

# *The United Kingdom and the European Union: Inevitably Drifting Apart?*

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## I. INTRODUCTION: THE UK'S DEBATE ON MEMBERSHIP OF THE EU

I AM DELIGHTED and truly honoured to be able to speak to you tonight to deliver the 2014 Mackenzie-Stuart lecture. President Barroso was speaking in London last Friday where he said: 'The European Union would not have become what it is today if it weren't for British politicians and entrepreneurs, British thinkers and British ideas'. Scholars from this University and from its Centre for European Legal Studies have contributed enormously. Looking just to the Union's Courts, Judges Lord Mackenzie-Stuart, David Edward, Konrad Schiemann, Christopher Vajda and Nicholas Forewood, Advocates-General Francis Jacobs and Eleanor Sharpston are true architects of our Union.

It is tremendously inspiring to come to a university that has been inextricably linked to excellence and culture for centuries. A place that puts great value on acquiring and passing on knowledge, but also encourages people—especially young people—to question and to debate. In doing so, your university is nurturing that great British debating culture which pervades not only academia and politics, but the whole of British society. Because the people of this country love to scrutinise. To challenge the establishment and hold the powerful to account. For you it comes naturally not to accept, but to probe; not to shout, but to reason; not to walk away, but to engage. Independent-minded, yes, but usually settling for the rational, the pragmatic view. This is a great strength of this country, something to be proud of.

How astounding, then, that the most important questions we are faced with in Europe are debated so very differently in this country. As soon as the issue of the United Kingdom's relationship with the European Union is raised, a strange reflex seems to kick in, pushing the public debate away from the facts.

I believe, to make this clear from the start, that the United Kingdom should be a central part of the European Union. This country has so much to gain from being in our Union, and the EU benefits greatly from having the UK as a confident member. To my mind, all the arguments, the hard facts, indicate that it is in the UK's national interest to remain part of the EU. Yet, what we have been seeing over the last couple of years is a sense that the UK is gradually, inexorably drifting away. As other countries, in particular the members of the Eurozone, have integrated much more strongly, the UK has remained apart. And it is preparing to loosen its ties to the rest of Europe in a number of policy areas. Will it sever them in the coming years? I sincerely hope not. This can be avoided, though the politicians and the people of this country will have some crucial choices to make. Do you still want to be part of this Union? How closely do you want to work with the other Member States? How do you want to (re-)define your relationship with the rest of the EU? Of course we, Continental Europeans, also have to seek answers. Most importantly, we will all have to decide on a way of reconciling the closer integration of the Eurozone countries with the wish of others, like the UK, to stay away—at least for the time being—from the new architecture being set up.

## II. THE HARD FACTS: IT IS IN THE UK'S NATIONAL INTEREST TO REMAIN PART OF THE EU

Let us now look at some of those hard facts. The UK benefits enormously from EU membership, both economically and politically. The Confederation of British Industry (CBI) estimates that four to five per cent of British Gross Domestic Product (GDP) can be attributed to the fact that it is a member of the European Union. And that each British household would be £3,000 worse off each year if the UK were outside the EU, for this simple reason: that the UK conducts half of its trade with the EU.

EU membership brings British companies the biggest prize: unfettered access to the Single Market of more than 500 million people. Around 3.5 million British jobs are linked to the single market. That is around one in every ten jobs in this country. The EU's clout allows it to negotiate valuable trade deals with other trading partners around the world—opening up a plethora of further markets for British businesses.

Only as a member of the EU can the UK safeguard these privileges. Because, as President Barroso also rightly said, 'size matters'. Leaving our powerful trading bloc would severely restrict British companies' access to this goldmine—and make the UK a much less attractive trading partner for third countries. The example of the financial services sector demonstrates this very clearly. This sector is vital for the British economy, employing more than one million people and providing over 10 per cent

of the government's tax receipts. It is often pointed out—rightly so—that the City competes with financial centres outside the EU, like Hong Kong, Singapore and New York. In this context, the UK's EU membership matters enormously. The City would most definitely lose its unhindered access to the single market in the case of an exit. Because EU Member States would obviously have no interest in supporting what would then be an offshore financial centre competing with their own financial firms. And companies from third countries would find London a much less attractive location to do business, since it would no longer be a gateway to the EU's single market.

I can see why one of the leading NGOs for keeping Britain in the EU has given itself the name 'British Influence'. The truth is, outside the EU, the UK would lose influence. Every day, banks and other financial services firms in the City carry out a huge number of transactions with their counterparts in the rest of Europe. In 2012, the City's trade surplus with the EU was £16.6 billion—more than a third of the UK's total finance sector surplus. This trade in financial services is extremely valuable for the British economy. That is why it is in the UK's interest to have a say on the rules that govern these transactions. If the UK were to leave the EU, however, it would no longer be able to influence EU regulation. It would have to live with the rules decided on by the EU countries—and these countries, some of them with little or no financial services industry of their own, would have very little incentive to take the City's needs into account.

