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**Research Report**

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# Core Europe and the United Kingdom

## Risks, Opportunities and Side-effects of the British Reform Proposals

*Nicolai von Ondarza*

The EU is in the midst of completing one of its most delicate negotiations to date – the talks on the “EU Reform” with which British Prime Minister David Cameron hopes to persuade the British to vote to stay in the Union. The heart of his vision for the EU is flexibility. Britain should be given the opportunity to cut loose from further EU integration and concentrate its membership on a deepened internal market. As such, Cameron is proposing to consolidate his nation’s existing special position within an increasingly differentiating Union. Concrete political considerations aside, the EU states must therefore find answers to two central questions in the negotiations: How much differentiation, how many opt-outs, can the European Union withstand? And how can a single market of 28, a Eurozone of 19 and more permanent differentiation be better managed?

Under the impression of manifold crises, the European Union is experiencing two closely linked parallel processes. On one side, differentiation has become a constitutive element of European integration. Over the course of the European debt crisis, the Eurozone has increasingly consolidated into a core Europe that is much more closely economically integrated than the rest of the Union. Equally, the refugee crisis, the relocation of asylum-seekers and the initiatives for joint border protection all only affect members of the Schengen zone.

On the other, during the same timeframe, precisely the member whose existing opt-outs from the common currency and Schengen actually put it outside the current crises asserts a massive need for reform. This is of course the United Kingdom.

After his re-election in May 2015, David Cameron kept his promise to set in motion a referendum on EU membership and initiate negotiations with the other member-states about an “EU reform”. In the talks he hopes to achieve a new status for the United Kingdom within the Union, in order to persuade the sceptics in the British electorate and above all in his own party to vote to stay in the Union. In his plans for this, differentiation is again the central element.

### **Demands for Greater Flexibility**

Prime Minister Cameron has very concrete ideas about how this is to be accomplished. In November 2015, following intense consultations with the other twenty-seven governments and technical talks with the

EU institutions, he presented his goals for “A New Settlement for the United Kingdom in a Reformed EU”. If agreement is reached, the British government can hold its referendum within four months. London is therefore pressing for the talks to be concluded by February 2016, in order to hold the vote in summer 2016.

But there will be tough negotiations before any agreement can be reached. At a superficial level, the British government is principally demanding reforms for the Union as a whole; in Britain itself the package has already been dismissed as purely symbolic and cosmetic. At second glance, however, the proposals amount to a plan to turn the Union into a loose network. The EU partners should bear these long-term consequences in mind if they compromise on at least some of the demands to keep the United Kingdom in the EU.

### **The Internal Market as the Heart of European Integration**

Concretely, Cameron is seeking reforms in four areas: competitiveness, sovereignty, migration and the relationship between euro states and non-euro states. While the public debate focuses almost entirely on the issue of migration, but the three other areas also raise tricky questions. At first glance the politically least controversial topic is competitiveness. Cameron’s demands in this area largely coincide with the work programme of the current Commission and have attracted the most support during his tour of European capitals. He argues for a deepening of the internal market in areas like services, energy and the digital economy, and supports both the development of a Capital Markets Union and the expansion of the EU’s free trade agreements, including with the United States (TTIP), China, Japan and ASEAN. Although these projects are highly controversial in the European public spheres, and in detail between the governments, as general goals they enjoy unanimous support at EU level. Cameron is not calling for changes

to EU primary law here, but instead wants to press ahead with ongoing legislative and negotiating processes.

Nevertheless, here the British prime minister reveals his vision for the UK’s future place in the Union. He wants “the best of both worlds”, the advantages of the internal market without the obligations that come with other areas of integration. In his words, he explicitly regards the internal market as a matter of free movement of capital, goods and services, and thus implicitly excludes free movement of persons. He also wishes to reduce regulation and labour rights. Even if there is a great deal of support for this approach, the other member-states should insist on the link between internal market and free movement, in order to underline the fact that even non-EU states like Switzerland or Norway cannot have one – market access – without the other – free movement and shared regulation.

