

CER Bulletin

Issue 108 | June/July 2016

**Why Britain voted to leave
(if it does...)**

By Charles Grant

Five Brexit economic myths

By Simon Tilford

**The EU after Bremain:
Kiss and make up?**

By Ian Bond



CENTRE FOR EUROPEAN REFORM



by Charles Grant

At the time of writing, neither side has a clear advantage in Britain's referendum campaign on EU membership. The British could easily vote for Brexit. If they do, this is the story to be written on June 24th.

The *zeitgeist* was hardly propitious for a referendum campaign on the EU. In many parts of Europe and the US, immigration and trade had become unpopular causes. Globalisation was thought to benefit elites but worsen inequality and threaten the livelihoods of poorer people. The financial crisis had made people think that whereas they paid for the losses, fat cats did nicely. Thus support for populists like Donald Trump, Marine Le Pen and Nigel Farage grew. Many Europeans viewed the EU as the friend of establishment interests.

So when, during the UK referendum campaign, the IMF, the OECD, the Bank of England, the G7, five former heads of NATO, the US president and a lot of men in dark suits told the British that the EU was good for them, it made little impact.

George Osborne, the British chancellor, had tried to dissuade Prime Minister David Cameron from promising a referendum. But Cameron was right that sooner or later there had to be one. Given the increasing EU-phobia within the Conservative Party, nobody could have succeeded him as leader without making such a pledge. So in February 2013 Cameron promised a referendum before the end of 2017. He had principled justifications: as long as the British voted, as he expected, for

continuity, the referendum would resolve tensions in the UK-EU relationship and enable Britain to play a more constructive role. And less principled reasons: the promise would (he prayed) keep the Conservative Party together, and limit the defection of its voters to UKIP.

Cameron assumed that, during a referendum campaign of a few months, he and other Remainers could overcome the hostility of British voters to the EU. But that euroscepticism was deeply engrained, having been reinforced over decades by slanted stories in newspapers and by politicians (and not only Tory ones) who saw knocking the EU as a vote-winner. Few political leaders had dared to make the case for the EU. And during the five years of the Cameron-led coalition government, most Conservative ministers had spoken negatively about the EU.

The government's review of EU competences, carried out in 2012-14, was a missed opportunity. This serious exercise, involving outside experts (including the CER and eurosceptic think-tanks), sought to establish whether the EU's various powers harmed or helped British interests. The review's 32 reports concluded that the balance of competences between Britain and the EU was about right. Cameron could have used the review

as the basis for an attempt to convince the British of the benefits of the EU. But Tory eurosceptics hated the review's conclusions and, for the sake of party unity, Cameron buried the reports.

In February 2016, after Cameron's 'renegotiation' had led to an accord with the rest of the EU on minor but useful reforms, the referendum campaign began. The government focused on Brexit's threat to trade and jobs, with some success. But its economic argument was blunted by the refusal of many pro-EU business leaders to speak out in public (they were scared of upsetting customers, employees or non-executive directors).

The Outers' most effective argument was that only Brexit would allow Britain to curb the number of EU migrants. Many Britons thought the country had too many immigrants and that most of them were from the EU; in fact about 70 per cent of those arriving in the previous 15 years had come from non-EU countries (the press had chosen to highlight the EU ones). But that still left 2 million EU nationals working in the UK. People believed they had put public services under strain (this was true in certain places, yet the NHS and social care between them depended on 135,000 EU workers); that they had held down wages for natives (for which the evidence was very limited); and that they had stolen jobs (though UK unemployment was only 5 per cent). Many Britons were unaware that EU migrants contributed much more in tax than they received from the state in benefits and public services (£20 billion more, in the decade to 2011).

The Remainers lacked an effective response to concerns about immigration. It had not helped that, during the renegotiation, Cameron talked up the 'problem' of migrants claiming in-work benefits, making a curb on those benefits his key demand. In the end he won the right to limit payments of in-work benefits for four years, but nobody thought this would affect immigration significantly.

