

Research Paper

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Britain, Europe and the World

Rethinking the UK's Circles of Influence



**CHATHAM
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Summary

- The approaching referendum on whether the United Kingdom should remain in or leave the European Union marks a defining moment for the country's foreign relations. In addition to determining the UK's future status in Europe, it will affect Britain's ability to thrive in and help shape a rapidly changing world.
- The international context presents three main challenges for the UK: the opportunities and pressures from economic globalization; a range of evolving security risks and crises, particularly in Europe's eastern and southern neighbourhoods; and the decay in the international institutions that have long amplified Britain's voice in international affairs. The UK must rethink how it interacts with the world if it is to remain influential in the face of these and other challenges.
- This will require an adjustment in mindset and strategy. Since 2010 the British government has sought to enhance its relations with the world's emerging powers so it can balance these alongside its relations with the United States and Europe. This approach will not succeed in the future. Today's global challenges, and structural pressures on the resources available to Britain to pursue its international agenda, mean that the UK should no longer try to commit itself equally on all fronts.
- Instead, the UK's foreign policy needs to be based on a different perception of the country's position in the world – one in which the country is surrounded by concentric circles of influence. The first or 'inner circle' is the EU, with which the UK's relationships need to be stronger and most active. Outside that is a second circle that consists of the protective and enabling set of economic and security relationships with the US. Finally, the UK benefits from an outer circle composed of its other key bilateral and institutional relationships.
- All three circles are important, but a foreign policy that prioritizes Britain's European 'inner circle' and does more to find synergies with the EU is likely to be most effective – all the more so now that the US, traditionally Britain's key ally, is increasingly looking towards the Asia-Pacific, where the UK is less relevant, and away from the Middle East and Europe, which are the biggest sources of risk to the UK.
- The EU has many structural weaknesses and is difficult to work through and with. However, it offers the UK essential leverage in accessing international markets, managing a more assertive Russia and the fallout from a disintegrating Middle East, and dealing with global challenges that range from climate change to failing states.
- If the British people decide that the UK should remain in the EU, then British politicians should lean in and work through the EU to influence the international context to the UK's and Europe's overall benefit.

Introduction

This paper addresses the debate over Britain's future relationship with the European Union by assessing the country's place in the world. It outlines how external forces are affecting the United Kingdom's domestic prosperity and security. It considers the extent to which the country's international economic competitiveness would be affected by remaining in or leaving the EU. And it proposes areas in which the UK could work with its EU partners to strengthen both its own and common European responses to a complex and dangerous external environment.

The paper's central observation is that the main drivers of international affairs today – globalization, competition between rising and established powers, state fragmentation in the Middle East and North Africa, and a paucity of effective institutions for international cooperation – make obsolete the notion that Britain can control its own destiny without prioritizing between its diverse channels of influence. For the past few years, it has been fashionable to consider the possibility of a 'neo-Elizabethan' age in international relations for Britain, in which the country reduces its traditional focus on the United States and Europe in favour of strengthening bilateral relations with rising powers and emerging markets. This idea – which, crucially, implied that the government could achieve the latter without sacrificing influence with its major allies – has animated aspects of the government's foreign policy since 2010.

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Britain's multiple vectors of international influence are indeed useful foreign policy assets. But given the breadth of the external challenges, the UK still needs a strong geopolitical base from which to ensure its prosperity, protect its security and project its interests. This paper proposes that the EU – both through its member states and through its institutions – provides that base. Despite its many imperfections, revealed most recently by the uncoordinated response to the 2015 migration crisis, the EU will be the principal source of international leverage for Britain in a world in which the country can have only limited influence alone.

Does it matter to its citizens whether Britain is influential or not? The simple answer is yes.

Britain is an open society and economy, more so than most other countries. Its prosperity and security are tied to developments around the world: through trade and investment; through vulnerability to the effects of conflict and the risks associated with ungoverned spaces; and through exposure to severe changes in the climate and environment. A country with the means to influence its external context should seize every opportunity to do so. The UK is one of a small number of countries that have this capacity, but in large part only to the extent that it can recruit help. Collaboration with like-minded states, and via institutions that share and promote its values and interests, will need to be at the centre of all that Britain attempts to achieve internationally.

This paper consists of four main sections. It starts by highlighting the principal opportunities and risks for the UK in a changing geopolitical and international context, arguing that the constraints on Britain's ability to influence its external environment are structural and long-term rather than cyclical and temporary. It goes on to summarize recent governments' approaches to dealing with changes in the international context. These approaches have generally involved balancing Britain's three main channels of influence: Europe, the transatlantic relationship (comprising both Britain's strong bilateral relations with the US and the NATO Alliance), and multilateral and bilateral relations with the rest of the world. The third section of the paper explains why British policy-makers now need to think of Europe as constituting the 'inner circle' from which the UK will have the best possible chance of managing the increasingly turbulent world beyond its shores. Finally, the fourth section looks at the transatlantic dimension to the UK's international affairs, which – although changing – will remain essential in complementing and providing the security underpinnings of a more committed British relationship with the EU.

Three International Challenges

The international context today presents three main challenges for the UK. The first consists of the economic pressures from globalization, with its associated implications for export competitiveness, productivity and investment. Globalization is creating opportunities for the UK, but it requires industries to adapt quickly to changing markets and technologies. Successive governments have not taken the tough decisions necessary, whether in education, political decentralization or infrastructure investment, to help the UK thrive in an increasingly competitive and interconnected global economy.

The second challenge concerns how Britain should best confront a set of diverse international threats – including terrorism, Russian aggression in Ukraine, conflict in the Middle East and geopolitical tensions in Asia – at a time when its domestic defence resources are dwindling. The country is now ill equipped militarily for a new era of interstate competition with Russia, and unprepared as Europe's southern neighbourhood becomes the crucible for state fragmentation, mass emigration and Islamist extremism.

The third challenge is the decay in international governance wherein Britain's capacity for influence is hampered by the lack of reform of, or credible alternatives to, the major multilateral institutions. The Bretton Woods institutions and the Atlantic Alliance, of which Britain was a founding member, must adjust to a new international balance of power revolving around the US–China relationship. All this is taking place as the UK's continued membership of the EU hangs in the balance.

Coping with intense global economic competition

Economic globalization has brought benefits to many countries and industries, and promises more in the future. The continued opening of markets to trade and investment and the spread of value-adding technology have spurred global development in recent years. The process has been aided by urbanization, better access to education for girls (as well as boys), and improvements in national governance. In 1991, people in extreme poverty accounted for 45.2 per cent of all workers in the developing world, but by 2011 this share had fallen to 15.2 per cent.¹ By one account the global middle class will grow from around 2 billion people today to 5 billion in 2030, in effect rising from just under 30 per cent of the world's population to nearly two-thirds in the next 15 years.² As a result, the Organisation for Economic Co-operation and Development (OECD) forecasts that by 2030 non-OECD countries will contribute over 50 per cent of global GDP, up from 35 per cent today.³ Developing economies already account for 36 per cent of foreign direct investment

¹ Steven Kapsos and Evangelia Bourmpoula, *Employment and Economic Class in the Developing World*, ILO Research Paper No. 6, International Labour Office, June 2013, http://www.ilo.org/wcmsp5/groups/public/---dgreports/---inst/documents/publication/wcms_216451.pdf.

² Homi Kharas and Geoffrey Gertz, 'The New Global Middle Class: A Cross-Over from West to East', Wolfensohn Center for Development at Brookings, March 2010, http://www.brookings.edu/~media/research/files/papers/2010/3/china-middle-class-kharas/03_china_middle_class_kharas.pdf, accessed on 7 October 2015.

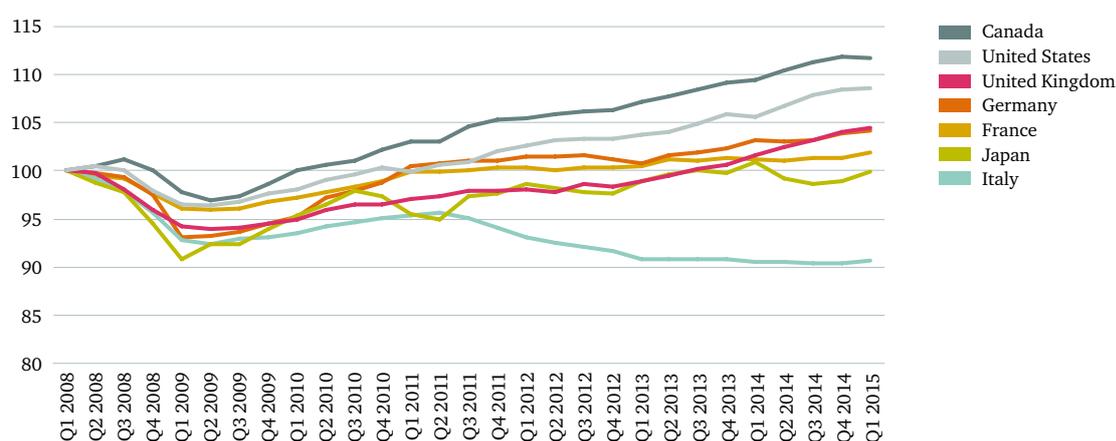
³ OECD, 'Looking to 2060: A Global Vision of Long-Term Growth', OECD Economics Department Policy Notes, No. 15, November 2012.

(FDI) outflows, and some 60 per cent of foreign-exchange reserves.⁴ All this is positive in many respects for the UK. Wealthier, more aspirational consumers in emerging economies create opportunities for British companies. Sovereign wealth funds and companies from these countries may invest in the UK.

The downside to globalization is that competitive markets create losers as well as winners. As governments feel increased pressure to support and develop their national economies, they may seek to protect or cultivate strategic industries (through non-tariff barriers and financial subsidies, for example); they may invest in physical infrastructure and education; or they may seek to strengthen their voice in international institutions. Regardless of the merits of specific policies – protectionism often masks unaddressed structural flaws, whereas investment in productive assets and human capital is usually a positive sign – British firms find themselves operating in a more competitive environment as markets become ever more integrated across borders. The UK will need to tackle its own structural economic weaknesses and maximize its strengths to avoid losing out more than it benefits from globalization.

On a number of measures the British economy has recovered well, compared with most of its European neighbours, from the financial crisis of 2008–09 (see Figure 1). Having contracted by 4.3 per cent in real terms in 2009, the UK's GDP increased by 3 per cent in 2014 according to International Monetary Fund (IMF) data. This was one of the highest rates of growth in the developed world. The IMF forecasts growth of 2.5 per cent and 2.2 per cent in 2015 and 2016 respectively.⁵ The UK also has one of the lowest rates of unemployment in the EU, at 5.5 per cent, having created 2 million new jobs since 2010 despite major cuts to employment in the public sector.⁶

Figure 1: GDP growth in G7 economies (Q1 2008=100)



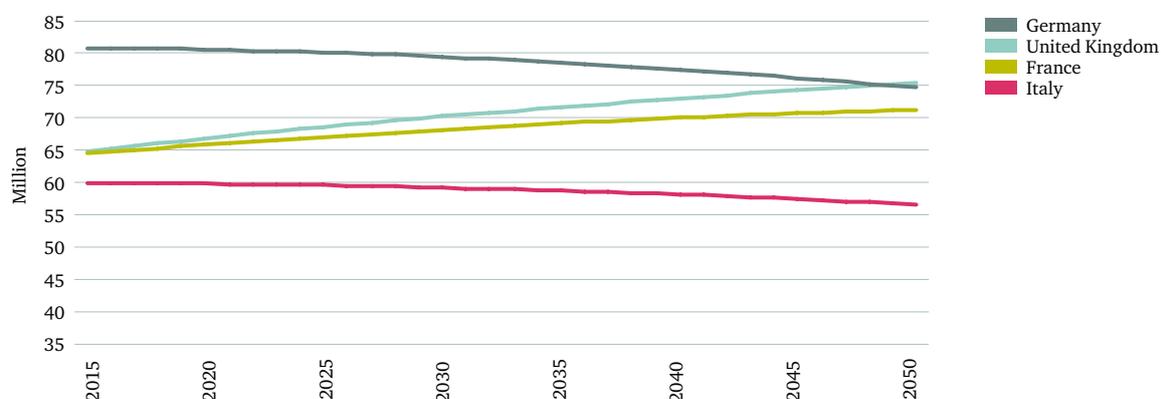
Source: OECD.

