



Britain and Europe: Where America's Interests Really Lie

Dr. Robin Harris

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Table of Contents

Introduction1
Section I: Recent Developments in Europe.....3
Section II: David Cameron’s Position.....6
Section III: Assessing the Options10
Section IV: U.S. Policy and Interests13
Conclusion.....16

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Abstract

The United States has a strong and continuing interest in a prosperous and stable Europe, but the policies and pronouncements of President Barack Obama and the U.S. Department of State are making that goal less, not more, attainable. This is especially true as regards current, very public U.S. pressure on Britain to stay inside the European Union, apparently whatever the cost and whatever the fate of the EU. History shows that in the past, the U.S. has often misread its own interests in Europe and then had to make sudden reversals.

The present juncture is particularly crucial. The EU is dysfunctional. Its model has failed. More important still, it is on the brink of evolving into a European Federation, effectively a new megastate, under conditions that ensure that it will be neither prosperous nor stable nor reliable. This Europe will be more difficult for the U.S. to manage, and within it, Britain can have no useful place, whether judged by the criterion of British national interest or by that of the national interest of the U.S. Britain is strategically well placed to secure either a radically different—and better—future within the EU or an equally good—and still better—future outside its formal structure. Doing so, however, will not be easy because of a range of internal and external pressures.

The U.S. should be helping Britain to confront these problems. Yet the current Administration does the opposite. It clings to outmoded analysis and refuses to recognize reality. If it continues to act on this flawed analysis, it will encourage dangerous trends in mainland Europe; it will press the U.K. in a direction that its people rightly consider unacceptable; and it will undermine the U.S.–U.K. special relationship. The cost of that combination of errors in the years ahead could be great. It is time for the Administration to reverse course.

Introduction

The United States has a strong and continuing interest in a prosperous and stable Europe, but the policies and pronouncements of President Barack Obama and the U.S. Department of State are making that goal less, not more, attainable. This is especially true as regards current, very public U.S. pressure on Britain to stay inside the European Union, apparently whatever the cost and whatever the fate of the EU. History shows that in the past, the U.S. has often

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The present juncture is particularly crucial. The EU is dysfunctional. Its model has failed. More important still, it is on the brink of evolving into a European Federation, effectively a new megastate, under conditions that ensure that it will be neither prosperous nor stable nor reliable. This Europe will be more difficult for the U.S. to manage, and within

**BRITAIN AND EUROPE:
WHERE AMERICA'S INTERESTS REALLY LIE**

it, Britain can have no useful place that accords with the national interests of Britain or the U.S. Britain is strategically well placed to secure either a radically different—and better—future within the EU or an equally good—and still better—future outside its formal structure. Securing the second future will be difficult because of a range of internal and external pressures.

Despite the difficulties, however, Britain does have a range of viable options, and its closest ally, the United States, should be anxious to see it pursue these options determinedly and skillfully because a sovereign, prosperous United Kingdom is a useful and potentially indispensable partner. The most important point for Washington to grasp is that while Britain is in a tactically weak position within the EU to get its way on small matters, it is in a

strategically strong position when it comes to asserting its interests in large ones. Therefore, as soon as diplomacy becomes less diplomatic, the EU can be expected to bend.

The U.S. should be helping Britain to confront these problems, yet the current Administration does the opposite, clinging to outmoded analysis and refusing to recognize reality. If it continues to base its actions on this flawed analysis, it will encourage dangerous trends in mainland Europe, press the U.K. in a direction that its people rightly consider unacceptable, and undermine the U.S.–U.K. special relationship.

The cost of that combination of errors in the years ahead could prove to be great. It is therefore time for the Administration to reverse course.

Section I: Recent Developments in Europe

Europe has been damaged by the financial and economic crisis of recent years in a way that the U.S., for all its financial and economic woes, has not been. The European centralized and corporatist economic and social model has been tried and found wanting. Despite frequent changes of government and much desperate summitry, European countries have remained unable to bring their spending and borrowing down to sustainable levels. This remains the case even though the current headlines are less shrill.

Above all, the European single currency, itself the crucial expression of European Union (EU) ambitions, staggers from crisis to ultimately unresolvable crisis. As soon as European politicians and bankers breathe a sigh of relief that the latest bailout has secured the position of Greece, Portugal, Spain, or Italy within the eurozone, some new internal or external shock shatters their complacency and once again drives bond yields up to dangerous levels. The prospect of an unpredictable new Spanish or Italian government was, for example, more than enough to revive previously quiescent fears.¹ France, the second country of the eurozone, is careering toward the financial abyss. Employment Minister Michel Sapin has recently admitted that the French state is “totally bankrupt.”²

In 2002, Margaret Thatcher warned that a currency union would lead, little by little, to demands for a fiscal union and a debt union. By effectively removing the central economic questions of taxing and spending from national elections, this development would render national democratic decision-making a sham, with dangerous consequences.

Most recently, the case of tiny Cyprus has again shattered European complacency. It threw up new versions of old problems in addition to setting some alarming precedents. The insolvency of the Cypriot banking system resulted in a botched bailout. At one

stage, its terms threatened to push Cyprus into the hands of Moscow. Even when, after modifications, this was avoided, the final deal left the country in political turmoil and—since it is still financially bound hand and foot by membership in the eurozone—with bleak prospects for economic recovery. Most significantly, the raid on personal deposits held in Cypriot banks, which some commentators have suggested may constitute a template for the future elsewhere, threatens long-term capital flight from banks in financially vulnerable eurozone countries.³

