Why not learn from the past as well as by predicting the future?

Evidence about the supposed benefits of EU membership and the Single Market on the UK economy 1973-2018

Michael Burrage,
Senior Research Fellow, Civitas

The starting assumption of Mrs May's negotiating strategy is shared by all remainers and is. one guesses, the same as that which persuaded her to vote remain. It is that the EU membership, and in particular the Single Market, have been of immense economic benefit to the UK, by boosting UK GDP, productivity and exports, both to fellow members and to partner countries with which the EU has concluded trade agreements, and by attracting much FDI to the UK. Outside it, by contrast, is supposed to be an unpleasant place, especially for countries that have no agreements with it.

Starting from this assumption, anyone negotiating for the UK to leave the EU would be ready to concede much of what EU negotiators asked for, in the hope that they could hang on to as many of these benefits as possible, and avoid the difficulties of trading under WTO rules. Correspondingly, knowing this was the negotiators' starting assumption, EU negotiators would not hesitate to make demands beyond those they would dare to make to a third country in negotiations about a trade agreement.

Much the most influential statement of the case for this starting assumption was the long-term predictions of HM Treasury in 2016 prior to the referendum[1] These calculate the relative benefits of remaining in the EU, of staying close to it, via EEA membership or trade agreements, which would preserve some of its benefits, and of leaving to trade with the EU under WTO rules and signing such agreements as the UK might with the rest of the world. This would mean a disastrous loss of GDP by 2030 of somewhere between 5.4% and 9.5%, and most probably of 7.5%. They thus presented a stark contrast between the prosperity of continued EU membership and the relative impoverishment of Brexit without a deal, meaning lower incomes than would have been the case, lower tax receipts and therefore large tax rises and/or major cuts in public expenditure.

The Treasury has reiterated this stark contrast between membership and exit without a deal, informally via leaks, media interviews and evidence to select committees, and more formally in a multi-department series of power point slides to which it contributed in January 2018 entitled '*EU*

[1] http://www.agefi.fr/sites/agefi.fr/files/fichiers/2016/04/treasury_analysis_economic_impact_of_eu_membership_web.pdf

Exit analysis- a cross-Whitehall briefing' in January 2018 [2] and again in *EU Exit Long term analysis* published in November 2018 to inform the members of the House of Commons before their fateful vote on Mrs May draft agreement on December 11th.[3]

Regardless of whether or not the assumptions on which these predictions are founded are plausible, there is no denying their historical importance and that of the stark contrast they have drawn between EU membership and of trading under WTO rules. They have influenced the negotiators, Mr Barnier, one imagines, as much as Mrs May. They have structured public debate before and since the referendum. They have also provided the main, and often the only, research support for various branches of the resurgent remain campaign, for groups within both the Conservative and Labour parties, for the LibDems, the ScotsNats and others. They have also been the key reference for all media interrogators who hope to challenge or embarrass leavers. Andrew Marr has confronted Dominic Raab and Michael Gove with a graphic of the losses predicted if the UK leaves to trade under WTO rules, and looks as if he means to make it a permanent prop.

There is, however, no good reason why we should evaluate their merits and demerits of continued membership and of trading under WTO solely by the somewhat circuitous, and necessarily speculative, method of predicting what their contributions to the growth of UK GDP might be over the next fifteen years, and ignore what we know about what happened to them over the past 45 years. There is copious, readily accessible, evidence of the experience of the UK as a member of the EEC/EU over these years, and of countries that have traded with the EU under WTO rules in the world's major databases such as OECD and IMF.DOTS, UNComtrade, UNCTAD, WITS, ITC, WTO RTAIS, World Bank, and Eurostat.

Why, one wonders, has this evidence been virtually ignored in public debate about Brexit. In large measure, one suspects, it is because of the influence, and continuing prestige of HM Treasury. It is still assumed by many consist of non-political and therefore disinterested and trustworthy experts, living up to the core values it proclaims of integrity, honesty, objectivity and impartiality. Its reports therefore receive more extensive and deferential media coverage than those from any private source, and since it believes itself to be above the noisy fray of partisan debate, it does not see any reason to abide by the normal etiquette of any research community, such as explaining its methodology to fellow researchers, by responding to their criticisms of their work.

