



**Government Response to the House of Commons
Foreign Affairs Committee Report HC 87 of Session
2013-14
The future of the European Union: UK Government policy**

Presented to Parliament
by the Secretary of State for Foreign and Commonwealth Affairs
by Command of Her Majesty

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**GOVERNMENT RESPONSE TO THE HOUSE OF COMMONS FOREIGN AFFAIRS
COMMITTEE REPORT HC 87 OF SESSION 2013–2014, *FUTURE OF THE EUROPEAN
UNION: UK GOVERNMENT POLICY***

The Government welcomes the Foreign Affairs Committee's Inquiry into the Future of the European Union. This Command Paper sets out the Government's response to each of the Committee's conclusions and recommendations. The Committee's text is in bold, and the Government's response is in plain text. Paragraph numbers refer to the Committee's report.

Introduction

1. Our Report examines the key overarching principles of Government policy for the UK's place in the EU, for as long as the UK may remain a Member State. It also starts to explore some of the implications of the Prime Minister's major EU speech of January 2013, in which he outlined policy to be pursued by any Conservative Government elected in the 2015 General Election. Our Report is not an examination of whether the UK should remain in the EU or withdraw. We did not include the 'in/out' question in our terms of reference, which we agreed well before the Prime Minister's speech, and as a Committee we have expressed no view on the 'in/out' question as part of our inquiry. We intend our Report to help inform the public debate on the UK's EU policy in coming years. (Paragraph 13)

The Government welcomes this report and the Committee's focus on the important issue of the future of the European Union. As the Prime Minister has said, the first purpose of the EU - to secure peace - has been achieved. And while that success should never be taken for granted, another rationale needs to guide the EU's current and future development: to secure prosperity. Renewed prosperity after the global economic crisis of recent years, as well as addressing the disconnect between individuals and the EU, is of importance to governments across Europe and the EU collectively. That is why the Government places a high priority on reform of the EU and is determined to work closely with our European partners to build a more competitive, flexible and democratic EU for the benefit of the UK and the EU as a whole.

This Government is clear that membership of the European Union is in the national interest, but that the EU must reform. The Government notes the Committee's intention for its report to help inform the public debate on the UK's EU policy in coming years. In his evidence to the Committee, the Foreign Secretary said the Government was "launching the debate in Europe." It is important that this debate is

well-informed and guided by high-quality analysis. We welcome this report as a valuable contribution to that analysis.

2. Before the first reports arising from the Balance of Competences Review are published in summer 2013, it is too soon to assess the usefulness of the exercise. However, as long as the Review is conducted transparently, impartially and on a wide evidence base, we feel that it has the potential to help improve understanding in the UK of the nature of the country's EU membership and possible future EU policy choices. (Paragraph 19)

The first six reports in the Balance of Competences Review were published on 22 July. The Review aims to broaden and deepen public understanding of the impact of our EU membership and the Government welcomes the Committee's recognition of its potential to achieve this. The Government agrees with the Committee on the importance of ensuring that the Review is transparent and impartial, and that it draws on a wide evidence base. Calls for evidence are being published online and Departments are engaging extensively with a wide range of interested parties including think-tanks, academia, businesses, Parliament, civil society and EU institutions to help ensure the reports present a comprehensive examination of the issues. The analysis in the first set of reports was clearly rooted in the evidence provided, which was itself published alongside the reports to ensure maximum transparency.

The Review aims to provide an informed and objective analysis of what EU membership means for our national interest. Reports do not make specific policy recommendations, although where appropriate they do set out policy choices and options that future decision-makers may face. This allows people to draw their own conclusions on what works well and where there is room for improvement and will be vital for the debate that we are having on the EU.

UK influence in the EU and the December 2011 European Council

3. Differing assessments of the extent of the UK's influence in the EU are likely to feature heavily in the arguments both for and against the UK's continued EU membership in coming years. There is no readily available objective measure of a Member State's overall influence in the Union. However, the point of a Member State having influence in the EU is to achieve EU policy outcomes that realise its interests and objectives. Policy outcomes are thus a useful indicator in the debate. We therefore recommend that, in the reports which the Government will publish arising from the Balance of Competences Review, it should indicate, in each policy area, the extent to which UK policy preferences

**have or have not been fulfilled. This could help to inform public debate.
(Paragraph 32)**

The Committee is of course right that it is important to achieve outcomes in the EU which protect and promote the UK's national interest. As the Committee outlined in its report, the UK continues to work successfully with allies to make progress on reform.

