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European Integration

A future in the EU?

Reconciling the 'Brexit' debate with a more modern EU

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The future of the British EU membership has become one of the most pressing concerns for the EU. Although member states will try – within limits – to accommodate British demands, Prime Minister Cameron's ambivalent strategy leaves many open questions.

The EU-British relationship has always been one of special character but a number of recent developments have led to a 'Brexit' gaining momentum. The UK's veto on the Fiscal Compact, Cameron's promise to hold a referendum on EU membership and the success of the eurosceptic UKIP party in the European elections, have further accrued tensions. With growing euroscepticism in the UK but also elsewhere in Europe, the political reality requires a targeted and joint European action.

Some of the British demands are legitimate calls for an EU reform. There is broad agreement on the necessity of an EU agenda for growth, competitiveness and fairness. Completing the Single Market and opening the EU to global competition are British priorities which overlap with the European roadmap anyway. Common ground among member states also exists on the necessity of cutting "EU red tape" and of reassessing EU competences.

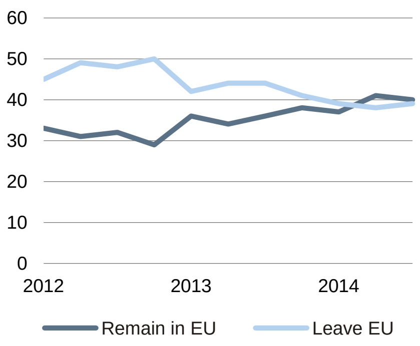
Yet a broader tug-of-war will emerge around those British reform demands which target the EU's basic principles at its core. There will be little room for manoeuvre in policy areas which destabilise the institutional interplay and fundamental principles such as the free movement of people.

Only the UK itself will be able to rationalise the domestic debate on EU membership. Although EU member states are favourable to some reform demands, possible concessions will not suffice to appease British eurosceptic hardliners. For a constructive EU reform, the UK government needs to detail its reform suggestions and engage in a more pan-European rhetoric.

Economically, Britain and the EU are inextricably linked. Realistic estimates predict losses in the range of 1 to 3% of British GDP in case of a Brexit. Likewise, the Single Market would shrink by 15%. Thus, it would be in the EU member states' own interest to demonstrate political will to address the British concerns. The German government repeatedly pointed to the valuable British influence in the EU. Despite Britain being a difficult partner, they share common values and remain indispensable partners.

Voting intention EU referendum 1

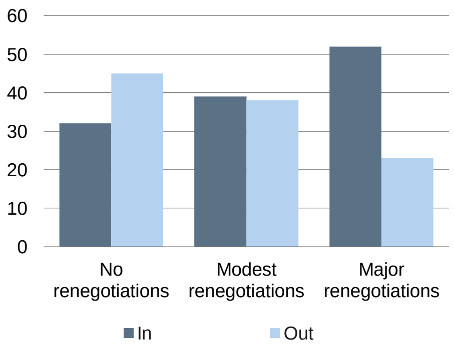
3M average



Source: YouGov

How would you vote in an EU referendum if David Cameron secured: 2

in %



Source: YouGov

The Dutch Subsidiarity Review 3

The Dutch government conducted an analysis of EU competences in different policy areas. This assessment should help to understand in which policy areas the Dutch government believes that the EU should or should not be involved. Contrary to the British Balance of Competence Review, this ‘Subsidiarity Review’ points to nine guiding principles and to 54 concrete policy areas and makes specific policy recommendations. This “list of points for action” is considered to be a basic document for the Dutch EU Presidency in the first half of 2016. It calls for a repatriation of EU powers under the principle “European where necessary, national where possible.”

Sources: Ministerie van Buitenlandse Zaken, EU Commission

Introduction

In the midst of an economic and financial crisis in Europe, the EU is confronted with yet another critical challenge: for the first time the withdrawal of an EU member state has become a real possibility. The British question in European politics will be a central theme throughout the new legislative period.

Driven by an increasing euroscepticism in domestic politics, Prime Minister Cameron paved the way for a referendum on EU membership. Even if the Conservatives lose the general elections in 2015, the possibility of a referendum remains as the Labour Party has not taken a clear position yet. The outcome of such a referendum appears uncertain as of now (chart 1) and with more than two years to go a swing in either direction can still occur. Before a potential referendum in 2017, Cameron seeks to renegotiate the British status within the EU, which would have a decisive impact on the outcome (chart 2). While pursuing deeper economic integration, politically, the UK government will attempt to repatriate powers to the national level.

This unprecedented situation requires tact by other EU member states – with Germany possibly playing a mediating role. To prevent both a dismantling of the European integration and a frivolous British exit from the EU a twin-approach is needed: the EU has to advance constructive negotiations with the British government on the one hand, but it should also protect particularly contentious policy areas. Despite Cameron’s objections against Jean-Claude Juncker as the new Commission president, Juncker’s political guidelines overlap with some of Cameron’s most prominent reform demands: extending the Single Market and strengthening a balanced relationship between euro- and non-euro states are key policy areas which need to be addressed during the next political cycle.

Repatriating powers to the national level, however, will be a more difficult exercise which may require substantive treaty revisions. Although some member states echo the idea of retransferring power to the national level, reluctance to reopen the Treaties makes comprehensive treaty revisions a remote possibility. The Netherlands first initiated a so-called Subsidiarity Review to assess EU competences. With this initiative the Dutch government responded to demands to curtail EU interference. Still, the government repeatedly emphasised that possible changes should occur within the current framework of EU Treaties (see box 3).

Launched by the UK Foreign Secretary in 2012, the UK government’s Review of the Balance of Competences pursues a different objective. It is an ambitious exercise to assess EU competences in 32 policy areas and aims to provide solid evidence for an objective debate around EU membership. Yet, the review’s primarily positive results met with little resonance in the public debate. Rather than constituting a rational discussion about costs and benefits of EU membership, the British EU debate is fuelled by emotions and identity politics. Therefore, the Brexit debate needs to be tackled with care. By a joint political will, it can be a wake-up call for Britain and for Europe to engage in a pan-European reform agenda. It raises the following questions:

— How can the EU accommodate the UK and convince citizens that the benefits of EU membership outweigh the costs of withdrawal?

— Which are the EU’s most contentious policy areas in which little room for negotiation exists?

— Could Britain even afford to leave the EU? And what would be the consequences if one of its most important member states left the Union?

In the following, the UK reform demands will be considered as another impetus for EU reform. Without denying the real possibility of a Brexit, this paper also seeks to assess the potential which the British requests could have on driving "a new start for Europe". In addition to analysing the reconciliation of British peculiarity with an EU Strategic Agenda, policy areas which are most difficult to negotiate as well as the consequences of an EU exit will be set out. In particular because some of the British reform demands require treaty revision accompanied by unanimity or a Qualified Majority Vote (QMV), possible alliances which Britain needs to forge will also be discussed.

Modernising the EU ... more than just British cherry-picking

A Strategic Agenda for Europe

With a falling share of the world population (~ 7%) and global GDP (~ 25%), but increasingly high social costs (~ 50% of global social expenditures), the Union stands at a crossroad between progress and stagnation. Without denying the difficulty in dealing with the British reform demands, the debate could potentially drive an EU reform to advance growth and competitiveness in Europe. For this purpose, the European Council agreed on a Strategic Agenda to define leading principles. It recognises the British concern about the future development of the EU and agrees to address them in the next institutional cycle.

A Deeper and Fairer Internal Market 4

"… the next Commission [should] build on the strength of our Single Market and [...] fully exploit its potential in all its dimensions."

"We need to complete the internal market in products and services and make it the launch pad for our companies and industry to thrive in the global economy."

