Civitas: Online Report

The Costs and Benefits of the European Union

Would we be better off if we left?

If the UK were to leave the EU, there would be no net loss of jobs or trade. In addition, we would be between £17 billion and £40 billion per year better off, possibly more. These are the findings of *A Cost Too Far?*, published by Civitas.

Prime Minister Blair often claims that 60 per cent of the UK's trade and three million jobs 'depend on' our EU membership. Closer analysis reveals this to be a highly misleading claim.

Sixty Per Cent of Our Trade? The first problem with Mr Blair's statement is that it refers to 'goods' and not 'goods and services'. In 2002, 59 per cent of UK exports of 'goods' were exported to the other 14 EU countries.[1] However, it is more usual to count exports of both 'goods and services' and, in 2002, UK exports of goods and services to the EU comprised about 52 per cent of the UK total. This figure needs to be adjusted for the Rotterdam-Antwerp distortion. These two huge ports serve as transit points for goods on their way to other parts of the world, but the official figures assume that goods sent there are going to the EU. After adjustment, 48 per cent of UK exports of goods and services go to the EU.

Sixty Per Cent of Our Economy? The second misconception is that 60 per cent of our *economy* depends on the EU, whereas the true figure is more like ten per cent. Exports of goods and services only account for 21 per cent of 'final demand'.[2] If exports of goods and services to the EU account for 48 per cent of total exports, then ten per cent of GDP is currently the result of exports of goods and services to other

EU members.[3] In other words, about 79 per cent of our economy is the result of domestic activity, involving buying from and selling to each other, and exports of goods and services to the rest of the world account for another 11 per cent.

Three Million Jobs Would Go? Mr Blair's third mistake is to believe that the jobs currently resulting from trade with the EU would be lost if we left. However, a number of authoritative studies have found that leaving the EU would have little impact on jobs, including a report by the National Institute for Economic and Social Research,[4] and a report for the US Congress by the US International Trade Commission.[5] In particular, if the UK left the EU, it is unlikely that UK companies would be denied access to other EU markets. The latest figures are for the period before enlargement and show that the other 14 members exported more to the UK than they imported from us.[6] It might be said that they need the UK more than the UK needs them. Moreover, about twenty countries as diverse as Switzerland, Gambia and Mexico have free trade agreements with the EU (with another sixty holding discussions), and it would be extraordinary if the UK could not negotiate a similar deal. In trading relations, self-interest tends to prevail, but in any event the EU's average external tariff on non-EU imports is down to about 1.5 per cent[7] and the World Trade Organisation would prevent any 'retaliation', however improbable.

Would there be a cost of leaving the EU?

The author concludes that, if the UK were to leave the EU, there would be no net loss of jobs or trade. However, to draw any such conclusion involves complex calculations, and it is widely accepted that assumptions have to be made that can influence the final figure. The author provides a range of estimates from 'rock bottom', through 'most likely', to 'high'. His rock-bottom figure draws largely on official sources and deploys the most cautious of assumptions. The net costs of EU membership are appraised in five areas: EU regulation, the common agricultural policy, net payments to EU institutions, the single market, and inward investment. In keeping with earlier cost-benefit studies the results in *A Cost Too Far?* are expressed as a percentage of GDP and rounded to the nearest half percentage point. In this Factsheet the estimates are in pounds. Overall, the net cost of remaining in the EU ranges from the 'rock-bottom' estimate of £17.6 billion to the 'most likely' of £40 billion.

EU Regulation: The rock-bottom estimate is £6.3 billion and the most likely, £20 billion. Based on the Government's own regulatory impact assessments (RIAs), the total cost of regulation between 1999 and 2004 (one-off costs spread over the period plus recurring costs), according to the British Chambers of Commerce, was £7.91 billion per year.[8] Based on information supplied by the House of Commons Library in May 2004, 83 per cent of the cost of regulations originated in EU directives. If rounded down to 80 per cent, then about £6.33 billion of the £7.91 billion total cost is due to the EU. There were no RIAs before 1999 and the estimate for the period from 1973 to 1999 has to be more tentative. An official study of the overall impact of EU regulation in the Netherlands has put the figure at two per cent of GDP.[9] If also true of the UK, the net cost would be £20 billion.

CAP: The rock-bottom figure is £7 billion and the most likely, £15 billion. The Treasury estimated the cost at about 1.2% of GDP (currently about £12 billion). Allowing for subsidies paid to UK farmers, this produces a net figure of about £7 billion. An OECD study put the total cost to the EU in 2002 at 1.4 per cent of GDP (£14 billion), producing a net cost of £9 billion.[10] However, allowing for costs and subsidies not included in the OECD study, and for subsidies received by UK farmers, the most likely net figure is £15 billion.

Payments to EU Institutions: This is an annual figure published by the Office for National Statistics and so no range is given. The latest *Pink Book* shows net payments of £4.3 billion. Over the last ten years, the UK has paid a similar net average amount each year, paying out an average of £11 billion per annum and receiving back £7 billion in 'aid'.[11]

Single (Internal) Market: A study by the European Commission in 1996 and an academic study published in 1998 are often quoted in support of the claim that the single market raised total EU output by between one and 1.5 per cent.[12] More recently, the European Commission has claimed that the internal market increased EU GDP in 2002 by 1.8% compared with a year earlier.[13]

However, a number of independent studies have found no hard evidence of net benefits. For example, the Bundesbank could find no evidence that it has helped German trade.[14] The UK economy is unlikely to be any different. The Institute of Directors reviewed studies from the Commission, the OECD and others and noted the absence of persuasive evidence of the benefits of the single market.[15] In 2003 an Institute of Directors' survey of members found that trading in the EU 14 was on balance unattractive and more costly, with more paperwork than before the single market. The overall conclusion of *A Cost Too Far?* is that the balance of costs and benefits for the UK economy is zero, that it could be negative, and that the UK would not suffer economically by being outside the single market.

