UK MEMBERSHIP OF THE EU – PUTTING INTO PERSPECTIVE

Key points

- The Prime Minister’s deal of 19 February set the stage for a period of debate up to the in-out referendum on Thursday 23 June.
- A prolonged period of uncertainty, up to the referendum and beyond, could weaken confidence in the UK economy and affect sterling exchange rates and the Government’s cost of borrowing.
- There are a number of uncertainties as to how co-operative the EU might be in negotiating the UK’s departure from the EU. Might the EU Institutions and member states make the UK’s exit process as difficult as possible to seek the best deal for the rest of the EU and possibly deter other member states from leaving? Or, might they recognise the need to maintain a good relationship and conduct such negotiations in an amicable fashion?
- The EU is undoubtedly a key market for the UK, with a number of jobs dependent on this trade relationship. However, it is not clear how that trading relationship would be affected by the UK departing from the EU – presumably EU consumers would still wish to buy UK goods and new trade agreements would in all likelihood ultimately be negotiated.
- The UK’s ability to follow radically different policies and practices if it was outside the EU may be limited, given the likely desire to continue to be a key player in European and international markets.
- Whilst this paper seeks to be objective and assess a range of facts, more subjective issues such as perceptions of the impact of immigration, fairness, cultural differences and national interests, are likely to play a big part in how the UK electorate votes. The safety and assurance of the status quo will in voters’ minds be balanced against the wish to “take control of our own destiny”.
- ICAS is not taking a formal position on whether the UK should leave, or remain in, the EU. That is a matter for our individual members and the electorate generally.

Introduction

ICAS’ Royal Charter requires us to support our members but also to take a public interest approach to the work which we do. In pursuing this dual mandate, we are keen to inform the debate on whether the UK should remain within the EU or vote to leave – to inform our members, but also to provide broader, objective views to the wider UK electorate.

The Prime Minister’s deal with the other members of the European Council on 19 February set the starting gun for a lively debate in the period up to the 23 June 2016 referendum. Whilst this deal represents one in a line of special arrangements which the UK has negotiated with the rest of the EU, views are divided as to how fundamental this particular agreement is, and indeed how enforceable, unless, and until, it is made part of EU treaties.

In essence the electorate is being asked whether it wishes to continue to share sovereignty with the other Member States of the EU, in return for the (net) benefits which EU membership brings to the UK. Clearly this assessment is dependent on the perception of the extent to which EU membership brings such benefits. Facts and figures are really only available for the status quo of EU membership: this document therefore seeks to avoid the use of hypothetical figures which speculate on the impact of the UK’s withdrawal from the EU.

ICAS issued an information paper The UK and the EU: What would the impact be if Britain withdrew from the EU? in March 2015, which was updated in October 2015. This looked at the more detailed impact of the EU in key subject areas of the most significance for ICAS members. This paper can be accessed on the ICAS website, but the two key messages emerging at that time were:
• EU policies and principles as set out in EU Regulations and Directives have established themselves at the heart of much of UK legislation and practice, especially in those areas relevant to business; and
• the scope for the UK to follow radically different policies and practices if it was outside the EU would appear to be limited, given the likely desire to continue to be a key player in European and international markets.

In March 2015, the results of a small ICAS survey of members in business suggested that 82% of respondents wanted to remain within the EU – 20% with further integration, 30% with a renegotiated relationship, and 32% with no change. Only 11% wanted to leave the EU. Sixty-five percent said that the EU yielded benefits for their business, nearly half of which indicated that those benefits, which related mainly to turnover, profitability and future growth prospects, were significant.

As the debate gears up in political circles and in the media, and well known figures voice their views publicly, ICAS is keen to build on its earlier contributions and provide a high level but objective summary of some of the key issues to consider. We hope that this short paper will be informative and of interest to ICAS members and to all members of the public who wish to read it.
Fundamental Differences between UK and EU Approaches

Philosophy and Purpose
Many in the UK take the view that the primary purpose of the EU is to facilitate economic development across the member states through deregulation of trade, the facilitation of cross border investment and the removal of barriers to the migration of skilled workers. The UK has always been significantly more sceptical about whether it should participate in ever closer political union, hence the determination of successive governments to retain the pound and to take a firm stand in budget negotiations where they perceive that member states are being asked to finance an expansion of EU bureaucracy.