As noted above, the Balance of Competences reports do not make policy recommendations. Where appropriate, however, they do highlight any divergence between the development and application of competence and agreed UK policy preferences. They also provide examples of how the UK has shaped EU policy to the benefit of the UK and the EU as a whole.

The Government will ensure that the Committee's recommendation remains in focus in future reports to be published between now and the end of 2014.

4. At the December 2011 European Council, concerns in principle about the possible implications for the UK of closer Eurozone integration led the Government to request safeguards in return for agreeing to EU Treaty change. We regard the Government's concerns as legitimate. Furthermore, the haste with which Member State governments—including that of the UK—were obliged to react to proposals for EU Treaty change in December 2011 posed significant diplomatic challenges. However, some of the specific requests which the Government put forward at the December 2011 European Council appear to have been misjudged for the circumstances. In some respects, the UK Government 'got ahead' of its EU partners and was seeking to mitigate risks for the UK which had not yet arisen, at a time when other Member States were more immediately focused on shoring up the Eurozone. The Government's diplomatic preparation for the December 2011 European Council, in terms of finding allies, appears to have fallen short. (Paragraph 42)

The Government agrees with the Committee's assessment that the events around the 8-9 December 2011 European Council were extremely fast moving. As the Foreign Secretary's letter of 12 February 2012 to the Chair of the Foreign Affairs Committee set out, it was only the day before this European Council that Angela Merkel and Nicolas Sarkozy made clear that they sought change to the EU Treaties.

The Government does not agree, however, that its diplomatic preparation for the Council fell short. As set out in the Foreign Secretary's 12 February letter, in addition to extensive contact at official level, the Prime Minister, Deputy Prime Minister, Chancellor and the Minister for Europe undertook a number of preparatory calls and visits. Our partners were well aware that the UK would require safeguards, even if

the detail of what the UK might seek could not be finalised until we had seen the Franco-German proposal. This issued on 7 December 2011, the day before the European Council.

The Chancellor's letter of 21 February 2012 to the Chairman of the Treasury Committee set out the substance of what the Government proposed at the December European Council. The Government did not seek UK opt-outs, exemptions or any other kind of special treatment for the UK. We proposed safeguards for the whole EU that would have supported open competition for financial services companies across the Single Market and upheld the existing commitment to ensure the ability of all Member States to supervise their domestic financial sectors. Given the importance of these issues, the Government does not agree with the Committee's view that we misjudged the importance of these safeguards. Indeed, the progress towards a banking union, including a single supervisor for banks in the Eurozone and other participating Member States, and the safeguards that we secured in that negotiation, show that our requests were prescient.

5. We conclude that the longer-term significance of the December 2011 European Council was twofold:

- **First, other Member States are willing politically to move to further integration without the UK when they are legally able to do so; and avenues may be available for them to do so under certain circumstances. In December 2011, for Eurozone states, meeting the perceived needs of the Eurozone took priority over negotiating EU Treaty change among all 27 Member States. For its part, the UK Government was prepared to see EU Treaty change fail at the negotiating stage—for the first time since the UK joined the then-European Economic Community in 1973—and other Member States move to a negotiation without the UK.**
- **Second, given the prospect of closer integration within the Eurozone, the UK Government now considers that protecting the UK's interests in the Single Market may no longer be possible under qualified majority voting, and that tougher decision-making thresholds may be required. This represents a significant shift in the position which the UK has held on the Single Market since the Single European Act of 1986. (Paragraph 47)**

The Government takes note of the Committee's assessment. The decision to conclude a Treaty outside the EU framework was, and remains, unusual. EU Member States' strong impetus to work within the framework of the EU is unchanged – indeed, the Treaty on Stability, Coordination and Governance includes a provision

under which its signatories will seek to incorporate its substance into the EU's Treaties.

The Government was clear in the months leading up to the December 2011 European Council that we supported the Eurozone in addressing its problems, which was also in Britain's national interest. This position remains unchanged. However, and as the Prime Minister told Parliament in December 2011, "the choice was a treaty without proper safeguards or no treaty – and the right answer was no treaty."