⁴ UN Conference on Trade and Development, Global Investment Trends Monitor, No. 19, 18 May 2015, http://unctad.org/en/PublicationsLibrary/webdiaeia2015d2_en.pdf.

⁵ IMF, *World Economic Outlook – Adjusting to Lower Commodity Prices*, October 2015, <http://www.imf.org/external/pubs/ft/weo/2015/02/pdf/text.pdf>, p. 169.

⁶ Office for National Statistics, Labour Market Statistics, 16 September 2015, <http://www.ons.gov.uk/ons/rel/lms/labour-market-statistics/september-2015/table-a01.xls>, accessed on 27 September 2015.

Figure 2: Projected populations to 2050, selected countries



Source: UN Population Division.

Economic growth is attracting immigrants, from the EU and beyond. As a result, the UK is on course to become the EU's largest country by population, overtaking Germany, by 2050 (see Figure 2).⁷ And it remains attractive and open to foreign investors. The UK's stock of inward FDI, at nearly \$1.7 trillion in 2014 according to the UN Conference on Trade and Development (UNCTAD), is second only to that of the US (\$5.4 trillion), and ahead of China (\$1.1 trillion, excluding Hong Kong) and Germany (\$744 billion).⁸ In addition to their counterparts from G7 economies, Chinese and Indian firms are now investing heavily in the UK.⁹ Despite the upheavals of the financial crisis and a far tighter regulatory environment, London has retained its status as one of the world's top financial centres. The UK has also maintained its position as the world's second-largest exporter of services after the US, tapping into growing demand in emerging markets for its skills and brands in finance, law, education and the creative industries.¹⁰

Nevertheless, the UK faces structural constraints in coping with an increasingly competitive global economy. High budget deficits following the financial crisis have raised the country's debt-to-GDP ratio from 52 per cent in 2008 to almost 90 per cent at the end of 2014 (see Figure 3).¹¹ Despite extensive cuts in public spending during the last parliament, the government deficit in 2014 – six years after the start of the financial crisis – still stood at over 5 per cent of GDP, one of the highest rates in the EU.¹² The Office for Budget Responsibility (OBR) now expects that the government will

⁷ UN Department of Economic and Social Affairs, Population Division, *World Population Prospects: The 2015 Revision, Key Findings and Advance Tables*, Working Paper No. ESA/P/WP.241, 2015.

⁸ UNCTAD, *World Investment Report 2015*, 'Annex Tables', 24 June 2015, <http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx>, accessed on 17 September 2015.

⁹ In 2014, Chinese companies continued to invest in some of the UK's most important redevelopment projects. The Chinese conglomerate Wanda committed £790 million to the Nine Elms hotel, office and housing development in London; Beijing Construction and Engineering Group, along with the Manchester Airports Group, Carillion and the Greater Manchester Pension Fund, committed £800 million to Airport City Manchester. See UK Trade & Investment, *Inward Investment Report 2013/14*, No. URN UKTI/14/125, 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341601/UKTI_Inward_Investment_Report_2013-2014.pdf.

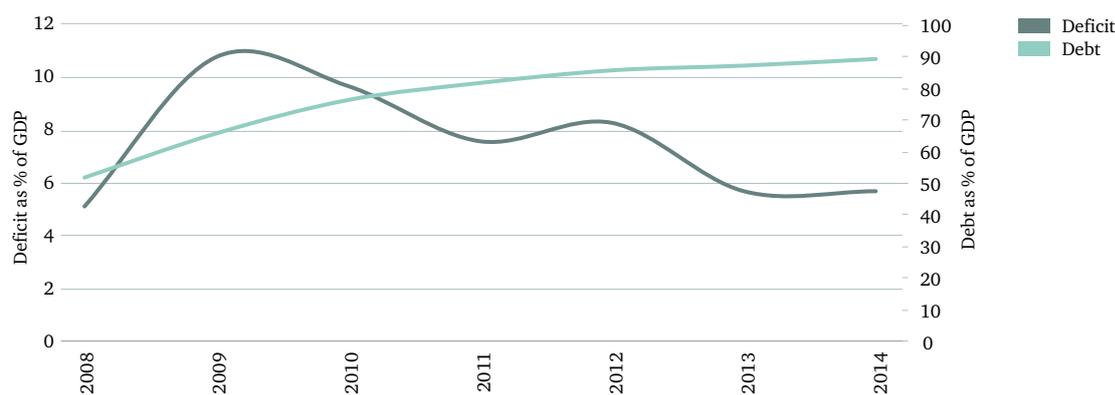
¹⁰ Andrew Sentance and Barret Kupelian, 'How the services sector is rebalancing Britain's economy', *UK Economic Outlook*, PricewaterhouseCoopers, November 2013, <http://www.pwc.co.uk/the-economy/publications/uk-economic-outlook/ukey-nov13-how-the-services-sector-is-rebalancing-britains-economy.jhtml>, accessed on 5 August 2015.

¹¹ Office for National Statistics, *Statistical Bulletin: EU Government Deficit and Debt Return including Maastricht Supplementary Data Tables, Q4 2014*, 17 April 2015, http://www.ons.gov.uk/ons/dcp171778_401596.pdf.

¹² Eurostat, 'General government deficit and surplus annual data', 2014, <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&plugin=1&language=en&pcode=teina200>, accessed on 5 August 2015.

not achieve its goal of a budget surplus until 2019–20 at the earliest.¹³ In the meantime the UK will spend £34.6 billion, more than its defence budget, on interest payments in 2015–16 alone.¹⁴ Annual interest on government debt is forecast by the OBR to grow to £53.2 billion by 2019–20, and could be higher if international bond markets start to doubt the ability of the British government to reduce the deficit.¹⁵

Figure 3: UK budget deficit and national debt as % of GDP, 2008–14



Source: Office for National Statistics.

Running relatively high budget deficits may have helped the UK economy weather the credit crunch that followed the financial crisis. Bringing the deficit down to a more manageable level and holding it there so as to stop overall debt from rising excessively will depend on the economy achieving sustainably strong growth. However, the UK has underperformed its OECD peers in terms of productivity since 2007, and economic growth remains overly dependent on consumer-led consumption and the housing market.¹⁶ Unbalanced growth between the north and south of the country; low levels of investment in research and development (the UK spends 1.7 per cent of GDP on R&D, compared with 2.9 per cent in Germany and 3.4 per cent in Sweden)¹⁷; ageing physical infrastructure, from rail to power stations; underperforming state primary and secondary schools; restrictive planning laws; and a shortage of long-term capital for new businesses – all remain structural impediments to the economy’s global competitiveness.

These factors partly explain why, despite a concerted effort by the last government to help companies boost their exports and the competitiveness of the UK service sector, the UK ran roughly the same size overall trade deficit in 2014 as it did in 2009, averaging around 5 per cent of GDP.¹⁸ Worryingly, the persistent trade deficit coincides with what may be a structural decline in the historically high income that the UK receives from its large stock of overseas investments, thereby weakening its overall balance-of-payments position.¹⁹

¹³ Office for Budget Responsibility, *Economic and fiscal outlook*, July 2015, p. 5, <http://cdn.budgetresponsibility.independent.gov.uk/July-2015-EFO-234224.pdf>.

¹⁴ *Ibid.*, p. 110.

¹⁵ *Ibid.*, p. 110.

¹⁶ *OECD Compendium of Productivity Indicators 2015*, <http://www.oecd.org/std/productivity-stats/>, accessed on 6 September 2015.

¹⁷ World Bank Data, ‘Research and development expenditure (% of GDP)’, http://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS?order=wbapi_data_value_2012+wbapi_data_value+wbapi_data_value-last&sort=asc, accessed on 5 August 2015.

¹⁸ Office for National Statistics, ‘Record trade surplus in services partly offsets record trade deficit on goods’, 23 January 2015, <http://www.ons.gov.uk/ons/rel/uktrade/uk-trade/november-2014/sty-record-trade-surplus-in-services-partly-offsets-record-trade-deficit-on-goods.html>.

¹⁹ For a discussion of this issue, see Ben Broadbent, ‘The UK Current Account’, presentation at Chatham House, 29 July 2014, <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech750.pdf>.

Growing insecurity

The UK must also adapt to the reshuffling of the international order that has been prompted in part by globalization, the end of the Cold War, the rise of China and other emerging powers, and violent upheaval in the Middle East. Some governments are using nationalism and atavistic resentments to enhance or protect their country's status as well their own political power. In Russia, Vladimir Putin is resisting his country's decline from former Cold War superpower to economically dysfunctional (if still nuclear-armed) commodity exporter. He is centralizing domestic political power and seeking to keep neighbouring countries as dependent as possible on Russia, if necessary using economic coercion or military force to achieve his aim. The US and China are sparring in the Asia-Pacific. As China's economy continues to grow, its leaders are determined to re-establish suzerainty over the South China Sea, through which so much of its trade passes. Neighbours and the US are attempting to resist. In the Middle East, Arab governments are funding military groups in Syria and intervening in Yemen, seeking to pre-empt a potentially more assertive Iran should it reintegrate into the global economy following the nuclear deal agreed with the E3/EU+3 on 14 July 2015.²⁰ As a permanent member of the UN Security Council, the UK could be expected to respond to escalation in any one of these contests.

The implications for Britain's international obligations do not stop there. As a key member of NATO, the UK is duty-bound to confront Russian threats against its European allies. In East Asia, its close security relationship with the US and commitments under the Five Power Defence Arrangements mean that it cannot ignore the possibility that a flare-up with China, for example over maritime interests, might lead to British involvement in conflict de-escalation. In the Middle East, Britain's long-standing security relationships with Gulf states and its new naval base in Bahrain mean that it will face pressure to play a greater role both in combating the rise of Islamic State of Iraq and Syria (ISIS) and in balancing the rise of Iranian power in the region.

The UK is finding it difficult to sustain the material resources and domestic political cohesion required to address the multitude of risks that it faces.

And yet, the UK is finding it difficult to sustain the material resources and domestic political cohesion required to address the multitude of risks that it faces. Between 2010 and 2015, the coalition government cut the defence budget by 19 per cent in real terms.²¹ Combined with the effects of cuts made under the preceding Labour governments, this has weakened British defensive capabilities (such as air maritime patrols) and impaired the country's ability to project power. The number of destroyers and frigates has fallen from 50 in 1990 to just 19 today,²² and Britain is also temporarily without an aircraft carrier to project airpower to conflict zones.²³

The government points to the fact that, despite recent cuts, the UK was still the fifth-highest spender on defence in the world in 2014 and has now committed to keeping defence spending at 2 per cent of

²⁰ The E3/EU+3 consists of China, France, Germany, Russia, the UK, the US and the High Representative of the European Union for Foreign Affairs and Security Policy.

²¹ Malcolm Chalmers, *The Financial Context for the 2015 SDSR: The End of UK Exceptionalism?*, Royal United Services Institute, Briefing Paper, September 2014, https://www.rusi.org/downloads/assets/201409_BP_Financial_Context_of_the_2015_SDSR.pdf, p. 2.

²² House of Commons Defence Select Committee, *Defence – Tenth Report, Re-thinking defence to meet new threats*, March 2015, <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmdfence/512/51207.htm>.

²³ The impact of the cuts was noticeable in the UK's contribution to defeating Muammar Gaddafi's forces in Libya in 2011. Senior US officials have been outspoken in their concern about the UK's potential inability to serve as an effective partner in future conflicts. See 'US army chief "very concerned" about impact of cuts on British forces', *Guardian*, 2 March 2015, <http://www.theguardian.com/politics/2015/mar/02/us-army-chief-of-staff-concern-defence-budget>.

