

## **UNDER EMBARGO UNTIL 1400 HRS, 14 JANUARY**

SPEECH BY THE RT HON LORD OWEN TO THE 12<sup>TH</sup> BERLIN CONFERENCE HOSTED BY THE GERMAN BRITISH FORUM AND BRITISH CHAMBER OF COMMERCE IN GERMANY, 14 JANUARY 2016

Let us start with Maurice Obstfeld's paper 'Finance at Centre Stage: Some Lessons of the Euro Crisis' published by the European Commission in April 2013 when he was an academic in the University of California. That has a new significance now he is playing such a key role at the IMF. The central conclusion of that paper remains highly relevant at the start of 2016 for it goes to the heart of the Eurozone crisis which began in 2009 "the euro area must also confront a financial/fiscal trilemma: countries in the Eurozone can no longer enjoy all three financial integration with other member states, financial stability, and fiscal independence, because the cost of banking rescues may now go beyond national fiscal capacities."

Unless the British people see a resolution of this eurozone trilemma very soon and a recognition of the need within the European Economic Area to safeguard the interests of countries in the EU, but outside the Eurozone, the British are likely to vote for Brexit in June or September this year. There is still time in theory to deal with this substantive issue, but only just, and there are worrying practical signs that the negotiations currently under way are not grappling with this trilemma with a sufficient sense of urgency. When are you in Germany ready for substantive Treaty changes being actually passed into law? Are you ready as some envisage to wait until 2023-25 having gone through an Intergovernmental Conference and full ratification procedures?

What has puzzled me for the last few years - and I believe as they start to think about the referendum choice is puzzling more and more people in Britain - is why a country like Germany is not insisting on substantive reforms now? Are you not worried about what is happening as we speak in China? Obstfeld, speaking for the IMF, said only last week "The global spillovers from China's reduced rate of growth.....have been much larger than we would have anticipated." This is a man who advised President Obama. Ever since 2009 the US Treasury has been making determined representations to the Eurozone to act to disentangle the euro crisis. Do you really believe that another global economic crisis cannot happen? Indeed as I speak the global economy might be in the process of unraveling again. The Chinese currency will become a reserve currency and must therefore be free to move against the other reserve currency, the US dollar, but it is important that they keep it stable against a basket of 13 trading countries. But an orderly transition is unlikely.

Over the last six years the message we hear repeatedly from the Eurozone is that the time is not yet right. I ask again when will the time be right? As Obstfeld reminded us in 2013 "most of EMU's first decade was passed in a singularly benign global environment." That allowed EMU to skirt the biggest potential challenges identified before its 1999 launch." Obstfeld went on to say "Given that the most persuasive reasons to fear unrestrained national deficits and debts rest on the financial stability threat, it is all the more remarkable that the Maastricht Treaty left the task of banking supervision and bank crisis management largely in national hands. In addition the lender of last resort (LLR) function of the ECB is not discussed in the Treaty." Why not? We know the answer over Maastricht, politics not economics.

Today politics is adjusting but by letting the ECB go beyond the interpretation of its mandate not by changing the mandate.

Adam Posen argues in January/February 2016 *Foreign Affairs* review of Ben Bernanke's new book *The Courage to Act* when the US Federal Reserve finished its first round of quantitative easing in March 2009 the Dow rebounded by 40% and GDP growth became positive. Posen writes: "Compare those results to the record of the European Central Bank, which eschewed quantitative easing when an analogous panic hit Eurozone bond markets and banks in 2010. Exactly as Bernanke had predicted in private and as a host of others had publicly warned - the ECB's inaction led to far higher unemployment, far greater drops in output, far faster declines in prices, and far more suffering among the European public. And although many factors were involved it is undeniable that after the ECB promised to use quantitative easing, in August 2014 economic conditions improved, unemployment has eased, the panic has subsided, and GDP growth rates have recovered."

Is the ECB doing enough? Looking at the Eurozone unemployment figures in Spain, Greece, and Portugal. Looking at the underlying economy in Italy and even France, I would say no, not nearly enough. But are these countries disciplining themselves enough with true social market reforms very necessary to accompany quantitative easing, I would say no, not nearly enough.

Trust the ECB and Chairman Draghi is no democratic recipe for an essentially structural and political crisis. Obstfeld's conclusion is still the challenge now, namely "to redesign the Eurozone in a way that indeed enhances policy discipline while promoting stability, growth, and the common interest in avoiding political and social unrest. New EMU-level institutions are needed to achieve these goals, but to be effective it is not enough that they be efficiently designed. They must also respect (and be seen to respect) the principle of democratic legitimacy and accountability."

