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Do the UK's European ties damage its prosperity?

By Philip Whyte

CENTRE FOR EUROPEAN REFORM

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- ★ Eurosceptics claim that EU membership has become a major drag on British prosperity. If the country left the EU, they argue, it would be freed of irksome continental influences like regulations and protectionism – and would thus become freer, more prosperous and truer to its globalising nature.
- ★ Many eurosceptic premises are misleading. Despite the constraints of membership, the UK's markets for goods, services and labour are already among the freest in the developed world. The reduction in regulatory costs that would follow a British departure would be more modest than eurosceptics imply.
- ★ Eurosceptics focus compulsively on EU regulations. But many of Britain's long-term economic failings have nothing to do with regulation, and those that matter the most originate at home rather than in the EU. It follows that leaving the EU would do nothing to improve Britain's economic prospects.
- ★ Leaving the EU would not boost trade and investment flows, not least because Britain would be unlikely to open its borders more widely if it left. Without the anchor of EU membership, goods, services and people would probably move less freely across UK borders than they do at present.

If the Conservatives form a government after the general election on May 7th, they will demand reforms to the EU and hold a referendum on Britain's EU membership by the end of 2017. The party's eurosceptics believe that the regulatory costs of participation have become too onerous and that EU membership has become a major – perhaps even the main – obstacle to economic growth. Britain, they argue, has "shackled itself to a corpse".[1] The costs of EU membership have ratcheted upwards just as the economic benefits of trading with an ageing and crisis-prone region have fallen. If the UK loosened its relations with the EU, it would free itself of irksome rules and regulations and could focus on developing commercial relations with faster growing economies outside Europe.

To many British ears, this sounds like a persuasive narrative. The trouble, however, is that it rests on a number of assumptions that Britain's national conversation tends to take for granted without ever bothering to examine. These include the following: the EU is an iron cage that condemns its occupants to rigid harmonisation; continental Europeans and Brussels institutions are addicted to regulation and protectionism; the UK is suffocated by a relentless flow of costly and silly rules that it would not choose if left to its own devices; outside the EU, the UK would be less regulated and more open to trade. If one accepts these premises, then the following conclusion seems all but inescapable: the EU is an obstacle to the UK's emergence from slump and a drag on its long-term prosperity.

This essay argues that these premises are not entirely wrong, but that they are crude and invite misleading conclusions. The EU is not a straightjacket which deprives its members of elbow room: despite the constraints of membership, the UK is one of the least regulated economies in the developed world. Britain's economic failings have nothing to do with the regulatory burdens of EU membership. The supply-side deficiencies that do most damage to Britain's long-term prosperity originate at home, not in Brussels. And while there is little evidence to suggest that EU membership hampers Britain's ability to develop commercial links outside Europe, there are good reasons to think that the flow of goods, services and people across UK borders would be less free outside the EU than inside.

1: Rowena Mason, 'Britain shackled to corpse of EU, says Douglas Carswell', *Daily Telegraph*, October 26th 2012.

Counting the cost of EU regulation

Complaints about regulation have become a central feature of Conservative eurosceptics' charge against the EU. The argument goes something like this: since continental Europeans are more inclined to regulate markets than the UK, and the EU itself has become so intrusive, the UK is subject to a torrent of silly regulations that damage the economy by placing huge and mostly unnecessary burdens on British businesses. The costs of regulation have become so onerous that they now outweigh the relatively modest benefits that the UK derives from its participation in the EU's single market. One reason is that the benefits of access to the single market only apply to the small and declining share of output that the UK exports to the EU, while the regulatory costs apply to the entirety of its economy.[2]

How does this story stack up? It is true that the EU is to a large extent in the business of regulation. It is also the case that rules emanating from Brussels are not always perfect. The Commission, which proposes EU legislation, is not infallible. It has made some progress on its 'better regulation' agenda, as the British government has acknowledged.[3] Nevertheless, its impact assessments are not always up to standard and a respectable case can be made that some of its proposals conflict with the principle of subsidiarity. In addition, it is true that other EU member-states on average have a greater appetite for regulating markets than the UK.The upshot is that the UK must sometimes implement EU regulatory standards that are more burdensome than those it would have chosen itself.

But how does one set about measuring the additional regulatory costs that Britain incurs from its membership of the EU? The method favoured by British eurosceptics generally proceeds as follows: add up every item of legislation agreed in 'Brussels'; assign a largely arbitrary, but invariably inflated, cost to that regulatory output; and then imply that the UK would face none of these costs if it left the EU. It is a method, of course, designed to produce conclusions that have been determined before the exercise has been carried out. It skates over the reasons why regulations exist in the first place; ignores why the EU might have a legitimate interest in regulation; and misleadingly implies that the UK would escape all the regulatory costs ascribed to membership if the country chose to leave the EU.

Regulations can and do impose costs on companies. When they are badly designed, such costs can be unnecessary and damaging. Even so, it is worth remembering that there are legitimate reasons why governments regulate markets. One of these is that markets are not perfect: they can fail, with devastating results. An unregulated free market may, for example, generate 'negative externalities' (like pollution or financial crises) because the social costs of activities are not borne fully by those who engage in them. In such cases, governments are justified in intervening to correct the failure. If the end result is that a firm is made to 'internalise' social costs which it had previously managed to 'externalise', the fact that its costs have risen is emphatically not a bad thing.

