

# CER Bulletin

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# Five ways to win a referendum, and five potential pitfalls

by Charles Grant

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David Cameron's new Conservative government is committed to a referendum on EU membership in 2016 or 2017. Many commentators assume that he will negotiate a package of EU reforms, cajole much of his party to back the result, and then cruise to victory in the referendum. And so he might. But there's many a slip twixt cup and lip. How can Cameron maximise his chances of winning? And what are the chief obstacles that lie in his path?

Here are five pieces of advice for Cameron. First, he should not over-bid. Many Conservatives will urge him to ask for the moon. But if he tries to make fundamental changes to the EU, he will fail. Britain's partners have no appetite for a new treaty, which would need ratification in 28 member-states, in some of them by referendum. Most capitals, including Berlin, fear that the lengthy process of changing the treaties would be like opening Pandora's box. There is no chance of a new treaty being ratified before the end of 2017. The best that Cameron can hope for is an agreement on minor treaty changes, to be ratified at some point in the future.

Second, Cameron must start making the case for EU membership. He did so with his Bloomberg speech of January 2013 – but never followed up, for fear of annoying Conservative eurosceptics and potential UKIP voters. Britain's partners will not take Cameron seriously until he is willing to explain to the British the benefits

of EU membership – and thus to make enemies in his own party. Cameron must grasp the nettle that at some point in the campaign his party will split into two hostile camps, perhaps undermining its long-term cohesion.

Third, Cameron should take initiatives in the EU and seek to lead in areas where Britain has expertise. One reason why Britain's influence has waned in recent years is that it has often sat on the sidelines and appeared happy for others to lead. Britain's EU partners would listen to it with more respect if it made concrete proposals in areas such as foreign and defence policy, climate and energy, trade and the single market or co-operation on policing and counter-terrorism. They would welcome a more pro-active Britain.

Fourth, he must work hard at building alliances in the EU, where he has few good friends. When the European Council chose the new Commission president last June, only Hungary's

Viktor Orban joined Cameron in voting against Jean-Claude Juncker. Angela Merkel is a friend on a good day, but she and Cameron are prone to misunderstand each other (as they did over Juncker's appointment). Other leaders sometimes complain that Cameron is a very transactional politician who does not invest sufficient time in building relationships. Britain's ties to the Central Europeans have frayed in recent years, partly because of the Conservatives' anti-immigration rhetoric. But the problem is not just the Conservatives. Under the last Labour government, too, many of the EU's smaller members complained that British ministers and officials seldom took them seriously, for example by making the effort to visit them to discuss areas where they could work together.

Fifth and finally, clubs have not only rules but also mores. British politicians tend to forget that their rambunctious style of domestic politics – involving confrontation, bluntness and a win-or-lose psychology – goes down badly in Brussels. The EU works through long negotiations and compromises that end in everyone feeling that they have got something. Sometimes Cameron gets this: two years ago he worked patiently with Germany and other partners to forge a deal that shrank the EU budget. Sometimes he does not: during talks over the Commission presidency, Cameron told one leader that Juncker's appointment could prompt him to campaign to take Britain out of the EU. Such threats alienate potential allies.

Cameron is an intelligent, successful and – so far – lucky politician, who will probably get some of these things right. But as the last few decades of European history show, governments often lose control during referendum campaigns on EU issues. Here are five things that could go wrong.

First, Britain's highly-charged debate on Europe may not only spur Conservative eurosceptics to demand reforms that are unattainable, but also damage the already tarnished British brand, and so make it harder for Cameron to clinch a good deal with his partners. In recent years, for example, sometimes hysterical press reports on EU immigrants have led many people on the continent to view Britain as a nasty country. The government's current refusal to take any North African boat people, and the prospect of Britain quitting the European Convention on Human Rights (so that it would join Belarus as the only European non-signatory) do nothing to help. The worse Britain's reputation, the less likely are other governments – who all have their own domestic politics to worry about – to give Cameron what he wants.

The second reason to worry is that other EU leaders may not make significant efforts to help Cameron. True, they hope Britain stays in the EU. But Cameron has nothing to offer them in exchange for their concessions. Several governments have indicated that they will not agree to his probable demands and that if the British choose to leave, that is their problem. Madrid, Paris and Vienna are three capitals where there is not much sign of a willingness to accommodate British desires.

The third worry is that a flaming row over migration during the renegotiation may energise the get-out campaign. For Cameron, and many Britons, the priority will be to restrict EU immigrants' access to in-work and out-of-work benefits. Some of Cameron's demands challenge the fundamental EU principle of non-discrimination and thus require treaty change. But as my colleagues Camino Mortera and John Springford have written, Britain's partners are in no mood to indulge Britain on this. The danger is that Cameron raises the expectations of the British people on what can be achieved and then disappoints them.