This is the hard truth. So why do some Euro-sceptics argue that the UK would be leaner and meaner on the outside, rid of all that alleged red tape imposed by the EU? After Britain's exit, they say, special access to the EU Single Market would be negotiated, this time at an advantage. They add that focus should shift to trade with other parts of the world. Maybe, also the Commonwealth could be revived.

So many ideas, so many lazy assumptions: 'fatally flawed', to use the words of the think tank, 'the Centre for European Reform'. First, to get access to the Single Market, you have to apply its rules. Just ask the Norwegians. It's difficult to see why the other Member States would grant the UK unfettered access to their markets without requiring it to apply the EU's rules. The equation would be simple—the more EU rules you apply, the more access to its market you will get. Secondly, the share of the UK's trade with the rest of the world is rising precisely *because* it is a member of the EU. It is testament to the effectiveness of the EU's trade policy in opening new markets for EU exports. The UK alone would not have the clout. And as for the Commonwealth, it represents only eight per cent of the UK's trade.

I would like to echo the words of Prime Minister Cameron, who very recently said the following with regards to the Scottish referendum on

independence: 'The plain fact is we matter more in the world together'. Well, the same is true in the case of the EU.

### III. DRIFTING APART: THE EUROZONE INTEGRATES AS THE UK SHUFFLES AWAY

In spite of the strong business case for UK membership of the EU, there is a clear sense, not just that the UK is semi-detached, but that it is drifting away. Dissatisfaction has moved well beyond the traditional bugbears like the Working Time Directive—whose impact on the private sector is limited, by the way, as even business representatives admit. Because British companies widely use an opt-out clause in the directive that allows individual employees to work more than the regulated 48 hours a week.

While we are used to people in this country fretting about issues like this one, their unease in other areas is more unexpected. Take the issue of free movement of EU citizens. You would think that a country as traditionally open to the world as the UK would embrace this fundamental freedom wholeheartedly. And for a long time it did. Let me give you a concrete example: Lord Mackenzie-Stuart was one of the judges sitting in the *Van Duyn* judgment of 1974.<sup>1</sup> In this case, it was a UK jurisdiction that asked the Court for the first time whether the provisions of the Treaty on free movement of workers were directly applicable. And the Court for the first time answered 'yes'. It held that workers in the Union can avail themselves directly of the freedom of movement without any discrimination on grounds of nationality.

Now something has changed. Openness is no longer seen as opportunity, but as a threat. Across political parties, there is talk of curbing immigration, of closing doors. Politicians have even abandoned their policy of pushing for ever more enlargement of the EU and are now taking a much more cautious stance. Whilst I welcome the fact that they finally agree with me on this topic, I still have to say this is a remarkable U-turn.

I have made my position clear: the four freedoms enshrined in the EU Treaties come as a package. You either enjoy all of them—or none. Those who benefit from the free flow of capital, goods and services must also accept that our citizens are free to move in the EU to travel, study and work. And the European rules allow Member States to fight abuse of this right.

I understand that in economically difficult times, people are worried about jobs, about opportunities for their children, about their ability to access public services. That is why all of us, but particularly politicians and businesspeople in this country need to reassure people. The people have a

<sup>1</sup> Case 41/74, *Van Duyn v Home Office* [1974] ECR 1337.

right to know the facts—for instance that 77 per cent of those EU citizens coming to the UK are in employment, a higher share than nationals, and a much higher share than third country migrants. They also deserve to hear that the UK hurts itself by making it more difficult for bright young people to come here to study and work, and by hampering the many employers who are looking to fill vacancies but cannot find suitable employees within the British workforce.

Politicians also need to work on the quality of education and welfare, so that people in this country can find employment and enjoy reasonable social standards. Simply trying to project all problems onto the supposed issue of too many foreigners moving into the country is certainly not the answer.

The discussion about EU policy in the area of police and judicial cooperation in criminal matters displays the same pattern. Of course, this is a challenging area in which the UK's common law tradition must interact with the civil law heritage of the majority of Member States. Yet all the elements that should ensure the UK's participation are in place. At present, the UK is only bound by instruments it has voluntarily opted into: all the measures were adopted under Protocols which give the UK broad opt-out rights. Most of these measures are not developments of the Schengen *acquis*, meaning that the UK can decide whether or not to participate on a case-by-case basis.