GDP. The Ministry of Defence is in the middle of a series of major planned procurements, even if many are delayed and over budget. The first of the new Queen Elizabeth class of aircraft carriers is expected to be operational by 2020, and the government has allayed fears that the second ship in the class will be mothballed or sold. The government will replace the Vanguard-class nuclear submarines and the Trident missile deterrent they carry, take delivery of new Astute-class attack submarines, procure the new Type-26 frigate, and purchase F35 joint strike fighters and A400M transport aircraft.²⁴

If these procurements continue on schedule, however, they will consume a major proportion of the defence budget for 2018–35. This will limit the funds available for full-time personnel, operations, training and maintenance. Total troop numbers in the British army have already been cut severely, while the planned rise in reserves has yet to materialize.²⁵ The UK may face a situation in which it has highly advanced equipment but lacks either the trained forces or the ammunition, maintenance, logistics and other supporting infrastructure to use it effectively.

As important as traditional defence spending may be in a contested world, it is insufficient when a principal threat to Britain's security comes from the spread of state fragmentation. This trend is most visible in the Middle East, North Africa and the Sahel, where many governments have failed to deliver economic growth and opportunity to large, youthful populations, contributing to their states being torn apart along sectarian, tribal and national fault lines. In particular the collapse of central government control over Libya, Syria and Iraq, along with the rise of ISIS, raises the risks to British citizens from terrorist attacks. It also guarantees that the unprecedented flow of refugees, asylum-seekers and economic migrants into Germany and other northern European states, potentially including the UK, will continue.

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Confronting a diverse range of state and non-state security risks requires political will as much as the right mix of military forces. Yet this is not always in evidence. The government's unexpected failure to secure parliamentary authorization to use military force in Syria against Bashar al-Assad in August 2013, the limited UK involvement in military operations against ISIS, and Britain's absence from the Minsk negotiations over the future of Ukraine have together given the impression that the UK has moved from the 'first team' to the 'reserve bench' in terms of helping to uphold international security. The recent experiences of troubled military interventions in Afghanistan, Iraq and Libya also raise doubts about the British government's capacity to use force effectively in future crises, and about its political appetite to do so.

The government argues that, far from demonstrating a pattern of disengagement, each decision – from intervention in Libya to non-intervention in Syria to taking a supporting role over Ukraine – was based on its merits. The government further contends that its position on each issue is open to revision should circumstances change, as the ongoing debate over airstrikes and the use of drones against ISIS in Syria demonstrates. But this underestimates the domestic political constraints on future decisions

²⁴ HM Government, *Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review*, Cm7948, 2010.

²⁵ Sam Jones, 'Wave of departures leaves British army under strength', *Financial Times*, 29 July 2015, <http://www.ft.com/cms/s/0/d3624138-3610-11e5-b05b-b01debd57852.html#axzz3mVXg4KZh>. In this article, Jones explains that cuts to 'the British army have been met three years ahead of schedule, with 20,000 troops having left the service since 2010'.

about military intervention. Already, a convention that parliament should authorize the use of military force or assistance appears embedded.

The May 2015 general election may have delivered a single-party government, but it also heralded a more fragmented domestic political environment that could make caution the default position in British foreign policy. The two leading insurgent parties – the Scottish National Party and UK Independence Party (UKIP) – are sceptical about the value of NATO and military intervention, while the 2015 Labour Party leadership contest has revealed that an increasingly vocal proportion of its supporters share similar views.²⁶ A recent Chatham House–YouGov survey showed that the British public strongly supports the idea of the UK remaining a ‘great power’, but also highlighted a deeply defensive public mood focused on protecting the UK at its borders and limiting the political scope for British governments to intervene militarily overseas in the absence of a clear international mandate.²⁷

Decaying international governance

The third external challenge to the UK is the inability of governments to reform existing international institutions or develop new ones to deal with the growing range of transnational threats to all nations – whether from climate change, pandemics or cyber insecurity. The UN Security Council continues to be dominated by the winners of the Second World War, with mutual suspicion often leading to lowest-common-denominator outcomes. The fact that voting weights at the IMF and World Bank still reflect the balance of global economic power that prevailed in the 1950s is encouraging the establishment of parallel bodies. The World Trade Organization (WTO) is paralysed, the nuclear Non-Proliferation Treaty partially observed, and the World Health Organization hampered by its intergovernmental decision-making. International cooperation will be harder to achieve and transnational threats harder to contain in a world of weak institutions.

Meanwhile the US, the world’s only superpower in 2015, appears at times reluctant to play a leadership role and at others incapable of doing so. After the disappointments of Iraq and Afghanistan, the Obama administration, reflecting majority US popular opinion, has become increasingly selective about the scope and intensity of its overseas engagements. Following the abortive Arab Spring and the administration’s failed efforts to broker an Israeli–Palestinian agreement, the US has disengaged from much of the Middle East – Iran negotiations and the ongoing air campaign against ISIS aside – while rebalancing its diplomatic and military footprint towards the Asia-Pacific. Its preferred strategy in dealing with outbreaks of violence that threaten US interests and those of America’s allies appears to be ‘offshore balancing’ – that is, avoiding major military interventions or attempts at nation-building in favour of occasional military strikes combined with more arm’s-length diplomatic engagement.²⁸

Despite the combative rhetoric already featuring in campaigning for the 2016 presidential nominations, the next administration is unlikely to want to return the US to a more interventionist posture. Even if the next president did try to reassert international US leadership more comprehensively, such a position would find fewer followers. Rising powers, increasingly confident

²⁶ Scottish Government, *Scotland's Future: Your Guide to an Independent Scotland*, 2013, <http://www.gov.scot/resource/0043/00439021.pdf>; UKIP, *Believe in Britain: UKIP Manifesto 2015*. <http://ucrel.lancs.ac.uk/wmatrix/ukmanifestos2015/localpdf/UKIP.pdf>.

²⁷ Thomas Raines, *Internationalism or Isolationism? The Chatham House–YouGov Survey*, Chatham House Research Paper, January 2015, https://www.chathamhouse.org/sites/files/chathamhouse/field/field_document/20150130Raines.pdf.

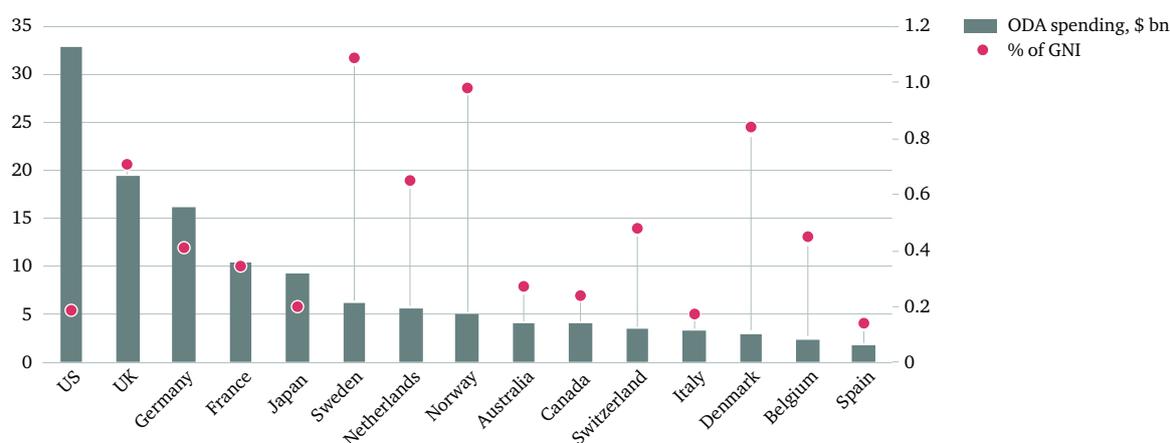
²⁸ See Stephen Walt, ‘Offshore balancing: An idea whose time has come’, *Foreign Policy*, 2 November 2011, <http://foreignpolicy.com/2011/11/02/offshore-balancing-an-idea-whose-time-has-come/>.

politically, are less inclined to accommodate US foreign policy agendas. The West's ability to promote liberal democracy and free markets has decreased as countries such as China and Russia have become more assertive. Suspicion of the US government's motives is also widespread in many countries, a view only reinforced by the Snowden revelations about mass surveillance and the recent investigations into the CIA's use of torture.

Little has been achieved at a multilateral level to address this more leaderless world. The G20 has become prominent since the 2008–09 financial crisis, but it serves principally as a more globally representative forum than the UN Security Council for debating major economic issues, and as a last-ditch crisis-response mechanism in times of financial instability. The increasingly formalized BRICS summits, the Shanghai Cooperation Organisation (SCO) and the informal MIKTA coordination arrangement cover relatively few countries, and have yet to prove their relevance or durability.²⁹ Many states still look to regional groupings or institutions to compensate for the lack of international consensus. The EU is the most fully developed and legally binding of these arrangements, but the African Union, the Association of Southeast Asian Nations (ASEAN), the Gulf Cooperation Council (GCC) and the Pacific Alliance in Latin America are all examples of states seeking to capture the benefits that regional coordination can offer in an interdependent but ungoverned world.

The UK retains the potential to be influential in this relatively unstructured landscape. It is the second-largest donor, after the US, of official development assistance (ODA). In 2014 ODA from the UK totalled \$19.4 billion, compared with \$32.7 billion from the US (see Figure 4).³⁰ In an increasingly networked and polycentric world, the UK also remains one of the best-connected countries. It is a permanent member of the UN Security Council; an active contributor to the G20, G7 and NATO; a founding member of the Commonwealth; one of the first non-Asian countries to join the Asian Infrastructure Investment Bank (AIIB); and, despite the uncertainty over its European future, still one of the 'big four' in terms of voting weight and diplomatic clout in the EU. London remains a global hub for international diplomacy, benefiting from the combined advantages of language, time zone and the largest concentration of international NGOs and media organizations in the world.

Figure 4: Official development assistance (ODA) donors, 2014



Source: OECD.

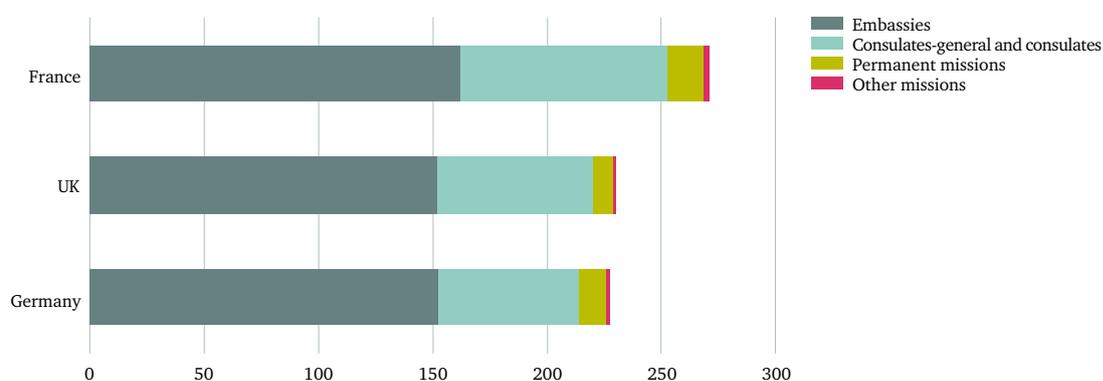
²⁹ The BRICS grouping consists of Brazil, Russia, India, China and South Africa. The SCO's members are China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan. MIKTA stands for the coordination between the foreign ministers of Mexico, Indonesia, South Korea, Turkey and Australia ahead of G20 meetings.

³⁰ OECD, *Development Co-operation Report 2014: Mobilising Resources for Sustainable Development*, November 2014.

