Item 7

To:	**Council**
On:	**28 April 2016**
Report by:	**Chief Executive**
Heading:	**Economic Implications for Renfrewshire of a UK exit from the European Union**

1. Summary

1.1. A motion was approved at the Council meeting 25 February 2016 to instruct the Chief Executive to prepare a report for the Council meeting on 28 April 2016 on the financial implications for Renfrewshire Council and, where possible, the wider Renfrewshire economy of a UK exit from the European Union (EU).

1.2. There is very significant uncertainty surrounding the implications of a UK exit from the EU and this is compounded by the strongly divergent and subjective views arising from both sides of the debate. In order to provide the Council with an informed and independent response to the motion, the Chief Executive of the Council commissioned the Chief Executive of the Improvement Service to carry out an independent review of the subject and his resulting review paper is attached as an appendix to this report.

1.3. The review concludes that while there can be no ultimate certainty, the available evidence and analysis suggests that the balance of probability is that a UK vote to leave the EU would be economically damaging for the UK. If realised, this reduction in economic growth would reduce Government fiscal receipts and put additional pressure on public spending.

1.4. The review highlights that it has not been possible to identify any specific economic modelling of the impact of a UK exit on Scotland or any region of Scotland. It does note however that the Fraser of Allander Institute considers it likely that the impact on Scotland's economy would also be negative based on the wider UK and international evidence.

1.5. In addition to the wider UK based analysis contained within the review, the report also highlights some potential areas of financial and economic risk specifically for the Council and Renfrewshire in relation to access to direct EU funding and foreign inward investment.

2. Recommendations

2.1. It is recommended that the Council note the content of this report and the review paper provided in appendix 1.

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3. Background

3.1. The UK Government has chosen to hold a referendum on Britain's membership of the European Union. The referendum will take place on Thursday 23 June 2016 and voters will be asked the question:

"Should the United Kingdom remain a member of the European Union?"

3.2. At the Council meeting 25 February 2016, a motion was approved to instruct the Chief Executive to prepare a report for the Council meeting on 28 April 2016 on the financial implications for Renfrewshire Council and, where possible, the wider Renfrewshire economy of a UK exit from the European Union.

3.3. Given the very significant uncertainty surrounding the implications of a UK exit from the European Union, the complex economic arguments and the strongly divergent and subjective views arising from both sides of the debate, the Chief Executive considered it appropriate to seek an analysis of the issue from an informed and independent source. It was identified that the Chief Executive of the Improvement Service, Colin Mair, was already undertaking research into the subject area and he was therefore approached, and subsequently agreed, to produce a detailed review paper for the Council.

3.4. In addition to the wider UK based analysis contained within the review, the report also highlights some potential areas of financial and economic risk specifically for the Council and Renfrewshire in relation to access to direct EU funding and foreign inward investment.

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4. Key findings from the review

4.1. The review paper from the Chief Executive of the Improvement Service is attached as Appendix 1 of this report and provides a detailed and systematic review and analysis of the debate and evidence relating to the economic implications of a UK exit from the EU.

4.2. The paper is structured into three sections:

- Section 1 reviews the UK's past and current economic relationship with the EU as a basis for considering the impact of the UK exit from the EU.

- Section 2 examines the likely impact of different models for a UK exit, and the conclusions that can be drawn from them.

- Section 3 provides a summary and conclusions.

4.3. A summary of the key findings and conclusions from the review paper are provided below:

- The EU is the largest trading partner for the UK, accounting for 46% of our exports and 53% of our imports, amounting to £820 billion of trade.

- Overall, the UK had a £97m trade deficit in goods with the EU in 2014, but a trade surplus of £35 billion in service, giving an overall net deficit of £62 billion. 50% of this deficit is with two EU countries, 25% of EU countries have a trade deficit with the UK and 50% do relatively little trade with the UK.

- The EU and the UK are highly integrated in terms of mutual investment with the EU holding 46% of all foreign assets in the UK, and 43% of the foreign assets held by the UK are within the EU.

- The economic benefits to the UK of EU membership in terms of trade and investment are accepted by both sides of the debate.

- The UK is a net contributor to the EU budget (the paper indicates it pays in around £5/6 billion per annum more than it gets back).