> *"Quantifying the regulatory costs of EU membership is harder than eurosceptics imply."*

It is also worth remembering that there are legitimate reasons why the EU should be interested in regulation. One is the single market. Since all 28 member-states regulate their markets, and conflicting regulations can act as barriers to trade, the EU sets the common minimum standards that are necessary for mutual recognition – the animating principle of the single market – to work. Another reason is that there are times when collective action at EU level may produce superior outcomes than countries acting independently at national level (in the jargon, the 'subsidiarity test' is met). In policy areas like climate change, for example, collective action at EU level should, in principle at least, produce superior outcomes by reducing the opportunity for individual member-states to 'free ride'.

Finally, it is important to be clear about the national dimension. For one thing, EU directives do not have direct effect: they must be transposed into national law. Some of the costs that firms complain about arise at this stage, when national legislatures impose regulatory burdens over and above those required by EU legislation (a practice known as 'gold-plating'). For another, many of the areas that the EU regulates are regulated by the member-states anyway. So it is misleading to imply that all the regulatory costs associated with EU legislation would simply disappear if the UK left the EU. British banks, for example, would not cease to be regulated. Indeed, the regulatory burden on them might not even fall, because the era of 'light touch' for banks is over: UK standards are now often stricter than those required by the EU.[4]

In short, quantifying the precise regulatory costs that flow from Britain's membership of the EU is much harder than eurosceptic accounts imply. Regulations may be justified, even if they impose a cost on firms. There are perfectly legitimate reasons why the EU regulates. And the regulatory costs often imputed to the EU will not necessarily disappear just because the UK leaves the EU. It follows that if a regulatory requirement in force in Britain

2: David Myddelton 'Saying no to the single market', Bruges Group, January 2013.

3: 'Cut the red tape: One year on', Department for Business, Innovation and Skills, November 2014.

4: Philip Whyte, 'Britain, Europe and the City of London: Can the triangle be managed?', CER essay, July 20th 2012.

is to count as a cost of EU membership, at least two conditions must be satisfied. First, it must be shown to be superfluous. And second, it must be proved that the UK would have no such requirements if it left the EU.

How flexible is the British economy inside the EU?

Given how hard such an exercise would be, a more straightforward way to approach the problem is to try and answer the following question: How flexible is the British economy inside the EU? EU membership is often portrayed as a straightjacket that imposes rigid uniformity on its members. Not only does the EU interfere too much, it also imposes continental levels of regulation on a reluctant but helpless Britain. If this account were true, one would expect two things. First, EU membership would have a tendency to level differences between its member-states. Second, EU membership would make Britain look more continental and less 'Anglo-Saxon': its markets for goods, services and labour would be markedly less free than in economically liberal countries in the Anglophone world.

How, then, to answer the question? A good way to do so is to consult indices compiled by the OECD that try to compare overall levels of market regulation in developed countries. The OECD has a number of advantages over pressure groups in Britain. It is unimpeachably sober and serious-minded. It is not in the business of conducting biased research carefully designed to produce predetermined (and embellished) conclusions. And its work is comparative. The OECD's indices for product and labour market regulation are not perfect. They are narrower than would be ideal to answer the question at hand (the OECD's labour market index, for example, only measures the strictness of employment regulation related to hiring and firing).

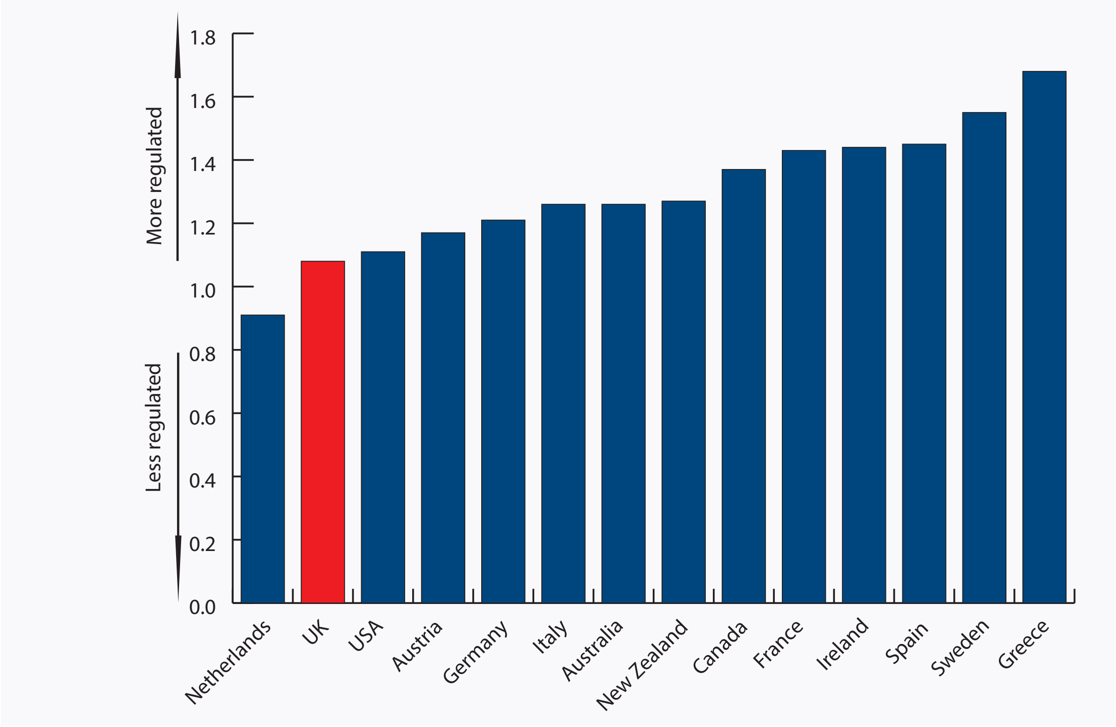
Despite their limitations, the OECD's indices are the best and most reliable available – and their findings are revealing. The first thing they show is that EU membership is not, as eurosceptic critics often suggest, a Procrustean bed: it does not entail rigid harmonisation across the bloc as a whole. The adoption of common minimum standards at EU level still allows scope for huge variations in levels of product and labour market regulation at national level. To state the obvious, Britain's business environment is not identical to France's. The second thing the OECD's indices show is that being a member of the EU has not turned Britain into a country with 'continental' levels of regulation. Indeed, despite EU membership, the UK's product and labour markets still look much more Anglo-Saxon than continental.

