ECONOMIC RESEARCH & CORPORATE DEVELOPMENT

Working Paper 160

February 6, 2013

} MACROECONOMICS } FINANCIAL MARKETS } ECONOMIC POLICY } SECTORS

Michael Heise, Richard Hewitt, Alexander Maisner, Ann-Katrin Petersen

The UK within the EU

Allianz

Working Paper

No. 160

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AUTHORS:

MICHAEL HEISE
Tel. +49.89.3800-16143
michael.heise@allianz.com

RICHARD HEWITT
Tel. +44.20.345-13338
richard.hewitt@allianz.com

ALEXANDER MAISNER
Tel. +49.69.263-53794
alexanderjohn.maisner@allianz.com

ANN-KATRIN PETERSEN
Tel. +49.69.263-19790
ann-katrin.petersen@allianz.com

1. THE UK AND THE EU – AN AMBIVALENT RELATIONSHIP

The UK's ambivalence to other European countries, along with therefore the EU, has built up over many centuries, shaped by its distinctive island independence, wars, different economic interests and political ideologies. In the post WWII era, while the UK was keen for Europe to bind itself together into a United States of Europe, it made clear that it would remain independent. However, during the late 1950s and 1960s the UK changed its mind. It increasingly became apparent that the UK's economic growth was lagging behind Germany and France, that the trade associations it was part of – such as EFTA and the Commonwealth – were not meeting expectations and its international influence – through the Suez Crisis, colonial independence and the Cold War – was on the wane. So, in 1973, after a couple of failed attempts, it joined the European Economic Community. Since then, as the European Project has gathered momentum, the UK's strategy has been to focus on developing free trade, EU enlargement, along with foreign and security policy.

For the most part, the UK's political leaders have been circumspect and resistant about expanding the UK's involvement within the EU beyond these interests. The reasons why are straightforward enough when it comes to public opinion as, more often than not, the UK public do not believe that they benefit from EU membership, which is in contrast to views in other EU countries. Originally in the 1970s, this was rooted among Labour left-wingers, but in the 1980s Margaret Thatcher weighed in with her anti-European sentiment, warning of a "European super-state" and its threat to national identity. Her tough negotiating led to the UK securing a rebate on its financial contribution to Europe in 1984 and a refusal to join the European single currency. Under the subsequent Conservative Prime Minister John Major, the UK negotiated opt-outs from the 1993 Maastricht Treaty on the single currency and Social Chapter, as well as not adopting the Schengen Agreement. Then under successive Labour governments led by Tony Blair and Gordon Brown the UK drew closer to the EU and adopted the Social Chapter, though the EU's foreign policy was regularly tested, in particular during the Iraq War when the UK asserted its relationship with the United States.

More recently in the wake of the euro crisis and plans to deepen EU integration, public opinion in the UK against the EU has risen and the United Kingdom Independence Party (UKIP), an anti-EU party, has gained in opinion polls. Although ironically, according to other polls, the EU does not feature in a list of issues that UK voters consider important, those that are mostly relate to the poor state of the UK economy. Nevertheless, with his eye on the 2015 General Election and ambition to win an overall Conservative majority, David Cameron believed that he had to do something significant on the UK's relationship with the EU to win back votes from UKIP and deflect damaging criticism of his leadership from right-wingers in his own party. In a speech delivered on 23 January, he therefore set out his strategy to achieve this, which will be to negotiate "a better deal" for the UK's membership of the EU and put this to a referendum after the 2015 election, possibly in 2017.

Although trying to shore up his party's election prospects and win votes back from UKIP, David Cameron is also gambling that other EU members will be sympathetic to the UK's concerns and agree "a better deal." He presumably expects that the eurozone's closer integration will require treaty changes to enable fiscal union that will open a window to address the UK's position and that countries like Germany will not want to risk losing from the EU an important trading partner, political ally and counterweight to France. However, it's not difficult to foresee that David Cameron's attempt to negotiate "a better

deal" for the UK is forced into a straight "In or Out" referendum by the time of the UK's 2015 general election.

As the UK ponders its future in Europe, it could do worse than consider the alternatives available to it outside and the course that led it to be desperate to join the EEC in 1973, ironically under a Conservative-led government. The other side of the EU fence may turn out to be a desert, rather than the promised green lawn with English tea and New Zealand buttered crumpets with its "special" US friends.

2. EU/UK ECONOMIC INTERLINKAGES

The UK and EU economies are closely intertwined. This interlinkage reveals itself inter alia in close trade relations and investment flows.

