

# 1 Introduction, Summary and Conclusions: Why the UK should Renegotiate or Leave the EU

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The UK joined the EU – or the European Common Market as it then was – in 1973, under Edward Heath’s Conservative government. Labour at that time was opposed and promised a referendum on withdrawal if it came to power. When it did so and the referendum was duly held in 1975, Labour had changed its mind; hence both Labour and Conservative parties campaigned for staying in. It was left to a minority in each party and to others to oppose and lose. Ever since there has been a shifting body of opinion opposed to EU membership, and both major parties have been seriously split on the issue, even though the official position of both has consistently been in favour of continued membership, as has been that of the Liberal Democrats.

It is not the purpose of this book to revisit the issues voted on in the 1975 referendum. Nor is it to speculate on, for example, what would have happened to the EU had we joined at the start; or indeed on a variety of ‘what if?’ questions of great interest. A great many things have happened since 1975, both politically and economically. Politically there has been most importantly the fall of the Berlin Wall and the steady expansion of the EU with the stated objective of underpinning peace in Europe and the world. Given the ferocious history of our continent in the twentieth century, there is no doubt that this is a crucial aim. The expansion of the EU to include the ex-Soviet countries of eastern Europe is a major contribution to this aim. The EU is therefore part of the emergence

of a world community of nations and powers, with powerful centres of legitimacy such as the UN, the WTO and the IMF/World Bank. Economically, there has been a widespread liberalisation of markets and an almost universal restoration of monetary stability; the UK itself, perhaps because it was in such a mess in the 1970s, has been a pioneer of such programmes, whereas market liberalisation in major parts of the rest of the EU has made modest, faltering progress. Thus, in the favourite phrase of some politicians, the UK, the world and the EU have ‘moved on’ since 1975; the aim of this book is accordingly to evaluate the UK’s relationship with the EU in the conditions of today, markedly different as they are from those of 1975.

Some people will be impatient with such an evaluation. They will say that this relationship is a given, a commitment, and it should be left alone to develop, with all partners contributing to the process – much as in a marriage or a nation. Talk of divorce, emigration or exit is simply counter-productive: instead one should focus on making it work.

The difficulty with this approach is that the EU treaty that the UK joined in 1973 has been under continuous change while, as we have seen, the surrounding political and economic circumstances have also been changing dramatically. Treaties come and go in the history of nations, as their interests change; and the EU relationship is just another treaty. It is not an indissoluble commitment; it was not for example a dissolution of the nation into a wider political union, such as a federation. If it was a marriage, then it was not a pledge to permanent union but rather to cohabit for convenience of cooperation in various important dimensions. It might be rejoined that the preamble of the Rome Treaty we signed in 1973 spoke of ‘ever-closer’ union and related ideas; however, UK politicians at the time stressed that such phrases were non-binding rhetoric and that the treaty merely committed us to certain key areas of practical cooperation, including – and especially in – trade. Look at the treaty commitments, they said, not at non-binding protestations of future intentions. And so we have; and so indeed the treaty has remained just that – a treaty.

The nations currently in the EU have different views about how the EU treaty (technically still the Rome Treaty as subsequently amended) should evolve. A majority, led by France and Germany, want greater central power, as exemplified by the draft EU consti-

tution produced by M. Giscard d'Estaing's Convention. Most UK citizens, it seems fair to say on the basis of the opinion polls, do not want this: hence the UK negotiating position, even under the current Labour government, which has taken an enthusiastic stance on EU integration, has, on the whole, been one of reluctance in a series of areas. It has drawn up 'red lines', detailing points beyond which further central EU power would be unacceptable to the UK, including tax, defence, foreign policy, and legal process. It has also agreed to put any finally-negotiated proposed EU constitution to a UK referendum. It is simply not clear where this process will lead. Will the EU majority give up on centralisation? Will the UK agree after a referendum to a federal Europe with strong central powers? Or will both sides agree to differ, with some centralisation and with a separate relationship for the UK?