The "well-known structural rigidities in labor and product markets" still exist. The

“powerful national vested interest” still protect “existing distortions”. Politicians, bankers, international bureaucrats and financial service industry experts still extol the Eurozone but are content for it to remain unreformed.

The US State Department also extols the Eurozone but the US Treasury criticizes it. America often fails to understand the limitations of a Eurozone that is not a country with one language, history and national purpose. But in order to make it work it has to become much closer to being one country. It is as simple as that. The US took decades before they were able to make a single currency work for their new country. America often fails to understand that the UK’s influence stems from the fact that it wants to remain a country, even if that means its influence is inevitably weakened as the Eurozone integrates further.

Looking back to July 1978 when James Callaghan was Prime Minister and I was the Foreign Secretary attending the European Council meeting on 2 April in Copenhagen I first heard the details of the ideas of Helmut Schmidt and Giscard d’Estaing for European Monetary Union. I little realised that I was hearing about a project that was eventually doomed to damage, if not destroy, European unity which was then slowly evolving. It was, in retrospect, the first outward sign of the vice of pretension that is doing so much to erode today's European Union. Callaghan realized the Exchange Rate Mechanism at best premature for the UK and the Cabinet decided we would not join the ERM but joined the EMS and pay up for our ECU share. How different everything looks today. Now we know that the ERM was a flawed design giving speculators a one way bet and the UK was forced to leave which we did. It had no dire consequences and we thank our lucky stars we never joined the euro.

The present UK government has correctly made it clear since 2010 that it is content to support an "efficiently designed" Eurozone, for its continued failure harms the British economy. But virtually every necessary reform puts the Eurozone on an escalator to greater political integration a direction of travel that is not one I and many British people wish to embark on. We must have credible safeguards, therefore, to prevent a Eurozone block vote not forcing the UK onto an escalator towards either the single European currency or towards accepting forms of integration in the single market which will damage London as Europe's only true international financial centre.

On integration we are told "don't worry there is ‘not a cat in hell' s chance' of this lot (the European Council and the European Commission) steering Europe towards greater integration." Which makes some of us aghast at being told "don't worry” for it means accepting an even more fractious, divisive, high unemployment, low inflation, low retail trade, Eurozone over the next few years.

It is that dialogue of the deaf within the EU that feeds the belief in the UK that it is better

to get out of the whole EU mess now before it damages our growth and prospects any more. This is not cynical but hard-headed realism. It comes on top of the fact that there are legitimate concerns not just in the UK over important aspects of the EU's foreign and defence policies.

- The provocative wording on defence in the EU Ukraine Association document triggered the war in Eastern Ukraine and the annexation of Crimea by Russia. So much for grandiose claims for EU foreign and security policy. This Ukraine Agreement is now being rightly challenged by a referendum in April to take place in the Netherlands. A Dutch poll by EenVandaag, a Dutch current affairs programme, found that almost three-quarters of Dutch voters will "probably or definitely vote against ratification in the referendum". It needs to be renegotiated.

- Most EU countries are coming nowhere near to fulfilling their obligation to pay 2% of their GDP into NATO and prefer to play around trying to make the EU into a defence organisation. Something of growing concern in the US who now pay for 75% of NATO costs.

- Angela Merkel and Francois Hollande chose to launch their since-stalled Minsk peace process without any consultation whatever with David Cameron when the UK was a signatory to the Budapest Memorandum dealing with the borders of Ukraine. Is that the shape of future EU diplomacy?

- While on that subject of unilateral action why did Angela Merkel feel free to act on her own to abandon the EU Dublin Agreement over the handling of people coming across EU boundaries and do the same over longstanding EU policies towards Turkey? Is this the shape of future EU political management?

EU unilateralism is now spreading not only to other Heads of Government but to the EU Five Presidents. The Commission President, Juncker, we are now told in leaks from Brussels, is discussing plans for a massive new treaty, which has a very significant bearing on David Cameron's negotiating plans. We are told Juncker now accepts EU Treaty changes are necessary and envisages bringing forward proposals to the Member States on a timetable for early 2017. Previously people believed they were being held back until after German and French elections but how democratic is that? Early 2017 makes it sensible to hold a UK referendum a year later than currently planned in November/early December 2017 taking into account these possible treaty changes of a fundamental kind involving the EEA, a negotiation I have long championed. But instead Whitehall wants to have our UK referendum on present plans in 2016 and that is what Brussels wants as well. Why? Because they are in cahoots.