In part, the desire for ‘ever closer union’ is a reaction to the long history of war and shifting national borders in much of Europe and, more recently, relates to efforts to improve stability in the euro-zone. Whilst Britain recognises the role the EU has played in uniting the nations of
Europe, many regard the maintenance of peace and security to be primarily a matter for NATO rather than the EU.

**Integration**
The extent of Member State adoption of the euro demonstrates the desire for further integration across much of the EU and, arguably, further integration of economies and national budgets within the Eurozone is likely to be needed to secure its longer term sustainability.

As noted above, the UK has generally been reluctant to engage in further integration of this nature. It has therefore generally sought to ensure that its interests are not adversely affected by those other EU member states which wish to integrate further, whilst continuing to benefit from being within the EU trading bloc.

**Culture**
Cultural differences exist between the UK and most EU member states. The UK has traditionally operated a freer, more liberal and less restrictive environment, whereas most other EU states operate in a much more regulated manner. There is no shared approach to the law, eg as to whether actions which are not specifically permitted are prohibited or whether actions which are not specifically prohibited are permitted, and economic disparities across the EU are wide. This can make it hard to secure agreement which caters for all EU member states and, arguably, this was one of the key drivers for the 19 February deal.

**Financial Services**
The UK is keen to ensure that London’s position as the world’s leading financial centre is maintained. Other EU states do not have such a large financial services market or one of such national importance. Accordingly, the UK has tended to argue against EU provisions which could undermine the UK financial services industry.

There is a need to stand back and reflect on the regulatory changes imposed on the financial services industry to date, a number of which have been introduced post financial crisis, and consider whether they are likely to achieve the desired outcomes, whether there are unintended consequences which need to be addressed, or whether the desired outcomes might be more effectively achieved in a simpler and less burdensome manner.

The UK is exporting services to a greater extent than goods, and the EU is only beginning to consider the regulation which is appropriate to services, starting with financial services, where arguably the regulation is not yet fit for purpose.
Some of the Arguments about EU Membership

Security in an Increasingly Uncertain World
There is common acceptance that we are facing an increasingly uncertain global environment, with quickly evolving geo-politics and global dynamics, concerns about very low oil prices, negative interest rates and shrinking global GDP, global warming, and cross-jurisdictional terrorism. In this situation, a key issue in the debate about UK membership of the EU may be security: being part of a larger bloc such as the EU may be worth compromising some of our sovereignty in order to obtain the benefits of EU security and co-operation, low cost access to a larger economic market, and the ability to tackle major global issues as part of an influential union of European nations.

Harmonisation
Harmonisation across the EU has facilitated cross border economic activity and fair competition. However, harmonisation is not complete across many areas, such as the provision of services (especially digital), and capital market regulation & enforcement.

By definition, harmonisation requires regulation and results in negotiated agreements that entail loss of national sovereignty. It would normally also result in approaches which favour...
the generality of EU member states and not necessarily specific UK circumstances. The rigidities of harmonisation can also constrain innovation and enterprise and, in turn, competition.

In the recent CCAB survey of a sample of business leaders (Business in Europe: Researching Reforms for Sustainable Growth, CCAB, January 2016), there was recognition of the advantages of standardisation and a wariness of the risk of “chaos” if countries were to start setting up their own rules again.

**Single Market**

UK membership of the EU provides easier access to EU national economies, free movement of goods, and no trade or tariff barriers. Other EU countries took 44% of all UK exports in 2015, and provided 53% of all UK imports. These exports sustained over 3 million UK jobs, around 10% of the total UK workforce.

It should be noted that the UK would still continue to trade with the EU if it voted to leave EU membership, but this would be under new trade deals under terms which would need to be agreed.