Consider the overall level of product market regulation in the UK. According to the OECD's index (see Chart 1), the UK's markets for goods and services are freer of red tape than elsewhere in the EU – bar those of the Netherlands. They are also freer and less regulated than in any of the developed liberal economies in the English-speaking world (Australia, Canada, Ireland, New Zealand and the US). In other words, because it shares a bed with European countries that have a greater appetite for regulation, Britain can at times find itself having to comply with regulatory requirements that are more onerous than it would have liked. Yet despite the constraints and burdens that supposedly flow from EU membership, Britain's product markets are still among the least regulated in the developed world.

Chart 1: Product market regulation, selected countries

0 = least restrictive

Source: OECD

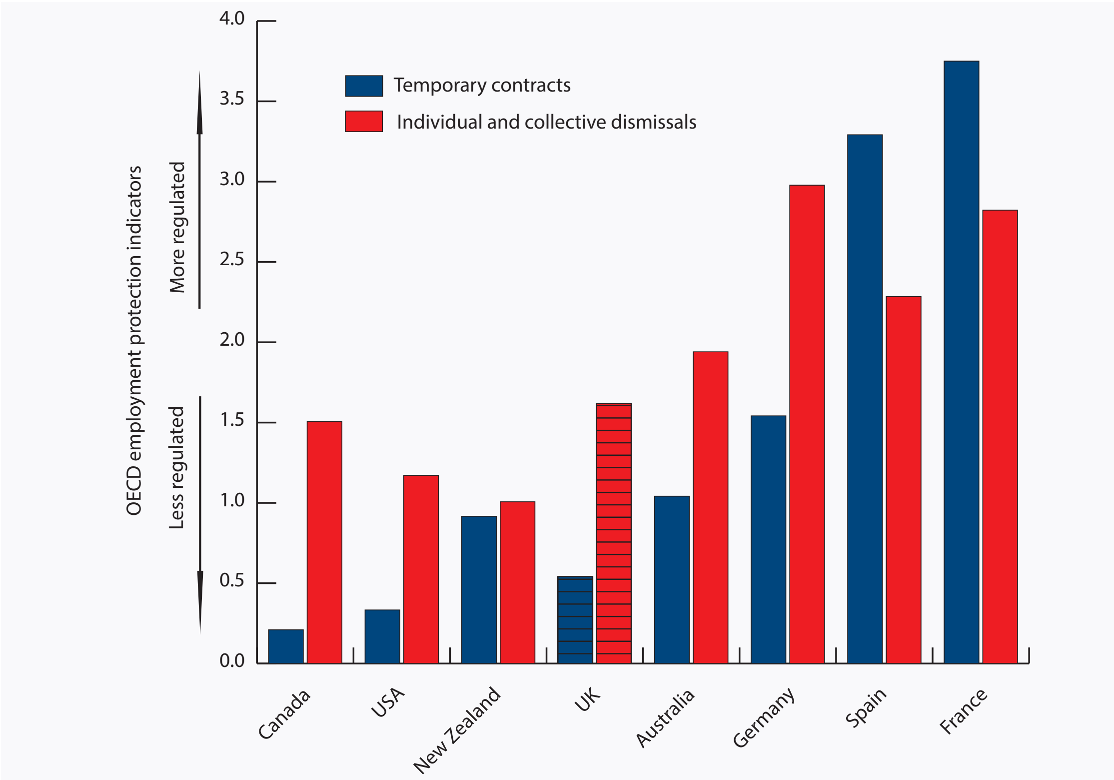


The same story broadly holds true for the labour market (see Chart 2). The OECD's index of employment protection legislation (EPL) shows a greater level of dispersion among the countries surveyed, with continental European countries embracing markedly higher levels of employment protection than the English-speaking countries outside Europe. So where does this leave the UK? The answer is that being a member of the EU does not prevent the UK from belonging firmly to the Anglophone camp. According to the OECD's EPL index, employment protection legislation is only slightly more restrictive in the UK than it is in the US or Canada, and less so than in Australia. It is, of course, much less restrictive than in continental European countries like France or Spain.

Chart 2: Employment protection, selected OECD countries

0 = least restrictive

Source: OECD



One might, of course, object that the OECD's EPL index is too narrow to capture the full regulatory burden that falls on national labour markets: aside from rules on hiring and firing, there are many other regulatory burdens on Britain's labour market (such as the EU's rules on working time). There is some truth to this, but only up to a point. For one thing, most of the supposedly burdensome labour market regulations identified in the 2011 Beecroft report on employment law originated in the UK, not the EU.[5] For another, it is not clear that the regulatory burden on Britain's labour market is quite the problem that the Beecroft report suggests. Indeed, its recent performance suggests that Britain's labour market is highly flexible, and that the country's main supply-side problems lie elsewhere.

