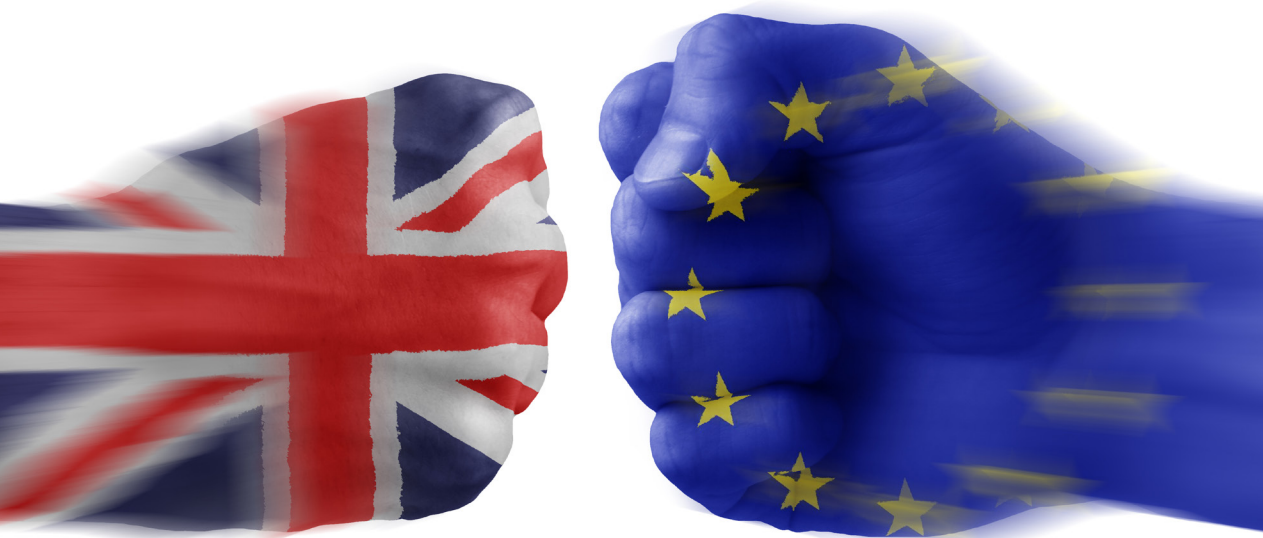


# BREAKING UP IS HARD TO DO

## BRITAIN and EUROPE'S dysfunctional relationship



Economists should welcome institutions that promote free trade and can help provide cross-border public goods. But, is the EU such an institution? If not, asks **LEN SHACKLETON**, what does it need to do to become such an institution?

'Should the United Kingdom remain a member of the European Union or leave the European Union?' is the rather clumsy question – its wording has been fought over – with which the electorate will soon be faced. Many EA readers may have a vote in this referendum; they will certainly be affected by

its consequences.

The debate around this question does not take place at the EU's finest hour. The euro zone crisis, and disagreements over how to handle the mass migration resulting from the crisis in the Middle East and elsewhere, have shown acrimonious disunity rather than a spirit of

'ever-closer union'.

Within the UK, there are considerable and constantly shifting political divisions about our relationship with Europe, and polls suggest that public opinion is volatile. The possibility of a 'Brexit' is very real. Much may depend on concessions which the Prime Minister has been able to

negotiate with the European Commission and fellow member governments. But what should he have been seeking?

The Institute of Economic Affairs has recently published a study exploring the issues in more detail than is usually found in the media. The authors undertook an unusual task. They have suggested what the EU should look like if it were designed to promote economic liberalism in line with the four freedoms of movement of people, goods, services and capital. Some of the authors argue that no changes can improve the EU sufficiently to make it worthwhile to continue in membership, but most offer intriguing suggestions for reform.

### Institutions

Firstly, consider the institutional framework. Martin Ricketts, using economic analysis of bargaining, agency and decision-making costs, argues that powers and responsibilities are not always assigned to the appropriate levels of government in the EU. One of government's basic roles is providing public goods, and the existence of spillovers between national jurisdictions may suggest that, in some fields, the appropriate level of decision-making is supra-national. However this does not necessarily mean that international public goods are best provided by the EU; in defence, for example, NATO is probably more appropriate.

Moreover an emphasis on spillovers should not detract us from noting that in some areas – such as corporate taxation – there are good arguments for

retaining national powers, as competition between jurisdictions can produce better policies. Yes, there may be problems arising from having 28 different tax systems, but the costs of centralisation may be greater.