A key principle of the Government's reform agenda is to enhance the EU's competitiveness, including through a serious effort to deepen the Single Market. Provision for Qualified Majority Voting (QMV) in Single Market decision-making is long established and has proved important to its development. As the Eurozone integrates, the Government will continue to ensure that those of us outside the Eurozone have necessary safeguards to ensure, for example, that access to the Single Market is not compromised. In the case of the Single Supervisory Mechanism, the Government concluded that a tougher decision-making threshold was required, and successfully negotiated a new "double-majority" voting system.

6. We have not found that, by itself, the Prime Minister's veto of EU Treaty change at the December 2011 European Council has so far had a decisive overall effect, either way, on the UK's ability to exercise influence in day-to-day policy-making in the EU. Although broader factors also carry weight, it is necessary—and may be sufficient—for a Member State to construct such influence on a case-by-case basis, by developing well-prepared positions and alliances. (Paragraph 52)

The Government agrees with the Committee's assessment of the importance of influence and alliance building. We continue to construct powerful alliances to protect and promote UK interests in the EU, from the first ever cut to the EU's multiannual budget to the landmark agreement to decentralise fisheries policy.

The Eurozone and the EU

7. Against the background of a history in which the UK has often appeared to underestimate the political determination of continental European states to move ahead with integration, we judge the Government's expectation of further integration in the Eurozone to be a correct assessment of the longer-term direction of travel. We commend the Government for its realism in this respect. (Paragraph 57)

We welcome the Committee's commendation of the Government's realism and assessment of long-term trends in the Eurozone. As the Government has repeatedly made clear, it is in Britain's national interest that the Eurozone should have the right governance and structures to secure a successful currency for the long term. At the same time, we will continue to ensure that the prerogatives of those outside the Eurozone are protected, as well as the integrity of the Single Market.

8. The issues facing the Eurozone states as they contemplate closer integration are technically and politically very difficult. As yet, the Eurozone has no 'grand plan' towards a desired or necessary end point. Rather, there are serious differences of approach among its members, and serious strains arising between and within them as a result of the steps being taken to tackle the crisis. We expect further Eurozone integration to take place incrementally to a great extent, and over a considerable number of years. The Government must reckon with the fact that reforming the Eurozone in coming years will take up much of the time and political resources of its EU partners. (Paragraph 61)

The Government agrees with the Committee's conclusion that Eurozone members face a number of significant challenges in ensuring the long term sustainability of the single currency. Some steps forward have been made: we welcome the commitment of the European Central Bank (ECB) to do what they can to ensure the proper functioning of Economic and Monetary Union (EMU), as well as the work taken forward by the President of the European Council to strengthen the single currency for the long-term. This work will no doubt continue to be a significant endeavour for our EU partners.

9. Assuming that it remains in the EU, the UK is likely to be part of a sizeable group of Member States outside the Eurozone for at least another decade. However, most other non-Eurozone states are under a Treaty obligation to adopt the Euro at some point, and appear to wish and expect to do so. The assumption that they will one day be in the Eurozone does not at all rule such states out as allies for the UK in particular EU policy areas. However, it is likely to push their longer-term orientation in the EU away from the UK and towards the Eurozone 'core'. (Paragraph 66)

10. In the face of more far-reaching Eurozone integration, it could be difficult for the UK and other non-Eurozone Member States to preserve their capacity to shape decisions affecting the Single Market. The Government is correct to have identified this risk for the UK and to have adopted a strategy of seeking to mitigate it by protecting the rights of non-Eurozone states. However, tighter integration in the Eurozone is far from rendering the UK's position in the EU

impossible or worthless. The Eurozone is not a homogenous bloc, and Member State alliances around the EU continue to vary from issue to issue and to straddle the boundary between the Eurozone and the rest. (Paragraph 78)

The Government agrees with the Committee's assessment that the Eurozone is not a homogenous bloc, and that alliances will continue to be built primarily on an issue by issue basis. The UK can both remain outside the Euro and be influential within the EU, as we are now. We work closely with a wide range of Member States on the key issues of the day – improving Europe's competitiveness, the Single Market, trade, and taking action on key foreign policy challenges like preventing a nuclear armed Iran. Eurozone members are often our closest allies, and we see no evidence to suggest that this will change as the number of Member States in the single currency changes. It is in the interests of all EU Member States, as well as the institutions, that the integrity of the Single Market be protected, and the Government will continue to work to ensure that this is the case.