Is Britain 'too European' to grow?

How does EU membership bear on Britain's economic performance? For eurosceptics, the answer is clear: the country's economic constraints are rooted in EU membership. The most radical version of this view asserts that the regulatory burdens of membership are the main supply-side constraint on the UK economy, so Britain's long-term growth potential can only be raised if the country leaves the EU.[6] But there are several problems with this view. It does not explain the disparity in Britain's performance before and after 2008. It wrongly implies that the main obstacles to growth originate in the EU, rather than at home. And it places too great an emphasis on the regulatory obstacles to growth, neglecting the other supply-side shortcomings that affect Britain's long-term performance.

Any account of the British economy must grapple with the disparity in its performance before and after 2008. Before 2008, the UK posted two decades of solid performance during which it reversed a longstanding trend of post-war relative decline. Thanks to rising employment (reflecting improvements in the functioning

5: Adrian Beecroft, 'Report on employment law', Department for Business, Innovation and Skills, October 2011.

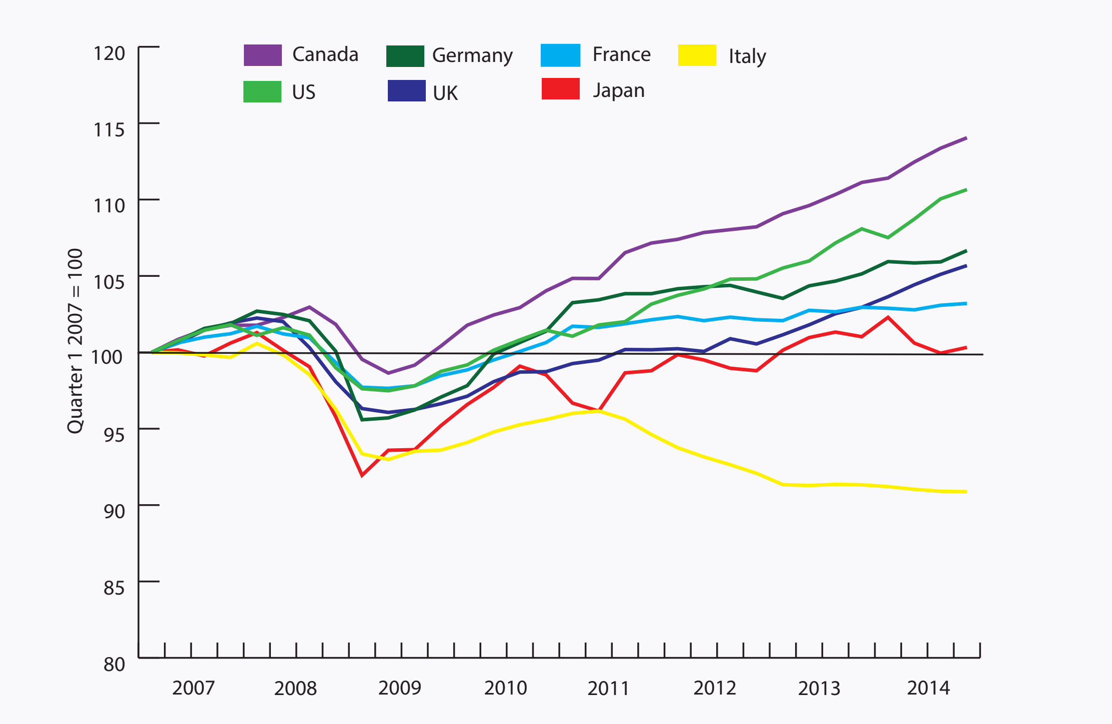
6: Tim Congdon, 'How much does the European Union cost Britain?', UK Independence Party, 2012.

of the labour market) and decent productivity growth, by 2007 UK GDP per head had overtaken France and Germany and narrowed the gap with the US. However, since 2008, Britain's performance has been pretty poor.

Recoveries from financial crises are always slower than after normal recessions.[7] But Britain's recovery has been slower than during the Great Depression, and only average among the G7 (see Chart 3).

Chart 3: Economic growth

Source: Federal Reserve economic data



There are several reasons why Britain's economic recovery has been weaker than in, say, the US. One is that North Sea oil production has fallen steeply. Another is that Britain has tightened fiscal policy more sharply than the US. A third is that UK exports are more exposed to markets in Europe where demand has been extremely weak.[8] It is hard to see, however, how eurosceptics could blame the weakness of Britain's recovery on the country's membership of the EU. Britain, for example, was not forced by the EU to tighten fiscal policy – it did so of its own volition. And the weakness of demand in many European export markets has much to do with the sort of policies that British eurosceptics prescribe, such as the aggressive fiscal tightening that many of them would like to see more of in the UK.[9]

Over the longer term, eurosceptics believe that 'de-Europeanising' Britain is essential if the regulatory burden on UK businesses is to be reduced. However, this twin focus on the EU and regulation invites three errors (or biases). The first is to exaggerate the importance of individual items of EU legislation they do not like. Take the EU's Working Time Directive. Although it is often cited as a burden on the labour market, its totemic significance is out of all proportion to its economic impact. Its negative effects marginal at best (not least because of the opt outs the UK already avails itself of).[10] But it is hard to look at Britain's performance since 2008 – a period of weak output, falling real wages but rising employment – and conclude that its key problem is an over-regulated labour market.