Why HMT did not study the impact of EEC/EU membership

To understand how Treasury mandarins came to place all their faith in predictions, one has to go back to 1973 when a decision was evidently taken by their predecessors that they would not regularly measure and analyse the impact of EEC membership on the UK economy, to inform both ministers and the public. One can only speculate as to why they took this decision, and why they have stuck to it over the forty four years of membership. Prime ministers and ministers evidently never asked them to conduct any research of this kind, probably because they were all engaged over

[2] https://www.parliament.uk/documents/commons-committees/Exiting-the-EuropeanUnion/17-19/Cross-Whitehall-briefing/EU-Exit-Analysis-Cross-Whitehall-Briefing.pdf

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/759762/28_November_EU_Exit_-_Long-term_economic_analysis.pdf

these years, to varying degrees, in persuading the ever-sceptical British public of the merits of EEC/EU membership. Empirical investigations might be an unpredictable ally in this task.

In its absence, prime ministers and ministers have been free to present their own opinions, hopes, impressions from the media or personal contacts of the benefits of EU membership, unsupported by any trustworthy analysis collected by the Treasury of any other government department. Some former prime ministers and ministers still campaign against Brexit in the same manner –without any reference to empirical evidence.

There was, as far as we know, only one marginal exception to the rule, though this was an *ad hoc* one-off analysis of the impact of membership on UK trade not a research series. It was conducted with the Treasury in 2005.[4] It found that 'membership initially boosted UK trade with the EU by 7%, while 'trade between member states as a whole was boosted by 38%', a difference that they thought might be because the UK 'was more open to trade than some other member states before accession.' The Single Market 'was found to have boosted intra-EU trade by a further 9%', though they added hopefully ' this may be an underestimate.' In sum, only 16% of the increase in UK goods trade over the 30 years 1973-2004 could be attributed to EU membership. They were surprised that their 'straightforward comparisons of UK trade with the EU15 do not immediately highlight the significant boost in trade amongst EEC members that one might have expected.' Aren't we all?

This 20-page report remained classified, for reasons we can only guess, until an FOI request in 2010 when it was released with other papers. It seems to have remained unknown to all prime ministers and ministers since, including Mrs May. None of them have referred to it, or qualified their support for EU membership in the light of it. When the Treasury came to prepare the case for remain in 2016, it was 'forgotten', in defiance of the ethics of all research communities, probably because it did not square with the stark contrast it then wished to draw between its predictions of the benefits of membership and of the misery of trading under WTO rules. This evidence, after all, suggested there was little difference between the two.

How is it, one must ask, that this Treasury research in 2005 showed such a slow growth of UK trade with fellow members into what had happened over the years 1973-2003 could differ so much from their prediction about what would happen to the growth of UK trade with other members by 2030? The answer is that the research in 2005 stuck close to the raw data and only made assumptions in an attempt to explain their findings, while their predictions in 2016 required a number of assumptions to be made before the empirical data was fed into the model.

The assumption that mattered, and had a decisive influence on the final prediction, was that UK trade in goods with the EU would grow at the same rate as the mean rate of intra-EU trade, which after 2004 included ten post-socialist societies transitioning to market economies, and was estimated to be 115%, from which it inferred that leaving the EU would mean a fall in trade of 53%.[5] HMT research in 2005 had, as mentioned, reported considerable differences between the

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/220968/foi_eumembership_trade.pdf

[5] p.163, http://www.agefi.fr/sites/agefi.fr/files/fichiers/2016/04/treasury_analysis_economic_impact_of_eu_membership_web.pdf

growth of UK-EU trade and the mean intra-EU rate, but they were forgotten- and the rest is history. HMT made its predictions.

One must also wonder whether research conducted in the same spirit as the 'straightforward comparisons' of HMT researchers in 2005, would have given a different impression from the predictions made by HMT in 2016 and provided Mrs May with a rather different starting point. What follows is a brief account of some of the research which examines the historical evidence about the economic impact of UK membership of the EEC/EU

GDP In 2017 Clarke, Goodwin and Whiteley found that membership of the EU made no difference at all to the rate of growth of the UK's GDP or to that of most other members.[6] They quoted Penn World Tables showing that the growth rates of only 8 of the 28 members increased after joining the EU. Six of these are post-socialist economies, and it is difficult to separate the impact of that transition from entry to the EU *per se.* The other two are Ireland and Luxembourg. In 2018 Coutts, Gudgin & Buchanan[7] similarly found no evidence that entry to the EU had raised UK growth at all.