- If the UK left the EU it would most likely seek to negotiate a free trade agreement to allow it to retain access to its most significant export market. Non EU countries who have negotiated similar access arrangements (Switzerland, Norway, Luxembourg and Iceland) are required to make a contribution to the EU budget of between 46% and 81% of the current UK per capita contribution, and also have to agree to free movement of labour and the EU's regulatory regime. It is considered likely that the UK would be required to accept similar conditions to retain tariff free access to the EU market, therefore limiting the gains in relation to sovereignty, reduced regulation and immigration control sought by those in favour of exit.

- The review paper concludes that while there can be no ultimate certainty, the available evidence and analysis suggests that the balance of probability is that a UK vote to leave the EU would be economically damaging for the UK, at least in the short to medium term. If realised, this reduction in economic growth would reduce Government fiscal receipts and put additional pressure on public spending.

- The review paper highlights that it has not been possible to identify any specific economic modelling of the impact of a UK exit on Scotland or any region of Scotland such as Renfrewshire. It does note however that the Fraser of Allander Institute considers it likely that the impact on Scotland's economy would also be negative based on the wider UK and international evidence.

4.4. As highlighted in the last bullet point above, the review paper does not make any specific comments on the financial implications for the Council. It is considered reasonable however to note that if the review paper's conclusion that UK economic growth and Government fiscal receipts will be negatively impacted by an exit from the EU was to materialise, then this would increase the risk of the Council's central government grant being reduced in the future.

5. Potential loss of direct EU funding to the Council and other partners

5.1. The Council has benefited from being able to apply for EU funding to support specific initiatives, the most significant of which has related to funding for employability. The Renfrewshire Employability Partnership received a total of £2.76million over the period 2011 to 2014 (£1.99m for the Council and £0.76m for partners). An additional £6.9m of EU grants to the Council are expected over the three year period 2015 to 2018 for the Council's Youth Employment, ESF Pipeline, and Poverty and Social Inclusion programmes. Renfrewshire will also receive a share of EU funding allocated to Renfrewshire, East Renfrewshire and Inverclyde through the Leader (£2.3m available to 2020) and ERDF (£0.7m to 2018) programmes. The Council also receives a management fee of 20% of the Leader funding for acting as the regional lead Council for this programme.

5.2. This EU funding averages around £1.6million per annum and which could be considered at risk from a UK exit. Whether or not this materialised as an actual loss of funds for the Council would depend on the timing of a UK exit and the extent to which the UK and/or the Scottish Government chose to provide alternative sources of funding to make up for this loss.

5.3. It is worth noting also that Universities UK, the body which represents the vice-chancellors of the UK's 133 Universities, has come out strongly in favour of the UK remaining in the EU. One of the concerns they highlighted was the perceived risk to the £1bn of research funding from the EU that comes to the UK each year. If this concern was to be realised, then one of the Council's key partners in Renfrewshire, the University of the West of Scotland, may also face a risk from a UK exit in relation to its ability to access EU funding to support its research activity.

5.4. There is a counter argument which can be made which is that since the UK is a net contributor to the EU, it would gain financially (by around £5/6bn per annum according to the review paper) by leaving the UK and this gain could be used to make up for the loss of EU funding for these type of programmes. However, it should be noted that the review paper in Appendix 1 concludes that it is likely that any free trade agreement negotiated between the UK and the EU following a UK exit, would involve some form of continuing UK financial contribution to the EU reducing the level of this gain. The review paper also suggests that any remaining gain may be required to offset the negative fiscal impact of the reduced UK economic highlighted in section 4 above.

6. Potential impact on local inward investment

6.1. The review paper indicates the potential for a UK exit from the EU to have a negative impact on the level of Foreign Direct Investment (FDI) into the UK. While it is not possible to predict how this might materialise in particular areas of the country, given the Council's ambitious plans to support inward investment into Renfrewshire through the planned City Deal related airport investment zone, this could represent a risk to achieving the level of economic benefits anticipated from this significant strategic investment.

Implications of this report

1. **Financial Implications**
   The report outlines potential financial implications for the Council of a UK exit from the European Union.

2. **HR and Organisational Development Implications**
   None.

3. **Community Plan/Council Plan Implications**
   None

4. **Legal Implications**
   None

5. **Property/Assets Implications**
   None

6. **Information Technology Implications**
   None

7. **Equality and Human Rights Implications**
   None

8. **Health and Safety Implications**
   None.

9. **Procurement Implications**
   None.

10. **Risk Implications**
    None

11. **Privacy Impact**
    None.

