces, the means to decide to use them, and a readiness to do so, in order to respond to international crises".

Many of the initial policy papers submitted to early meetings of EU foreign ministers were drafted in Whitehall. Their drafts formed the basis of declarations by the Heads of State and Government in the European Council. It was the UK, with assistance from the US, which negotiated the important arrangements with Turkey (known as "Berlin Plus") which allowed the EU access to NATO assets in order to embark on overseas military missions with which the US did not wish to be involved. The current CSDP mission EUFOR-Althea which began in 2004 as a follow-on mission to NATO's Stabilisation Force (SFOR) in Bosnia-Herzegovina, was an important example of this mechanism. Without the impetus and inputs of the UK, the EU's CSDP would probably never have come to fruition – at least not in the form which it has now assumed.

The precise reasons for this apparent reversal of traditional UK thinking are still shrouded in controversy. The UK does not have a single, consensual approach to security and defence policy, still less a clear strategic vision. Most innovations in security policy are hotly contested from various quarters. Nevertheless, most serious analysts agree that there were two key drivers behind the CSDP narrative.

Washington, London, Paris

The first was pressure from the United States for Europe to begin to stand on its own two security feet. This became intense during the crises in the Balkans in the 1990s. Most European member states of NATO had long been free-riding. It was urgent for the Europeans to generate usable military capacity. Among those leaders (including Tony Blair) who wished the EU to become a consequential actor, there was a widely shared assumption at the turn of the century that EU member states would be more likely to improve their military capacity through a European mechanism than through NATO.

The second reason for the UK's support for CSDP was the growing recognition in both London and Paris that the agency initially selected to deliver that robust EU security capacity – the Western European Union (WEU) – possessed neither the political clout nor the military wherewithal to accomplish the task. At the same time, the initial reverberations from the ending of the Cold War – the proliferation of failed states, the return of military conflict to the greater European area and to the Middle East, the multiplication of civil wars, the growing threat of trans-national terrorism and criminality – made it quite clear that the much-discussed prospects of "peace dividends" and the "end of history" were illusory. If the European Union, now empowered as a global player through the Single European Act and seemingly consolidated through the Single Currency, was to become a consequential actor on the turbulent global stage, it could not avoid the challenge of equipping itself with a modicum of hard power. In addition to possessing its own intrinsic value, this also constituted the necessary underpinning for the effective delivery of soft power.

Such a project resonated perfectly with the extrovert approach to foreign and security policy which had traditionally been that of the UK. France shared this approach to international relations. These considerations, which initially drove CSDP, have not gone away in 2013. Indeed, the case for some type of autonomous European military capacity (or, more accurately civilian-military) has become even more compelling than it was in 1998 when CSDP was launched. This poses a conundrum for the UK's ongoing relations with the European Union.

From active missions to 'malign neglect'

The United Kingdom has been an active participant in the majority of the almost thirty overseas missions launched under the CSDP badge since 2003. It has provided crucial leadership for the most significant military missions (Althea in Bosnia-Herzegovina and the on-going anti-piracy mission Atalanta in the Gulf of Aden) and it has been involved in most of the quintessentially "civilian" missions. The UK also took a leading role in the establishment of the European Defence Agency, providing its first chief executive, Nick Witney. It was the UK which persuaded its EU partners to develop Battle Groups as the optimum size units for effective deployment under CSDP crisis management missions. It was under the UK's presidency of the EU in late 2005 that a record number of CSDP missions – seven – were launched. The UK was also, initially, the principal cheerleader for CSDP in Washington, being reasonably effective in reassuring the Americans that the European project was entirely compatible with the interests of the Atlantic Alliance.

However, the UK's attitude has also been marked by ambivalence, bringing with it a serious down-side to the UK's role in CSDP. The operational requirements of the UK's participation in both the (US-led) Afghanistan and Iraq operations throughout the greater part of the 2000s resulted in a reduced British participation in CSDP missions in the second half of the decade. Moreover, the very public polemics between Tony Blair and Jacques Chirac at the height of the crisis over Iraq in spring 2003 appeared to call into question the solidity of the European security project. In particular, the proposal, formulated by France, Germany, Belgium and Luxembourg at the controversial "chocolate summit" held in April 2003, to create an EU Operational Headquarters (OHQ) separate from NATO's Supreme Headquarters Allied Power in Europe (SHAPE) gave rise to vociferous opposition from London.

The UK formally denounced this proposal as an unnecessary duplication of precious defence resources, although there is little doubt that an equally serious (but unstated) British concern was that such a venture would lead to a much greater degree of integration of the EU's security capacity than London would feel comfortable with. Proposals for an EU OHQ have been regularly put forward by various European leaders, to the point that the US's opposition has now mutated into a simply agnostic view. The UK, alone, has remained utterly opposed. Since the election of the conservative-led government in 2010, London has appeared to attach less and less importance to CSDP, in part as a result of the UK's growing frustration with the perceived lack of seriousness of purpose about defence on the part of many EU member states. The UK has consciously refused to allow CSDP to develop to its fullest capacity. The first Defence Secretary in David Cameron's government, Liam Fox, was unambiguously hostile to CSDP, openly inviting it to a future of "malign neglect".

Over-expectations and underestimates

While London has not begun to have serious second thoughts about the overall necessity for some common EU approach to security and defence, CSDP itself has recently become subject to a number of probing questions about its profile, its trajectory and even its viability. Prior to the Lisbon Treaty, researchers analysing CSDP tended to take it very seriously. Most European analysts, while warning against excessive optimism, concluded that CSDP was a dynamic and significant new policy area, even possessing the potential to drive forward European integration more generally. American neo-realist analysts, for their part, went so far as to interpret CSDP as a form of strategic "balancing" against the Unites States. The Lisbon Treaty, ratified in 2009, initially fuelled this upbeat analysis since, of its 62 amendments to the previous Treaties, 25 concerned the EU's Common Foreign and Security Policy (CFSP) and CSDP. Lisbon, it was widely expected, would give considerable new impetus to CSDP. This simply did not happen.

Since 2010, an analytical re-assessment has set in, offering a starker, more sober interpretation and asking tougher questions about the coherence, ambition and overall direction of the EU as a global actor. This re-assessment is based on a lucid analysis of the inherent weaknesses of the CSDP dimensions of the Treaty; on the "mission fatigue" which precluded any new CSDP operations between 2008 and 2012; on the continuing failure of the member states to deliver much in the way of deployable military and civilian assets; and on the global and European contexts of financial crisis and retrenchment in military spending. This reassessment is also taking place in the context of a lively academic debate about the nature and likely outcome of the current power transition affecting the major global players.

Meanwhile, a significant new development posed further questions about the viability of a European defence project "at 27". In November 2010, France and the United Kingdom concluded a Treaty on Defence and Security Co-operation. This underscored recognition in both London and Paris that these two would-be global players and permanent members of the UN Security Council could only continue to aspire to global player status if they combined their military efforts in a number of highly strategic sectors, These included aircraft-carriers, transport aircraft, nuclear submarines, military satellite technology, UAVs, expeditionary forces, and eventually combat systems.

The fundamental question sparked by this development for experts and commentators was: would this Franco-British co-operation act as a complement to CSDP or as an alternative? Would those member states less keen to play a military role (either through CSDP or through NATO) see this as an incentive to continue to free ride, or would they be inspired to emulate the Franco-British lead? France and the UK together account for almost 50% of the collective EU defence spending of the (now) 28 member states. What exactly is to be the contribution of the remaining 50%, coming from the 26 other states? The Libyan crisis in spring 2011 appeared to offer some sort of answer.

Libya: CSDP or NATO?

Libya was a major turning point in the CSDP narrative. Exactly twenty years after the Balkans erupted – when Europe proved, like Frances Cornford's Young Apollo, to be "magnificently unprepared," – the EU confronted a new crisis in Libya, precisely the type of regional crisis management challenge the CSDP had been designed to address. It was a medium-scale mission in the immediate neighbourhood and militarily not overly challenging. Furthermore, it was a mission involving military and civilian components (the "comprehensive approach" which is at the heart of the EU's security identity), a mission the United States did not (at least initially) want to be involved in, and one which key EU member states, on the other hand, were pressing very hard to take on. It checked all the boxes for the ideal CSDP mission.

Yet CSDP as a potential agent or actor in the crisis was nowhere to be seen. In the early days of the crisis, European statesmen reacted just as they had twenty years earlier: with overwhelmingly national responses. Italy, Greece and Malta initially refused to endorse sanctions against Libya, since their historic trade partner Muammar Gaddafi not only sat upon billions of their investments (and vice versa), but had also helped suppress the migrant flow from North Africa. In the most serious crisis on the EU's borders since the birth of CSDP, the European Union proved totally incapable of action.

A clear majority of EU member states did not want to touch Libya with a barge pole, let alone a fighter plane. They were strongly supported by the EU High.-Representative for Foreign Affairs and Security Policy, Catherine Ashton, who has seldom paid appropriate attention to CSDP and who went to extraordinary lengths, at the European Council meeting of 11 March 2011, even to prevent discussion of a potential no-fly-zone, though it was backed by both the UK and France. The Libyan mission, authorised by the UN on 17 March, became, almost by default, essentially a Franco-British operation within a NATO framework.

Those two countries alone conducted 50% of the air strikes. They enjoyed crucial and indispensable US support (despite the official Obama mantra of "leading from behind") and benefited from air power inputs from EU member states Italy, Spain, the Netherlands, Sweden, Belgium, Denmark and Greece. In addition, Romania and Bulgaria deployed one (token) naval vessel each to help impose the UN-decreed arms embargo. Thus only nine EU member states (out of twenty-seven) took part in the central air operation to impose a No-Fly-Zone and five of those (Italy, Spain, Netherlands, Greece and Sweden) initially imposed caveats which excluded their planes from attacking ground targets.

The mission was technically "badged" by NATO as Operation Unified Protector, and eventually fourteen of NATO's twenty-eight member states (exactly 50%) participated in some form. Thus, as many as sixteen EU member states and fourteen NATO member states opted to sit on the side-lines. If a clear majority of EU member states (including major ones such as Germany and Poland) do not consider Libya a fit subject for discussion as a possible CSDP mission, then what exactly is CSDP for? CSDP seemed to have declared itself to be irrelevant and to have handed back the responsibility for greater-European security to NATO.

Following a period of apparent somnolence between 2009 and 2012, CSDP has nevertheless begun once again to show signs of life. It boasts the "Ghent Framework," eleven major initiatives developed by the European Defence Agency (EDA), and the planned European Council on Defence in December 2013. Additionally, there are the European Commission's Defence Industry and Markets Task Force, the proposals from the "Future of Europe" group, the European Global Strategy initiative, "clusters" of regionally-based member states cooperating on "pooling and sharing," much talk of a European White Paper on security and defence, and three new CSDP missions launched in 2012. All of this is encouraging, but it is missing the real question: where is CSDP actually heading?

The EU's security conundrum

The EU's most crucial challenge is to find the right balance between hard and soft power, between civilian and military approaches to conflict resolution and crisis management. This poses the key question: what sort of role should military instruments play in the toolbox of EU power resources? The answer to that question can only become apparent with the resolution of the concurrent issue of the on-going and future relations between CSDP and NATO, of which more below. This conundrum lies at the heart of the UK's complex relationship with European security and defence.

In this new and somewhat unsettling context, the decision taken by UK Prime Minister David Cameron to attempt to renegotiate Britain's role in the EU cannot but have potentially serious implications for the UK's ongoing role in CSDP. Whether or not the UK, by accident or design, finds itself leaving the formal structures of the EU, the defence and security conundrum facing the Union will remain exactly the same. That conundrum involves three main elements.

The first is that the EU, contrary to the assumptions of the many advocates of "normative power Europe", does not exist in a conflict-free zone of post-modern multilateralism. There is no paucity of potential crises on the periphery of the EU, from the Arctic to the Baltic and on to the Black Sea, from the Caucasus to the Bosporus and all the way via the Northern third of Africa to the Atlantic Ocean. Frozen, potential or actual conflicts plague that entire borderland. This is not a security situation from which the EU can afford to avert its gaze.

The second element in the conundrum is the relative disengagement of the US from its traditional responsibility for underpinning European security. Three recent developments illustrate this uncomfortable (for Europeans) truth.

a NATO's Libyan mission Operation Unified Protector introduced the concept of the United States "leading from behind." This was technically a misnomer. The NATO mission benefited from massive US military inputs. But the Obama administration's insistence that Europeans should at least be perceived to be "taking the lead" in Libya represented a paradigm shift in both political and symbolic ways. The US signalled that, henceforth, it was prepared to transfer responsibility in the European theatre to the Europeans.
b Defence Secretary Robert Gates' June 2011 valedictory speech in Brussels, effectively warned the Europeans of a "dim and dismal future" for NATO if the free-riding and burden-sharing imbalances in the Alliance continued. He cautioned darkly that the new generation of US politicians, who had not come of age during the Cold War, would cease to feel that the US investment in European security via NATO was worthwhile.
c The US Defence Department's January 2012 Strategic Guidance paper announced the US "tilt" or "rebalancing" to Asia. All three developments reflect strategic priorities in Washington as well as the financial and budgetary constraints limiting US global strategy. The bottom line is that there is a very clear time-limit on the willingness of Americans to continue to supply global public goods to European allies who are both wealthier and more numerous than they are, who face no existential threat, and who appear to be doing all too little to contribute to their own regional stability.

The third feature of the conundrum is that the EU is neither a nation-state nor a federal system, and does not enjoy central political authority or recognised leadership. It is, by any objective measure, extremely difficult for the Union to devise an effective way of maximising the collective impact of its – still very considerable – defence expenditure and planning. CSDP has succeeded in taking the member states a long way down the road of joint decision-making in security and defence, joint procurement objectives, pooling and sharing of scarce resources, specialisation and niche capacity. But it still has a very long way to go before it can begin to approximate a credible security actor even in its own near-abroad. In this context, the impact of a new and different relationship between the UK and the EU would have a number of serious implications.

