

Briefing 15:02

THE EU JOBS MYTH

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March 2015

2020
VISION

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Economic Affairs



The EU Jobs Myth

Why 3 or 4 million jobs are not
'dependent on our membership
of the EU'

About 2020 Vision

2020 Vision focuses on the future of the UK economy and identifies the key economic issues likely to face the next UK government.

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About the author

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Summary

- Politicians regularly claim that 3-4 million jobs either 'depend on' or are 'associated with' our membership of the European Union (EU). This is calculated as the number of jobs linked – both directly and indirectly – to exports from the UK to customers and businesses in other EU countries.
- It is further suggested that the UK leaving the EU would put 3-4 million jobs 'at risk'. Yet these jobs are associated with trade, not membership of a political union. There is no evidence to suggest that trade would substantially reduce between British businesses and European consumers, even if the UK was outside the EU.
- Even in a hypothetical world where trade completely broke down between the UK and EU, there would still not be the loss of 3-4 million jobs, as 'import substitution' would partially offset the fall in exports and trade would develop with other parts of the world.
- The worst case scenario would be a failure to negotiate a free trade deal in the result of Brexit. If this were the case, both parties would be bound by the World Trade Organization's 'most favoured nation' (MFN) tariffs paid by other developed countries. This would prevent the imposition of punitive tariffs by the EU following the UK's exit, meaning job losses would not be significant.

- The UK labour market is incredibly dynamic, and would adapt quickly to changed relationships with the EU. Prior to the financial crisis, the UK saw on average 4 million jobs created and 3.7 million jobs lost each year – i.e. there is substantial churn of jobs at any given time. Indeed, the annual creation and destruction of jobs is almost exactly the same scale as the estimated 3-4 million jobs that are associated with exports to EU actors.
- A changed relationship with the EU could of course likely change the structure of the economy, so that jobs might not be in exactly the same industries as they are today. There is likely to be a substantial degree of trade diversion and distortion which occurs at the moment due to our membership of a customs union.
- Ultimately, whether EU membership is a net positive or negative for jobs and prosperity in the UK depends on what policies the UK pursues outside of the EU (in relation to employment regulation, welfare and tax); the way the UK decides to use its saved contribution to the EU budget; and the extent of new trade deals adopted with third parties. For a healthy labour market, liberal economic policies in each of these areas should be pursued.
- We can say with certainty that 3-4 million jobs are not at risk if the UK leaves the EU. There may well be net job creation or a range of other possible outcomes which should be debated rationally.

Context

'There are three million of our fellow citizens, men and women, in this country whose jobs rely directly on our participation and role and place in what is after all the world's largest borderless single market with 500 million consumers right on our doorstep... isolation costs jobs, costs growth, costs people's livelihood.'
Nick Clegg, Today Programme, 31 October 2011

As the debate about the UK's future relationship with the European Union (EU) takes increasing prominence, much of the focus will be on the economic impact of the UK deciding to leave the EU through an exit vote in a future referendum. The effects on employment are likely to be a significant debating point. This has been a clear area of contention over the past fourteen years.

In 2000, the South Bank University produced a report which estimated that 3.45 million jobs were associated with UK exports to the rest of the European Union (Ardy et al. 2000). This was calculated through estimating both the direct jobs associated with exporting to the EU¹ (approximately 2.5 million jobs) and the indirect effect of the demand for other goods and services this trade generated (0.9 million jobs). This figure has since been used as a killer statistic for those politicians advocating remaining a member of the EU, and is regularly held up as representing jobs 'dependent' on our membership.

In fact, updated analysis from the Centre for Economics and Business Research and British Influence published in 2014 estimated that now 4.2

¹ Calculated as the sum of output, by industry, divided by labour productivity in each industry.

million jobs were supported by exports by UK firms to the EU – 3.1 million supported directly by exports and 1.1 million indirectly through the spending this generated. This report was headlined as ‘Over four million British jobs depend on trade with the EU’ on the British Influence website.

Of course, this headline gives a disingenuous and mistaken interpretation. To the extent that these figures are correct, they represent the effects of **trade** with European Union firms and individuals, not trade with a political union.