Successive British governments have sought to use these diplomatic advantages to encourage a coordinated response to international challenges. In recent years this has included: hosting conferences to provide support for the stabilization of Somalia, promote efforts to combat sexual violence in conflict, and open international dialogue on the future of cyber security; and using the UK's 2013 G8 presidency to promote more open and transparent government and tackle tax avoidance.³¹

The UK still has one of the world's most extensive diplomatic networks, despite the budget for the Foreign & Commonwealth Office (FCO) falling by 16 per cent in the last parliament.³² While the government cut diplomatic representation in parts of Europe, it expanded the UK's presence in key cities across the world: creating 50 new positions in Beijing and 30 in New Delhi, and opening embassies and adding some 300 more staff in countries that include South Korea, Malaysia, Nigeria, Angola, Argentina, Peru, Pakistan, Vietnam and the Philippines.³³

Figure 5: Diplomatic networks, 2014 (number of embassies and other posts)



Sources: Auswärtiges Amt 2015; France Diplomatie 2015; FCO 2014, 2015.

Yet here, too, the UK faces structural challenges to its influence. The overall increase in the number of British embassies and missions around the world masks the reality that many are now thinly staffed. Capabilities in certain critical regions and countries, such as central and eastern Europe and the Middle East, have declined.³⁴ At a practical level, restrictions on spending and cuts to compensation packages are leading to difficulties in matching personnel at mid-career levels to increasingly heavily loaded, high-profile roles in sometimes dangerous environments. Continuing to employ more local workers at embassies may keep total staff numbers at or near current levels and improve local knowledge, but it also narrows the channels for effective coordination between embassies and policy circles in London.³⁵ In the meantime technological infrastructure – increasingly important if the UK is to coordinate, communicate and interact rapidly and coherently in respect of a complex range of policy challenges – has suffered from a lack of necessary investment. The new round of spending cuts planned for 2015–16 will likely exacerbate these trends.

³¹ House of Commons Debate, 19 December 2013, vol. 572, col 134 WS.

³² House of Commons Foreign Affairs Committee, *Foreign Affairs – Ninth Report: The FCO's performance and finances in 2013–2014*, February 2015.

³³ House of Commons Debate, 11 May 2011, vol. 527, cols 1165–1668.

³⁴ House of Commons Foreign Affairs Committee, *Foreign Affairs – Ninth Report*, paras 21–23.

³⁵ In March 2011 the FCO employed 5,045 civil servants from the UK and 8,500 local staff. By March 2014, the number of UK staff had fallen to 4,609 while the number of local employees had risen to 9,200. See Kiran Stacey, 'Britain's Foreign Office loses direction as more cuts loom', *Financial Times*, 14 November 2014, <http://www.ft.com/cms/s/0/f7e4c1e8-69ab-11e4-8f4f-00144feabdc0.html#axzz3mVXg4KZh>.

For 70 years the UK has enjoyed a privileged position in a Western-led world order, but this may soon be eclipsed. The country now risks being less influential in a host of international institutions as rising powers seek more central roles. It could also find itself less relevant to the US, as that country's leaders focus more on Asia; and less significant in a leaderless 'G20 world' than in one led by the G7. To the extent that the lack of reform of the multilateral Bretton Woods institutions results in jockeying for influence between the world's great and mid-sized powers, the UK may find its voice is dampened. This context compounds the negative effects of the UK's current detachment from the EU, which coincides with a period when all EU member states, the UK included, face the stiffest internal and external challenges to their prosperity and security in a generation.

In short, British leaders need to position the country strategically in such a way as to mitigate these risks and take advantage of the opportunities that the new context presents.

Recent Thinking about the UK's Place in the World

Interlocking or concentric circles

Since the end of the Second World War, Britain has had to make a sequence of pragmatic adjustments to its position within the changing international context. In 1948, Winston Churchill thought of Britain as lying at the intersection of three interlocking circles: broadly, the empire and Commonwealth; what he called 'the English-speaking world' (dominated by the US); and Europe.³⁶ The Suez crisis of 1956 was a pivotal point as Britain was forced to abandon its imperial vocation and commit itself to the role of junior partner to the US. Although the Commonwealth enabled it to retain a connection with its former colonies, this circle was never equal in weight to the other two. Economic decline in the 1960s and then depression in the 1970s drove Britain to seek membership of the European Community. Yet, from Margaret Thatcher's combative relationship with Britain's European partners to the failed ambitions of John Major and Tony Blair to put the UK at the 'heart of Europe', the relationship with the EU has always been awkward. This was epitomized by the UK's conscious decision not to join one of the EU's most ambitious political projects, the euro, which was launched in 1999.

In recent years different British politicians have tried to redefine the country's international role. As foreign secretary, David Miliband offered the vision of Britain as a 'global hub'. Taking advantage of the country's deep well of diplomatic connections and international linkages, Britain could serve as a global thought leader and agenda-setter in dealing with the 21st century's principal challenges.³⁷

In his first term as prime minister, David Cameron retained this notion of Britain being at the centre of a web of global networks. The thrust of his foreign policy was to wean Britain off its instinctive deference to the US, and the Conservative Party off its political obsession with Europe. He championed instead the idea of Britain rebuilding political and economic connections with the world's emerging markets and rising powers, some of which, like India, had formed part of its former empire. To a certain extent, this was a return to Britain sitting at the intersection of Churchill's interlocking circles. By setting to one side the country's focus on the EU and relinquishing its sense of obligation to the US, the new government could attempt to rebuild Churchill's first circle, this time under the mantra of a more commercial diplomacy so as to underline the economic imperative behind the strategy.

This change in focus made sense on one level, given the shift in the centre of global economic gravity that has accompanied the rise of emerging markets.³⁸ Over the past five years, the UK has indeed made some progress towards a more balanced set of international relationships. Despite a wobbly political start, following Cameron's meeting with the Dalai Lama in 2012, economic relations with China have steadily improved. Beijing has rewarded Chancellor George Osborne's persistence and given the UK

³⁶ Winston Churchill, 'Speech at a Conservative Mass Meeting, Llandudno, 9 October 1948', in Randolph S. Churchill (ed.), *Europe Unite – Speeches: 1947 and 1948 by Winston S. Churchill* (London: Cassell, 1950), pp. 417–18.

³⁷ David Miliband, speech at the FCO Leadership Conference, Queen Elizabeth II Conference Centre, London, 4 March 2008, <http://collections.europarchive.org/tna/20080205132101/www.fco.gov.uk/servlet/Front%3fpagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1007029391647&a=KArticle&aid=1203947979613>.

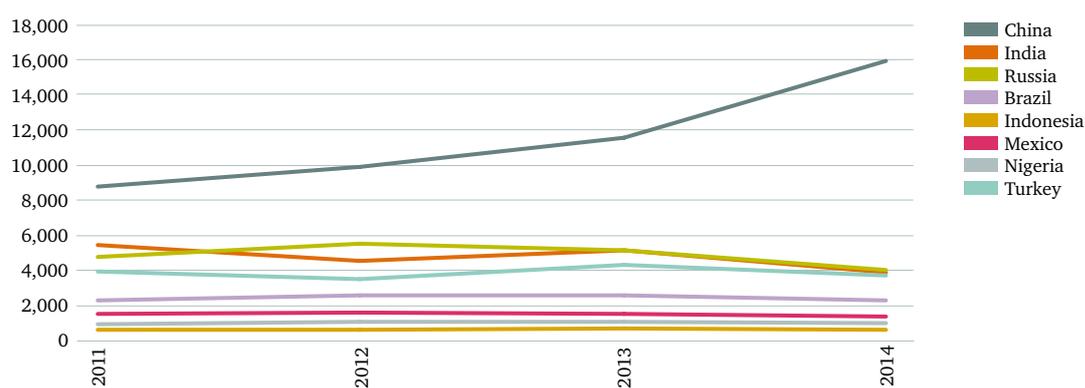
³⁸ Robin Niblett, *Playing to its Strengths: Rethinking the UK's Role in a Changing World*, Chatham House Briefing Paper, June 2010, https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Europe/r0610_niblett.pdf.

a prominent role in the Chinese government's strategy to internationalize the use of the renminbi. Britain's exports to China have grown from £7.3 billion in 2010 to £15.9 billion in 2014, an average annual growth rate of a little over 20 per cent.³⁹ This attempt to forge closer relations with Asia has not been restricted to China. Since 2013, the UK and Japan have signed a Defence Equipment Cooperation Framework and an Information Security Agreement, with the first UK–Japan Foreign and Defence Ministerial Meeting taking place earlier this year.⁴⁰

Overall, however, the rebalancing of British foreign and economic policy has been only partially successful. Far from deepening their bilateral economic relationship, Russia and the UK since 2014 have become adversaries. Most Gulf states remain wary of considering Britain a strategic partner, following its support for the Muslim Brotherhood government in Cairo in 2012 and its criticism of Bahrain for human rights transgressions during the Arab Spring. India ignored the early blandishments of the coalition government, and the two countries have yet to strike up a new 'special relationship', as London had hoped. Instead India has sought more cooperation with the US, a move motivated in part by the British government's tightening of visa controls and limits on after-study work experience (policies that continue to disappoint tens of thousands of Indian and other non-EU students interested in studying at British universities).

There is also the problem that building stronger bilateral relations with the world's emerging powers is a competitive business. The US and China are looking to do the same, and have the advantage of far larger domestic markets and financial resources for foreign investment – aided, in China's case, by powerful government-supported commercial diplomacy. The UK must also jostle for influence and market access with other EU member states, many of which have more competitive products and longer-standing commercial relationships with emerging markets. The UK's exports to leading emerging markets other than China have remained flat (see Figure 6).

Figure 6: UK exports to BRIC and MINT countries, 2011–14, £ million



Source: HMRC.

³⁹HMRC, 'Summary of Import and Export Trade with EU and Non-EU Countries – Annual 2007–2014', 3 July 2015, <https://www.uktradeinfo.com/Statistics/Pages/Annual-Tables.aspx>, accessed on 5 August 2015.

⁴⁰John Nilsson-Wright, 'UK Election Notes: Foreign Policy Opportunities – Security Cooperation with Japan', Chatham House, 23 April 2015, <https://www.chathamhouse.org/expert/comment/17500>.

And while the UK has had success in boosting trade with China, British exports of goods to the country still accounted for only 3.2 per cent of total UK exports in 2014, whereas 6.6 per cent of Germany's exports went to China.⁴¹ There has also been recent disappointment for Britain's defence industry, with France's Dassault Aviation securing an off-the-shelf order from India for 36 Rafale aircraft after beating a rival bid from the makers of the UK-backed Eurofighter Typhoon.⁴²

Expanding the UK's economic footprint in emerging economies is likely to get tougher. Some are entering complex political and economic transitions. China is in the midst of a risky but essential move to escape the 'middle-income trap' by trying to build an economy driven more by private consumption and services than by cheap exports and fixed investment. Making this transition is already causing domestic disruption financially, economically and politically. In other emerging economies, from Brazil to Turkey, deficiencies in political and regulatory systems and institutions still impede efforts to move up the global value chain and raise incomes. Some are seeing slower growth or recession. Meanwhile, the risks of political as well as economic instability are present in many other emerging economies, from South Africa to Malaysia to Indonesia.

All this suggests that the EU market's relative importance to the UK could actually increase again, if emerging markets continue to encounter turbulence while moving towards a middle-income economic model. It bears noting that their transitions are taking place just as the majority of EU countries implement a range of structural reforms in response to the euro crisis. Some of these changes should improve their competitiveness and growth prospects in the medium term, making them more valuable to the UK as trade and investment partners.⁴³

Off-balance on the world stage

While the policy of concentrating on the rest of the world remains a work in progress, the UK's relationship with the EU has once again come to dominate the British political agenda. The decision by eurozone members to respond to the sovereign debt crisis by deepening their fiscal coordination raised concerns in London that this process might hurt Britain's interests in the single market. The eurozone's focus on crisis management through deeper integration, including steps towards common banking supervision and resolution, coincided with a weakening of David Cameron's domestic position. As the British economy struggled to recover from the 2008–09 financial crisis and UKIP rose in the polls, many in the increasingly restive Conservative Party rallied once again around the Eurosceptic cause. The result was Cameron's promise in January 2013 to hold a referendum on Britain's continued membership of the EU. This was partly to regain the consent of the British public to be members of a club whose central project, economic and monetary union, excludes the UK; and partly to confront the perennial divisions over Europe within the Conservative Party.