Europe without the UK?

Experts are often asked: could the EU develop a robust security and defence capacity without the UK? The answer comes in two parts. The first is that CSDP without the UK would be a pale shadow of what it might be if the UK were fully involved. The second is that, because the European defence and security project arises out of the movement of history's tectonic plates, CSDP would have no alternative but to continue to develop, even without the UK. By the same token, the UK, because it is a significant defence player geographically situated in Europe, would have no alternative but to continue to have some sort of relationship with CSDP. This might involve the negotiation of a special status for the UK (similar to that of Turkey perhaps) within the European security project. But whatever the precise nature of such an arrangement, the UK would clearly henceforth wield significantly less clout in CSDP than it has to date. There would be a serious cost to pay in terms of the UK's influence over this crucial policy area.

Despite this cost, some in the UK may nevertheless welcome their country's adoption of a more arms-length relationship with CSDP. They might be tempted to think that Britain, once "outside" the integrated structures of the EU, would be in a good position to prioritise and leverage its bilateral relationship with both the US and France. This would be an illusion.

The US has consistently pressured the UK to become a full and active participant in all EU policy areas, including defence and security. That was one fundamental reason why Tony Blair went to Saint-Malo. If the UK found itself outside the EU, what could it offer the US in terms of security and defence? Apart from a traditional role in NATO (but see below for an assessment of NATO's likely trajectory post-Afghanistan), which would in any case become more complicated in the hypothesis of a British stand-off with CSDP, the UK might be tempted to respond to various recent American invitations to EU member states to accompany the US in its "tilt to Asia". But with the current draconian cuts in the UK's defence budget, it would make no sense whatsoever for Britain to relocate its strategic profile to the Asia-Pacific region. Nor would there be any reason for the US to welcome such a shift.

Seen from Washington, the UK's contribution to collective security only makes sense if centred on Europe. Furthermore, if the UK were to emerge as a kind of "large Switzerland/Singapore" off the coast of mainland Europe, America's strategic interest in such an actor would wane significantly. Such a country would hardly be subjected to any external threats. Therefore, the US would feel a lesser obligation than hitherto to contribute in any significant way to the UK's "defence". On the other hand, the evolving EU with its CSDP project would continue to feature as the US's primary strategic partner in the greater European theatre, even if US interest in European security might decline in the context of Washington's other global priorities. It is difficult to imagine how the US would interpret a hypothetical "Brexit" in any way other than very negatively.

The same would be true of any hypothetical "post-Brexit" UK special defence relationship with France. The 2010 Franco-British Defence Treaty has already begun to demonstrate its fragilities. The unilateral, cost-driven UK decision to opt for vertical take-off F-35B aircraft to equip its sole remaining aircraft carrier means that French Rafale aircraft will not be able to land on the British vessel, thus severely undermining the two countries' plan to have an integrated carrier capability. François Hollande has proven less interested in a privileged security relationship with the UK than his predecessor Nicolas Sarkozy. But above all, France will continue, as it has throughout, to give pride of place to the development of a viable EU security and defence capability. The absence of the UK will undoubtedly lead to ever closer security and defence co-operation between France and Germany (however fraught with problems programmatically and strategically), and, beyond that, with the Weimar group (France, Germany and Poland) supplemented by Italy and Spain. It would be very difficult for France to find a justification for establishing a privileged partnership with a "post-Brexit" UK which looked fixedly across the Atlantic rather than across the Channel. Britain, in short, would have lost its main security anchor and failed to find any acceptable alternative. This would be all the more serious for London in that NATO, post-Afghanistan, is likely to become a very different type of actor.

After Afghanistan

There are only two post-Afghanistan options for NATO. One, the long-time American preference, is for NATO to become a "global alliance." In 1993, U.S. Senator Richard Lugar, a primary exponent of this option, coined the expression "out of area or out of business." Yet, throughout the 1990s, the American agenda for a Global Alliance, never found favour with Europeans and has probably been administered the coup de grâce by the experience of Afghanistan, which, however strong the official spin may be, is almost certain to be judged by history as a military and political failure. NATO's Chicago summit in May 2012 formally kept all strategic options on the table, but on-going questions about the real nature and purpose of the Alliance are unlikely to be resolved any time soon. NATO needs a radical re-think. This is likely to prove highly uncomfortable for the UK.

Assuming, as seems reasonable, that NATO will elect not to "go out of business," the most likely future for the Alliance is to be re-designated as a mechanism for guaranteeing regional stability in the European area and its neighbourhood. Collective security will complement collective defence. This will require a new and constructive relationship between NATO and CSDP. This has now become the clear preference of France. The Report issued by former French foreign minister Hubert Védrine on 14 November 2012 makes it clear that France, henceforth, will devote major energies to what Védrine calls "Europeanising the Alliance." In one sense, this might well offer the UK some traction, but it would come at the price of recognising France as the leading European player in the Alliance, a player with a very clear idea about how to resolve the ongoing tensions between NATO and CSDP.

If the UK were to find itself outside the formal structures of the European Union, its central role in the development of an effective and robust security and defence policy, both via NATO and via CSDP would be massively diminished. It is highly likely that the necessary recalibration of the relationship between CSDP and NATO would take place with Paris, Berlin and Washington as active players and the UK as an increasingly bemused onlooker. It would be a sad prospect indeed for the country which has always prided itself on being the foremost military player in Europe and the guardian of the transatlantic relationship.

Facts and Figures

Military expenditure

Overall military expenditure by EU member states is approx. 200 billion $ p.a. (194 billion $ in 2010).

The largest spenders each year are the UK and France, each close to 60 billion $, followed by Germany, Italy and Spain. The average spend per member state is 1.6% of GDP, with the UK spending more than any other. (2.56% of UK 2010 GDP). For comparison, the USA spends 4.8% of GDP.

Only 8 member states spend more than the 1.61% EU average: UK, France, Poland, Greece, Bulgaria, Slovenia, Cyprus and Estonia. Lack of standardisation for land, sea and air forces implies, however, that EU states' expenditure is not as cost effective as it could be.

Military capacity

EU states' active forces are larger than either the USA or Russia and second only to China. They total close to 5.350,000 potentially under arms, 1.700,000 active, 2.850,000 in reserve and a further 800,000 paramilitary.

Only the UK and France are nuclear powers in the EU. Together they make up 50% of the military capacity of all EU states, and spend 70% of total EU states' military research and development.

EU states fly approx 1,880 combat aircraft and a further 500 or more tankers and transport planes, but they are made up of at least twenty different models. The UK provides slightly fewer than 200 of the former and over 50 of the latter.

The naval forces of the EU member states – 600 commissioned warships – are more numerous than the navies of either the USA, China or Russia. The UK provides approximately 80 of these ships, ranging from submarines to small patrol ships.

Military/civilian operations

The EU member states have engaged in nine military operations since 2000. Five have been completed: Concordia (FYROM) in 2003; Artemis (RD Congo) 2003; Anis (Sudan/Dafur) 2005/6; EUFOR (RD Congo) 2006; EUFOR (Tchad/RCA) 2008/9. Four are still on-going: EUFOR Althea (Bosnia-Herzegovina) since 2004; EU NAVFOR Atalanta (off Somalia) since 2008; EUTM (Somalia) since 2010; EUTM (Mali) since 2013. They involve currently approximately 2,500 military personnel.

In the same period the EU has undertaken twenty civilian missions, mainly in the Balkans and in Africa, of which twelve are still ongoing.

Membership

22 of the 28 EU member states are part of the NATO alliance which also includes the US, Canada, Turkey, Albania, Iceland and Norway. The EU states not members of NATO are Austria, Cyprus, Finland, Ireland, Malta and Sweden.

Police Co-operation

Rob Wainwright
Director of Europol

The UK's relationship with the EU is under scrutiny because of the Government's decision to review the "balance of competences" across all areas in which the EU is currently mandated to act.

Rob Wainwright

Context

The development of a European Area of Freedom, Security and Justice is one of the main objectives of the European Union today. And although it is sometimes overshadowed by more resource-intensive policy sectors, not least the enduring Eurozone crisis, the Justice and Home Affairs (JHA) domain provides some of the best examples of the EU adding value to the lives of European citizens. The decisions made in this field by the UK and its European partners affect issues ranging from organised crime (OC), drug trafficking and terrorism to migration and border security. Such decisions directly affect millions of citizens: their security, their safety and their basic freedoms, not least in the UK which is among the European countries most affected by the threats of OC and terrorism.

The UK's relationship with the EU is under scrutiny because of the Government's decision to review the "balance of competences" across all areas in which the EU is currently mandated to act. In the case of law enforcement cooperation, there is an additional reason for scrutiny and debate. In the negotiations leading to the Treaty of Lisbon, the UK secured the right to "opt out" of a set of JHA measures within the first five years following the entry into force of the Treaty. The situation is fully described in *EU police and criminal justice measures: The UK's 2014 opt-out decision,* report of the House of Lords Select Committee on the European Union. April 2013. In other sectors the modalities for any possible repatriation of powers remain to be defined; in the case of JHA these are clearly laid out in the Treaty.

The Opt Out is a matter for Parliament, which will consider the relative merits of EU JHA cooperation against a wider range of issues. This article does not offer a prescribed solution for these dilemmas, but is a contribution to the debate based on the professional experience of a 'practitioner'. As Director of Europol, it is my responsibility to ensure that Europol is effective in adding value to the endeavours of national law enforcement agencies. A key pre-requisite for such effectiveness is full engagement and co-operation from those same agencies. Few would deny, therefore, that the UK Opt Out decision will have a long-lasting impact on the UK's ability to respond to the threats of OC and terrorism and to influence the EU's internal security policies.

An overview of the evolving crime situation in the EU provides the context for the co-operation measures under review. The history of EU JHA co-operation and the circumstances of the UK Opt Out (as far as possible at the time of writing) set the scene for a review of what EU JHA co-operation offers to UK law enforcement today, followed by a brief assessment of the costs and benefits of different scenarios for the future.

Cross-border Crime Trends

Why was JHA co-operation considered necessary in the first place? The desire for increased police and judicial co-operation was not driven by an ideological desire for a federal EU or a European FBI, but by the practical needs of law enforcement officers to respond to evolving and increasingly international crime trends.

The global terrorism picture changed overnight with 9/11, which prompted fundamental changes in counter-terrorism strategies, not only at national level in the United States and in EU Member States, but also at multilateral level. New measures included the appointment of an EU Counter-Terrorist Coordinator, the inclusion of counter-terrorism in Europol's mandate, an operational co-operation agreement between Europol and the United States, and the production of an annual EU Terrorism Situation and Trend (TESAT) report for the European Parliament, produced first by the rotating EU Presidency and, since 2007, by Europol.

It would be a mistake to assume that these developments were driven by political considerations alone. The findings of TESAT demonstrate the inherently transnational nature of modern terrorist threats and the need, therefore, for multilateral law enforcement cooperation. And despite the impetus created by 9/11 and subsequent Al Qaeda-inspired attacks in Madrid and London, the need for such cooperation is not limited to religiously inspired terrorism. Investigations of politically-motivated violent extremists also often uncover international connections. Even in cases where suspects act alone, or in small local groups, evidence is often found of international travel and/or communication with groups in other countries. Anders Breivik, perpetrator of the Oslo bombing and Utøya massacre in July 2011, travelled extensively in his attempts to procure firearms and undertook significant cross-border financial activity. Mohammed Merah, who killed seven people in March 2012 in South-West France, was known to have received terrorist training in the Afghanistan/Pakistan region. The increasing use of the internet as a means of communication between terrorists further increases the international dimension of investigations: even suspects who have not travelled outside their country of origin are frequently in contact, via the internet, with extremists elsewhere in the EU or beyond, as reported in various TESAT reports.

Turning to organised crime (OC), the scale and complexity of the international dimensions involved is striking. American commentators such as Moisés Naim in his 2006 study *Illicit* already indicated how "Smugglers, traffickers and copycats are hijacking the global economy". The report from the White House in 2011 entitled *Strategy to Combat Transnational Organized Crime: Addressing Converging Threats to National Security* and Europol's *Serious Organised Crime Threat Assessment* (SOCTA) in 2013 concur and provide more contemporary data.

Some more traditional forms of OC, such as protection rackets, can be understood locally. But nearly every other form of OC – and these are the activities which have helped OC groups to reap unprecedented profits – is inherently transnational. OC groups typically exploit legislative, enforcement and/or fiscal differences between jurisdictions, as in the cases of tobacco smuggling and VAT fraud. The trafficking of drugs and other commodities is inherently global because of the geographical space separating production and demand. Cross-border factors contribute to the vulnerability of victims of human trafficking and facilitated illegal immigration. Finally, cross-border activity adds to the difficulties associated with identifying, locating and prosecuting suspects in all types of OC.

These observations are not entirely new: the *EU Organised Crime Report* in 2005 pointed to international trafficking routes and OCGs which were already well established and widely recognised at the time, such as the trafficking of cannabis from Morocco via Spain, and the trafficking of women for sexual exploitation from the former Soviet Union. Since then there has been a further diversification of OC activity which has taken its globalisation to a new level. While some highly structured, ethnically homogenous OCGs remain, they are now rivalled by looser, networked criminal structures.

Individuals or smaller groups are "coming together" for as long as it is necessary to take part in, and secure the proceeds of, a particular illicit activity. Even the more stable OCGs are becoming far more heterogeneous: according to the SOCTA report for 2013, 70% of identified OCGs are now multi-national in their membership, and only 25% even have a recognisably dominant nationality. Another trend which points in this direction is the increasing evidence of "poly-drug trafficking", whereby multiple types of illicit drugs are trafficked by the same criminals. This also applies to other commodities being trafficked in "mixed loads", including weapons and even trafficked human beings.

