

# **EUtopia**

**What EU would be best and  
how do we achieve it?**

By  
**KEITH BOYFIELD  
&  
TIM AMBLER**

**ADAM SMITH INSTITUTE**

**2006**

# Contents

---

Acknowledgements	3
Executive summary	4
1. Introduction	6
2. Dimensions of attractiveness	8
<i>External trade</i>	
<i>The Single Market (internal EU trade in goods and services)</i>	
<i>The Common Agricultural Policy (CAP) and fisheries</i>	
<i>Levels of law and decision-making</i>	
<i>Budget and finance</i>	
3. What do others want?	28
<i>External trade</i>	
<i>The Single Market (internal EU trade in goods and services)</i>	
<i>The Common Agricultural Policy (CAP) and fisheries</i>	
<i>Levels of law and decision-making</i>	
<i>Budget and finance</i>	
4. Getting to Eutopia	38

## Bibliographical information

The Adam Smith Institute has an open access policy.

Copyright remains with the copyright holder, but users may download, save, and distribute this work in any format provided (1) that the Adam Smith Institute is cited; (2) that the web address [www.adamsmith.org](http://www.adamsmith.org) is published together with a prominent copy of this notice; (3) the text is used in full without amendment [extracts may be used for criticism or review]; (4) the work is not re-sold; (5) the link for any online use is sent to [copyright@adamsmith.org](mailto:copyright@adamsmith.org).

The views expressed in this report are those of the author and do not necessarily reflect any views held by the publisher or copyright owner. They are published as a contribution to public debate.

Published by ASI (Research) Ltd. © Adam Smith Research Trust 2006.  
Some rights reserved  
Printed in England

ISBN: 1-902737-50-4

# Acknowledgements

---

Many people were kind enough to help us with the research for this report. Some wanted to do so on an anonymous basis, but here we would like to thank the following individuals for sparing their time to discuss and comment on our work. We should stress that those listed do not necessarily agree with our analysis or conclusions, for which we – as the authors – accept full responsibility.

Jean Pierre Bache, Director, Budget Directorate, European Commission

Dr Jon Bird, Director, External Affairs, CE Electric UK

Graham Brady MP

Bryan Cassidy, Member, EU Economic & Social Committee, Brussels

Dr Tim Evans, former Special Adviser to the Prime Minister of Slovakia

Jean-Pierre Fauré, Single Market Observer, EU Economic & Social Committee, Brussels

David Heathcoat-Amory MP

David Lascelles, Co-Director of the Centre for the Study of Financial Innovation, London

Lars Mitek, Head of Unit, Institutional Matters & Better Regulation, Secretariat General, European Commission

Michael Murray, Cabinet Member, Internal Market Directorate, European Commission

Mattias Bengtsson, President, Centre for the New Europe, Brussels

Rt Hon Lord Simon

Neil O'Brien & Paul Stephenson, Open Europe, London

J Stuart Wheeler

Kyle Wingfield, Editorial Page, *Wall Street Journal Europe*, Brussels



# Executive summary

---

The crucial EU issue for the UK is not whether to leave or stay in the Union, but what Britain can do to achieve the EU it most wants. Threats to leave are counter-productive and reinforce an image of Britain as a grumpy old man best left alone and placated only when essential. Success will require a positive approach and cordial relations with those other member states likely to share those particular goals. Grandiloquent claims of British 'leadership' are equally unhelpful. The UK needs a strategic plan, to which this report is intended to contribute, and rather more effective diplomacy.

What then are the key attributes of the EU that attract Britain when they are favourable and repel Britain when they are not? This report begins by analysing the key issues into five groups:

- External trade. Britain can gain from being part of a larger negotiating body.
- The Common Agricultural Policy and the fisheries policy.
- The single market, i.e. internal EU trade in goods and services
- The level of law and decision-making, including the principle of subsidiarity: legal system, Commission, Council of Ministers, EU Parliament and member states.
- Budget and financing.

Discussion of these dimensions forms the bulk of this report, which concludes with chapters analysing which other member states are likely to join with the UK in pushing for reforms favourable to Britain, and what the next steps should be. Of course, other member states are not necessarily interested in reforms favourable to the UK. British diplomats have to show that the reforms we are proposing are favourable for the other member states too, and the EU as whole.

We do not discuss the Euro, because opting into (or out of) the single currency is a matter for member states. On the five dimensions we analyse, however, our conclusions are (in reverse order, because as we show, we need to begin by setting constitutional rules):

1. **External Trade:** The UK can benefit from being part of a larger negotiating body, but the full benefits are not being achieved within the current situation. The UK must push to reduce EU trade barriers in ways that will help the Union's long-term economic development. Solutions to the short-term transition problems (such as sectoral job losses) need to be found, but lower tariffs must remain the target.
2. **Agriculture and fisheries:** The CAP costs EU consumers twice: high retail prices and taxes. Claims that the CAP is taking a declining share (now about half) of the total EU budget are distorted by re-labelling money to landowners as rural preservation. The goals for the CAP (EU self-sufficiency of food production, rural preservation and decent wages for rural workers) can be achieved by other means, such as the Italian proposal to shift funding responsibility to member states. This would also help to reduce fraud and waste.



3. Iceland has growing stocks of the most important species of fish, such as cod, because it fenced off its own waters and introduced a conservation policy based on property rights. Fishing grounds should be returned to their owners. This is not an unfairness: different countries have different resources (some have fish, others have sunshine).
4. **The single market:** It is extraordinary that 50 years after the 'Common Market' was founded, we still do not have a common market. After all, this is the *raison d'être* for the EU and should take priority over all other issues. Some countries favour political union and social cohesion more than others, but these are not a requirement of economic union. Considerable progress has been made for goods, but this now needs to be followed with progress on services.
5. Achieving a single market is inhibited by too much regulation and red tape. A single market requires only one set of regulations. EU Directives, which allow member states to make different regulations, are unhelpful. Such differences fracture the EU market into national markets and promote gold plate. In single-market sectors, only EU regulations can prevail. All other areas should be left to national regulation.
6. **Decision-making:** Member states (though not the UK) have failed to recognise the implications of superimposing different tiers of law making. Law and regulation should be made either at the EU level or the member state level, but not both.
7. EU regulations need to be effectively challenged by others beside the politicians and bureaucrats involved in those initiatives. In place of a large number of well-intentioned bodies operating ineffectively, the UK needs a single body, to provide effective challenge, modelled on the National Audit Office. This new entity should be accountable to Parliament, rather than to the administration, and should audit the system, and individual measures, reporting annually with recommendations for improvement.
8. **Budget and finance:** The EU has a far larger budget than it can administer. This leads to waste and even fraud. Accountability would be improved, and the budget reduced and simplified, if member states did not transfer money to the EU only for it to be returned to them as CAP or regional development grants. As Sweden has suggested, rich countries should take care of their own poor areas. The EU should be properly accountable for spending its own much smaller budget covering three areas: poorer accession states as they bring GDP per head into the EU range; EU-wide value-added projects (such as space exploration) that are simply too large for, but required by, member states; and the administration of the Union (such as the Commission, Parliament, and European Court of Justice). The budgetary process needs simplification.
9. **Constitution:** Many of these recommendations could not proceed without a new constitution to bring the confused, overlapping (and some would say expanding) powers of the institutions under democratic restraint. A number of member states aim to revive versions of the rejected draft constitution. But a new constitution should be short, businesslike, and focused on defining these institutional powers. The UK should therefore take an active and positive role in the lead group of those taking a fresh approach to this issue.



# 1. Introduction

---

Despite lingering debate, the UK is unlikely to withdraw from the EU in the foreseeable future. For this reason, and others, most of the argument between Europhiles and Europhobes has been fruitless.<sup>1</sup> The UK is likely to remain one of the leading economies within the EU. On the other hand, we seem to be constantly on the back foot, resisting threats to sovereignty, drawing red lines and defending rebates. Fellow member states see us as reluctant, negative and grumpy. That does not win friends, nor does it provide a platform for leadership. Instead, the UK needs to be seen as promoting changes that would be good, not just for the UK, but for the whole EU.

The UK sees itself as one of the leading proponents of the Lisbon agenda,<sup>2</sup> a theme close to Gordon Brown's heart. But in this context, critics would cite the British EU 2005 presidency as a wasted opportunity — initial brave words were overtaken by the UK being attacked by all other member states over the budget rebate — although such a perception may not be entirely fair.

We should stop agonising about staying in or leaving the EU and instead focus on creating a better Europe for all the citizens of the EU. However, the UK cannot accomplish a better EU, either for all EU citizens or its own, without friends and partners. Any such strategy, therefore, requires a careful analysis not only of where we want to get to, but how the UK can participate in pragmatic coalitions of member states. Different issues will require different coalitions.

This report explores what might be achieved — and how — on the understanding that we must look at what is good for Britain within the context of what is good for the EU as a whole.

Across Europe, there is widespread disillusionment with the Union, reflected in the poor turnout for elections to the European Parliament. Increasingly, governments are growing frustrated with a budget out of control and the slow pace of institutional reform. This of course suits many lobbyists, bureaucrats and representatives, whose livelihoods might be threatened by reform and simplification<sup>3</sup> whilst adding to the growing divide between the political elites and the people.

In his speech to the European Parliament on 22<sup>nd</sup> July 2005, the Prime Minister set out an agenda for the future of the EU. Faced with the challenge posed by globalisation, Mr Blair told MEPs that the EU 'must change or fail on a grand scale'. The speech impressed many observers as well as parliamentarians, but the subsequent non-delivery of these goals was disappointing.

---

<sup>1</sup> For the exit side of this argument see Patrick Minford, Vidya Mahambare and Eric Nowell (2005) *Should Britain leave the EU?* Cheltenham: Edward Elgar in association with The Institute of Economic Affairs.

<sup>2</sup> This was agreed at the Lisbon European Council in March 2000 and aimed at 'creating more and better jobs in a more dynamic, innovative and attractive Europe'. In terms of prosperity, the goal was to overtake the USA by 2010. Progress to date on achieving this ambitious target has proved elusive.

<sup>3</sup> One of the most striking developments that hits visitors to Brussels in the eye is the profusion of representative offices for regions throughout the EU. All these bodies are lobbying for EU financial support in one form or another. The Scottish Executive, for example, now has 15 officials in its Brussels office, with a further 15 officials liaising on EU affairs in Edinburgh.



Several other leading member states, notably France, have a clear idea of what they want out of the EU, and they seem to be able to achieve these goals. The fact that the CAP still accounts for 40% of the EU's budget, despite three concerted attempts at reform over the last 20 years, is an illustration of this point.

The UK, by contrast, has been less successful at realizing its goals. While the Prime Minister has set out a vision for the future of the EU, we do not appear to have a fully thought-through plan for achieving it. We allow critics to believe that we are (like too many member states) focused more on maximising our own benefit at others' expense. This is a persistent failing in our foreign policy. We should be making it clear that our vision is the long-term benefit of the whole Union.

The possible futures for the EU can be seen as a multi-dimensional terrain. From all those future possibilities we can draw a boundary around the ones that are both feasible and acceptable to the UK. This report is an attempt to map the feasible and acceptable terrain, for the maximum benefit to the EU as a whole, and within that to the UK. This marks the borders of the UK's EUtopia: and we need to move from the back to the front foot in promoting it.

The structure of the report is as follows. Chapter 2 outlines the five key dimensions of the terrain of future EUs. Chapter 3 analyses where the UK may find common interest with other member states to achieve meaningful reform across these five dimensions (with the accession of ten new member states, there are large opportunities here). Chapter 4 assesses the chances of achieving significant progress on each of these five dimensions.

Our five dimensions include trade, the single market, agriculture and fisheries, governance, and finance, but they do not include discussion of the Euro. This is because we believe that UK membership of the Euro, like UK withdrawal from the EU, is very unlikely. We have tried to focus our analysis solely on practical options. Joining the Euro would also have implications for political unions which, again, are outside the scope of this report.



## 2. Dimensions of attractiveness

---

What then are the key attributes, or dimensions, of the EU, which attract the UK when they are favourable and repel the UK when they are not? As we discussed in the introduction, the argument about whether we should remain with, or leave, the EU is fruitless. The key question is the boundary between the future EUs that the UK is prepared to inhabit and those that are impractical and/or unacceptable. If the UK does not adopt a positive stance in achieving the EU it wants, the actions of other member states towards their goals are likely to drive us to the negative part of the territory. While others' intransigence makes it hard to make any progress at all on some fronts, in other areas the EU can be changed for the better, and the UK must do more to make the case. Failure will cost UK citizens dear.