It is little surprise then that politicians have thus watered down their interpretation of the use of this statistic, to state that there are 3-4 million jobs ‘linked to’ our membership of the EU. However, this interpretation is still incorrect.

This short briefing note will explain why the figures tell us little about the number of jobs linked to our EU membership, and concludes that politicians continuing to use this figure in public discourse should be publically challenged over its misuse.

The remainder of this note sets out clear reasons why the 3 million or 4.2 million jobs figures do not give us a good indication of the effect on jobs of leaving the EU:

- The jobs are associated with trade, not membership of a political union
- Even if the other EU countries ceased to trade with us, some extra domestic jobs would result from import substitution
- The labour market is dynamic and adapts over time
- The EU itself distorts and diverts trade
- Counter-factual uncertainty: what would a post-EU UK look like?

Jobs are associated with trade, not political union

The 3 to 4.2 million jobs are associated with **trade**, not with being a member of a collective political union with 27 other states. Trade occurs when importers and exporters in different countries interact, buying and selling their goods. This is an almost entirely separate argument from where UK sovereignty should lie.

Almost all economists recognise the importance of trade for economic well-being. Indeed, trade is widely regarded as being good for economic growth and hence facilitating job creation, primarily because it improves the efficiency of the economy and provides opportunity for technological and knowledge transfer between countries. By moving resources according to the principle of comparative advantage we can increase the efficiency of production processes, allowing lower prices. This facilitates cheaper imports and more choices to consumers, meaning they can buy extra goods or services. Meanwhile, export-driven growth tends to create jobs directly.

Trade and specialisation therefore creates more productive jobs. OECD analysis has shown, for example, that all 14 main studies undertaken since 2000 which were reviewed in the publication *Policy Priorities for International Trade and Jobs*, concluded trade helps raise incomes. In Chile, for example, the OECD report that workers in the most open sectors earn on average 25 per cent more than workers in sectors which are relatively closed.

The effect on jobs of open markets and trade will not be uniform, of course. Increased openness to trade could fundamentally change the structure of an economy, such that some industries cease to operate domestically. As such, trade can be associated with job destruction as well as job creation. Many of the former employees in those industries which face competition from overseas might find it incredibly difficult to find new work. The ability of economies to adapt can be strongly influenced by the flexibility of its labour market, by its welfare programmes and by employment protection laws. But overall, most economists agree that trade is good for the competitive process, with this competition and specialisation enhancing the productivity of labour and thus leading to more prosperity.

The implications of this are that the more free the trade the more prosperous, *ceteris paribus*, we are likely to be. Therefore trade should be as free as possible. Yet there is no a priori reason why not being a member of a political union would lead to substantially less trade. After all, consumers and businesses already undertake trade with consumers and businesses in other countries which are not part of political union nor members of the EU's single market. Indeed, 55.3 per cent of our exports in 2013 went to non-EU countries (ONS 2014). This also generates jobs in the UK. And there is no evidence to suggest that trade would substantially cease between British businesses and European consumers, even if the UK was outside the EU.

Import substitution

The idea that 3-4.2 million jobs are 'dependent on the EU' implies that none of the current jobs linked to British exports would remain if we were to leave the EU. In effect, it suggests that no trade would be undertaken between businesses and individuals in the UK and the rest of the European Union if we ceased to be an EU member.

Even in the bizarre event that protectionism or a trade war completely eliminated all trade upon British exit, we would expect there to be a degree of import substitution which would offset at least some of the job losses.

Trade between the UK and the EU to a certain extent displaces domestic economic activity in particular industries, whilst encouraging other industries to grow. This is a good thing, since it enables us to benefit from the gains of broader competition and the relative efficiency of different business sectors in different countries. The mercantilist view that exports are inherently good and imports are inherently bad has long since been dismissed. However, if we are purely examining the impact on the number of jobs of leaving the EU, then it also has to be recognised that jobs lost as a result of fewer exports will be replaced by jobs producing domestically what was previously imported.

Table 1 below, for example, shows that the UK imported 25 per cent more in goods and services from the EU than it exported in 2013. For trade in goods alone, the UK imported 45 per cent more than it exported. Making the very crude assumption that the labour intensities of industries in the EU are the same as in the UK, this would imply that around 5 million jobs in the EU are currently linked to trade with the UK. Previous estimates using more disaggregated figures have suggested nearly 6½ million EU jobs were linked to the EU's trade with the UK, as far back as in 2006 (Lea 2008).