Source: J.-C. Juncker (2014). Political Guidelines for the next European Commission

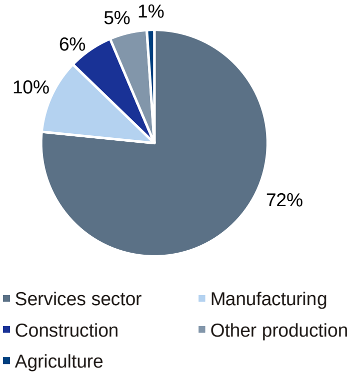
Undoubtedly, one of the key British priorities in the EU is the completion of the Single Market. In this aspect, most member states agree that there is still potential to deepen the EU economic integration and to support changes in this area. Instead of requiring comprehensive treaty revisions, economic integration could be strengthened within the existing treaty framework and by amending EU secondary law. Already in 2010, the European Commission's 'Monti-Report' presented strategic areas in which the Single Market could be extended. Among these policy areas, liberalising trade in services and promoting the digital economy are particularly apt to exploit the full potential of the EU economy.

Completing the Single Market

The 'Monti-Report' presented the Single Market for services as the powerhouse of the European economy. Services account for around 70% of the EU's economic activity and are an important source of employment and growth. As the UK is highly competitive in many service sectors it would be among the biggest winners of a strengthened Single Market for services. Indeed, trade liberalisation in services counts among the five priorities for the next political cycle that the European Council has named in its Strategic Agenda. Recognizing the need of joint action, however, German Finance Minister Schäuble concluded with his British counterpart, that "we must complete the Single Market, especially in services."[1] Likewise the Department of Business, Innovation and Skills found that for Britain the completion of the Single Market would bring growth benefits of up to 7% of GDP if all barriers to trade were eliminated.[2]

UK - a prototypical service economy 5

Share of gross value added in %

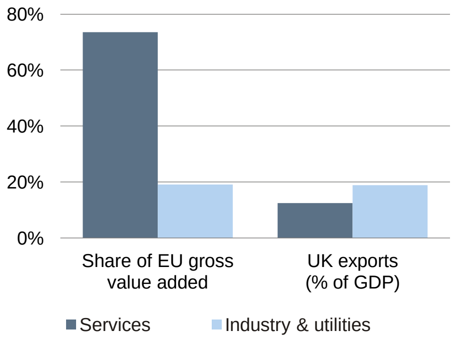


Source: ONS

The UK Review of the Balance of Competences for the Free Movement of Services found that principally respondents supported the current power balance for Single Market policies. Yet, they consider the underperformance of the Single Market in services to be due to a "poor implementation of the Services Directive."[3] Traditionally, the German government has been reluctant

[1] Osborne, G. & W. Schäuble (2014). Protect Britain's interests in a two-speed Europe. Financial Times.
[2] See BIS Economic Paper No.11 (2011). The economic consequences for the UK and the EU of completing the Single Market.
[3] See Review of the Balance of Competences, the Single Market: Free Movement of Services.

Unrealised potential in the services 6



Source: Eurostat

in fully implementing the Services Directive because of the relatively higher number of protected professions in Germany.

The full implementation of the Services Directive is expected to bring economic benefits for both the UK and the EU. Estimates by Open Europe predict an increase of EU GDP of up to 2.3%, corresponding to around EUR 300 bn.[4] Many types of services are less easily traded (across borders) than manufacturing goods. The share of industrial goods in UK exports is still higher than the one of services (chart 6), but the increasing share of tradable services creates potential that is far from being fully exploited.

Completing the Digital Single Market is another strategic goal embedded in the Council's agenda. The potential gains are mutually beneficial: Britain has the most developed e-commerce market in Europe and a connected digital economy could raise EU GDP by around 4%.[5]

Free Trade Agreements

Yet another part of the EU's Strategic Agenda is the aim of promoting the Union's global attractiveness – one more aspect which overlaps with the British demands to modernise the EU. Although the current timeframe does not allow for the Transatlantic Trade and Investment Partnership (TTIP) to be concluded before 2015, supporting this trade agreement constitutes an important step to underline the EU's global ambitions.[6] For the UK, this TTIP is both politically and economically valuable. Upon leaving the EU, the UK might not only face potential barriers to enter the EU Single Market but it would also be excluded from all bilateral trade agreements between the EU and third countries.

Reversely, we should not neglect that the UK is also an important standard setter for EU trade policy. The UK plays a leading role in advancing trade agreements with emerging economies (EMEs) and therefore remains a partner with global impact. The UK advocates for example free trade agreements with Thailand and Korea and is further pushing an agreement with Canada. Hence, the UK's trade policy corresponds to the ideas specified in the Balance of Competences Review for the Single Market: the EU needs to maintain its trade openness, foster competitiveness and pursue further tariff reductions.

Cutting EU red tape

Over-regulatory burden and EU interference has also been a common criticism among member states which coincides with British reform demands. Although standardizing rules across the EU-28 has been a source of success for the Single Market integration, cutting EU red tape has been a recurrent theme in the European rhetoric – already being addressed without the British push.

The Commission's REFIT programme 7

"REFIT is the European Commission's Regulatory Fitness and Performance programme. Action is taken to make EU law simpler and to reduce regulatory costs, so contributing to a clear, stable and predictable regulatory framework supporting growth and jobs."

Source: EU Commission

In response to widespread criticism, in October 2013, the European Commission started its REFIT – "Regulatory Fitness and Performance" – programme. It aims at creating more efficient EU laws by examining EU regulation and by taking measures to reduce redundant rules (see box 7). Eventually, the revision process could entail recommendations in which areas member states can increase their room for action. The programme could join with the EU Impact Assessment board to monitor the Commission's compliance with the Principles of Subsidiarity and Proportionality.

So far, the programme has already taken determined steps to assess EU's regulatory activities and it is therefore recommended that the new Commission continues this review. It could further be envisaged to establish a European Review of the Balance of Competences. By including national actors in this exercise, the Commission could send a strong political signal about the EU's willingness to decrease regulatory burden.

4 Open Europe (2013). How to reignite the EU's services market and boost growth by EUR 300 bn.
5 See Review of the Balance of Competences between the United Kingdom and the European Union. The Single Market.
6 See Deutsch, K. (2014). Atlantisches Fragment? Finanzmarktregulierung, die G20 und TTIP. Deutsche Bank Research.

Institutional Fairness

The eurozone crisis has exposed the difficulty that exists around reconciling the interests of the eurozone and the EU-28. Non-euro area member states fear that the eurozone will dominate over the eurozone-"outs"; and that a continued integration of the eurozone will result in parallel structures which develop to the detriment of EU-28's decision-making capacity. When the UK vetoed the Fiscal Compact, eurozone member states circumvented the British (and Czech) objections by establishing an intergovernmental treaty. Such a development that forces political solutions outside the EU Treaties cannot be regarded as a sustainable strategy for the EU as a whole. But describing this vote as eurozone "caucusing" would fail to take into account the overwhelming majority of EU members that finally signed the fiscal compact. Instead, the banking union project might be a better case to illustrate that the British concern of eurozone "caucusing" was a legitimate call – which was eventually incorporated into the design of the banking union (see below).

These developments demonstrate that the EU is well aware of the need to establish a tenable relation between the euro-18 and the EU-28. It represents yet another area in which the British demands collide with the European acknowledgement of pursuing a strategy of differentiated integration.[7] Although the UK recognises the eurozone's need to integrate – a "remorseless logic [of integration]" as the British Finance Minister George Osborne states – it also calls for fairness with non-euro area countries. Particularly in this area, Britain has a common interest with countries outside the eurozone such as Poland and Sweden. The appointment of the Polish Prime Minister Donald Tusk as President of the Council has consequently been endorsed by David Cameron.