### **More than Just Symbolic: Sovereignty**

David Cameron’s second basket of demands relates to strengthening British national sovereignty versus the European Union. First, he wants national parliaments to be given greater influence, in the form of the right to join together to stop Commission legislative initiatives (“red card”). This would supposedly enhance the Union’s democratic legitimacy – but also implies strengthening national parliaments at the expense of the European Parliament. Rather than demanding a veto just for the British House of Commons, Cameron proposes that national parliaments should not only be able to raise objections to EU legislative initiatives – as with the existing “yellow card” – but be given the right to completely block them. The key question here is the size of the required quorum. As long as the current quorum of at least one-third of national parliaments is kept in place for the red card, such a reform would have little in the way of practical implications for the Union (see SWP-Studie 4/2014). But nor would it contribute meaningfully to

strengthening the democratic legitimacy of the EU or the sovereignty of the United Kingdom.

More decisive for the future structure of the EU is the demand to drop the objective of an “ever closer Union”. For British Euro-sceptics that clause is *the* symbol of what they regard as the EU’s boundless appetite for power and the transfer of ever more powers from London to Brussels.

The paradox is that even today no member-state can be forced to participate in an integration project. As the “masters of the treaties”, the member states possess a veto over any treaty change, a right that London in particular has repeatedly threatened to use in order to negotiate opt-outs, for example on monetary union, the Schengen Agreement and the application of the European Charter of Fundamental Rights in the UK. No treaty change since the Treaty of Maastricht has been adopted without London securing a new opt-out to avoid participating in at least one aspect of integration. Conversely, that also means that each time London refrained from actually using its veto.

If the other member states were to agree to strengthen this principle, there are still different means to put this idea into practice. Cameron’s maximum demand is a specific, legally binding opt-out from the “ever closer Union” for the United Kingdom. This demand is more than just political symbolism: Cameron wants not just to underline Britain’s permanent rejection of further integration – but also lay to rest the model of a multi-speed Europe in which the member states move at different speeds but ultimately towards the same objective, as with the euro. If the EU concedes this it will be opening the door for two developments: On the one hand, it would for the first time codify that the only longer-term options are core Europe or Europe à la carte, abandoning uniform integration as even a distant goal. On the other, it would open the floodgates for other member states that might wish to back away from the present state of integration. That currently means in par-

ticular Hungary and also Poland under its new government.

A better alternative would therefore be to reiterate the principle that the member-states themselves determine their level of integration. In fact, a political declaration by the European Council in June 2014 already confirmed that the concept of ever closer union “allows for different paths of integration for different countries, allowing those that want to deepen integration to move ahead, while respecting the wish of those who do not want to deepen any further”. This declaration could be made legally binding in order to stress the already inherent principals that underpin a multi-speed Europe without completely abandoning the course of European integration.

#### **One Differentiation Too Far**

Cameron’s third basket of demands also involves greater flexibility, namely in relation to internal migration from elsewhere in the EU, which London wishes to restrict. As an island outside the Schengen zone, the United Kingdom has remained largely untouched by the refugee crisis. Following the 2004 enlargement, when Tony Blair’s Labour government – unlike almost all other member-states – directly opened the British labour market to workers from the accession countries, the UK now hosts more than three million people from other EU countries. Although in overall economic terms Britain has undoubtedly profited from this migration, criticisms that London has lost control over immigration have caught the public imagination. For the British public (and thus for the referendum) migration is therefore the most important of the four areas. At the same time crucial European actors like German Chancellor Angela Merkel, Commission President Jean-Claude Juncker and the Visegrád states have defined freedom of movement as a non-negotiable red line.

As a result Cameron decided back in November 2014 to avoid challenging freedom of movement *per se*. Instead he pro-

poses to combat abuses of freedom of movement and reduce the incentives for EU citizens to migrate to Britain. He proposes that they should first work and pay taxes for four years before becoming entitled to receive British in-work benefits and tax credits. With this, however, London is calling into question the fundamental principle of non-discrimination, the requirement to grant all EU citizens equal treatment. Equally problematic, Cameron apparently wants to introduce differentiation into one of the core tenets of the internal market, which has been firmly anchored in the treaties since the founding of the Union. This is the prime example of differentiation being used to cherry-pick only those rules that benefit a state while rejecting the overall principles underpinning the EU. From the European perspective that is one differentiation too far, and would seal the shift to a Europe à la carte where member-states pick and choose only those aspects that serve their interests. That would further stretch the Union's already battered cohesion. It is hardly surprising that this issue has therefore become the make-or-break question in the negotiations between the UK and the other member states.