A second bias of which eurosceptics are often guilty is to focus on EU rules, while overlooking domestic restrictions that are vastly more damaging to national prosperity. Consider Britain's rigid planning rules and its restrictions on making land available for development to protect the 'green belt' that surrounds British cities. They help to explain why, despite rapid growth in the population, housing construction is running at half the level of the 1960s; why the average size of new homes built is smaller than anywhere else in the EU; why office rents are the highest in the EU; and why Britain's transport infrastructure is so congested and expensive to build.[11] The UK's highly regulated market for land is a supply-side constraint that has far more damaging consequences than anything which emanates from Brussels.

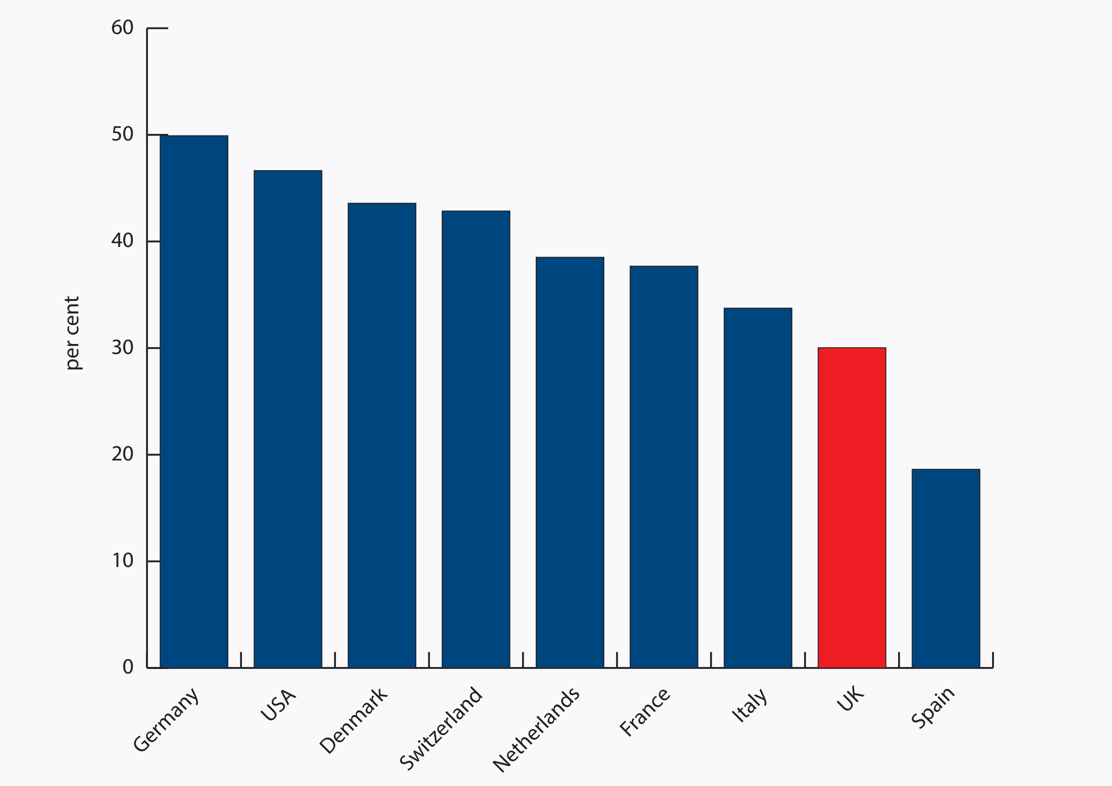
A third bias among eurosceptics is to reduce all supply-side problems to 'red tape'. But some supply-side issues

7: Carmen Reinhart and Kenneth Rogoff, 'This time is different: Eight centuries of financial folly', Princeton University Press, 2009.
8: Simon Tilford, 'Does a eurozone slump make Brexit more likely?, CER insight, November 10th 2014.
9: Dominic Raab, 'UK needs spending cuts and less red tape', *Financial Times*, February 17th 2013.
10: Katinka Barysch, 'The working time directive: What's the fuss about?', CER policy brief, April 26th 2013.
11: Simon Tilford, 'Why British prosperity is hobbled by a rigged land market', CER insight, February 13th 2013.

– like the provision of public goods – may have little to do with regulation. Education, for example, is a critical public good, given the importance of human capital to most countries' prosperity. The UK's record in this area is patchy. It has assets, such as its universities, the best of which are world class. But its rates of literacy and numeracy at age 15 are only around the OECD and EU averages, and its rates of graduation from secondary education are poor (see Chart 4). Add to this the longstanding weaknesses in vocational training, and the result is that Britain has a long tail of people with low skills – a failing that hurts the economy far more than EU employment rules.[12]

Chart 4: Upper secondary graduation rates (per cent of workforce who have completed secondary education)

Source: OECD



Would Britain be more 'globalised' outside the EU?