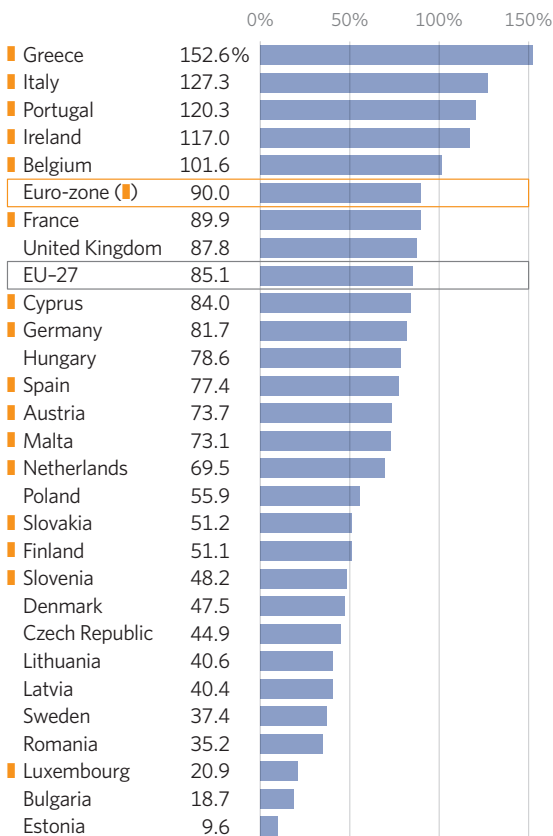
Moreover, whatever success the European Central Bank achieves in this or other instances in reducing the immediate risk of a sovereign default is not matched by any success by European policymakers in overcoming the fundamental cause of the continuing eurozone crisis, which is structural. To adopt a single currency and so apply a single monetary policy and a single interest rate to countries with altogether different long-term productive capacities was to invite trouble.

This “trouble” has turned out to be financial, economic, and political, and it is inherent in the system. The financial aspects make most of the international news headlines, but the deeper economic aspects—collapsing businesses and soaring unemployment—are what principally preoccupy domestic electorates. These, in turn, are enmeshed, particularly in Southern Europe, with political aspects: the decline of respect for traditional parties, and indeed for the legitimacy of state institutions, combined with bitter resentment at solutions imposed by foreigners and technocrats. These political aspects should worry the world, including America, deeply. The European project was, of course, intended to unite. Indeed, that was its whole intellectual and historical rationale. But it increasingly serves to sharpen division both within and between states.

The latest figures for European government debt and gross domestic product (GDP) illustrate how little progress is being made, even on the narrower financial front. They show that with GDP contracting sharply, partly as a result of unpopular austerity measures, debt is actually rising rather than falling among some of the weakest eurozone members: Ireland, Spain, Portugal, and Italy. They also illustrate the well-known fact that these countries face unsustainable levels of debt and the rather less

CHART 1

**Government Debt in the European Union,
as a Percentage of GDP, Q3 2012**



Source: Eurostat news release, “Euro area and EU27 government debt nearly stable at 90.0% and 85.1% of GDP respectively,” January 23, 2013, http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-23012013-AP/EN/2-23012013-AP-EN.PDF (accessed March 7, 2013).

SR 131 heritage.org

well-known fact that the countries expected to stand behind it, above all Germany, already face their own substantial debt problems.

As numerous (above all, Anglo-Saxon) critics warned at the time, there was no reason to believe either that the political construct that was the European Union as created by the 1992 Maastricht Treaty was an optimal currency area or that it would somehow have become one 10 years later when the euro was actually launched.⁴ Moreover, then-British Prime Minister Margaret Thatcher, among others, also warned that moving to a European single currency should be considered a fundamental constitutional change, not just an economic change. A currency union would lead, little by little, to demands

for a fiscal union and a debt union. By effectively removing the central economic questions of taxing and spending from national elections, this development would render national democratic decision-making a sham, with dangerous consequences.⁵

That prediction has been proved correct by the response to the eurozone crisis: It has proved impossible to have a single currency without a single economic government. Although different countries wish to proceed in somewhat different ways, with different short-term ends in view, this broad analysis is now accepted by the governing elite within the eurozone.

The principal reason why, despite detailed proposals from the President of the European Council and others, little progress has been made toward such a common economic government is political.⁶ Everything ultimately depends on Germany, and German Chancellor Angela Merkel faces a general election in the autumn. German public opinion remains staunchly hostile to further bailouts of failing South European states. This is a problem for almost any course of action likely to be proposed by European leaders.

Recent European developments have also exposed a different but intersecting group of issues confronting Britain. Particularly since the beginning of the eurozone’s public turmoil in 2010, British public opinion has been moving quite sharply against European integration. This did not matter greatly in British politics as long as newly elected Conservative Prime Minister David Cameron, who had publicly deplored the tendency to “bang on about Europe,” was able to keep European business off the top of the domestic agenda. But in December 2011, partly because of pressure within his own party, a lack of diplomatic dexterity, and bad intelligence before the Brussels Summit, Cameron was forced to exercise what amounted to a veto of a planned new European Treaty.⁷

Mr. Cameron hoped that he would be able to have a protocol added to such a treaty to protect the City of London from damaging regulation and a proposed new tax on financial transactions. He discovered only at the last moment that Chancellor Merkel had decided to back then-President Nicolas Sarkozy of France. (France had long been envious of Britain’s primacy in financial services and hoped to use the eurozone crisis as an excuse to end it.)

By his “veto,” Mr. Cameron won plaudits from most of the press, his own party, and wider British

public opinion. In practice, the results were somewhat less than they first appeared. Regulatory threats to Britain's financial sector have not vanished. The British government later quietly conceded without a fight the important principle that European Union institutions could be used legally to transact exclusively eurozone business. For their part, the Europeans continued with their plans for more integration.

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Most important, however, the British Prime Minister and his advisers were forced by the clash in Brussels to rethink the logic—and tacitly recognize the lack of logic—of their own position on the eurozone's future.