If at all, a compromise should therefore be sought that does not involve new privileges for the United Kingdom, but applies to all twenty-eight member-states. One possibility would be – similar to Schengen – to give the member-states options to impose temporary restrictions in emergencies. As the refugee crisis and the current situation in the Schengen zone demonstrate, however, these emergency options would need to come with clear temporal and functional restrictions.

### **A Viable Relationship between Eurozone and Non-Euro States**

Cameron's fourth package of demands is a different matter: the relationship between the Eurozone and non-euro states in the internal market. This is an area whose technical nature means it plays only a minor

role for British public opinion – but it is of exceptional importance to the British government. In essence, London wants to avoid any potential negative effects of staying out of the Eurozone.

The background to demands in this area is obvious: the United Kingdom already enjoys a permanent opt-out from the third stage of monetary union and will not be introducing the euro in the foreseeable future. But the Eurozone has deepened in the course of the European debt crisis since 2010 and further integration steps are at least under discussion. Unlike Denmark, Poland or Sweden, Britain has participated in none of these integration steps. At the same time, with the City of London, it is home to the EU's largest financial centre, where euros are traded in greater volumes than in Frankfurt or Paris. It is above all the financial centre that Cameron wishes to protect. Concretely, the British government is concerned about two different risks.

### **Fear of Discrimination**

First of all, London wants to protect its businesses from discrimination by the Eurozone. Cameron is calling for a ban on discrimination and greater transparency in Eurozone decision-making. As one example of discrimination, British Chancellor of the Exchequer George Osborne cited an ECB decision of 2011 under which clearing houses trading primarily in euros must also be based in the Eurozone. From the British perspective this decision clearly discriminated against the City of London and was regarded as an attack on the compatibility of the internal market with a separate British currency. London subsequently successfully challenged the decision before the European Court of Justice.

From the European perspective this concern should also be regarded as legitimate. The general instrument for differentiated integration, enhanced cooperation, already stipulates that decisions made under its scope, such as the financial market transaction tax, must have no discriminatory

effect in the internal market. In its ruling on the ECB decision the European Court of Justice suggests that this principle also applies implicitly in relation to the Eurozone. A legal anchoring of such a prohibition of discrimination would therefore be acceptable to the Eurozone and the EU. And as long as this principle can only be enforced through the courts, the decision-making of the Eurozone would not be impaired.

But Cameron is also demanding that the Union formally confirm that it has more than one currency (“a multi-currency Union”). Presently the euro is treated as the currency of the Union, from which certain member-states are exempted either permanently (United Kingdom, Denmark) or temporarily (for example Poland, Hungary, Sweden). But apart from Britain and Denmark, all the other member-states are legally required to introduce the euro in the course of time. Although they will not be forced to do so, explicit recognition of a multi-currency Union would – like abolishing the objective of an ever closer Union – cement a permanent division between Eurozone and non-euro states, in the sense of a core Europe.

#### **(No) Eurozone “Caucus”**

Even more important from the British perspective is to prevent the Eurozone states from joining together to dominate the non-euro states, including Britain. The possibility of such a “caucus” has existed in theory since November 2014, when the reform introducing qualified majority voting in the Council of the European Union (under the Treaty of Lisbon) came into force after a five-year transitional phase. Under the new arrangement a decision requires 55 percent of the member-states, representing 65 percent of the EU population. Unlike in the previous system, whose politically weighted voting rights favoured the smaller and medium-sized member states, the nineteen euro states now possess a qualified majority on their own. Thus, they could now push through decisions even against all nine

non-euro states, as they represent 68 percent of the EU states and just above 66 percent of the EU population. This could strengthen the position of the euro states in negotiating situations, *if* they were able to agree in advance on a joint position.