Attachements

Annex 1 The EU Referendum: Economic Implications Report Prepared For Renfrewshire Council By Chief Executive, Improvement Service

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Chief Executive

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Appendix 1

THE EU REFERENDUM: ECONOMIC IMPLICATIONS

REPORT PREPARED FOR RENFREWSHIRE COUNCIL

COLIN MAIR, CHIEF EXECUTIVE, IMPROVEMENT SERVICE

Introduction

The EU Referendum has been driven less by economic analysis than by concerns with "sovereignty" and immigration. The "Brexit" campaign particularly has emphasised the constraints on UK Parliamentary sovereignty of UK membership of the EU, and "loss of control on our borders". Their economic analysis is not their primary reason for proposing "Brexit", but it does suggest that the UK economy could survive and even benefit from Brexit. This includes the potential for greater deregulation of product and labour markets on leaving the EU, the likelihood that the UK would reach a favourable trading agreement with the EU, and greater freedom to form trade relations with non EU countries.

The case for remaining in the EU has been primarily economic in focus and has emphasised the advantages of EU membership in terms of trade, inward investment, simplicity of regulation, and strengthening the UK's position as a major global financial centre. For these reasons, "Brexit" is seen as short term disruptive and long term economically damaging.

The focus of this paper is on the economic issues but some brief remarks on "sovereignty" and "immigration" are necessary. UK membership of the EU **is** an exercise of sovereignty, not the denial of it: the UK chose to join the EU and it can choose to leave. The decision to join any partnership implies also a decision to accept the rules of that partnership, and that may constrain subsequent decisions (e.g. with respect to movement of labour or capital; restrictions on state aid etc). The question is the balance of benefits and constraints. Equally:

(i) Any imaginable future economic relationship that the UK could negotiate with the EU will have exactly the same effect: it will have constraints as well as benefits.

(ii) Any imaginable future economic relationship that the UK can negotiate with non EU economies will have exactly the same effect: it will have constraints as well as benefits.

(iii) The deeper any trade agreement negotiated, the greater the benefits but also the greater the constraints (e.g. totally free access to foreign markets typically means conceding totally free access to domestic markets for these countries. This would normally include foregoing the right to impose tariff or non-tariff barriers to inwards trade and investment).

The only way of avoiding this would be to have no formal trade agreements at all but that is precisely not what the vast majority those who favour leaving the EU are advocating. The assumption is that some alternative trade agreement will be put in place. The issue is, therefore, <u>not</u> of sovereignty: it is whether the constraints of EU membership are justified by the benefits of EU membership <u>and/or</u> whether these benefits could be achieved with fewer or lower constraints.

The major constraint emphasised by those advocating of Brexit is free movement of labour within the EU, and consequentially "loss of control" of UK borders. This has been argued to have an impact on housing demand, demand on public services, and employment and wages. Cultural/cohesion concerns about immigration and, more recently, security concerns are beyond the scope of this report, but the economic and fiscal impacts of immigration are open to factual analysis. The analysis of immigration from an economic point of view includes:

- The impact of immigration in balancing the working age and "dependent" population in the UK.
- The impact of immigration on finance and demand for public services in the UK, i.e. fiscal impact.
- The impact of immigration on the skills base and productivity of the UK economy.

The final point by way of introduction is that any analysis at present is about the probable balance of risk and reward in leaving or remaining in Europe. As the UK is presently in the EU, much analysis has focused on the risks and rewards of leaving. Given the UK's relatively poor productivity, weak export performance, and worsening balance of trade with the EU, there are clearly risks as well as rewards with EU membership as well.

It is impossible, given the uncertainties, to make a separate assessment of the potential specific impact of Brexit on Scotland. We can identify no specific modelling of the potential impact on Scotland, although the Fraser of Allander Institute has made a strong statement of likely negative impact, based on wider UK and international evidence (Fraser of Allander 2016). Specific judgements about impacts on particular sectors in Scotland, e.g. retail or air passenger transport, are simply not possible at this juncture.

The rest of this report is structured as follows:

Section 1 reviews the UK's past and current economic relationship with the EU as a basis for considering the impact of Brexit.

Section 2 examines the likely impact of different models of Brexit, and the conclusions that can be drawn from them.

Section 3 provides a summary and conclusions.

Section 1: The UK Economic Relationship with the EU

The EU is overwhelmingly the largest trading partner of the UK, accounting for almost 50% of external trade (£820 billion of trade in 2014). It accounts for 46% of our exports, and is the source of 53% of our imports.

