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Book Review

Should Britain Leave the EU?
An Economic Analysis of a Troubled Relationship

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reviewed by Christopher Tsoukis*

This book is an effort to bring economics to bear upon the question of whether being a member of the European Union (EU), or exiting from it, is in the interests of the UK. The second edition of the book (2015) is timely, with an impending referendum on EU membership that is now set for 23 June 2016; however, it was announced several months ago (and, thus, known, when the book was published, to be due at an uncertain time in the near future). Arranged in seven Chapters, the book brings together, in a fairly impressive way, much of what economics can offer in answering the question of its title – including factual information, literature reviews, technical analyses and simulations.

Chapter 1 is a pre-amble, summarising the relationship of the UK with the EU and the conclusions arising from subsequent Chapters. Chapter 2 is a descriptive account of EU regulation in all spheres, namely, labour and product markets, financial services, social protection. A key conclusion running through the book is that regulations of all kinds have eased in recent years, while the UK remains more liberal on all fronts, with lighter regulation than the EU average; that in service markets, the EU is more interested in harmonising regulatory practices than creating greater competition; and, finally, that in the case of financial services, in particular, EU regulation threatens to weaken, often purposefully, the UK's comparative advantage. In the book's estimates (see Table 2.1), the costs of imposing protective measures like those in the EU on the UK labour market are moderate to large (mostly in the order of a few percentage points of lost output or increased unemployment).

Chapter 3 is about the benefits and costs (more likely) of the UK joining the Eurozone. This is now more of a historical question, as the prospect is not likely to arise any time soon, but the Chapter is a tour de force of relevant literature including references to

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optimal currency areas. The main point is that a potential Euro entry would deprive the UK of the stabilising force of an independent monetary policy, but would also recalibrate the volatility of the UK currency; it would stabilise the latter versus the Eurozone (self-evidently) but increased volatility vis-à-vis the rest of the world (including the US) would ultimately be detrimental.

Chapter 4, on the cost of EU trade policies for the UK, is in many ways the core of the book. Currently, the EU is a 'common market', where there is free trade between member states and common trade policies vis-à-vis the rest of the world. The key-argument of the book is that the UK would benefit from exiting the EU and trading with the rest of the world independently, with trade policies decided by the UK in line with WTO rules and likely communication with trade partners. The big question that emerges here is what trade arrangements will arise between the UK and the EU. The discussion in pages 19-20 treats the issue as a straightforward question, arguing that, as a rule, the "EU [will levy] its usual (MFN) tariff-equivalents on us when we leave." (p. 19) Then, it is conceded, highly integrated sectors, such as the high volume car industry, are likely to seek special arrangements in order to preserve market integration. However, fixing such arrangements will certainly require protracted and costly negotiations with the EU during a period of uncertainty. Anyway, disregarding this question, it is implied that trade protection is costly, but estimates are rather small, in the order of 3-4% of one-off lost output or welfare (Tables 4.3/4). Consequently, the UK would gain from exiting and liberalising trade, but relevant estimates are hardly show-stoppers (or rather, show-movers).

The same overall conclusions emerge from Chapters 5-7, which present a detailed, informative, and quite interesting -in their own right- descriptive accounts of agriculture, manufacturing and service sectors and the state of EU trade protection for them. These sectors are interesting for a variety of reasons: agriculture is the sector subject to the heaviest trade and overall policy intervention by the EU; protection in manufacturing is weakening as (any correlation here?) the sector is becoming less important, while services are increasingly more important but still fairly heavily protected. Whatever the estimates might be (from other sources surveyed) on the effects of trade liberalisation, they point to modest gains at best (see Section 5.5 on agriculture, Section 6.5 on manufacturing, Tables 7.6/7 on services). It could be argued that dynamic effects (gains?) may be greater than such, mainly static, estimates, but there is limited concrete evidence supporting this view. Estimates in Chapter 4 on trade liberalisation gains are derived from the authors' previous work using dynamic simulations. Those are rigorous, drawing on state-of-the-art technical advances, based on carefully thought out assumptions and questions raised seeking answers (nature of shocks, etc). But, inevitably, brought to bear on big questions like that of the title, such simulations are in for the Lucas critique (as the author(s) themselves acknowledge): Simulations are OK when a limited change to the structure is being considered (a 'shock'); would, however, a model's structure hold unaltered when a potential game-changer (a massive and multi-faceted 'shock'), such as an exit from the

EU, occurs? Would elasticities, factor shares and intensities, and other such parameters, routinely taken as ‘deep’, ‘structural’ and constant, not change? If so, simulations and other technical welfare analyses of a possible entry into the Eurozone, or trade liberalisation, etc. offer rather tenuous information.