It is astounding to see the caution gripping the UK in this area. After all, the principle of mutual recognition, which underpins the European Arrest Warrant, was first advocated by the UK itself. Far from being an alien concept foisted on the UK by the EU, it is in fact a system which originated in this country and one which is still applied today between the different parts of the UK. Even more than this: the principle of mutual recognition was introduced for the first time into European law by the famous *Cassis de Dijon* judgment of 1979.<sup>2</sup> Lord Mackenzie-Stewart, to whom this lecture is dedicated, was again one of the sitting judges.

So why has the prospect of full judicial control by the Court of Justice shaken these foundations? The UK's Government has notified its intention to opt out of 135 measures in this area. This has raised considerable concern—voiced by practitioners, Police Chiefs and even a former Director of MI5. Cambridge's Centre for European Legal Studies has warned that the UK could become 'the Brazil of the EU' were it to opt out. Regardless of these warnings, the Government has pressed on. It has announced that it will request to opt back into certain measures. But this is an uncertain process in which decisions are taken by a qualified majority of the Member

<sup>2</sup> Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 42.

States, without the participation of the UK. It will lead to uncertainty in an area where clarity is needed to ensure our mutual security.

Just as the UK drifts away from the EU, there has been a strong push for integration in the Eurozone. This integration has been extraordinary. The economic crisis brutally exposed how incomplete and inadequate governance of the Eurozone was before the crisis. As a consequence, major reforms were undertaken. The economic and fiscal policy is much now more strongly coordinated and supervised at EU level. The aim is to spot difficulties early on and stop them spreading from one country to others. The European Commission is now even responsible for analysing the budgetary plans of euro area countries before national Parliaments have had their say—this development would have been unthinkable of a few years ago.

And stronger integration does not merely concern fiscal policy, it goes much further. A key plank is the European Semester, a yearly cycle of economic policy coordination. Member States draw up programmes for economic and structural reforms designed to improve competitiveness and drive economic growth and job creation. The Commission then analyses them and issues detailed recommendations for the next 12–18 months. The scope of these recommendations is broad—they cover issues such as taxation and pensions, public administration and the labour market. Suggested reforms include initiatives as diverse as improving companies' access to finance, promoting research, adapting wage-bargaining systems and making it easier to set up a business. Even though these are recommendations, the degree of coordination is remarkable.

Similarly huge leaps are being taken in the financial sector. To make our banks more stable and to ensure they fulfil their role of responsibly lending to businesses and consumers, we are building a Banking Union. We have already set up a central supervisor. This will soon be complemented by a common system for restructuring and resolving failing financial institutions that involves pooling money at EU level to be used in such cases. Again, a few years ago no one could have imagined Member States being prepared to cede sovereignty in such a sensitive area. But we learned the lessons of the crisis and created the necessary instruments to avoid problems in the future.

In order to strengthen the Single Currency, the Union had to address the causes of the crisis which lay in Member States' fiscal bases, their financial sectors and the potentially fatal link between the two.

All these reforms have serious implications for the EU's Single Market. Whereas in the past, the Single Market and the single currency developed side by side, the crisis made clear how interconnected the two are. For the Eurozone members, the ultimate goal is to ensure the stability of the euro. They view and approach the new rules and architecture first and foremost with this objective in their minds. While a stable currency union is obviously also essential for Member States outside the Eurozone, their main

interest may lie elsewhere—for instance in preserving the Single Market for all 28 EU countries and their unimpeded access to it.

These different starting points create strong tensions. And these tensions are likely to grow as the process of stronger integration of the Eurozone advances further. We have made great strides, but more bold reforms will be needed. Of course the debate on the future of the EU is ongoing, but there is a strong case for a true fiscal and ultimately political union. In my personal view, the Eurozone should become a kind of ‘United States of Europe’. Like Winston Churchill, I believe that the UK will not be part of this, but it should remain a close ally with the federated Eurozone, with which it would continue to share a common market, a common trade policy and hopefully a common security agenda.

How then do we ease the tension and reconcile the interests of Member States which share a currency with the interests of others? This is the crucial challenge we will have to master over the next 5 to 10 years. Given its dependence, for better or for worse, on its financial services sector, resolving this issue is the key to the UK’s future in the European Union.

#### IV. A SEPARATION IS AVOIDABLE: FINDING THE RIGHT LINK BETWEEN THE SINGLE MARKET AND THE SINGLE CURRENCY

This will require two preconditions. First, the UK should accept that it is in its interest to allow the Eurozone members to do what it takes to strengthen the euro. This was not immediately clear to British politicians. The UK opposed the proposed Fiscal Compact, forcing the remaining Member States to proceed on an inter-governmental basis to save the single currency. Since then, the tone and the policies have changed. The Chancellor has said very clearly that a stable euro on the UK’s doorstep is good for growth and jobs in the UK.