In 2011, with a share of 53.2%, more than half of Britain's total exports flowed to its EU partner countries.[1] With the US being the UK's major export market (13.3% share in total UK exports in 2011), member countries such as Germany (10.9%), the Netherlands (7.9%), France (7.9%), Ireland (6%), Belgium and Luxembourg (5.4%) as well as Italy (3.4%) and Spain (3.3%) follow close behind and not only belong to the UK's top ten export markets but also to its top ten import sources.[2]

Moreover, both inward and outward investment flows bear witness to the close economic relationship between the UK and its partner countries. EU companies were the major investors in 2011. More than half of Britain's foreign direct investment (FDI) came from EU countries in 2011 (57% of total net FDI in the UK), with net earnings from FDI by European companies amounting to GBP 19.7bn (45% of total net FDI earnings). Net investment by UK companies to the EU accounted for 24% of the total.[3]

3. A UK EXIT: THE ECONOMIC AND POLITICAL CONSEQUENCES

Life on the outside would involve plenty of unknowns for the British. It would be the first time a country had left. If the UK were to leave the EU, it would, however, definitely no longer be part of the Single Market with its "four freedoms", the free movement of people, goods, services and capital. UK trade flows with a market that accounts for more than half of British exports (see above) would be hampered unless new free trade agreements were negotiated and EU standards taken into account. Britons' right to live, work, study or retire in another EU country would cease to apply. UK businesses would find it harder and more expensive to do business across borders. At the same time, the UK would lose its attractiveness as a European operations base for carmakers and the financial industry (where UK is used as a "gateway to Europe"). From a weaker position, the UK would need to renegotiate dozens of bilateral trade deals.

As a global financial center, the UK is of pivotal importance to the EU. To offset the potential loss of the gateway benefits, a detached UK might well be tempted to relax its regulatory framework in order to remain attractive to foreign banks. Such regulatory competition would undermine EU drives towards uniform financial market rules aimed at achieving more financial market stability. This would damage the EU as a whole.

[1] Source: IMF.
[2] See "Monthly Review of External Trade Statistics", Office of National Statistics (ONS), November 2012 edition.
[3] See "Foreign Direct Investment Involving UK Companies, 2011", ONS Statistical Bulletin, December 6, 2012.

Influencing EU regulation is possible on the inside but impossible on the outside. Visions of a Norway/Switzerland-like role for the UK – with access to the Single Market but outside the EU and therefore no say in setting the rules – seem unrealistic. Would the UK be willing to lose its influence in shaping regulations and policies that would still affect it?

Apart from these challenges, a "BrExit" involves the risk of a greatly diminished figure on the world stage, especially against the background that, not only due to greater political integration, the EU is set to gain more political weight globally. It would be no surprise if, sooner or later, it were called into question why a cut-off UK, with no influence on European policymaking whatsoever, would still deserve to have a seat on the UN Security Council and be a G8 member.

On a more positive note, the UK would save its budget contributions to the EU budget which amounted to EUR 11.3bn, after the rebate, in 2011.[4] Freed of the common agricultural policy, its food could become cheaper. Pulling out of the Single Market, the UK would no longer have to abide by the rules and regulations (such as labor directives, consumer protection etc.) and thus gain flexibility in economic policymaking. It could avoid creeping European finance rules that could enchain the financial center of the City of London, one of the outstanding success stories of the UK economy.

In sum, this looks like little gain in sovereignty at factually large economic and political costs.

From an EU perspective, moves towards integration might become easier without the reluctant Brits. But British pragmatism and its liberal stance have been an important counterweight to excessive centralist and/or protectionist tendencies in Europe. The UK being one of the Big Four, the EU's image would be damaged. The risk that a UK referendum could become part of a broader fracturing of the EU would rise. A UK exit would have major implications for the EU budget. Yes, the EU might save the rebate but who would plug the gap created by the absence of the UK's net contribution?

As for the political consequences of an exit, the EU would probably lose access to the UK's excellent diplomatic network, its experience in international affairs, including its seat on the UN Security Council (if it were to keep it), and the Commonwealth, its able military, and function as a bridge over the Atlantic. Although the EU's political voice in the world has gained in strength, this loss would without a doubt diminish the EU's clout in the world.

Summa summarum, the disadvantages are considerable for both sides.

4. FUTURE CHALLENGES: A BETTER DEAL FOR EUROPE?

Given the arguments highlighted above, what is the way forward? How can Europe ensure that it has the flexibility to accommodate members such as the UK who do not wish to partake in enhanced integration – but are still a pivotal element of the EU construct – without unraveling the whole edifice? Can this circle be squared?

[4] EU contribution: "In 2011 the UK contributed €11.27 billion to the EU budget (after a rebate of €3.56 billion)." EU spending: "In 2011 the UK received €6.57 billion in EU funding. Of this, €3.96 billion, or 60%, went on farm spending, which is above the EU average of 49%. Regional policy ("cohesion" and "structural" funds) accounted for €1.21 billion (18%), well below the EU average of 36%. Research and development accounted for €1.19 billion (almost 18%), well above the EU average of 11%." http://www.europarl.europa.eu/news/en/headlines/content/20111107MUN30717/html/EU-budget-at-glance

Any "repatriation of powers" to the UK alone, as demanded by David Cameron in his recent policy speech, must surely be a non-starter as it would open a Pandora's box of special exemptions for others. There is little appetite in other member states to make further concessions to the 'awkward' UK. Support for the EU in the UK might be wafer-thin, but so is patience with the UK in Europe. There is a widespread view that the UK has long acted as a serious brake on progress. The refrain that the EU would be better off without the UK is growing louder.