For months, Mr. Cameron and Chancellor of the Exchequer George Osborne had been pressing

European leaders, especially Chancellor Merkel, to move swiftly toward much greater integration of the eurozone. They demanded a “firewall” against speculation at the expense of the weaker eurozone members. They urged bailouts; a debt union (the issue of “Euro-bonds”); and—insensitively rehearsing the accurate but offensive British argument that a single currency must lead to a single economic government—what amounted to real political union, necessarily under German leadership.⁸ They felt able to adopt this Olympian objectivity and chiding tone because, whatever its economic difficulties, Britain was itself outside the euro.

For the British government, Europe was a problem, but it was also to some degree a useful excuse. The problem was that, with the eurozone floundering, the scope for British economic recovery was necessarily reduced. The excuse, conversely, was that Europe's dreadful difficulties could be used as an alibi for the United Kingdom's economic stagnation. What the Prime Minister, the Chancellor, and their advisers had failed to do, though, was to think through how the changes they were urging on Europe, along with other changes that the European leaders had long wanted to see, would affect Britain's interests. Now, with the fiasco of the Brussels Summit, the reality was brutally brought home to them, along with the lacuna in their own thinking.

Section II: David Cameron's Position

As noted, David Cameron, from the time of his accession in December 2005 as Conservative Party Leader, had sought to avoid concentration on European questions, which he and fellow Tory modernizers considered “toxic” for the party’s image. The fact that from May 2010, the Conservative Party was in a coalition government with the highly Euro-enthusiastic Liberal Democratic Party and that Mr. Cameron’s Deputy Prime Minister was former European Parliament Member Nick Clegg strongly reinforced that tendency. But circumstances changed.

The main domestic factor in pushing the Prime Minister toward an ever-harder Euroskeptic stance has been the rise in the polls of the United Kingdom Independence Party (UKIP). Following an early and so far largely unreversed collapse in Liberal Democratic support, the UKIP had emerged by the end of 2012 as the alternative “third party,” behind Labour and the Conservatives but a little ahead or just behind the Liberal Democrats.

The eurozone countries constitute not just the core of Europe: They are now in the process of becoming a single European entity that will effectively control all European institutions.

The rise of the UKIP was particularly worrying to Conservative Members of Parliament (MPs). The UKIP is historically and ideologically a breakaway from the Conservative Party. Tory supporters are also more likely than others to defect to the UKIP if supporting the latter’s candidates no longer seems (in Britain’s first-past-the-post system) a “wasted” vote. Tory MPs therefore had every reason to press the Prime Minister to pick a fight with the EU and thus blunt the UKIP’s electoral threat. In fact, this has turned out to be a sensible electoral strategy, though it seems unlikely that it will be sufficient to ensure a Conservative majority at the next general election, scheduled for 2015.

The other factor lending urgency to the need to recalibrate U.K. policy toward Europe was the step-change in moves toward the creation of a European federal state. The fairly even balance of argument in

British public discussion about the benefits and disadvantages of EU membership has been overtaken by the understanding that, whatever the Common Market was and whatever the European Union is, the Europe of the future is going to be markedly different from both.

The eurozone countries, to which one must add those countries that are determined sooner or later to enter the euro, constitute not just the core of Europe: They are now in the process of becoming a single European entity that will effectively control all European institutions. A succession of European treaties, up to the Lisbon Treaty, which came into force on December 1, 2009, have gone so far in eroding national vetoes and establishing European institutional and legal supremacy that it is all but impossible for Britain to stand out against moves that it deems damaging to its interests.

Europe now has an important say in human rights provisions; border controls; immigration flows; employment laws; criminal justice (Eurojust, Europol, the European Arrest Warrant); foreign policy (Common Foreign and Security Policy, now including the EU diplomatic corps, the “Common External Action Service”); defense (Common Security and Defense Policy); and defense procurement. The institutional structure of the EU, particularly the powers of policy initiation attaching to the European Commission and the expansive judicial policy pursued by the European Court of Justice, ensures that the momentum is toward centralization and top-down control.⁹ The European Union also, of course, has its own citizenship and legal personality.

But in order to make what the European leaders, and especially Chancellor Merkel, consider the next crucial change—i.e., toward a European economic government—a further treaty is certainly required. This will give Britain one last opportunity, at least from within the European Union, to protect its national interests and, within the already very straitened limits, to press for the kind of Europe it wants to see. That combination of domestic pressure and external events is what lay behind David Cameron’s long-prepared and much-delayed speech about British policy toward Europe on January 23 of this year.¹⁰ On the coherence (or incoherence) of its approach, much now depends.

Despite the headlines, Mr. Cameron's speech was highly—perhaps excessively—flattering about the past achievement of the European Common Market/European Community/European Union. For example, he ascribed to it a major role in securing peace in the postwar years, which any close study of events hardly justifies. He also emphasized, "I am not a British isolationist. I don't just want a better deal for Britain. I want a better deal for Europe too." He urged action to tackle the problems of the eurozone. In contrast to some of his previous pronouncements, however, and in recognition of what he had learned from his Brussels Council of December 2011, he added quickly: "Those of us outside the Euro-zone also need certain safeguards to ensure, for example, that our access to the Single Market is not in any way compromised."¹¹

The British Prime Minister then listed some widely acknowledged failures in Europe's performance.