In March the EU struck a deal with Turkey, which included a conditional promise by the Schengen countries to give Turks visa-free access, and the opening of a new chapter in Turkey's accession talks. The outers used this to stoke fears that imminent Turkish accession would give 80 million Muslims the right to work in the UK (the truth, of course, is that each of 28 members can veto Turkey, which will not join for decades, if ever).

The Brexiters could not have dreamed of more favourable circumstances in British and EU politics. Within Britain, the credibility of Cameron and Osborne, the two most senior politicians backing Remain, began to drop at about the time the campaign started. Cameron mishandled the

Panama papers affair, appearing to have had something to hide about his family's finances (though he had done nothing wrong). Osborne made a mess of his annual budget, being forced to withdraw several key proposals, including cuts to disability benefit. Some of the ministers and other figures put up to defend the EU were uncharismatic and lacked expertise.

“The arguments for staying in were complex, numerical, hard to explain and often dull.”

This Tory-led campaign did little to inspire Labour voters, many of whom were naturally sympathetic to the EU. The Labour Party was in a febrile state, more focused on what to do about its controversial hard-left leader, Jeremy Corbyn, than on winning the referendum. Corbyn, though formally for Remain, sometimes appeared ambivalent on the EU.

Meanwhile the EU itself was a hard sell. The euro crisis was far from resolved, with Greece and other parts of the eurozone still suffering economic distress. Since the summer of 2015, the influx of refugees into Greece and Italy had turned European leaders against each other and made the EU appear ineffective. Brexiters mendaciously claimed that Syrian refugees in Germany could easily get EU passports and so move on to the UK. Outers also profited from the Daesh attacks in Paris and Brussels, asserting (wrongly) that terrorists with EU citizenship could not be excluded from the UK.

The Vote Leave campaign exploited these favourable circumstances ruthlessly. It was cynically and deliberately cavalier with 'facts', for example stating that "Britain sends £350 million a week to Brussels" (the net figure is £120 million) or that "60 per cent of UK laws come from the EU" (in fact it is 13 per cent).

The opposing Stronger in Europe occasionally exaggerated but did not lie. Its job was much tougher: the arguments for staying in were complex, numerical, hard to explain and often dull. It focused on the risks of Brexit for the UK's economy and security. These arguments proved powerful with parts of the electorate but failed to motivate sufficient numbers of youngsters, who tend to be pro-EU. On June 24th, when the Outers scraped home to a narrow victory, and Cameron resigned, the pollsters explained that low turnout of younger voters had been decisive.

Charles Grant
Director, CER



Five Brexit economic myths

by Simon Tilford

Eurosceptics peddle a raft of myths about the economic costs of EU membership. These have little, if any, empirical basis, but Brexiters cling to them doggedly, however many times they are refuted by proper academic research. These myths form a kind of comfort blanket: the simple act of quitting the EU would inject oxygen into a suffocated British economy, in the process addressing a whole raft of complex social and economic problems. The myths are, in no particular order:

EU regulation is costly: According to eurosceptics, the costs of EU regulation have become so onerous that they now outweigh the relatively modest benefits of Britain's membership of the single market. This is nonsense. The OECD's indices of regulation show that Britain's product markets are the second least regulated in the OECD, and its labour markets are far more 'Anglo-Saxon' than 'continental'. Moreover, most EU regulation would need to be replaced by comparable UK regulation if the country quit the EU. For example, no British government would scrap statutory sick or holiday pay, or tear up environmental legislation.

There is no doubt that some EU regulation could be improved, such as the working time directive. But by far the most serious supply-side constraints on UK economic growth – an acute housing shortage, congested infrastructure and skills shortages – are home-grown.