These are important questions and they are now at the centre of political debate in the UK and to a large extent also in other countries of the EU. There is rightly a demand for facts and analysis to help UK and EU citizens to reach well-informed views about what to do at this important watershed in EU affairs. This book aims to help satisfy this demand. It is primarily designed for UK citizens; but there is plenty of material that will be useful for citizens of other EU countries and also of those countries in the rest of the world, especially the Cairns group and the USA, for whom EU trade policies are of vital interest.

In the rest of this chapter we sketch out the lines of our investigation. Our main focus is on the economics of the UK's relationship with the EU. The reason for this is two-fold. First, in the UK the economics have supposedly been the main benefit to Britain of EU membership, and we believe they have been far from well-understood. Second, the political benefits of the EU for the UK are quite hard to define, as compared with being outside the EU and politically collaborative (like Norway, Iceland, the US and many others), whether in the UN, NATO, the WTO, the IMF or simply in specific multilateral and bilateral relationships. We do however consider the political arrangements after we have sorted through the very specific details of the economics.

In considering the economics of the EU, we interpret the thrust of future EU policy in the light of recent policy actions by the EU (for example the decision by France and Germany to scrap reform of the CAP) and of the general thrust (in favour of protectionism

and social rights) of proposed new policies, such as those envisaged in the new draft constitution. We emphasise that the EU does not have to be this way; one can envisage an alternative, liberal set-up in which the CAP would be drastically reformed, free trade announced as the EU's commercial objective, and market forces as its guiding light in internal economic policy. But this, unfortunately, is not the EU we are currently asked to contend with. This book takes the EU as we find it and must accept it will develop, barring some currently unforeseen policy development.

We identify six areas in which economic issues arise. These are in turn the three major sectors of the economy – agriculture, manufacturing and services each of which is shielded by a variety of protective regimes; monetary policy and the euro; pressure to harmonise UK tax, regulation and social policy with other EU countries; and lastly public finances and the question of 'bail-out'. The chapters that follow deal carefully with all these questions. Here we give a brief summary of the arguments and of our conclusions.

First of all, there are the well-known costs of agricultural protectionism in the form of the Common Agricultural Policy (Chapters 2, 4 and 7). We put this at some 0.3–0.5 per cent of national income – a fairly typical estimate from the range available (1 per cent of national income is £10 billion per year). The sums involved vary with the state of the world market in agricultural products. But this estimate would correspond to an average year for relative world prices of food. The way in which the Common Agricultural Policy works is that it boosts the prices paid to farmers by consumers from across Europe by about 50 per cent above world prices and therefore, since we are big net importers of food in this country, that means that our consumers are basically paying a lot more for their imports than they need and therefore generally for their food. Furthermore they are paying this excess not in the main to UK farmers but rather to continental farmers, especially French ones.

The second cost is not so well known: the protectionism of manufacturing (Chapters 2, 5 and 6). Now again we were told that it is very important for us to be in the European Union because it would be good for our manufacturing industry. The truth of the matter is again we import more manufactures from the European Union than we export and therefore what is happening in manufacturing is very much like what is happening in food.

Manufacturing is a declining industry in the West: it is uncompetitive for obvious reasons, because we have emerging markets like China that undercut it so massively. What is left is in specialised, high-tech and niche areas. In our economy we have largely let market forces take effect, with generally favourable results for employment and growth; as a result we have let manufacturing go where it was essentially uneconomic. That has not happened to the same extent on the continent. As a result we find there a great deal of protectionist pressure. The EU is accordingly a customs union: for raising tariffs externally on manufactured imports, so that prices are kept up inside the European Union for manufactures. In addition to tariffs the European Union protects manufacturing through quotas in certain areas like textiles, but mainly through informal agreements (as in cars) and anti-dumping measures. Anti-dumping operates both through explicit duties and more generally through the threat of levying them, which results in importers raising their prices instead. (For some estimates of the effects of tariffs and non-tariff barriers in raising EU prices above world prices see Tables 1.1 and 1.2.) The latter action is more costly to us because not only do our consumers pay higher prices, the excess revenues resulting do not go to EU governments, including the UK, but rather to foreign non-EU producers. However, because it is not the result of an explicit action but rather of a threat, it is convenient to a protectionist bureaucracy both in its ease of imposition and in its non-transparency to the general public.