11. The Government's stance towards greater Eurozone integration requires it to tread a very delicate line—both encouraging further Eurozone integration but also preventing the process from damaging UK interests; and distancing the UK from the Eurozone while maintaining that the country has an interest in developments in the single currency area. The Government can minimise the risk of causing aggravation and maximise the prospect of exercising influence by adopting a constructive and cooperative tone and approach. (Paragraph 81)

The Government agrees with the Committee's assessment and will continue to work closely and constructively with all EU partners as the Eurozone integrates to ensure both that it addresses its challenges and that UK interests are protected.

12. The agreement on the Single Supervisory Mechanism (SSM) which was struck among EU Finance Ministers in December 2012 was significant on several grounds. It shows what the UK can achieve, in terms of protecting its position in the Single Market, through close and constructive engagement and innovative policy solutions. We note that the deal went some way towards entrenching the kind of safeguard against discrimination in the Single Market that the Government failed to secure in the December 2011 negotiations on the 'fiscal compact'. We also note that the arrangements that were agreed to protect non-Eurozone states—on this occasion, for 'double majority' voting in the European Banking Authority—responded directly to a concrete proposal (in this case, one which gave rise directly to a risk of caucusing). Finally, we note that the SSM agreement protected the interests of non-Eurozone states

by moving away from qualified majority voting: the deal established a decision-making rule that operates on the basis of the different statuses of two different groups of Member States, those participating in the SSM and those not. (Paragraph 87)

The Government agrees with the Committee's assessment of the introduction of a "double majority" voting system in the European Banking Authority. As the Foreign Secretary made clear in his oral evidence to the Committee in February 2013, the Government's approach is not to block changes that Eurozone members seek, but to ensure at the same time that our own interests are safeguarded. In the case of the Single Supervisory Mechanism agreement, this was achieved in a new way through the double majority voting system, as well as explicit recognition of the importance of non-discrimination and the integrity of the Single Market.

13. We recommend that, when the issue comes onto the agenda, the UK Government should support the incorporation of the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) (the 'fiscal compact' treaty) into the EU legal framework, including through EU Treaty change if necessary, assuming that this could be achieved as part of an overall Treaty amendment package that includes appropriate safeguards for the UK. With appropriate safeguards, the incorporation of the TSCG into the EU Treaties would, at the least, not be more damaging to UK interests than the existence of the TSCG outside the EU Treaties; and it would also open the way to an EU Treaty renegotiation process. (Paragraph 92)

Article 16 of the TSCG states that, within five years of that Treaty's entry into force (1 January 2013), *"the necessary steps shall be taken ... with the aim of incorporating the substance of this Treaty into the legal framework of the European Union."* A revision to the EU's Treaties would be necessary to fulfil this aim fully, and this would require the consent of all Member States. The Government takes note of the Committee's recommendation, and will factor this into its consideration.

The Prime Minister's agenda: reform, renegotiation, referendum: EU reform

14. We commend the Prime Minister for launching an ambitious agenda for EU reform in his January 2013 speech, and especially for couching his language explicitly in pan-EU rather than UK-only terms. With the Eurozone and several of its Member States in crisis, and popular disaffection with the EU on the rise, it would be hard for others in the EU to argue that change is not required. (Paragraph 101).

The Government welcomes the Committee's assessment. We strongly agree that it would be difficult to conclude that urgent reform of the EU was unnecessary.

The Government is making real progress on EU reform, working with EU partners who share our priorities. For example, we secured agreement to establish a unitary patent for Europe which will cut costs for entrepreneurs and encourage innovation and growth. The UK has also been instrumental in promoting external trade, including the launch of negotiations on EU-US and EU–Japan trade deals and conclusion of agreements with South Korea and Singapore. According to European Commission figures, the completion of all ongoing EU trade negotiations would add 2.2% to the EU's GDP.

In terms of improving regulation, the Government secured an agreement that the Commission should exclude Europe's smallest businesses from proposed legislation. Up to 1.4 million UK small businesses are now exempted from certain EU accounting rules.

The UK has also established a group of like-minded Member States who support action to complete the Single Market and promote growth, particularly in the services and digital sectors. The European Council and European Parliament have agreed legislation on Online Dispute Resolution, enabling consumers and businesses to solve their disputes across Europe easily and at little expense.

The Government will build on these examples. It will continue its work on reforms that will make the EU more competitive, flexible and democratically accountable in order to tackle the challenges that Europe faces today.