A fourth risk is that the euro crisis turns nasty. Despite the eurozone economy's modest improvement this year, Greece's place in the currency union remains precarious. A Grexit could trigger panic in the financial markets and thus the need for emergency summits and improvised institutional repairs. If eurozone leaders – who are the same as EU leaders – are once again seen as economically incompetent, the EU's image in Britain will suffer. A new eurozone crisis would also divert leaders' time and energy from addressing British concerns.

A final concern is whether Britain's pro-Europeans can run an effective keep-Britain-in campaign. As in the EU referendum of 1975, much of the establishment is likely to support staying in. But the country has become less deferential since then. In Britain, as in much of Europe, the EU is disliked because it is seen as a project of the rich, successful, cosmopolitan and well-travelled elite. Pro-EU forces must marshal arguments that appeal to people who never went to university. A top-down, 'we know what is good for you' campaign could easily fail. But if Cameron keeps his demands modest, works on his relationships with other leaders and uses his fine skills as a salesman to make the case for the EU, the referendum is winnable.

Charles Grant

Director, CER



# Don't mention Beijing: The EU and Asia's maritime security

by Rem Korteweg

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The security challenges facing EU member-states and south-east Asian countries are strikingly similar. Both regions have difficulties with their neighbours: assertive Chinese claims in the South China Sea are a less dramatic version of Russia's annexation of Crimea; refugees in boats and illegal migration are creating humanitarian and security challenges, and piracy threatens sea-borne commerce. More co-operation between the EU and ASEAN (the Association of South East Asian Nations) on maritime security could help both of them, but it could especially contribute to south-east Asian security.

Mention maritime security at an ASEAN meeting and the conversation quickly turns to China and the South China Sea. Five of its six littoral states are members of ASEAN. But China claims 80 per cent of the South China Sea, including its islands, rocks and reefs and the natural resources it contains. That does not go down well in the region. The most recent spat arose when satellite photos showed China reclaiming land, erecting infrastructure and even building a runway on Mischief Reef and Fiery Cross Reef. These semi-submerged reefs are part of the Spratly island group, some or all of which is claimed by Vietnam, the Philippines, Taiwan, Malaysia, Brunei and China. In this tangled mess of maritime disputes, China's construction work creates new brick-and-mortar facts and further weakens prospects for international dispute settlement. On April 28<sup>th</sup>, increasingly alarmed by Chinese moves, ASEAN's ten member-states

adopted an uncharacteristically unified position, saying that the land reclamations "eroded trust and confidence and may undermine peace, security and stability in the South China Sea." South-east Asian officials next expect China to declare an air-defence zone over a major part of the South China Sea, in a further step to bring the sea under de facto Chinese control. Not surprisingly, all littoral states have been investing in submarines, ships or other capabilities as part of a naval arms race.

For Europe the main concern is that trade disruptions resulting from tensions in the South China Sea affect European companies and consumers. The EU is ASEAN's second largest trading partner; the largest source of foreign direct investment, and main development aid donor. The EU has concluded, or is negotiating, free-trade agreements with nearly all ASEAN

members. Thus, Europe shares south-east Asia's interest in maritime security.

That security is not only jeopardised by Chinese assertiveness; boatloads of migrants from Bangladesh and refugees from Myanmar pose a challenge to the Thai, Malaysian and Indonesian authorities. European states are also grappling with the migration issue. In April, the European Council held an emergency meeting after more than 800 migrants died when their boat capsized in the Mediterranean. The European Commission now wants to disrupt the smuggling networks. Some ASEAN governments, controversially, opt to turn the boats around, leaving the refugees to face uncertainty and peril. The symmetry of the threat posed by illegal migration, and the diversity of their responses, should convince the EU and ASEAN at least to share their experiences of approaches that work.

Piracy is another area where the two regions share interests. Since 2008 European navies have co-ordinated a multinational anti-piracy mission off the Horn of Africa, to which some Asian navies have contributed, including those of Singapore and Malaysia. In the Straits of Malacca, since 2004, four littoral states have organised a patrol with aircraft and naval vessels to increase security in the strategic waterway. Both operations have had success, as piracy rates have dropped, although the threat remains and the two organisations should share lessons learnt.

