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## Britain's unresolved eurozone dilemma

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The UK has long enjoyed a fractious relationship with the rest of Europe. At times, Britain's role as useful troublemaker has served as a counterweight to Franco-German dominance and federalist over-reach. Now, however, the eurozone's sovereign debt crisis is forcing all members of the EU to confront hard choices. For Britain, these choices are especially delicate because they touch on the terms of the country's continuing membership of the EU.

When David Cameron withheld support for the fiscal compact in December, he cited the need to defend vital British interests, specifically those of the City of London. As the Financial Times reports today, however, the City corporation's regulatory strategy group has found that six out of the seven "safeguards" laid down by Mr Cameron were either unnecessary or potentially harmful to London's commercial interests. This revelation undercuts the government's whole negotiating strategy.

Mr Cameron has a tricky hand to play. He must work in partnership with the Liberal Democrats, who are at heart more pro-European than his own party. On his own backbenches, Mr Cameron must manage Tory MPs who range from the irreconcilable on Europe (perhaps 30 in number) to the fundamentally eurosceptic (perhaps as many as 100). The prime minister must therefore negotiate not only with Berlin, Brussels and Paris but also with those who sit behind him in the House of Commons.

The government's response has been to emphasise the need for closer economic integration in the eurozone. George Osborne, chancellor, has spoken of the "remorseless logic" of closer fiscal union. The Obama administration has taken a similar view, but avoided the odium of lecturing from the sidelines, a lesson the British government would have been wise to observe. More seriously, Mr Cameron's approach of urging the continental Europeans to press full steam ahead has reversed decades of British foreign policy, which stressed the need for the UK to retain a seat at the top table.

This shift in longstanding British policy towards the EU is what is worrying the City of London. If euro members unite to address the crisis, the fear is that they will form a permanent caucus in the councils of the EU that can override special British interests in the single market. This could include redrawing financial regulation, which is subject to qualified majority voting and therefore beyond the reach of any UK veto.

Last December the British goal was to roll back qualified majority voting on finance-related measures. The European response was instructive: given the urgency of the crisis, eurozone

members would, if necessary, circumvent the veto rather than negotiate special unilateral accommodations for Britain that could lead to a new political settlement with Europe short of withdrawal.

Since the diplomatic debacle of last December, matters have become even more tricky for the UK. The EU is now seeking to build a so-called banking union that would place the financial systems of member states under common regulatory structures. The fiscal union is still very much alive and there are now proposals that would create something akin to a European finance ministry in Brussels that would have the power to rewrite national budgets. This is enough to send most Tory backbenchers scurrying for the hills, and could easily be the prelude to a referendum on British membership of the EU.

The government – by disposition euro-wary and finance-friendly – has not faced up to the contradictions in its policy. While it is true that Britain as a non-eurozone member is not going to be part of a newly integrated core, it still needs to be at the heart of the negotiations. Tony Blair and Gordon Brown, whatever their failings elsewhere, understood this and proved effective defenders of British interests in Europe.

Britain remains a crucial trading partner for the eurozone. Many EU countries welcome British interventions, especially in matters of trade and finance. It is defeatist to start from the assumption that the bureaucrats in Brussels are engaged in some blessed plot to undermine the City and strip Britain of its sovereignty. It remains unclear whether the eurozone will be able to achieve the leap towards full fiscal union, with all its profound political implications. Mr Cameron can play a constructive role in which safeguards for the City may well have a place. But he should not at this stage set preconditions that would in effect renegotiate British membership of the EU.

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