Inward Investment: The UK is one of the world's leading overseas investors, but also a recipient of significant inward foreign direct investment (FDI). UK Trade and Investment, part of the DTI, monitors investment flows and its annual review for 2002/03 lists the main reasons why the UK attracts investment. Access to the single market is one among several other advantages, including the skilled and English-speaking labour force, the flexible labour market, good communications, the strong science and technology base in universities, low corporation tax, ease of market entry and tax allowances for start-ups.[16] These other advantages would remain and, if the UK left the EU, the impact on inward investment is likely to be neutral.

Some studies, including one by the NIESR, claim that FDI would fall if the UK left the EU.[17] *A Cost Too Far?* questions this contention by looking at the earnings on all inward investment made by the main economic sectors. The two biggest are oil and gas (39 per cent of earnings) and financial services (18 per cent). The study argues that oil and gas would continue to attract investment because they are high value products in a stable part of the world. Investments in financial services, another global industry, are mainly denominated in US dollars, and will go wherever the best return is to be found. The City has not suffered from the introduction of the euro and would be unlikely to suffer if the UK left the EU. Investment in manufacturing of 'chemicals, plastics and fuel products' (10 per cent by earnings) and 'other industries' (11 per cent) might be influenced by our EU membership, but it is a factor of declining importance.

Hitched to a 'Falling Star'?: Is it wise to link our fortunes to a region of the world with a poor record of economic growth and whose share of both world markets and GDP is destined to fall? Even the European Commission takes a gloomy view of the EU's prospects.[18] In its December 2002 review it forecast a 44 per cent decline in the EU-15 share of global GDP from 18 per cent in 2000 to ten per cent in 2050. In 2050, as in 1950 and 2000, the three most populous countries in the world are likely to be India (1.6 billion), China (1.5 billion) and the USA (0.4 billion). The working-age population of the EU, even after its current enlargement to 25 members, is projected to decline by 20 per cent to 30 per cent by 2050; whereas the working-age population of the USA is expected to increase by nearly one-third.

From: Ian Milne, *A Cost Too Far: An analysis of the net economic costs and benefits for the UK of EU membership*, published by Civitas, July 2004.

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Notes

1 Figures after enlargement are not yet available.

2 ONS, *The Blue Book 2003*, p. 84. Final demand is calculated by the ONS to remove inconsistencies between the income, expenditure and production methods of calculating GDP.

3 The calculation is 21/100 x 48. If the calculation is based on GDP at market prices, then exports of goods and services make up 26 per cent of the total, which means that exports to the EU account for 12.5 per cent of total national product. ONS, *The Pink Book 2003*, Table 1.2.

4 Pain, N. and Young, G., *Continent Cut Off? The Macroeconomic Impact of British Withdrawal from the EU*, NIESR, February 2000. Republished as 'The macroeconomic impact of UK withdrawal from the EU', *Economic Modelling*, 21 (2004), pp. 387-408. They concluded that there was 'no reason to suppose that unemployment would rise significantly if the UK were to withdraw from the EU'. However, they argued that foreign investment would fall, leading to a reduction in GDP of 2.25 per cent.

5 *The Impact on the US Economy of Including the United Kingdom in a Free Trade Arrangement with the United States, Canada and Mexico*, International Trade Commission, Investigation No. 332-409, Publication No 3339, August 2000. www.usitc.gov

6 ONS, *UK Balance of Payments*, *The Pink Book 2003*. www.statistics.gov.uk

7 Based on actual tariffs collected and derived from Written Answer P-0472/04EN given in the European Parliament by the Commission (Mrs Schreyer) on 5 March 2004.

8 British Chambers of Commerce, *Burdens Barometer 2004* and *Are regulators raising their game*?, 31 March 2004. www.britishchambers.org.uk

9 Speech by Dutch Vice Prime Minister and Finance Minister, Mr Gerrit Zalm to the UK Government sponsored conference 'Advancing Enterprise: Britain in a Global Economy', 26 January 2004.

10 *OECD Database 1986-2002, Producer and Consumer Support Estimates, Agricultural Policies in OECD Countries: Monitoring and Evaluation*, 2003; its figures are in US dollars. www.oecd.org

11 *UK Balance of Payments, The Pink Book 2003*, Autumn 2003, Table 9.2. www.statistics.gov.uk

12 European Commission, *The Single Market and Tomorrow's Europe: A Progress Report from the European Commission*, 1996; Allen, C., Gasiorek, M., and Smith, A., 'The competition effects of the single market in Europe', *Economic Policy*, 1998, 27, pp. 441-86.

13 European Commission, *The Internal Market: Ten Years Without Frontiers*. Online report, no date (approx. 2004), p. 6.

14 *Germany's competitive position and foreign trade within the euro area* (in English): Monthly Report October 2003, Deutsche Bundesbank. www.bundesbank.de

15 Leach, G., *EU Membership: What's the Bottom Line?*, Institute of Directors, March 2000, chapter 6. www.iod.com

16 UK Trade and Investment (formerly Invest UK), *Operations Review* 2003, July 2003. www.invest.uk.com

17 Pain, N., and Young, G., 'The macroeconomic impact of UK withdrawal from the EU', *Economic Modelling*, 21 (2004), pp. 387-408.

18 European Commission, *The EU Economy: 2002 Review*, ELFIN/475/02-EN: 11 December 2002, pp. 197-99.