15. We conclude that there is support for some of Mr Cameron's reform ideas around the EU, and that there is significant scope for further progress on deepening the Single Market, pursuing free trade agreements with third countries, and improving the quality of the EU's regulatory practice. Pursuing reforms may allow the Prime Minister to be seen to be committed to the UK's EU membership and to build influence. Mr Cameron's main challenge will be to make the case that some elements of his agenda, namely more differentiated integration in the EU and the repatriation of powers from the EU, are workable and can help the Eurozone states, in particular, to overcome the problems they face. (Paragraph 106)

The Government welcomes and agrees with the Committee's analysis of Member States' support for EU reform. Member States such as Germany, France, the Netherlands and Italy have all spoken of the importance of delivering enhanced competitiveness, flexibility and democratic accountability. For example, President Hollande addressed the European Parliament in February and argued in favour of a

“differentiated Europe” based on a “new European architecture.” Similarly, Italian Prime Minister Letta addressed the question of reforming the EU to increase flexibility at the same time as achieving closer integration within the Eurozone. During a visit to Downing Street in July, he said that he could envisage a *“future in which we can have Treaty changes for [...] a more flexible Europe in the interest of the UK, but also in the interest of [...] countries like Italy and [...] the euro area countries.”*

A Dutch Government review into the application of subsidiarity *Testing European legislation for subsidiarity and proportionality* concluded in June that where action is taken, it should be *“European where necessary, national where possible”*, and noted that *“the time of an ever closer union in every possible area is behind us”*. In an interview in May at a Berlin conference on the EU, *WDR Europaforum*, Chancellor Merkel said *“Can there perhaps be a point in the history of the European Union at which one says: We may have been doing that in Europe for 20 years but now we find that it could be done better at local level.”*

Support for reform along these lines is also evident in the EU Institutions. For example, the President of the European Parliament, Martin Schultz said in a July 2013 interview with a Dutch current affairs publication, *Elsevier*, that Europeans should *“do locally what can happen locally, regionally what can happen regionally, nationally what can happen nationally.”*

The Government will continue to work with our partners across Europe to translate this momentum into further concrete reform.

16. The Balance of Competences Review seems likely to remain a primarily UK rather than pan-EU exercise. As such, it may still provide a substantive basis for a UK contribution to a debate over EU powers and competences. (Paragraph 109)

The primary aim of the Review is indeed to broaden and deepen public understanding of the impact on the national interest of our membership of the EU. The first reports have already begun to do this. However, the Government agrees with the Committee that the Review will also provide a constructive and serious contribution to the wider European debate about how to modernise, reform and improve the EU in the face of its collective challenges. We have invited foreign governments and international organisations to contribute - and several provided evidence in the first semester – and we have engaged extensively with our partners across the EU on publication of the reports. The Government also notes that a number of other Member States are carrying out their own parallel exercises to contribute to this European debate, including the Dutch subsidiarity review and the Slovak Convention on the European Union.

17. Given that the Prime Minister and Foreign Secretary have not spelled out in any detail the content of the “new settlement” that they might seek for the UK in the EU, and given that it is over a year, at least, before any major EU Treaty reform process seems likely to get underway, it is impossible to assess the likelihood of the Prime Minister securing the kind of “new settlement” that he might seek. However, we are clear that UK proposals for pan-EU reforms are likely to find a more favourable reception than requests for further ‘special treatment’ for the UK. We are sceptical that other Member States would renegotiate existing EU law so as to allow the UK alone to reduce its degree of integration, particularly where this could be seen as undermining the integrity of the Single Market. The Government must reckon with the fact that the body of existing EU law is a collective product in which 27 countries have invested. (Paragraph 113)

It would not be appropriate for the Government to comment on statements made by the Prime Minister and Foreign Secretary on Conservative Party policy. But more broadly, while this Government is clear that membership of the EU is in the UK’s interest, we are also clear that the EU needs to reform – to become more competitive, more flexible and more democratically accountable. This is reform in the interests of all Member States. And, as per the Government’s response to the Committee’s assessment in paragraph 106 of its report (set out at point 15 above), there is widespread support amongst our EU partners for reform.

18. The nature of some of Mr Cameron’s ideas for a “new settlement” for the UK in the EU, and the general terms in which he is currently setting them out, might leave him room to negotiate a “new settlement” without EU Treaty change. However, some of the “new settlement” ideas which have been floated would clearly require EU Treaty amendment. (Paragraph 116)

19. Many Member States would be reluctant to embark on a major EU Treaty amendment process under current rules, because of the amount of time involved and the risk of any new Treaty failing at the ratification stage, especially if one or more referendums were to be held. There appears to be a growing body of opinion that EU Treaty change requiring unanimous agreement and/or ratification by all Member States may no longer be possible. (Paragraph 127)

It would not be appropriate for the Government to comment on statements made by the Prime Minister and Foreign Secretary on Conservative Party policy.

