

EUROPE: UNTANGLING THE ECONOMIC ISSUES

Lunar Society Dinner Discussion held at Edgbaston Priory Club, 8 June 2016

John Fender, Professor of Macroeconomics at Birmingham University, introduced the topic with a high-level review of the economic issues involved in the decision to remain in or to leave the European Union – to be decided by a referendum on 23 June. He spoke to an audience of around 60 Lunar Society members and guests at the start of the dinner, points and questions were gathered up during the meal and used to structure a lively discussion as the meal came to an end. While Prof Fender's introduction is (with his permission) summarised, the discussion was conducted under Chatham House Rules, and views are not attributed to individuals.

John Fender's Introduction

The UK pays a net sum of £8.5 bn per annum for EU membership (about £130 per citizen – similar to Lunar Society membership). So what do we get for the money, and what would we lose by leaving? John Fender's introduction focused primarily on trade, but commented on issues of sovereignty, immigration and regulation.

Importance of trade

Ricardo showed 200 years ago how trade between two countries could benefit both, through exploiting their comparative advantages. More recent work has suggested that trade may be beneficial through enabling countries to enjoy the economies of larger-scale production, and improve their own productivity through competition. The importance of trade to prosperity has been a fundamental plank of economic theory ever since, and a central role of the EU has been to exploit this to the benefit of its members. It aims to do so by:

- Providing tariff-free trade between its 28 member states
- Harmonising rules and regulations so as to reduce non-tariff barriers to trade
- Negotiating preferential trade agreements with other countries (53 at present, with more in the pipeline)

Trade implications of leaving:

Article 50 of the Lisbon Treaty provides for a 2-year period of negotiation of the terms on which a country can withdraw following its deciding that it wishes to leave.. But it is unlikely that we would emerge from this two-year period with a fully fledged trade deal. More likely we would emerge with an interim arrangement, and would then need to negotiate a more satisfactory trade deal over the following few years. While the EU trade surplus with the UK may motivate a deal, we would lose our influence on the EU's trade rules whatever the outcome. There are many conflicting interests and the process of negotiation is inherently lengthy and difficult. Even when the final deal is reached, its terms and coverage may be less than it is now. Another point is that after we formally left the EU after the conclusion of the initial two-year negotiation period, we would no longer participate in the preferential trade deals the EU has with other countries.

There might well be reversion to World Trade Organisation rules in the period before a trade deal is reached with the EU. The UK would undoubtedly seek bilateral agreements with individual countries, outside the EU, but there would almost certainly be a long period during which the UK would have far fewer trade agreements with other countries than it would if it remained a member of the EU. There would be further complications in UK trade with the EU because certificates of origin and customs inspections would probably be required. Uncertainty and transitional costs would be additional complications.

Sovereignty, immigration and regulation

Membership of EU involves a loss of sovereignty as UK cannot set its own tariffs on imports, agree trade deals with other countries, set VAT rates below 15% or prevent EU citizens from working here (etc.). However, many other areas of policy and taxation are entirely at UK discretion, and the UK also has a fair amount of influence on the EU through the Council of Ministers and the European Parliament (and has been good at getting its way). UK citizens benefit from the reciprocal freedoms to live, work and access public services elsewhere.

While EU regulation has high political salience, few businesses have substantive complaints (even of the Working Time Directive, generally seen as the most intrusive), while workers and consumers generally benefit. Environmental regulation must often be supranational to be effective.

The fundamental issue for consideration is whether the benefits outweigh the costs. As context Prof Fender pointed out that since joining EU in 1973, the UK per capita real GDP has grown by 103%, , which is more than the US, Germany or France, while New Zealand (which lost the benefit of Commonwealth Preference at the same time) has done much worse.

Discussion

The Chairman suggested five headings to structure the discussion (Trade, Finance, Labour markets, Society, and Environment), and also invited comment on the relative importance of the economic issues (and economists' views on them). About 30 questions were submitted, nearly half concerning trade and closely allied topics of finance and labour. The rest were split evenly (five each) between social/environmental matters, the relative importance of the economy to the referendum decision and other issues. This is followed in the summary which follows, which brings together the points and questions raised with Prof Fender's responses (we ran out of time before all questions had been raised, but the gist of all those submitted is reported).

Trade finance and labour markets

- Trade deals with EU enjoyed by Switzerland and Norway, required payment into EU funds, adherence to EU regulations and free movement of labour. However Prof Fender confirmed that while EU has generally insisted on free movement of labour, free trade does not in principle require this.
- UK share of global clinical trials went from 12% in 2004 to 1% now. While this has been attributed the negative effect of EU regulations, this could not be confirmed or denied. Similarly with a figure of £30bn pa regulatory costs without a baseline for such comparisons.
- A number of questioners suggested that the interests of other EU countries with trade surpluses with the UK were such as to ensure a swift and favourable negotiation of new trade deals following exit. The significant slice of European Commission income from the UK might point the same way. Prof Fender re-emphasised the multiplicity of interests and the inherent complexity of the negotiation process, counselling against undue optimism on this score.
- A businessman who sends one third of his exports to the EU commented that additional work on Certificates of Origin would not add greatly to his present workload. Another with a Polish building supplies client was very concerned about the effect of Brexit on their ability to ship goods to SE England.
- There was concern expressed about the effect of exit on the present serious imbalance of trade and the level of national debt. Will sterling decline and interest rates rise?
- Does the survival of the EU require 'Completing fiscal and monetary union', as implied by a report by 5 Presidents last year? Is this essential to prevent it pulling itself apart (or are the ECB's policies doing that)?
- Are employees better off relatively than before we were in the EU?
- The effect of the Working Time Directive on NHS staff has been fewer, larger hospitals – are there parallels in commerce and industry?

Society and environment

- EU has been a source of significant regional regeneration funding in the UK (and some would argue continues to be) including the West Midlands. If we leave, will UK Governments continue to support regional initiatives to the same extent or will London/Whitehall centrality rule?
- Is it true that staying in will increase the load on NHS and local services?

Relative importance of the economy (and economists) – and other questions

- Is the track record of economic forecasting good enough to place weight on? Prof Fender responded that while the implied precision of some projections was dubious, the overall weight of evidence was strong.
- Countries go to war to preserve sovereignty: perhaps an 'economic hit' is a lesser price?
- If the EU collapses will we be blamed? Would it be better to remain until it does?
- Do you agree with Daniel Kahneman that the Brexit camp is acting irrationally? Will economics actually play much part in the decision-making of voters?
- If you were leaning towards exit, what would be the strongest argument to remain (and vice versa)?

Conclusion

A straw poll was undertaken at the close of proceedings. This revealed around a dozen in favour of exit, about thirty for remain, with a handful undecided. No-one admitted to having changed their mind!