In the book, German economist Roland Vaubel insists that the EU's major institutions are inappropriate for effective governance. The European Court of Justice has a vested interest in centralising powers: its judgments have in his view inappropriately extended

## MASSIVE INSTITUTIONAL INERTIA MAKES REFORMING THE UK'S STATUS WITHIN THE EUROPEAN UNION VERY DIFFICULT – PERHAPS IMPOSSIBLE – TO ACHIEVE

European control over areas such as employment regulation and social security. The European Commission breaches the liberal principle of the separation of powers by being both the initiator of legislation and its enforcer. The European Parliament is too large and an ineffective check on the Commission.

Vaubel offers a programme of reform based on institutions such as arbitration tribunals to settle disputes between member states; independent international prosecutors to enforce laws; a second revising chamber; and a separate competition authority.

According to Vaubel and Gwythian Prins, another contributor, EU institutions were designed by the founding fathers of European integration as a means to bring about 'creeping federalism'. They imply a ratchet effect by

which the famous *acquis communautaire* – the body of existing EU law and regulation – can only be added to, rather than reduced, as the EU moves towards greater integration.

Massive institutional inertia, lawyer Martin Howe argues, makes reforming the UK's status from within the European Union very difficult – perhaps impossible – to achieve. He believes that the best chance for real change, though it would be a risky strategy, is for the country to vote to leave the EU and then

negotiate from first principles for a new arrangement which would be beneficial to both parties – the 'zero-plus' approach to renegotiation.

### Core EU policies

Central to the European Union's development from the 1957 Treaty of Rome onwards has been an emphasis on the free mobility of labour. This principle has been increasingly challenged, not least in the UK.

However, Philippe Legrain offers a spirited defence of the principle. Most migrants wish to work. Their energies are likely to promote entrepreneurship, innovation and growth. They may also make a substantial net contribution to government revenue. Legrain emphasises, though, that his is not a narrowly economic argument. The freedom to travel and work abroad is a liberal freedom of value in itself.



In Legrain's ideal world, everybody would be free to relocate to wherever they want. Freedom within the EU is a step towards his ideal.

Two other core EU features are the customs union - a common external tariff but no import duties between members - and the Common Agricultural Policy (CAP). These are more problematic from a liberal perspective. Patrick Minford argues that the customs union has been negative in its impact on the UK. Firstly, it is incomplete, as many EU countries have erected non-tariff barriers (such as unnecessary product standards) against imports, and it has never been properly applied to services, which now account for a much larger proportion of our GDP than manufacturing. Secondly, there is significant 'trade diversion' arising from the fact that we import goods from within the EU rather than cheaper goods from the rest of the world. This arises because the EU is protectionist in relation to the rest of the world. The CAP also diverts trade in agricultural products,

meaning that member countries pay more than they need to for food, and it has a substantial budgetary cost (accounting for 40 per cent of EU expenditure).

Minford estimates the total cost of these policies to be about 4 per cent of UK GDP. In addition, Sean Rickard, writing in more detail about the CAP, sees it as holding back productivity growth through its emphasis on supporting small farms, its susceptibility to farmers' lobbies and its opposition to GM crops. He argues that agricultural policy should be devolved as far as possible to nations or regions.

The management of sea fisheries was originally something of an add-on to the CAP, agriculture being defined in the Treaty of Rome to include the products of fisheries. Since the 1970s the EU has treated European fish stocks as a 'common resource', allocating fishing rights and quotas to member nations, and using structural funds to reshape the fishing industry by reducing capacity. As Rachel Tingle explains, the Common Fisheries Policy

has been unsuccessful in preserving fish stocks and its control and inspection regimes have been costly and ineffective. Fisheries need to be managed at the appropriate ecological unit for the fish concerned, while the quota system would benefit from allowing tradable quotas.

#### **Economic regulation**

The European Union obtained a significant role in employment regulation following the Maastricht Treaty of 1992 (although the UK opted out until 1997). Interventions such as the Working Time Directive and the Temporary Agency Workers Directive have imposed significant costs on UK employers. These have been passed on through lower wages and lower levels of employment, as I argue in the book.

Employment regulation should be largely devolved to member nations although there are some areas - such as working time in cross-border transport - where EU co-ordination makes sense. However in this as in other areas, there is a strong domestic appetite for regulation. Eurosceptics should not assume that returning powers over employment to UK governments would lead to substantial deregulation - it may well not do so.

The EU plays an increasing role in transport policy, particularly in relation to emissions standards, plans for switching freight from road to rail, and partial funding of (often wasteful) infrastructure. Kristian Niemietz and Richard Wellings, while recognising that aviation policy and

cross-border rail transport (for example), need some international co-operation, argue that equivalent results could be achieved by bilateral agreements. They advocate a comprehensive deregulation of transport. If the EU retains a competence in this area, much decision-making should be shifted down to nations and regions.