In fact, with the coming into force of the new Qualified Majority Vote (QMV) in November 2014, the euro-18 (euro-19 with Latvia joining in 2015) will in theory be able to impose any rules around the EU Single Market on other member states outside the eurozone.[8] The voting weights develop to their advantage and in theory; the euro-18 could attain the necessary threshold for a QMV under article 238 TFEU. This article defines the QMV as gathering "at least 55% of the members of the Council representing the participating member states, comprising at least 65% of the population of these states." Combined the euro-18 account for 64.3% of EU member states and for 65.9% of the EU population. In contrast, under the old voting provisions the euro-18 would have been unable to form a unified bloc, as they did not reach the necessary 260 votes (table 8). Thus, they could potentially override British interests but past votes have shown that the eurozone does not always constitute a unified voting bloc. The 'threat' deriving from a potential eurozone "caucus" must therefore be relativised.

The new qualified majority will shift voting weights to the advantage of euro-18 — 8

	Member states	Votes weighted by population
Pre-Lisbon Rules	euro-18 (15 required)	217 votes (260 needed)
Lisbon Rules	64.3% (55% needed)	65.94% (65% needed)

Sources: Stiftung Wissenschaft und Politik, EU Treaties

Moreover, the agreement on the establishment of a Banking Union already constitutes a first step towards securing the interests of non euro-area countries.

[7] Ondarza, N. von (2012). Den Euro retten, ohne Europa zu spalten: Die EU braucht eine Strategie differenzierter Integration. Stiftung Wissenschaft und Politik.

[8] Between 1 November 2014 and 31 March 2017, when an act is to be adopted by qualified majority, a member of the Council may request that it be adopted in accordance with the qualified majority as defined in paragraph 3. In that case, the current definition of QMV applies. Protocol (No 36) on transitional provisions, Article 3 (2).

An intergovernmental agreement which guarantees that non-euro countries have the right to join at a later time, confirms a political will to prevent fragmentation of the EU-28's capacity to deal with questions related to the Single Market. Indeed, the institutional arrangements encourage non-euro members to participate in the Single Supervisory Mechanism (SSM).[9]

Safeguards against eurozone "caucusing" 9

Article 44, Regulation (EU) No 1093/2010 of the European Parliament and of the Council

"[Decisions shall be taken] on the basis of a simple majority of its voting members, which shall include a simple majority of its members from competent authorities of participating member states and a simple majority of its members from competent authorities of non-participating Members"

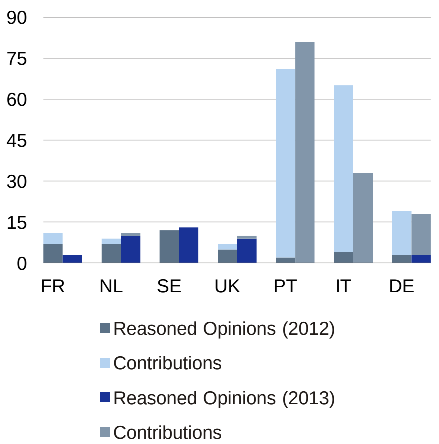
Hence, the voting procedure within the European Banking Authority (EBA) corresponds to British taste. For decision-making within the EBA a double majority vote was institutionalised (see box 9). Establishing a similar procedure for Single Market legislation could be an adequate measure to counter creeping disintegration. Yet, whether or not this new voting procedure could be a realistic option remains open to debate. Particularly with more and more pre-ins joining the eurozone, this procedure would end up giving Britain disproportionate power to direct decisions. With increasing scepticism by other member states with regard to this power, they might be less and less willing to grant Britain special treatments of this sort.

Revitalising the Principles of Subsidiarity and Proportionality

With a voter turnout of around 42.5% in the 2014 European elections and euroscepticism on the rise, there is a strong need to bring the EU closer to its citizens. In response to this criticism, policy-makers discuss the empowerment of national parliaments to counteract growing alienation and to enable national parliaments to "block unwanted European legislation."[10]

Currently, one third or more of national parliaments are needed to hand in a 'reasoned opinion' and to collectively push the Commission to interrupt a legislative project.[11] A Dutch proposal suggests to complement this so-called "yellow card mechanism" by a "late card" and a "red card" mechanism. Both initiatives are fully supported by the British government.[12] While Britain advocates this strengthened power for national parliaments to repeal EU law whenever they consider it to be inadequate, Germany apparently considers the "red card" mechanism to be too intrusive and objects it because of fears that it may hamper the decision-making process. Interestingly enough, however, the British parliamentary chambers are by far less active than other parliaments in the preparation for using the yellow card mechanism (chart 10).

The role of national parliaments 10



Source: European Parliament

Still, a range of other methods can be envisaged to reconcile individual and collective national interests of empowering national parliaments:

— Extend the time-period available for national scrutiny from 8 to 12 weeks and lower the threshold to triggering the yellow card

— Foster inter-parliamentary cooperation and use the Conference of Community and European Affairs Committees of Parliaments of the European Union (COSAC) to socialise national parliaments in European politics

— Establish a National Parliamentary Forum – an often discussed proposal which suggests that national parliamentarians meet in Brussels to report on policy-issues in which European Parliament itself plays a less important role. By doing this, it could play an advisory role.

[9] See Decision of the European Central Bank of 31 January 2014 on the close cooperation with the national competent authorities of participating member states whose currency is not the euro (ECB/2014/5).
[10] Cameron, D. (2014). David Cameron: my seven targets for a new EU. The Telegraph.
[11] So far, national parliaments achieved the necessary quorum for the use of a yellow card only two times (1) legislative proposal by the Commission on the right to strike Monti II and (2) proposal for the establishment of a European Public Prosecutor.
[12] Lidington, D. (2013). A constructive case for EU reform.

Even though these measures would require revising treaties – namely Protocol Number 2 on the Application of the Principles of Subsidiarity and Proportionality – public opinion and national governments have expressed readiness to realise change. Whether this will truly encourage national parliaments to engage more in European politics remains open to debate.

Institutional interplay

The tug-of-war that has taken place between the Council and the European Parliament over the nomination of the new Commission president also offers some insights into the institutional triangle. Institutional procedures need to be clarified in order to avoid a gridlock within the inter-institutional decision-making process. While the European Parliament has gained in power since the Lisbon Treaty, the Commission should seize a stronger role and become again more independent. In particular, the idea of organising the new EU Commission along "clusters" has therefore been revived. This proposal is widely recognised as being a necessary step to reinforce the Commission's efficiency. Next to claiming a high position within the EU Commission – as do other (bigger) EU members, – the British reform agenda for the EU also foresees such organisational changes.

A College of Commissioners organised along clusters of key policy areas would also address the widespread concern that the high number of EU commissioners makes the Commission vulnerable to the pursuit of national interests. Establishing a college of commissioners, in which senior commissioners would be designated around the EU main policy areas, is a recurrent proposal. According to the rules of procedure of the Commission, the president has the formal power to organise a Commission along these lines (see box 11). All commissioners would maintain the same legal status and were to meet regularly to discuss ongoing policy. The senior commissioner would mainly take a coordinating role.[13]

Rules of Procedure of the Commission 11

The Commission, Article 3:

"The President may assign to Members of the Commission special fields of activity with regard to which they are specifically responsible for the preparation of Commission work and the implementation of its decisions. He may also change these assignments at any time. "

"The President may set up working groups of Members of the Commission, whose chairperson he will designate."

"The President shall represent the Commission. He shall designate the Members of the Commission to assist him in this task."

Difficulties concerning the realization of this project are yet conceivable: bigger member states will be unwilling to engage in a rotational system for the positions of senior Commissioners. At the same time, smaller member states are unlikely to agree to the empowerment of bigger member states to their detriment. Hence, finding a common ground on the reorganisation of the Commission will be highly political.[14]

In response to British concerns over EU-parliamentary power grab in nominating the Commission's president, the Council concluded on reviewing and strengthening the legislative procedure (see box 12).[15] This is particularly important since art. 17 (7) TEU defines clearly the procedure for nominating the Commission president. Bound by EU treaties, the Council has to take into account the results of the European Parliament elections when it proposes a candidate for the position of the Commission President. The candidate has to be accepted by a majority vote in the Parliament. If the candidate does not obtain the necessary majority, the Council needs to reconvene on another candidate. Despite legal concerns, the British intransigence on the nomination of Juncker remains debatable. If the UK government genuinely preaches democratic accountability and the fear of alienating the EU from its citizens, it should rather have an interest in strengthening parliamentary power.