While this strategy may have made perfect sense in No. 10 Downing Street, it has damaged Britain's international reputation and caused resentment in other European capitals and in the corridors of the

⁴¹ Office for National Statistics, 'How important is China to the UK economy?', 9 June 2015, <http://www.ons.gov.uk/ons/rel/international-transactions/outward-foreign-affiliates-statistics/how-important-is-china-to-the-uk-economy/-sty-china.html>. See also Federal Ministry for Economic Affairs and Industry of the Federal Republic of Germany, 'Facts about German foreign trade in 2014', Berlin, May 2015, <https://www.bmwi.de/English/Redaktion/Pdf/facts-about-german-foreign-trade-in-2013,property=pdf,bereich=bmwi2012,sprache=en,rwb=true.pdf>, p. 12, calculations based on Federal Statistical Office of Germany data.

⁴² Peggy Hollinger and Amy Kazmin, 'Narendra Modi promises to buy French warplanes', *Financial Times*, 11 April 2015, <http://www.ft.com/cms/s/0/2f352ba0-e02c-11e4-a4e2-00144feab7de.html>.

⁴³ For a review of the different impacts of various structural reform policies, see Martin Sandbu, 'Free Lunch: The Good, the bad and the ugly in structural reform', *Financial Times*, 15 April 2015, <http://www.ft.com/cms/s/0/e9c6e16e-e349-11e4-9a82-00144feab7de.html>.

EU's institutions. Even traditional allies of the UK are increasingly concerned that commitments from Cameron on EU policy cannot be trusted, given the perception of Britain only being engaged in EU business while keeping one 'hand on the door'.⁴⁴

At the same time, US frustration with what one American diplomat privately called the UK's 'self-indulgent' obsession with EU membership has accelerated the gradual diversification of the US's key relationships in Europe. On international finance and trade, and sanctions policy towards Russia, the Obama administration has given primacy to Germany. Washington has deepened security cooperation with France on the Middle East and the Sahel, and with Poland on security in central Europe.⁴⁵ American unease with the UK's ambivalent attitude to the EU is compounded by the recent cuts to the UK defence budget.⁴⁶ There is also a sense in Washington that the Cameron/Osborne government has allowed economic interests with China to upset the balance that successive US governments have sought in Sino-US relations. The US accusation that the UK was involved in a process of 'constant accommodation' with China, following the UK's surprise decision in March 2015 to join the China-led AIIB, was a rare public revelation of underlying US frustrations.⁴⁷

Early in this new parliament, therefore, the UK finds itself off-balance on the international stage, struggling to sustain its relevance and influence at the nexus of three principal channels of influence: Europe, the transatlantic partnership, and a set of wider international relationships. At the core of the problem is the continuing desire of British leaders to retain maximum international flexibility, with Britain trying to serve variously as a pivot, bridge or connecting node in a networked world or, as William Hague once put it, 'a centre with many spokes coming out of it'.⁴⁸ Each of these concepts implies that Britain can pursue a foreign policy that is 'expeditionary and agile' and capable of facing in multiple directions simultaneously. It also suggests that Britain wants to continue to act as a free agent in international affairs, capable of giving equal priority to multiple bilateral and institutional relationships, despite growing international competition and constrained resources.

Given growing global competition for power and wealth, British leaders can no longer afford to think of the UK as lying at the intersection of a set of interlocking circles of influence. Instead, a concentric structure seems a more appropriate analogy.

This approach will not work. It is not just difficult in practice for British policy-makers to try to have their proverbial cake and eat it, as recent power shifts in the world order coincide with growing limitations on the UK's international influence. The structural underpinnings of Britain's security and international influence are also beginning to look less sound. Given growing global competition for power and wealth, British leaders can no longer afford to think of the UK as lying at the intersection

⁴⁴ Herman Van Rompuy, 'Britain in Europe: channelling change together', speech to Annual Conference of Policy Network, 28 February 2013, <http://www.policy-network.net/uploads/media/164/8266.pdf>.

⁴⁵ In a 5 June 2015 article describing Poland's foreign and security ambitions for Carnegie Europe's Strategic Europe, Eugeniusz Smolar notes that a third of the US cabinet had visited Poland in 2014, while also highlighting the contributions of France and Germany. The UK is not mentioned in the article. See Eugeniusz Smolar, 'Letter from Warsaw', Strategic Europe Series, Carnegie Europe, 5 June 2015, <http://carnegieeurope.eu/strategieurope/?fa=60322>.

⁴⁶ Ivo Daalder, 'Europe lacks commitment to spend on defence', *Financial Times*, 11 March 2015, <http://www.ft.com/cms/s/0/0eaa9cb4-c7e8-11e4-8210-00144feab7de.html>.

⁴⁷ Geoff Dyer and George Parker, 'US attacks UK's "constant accommodation" with China', *Financial Times*, 12 March 2015, <http://www.ft.com/cms/s/0/31c4880a-c8d2-11e4-bc64-00144feab7de.html>.

⁴⁸ For a review of these different concepts of the UK's role in the world, including William Hague's ideas, see Michael Harvey, *Perspectives on the UK's Place in the World*, Chatham House Programme Paper, 2011, p. 10, https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Europe/1211pp_harvey.pdf.

of a set of interlocking circles of influence. Instead, a concentric structure seems a more appropriate analogy. For Britain to be economically successful, secure and influential internationally in the future, its leaders need to think of the EU as constituting Britain's first or 'inner circle' – from which it can leverage its strengths to maximum effect. The US constitutes the next 'circle' in this model – playing both a defensive role, thanks to its position in NATO; and an enabling one, through the economic heft of a more integrated transatlantic market. The UK's other key bilateral and multilateral relationships – from the UN Security Council, G7 and Commonwealth to its relations with major emerging economies like China – can be seen as making up an outer circle of influence arrayed around these two. The implications of this model, explored in the next section, are that an effective British foreign policy must be anchored in the European 'inner circle'.

Europe: the Inner Circle

British policy-makers have long resisted seeing the UK's international security and prosperity as anchored first and foremost in Europe. The reasons go well beyond current concerns about immigration and interference from the 'Brussels bureaucracy'. They are rooted in an island-nation outlook and British leaders' history of offshore balancing in Europe. They reflect the country's reluctant and late arrival into the European Community, its continuing attachment to the idea of a sovereign parliament and its belief that it can take care of its own security as a nuclear-armed NATO member. The yearning for exceptionalism in Britain's international relations is reinforced not just by the country's former status as an imperial power and continuing status as a mid-sized international power, but also by the uncomfortable reality that the only alternative is to seek influence primarily through Europe – an explicit choice that no UK leader, save perhaps Edward Heath, has been willing to contemplate.

There is a growing concern in London that further integration around the single currency may come at the UK's expense, while making the EU's internal decision-making even more impenetrable and divided.

A number of factors have hardened the innate Euroscepticism of many Britons. Among these is the EU's drive towards economic and monetary union, the defective design of which has contributed to the extended economic crisis in many euro member states. There is a growing concern in London that further integration around the single currency may come at the UK's expense, while making the EU's internal decision-making even more impenetrable and divided.⁴⁹ British scepticism about the EU has also been heightened by the large number of EU migrants who have come to the UK in the past 10 years, subduing blue-collar wages in some sectors and straining public services in some communities, even though their impact on the UK economy in aggregate has been positive.⁵⁰ As a member of the EU, the UK has very limited capacity to stem this flow, especially while its economy continues to outperform those of its peers. And proposals to limit the number of economic migrants have been vehemently contested by European member states. Yet, as some EU members warn Britain not to tamper with the sanctity of free movement of labour in Europe, they also refuse to open their own markets to the free flow of professional services in which the UK often has a competitive advantage.⁵¹

Why, then, put Europe at the centre of Britain's foreign policy? Because working through EU institutions, despite their flaws, and with the UK's European neighbours offers the best prospects of managing the changing global context. First, it allows the UK to leverage the EU's global economic weight to secure the UK's economic interests internationally. Second, it gives the UK a say in designing new EU initiatives to strengthen both British and European security in the face of the complex and diverse threats in the EU's eastern and southern neighbourhoods. Third, cooperating with other EU

⁴⁹ See, for example, Charles Grant, 'David Cameron should stand up to the eurozone', *Financial Times*, 30 July 2015, <http://www.ft.com/cms/s/0/c8d9bf0c-3453-11e5-bdbb-35e55c8ae175.html>.

⁵⁰ Christian Dustmann and Tommaso Frattini, 'The Fiscal Effects of Immigration to the UK', *The Economic Journal*, 124: 580, 4 November 2014, pp. F593–F643.

⁵¹ For a thoughtful Conservative critique of the EU's double standards, see Sir John Major's speech to the Konrad Adenauer Stiftung in Berlin. John Major, 'Britain and the EU: in or out?', 13 November 2014, http://www.kas.de/upload/dokumente/2014/11/141113_Rede_John_Major.pdf.

members offers a way of maximizing opportunities for the international community to find joint solutions to shared problems in an ungoverned world.

Global economic leverage

As mentioned, in the past few years Britain's international economic policy-making has placed a particular focus on bilateral engagement with fast-growing emerging markets. This was understandable in the context of the investment and trade opportunities presented by the increasing integration of countries such as China into the global economy, and in light of the downturn in advanced economies after the global financial crisis of 2008–09. However, the recent rapid growth and future economic potential of emerging markets do not make the UK's membership of the EU any less relevant. And while the crisis in the eurozone has provided abundant ammunition to Eurosceptic critics of the UK's relationships with the EU, the continent retains its underlying importance to Britain's long-term economic prospects.

The first point to bear in mind is that the EU is not the obstacle to improved UK competitiveness that is sometimes claimed. The decline in the UK's share of world exports started well before the downturn in EU economies following the financial crisis.⁵² This has reflected deficiencies in UK economic productivity described above, as well as the relative underperformance of British small and medium-sized enterprises (SMEs) in export markets. In contrast, Denmark, Germany, the Netherlands and Sweden all show that EU membership can be compatible with high GDP per capita and global economic competitiveness.⁵³

To suggest that Britain's low productivity since 2007 is the result of a once-dynamic trading nation now being 'shackled' to the economic deadweight of a continental European 'corpse', as Daniel Hannan put it,⁵⁴ ignores the fact that the necessary remedies largely consist of domestic reforms and policies. As indicated earlier in this paper, the country needs to improve primary and secondary education; invest more in R&D; streamline planning laws; develop sources of long-term finance for SMEs; and modernize energy and transportation infrastructure. As the UK addresses these domestic challenges, it can make more of its EU membership.

The key reason for the EU's enduring relevance to the UK economy comes down, in a word, to size. With a population of 500 million, GDP higher than America's at an estimated \$18.5 trillion, and exports and imports amounting to about 20 per cent of the world's total, the EU constitutes the world's largest market.⁵⁵ The EU will remain the UK's principal trading partner for the foreseeable future – even though its share of Britain's export market has declined. In 2014, after six years of post-crisis sluggish growth, some 45 per cent of British exports still went to the EU, totalling £227 billion (see Figure 7).⁵⁶ At the same time, the EU's size gives it corresponding influence in international trade

⁵² The UK's share of world exports of goods and services fell from 5.8 per cent in 1998 to 4 per cent in 2008, despite a rise in total export volume. See Department for Business, Innovation and Skills/Department for International Development, *UK Trade Performance Over The Past Years, Trade and Investment Analytical Papers: Topic 3 of 18*, 2011, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/43313/11-720-uk-trade-performance.pdf, p. 5.

⁵³ Eurostat, 'AB Volume indices of GDP and AIC per capita, 2014', http://ec.europa.eu/eurostat/statistics-explained/index.php/File:ABVolume_indices_of_GDP_and_AIC_per_capita_2014_%28EU-28%3D100%29.png, accessed on 15 September 2015.