As the Independent Reviewer of Terrorism Legislation, David Anderson QC, recently observed in his July 2013 report *The Terrorism Acts in 2012*, "It seems axiomatic that as criminals operate with increasing ease across internal European frontiers, so law enforcement needs to improve its ability to do the same." Recent parliamentary debates and government publications all show a broad consensus on both the international nature of OC and terrorism and on the need for multilateral responses.

EU Policy from Maastricht to Lisbon, and the UK Opt-Out

The creation and strengthening of a European Area of Freedom Security and Justice is one of the main objectives of the European Union today. Yet despite its increasing prominence among EU priorities over the last two decades, police co-operation is a relatively recent addition to the policy areas in which the European Union has a role to play. Even after the 1992 Treaty of Maastricht, which heralded the formal advent of EU JHA cooperation, police co-operation remained outside the mainstream of European integration.

Recognition of the need for increased co-operation grew steadily in the 1990s and 2000s, as public authorities came to terms with the dramatic increase in opportunities for organised criminal activity and the increased terrorist threat following 9/11. And yet, despite wide recognition of these strategic developments, the letter of EU law kept police cooperation in the slow lane – the so-called 'Third Pillar' – of EU integration. All decisions required unanimity in Council (effectively giving all member states the power of veto) and the European Court of Justice (ECJ) had almost no power to review decisions. This situation endured until the entry into force of the Treaty of Lisbon in December 2009, which brings us to the issue of the UK's 'Opt-Out'.

Mindful of the national interest and keen to preserve sovereignty in such a sensitive area, successive British governments have agreed with their European partners to retain the option to choose, on an ad-hoc basis, to participate or not in new EU measures proposed in this field. This opt-in facility for JHA matters, which was granted to the UK and Ireland under the Amsterdam Treaty in 1997, also meant that the UK could decide to participate in measures where the ECJ had no jurisdiction.

Following the Lisbon Treaty, which entered into force in December 2009, the UK's participation in EU JHA legislation is now governed by two protocols: Protocol 19 concerning Schengen (according to which the UK is deemed to be participating in the police and judicial co-operation measures of the Schengen acquis in which it already takes part, unless it decides to opt-out) and Protocol 21 concerning the JHA area (according to which JHA decisions will not apply to the UK unless it decides to opt-in).

However, those technical arrangements for the UK cannot hide the fact that the Lisbon Treaty has substantially increased the powers of European supranational institutions in proposing and enforcing EU legislation in the JHA field. This has an important impact for the UK and for the future of EU internal security policy. The Lisbon Treaty included a shift from unanimity to Qualified Majority Voting (QMV) in the Council of Ministers on the vast majority of crime and policing legislation, meaning no more veto for individual member states. It also put the European Parliament on an equal footing with the Council. Furthermore, after a transitional period of five years (which ends in December 2014), the jurisdiction of the ECJ will apply fully over all EU JHA instruments. This means, for example, that the Commission will have the right to take member states to the ECJ for failing to implement EU JHA legislation. It also means that member states can no longer opt out of the Court's jurisdiction.

The protocol on transitional provisions annexed to the Lisbon Treaty sets 1 June 2014 as a deadline for the UK to decide whether to accept the normal jurisdiction of the ECJ in the field of police and justice criminal matters. If it does not, all former legislation in police and justice co-operation in criminal matters will no longer apply to the UK as of 1 December 2014. This decision is referred to as the 'Opt-Out'. The body of EU laws covered by the Opt-Out includes 133 instruments, including significant pieces of legislation which form the backbone of the European internal security architecture, including the Europol Council Decision, Joint Investigation Teams (JITs) and the European Arrest Warrant (EAW).

The Opt-Out has been extensively reviewed by the House of Lords Select Committee on the European Union in its April 2013 report: *EU police and criminal justice measures: The UK's 2014 opt-out decision.* Also by the Centre for European Legal Studies at the University of Cambridge by Hinarejos, Spencer and Peers in an article entitled *Opting out of EU Criminal law: What is actually involved?*, published as CELS Working Paper No.1 in September 2012, and by Dominic Raab MP in a pamphlet the same year published by the think tank Open Europe, entitled *Co-operation Not Control: The Case for Britain Retaining Democratic Control over EU Crime and Policing Policy.*

The package of measures covered by the Opt-Out decision is diminishing in size because, even before June 2014, once an existing "pre-Lisbon" measure is amended, the ECJ's normal jurisdiction applies and the UK must decide whether it wishes to participate on a case-by-case basis. This will be the case for any EU law which is currently the subject of proposed new measures, including the EU's judicial cooperation body Eurojust, the European Police College (CEPOL) and Europol itself, where the European Commission presented a proposal for a new legal basis for Europol in March 2013. This could bring about significant benefits for the agency: the Europol Regulation is an opportunity to equip the agency to face the new demands of fighting OC and terrorism, particularly in cyber space.

Under the 'opt-in' deal, the UK has three months to decide if it wants to participate in the adoption and application of any post-Lisbon JHA proposal. If it does, there is no possibility to opt out later. If such a bill is adopted, the UK will be bound by it and will have to accept the jurisdiction of the ECJ over the matter. The UK can also decide not to opt-in initially. If it does not, the UK is still allowed a place at the negotiating table but will have no vote, and therefore a reduced ability to shape the proposal. If this option is taken, the UK has a second opportunity to opt in later, after the legislation is adopted.

In the case of Europol, the Government has announced that it will not opt in to the Regulation in the first instance and that it will seek to influence the negotiations, with the intention of opting in to the legislation after its adoption by the other Member States, providing the UK's key concerns are addressed. *Hansard 12 June 2013 (Volume No. 564, Part No. 16) and 15 July 2013 (Volume No. 566, Part No. 36)* cover the debates in the Commons; *Hansard 1 July 2013 (Volume No. 746, Part No. 26)* covers the Lords.

EU Law Enforcement Cooperation

The real story of EU police cooperation is not told in legislative developments but in the information exchange, joint investigations, border controls, seizures, arrests, extraditions and so on which take place every day. EU legislative measures have certainly facilitated police cooperation but it is the practical demands of law enforcement agencies that have driven it. Many JHA measures have their origin in practical considerations identified by police forces themselves.

More than most, the police community is a pragmatic, conservative one with a culture developed over 200 years. It seldom embraces change eagerly; it tends to work with what it knows best rather than taking risks with innovation. This is even truer in some other parts of Europe than in the UK.

The process of establishing Europol as a mainstay of the police community in Europe, therefore, has not been easy. The political decision created the agency twenty years ago. Unlike some other JHA measures, pressure for it at that time did not come from the grassroots. Over the years Europol has had to work to earn respect and a recognised place in the police community. But the volume and nature of work processed through Europol is now impressive. Law enforcement agencies - Europol's counterparts in the member states - have reached the stage where multilateral co-operation instruments are part of their everyday investigative toolkit. From a Europol perspective, this practical cooperation has been achieved with a pragmatic approach, a degree of humility, and a strict focus on work that genuinely makes a difference.

Europol does not exist in isolation from other EU JHA measures, many of which are complementary. Europol's growing operational relevance has led to increased usage of certain instruments, depending on the investigation or prosecution in question. Obvious examples are the cooperation between Europol and Eurojust and the use of JITs. Depending on the national authorities in question, some investigations are more likely to be brought forward for multilateral co-operation via Eurojust, and some via Europol. In both cases, JITs can provide an efficient means to co-ordinate in-depth investigative work between two or more Member States.

Strategic benefits for the UK

The UK's contribution to policy-making in EU internal security is invaluable. It is, without question, one of the most influential Member States in shaping European internal security legislation.

When EU Ministers urgently considered how to respond to 9/11, an overhaul of the Schengen Information System (SIS) emerged as a priority. The UK subsequently provided the lion's share of the functional requirements for SIS II, based on the Police National Computer and the UK's own border protection system. It is a lasting testament to the high regard in which the British police are held across Europe, and to the UK's influence at the negotiating table, that the EU member states allowed the UK to participate fully in SIS, and then agreed on the requirements for SIS II based largely on UK proposals, despite the fact that the UK has always been outside the Schengen area.

During the British Presidency of the EU in 2005, the UK successfully pushed for the adoption of a European Criminal Intelligence Model (ECIM). The ECIM laid out the scope and terms of reference for the production of the Organised Crime Threat Assessment (OCTA) and its use in agreeing EU priorities in tackling OC – introducing the concept of intelligence-led policing to EU police co-operation. Eight years later, this concept can be found in almost all EU strategic documents relating to police co-operation and has become the cornerstone of the EU policy cycle for combating organised and serious international crime. At domestic level, intelligence-led policing is now considered best practice and a growing number of member states and EU candidate countries are expected to implement it. This British model is now a main feature of policing across Europe.

In evidence to the House of Lords Select Committee on the European Union in June 2013, David Anderson QC, Independent Reviewer of Terrorism Legislation, offered another example of UK influence in Brussels:

"The EU Action Plan on combating terrorism, first drafted during the UK presidency in the second half of 2005, is closely modelled on the UK's own CONTEST strategy. An indicator of the high degree of UK influence may be seen from the fact that the four elements of the CONTEST strategy, which governs the entirety of UK counter-terrorism policy (Pursue, Prevent, Protect, Prepare) were translated into four equivalent and only slightly less alliterative EU elements: Pursue, Prevent, Protect and Respond".

In short, the British police are highly regarded across the EU, which translates into a readiness on the part of other member states to adopt best practices first developed in the UK. Recent Council discussions do not give any reason to believe that the UK's influence, and its ability to ensure that EU JHA measures reflect its own policies, have been reduced in any way.

Operational benefits for the UK

The UK derives significant operational benefits from the use it makes of EU JHA co-operation instruments. The rationale for EU police co-operation is plain in the light of the internal security threats across Europe. Investigators are now increasingly aware of, and make more use of, the cross-border cooperation opportunities that are available to them. The number of cases initiated annually through SIENA, Europol's secure communications system, increased by 69% from 2009 to 2012. Entries in the Europol Information System (EIS), a reference system fed directly by the national competent authorities, increased by 36% during the same period.

The UK is leading the way in extracting optimal value from Europol's unique capabilities. The Serious Organised Crime Agency (SOCA) co-ordinates the UK's engagement with Europol, but the UK Liaison Bureau at Europol is staffed not only by SOCA but also by HM Revenue and Customs, Police Scotland, the UK Border Agency and the Metropolitan Police Service (MPS). Indicators consistently show the UK, along with France and Germany, to be among the top three users of Europol's service.

The UK law enforcement agencies, and increasingly others, recognise that Europol offers assets that they do not possess themselves and cannot acquire elsewhere, including, for example, a set of intelligence databases on SOC and terrorism, unique in their pan-European scope and increasingly powerful in identifying criminal connections across borders. SOCA now routinely interrogates these databases, generating a growing number of investigative leads. Whereas some co-operation mechanisms still operate on a bilateral request-respond basis, and can be quantified as such, intelligence work at Europol is more complex. Requests are sent and received, but information is also cross-checked against other investigations and 'hits' can often generate new lines of enquiry. As such, the UK's work with and via Europol cannot be quantified simply in terms of "incoming and outgoing" volumes. In a significant number of cases, Europol is able to offer SOCA unique intelligence about an aspect of their investigation which was not already known, such as links between the SOCA target and criminals elsewhere in Europe.

Europol is not only about data processing. It offers a breadth of expertise in every form of SOC and terrorist activity, drawn from its diverse workforce, which includes experienced officers from every major law enforcement agency in Europe. In total, Europol's headquarters houses almost 800 people, including Europol's own experts and analysts and 140 liaison officers from approximately forty countries. They are co-located with their counterparts from other countries and make use of a purpose-built secure information exchange network (SIENA) which is being rolled out to every agency in Europe. The combination of a shared secure network and the co-location of Liaison Officers is a unique arrangement, found nowhere else in the world.

The added value of EU cooperation on JHA issues is best understood by looking at operational successes which could not have been achieved by any other means. The bulk of Europol's work takes place at the intelligence phase of investigations, so a significant period of time can often elapse between Europol's contribution and the investigation becoming public and/or a prosecution being sought. As a result, much of Europol's most recent work cannot be disclosed without jeopardising live investigations or otherwise breaching confidentiality rules, but here are two examples.

In 2010 Operation Rescue targeted a worldwide online paedophile network. The server of the forum co-ordinator was seized by Dutch police, allowing for forensic examination. Europol experts cracked the sophisticated security features that were built into the server to uncover this huge network of up to 70,000 suspected child sex offenders. Working with the Child Exploitation and Online Protection Centre (CEOP) in the UK and their Dutch counterparts in particular, Europol analysts were able to piece together the activities of the forum, identifying its members worldwide and issuing over 4,200 intelligence reports, allowing national authorities to track down offenders and potential victims. To date, 800 suspects have been identified, 184 arrests made and 252 child victims rescued from further harm. In addition to the computer forensic expertise needed to penetrate the network, Europol's ability to co-ordinate police action across 32 countries was indispensable.

Another example was Operation Golf, an MPS investigation into a Romanian criminal group involved in trafficking and exploitation of children "acquired" in Romania, brought to the UK, and then used to generate income through thefts and begging. Their identities were also used to carry out benefits and other fraud. Over a two-year period, Europol was able to support the operation by co-ordinating operational meetings, facilitating the exchange of intelligence and co-ordinating simultaneous enforcement activity in the UK, Romania, Spain and France. The operation resulted in 115 arrests (90 in the UK and 25 in Romania) and the identification of 268 trafficked children in the UK, of whom 45 were located and rescued. The criminal organisation was disbanded and 4 million pounds worth of benefit fraud was identified and stopped in the UK.