Our analysis concludes that five dimensions define the attractiveness (or unattractiveness) of the EU to the UK:

1. **External trade** (that is, trade with non-EU countries)
2. **Agricultural policy and the fisheries policy.**
3. **The single market**, i.e. internal EU trade in goods and services
4. **Law and decision-making**, including the principle of subsidiarity:<sup>4</sup> the legal system, the Commission, the Council of Ministers, the EU Parliament and member states.
5. **Budget and financing.**

### 1. External trade

The European Commission has been vested with far-reaching powers in trade matters, and usually has the dominant say over member states (although an exception seems to have been the 'bra wars' with China in September 2005, where member states refused to ratify the Commission's agreement). In World Trade Organisation (WTO) negotiations, the EU negotiates on behalf of all 25 member states.

In practice (despite some recent liberalisation following pressure from the UK and others), EU trade policy has been protectionist; and in the long term, this damages the economy of the UK and other member states. Poorer families suffer more than most, since they spend a higher proportion of their income on the high-tariff necessities of life, such as food and clothing. And since the UK trades externally more than it does with other member states, we pay more EU customs duties than other European countries — twice as much as France and 17.8% of the total budgeted for 2006.<sup>5</sup>

<sup>4</sup> We need to be careful with this word as the devil is in the application. What we mean is a clear distinction between items given exclusively and deliberately to EU legislative competence and everything else, especially items overlooked, being left with member states. The Nice Treaty and draft constitution (Title III, Union Competences, Articles I-11, page 17) unfortunately muddle this concept by making legislative and administrative competences non-exclusive, i.e. both EU and member state bureaucracies can regulate in the same areas.

<sup>5</sup> [http://europa.eu.int/eur-lex/budget/data/COL22006\\_VOL1/EN/nmc-grseq42960935830-3/index.html](http://europa.eu.int/eur-lex/budget/data/COL22006_VOL1/EN/nmc-grseq42960935830-3/index.html) 4 Jan 2006



Oxford Economic Forecasting (OEF) estimate that if the EU abolished the trade barriers it has imposed over the last half century, EU growth rates could be boosted by 90bn. Trade reforms would benefit the UK in particular, as a major trading nation. OEF estimate that if trade barriers were lifted, the UK economy would benefit to the tune of £11bn, nearly 1% of GDP, equivalent to £750 a year for a typical household of four.<sup>6</sup> Trade liberalisation would also reduce unemployment by as much as 0.4% over three years, creating hundreds of thousands of new jobs in the process.

OEF found that reciprocally removing EU trade barriers just for goods (services were not considered) would raise GDP across the Union by 0.9% (110bn in today's prices) by 2015. Unilateral liberalisation by the UK alone would boost the UK GDP by 0.2% (£2.7bn in today's prices) by 2015.<sup>7</sup>

Professor Patrick Minford and his colleagues have delved into the cost of the EU's trade policies.<sup>8</sup> Besides pointing out that EU consumers are paying over 50% more than world prices for agricultural products, Minford argues that the EU's trade policies impose heavy costs on consumers of manufactured products. In practice, the EU acts as an old-fashioned customs union, raising prices on imported manufactured goods in order to make its manufactured products competitive. This 'Common Manufacturing Policy' costs EU consumers between 2 to 3% of GDP — about 1000 for every man, woman and child.

The French economist Professor Patrick Messerlin<sup>9</sup> argues that progress towards the completion of a single market<sup>10</sup> is hampered by the EU's reluctance to simultaneously open its trade to the wider world economy: external liberalisation should be integral to the removal of internal trade barriers, he says. Messerlin notes that the EU would greatly benefit from a successful completion of the Doha round of world trade talks. In the agricultural sector, for example, the EU would be the major beneficiary, with around half of all global gains. Unfortunately, only modest headway has been achieved so far in the Doha round of world trade talks, due to be concluded by early 2007; and (according to media reports) a key reason for this is French pressure on the Commission, aimed at defending its agricultural sector, but leaving EU Trade Commissioner Peter Mandelson little scope to negotiate.<sup>11</sup>

In calling for a relaxation of tariff barriers, Messerlin points out that even in France, 80% of those questioned in opinion surveys are 'strongly' or 'somewhat' in favour of freer trade. So there would appear to be popular support: and yet 'the EU has never fully embraced free trade beyond its borders'.<sup>12</sup>

<sup>6</sup> *Open up: Why the EU must reform to survive*, Open Europe, Oxford Economic Forecasting, October 2005.

<sup>7</sup> Trade liberalisation and CAP reform in the EU, A report for Open Europe, Oxford Economic Forecasting, October 2005.

<sup>8</sup> *Should Britain Leave The EU? An Economic Analysis of a Troubled Relationship*, Patrick Minford, Vidya Mahambare and Eric Nowell, published by Edward Elgar in association with the Institute of Economic Affairs, 2005

<sup>9</sup> Professor of Economics, Institut d'Etudes Politiques de Paris (Sciences Po), Wincott Lecture 2005.

<sup>10</sup> It is worrying that some players try to avoid the logical implications of the term 'single market' by using alternatives such as 'internal market' or 'integrated market'. Since we hold that the 'single market' should mean just that, we reject such circumlocutions and stick to this term.

<sup>11</sup> The *Financial Times* reported on 21 December 2005 that Mr Mandelson had concluded that following the Hong Kong summit, the EU was even less likely to make further concessions on agriculture in the current Doha round.

<sup>12</sup> The *Business*, Derek Scott, 30th October 2005, "If Europe's trade wall falls, all the world's poor will benefit". Derek Scott was Prime Minister Blair's economic adviser.



In addition to tariffs, the EU has also adopted a raft of non-tariff trade barriers in recent years.<sup>13</sup> Between 1995 and 2000, for example, the European Commission initiated 145 'anti-dumping' investigations against developing countries. This compares with only 89 by the US over the same period, while Japan, another trading power, felt no need to launch any such investigations over the same five-year period.

The Commission has employed 'EU standards' as another means to block imports from poorer developing countries. The imposition of an EU standard aimed at protecting consumers against aflatoxin (a mould-produced toxin in foodstuffs) inflicted additional costs of \$670m a year on African exporters of nuts, cereals and dried fruits. As a result, their exports to the EU have been hit by 64%, yet the World Bank estimates that, on an annual basis, this regulatory intervention has prevented only one death per billion people in Europe.<sup>14</sup>

The EU does not have Free Trade Agreements (FTAs) with several of its key trading partners, and the European Commission has postponed any bilateral trade deals until the Doha round of world trade talks is completed. Consequently, trade liberalisation has slowed to a crawl. This short-sighted stance is highly damaging since bilateral trade agreements are often an extremely effective means of achieving faster economic growth. Indeed, a number of countries such as Chile, New Zealand and Australia have reaped substantial economic gains as a result of unilateral free trade initiatives.

One of the attractions of EU membership to the UK is the negotiating strength of the larger trade entity. In practice, however, this strength is being used negatively to prevent liberalisation rather than employed positively to open markets and thereby grow long-term GDP. The Commission does not do this out of perversity, but to placate national lobbies for industries and jobs. The September 2005 'bra wars' illustrated that well: cheap clothing imports benefit consumers and the economy, but in the short term pose a threat to EU textile producers. Unfortunately, short-term considerations weigh more heavily among many politicians, and the decision-making process reinforces these political pressures.

Such crises underline the need for reform. The EU needs to change its external trade policy process and decision-making so that it can secure economic opportunities for its consumers as well as enhancing its long-term business interests.

## 2. The Common Agricultural Policy (CAP) and fisheries

The CAP is one of the most contentious features of the EU and accounts for about 40% of the EU's annual budget, which for 2006 is 111bn.<sup>15</sup> However this is just the direct farm subsidy part. Another 10% is now labelled 'rural development'. This did not exist at the time when Margaret Thatcher negotiated the UK 'rebate'. But it nonetheless amounts to payments to landowners, undermining Tony Blair's claim that the CAP has since fallen from 60 to 40%.<sup>16</sup>

<sup>13</sup> *Open up: Why the EU must reform to survive*, London, Open Europe, November 2005.

<sup>14</sup> These figures are drawn from a World Bank study by Otsuki et al, '*A Race to the Top? A Case Study of Food Safety Standards and African Exports*', published in 2001.

<sup>15</sup> [http://europa.eu.int/eur-lex/budget/data/COL22006\\_VOL1/EN/nmc-grseq42960935830-3/index.html](http://europa.eu.int/eur-lex/budget/data/COL22006_VOL1/EN/nmc-grseq42960935830-3/index.html) 4 Jan 2006

<sup>16</sup> Press conference given by UK Prime Minister, Mr Tony Blair, on the EU Budget, 9 December 2005.



The EU clearly intends to promote this re-naming. The 2006–2013 budget summary makes no reference to the CAP but only to 'the preservation and management of natural resources'. Indeed, such spending will decline as a percentage of the budget, in cash terms it will increase. The lack of reform is being concealed by verbal juggling, in which the UK is now complicit.

Within an overall strategy of food self-sufficiency for Europe, the CAP aims to increase productivity, ensure a fair standard of living for farmers, stabilise markets and ensure the availability of food supplies at reasonable prices to consumers. It may have made some farmers better off, but consumers have had to pay high prices for that gain. An increasing body of evidence reveals that the CAP has caused damage to the landscape, biodiversity, and soil and water quality.<sup>17</sup>

The question now is whether the gains could be achieved more cheaply and less damagingly, at the same time providing consumers with better food at less cost. In a world characterised by food surpluses, the self-sufficiency strategy that was originally designed to address a post-war Europe beset by food shortages and rationing, is open to debate. Some would argue that security of food supply is the least of our current worries.

Meanwhile, Oxford Economic Forecasting reports that EU citizens pay far more than they should for a wide range of foodstuffs and products: prices are 173% higher for lamb, 149% for beef, 134% for mushrooms, 111% for bananas, and 114% for sugar. EU consumers pay more than double the world market price for milk and rice.<sup>18</sup>

The CAP has remained largely unchanged despite three attempts at reform: MacSharry (1992), Agenda 2000 and Fischler (2003). This last was a cynical hijacking of future budget discussions by France and Germany. Franz Fischler described it as the 'beginning of a new era'<sup>19</sup> but the overall level of subsidy declined only from 119bn to 117bn per annum. As a direct result, the UK 2005 presidency was left with a budget problem that could only be solved by dipping into the UK rebate.

The CAP is supported by a range of special interest groups that derive substantial benefits from it. Fraud is also rife. For example, those who farm on land designated as poor farmland are entitled to additional grants under the CAP. Member states make their own assessment of land quality, so the scheme inevitably encourages abuse. In Luxembourg, 98% of farmland is officially categorized as less favoured. As Peter Morgan observes, 'this will come as a surprise to anyone who has driven through its green fields'.<sup>20</sup>

<sup>17</sup> For example, see *Green and Pleasant Land*, by Anthony Batty and Cameron Carswell, Globalisation Institute, 2005. The authors demonstrate how the CAP - rather than being the saviour of the countryside - has been an environmental disaster, creating pollution with no economic benefit, and requiring more chemicals and energy use than had market forces been allowed to run. By encouraging the pre-emptive use of antibiotics, it threatens to create antibiotic-resistant diseases. It imposes costs on taxpayers, consumers, other industries and the environment - for benefits described as "trivial".

<sup>18</sup> OEF Report for Open Europe, October 2005.

<sup>19</sup> EU Commission press release, 26/6/03.

<sup>20</sup> *Alarming Drum: Britain's European Dilemma*, Peter Morgan, published by Imprint Academic, 2005, page 53.



Ireland, France and Spain benefit particularly from the CAP. The corollary is that there are a number of countries, including the UK, the Netherlands and Germany, which pay out a great deal to support the CAP, even after the UK rebate.<sup>21</sup>

The CAP is a big money-spinner for relatively few large landowners. Some 70% of the benefits derived from CAP go to a mere 20% of farmers, mostly in the more advanced EU economies (including the UK, France and Ireland.<sup>22</sup>). In Britain 10% of farms and businesses receive 67% of the UK's CAP payments. The top 100 recipients received more than 23% of the total UK CAP expenditure, while the bottom 50 received a mere 2.6%.

Yet the CAP has done little to sustain employment in the agricultural sector. Indeed, farming has seen more jobs disappear than in other sectors. Less than 4% of the EU15 labour force is employed in the agricultural sector (in the UK it is just 1.5%). Farmers' incomes have also slumped over the last couple of decades. According to the official statistics, income per person in the agricultural sector fell by 70% between 1995 and 2000. The same pattern emerges in the UK, where DEFRA acknowledges that the 'long term trend in aggregate income has been downwards'.<sup>23</sup>

As with manufactured goods, the EU has resorted to a wide range of non-tariff barriers to shut out imports from developing countries. These include so-called 'cross compliance criteria' – rules imposed by the European Commission which effectively exclude imported foodstuffs from the Third World because they are deemed not to meet a list of 18 statutory standards.<sup>24</sup>

As things stand, EU protection<sup>25</sup> for agricultural markets ranges from approximately 20–25% to 173%, as in the case of lamb. If a uniform rate of between 20–25% was chosen as the basis for a uniform level of protection at the end of the Doha Round implementation phase, this would create a substantial liberalisation of the most protected farming sectors, and trigger a major reallocation of resources with regard to the type of agricultural products and foodstuffs produced.