ASEAN's main geopolitical challenge, however, is the rise of China. The organisation is too divided and weak to balance China's growing influence. Individual states, such as Thailand, the Philippines and increasingly Vietnam, look to Washington for help. Simultaneously, these and other governments express concern at being caught in the middle of a Sino-American 'great power' clash. Stronger relations with the EU could offer a way for south-east Asian states to hedge; to avoid being overly dependent on either Washington or Beijing. In a region of intense geopolitical competition, the EU is welcomed as a non-threatening party that promotes multilateral, not zero-sum, solutions. Meanwhile Europe, reluctant to play the part of America's junior partner but increasingly aware of its economic and security interests in Asia, is slowly finding its voice.

In 2013, the EU and ASEAN set up a high-level dialogue focused on maritime security. This dialogue could eventually contribute to resolving South China Sea disputes by encouraging ASEAN to act coherently on maritime issues, although this is not its official objective. For now, the question

of how to handle China is too controversial for ASEAN. And so, the EU and ASEAN talk about a response to China's actions, without actually mentioning the big neighbour: after all, many of the things ASEAN could do to counter piracy, illegal migration or smuggling would also improve the region's ability to monitor, respond to and possibly discourage Chinese moves in disputed areas of the South China Sea.

The EU should offer its support and expertise on maritime security – drawing on its own experiences. By focusing on issues like people smuggling or piracy, Europe's involvement in south-east Asian security affairs will increase; it will build trust between the two organisations, and, by making maritime security about more than just China, it will invite the involvement of all members of ASEAN, not just those who have problems with Beijing.

As part of its dialogue with ASEAN, the EU should launch practical and political initiatives. On the practical side, resolving technical issues related to data sharing and analysis between coast guards and other regional agencies would improve maritime awareness. The EU could also help ASEAN member-states identify shortfalls in their maritime assets and develop ways to resolve them. On the operational side, the EU and ASEAN should organise joint exercises and training, for instance in the field of search and rescue operations. European navies, coast guards and Frontex – the EU's border agency – should share experiences (whether positive or negative) from Operation Triton, the EU's border security mission in the Mediterranean. The EU could give advice on how to organise civil-military missions with a group of 28 diverse member-states. At the political level, the EU should help ASEAN develop common norms for policing its maritime zone. This could result in a code of conduct that respects international maritime law and the freedom of navigation. This would help countries in the region to defuse tensions and avoid misunderstandings.

These measures will not easily change the security dynamic in the region, but they would better equip south-east Asian nations to respond to maritime challenges. They may be designed to address non-traditional security issues like piracy or illegal migration, but a more coherent and capable ASEAN would also offer the best chance of deterring risky Chinese manoeuvres. Sometimes it is best to pretend that the elephant is not in the room.

Rem Korteweg  
Senior research fellow, CER



# How will the eurozone cope with the next downturn?

by Simon Tilford

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Spring brought a burst of sunshine over the eurozone economy. The French economy expanded rapidly in the first quarter of 2015 and even the Italian one managed respectable growth. Fiscal policy is no longer contractionary across the eurozone as a whole. Cheaper oil is boosting consumption. A weaker euro is boosting exports. And the ECB's quantitative easing appears to be working: money supply growth is picking up, suggesting deflationary pressures are easing.

But it would be risky for eurozone policy-makers to mistake a modest cyclical upturn after years of stagnation for something more than that. First, business cycles are getting shorter and downturns deeper. The reasons for this are complicated but globalisation and increasingly complex financial linkages between countries appear to be playing a part. Nobody knows how long this eurozone cycle will last but it is probably fair to assume that we are already some way into it.

Second, when the next downturn comes, the eurozone is going to be poorly placed to handle it. There is little to suggest that the current upturn will be strong enough to undo the damage caused by the crisis. Eurozone growth is unlikely to exceed 2 per cent even at the peak of the cycle, with growth in the weaker economies much lower. This will not be enough to render debt sustainable (whether public or private). Given the amount of slack in the eurozone economy, unemployment will remain high and

inflation pressures weak. Against this backdrop the ECB is unlikely to raise interest rates, meaning that it will have no room to cut them in an effort to counter the next downturn.

Furthermore, the eurozone has largely failed to address the underlying institutional weaknesses of the currency union. The reforms that have been made basically comprise crisis management tools and rules, whereas the crisis has demonstrated that monetary union without fiscal and financial integration is unstable. Unfortunately, there is little appetite for this integration, especially now that the eurozone is growing. Meanwhile debt burdens continue to grow in the weaker economies and the eurozone governments refuse to acknowledge the need for debt write-downs.

The eurozone needs further fiscal and financial integration to prevent its members from having to pursue precisely the opposite macroeconomic policies to the ones they need. Eurozone countries have given up the safety valve of an

independent currency and monetary policy, hence need an even larger shock absorber in the form of fiscal policy. Not only does the eurozone lack any fiscal transfer mechanism, but the rules of the fiscal compact tightly circumscribe the ability of member-states to impart counter-cyclical fiscal stimulus.