Other EU member states can benefit from the UK's engagement with Europol, just as the UK can benefit from operations initiated by other member states. A number of OC groups facilitating illegal immigration have been dismantled, involving cases where irregular migrants had been promised access to the UK. They are documented in recent Europol press releases. Examples of similar operational impact are becoming increasingly frequent in emerging crime fields, from payment card fraud to counterfeit goods, as well as more traditional areas such as drugs trafficking.

Options

The case has been made, and it is hard to deny the growing need for cross-border co-operation. Some argue, along with the Open Europe critique already mentioned, that such co-operation can be achieved without recourse to EU structures. According to this argument, the UK police, judiciary and diplomatic corps could establish bilateral co-operation mechanisms wherever necessary. Given the globalised nature of OC and terrorism, however, the UK would need such mechanisms with every single EU member state and many other countries besides, to make up for the contacts it has already within Europol. Having seen the difficulties that had to be surmounted to establish and develop Europol, the effort – and cost - needed to establish a whole new set of co-operation arrangements between the UK and so many other countries would be excessive. The legal requirements are only part of the battle. There is also the practical need to support real-time communication between investigators while respecting relevant confidentiality, information security and data protection, as well as the process of familiarising and training front-line staff with a bewildering new range of procedures.

Europol provides a 'one-stop shop' for investigators: a secure communications system with access to users in forty countries; automatic cross-checking of information against various data sets; on-demand analysis of complex investigations and criminal structures; and the availability of specific expertise in a range of crime fields, from witness protection to computer forensics.

These provisions come at relatively low cost from a national perspective, especially when compared with maintaining a network of bilateral liaison officers across the EU. This fact has not been lost on some European police forces: Denmark has now closed all its bilateral police liaison posts and routes all operational work through Europol channels, while Belgium has significantly scaled back its bilateral network, relying on Europol for the majority of its casework. SOCA has taken a similar approach, only retaining a bilateral presence in a handful of countries.

As in other policy domains, another option sometimes proposed is for the UK to replace its role of full member with a role as a privileged partner. Norway and Switzerland are often cited as examples. Both countries enjoy good operational cooperation with Europol and have Liaison Officers permanently posted to Europol Headquarters. Europol led the deployment of the EU's "First Response Network" to support the Norwegian authorities following the terrorist attacks in Oslo and Utøya in 2011, and Europol formed part of the international support deployed to the European football Championship in Switzerland and Austria in 2008.

But even Europol's closest non-EU partners do not enjoy the same rights and benefits as member states do. They do not have direct access to the Europol Information System, but must send requests via Europol. They can only be associated to the Analytical Work Files (where the bulk of Europol's operational work is processed) upon unanimous agreement of the participating member states. They cannot second officers to form part of Europol's staff. And of course, they are not party to any of the decision-making processes, either in Europol's Management Board or at Council. For a country such as the UK, which has long enjoyed such an influential role at Europol and in the wider field of EU JHA cooperation, watching from the side-lines without enjoying any of the influence described in the 'Strategic Benefits' section above would surely be difficult to countenance.

Ultimately Europol and the other EU JHA instruments work best for their members, who designed, developed and implemented them with their own operational requirements in mind.

(Assistance in researching this article by Ben Waites and Gregory Mounier of Europol.)

Facts and Figures

Initial collaboration between police authorities of the member states began in 1975, under the TREVI arrangements agreed among Ministers of Justice. In the Maastricht Treaty in 1992, member states agreed to establish a European Police Office (EUROPOL) and a first step was taken in 1994 with a European Drugs Unit. EUROPOL itself became fully operational in July 1999 as a support service for law enforcement agencies in the member states. In 2010 its responsibilities were redefined in the light of the Lisbon Treaty to include the collection of criminal information and oversight by the European Parliament of its activities and its budget.

EUROPOL offers law enforcement agencies technical co-operation, including training; strategic cooperation, in particular concerning trend analysis regarding organised crime and threat assessments; and exchange of personal data for specific cases.

Cases initiated via Europol's Secure Information Exchange Network Application (SIENA)				
	2009	2010	2011	2012
UK	980	1,163	1,102	1,523
All EU MS	7,760	8,957	10,991	13,079
Overall (EU MS + Third Parties + Europol)	10,487	11,738	13,697	15,949

UK activity via SIENA in 2012				
Category	System Total	UK total	UK as % of total	UK position among EU MS
Cases initiated	15,949	1,523	10%	2nd
Requests sent	25,820	3,238	13%	2nd
Requests received	66,138	3,845	6%	5th
Overall activity (all messages)	272,747	22,217	8%	3rd

UK activity in the Europol Information System (EIS), measured 3 January 2013				
Category	System Total	UK total	UK as % of total	UK position among EU MS
Number of objects	186,896 (total)	26,858	14%	3rd
Number of persons	48,023 (total)	10,674	22%	1st

Surveys confirm that law enforcement agencies are increasingly satisfied with the national services provided to them by EUROPOL.

EU Development Co-operation

Mikaela Gavas

EU Programme Manager and Research Fellow, Overseas Development Institute

Collectively the member states of the EU make the European Union the world's largest provider of Official Development Assistance (ODA) in value. They provided €53.5 billion in aid in 2011, more than half of total global aid.

Mikaela Gavas

Size and Scope

The European Union's role in development co-operation has evolved considerably over the past 50 years. Up until the 1990s, the EU was a niche development actor, focusing on specialised programmes linked to trade policy and humanitarian assistance, clearly taking a backseat to national donors. Today, the EU is an important aid donor and development actor in its own right, alongside its member states.

Collectively the member states of the EU make the European Union the world's largest provider of Official Development Assistance (ODA) in value. They provided €53.5 billion in aid in 2011, more than half of total global aid. The EU is also among the most generous of donors. Its ODA/Gross National Income (GNI) ratio is more than double those of Japan and the USA. The EU as a whole is a larger provider of bilateral aid than any of its Member States, and it is the second largest donor in the OECD's Development Assistance Committee (DAC), just behind the USA. In addition, the EU now also offers an experienced and tested framework for the co-ordination of its member states' national policies in this area.

Exclusive, shared or supporting competence?

EU competence governing development cooperation is currently characterised as 'shared' or 'parallel'. The Treaty states: "In the areas of development co-operation and humanitarian aid, the Union shall have competence to carry out activities and conduct a common policy; however, the exercise of that competence shall not result in Member States being prevented from exercising theirs." Specifically, the EU may undertake activities and conduct a common policy, but may not prevent Member States from exercising their own competence in these areas. Nevertheless, there is enough flexibility and ambiguity for the balance to shift either towards the consolidation or the co-operation model in practice.

Three competing views of the relationship between the European Commission and the Member States lie at the heart of the debate about the future of EU development cooperation.

- › First, some argue that there is a strong case for the Commission to play a greater part in shaping policy and delivering programmes;
- › Second, others say that the Commission's role is primarily one of coordination and network management, with no authority to shape policy and little capacity actually to deliver aid;
- › Third, some suggest that the Commission's role is merely one of support and general coordination.

In the first view - the consolidation or the supranational model - the EU institutions should set the policy and, to a large extent, implement it. This would entail the major part of development aid being channelled through Brussels and a smaller share through the member states' bilateral programmes. In EU terms, this would change the competence from "shared" to "exclusive".

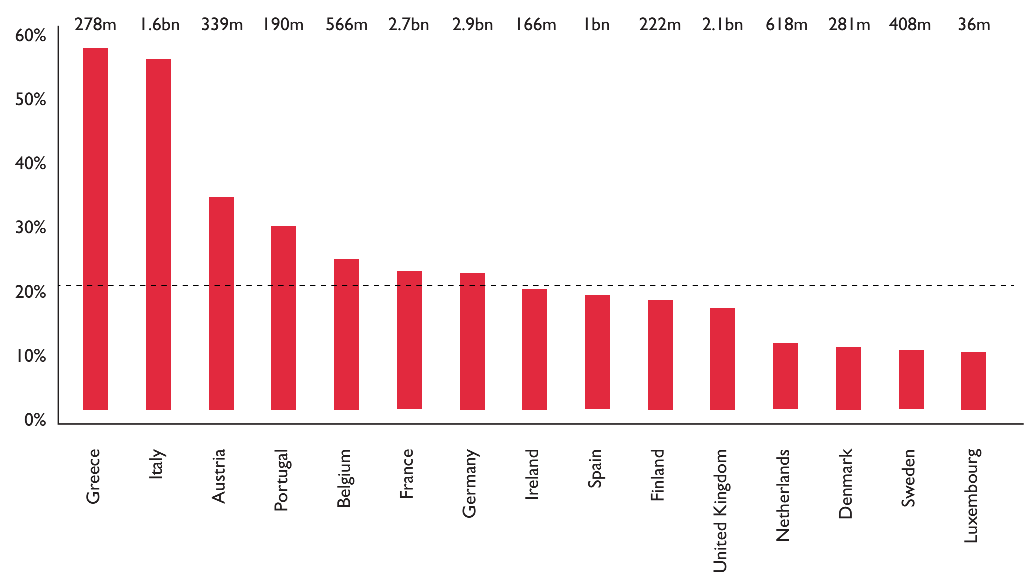
In the second view - the co-operation or the decentralised model - the EU institutions would concentrate on constructing a shared policy and coordination framework within which individual Member States would implement independent programmes, to run alongside a small EU programme. This would represent "shared" or "parallel" competence.

In the third view – the supporting model – the Member States renationalise their ODA contributions, and the Commission merely supports and co-ordinates their actions, with no authority or legally binding framework. In EU terms, this would represent merely "supporting" competence.

This range of opinion is reflected in the range of different shares of national aid programmes that the member states currently channel through the EU.

On average, Member States contributed 19% of their gross aid disbursements to the EU in 2010. Greece and Italy had the highest shares, with more than 50% of their ODA going through the EU, whereas Denmark, Sweden and Luxembourg had the lowest shares with less than 10%. In volume terms, the biggest ODA contributors to the EU were Germany ($ 2.9 billion), France ($ 2.7 billion), and the United Kingdom ($ 2.1 billion). Luxembourg ($ 36 million), Ireland ($ 166 million), and Portugal ($ 190 million) were the smallest. A 19% share means that the EU is currently disbursing around €12 billion a year, which makes it a very large aid donor in its own right, and to some extent a consolidator of aid originating from its members.

Total contributions to the EU as a percentage of gross ODA disbursements (constant 2010 prices)



Source: OECD (2012), DAC Aggregate Statistics, OECD: Paris; OECD (2012), Creditor Reporting System Database, OECD: Paris.

Most states appear happy to keep the relationship with the Commission roughly as it is, leaving them considerable room for manoeuvre with their own national aid programmes, yet making sure that the EU has a big enough programme for all members collectively, both in order to be effective in achieving development goals and to carry considerable clout in international affairs.

The share of aid channelled through the EU has been between 18% and 20% for the last decade or so, and this suggests that the co-operation model is well established. From this perspective, the *European Consensus on Development*, adopted by the European Commission, the European Parliament and the Council in 2005, provides a shared framework and sets the rules of engagement within which the member states deliver bilateral programmes. It lays down the common vision of values, objectives, principles and means to development shared by all Member States and by the EU.

In 2012, the EU adopted its revised development policy, *Agenda for Change,* which sets out a strategy for improving the EU's efforts as an aid donor. It signals two important shifts:

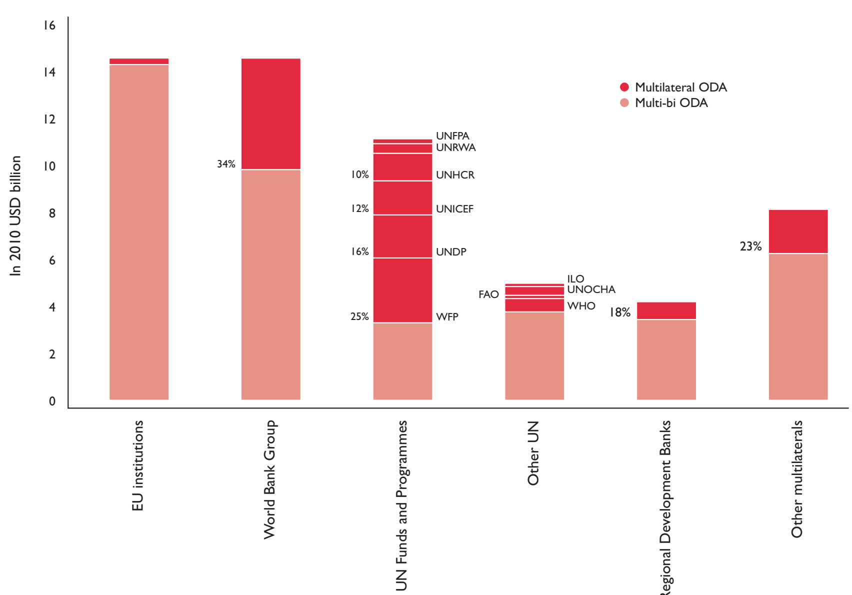
a concentrating assistance on two pillars: good governance, democracy and human rights, linked to greater conditionality; and growth, with a strong focus on leveraging private sector money; and
b introducing new aid allocation criteria with a view to "aid graduation" for well-off developing countries, leading them to dispense with this form of support.

The European Commission's commentary on the *Agenda for Change* aims to target resources "where they are needed most to address poverty reduction and where they could have the greatest impact". It announced that "grant-based aid should not feature in geographic co-operation with more advanced developing countries". The *Agenda for Change* itself establishes a clear framework for the EU to concentrate its resources on fewer sectors and countries, thus enabling it to make better use of its comparative advantages as an aid donor.