**Fisheries.** Whatever the arguments for and against the CAP, Europe has no shortage of food — quite the reverse. The fisheries policy is a much larger disaster because it is progressively leading to the elimination of North Sea and Atlantic fish stocks. Imagine a CAP where any licensed farmer could take crops from anyone else's land. That, in effect, is what the fisheries policy is — a costly example of the 'tragedy of the commons'.

Given the EU free-for-all, it is no surprise that over-size trawlers come onto small fishing grounds, scoop everything up in their nets and then throw back, dead, enough small fish to ensure their catch complies with regulations. The only surprise is that we have any fish left at all. Iceland, by contrast, has increasing stocks of the most important fish species, such as cod, because it fenced off its own waters and instituted a system of transferable fishing quotas, which give those in the fishing industry a long-term interest in conserving stocks in order to maximise long-term yields.<sup>26</sup>

<sup>21</sup> In 2004, after the rebate, the UK sustained a net loss of €1.3bn in subsidies to farmers via the CAP. In contrast, France benefited to the tune of over €2bn. Source: Open Europe.

<sup>22</sup> WTO and OECD estimates for 2002, see *Financial Times*, October 2005.

<sup>23</sup> *Agriculture in the UK 2003*, DEFRA

<sup>24</sup> For further details see Patrick Messerlin's 2005 Wincott Lecture, page 4.

<sup>25</sup> In PSE terms, combining tariffs and subsidies.

<sup>26</sup> See Hannes H Gissurason, *Overfishing: the Icelandic Solution*, Institute of Economic Affairs, 2000.



Ireland, France and Spain benefit particularly from the CAP. The corollary is that there are a number of countries, including the UK, the Netherlands and Germany, which pay out a great deal to support the CAP, even after the UK rebate.<sup>21</sup>

The CAP is a big money-spinner for relatively few large landowners. Some 70% of the benefits derived from CAP go to a mere 20% of farmers, mostly in the more advanced EU economies (including the UK, France and Ireland.<sup>22</sup>). In Britain 10% of farms and businesses receive 67% of the UK's CAP payments. The top 100 recipients received more than 23% of the total UK CAP expenditure, while the bottom 50 received a mere 2.6%.

Yet the CAP has done little to sustain employment in the agricultural sector. Indeed, farming has seen more jobs disappear than in other sectors. Less than 4% of the EU15 labour force is employed in the agricultural sector (in the UK it is just 1.5%). Farmers' incomes have also slumped over the last couple of decades. According to the official statistics, income per person in the agricultural sector fell by 70% between 1995 and 2000. The same pattern emerges in the UK, where DEFRA acknowledges that the 'long term trend in aggregate income has been downwards'.<sup>23</sup>

As with manufactured goods, the EU has resorted to a wide range of non-tariff barriers to shut out imports from developing countries. These include so-called 'cross compliance criteria' – rules imposed by the European Commission which effectively exclude imported foodstuffs from the Third World because they are deemed not to meet a list of 18 statutory standards.<sup>24</sup>

As things stand, EU protection<sup>25</sup> for agricultural markets ranges from approximately 20–25% to 173%, as in the case of lamb. If a uniform rate of between 20–25% was chosen as the basis for a uniform level of protection at the end of the Doha Round implementation phase, this would create a substantial liberalisation of the most protected farming sectors, and trigger a major reallocation of resources with regard to the type of agricultural products and foodstuffs produced.

**Fisheries.** Whatever the arguments for and against the CAP, Europe has no shortage of food — quite the reverse. The fisheries policy is a much larger disaster because it is progressively leading to the elimination of North Sea and Atlantic fish stocks. Imagine a CAP where any licensed farmer could take crops from anyone else's land. That, in effect, is what the fisheries policy is — a costly example of the 'tragedy of the commons'.

Given the EU free-for-all, it is no surprise that over-size trawlers come onto small fishing grounds, scoop everything up in their nets and then throw back, dead, enough small fish to ensure their catch complies with regulations. The only surprise is that we have any fish left at all. Iceland, by contrast, has increasing stocks of the most important fish species, such as cod, because it fenced off its own waters and instituted a system of transferable fishing quotas, which give those in the fishing industry a long-term interest in conserving stocks in order to maximise long-term yields.<sup>26</sup>

<sup>21</sup> In 2004, after the rebate, the UK sustained a net loss of €1.3bn in subsidies to farmers via the CAP. In contrast, France benefited to the tune of over €2bn. Source: Open Europe.

<sup>22</sup> WTO and OECD estimates for 2002, see *Financial Times*, October 2005.

<sup>23</sup> *Agriculture in the UK 2003*, DEFRA

<sup>24</sup> For further details see Patrick Messerlin's 2005 Wincott Lecture, page 4.

<sup>25</sup> In PSE terms, combining tariffs and subsidies.

<sup>26</sup> See Hannes H Gissurason, *Overfishing: the Icelandic Solution*, Institute of Economic Affairs, 2000.



This example suggests that the solution to the fisheries policy problem is simple. We should return fishing grounds to the countries they belong to, which in turn should manage them using a property rights-based system like Iceland's. Some member states may argue that this is unfair since just a few countries in the Union have all the fish. But it is no unfairness that different countries have different natural assets. The northern countries might have all the fish and the income commercial fishing generates, but the southern countries have all the sunshine and the bulk of the money generated by tourism.

### 3. The Single Market (internal EU trade in goods and services)

#### *Background*

One of the key goals for the EU is to establish a single market for goods and services, and also the free movement of people. The original six member states may well have had, and still have, political union in mind, but the UK has always seen the EU as a 'common market'.

Article 14 of the Treaty of Rome defines the single market of its ambition as 'an area without frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty'. Fifty years on, there remains much to do.

Until 1986, the European Economic Community (as it then was) effectively operated as a customs union. In other words, it had a shared set of tariffs for imports, and no tariffs on intra-EU trade. But the internal market remained as separate country markets in other respects. In 1985, the EU adopted the 'Single Market Programme', a strategy aimed at removing invisible trade barriers within the internal market. More than 300 directives were passed in an effort to achieve this goal, using majority voting.

Brian Hindley and Martin Howe<sup>27</sup> distinguish seven key features which, if attained, would demonstrate that a single market was successfully being established within the EU:

- No customs formalities or tariffs on the movement of goods between member states.
- No quotas on traded goods and services between member states.
- The general prohibition of any measures having 'equivalent effect' to quantitative restrictions.<sup>28</sup>
- A wide range of specific harmonisation measures that seek to impose uniform standards on goods and services traded within the EU.
- A series of harmonisation measures related to the regulation of services.

<sup>27</sup> *Better Off Out? The Benefits or Costs of EU Membership* by Brian Hindley & Martin Howe, IEA Occasional Paper 99, Institute of Economic Affairs, revised edition 2001, reprinted 2004, pages 42-43.

<sup>28</sup> Specifically, under Articles 28 to 30 of the Treaty of Rome and the case law developed by the ECJ relating to these Articles.



- In the services sector, general restrictions against unjustified discrimination against other member state nationals, as well as the observance of general rights of establishment and movement in order to offer services throughout the EU.
- Controls on unfair state subsidies and discriminatory public procurement practices.

Hindley and Howe point out that the problem associated with harmonisation measures is that certain member states are unwilling to accept less rigorous standards. The authors claim 'this leads to the 'gold plating' of harmonisation directives under which the whole Community ends up adopting highly detailed and often excessive standards for its goods. This approach to constructing a single market has led to many thousands pages of detailed legislation. The direct cost is compliance with unnecessary standards in the domestic market and other EU markets, and possible loss of competitiveness in world markets'.<sup>29</sup> For firms that export little or nothing, such regulations impose a substantial unnecessary cost.

The 1985 Single Market Programme can be judged unsuccessful if only because it had to be followed by a whole new initiative, the 1997 Single Market Action Plan. Majority voting featured in both plans because horse-trading was expected. Unfortunately, everyone wanted to take and no one much wanted to give.

Also, the ideal of a single economic market competes with the ideal of a single federal state. Some say that a market cannot exist in a vacuum, i.e. a single economic market can only exist in the context of a legal political entity. According to Ed Smith: 'In the recent history of Europe, from Jean Monnet's plan for a European Coal and Steel Community in 1950 to today's European Union, one pattern seems clear: where economic integration leads, political integration will eventually follow.'<sup>30</sup> But others see the two as independent, while still others see increased economic integration as *reducing* the need for political integration.<sup>31</sup> It does seem, though, that in the EU the energy put in to political integration comes at the expense of the pursuit of economic integration.

Coincidentally or not, some member states, notably France and Germany, speeded up their federalist agenda. This led on to a raft of regulations aimed at imposing uniform health and safety, environmental and employment policies throughout the EU, and moves to impose a single monetary policy and harmonise taxation policies.

In his analysis for Goldman Sachs of *The Lisbon Strategy and the Future of European Growth*, the report's<sup>32</sup> main author, Kevin Daly, points out: 'The persistence of market segmentation is reflected in a lack of cross-border M&A activity in Europe — more than a decade after the formal creation of the single market and six years after the start of EMU, there are few genuinely pan-European firms'. Ironically, the exception to this pattern tend to be French owned multinationals, such as Pernod Ricard in the drinks sector, and Thales in the defence sector.

<sup>29</sup> Ibid., page 44.

<sup>30</sup> Ed Smith, "Will EMU Lead to Political Union?" OCTOBER 1998 – Centre for European Reform *Bulletin*, Issue 2 [http://www.cer.org.uk/articles/n\\_2\\_4.html](http://www.cer.org.uk/articles/n_2_4.html) 3 January 2006

<sup>31</sup> Alesina, Alberto F. and Wacziarg, Romain T., "Is Europe Going Too Far?" (January 1999). NBER Working Paper No. W6883. <http://ssrn.com/abstract=147012>

<sup>32</sup> Global Economics Paper, no 121, 21<sup>st</sup> January 2005, Goldman Sachs International, page 15.



In Spring 2004, Frits Bolkestein, the EU's Commissioner for Internal Market, Taxation and Customs Union issues, proposed a draft Directive aimed at removing existing barriers hampering the development of a thriving cross-border trade in services. Specifically, the draft Directive seeks to apply the 'country of origin' principle<sup>33</sup>. This means that provided a service complies with the regulation of the member state in which it originates, it can be offered anywhere in the EU. This means that service providers have to deal with only one set of regulations, rather than the various regulatory regimes of the countries they are selling in to; and it prevents discrimination by member states against providers of services from other EU member states. This initiative focused mainly on the construction, distribution (logistics) and business services markets. It excluded finance and insurance, and transport services, which are the subject of separate initiatives.

The Bolkestein Directive is crucially important, since around 70% of GDP and employment is generated by the services sector of the EU economy, far more than manufacturing or agriculture and extractive industries such as coal mining.<sup>34</sup> The services sector is now the engine of economic growth, underpinning the efficient development of the economy.<sup>35</sup> Earnings also tend to be higher in the services sector compared with manufacturing or agriculture. Yet, as Professor Minford points out, 'At present, regulatory barriers, taxes and minimum wages impede the development of (knowledge intensive) services in a number of countries, particularly in continental European countries'.<sup>36</sup>

Much of the fierce debate on the future of services within the EU focuses on whether or not to adopt the 'country of origin' principle. The Commission has proposed that services supplied from one member state to customers in another member state should be subject only to the rules of the supplier's home country.<sup>37</sup> This model implies mutual respect of different member states' regulatory regimes. Accordingly, if the Union has done its job by enforcing the minima, the principle should be sufficient to guarantee proper standards and consumer protection, with least fuss for providers.<sup>38</sup> And if the 'country of origin' principle were adopted, services will be treated in the same ways as goods in so far they will be freely traded within the EU — one of original objectives of the Treaty of Rome.<sup>39</sup>

For years, however, a number of leading member states, notably France and Germany, have opposed the 'country of origin' principle. They argue that this may

<sup>33</sup> The country of origin principle is set out in Article 16 of the draft Directive.

<sup>34</sup> The services sector is particularly advanced in certain Member States such as the UK where it accounts for three quarters of employment and total value added. The accession states in eastern Europe are more reliant on manufacturing, agriculture and extractive industries.