EU membership damages Britain's trade: Many eurosceptics argue that Britain's trade and investment ties with the rest of the world are sapped by the protectionism of its European partners. Outside the EU, Britain would be more open and truer to its globalising nature. It would trade more with countries whose demand for British goods and services is strong (the UK has a trade surplus with non-EU markets) and trade less with the EU, where demand for British exports is weak and with whom Britain is running a large trade deficit. This is profoundly misleading.

First, Britain is not a frustrated globaliser inside the EU: opinion polls do not suggest that ordinary Britons are much more supportive of free trade than their counterparts in other EU countries. Second, there is no indication that Britain's trade with the rest of the world is being held back by EU membership. Why should it constrain British exports to China, but not Germany's? Third, there is little evidence that British trade is being diverted from non-EU countries to EU ones, but plenty that

EU membership has boosted Britain's European trade. And it is trade with other wealthy countries producing similar goods that does most to boost competition and with it productivity growth; trade with emerging markets provides fewer of these 'dynamic' gains. Britain's European trade has certainly been hit by weak eurozone domestic demand. But this will be a problem whether or not the UK is in the EU.

Inward investment is not linked to EU

membership: Britain is home to more foreign investment than any other EU country. Eurosceptics are right to argue that this reflects the UK's strengths: liberal product and labour markets, the integrity of its legal system, the attractions of its commercial clusters (like the City of London) and the English language. But they are wrong to argue that Britain's success has nothing to do with its EU membership, and doubly wrong to suggest that Brexit would boost foreign investment in the UK by freeing the country of EU regulation.

For many foreign investors, especially in manufacturing and financial services, Britain's access to the single market is a major pull factor. Outside the EU, the loss of market access and influence over EU rules and regulations would, for at least some of them, more than offset the other attractions of the UK as an investment location.

The eurosceptic assertion that a Britain freed of the EU would be able to deregulate its economy and hence attract more foreign direct investment (FDI) is based on a series of fallacies. First, EU regulations are not a drag on the economy; they generate trade between the member-states. For example, the EU's drive to open up member-states' financial sectors to competition has increased investment in the UK, which has a strong comparative advantage in finance. This would not have been possible without the EU setting common standards. The second fallacy is that the UK would recover regulatory sovereignty if it quit the EU. But in order to broker free trade agreements with the EU and US, Britain would have to agree to common regulatory standards in many areas. The third is that the British electorate would accept a dilution of environmental, social or labour standards following Brexit.

EU immigration is costly: Immigration into the UK from the EU jumped in 2004 following the accession of the Central and Eastern European countries and has remained relatively high since. Britain is now home to a comparable proportion of people from other EU countries as Germany and France, though still less than the Netherlands or Spain.

Many Britons are uncomfortable with what has happened. But immigrants from the rest of the EU are, on balance, positive for the UK economy. There is little evidence that they take jobs from Britons. And the limited evidence that EU migrants reduce the wages of low-skilled British workers suggests that any impact is small. Britain's EU migrants are young and more likely to be in work than Britons, and thus pay more in taxes than they receive in benefits and public services.

“There is no indication that Britain's trade with the rest of the world is being held back by EU membership.”

Where there are negative effects for particular groups of Britons from EU immigration, these can be offset by public policy, for example by increasing the supply of public services in areas of high immigration, and changes to taxes and benefits to boost the disposable incomes of the low-skilled. Unfortunately, this is not happening: Britain is building a third fewer houses than it was in 2007; the supply of public services is too slow to respond to increased demand; and changes to the tax and benefit systems are making the poor worse, not better off.

Brexit would improve Britain's public finances: Between 2014 and 2020 Britain's net contribution to the EU budget will be around 0.5 per cent of GDP (currently £9 billion) per year. Eurosceptics argue that this money could be better spent at home. This is simplistic. First, the UK could end up paying into the EU budget even if it quits the EU. If the UK were to join the European Economic Area (EEA) and pay into the EU budget on the same basis as Norway, its budget contribution would not fall by much at all. In the unlikely event it was successful in negotiating an agreement similar to Switzerland's, Britain's contribution would fall by around half. Moreover, under both scenarios the UK economy would suffer – more under the Swiss option than the Norwegian one – thereby hitting tax revenues.