It is not difficult to make the argument that multilateral action is required on a range of future development challenges. The increasingly global nature of development challenges, such as climate change, peace and security, food security and financial stability, clearly indicate that global problems require global solutions and - potentially - new forms of international co-operation. This has implications for both policy and the organisation of development co-operation. In particular, it makes the case for two major changes:

- First, a shift from thinking about development in narrow terms of aid, to thinking about 'whole-of-government' approaches, covering trade, financial, security and environmental policy, as well as aid. In EU terminology, this is described as 'policy coherence for development'.
- Second, a shift towards a more multilateral approach – partly because 'competence' on some aspects of the international agenda is vested in supra-national institutions, but more importantly, because managing global problems requires investment in collective action.

Total use of multilateral system, gross ODA disbursements
(constant 2010 prices)



Source: OECD (2012), DAC Aggregate Statistics, OECD: Paris; OECD (2012), Creditor Reporting System Database, OECD: Paris.

However, the Member States have a number of different multilateral channels for policy and aid disbursement open to them, not just the EU. They also use the United Nations (UN) and its various agencies, as well as multilateral development banks such as the Asian Development Bank. Despite this variety of possible instruments, contributions to the EU account for the majority of member states' multilateral ODA.

The comparative advantages of EU development cooperation

The UN, the multilateral development banks and the EU have very different mandates and roles. What then are the advantages that member states see in using the EU rather than other multilateral agencies for delivering development aid?

The UN and its agencies have a global political authority, but not the capacity to disburse on the scale or with the variety of instruments available to the EU. The World Bank and the other multilateral development banks have the financial resources, but neither the voice on trade, nor the role in foreign and security policy that the EU now has. The regional development banks lend long-term but generally do not engage in humanitarian crises, as the EU does. The EU also has greater flexibility than other multilateral agencies, including the UN, and a slightly depoliticised persona which enables it to provide aid directly to non-state institutions. This is particularly important in conflict-affected countries, for instance in the Middle East, where individual governments may be perceived to be active players in the conflict.

Practically speaking, the EU does indeed have a considerable number of assets that come into play in managing development cooperation:

- a values-based approach and a commitment to poverty reduction enshrined in the Treaty;
- shared approaches in development policy through the *European Consensus on Development* and the *Agenda for Change;*
- promotion of development best-practice based on considerable experience;
- wide geographic spread with a presence in approximately 140 countries;
- joined-up engagement in multiple policies and through a full range of instruments;
- a variety of international political and economic partnerships, often of a regional nature, for example the Cotonou Partnership Agreement with the African, Caribbean and Pacific (ACP) countries;
- economies of scale as the world's second largest provider of ODA;
- critical mass which gives it the ability to address global challenges and provide global public goods as a result of its size.

The EU also provides a potential vehicle for improving the effectiveness of aid provided by other member states. It can provide a neutral leadership by creating platforms for establishing increased co-ordination, shared analysis and the development of joint strategies. This leadership can be perceived as non-threatening to the interests or autonomy of Member States, because the principle of parallel competence permits the voluntary acceptance by each Member State of any common analysis or strategy. It does not compel its agreement.

In some recipient countries, the EU is considered to be a more neutral player than bilateral donors, some of which have particular interests or a particular (colonial) history with a country or a region. This perception of neutrality may be particularly important for the Member States when they want to provide assistance in conflict-affected countries, or in parts of the world where their colonial past or other historical engagement raises difficulty.

Development co-operation is linked to many other policy fields that rest in legal terms on different articles of the Treaty and imply different degrees of EU competence. These include foreign and security policy, defence, trade, agriculture, environment, migration, fisheries, and many others. The formal Treaty-based competence of the EU differs across these policies, with some being exclusive (for example, trade and fisheries) and others being shared. Engagement with the EU on development aid thus offers Member States the potential to achieve development co-operation goals through policies in areas where the EU sometimes has exclusive competence and sometimes where the Member States can take the lead. It creates an interesting and potentially fruitful overlap of competences with both legal and practical implications.

In an increasingly multi-polar world it is reasonable to anticipate that the geopolitical advantages of the EU in terms of ability to influence global debates through its critical political-economic mass will grow more significant in coming years. Developing countries (for example, India) are already expressing a preference to work with a small number of partners - in total or by sector – and that would exclude small players. The advantages of being a member of a big club (with the option of acting separately on occasion) are thus likely to grow.

The constraints of shared competence

As a result of the commitments required of EU member states in the development provisions of the acquis communautaire, each new member state now is required to pursue a bilateral development co-operation programme. There are therefore at least 28 different donors, plus the EU, formulating European policies. There are a number of advantages to this, including:

- the growth of shared expertise regarding development co-operation as a result of the involvement of all Member States;
- the potential of joint working which eases the administrative burden on recipient countries;
- the provision of a 'safety valve' for Member States, allowing them to act independently on issues they feel strongly about.

On the other hand, the multiplication of actors increases the likelihood of variations in the interpretation of norms and principles, and it does introduce the risk of spreading aid thinly – thematically and geographically – in order to satisfy the multiple specific requests of the member states.

Despite the common framework embodied in the European Consensus on Development, differences prevail in terms of the nature of individual member states' engagement on development issues.

Firstly, there is wide variation across the EU with respect to how much development assistance member states provide in relation to their GNI. In 2012, Luxembourg, Sweden, Denmark and the Netherlands exceeded 0.7% of their GNI in aid, while Greece, Italy, Spain, Portugal and Austria allocated less than 0.3% of their GNI in aid. Although the EU has prepared a timetable for its Member States to reach an ODA commitment of 0.7% of GNI by 2015 (or 0.33% of GNI for the newest member states), this goal is becoming more remote than ever as a result of the financial crisis and Eurozone turmoil, and the wave of austerity across Europe.

Secondly, although the EU Commission itself continues to manage a substantial amount of aid, its budget is also stagnating. Under the next seven-year multi-annual budget - the EU Multi-Annual Financial Framework (2014-2020) - the EU's external actions budget, including development cooperation, will grow by just 3.3% from €56.8 to €58.7, yet its main budget for funding cooperation with the ACP countries, the European Development Fund (EDF) will remain unchanged compared with the previous seven-year settlement. The failure to increase development aid until 2020 has taken the wind out of the EU's sails. And the smaller the EU's footprint, the less the Commission will be able to be a driving force in EU development policy.

Thirdly, Member States have different external relations priorities, which influence preferences concerning where development investments should be directed. For example, although there is general agreement on the principle that the EU should reduce the number of its grant-based bilateral aid programmes and focus more development funds on Least Developed Countries (LDCs) and fragile states, the member states have different ideas on how the policy should be implemented, with some member states wanting exceptions, often based on their former colonial links.

Member states try to shape EU development policy by 'uploading' their policies and objectives to the European level. Thus, EU policy tends to be a compromise or composite of many member states' policies. It can be criticised as not yet having established working relationships and systems that lead to effective coherence and strategic coordination. The result is an EU development programme with an overloaded and broad agenda, operating in almost every country in the world.

Thus, although the current system of shared or parallel competence in development co-operation has advantages, the EU Commission and the Member States need to find ways to optimise these strengths and minimise some of the disadvantages. If the Member States views converged more about how far to use the EU as their instrument of choice in development policy, they could reasonably work towards an agreement on the optimal division of labour, based on the principles of complementarity and subsidiarity and comparative advantage.

Organising cooperation

The EU took some steps towards this when in May 2007 it agreed a first *Code of Conduct* on the division of labour in development cooperation. The Code addressed the division of labour between the Member States and the EU, across developing countries and across sectors within each developing country, trying to simplify a complicated system where many Member States were diluting effects by spreading their effort too widely. The new Code restricted donors to a maximum of three sectors per donor country and suggested they redeploy development effort out of other sectors or work as a 'silent partner', allowing another EU donor state to take the lead for them. It also restricted the number of donors' countries to between three and five per sector. The EU has promoted the application of the *Code of Conduct* and tried to facilitate co-ordination and co-operation at in-country, cross-country and cross-sector levels. However, progress on the ground has been slow. It is a truism that everybody wants to coordinate, but no one wants to be co-ordinated. As a report by the European Think Tanks Group in 2010 pointed out, the desire to "plant a flag" still often hinders progress.

More recently, the European Commission has put joint programming back on the agenda. In the *Agenda for Change,* the European Commission proposed that the EU and the Member States jointly prepare strategies and programmes and improve the division of labour among themselves. Behind this was the idea that the European Commission would take a more active leadership role in co-ordinating and harmonising donor activities. The Agenda for Change proposed that the EU, together with the Member States, develop a single programming document for each recipient country, incorporating EU and Member State aid, and laying down the division of labour and financial allocations as well. However, some Member States interpreted this as a bid by the European Commission to have a bigger say over national development aid and aid channelled through the European Development Fund (EDF).

The EDF is technically an inter-governmental agreement of the member states, based on their direct contributions, and considered "off budget" in the calculations relating to financing the EU. Consequently, unlike the EU budget, where the European Parliament makes the decisions together with the Council, the management of the EDF and its resources are under the direct control of the Member States. The EDF represents about 35%

of EU spending on development co-operation. Importantly, assessments of the EDF have rated it more effective than other on-budget EU financial instruments in its contribution to poverty reduction, financial resource management, monitoring, transparency and predictability of funding.

Consensus on commitment to an EU policy

There is a growing consensus among experts both in and outside governments about the future of development cooperation. In brief, development co-operation is likely to continue to focus on poverty reduction in the poorest countries, but with increasing prominence also given to a new agenda of global public goods (such as climate change and security), international governance (including finance and trade), and new partnerships with emerging economies. This, in the jargon of development economics, is called "cross-government support for shared human development objectives and the delivery of global public goods". And the strengthening of multilateral providers of development assistance will help strengthen the negotiating power of recipients, making it more difficult for traditional bilateral donors to influence policy.

For all the current challenges faced by the EU, it remains an indispensable part of this multilateral architecture. The EU strives to be an active player in shaping globalisation and in providing global public goods. It brings multiple assets to the new agenda. It has a long-standing and reasonably effective development and humanitarian aid programme. It contributes to the aggregation of aid flows and reduced transactions cost. It acts for all member states on trade. It is a leader in climate policy. It has an emerging foreign policy and security apparatus, and is especially active in fragile states. It also has strategic political relationships with all regions of the world, not least through joint ministerial and parliamentary institutions with developing countries.

From a UK perspective, the EU offers many distinct comparative advantages as a channel for UK aid and as a means of securing UK development objectives. The EU's economies of scale reduce administration costs and allow the UK to be involved in many more countries (including a number of Commonwealth countries) than its current 27 priority target countries. Both the UK and the EU highlight growing private sector involvement as key to future development assistance, but only the EU has the variety of instruments allowing for international political and economic partnerships, 'aid for trade' expertise and the blending of grants and loans. Meanwhile, the EU's experience in regional integration and co-operation, and institutional capacity-building, offer it a political weight that the UK cannot match. The UK Department for International Development (DFID) has noted (on its website) that "through its policies on aid, trade, climate change and conflict the EU sets the global development agenda and provides a powerful platform from which to tackle global challenges and take collective action". Given that the EU's development programme is fundamentally dependent on the interests of EU member states, reducing or severing its ties to the EU on development co-operation could cost the UK considerable international influence.

Facts and Figures

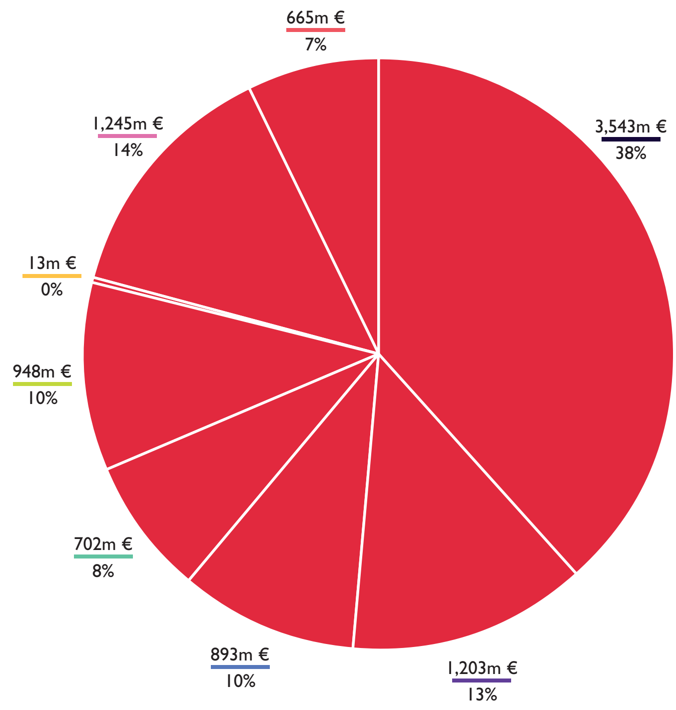
The EU as a whole - the EU institutions and the member states - account for over half of global Official Development Assistance (ODA). EU ODA amounted to €53.5 billion in 2011, 0.44% of the combined Gross National Income (GNI).

Around 20% of Member State aid is channelled through the EU institutions, amounting to €12 billion in 2011. This makes the EU a larger provider of bilateral ODA than any of its member states and the second largest among DAC donors (following the USA). EU Delegations are present in around 140 developing countries around the world.

EU aid is resourced from both the EU budget (64% in 2011) and the European Development Fund (EDF) (36% in 2011). In 2011, overall spending on aid by the EU represented around 9% of the total value of the EU budget.

The EDF is funded outside the EU budget by "voluntary" contributions from the EU member states on the basis of specific contribution shares for a multi-annual period.