<sup>35</sup> Increasingly, wealth is being created by the creative use of information and data, delivering entertainment and other services via the internet. The UK earns far more revenues from its thriving rock and pop musicians than it does from exporting steel.

<sup>36</sup> *Should Britain Leave the EU?* Patrick Minford et al, IEA & Edward Elgar, 2005, page 128.

<sup>37</sup> Furthermore, this 'country of origin' principle places responsibility on the authorities in the home country to supervise services provided to customers in other member states.

<sup>38</sup> Another notable feature of the draft Directive is the proposal to oblige each EU nation to establish 'one-stop shops' to authorise and register service providers registered in other member states. This should remove a significant barrier to market entry.

<sup>39</sup> In February 2006, the European Parliament voted to water down the Services Directive, removing the country of origin principle and adding a series of exemptions. However, each member state must still decide on the adoption of the amended directive.



expose their citizens to inferior standards or aggressive marketing techniques (Germany, for example, until recently outlawed certain marketing initiatives such as 'three for the price of two' offers and free gift promotions.) Nonetheless, underlying these publicly professed concerns is a worry that domestic suppliers of services may be unable to compete with foreign rivals, particularly from lower-wage member states in Eastern Europe and the Mediterranean.

### *Not all sectors are the same*

The French appear to be implacably opposed to allowing workers from lower-wage member states to provide a range of services, including architecture, construction and plumbing services in their home country. The fear is that the 'country of origin' principle will lead to Polish plumbers (for example) being overemployed and underpaid in France while French plumbers would lose their jobs and their income. However, the head of the French plumbing union (the GCCP) concedes that France is short of six thousand qualified plumbers.<sup>40</sup>

At the same time, progress exists in other sectors. There are now scores of no-frills airlines operating throughout the EU. Entrepreneurs such as Stelios Haji-Ioannou, the founder of easyJet, and Michael O'Leary, the CEO of Ryanair, have done more than a raft of European politicians to further the goals of the Treaty of Rome.<sup>41</sup>

In energy services, member states agreed at the Barcelona European Council Summit in Spring 2002 to introduce an open competitive market for gas and electricity for business consumers, starting in 2004. Despite the reluctance of some member states,<sup>42</sup> competition in energy services will also be extended to the residential household market as from July 2007. In the UK, the first member state to liberalise its energy markets, competition has brought significant benefits to residential and business users alike. Since 1995, EU firms in different countries have paid different amounts for electricity up to now, an indicator of how far we are from the single market concept.<sup>43</sup>

The EU's Energy Commissioner, Andris Piebalgs, may be keen to ensure that each market participant has an equal chance of developing a successful business across Europe, but the French gas and electricity markets remain difficult to crack, being dominated by state monopolies. Although the French government is selling off some shares in both companies, it will retain a majority stake in EdF and Gaz de France.

The reluctance to accept non-nationals has effectively reinforced the trend in favour of national champions, whether they are Enel in Italy or EdF in France. This strategy also underpins the takeover bid mounted by Gas Natural in Spain for Endesa. Furthermore, deals have been encouraged between national governments to facilitate

<sup>40</sup> 'Polish plumber symbolic of all French fear about constitution', *Financial Times*, 28 May 2005.

<sup>41</sup> It is sometimes overlooked that traditional flag carriers, such as BA and Air France, have had to tackle their inflated cost structure in order to remain competitive. Low cost carriers are not always the lowest priced. Either way, customers benefit.

<sup>42</sup> For a more detailed assessment of this potential threat and the attempt being made by certain member states to exclude utilities, public transport and water from the proposed Services Directive, see *Services of General Interest: Issues and Options*, Sir Ian Byatt, European Policy Forum, September 2005.

<sup>43</sup> See Figure 2: *National differences of end-user prices for industrial users (24 GWh, 1995 – 2004, nominal)* Note: Prices exclude VAT, based on EUROSTAT data, p.7 of *Review of European Electricity Prices*, Kema Consulting GmbH on behalf of Eurelectric, Bonn, Germany, November 2005



this process. Hence, Enel has gained a modest degree of access to the French market as part of the resolution of EdF's investment in Edison.<sup>44</sup>

Opening up professional services to greater competition has proved even more difficult. The legal profession, for example, has proved adept at excluding unwanted foreign competition by erecting local barriers against them.

Financial services have proved to be one of the more difficult service markets to open up to cross border competition and trade. Member states launched a Financial Services Action Plan in June 1999 aimed at developing a single, integrated capital market by 2005. Yet the UK's Financial Services Authority (FSA) is simultaneously creating a web of national regulations with only loose regard for the single market.

Wholesale capital markets are now largely liberalised on a global basis. Eurobonds are a good example, and it is the lack of national regulation that explains this market's success. However, other financial markets continue to be held back by unnecessary regulation. A study by London Economics, a consulting firm, suggests that a single EU market for securities coupled with improved market access could — over the period of ten years — enhance the EU's GDP by 1.1% in 2002 prices. Such a reform would also bring many thousands of additional jobs.<sup>45</sup>

The European Commission appears to be enforcing EU rules on the ability of financial institutions to launch bids for banks, insurance companies and other financial entities in other member states' jurisdictions, such as pressuring the Italian government and banking authorities to desist from blocking foreign takeovers of its leading domestic banks.<sup>46</sup>

### *The way forward*

EU citizens are overwhelmingly in favour of a single market in goods and services. In a recent survey of EU citizens, 80% of respondents felt that moves towards completing a single market had increased the choice of products available, and 75% welcomed the increased competition associated with opening up national markets. Two-thirds approved of the way in which the liberalised airline market had made it easier to travel throughout Europe and four times as many businesses (46%) see a positive impact for their firms as perceive a negative one (11%).<sup>47</sup> There are perhaps particular advantages in border areas where open markets — and a common currency — enable EU citizens to make clear cut comparisons between different commercial suppliers.

<sup>44</sup> For a further discussion, see 'Europe's energy for mergers' Keith Boyfield, *Wall Street Journal Europe*, 14 September 2005.

<sup>45</sup> London Economics, 'Quantification of the macroeconomic Impact of integration of EU financial markets', November 2002.

<sup>46</sup> However, this did not prevent Antonio Fazio, the governor of the Bank of Italy from attempting to block ABN Amro's recent bid for Banca Antonveneta. Unbeknownst to him, Mr Fazio's covert intervention was monitored by Rome's prosecuting authorities, who had been tapping his telephone for several months as part of a criminal investigation into his possible abuse of power. This debacle led to Mr Fazio's resignation. See 'Wiretaps of an Executive in Italy Put Central Banker in Hot Seat', *Wall Street Journal*, 13 September 2005.

<sup>47</sup> Internal Market has brought big gains in last ten years, but more needed, say citizens and companies, European Commission Internal Market Directorate press release, 11 November 2002.



Whereas the US has seized the opportunities for inter-state trade triggered by the latest advances in new technologies (most notably those based on the internet), companies based in the EU are still shackled by a raft of unnecessary national regulatory barriers and stipulations.<sup>48</sup>

Professor Minford points out that: 'Insufficient integration in service sectors may have been one of the reasons (besides others such as labour market rigidities or planning regulations) delaying the diffusion of ICT (information and communications technologies) and therefore preventing European firms from benefiting from the large productivity increases experienced by their American competitors in recent years'.<sup>49</sup>

All these initiatives, counter-initiatives, backsliding and inflated claims conceal a simple truth: a single market requires a single set of regulations for that market. It follows that the single market cannot be created with Directives, since Directives state broad principles but leave it to member states to regulate in different ways — which they do, blaming Brussels when they are criticised. As we pointed out in *Road Map to Reform: Deregulation*, the problem is not that the proportion of business legislation from the EU is too high but that it is too low.<sup>50</sup>

While our proposal was treated with scepticism by some, we were encouraged to discover that the Commission has warmed to it and now seeks to legislate via Regulations.<sup>51</sup> However, they are inhibited in this new policy by the Nice Treaty, which gave new emphasis to Directives over Regulations, and by member states who misguidedly resist it on grounds of 'subsidiarity'. But these member states and their citizens overlook that Directives and gold plate are two sides of the same coin: they cannot insist on Directives without creating gold plate. Similarly, any national regulation in an area legislated by the EU, such as agriculture, is by its nature gold plate.

The single market is clearly desired by citizens and by business, although they lobby intensively for protection from the short-term negative effects in their own backyards. The UK's relatively greater commitment to free trade has meant that we have opened our markets to foreign competition much more than others, so that to us, the cost of a single market would be relatively low and the benefit would be greater.

<sup>48</sup> For a more detailed analysis, see 'Changing Gear: Productivity, ICT and Service Industries: Europe and the United States' by B Van Ark et al in *The Industrial Dynamics of the New Digital Economy* edited by J F Christensen and P Maxwell, Edward Elgar publishers, 2003.

<sup>49</sup> Op cit, page 145.

<sup>50</sup> *Road Map To Reform: Deregulation*, Tim Ambler and Keith Boyfield, Adam Smith Institute, London, March 2005.

<sup>51</sup> EU Comm 535, 25 October 2005: "**From Directives to Regulations:** As the Commission made clear in its Communication on Better Regulation for Growth and Jobs, the choice of the appropriate legal approach must be based on a careful analysis. Replacing directives with regulations can under certain circumstances be conducive to simplification as regulations enable immediate application, guarantee that all actors are subject to the same rules at the same time, and focus attention on the concrete enforcement of EU rules. This contribution to simplification was widely recognised in the consultations underlining the view that it would prevent divergent national implementation. In conformity with Treaty provisions and taking into account the Protocol to the Treaty on subsidiarity and proportionality, the Commission intends to further exploit, on a case by case basis, the potential for simplification through substituting directives with regulations."



The single market ideal therefore requires:

- No further use of Directives for business and economic legislation.
- Consolidation of existing EU business and economic legislation into a coherent set of the essential Regulations.
- No new Regulation by member states in this area (see subsidiarity below).
- Sunset clauses for existing member state legislation so that it can be transposed by the sunset date to the EU equivalents, if still required.

All this can be expressed more simply. Achieving a single market is inhibited by an excess of regulations and red tape. One market requires one set of regulations and no more than one. The introduction of Directives as a political fudge allowing member states to make their own, and therefore different, regulations has been unhelpful. The differences may have been reduced but it is the fact that there are differences at all which fractures the EU market into national markets. The solution to the excess is the institution of a single market, namely that in matters governed by the single market (the EU) only EU regulations would be recognised, not Directives and not national regulations. In other areas, national regulations would prevail.

It may be unlikely that the UK can make fast progress on this dimension, though as we say, the Commission's preference for Regulations over Directives is heartening. Later chapters discuss what might be feasible and how it could be achieved. But the position described here represents a vision of the ideal and a positive contribution to the debate on the future of Europe, in contrast to the negative stance for which the UK is often criticised.

#### 4. Levels of law and decision-making

##### *Confusion between the two law-making tiers*

It seems extraordinary that so little thought, or publicity, was given to the imposition of one law-making tier on top of another. It was always inevitable that too many regulations would result unless the roles of different decision-making tiers were carefully defined and separated. And yet 'subsidiarity', namely the right of member states to legislate in any area not specifically reserved for the EU, became an issue only 50 years after the EU was founded<sup>52</sup>.

This is especially important now that the European Court of Justice (ECJ) is increasingly engaged. For business and economic cases it is the highest court of appeal and therefore difficult and subtle issues tend to go there. But the ECJ applies European, not national law, unless the issue has been specifically reserved for member states. For example, the ECJ has ruled that the Commission can require member states to impose criminal sanctions, including prison terms, for infringements of EU law. This is a dramatic turn of events as, until November 2005, only national legislatures were able to establish what was a criminal offence that could put an offender in jail.

<sup>52</sup> Subsidiarity is an unfamiliar concept in the British legal tradition. In continental countries the term is commonly used to denote activities which are subsidiary to some overriding authority, notably central government. In his recent book, *Alarming Drum*, Peter Morgan argues that subsidiarity "allows subordinate institutions to deal with the trivial, while all initiatives, wisdom and power remains at the top of the hierarchy, in the centre". See *Alarming Drum: Britain's European Dilemma*, Peter Morgan, published by Imprint Academic, 2005, page 68.



The ECJ overrules some of the decisions taken by the Commission, notably in the field of competition policy. For example, the ECJ overruled the objections raised by the Competition Directorate to the proposed acquisition of Honeywell by GE Electric.

The Court comprises 25 judges and eight advocates-general. They are appointed by member state governments and serve renewable terms of six years. In contrast to UK courts, the ECJ tends to be political in its outlook and rulings. To some extent, the ECJ is making the law up as it goes along (just as national courts do). If a Directive has been loosely written and a member state's transposition of it is challenged, the ECJ will look to the presumed intent of the Directive thereby, in effect, tightening up the wording.