Table 1: UK trade with the rest of the EU (£bn)

	2012	2013
Export of goods	153.18	154.58
Import of goods	209.64	223.71
<i>Balance</i>	-56.46	-69.13
Export of services	77.22	76.32
Import of services	60.27	64.53
<i>Balance</i>	16.95	11.79
Export of goods and services	230.40	230.90
Import of goods and services	269.91	288.25
<i>Balance</i>	-39.51	-57.35
Import/export ratios		
Goods	1.37	1.45
Services	0.78	0.85
Goods and services	1.17	1.25

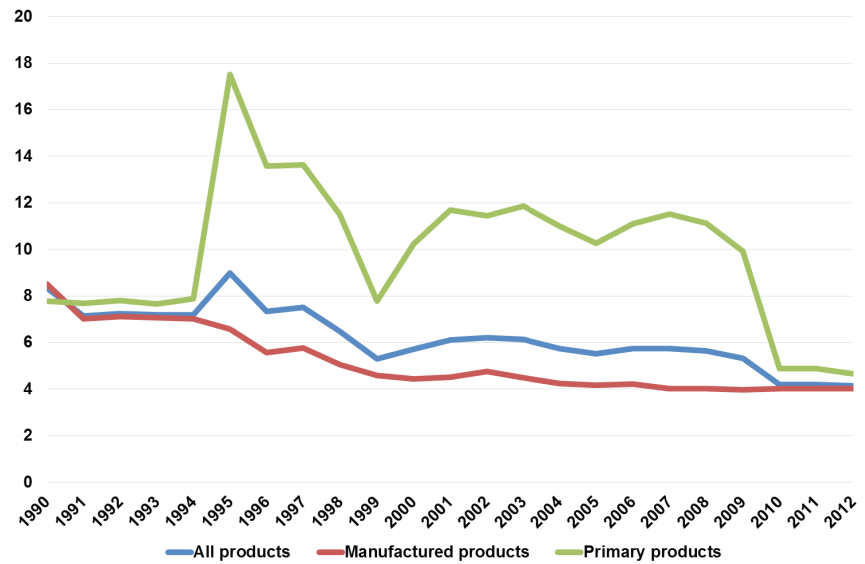
Source: ONS (2014).

This interdependence shows not only that it would be against the interests of other EU countries to engage in any sort of protectionist arms race with the UK, but also that it is likely a complete breakdown of trade would result in a substantial degree of demand substitution towards British firms, in part – or possibly in whole - offsetting jobs eliminated by the ceasing of export activity. It should be noted that these jobs would tend to be less productive because we would be losing the ability to exploit our relative efficiency by exporting financial services and other goods and services the revenues from which are used to buy imports. The standard of living of individuals and families would fall but the impact on the ‘number of jobs’ would be ambiguous.

Putting aside this extreme case, the realistic worst case scenario would be a failure for the UK and the rest of the EU to negotiate a free trade deal in the result of Brexit. If this were the case, both parties would be bound by the World Trade Organization’s ‘most favoured nation’ (MFN) tariffs paid by other developed countries. This would prevent the imposition of punitive tariffs by the EU following the UK’s exit.

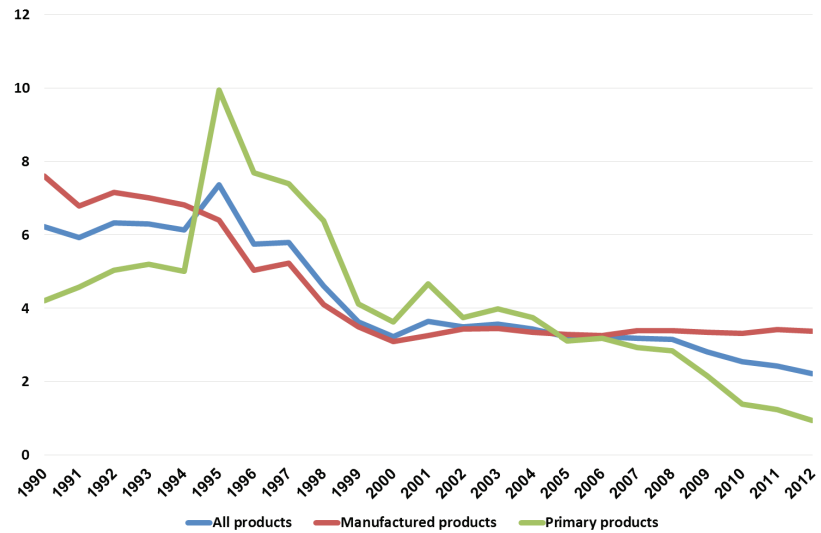
As Figures 1 and 2 show, the average EU tariff rate across all products had fallen to just 4.1 per cent by 2012 – or 2.2 per cent on a trade-weighted basis. These tariffs would of course hurt exporters at least to some extent with the costs being felt by some industries more than others.