- He said that European countries and companies were failing to compete successfully and that the labor market was overregulated (a particular bugbear for Britain).
- He pointed to people's resentment of "decisions taken further and further away from [them, which] mean that their living standards are slashed through enforced austerity or their taxes are used to bail out governments on the other side of the Continent."
- He complained of too much bureaucracy, inflexibility, and a failure to press ahead with a single market in "services, energy, and digital."
- He urged "a bigger and more significant role for national parliaments."
- He explicitly rejected the governing idea of the European Common Market since the 1970s of "ever closer union."
- He also rejected the idea of a "single European demos."¹²

Addressing principally his domestic audience, he observed that people in Britain asked why they could not "just have what [they] voted to join—a Common Market" and said that they felt that the "EU [was] now heading for a level of political integration that

[was] far outside Britain's comfort zone." He also observed that "democratic consent for the EU in Britain [was] now wafer thin." He then promised to renegotiate the terms of British membership, which he elided with reshaping the future of Europe itself, and pledged to give the British people an "in-out" referendum. His words on this matter have been closely scrutinized, so they are worth giving *verbatim*:

The next Conservative manifesto in 2015 will ask for a mandate from the British people for a Conservative Government to negotiate a new settlement with our European partners in the next Parliament. It will be a relationship with the Single Market at its heart. And when we have negotiated that new settlement, we will give the British people a referendum with a very simple in or out choice. To stay in the EU on those new terms, or come out altogether. It will be an in-out referendum. Legislation will be drafted before the next election. And if a Conservative Government is elected we will introduce the enabling legislation immediately and pass it by the end of that year. And we will complete this negotiation and hold this referendum within the first half of the next Parliament.¹³

Mr. Cameron then concluded by stating why he thought that the right choice would still be to stay inside the European Union because of what he asserted were the economic and other benefits that it bestowed. He almost—but not quite—promised to campaign for a "yes" vote, whatever the terms: "And when the referendum comes, let me say that if we can negotiate such an arrangement [i.e., one that is satisfactory for Britain], I will campaign for it with all my heart and soul."¹⁴

In Britain, the press and public reaction was generally positive—in some cases, almost ecstatic.¹⁵ It evoked predictable criticism from Nick Clegg, who claimed that it would lead to "years of grinding uncertainty."¹⁶ Of greater political importance, it placed Labour Leader of the Opposition Ed Miliband in an awkward position. Mr. Miliband immediately ruled out offering a referendum, but this created consternation among some of his colleagues and advisers, who had privately been discussing just such a referendum to outflank the Conservatives. The Labour Party line was soon modified to not offering a referendum "now."¹⁷

In one respect, Mr. Cameron's initiative did what it was intended to do: It shot (or at least wounded) the UKIP fox. In the immediate aftermath of the speech, support for the UKIP fell sharply. The Conservative Party's polling also improved, although the Labour Party's roughly 10 percentage point lead over the Conservatives was later restored as public attention focused on other issues.¹⁸

Foreign reaction was mixed, though broadly hostile.

- Angela Merkel's comment was ambiguous. On the one hand, she noted, "We are prepared to talk about British wishes," but she added: "We must always bear in mind that other countries have different wishes and we must find a fair compromise."
- German Foreign Minister Guido Westerwelle elaborated: "Cherry picking is not an option."
- French Foreign Minister Laurent Fabius, alluding to Mr. Cameron's earlier remark that Britain would "roll out the red carpet" for businessmen fleeing high French taxes, noted: "If the UK decides to leave the EU, we will roll out the red carpet to businessmen." He added: "We can't have Europe a la carte." Warming to his theme, he proposed to take "an example which our British friends understand. Let's imagine Europe is a football club. You join, but once you're in it you can't say 'let's play rugby'."
- Spanish Foreign Minister Jose Manuel Garcia-Margallo simply accused Mr. Cameron of playing a "very dangerous game."
- Then-Italian Prime Minister Mario Monti added that "the EU does not need unwilling Europeans."
- European Parliament President Martin Schulz warned of "piecemeal legislation, disintegration and potentially the break-up of the Union" if Britain were allowed to sign up only to those policies with which it agreed.¹⁹

These reactions, domestic and foreign, confirm that, on the one hand, Euroskepticism is popular in Britain and that, on the other, barring a degree

of amicable flexibility from the German Chancellor, Mr. Cameron is going to find it difficult or impossible to have his reform proposals taken seriously by other European leaders. This does not mean that his strategy is doomed, but it does mean that tactics are a problem. In particular, the Prime Minister risks finding himself the slave, not the master, of events.

Seven tactical problems can readily be enumerated.

1. The eurozone bloc and associated countries will press ahead with much greater integration whether Britain likes it or not. Arguments such as those advanced by Mr. Cameron for strengthening national parliamentary control and devolving power will get no further now than they did when Mrs. Thatcher put them in her famous speech in Bruges on September 20, 1988.²⁰ The "identikit European personality," against which she warned then, is indeed what the European elites want, and they will run great risks to obtain it.
2. Britain's bargaining power is limited because, as noted, so many powers have already been ceded.
3. The timetable for any British renegotiation, assuming that Mr. Cameron seriously intends one at all, is difficult. Nothing useful can be done before the summer of 2015 because it must be assumed that the Liberal Democrats within the coalition will block it. In the meantime, Europe will not stand still. A new treaty will be prepared.
4. How will Britain react? If a majority Conservative government should be returned after the next election, a lengthy period of intense negotiation would probably be necessary—longer and more intense, anyway, than the few months of sham "renegotiation" by Harold Wilson's government in 1975.²¹ This is because Article 48 of the Lisbon Treaty formalizes and complicates the process, especially by involving the European Parliament, which (as its President's words suggest) must be expected to be thoroughly obstructive. Mr. Cameron, however, must have achieved his renegotiation in time for the referendum he has promised in the first half of 2017.