This is another fundamental flaw with Directives: they are an accommodation to achieve political agreement, but they are bad law for business, consumers and lawyers.<sup>53</sup> Clarification is left for each member state to determine separately, with separate results, until someone involves the ECJ.

The solution is not to write Directives more accurately, but not to write them at all. Again the logic is simple: where legislation can be agreed on a pan-EU basis, it should be expressed as a Regulation and go unchanged into the law of member states. If agreement is not possible, then the decisions have to be left to member states.

Given that member state law-making factories, or at least the UK's, have been no less productive, the problem of having two law-making levels (EU and member state) has been escalating, as Figure 1 shows:

**Figure 1: EU legislation produced annually from 1958 to 2003**

Year	Regulations	Directives	Decisions	Total
2003	2,461	153	804	3,418
2002	2,537	120	896	3,553
2001	2,769	136	820	3,725
1998	3,008	158	735	3,901
1993	1,566	166	707	2,439
1988	1,801	133	546	2,480
1983	1,454	84	514	2,052
1978	1,329	116	615	2,060
1973	1,110	57	254	1,421
1968	443	37	182	662
1963	96	8	266	370
1958	20	0	23	43

Source: Extracted from CELEX

Note: *Decisions* are conclusions to individual cases and therefore not statutory but precedents for future decisions in the manner of English common law. *Regulations* are like Statutory Instruments in the UK, but combine actual laws which apply as written throughout the EU with administrative orders, such as variations in tariffs. It is obviously unsatisfactory to use the same word for quite different roles and the draft EU constitution proposed to divide Regulations into *Laws* and *Administrative Orders*. Probably less than 10% of Regulations would be Laws.<sup>54</sup>

<sup>53</sup> Robin Bellis, "Implementation of EU legislation", An independent report for the Foreign and Commonwealth Office, November 2003, (<http://www.fco.gov.uk/Files/kfile/EUBellis.pdf>)

<sup>54</sup> Tim Ambler, Francis Chittenden and Chanyeon Hwang (2005) "Is EU Regulation good for us? A study of EU Regulations in 2003/4," British Chambers of Commerce, London.



UK public opinion has been encouraged by Whitehall to identify Brussels as the villain, whereas it is Whitehall's own excessive meddling with Directives and their own legislation that is to blame. In a single market, something either needs to be regulated across the whole market or it does not need to be regulated at all. Where possible, consumer protection should be left to market competition and the strength of brands as a guarantee of quality.<sup>55</sup>

Although many in the UK celebrated the demise of the draft constitution, they may have been wrong to do so. The constitution was seen as extending the EU's powers, as indeed it did; but it also limited them. Without the constitution, EU institutions are extending their powers by stealth and without limit. Anthony Browne, the Europe correspondent of *The Times*, claims that one senior Brussels official admitted that although the constitution has failed to win popular electoral support, 'the Commission can actually do pretty much all that it wants without it'.<sup>56</sup>

### *Lack of challenge to regulation*

Part of the problem is the lack of challenge to new regulations at either EU or member state level. Extended Impact Assessments (EIAs), now just IAs, were introduced in 2002 to mirror, at the EU level, what at member state level are now 'road maps' at the preliminary stage and Regulatory Impact Assessments (RIAs) at the conclusion. Regulatory Impact Assessments are well developed in the UK but in the EU and other member states, the process is still evolving, and there are differences: while the UK's RIAs are designed to consider the impact of regulations on business and other organisations, for example, the EU's IAs are meant to give similar attention to environmental and other considerations. Ideally, the production of member states' own impact assessments should be synchronised with European IAs in order to facilitate adequate consideration and challenge at both levels — but in practice, neither content nor timing is synchronised. Indeed, some assessments are even prepared after the decisions have already been made, which negates their objectives.<sup>57</sup>

It may be argued that the European IA system is still in development and we should be pleased with its progress rather than critical of its failings. That would be too generous: member states still cling to their own procedures with little regard for the demands of a single market. The Netherlands, for example, developed a 'Standard Cost Model' (SCM) for assessing the administrative burden of regulation, which was widely welcomed. The UK gladly followed this lead, but unfortunately, its officials felt the need to make 'improvements' to the SCM system. In turn, the Commission was critical of the UK version and felt the need to develop its own.<sup>58</sup> At this rate, we will soon have 26 'Standard' Cost Models, and EU legislation will continue to be inadequately reviewed.

At the EU level, no committee or organisation is charged with challenging new legislation, although bodies like the European Economic and Social Committee may be consulted — it being presumed that member states will do that. But as we have seen, regulators in member states have their own agenda and will challenge EU proposals at best selectively.

<sup>55</sup> See Tim Ambler, 'Do Brands Benefit Consumers', *International Journal of Advertising* 16(3) pp 167-197, 1997. *The Spectator*, 26 November 2005.

<sup>56</sup> Tim Ambler, Francis Chittenden and Chanyeon Hwang (2005) "Is EU Regulation good for us? A study of EU Regulations in 2003/4," British Chambers of Commerce, London.

<sup>57</sup> Unattributable discussions with EU officials, February 2006.



On the other hand, the UK is not short of quangos that are supposed to challenge new regulation. The Better Regulation Executive, part of the Cabinet Office, is supposed to improve the working of the RIA system, but in practice it does not intervene. The Better Regulation Commission (formerly the Better Regulation Task Force) has likewise been long on theory but short on practice. Its ineffectiveness may be judged by the fact that the Prime Minister himself took over the chair of another watchdog, the Panel for Regulatory Accountability (PRA), which was strengthened in 2004 supposedly to reduce the flow and improve the quality of regulations and to ensure that regulation is used only where necessary. Since the PRA meets in secret, and attempts to discover their conclusions through the Freedom of Information Act failed, we cannot know how effective it may be.

In addition, both Houses of Parliament have committees to review regulation, though neither have the resources for effective challenge. According to Ambler and Chittenden, over 2,000 Statutory Instruments (secondary legislation akin to EU Regulations) need to be scrutinised per annum, along with their RIAs. But they could not find a single example of one being rejected.<sup>59</sup>

Finally, there is the Office of Fair Trading which has a good reason to oppose many regulations on the grounds that they are anti-competitive (much regulation is anti-competitive since it benefits large incumbents rather than SMEs or new entrants; larger firms can afford to have specialist departments to cope with regulatory change, but compliance costs are much more burdensome for small companies).<sup>60</sup> Nevertheless, while the OFT may object to some new regulations, any complaint only goes to the department sponsoring the new regulation. So one should not expect much change.

The UK watchdogs are also supposed to use RIAs to challenge forthcoming EU regulations, but since they are not produced in time to be challenged and the watchdogs are toothless, the whole exercise is ineffective.

The Lisbon initiative towards a more modern competitive single market with less regulation is welcome in principle, but has failed to yield results. The UK Presidency made 'better' regulation one of its 'priorities', but it was only one of 20. On the other hand, the EU institutions do not get credit for new 'Regulations' that actually deregulate (such as reducing national barriers); while member states should be castigated for restoring the same barriers by other means.

### *Decision-making*

Apart from the European Court of Justice, the EU has three decision-making bodies: the Council of Ministers, the Commission, and the Parliament. As this structure is well known, we make only brief comments.

The Council of Ministers is the main decision-making forum of the EU and is meant to fulfil a legislative function, initiating new policy, along with determining budgetary policy and programme allocations in conjunction with the European

<sup>59</sup> Evidence to the Select Committee on the Merits of Statutory Instruments, Inquiry into the management of secondary legislation, Tim Ambler and Francis Chittenden, November 2005.

<sup>60</sup> Chittenden F, S. Kauser and P. Poutziouris (2002) "The Regulatory Burdens of Small Firms: A Literature Review," Sheffield: The Small Business Service.



- Defining the areas for regulation by the EU and 'subsidiarity' which will apply to the remaining areas.
- Using 'Laws', as defined by the draft EU constitution, and cessation of Directives or 'Framework Laws'.
- Reducing the number of new regulation watchdogs to one for the EU and one for each member state. These watchdogs should be independent of government. In the case of the UK, for example, the new body should report to a Joint committee of the House of Commons and House of Lords. It should operate openly and report annually. The most appropriate model may be the highly respected National Audit Office, which reports to the Commons Public Accounts Committee.

### **5. Budget and financing**

#### *The current situation*

The EU's budget continues to spiral, having shot up from 84bn in 2003 to 105bn in 2004 following the accession of ten new member states. Around 80% of the whole annual budget is spent on just two items: the CAP and the so-called 'Cohesion Funds'. Both these expenditure programmes include significant wastage of resources.

The EU funding comes mostly from three basic sources:

- levies on agricultural imports (which helps to explain why they are so high) and duties on goods imported from non EU countries;
- a percentage of the VAT levied by each member state (worth 21.3bn in 2003); and
- a fixed share of the EU's Gross National Income, capped at 1.24% for the period 2000–2006. (The six member states that contribute the bulk of the EU's budget — France, Germany, the UK, the Netherlands, Austria and Sweden — have formally asked for this cap to be reduced from 1.24% to 1% as from 2007. The eventual compromise reached in the December 2005 Summit was 1.045%.)



**Figure 2: EU contributions and expenditure by country, 2003**

Country	Contribution €bn	Receipt €bn	Net contribution
Germany	22	-8.6	30.6
France	16.6	-1.7	18.3
Italy	13.6	-1.1	14.7
United Kingdom	13.5	-3.8	17.3
Spain	7.8	8.5	-0.7
Netherlands	5.7	-2.9	8.6
Belgium	3.7	0.7	3
Sweden	2.6	-1	3.6
Austria	2.2	-0.4	2.6
Denmark	2	-0.3	2.3
Greece	1.6	3.3	-1.7
Portugal	1.4	3.5	-2.1
Finland	1.4	0	1.4
Ireland	1.3	1.6	-0.3
Luxembourg	0.2	0.9	-0.7
Total EU budget	95.6	-1.3	96.9

**Sources:**

[http://europa.eu.int/eur-lex/budget/data/COL22006\\_VOL1/EN/nmc-grseq42960935830-3/index.html](http://europa.eu.int/eur-lex/budget/data/COL22006_VOL1/EN/nmc-grseq42960935830-3/index.html)

4 Jan 2006, and European Commission

We need to identify the central functions of the EU before we can identify how best to fund them. However, as one of the authors has pointed out in a submission to the House of Lords select sub-committee inquiry into the future financing of the EU, 'The constitution as presently drafted seems unlikely to provide a precise blueprint for dividing, i.e. clarifying, the differences between, the roles of EU and member state governments'.<sup>63</sup>

Furthermore, in deciding which roles are appropriate for the EU and which for national governments, we should adhere to the principle of taxpayer value — getting the best public services at least cost — and the principle of subsidiarity — that the Union should only do what it has to do and what is it best at doing, leaving other things to the member states. This (or some other) logical approach would make the budget much easier to establish.

Regrettably, this is not the approach currently employed within the EU. As it presently operates, the EU transfers scarce resources away from the poorer member states in order to maintain flagging agricultural sector in richer ones.

<sup>63</sup> Submission by Tim Ambler, 16 August 2004.



Comparing EU budget contributions and expenditure by country is remarkably difficult. The EU publishes national contributions, but does not appear to be keen to analyse expenditure by country. The myth is that the EU is directly funding good causes, but the reality is that it does not have the administration to do so — hence the waste. Figure 2 is our best estimate for the largest EU member states in 2003. (Note that these figures are after adjustment for the UK 5bn in that year.)

### *The Law of Other People's Money*

In many ways the EU simply re-circulates member states' money, retaining a significant cut for its own administration (6% of the total budget<sup>64</sup>). Channelling member states' money to the EU, only for it to be returned, is wasteful for three reasons:

- it involves additional, unnecessary administration, which imposes cost;
- it opens the door to fraud and rackets;
- it is subject to the 'Law of Other People's Money', which is that money is wasted in proportion to the number of pockets through which it travels. When taxpayers' money is funnelled through member state governments, to the EU and then back again to the member state, it is easy to see how accountability gets lost.

The extent of corruption and fraud is indicated by the eleven successive years that the Court of Auditors – the Commission's own accountants – has refused to approve the EU annual accounts. In each of these years the Auditors have been obliged to concede that they are unable to identify where much of the Commission's annual budget is spent.<sup>65</sup> Between 1994 and 2003, a period of ten years, over 511bn of EU funds has been allocated in such a way that the Court of Auditors cannot vouch for it. The Commission blames member states on the grounds that they administer about 80% of EU spending and the frauds and corruption take place on their. Addressing the European Parliament in November 2005, the President of the Court of Auditors, Hubert Weber, warned legislators that the 'the improvement in systems and controls at the level of the Commission has not been reflected in those within member states'.<sup>66</sup>

This illustrates the Law of Other People's money quite neatly. Member states are not bothered since they regard it as 'EU money', while the EU lacks the agencies to distribute the funds responsibly and has to rely on the member states.<sup>67</sup>

Giving the EU less money to return to member states would go a long way to resolving the problem.

