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REVIEW

A Less Costly Trading Environment for the UK?

Patrick Minford, Vidya Mahambare and Eric Nowell, ***Should Britain Leave the EU? An Economic Analysis of a Troubled Relationship***, *Edward Elgar in association with the Institute of Economic Affairs, 2005*

Reviewed by ***Viv Hall***

The primary aim of this thought-provoking book (hereafter MMN) is to evaluate the UK's relationship with the EU, under conditions of the mid-2000s. These conditions differ markedly from those of 1975 when withdrawal from the EU was rejected by a referendum. MMN's analysis finds first, that current EU economic policies are immensely costly, not only to citizens of the UK but also to those in the rest of the European Union (REU). Secondly, economic costs are likely to escalate rather than lessen. MMN seem of the view that the UK should continue to collaborate with EU political aims to ensure the unity of Europe and help prevent future wars, but consider that those aims should not impose massive economic costs to EU members. They advance three broad policy options for public debate that are presented primarily, but not solely, from a UK perspective.

The first policy option is MMN's 'reform solution' that would require EU policies changing 'in the direction of free markets, free trade and an effective commitment to no bail-out of insolvent states' (p. 16) and a satisfactory resolution of key political issues. This solution is consistent with the results from their empirical analysis, but they concede its prospects are at best poor.

The second option, a 'UK Protocol' or 'renegotiation solution', proposes renegotiation of the UK's relationship under the Rome Treaty. Its three most far-reaching components would involve: (i) the UK leaving altogether EU protective agreements, such as those on the Common Agricultural Policy (CAP), tariffs and anti-dumping, so as to resume benefits from unilateral free trade. The UK would then have the same access to the EU market as any WTO non-EU member, and the REU would have WTO member access to the UK market; (ii) abrogating the 'social dimension' of the EU, including the Working Time Directive under Single Market laws; and (iii) incorporating into UK law only those agreements explicitly made with the EU, with the result that EU law would no longer be binding on the UK. Three significant further elements would be: (iv) to retain arrangements involving freedom of movement of capital and labour; (v) to continue to participate by arrangement in areas such as competition policy, economic consultations, and coordination of anti-terrorist policies; and (vi) despite the UK already largely having free trade and free market entry in the area of services, to

stay in discussions on the Single Market for services, cooperating on a case by case basis. In essence, the UK would be withdrawing to a unilateral free trade environment, while maintaining EU freedoms of movement of labour and capital, and aspects of a potentially improved Single Market in services. MMN believe this option is not beyond the bounds of possibility.

Option three, ‘unilateral withdrawal’, would essentially involve the UK withdrawing from EU trade arrangements in favour of ‘unilateral free trade’, while continuing to co-operate in certain fields.

Although MMN’s clear preference is for the ‘reform’ option, they acknowledge this is unlikely ever to eventuate and advance the second best ‘UK Protocol’ option for serious consideration. The third option seems a fall-back, but still very serious option. A potential 4th option, ‘defensive posture’, would involve resisting new incursions from the ‘draft EU constitution, the euro, new efforts at harmonisation and any demands for bailout’ (p. 225). They ruled that out of consideration, as it would leave the UK still responsible for the very large costs from existing arrangements.

A key reason advanced for the persistence and potential escalation of the substantial economic costs, is what MMN term the ‘democratic deficit’ within the REU, i.e. consumers’ voices are not sufficiently powerful at EU level, as it is the views of governments and industries’ representatives that essentially prevail.

Target readership for the book is primarily UK citizens, though its information is also hoped to be of value to citizens of the REU, and those in the Cairns group and the US. Readers pressed for time can get the key messages from reading just Chapter 1; those wanting a considerably more detailed empirical understanding should delve also into Chapters 3 through 6.

Chapter 1 includes a summary view of MMN’s quantitative and qualitative judgements, with Table 1.4 providing a short conspectus of economic costs. These are made up of: net UK transfer costs and CAP costs of 0.4 and 0.3 per cent of GDP respectively; manufacturing trade costs of 2.5 to three per cent; potential costs from harmonisation and from insolvent continental state-pension deficits ranging from six to 25 per cent and two to nine per cent respectively; and potential ‘doubling of macro volatility’ costs from any membership of the Euro. Countervailing economic benefits are judged as hard to identify, and are therefore treated as nil on a net basis.

Chapter 2 provides a basic treatment of MMN’s evaluation methodology. It starts with simple comparative static partial equilibrium diagrams, and continues with their 4-bloc, 4-sector, world Computable General Equilibrium (CGE) model, and its Heckscher-Ohlin-Samuelson underpinnings. Those wanting a fuller appreciation of their CGE methodology and empirical simulations are advised at this point to proceed to Chapter 7 and its 4 Appendixes.