This might be seen to be completely natural, and no great credit to the EU: across the world, countries are likely to trade more with neighbouring countries than countries that are further away, and more with richer rather than poorer countries. Modelling by the Centre for European Reform, that controls for proximity and relative

GDP, shows trading between EU members is around 33% higher than would be expected on world trends. For the UK, that difference would equate to around £290 billion of trade in 2014 (CER 2016).

UK exports to the EU are 60% goods and 40% services. As we import more value in goods from Europe than we export to Europe, the UK had a £97 billion trade deficit with Europe on goods in 2014. For services the opposite was the case, and the UK had a trade surplus on services of around £35 billion (ONS 2015 B). Financial services were central to that surplus, reflecting the major European role of the City of London.

The proportion of all UK trade (goods and services) that is with Europe has declined over the last decade as the global economy, and developing markets within it, have expanded. That said, UK trade with Europe has continued to grow in volume and value across that period (from £557 billion in 2004 to £820 billion in 2014). In comparison, trade with the Americas (North and South) has grown from £203 billion to £293 billion, and with Asia from £139 billion to £259 billion. Trade with China is less than 10% of trade with the EU. Around 48% of UK trade remains with the EU, but that is down from around 56% in 2004.

The Brexit proposition is that, over time, trade with the EU has become, and will become, less important and that membership of the EU has restricted the UK's trade relationship with other parts of the world economy. Finally, as the UK has a substantial trade deficit with the EU , it is assumed that the EU would wish a favourable trading relationship, even if Brexit occurs.

All of these propositions are open to question. It is true that the relative share of UK trade with Europe declined across the decade from 2004 but growth in trade was faster with the EU than any other part of the world, and the value of trade with the EU grew by about 50% (CER 2016). The decline in relative share of all UK trade that is with the EU was 14% across a decade that saw spectacular economic growth in China, India and Brazil that is unlikely to be replicated. Even if that level of decline in relative share continued, the EU would still be the UK's largest trading partner 20 years from now.

The suggestion that UK trade growth with the EU has "diverted" trade that would have otherwise gone elsewhere in the world is simply false. The research evidence shows that Britain's trade with non EU countries has grown in line with the trend for non EU countries, and that other EU members, e.g. Germany, have exceeded that trend (CER 2016, ONS 2015). As importantly, the EU has greater muscle in negotiating collective trade agreements with third party countries than any individual member state has due to the scale and wealth of the EU as a trade partner. The UK has benefited, and will benefit, from this capacity. Brexit would potentially opt the UK out of forthcoming free trade agreements with America and Japan.

Finally, the proposition that the UK trade deficit would mean that the EU would need a favourable trading relationship after Brexit is overly general. First, this applies only to trade in goods, not services, and the UK would have to continue to meet product regulations set by the EU to access their markets. Second, 50% of the UK deficit is with two countries, and 25% of EU members actually have a trade deficit with the UK. All 27 members would have to agree to any new relationship with the UK.

Third, short of the type of arrangement Norway, Iceland and Luxembourg have with the EU, which includes contributing to the EU budget, abiding by all of its regulations, and free movement of labour and capital, it is hard to see that the UK's most successful export, financial services, would not be negatively affected by Brexit. No non EU country, including Switzerland, has free access to the EU financial services market. They are obliged to have "equivalence" in financial services regulation, overseen by the EU, and to create subsidiaries within the EU as a basis for trading with the EU. The UK has attracted substantial inward investment in financial services across the last decade for this reason: the City of London as a base for euro denominated financial trading and access to EU financial services markets (CEP 2016, CER 2016).

The crux of the post Brexit impact would be the nature of the trading agreement the UK negotiated with the EU. Anything close to "free trade" would likely require free movement of capital and labour, and abiding by EU product and labour market regulation, i.e. would be much the same as now and defeat the point of Brexit in the first place. Anything that avoided free movement of labour and EU regulatory requirements would fall very far short of free trade, and would face substantial tariff and non-tariff barriers (e.g. the need to establish subsidiaries in an EU member state and thus come under EU regulation). The Brexit proposition assumes a more favourable treatment of the UK on exit than is offered to any other non EU country, including the USA. It is worth nothing that though trade with the EU accounts for 48% of the UK's external trade, trade with the UK accounts for only 10% of the rest of the EU's external trade. UK leverage is not as great as implied by Brexit advocates.

To pull the foregoing together:

(1) Whether viewed as positive or not, the UK is highly integrated with the EU economy.

(2) Around 48% of UK external trade is with the EU with a substantial trade deficit on goods, and a substantial trade surplus on services.