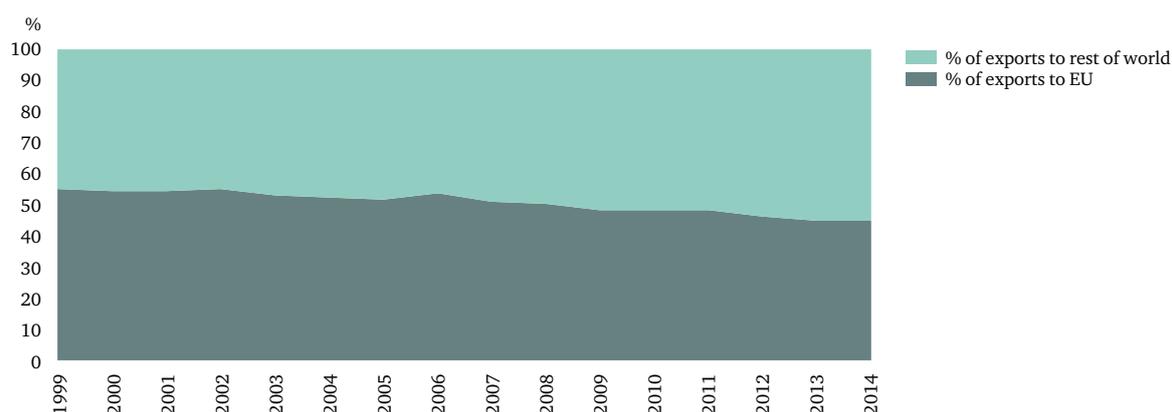
⁵⁴ Daniel Hannan, 'Diary', *The Spectator*, 7 April 2012, <http://www.spectator.co.uk/australia/7764418/diary-447/>.

⁵⁵ See World Bank Data, 'European Union', <http://data.worldbank.org/region/EUU>, accessed on 15 September 2015; and European Union, 'The economy', http://europa.eu/about-eu/facts-figures/economy/index_en.htm, accessed on 15 September 2015.

⁵⁶ Office for National Statistics, 'How important is the European Union to UK trade and investment?', 26 June 2015, <http://www.ons.gov.uk/ons/relation-international-transactions/outward-foreign-affiliates-statistics/how-important-is-the-european-union-to-uk-trade-and-investment/-sty-eu.html>, accessed on 12 October 2015.

and investment. Being a leading member of this bloc increases the UK's power in international trade negotiations, and gives it a potentially louder voice at a time when the world's established and rising economies are jostling to write the rules that will determine future product development and market access.⁵⁷ Far from holding the UK back, membership of the EU can improve the opportunities for British businesses to access these markets.

Figure 7: Shares of UK exports, EU and rest of world, 1999–2014



Source: Office for National Statistics.

That is why successive UK governments have strongly backed the EU's main market-opening initiatives, including: the recently negotiated EU–South Korea and EU–Canada free-trade agreements; those currently being negotiated with the US (the Transatlantic Trade and Investment Partnership) and Japan; and those agreements that seek to open up markets on a bloc-to-bloc basis, such as between the EU and ASEAN, the GCC and Mercosur respectively. UK exports to South Korea grew 57 per cent in 2012, the year after the EU's free-trade agreement entered into force. It is estimated that the recent EU–Canada agreement will deliver a long-term positive annual impact of £1.3 billion to UK GDP.⁵⁸ To date, over 80 per cent of all non-European countries have either concluded or are negotiating trade agreements with the EU, with the EU estimating that an additional €275 billion could be added to its GDP if all trade talks were completed.⁵⁹ Conversely, leaving the EU would require the UK to renegotiate over 100 trade agreements, which would be a lengthy and complex process.

Part of the reason why the UK continues to run trade deficits is that its relative competitive strength lies more in the service sector, which has not undergone the same level of market opening as manufactured goods, either in the EU or globally via the WTO. Over the years, the UK has argued in favour of EU governments breaking down protections on national service sectors. Fully liberalizing the EU's services market could increase EU GDP by 1.8 per cent, with a further €260 billion added if

⁵⁷ For information on the influence that rule-setting by the EU and other trading blocs has had on the British economy, see HM Government, *Review of the Balance of Competences between the United Kingdom and the European Union: Trade and Investment*, February 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279322/bis_14_591_balance_of_competences_review_Trade_and_investment_government_response_to_the_call_for_evidence.pdf.

⁵⁸ HM Government, 'Government welcomes historic EU-Canada free trade agreement', 18 October 2013, <https://www.gov.uk/government/news/government-welcomes-historic-eu-canada-free-trade-agreement>.

⁵⁹ European Commission, Directorate-General for Trade, 'Agreements', <http://ec.europa.eu/trade/policy/countries-and-regions/agreements/>, accessed on 15 September 2015.

a fully functioning single market in digital services is created.⁶⁰ However, EU governments would be less likely to sustain their increasing interest in liberalizing services if Britain were outside the EU. This would disadvantage the UK in areas such as financial services, in which it is especially competitive. It is also unlikely that the UK would have greater success opening third markets to its service exports alone or via the WTO than it would by ensuring that this objective is fully incorporated and secured in ongoing EU trade negotiations, and by using the lure of access to the EU's market to gain concessions from third parties.

In addition, a major reason for the UK's position as the leading EU destination for FDI is that it combines an English-speaking and relatively flexible labour market with barrier-free integration into the rest of the EU. And the barriers that matter to investors in a competitive modern economy are not so much tariffs, which are generally low (whether as a result of WTO commitments or regional free-trade agreements), as non-tariff barriers that include divergent national standards and regulations. These are precisely the barriers that the EU has removed across the single market to encourage its own cross-border economic integration. If the UK were outside the EU, it might retain largely tariff-free access to the EU as a member of the European Economic Area (EEA). However, like Norway it would be excluded from setting the EU's business standards and market regulations, to the potential detriment of UK-based companies.⁶¹

A major reason for the UK's position as the leading EU destination for FDI is that it combines an English-speaking and relatively flexible labour market with barrier-free integration into the rest of the EU.

As the UK Business Taskforce has noted, EU product standards and business regulations remain burdensome and frustrating for British firms.⁶² But even if Britain were outside the EU, relevant regulations would still need to be designed in London, where divergent political and social views on issues from workers' rights to environmental protections would be no less strongly argued and compromised over than at the EU level. And British officials would still need to ensure UK regulations were compatible with those of the EU, but without the benefit of having helped negotiate their parameters in the first place.

The success of the British car industry in recent years shows how UK business can benefit from being integrated into the EU single market. Representing 4 per cent of Britain's GDP and around 10 per cent of its exports in goods, the automotive sector posted turnover in excess of £60 billion in 2013.⁶³ As the second-largest vehicle market and fourth-largest vehicle manufacturer in Europe, the UK has attracted substantial automotive investments from EU and non-EU companies alike. This has helped the UK to

⁶⁰ HM Government, Department for Business, Innovation and Skills, *UK non-paper: Deepening the single market in goods and services*, July 2015, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/448444/BIS-15-436-deepening-the-single-market-in-goods-and-services.pdf. See also Josefa Monteagudo, Aleksander Rutkowski and Dimitri Lorenzani, *The economic impact of the Services Directive: A first assessment following implementation*, European Commission Economic Papers 456, June 2012, http://ec.europa.eu/economy_finance/publications/economic_paper/2012/pdf/ecp_456_en.pdf. Also see Joseph Dunne, *Mapping the Cost of Non-Europe, 2014–2019*, European Parliamentary Research Service, March 2014, <http://www.europarl.europa.eu/the-secretary-general/resource/static/files/files/mapping-the-cost-of-non-europe--march-2014-.pdf>.

⁶¹ Stephen Booth and Christopher Howarth, 'Trading Places: Is EU membership still the best option for UK trade and what are the alternatives?', Open Europe, June 2012, <http://openeurope.org.uk/intelligence/britain-and-the-eu/eu-membership/>; Emily Cadman and Chris Giles, 'Annual FT economists' survey: EU referendum would damage economy', *Financial Times*, 1 January 2015, <http://www.ft.com/cms/s/0/9d646b06-9124-11e4-914a-00144feabdc0.html>.

⁶² HM Government, *Cut EU red tape: report from the Business Taskforce*.

⁶³ KPMG, *The UK Automotive Industry and the EU: An economic assessment of the interaction of the UK's Automotive Industry with the European Union*, April 2014, <https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Market%20Sector/Automotive/uk-automotive-industry-and-the-eu.pdf>.

become a major car exporter.⁶⁴ Some 80 per cent of UK cars are now manufactured for export, and 50 per cent of production goes to the rest of the EU. In 2013, Nissan's Sunderland plant manufactured over 500,000 cars, of which 19 per cent were sold in the UK, 71 per cent in Europe (including Russia) and 10 per cent in the rest of the world.⁶⁵

Recent analysis by KPMG shows that less than 40 per cent of spending in the UK car manufacturing supply chain is on locally sourced components. Instead, the globalization of the motor industry has meant that the UK supply chain has become increasingly integrated across borders. A majority of the component suppliers in this network are in the EU. For British car manufacturing, unrestricted access to the single market and UK participation in setting relevant EU automotive regulations are critical for sustaining current growth in exports and inward investment.

Despite the recent economic crisis and a likely decline in its relative size, the EU together with the EEA will continue, collectively, to constitute one of the world's most influential economic spaces for several decades. EU countries still account for five of the world's 10 most competitive economies, according to the World Economic Forum.⁶⁶ High-quality European brands and technologies are among the most sought after by consumers and investors in established and emerging markets alike, explaining why EU companies still make up over a quarter (129) of the Fortune Global 500.⁶⁷ Toppling European companies from their perch will be a slow process for emerging-market rivals, especially if firms in Europe can build on recent advances in technology and customization to bring manufacturing processes and related services back 'onshore'.

By working with EU partners and institutions to open EU service markets and secure beneficial trade agreements, and by contributing actively to EU standard-setting and rule-writing, the UK has its best chance to leverage its growing competitiveness in the global marketplace.

Enhanced security

The EU is not a traditional security actor. It is not a military alliance, and defence remains a sovereign matter for each of its members. Although collective defence expenditure in the EU came to around €186 billion in 2013, they still have great difficulty achieving synergies in defence research and procurement or avoiding wasteful duplication in force structures and capabilities.⁶⁸ The result is that EU members are only capable of sustaining some 110,000 deployable land forces from total active forces of a little over 1.4 million, despite the serial commitments to build a more robust EU Common Security and Defence Policy (CSDP).⁶⁹ This, in turn, weakens EU members' ability to react to conflicts and, arguably, marginalizes the EU's collective ability to address the current challenges to its security. While prospects for strengthening the CSDP appear remote, other countries around the world are steadily increasing their own defence investments (see Figure 8).

⁶⁴ Ibid., p. 1.

⁶⁵ Ibid., p. 5.

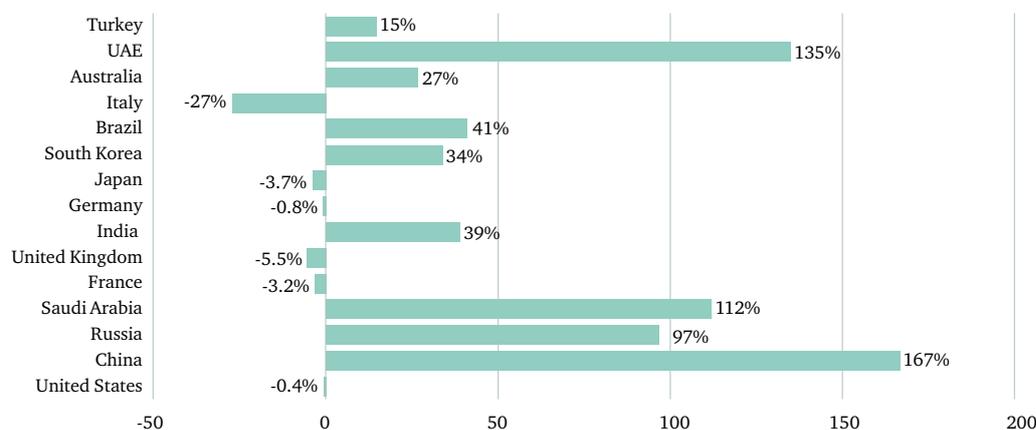
⁶⁶ World Economic Forum, *Global Competitiveness Report 2014–2015*, <http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/>, accessed on 6 September 2015.