Secondly, the Eurozone members must acknowledge the need to find solutions where their interests are different from those of the Member States who do not share the single currency. Otherwise, they risk pushing the UK out of the EU before it decides of its own accord, as it might, to jump.

Striking this balance has so far not proven easy. That might explain why the views of the European Court of Justice are in high demand. Take the lawsuits against EU rules curbing bonuses and against plans by some Member States to introduce a financial transaction tax, or the latest one concerning ‘short selling’. Obviously, it is neither in the UK’s interest nor in that of the other Member States to negotiate their relationships through court cases. And there are signs that when the two sides are willing to find solutions, progress is possible.

In a positive tone, the area of banking regulation offers some interesting examples of how the other Member States and the Commission accommodated the UK's interests and concerns. Take the rules governing the European Banking Authority (EBA) in London. By developing the single rulebook for Europe's financial institutions and promoting consistency of supervision across all 28 EU Member States, the EBA has a crucial role in ensuring a level playing-field for European banks and preserving the Single Market in financial services. While the Eurozone countries were setting up the Single Supervisory Mechanism, the UK was worried that they would form a bloc to outvote it on the EBA's Board of Supervisors which is the main decision-making body of this institution and where each of the national supervisors is represented. This was resolved through the creation of a double majority voting system: now, when the EBA decides, for instance, on binding technical standards, a majority of both Eurozone and non-Eurozone countries need to agree for the standards to come into force. Another example: Eurozone countries agreed to insert a non-discrimination clause into the Regulation setting up the Single Supervisory Mechanism. It states that 'no action, proposal or policy of the ECB shall, directly or indirectly, discriminate against any Member State or group of Member States as a venue for the provision of banking or financial services in any currency'. This clause recognises that London's role as a leading financial centre is based in part on the euro-denominated banking services it provides. The purpose of the clause is to prevent any restriction of London's role as a financial centre in the Single Market through measures connected to the euro.

What's more, when drawing up its proposals for the structural reform of banks, the European Commission took the situation in the UK into account. One of the key elements of the draft regulation would give supervisors the power to require large banks to separate certain potentially risky trading activities from their deposit-taking business if the pursuit of such activities threatens financial stability. In the context of the Banking Union, the ECB would be the supervisor taking this decision for the countries taking part in it. Rather unusually, for a regulation grounded on a single market legal basis, it opens up ways for a Member State to apply its own rules on this particular point: a derogation may be granted to individual banks that are already subject to equivalent measures in another Member State. This means that banks in the UK, if already subject to British ring-fencing rules, would not necessarily have to apply a second set of EU rules.

Of course, this could still be changed during negotiations by the Member States and the European Parliament. But if the provision stays, the UK could use it, as it is already in the process of implementing its own rules designed to reach the same objective, but in a different way (by requiring banks



to ring-fence the deposit-taking part of their business against difficulties arising from their riskier activities).

## V. CONCLUSION: A DEBATE THAT LIVES UP TO BRITISH STANDARDS

This brings me back to what I said in the beginning. The debate in this country about the UK's place in the EU is distorted. All that talk about opt-outs, renegotiations and referenda distracts from the real issue. Finding more solutions like the ones I have described is what we should all be focusing our energy and creativity on.

Unfortunately, the debate is distracting from the real challenge in the relationship between the UK and the EU. And it is even inflicting wider damage by holding back our Union as a whole. We don't need this. What we need are great ideas and solid arguments about how we can strengthen the EU and make it more competitive on the world stage. What we need is to push for valuable policies: creating a real single market in services, strengthening small and medium-sized enterprises, boosting free trade with other parts of the world.

The UK could make a real difference here, and this is one of the reasons why I would argue that the EU is stronger with the UK in it. Indeed, it is one of the reasons why I want it to stay in—and why I also want to say to you: if this country decides one day to be part of a stronger integration, you know where to find us. The door is open, and there is a seat at the table for you.

Right now, however, we have a problem: the potentially constructive and forward-looking arguments are overshadowed by the negative debate on the relationship between the UK and the EU. The solution? It should be clear to everyone in this room; everyone in this country, in fact. Mark Carney, Governor of the Bank of England, made it very clear in a recent statement. We need to replace the current debate, which leads to uncertainty for business and holds off investment, with constructive proposals that bring about certainty, investment and progress. This would be beneficial for both the UK and the EU.

The British can still do what comes naturally to them and debate their way out of this. They have every right, and even a duty, to be critical, to scrutinise and to question. But whatever they do, I just hope they do it in true British style.