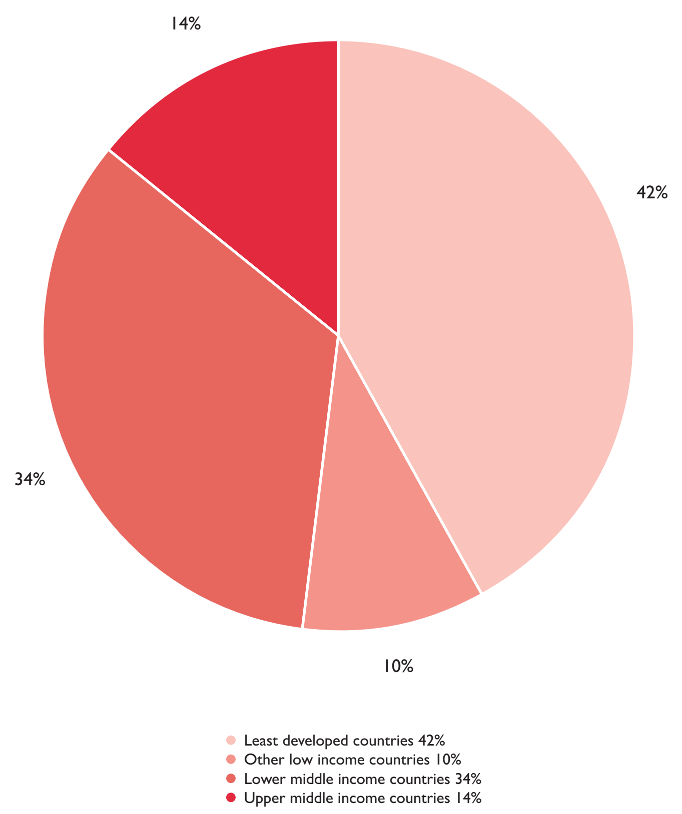
EU aid sectors in 2011
(Disbursements)



- Social infrastructures: education, health, water, government and civil society, other 38%
- Economic infrastructures and services: transport, communications, energy, other services 13%
- Production: agriculture, forestry and fishing, industry, mining and construction, trade and tourism 10%
- Multisector/Crosscutting: environment, other 8%
- Budget support, food aid, food security 10%
- Action relating to debt 0%
- Humanitarian aid: Emergency response, reconstruction relief and rehabilitation, disaster prevention and preparedness 14%
- Other/Unallocated: admin, costs, unspecified 7%

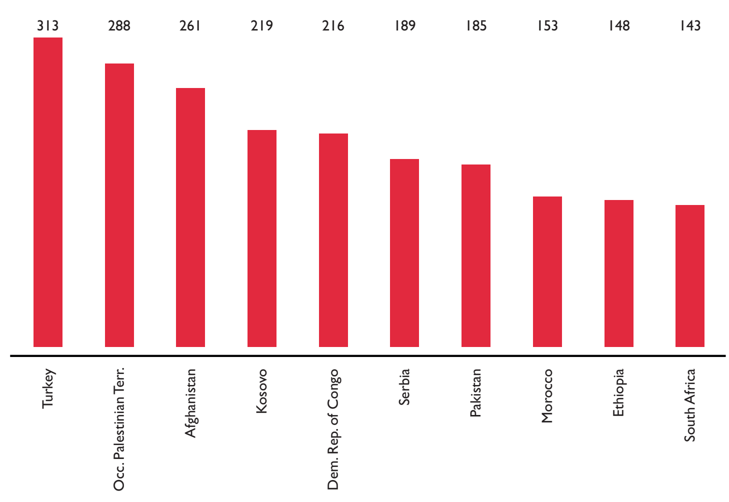
Source: Annual Report 2012 on the European Union's development and external assistance policies and their implementation in 2011

EC aid by income group for 2011
(excl. regional and unallocated projects)



Source: Annual Report 2012 on the European Union's development and external assistance policies and their implementation in 2011

Top ten recipients of EC aid in 2011
(disbursements in €million)



Source: Annual Report 2012 on the European Union's development and external assistance policies and their implementation in 2011

Higher Education

Professor Peter Scott

Professor of Education Studies, Institute of Education, University of London, and former Editor, Times Higher Education Supplement

UK universities have always been at the heart of Europe. Oxford is one of Europe's oldest universities, founded not long after Bologna and Paris. Scholars and students circulated freely between universities in medieval and early-modern Europe.

Peter Scott

Outlining the issues

The advantages that British universities and colleges derive from the United Kingdom's membership of the European Union are indirect – but nevertheless substantial. This paper considers these issues under five main headings:

- First, the role – historical and current – of UK universities within the wider European university system. From their earliest days they were fully part of this system. Even today, in an age of post-imperial and mid-Atlantic 'Anglophonia', these links remain unbroken. So there can never be any question of UK universities 'joining' or 'leaving' Europe.
- Secondly, the development of EU-level responsibilities for higher education. These responsibilities have gradually evolved, initially in the context of the mutual recognition of professional qualifications to underpin the free market in labour across the European Community (and now the European Union). Subsequently they have been reinforced by the drive to ensure the competitiveness of the EU in the global knowledge economy.
- Thirdly, the European programmes that are directly relevant to higher education and research, and the value that UK higher education derives from its participation in these programmes. These fall into two broad categories:

  Programmes designed to promote student (and, to a lesser extent, staff) mobility within Europe. The largest is the Erasmus programme but there are several others.

  Programmes designed to promote research, the best examples of which are the successive 'Framework' programmes.

- Fourthly, the development of the so-called Bologna process, and the UK's role in that process. Although not formally an EU initiative (and also involving non-EU states), this process is designed to promote core EU objectives such as greater transparency, and so consistency, of course structures and academic qualifications. It is largely driven from Brussels by the European Commission.
- Finally, the impact of UK withdrawal from the EU, or renegotiation of the existing relationship between the UK and the EU, on these European programmes and also on the UK's participation in the Bologna process. That impact would be likely to be significant – and negative.

The role of UK universities in Europe

UK universities have always been at the heart of Europe. Oxford is one of Europe's oldest universities, founded not long after Bologna and Paris. Scholars and students circulated freely between universities in medieval and early-modern Europe. Scotland's four 'ancient' universities – Aberdeen, St Andrews, Glasgow and Edinburgh – were also part of the European university mainstream. Indeed, in the eighteenth century the links between the Scottish Enlightenment with major figures such as David Hume and Adam Smith and similar Enlightenment movements in other European countries are still perhaps among the best examples of the intellectual and cultural integration of Europe.

The establishment of the University of Berlin in 1810, often taken as the origins of the modern university, deeply influenced the development of civic universities in Victorian Britain, in thrall to German thought and culture until the rupture of 1914. Universities in the United States (notably Johns Hopkins) also were decisively shaped by the German model, and these influences then often travelled back across the Atlantic to Britain, influencing the subsequent expansion and reform of the university sector. Even the rather belated introduction of the PhD after the First World War was motivated by the need to substitute for opportunities in Germany that had been cut off. Between the wars, of course, UK universities benefited hugely from an influx of refugee scholars, scientists and intellectuals from central and eastern Europe, mainly but not exclusively Jewish – among them Lewis Namier, Karl Popper and Sigmund Freud.

More recently these close links have been maintained. UK universities made an important contribution to the post-war reconstruction of German universities. The evolution of the social sciences cannot be explained with recognising the influence exercised by scholars from other parts of Europe – Braudel and Foucault from France; Adorno and Habermas from Germany – just as British scholars exercised a corresponding influence in other European countries.

In the 1980s British scholars and scientists played a key role in supporting dissident academic movements in central and eastern Europe, and in the 1990s, as they had done in Germany 40 years before, they provided equally significant support to the reconstruction of higher education in post-Communist Europe.

Long before there was talk of creating a single 'European Higher Education Area' (EHEA) universities across Europe, including those in the UK, constituted a single intellectual and academic space. Policy divergences and organisational particularities cannot disguise these profound academic and scientific commonalities. UK universities have always been 'in' Europe – and there they will remain, whatever political decisions are taken about the UK's relationship with the EU.

The evolution of European-level responsibilities for higher education

The European Economic Community (later revealingly abbreviated to the European Community) did not originally have any competence within the field of education. It was only indirectly that its responsibility in the field of professional and vocational training was recognised by its member states, in order to ensure that qualifications could be mutually recognised across borders. Without this mutual qualification the free movement of labour, a key principle of the EEC/EC, would have been impossible to achieve.

This narrow competence was enlarged when student mobility programmes such as Erasmus were developed, with the greatest enthusiasm during the 'high noon' of the movement towards greater European integration when Jacques Delors was President of the European Commission in the years leading up to the Maastricht Treaty. Strengthening the European dimension in education, and more specifically higher education, was justified in terms of its contribution to engaging the young people of Europe (and, in particular, its futures elites) in this wider European project, symbolised by a further change of name, to the European Union.

Towards the end of the 1990s the Bologna process, which was originally a matter for separate negotiation between EU (and non-EU) states outside the formal Brussels administrative structures, brought these two strands together: the vocational and professional strand, directed initially at the completion of the single market and later focused more on enhancing the competitiveness of Europe in the global economy; and the political and cultural strand, linked more controversially with greater European integration, and also with the promotion of the European 'brand' in the guise of the EHEA.

Since the banking crisis of 2008 and the subsequent economic recession, more attention has naturally been paid to the first of these strands. The focus has notably been on lifelong learning as a means of re-skilling and up-skilling the workforce. Measures to strengthen science and research in Europe have also been taken, including the establishment of a parallel European Research Area (ERA) and of a European Institute of Technology (EIT). Alongside these developments, however, the wider political and cultural focus has also been maintained. Two different conclusions can be drawn from the evolution of these strands of European-level competence in higher education.

The first is that this competence has always been marginal – and also to some extent discretionary. As a result, from the perspective of national higher education systems (certainly the large national systems such as the UK's) the European influence, in a political and administrative sense, has always been peripheral. So its weakening or abandonment would make little difference.

The second conclusion is that it is precisely because this competence is largely informal that Europe has been able to exert a powerful influence. The strength of the EU depends as much, or more, on these Europe-wide networks of collaboration as on the formal powers and responsibilities of European institutions. If this second conclusion is preferred, the role of Europe (in its widest sense) in the development of UK higher education can no longer be regarded as peripheral.

The development of the European dimension

The European dimension in higher education is wide-ranging. It is directly expressed in two main forms. The first is the various student and staff mobility and other development programmes funded by the EU and managed by the European Commission; and the second is the research programmes funded and managed in the same way.

However, these programmes need to been seen in the wider context of the EU's 'Europe 2020' strategy. This strategy succeeded the earlier 'Lisbon strategy' that aimed to make Europe the world's most competitive area in terms of advanced technology by 2010, a target that was not met as a result of the economic downturn following the banking crisis of 2008. Higher education is seen by the member states as central to realising the new strategy, a view confirmed in the European Commission's white paper published in September 2011 *A New Agenda for the Modernisation of Europe's Higher Education Systems*, highlighting innovation and employability, student mobility and closer links between higher education, research and business.

Finally it is important to recognise that other European initiatives have an important, if less direct, impact on higher education – notably structural funding that includes regional development and the social fund.

Mobility and development programmes

The largest of these is the Erasmus programme, which was established in 1987 and celebrated its 25th anniversary in 2012. Since 2007 it has been part of the wider Lifelong Learning Programme. It is the largest student (and staff) mobility programme in the world. More than three million students have participated in Erasmus since it was established, and more than 300,000 staff since they became eligible to participate in 1997. Every year almost a quarter of a million students from 4,000 higher education institutions in 31 countries (EU member States plus Iceland, Switzerland and Turkey) take part. The annual budget is 450 million Euros.

In the case of the UK there are significantly more incoming than outgoing Erasmus students. In 2010-11 there were 24,474 incoming and only 12,833 outgoing students. This 2-to-1 ratio is also reflected in the totals for the past decade – 206,836 incoming and only 100,247 outgoing students. The largest destination for outgoing Erasmus students is France followed by Spain, and the largest source for incoming students is Germany. The next most important sources and destinations are Italy and the Netherlands. The UK universities most involved in Erasmus are the big civics such as Manchester, Leeds, Nottingham, Sheffield and Bristol. Staff exchanges under the Erasmus programme have been more balanced with 18,811 incomers and 16,739 outgoers between 2000 and 2010.

However, this picture of unbalanced flows needs to be modified in five respects.

i First, there has been rapid growth recently in the number of UK students participating in the Erasmus Programme. The number increased by 6.5 per cent in 2011/12 to 13,668 – a faster rate of increase than in almost every other participating country.
ii Secondly, Erasmus is not the only European programme. The UK has been an active participant in Erasmus Mundus that funds institutions and individuals to take part in joint programmes with institutions outside the EU. The UK is also involved in the largest number of projects supported under the Tempus programme, designed to assist the modernisation of higher education in eastern Europe, central Asia, the Balkans and the Mediterranean through collaborative activities – 44 projects in total compared to Spain's 41, Germany's 39 and France's 22.
iii Thirdly, many students from other EU countries study in UK institutions outside the framework of the Erasmus programme. In England 5 per cent of all students are from other EU countries, and 8 per cent in Scotland. For example, students from Fachhochschulen in Germany or HBO schools in the Netherlands enrol on Masters degrees in UK universities because of difficulties in transferring to universities in their own countries. Students from other EU countries also help to fill gaps where demand is low from UK students, crucially in some STEM (science, technology, engineering and mathematics) subjects.
iv Fourthly, a small – but increasing – number of UK students are now choosing to study in other EU countries – often 'fee refugees' from England wishing to escape an increasing burden of debt. The University of Maastricht in the Netherlands, which has aggressively branded itself as an international university, has been particularly active in seeking to recruit UK students.
v Finally, UK institutions have actively franchised and/or validating programmes in other EU countries – both in non-university institutions that are prevented, or discouraged, from offering courses in their own countries leading to higher degrees and in private institutions. The main clusters are in Greece, Cyprus and central and eastern Europe. In addition the number of joint degrees between UK and other EU universities has substantially increased.

Research programmes

The European dimension in research has an even more substantial and significant impact than through mobility and other development programmes. The major instrument has been a succession of Framework programmes that now provide an important stream of research funding in many UK universities. The most recent is Framework Programme 7 (FP7) that began in 2007 and is due to end this year. The budget for the first Framework programme (1984-87) was only 3.2 billion Euros (at current prices). The total budget for FP7 is 50.5 billion Euros, representing a 40-per-cent increase on the budget for FP6. This activity has evidently proved its worth, and the next Framework Programme will have an increased budget again.