Some opponents of EU membership, notably on the libertarian right, like to portray Britain as a country whose globalising ambitions are thwarted by the provincialism of its continental commitments and obligations. On this view, the vitality of the country's trade and investment relationship with the rest of the world, and with fast-growing emerging economies in particular, is sapped by the protectionist influences of its continental European partners. Outside the EU, Britain's borders would actually be more open, and the country would be truer to its globalising nature. The appeal of this story, which harks back to a golden age when Britain was a globe-trotting nation mostly unencumbered by continental entanglements, is not hard to understand. But it is also profoundly misleading.[13]

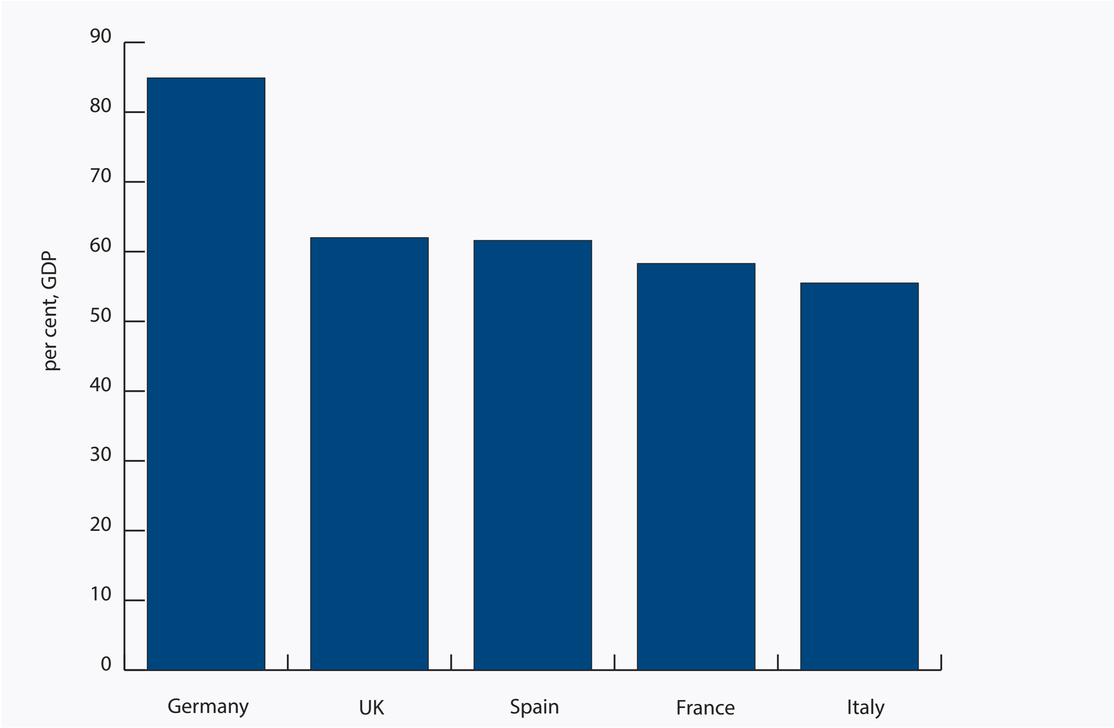
Britain does not stand out as being a much more open economy than its continental neighbours, and there is little reason to suppose that the UK would be more open outside the EU than it is inside. Combined, exports and imports account for over 60 per cent of UK GDP. This is slightly more than the equivalent shares for other similarly-sized EU countries such as Italy and France – but it is markedly less than Germany (see Chart 5). Germany's example is instructive, for at least two reasons. First, its economy is larger, so it might have been expected to trade a lower share of its GDP than Britain.[14] Second, it shows that membership of the EU is no bar to developing thriving commercial links with countries outside Europe: Germany sells four times more to China than does the UK.

"Britain does not stand out as being a more open economy than its continental neighbours."

12: LSE Growth Commission, 'Investing for prosperity: Skills, innovation and growth', Centre for Economic Performance, LSE, January 2013.
13: Centre for European Reform Commission, 'The economic consequences of leaving the EU', CER report, June 2014.
14: Other things being equal, the larger a country, the lower its trade share of GDP tends to be.

Chart 5: Exports and imports of goods and services as a share of GDP, 2014

Source: Haver



Claims that leaving the EU would spur trade and investment flows across British borders should therefore be treated with a pinch of salt. Indeed, the result would probably be the reverse. Consider foreign direct investment (FDI). There are many factors that encourage foreign firms to invest in the UK – from the liberal nature of its product and labour markets, to the integrity of its legal system, the security of property rights, the attractions of its clusters (like the City of London) and the international status of the English language. But many foreign companies also invest in the UK so they can serve a wider EU market. So while Britain would retain a lot of the FDI it has attracted if it left the EU, it is doubtful that leaving the EU would make Britain a more attractive location to foreign investors.[15]

Aside from the impact on trade and investment flows, it is also doubtful that withdrawing from the EU would have a liberating impact on British public policy. It is true that Britain is admirably open in a number of respects. Few countries are as relaxed about foreign firms acquiring domestic ones, or about foreigners exercising key positions in national life (the appointment of Canada's Mark Carney as governor of the Bank of England being a notable example). But the idea that openness to the outside world is hard-wired into Britain's national identity – in a way not found elsewhere in Europe – is not convincing. The consensus around free trade is more recent and weaker than is sometimes recognised. And in some areas, such as immigration, the domestic pressure is towards less openness, not more.

Many Britons tend to assume that theirs is a natural, free trading country – in contrast, say, to protectionist France or mercantilist Germany. This assumption is not totally devoid of evidence to support it, but is weaker than generally assumed. Opinion polls, for example, do not suggest that ordinary Britons support free trade more strongly than their French or German counterparts. It is not necessary to go back to the Corn Laws in the 1840s to unearth cases of British protectionism: for much of the period between 1945 and the late 1980s, the UK was riddled with measures that were intended to protect national industries and which violated its obligations under international trade agreements and the Treaty of Rome.[16]

Finally, there is one area where the country clearly wants its borders to be less open than EU law requires them to be. Following a decade or so of large net inflows, immigration has become a leading concern of voters.[17] Surveys show that a majority of Britons would like less immigration (see Chart 6). The government has responded by calling into question the free movement of labour – a fundamental principle of the EU's single market – and by looking at ways to prevent citizens of other EU countries from accessing the UK's welfare system and public services. In addition, Theresa May, the Conservative home secretary, has tried to meet the government's electoral commitment to reduce immigration by tightening visa requirements, notably for non-EU nationals wanting to study in the UK.