On the question of Treaty change more broadly, the Government notes that many influential figures have highlighted the need for EU Treaty change and/or made proposals which would necessitate the same. A ‘Blueprint Report’ by Commission

President Barosso in November 2012, the 'Four Presidents Report' in December 2012 (written by the Presidents of the European Council, European Commission, European Central Bank, and Eurogroup), and others including the German Finance Minister Schäuble and Italian Prime Minister Letta, have argued that the EU's Treaties will need to be changed to introduce reforms that will promote the EU's prosperity in the long term.

The Government will look at all proposals for Treaty change on their merits and will, as part of the ensuing negotiations, ensure that the interests of the UK and the need for reform are fully reflected. The Government's position on the establishment of a European Stability Mechanism was one such example. The Prime Minister secured a commitment at the European Council in December 2010 that the UK would not be liable through the EU budget for any future Eurozone bailouts once the European Stability Mechanism came into force in October 2012. The Conclusions and the recitals of the European Council Decision stated that the Treaty base for establishing bailouts under the EU budget "will no longer be needed for such purposes" and "should not be used for such purposes".

In advance of any further Treaty change process, the Government will continue to push for reform within the scope of the existing Treaties. The Government's recent track record, such as the landmark agreement to decentralise fisheries policy, shows that this too can bear fruit.

20. Precedent suggests that the Prime Minister's envisaged timetable for the negotiation of a "new settlement" between 2015 and 2017 might be achievable: some recent EU Treaties have been negotiated in under two years. However, much would depend on whether the EU Treaty amendment process would involve a Convention: some of the reforms that the Prime Minister might seek as part of a "new settlement" would require the type of amendment process that normally involves a Convention, and we find it difficult to envisage the European Parliament consenting to waive this element of the procedure. The last time that a Convention formed part of an EU Treaty amendment process, on the failed Constitutional Treaty, the process took nearly three years. (Paragraph 132)

As above, the question of a "new settlement" for the UK's relationship with the EU is one of Conservative Party policy. It would therefore not be appropriate for the Government to comment on the Committee's analysis on this point.

21. We agree with the Prime Minister that, in principle, a more flexible and differentiated model of integration might accord better with the demands of diversity and democratic consent in the EU than the traditional homogenising model. However, the demands of a pan-EU Single Market without discrimination would appear to place limits on the degree of flexibility that might be achievable. The institutional implications of more differentiated integration are also complex. (Paragraph 143)

Flexible integration has a long heritage in the EU. Today, seventeen Member States are part of the Eurozone; eleven are not. Twenty six European countries are members of Schengen (including four outside the European Union), while six EU Member States, including the UK, are not. And the UK is one of twenty five Member States who participate in the EU-wide patent court. This differentiation is also evident more broadly. For example, some Member States, like Britain and France, are willing to take action in situations like those in Libya or Mali; others are uncomfortable with the use of military force and so choose not to participate in this way. And there are also many derogations in place to accommodate Member States' specific legal and cultural traditions.

Reforming the EU to stimulate growth and increase competitiveness also means placing the Single Market at Europe's core. As the Prime Minister made clear in January, there is a fine balance to be struck. The need to respond flexibly and so remain competitive must be balanced against a common set of rules needed for the Single Market to function efficiently and fairly, particularly as the Eurozone crisis leads to changes in the rules on fiscal coordination and banking union. Agreement on a double majority voting mechanism in the European Banking Authority and explicit safeguards for the Single Market have shown how this might be done.

But even within the operation of the Single Market there remains scope for flexibility. For example, the UK and other Member States successfully negotiated a commitment for the European Commission to exempt Small and Medium-sized enterprises from new legislative proposals wherever possible. Since January 2012, seventeen proposals have been adapted for these businesses. The Commission is now screening existing EU legislation for further opportunities to put in place lighter regimes or exemptions.

The EU's capacity to accommodate flexibility is a strength on which the Government's reform agenda will continue to build. The Government does not underestimate the challenges ahead in this regard.