The next institutional cycle 12

"The UK raised some concerns related to the future development of the EU. These concerns will need to be addressed ..."

"... Once the new European Commission is effectively in place, the European Council will consider the process for the appointment of the President of the European Commission for the future, respecting the European Treaties."

Source: European Council Conclusions, June 2014

[13] See CER (2013). How to build a more modern EU.

[14] The decision to remain at the one Commissioner per Member State provision goes back to a political promise made to Ireland in prospect of a potential rejection of the Lisbon Treaty in 2008. See Piris, J.-C. (2014). The Future of Europe, Towards a Two-Speed EU?, p. 25 ff.

[15] See European Council June 2014: David Cameron's speech.

"An ever closer Union?"

A multi-speed Europe

The preambulatory clause of the EU Treaty which refers to the commitment of "an ever closer Union" is one of the most symbolic British reform demands – with significant weight on the European question in British politics. To understand the symbolism, we have to understand the differing interpretation of what "more Europe" means for the UK and the rest of Europe. One part of the EU – among which is Britain – paradoxically understands less integration by the expression of "more Europe", while the rest understands more integration. Cameron underlined this perception when he said: "We understand and respect the right of others to maintain their commitment [to an ever closer union]. But for Britain – and perhaps for other – it is not the objective." Although there is no way that member states would agree on abolishing this emblematic clause, the Council stipulates in its conclusion the right for different paths of integration. Embedding this into the Council's mandate from the very beginning is already considered as a first start. A final line can be drawn if member states formally recognise the principle of differentiated integration within the EU treaties.[16]

Provisions on enhanced cooperation 13

Art. 20, TUE

(1) Member states which wish to establish enhanced cooperation between themselves within the framework of the Union's non-exclusive competences may make use of its institutions and exercise those competences by applying the relevant provisions of the Treaties [...]

Enhanced cooperation shall aim to further the objectives of the Union, protect its interests and reinforce its integration process. Such cooperation shall be open at any time to all member states, in accordance with Article 328 of the Treaty on the Functioning of the European Union.

In fact, rather than representing a controversial political question, the multi-speed Europe is widely recognised by member states. In many policy areas beyond the Single Market, there are signs of differentiated integration. With this in mind, it appears that the intersection of shared interests between the UK and the EU increases. A statement incorporated into the treaties that "we do not necessarily all have to move at the same speed"[17] can be a first step towards accommodating British concerns and leaving room for tailored interpretation. If managed with care, the risk of cherry-picking or "Europe à la carte" should remain limited. Such an approach could be discussed in the context of the enhanced cooperation which is provided for in art. 20 TUE (see box 13). Moreover, the discussions about editing Protocol number 14 on the Euro Group and the Treaty on Stability, Coordination and Governance (TSCG) provide room for preparing future treaty tweaks. According to Article 16 (TSCG), necessary steps shall be taken to incorporate the treaty provision into the EU treaty framework within five years. Thus, there are many possibilities for formally institutionalizing a Europe that integrates at different speeds and which provides room for more flexibility.

Opt-outs, opt-ins – opt-arounds?

EU Justice and Home Affairs (JHA) is the fastest growing legislative area in the European Union and one which requires reliable cooperation. However, the EU JHA policy is increasingly seen as having shifted from "cooperation to a limited form of integration."[18]

The British decision to opt-out from the JHA pillar of the Lisbon Treaty, while at the same time requesting an opt-in for 35 sub-areas, demonstrates how Britain has understood to use legislative loopholes in the EU. Such moves fuel a British credibility problem among its fellow partners. Member states appear to have reached the peak of tolerance and special treatments – in the form of new policy opt-outs – will be less likely.[19] This opt-out could stand as an example for the final opt-out being granted to Britain. The course of the euro-crisis and the arrangements found around the establishment of the EBA show that instead of granting further policy opt-outs, opt-ins could gain in relevance. Opt-ins could provide a tenable solution for other member states to join EU policies at a later

[16] See Council Conclusions. "On the issue of ever closer union we've made a start. – embedded these issues in the Council's mandate for the Commission from the very start."
[17] See Juncker, J.-C. (2014). A new start for Europe, My agenda for jobs, growth, fairness and democratic change, political guidelines for the next European Commission.
[18] Brady, H. (2012). Cameron's European 'own goal', Leaving EU police and justice co-operation. Centre for European Reform.
[19] UK Parliament. Ministry of Justice measures in the JHA block opt-out.

stage. In return, a more frequent use of policy opt-ins could also bear inherent risks of increased fragmentation between all EU member states.

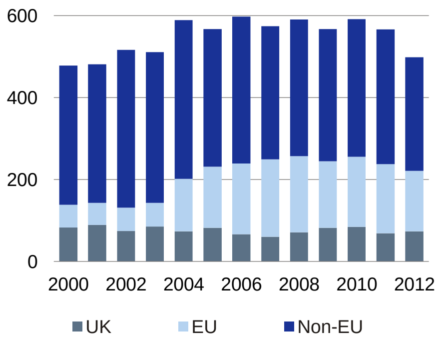
Contentious matters for the EU

The free movement of persons within the EU is generally assessed to be beneficial for the economy and has the potential to enhance competitiveness and growth in Britain and the rest of Europe. Especially, British companies appreciate the advantage of drawing on a talent pool of young and skilled labour primarily coming to Britain in search of work. However, the debate cloaks a range of challenges related to the free movement with (1) competition in low-skilled segments of the labour market, (2) driving down wages and (3) growing claims for public services by migrants being some of the points raised by Britain. Yet, the freedom of movement is one of the most symbolic and fundamental EU-rules, and exceptional limitations of this freedom need to be based on universal consensus.

Migration rules and access to benefits

Migratory flows to the UK by nationality 14

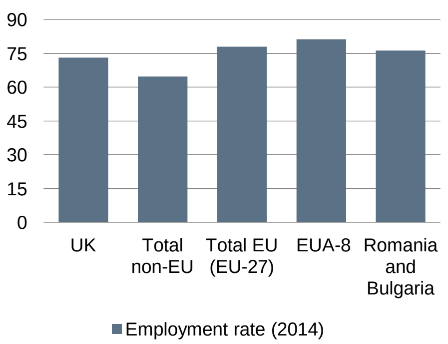
In thousands



Source: ONS

Employment rate by origin 15

%



Source: ONS

Rather than limiting the free movement of persons per se, the British government raises concerns about reforming EU rules on access to benefits. In this context, the UK Balance of Competence Review for the free movement of persons finds that "rules have developed beyond the original scope" – and it provides a deeper insight into one of the British primary EU reform targets.[20] Even though it appears to be one of the most contentious British demands, it actually meets with some approval by other member states. Germany and the Netherlands have expressed concerns over so-called "benefit tourism." They support tougher eligibility criteria but they provide more evidence-based arguments on how migration flows affect their labour market. An extension of the eligibility criteria could establish (1) a longer time period after which a worker is eligible for benefits and (2) longer transitional rules for workers. Yet, unilateral British measures to hold migratory flows in check such as the British Habitual Residence Test are currently reviewed by the European Commission. It referred the issue to the European Court of Justice (ECJ) assuming that the "right to reside"-element of the test breaches EU law. The basic legislative documents are provided by the Free Movement Directive and the Regulation on the free movement of Workers – of which only the latter has a direct legal impact in Britain.[21]