Climate change policy is another major area of EU responsibility which the Treaty of Rome never envisaged. However, given its cross-border nature, there is at least an economic justification for EU action in this area. EU policy currently comprises emissions reduction targets, the Emissions Trading System, renewable energy subsidies and green taxes. There is also a range of requirements for greater energy efficiency (for example, in regulations setting requirements for average fuel efficiency in motor vehicles).

Matthew Sinclair argues that the European Union has

## **EUROSCEPTICS SHOULD NOT ASSUME THAT RETURNING POWERS OVER EMPLOYMENT TO UK GOVERNMENTS WOULD LEAD TO SUBSTANTIAL DEREGULATION**

been hugely ambitious in target-setting, but ineffective in devising detailed policies. The Emissions Trading System has been subject to fraud and the carbon price has been subject to excessive fluctuations, caused partly by over-allocation of emissions allowances. Renewable energy subsidies have been poorly directed, with the most expensive energy sources receiving the most subsidy,



and are proving so costly that governments are having to cut back on them.

Sinclair thinks that EU climate policy attempts the impossible: it assumes that an effective global policy can be instituted, and tries to organise Europe's 'share' of such a policy. In reality no effective global policy is ever going to be implemented. The EU should recognise

because, arguably, there is a theoretical economic justification for EU action but the practicalities of an organisation with 28 members and highly complex institutions with different interest groups fighting for particular policies have meant that the result has been widespread "government failure".

Finally Christopher Snowden focuses on the growing field of 'lifestyle regulation' - in particular, attempts by government prohibitions, taxes and subsidies to cut tobacco and alcohol consumption and change diets to reduce the prospect of obesity.

This overtly anti-market agenda threatens to limit personal freedoms. In the context of the EU, however, the interesting issue is that measures such as tax rises, advertising bans and minimum pricing can conflict with free trade and the single internal market. The European Commission (which funds many 'lifestyle' pressure groups) may indeed sometimes have been frustrated by the European Court of Justice. For the ECJ



has usually held that the single market trumps lifestyle regulation, if such regulation threatens competition across the EU. An example is the recent ECJ opinion against the Scottish attempt to introduce a minimum per-unit alcohol price.

Snowdon finds that the British (and Scottish) governments are frequently more draconian than the European Union has so far proved to be. UK consumers have thus been protected against their own governments' legislative appetite by EU requirements for free trade. Although 'sin taxes' such as those on tobacco and alcohol are arguably far too high in the UK, they would probably be higher still if the possibility of consumers legally importing significant amounts of these goods for personal use from the rest of the EU did not exist. Paradoxically British governments outside the European Union - whether Conservative, Labour or Coalition - would be likely to be more interventionist, restrictive and bureaucratic lifestyle regulators than the European Union.

### Conclusion

A common thread running through the book is that the goal of 'ever-closer union' - understandable for the generation which pioneered European integration - is no longer a useful guide to the EU's future development in a rapidly-changing world. It is certainly not a useful guide to the EU's appropriate economic role.

This study suggests that there are some areas where co-operation with our European neighbours brings positive benefits. There

## SOME SUGGESTIONS FOR REFORM

- There should be greater competition between national jurisdictions in regulatory matters
- The role of the European Court of Justice in interpreting EU Law should be ended
- The European Parliament should be reduced in size
- The European Commission's dual role as initiator of legislation and enforcer of regulation should cease
- The commitment to 'ever-closer union' should be dropped
- Most aspects of the Common Agricultural Policy and the Common Fisheries Policy should be 'repatriated'
- There should be free trade in services
- Non-tariff barriers to internal trade should be scrapped
- EU transport policy should concentrate on issues where there are genuine externalities across border, though this could be done with cross-border agreements
- EU climate change policy should concentrate on promoting research rather than setting emission standards
- The EU should not try to push its competence into lifestyle regulation, and should stop funding activist organisations to lobby governments
- The EU role in restricting nation state regulation of lifestyle issues and of migration is to be welcomed

are also some areas where the EU and its institutions actually help to promote a more free and prosperous economy. However, in many other areas, the EU moves us in a direction of much less economic freedom than we could have outside - including in the crucial area of trade. If the EU is going to be a liberal institution in the long term it also needs institutional reform. This book provides a benchmark for such reform.

David Cameron's much more limited reform agenda may have moved the EU a little in the right direction. On the other hand, depending on what happens in relation to migration policy, it is possible that renegotiation will leave us with a European Union that is less liberal than the one we have now. •

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