Figure 1: Tariff rate, most favoured nation, simple mean



Source: World Bank Databank.

Figure 2: Tariff rate, most favoured nation, weighted mean



Source: World Bank Databank.

Given that average tariffs are so low, however, and in the case of products such as cars, for example, dwarfed by variations in the cost of physical inputs, interest rates and exchange rates, there is simply no chance that a particularly significant number of jobs would be at risk as a result of free trade giving way to 'most favoured nation' tariffs. In fact, to the extent that tariffs represent an impediment to trade, it is likely that continental car manufacturers (for example) will also have a strong interest in ensuring trade remains tariff-free too (continental EU manufacturers have been estimated to have a 53 per cent share of the domestic UK car market - see Stewart and Milne (2014)). Thus, it seems extraordinarily likely that free trade with the European Union would remain, and thus any disruption to jobs from a Brexit would be minimal.

The dynamic labour market

When discussing these issues, it is common to hear people claim ‘well, it may be true that there won’t be a large aggregate impact, but there is likely to be a significant impact on some industries – potentially causing severe disruption to the labour market’. The 3-4 million jobs are therefore held up as those that could potentially be disrupted by any change to trade arrangements, with much of the debate couched in terms of the virtues of stability within the labour market. In this context, 3-4 million jobs sounds like a significant proportion of the workforce with a potentially uncertain future.

In reality, however, the UK’s labour market is very dynamic. Research has shown that, in the period prior to the recession in 2008, jobs in the UK labour market were created a rate of 4 million per year and were lost a rate of 3.7 million, with average annual net job creation of 300,000 (Shaw and Butcher 2013). This shows that the UK labour market adapts extraordinarily quickly to changed circumstances with a substantial churn of jobs every year. Indeed, the rate of new job creation has been extremely rapid in the UK post-recession. Taking the whole period 2004-2011, the UK economy created 3-4 million jobs a year.

Too often, many debates about the labour market are couched in terms of stability, when in reality labour markets are ever-changing with people losing and gaining jobs. Though changed arrangements with the European Union could lead to some changes in the composition of jobs in the UK economy, the maximum overall disruption over a number of years, under extreme and completely unrealistic assumptions, would be significantly less than the annual churn we tend to see in the jobs market anyway.

The EU distorts and diverts trade

Were the UK to leave the European Union, of course there would likely be a degree of change in the UK's trade patterns. This would be influenced both by the new trading relationship that the UK was able to negotiate with the European Union and agreements made with other countries. If it were impossible to come to an agreement on the maintenance of free trade, then British exports to the EU which would incur high tariffs from the EU would suffer, resulting in job losses in some industries. Yet at the same time, the UK would not be bound by the trade policy of the European Union as a whole, and would be able to negotiate new agreements so that exports to third countries could increase.

Being a member of a customs union changes the patterns of trade from those that would prevail if there were global free trade or if all countries had the same tariff and non-tariff barrier regulatory regimes. If all countries had the same barriers then importers would choose to import from the most efficient producers even though domestic industry would be protected. However, membership of a customs union means that the UK faces no tariff barriers within the EU, but there are external tariffs on importing goods from many third countries. The existence of tariffs on third countries may mean that we import many things from the EU, when there are more efficient producers elsewhere. For example, we might buy more lamb from Ireland and less from New Zealand and more wine from France and less from Australia or Chile. If the UK left the EU, we would conduct more trade – both import and exports – with non-EU countries: trade with other countries would replace reduced trade with the EU. More jobs would be associated with non-EU trade and fewer with EU trade.