(3) This level of external trade is much larger than would be predicted on global trends, taking account of proximity and GDP, i.e. membership has enhanced trade.

(4) There is **<u>no</u>** evidence that UK membership of the EU has restricted or "diverted" trade with the rest of the world. UK trade growth with other countries is in line with global trends.

(5) Post Brexit, the UK would be likely to either face tariff and non-tariff barriers in its trade with the EU, or it would have to accept EU free movement and regulatory requirements.

(6) The Brexit advocates exaggerate the UK's importance to Europe and the world economy. Trade with the UK is 10% of Europe's external trade, and only 4% of world trade. These are not insignificant percentages, but they do not support the leverage suggested by advocates of Brexit.

The final element in this section is Foreign Direct Investment (FDI). All of the evidence is that over time, the EU and the UK have become more integrated through mutual investment patterns. Some simple facts make this point:

- Between the mid 1990’s and 2014, the proportion of the total stock of foreign investment in the UK held by the EU rose from 30% to almost 50% (Office of National Statistics 2015).

- The proportion held by the USA fell from 45% to 28% (Office of National Statistics 2015).

- 46% of **all** foreign assets held in the UK were held by the EU: equivalent in value to 30% of GDP (Office of National Statistics 2015).

- 43% of all foreign assets held by the UK are held within the EU (Office of National Statistics 2015).

- 60% of FDI into the UK across the last decade has been in services and 50% of that total is in banking (CER 2016).

- The EU effect in FDI is greater than FDI from Europe alone: the need for non EU traders to have a base in the EU to trade freely within the EU has had a positive impact on inward services investment (Capital Economics 2016).

- Productivity gains to the UK economy from FDI, and the associated flow of high skill European labour, have been variably estimated to have added between 1% and 5% to UK GDP (Dustmann & Frattini; Pain & Young).

The foregoing shows how integrated the UK is with the EU in terms of mutual investment, and the implications of that need teased out. Advocates of Brexit can reasonably argue that the scale of EU holdings in the UK mean that a mutually beneficial agreement between the UK and EU would be negotiated post Brexit. (This is probably more compelling than the trade deficit argument.) However, any deal that allowed continued openness, in both directions, to FDI would almost certainly be linked to free movement of labour and mutually agreed regulation, particularly in financial services. This might be very hard for a UK Government to agree after a vote to leave motivated by sovereignty and control of borders.

Those who favour remaining in Europe would point out that leaving puts major flows of future investment at risk, and might have particular implications for financial services and London’s role as a global financial centre. Inward investment by non

EU financial institutions in London is partly driven by the institutional infrastructure, critical mass of related services and high quality human capital that London provides as a basis for banking and financial services. However, it is also based on the need for non EU financial institutions to have a base within the EU. If the UK was no longer in the EU, London's other locational advantages would remain but access to the EU market would almost certainly diminish. London's positon as the largest centre for euro denominated trades, despite the UK not being in the Eurozone, would also be potentially undermined.

There is practical sense in both the Brexit and Remain arguments, and the core point is that, for trade and investment, the economic impact would depend on the agreement concluded after exit was decided. The options here are examined in the next section. The period between a referendum vote to leave and the UK actually leaving the EU has been identified by the Monetary Policy Committee of the Bank of England as the greatest "volatility" risk to the UK economy in the medium term: trade and investment would be disrupted until an agreement was reached, and that would have a negative impact on the UK economy. Arriving at a deal quickly would be a key priority.

Section 2: Brexit Options and Impacts

Given the scale of the UK's trade and investment relationship with Europe, the free trade advantages of membership, and the degree of economic integration of the UK with Europe, it is worth teasing out further what the point of Brexit would actually be. A number of points have been made:

- Freedom to negotiate trade and investment agreements with non EU countries.
- Eliminating the need for the UK contribution to the EU budget.
- Sovereignty of the UK Parliament to set its own regulatory and legal frameworks, and a reduced level of regulation.
- Controlling the flow of immigrants into the UK by terminating free movement of labour with and from Europe.

All of these points are questionable. The UK is already free to strike agreements with other countries as long as these do not infract agreed EU rules (Germany, for example, has had successful agreements with China and the USA, and trades far more extensively with non EU countries than the UK). As importantly, as a member of the EU, Britain benefits from free trade agreements negotiated by the EU. 17% of UK exports are estimated to be achieved through EU negotiated trade agreements with non EU countries (Capital Economics 2016). As the "Transatlantic Trade and Investment Partnership" (TTIP) is being concluded with the USA, as is a free trade agreement with Japan, now seems a modestly odd time to leave.