As it stands, the eurozone is a mechanism for divergence among its members, not convergence: real interest rates are highest in the weakest countries, lowest in the strongest. This almost guarantees divergence as capital and the more productive labour become concentrated in the core. This state of affairs persists in currency unions such as the US, the UK or Germany, but the negative effects of it are offset by fiscal transfers between the participating regions or states. The banking union is work in progress: regulation has been federalised but risk not mutualised; banks are still largely back-stopped at national rather than federal level.

What happens regarding Greece will have a bearing on how the eurozone copes with the next downturn. If Greece leaves the eurozone, the ECB might well be able to contain the immediate financial fall-out. But a Greek exit will end the irreversibility of membership. Unless it acts as a catalyst for closer integration, the risk is that the eurozone will come to look like an exchange rate mechanism rather than a currency union. This will increase the likelihood of speculative attacks on the weaker members come the next recession.

The eurozone is all but certain to go into the next downturn with interest rates close to, or at, zero, high levels of public and private sector

indebtedness and unemployment still well above pre-crisis levels. The ECB will be able to employ quantitative easing, but its effects will probably be exhausted by then. Critically, there will be little scope for fiscal policy to counter the weakness of private sector demand, especially in the countries most in need of it. And weak banks in struggling countries will essentially still be back-stopped by fiscally constrained governments.

In short, many eurozone governments could face the prospect of further deep recessions despite having barely recovered pre-crisis levels of activity, amid persistently strong support for populist parties. The politics of this is likely to be combustible. At this point it could be make-or-break regarding the bigger institutional questions hanging over the eurozone. It is possible eurozone governments will bite the bullet and agree a fiscal union including a degree of risk mutualisation and transfers between participating economies. But this could prove politically impossible.

The euro is not out of the woods. Eurozone reforms have not abolished the business cycle and the need for counter-cyclical fiscal policy. There is little to suggest that the current upturn will be strong enough to bring down debt levels or enable the ECB to raise interest rates in any meaningful way. But there is much to suggest that the upturn will be used as a justification for further delaying the adoption of the federal structures needed to make the euro a success.

**Simon Tilford**  
 Deputy director, CER

## CER in the press

### **The New Yorker**

22<sup>nd</sup> May 2015

"Northern member-states want an asylum policy that keeps migrants in the South but treats them humanely," wrote Camino Mortera-Martinez and Rem Korteweg of the CER.

### **The Economist**

16<sup>th</sup> May 2015

The prime minister appears to realise that he needs to work to improve his relationships with other European leaders. In the past he has been seen by

his prospective partners as rather "transactional", says Charles Grant of the CER.

### **Bild**

7<sup>th</sup> May 2015

"The British perception is that the EU is dominated by Germany and France to their advantage, and against British interests," says Charles Grant of the CER.

### **The Wall Street Journal**

7<sup>th</sup> May 2015

"The ultimate goal of achieving debt sustainability was not properly served

by overdoing the fiscal consolidation," says Christian Odendahl of the CER

### **The New York Times**

23<sup>rd</sup> April 2015

"The EU hasn't had a coherent immigration policy since forever, and the situation is getting worse since the Arab Spring," said Camino Mortera-Martinez of the CER."

### **The Independent**

6<sup>th</sup> April 2015

"Regions with manufacturing sectors that

make up a large proportion of their economies look to be most at risk, and since these tend to be poorer, an exit from the EU risks making Britain an even more unequal place," said John Springford of the CER.

### **The Telegraph**

6<sup>th</sup> April 2015

"Flirting with Russia is almost guaranteed to antagonise and make it harder for those who want the Germans to be more conciliatory towards Greece," said Simon Tilford of the CER.

## Recent events



Commissioner Jonathan Hill

### 16<sup>th</sup> April

Annual dinner,  
London  
With keynote speech by  
Commissioner Johnathan Hill



(L to R) Frederick Studemann, Andy Bagnall, Geoffrey Evans, Charles Grant and George Parker

Photo courtesy of Financial Times Live

### 29<sup>th</sup> April

FT/CER/King's College panel  
discussion, 'The future of  
Europe: Will the election  
decide the future of the UK  
in Europe?', London

## Recent and forthcoming publications

A ten-point plan to strengthen  
Wesminster's oversight of EU policy  
*Agata Gostyńska*

How Europe can make the digital  
economy pay  
*John Springford*

The undiplomats:  
Populist radical right parties and their  
influence on European foreign policy  
*Yehuda Ben-Hur Levy*

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