A bigger point emerges here: One is led to concur with Backhouse (2010, The Puzzle of Modern Economics, CUP) that Economics is better geared to answering specific, but, from a broader point of view, more focused questions, rather than answering ‘big issues’ (e.g., it helped design efficient telecoms auctions, but failed to predict the 2007-9 and other crises). Of course, big questions do not admit of precise answers; what one should aim for (I think in line with Backhouse’s ideas) is reasonable arguments indicating clear directions - whether the gains be ‘x%’ or ‘y%’ is irrelevant or even misleading. The book’s arguments stem from the basic tenets of neoclassical economics, i.e., free markets and free, unimpeded trade maximise economic welfare. The authors see no ‘market failures’ (such as some goods being of the nature of public goods, or the presence of externalities, natural monopolies, asymmetric information, and the like) that would justify departure from these principles. Trade protection, it is argued, is often motivated by rent-seeking rather than the objective of maximising welfare. These are the only (albeit strong) guiding principles, coupled with a belief that the EU is inexorably moving towards an ever-closer union with an (unspoken) aversion to joint decision-making. There is no consideration of the ‘unknown unknowns’: The rise of other economic areas and a possible challenge that this might present to the ‘first world’; climate change and the challenge of shifting to sustainable resources; demographics and debt crises; migration and other political and security challenges for Europe. Many of these challenges involve important economic dimensions that the discussion, as framed in the book, ignores. There is much emphasis these days, even within mainstream economics, on the fact that cooperative solutions are superior exactly in cases of shared problems like those above, which would, otherwise, be likely to receive selfish, but inferior, solutions. The overarching question is whether global or regional challenges can best be met using national or pooled powers? The likely answer, i.e. shared decision-making, is hugely different to subservience to the EU, as projected by popular discourse (though the book never suggests that). With its simple prior guiding principles and technical focus, the book misses out on all these considerations.

Besides, not everyone shares the view that socially-minded regulations, like EU social and labour market protection regulations, are bad – for many people, they are, indeed, good, and help protect the UK labour force from being exposed to an otherwise ruthless labour market (as evidenced by the duality of labour markets and arrangements like the ‘zero hours contracts’, for example). Moreover, on the whole, the EU is more interested in fighting inequalities (social, regional) and promoting industrial regeneration than the UK seems to be. What we are encountering in the UK these days is a reminder of regional inequalities and the threat posed by industrial decay, with the impending bankruptcy of

Tata Steel and the possible loss of tens of thousands of jobs; we hear that UK politicians are lobbying the EU to allow anti-dumping tariffs so as to protect the industry from the unduly low prices of Chinese imports. In other words, not only is the EU's concern on such matters justified and greater than the UK's, but at a moment of crisis, the EU is part of the solution and not of the problem. Similarly, on the issue of general inequality, the EU shares many people's great concern, which is greater than that of either general mainstream economics or of the book, the implicit throughout emphasis of which is mainly on 'efficiency' and very little on 'equity'.

The question of membership, of course, involves even broader considerations: Despite numerous criticisms it can and does receive, paramount among which must be the democratic deficit, the European Union is a zone of economic prosperity, political liberty and social solidarity. Do we want this to break up? Are we sure of the alternatives that will emerge? If the break-up process of the EU begins, for the first time in its history, what is the 'economic atom', the smallest unit that will be immutable to break-up, that will emerge? If it is in the interests of the UK to be an independent, free-market economy, might that not also be the case for Scotland or Wales versus the UK? Might we, therefore, see a large number of regions breaking away from current conventional states? What will their number be? Who can guarantee stability in this possibly chaotic world? These considerations may lead one to suggest that wholehearted engagement and work towards reform, rather than exit, should be the way forward.

It was said (by the late UK Labour Party politician Denis Healey) that an economist is one who, asked about a telephone number, offers an estimate. That may be so more due to the nature of reality than because of the nature of economists, but this book offers quite a sophisticated estimate. As precise and clear an estimate as the jumbled and fuzzy section of human affairs called 'the economy' can offer, the book draws on a big pool of knowledge of all relevant, recent and rigorous advances concerning the subject. For any professional economist, no less interested than the general public, it is a joy to read and sharpen one's arguments whatever one's views. Ultimately, though, one is left with the impression that the real driver of the book's unambiguous conclusion, i.e., that exit from the EU is in the UK's interests, implies two preconceived tenets: that free, unimpeded trade and a free-market economy are the best creators of economic welfare; as those ideals are best pursued outside the EU, an exit is the best option. Technical, factual and other analyses are only providing limited support to this prior. If someone is completely agnostic, the results of Chapters 2-7 would perhaps suggest an exit but would not be enough to create strong convictions. Put it another way, due to priors, there is an implicit null hypothesis, namely 'exit is best', that technical results fail to disprove. I strongly suspect that, had the null been 'stay in', the evidence would have been sufficient to disprove that, as well.

So, one could discern three parts in the title question: firstly, 'what input can mainstream economics offer to the question of the UK's EU membership?', secondly, 'what are the broader considerations involved in the question and, particularly, their economic dimensions?', and, finally, what is a possible final answer?' A review of this book cannot but be concerned with all three questions. As far as the first question is concerned, taking neoclassical, mainstream economics as the reference framework, the book gets nearly full marks; it suggests that there are small to moderate (at best and not fully certain) gains to be had by the UK moving out of the EU and pursuing 'free' trade with the rest of the world, with trade relation between the UK and the EU left to be decided. Yet, the book fails to consider the second question, the broader questions and challenges mentioned above and their economic dimensions. We argued that there are reasons to support that the EU is a force for good on these matters, that co-operative solutions and joint decision-making may be the answer to regional and global questions. By framing the discussion in terms of seeking precise and, therefore, narrow estimates of free trade gains outside the EU, and the like, the book misses out on such considerations. As a result, when it comes to the third question on the final verdict, readers are left with considerable food for thought before they can make up their own minds.