22. Our sense is that other Member States want the UK to remain an EU Member. However, we do not think that a UK Government could successfully demand ‘any price’ from other Member States for promising to try to keep the UK in the Union. (Paragraph 148)

This Government could not be clearer: membership of the EU is in the UK’s interest. We will continue to make that case vigorously as we progress with our partners on proposals to reform the EU for the benefit of all Member States. We agree with the Committee’s assessment that other Member States value the UK’s membership of the EU, and that we play a strong and positive role with our partners. As per the Government’s response to the Committee’s assessment in paragraph 106 of its report (set out at point 15 above), there is widespread support amongst our EU partners for reform.

23. We recommend that the Government should conduct and publish an assessment of the impact on business investment in the UK of the Prime Minister’s commitment that a Conservative Government elected in the 2015 General Election would hold an ‘in/out’ referendum on the UK’s continued EU membership by the end of 2017. (Paragraph 151)

In line with the Coalition Agreement, this Government has no plans to hold a referendum on the UK’s membership of the EU in this Parliament. As the Committee has noted, David Cameron, speaking as leader of the Conservative Party, has outlined his party’s proposal for such a referendum. Other parties may outline their policies on this issue in due course. It would not be appropriate at this stage for the Government to assess the impact of one political party’s policy.

However, data is available on investment in the UK more generally. The Office for National Statistics reported that in the first quarter of 2013, overall direct investment into the UK was up £10bn (or 1.2%) on the last quarter of 2012. According to UK Trade and Industry’s latest annual report, inward investment projects increased by 11% in 2012/13 and all UK regions attracted an increased number of projects. Ernst and Young’s *European Attractiveness Study 2013* also showed that, in 2012, the UK retained its position as the top European destination for Foreign Direct Investment (FDI) projects in 2012 and increased its share of overall FDI into Europe. Investors reported that they felt the investment climate in the UK improved between 2011 and 2012 as a result of increased access to finance, more support for SMEs and the facilitation of successful trade missions. The latest available figures from the Office for National Statistics¹ show that other EU member states account for 48% of the UK’s FDI stock.

¹ See table 6 at www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-290450

The Single Market and the EU: Norwegian and Swiss options

24. In Europe's current institutional architecture, any decision as to whether the UK should remain in the EU would to a significant extent be a decision about whether the UK should remain in the Single Market—that is, a common area of free movement for goods, services, capital and people. This engages profound questions of economic, social and regulatory policy that were beyond the scope of our inquiry. (Paragraph 163)

25. We agree with the Government that the current arrangements for relations with the EU which are maintained by Norway, as a member of the European Economic Area, or Switzerland, would not be appropriate for the UK if it were to leave the EU. In both cases, the non-EU country is obliged to adopt some or all of the body of EU Single Market law with no effective power to shape it. If it is in the UK's interest to remain in the Single Market, the UK should either remain in the EU, or launch an effort for radical institutional change in Europe to give decision-making rights in the Single Market to all its participating states. (Paragraph 164)

The Government welcomes the Committee's conclusion that the institutional relationships between the EU and both Norway and Switzerland would not be appropriate for the UK and notes the Committee's point on the UK's interest in the Single Market.

The UK's situation is different from that of Norway and Switzerland, including because of factors such as those countries' respective sizes, economies and political structures. Members of the European Free Trade Association (EFTA) have the opportunity for non-binding consultation on Single Market rules. But only EU Member States have a say in the final decisions made.

The Government believes that the UK should participate fully in decision making over how the Single Market functions, given its significance to the UK economy. An independent report *Inside and Outside* commissioned by the Norwegian government calculated that, despite not being an EU Member State, Norway had incorporated approximately three-quarters of all EU legislative acts into Norwegian law without having had a say on their content. The Government's view is that that this would be undesirable for the UK.

This Government is also clear that the UK's interest in being a member of the EU is not limited to the benefits it derives from the Single Market. The UK often leads EU initiatives where collective and cross-border action is more effective than individual states acting alone. For example, working with the EU, the UK has amplified economic pressure on Iran through sanctions which has brought Iran back to negotiations on its nuclear programme with the UK, US, France, Germany, Russia

and China (E3+3). The UK is a key influencer in that process. The UK has a stronger role in international climate change negotiations when working with the EU. The EU can also act as an important multiplier for national efforts. For example, evidence gathered for the Government's Review of the Balance of Competences in relation to development and humanitarian aid indicated that EU spending was aligned with the UK's development priorities and geographical focus.