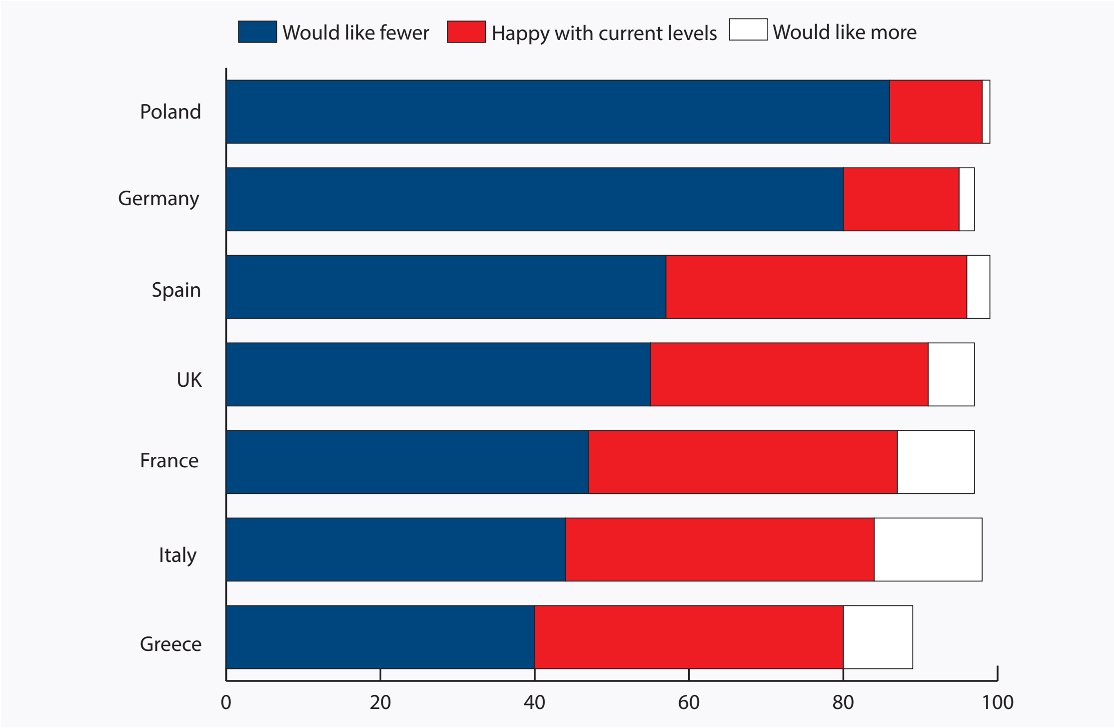
15: John Springford and Simon Tilford, 'The Great British trade-off: The impact of leaving the EU on the UK's trade and investment', CER policy brief, January 2014.

16: David Henderson, 'Orthodox economics versus the people', BBC Reith Lectures (Lecture 4), November 27th 1985.

17: John Springford, 'Is immigration a reason for Britain to leave the EU?', CER policy brief, October 2013.

Chart 6: Attitudes to immigrants

Source: Pew Global Attitudes Survey, Spring 2014



Britain, in short, does not really look like a frustrated globaliser inside the EU. Leaving the EU would not boost trade and investment flows into and out of the country, and there is little reason to think that Britain would use the opportunity of exit to open its borders more widely than they already are inside – if anything, the reverse. The reality is that the EU keeps its members 'honest' by anchoring their behaviour. Freed of the obligations of EU membership, the need to assuage public concerns about immigration – and to be seen to be doing so – would take precedence over economic logic.[18] British governments would almost certainly take steps to make it harder for non-nationals to visit, work and study in the UK, even if such measures hurt important economic sectors like tourism and higher education.

How freely would Britain trade outside the EU?

British eurosceptics often say they like trade, but hate regulation. They want one, but not the other. Many, moreover, think that this goal is achievable. If Britain left the EU, they argue, the country would free itself of the associated regulatory burdens, but would still be able to conclude agreements that allowed it to trade freely with the EU (as have non-EU countries such as Norway and Switzerland). In addition, Britain would be able to conclude trade agreements with fast-growing countries outside Europe without being constrained by protectionist foot-dragging in other EU member-states such as France. All this may sound appealing. But it turns out on closer inspection to be airily vague about basic distinctions – and consequently about the real choices available to Britain.

Start with the distinction between a free trade area and a single market. A free trade area is a bloc whose members have signed an agreement to eliminate all tariff barriers to trade. A single market does what a free trade agreement does, but goes much further. It eliminates all tariffs – but it also tries to sweep away all the non-tariff barriers which these days are the most important obstacles to trade between countries. The ultimate objective of a single market is for goods, services, capital and people to move as freely across its members' borders as they do within them. Because many of the barriers hiding 'behind borders' are regulatory, the EU seeks to achieve its objective with two principles: common minimum EU standards and mutual recognition. In essence, the first allows the second to work.

British eurosceptics' failure to appreciate the distinction between a free trade area and a single market helps to explain some of their more puzzling statements. It is perfectly consistent for a eurosceptic to say that the single market comes with too many regulatory costs attached, and that a looser free trade agreement would be preferable. It is incoherent, by contrast, to say (as some do) that the UK should continue to participate in the single market, but freed of its regulatory burdens; or that the UK should remove itself to an 'outer tier', alongside

18 Helen Warrell, George Parker and Kiran Stacey, 'Cabinet's growth versus visas dilemma', *Financial Times*, March 4th 2013.