5. Mr. Cameron has expressed optimism that his campaign to shift the direction of Europe will be successful and that he will secure Britain's position in it, despite the emergence of a dominant eurozone bloc. But if, as seems clear, he will have little to show for his efforts, he will then have a difficult choice. He will either have to pretend that he has achieved a lot and campaign in the ensuing referendum to stay inside the EU—his preferred choice—or have to advise coming out. He has given credence to so many dangers and disadvantages, however, that the latter course would cause him to find defending a policy of exit highly problematic.
6. The problem would be acute within his own party. If he campaigns—as did the Conservative Opposition Leader of the day, Mrs. Thatcher, in the 1975 referendum alongside the other main party leaders—for a vote to stay in the EU, he will almost certainly (unlike her) find a majority, and perhaps an overwhelming majority of his highly Euroskeptic Conservative Party, against him. The “yes” lobby might well win, but this would leave Mr. Cameron's own leadership in precisely the perilous shape that it was in before he promised his referendum in his recent speech.
7. Indeed, Mr. Cameron's speech, though politically skillful, made the practical options of renegotiation even more difficult than they would otherwise be. He repeatedly emphasized that he wanted Britain to be within “the Single Market,” which he described as “vital for British business and British jobs,” but he did not recognize that along with the European Single Market comes the European *Acquis communautaire*, the body

of law that underpins it and is also a source of costly and burdensome regulation. It is thus not an unalloyed boon.²² He dismissed the semi-detached arrangement enjoyed by Norway and Switzerland as unsuitable for Britain, but he did not recognize that both countries are doing remarkably well or that Britain, as a major European power and a global economy, would be in a better position to negotiate its own relationship with Europe.

He likened membership in the EU to membership in NATO as a means of enhancing British global influence. This suggestion that Britain would carry less weight in the world outside the EU, much pushed by the British Foreign Office, may come back to haunt him. Moreover, there is no reason to believe it is true. Britain's influence depends on its global reach, its language, its wealth, its defenses (particularly its nuclear deterrent), its membership in NATO, and its uniquely privileged security ties with the U.S.

Despite the difficulties, Britain does have a range of viable options. Britain's closest ally, the United States, should be anxious to see it pursue these options determinedly and skillfully because a sovereign, prosperous United Kingdom is a useful and potentially indispensable partner. The most important point for Washington to grasp is that while Britain is in a tactically weak position within the EU to get its way on small matters, it is in a strategically strong position when it comes to asserting its interests in large ones. Therefore, as soon as diplomacy becomes less diplomatic, the EU can be expected to bend.

Section III: Assessing the Options

There can be no doubt that the U.K.'s membership in the EU involves costs. Disputes concern only the scale of these costs and how they are balanced by the equally undoubted benefits.²³ The costs can be summarized as follows.

The U.K. makes a large gross contribution to the EU budget: £15.4 billion in 2011 and £15.0 billion in 2012. The net contributions after public receipts are £8.1 billion and £6.9 billion, respectively.²⁴ They will be higher in future years because Tony Blair surrendered part of the U.K. budget rebate, originally secured by Mrs. Thatcher in the 1980s, and they would be higher still if David Cameron had not successfully forced the EU to accept a real cut in its budget.²⁵ (To this, one should add the disputable cost resulting from misallocation of resources as a result of the EU's spending priorities.) To place these figures in a wider context, the gross contribution of the U.K. to the EU budget is about 1 percent of GDP. U.K. spending on defense, depending on how it is calculated, hovers somewhat above 2 percent of GDP. (See Table 1.)

There is also the cost of regulation, which is perhaps double the direct fiscal cost of membership (though one should remember that the U.K. would doubtless choose to impose its own regulations even if not forced to do so by the EU). Particular costs are associated with the Working Time Directive. Illustratively, it has been estimated that 100 percent deregulation of EU social law would add an annual £14.8 billion to Britain's GDP. There is therefore a strong argument for repatriation of EU social policy if it is possible.²⁶ Recent worries have also focused sharply on the cost of planned EU regulation of the City of London.

An important point—which, to judge by his unstinted praise for the Single Market, Prime Minister Cameron has still not grasped—is that while it is simpler for British businesses exporting to Europe to have to deal with a single set of regulations rather than multiple sets, the Single Market itself imposes costs.²⁷ This is partly because, as one would expect from application of public choice theory to a centralized regulatory system, a high level of regulation is always regarded as preferable to a low level.²⁸

The U.K., in fact, relies far less on the EU market than do the majority of EU member states. The U.K. is particularly strong in services, yet this is the area

within which EU liberalization, effected through the Single Market, is least developed.²⁹ Moreover, although Britain is and always has been a country that depends on trade, the Single Market's regulatory corpus also applies to that part of the economy which does not depend on trade at all. Over 70 percent of the U.K. economy depends only on U.K. domestic demand; only 13 percent depends on exports to the EU (and not all of that requires EU regulation).³⁰

The U.K. relies far less on the EU market than do the majority of EU member states. Over 70 percent of the U.K. economy depends only on U.K. domestic demand; only 13 percent depends on exports to the EU.

A potentially larger but even less easily quantifiable cost, against which must be set large if all but unquantifiable benefits, flows from the fact that the EU's Common Commercial Policy (CCP) prevents the U.K. from reaching its own (more liberal) trade agreements with other countries and trade blocs. The CCP is necessarily conducted by consensus, which means slowly, and members are inclined to protect domestic markets. On the other hand, it can be argued that acting within the CCP gives the U.K. clout in trade disputes (for instance, with China).

In examining the different options currently in force and assessing their advantages and weaknesses, one important preliminary observation is necessary: Britain is in a number of ways unique, and this uniqueness will ultimately determine what sort of new deal with Europe it is able—if it wishes—to strike. Despite the dismal story of economic non-recovery, with growth stagnating or dipping, the U.K. is not going to face the kind of financial trauma that threatens other major EU countries, because it is outside the euro. More positively, the U.K.'s historically well developed and now increasingly strong links with non-EU markets give it a global reach in an age when Asian markets are forecast to grow much more quickly than Europe's.

These ties also make the country less vulnerable to threats by disgruntled eurozone members if

and when it insists on altering its terms of EU membership. Since 2000, there has been a trend toward diversification of U.K. trade from the eurozone, and this trend has accelerated since the eurozone crisis began. British exports to China in 2011 (goods, services, and remittances) rose 17.6 percent on 2010, and exports to India increased by 29 percent, making India the U.K.'s largest non-EU market.³¹

The EU's Common Commercial Policy (CCP) prevents the U.K. from reaching its own (more liberal) trade agreements with other countries and trade blocs.