Although Britain would be able to form a strategic alliance in this area, Britain is widely criticised in this debate. In addition to cutting the time period during which migrants are able to claim benefits from six to three months, Cameron also announced a more vigorous stance against illegal migrants.[22] But evidence shows that the British concerns are not entirely justified. The migratory flows to the UK primarily derive from non-EU countries (chart 14), though the rise in migration flows comes mainly from the EU. The European Commission also argues that the UK has so far been unable to provide viable evidence on benefit tourism from EU member states. Quite the contrary: Britain counts among the countries which actually benefit most from migration. A vast majority of migrants coming to Britain are young, well-educated – and net contributor to public finances. Moreover, their employment rate is actually higher than the one of British workers (chart 15) and it remains questionable whether reducing EU migration to Britain would indeed be beneficial for the British economy.[23]

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[20] See Review of the Balance of Competences between the United Kingdom and the European Union, Single Market: Free Movement of Persons.
[21] Open Europe (2013), Submission to the UK Government's Balance of Competence Review: Free Movement of Persons.
[22] Parker, G. (2014), UK parties compete on migration, Financial Times.
[23] Bräuninger, D. (2014), The dynamics of migration in the euroa area, DB Research.

The Working Time Directive

The Working Time Directive (WTD) is yet another contentious matter in the EU-British relations. Without particularly affecting all EU member states, Britain could opt for minor treaty tweaks to adopt the Directive to its national needs. But since Britain has already obtained an opt-out from the 48-hour week as stipulated in the WTD, discussions around the directive remain controversial. It raises the impression that the WTD is often used as a pretext to repatriate employment and social legislation – supposed to be a "national prerogative" as Cameron contends. The eurosceptic lobby group EU Fresh Starts criticises the high costs associated with the WTD which Open Europe estimates to be around GBP 4.1 bn a year. While other countries, among which also counts Germany, agree that the WTD needs revision, they oppose complete national derogation from EU social legislation. Such measures are thought to hamper labour mobility across the EU.

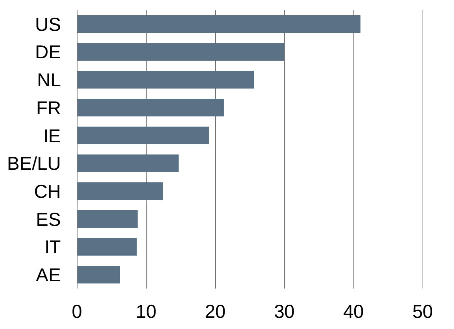
Leaving the European Court of Human Rights

Some of the British reform demands meet with incomprehension and even exceed EU competences. In his agenda for renegotiating Britain's EU membership Cameron for example points to freeing the British police and courts from "unnecessary interference from the European Court of Human Rights (ECHR)." If powers are not sufficiently channelled back to the member states in this policy area, sidelining the ECHR remains a possible move. Such a move, however, would damage the British international reputation. Especially since the only European country which does not recognise the ECHR is the Belarus.

The consequences of a Brexit

Main British Trading Partners 16

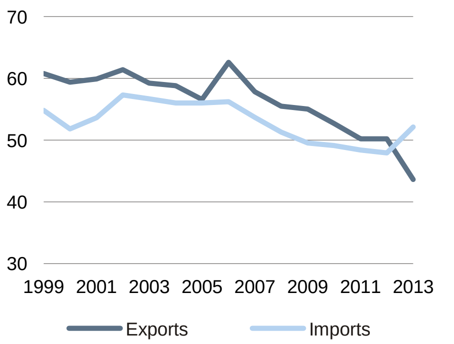
UK exports in GBP bn



Source: ONS

UK imports and exports to EU 17

Share of total imports and exports in %



Source: Eurostat

A British withdrawal from the EU would entail deep political, economic and legal ramifications for both the EU and more importantly for Britain. While some experts argue that Britain is moving towards a Brexit no matter how profound EU reforms are, others contend that it is mainly the – sometimes irrational – domestic debate which is manoeuvring Britain towards a Brexit. All speculations apart, it is questionable whether Britain will be able to exercise as much global influence, if it leaves the EU. Similarly the US government announced that "Britain has been a special partner of the United States. [...] More than most others, its voice within the European Union is essential and critical to the United States."[24]

Why Britain needs the EU

The economic interdependencies between Britain and the EU are uncontested. In 2013, around 50% of British exports were sold to the EU (compared to 30% in 1973) while it imported about 53% of goods and services from the EU. Even though these figures are overstated due to the "Rotterdam-Antwerp effect", they illustrate quite clearly importance of the EU Single Market for the British economy. More importantly since the majority of the British trading partners are EU member states (chart 16).[25]

[24] Blair, D. (2013). US publicly voices concerns over Britain leaving EU. The Telegraph.

[25] The "Rotterdam-Antwerp effect" designates the overestimation of trade with the Netherlands and Belgium, and thus the EU as a whole, as many goods from non-EU countries enter and leave the UK (and other EU countries) via these transit ports. The magnitude of this effect is hard to pin down and there are no official estimates. The Single Market component of HM Government's Balance of Competences Review cites studies which find an overestimation of between 5% and 11%. However, these estimates rest on the heroic assumption that in the absence of transit harbours Belgium and the Netherlands would have the same per-capita trade intensity with the UK as France or Germany. In addition, the Balance of Competences Review cautions that high values with the Netherlands and Belgium also stem from trade in natural gas, oil and diamonds.

Studies on the economic consequences of a Brexit 18

The Centre for European Reform (CER) argues that although British trade with emerging economies is growing faster than with EU member states, this is primarily due to the fact these economies show higher growth rates. Trade with EU countries is not found to be trade-diverting. The report concludes that economic integration between Britain and the EU has reached a level at which competition and investment is indispensable for British productivity.

The CBI report "Our Global Future" presents an overall positive picture of British EU membership. The study found that a 8 out of 10 CBI members would vote for remaining within the EU. More importantly, 52% of CBI members agree on the benefits of common rules standards across the Single Market. Although the EU over-regulation is often criticised, only 15% of CBI members consider it to have negative impact on their business activity.

The National Institute of Economic and Social Research estimates damaging macroeconomic impacts which result in (1) lower inward FDI implying a loss of around 2.25% of GDP in the long-run, (2) subsequent reduction in productive efficiency and (3) higher trade barriers with EU. But it expects a fiscal windfall because of lower net transfers to the EU.

A report commissioned by London's mayor Boris Johnson echoes PM Cameron's position. It concludes that the best solution for Britain in economic terms would be to stay within a "significantly reformed EU."

The Civitas Think Tank reports in a study on the net economic costs & benefits of EU membership that the cost of remaining in the EU is 'unequivocally negative'. It is estimated to be around 3 to 5% of GDP, corresponding to GBP 40 bn.

Bruges Group claims that the Single Market will become less important to the UK. In return, trade with non-EU countries is in the rise and is estimated to represent a share of 70% by 2020.

A UKIP report assessing the costs of EU membership for Britain concludes that membership implies a loss of 11% of GDP (around GBP 165-170 bn). The report attributes the main costs to "misguided legislation [which damages] British business." Yet, UKIP uses gross costs of EU membership for their estimates which could explain the upward bias.

Due to these interdependencies, the economic impact of a Brexit would have crucial implications. Estimates of potential costs or benefits are strongly shaded by strong convictions (see box next page). However, most independent studies conclude that the benefits of EU membership outweigh its costs, for the following reasons:

— The EU is a regional trading hub: according to estimates by the Centre for European Reform, EU membership has boosted British trade with the rest of the EU by around 55%.Within the EU, Britain benefits from lower trade costs and is therefore Britain's most important market (chart 17). The trade benefits apply to intra-EU trade but also to the European free trade agreements. Upon exit, these free trade agreements would no longer apply and Britain would have to negotiate separate trade agreements. The Centre for Economic Performance estimates losses in the range of 1 to 3% of British GDP, mainly associated with a plummet in trade with the EU. In return, they estimate a benefit of only 0.5% of national income associated with a withdrawal from the EU.[26]

— The UK has been an important driver of EU trade policy and TTIP. Leaving the EU could also diminish the UK's leverage in the US-UK relationship since the US administration has repeatedly announced that they value the US-UK relationship because of the British position in the EU.