If Britain were to quit the EU's orbit entirely, it would save the full 0.5 per cent of GDP. But it would only take a modest weakening of trade and investment following Brexit to weaken Britain's fiscal position by 0.5 per cent of GDP. And, in any case, Britain would find it difficult to cut farm subsidies and development funds to poor areas of the UK.

Simon Tilford
Deputy director, CER



The EU after Brexain: Kiss and make up?

by Ian Bond

What happens if Britain votes decisively on June 23rd to stay in the EU? None of the EU's other problems – the economy, the Syrian conflict, the refugee crisis or Russian sabre-rattling – will be solved. European leaders, including British Prime Minister David Cameron, could pretend that the referendum never happened and resume fire-fighting. British ministers will have a mandate to re-engage with the EU. But will it be a mandate to remain Europe's curmudgeon, or to be more ambitious?

Home Secretary Theresa May, previously eurosceptic though now arguing for staying, said in April "we have become so used to being in this permanently defensive crouch that ...Britain has forgotten how to stand up and lead". That is an exaggeration. But since the prime minister proposed an in-out referendum, ministers have indeed been less active in the EU, even in traditional areas of British influence like foreign policy.

Some member-states may resent Britain trying to lead the EU with the zeal of the convert. But the UK can be a force for good in the EU when it commits itself to a project – as with the single market in the 1980s. So here are ten areas in which the UK can bring a new positive tone to its EU membership.

Security and counter-terrorism In the campaign, Cameron has stressed the EU's contribution to Britain's security. Other member-states may have been irritated by Britain withdrawing from justice and home affairs

measures in 2013, only to opt back into the most important; but the UK remains a crucial partner in fighting crime and terrorism. UK expertise could help the EU to construct a data sharing and privacy regime able to withstand challenges in the European Court of Justice.

Migration Though outside the Schengen borderless area, Britain cannot escape the impact of the refugee crisis. The UK has argued that giving asylum seekers legal channels to come to Europe would ruin the people smugglers' business model; it should both set an example by resettling refugees in Britain, and persuade Central Europeans to take more.

Defence Britain will not back an EU army; but it should support more EU collaboration in operational intelligence sharing (for example, to target people smugglers in Libya), logistics (including pooling of air-to-air refuelling tankers and strategic lift) and defence research (including an increased budget for the European Defence Agency).

The single market Britain's strength in service industries gives it a special incentive to push for the single market to cover more of the services sector. With the referendum behind, the British government should acknowledge that more single market means more regulation at the EU level, and support growth-promoting reforms.

Energy The UK has pushed a market-based approach to reforming the EU energy sector, but it should accept that the market alone will not protect Central European countries reliant on Russian gas, and work with the Commission to ensure that countries have both an obligation and the infrastructure to supply their neighbours in a crisis.

Neighbourhood The EU's neighbourhood, to the east and south, is a mess. Enlargement, which stabilised Central Europe after 1989, is increasingly unpopular in the EU (including in Britain, its traditional champion), and not on offer to countries in the Middle East and Maghreb. Britain should work with other leading member-states to devise a comprehensive plan of security operations, political engagement and free trade to stabilise the neighbourhood.

Foreign policy British activism in the Balkan conflicts of the 1990s contrasts sharply with Britain's disengagement from efforts to resolve the conflict between Russia and Ukraine. It may be too late to persuade France, Germany, Russia and Ukraine to include the UK in the 'Normandy format'; but London should push for the EU to do more wherever international tensions threaten European interests, including in East Asia.

Trade Brexiters are not entirely wrong when they argue that protectionism elsewhere in Europe may slow down EU trade deals with important partners. The UK should co-ordinate northern and central European free-traders to push for faster progress. It should encourage its friends in Beijing and Tokyo to move forward on the EU/China bilateral investment treaty and the EU/Japan free trade agreement.