The essence of the Brexit proposal is therefore that the UK on its own would be able to negotiate more advantageous trade agreements than the EU. This seems implausible: the EU (minus the UK) is a market of 500 million people and accounts for 15% of external world trade while the UK is a market of 67 million people that accounts for 4% of external world trade. EU leverage in trade negotiations is simply greater. It is also simply not true: the USA has indicated it would not negotiate a bilateral trade agreement with the UK, separate from TTIP.

Eliminating Britain's contribution to the EU budget seems the most certain outcome of Brexit but it would depend on the subsequent relationship negotiated with the EU. Switzerland, Norway, Luxembourg and Iceland are not members of the EU but make substantial contributions to the EU budget in return for trade agreements (they contribute between 46% and 81% of the UK per capita contribution). Furthermore, the net saving would be less than 50% of total contribution as the UK already receives a rebate, and money is returned to the UK through agriculture and regional development subsidies. The net gain would be well below 1% of the UK current budget (OBR 2016).

The objectives around "sovereignty", deregulation and controlling immigration are both unlikely, and very restrictive of post Brexit options. As noted, any imaginable trade agreement with anyone would qualify subsequent sovereignty so it is hard to view full sovereignty as a credible aspiration, and even less as an achievable objective. The OECD regards the UK as already having amongst the most deregulated labour and product markets in the world (CER 2016). Many of the most expensive regulatory burdens in the UK were led by the UK Government and are more demanding than EU requirements (e.g. green energy requirements; minimum/living wage; capital/debt ratios in banks, etc.). Even if the EU were taken entirely out of the picture, it is hard to see that the UK would be much more deregulated than it is now.

The **maximum** cost of EU regulation we can identify from the literature is it is equivalent to 0.9% of GDP (Minford 2016). This is assertion rather than modelling, includes (as above) regulation the UK would almost certainly continue to have anyway, and compares with the modelled 2.5% of GDP attributable to EU FDI (Pain & Young), the 2% to 5% GDP gain from free trade within Europe (CEP 2016) and the 0.6% GDP gain from skilled immigration from Europe (Dustmann & Frattini 2014). Even if true, it is small beer.

In reality, EU membership simplifies the regulatory landscape, and reduces the regulatory burden, by rationalising and integrating the regulatory requirements of 28 countries into a single framework of minimum requirements. Regulatory costs to business would be far higher if they had to provide goods and services to meet 28 separate sets of requirements.

Finally, the objective of controlling immigration is less than clear. From peer reviewed research, EU immigrants are much younger and more economically active than the UK population; have no statistically measured impact on indigenous employment; have a positive impact of indigenous wages; are net fiscal contributors to the UK, and add between 0.6% and 1% to UK GDP (Dustmann & Frattini 2014; Oxford University Migration Observatory 2015; Springford 2015). As importantly, they are essential to filling high and low skill labour force gaps due to an ageing workforce and retirement (Springford 2015). The Office of Budget Responsibility estimate that, if current flows are restricted, future tax revenues will be much lower, and Government borrowing higher (OBR 2015 & 2016).

From a purely economic rationale, there is no evidence case at all for restricting EU immigration to the UK. If all UK citizens resident in the EU returned to the UK (1.8 million), and all EU citizens resident in the UK returned to their countries (2.6 million), UK economic output would fall and demand on public services would rise as those returning to the UK would be much older, less qualified and much less economically active than those leaving (450,000 would be OAP's) (Springford 2015).

In short, it is very hard to identify coherent economic objectives in the Brexit case and much of it seems either misconceived or simply factually incorrect. However, if these are the objectives for Brexit, what would this mean for options for the future economic relationship with the EU?

The associate membership model through the European Economic Area (EEA), like Norway, would clearly not be an option. That would require a continuing high net budget contribution, sign up to EU regulatory requirements, and free movement of capital and labour. In essence, membership requirements without being a member. These requirements give full free trade and investment access, and allow Norway to operate within free trade arrangements negotiated by the EU with non EU partners. However, this would meet none of the stated objectives of Brexit so is very unlikely.

The Swiss option of multiple bilateral sectoral trade agreements with the EU is probably not a feasible option either. This still requires a substantial contribution to the EU budget (about half the British level), free movement of labour, and sign up to the relevant EU sectoral regulatory requirements. Again, that fails to tick almost all of the Brexit boxes and would give little point to leaving.