⁶⁷ See Fortune Global 500, <http://fortune.com/global500/>, accessed on 5 October 2015.

⁶⁸ European Defence Agency, Defence Data of EDA in 2013, <http://www.eda.europa.eu/info-hub/defence-data-portal/EDA/year/2013>. See also Anand Menon, 'European Defence Policy from Lisbon to Libya', *Survival*, 53:3, 2011, pp. 75–90.

⁶⁹ 80 per cent of EU military spending is by four member states: Germany, France, Italy and the UK. European Defence Agency, Defence Data Portal, <http://www.eda.europa.eu/info-hub/defence-data-portal>, accessed on 5 August 2015.

Figure 8: Percentage change in military expenditure 2005–14, selected countries (\$ bn, constant 2011 prices)



Source: SIPRI Military Expenditure Database.

This does not alter the fact that, at a time when the limited effectiveness of using military force has been made readily apparent, cooperation with Europe still offers Britain an increasingly important range of options through which to enhance the security of its citizens and promote its broader international interests.

First, cooperation with EU members and institutions will become ever more necessary for dealing with the effects of instability in the Middle East and North Africa. For example, the 2005 EU Counter-Terrorism Strategy aims to assist member state authorities in preventing Europeans from joining terrorist organizations, and to facilitate the sharing of intelligence to protect citizens and infrastructure from attack.⁷⁰ As senior British law enforcement officers and legal experts have argued, cooperation between police, border forces and the judiciary in the UK and their counterparts in the EU constitutes an essential component of the country's counterterrorism capabilities.⁷¹ Such efforts will be relevant, in particular, as British and other European citizens who have fought in Syria and Iraq return home, some of them intending to undertake acts of domestic terrorism.

In addition, cooperating with other EU member states offers the only realistic prospect of managing and, if necessary, staunching the massive flow of refugees and other emigrants from the Middle East, Africa and South Asia, many of whom will continue to try to come to Britain. In September 2015 the UK committed a second warship and a contingent of Royal Marines to strengthen EUNAVFOR MED, the EU mission launched in April 2015 to combat illegal people-trafficking in the Mediterranean.⁷² But dealing with the crisis of migration into European countries will need a layered and more comprehensive approach in which EU governments and institutions combine resources at several levels: to engage diplomatically with countries directly involved in conflict as well as neighbours over which they might have influence, such as Turkey; to improve conditions in refugee camps; to establish processing centres,

⁷⁰ European Commission, Directorate-General for Migration and Home Affairs, 'Crisis & Terrorism', available at http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/crisis-and-terrorism/index_en.htm.

⁷¹ Helen Warrell and George Parker, 'Police defend EU arrest warrants', *Financial Times*, 6 February 2012, <http://www.ft.com/cms/s/0/228609b4-50f2-11e1-939d-00144feabdc0.html>; A review of the United Kingdom's extradition arrangements, 30 September 2011, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/117673/extradition-review.pdf.

⁷² Deborah Haynes and Bruno Waterfield, 'Britain sends warship to stop people smugglers', *The Times*, 16 September 2015, <http://www.thetimes.co.uk/tto/news/uk/article4558159.ece>.

from Italy across the Balkans, as people arrive in the EU; and to apportion those entitled to remain more equitably across the EU.

One of the main challenges in this crisis is to address the root causes of displacement and migration – from conflict to lack of economic opportunity in migrants' countries of origin. It is evident that European governments and EU institutions have been unable to encourage national leaders to improve political governance and offer better economic prospects to their own populations. The EU's European Neighbourhood Policy has proved overly bureaucratic and has failed to catalyse meaningful reforms in countries on Europe's fringes. Moreover, the EU has refused to open its markets to the few goods in which North African countries have a small comparative advantage, further limiting economic opportunities in those states.⁷³ That being said, blame for the convulsions that accompanied and have followed the Arab Spring should not be laid mainly at the door of the EU. Arab leaders bear by far the greater responsibility.

The EU's European Neighbourhood Policy has proved overly bureaucratic and has failed to catalyse meaningful reforms in countries on Europe's fringes.

Looking ahead, the main leverage available to British policy-makers to help stabilize Libya, protect the fragile political progress in Tunisia or implement reform in Morocco will still come through the EU and its ability to pool financial assistance, exchange technical know-how, and foster trade and investment. Boosting employment among these states' ever-growing young populations can reduce sources of political and social unrest. The incentive of access to EU markets means that coordinated and consistent political messages from EU governments to leaders in North Africa and elsewhere are likely to be more effective than bilateral UK diplomacy at promoting reform.

To the east, NATO will retain the principal responsibility for reassuring central European allies and deterring Russian adventurism. Here too, however, neither NATO nor the UK acting alone will improve the situation. The most meaningful way to blunt over the long term Russia's efforts to reassert its influence in central and eastern Europe is to help strengthen the political governance and economic prospects of countries in that region. A key means of achieving that is to persist with EU association agreements (including market-opening concessions) for non-EU members, given such initiatives' emphasis on improving legal standards, structural economic assistance, know-how funds, competition policy and energy cooperation. At the same time, the integrated energy market envisaged under the European Commission's proposed Energy Union could provide EU members in the region with a bulwark against the risks associated with reliance on Russian energy. In 2013 some 33.5 per cent of the EU's crude oil imports and 39 per cent of its natural gas imports came from Russia.⁷⁴

However, countering the impact of Russian aggression could prove to be the work of one or two generations, given the ingrained problems in many former communist states in central and eastern Europe. In addition to dependence on Russian energy imports, prospects for reform and stability are hampered by entrenched political and economic corruption, weak judiciaries and law enforcement, and susceptibility to media manipulation. The limited impact of the EU's Eastern Partnership since 2009 highlights the challenges ahead. In the long-term contest to determine the political

⁷³ Interview with Michael Leigh, 'ENP overhaul: are DCFTAs still a good idea? Michael Leigh shares his views', Borderlex, 24 April 2015, <http://www.borderlex.eu/enp-overhaul-dcftas-still-good-idea-michael-leigh-shares-views/>.

⁷⁴ Eurostat, 'Energy production and imports', http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy_production_and_imports, accessed on 24 September 2015.

and economic future of Europe's eastern neighbourhood, the Kremlin will continue to use the full spectrum of policy tools, from energy diplomacy to propaganda to irregular military operations, to intimidate and coerce its European neighbours.

Yet the events of the past year or so have shown that collective action offers the UK and other EU members a range of asymmetric responses that are far more powerful than any unilateral step. These have included strict application of EU public-procurement laws (which contributed to the cancellation of Russia's planned South Stream gas pipeline through the Balkans to EU markets in December 2014); efforts to improve energy-pricing transparency (which have forced Gazprom to auction gas supplies on the spot market, potentially reducing its scope to overcharge European customers); and the imposition of sanctions since July 2014 (which have carried real costs for the Russian economy).

Sustaining an influential global voice

The future prosperity and security of British citizens are increasingly affected by challenges that are global in scope and require coordinated responses among a range of governments and non-state actors. These challenges include controlling the rise of carbon emissions and addressing the effects of climate change; managing growing cyber insecurity; reversing the decay of governance in failing states; and combating the rise of dangerous non-state actors whose ambitions and impacts ignore borders.

As noted above, the UK benefits from its strong reputation for thematic as well as regional diplomatic expertise across most of these topics. It boasts networks in a host of multilateral forums, has an internationally powerful non-governmental sector, and is a major development donor. This puts the country in a position to shape effective responses to global challenges by using its national resources to marshal support among its EU counterparts. Being a leading member of the EU – the world's largest economic bloc, with a track record of establishing regulatory and institutional responses to cross-border challenges – enhances the UK's soft power and thus helps it to build broader coalitions, beyond the EU, to confront these challenges.

Countering the drivers of climate change is a good example of UK international leadership successfully leveraged through the EU. The UK government used the 2006 Stern Review on the economics of climate change to encourage EU member states between 2007 and 2008 to set ambitious targets for improving energy efficiency, reducing carbon emissions and increasing the use of renewable energy. The goal was that European standards would influence the global debate and drive support for an international agreement. The process has proved predictably tortuous, with the EU sidelined rather than supported by other governments at the Copenhagen climate summit in 2009. Yet EU members' persistence in pursuing EU targets has helped coalesce what is now a growing global consensus among governments and businesses in the lead-up to the Paris summit in December 2015 on the need to lower carbon emissions.

Cooperation within the EU also promises a number of specific energy-related benefits for the UK, other EU members and the world. EU renewable-energy markets have dramatically improved the economics of solar power and are likely to continue to do so in the next few years. In October 2014 the European Council endorsed the plan for an Energy Union, which aims to diversify energy supplies across Europe and cut greenhouse gas emissions by 40 per cent by 2030.⁷⁵ The UK has a key stake in this debate. A more integrated market could help the UK bring down wholesale power prices and boost prospects

⁷⁵ European Commission, 'Commission Priority: Energy Union', http://ec.europa.eu/priorities/energy-union/index_en.htm.

for offshore renewables in Britain and Europe. EU funding for R&D in renewable energy could also facilitate options for carbon capture and storage in the future.⁷⁶

Another example of how the UK could use its EU membership to help manage global challenges concerns internet governance. The British government, civil society organizations and businesses are struggling to achieve the potentially contradictory objectives of, on the one hand, improving UK citizens' access to online services and strengthening their rights to digital privacy; and, on the other, modernizing online surveillance to tackle terrorism and organized crime. Achieving acceptable compromises will be most likely if the UK works alongside its European counterparts to create a single digital market in the EU, an objective listed by European Commission President Jean-Claude Juncker as one of his 10 priorities.⁷⁷ The size and sophistication of such a market, if established, could improve the UK's chances of influencing the development of international standards of internet governance alongside the US and China, as the ongoing EU–US negotiation over so-called 'safe harbour' arrangements for transferring EU citizens' data to the US makes clear.

One of the main ways of addressing global challenges will be to help other societies become more resilient. EU leverage can be helpful to the UK in this respect also. The entry into force of the Lisbon Treaty in 2009 opened the way for EU members and institutions to adopt a more 'comprehensive approach' to European foreign policy, drawing on their wide range of economic, political, development and military instruments. Nowhere will this be more important than in sub-Saharan Africa. The ongoing growth in youthful African populations could be a boon to the sub-continent's future economic growth. But, if they are trapped in a cycle of violence and lack of opportunity, this will drive a massive new wave of migrants into Europe.

The British government, civil society organizations and businesses are struggling to achieve the potentially contradictory objectives of, on the one hand, improving UK citizens' access to online services and strengthening their rights to digital privacy; and, on the other, modernizing online surveillance to tackle terrorism and organized crime.

The 2011 European Strategy for Security and Development in the Sahel has sought to combine the use of civilian and military missions with development assistance, and has had some success in Mali and the Central African Republic. The EU operation known as EUNAVFOR Atalanta, which was launched in 2008 alongside NATO and US marine missions, and which is headquartered in the UK, has contributed to a dramatic reduction in the number of attacks by Somali-based pirates against commercial and civilian ships. Some 176 such attacks occurred in 2011, but only two were recorded in 2014.⁷⁸ The EU operation is supported by EUCAP Nestor, a civilian mission, which was launched in 2012 to help train forces in Somalia, Djibouti and the Seychelles to combat piracy.⁷⁹ Coordinating these collective EU efforts with the UK's plans to deploy more forces on tours to train third-country militaries (one aspect of so called 'defence engagement') would boost the chances of success for both.

⁷⁶ European Commission, Directorate-General for Energy, 'Towards an Energy Union – UK. Assessment of country performance and opportunities from the Energy Union', June 2015, http://ec.europa.eu/priorities/energy-union/docs/uk-benefits_of_the_energy_union_en.pdf.

⁷⁷ European Commission, 'Commission Priority: Digital Single Market', http://ec.europa.eu/priorities/digital-single-market/index_en.htm.