Now we are net importers so that this protectionism is costly to us in just the same way that the CAP is; it is, if you like, a ‘Common Manufacturing Policy’. Our estimates below put the analogous cost at 2–3 per cent of GDP.

We now come to the third area of EU economics – services trade (Chapters 2, 6 and 7). British traded service producers are generally efficient and the UK has a comparative advantage in services, of which we are net exporters on a large scale. We are talking of such industries as insurance, banking, airlines, ground transportation, communication and electricity. It is often argued that, therefore, the UK stands to gain from the single market in services that is one aim of the EU. At present the services environment in Europe is one of national protection, mostly very high. According to available estimates of services protection the UK and the US both operate fairly unrestricted regimes, whereas EU countries

Table 1.1: Effects of EU manufacturing trade barriers on prices – deviation from the US price (%)

	PCs <sup>a</sup>	Brown goods <sup>b</sup>	White goods <sup>c</sup>	Small domestic appliances <sup>d</sup>
US Price (£)	647	799	854	103
UK	24.0	66.3	11.2	55.3
Belgium	69.6	102.3	36.4	23.3
Sweden	38.9	118.8	47.3	14.6
France	27.0	74.1	18.9	68.0
Germany	8.2	77.0	32.9	37.9
Italy	38.9	65.8	-0.4	9.7
Spain	-3.2	64.6	0.1	5.8
European average	29.1	81.3	21.0	30.7

*Notes:*

<sup>a</sup> PCs: notebooks and desktops.

<sup>b</sup> Brown goods: audio home systems, cameras, camcorders, TVs and VCRs.

<sup>c</sup> White goods: refrigerators, dishwashers and washing machines.

<sup>d</sup> Small domestic appliances: irons, toasters, vacuum cleaners.

*Source:* The Arthur Andersen study reported in Haskel and Wolf (2002)

operate highly restrictive regimes at national level, presumably to protect their national companies (Table 1.3). The argument goes that if this national protection is replaced by an EU-wide protective regime of a customs union type, then Britain would gain greatly, in a mirror image of its losses on other trade.

Unfortunately there is a great difficulty with this argument. Why should the continental EU countries participate in a customs union for services that would retain high prices for their consumers while transferring service production from their own companies to UK companies that are more efficient? For these countries this would be like our opting for a CAP; they would be foolish to do it. (We only did it in the early 1970s because it was the price of

Table 1.2: Estimates of tariff-equivalents on manufactured goods due to all trade barriers (%)

	1990	1996	1999
Belgium	42	65	42
Germany	39	60	29
Italy	38	36	21
Netherlands	42	58	41
UK	41	41	50
US	16	14	15

*Note:* Data are expenditure-weighted average ratios of imputed producer prices to the landed prices of goods from the country with the lowest level of price in the sample.

*Source:* Bradford and Lawrence (2004)

Table 1.3: Survey indicators of service barriers (Scale 0–6 from least to most restrictive)

	1978	1988	1998
UK	4.3	3.5	1.0
REU	5.4	5.1	3.4
US	4.0	2.5	1.4
Australia	4.5	4.2	1.6
Canada	4.2	2.8	2.4
Japan	5.2	3.9	2.9
Switzerland	4.5	4.5	3.9

*Note:* Simple averages of indicators for seven industries – gas, electricity, post, telecoms, air transport, railways and road freight. Depending on the industry the following dimensions have been included: barriers to entry, public ownership, market structure, vertical integration, price controls. For the Rest of the EU, simple averages of individual EU countries.

*Source:* Nicoletti and Scarpetta (2001)

joining the EU and our politicians at that time felt there were compensating benefits.) It seems that instead they would be rational to opt for one of two alternative outcomes: either full deregulation or no change. No change would keep their own producers' privileges while continuing to penalise their consumers; the difficulties of achieving service liberalisation bear testimony to the tenacity of these producers' lobbying. If on the other hand liberalisation, as in the Single Market agenda, is effective, then full deregulation would give each country large gains to their consumers that would more than offset the losses of their producers. These countries would then if they chose be able to sweeten the pill for their producers by some transfer programme, at least for a transitional period.