The UK could simply trade with the EU, under general World Trade Organisation rules, accepting tariff and non-tariff barriers as part of the cost of Brexit, i.e. without any specific trade arrangement with the EU. This would still mean complying with all EU product regulation as a condition of marketing within the EU. This option would give the maximum freedom from regulation, and full control of immigration. However, it would be potentially damaging to key sectors. For example, the car industry would face a 10% tariff imposition on UK manufactured car exports to the EU.This would damage competitiveness and would reduce the flow of FDI into the UK car industry which is entirely owned by foreign companies. Some of these companies might relocate their production as the UK would no longer provide a base for “free trade” export to Europe.

Financial services would certainly be subject to EU regulatory requirements and oversight: something the UK Government has successfully fought against as a member of the EU. UK owned banks, and the subsidiaries of foreign owned banks based in London to get access to the EU market, would have to relocate and form subsidiaries within an EU member country. London would remain a major global financial centre, but the competitive position of other EU financial centres (Paris, Frankfurt, etc.) would probably be strengthened. It is hard to see any merit in this option at all economically but it is at least compatible with the "sovereignty", control of borders arguments.

The only other option would be that the UK negotiates a comprehensive bilateral free trade agreement with the EU. This seems to be both the assumed and preferred option of those who favour Brexit, and one accepted by almost all commentators to be likely given the pre-existing level of mutual trade and investment. The question is whether any realistically achievable version of this option would satisfy the Brexit objectives noted above.

The first point to make about this option is that it already exists: the UK has a free trade agreement with the EU through its membership of the EU. That comes with conditions that Brexit advocates do not like. The oddity of the Brexit proposition is that it assumes that EU would extend the UK all the privileges of membership without the responsibilities in terms of budget contribution, regulatory requirements and free movement of labour. It is not immediately clear why the EU would agree to such a one sided deal, and fairly easy to think of reasons why they would not.

The Brexit advocates are right to point to the scale of the UK economy and the scale of established trade and investment flows. The fact that the UK is running a large deficit on trade of goods would also be an important facilitating factor but, in logic, the UK's large surplus in trade of services would therefore be an obstructive factor. It is entirely imaginable the EU would agree to barrier free trade in goods: much harder to imagine it for services, particularly financial services. It is hard to envisage any agreement of substance that does not include continued contribution to the EU budget, free movement of labour at minimum for the economic sectors covered by the agreement, and compliance with relevant EU regulatory requirements. <u>**No**</u> country that wanted to have full access to EU goods and services market has been able to avoid these requirements.

The Brexit presumption is that Britain would be treated as an exception but this would set a very difficult precedent for the EU: if the UK could secure this by leaving the EU, why not Switzerland, Norway, etc. Equally, every EU country now has euro sceptic and nationalist parties with growing support and there is likely to be concern about setting a precedent of rewarding exit by making it “pain free”.

The timing could scarcely be worse: major elections forthcoming in the next two years in Germany and France with strong euro sceptic opposition parties with growing support. Noticeably, the recent reform negotiation between the EU and the UK resulted in the EU conceding nothing on core principles of free movement, equivalence of regulation, or contribution to the EU budget. The very minor concession on welfare benefits for immigrants is highly circumscribed, requires EU approval, and will have a very minor impact. It is hard to see why the EU would concede more to Britain once it had decided to leave than it was willing to concede while it was trying to keep Britain in the EU.

As noted above, the Brexit case simply **presumes** an importance of Britain to the EU that it does not any longer have. It accounts for 10% of EU external trade: the EU accounts for 48% of UK external trade. Only two countries have substantial trade surplus with the UK, 25% of countries actually have trade deficits and 50% do relatively little trade with the UK at all (ONS 2015 & 2015 B).

All 27 remaining countries would have to agree a new trade agreement. It is worth noting that the argument that the EU is of declining importance to the UK is more true in reverse: the EU has major trade agreements with America, Canada and Japan imminent: the UK would be a declining percentage of EU external trade. The UK has no such agreements anywhere near the starting gate, and would lose out on the EU deals with Brexit.

Finally, even if we assume an optimistic scenario (free trade agreement; no tariff barriers; lower regulatory costs than other non EU countries face), the detailed modelling work by the “Centre for Economic Performance” (CEP) at The London School of Economics still suggests an immediate negative effect of Brexit on UK GDP of 1.8% (CEP 2016). This reflects the disruption effect of leaving and the uncertainties it would generate. Most Brexit advocates accept a short term disruptive impact on the UK economy, and that has been also endorsed by the Bank of England.