But in reality the Eurozone is further away than ever from such a unified position. In the debt crisis and the protracted Greek “rescue”, fundamental differences in economic policy alignment – not least between Berlin and Paris – have exploded into open disagreement. In 2011 the introduction of a financial market transaction tax in the EU-28 was torpedoed by the principle of unanimity, especially London’s categorical rejection. But even within the Eurozone there was no united front for the proposal. Ultimately only eleven Eurozone states joined together in an enhanced cooperation to introduce the transaction tax in principle, and they have yet to agree on the details.

But above all, no structural dominance of the euro states can be discerned in practice, not even towards the United Kingdom. Examining the about seven hundred votes the Council of the EU has published since 2009, the United Kingdom was outvoted in 12.6 percent of cases (43 no votes, 46 abstentions, source: VoteWatch Europe). That is by far the highest figure of all the EU states. But this has little to do with its status as a non-euro state. The next three on the list are Austria, Germany (each 5.6 percent) and the Netherlands (4.8 percent), all three of which are euro states. Moreover, of the fifteen states with which the United Kingdom most frequently voted together, only two are non-euro states (Sweden and Denmark), the rest are euro states. This also holds for votes concerning the internal market.

#### **No Quasi-Veto**

Various models for better safeguarding British interests in the EU are nonetheless being discussed in London. David Cameron has not laid out a specific demand here, but merely insists that questions that affect all member-states must also be negotiated and

decided by all. As such he is implicitly calling for safeguards. Two principal options are under discussion at Westminster, both of which are unacceptable to the Eurozone for different reasons:

On the one hand, the British Think-Tank Open Europe and others have proposed new blocking options for non-euro states, to permit them to continue to assemble a blocking minority. The model for this is the special arrangements for the European Banking Authority (EBA) introduced in 2013 in the course of establishing the Banking Union. The EBA is an agency of all twenty-eight EU states tasked with harmonising banking regulation and control in the partner countries. After banking oversight was supranationalised for the Eurozone, the non-euro states in the EBA were granted a safeguard to prevent them being outvoted. For important decisions the EBA now requires a majority of both the nineteen euro states and the nine states not involved in Eurozone banking oversight. Thus de facto five non-euro states possess a weight equal to that of ten euro states.

Applied to the EU as a whole, Open Europe now proposes that either rejection by three non-euro states should be sufficient to block decisions in the Council, if they believe the internal market or core principles of the EU to be endangered, or that to achieve the same effect the hurdles for blocking minorities should be lowered. This could occur either via a treaty change or by amending the “Ioannina compromise” to allow member states representing just 20 percent of the EU population to block a decision (rather than the current 35 percent). Following this model for example, the United Kingdom (12.6 percent of the population) and Poland (7.5 percent) could prevent a decision on their own. Regardless of the details of implementation, both proposals aim to lower the threshold to form a blocking minority so that it would be significantly easier for London to stop any EU initiatives it disapproved of, for example in connection with financial market regulation. This would also expand the blocking

options and weight of the non-euro states in relation to the euro states, from which Britain as the most populous and influential non-euro state would especially profit.

The second option discussed in London – a safeguard in the form of an “emergency brake” for non-euro states in the internal market – is problematic for other reasons. The EU already has such emergency brakes, for example in interior and justice policy, where a group of EU states can in certain cases stop a legislative procedure in the Council of the EU and have it referred to the European Council. The latter then has four months time to reach an agreement, which must be by consensus. If that cannot be achieved the only remaining option for the other EU states is to establish an enhanced cooperation, whose procedures are then simplified.

Although this variant would at first glance permit the other EU states to push forward on controversial matters without Britain, it comes with two central problems. Firstly, the treaty forbids the use of enhanced cooperation in areas that would endanger the internal market. So in that sphere, which is especially important to London, the process would end with the European Council or an enhanced cooperation would be open to legal challenge. Secondly, from the British perspective forcing differentiation in the sector it regards as its top priority, financial market regulation, could in fact be advantageous if it permitted the City of London to insulate itself from stricter regulation in the rest of Europe. For example, the British government vehemently rejects the cap on bankers’ bonuses adopted by the EU in 2013 and would certainly have used an “emergency brake” to detach itself from the rest of the EU and gain a competitive advantage, even in a matter where the decision had nothing to do with the relationship between Eurozone and non-euro states.