From the UK viewpoint either outcome means that UK service firms would make no gains. Under no change they cannot enter the continental markets except at world prices – no attraction in doing so relative to any other world market. Under full deregulation the same applies, as EU prices would drop to world levels. (Under partial national deregulation, the same applies again; UK firms would still only get world prices.)

The whole point about the single market in services, if it were ever to happen, is that it gives a great benefit to continental consumers by dragging down prices of services across Europe. But it would not benefit British consumers because we have already got a highly competitive market in services and it would not benefit British producers of services because they would not get better profits in Europe than they can get anywhere else in the world. Therefore, there is no benefit. The only qualification to this is that if the EU deregulates services, this (by contracting EU production and expanding EU consumption) would drive up world prices of services and so improve the UK's terms of trade. But of course this benefit accrues to the UK whether she is in or out of the EU. Services therefore will not provide an area of gain that can offset the losses we make in our other trade with the EU.

We must emphasise that these 'costs' we have so far identified, in connection with the EU's arrangements for trade in goods and services, compare being inside the EU customs union with being outside under free trade. Some people then ask whether we could not still have some trade arrangement with the EU, other than the normal WTO guarantees of non-discrimination. But of course this is to miss the point of a customs union in which there is horse-

trading between the producers of different countries, paid for by their consumers; if a country refuses to trade by penalising its consumers it has nothing to offer! Were the UK to be outside and let its consumers receive world prices, continental EU countries would be mad to let UK producers have access to their markets at preferential customs union prices; this would amount to asking their own producers to transfer profits to UK firms with no quid pro quo.

This is a familiar enough point in the content of the CAP. No one would expect that, if we left the CAP, thus being able to once again to buy our food at low world prices from countries like New Zealand, our farmers would still be able to obtain much higher CAP prices from selling their food inside the EU to EU consumers. The CAP is an arrangement whereby our farmers obtain high prices from consumers across the EU and in return our consumers pay high prices to producers across the EU. Once our consumers buy elsewhere at low world prices we cannot expect EU consumers to pay high prices to our farmers. Exactly the same logic applies if we withdraw from the customs union in manufactured goods.

Thus it must be realised that ceasing to participate in EU customs union arrangements would be just that – free trade at world prices would be in its place, with no ‘EU preferences’. From this though we gain that 2–3 per cent of GDP.

The fourth area in our EU relationship – joining the euro (Chapter 3) – has now been amply explored, not least by HM Treasury in its voluminous study of the Chancellor’s ‘Five Tests’. The debate of the last few years has now clearly revealed how costly it could be to us, in the form of increased economic volatility, ‘boom and bust’ in the Chancellor’s phrase. The recent experiences of Germany and Ireland within the euro-zone have borne witness to the problems the UK would itself experience. As a trading nation with over half our trade (inclusive of services and investment earnings) with the dollar area, we would be particularly destabilised by the fluctuations of the euro against the dollar, over and above our inability to set our own interest rates. Ironically, we would not even achieve currency stability, the main aim of our membership, for this very reason: that by joining the euro we would increase instability against the dollar. Indeed we find that our overall currency instability remains about the same.