— HM Treasury found that EU membership increased British trade with EU member states by 7%. Reversely, it only diverted 4% of trade with non-EU countries. HM Treasury further expects a decline of intra-EU trade costs over the next ten years. Britain would be deprived of additional welfare gains of around 1.3% of GDP which are primarily to be associated with falling barriers to trade.[27]

— 3.5 million jobs are linked to trade with the EU. Yet while these jobs are directly or indirectly associated with exports to the EU, it does not imply that these jobs are dependent on EU membership. The UK government estimates that trade with Europe will still remain significant and therefore jobs linked to EU-trade are not directly at risk.[28]

— The UK has been a magnet for foreign direct investment flows. If Britain leaves the EU, foreign banks and firms could relocate their branches and subsidiaries to other parts of the EU. Depending on how a post-withdrawal agreement between the EU and Britain would look like, Britain's position as an "export platform" may be threatened. Various foreign companies are already critically assessing impacts of a potential Brexit. Although it is clear that international companies will not stop investing in Britain, the scale of investment would probably decrease. Not only is the inflow of foreign capital beneficial for accruing national wealth but it also creates new job opportunities and transfers knowledge and technology.

— Some regions in the UK are net beneficiaries of the EU Budget. Over the period 2014-2020, Northern Ireland and Wales will receive funding of EUR 2,526 and EUR 2,600 million respectively.[29]

— Upon leaving the EU, Britain would still need to comply with EU regulation and rules. Most rules would need to be replicated at the national level which does not only require substantial interference in domestic policies and national laws but also entails high costs. Adding to economic disadvantages, Britain would be excluded entirely from the decision-making process which defines Single Market rules.

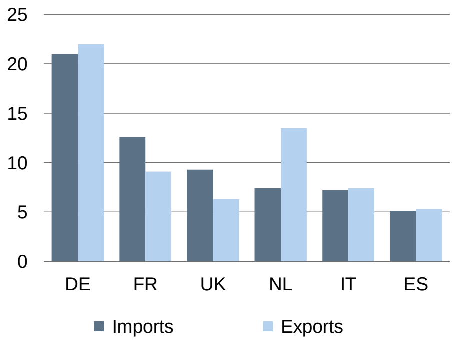
[26] See Ottaviano, van Reenen et al. (2014). The Costs and Benefits of Leaving the EU.
[27] See HM Treasury. EU Membership and Trade.
[28] See House of Commons Library (2013). UK-EU relations – key statistics.
[29] CAP Reform 2014-20: EU Agreement and Implementation in the UK and in Ireland.

— The City of London is Europe's most important financial centre and heavily dependent on financial institutions from continental Europe.

Why the EU needs Britain

Intra-EU trade 19

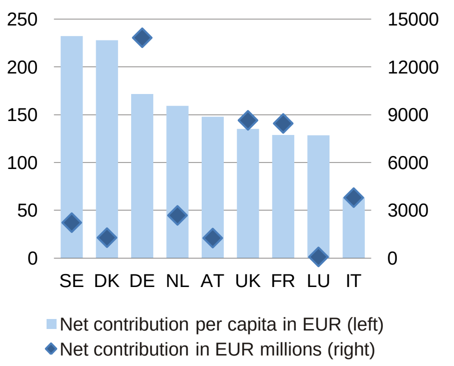
Share of total EU exports and imports in %



Source: Eurostat

Net contributors to the EU budget 20

2013



Sources: Eurostat, EU Commission

Undeniably, Britain has the reputation of being a difficult partner within the EU. After all, it has negotiated more policy opt-outs than any other EU member states but the UK still remains an important part of Europe for a variety of reasons:

— By population share, Britain is the third largest country in the EU accounting for 12.5% of the EU population.

— The British economy accounts for around 15% of EU GDP. It also accounts for an important part of intra-EU trade with a share of 9.3% of EU imports and a share of 6.3% of EU exports in 2013 (chart 19).

— Britain is the economy with the largest stocks of foreign direct investment in the EU. In particular, it is the main recipient of extra-EU FDI, especially from the US, China and Japan. However, Britain is also an important investment location for European firms, as 47% of its FDI stock is intra-EU.

— Britain is the second largest net contributor to the EU budget (EUR 8.6 bn in 2013), but only the sixth largest net contributor per capita (chart 20).

— Britain is an ardent supporter of liberal free trade and because of its global economic outlook; Britain has played a crucial role in extending the scope of the EU Single Market.

— Britain is one of the most competitive economies in the world. According to the World Economic Forum's Global Competitiveness Report 2013 - 2014, Britain ranks on place 10 out of 144 countries in terms of overall competitiveness. The only other EU members in the top 10 are Finland, Germany, Sweden and the Netherlands.

— As a permanent member of the UN Security Council and a driver of the European Common Foreign and Security Policy (CFSP), the EU relies on the British global political weight. With USD 57.9 bn in 2013, Britain is the sixth largest military spender in the world and also accounts for a share of around 23% of the European defence expenditure.[30]

These figures show that the EU-British relationship is mutually beneficial. On the one hand, EU membership is a source of economic prosperity and growth for Britain and it also continues to be a useful forum to increase the British global

Germany's interest in playing a mediating role 21

Losing a liberal minded partner. Germany and other Northern European countries fear that a Brexit would have implications on the European economic understanding. Concerns are widespread that the EU might become more protectionist. Experts fear that it could potentially widen the gap between the French and German economic positions. In addition, Britain is one of Germany's most important trading partners. In 2013, Germany exported EUR 623 bn (57%) to EU member states, with Britain being the second largest European recipient of German exports.

Politically, a Brexit would also have significant ramifications on Germany. Since Britain plays a leading role in the Common Foreign and Security Policy, its withdrawal would exercise pressure on the EU's defence capacities. Certainly, Germany would have to take a more determined role in the EU foreign policy. If Germany would be ready to fill this British vacuum is questionable.

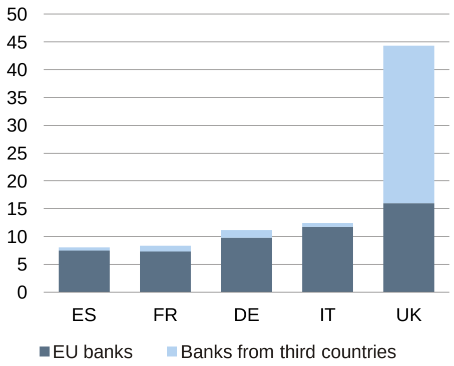
Who fills the EU-budget gap? Behind Germany, Britain is the second largest contributor to the EU budget. In 2013, Britain paid a net sum of EUR 8,641 million against EUR 13,824 million paid by Germany and EUR 8,445 million contributed by France, the third largest contributor. Eurosceptics often use this as a strong argument for withdrawal. If Britain was truly to leave the EU, its contribution to the EU budget would need to be distributed among member states – with Germany possibly accounting for the largest share of these budgetary implications. Moreover, Germany would have lost an important ally for EU budget negotiation.

[30] See Stockholm International Peace Research Institute & European Defence Agency.

influence. On the other hand and apart from the economic aspect, the political, diplomatic and military strength with which the UK contributes to the EU is a valuable asset.