### **A Mechanism for Political Compromise**

Thus from the European and German perspectives neither of the two proposals are acceptable. Above all, they would not contribute to balancing the relationship between a closely integrated Eurozone and the non-euro states, but instead strengthen the latter at the expense of the EU as a whole.

Lessons should instead be drawn from the one case that British representatives cite as a prime example of the formation of a Eurozone “caucus”: the use of the European Financial Stabilisation Mechanism (EFSM). Unlike the similarly-named European Financial Stability Mechanism (ESM), the EFSM is funded by all twenty-eight EU member states. Consequently, in 2011 the non-euro states were given a political commitment that EFSM funds would no longer be used to support euro states. But in the negotiations with Greece in summer 2015 the Commission believed the EFSM to be the only European instrument suitable for providing Greece with short-term bridging loans until long-term ESM credits could be provided. In July 2015 the euro states agreed to tap the EFSM facility without previously consulting the non-euro states, and could in theory have imposed that decision on their own thanks to their qualified majority. Britain, whose prime minister had explicitly promised not to participate in rescuing euro states, was extremely displeased, as were Sweden and Poland.

In subsequent negotiations it was agreed that while the EFSM could still be used, the non-euro states received a guarantee that the euro states would bear their losses in the event of Greece becoming insolvent during the bridging period. The decisive aspect for the structure of the EU here is less the technical than the political solution, which ultimately led to a compromise acceptable to all. So what the Eurozone and the non-euro states need are not new blocking instruments, but a mechanism that forces compromise in an increasingly differentiated Union.

One way to achieve this would be to implement the emergency brake proposal in a

purely suspensive form. Under this model any EU state that believed the fundamental principles of equal participation had been violated could delay a legislative procedure in the Council for a maximum of three months or until the next European Council, whichever comes first. This period of heightened political attention would force the heads of state and government to search for a compromise. If they fail, the decision can be taken anyway. But the majority must then accept that it is outvoting the minority under full public scrutiny. This approach would avoid decisions being held up indefinitely, while the pressure to find a compromise could contribute considerably more to cohesion in the Union than divisive new veto options.

### **The Transformation of the European Union**

The British demands encounter a European Union that is already undergoing a difficult transformation after years in crisis mode. Differentiated integration has become the *modus operandi*, without which scarcely a step forward can be taken at the EU level. The EU partners must now decide how to respond to the British demands for greater differentiation. Outside the big issue of treaty change (see SWP Comment 50/2015) and the other politically no less crucial current questions (deepening internal markets, role of national parliaments, rules on freedom of movement) the member states’ response to the British catalogue of demands will incisively define the future structure of the Union. Three paths are open:

Firstly, the EU partners can reject London’s demands. Although no EU state takes the prospect of a British exit lightly, the resistance remains very strong in certain member states and public spheres, in particular regarding demands involving differentiated treatment of EU citizens. But in so doing the EU would show itself to be rigid and incapable of reform, and play into the hands of opponents across Europe. A



Brexit would do great harm to both sides, symbolically, politically and economically.

The second option would be for the EU partners to largely concede Cameron's demands, either to keep the United Kingdom in the Union or because certain other EU governments in fact share some of his reservations about further integration. That, however, would not only widen the differentiation within the EU but clearly point down the road to a Europe à la carte, in which national interests are placed before European solidarity – even more strongly than is already the case in the euro and refugee crises. That would be another step towards the political disintegration of the Union. At the same time, even these reforms would be insufficient to dispel the fundamental reservations of the British Eurosceptics, and offer no guarantee for a “remain” vote in the referendum.

The third way would be to take the negotiations with London as a starting point for reordering the European Union's complex differentiated structure. While an outcome to the satisfaction of all might not be achievable within the ambitious British timetable, agreement could be within reach if the EU partners reject excessive differentiation, implement procedures for finding compromise rather than blockades between Eurozone and non-Eurozone, and adapt the objective of an ever closer Union to an EU that is heading gradually towards a core Europe. In that way the negotiations with London could actually lay the foundations for a more stable structure for an increasingly differentiated Union.

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