We come now to the fifth area, to which the draft constitution

is particularly relevant – harmonisation. Here matters have taken a new and dangerous turn with the appearance of the draft new constitution produced by M. D’Estaing’s Convention. This constitution embodies tendencies that have long been quite apparent, not merely in the actions of the Commission but also and perhaps more importantly in the judgements of the European Court which have favoured the centralising and socialising objectives written into the previous EU treaties’ vague preambles. By including the Charter of Fundamental Rights, the constitution has handed these judges the power to extend this agenda very extensively. The Constitution emphasises rights. The Charter of Fundamental Rights incorporated in it could take the UK back to the 1970s in terms of rights of collective bargaining and the unions. This may well be its the most significant feature. There is also a great deal on workers’ rights and social entitlements. One of the key achievements of the Conservative governments of 1979 onwards was to destroy union power as a way of holding back development in this country. All the evidence we have shows that this was most significant in terms of the effect on our growth. Another thing they did was to make benefits highly conditional on looking for a job. So the Benefits Agency would help people who could not find a job but otherwise enact penalties such as benefit withdrawal. All this is potentially rolled back by the constitution and the Charter of Fundamental Rights. Some try to maintain that the declarations in the charter could be somehow non-binding; but then why have them in the constitution at all? Either they are in and have some potential force in terms of the interpretation and development of laws; or they are out. The experience of law-making by the European Court shows in fact that use will very likely be made of any material agreed in the constitutional treaty; the European judges have acted quite deliberately to increase the power and scope of the EU jurisdiction.

This would be harmonisation of a particularly damaging sort for the UK. Using the Liverpool Model of the economy of the effects of such policy changes we examine in Chapter 3 what might be the effects of these policies, which amount to the reversal of the reforms brought in by the UK government from 1979. On the assumption of rather moderate changes (a minimum wage raised to 50 per cent of male median wages, union power restored to mid-1980s levels, social cost rises worth 20 per cent of current wages), the model

predicts that they would raise unemployment by 5.7 per cent – that is 1.8 million – and cost us 6.4 per cent in reduced output. It could of course be either more or less depending on just how extensively this harmonisation was pursued; but the constitution indicates clearly enough that what we have seen so far – including the working time directive, the social chapter and the works council directives – is just a beginning.

Finally, we come to the sixth area – the cost of potentially insolvent state pensions on the continent. Extensive estimates were made of these pension deficits in an OECD study in the middle 1990s. Recent attempts to recompute these prospects suggest little change. If we take these 1995 OECD projections as illustrative at least, the projected deficits as a percentage of GDP come out at Germany 10 per cent of GDP by 2030, Italy about the same, France a little bit less. Add up these deficits as a percentage of UK GDP, which is of similar size to each of these countries, and you come to some 30 per cent. If we were to pay a quarter of that, suppose we were via some federal system to be asked to ‘share the burden fairly’, then the bill would be some 7 per cent of GDP. Again, like harmonisation, the extent of this is rather uncertain; it could be a lot more or a lot less, depending on both the extent of reforms undertaken by these countries and the extent to which the progress of federalism enables burden-sharing between countries. But this is certainly a burden we do not want to share or risk sharing, at even a modest level.

What we find therefore in these chapters is that the economic cost of our current relationship with the EU is already high and carries the prospect that it might escalate alarmingly under the thrust of the sort of policies set out in the draft constitution, itself a clear enough indication of what the dominant coalition of our EU partners wishes to happen. Nor is there any likelihood from this policy thrust that the existing costs from protectionism will be alleviated. Briefly and brutally, this prospect amounts to little less than ruin for the UK – a return to the awful 1970s and yet worse again.

Summarising our findings, we have identified 3.2–3.7 per cent of GDP in ongoing costs and additionally substantial potential future costs of harmonisation, pension sharing and euro membership; these latter costs could escalate to very much larger sums than those currently being faced.

Table 1.4: A conspectus of costs

	% of GDP
Net UK contribution	0.4
CAP costs	0.3
Manufacturing trade costs	2.5-3
Harmonisation	6-25
Pensions	2-9
Euro membership	doubling of macro volatility

When one asks what are the countervailing benefits, one finds that they are hard to identify on the economic side. Some might point to an easier flow of immigration (from the rest of the EU) perhaps or an absence of EU exchange controls and consequently wider capital markets. However, it would be easy for a UK outside the EU to allow immigration from anywhere it chose; and for it to access any part of the world capital markets similarly.