<sup>64</sup> <http://europa.eu.int/comm/budget>. Accessed 4 January 2006.

<sup>65</sup> See Europa website, Press release ECA/05/11, 15 November 2005, 'European Court of Auditors published today its Annual Report on the implementing for the 2004 EU general budget'.

<sup>66</sup> Debate on the 2004 annual report at the European Parliament Strasbourg, 15 November, 2005 <http://europa.eu.int/rapid/pressReleasesAction.do?reference=ECA/05/14&format=HTML&aged=0&language=EN&guiLanguage=fr>

<sup>67</sup> There is also a view that the EU and member states *should* jointly fund and manage projects: that 'co-finance' and 'co-management' are virtues. But clear lines of responsibility are surely a bigger virtue.



## Recommendations

In the absence of an agreed constitution, we should start from first principles. The roles of the EU and member state governments should be more clearly divided. Taxpayers' money is wasted when these two levels of legislature squabble over the same territory and try to regulate and administer the same topics.

The constitution should define responsibilities by EU cost centre (such as each commissioner's responsibilities), which then makes it possible to define the appropriate budget. (The cost centres should be either executive, as in the case of the internal market, or advisory / liaison, in cases where executive authority lies with member states. Budgets for advisory / liaison cost centres need be only minimal except where added value can be clearly shown. Member states can, after all, communicate directly with each other without Brussels intervening.)

The principle of subsidiarity implies that all roles not specifically and exclusively defined as being executive matters for the EU should lie with member states. They would, however, have the right to use the central secretariat services of the Commission provided that both they, and the Commission, agree what must be done and the budget necessary to fulfil this work programme. In this sense, we are suggesting that they would constitute 'side deals', financed outside the main budget agreements.

Our main recommendation is that the EU budget should no longer include money to be returned to contributors. The EU would then become properly accountable for spending its own (much smaller) budget covering three areas:

1. Supporting poorer accession states with lower GDP per head as they integrate with the EU. This would remain a temporary process for accession states, and the money should be administered through the EU's own agencies. (According to the Polish government, only 4% of the EU money allocated to Poland has actually been spent due to bureaucratic tangles between Brussels and Warsaw. Under that system, whether Poland gets all, or only 95%, of the expected funds is immaterial.) And as already proposed by Sweden, rich countries would be expected to take care of their own poor regions.
2. Funding EU-wide value-added projects, such as space exploration, which are simply too large for any member state or even *ad hoc* combination of member states. These should be limited to those that member states want and would pay for; and do not include cohesion, solidarity or regional funding.
3. Paying for the administration of the EU, such as the Commission, Parliament, and ECJ.



### 3. What do others want?

---

This chapter seeks to identify the aspirations of other member states. Where their wishes coincide with those of the UK, meaningful progress across the five dimensions discussed in the previous chapter becomes possible: as when the 2005 British presidency elicited the interest of the Scandinavian countries in pruning EU expenditure, for example.

The focus on budgetary issues leading up to the Brussels summit in December 2005 blocked meaningful debate about the EU's future strategic direction. Difficult decisions over how the budget should be allocated were postponed to a review exercise in 2008/9. The compromise deal, brokered by the new German Chancellor, Angela Merkel, led to Britain surrendering a significant proportion of the UK rebate<sup>68</sup> negotiated 20 years earlier by Margaret Thatcher. In exchange, all 25 member states agreed to a major review of the EU budget in the year 2008/9. In some ways, this was welcome: the EU did finally achieve a budget and the UK rebate (which many saw as being fair originally but growing less so), was 'stabilised' at a level where UK and French EU net contributions came roughly into balance. Critics, naturally, saw it as the Prime Minister giving away part of Britain's birthright in return for an agreement to talk about the CAP, which is unlikely to translate into any real change. As noted earlier, no previous revisions of the CAP have resulted in substantial change. Philippe Douste-Blazy, the French foreign minister, told press reporters that 'Jacques Chirac has secured that there won't be reform to the CAP before 2014'.<sup>69</sup>

However, the agreement to review the entire EU budget, and implicitly its strategy, does give member states both the opportunity for radical reform, and the time to prepare for the discussion. Surveys of public opinion suggest that people across Europe are disillusioned with the way in which the EU is proceeding. They want to see meaningful reform. But to achieve these goals, the UK must identify shared interests and goals with the other 24 member states and find ways of working together to achieve those goals. Different potential partners will share different goals, so the diplomacy involved will be highly complex.

The UK may secure the kind of EU reform it likes by threatening to leave, or at least opt out of key aspects such as the CAP,<sup>70</sup> but this approach does not make friends and allies. Our potential partners can see that if every state sought to pick and choose the EU bits they like, the EU would quickly collapse. Such threats can be only a last resort.

The national leaders sitting down in 2008 to resolve the future of the EU will be different from those immersed in the 2005 difficulties. Angela Merkel, who did provide solutions more than problems, may still be there but Schröder, Chirac, Berlusconi and Blair will be gone. So, turning to the five key issues discussed in the last chapter, where can the UK find allies in achieving meaningful reform?

<sup>68</sup> The foregone rebate is equivalent to €10.5bn over the seven year period 2007 – 2013. The rebate concession amounts to £500m in 2007-8 but will reach between £1.6 and £1.9bn in the final three years 2010 to 2013.

<sup>69</sup> 'Aftermath of EU deal turns ugly', *The Times*, 19 December 2005.

<sup>70</sup> Christopher Fildes, the award winning financial journalist suggests the UK should give an ultimatum notifying our partners of intention to quit the CAP within five years, see 'Why this CAP doesn't fit the bill for Britain', *Evening Standard*, 16 December 2005.



## 1. External trade

In theory, it should be in the interests of every member state to remove EU tariff barriers on a reciprocal basis. As Professor Messerlin emphasises, the EU would be one of the main beneficiaries from a successful completion of the Doha round of world trade talks. In the agricultural sector, for example, the EU would be the biggest winner with around half of all global gains. The previous chapter suggested that if tariff barriers were removed, the EU's growth rate would surge by more than 1%.<sup>71</sup>

Supporters of free trade argue that globalization is not a zero sum game if Europe loses jobs to the Far East. They promise it will propel Europe to a new level of wealth because it creates a whole new raft of opportunities that mutually benefit the trading partners concerned. Gordon Brown recognises the logic of this argument. In autumn 2005, he issued a Treasury paper setting out a series of proposals to enhance Europe's potential economic growth. 'Europe,' he suggested, 'should lead the way in rejecting agricultural protectionism, responding to the US offer to abolish export subsidies and cut tariffs, and reforming the CAP.'<sup>72</sup>

Accession states such as **Slovakia** and **Estonia** recognise that in order to promote export-led growth they must drop tariff barriers. They have already led the way by implementing flat tax policies in order to attract foreign direct investment.<sup>73</sup> The other member states likely to be at the forefront of trade reform are the Scandinavian countries (such as **Finland**, which has emerged as a major exporter of mobile telecommunications equipment) and trading nations (such as **the Netherlands**, which has centuries-old trading links with the Far East, and **Germany**, which has consistently favoured more open trade, reflecting its national interests as a major exporter of manufactured goods, notably motor vehicles).

Some progress was made at the WTO talks held in Hong Kong in December 2005. The Trade Commissioner, Peter Mandelson, agreed to phase out EU export subsidies on agricultural products from 2010 and end such subsidies entirely from 2013. But much remains to be done in the detailed talks to be held in Geneva in early 2006.<sup>74</sup>

Attitudes may also be changing in **France**. When asked their views, the vast majority of French citizens favour freer trade, so there would appear to be far more popular support for open trade than is often perceived.<sup>75</sup> But then France is one of the world's major exporters (the world's third largest for services) and is particularly strong in sectors such as defence, electronics and luxury goods; while foreign companies employ one-third of the French workforce.<sup>76</sup>

At the same time, each country has strong lobbies against free trade and tariff reduction. The fair trade lobby argues that free trade favours the strong over the weak, and that developing countries need more targeted reforms. Others contrast the real and immediate threats to jobs in the short term against the theoretical and distant gains in the long term. Even if free trade has usually benefited all sides in the past, they argue, that does not mean it will always do so in the future.

<sup>71</sup> For goods alone OEF argue that aggregate GDP would climb by €110bn. in today's prices, so if services are added the boost is likely to be considerably higher.

<sup>72</sup> *Global Europe: Full-employment Europe*, Rt Hon Gordon Brown MP, H M Treasury, October 2005, page 17.

<sup>73</sup> See Andre Greco: *Flat Tax: The British Case*, Adam Smith Institute, 2004.

<sup>74</sup> For a commentary on the issues, see 'A blend of strong measures puts trade talks back together', Professor Jagdish Bhagwati, *Financial Times*, 20 December 2005.

<sup>75</sup> This is also a trend observed by some Members of the European Parliament, notably Daniel Hannan, source: discussion with Keith Boyfield, 19 December 2005.

<sup>76</sup> According to the latest statistics, 16,000 foreign companies employ 3.5m people in France.



The current Doha round of world trade talks, due to be concluded by early 2007,<sup>77</sup> is unlikely to be any more revolutionary than previous ones, though we can cautiously expect some progress with tariff reduction. The UK needs to identify, from the patchwork of views in the EU, the countries and leaders who are at least looking for radical liberalisation, even though their domestic politics may constrain their outward enthusiasm. Whatever the Doha round has for the EU, the UK should be using the preliminary discussions to identify the partners and the issues where progress is not so much likely to benefit the UK, but to provide common ground with the UK.

The UK's reform package must have attractions for each of the coalition members driving it. It needs to open up trade at the same time as providing realistic short-term support for endangered sectors. That need not mean just short-term taxpayer support: for example, as Goldman Sachs point out,<sup>78</sup> adjustment in the services sector would be helped by regulatory liberalisation.

## 2. The Common Agricultural Policy (CAP) and fisheries

No sector sees itself as more endangered, but at the same time more in need of protection, than agriculture.

The CAP emerged, like the Common Market, partly as a response to the supply problems during the Second World War. The UK may not have been one of the original six member states, but no country came closer to disaster in the 1940s as a result of allowing agriculture to decline during the inter-war years. With its empire and enthusiasm for free trade, by 1939 its food was almost entirely imported. Mindful of that wartime experience, the EU decided it should be self-sufficient in food for strategic reasons, and largely it is: the net food imports of the EU25 in 2003 was just 2bn, compared with 16bn for the UK alone. ( **Germany** was the second largest net importer at 11bn; **the Netherlands** was the largest net exporter at 19bn, with **France**, perhaps surprisingly, second at 11bn. See Figure 3.)

We can expect the Doha talks to lead to further declines in EU food exports to the rest of the world and, if strategic net self reliance is to be maintained, a corresponding decline in imports.

<sup>77</sup> The Bush administration's 'fast track negotiating authority' runs out in 2007.

<sup>78</sup> 'German Manufacturing will survive EU Enlargement', edited by Dirk Schumacher, Goldman Sachs Global Economics Paper No 135, 9<sup>th</sup> December 2005.