The key objectives of FP7 are (i) to strengthen Europe's scientific and technological base; and (ii) to encourage international competitiveness, while also providing support for EU policies. This is done by making grants to institutions and individual researchers, and also through joint programming initiatives that identify key pan-European topics for research, such as Alzheimer's disease, cultural heritage, urban Europe and antimicrobial resistance. Fifteen per cent of the total funding for FP7 (7.5 billion Euros) is channelled through the European Research Council (ERC) which was established in 2007. Since then the ERC has funded 3,400 grants and by the end of FP7 expects to have provided funding to support 10,000 PhD students and 5,000 post-doctoral positions. National shares of FP7 and

ERC funding are difficult to calculate because most projects involve institutions or researchers from more than one EU country. However, it is clear the UK is 'punching well above its weight', as would be expected given the research strength of many UK universities. So far UK institutions have been involved in 334 ERC-funded projects, more than any other European country. Next comes Germany with 301, France with 180 and Switzerland with 126.

The Bologna process

The UK was one of the 'Gang of Four' that effectively founded the Bologna process. The relevant Ministers from the UK, France, Germany and Italy met in Paris in 1998 and agreed the Sorbonne Declaration that began the process of harmonisation, integration and reform and eventually led to the signing of the Bologna Declaration by 27 Ministers the following year. The Bologna process has now been adopted by the 47 countries that constitute the European Higher Education Area (EHEA), extending more than half way round the world from Reykjavik in the west to Vladivostok in the east. Although not formally linked to the programmes run by the European Union, EU member states are the driving force behind the Bologna process. The Bologna process has become Europe's flagship initiative in higher education.

Of course, as is generally the case with such initiatives, the motives behind Bologna are many and varied:

› In some countries it offers a stalking horse for national reforms, such as the reduction in average course lengths in Germany (where shorter Bachelors' courses have replaced traditional Diplomas) or the post-Communist reconstruction of higher education systems in central and eastern Europe. In the UK this motive has been secondary, although Bologna has perhaps helped to open up the curriculum and produce better articulation between Bachelors and Masters degrees.

› In all countries it has provided a vehicle for the promotion of greater transparency, and so portability, of awards and qualifications. Without Bologna it would have been difficult to carry forward the development of the open market in skilled labour within the EU and, after the incorporation of doctoral programmes to produce a three-stage pattern, the all-important open market in young researchers. As one of the most scientifically productive systems in Europe, UK universities have disproportionately gained from the latter in particular.

› Finally, a third motive of Bologna has been to promote a European 'model' of higher education that, while promoting modernisation and competitiveness, still places a high value on the so-called 'social dimension'. Those in the UK most enamoured of the power of the market have baulked at the promotion of this 'model'. But they are almost certainly a small minority. In most essential respects UK higher education remains a quintessentially European system with a similar mission and values in the eyes of the academic community right across the continent.

There are two broad interpretations of the significance of the Bologna process. The first is to regard it as an administrative, even technical, process concerned with the adoption of a two-stage structure of courses and awards (Bachelors and Masters), of standard measures of academic credit and of compatible quality assurance arrangements. The second is to see it as a dynamic process of modernisation, establishing stronger links between universities, research, innovation and business and also building a more coherent European 'brand'.

In the early years of the Bologna process the former interpretation was perhaps more accurate, but more recently the second has become widespread as the process has taken on a momentum of its own. It has also become a succes d'éstime on the wider world stage, rather to the surprise of Bologna 'insiders'. Careful examination of the documents produced by successive bi-annual Bologna ministerial meetings (Bologna 1999, Prague 2001, Berlin 2003, Bergen 2005, London 2007, Leuven / Louvain-La-Neuve 2009, Budapest /Vienna

2010, Bucharest 2012) supports this view of the progressive enlargement of the Bologna agenda.

Which of these two broad interpretations is preferred has important implications for UK higher education. If it is the former, it can be argued that the UK had little to learn. The two-stage Bachelors-Masters pattern was already standard, and quality assurance arrangements were more developed than in many other parts of Europe. However, if the second interpretation is preferred, a very different balance of advantages emerges. Higher education in the UK has much to gain – for example, the reform of doctoral programmes, the links to the wider lifelong learning agenda and more effective articulation between scientific agendas and innovation strategies. Although the UK would still be able to play a role in the Bologna process, from a more peripheral position within or even outside the EU, it would inevitably lose its key position on the inside track. From being a member of the original 'Gang of Four' to become a peripheral member (like the Russian Federation or Turkey) would clearly not enhance the UK's influence in what has become the key European initiative in the reform of higher education.

The consequences of withdrawal

The direct impact of the UK's withdrawal from the EU - or significant loosening of the UK's links with other EU states following renegotiation - on UK higher education would be limited. In terms of their history and character UK universities would remain at 'the heart of Europe' as they have been since their earliest beginnings. There is no reason to believe that the UK would not be able to continue to participate in Erasmus and other mobility programmes on the same terms (and at a proportionate cost) as non-EU members such as Iceland and Switzerland. The attractions of an Anglophone environment would remain, making the UK a popular destination. The UK's continuing participation in European research programmes might be more difficult to sustain – but, given the world-class reputation of our leading research-intensive universities, it is likely that our European neighbours would still wish to continue to build research links and collaboration. Finally, the UK would continue to be part of the EHEA, and included in the Bologna process.

However, the indirect impact of withdrawal from or a weaker relationship with the EU could be considerable:

i First, despite the central role played by UK universities in the historical development of European higher education, withdrawal or a lesser role would increase the impression that the UK is becoming 'semi-detached' from Europe. In the past, this might have been in the context of imperial and post-imperial links to the wider world, but such an orientation has lost much of its significance in the 21st century. Now it would tend to confirm the 'Mid-Atlantic' status of UK higher education, as a system in ideological thrall to US higher education models.

ii Secondly, although participation in Erasmus and other European programmes would continue, the imbalances in student flows would remain and probably increase, perhaps intensifying the simmering resentment that UK universities are losing more than they are gaining from these programmes.

iii Thirdly, it is also difficult to imagine that UK universities would continue to be able to 'punch above their weight' in terms of access to European research funding, because the remaining EU Member States would be unlikely to tolerate a non-EU member securing disproportionate advantages.

iv Finally, although the UK could continue to be part of the Bologna process, in a peripheral role it would no longer enjoy the enhanced status of a 'founding member'. Its enthusiasm for Bologna actions designed to promote EU agendas might also wane.

In short, although the formal relationship between UK higher education and other European systems would change little if the UK withdrew from (or substantially loosened its links with) the EU, much might be lost – and these losses would tend to accelerate and accumulate. By withdrawing from, or loosening its links with, the EU the UK would have served notice that it was no longer part of the 'European project' in wider political, historical, cultural and scientific terms and regarded its association with the rest of Europe only in terms of market liberalisation – the original 'common market'. Whether they liked it or not, UK universities would be complicit in this decision by the UK Government. At the same time the message would be received loud and clear in academic and intellectual circles as strongly as in the chancelleries across the rest of Europe.

From the perspective of higher education two factors need to be considered in any discussion of the impact of the UK's withdrawal from the EU – one negative and the other positive. The first is where does this leave the UK system in terms of global positioning? 'Going it alone' in a global environment dominated either by present and would-be giants such as the United States and China and by increasingly coherent regional blocs is not a realistic option. The second is how far is UK higher education still 'at the heart of Europe', historically and scientifically? Although its links can be described as 'soft', in the sense that they are not the product of treaties, laws or regulations, they are more rather than less powerful as a result. The success of the Bologna process is perhaps a demonstration of how Europe might evolve more broadly in the 21st century – not only (or particularly) as a single economic area but as a cultural, even imaginative, space. In this wider context higher education and research are key domains, not peripheral areas, in the European project.

Facts and Figures

Higher Education in Europe 2010-11

Country	Student (millions)
Germany	2.56
United Kingdom	2.49
France	2.25
Poland	2.15
Italy	1.98
Spain	1.88
(Turkey)	(3.53)

Student and Staff Mobility

Student flows between UK and rest of European Union (2000-2010):	
Incoming	Outgoing
206,836	100,247

Erasmus Programme (1987 -2012)		
Student mobility	Staff mobility	Participating institutions
3 million	300,000	3,174

Erasmus student flows (2010-11)			
Outbound (thousand students)		Incoming (thousand students)	
Spain	36	Spain	37
France	32	France	28
Germany	30	Germany	25
United Kingdom	12	United Kingdom	24

EU students in UK higher education institutions (2011-12) **132,555 overall**	
Undergraduate: 83,090	Postgraduate: 49,465

European research programmes:
FP 7 (Framework Programme 2007-2013): 50.5 billion Euros
European Research Council (ERC): 7.5 billion Euros
3,400 grants made since establishment in 2007
ERC-funded projects: 334 UK, 301 Germany, 180 France and 126 Switzerland

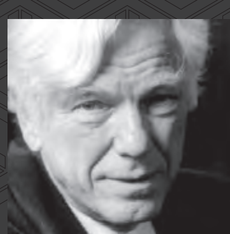
The Bologna process

Participating countries grown from 4, including UK (1998) to 47 (2013)

The debate about Sovereignty

Rt. Hon. Sir Konrad Schiemann

Former UK judge at the European Court, Luxembourg



Throughout Europe - and indeed the world - there are frequent references in political discussion, in the media and elsewhere, to some outside body or state "interfering" in the internal affairs of a country, interfering with "national sovereignty".

Rt. Hon. Sir Konrad Schiemann

The key issue

Throughout Europe - and indeed the world - there are frequent references in political discussion, in the media and elsewhere, to some outside body or state "interfering" in the internal affairs of a country, interfering with "national sovereignty". The writer or speaker takes it as self-evident that the concept of sovereignty is clear and that any interference with his nation's sovereignty is a bad thing. I suggest that such a concept of national sovereignty is too vague and general to be a helpful decision-making tool when deciding as a nation on how we should deal with any particular problems which confront us.

An all-embracing concept of sovereignty, which is based on the theory that all decisions in all fields must be under the control of a single sovereign, cannot play a useful part in the discussion as to the relationship between the UK and the EU.

The UK cannot control or contain within its borders the impact of policies pursued by other states or events which take place elsewhere. They impact on its citizens and its companies and institutions, whether we like it or not. Consequently it is in the UK's interest to acquire forms of constitutional control over decision-making by others which takes place outside its borders, in order to mitigate the bad and optimise the good effects on us of the actions of other states. The UK needs to share the sovereignty of others even at the costs of sharing some of its own.

Each state has aims and policies of its own, some of which will differ from, and others of which will be incompatible with, the aims and policies of the UK. In some fields continued differences pose no problem; in others continued differences frustrate the objects that one or more - or all - of the governments are trying to achieve. There is room for legitimate differences of opinion as to whether continued differences in any particular field are desirable, undesirable or simply do not matter, but a major policy aim of any government is to try and influence other states to act in a way which does not frustrate its own policies.

We no longer live in a time when the military and economic might of the UK was such that the Government could hope to achieve whatever it desired by threats. Gunboat diplomacy has gone. The achievement of our national aims requires the cooperation of other governments, just as the achievement of their national aims requires our cooperation. We cannot all do exactly what we want, because we do not all want the same things. Progress is made by giving up one desideratum in order to achieve another. This involves making choices difficult for all parties - a task which is made impossible if each party relies on a concept of sovereignty which implies that it must be free of all constraints and allowed to do whatever it wants.

International Justifications

Negotiating separately with many other states on every single issue where we have shared interests is not an efficient or effective way of making progress. That is why innumerable international bodies, including the WTO and the EU, have been set up. They facilitate negotiation by bringing their members together to discuss and decide on issues within the remit of the Treaties that set them up. The structure of the EU is designed to facilitate the inevitable compromises. The best democracy is one that insists on levels of democracy appropriate to the decision required to be made, and the doctrine of subsidiarity requires decision-making to be conducted at the lowest appropriate level.

It is inappropriate and ineffective to have one decision-making body for all decisions in a particular state. Some decisions by their very nature are best taken locally, left to parishes, for instance. Others are appropriately taken by County Councils. Others still should be taken by central government. And others are best resolved in international bodies. There may at times be legitimate argument as to the level at which a particular decision should be reached. However, to suggest that all decisions should in the last analysis be capable of being made by the nation state – and even more explicitly at the level of the national parliament or even by a referendum - is a fundamental misreading of the actual situation in which states find themselves in the contemporary world.

Democracy and Sovereignty

In contemporary democracies people are expected to exercise a high degree of political responsibility and they enjoy a high degree of political independence. They like - and are often expected - to make decisions for themselves, and the concept of sovereignty rests on that assumption and that desire. National sovereignty - the alleged international independence of a state, giving it the right and power to regulate its internal affairs without interference by any other state – is the right of the individual writ large for the community in which that individual lives. Underlying the concept of national sovereignty, which appears in political discourse in every nation, is the notion that the possessor of sovereignty has or should have absolute power to prevent others from interfering with his exercise of his sovereignty. But we all know that our individual sovereignty is limited, by the laws of the land, by moral imperatives, and by own strength or weakness, as well as the material resources we can command in our own society. We thrive when we compromise with our family, friends and neighbours, to optimise our situation in life, not when we insist on having our own way and throw a tantrum when we cannot get it. States live in an international community and are not dissimilar to individuals when it comes to sovereignty.