The Cecchini Report claimed that there would be large benefits in greater specialisation and exploitation of scale economies because of the Single Market: the logic was that lower barriers within the EU would encourage a better adjustment to market forces. The evidence has not supported gains on the scale predicted by Cecchini; our model by construction does not impute scale economies but it does include any gains (the majority according to studies of UK Cecchini-style effects) from greater competition within the Single Market, whatever in practice they may have been. Free trade with the whole world (facing whatever unilateral barriers each country chose to levy) would permit the UK to exploit the same processes but in a way consonant with its comparative advantage. The gains we have identified from leaving the EU relate to the UK's exploitation of its true comparative advantage in services essentially; most studies agreed that in services scale economies are unlikely.

The NIESR (see Chapter 3) claimed that there are gains of foreign direct investment (FDI) from membership of the EU. FDI (see Chapter 2) is related to technology transfer and *where* it occurs depends on the structure of the economy. As we see in Chapter 6, that structure changes dramatically if we leave the EU. Whether

FDI as a method of technology transfer is as needed when the economic structure shifts to its true comparative advantage, we simply do not know. But if it is, it will occur equally in the new structure. The essential point concerns whether the economy's technology is at its maximum in the new structure as compared with the old: given that all industries will be competing on a level with the best in the world, the pressure at least will be maximal. But of course we have no real way of measuring this matter in practice. Thus to summarise, the NIESR rightly observed that in the old structure there was a high FDI level, much of it in manufacturing; and it conjectured that there would be less FDI outside the EU and concluded that this would reduce productivity. However, as our argument indicates, this conclusion is a non-sequitur: less could occur because the technology level in the new structure is higher, in which case productivity too would still be higher.

## 1.1 WHAT IS TO BE DONE?

In Chapter 8 we consider this question, in the context of the politics of our relationship with the EU. Some people say that the overriding reason for our membership of the EU is political: to ensure the unity of Europe and to prevent future wars. There is no doubt, given the ferocious history of our continent in the twentieth century, that this is a crucial aim. The expansion of the EU to include the ex-Soviet countries of eastern Europe is a major contributor to this aim. The EU is therefore plainly an important institution alongside others that govern inter-country relations in the twenty-first century including NATO, the UN, the WTO, the IMF and the World Bank.

However, the political aims of the EU as a community of nations do not need to be achieved by the exaction of huge economic costs from members of that community. We argue in the following chapters that these costs are large also for other members of the EU, but that is a matter for them; our focus is the costs for the UK which are of great size, as we have seen. Indeed, quite obviously the costs are unacceptably high by a large margin. Hence inevitably the UK is being forced to a reconsideration of its relationship with the EU in such a way that the political aims of peace and amity in Europe are not jeopardised.

It is obvious from our analysis that were the EU to change its policies in the direction of free markets, free trade and an effective commitment to no bail-out of insolvent states, the economic problems for the UK we have identified would be essentially dealt with in a way that would be optimal. Provided political issues, such as the threat to habeas corpus and the unacceptability of EU control of our national defence, were also dealt with, the UK could then happily continue within the Rome Treaty. Let us call this the 'reform solution'. We must naturally hope for this but, as our analysis shows, the direction of EU policies has been away from such ideas and the prospects for this solution seem at best poor.

If this indeed turns out to be confirmed in the coming months and years, the logic of the resulting situation would point to the UK doing one of two things. It could renegotiate a relationship within the Rome Treaty, a 'UK protocol' let us call it. Or it could leave the Treaty altogether and achieve its political aims through other avenues – much as other friendly countries outside the EU, such as Norway or the US, do.

It may seem that the idea of renegotiation is a hopeless one, since why should other EU members agree to it? Yet in the present context where a dominant coalition of EU members is bent on creating a federal structure and the UK is largely isolated in its opposition to such a structure, the renegotiation offers an opportunity of universal progress. Under the terms of the Rome Treaty agreement on a new structure must be unanimous; thus the UK has the power of stalemate. This power has been greatly enhanced by this government's agreement to a UK referendum on the new draft EU constitution; it seems fairly unlikely that any structure remotely like the draft constitution would get UK popular assent in a referendum. However, by renegotiation the UK could agree to allow others who so wish, to proceed to a new federal structure within the treaty.