**Negotiating Power in Trade Deals**

The UK benefits from international trade deals as part of the EU trading bloc: the EU bloc wields greater influence than the UK alone. On the other hand, the UK may be able to negotiate its own deals with important partners in a reasonable time and make sure that UK interests were foremost.

The UK would need to negotiate separate trade deals with separate non-EU countries, if it voted to leave EU membership. Neither the terms of such deals nor the time to negotiate these can be estimated at the present time.
Trade with the EU

44% of UK exports
223bn

53% of UK imports
291bn

By contrast
Exports to USA
95bn
Exports to China
16bn

Over 3 million UK jobs are linked to exports to the rest of the EU

10% of the total UK labour market

Total EU foreign Direct Investment into UK
496bn
48%

Of total FDI into UK

By contrast
The USA
24%
Other countries
28%

UK outward investment totalled
£1.015bn in 2014.
46.7% into Europe

Refer to Appendix 2 for further details.
**Foreign Direct Investment**

Other EU countries accounted for £496bn (48%) of the UK’s stock of inward Foreign Direct Investment (FDI) in 2014. By contrast, the US accounted for 24%, with 28% accounted for by other countries. The UK attracted more FDI projects than any other EU country in 2014 – 887, compared to 763 in Germany and 608 in France.

By comparison, UK outward investment totalled £1.015bn in 2014, 46.7% of which was into Europe.

Clearly the EU is an important counterparty for UK inward and outward cross border investment. Despite a number of recent comments from business on this matter, it remains unclear as to the short or longer term impact of a departure from the EU. The key issue is whether the FDI into the UK is more driven by its membership of the EU or other advantages (language, workforce skills or culture for instance).

**Free Movement of Labour / Migration**

The free movement of labour within the EU has often been regarded as a benefit and many EU citizens have taken advantage of this flexibility:
- for UK nationals moving within the EU; and
- other EU nationals moving into the UK.

There are also economic benefits of migration for the host state, especially for those member states with ageing demographics which wish to increase their working age population to support a growing pensions cost.

However, there remain some aspects which work against the free movement of labour:
- lack of portability of qualifications, pension arrangements, social health insurance etc across the EU; and
- within the UK, concern over immigrants “taking our jobs” and “taking advantage of UK welfare benefits”.

There are around 2m EU immigrants working within the UK, and 1.2m non-EU immigrants. These comprise 6.5% and 3.9% of the total UK workforce respectively.

As noted in the recent CCAB survey, some business leaders believe that freedom of movement has been a major success which has generated enormous opportunities to attract talent and grow their businesses. They also highlight the level of co-operation and compromise which will be required to improve the efficiency of labour movement over time.

If the UK left the EU, however, the UK would have the ability to develop a much more targeted immigration policy which could be tailored to the specific skills needs of the UK.
Regulation – Burden or Benefit?

There is a widely perceived imposition of EU regulatory and legislative burdens on business in a broad range of subject areas. However, this does appear to have already been recognised by the European Institutions and there is an existing European Commission initiative for deregulation and to reduce burdens, which is being reinforced by the competitiveness provisions of the recent UK deal with the EU. Quantification of the costs and benefits of such regulation is fraught with difficulty and in our view should be treated with some scepticism.

There are a number of areas where the UK Government has, in the past, been considered as slow to act, to protect individuals and the environment, and where the EU has taken the lead:
- employment law and working restrictions;
- health & safety regulation;
- data protection and consumer rights;
- environmental regulation;
- waste regulation.

Migrants

1.26m UK citizens live in other EU member states, with the largest groups in Spain, Ireland, France and Germany

In July to September 2015, there were an estimated

2.0m EU nationals working in the UK and 1.2m non-EU nationals

DWP figures estimate that in March 2013 there were 525,000 EEA nationals who had been resident in the UK for less than four years.

It was estimated that 37 to 45% of migrants (ie between 195,000 and 235,000) receive some form of benefits, with about two thirds of these in work.