Market share of foreign-owned banks in the largest EU countries 22

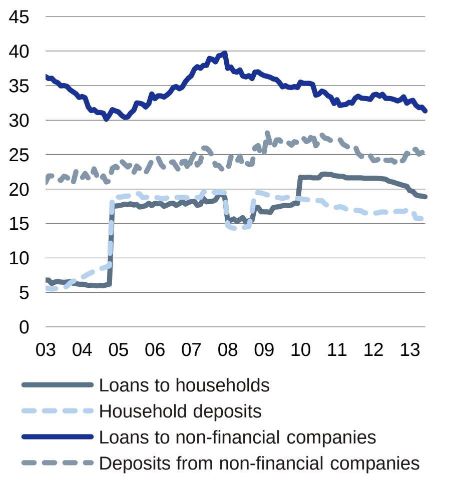
% of total assets, 2013



Sources: ECB, Deutsche Bank Research

Market share of foreign-owned banks in Britain 23

%



Sources: BoE, Deutsche Bank Research

Intense financial linkages between Britain and the EU at risk[31]

The UK, and specifically the City of London, operates as *the* financial hub of Europe as a whole. Part of this is due to its long-standing tradition and network effects as well as the country's general openness to foreign business, part of it is due to relaxed financial regulation pre-crisis, the English language and London's multicultural appeal. These advantages have been compounded by Britain's membership in the EU which allows non-European financial firms to set up subsidiaries or branches in the UK and use the single European passport to do business in all other member states without requiring further regulatory approval (which is particularly important in banking). Indeed, the hub function is underlined by the fact that most foreign banking business in the UK is conducted via branches instead of subsidiaries which greatly simplifies dealings with supervisory authorities in the case of multinational franchises.

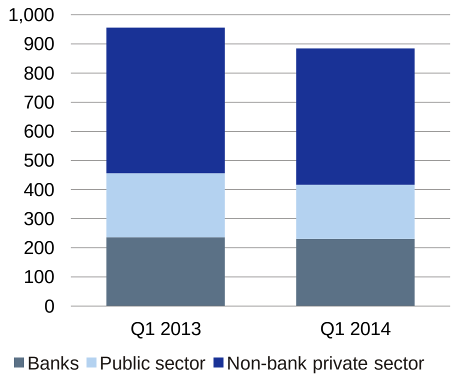
At the same time, the UK has a large domestic financial sector, with both highly indebted corporates and households. At more than 190% of GDP, outstanding levels of private credit (including loans as well as debt securities) are among the highest of any major advanced economy (for Germany, France or Italy it is between 100-120%). Foreign banks play a prominent role in this large financial sector. Compared to other EU countries, they command a much higher market share (44% vs 11% in Germany or 8% in France) – both banks from other EU countries but even more so banks from around the world (see chart 22). To a large extent, this reflects London's function as a financial hub and as the entry point into the entire European market.

However, foreign banks are not only channelling their European activities through London or centralising their investment banking operations there. Instead, they also contribute significantly to the financing of the British real economy. They are heavily active in the core lending and deposit taking with companies and private households, recent setbacks following the financial crisis and regulatory refragmentation across Europe and beyond notwithstanding. E.g., foreign(-owned) banks provide about a third of all loans to non-financial firms in the UK, a figure probably unmatched in all large European countries.

Yet it is not only foreign banks that are strongly present in the British market. Likewise, UK banks have substantial exposures to the rest of Europe. Total

Claims of UK banks on EU-15 countries 24

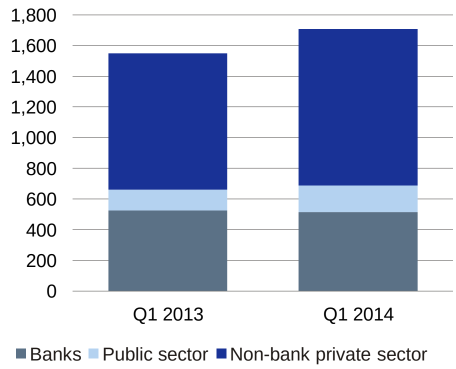
USD bn



Sources: BIS, Deutsche Bank Research

Claims of European banks in UK 25

USD bn



Sources: BIS, Deutsche Bank Research

31 This and the following section are based on a contribution by Jan Schildbach.

claims on the "old" EU-15 (no data available for all EU countries) amount to USD 880 bn. Most of that is credit to companies and households, but British banks also have significant government bond holdings and interbank assets. In return, all European banks combined have an even greater UK exposure of USD 1.7 tr.

The City of London – still a global financial hub after the "Brexit"?

Globally, the UK is the centre for over-the counter (OTC) interest rate derivatives activity which accounts for 49% of total activity. With 41% of global turnover, it also was the single largest centre for foreign exchange activity in 2013. Despite being outside the eurozone, the City accounts for the highest share of euro-denominated foreign exchange trading.[32]

In 2011, Britain took the European Central Bank to the European Court of Justice arguing that the Bank's location policy would imperil the City as a centre of euro-denominated financial instruments trading. The Court has not yet issued a sentence but it is expected that it will argue in favour of the City. Any attempt to set the location of clearing houses could be considered as a breach of the EU principle of free movement. If Britain were to leave the EU, it would be unable to call on the ECJ to defend its Single Market rights.[33]

London losing against Frankfurt, Paris and Zurich?

Overall, the financial interlinkages between the UK and the rest of the continent are extraordinarily well developed. The symbiotic relationship between the City of London and European capital markets as well as the numerous British clients of European banks would be adversely impacted if the UK were to leave the EU. Financial activity could partly shift towards other financial centres such as Frankfurt and Paris. Compared to Zurich London would lose the advantage of being in the EU. According to a survey among financial sector executives conducted by TheCityUK, 37% of respondents considered a (partial) relocation to the EU as likely. The survey also found that 81% of respondents regard a Brexit as detrimental for the UK's competitiveness as a financial centre.[34]

Non-European banks would have to find other ways into the Single Market, probably boosting Ireland's position (which is already strong in certain segments such as fund management or hedge funds). For European banks doing business in Britain, being forced to comply with different rules than in the EU would reduce the attractiveness of this market. What makes matters worse: after Britain's U-turn in recent years, financial regulation in the UK is nowadays usually even tougher than elsewhere in Europe. Since the crisis, the City underwent important changes in terms of financial regulation. Although some argue that a Brexit would free the City from excessive EU regulation, British regulators were actually pushing for higher capital and liquidity requirements.

With foreign banks pulling back, the intensity of competition in the British market would probably decrease, with customers having to pay more to borrow and the reliance on the (few and large) domestic banks rising. British banks' business in the rest of Europe would equally suffer from more difficult market access, higher regulatory and compliance costs and a less favourable legal and political environment, in turn affecting these banks abroad and at home.

Impact would crucially depend on the post-EU arrangement

In sum, while the City would in all likelihood continue to be an important global financial centre, short-term regulatory benefits of leaving the EU (if any) would be outweighed by long-term costs of reduced access to EU markets. As in other

[32] Bank of England (2013). BIS Triennal survey of Foreign Exchange and over-the counter interest rate derivatives markets in April 2013. UK Data.
[33] Springford John et al. (2014). The consequences of Brexit for the City of London, CER.
[34] TheCityUK (2013). A milestone study of the views of financial and related professional services leaders on the EU.

The withdrawal clause of the Lisbon Treaty 26

Article 50

(1) Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
(2) A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
(3)The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
(4) For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.
A qualified majority shall be defined in accordance with Article 238(3) (b) of the Treaty on the Functioning of the European Union.
(5) If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.

areas, the impact would crucially depend on the post-withdrawal agreement with the EU. An exodus of foreign banks – both EU and non-EU – and a weakening of domestic banks would hit employment, exports and economic growth given the important role of the financial sector (including related services) for the UK economy. Given the mutual dependence, the adjustment process would be painful both for the UK and its European (financial) partners, yet the greater negative consequences would probably be felt in London and the rest of the UK.