The obsession with Europe is inclined to disguise the fact that the Commonwealth consists of 53 member states and 2 billion citizens and over 15 percent of world GDP. Britain's common language with this huge section of humanity, over and above the United States, gives it a tangible advantage in doing business.³² Although the EU accounts for just under half of total U.K. goods and services exported, the figure is distorted somewhat by the so-called Rotterdam–Antwerp effect, whereby goods apparently destined for Europe are re-exported to non-EU states.

Although the U.K. relies far less on the EU market than the majority of other member states do, within the EU it does have one crucial link: with Germany. For the first time in the modern era, Britain has overtaken France as Germany's biggest global trade partner. This is one of the fastest growing trade relationships in the developed world.³³ Both Germany and Britain have their problems. They also have their differences, notably about European integration. But both are serious European players, pursuing rational policies of self-interest, and have strong common economic interests, which must count in Berlin as in London, when the process of British renegotiation, or perhaps disengagement leading to departure, actually begins.

Several models for a semi-detached relationship with the European Union already exist. Each has its merits and drawbacks. Moreover, each model reflects the circumstances—historic and contemporary—of different countries, and any comparable arrangement for the United Kingdom would do so too.³⁴

The European Economic Area (EEA). The EEA is an arrangement between the EU and Norway, Iceland, and Liechtenstein, three countries that are members of the old European Free Trade Area, founded in 1960 and pushed originally by Britain as an alternative to the Common Market, before Britain chose to forge a closer relationship with the European Economic Community (EEC). The EEA is a comprehensive free trade deal allowing tariff-free access, but it also extends to inclusion within the Single Market, for good *and* ill.

The EEA can influence but cannot vote on Single Market measures. Its members have the power to negotiate free trade deals unilaterally. The EEA package does not include the Common Agricultural Policy (CAP), the Common Fisheries Policy (CFP), and some other functions that irritate the British. However, Norway, the most important and prosperous EEA state, has chosen to join the passport-free Schengen Zone. It also makes a sizeable “voluntary” contribution to the EU budget.

The European Free Trade Area (EFTA). Switzerland, a member of the EFTA only, has a specific 1972 free trade agreement (FTA) with the EEC, supplemented by further bilateral agreements, that give it tariff-free access to the EU. It is not subject to Single Market regulations and has no power and little influence on their creation. This is a particular problem as regards new restrictive EU moves on financial services. Switzerland can make its own trade deals. It too makes a “voluntary” financial contribution.

Like the EEA, but to a greater degree because it is outside the ambit of the Single Market provisions, Switzerland has been forced to cope with the sometimes complex “Rules of Origin” (ROO) tests, though it has had many years to do so. (Britain, in a similar position, would have to do so much more quickly, which might cause problems for manufacturers).³⁵

Simple Customs Union: The Turkish Option. Turkey is within the EU Customs Union and enjoys free movement of goods but not of services (or, of course, people). It is outside the Single Market. Turkey retains the ability to negotiate its own agreements on services, which would be of particular importance to Britain. It is outside the CAP and CFP and (naturally) makes no contribution to the budget.

Some Other Free Trade Agreement. The breakdown of the Doha round trade talks in 2008 accelerated the trend toward bilateral free trade

agreements, in which Europe has actively participated. Negotiations have been underway with Singapore, Canada, and India. There is again much talk on both sides of the Atlantic of a U.S.–EU FTA. Each of these agreements (and their predecessors) is to some extent bespoke, with broader or narrower scope and implications, and the number of FTA models available to Britain continues to grow.

Unilateral Free Trade Within the World Trade Organization (WTO) Rules. This is the cleanest and simplest option—and much less frightening than most diplomats and politicians in the U.K. and the EU pretend.³⁶ In British law, it would involve repeal of the 1972 European Communities Act and other connected statutes. In European terms, and taking advantage of the insertion of this provision for the first time in the Lisbon Treaty of 2007, it would involve action under Article 50. The U.K. would henceforth rely on the multilateral trading system policed by the WTO.

A question arising from any relationship with Europe that saw Britain outside the Customs Union

and tariff wall is what the effect on inward investment would be. The arguments here are finely balanced. To what extent do businesses invest in Britain in order to sell elsewhere within Europe? To what extent do they do so simply because of favorable conditions in the host country?³⁷ The cases will differ over time and between sectors.

Unless the world reverted to protectionism, and unless a majority of European states decided to behave in a wholly irrational manner, Britain would probably be better off economically under these conditions of trade sovereignty, able to respond quickly and flexibly to its own interests and changing conditions, but there clearly are some risks. There would be a period of uncertainty. In these circumstances, Britain ought to be able to rely on its closest allies, especially the U.S., for diplomatic support. It would have a claim on such support, because a stronger, more prosperous, and contented ally serves other—and American—interests as well as its own. Unfortunately, so far, the U.S. has been unhelpful.

Section IV: U.S. Policy and Interests

Since the end of the Second World War, the United States has fairly continuously supported closer European integration. Indeed, from the time of the Marshall Plan in 1948, the U.S. was keen to see the construction of supranational European institutions. America made it clear to Britain that the U.S.–U.K. “special relationship” would not be allowed to stand in the way of that strategy. The Truman, Eisenhower, and Kennedy Administrations kept up the pressure. The U.S. State Department was, for example, hostile to the EFTA. It wanted Britain to be instead a full participant in the European Common Market.