Refer to Appendix 2 for further details.
For some, these provisions might be regarded as burdensome, for others these might be regarded as necessary and welcome protection. It is widely recognised that regulation in certain areas is essential and can be beneficial, and that UK companies would probably need to comply with EU regulations to the extent to which they wished to trade with the EU. In relation to employment law and regulation, business has a strong interest in deregulation and harmonisation to encourage the free movement of labour, whilst also recognising the need for some legal protection for employees who might be vulnerable to the consequences of deregulation. These are areas which are important to the well-being of our citizens and our ability to adopt forward thinking and potentially beneficial rules.

**Taxation**

Indirect taxation is subject to a high level of harmonisation, which benefits companies trading across the EU. Such harmonisation, however, restricts the UK’s ability to vary VAT rates and rules. National control substantially remains over direct taxation.

The recent CCAB survey of a sample of business leaders noted that the OECD’s work on Base Erosion and Profit Shifting (BEPS) was potentially a useful contribution to help national Governments address tax avoidance through transfer pricing. There was also a recognition that the longstanding idea of a common consolidated corporate tax base (CCCTB) across the EU had some logic, although this is unlikely to be implemented in the short or medium term. The problem of dealing internationally with corporation tax in particular has been recognised by the Treasury Committee in comments by its chairman Andrew Tyrie. Certainly, the future corporate taxation landscape may be quite different in 20 years.

**Extent of Legislative & Regulatory Freedom**

After any decision to leave the EU, Westminster and Holyrood would have flexibility to decide which existing laws and regulations to retain and which to amend or scrap. Nothing would change overnight. Similarly, going forward, UK legislators would be free to plagiarise EU legislation for the UK if they wished to maintain comparability in certain areas: this would need to be the case in relation to continuing trade with the EU.

Similarly, as a key jurisdiction for international trade and finance, the UK would wish to continue to adopt international norms and standards, and would therefore be unlikely to diverge too far from the international rules and regulations adopted across the EU.

**Considerations after “Remain” Vote**

1. Will all the 19 February reforms agreed by the European Council be implemented as intended?
2. Specifically, will the reforms agreed by the European Council but requiring the involvement of the European Parliament, be agreed by the Parliament and approved as intended?
3. How long will it take for the agreed reforms to be effectively implemented, so that the 19 February deal is seen as being effectively delivered?
4. How will the UK Government respond if the deal is not delivered as expected?

**Considerations after “Leave” Vote**

**Transitional Process**

1. Article 50 of the Lisbon Treaty (see Appendix 1) governs a member state leaving the EU, but no member state has ever left before – how would Article 50 be applied in practice and how co-operative will the other EU member states be in taking this process forward?
2. Will the EU Institutions and member states make the UK’s exit process as difficult as possible to deter other member states from doing this?
3. Would the UK be able to negotiate a specific withdrawal agreement with the rest of the EU within the prescribed two-year timeframe? What sort of transition would the UK experience if not?
4. Will there be adverse sentiment towards UK goods and services in EU markets and how will this affect trade over the longer term?
5. Will there be a prolonged period of uncertainty whilst the terms of the UK departure are (i) negotiated and (ii) implemented?

**Impact on UK Citizens and Economy**
6. How will a UK departure affect UK citizens living elsewhere in the EU? How will this affect UK citizens wishing to work in the EU? Will UK citizens need a visa to take a holiday in an EU country?
7. Will there be a collapse in confidence in the UK (as suggested by Goldman Sachs in early February)? Will the UK be able to attract the necessary capital inflows to balance its current account deficit? Could this lead to a collapse in the value of sterling – leading to inflation and more costly imports and overseas holidays, but a more competitive rate for exporters? Will this make it more expensive for UK Government borrowing?
8. How long will it take for the UK to be able to negotiate a trade deal with the EU or to join the European Economic Area (EEA) or European Free Trade Association (EFTA)?
9. How long will it take for the UK to be able to negotiate trade deals with other major trading partners worldwide (currently covered by pan-EU deals)?
10. How favourable would the trade deals be which the UK was able to negotiate?
11. What will be the broader impact of a “Leave” result on confidence in the UK economy?
12. Will there be an impact on foreign inward investment into the UK – on a temporary and/or permanent basis?