Figure 3: Agriculture statistics  
(2003 except where indicated)

	Agriculture as % of workforce	Agriculture as % of GDP	Agriculture as % of all imports	Agriculture as % of exports	Agriculture trade balance ( m)	Trend of food prices (%)	Food & drink as % of consumer spending*
Austria	5.5	1.2	6.7	6.1	-613	1.7	15.0
Belgium	1.7	1.0	8.9	9.3	2,576	2.0	17.3
Cyprus	5.2	3.7	12.2	34.2	-292	5.1	21.9
Czech Rep	4.5	1.1	5.6	3.6	-988	-2.1	26.1
Denmark	3.3	1.6	10.7	17.6	4,918	2.0	16.7
Estonia	6.3	2.2	9.7	5	-355	-1.9	31.2
Finland	5.3	1.0	6.3	2.6	-1,151	0.6	18.7
France	4.3	2.0	8.1	11.4	11,060	2.3	17.9
Germany	2.4	0.7	8.3	4.9	-11,285	-0.1	16.1
Greece	16.3	5.4	11.2	22.7	-1,716	5.0	20.5
Hungary	5.4	2.7	3.7	7.5	1,309	1.2	27.4
Ireland	6.4	1.9	8.8	12.5	6,105	1.4	14.6
Italy	4.7	2.2	9.4	7.2	-5,681	3.3	17.1
Latvia	14.6	2.1	12.3	7.3	-383	2.8	31.7
Lithuania	18.7	2.6	7.9	10.2	-44	-3.7	36.1
Luxembourg	2.4	0.5	9.5	5.7	-689	1.9	21.2
Malta	2.5	1.6	10.5	3.1	-237	2.1	22.9
Netherlands	2.7	2.0	11.4	17.7	19,689	1.4	14.3
Poland	18.2	2.3	6.0	8.1	202	-1.2	26.5
Portugal	12.8	2.5	11.2	6.7	-2,777	2.3	22.6
Slovakia	6.0	1.2	5.2	3.3	-392	3.3	28.0
Slovenia	8.4	1.6	6.5	3.9	-355	4.4	21.9
Spain	5.6	3.6	8.3	14.6	4,752	4.1	19.0
Sweden	2.5	0.6	7.3	3.0	-2,680	0.7	18.3
UK	1.2	0.7	9.2	5.9	-16,086	1.4	13.3
EU-25	5.2	1.6	6.4	6.5	-2,159	1.7	16.9
EU-15	4.0	1.6	6.2	6.2	-493	2.0	16.4
Bulgaria	11.1	8.7	6.3	10.8	115	-1.0	
Croatia			8.5	10.6	-576		
Romania	37.7	11.2	7.5	3.3	-1,072	14.7	
Turkey	32.7	11.5	6.1	10.3	641		
United States	1.6	2.0	4.2	9.3	5,939	2.3	
Japan	4.0		9.7	0.4	-37,429	-0.3	

Source: *Agriculture in the European Union. Statistical and Economic Information 2004*, European Commission, 2005.

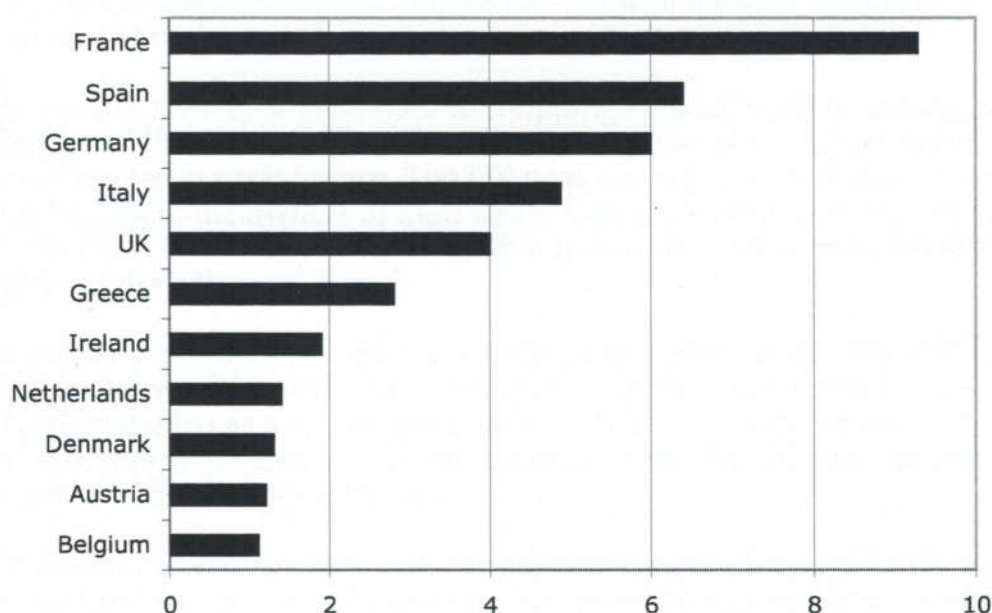
Note: \* = 2003

Unsurprisingly, reform of the CAP is supported by net contributors, such as **Sweden, Finland and Austria**, and resisted by those member states that benefit from this market distortion.<sup>79</sup> **Portugal** and **Slovenia** are also highly critical of the EU's generous support for big farmers. While **the Netherlands** receives over 1bn in CAP support and is the leading food exporter, Dutch taxpayers and consumers have to pay for these gains, and the net benefit for the country is hard to determine.

<sup>79</sup> The Sapir Report, *An Agenda for a Growing Europe*, published by the European Commission in 2003 referred to the CAP as 'an old relic'.



Figure 4: Main CAP recipients, 2004 (€bn)



Source: EU Court of Auditors

Figure 4 lists the top eleven CAP recipients in 2004. France receives almost a quarter of the total CAP budget while Spain, Germany, Italy and Greece also do well out of the scheme. Ireland receives almost 2bn, which represents a significant contribution to its total GDP. But British farmers also draw more than 4bn from the scheme.

**Spain** and **Ireland** have been strong supporters of France when it comes to the future of the CAP. **Poland** has also emerged as a strong backer: it does well out of the CAP and expects to do better.<sup>80</sup> The French trade minister, Christine Lagarde, claims that France is supported by 13 other member states in resisting any further reform of the CAP.<sup>81</sup>

While there may be little chance of reforming the CAP before 2013, the EU — for its own sake — needs to be more imaginative, both in awakening consumers to the unnecessary costs they are incurring, and in finding a new solution to the objectives of maintaining strategic self-sufficiency, preserving the countryside, and ensuring that small farmers and other rural workers receive fair rewards. Unfortunately, it is currently doing the opposite — trying to 'sell' the benefits of the CAP because it realises that the policy is potentially unpopular with consumers.

Perhaps electors can be shamed into demanding reform. Consumers are already becoming more embarrassed by the manifest obscenities of the CAP in terms of closing EU markets to low-cost developing nations, thereby spreading hunger and malnutrition in the developing world.

<sup>80</sup> 'Friction with UK causes Warsaw to seek allies elsewhere', *Financial Times*, 13 December 2005.

<sup>81</sup> Interview with *La Tribune*, 7 December 2005. Madame Lagarde explained that 13 other member states had signed a letter sent by France to the European Commission warning officials not to exceed the CAP reforms introduced in 2003.



But modest progress towards reform has already been made with 'set-aside' and other incentives aimed to protect the environment rather than maximise food production, while the Doha round may reduce some of the CAP's most negative effects on the rest of the world.

In France, people are well accustomed to shopping at local markets. Indeed, this is one of the joys of life for many French citizens, not to mention visiting Britons, some with second homes in rural France. The UK does not object to the French funnelling massive subsidies to the owners of their larger farms; we need to make clear that our quarrel with them is only the expectation that taxpayers in other member states should pick up the bill.

It is clear from Appendix 1 that the UK's most important potential ally in CAP reform is **Germany**, which is the second highest importer. Agriculture represents 1.6% of GDP in the EU as a whole, but only 0.7% in the UK and Germany (the lowest in the EU apart from Sweden and Luxembourg, whose GDP calculations are complicated by cross-border activities).

The ideal budgetary arrangements described above require the CAP to be replaced by countries funding their own farmers (if they so wish) within a framework established by the EU, as part of economic union, to prevent uncompetitive practices. As part of development aid, poorer EU countries may be assisted by block grants for this purpose: block grants to countries are auditable; penny packets to farmers are not.

This scheme is consistent with the **Italian** government proposal that a substantial slice of CAP expenditure should be switched from Brussels to national governments. This appears to have won favour with many other member states. They clearly recognise that it makes far more sense for national governments to provide assistance, where justified, to their own farmers than to send money through the convoluted EU route.

One opportunity is the promised 2008/9 review of the EU budget and the CAP, as outlined in the Sapir report.<sup>82</sup> The UK may find more common interest in replacing the CAP than the newspapers would have us believe. On the above analysis, **Germany, Sweden and Italy** might well be prepared to work with the UK in finding a solution.

### 3. The Single Market (internal EU trade in goods and services)

Chapter 2 showed the erratic progress so far towards achieving the single market goal, despite it being one of the two main reasons (**along with security**) for creating what was originally called the 'Common Market'. While some positive advances have been in a number of sectors (notably scheduled airline services, utilities, and telecoms) much remains to be done in other sectors (such as financial services).

<sup>82</sup> The Sapir report, *An Agenda for a Growing Europe*, was compiled by a group of leading European economists, was initiated by the European Commission in 2003.



A single market requires a single set of regulations to govern it: not 25 as we have currently. To this end, we have already proposed four key reforms:

- an end to Directives;
- the consolidation of existing EU regulation;
- no new regulations **in single-market sectors** by member states; and
- the introduction of sunset clauses for existing business regulation passed by member states.

Such a series of major reforms is unlikely to be accomplished soon, but there are some promising signs. Notable among these is the Six Presidency Initiative,<sup>83</sup> aimed at tackling the EU's regulatory overload. And there have been encouraging comments from Charlie McCreevy (the Commissioner for the Internal Market) and Gunter Verheugen (the Commissioner for Industry & Enterprise).

The 'northern league' of member states, comprising the UK and **Ireland, Sweden, Finland, Denmark and the Netherlands**, share an interest in seeking to complete the single market. Sweden, for example, has liberalised many sectors of its economy including electricity, financial services, telecoms and the media. Johan Norberg points out that 'Sweden is now pushing for commensurate deregulation in other EU member states'.<sup>84</sup>

The accession countries of eastern Europe, many of whom have adopted pro-enterprise fiscal policies, may well be glad to join the drive. **Estonia, Lithuania and Latvia** have proved to be among the most radical promoters of free market capitalism, even adopting flat tax policies.

**Poland** elected a new centre-right government that should hold power until 2009.<sup>85</sup> Poland is proceeding with a wave of privatisations, particularly in the energy utility sector, and its well educated, highly mobile workforce should be keen on removing internal barriers to trade: Polish architects, as well as plumbers, want to be able to offer their services throughout the EU.

**Hungary** is another accession state which is adopting flatter tax regimes<sup>86</sup> and pro-enterprise policies and could prove a useful ally, particularly if Foidesz, the main opposition party committed to free enterprise, does well in the forthcoming general election.

**The Czech Republic** may prove one of the single market's staunchest proponents, but only if ODS, the main-free market opposition party, wins the next general election. Like Civic Platform in Poland, it advocates radical policies, and is extremely sceptical about the regulatory zeal of the European Commission. The Czech President, Vaclav Klaus,<sup>87</sup> formerly served as Prime Minister of an ODS government, remains one of the most effective critics of EU institutions.

<sup>83</sup> The Six Presidency initiative includes Austria, Finland, The Netherlands, Ireland, Britain and Luxembourg. Each of these member states has agreed to participate and promote a deregulatory initiative in their term as president.

<sup>84</sup> See Johan Norberg's contribution to *The State of the Union*, Stockholm Network, 2005.

<sup>85</sup> Civic Platform's policy proposals include a 15% flat tax, more privatisation and the shrinking of the state (their leader, Mr Rokita, may have been reading Adam Smith Institute publications), but their coalition partner, Law and Justice, oppose the flat tax proposal and remain sceptical about privatisation. Though the party claims to be in favour of a smaller state, candidates in the election made expensive promises relating to 'social protection'.

<sup>86</sup> For example, the government recently extended the 15% flat tax scheme for smaller and medium sized enterprises.

<sup>87</sup> See his Lecture to the IEA at the Cass Business School, London, 23 November 2005.



Two other accession states — **Slovakia** and **Slovenia** — have already shown commitment to EU reform. Slovakia is pursuing a radical domestic reform agenda, with a flat-rate of 19% on income tax, corporate tax and VAT, while Slovenia is adopting pro-business, free-market reforms.

Some Mediterranean countries may also support reform. **Italy** is the most important of these, but backing is likely to last only so long as Sr Berlusconi is in power: Sr Prodi, the former President of the Commission, may adopt a wholly different stance. Two other potential supporters are **Malta**, which is trying to develop as a financial centre, and Cyprus which is seeking to do likewise, even though its current government includes (nominal) Communists.

The main obstacles in the path of single market reform are **France**, **Spain**, **Portugal** and **Greece**. France remains committed to heavy intervention; that may ameliorate once Jacques Chirac has departed, but probably not much. In **Germany**, it remains unclear how Angela Merkel will be able to push through the deregulation agenda that she would favour, but Germany's earlier siding with France to block single market reforms makes it a doubtful ally on this subject.

EU Membership obliged **Spain** to lift restrictions and liberalise many parts of its economy, but this welcome trend appears to be going into reverse. The new government, a loose coalition of the left and regional parties, favours greater regulatory intervention (on retail shopping hours, for example).

In **Greece**, Sotirios Papasotiriou of EKOME, a Greek free-market think-tank, says that most of his fellow citizens regard themselves as exceptional within the EU, being on the edge of Europe both geographically and culturally, so that 'they feel entitled to seek special conditions and exemptions for joining the single market, such as prolonged adjustment periods and a more tolerant attitude to compliance failures'.<sup>88</sup> As a result, market liberalisation has been slow and unenthusiastic.