National sovereignty is a man-made concept designed essentially to prevent or limit the horrors of war. Historically it expressed an idea that the individual ruler could do what he liked in his territory, but in return must let other sovereigns do what they liked in theirs. This may have been as a way of resolving some of the issues arising from the wars of religion in the sixteenth and seventeenth centuries, but more recent mass slaughter, often of vulnerable minorities, carried out by various states in the exercise of their absolute sovereignty within their own borders, has frightened neighbouring states and horrified world opinion. So nowadays it is widely accepted that interference by outsiders in the internal affairs of another state - infringing their sovereignty - is at times desirable in the common interest of humanity, of all of us as individuals, even in the teeth of opposition by the state concerned. The debate centres on in what circumstances it is desirable or permissible to intervene or interfere, and what form any intervention/interference should take.

After the Second World War, the democratic states of Western Europe, grouped together in a number of international organisations, agreed to various rules which limited their sovereignty in specific fields. In the context of the European Union an additional issue arose because the member states not only signed Treaties and set up institutions to make laws but also agreed to abide by the laws that those bodies might make in the future. In so doing, member states were exercising their individual sovereignty in the present by limiting their sovereignty in the future. They created a dynamic process which has led to more decision-making at EU level, and a reduction in the range of issues that can usefully be decided at national level.

One can have a fruitless debate as to whether this dynamic is compatible with the doctrine of sovereignty. The fact is that the treaties were the result of decisions to co-operate in order to achieve aims jointly which no state was in a position to achieve on its own. But one must also recognise that, since member states created law-making institutions and gave those institutions powers to make laws and decisions in the future, Member States lost what power they had to act independently in the future in those fields.

Temporary concessions or permanent arrangements

Previous governments entered into these agreements. Are present governments or parliaments bound by them? Backwards-looking defenders of the notion of national sovereignty assert that it cannot be given away by one generation at the expense of the next. This is strange, since there is no way to define a generation for this purpose. We are all born, we live and die on a continuum, and so the logic of this argument is that at any time such shared sovereignty can be recalled or cancelled. But this is nonsense, since it introduces an element of permanent instability into all international relations. Once concluded, such a sharing of sovereignty is assumed to be permanent, and that assumption must be valid for all partners to the compact.

Concepts such as sovereignty are there to help us solve our political problems and should not be used to prevent us from doing to. It is obvious that agreements from which anyone can escape at any time are pretty well useless. For shared sovereignty to be effectively exercised requires mutual trust and mutual commitment. If you wish to obtain the certainty that your partner will be bound by the agreement even when he or she finds it inconvenient, then you have to live with the fact that you must agree to be bound by it even when you find it inconvenient.

In any event all useful discussion in this field must be rooted in practical realities. It is clear that some countries are more powerful than others, but it is equally clear that even the most powerful cannot achieve all that they might wish to achieve without the cooperation of others. A state's domestic law may permit it to export sausages with a large bread content, or beer with a small hop content, or indeed nuclear detritus or other refuse. But this is of no practical value unless other states permit the import of those goods. So mutual agreement has to be reached. A state may design its own road signs but this is of little practical value unless drivers from other states easily recognise the meaning of those road signs and obey them. So uniform practice is needed. A state's domestic laws may limit radiation emissions or prescribe air quality of a particular purity, but this is of limited practical value if emissions or air of inferior quality comes in from the state next door. So equivalent standards are desirable. A state may wish to encourage its companies to establish subsidiaries in other states, but this is of little practical value unless the other states in question allow the establishment of such subsidiaries. So mutual recognition is required.

In order to reach agreement one can act in a series of bilateral negotiations or have multilateral negotiations. In either case the process is a voluntary one on all sides. Any state can, in the last analysis, block any other state's desires. Each state can impose different conditions and so create a business and bureaucratic nightmare for anyone exporting goods or offering services to several countries with different regulations and mutually incompatible requirements.

If such a system as the European Union has its own law-making powers, then you may be in a position to achieve your goals - and bureaucratic simplicity - by persuading the appropriate bodies to legislate with the appropriate majorities for all the states that are party to the original compact. That is delightful if it enables you to get your way in the face of opposition. The downside is that the same technique can enable another state to get its way in the face of your opposition. You have to take the rough with the smooth, and you have to accept compromise.

Practice and theory

Different problems require different solutions, and therefore it is unhelpful to assume that a doctrine of sovereignty necessarily imposes extreme solutions independent of our volition and allocates all power to one source – a "superstate" - beyond our own nation state. The truth of the matter is that decisions have to be made in all sorts of different fields as to what institutions should regulate what problems, and the Member States are party to these decisions. In each of those fields different procedural requirements can be prescribed. An abstract insistence on sovereignty does not give any assistance to understanding and analysing the underlying issues in any particular case.

Politicians seeking election tends to give the impression that, once elected, they will and should have power to achieve what they promise their electors. Otherwise why should anyone elect them? The more power to which they can plausibly lay claim, they assume, the more will voters take the trouble to vote. In consequence all politicians of whatever party tend to oppose those who assert that politicians have less power than they claim. Likewise they oppose those who seek to remove from politicians some of the power that they in truth do have. This reaction may be understandable, but an explicit, or more usually implicit, assertion by politicians that they have more power than in truth they have is a very bad basis upon which to frame major national policies.

It may be irritating and frustrating for UK politicians to find they have less power – especially in international relations – than they thought they had when they were electioneering. The problem is that they will find themselves even more irritated and frustrated if politicians in other countries assert their nation's sovereignty to entitle them to do acts which disadvantage the UK. If the UK claims to exercise sovereignty over a matter, it must in effect accept the right of others to do the same. Then the question becomes whether on the whole we get a better deal if we stress everyone's sovereignty or if we accept limits to everyone's sovereignty, and share its exercise together.

The truth of the matter is that national politicians as a matter of practical reality have far less power than they often claim. Political memoirs written in old age repeatedly recount how the author found himself or herself out of reach of levers which he or she wished to pull. And pulling those levers which were within reach proved ineffectual and underlined their powerlessness. Experience tends to show that co-operation - a bit of give and take - is often the best way of achieving some desired goal, and that the occasional shortfall in one's desires is compensated by gains in other fields.

The major achievement of the EU has been the setting up of a mechanism for arriving at policy decisions which bind everyone. The mechanism is based on contributions by elected national politicians, an elected European Parliament, an appointed civil service and an appointed judiciary. The mechanism specifies different degrees of consensus required for different types of decisions. Some describe this as sharing sovereignty. If one insists on using the word sovereignty in the intellectual analysis, then this is not a bad phrase.

Future perspectives

The result of the operation of the EU mechanism is legislation and decisions which, over a period of time and on the whole, are now regarded as acceptable compromises between differing viewpoints. Over the last sixty years the traditional way of resolving European disputes by force has become a historical curiosity. By and large the citizens of the EU have become wealthier and more secure, more educated, more able to work in different countries, and they can be cared for by the medical and social systems of those countries. By and large the individual citizen has acquired greater personal freedom than was previously the case. Countries which have escaped from dictatorship have found a political system in which their citizens can develop their talents more freely. Some decisions, after a while, may turn out by common consent to have been unwise. If there is a consensus that they require changing and an acceptable alternative can be found, then they can be changed. The same is true at national and local level.

In my judgment it is not wise to put all this at risk because of an inflexible application of outdated doctrines of national sovereignty to all issues. We should look at each problem separately, identify what we are trying to achieve and what is the best way of achieving it. This will seldom turn out to be an appeal to national sovereignty which by its very nature is likely to antagonise others and give rise to opposing claims. The most effective way for the UK to achieve what it wishes to achieve is by seeking to persuade others that they are likely to achieve more of what they want if they do not stand in the way of the UK achieving what it wants. We need allies and alliances.

This is more easily done within the EU than outside it. If we are outside, those countries inside will devote their energies to doing deals with their partners inside the Union and are likely – politely or less politely - to ignore us. They may well do deals at our expense, since we are not present or party to them, and that would not be in our interest.

When other countries outside the EU – such as the US – wish to deal with European states, they will make more concessions to a larger bloc of 500 million or so inhabitants than to a smaller country – like the UK – with 60 million or so. There is strength in numbers, and isolating ourselves from our neighbours limits our sovereignty. It is no way to achieve the critical mass necessary for successful trade negotiations in the modern world.

The EU constitutes the first truly multi-centered continent-wide polity since the emergence of the European state system more than three hundred years ago. Instead of a new hierarchically organised construct modelled after the nation state, we are confronting a situation where different authoritative orders and circles overlap, compete and collaborate. The word sovereignty means something much more nuanced and multi-facetted in this new context than it did in the past.

Conclusions

Peter Sutherland, KCMG

Chairman of Goldman Sachs International, former Irish Attorney General, Director General of the World Trade Organisation and European Commissioner for Competition

It is a familiar reflection that globalization reduces the role of individual European states in international fora. A Britain outside the European Union would certainly count for less and less on its own account than it can as a leading member of the European Union.

Peter Sutherland

Analysis

Most political commentators believe that the United Kingdom will, by one path or another, hold in the next five years a referendum on its membership of the European Union. If the British electorate is to make a rational and sustainable decision on this issue, it is obviously vital that the coming years should see an intensification and refinement of the European debate within this country. Much of what currently passes for reporting of European questions in this country is superficial and tendentious, often deliberately so. All the more praiseworthy therefore is this initiative of Regent's University in bringing together such a distinguished group of independent experts and commentators to analyse a range of issues concerning the United Kingdom's position in the European Union. Each author has carefully considered costs, benefits and options for Britain and the European Union in his or her area of expertise. The overwhelming conclusion that I believe any fair-minded reader must draw from these contributions is that Britain is much better off in the European Union than outside it.

Negotiating power

I come originally from a smaller member state of the European Union and have spent much of my public career in the field of international trade negotiations. It is not perhaps surprising therefore that I place the debate about British membership of the European Union firmly in an international, particularly trading context. There is a growing awareness in the United Kingdom that the template of relationships between the European Union and other developed countries outside the Union such as Switzerland and Norway is an unsatisfactory one for the latter. Switzerland and Norway have considerable obligations towards and limited rights to expect from the European Union. Those controversialists who argue that Britain outside the European Union will inevitably be able to negotiate arrangements for itself with the Union much more favourable than the Swiss or Norwegian models have little ground for their optimism. There is on the contrary good reason to believe that Britain's negotiating hand would be considerably weaker than that of Norway or Switzerland. There would be little incentive for the remaining countries of the Union to reward to their own disadvantage a country which will have caused such disruption to its neighbours by its decision to abandon them.

Global standards

It is a familiar reflection that globalisation reduces the role of individual European states in international fora. A Britain outside the European Union would certainly count for less and less on its own account than it can as a leading member of the European Union. There is strength in numbers, and at the negotiating table "big is beautiful". But it is not merely in the set-piece negotiations of international trading diplomacy that Britain would find itself at a disadvantage estranged from the European Union. The hope that to any significant extent the United Kingdom could emancipate itself from the regulatory "constraints" of European legislative activity is anyway a chimera. In its trade with the remaining European Union, the United Kingdom would obviously be expected to observe the rules of the Single European Market, as it does currently, these rules developing over time with little or no British influence on their evolution. But the rules of the European Union's single market are widely observed throughout the rest of the world as well, not least in the United States of America. The European Union is in many regulatory respects a global standard-setter. In turning its back on Europe, Britain will in no way be easing its trading relations with the rest of the world. Britain's attractiveness to trading partners outside the European Union is likely, paradoxically, to depend to an increasing extent on its observance of European norms and standards in its trade with them, irrespective of whether Britain remains a member of the European Union or not.

Sharing sovereignty

These economic and trading realities have their political implications as well. One contributor quotes Winston Churchill's article of 1930, in which he wrote that "as international structures become more complex … (they will) require not the merging or discarding of various loyalties, but their simultaneous reconciliation in a complete or larger synthesis." In my view, the European Union is the most successful attempt yet undertaken to achieve this larger synthesis. It would be weakened, not fatally but noticeably, by an attempted British regression to simply national decision-making. This would be neither to Britain's advantage nor that of its neighbours. Britain has often over the past forty years found the principle, and sometimes also the practice of sovereignty-sharing within the European Union irksome. But in an interdependent world, and more particularly in an interdependent Europe, sovereignty-sharing is not an option that national governments or electorates can accept and reject at their pleasure. Sovereignty-sharing is an unavoidable reality. Without it the European Union would cease to exist. It is only the terms and extent of this sovereignty-sharing that are reasonable subjects for political dispute. This insight is as applicable to the larger member states of the Union such as Germany and the United Kingdom, as it is to the smaller such as Ireland and Slovenia. Discussion therefore of sovereignty as an absolute issue is absurd. Sovereignty is in reality the power to have true influence over one's own destiny, and membership of the European Union enhances that sovereignty rather than diminishes it.

Reform process

The preceding articles in this Report make it clear that there is still much to do to improve the European Union. Like all member states, Britain has preferences and policies that it wants to advance within the Union, and on many of them it has firm allies, which if anything are growing in number. There is a widespread recognition within the Union that Europe needs to be more flexible, more innovative and more competitive in its economic structures. Britain has much to contribute to this agenda, the implementation of which will help British economic recovery as much as that of the rest of Europe. It would be political and economic self-harm of a tragic degree if the United Kingdom deprived itself by withdrawing from the European Union at a time when the implications of the global financial crisis are still working themselves so painfully, but importantly, through the economic and political structures of Europe. I have always very much shared the view of Jean Monnet, that the European Union is not a product but a process. How the European Union will evolve over the coming decades will be for the United Kingdom a crucial question for its economic and political well-being. To accept any limitation upon Britain's ability to shape this evolution by withdrawing from the European Union would be, properly understood, a diminution rather than an enhancement of British national sovereignty.

REGENT'S
UNIVERSITY LONDON

Regent's University London is one of the UK's most respected independent universities and one of the most internationally diverse, with around 140 different student nationalities on campus.

To order additional copies or download a digital version please visit www.regents.ac.uk/europereport

Web www.regents.ac.uk/europereport
Email research@regents.ac.uk

Price £25