Of course, such a renegotiation would no doubt cause other countries unhappy with aspects of the treaty to consider asking for renegotiation also. This would be a matter for them; many would in all probability rather settle to join the dominant coalition for a variety of reasons of national interest.

Thus it seems reasonably likely that this coalition of the EU majority would be happy to agree on a UK protocol as the price of using the treaty to forge a federal union. However, one cannot

be sure; such inter-national bargaining is inherently unpredictable. Suppose they refused and did one of two things. First, they could accept a stalemate and rely on the forces of gradual pressure to achieve the same federalist objectives over a longer period of time. Or second, they could decide to proceed en bloc to recreate the desired federal union outside the EU institutions, creating in effect a duplicate structure; though this would pose practical difficulties as well as difficulties in the process of obtaining a completely fresh agreement on all previously agreed areas, it is not to be ruled out.

What should the UK do in these two cases? In the second the UK would de facto have left the EU since the existing treaty would be without practical content. In the first, the UK could wait and see, meanwhile resisting the pressure from the federalist agenda. However, given the extensive and subtle powers conceded already to the EU's central bodies, this resistance would be likely to fail. It is likely that before long the same crisis as has currently arisen with the draft constitution would reappear. It would therefore be an attractive option in this stalemate case to leave, given the lack of desire for accommodation.

In all this it needs to be remembered that the other EU members could react to the genuine threat of UK departure by becoming more accommodating. This is possible precisely because these members see the EU primarily in political terms and the loss of the UK would diminish the political weight of the EU.

There is a further point: that the present policy arrangements of the EU damage the welfare of the other EU country citizens just as they do that of UK citizens. With the UK threatening to leave over these policies, there could be a strengthening of the voices of those demanding change within the rest of the EU. The EU could reform in the direction of free trade, non-interventionism and competition, removing the arguments with the UK. However, in this debate it is essential to be realistic. Time and again UK politicians have announced 'game, set and match' after EU negotiations, only to have it explained to them red-faced that they have been comprehensively duped and defeated. The fact is that our EU partners and the EU Commission show no sign of adopting an agenda to our tastes: indeed, if anything, it is the reverse.

Some people fear a different reaction: where either the EU as a whole or individual EU member states erect discriminatory barriers against UK exports, whether special tariffs or other arrangements

such as onerous customs requirements – all in retaliation against what they see as our unreasonable departure or renegotiation. But such fears can be dismissed, for three main reasons. First of all, the changes the UK would ask for would not end a high degree of mutual cooperation in a variety of economic and political areas; any such retaliation would put such other areas of cooperation at risk and be against EU and individual EU members' interests. Second, the EU exports far more food and manufactures to the UK than the UK does to the EU; the UK is a net importer of both and a war of trade retaliation would be damaging to the EU. Third, once the UK had opted for free trade in food and manufactures, such barriers would not affect the prices we paid for our imports or obtained for our exports, they would merely lead to a diversion of trade elsewhere than the EU. (The same applies to services where in any case the UK faces high barriers). The only cost in this case would be temporary disruption as trade patterns were changed. But last and most important, such actions would be illegal under WTO trade law, since the EU is a signatory to the WTO by implication under EU law. It is absurd to imagine that the EU, which relies so heavily on WTO law for large numbers of trade disputes, would put itself at risk by ignoring WTO law in its dealings with the UK, a state involved with it in friendly cooperation across so many areas, including the development of the single market in services.

What form in that case should a renegotiation of the UK's relationship take? We suggest in our final chapter that it should be:

1. The UK should leave the EU's protective agreements altogether – the CAP, tariffs and anti-dumping and all else – and resume unilateral free trade. The agreement would place the UK outside the EU's protective arrangements; non-discrimination would be agreed, so that we would have the same access to the EU market as any WTO non-EU member and EU members would have the same free access to the UK market as any WTO member.
2. If there were genuine concern about the EU pursuing discriminatory trade policies against us, then the UK could also join NAFTA to create countervailing power in the event of trade disputes. NAFTA allows each member to pursue its

own trade agenda, providing it allows other NAFTA members free access in agreed trade areas. It would therefore be entirely consistent with the UK's free trade policy. However, as noted in our discussion just above, there should be no concern on this score: joining NAFTA is unnecessary.