In this climate the initial, broadly hostile reception to Cameron's speech was predictable. On closer examination, however, the speech touched on many a sore point, exposing a host of shortcomings which Europe needs to address if it is to prosper and (re)gain the confidence of its citizens. Cameron struck a chord in many quarters with his impassioned appeal for a better deal for Europe, for a flexible, open and fair EU.

In recent years too little attention has indeed been paid to the principle of subsidiarity in some fields. This will be a key issue on the table for the upcoming negotiations and a sensible redistribution of decision-making powers away from Brussels to the national level will go a long way to assuaging British concerns. In many areas "more Europe" could be achieved through "less Europe". Harmonization of every aspect of European citizens' lives is not necessary (cucumbers, lightbulbs, shower heads spring to mind). National parliaments and policymakers need leeway to adapt central EU guidelines to local particularities. The examples above are trivial, but the same applies to some areas of labor and social policy.

A related problem is actual adherence to the rules. The UK has a good track record of adhering to the rules agreed, even if it doesn't like them. Without naming names, this cannot be said of all countries – the rules are nodded through but subsequently ignored. The bottom line must be: fewer rules, more adherence.

The democratic deficit problem is not new but is perhaps perceived particularly acutely in the UK with its long democratic tradition. All players are aware that action is needed on this front. Where enhanced integration is needed, there will need to be at least a limited transfer of sovereign rights to the EU level. This means that the democratic accountability of the beefed-up EU institutions has to be strengthened.

In a first step, the role of the European Parliament should be upgraded by empowering it to initiate legislative procedures. The result would be a de-facto two-chamber system, with two powerful legislative branches: the European Parliament on the one side, the European Council on the other. Representation in the former would be more in line with population size, the latter would give interests of small countries disproportionate consideration. Furthermore, cooperation between the European Parliament and national parliaments should be intensified, particularly in the areas of economic and fiscal policy.

In a second step, the EU Commission should be transformed into a streamlined and effective executive branch whose membership is based on merit, not nationality. The present posts of EU president and Head of the EU Commission could be merged and the position of EU president opened up to EU-wide elections.[5]

As it stands today, the EU also needs to address a number of reputational issues. The public perception (not only in the UK) is that Brussels has become an unwieldy and

[5] cf. our "Euro 2022" paper of December 2012:
https://www.allianz.com/v_1355132430000/media/economic_research/publications/specials/en/Euro202210122012.pdf

costly bureaucratic monster, a veritable gravy train. The tendency of politicians who have floundered at home to resurface as an EU Commissioner or a Member of the European Parliament (MEP) has not helped to burnish the EU's reputation. The monthly caravan between Brussels and Strasbourg is also viewed as a scandalous waste of time and money. The refusal of the EU auditors to sign off EU accounts in the last 15 years does not inspire confidence that taxpayers' money is being spent wisely.

Going forward, and with embryonic plans for a separate eurozone budget already on the table, it will be important to ensure that all EU spending is stripped of any deadwood, refocusing it away from agriculture and channeling it towards areas that generate growth and create jobs.

Opinion in the UK (and elsewhere) will ultimately hinge on the economic success of the European Union. Unless growth is rekindled, unemployment reduced and competitiveness restored, the EU will not be able to fulfil its promise.

Given its emphasis on the importance of the Single Market, the UK needs to be convinced that the best route to boosting intra-EU trade is through greater integration and harmonization. The single market in the US provides a prime example. Intra-US trade is significantly higher than intra-EU trade.

The US, which unprecedentedly warned the UK about the potential loss of influence should it sleepwalk out of the EU, seems to be keen to seek an EU-US trade deal, a prospect that offers a powerful political argument for continued UK engagement with Europe.

Recent EU Commission estimates show that deepening relationships between the EU and its key trading partners can contribute significantly to Europe's recovery. If the EU pursues its ambitious external trade agenda, this could boost the EU's GDP by 2% or more than EUR 250bn. This is equivalent to adding an economy of the size of Austria or Denmark. An ambitious agenda could also help create more than 2 million jobs across the EU. More than two-thirds of these gains in growth and jobs would materialize through trade agreements with the US and Japan.[6]

There are many other areas in which both the UK and the EU as a whole could benefit from enhanced integration and full implementation of the Single Market – these include foreign and defense policy, the digital economy, energy.

As it turns its focus away from Europe and towards Asia, the US is looking to the EU to play an increasing role on the world stage. Cushioned in its warning to the UK not to drift towards the exit was the concern that the EU as a whole would be weakened. Britain, helped by its history and its long-standing Commonwealth links, has always managed to "punch above its weight". A close US relationship with a strong Europe would also help to create more opportunities with emerging economies in both Asia and Latin America.

A UK departure from the EU would be a lose-lose situation for all. As a global financial services provider, with a keen interest in open and fair markets, it is in the interest of Allianz that this does not happen.

[6] See "Concluding trade deals could boost EU's GDP by 2 per cent", European Commission, MEMO/12/587, July 20, 2012, http://europa.eu/rapid/press-release_MEMO-12-587_en.htm.

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