The interruptions in that view, though important, have proved to be only temporary. In the 1970s, the Nixon Administration developed severe doubts about the direction and intentions of Europe, doubts fuelled by the thinly veiled hostility of British Prime Minister Edward Heath. In the 1980s, the close relationship between President Ronald Reagan and Prime Minister Margaret Thatcher meant that there was no significant U.S. pressure for Britain to embrace European federalism. President George H. W. Bush somewhat shifted the U.S. position and welcomed the plans for integration, opposed by Mrs. Thatcher, which in 1992 resulted in the Maastricht Treaty. The U.S. also appeared to view reunited Germany as the leader of Europe, but Britain’s role in the First Gulf War again reminded the State Department of the country’s reliability as an ally, and British interests duly moved up the U.S. diplomatic agenda, significantly above Germany’s. The Clinton Administration once again welcomed the process of European integration.

Under President George W. Bush, the U.S. position was unclear. On the one hand, the Administration was disappointed with the response of “Old Europe” to the Iraq War and grateful for British support, but British Prime Minister Tony Blair welcomed European integration, even wanted Britain to enter the euro, and professed to see no conflict between incorporation into a federal Europe and maintaining a close relationship with the U.S. The contradictions in that position have become clear once more with the euro-zone crisis.³⁸ Under President Obama, the U.S. State Department’s traditional support for the European project has been sharpened by the Administration’s ideological preference for multilateralism and suspicion of traditional concepts of national sovereignty.³⁹

The constant thread in U.S. policy toward Europe since 1945 has, of course, been America’s obligations as a world power. The U.S. wanted to see a prosperous and stable Europe essentially because it wanted European powers to be able to share the security burden. In the immediate postwar period, this required West German rearmament, which could be acceptable to the other main Continental European power, France, only if it took place in a supranational context.

But Britain over the decades has had an even more important role to play. Washington hoped that Britain’s influence—perhaps even leadership—in a united Europe would set a good example because the U.K. was a significant military power, because it was determinedly engaged in the Cold War, because it was culturally and historically pro-American, and because it was not protectionist.

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The requirements of U.S. policy changed somewhat after the end of the Cold War, but there was more continuity than alteration in one particular respect: the way in which long-term U.S. concern for the security situation in Asia and the Far East—Korea, Vietnam, and (now) China—has meant that successive generations of American policymakers have wanted to be able to leave European states to protect themselves with their own resources in order to give the U.S. a free hand elsewhere. The Obama Administration’s declaration of the “top priority” that it intends to give to the Asia-Pacific, alongside its vocal support for what is emerging as a European megastate, fits into that pattern.

Although perhaps not the only test of whether this analysis is sound, levels of military spending are surely the most significant one. The question is: Does a more closely integrated Europe spend more

**BRITAIN AND EUROPE:
WHERE AMERICA'S INTERESTS REALLY LIE**

TABLE 1

**NATO Defense Expenditures
as a Share of GDP**

BASED ON CURRENT PRICES

	2007	2008	2009	2010	2011 (est.)
Albania*	—	—	1.5	1.6	1.5
Belgium	1.1	1.2	1.2	1.1	1.1
Bulgaria	2.4	2.2	1.9	1.7	1.4
Croatia*	—	—	1.6	1.5	1.5
Czech Republic	1.4	1.4	1.6	1.3	1.1
Denmark	1.3	1.4	1.4	1.5	1.4
Estonia	1.7	1.8	1.8	1.8	1.7
France	2.4	2.3	2.1	2.0	1.9
Germany	1.3	1.3	1.4	1.4	1.4
Greece	2.7	3.0	3.2	2.6	2.1
Hungary	1.3	1.2	1.2	1.1	1.0
Italy	1.3	1.4	1.4	1.4	1.4
Latvia	1.5	1.6	1.2	1.0	1.0
Lithuania	1.2	1.1	1.1	0.9	0.8
Luxembourg	0.6	0.4	0.4	0.5	0.5
Netherlands	1.5	1.4	1.5	1.4	1.3
Norway	1.5	1.4	1.7	1.6	1.5
Poland	1.8	1.5	1.7	1.8	1.7
Portugal	1.4	1.5	1.6	1.6	1.5
Romania	1.5	1.5	1.4	1.3	1.3
Slovak Republic	1.5	1.5	1.5	1.3	1.1
Slovenia	1.5	1.5	1.6	1.6	1.3
Spain	1.2	1.2	1.2	1.1	0.9
Turkey	1.8	2.0	2.1	1.9	1.9
United Kingdom	2.4	2.6	2.7	2.7	2.6
NATO-Europe	1.7	1.7	1.8	1.7	1.6
Canada	1.3	1.3	1.4	1.4	1.4
United States	4.2	5.1	5.4	5.4	4.8
North America	3.9	4.7	5.1	5.0	4.5
NATO-Total	2.8	3.1	3.4	3.4	3.0

* Albania and Croatia joined NATO in 2009.

Source: NATO press release, "Financial and Economic Data Relating to NATO Defence," April 13, 2012, Table 3, http://www.nato.int/nato_static/assets/pdf/pdf_2012_04/20120413_PR_CP_2012_047_rev1.pdf (accessed March 7, 2013).

SR 131  heritage.org

for U.S. public interventions were economic. Thus, U.S. Treasury Secretary Timothy Geithner back in September 2011 publicly urged European “governments and central banks...to take out the catastrophic risk to markets.” This, in practice, meant more European Central Bank bailouts and Germany standing behind the debt. At the time, Germany angrily rejected this unsought advice, though that is the direction in which events have indeed moved.⁴⁰ This direction also implies deep political changes—namely, the emergence of a German-dominated economic government of the eurozone countries—but that also is apparently welcome in Washington, despite the boiling resentments already witnessed in Southern Europe.