Switzerland and Norway (and so outside the EU), while continuing to play an active part in shaping the EU's single market legislation. What, then, would Britain's options really be outside the EU?

One would be the Norwegian model. Norway has opt-outs from a few areas (such as fisheries and agriculture), but it is otherwise a full member of the EU's single market thanks to its participation in the European Economic Area (EEA) agreement. Because it participates in the single market, Norway must implement all the EU legislation that is associated with it. So the difference between Norway and the UK is not that Britain must implement EU law, while Norway does not. It is that Britain belongs to the EU and so actively shapes the rules, while Norway is not and so does not. The price that Norway pays for being in the single market is a high level of regulatory subservience to the EU. This empties some of its domestic political debate of substance.[19]

An alternative to the Norwegian model is the Swiss one. Switzerland has a free trade agreement with the EU, which means that trade in goods is tariff-free. In addition, Switzerland has a series of bilateral agreements covering areas such as public procurement, technical standards and land transport – but not financial services. Switzerland's integration in the EU's single market, in other words, is less complete than Norway's. It is not obliged to implement new EU legislation, but the result is that it enjoys less market access. In addition, while it has more freedom than Norway to shape its regulatory framework (in, for example, areas like banking), the reality is that its autonomy is more qualified in practice. The reason is that Swiss firms must still comply with EU standards if they are to sell there.

In short, neither the Swiss nor the Norwegian models are quite as attractive as British eurosceptics appear to believe. Norway does participate in the single market without being in the EU. But the price it must pay is to implement vast numbers of EU rules it does not influence (a status sometimes described as 'fax democracy'). Norway, then, is not exempt from EU legislation – and it is a peculiar poster child for eurosceptics concerned about regulation, sovereignty and democracy.[20] Switzerland, by contrast, is not obliged to comply with EU legislation. But what it gains in autonomy relative to Norway, it loses in market access. Whatever British eurosceptics believe, the Swiss and Norwegian models do not suggest that an option exists that would allow Britain to have its cake and eat it.

"Neither the Swiss nor the Norwegian models are as attractive as British eurosceptics appear to believe."

Nor is it clear that the UK would have as much negotiating clout with non-European countries as it currently does inside the EU. Membership of the World Trade Organisation would give the UK some protection against discriminatory trade measures. But Britain would be a bystander to trade talks involving large trading blocs, such as the Transatlantic Trade and Investment Partnership. And it would have very little influence in shaping the international standards and regulations which have such a decisive impact on 21st-century trade. Outside of the EU, Britain would become more of a policy-taker than a policy-maker: its exporters would therefore have to comply with regulations and standards overwhelmingly set by others.

Conclusion

Even its most committed supporters would concede that there is much to criticise about the EU. The single market remains incomplete, notably in the services sector (an area where Britain is a large net exporter). The EU regulates a lot and not everything that emerges from its legislative machinery complies with its 'better regulation' agenda, or with the principle of subsidiarity. Some of the EU's policies, such as the Common Agricultural Policy, are wasteful and difficult to justify. The structure of the EU's budget is flawed. The eurozone crisis, moreover, has been a terrible advert for the EU, both economically and politically. It has deepened the EU's democratic deficit, exposed a gulf between the rhetoric and reality of political union, and divided rather than united its member-states.

All the same, many of the economic claims advanced by British eurosceptics are profoundly misleading. EU membership is not, as many of them assert, a shackle on the long-term performance of the British economy, and leaving the EU would do nothing to improve it. Because of their compulsive focus on regulation and the EU, eurosceptics tend to exaggerate the damage done to the UK economy by individual items of EU legislation; they pay insufficient attention to domestic regulations that damage growth more than EU ones; and they tend to reduce all supply-side issues to an excess of red tape.

Finally, eurosceptics are often vague about the options available to the UK outside the EU. Some have (or, at any rate, give) the impression that the UK could extricate itself

19: David Buchan, 'Outsiders on the inside: Swiss and Norwegian lessons for the UK', CER policy brief, September 2012.

20: Hugo van Randwyck, 'Norway option a clear choice for Britain in Europe', *Public Service Europe*, March 7th 2013.

from the EU and its associated regulatory burdens yet still partake in the EU's single market. But a closer look at the Swiss and Norwegian experiences shows that there is no option that would allow Britain to be in the single market but free of its rules. In addition, Switzerland's example shows that even if the UK opted for looser trade ties, British firms would still have to comply with EU standards if they wanted to export to the EU.

The British economy would not collapse if the country were to leave the EU. But the opposite claim – that leaving the EU would be a supply-side liberation for the economy and that the UK would be more open to the world outside the EU than inside – is nonsense. The truth is that the factors that weaken long-term growth are overwhelmingly domestic, not European; and that the economy's supply side might be hurt if – as seems likely – barriers to the flow of goods, services and people between Britain and the continent rose after the country left the EU. For all its imperfections, the EU is a more important anchor for Britain than is commonly realised. Britain may resent some of the obligations of membership. But they may be what prevents the country from shooting itself in the foot.

Philip Whyte

Philip was chief economist at the CER.
He died on April 5th 2015, 18 months after being diagnosed with incurable cancer.

This is a revised version of '*Do Britain's European ties damage its prosperity?*', which was published in March 2013.

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