And if it becomes reality? There are many unknown variables.

There are many open questions about how the EU's future without Britain would look. If the British population truly votes for an exit, triggering article 50 of the Lisbon treaty defines necessary legal steps to take (see box 26). In case of a "yes"-vote and the subsequent use of article 50 a two-year negotiation process about future EU-UK relations would follow. During this period, the EU would need to convene on a post-withdrawal relation with Britain. Certainly, Britain would try to secure access to the Single Market, but fears of opening a Pandora's Box could induce the EU to make access to the Single Market more costly. The withdrawing country would be excluded from discussions in the Council and would also be denied a right to vote on the final deal. Therefore, the use of article 50 could lead to a vicious circle which unbalances the relationship between the EU and a withdrawing member. All decisions on a post-withdrawal relation will have to be taken by QMV. Although the arrangement itself would be negotiated between the Council and the withdrawing state, the European Parliament will have the final say – with a right to veto any final agreement. These legal requirements would reduce Britain's bargaining leverage.

Upon a British exit, accounting for the loss of 29 votes (8.5% weighted votes) would require a redefinition of the qualified majority weights. This could have considerable effects on the balance of power in decision-making since larger member states fear the empowerment of smaller member states and vice versa. With the British parliamentary delegation being the third largest group (73 seats) in the European Parliament, these seats would need to be reallocated.[35]

The open questions demonstrate that neither the EU nor Britain are prepared for a worst case scenario. A Brexit would leave a political and institutional vacuum. While some member states fear that this institutional bargaining could develop to the advantage of smaller members, a power shift towards more dominant member states such as Germany and France can be as easily envisaged.

Post-withdrawal relations

There are many speculations about how an alternative EU-British relationship could look (see table 27). No alternative, however, comes close to the benefits of EU membership. The "Norwegian option" represents the most prominent one. Britain would remain a member of the EEA and EFTA, maintain full access to the EU Single Market and comply with the four freedoms.

According to a study by the Bruges Group, an EEA/EFTA membership would bring about a significant reduction in EU regulations from more than 1,000 regulations a year to an estimated 300 which Norway adopts annually.[36] It is assumed that the reduced number of regulations could be beneficial for British businesses and could boost competitiveness. But Britain would still have to comply with any EU laws associated with the Single Market, without having formal influence on shaping these rules ("EU regulation without representation").

[35] Oliver, T. (2013). Europe without Britain. Stiftung Wissenschaft und Politik.
[36] Randwyck, H. Van (2011). EFTA or the EU. The Bruges Group.

Moreover, the Norwegian example shows that Britain would still be subject to regulation in social policy – it would therefore be difficult to reject the WTD under this scenario. Although a White Paper by the Norwegian government concludes that the EEA agreement contributed to an era of high growth in Norway, it also regards cooperation in areas of social policy as primarily beneficial. At the same time, the report acknowledges a lack of "democratic basis for the development of Norway's European policy...and debate on the EU and the EEA in Norway."[37] Furthermore, there is a crucial difference between the Norwegian and the British economy. With Britain's focus on the services market the loss of direct influence of services regulation could be extremely detrimental for Britain and the UK would be unable to reap the benefits of greater liberalisation in the services sector. Last but not least, Britain would still be obliged to make financial contributions to EU and EEA programmes. Thus, the economic benefits associated with the Norwegian options seem negligible and would not outweigh its loss of influence.

Alternatively, the UK could try to get a "Swiss-style" agreement with the EU, in which it would be part of EFTA, not however of the EEA. Principally, a Swiss option for Britain would imitate the EU's relationship vis-à-vis Switzerland "rooted in free trade and mutually beneficial bilateral agreements."[38] Such an agreement would result in a cut of the British annual contribution to the EU budget and it could exit EU policies such as CAP and JHA. But even though the Swiss option seems to be most attractive for the UK, it is highly questionable whether the EU would be willing to replicate such a model. Moreover, Switzerland is under no formal obligation to adopt EU legislation, but EU legislation and rules still remain prevalent. Thus, the benefits of such a post-withdrawal relation seem to be marginal and entail some risks as well. Not only is it expected that trade with other EU members would fall under this scenario[39], but it also bears some political risks. Despite being one of the founders of EFTA, Britain would need to initiate a new application process for its EFTA-membership – potentially facing a veto by other EFTA members.

Under both options, Britain would however be able to conclude independent FTAs with economies across the world. In addition, eurosceptics often advance the argument that the level of unemployment is particularly low in EFTA member states (less than 5% in Switzerland and less than 4% in Norway). However, to suggest that there is a causal relationship between EFTA membership and lower unemployment is invalid and misleading.

Alternatives to EU membership 27

Norwegian option	Full access to Single Market
	Pay contributions to the EU budget (gross payments estimated to be around EUR 550 m in 2013)
	Subject to (reduced) EU regulations (Norway adopts around 75% of EU regulations)
	No political power to shape EU rules
Swiss option	Limited access to Single Market
	Pay contributions to the EU
	Adoptions of EU regulations based on bilateral negotiations
Turkish option	Customs union
	No EU budget contribution
WTO option	All trade will be subject to tariffs under MFN

Sources: Open Europe, Norwegian Ministry of Foreign Affairs

[37] See: The EEA Agreement and Norway's other agreement with the EU. Meld.St. 5 (2012-2013). Report to the Storting (White Paper).
[38] Clements, B. (2014). IEA Brexit Prize: Britain outside the European Union.
[39] Ottaviano, G. et al. (2014). The Costs and Benefits of Leaving the EU, CEP.

Two less attractive (and thus more remote) alternatives are the "Turkish option" of a custom union and the "WTO option" of tariffs under the most-favoured nation (MFN) principle. Article 16 of the EU-Turkey Customs Union agreement requires Turkey to "align itself ... with the preferential customs regime of the Community", obliging the country to adopt EU commercial policies and thus leaving little margin for manoeuvre. All the same, the WTO option represents the least attractive option, since under this scenario British car exports could potentially face a tariff of around 10% which would imply a welfare loss for consumers. Overall, the alternatives to EU-membership hardly seem appealing.

Conclusion

The Time Framework 28

2014: On Sept. 18th, the Scottish people will vote in a referendum on Scottish independence from the UK

2015: General Elections in the UK will be held, setting the basis for an 'In-Out-Referendum' on EU membership

2016: According to article 16 (TSCG) necessary steps shall be taken to incorporate the Fiscal Compact in the legal framework of the European Union

2017: Election year

Potential British 'In-Out-Referendum'

Germany & France will hold national elections

If the British population votes for an exit of the EU, article 50 of the Lisbon Treaty would allow for two years during which a British post-withdrawal relation with the EU will need to be determined.

Despite the sometimes tough rhetoric, there are many areas in which Britain and the EU could agree on a common ground. Although the British reform demands need to be taken seriously, it should be equally clear that an EU agenda for growth, the importance of the Principles of Subsidiarity and Proportionality and the idea of a differentiated integration are recurrent themes throughout the European history and nothing the EU would ignore without the British reform demands. Modernizing the EU to fit the 21st century realities should be a common endeavour by all member states. To achieve this aim and to accommodate the British reform demands, however, a political commitment by all member states is indispensable.

The perspective of damaging economic and political consequences in case of a Brexit, should be reason enough for EU member states to work on a solution which would be acceptable for both. In its own interest, the Union should seize the opportunity to set necessary policy targets at the beginning of a new political cycle.

Over the last couple of months the EU debate in Britain appears to be more and more entrenched. Yet, instead of leading a constructive European campaign and convincing the British people of the EU's merits, it appears as if, so far decisions have been taken with the aim of accommodating British eurosceptics. Yet, to gain support for the British cause, the UK government will need to forge more actively alliances with EU partners. In a spirit of compromise, both Britain and the EU should be able to deescalate the European question in British politics.

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