3. In the area of services, the UK already largely has free trade and free market entry. Here the Single Market could bring about competition within the EU through the discussions going on area by area. The UK has nothing to lose by participating in these discussions; and to the extent that residual UK barriers could be dismantled in particular areas, the UK would actually gain. Therefore, the UK should stay in the discussions on the Single Market for services, cooperating on a case-by-case basis to create new agreements. Existing competition agreements, as for airlines, would be kept to.
4. Freedom of movement of capital and labour has already been established and brought about benefits. The UK should continue in these arrangements.
5. In other areas – such as competition policy, economic consultations, coordination of anti-terrorist policies – the UK would continue to participate, by specific agreements in each area.
6. The 'social dimension' of the EU, including the Working Time Directive imposed for 'health and safety' reasons under the Single Market laws, would be abrogated in the UK.
7. Finally, EU law would no longer be binding on the UK. Instead, only those agreements explicitly made with the EU would be, as any treaty obligation, incorporated into UK law.

As already extensively discussed above, the UK would under these circumstances be outside the EU's customs union in food and manufactures and would enjoy world prices. The EU could not reasonably be expected – nor would it be likely – to extend to the UK preferences in EU markets for UK food and manufactured exports. Instead the UK would be treated like any other world

trading country outside the customs union. It would have to pay any tariffs and anti-dumping duties and be subject to any other non-tariff barriers imposed on external suppliers. In whatever markets EU prices are kept up by the operation of an implicit cartel forcing potential low-price exporters to raise their EU prices – an arrangement we have suggested could be the most widespread of all the non-tariff mechanisms in EU use – then UK exporters too would be subject to this cartel. Ironically, this would benefit them considerably, just as it benefits other low-price participants in the cartel, provided they have a good market share. UK exporters are well established in the EU market and could well find that they continue to do well in it after UK exit to free trade. Since this situation would be costly to the EU and would draw wide attention to the existence of such cartel arrangements, the result could be greater pressure for EU competition, which would be beneficial to EU members. Such a development would bring about greater harmony in the long term in relations between the UK and the EU, making possible closer cooperation in trade policy, a key area from which the UK would have withdrawn.

Inside the UK either this new relationship, or total departure from the EU, would lower the prices received by farmers and by manufacturers previously protected by the EU customs union barriers. Transitional assistance should be given to them by the UK taxpayer (who of course will reap substantial gains from the new set-up). The whole issue of farm support and support of the rural environment will have to be visited afresh; in broad terms a long-lasting package that rewarded farmers for preserving the rural environment and freed them to carry out entrepreneurial development of their business and their assets (especially their land) could be devised that would make sense for both farmers and the taxpayer. For manufacturers, however, any assistance should only be transitional, since the UK's comparative advantage implies that resources should be shifted from this sector into the service sector.

In conclusion, the UK and the EU have had a seriously troubled relationship for some two decades. These troubles have concerned not merely the obvious irritations of rising political interference by the EU in UK affairs but also the major costs of the EU's use of its steadily-increasing powers in economic affairs; the latter are the focus of this book since they are of a technical nature and therefore not at all widely understood and appreciated. Since our

analysis suggests that the EU generally is damaged by current policies, we must hope that these policies would change in a way that would progressively also reduce the UK's costs arising from the EU, making formal changes in the UK's treaty with the EU unnecessary. However in the event that this does not occur, as the tendencies of the last two decades suggest it will not, then such formal changes are inevitable. We have shown that they are possible and highly beneficial to the UK. We have also argued that they are likely to help the forces of change within the EU since they will highlight the problems there by the very fact that they will no longer be present here; institutional competition between countries is a potent force in world affairs. Thus in the long term it is in all EU members' interests that the UK puts an end to what we have shown are the intolerable economic costs of its relationship with the EU.