& Productivity Wolfgang Munchau, an FT columnist, found that the productivity growth of EU members 'has been downhill ever since the official start date of the single market in 1992', and since 'it is not visible in the macro statistics', the data tells us that the Single Market 'was a giant non-event for both the EU and UK.'[8] The Conference Board also found that there has been little growth in EU productivity over the years 1992-2015 whether measured *per capita* or per hour worked. [9] There is, moreover, no sign of the convergence of productivity amongst EU members that one might expect if membership itself had been contributing significantly to its growth. Nor is there of any collective closure towards the benchmark of US productivity. [10]

By itself, UK showed a respectable growth rate of 1.17% in GDP per capita over the years 1993-2015 in the International Comparison Program of the World Bank. This put it ahead of the EU mean of 1.14%, of the US rate of 1.11% and the Canadian of 1.09%, though how much of this was due to EU membership is unknown.[11] A slightly different measure, GDP per person employed, also shows the UK with growth rate slightly above many other EU members over the years 1993-2014, but this said nothing of the cause and was not sufficient to move the UK from 13th place in the EU 15, above only Greece and Portugal.

The Single Market in goods While UK goods exports to other members grew quite rapidly under the Common Market, OECD and IMF.DOTS data shows that those to EU 14 over the years 1993-2015 slowed to a very modest CAGR of 0.09%. This was slower than the mean rate of all EU members' exports to each other of 2.4% and of 19 non-members of

[6] p.187 Harold D. Clarke, Matthew Goodwin and Paul Whiteley *Brexit: Why Britain Voted to Leave the European Union* Cambridge University Press, 2018 p.187
[7] http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp493.pdf

[8] https://www.prospectmagazine.co.uk/magazine/would-it-actually-matter-if-we-left-the-eu
[9] https://www.conference-board.org/data/economydatabase/index.cfm?id=27762
[10] https://www.civitas.org.uk/content/files/itsquiteoktowalkaway.pdf
[11] http://siteresources.worldbank.org/ICPEXT/Resources/ICP_2011_html

4.0%.[12] A comparison of countries trading with the founder members of the Single market from 1993-2015, under different relationships found that the 15 trading under WTO rules had grown by 135%, that the 6 trading under bilateral agreements had grown 107%, that intra-EU exports had grown by 70% and the exports of the UK to the other 11 had grown by just 25%.[13] The high growth rates of China, and the other still developing economies among the 15 are no surprise perhaps, but they also included more developed trading countries such as the United States whose exports had grown by 68% over the period. Comparison with the United States is particularly interesting since under Common Market UK goods exports were both larger in value and grew faster than those of the US, while over the Single Market years their positions in both have progressively reversed. US exports to the EU are now both larger in value than those of the UK and have been growing faster.

The Single Market in services By the EU's own preferred measure, the ratio of extra- to intra-EU service exports as a proportion of EU GDP, a single market in services can scarcely be said to exist. By this measure, it reached its highpoint in 2007[14] when extra-EU exports were 4.87 percent of EU GDP and intra-EU exports were 5.98 per cent, a ratio of 1:1.22. The ratio has been less ever since. In 2015 it was 1:1.18, so a single market in services has been neither 'widening' nor 'deepening' but shrinking. Moreover, the benefits of membership and the disadvantages of non-membership are difficult to discern in services trade statistics. Over the years 2004-2012, the only period over which there is a uniform series of data, the services exports of 27 non-members to the EU grew slightly faster than those of 27 members though the latter were some 40% greater in value.[15]

EU trade agreements In recent years, the Commission has begun to negotiate with larger countries, most notably the agreements with Korea, which came into force in 2016, and with Canada which came into force in 2017. However, the 36 agreements with some 60 countries concluded over the preceding 43 years, could hardly have significantly boosted UK exports since the EU then preferred small or micro-states as partner countries. In 2014 the mean GDP of all EU partner countries was $191billion, which is a little less than the GDP of Peru, and far smaller than the mean GDP of the partners of Chile, Korea and Singapore in that year. [16] In 2014, the EU's partners covered just 6.1% of the export markets of UK goods outside Europe, and 1.8% of its export markets for services. And EU agreements were not especially helpful from a British point of view, covering only 6% of the total GDP of the Commonwealth, and frequently omitting services. A pilot study of the 15 partner countries for which there was at least five years data to permit pre and post agreement comparisons, found that the growth of UK goods exports to 10 of the partner countries had actually *declined* after the agreement came into force, in sharp contrast to those of Switzerland, Singapore, Korea and Chile.