European Parliament Cameron should reverse his decision to take the Conservative Party out of the European People's Party (EPP) group, which robbed the Tories of influence in the Parliament. Not every party in the EPP is irredeemably federalist; Cameron could strengthen his alliance with Angela Merkel while still working to make the EPP more economically liberal and politically flexible.

Rebuilding Britain's EU expertise The UK is now very under-represented in EU institutions. The government should launch a concerted effort to get the best young civil servants to work in the Commission and the External Action Service, and to challenge the prejudice that British 'eurocrats' have betrayed the UK for salaries and perks. And it should simultaneously increase its bilateral diplomatic effort in Europe to rebuild the UK's influence with partners.

Such ambitious goals would serve UK interests. The question is whether Cameron will pursue them boldly, and face down eurosceptics who are already preparing for another membership referendum. In the national interest, he should do both.

Ian Bond
Director of foreign policy, CER

CER in the press

Sky News

22nd May 2016

Appearing on the Murnahan Show to comment on the referendum campaign, the CER's director Charles Grant argued that Remain have a much harder argument to make than the Leave side. He said "the international outlook also doesn't help".

The Telegraph

18th May 2016

Spain could ask British retirees to pay for their own healthcare – according to the CER's John Springford – or move to curb access to healthcare services outright.

Bloomberg

11th May 2016

"When the economy or energy prices begin to push inflation higher, the real test will be whether the ECB has the stamina to hold on," said Christian Odendahl of the CER.

The Wall Street Journal

29th April 2015

In a recent article the CER's Agata Gostyńska-Jakubowska drilled deeper into the questions that surround Article 50 of the Lisbon Treaty, the clause that would have to be used to negotiate the UK's departure.

The Sun

22nd April 2016

Gordon Brown told a meeting of 100 leading economists held by the CER: "People's concerns are not just economic, but they relate to security and they relate to what kind of country we are becoming and what is happening on our borders."

The Daily Mail

22nd April 2016

"Obama isn't an instinctive pro-European," said the CER's Ian Bond. "He opposes Brexit because it risks creating more problems for America in Europe."

The New York Times

19th April 2016

Simon Tilford of the CER noted that referendums in Europe had often fallen prey to oversimplification. "Lots of people ...will allow their frustrations with immigration and globalization to influence how they vote," he said.

Politico

7th April 2016

Rem Korteweg of the CER said "[the result of the Ukraine referendum] will slow the accession process down and raise doubts about whether the EU can stand by commitments it makes."

Recent events



Jean-Luc Demarty

24 May 2016

CER/Kreab breakfast on 'TTIP and the future of multilateral trade', Brussels
With Jean-Luc Demarty

18 May 2016

The CER annual dinner, London
With a speech by Martin Selmayr



Martin Selmayr



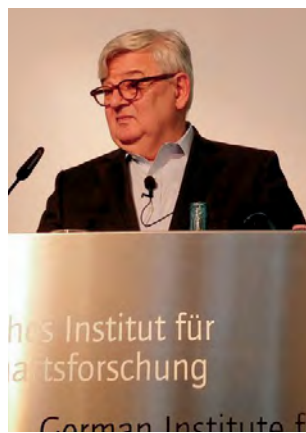
Julian Lewis MP

10 May 2016

Dinner on 'The prospects for the NATO Summit in Warsaw', London
With Julian Lewis MP

28 April 2016

CER/DIW Berlin roundtable on 'Britain's role in Europe', Berlin
With Joschka Fischer and David Lidington



Joschka Fischer



Gordon Brown

21 April 2016

Economists on Brexit conference, London
With a keynote speech by Gordon Brown

18 April 2016

Panel discussion on 'Business, Brexit and Sovereignty', London
With Andrew Mackenzie, Dominic Grieve MP and Andrea Leadsom MP



(L to R) Andrew Mackenzie, Andrea Leadsom and Dominic Grieve