What is being proposed, as reported in the *Sunday Telegraph* on 19 December and again on 10 January is “a radical reorganisation of the EU into two groups. A "core group" of the 19 Eurozone countries will move on to much closer political and economic union, leaving Britain and the non-Euro outer ring as mere "associate members" (possibly also including countries outside the EU such as Norway and Switzerland even Turkey)”<sup>1</sup>. “As Juncker explained none of this is to be formally revealed until 2017 when the Commission issues a White Paper to trigger the laborious procedures now required for any new treaty. And these might not be concluded until 2025.”<sup>2</sup>

If the *Sunday Telegraph* is correct – and I think it is – some will argue we in the UK would be wiser to vote to leave in 2017 and have all this discussed during the two-year exit period and if we achieve what we need and a new treaty we can put that to a second referendum in 2019 as we might have to do anyhow under the European Union Act 2011 if we were still in the EU. But no one should count on there being a referendum in these circumstances, after all we have twice been denied referendums first over the Constitutional Treaty by Tony Blair and then over the Lisbon Treaty by David Cameron. It will be claimed that if we vote to remain in 2016 or 2017 the Juncker proposed Treaty changes in 2024/5 that might have triggered the 2011 legislation involving loss of sovereignty would have already been authorized.

I do not believe therefore that there is any way in which we can rely on negotiating during the exit period and pretend that we will be able to continue within the EU. The time for negotiating is now in 2016 and 2017 and if Juncker and Cameron do not bring together their separate negotiations and we have a referendum in 2016 we should vote to leave and carry through that decision by the British public. What we negotiate over the Single Market, outside the EU, would stand alone.

Combining the Juncker and Cameron negotiations on treaty amendments would fit in naturally with bringing forward Turkey's accession process and the EU opening negotiations on Chapter 17 of the *acquis* covering economic and monetary policy. This would be the moment to negotiate that while freedom of movement of people and labour are necessary for Eurozone membership they are not vital for membership of a changed Single Market through the EEA. Free movement of labour is part of the philosophy behind ever closer union of the peoples of Europe. If that is to be changed meaningfully in the Cameron negotiations, it must also be incorporated in any proposals coming from Juncker and the Five Presidents. When speeded up Turkish membership was acquiesced in by

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<sup>1</sup> Christopher Booker, ‘David Cameron’s ‘new EU relationship’ is not what we’re being told’, *Sunday Telegraph*, 19 December 2015.

<sup>2</sup> Christopher Booker, ‘What they’re all missing in debate on the EU’, *Sunday Telegraph*, 10 January 2016.

Cameron it showed that either Britain expects a veto at a later date, perhaps from France, or Cameron has no plan to limit freedom of movement of people and labour being extended to what is likely to become Europe's largest nation, with 75 million citizens based on 2014 estimates. The fuss Cameron is making for a retrospective change on access to benefits for existing EU members like Bulgaria and Romania means nothing unless the UK's negotiating position is also about limiting more than automatic access to benefits for new EU members like Turkey to non-Eurozone countries like Britain.

It is not too late to negotiate now with the President of the Commission for an expanded non-integrated European Economic Area to continue alongside an integrated Eurozone and that must now become Britain's negotiating position right up until November/December 2017 after the German and French elections.

The alternative is of Britain proceeding with a cynical short-term fix referendum in 2016 as if President Juncker's planning does not exist for 2017. Meanwhile hoping against hope that the British people will vote on what is merely an initial position while not being told what is to come from the Commission. I am not convinced that Cameron and Juncker accept another referendum is inevitable in 2023-2025. They will claim the UK can avoid William Hague's 2011 legislation by invoking the authority of an early 2016 referendum. This cynicism is exactly why we are in the current mess over the EU with public opinion in many EU countries.

It is absurd to go on with the myth that it is only the UK's interests that we are negotiating over. The great tragedy of Cameron's approach from the moment in 2013 he locked himself in to a purely British domestic timetable was that he also locked himself in to presenting changes as if they were of value only to us in Britain. Most of these changes can and should be presented as of value to Europe as a whole, not just the EU but the wider membership of the EEA and indeed eventually of benefit to all European countries.

We need to wake up. We are all of us being fooled in the EU, not just the UK: by Cameron over this short term fix and by Juncker and the Five Presidents. It is time to call both Cameron and Juncker's bluff and in doing so restore some confidence to financial markets that Europe and the UK are getting their act together. If either Cameron or Juncker fail to put their negotiations together and we are asked to vote in 2016 then the chance of BREXIT will markedly increase.

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