U.S. Administration advice to Britain has been still blunter and less diplomatic. Speaking to Members of the European Parliament two years ago, U.S. Ambassador to the U.K. Louis Susman warned: “The US does not want to see Britain’s role in the EU diminished in any way.... All key issues must run through Europe.”⁴¹

Washington also reacted strongly to the fairly innocuous observation by David Cameron, made at the end of 2012, that Britain outside the EU was now “imaginable.” A senior U.S. Administration official confirmed that the issue was raised by President Obama in a call to Mr. Cameron. The spokesman said: “It is important to state very clearly that a strong U.K. in a strong Europe is in America’s national interest. We recognise national states, but we see the EU as a force multiplier.”⁴²

On the eve of Mr. Cameron’s key speech on Europe, Philip Gordon, U.S. Assistant Secretary of State responsible for European Affairs, gave a press conference in London. Mr. Gordon observed: “We have a growing relationship with the European Union as an institution which has a growing voice in the world—and we want to see a strong British voice in that European Union. This is in the American interest.” Mr. Gordon conceded, “What’s in the British interest is for the British people and the British Government to decide,”⁴³ but the intervention could hardly have been more heavy-handed, and it was widely commented upon and resented in the U.K.

The U.S. President again decided to become directly involved. In a telephone conversation about the rather more pressing Algerian hostage crisis, Mr. Obama repeated that he valued “a strong UK in a strong European Union.” The initiative was for

on defense? And the answer is: No, it does not, as Table 1 shows.

This woeful record has not inhibited the current U.S. Administration from urging Europe to come together more closely. The main recent occasions

public consumption. Thus, in a statement, the White House confirmed, “The President underscored our close alliance with the United Kingdom and said that the US values a strong UK in a strong European Union,” adding perhaps over-generously, “which makes critical contributions to peace, prosperity and security in Europe and around the world.”⁴⁴

Further reflection by Washington is in order on the wider front of America’s long-term policy toward Europe. The starting point, as always, must be one of realism.

Heavy-handed diplomacy, of course, has its place, and a world superpower like the United States can get away with applying it more than other powers can. But it does need to be exercised prudently and after due reflection. Indeed, further reflection by Washington is in order on the wider front of America’s long-term policy toward Europe. The starting point, as always, must be one of realism.

Whatever one thinks of their reasoning, Germany and the other key players within the eurozone are now clearly determined to press ahead with much closer integration. Although the immediate objective is to uphold the euro itself, one should not overlook the long-term objective, traceable back to the late 1940s, of creating a politically united Europe within which national sovereignty has no real place. At crucial stages, the U.S. has encouraged this process, though it has received no gratitude or even recognition from doctrinaire Europeans for doing so.

On the other hand, realism also requires an honest assessment of whether this project will succeed or fail and, in either case, what the consequences may be. American experience is not necessarily a good guide here, because the way in which the United States came into existence is quite unique. For European nations, differences of language, tradition, culture, and economic and other values remain huge. There is, as David Cameron has pointed out, no European “demos.” Thus, there can never be a European “democracy.” So the political nature of the emerging European megastate is uncertain, problematic, and even potentially worrying.

This insight is closely connected with both economics and security, the two aspects of Europe’s development with which American policymakers must come to grips because they are of practical long-term importance to American interests. On the economic front, the Administration’s repeated insistence that anything and everything must be done to stabilize and secure the eurozone is profoundly shortsighted. If a single monetary policy is pursued in conditions where the productive potential of different eurozone members is ineradicably different, then huge imbalances will occur. Rich countries will need to bail out poor ones. Poor countries will, in exchange, have to allow rich countries to dictate their fiscal policies. Immigration flows across boundaries will be necessary but highly unsettling.

Furthermore, it is Germany that will be expected to lead, but because of history, it is ill suited to doing so. Germans are especially resented in many Southern European countries. Germans themselves, because of their healthy but perhaps exaggerated historic fear of inflation and indebtedness, are deeply unwilling to take up the quasi-colonial burden that the eurozone system ultimately requires of them.

Conclusion

The foregoing analysis is sufficient to demonstrate how many worrying uncertainties lie ahead for a system where financial and political demands are mutually opposed. It also suggests that the eurozone will have to shed some members if it wants to survive without a distracting series of crises.

All of this will have an impact on Europe's role as a world power able to defend itself and to contribute to global security. As noted, there is no evidence that more European integration has encouraged a greater defense effort by member countries: The evidence is all to the contrary.

More significantly, perhaps, what will be the orientation and where will lie the allegiances of the emerging European megastate? Neutralism is a long-term tendency that may re-emerge. Even if Europeans are able to overcome the contradictions inherent in the model they have chosen—and it is a very big “if”—will they look strategically to partnership with the U.S. or perhaps prefer (as France has always done) a multipolar framework within which ties with the U.S. in certain areas will be balanced by ties with Russia or China or other powers elsewhere?

Just to raise these questions shows how large a gamble is involved in the course upon which the core European countries have embarked. It shows how ill-judged it is for the U.S. to intervene on an ad hoc basis, pushing Europe in one direction or another, without considering the wider implications. It recalls the risks for the United States if it abandons the traditional mode of doing business

with European powers—through NATO and through bilateral links between sovereign states—in favor of bilateral deals with a European megastate, something altogether different and completely untried. Finally, having the common sense to recognize that the course of events in Europe is neither fully predictable nor easily manageable should also remind Washington of the value of old and proven allies like Britain.

The U.S. now needs to ask:

- First, is the new Europe viable?
- Then, does America want Britain to become more deeply embroiled in the new Europe if it is (as many believe) systemically flawed?
- Does the U.S. State Department really know better than the British what is in Britain's interests?
- Will America's most important and historically closest ally be more or less able, and more or less willing, to stand by America as a result of U.S. initiatives?
- Finally, can the U.S. seriously influence the outcome anyway? And if not, why expend precious diplomatic capital in trying?

All things considered, the case for a period of benevolent silence, accompanied by supportive planning for whatever course the U.K. decides is in its national interest, seems overwhelming.

Endnotes

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**BRITAIN AND EUROPE:
WHERE AMERICA'S INTERESTS REALLY LIE**

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