Why BRITAIN should leave the EU

Supporters of a free economy have different views on whether the UK should leave or remain in the European Union. In this article, **PATRICK MINFORD** explains why he believes Britain should leave

The impact of the euro crisis on the UK

The euro zone crisis is likely to continue for a number of years. The European Central Bank will act as a backstop until agreement is reached on a new institutional structure that reassures northern Europe that its transfers to southern Europe will have a good chance of being repaid.

The UK's exclusion from the euro has meant that it is neither vulnerable to the panic that has engulfed southern European sovereign bonds nor will it directly make large transfers to the crisis-stricken south.

The institutional framework now being developed implies a high degree of monitoring and intervention by creditor countries of debtor countries within the euro zone. There will be controls on bank behaviour, targets for governments and, possibly, new financial taxes.

While in principle this will take place within the euro zone, there will be pressure to extend the regime to all EU countries on the grounds that other EU members could 'undercut' euro zone arrangements.

The UK will be seen as an offshore competitor against banks, businesses and governments in the euro zone that are burdened with these controls and regulations.

Such competition, it will be argued, is unfair within the Single Market. It may well be quite easy for the measures that currently apply only to the euro zone to be extended to the UK through the qualified majority voting system.

This tendency for the euro to strengthen the drive towards excessive regulation as a way of bolstering the single currency was something widely foreseen at the start of the euro project.

But the crisis is likely to make this tendency much stronger. And the City of London, towards which the prevalent attitude on mainland Europe is one of extreme hostility, is likely to suffer.

This all strengthens the argument for the UK to leave the EU. The economic case was already quite strong, but the risks of remaining within the EU are now that much greater. So, what are the costs of EU membership as far as the UK is concerned?

Category of Cost	Cost (% of GDP)
Net UK contribution	0.4
Costs of the Common Agricultural Policy	0.3
EU protection of manufacturing	2.5–3
Regulation	6–25
Bail-out transfers	2–9
Total costs of EU membership	11.2-37.7

Table 1: A survey of costs from EU membership[1]

THE ECONOMIC COSTS TO THE UK OF EU MEMBERSHIP ARE SUBSTANTIAL…THEY TOTAL A MINIMUM OF 11 PER CENT OF GDP

Costs of EU membership

Even without any change in the status quo, the economic costs to the UK of EU membership are substantial.

Table 1 summarises the estimates made in 2005. They total a minimum of 11 per cent of GDP. Later work confirms that these estimates are still of the right order of magnitude. The costs arise from various sources.

Firstly, there are the obvious costs of our budgetary contribution and the possible cost of future bail outs (which could arise as a result of the ongoing euro crisis or relate to the huge cost of future EU pensions).

Secondly, there are the costs of enforced EU protectionism via a variety of trade measures which force up costs.

Thirdly, there are the costs of regulation to UK industry. These costs include measures that raise the price of energy, regulation on the City and regulation of the labour market (through trades union powers, hiring and firing restrictions, and a variety of extra worker rights).

These measures raise the cost of doing business in the UK and reduce employment. With the ongoing euro crisis these costs threaten to get ever heavier.

At Cardiff University, we estimated these costs in three main ways. For the costs of protectionism we used what economists call a "computable general equilibrium model" of the UK, the EU, the US and the Rest of the World. This allows the second- and third-round effects of protectionist measures to be estimated.

Protectionism raises the costs of consumption, it can raise the costs of production, and it leads to a misallocation of economic resources.

Such a model allows all those costs to be taken into account as well as any offsetting benefits.

The regulatory costs are estimated using the Liverpool Model of the UK economy which can measure how costs of regulation affect employment and output.

The bail-out costs are computed by looking at potential scenarios for fiscal crises (both due to the euro and due to the growing costs of pensions and other costs of ageing populations) across the EU on the assumption that a bail out would in practice occur if members got into difficulties.