⁷⁸ European External Action Service, 'Key Facts and Figures, EU Naval Force Somalia – Operation Atalanta', <http://eunavfor.eu/key-facts-and-figures/>, accessed on 10 September 2015.

⁷⁹ European External Action Service, 'EUCAP Nestor', <https://www.eucap-nestor.eu/>.

The EU also has a role in building resilience and easing geopolitical tensions in Asia and the Middle East. In Southeast Asia – where all EU countries, including the UK, have growing interests but increasingly lack the necessary diplomatic presence – working together at an EU level with ASEAN members could assist in controlling the spread of piracy and improving resilience to climate-related events. In November 2013, the EU and ASEAN held their first high-level dialogue on maritime security. They discussed opportunities for collaboration in maritime surveillance and securing ports from piracy.⁸⁰ In the Gulf, support for regional economic reform and integration, including efforts to achieve greater collective energy efficiency and security, seems a natural space for EU dialogue in which the UK could play a leading role. The value of coordinated policy can also be seen in the efforts to control Iran's nuclear programme. Extended EU sanctions on Iran since 2012, alongside unilateral US measures and those supported by the UN Security Council, were instrumental in bringing Iran to the negotiating table, thus addressing one of the most significant near-term risks to the Non-Proliferation Treaty.⁸¹

Some of the above-mentioned initiatives will fail, some will succeed. All will have a better chance of success if the UK brings its considerable national diplomatic and material resources to bear and integrates cooperation with the EU into its own efforts from the outset.

⁸⁰ European Commission and the High Representative of the Union for Foreign Affairs and Security Policy, 'Joint Communication to the European Parliament and the Council. The EU and ASEAN: a partnership with a strategic purpose', JOIN(2015) 22 final, 18 May 2015, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=JOIN:2015:22:FIN&from=EN>.

⁸¹ European Commission, Directorate-General for Trade, 'Iran', accessed on 21 August 2015, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/iran/>.

UK–US Relations: the Second Circle

Over the past three decades at least, British leaders have tended to downplay the EU's strategic role so as to underscore the primacy of the transatlantic relationship in the UK's foreign affairs. Looking to the future, this approach is illogical, from both the British and American perspectives.

As noted above, notwithstanding revived tensions with Russia, the US is in the midst of a long-term rebalancing of its diplomatic and security focus from the Middle East and the Euro-Atlantic region towards the Asia-Pacific. The UK is not a principal player in Asian security, whether as a US ally or alongside countries in the region. Nor does the UK have either the political appetite or the material resources to play such a role.

On the other hand, the UK will remain central to US economic and security interests in Europe's neighbourhood, especially given the rise of instability to both the south and east of the EU's borders. The UK's value to the US is, first, as an essential contributor to what will need to become a stronger European pillar in NATO. Just as important, the UK is useful to the US as a security-conscious, leading member of an EU that shares with the US a commitment to a rules-based, liberal and open international order. In practice, this means the UK helping the EU craft and implement policies that support its more exposed central and eastern European neighbours economically and politically, and assist countries in the Middle East, such as Morocco, Tunisia, Lebanon and Jordan, which are attempting to promote reforms that will halt the spread of instability.

While the US remains essential to British and European security, its role is evolving into one of providing back-up to the EU's efforts to stabilize its own neighbourhood, as US leaders direct their country's resources to fulfilling more diverse responsibilities. America's relative disengagement from the ongoing conflicts in Libya and Syria stands out in this context. In other words Europe, Britain included, will need to take on greater day-to-day military, political and economic responsibility for European security, while the US sustains the strategic underpinning of that security through its political-military commitment to NATO, including through the continuing extension of its nuclear umbrella and its ballistic missile defences.

If it leaves the EU, Britain will find itself truly the junior and dependent partner in an unbalanced bilateral security relationship with the US.

The uniquely close UK–US coordination and cooperation on intelligence and counterterrorism will undoubtedly persist. But these manifestations of the 'special relationship' should not blind British decision-makers to the fact that the US continues to look for a capable *European* partner in Britain. From the US perspective, preserving an intimate UK–US security relationship matters less than being able to rely on a group of European countries, including the UK, that are capable of working closely together, pooling resources and sharing investments where necessary in order to take on more responsibility for preserving security in and around Europe. Unless Britain helps unblock the current obstacles to closer European cooperation in security and defence, then it will weaken the Atlantic Alliance rather than preserve it. And if it leaves the EU, Britain will find itself truly the junior and dependent partner in an unbalanced bilateral security relationship with the US, with the dominant partner's priorities and interests not always coinciding with its own.

This point is also relevant to the close UK–US economic relationship. The US has the largest stock of FDI in the UK, and is the UK's leading individual export market.⁸² The idea that the UK could enhance this bilateral economic relationship outside the EU, as some argue, ignores the fact that for US investors, as for others, the UK's ability to offer barrier-free access to the EU is an important part of its appeal.⁸³ For example, London's attractiveness to US financial institutions, as well as its pre-eminent position alongside New York in global finance, may be diminished by detaching the City, with its relatively small domestic economic hinterland, from its integrated place within the EU's far larger overall economy.⁸⁴ The persistence of protectionist 'Buy American' clauses at federal and state levels serves as a salutary reminder of the struggles that the UK would have in breaking down trade and investment barriers in the US without the leverage of the EU.

This underscores the importance of completing the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU. When negotiations for TTIP were launched in 2013, governments on both sides foresaw a groundbreaking agreement that would not only remove the bulk of remaining tariff barriers across the Atlantic on sensitive issues such as agricultural produce, but also establish a system whereby regulators in the US and EU would mutually recognize each other's standards and regulations across a range of sectors from medical devices to car safety. A revolutionary international innovation of this sort has only existed to date among EU members within their single market. To achieve such an agreement across the Atlantic could unlock significant long-term economic benefits. The US and the EU already have the most integrated economic relationship in the world. Sales by US companies' affiliates in the EU and by EU firms' affiliates in the US totalled \$5.2 trillion in 2013, eight times as much as US–EU merchandise trade of \$650 billion.⁸⁵

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However, TTIP has unleashed a wave of popular and legislative criticism across Europe and in some segments of the US, with each side fearing that the other will use the agreement to undermine cherished standards for environmental protection and food safety, and that it will allow companies to penetrate politically sensitive sectors such as healthcare, the media or aviation. Nevertheless, even if the two sides can sign only a 'lowest common denominator' TTIP agreement that creates frameworks for coordination on future regulations, this could have a powerful long-term stimulatory effect on transatlantic trade and investment and boost job creation both in the US and the EU. Just as importantly, it could help to establish standards and regulatory approaches that other countries would want to adopt, so as to improve their own access to a more integrated transatlantic market linking some 825 million people and nearly half of global GDP. In other words, if the UK treats the EU as its inner geo-economic circle, it will be able to use that position to improve its prospects not only within the larger transatlantic market, but also globally.

⁸² Grahame Allen and Aliyah Dar, 'Foreign Direct Investment', *House of Commons Library Standard Note*, SN/EP/1828, March 2013. See also HM Revenue & Customs, 'Top 10 Trading Partners – Non-EU Exports. 2007 to 2014', https://www.uktradeinfo.com/Statistics/EUOverseasTrade/Documents/Webtbls_2014.xls, accessed on 20 September 2015. Calculations based on HMRC and Overseas Trade Statistics data.

⁸³ John Springford and Simon Tilford, *The Great British trade-off: The impact of leaving the EU on the UK's trade and investment*, Centre for European Reform, January 2014, http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2014/pb_britishtrade_16jan14-8285.pdf.

⁸⁴ See interview with Guy Hands, chairman, Terra Firma, 'Transcript: for the City to thrive must the UK stay in Europe?', *Financial Times*, 1 December 2014, <http://www.ft.com/cms/s/0/129f5c98-762f-11e4-9761-00144feabdc0.html>.

⁸⁵ Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2015: Annual Survey of Jobs, Trade and Investment between the United States and Europe*, Center for Transatlantic Relations, John Hopkins University, 2015, p. v. For 2013 merchandise trade, data are from the US Census Bureau, <http://www.census.gov/foreign-trade/balance/c0003.html#2013>.

Conclusion: Committing to the EU

Seventy years after the end of the Second World War and 25 years since the end of the Cold War, Britain is struggling to find the right balance between its three traditional circles of international influence: the transatlantic partnership, Europe, and broader bilateral and multilateral networks. For a mid-sized country like the UK, which will never again be economically dominant either globally or regionally, and whose diplomatic and military resources are declining in relative terms, being a major player in a strong regional institution can offer a critical lever for international influence. In the UK's case, this means committing to be a leading member of the world's principal civilian power, the European Union.

Today, however, Britain's international influence is being weakened by concerns that the UK will not constructively reset its relationship with its European partners. These concerns sometimes underestimate the UK's national strengths, many of which would persist even if the UK were to leave the EU. But they are correct that Britain is likely to be richer, safer and more influential in the coming decades if it treats Europe as the 'inner circle' of its foreign and security policy, as well as of its international economic policy. Despite the UK's many attributes as an international hub, it is wrong to think that it can act alone as a flexible intermediary in an increasingly competitive and networked world; to try to do so would yield ever-diminishing returns.

Shifting the country's Eurosceptic perception of its place in the world to a more EU-centred outlook will be one of the most difficult but important challenges for British politicians in the coming years. Whether they belong to the moderate right or left, most see the UK as the champion of a reformed, open EU that helps its members prosper in an increasingly competitive world while maintaining the values and social standards of liberal democracies. They see the UK as the standard-bearer for a more democratic EU that better connects national polities with the EU agenda, and as one of the natural leaders of Europe's common foreign and trade policies. For the same reasons, many people in other EU countries wish to see the UK remain an influential EU member.

British politicians rarely engage in the diplomatic leg work and hard graft that would help the EU to live up to their expectations.

But British politicians rarely engage in the diplomatic leg work and hard graft that would help the EU to live up to their expectations. And for the next 12 to 18 months, the UK's ability to play constructive roles in Europe will be eclipsed by negotiations with its EU partners in preparation for the 'in-out' referendum. While the UK is currently a disengaged member of the EU, rising tensions between other member states and the EU's institutions may contribute to sub-optimal EU decisions on issues that closely affect UK interests, such as trade policy and dealing with migration.

Should the British people decide to leave the EU, then the UK and the EU would enter an extended period of economic and political dislocation before arriving at a new, mutually diminished *modus vivendi*. At the same time, British policy-makers would still be forced to deal and negotiate with the EU on critical policy issues from the outside. It is hard to see how that could lead to EU policies more in line with British interests. On the other hand, should the British people decide that the UK should

remain in the EU, British politicians will need to 'lean in' and engage far more consistently than in the past with their EU counterparts to help build the sort of European policies they advocate. A key question then will be how the government defines the UK's place as a non-eurozone member at a time when euro members are likely to deepen their political and financial integration.

Despite this challenge, British policy-makers need not necessarily fear a marginal position in the EU in the event of a 'remain in' victory in the referendum. They would have the opportunity to use the UK's economic size, diplomatic skills and networks, and broader national capabilities to play a leading role in defining and leveraging more effective EU-wide policies on trade, energy, foreign affairs, security and the single market. This would be a gruelling prospect, given the EU's structural flaws and competing national and institutional interests. But it would present the best pathway for the UK to sustain its economic welfare and enhance its security and influence in an ever more challenging global context.

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Robin Niblett became the director of Chatham House in January 2007. Before joining Chatham House, between 2001 and 2006, he was the executive vice-president and chief operating officer of the Center for Strategic and International Studies (CSIS) in Washington, DC. During his last two years at CSIS, he also served as director of the CSIS Europe Program and its Initiative for a Renewed Transatlantic Partnership.

He served as chairman of the World Economic Forum's Global Agenda Council on Europe (2012) and chairman of the NATO Policy Experts Group ahead of the NATO Wales Summit (2014). He has written extensively on UK and European foreign policy and has testified on a number of occasions to the UK's House of Commons Defence Select Committee and Foreign Affairs Committee, as well as to the US Senate and House of Representatives committees on European affairs. He received his BA, MPhil and DPhil from New College, Oxford.

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Robin Niblett

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