**Impact on UK Policy and Wider Influence**
13. What will the UK Government do with its new found freedom from EU legislation and regulation in the areas of interest to ICAS members? What policies would it follow?
   - How might the UK depart from EU and international expectations over direct taxation?
   - How might the UK change its VAT system?
   - Might the Government selectively support UK companies which EU state aid rules have hitherto prevented? Would our trading partners see this as unfair competition and seek to retaliate in some way?
   - How would a departure from the EU affect the UK’s previous leadership and current adoption of international accounting and auditing standards? Would the UK still be as influential over the international standard setting bodies if it was outside the EU bloc?
14. How would the agreed Fiscal Framework need to be amended to fund the exercise of new powers cascading from the EU back to the UK and devolved Governments in relation to areas which are devolved to the Scottish Government?
15. What will be the broader impact on the UK’s influence and reputation at the UN and across the world? Will we retain a seat on the UN Security Council? Will our influence in NATO reduce?

**Conclusion: Next Steps for EU Reform?**

On 23 June 2016 the UK electorate will decide whether they believe that the benefits from being in the EU justify the sharing of sovereignty and the costs of membership, whether the opportunities counterbalance the risks. Those costs and benefits, opportunities and risks should be assessed not just in financial terms, but also across a broader perspective, and each UK citizen will have a different view on what is important for them and what is important for their country.

This paper has sought to highlight a number of issues which might be relevant to ICAS members and to the general public in considering which way to vote in the June 2016 referendum. We hope that it has been useful in this respect, and look forward to engaging in what is already proving to be a most interesting debate.
ARTICLE 50 OF THE LISBON TREATY

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.

5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.
KEY STATISTICS


- The UK is the world’s fifth largest economy, with a GDP of £1.79 trillion. (Source: ONS: Statistical Bulletin: Quarterly National Accounts: Quarter 4 (Oct to Dec) 2015)
- Services accounted for approximately 79 per cent of the economy in 2013. Manufacturing accounted for around 10 per cent. (Source: ONS: An International Perspective on the UK – Gross Domestic Product, 24 April 2014)
- The UK’s population at 30 June 2014 was estimated to be 64,596,800. (Source: ONS: Population Estimates for UK, England and Wales, Scotland and Northern Ireland, Mid-2014)
- There were 31.41 million people in work. (Source: ONS: Statistical bulletin: UK Labour Market: April 2016)

Trade with the EU

- Other EU countries took 43.7% of UK exports (£223bn) and provided 53.1% of imports (£231bn) – both goods and services - in 2015. By contrast, exports to US were £95.1bn, China £15.9bn. (Source: House of Commons Library Briefing Paper 06091, 13 April 2016). By way of further contrast, UK imports and exports with commonwealth countries (of goods, not including services) have dropped from around 40% of UK imports and exports in the early 1950s to just less than 10% in 2010/11 (Source: House of Commons Library note of December 2012)
- In 2011, the Commonwealth accounted for an estimated £29 billion or 10% of all UK goods exports and £22 billion or 12% of all UK services exports. As a source of imports for the UK, the Commonwealth accounted for an estimated £28 billion or 7% of all UK goods imports and £12 billion or 10% of all UK services imports. The UK had an estimated trade surplus of £0.7 billion in goods with the Commonwealth and a trade surplus of £10 billion in services. (Source: House of Commons Library note of December 2012)
- Over 3 million UK jobs are linked to exports to the rest of the EU (these jobs are not necessarily linked to EU membership). Most recent Government estimate (June 2014) suggests 3.3m jobs.* This represents around 10% of the total UK labour market of 31.41m (Source: ONS: Statistical Bulletin: UK Labour Market: April 2016)
- UK trade with the EU is dominated by goods rather than services; in 2014, trade in goods represented close to 67% of all UK exports to the EU, and over 75% of total UK imports from the EU. Between 1999 and 2014, goods imported by the UK from the EU have risen by 4.9% per year on average, compared to exports which have risen by 2.5% per year, causing the UK’s trade in goods deficit with the EU to rise to £77.0 billion. (Source: ONS: How important is the European Union to UK trade and investment? A brief analysis of the UK’s trade and foreign direct relationship with the EU, 26 June 2015)
- The UK trades at a surplus in services with the rest of the EU, with a surplus of £15.4bn in 2014. (Source: ONS: How important is the European Union to UK trade and investment? A brief analysis of the UK’s trade and foreign direct relationship with the EU, 26 June 2015)
- The UK continues to trade at an overall deficit with the EU with a deficit of £28.5 billion being recorded with the EU in Quarter 4 2015, compared with a deficit of £25.2 billion in Quarter 3 2015. (Source: ONS: Balance of Payments, Oct to Dec and annual 2015, 31 March 2016)
Foreign Direct Investment