The wide range of estimates in the last two categories reflects huge uncertainty about how regulation

[1] These estimates use work done over a number of years under the auspices of the Julian Hodge Institute of Applied Macroeconomics in Cardiff University Business School.

will develop and how fiscal problems will be dealt with.

An aspect which we do not examine is the effect of EU policies on UK growth. Here research is ongoing but it seems likely that these policies also reduce the UK growth rate by reducing the dynamism of the economy rather than just creating "one-off" costs.

But what about the costs of leaving?

A popular argument is that there are benefits of EU membership such as from foreign direct investment (FDI).

However this argument is largely fallacious. FDI does not bring a direct benefit. It is an input into production and the foreign funders providing the capital benefit from the returns.

It is true that FDI brings indirect benefits because of technological spill-overs from foreign firms which raise productivity.

But the UK economy's productivity is likely to be maximised when comparative advantage is allowed its fullest rein: i.e., outside the EU, under free trade. Indeed, if free trade leads to industries operating more efficiently, then less FDI will be required.

Some argue that exclusion from the EU's Common Tariff would be damaging. But tariffs lead to costs. The removal of the common tariff would mean cheaper goods for consumers and cheaper inputs for manufacturers. And our production would be governed by our comparative advantage. In fact, we would gain around 3 per cent of national income from the removal of the common tariff.

It is also said that we would no longer influence EU regulations if we left. This is true. But we do not influence the regulations of any country to which we export. And, in reality, we have negligible influence on EU regulation as just one of 28 members.

If we left the EU, producers of goods and services would not have to adhere to inappropriate regulations on the 90 per cent of output that is not exported to the EU.

Of course, if we left the EU, political and economic co-operation will continue in areas of mutual interest as it does with all our allies.

Transitional issues

There are a number of problems of transition from our current full membership to total departure from the EU.

These must not be allowed to blur the basic point: Britain's interests lie in leaving the EU because of the large balance of costs over benefits of our membership.

BRITAIN'S INTERESTS LIE IN LEAVING THE EU BECAUSE OF THE LARGE BALANCE OF COSTS OVER BENEFITS OF OUR MEMBERSHIP

Transitional issues basically relate to the adjustment for industries and groups currently enjoying gains from the protection given by EU arrangements.

These industries and groups are likely to be vocal in their opposition to leaving the EU; they will get added impetus from the CBI and TheCityUK, two big business organisations. This opposition will be reminiscent of the opposition from essentially the same groups to the UK's decision not to join the euro.

These groups will have to adjust using their own resources and strategies. For example, it is likely that the euro zone and the EU will attempt to restrict certain euro financial transactions from taking place outside the EU after we leave.

This means that City institutions that were previously successful in this market will need to find alternative markets. The general efficiency of City services is such that it dominates the world market in a wide range of financial transactions. The City will therefore find little difficulty in attracting other worldwide business.

Another industry that is likely to suffer from EU departure is volume car production. In this industry, factories in parts and assembly have been located all around the EU under the assumption of a continued customs union.

When the UK leaves the EU cars from non-EU countries would be free to enter the UK at world prices in as large a quantity as consumers desire. Hence UK car prices would drop to world prices.

UK producers of volume cars will not get protected prices in the EU markets, while EU producers will continue to do so.

In the long run this must lead to a contraction of UK-based capacity up to the point that the remaining industry can survive at world prices. The industry will lobby intensely for some transitional compensation. Probably the easiest way to provide compensation is through transitional trade arrangements. This is also the most likely route for other sensitive industries affected.

The key reference is '**Should Britain leave the EU? An economic analysis of a troubled relationship**', by Patrick Minford, Vidya Mahambare and Eric Nowell, published by Edward Elgar in association with the Institute of Economic Affairs, 2005. The work has been updated in various other publications.

Conclusion

The institutional evolution triggered by the euro crisis threatens to make the economic costs of EU membership higher than ever, in a highly visible way. The case for leaving the EU has become overwhelming•

Patrick Minford
Professor of Applied Economics
Cardiff Business School
MinfordP@cardiff.ac.uk