#### 4. Levels of law and decision-making and constitutional issues

Institutional reform was the subject of the draft constitution rejected last year by both the French and Dutch electorates. With 25 countries currently members of the EU and the number likely to rise,<sup>89</sup> some streamlining of the Commission and other institutions of the EU is inevitable.

However, focusing on single market matters and leaving everything else to national legislatures may well generate real benefits and fulfil the original hopes for the EU as a galvanizing vehicle for freer trade. This is the most delicate of the five dimensions, since it is really about political union. The UK wanted only economic union from its membership, but to post-war France and Germany, political union was at least as important; and some doubt whether one is possible without the other.

In the absence of a new constitution, we can expect the EU institutions such as the Commission, Parliament, and Court of Justice to proceed with their own agenda for closer integration and progressive involvement in all national matters. That will be no more welcome to the citizens of France or the Netherlands than the constitution they rejected on those very grounds.

<sup>88</sup> *The State of the Union: Market Orientated Reform in the EU*, Stockholm Network, 2005, page 24.

<sup>89</sup> For instance, Macedonia was given the go-ahead to apply for full membership at the Brussels summit held in December 2005.



The draft constitution had many flaws. Crafted by diplomats, it became too large and complex to be understood by the people. A number of member states may well now conclude that they need to progress with a new formal constitution, if only to prevent the emergence of a less attractive informal one.

But recent opinion polls, and the constitution referenda in France and the Netherlands, indicate that while EU electorates welcome economic integration, they are less supportive of political integration than many of their leaders. The UK should exploit these popular sympathies for a single market without a centralized government (the Mercosur model).<sup>90</sup>

The rejected constitution moved beyond the consolidation of existing treaties to become a grandiose road map for future development. A successful constitution would be much shorter (perhaps a tenth of the length), businesslike, and comprehensible. It should focus on bringing the confused, overlapping (and perhaps expanding) powers of different EU institutions into coherence and under democratic restraint.

EU citizens are not well served by the EU and member states competing to legislate in the same areas. All sides pronounce against gold plating, for example. But then member states reject EU-wide Regulations in favour of Directives that they can implement in their own particular ways — making gold plating inevitable. We need a constitution that allocates legislating powers to one level or the other, sector by sector.

EU political leaders know that the mood has changed. The UK should therefore take an active and positive role in the lead group of those taking a fresh approach to the constitution issue. The potential partners in a working party for a new constitution would be much the same as those pressing for a single market in services.

## 5. Budget and finance

On the face of it, the EU budget seems to have been set in stone for the next eight years. The summit held in December 2005 hammered out a compromise deal that set the budget at 862bn over the seven-year budgetary period 2007–2013, equivalent to an annual spend of just over 123bn. Setting budget ceilings well ahead of time like this may make sense, but of course these ceilings are relative: they are not cash amounts but are based on a percentage of GDP. Since future GDP and inflation not entirely predictable, the final amounts may be different.

In practice, the budget is set by the EU Parliament. In fulfilling this role, MEPs are meant to pay attention to the framework principles set out in the 2007–13 agreement. But the Commission actually fails to spend the amount it is given;<sup>91</sup> consequently, the remaining assigned budget is returned to national governments (assuming they in fact remitted the funds in the first place. While it may be sensible to hold strategic budget discussions in good time, the present process is a series of indecisions. A simpler and more robust process would be better for all.

<sup>90</sup> Mercosur is a common market between South American countries.

<sup>91</sup> It was left with a surplus of €15bn in 2001, €7.4bn in 2002, €5.5bn in 2003, and €2.7bn in 2004.



However, there is hope even here. In the negotiations over the EU budget for the 2007–2013 period that so disrupted the UK Presidency, it was evident that several member states — **Denmark** and **Sweden** prominent among them — wanted to see radical change.

Clearly, major budgetary reform is a long game, since it could only come from a root and branch review of what the EU is for. Budgetary issues (such as the absurdity of money going to Brussels, only to be given back to member states) should illuminate the constitutional debate, but can only be settled once the matters of principle and strategy are decided. It would be a mistake for the UK to make any further budgetary concessions until those matters are decided.

But the need to settle on a new constitution before budgetary reform gives the reformers little time to mobilise. The main potential partner on budgetary reform is the largest contributor, **Germany**. In addition, **the Netherlands** makes a high per-capita contribution, and its citizens have already shown the taste for reform by rejecting the constitution. Other supporters would include **Sweden** and **Finland**. The accession countries would not be disadvantaged by budget reform, because the social cohesion and regional development programmes would continue for the poorer member states; and by the time budget reform becomes effective, they would no longer be accession countries anyway.

A practical proposal that would help build up such a coalition for budgetary and constitutional reform, and one which would serve as a litmus test of the alliance, might to call a halt to the absurd and costly situation whereby the European Parliament operates from two different sites.

Similarly, the UK may find like-minded member states prepared to challenge the budget cycle. The practice of agreeing detailed EU budget up to eight years in advance of the actual spending seems self-serving at best. No member state — as far as we are aware — commits itself to public expenditure so far in advance. It may insulate the EU budget from the vagaries of the endless round of national elections, but it is profoundly undemocratic.



## Chapter 4: Getting to EUtopia

---

This final chapter lays out what the UK needs to do to move the EU toward what its members should want it to be. Other countries have their own plans for the Union. Austria, as new president, and The Netherlands, for example, are expected to table plans for amending the draft constitution later this year. The UK needs a clear vision and a thought-out strategy. The key elements need debate, but in brief, we see them as the following.

**Priorities.** First, we need to confirm the five dimensions in this analysis as the critical ones and prioritise them in sequence for attention: the budgetary, trade and single market questions cannot be resolved until the 25 member states agree, however approximately, what kind of EU they want, i.e. the constitution.

- **Action:** Prioritise the key dimensions of external trade, the single market, the CAP, law and decision-making, and budget and finance.

**Governance.** The unavoidable sequence of priorities means, for example, that Austria is right to put the constitution at the top of the agenda — and the UK should immediately cooperate with them. In addition, we are both likely to agree that the single market must be made a reality, which has implications (explained earlier) about the future of Directives.

Being in the lead group pressing for the ideal constitution should help the UK to achieve that very outcome. Such a constitution would be a short and comprehensible statement of principles and governance institutions — not the door-stop that emerged from the previous round. The UK Foreign Secretary, Jack Straw, extolled the virtue of such a coherent, 'pocket-sized document'.<sup>92</sup> The goal should be a constitution of perhaps 25 pages or less, setting out what the EU is and how it works, distilling the key elements of governance and the process to agree a budget that the Union can actually manage. We certainly need to avoid the accretion of complexity that emerged from the Convention on the Future of Europe, which produced a document of 325 pages: no wonder it was largely unread.<sup>93</sup>

- **Action:** Draft the simplest possible (principled) constitution to serve as a framework for the recommendations in this report — realising the single market in particular and therefore dropping directives/framework laws. Set up joint working parties with Austria (as EU President) and Finland (the next EU President) to advance this objective.

Political union is more contentious; but governments seem keener on it than their electorates, the accession countries are less keen on it still, and other world groupings like Mercosur suggest that economic union does not actually require political union. Such a tide of opinion might prompt the UK to suggest that member states should choose for themselves which goals they should pursue in common and which should remain national, on the precedent of the Schengen agreement on passport controls.

---

<sup>92</sup> 'By invitation', *The Economist*, 10<sup>th</sup> July 2004.

<sup>93</sup> The UK Foreign Secretary, Jack Straw, has conceded that one would need a 'poacher's pocket' to carry this document around — a far cry from his original goal. Source: Ibid.



(National action could not, however, be allowed to undermine the working of the single market.)

- **Action:** The new constitution should start from economic union and make exceptions only where necessary. It should endorse political union only where strictly necessary.

**The single market:** Forming a common marketplace was founding purpose of what became the European Union. Some countries may wish to go further in terms of political union, but this is not necessary to the formation of a single market and should not delay it any further. There is a particular need to make progress in financial services. Regulation of single-market sectors should be agreed at EU level, rather than through Directives which create different regulatory regimes in different member states.

- **Action:** The UK should press for the EU to re-assert its commitment to becoming a single market and commission an analysis of the steps necessary and timetable, sector by sector, to complete that mission.

**Agriculture and fisheries.** The strategy of self-sufficiency in food production may still make sense today; but it is clear that the CAP is a thoroughly wasteful way to achieve that goal. In a remarkably candid e-mail that was leaked to the media, Britain's Ambassador to Poland, Charles Crawford CMG, described the CAP as, "The most stupid, immoral state-subsidised policy in human history, give or take Communism."<sup>94</sup>

In terms of reforming it, there are strong national interests to overcome, and France is rightly portrayed as the main obstacle. But while most French politicians continue staunchly to defend this discredited policy, the political arithmetic is changing. There are now far fewer farmers in France than there were when the CAP was conceived,<sup>95</sup> and even they know that their industry cannot remain protected from global competition indefinitely. Furthermore, most of the money goes to a few large-scale farms and corporations, not the millions of small-scale farmers of myth.<sup>96</sup> Subsidies also vary widely between products, meaning that fruit and horticultural growers are already largely self-sufficient, wine producers even more so. And French consumers have begun to see that they pay for the CAP twice over: once through taxation, and again through higher retail prices for food.

- **Action:** Create a solution for the CAP impasse from within France. The CAP benefits French agricultural corporations and rich landowners at the expense of French consumers and peasant farmers.

More widely, there is increasing concern in Europe about Third World poverty, and a growing number of consumers and electors are embarrassed that the CAP, by keeping out the exports of low-cost developing countries, thereby spreading hunger

<sup>94</sup> Reuters report, 12<sup>th</sup> December 2006. The original e-mail was sent by Charles Crawford, the UK's Ambassador in Poland, to Kim Darroch CMG, the Prime Minister's EU Adviser and Nicola Brewer, the Director General of the Foreign Office's Europe policy directorate.

<sup>95</sup> It is estimated that in 1950 there were well over two million people employed in the French agricultural sector. Today the number is roughly 550,000.

<sup>96</sup> Over a quarter of all CAP payments go to 5% of French farmers, including Prince Albert of Monaco, who hardly qualifies as a pauper. Source: *The Economist*, Special Report: The EU's agricultural policy, 10 December 2005



and malnutrition among some of the world's poorest nations. This again is a change of thinking that the reforming EU nations can use in pressing their case.

- **Action:** Within the CAP strategy, harness the increasing concern in Europe about Third World poverty caused by EU tariff barriers.

Before getting caught up in what are bound to be lengthy and difficult CAP discussions, the UK should press for the revision of the fisheries policy. Whatever the intentions, it is clear that this policy has not prevented over-fishing, and it encourages perverse behaviour (such as throwing back, dead or dying) fish or species that are outside the vessel's quota. The only solution is to return fishing grounds to member states, so that it becomes in the long-term interest of national fleets to conserve fish stocks; and Iceland provides a good model for how to manage fishing rights within such a system. Throughout his debate, agreeing the principle is more important than agreeing the precise boundaries; but the pre-EU boundaries might be a good place to start.

- **Action:** Separately agree with traditional North Sea countries that Iceland provides a better model for how to manage fishing rights and that fishing grounds should be returned to national sovereignties (starting the discussion from the pre-EU boundaries), with the EU simply monitoring and reporting conservation.

**Budget and finance.** It is clear that budgetary reform is essential, although it may be a long game. A great deal of waste and fraud could be saved if funds were not being sent to Brussels and back again. This is little more than bribing citizens with their own money — the worst form of pork-barrel politics. Member states should apply their own funds to agreed EU programmes, with only surpluses or shortfalls moving into and out of Brussels. Richer countries should look after their own poorer regions as proposed by Sweden. The EU should continue to support economic development of poorer countries such as the accession countries.

- **Action:** Press for the simplification and reform of financial and budgetary arrangements. The EU should deal with countries not regions, richer countries should not receive their own money back, and the EU should be properly accountable for its budget.

The budget process is also excessively lengthy and complex. With the reforms described immediately above, the EU would be actively and directly managing a smaller budget, which should not only make the budget process shorter and simpler, but should help to reduce fraud and waste.

- **Action:** Press to simplify and abbreviate the excessively long and complex budgetary process as part of the budget reform exercise.

**External trade.** Having prioritised governance, the budget, the single market and the CAP, external trade has to take last place on the agenda. The ideal objective here would be to see the EU lift tariff barriers on a reciprocal basis. As Chapter 2 explains; the potential benefits are immense. Such an outcome may not come soon; but then a new generation of political leaders is already assuming office across Europe. And most of them are more inclined to favour rational economic arguments in favour of removing trade barriers than were their predecessors.

- **Action:** Press for the EU to lift tariff barriers on a reciprocal basis.