- Other EU countries accounted for £496bn (48%) of the UK’s stock of inward Foreign Direct Investment in 2014. (By contrast, the US accounted for 24%, with 28% accounted for by other countries.) The UK attracted more FDI projects than any other EU country in 2014 (887 compared to 763 in Germany and 608 in France - EY 2015 European Attractiveness Survey)*. (Net FDI flows are much more volatile.) By comparison, UK Outward Investment totalled £1.015bn in 2014, 46.7% of which was into Europe (Source: ONS Statistical Bulletin: Foreign Direct Investment Involving UK Companies 2014)

Cost of EU Membership

- UK Contribution to EU Budget (2015) = £8.5bn (£17.8bn gross less rebate of £4.9bn and public sector receipts to UK of £4.4bn)* This represents 0.5% of the UK’s estimated total GDP of £1.79 trillion for 2015.

- Net cost per person (2015) = £131 which is about 2.6% of the average amount of income tax paid by UK taxpayers (UHY survey of July 2014 stated that average income tax across the UK was £4,985 per taxpayer)

Costs and Benefits

- Various studies have attempted to calculate the cost/benefit of EU membership – very difficult and depends on a wide range of assumptions. Estimates range from a net cost of 3-4% of GDP to a net benefit of 4-5% of GDP.*

- Open Europe in March 2015 estimated that the cost to the UK economy of the 100 most burdensome EU regulations was £33.3bn a year. (The benefit of these regulations was estimated in Government Impact Assessments as £58.6bn per year – which Open Europe suggest are vastly overstated.) * It is broadly recognised that such estimates are very dependent on a range of underlying assumptions.

Migrants

- There are 1.26m UK citizens living in other EU member states, with the largest groups in Spain, Ireland, France and Germany. (Source: International Business Times summary of UN/ONS/World Bank data, October 2015)

- In July to September 2015, there were an estimated 2.0m EU (excluding British) nationals working in the UK and 1.2m non-EU nationals. (Source: ONS Statistical Bulletin Migration Statistics Quarterly report, February 2016)

- Immigration of EU citizens to the UK was 257,000 for the year to September 2015 (246,000 for previous year). Immigration of non-EU citizens for the same period was 273,000 (289,000 for previous year). (Source: ONS Statistical Bulletin Migration Statistics Quarterly report, February 2016)

- DWP figures estimate that in March 2013 there were 525,000 EEA nationals who had been resident in the UK for less than 4 years. It was estimated that 37 to 45% of migrants (ie between 195,000 and 235,000) receive some form of benefits, with about two thirds of these in work. (Source: Department for Work and Pensions Benefit Claims by EEA Nationals, November 2015). The DWP said that EU migrants on “in-work” benefits cost the taxpayer £530m in 2013 - which represents 1.6% of the year’s total tax credit bill. (Source: The Guardian, 10 November 2015)