FDI Claims that membership of the Single Market is the main reason for FDI in the UK are difficult to prove or disprove. As UNCTAD, the primary data source on them since

[12] pp.19-21, https://www.civitas.org.uk/content/files/itsquiteoktowalkaway.pdf p21
[13] https://www.civitas.org.uk/content/files/itsquiteoktowalkaway.pdf p.26.
[14] https://www.civitas.org.uk/content/files/itsquiteoktowalkaway.pdf pp52-56
[15] https://www.civitas.org.uk/content/files/itsquiteoktowalkaway.pdf pp.60-65
[16] https://www.civitas.org.uk/content/files/The-Eurosceptics-Handbook.pdf pp.174-187

1970 often observes, the motives of FDI decisions are impossible to identify. One may first note, however, that in 2007 the European Commission itself acknowledged that the Single Market had not been the magnet for FDI as had originally been hoped, and it documented the steady decline in the rate of FDI from the rest of the world into the EU 25 since 2001,despite the adoption of the euro which it was thought would increase FDI.[17] It noted in particular the decline in international R&D investment by comparison with the US, China and India.[18]

In 2014 an OECD report noted the conspicuous failure of the EU single market to attract FDI when global investment flows recovered after the financial crisis. 'One thing is clear', it concluded, 'the collapse in international investment flows in Europe, both outward and inward, is more than just a passing cyclical phenomenon…. And it's time to sound the alarm.'[19]

In 2016, when preparing its pre-referendum predictions, HM Treasury could find no statistical evidence to support the view that the Single Market had boosted FDI from the rest of the world to the UK.[20] It then decided that this must be due to 'data limitations' and felt free to 'estimate' a 22% post-Brexit fall of FDI into the UK if the UK left to trade under WTO rules, which is one more of the assumptions which contributed to its predictions of the reduction of UK GDP by 2030. In 2017, after the vote for Brexit, the ONS reported that the UK had recovered sharply from the slide reported by OECD in 2014.[21]

Conclusion

The evidence described above suggests that the benefits of the EU membership have been largely imaginary, though it is possible that it may have helped FDI in the UK, especially that from other member countries. Existing research cannot give a decisive answer on that question. But there can be very little doubt that it has had no impact on GDP growth, productivity, exports of goods and service**s.**

Since we also know that countries trading with the EU under WTO rules have been growing at a more rapid rate than exports of founder members of the Single Market exports to each other and of UK exports to other members, there must be considerable doubt about the stark contrast that the Treasury has been drawing by remaining, or remaining close to the EU, and leaving to trade under WTO rules.

If this evidence had formed part of the Brexit debate, and influenced Mrs May negotiating strategy, she would probably have been rather less willing to make concessions. Public debate would also be different, since many current remain arguments would be shown to be implausible

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[17] January 2007, *Steps towards a deeper economic integration: the Internal Market in the 21st century: A contribution to the Single Market Review* by Fabienne Ilzkovitz et al, http://ec.europa.eu/economy_finance/index_en.htm

[18] http://ec.europa.eu/economy_finance/publications/pages/publication784_en.pdf

[19] http://www.oecd.org/investment/investment-policy/InvestmentInsights-Nov2014.pdfpy/

[20] pp172-3. http://www.agefi.fr/sites/agefi.fr/files/fichiers/2016/04/treasury_analysis_economic_impact_of_eu_membership_web.pdf

[21] https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/ukforeigndirectinvestmenttrendsandanalysis/july2018

and imaginary. They would have to rest less on adverse economic consequences of Brexit, and of no deal with the EU, and more on the merits of ever greater union.

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