Conclusions: Maintaining UK influence in the EU

26. We recommend that the Government should always bear in mind the extent to which exercising influence effectively in the EU can depend on administrative and diplomatic capability and coordination. (Paragraph 170)

The Government welcomes the Committee's conclusion that administrative and diplomatic capability and coordination are an important element of exercising influence in the EU. The Government took note of witness evidence quoted in the Committee's report suggesting that the UK's EU policy coordination system is "the envy of our European partners" and the UK "has always had the best civil servants and [...] been the best prepared at meetings."

Providing appropriate training is an important aspect of ensuring the UK's diplomats and civil servants are equipped to deliver for the UK in the EU. The FCO is running a reform and improvement programme for 2011-15 called *Diplomatic Excellence* with the ambition of being the best Diplomatic Service in the world. The Continuous Improvement Strategy that the Cabinet Office requires each government department to have in place mirrors this programme.

The FCO's Europe Directorate, with the support of Ministers and the Permanent Under-Secretary has recently reinvigorated and formalised its work to build a stronger Europe cadre in the FCO and a broader network of EU experts across Whitehall. Both are aimed at strengthening the Government's long-term capacity to shape and deliver EU policy.

Another important part of maintaining and extending diplomatic influence is ensuring we have the right staff in the right posts. For EU positions, this is discussed in more detail in the response to the Committee's report *The UK staff presence in the EU institutions*. This response deals with issues including the establishment of an EU Staffing Unit, secondments to the EU institutions, and wider efforts to increase the number of UK nationals working in the institutions.

27. We welcome the Government's recognition of the importance of fostering bilateral relationships widely with other Member States around the EU. We commend the Government for devoting increased resources to this objective, in the form of FCO Ministerial time. We particularly welcome the establishment of a regular meeting between junior UK Ministers and their German counterparts. We recommend that the Foreign Secretary and Europe Minister should encourage ministerial and senior official colleagues from other Departments also to visit EU capitals widely, to help to build alliances in support of key pieces of EU business. (Paragraph 174)

The Government agrees on the importance of sustained bilateral engagement. Bilateral relationships with individual EU Member States and overarching strategies for managing relationships across EU partners are considered regularly by the Cabinet in the European Affairs Committee (EAC) and the European Affairs Sub-Committee (EASC).

Working with partners across Europe, including through visits to EU capitals, remains an important element of the Government's work on EU business. The Prime Minister signalled the value of such relationships across Europe in his January speech on Europe and has continued to lead the Government's engagement, visiting Prime Minister Rajoy in Spain, President Hollande in France and Chancellor Merkel in Germany, as well as welcoming Commission President Barroso and Italian Prime Minister Letta to Downing Street in recent months.

Since the beginning of the year, the Foreign Secretary has held bilateral meetings with a range of counterparts including those from France, Luxembourg, Poland, Sweden and Croatia, as well as EU candidate countries such as Serbia. The Minister for Europe has done likewise, holding meetings with counterparts from countries including Germany, Bulgaria, Ireland, France, Poland and Romania. The Minister has also visited every Member State capital at least once since taking office. Both the Foreign Secretary and the Minister for Europe have made major speeches on the EU in Germany. In addition, Ministers from across Government see their EU counterparts on a regular basis, including for meetings of the Council of Ministers. For example, since 2010 there has been a quadrupling of UK Ministerial and senior official visits to Germany.

Senior officials from across government departments are in constant discussion with their counterparts in EU Member States as well as the EU institutions. They travel regularly to the relevant EU capitals and receive frequent visits to London. Brussels also remains an important focus for senior official engagement. For example, Head of the UK Civil Service, Sir Bob Kerlake, and Cabinet Secretary, Sir Jeremy Heywood, led a delegation of 11 Permanent Secretaries to Brussels in July.

28. In conclusion, we reiterate the importance of the Government's tone, language and overall approach in retaining influence in the EU. We recommend that the Government should frame its approach and its language in pan-EU rather than UK-only terms; and should remain constructive, positive and engaged. (Paragraph 175)

The Government welcomes the Committee's overall conclusion. In pushing the EU reform agenda, the Prime Minister was clear that his aim was reform for the benefit of all EU Member States.

As the Committee rightly notes, the best way to solve issues of common concern is by working constructively and positively with other Member States. Recent agreement to the first ever reduction in the Multi-annual Financial Framework demonstrated what the UK can achieve by working closely with our partners in Europe.



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