In other words, the existence of a common external tariff policy, with free trade within the EU, leads to more intra-EU trade than we might get if we left the EU. Furthermore, the EU distorts trade so that, overall, the economy

is less productive and imports more expensive. The UK's trade patterns would change if we left the EU, just as they did when we joined the EU.

Counter-factual uncertainty: what would a post-EU UK look like?

Ultimately, the health of the labour market were the UK to leave the European Union would be dependent on how the policy framework alters. This includes: labour market policies, welfare and tax policies, the way that the UK decided to use its saved contribution to the EU budget, new trade policies adopted with third parties, and levels and scope of regulation (including of immigration) in a post-Brexit world.

Though not addressing this question of job destruction directly, the Brexit prize winner Iain Mansfield's winning entry outlined a range of scenarios – from best case to worst case in terms of their economic impact – that the UK could experience outside of the European Union (Mansfield 2013). In the best case scenario, the UK would maintain free trade with the EU through entry to EFTA with significant access for service exports whilst accepting around half the EU's existing body of law. It could halve the EU's regulatory burdens on business, and sign a range of free trade agreements with fast-growing economies, such as China, India, Australia and Brazil. All existing free trade agreements are maintained, and the UK offers a more competitive corporate tax environment to encourage foreign direct investment.

In the most likely scenario, free trade is maintained through EFTA access with significant access for service exports but the UK has to accept two-thirds of the EU's existing body of law. There is some deregulation, and the UK's contribution to the EU budget is reduced significantly. Existing free trade deals are maintained, and the UK signs new Free Trade Agreements (FTAs) with some mid-level trading partners such as Australia and Brazil.

In a worst case scenario, no FTA is agreed and so British exporters face the 'most favoured nations' tariffs when exporting to the EU. Some existing FTA agreements, such as those with Canada and South Korea, are no longer honoured. The UK cuts regulation significantly and no longer has to contribute to the EU budget, but suffers from a loss of foreign direct investment and a spike in borrowing costs.

It is beyond the scope of this Briefing to attempt to calculate the impact of each of these three scenarios on the number of jobs. These scenarios have been set out, however, to show that it is self-evident that it is almost impossible to say how many jobs are ultimately 'dependent' on our continued EU membership without knowing what policies the UK would adopt outside of the EU.

Conclusion

It is wrong to claim or imply that 3-4.2 million jobs are ‘dependent’ on our membership on the European Union. Whilst it is true that the number of jobs associated directly with exports to EU consumers and indirectly with the income these generate is of this magnitude, these arise because of *trade*, not membership of the EU. There is no evidence to suggest that trade would substantially fall between British businesses and European businesses and consumers if the UK was outside the EU – even in the worst case scenario by which we failed to negotiate a free trade agreement.

In order to claim that all 3-4.2 million jobs associated with trade with EU companies and individuals are ‘dependent on the EU’, it has to be assumed that leaving the EU would lead to a complete ceasing of trade (such that the UK no longer exports to EU countries); that goods and services previously imported from the EU would not be produced domestically; that trade would not increase with the rest of the world; and that the labour market is incapable of creating new jobs to replace lost jobs. These assumptions are absurd. If trade breaks down completely, productivity and living standards will fall but this is a separate argument, itself based on a highly unlikely scenario.

In reality, our labour market is dynamic and would adapt quickly to changed relations with the EU. There may well be a change in the structure of the economy – particularly given the degree of trade diversion and distortion which occurs owing to membership of a customs union – and in the event of failing to negotiate a free trade agreement, UK-EU trade would probably fall to a small degree.

The net effect of leaving the EU on jobs, and (more importantly) productivity and living standards depends on an as yet unknown counterfactual situation – when we will have sought to negotiate a new trade arrangement with

the EU, whilst having the opportunity to reassess our regulatory burden and external trade policy. What we can say with certainty though is that there will not be a net loss of 3-4 million jobs on any rational assumptions. Politicians who seek to imply that 3-4 million jobs depend on our membership of the EU are either being dishonest or have not considered the economic arguments sufficiently carefully.

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