But back to Chapter 3, which I found among the more valuable. The chapter is somewhat heroic in attempting to assess potential costs of three relatively seldom included ‘other issues’: harmonisation costs, associated with the proposed draft new constitution and its Charter of Fundamental Rights; and the state-pension and Euro-membership costs referred to above. The costs they consider

might emanate from the three selected areas clearly have the potential to dwarf costs associated with the agriculture and manufacturing sectors. Australians and New Zealanders may find aspects of this material particularly thought-provoking. Firstly, this could be from the perspective of whether New Zealand should or should not consider abandoning its independent monetary policy, and either participating in an Australasian currency or adopting the US dollar (see Hall, 2005; and Hunt, 2005, for further details). Secondly, MMN's focus on issues of harmonisation together with their associated analytical framework for services presented in Chapter 7, should attract the attention of those interested in assessing progress towards improved Australasian Single Economic Market (SEM) harmonisation of business regulations against the benchmark of a 'world-best' internal and international trading environment.

The broad aims of Chapters 4, 5 and 6 are to analyse issues surrounding the impact of trade barriers associated with the agriculture, manufacturing and services sectors. The chapters largely utilise best available evidence from the studies of others. Facts and findings from Chapter 4 on agriculture are generally well-known, and will be unsurprising to members of the Cairns Group of countries, such as Australia and New Zealand. Chapter 5 on manufacturing is of considerably greater interest, as the extent of these costs is nowhere near as well appreciated. The material on anti-dumping is of particular significance. As emphasised in Blonigen and Prusa (2001), costs of investigations and determinations, have considerable significance beyond any levied anti-dumping duty. In this wider context, efficient New Zealand apple exporters, and other Australasian exporters to the US, Japan and the EU will be able to associate particularly with the flavour of this material. Chapter 6, set in the context of a potential Single EU Market for services, should also be of widespread interest. MMN are suitably cautious on well-known measurement difficulties in service sector areas. Their illustrative partial equilibrium assessment framework appeals as a very useful way of structuring one's thinking on single market issues. They see the basic aim of the proposed form of single market in services as equalising the levels of trade barriers across the EU, rather than aspiring towards the UK's generally efficient, largely free trade and free entry, trade service standards.

Chapter 7 will be of most interest to those wishing to assess the robustness of MMN's judgements. It documents the economic costs associated with each of their 4 sectors, disaggregated into potential gains and losses from 'transfer cost', 'consumer surplus' and 'terms of trade' effects. Empirically, magnitudes of consumer surplus gains or losses dominate those from the other two categories. Also, 'basic manufacturing' and 'hi-tech manufacturing' sector cost magnitudes dominate those associated with agriculture and services. The chapter starts by pulling together the most appropriate effective protection estimates from Chapters 4 to 6. In essence, Bradford's (2003) measures are taken for the agriculture and two manufacturing sectors. Services sector judgements are those of MMN. The key CGE model assumptions, simulation experiments, and basic outcomes are also presented. Their basic modelling is conducted under 'realistic' CAP restrictions, requiring agricultural output to be held at original levels, and agricultural land

supply not to respond to price changes. But a spectacularly illustrative, politically unlikely additional empirical case is described in Appendix C, featuring the implications of relaxing these two restrictions.

Another issue that arises from their basic case CGE modelling, which is potentially controversial for UK citizens, and which applies to somewhat different degrees also to REU citizens, is acknowledged briefly. This involves the potentially major adverse implications for the UK's now relatively modest-sized basic manufacturing and hi-tech manufacturing industries. MMN suggest transitional assistance should be given to manufacturing by UK taxpayers, paid for out their considerable net gains; and that a fundamental re-working of farm and rural environment support should also take place. Dynamic CGE modelling might throw further light on the time paths for these processes of adjustment.

A full appreciation of the material presented in Chapter 7, and hence of the robustness of MMN's overall judgements, requires considerable reader perseverance and some expertise in interpretation of CGE model results. To assist the speed of linking material in the text to specific tables, this reader would have liked more explicit linkages in places, for example to Tables 7.A.1 through 7.A.4. Chapter 8 can be skipped, as most of it appears word for word in Chapter 1.

In summary, this book is a valuable contribution to the economic aspects of a debate which will be of increasing importance, not only to citizens of Britain, but also to those in the rest of the EU, and those currently excluded from trading freely with the EU. In the context of projected major escalations in economic costs to Britain, it is also very useful in constructively advancing three potential policy options for Britain. Citizens of Australia and New Zealand should also find the book's material on Britain and the Euro, and on the analytical frameworks for examining services and harmonisation regimes, particularly thought-provoking.

References

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