The Brexit assumption is that, after an initial period of disruption, a deregulated and more globally focused UK economy would then grow rapidly. The CEP modelling suggests the opposite. The loss of the enhanced trade and the FDI that went with EU membership; the probability that non EU FDI looking for a base in the EU would now not locate in the UK; loss of productivity through a reduced flow of both FDI and skilled EU migrants and the loss of ability to trade under EU free trade agreements would all have long term negative effects on the UK economy. The CEP estimate is a long term negative impact of up to 6% of GDP (CEP 2016).

We emphasise this is a model but it is a very detailed one that is fully explicit about its assumptions and methodology (CEP 2016 Technical Paper). We can find no developed model of post Brexit scenarios that shows Brexit to be economically beneficial to the UK. Those who argue that Britain could do well post Brexit assume a highly liberalised, deregulated and open economy (e.g. Minford). This would probably include reduced worker protection (deregulated hire and fire, etc.), reduced environmental regulation, and wider exposure of UK public services to international competition. This would seriously constrain any future relationship with the EU, and reflects an outright free market philosophy that has never commanded majority political support in the UK. It is a possible scenario, but a very unlikely one.

Section 3: Summary and Conclusions

The review of evidence and analysis above can be summarised as follows: there is no credible economic case for Brexit. That is not to say that no other case can be made for Brexit in political or cultural terms but it should not pretend to be an economic case. In summary:

- The economic benefits of EU membership in terms of trade and investment are accepted by all sides.
- The Brexit argument is that the costs of these benefits in terms of restricted sovereignty, imposed regulation and loss of immigration control are unacceptably high.

- The **key** Brexit proposition is that the UK can retain the economic benefits of membership while leaving the EU and avoiding the constraints of membership.

- Purely on the evidence, this overestimates the economic importance of the UK to the EU and significantly underestimates the economic important of the EU to the UK.

- It is highly probably that a free trade agreement would be negotiated post Brexit but it is very hard to envisage a scenario where the EU agrees to full, free access to its markets without contribution to the EU budget, equivalence of regulation and free movement of labour. Such an agreement would be without precedent, and is politically and economically implausible.

- Even if a very optimistic scenario is adopted, the detailed modelling suggests Brexit would still be short and long term damaging to the UK.

- The evidence suggests that EU immigration is **net** beneficial in terms of productivity, economic output, fiscal contribution and demographic balance in the UK.

There can be no ultimate certainty here but, on the balance of evidence and analysis, Brexit would be economically damaging to the UK. It would negatively affect inward investment and business location; it would reduce productivity over time and reduce GDP. It is perfectly proper to argue that an economic hit is worthwhile to get sovereignty and immigration control benefits of Brexit. It is more questionable to deny there will be an impact or to avoid the implication by developing implausible future scenarios.

There is inevitably a tone of "project fear" in the foregoing. Clearly, and irrespective of negative impacts, the UK would remain a major world economy post Brexit, the City of London would remain a global financial centre and the UK would continue to have trade and investment relations with the EU. However, given the probable negative impact, a strong positive vision for a post Brexit UK would be necessary: the gain that justifies the pain. That seems largely lacking in the Brexit position which seems more focused on the negatives perceived in the EU than on the merits of a post Brexit UK. What is noticeable is that , to date , the Brexit side have produced no detailed economic modelling at all of a post Brexit UK economy , but neither have they produced anything substantial on the social or political character of their desired future.

However ,the final point worth noting is that if the UK remains in the EU, it still faces very serious challenges and risks. There is a substantial productivity gap between the UK and the rest of Europe, and our research and development, and skills development, remain relatively poor. TTIP and the free trade agreement with Japan will further expose these disadvantages. The UK has poorly capitalised and poorly performing manufacturing and we have a growing trade deficit with the rest of Europe. The UK has an ageing population and an ageing workforce and is dependent on a substantial net immigration annually to maintain economic output (the OBR estimate net migration of 170,000 annually is essential).

These issues are in no sense caused by EU membership but neither can they be solved simply by remaining in the EU. The wider slowdown in the world economy is likely to exacerbate competitive pressures and, outwith services, the UK is poorly placed to withstand that. This reinforces the risk of leaving the relatively protected space of the EU, and the benefit of being part of a larger trading block. However, the UK needs to be much more competitive in that context. In this sense, the whole EU referendum debate could be seen as a diversion from much more fundamental economic issues of productivity and competiveness that the UK, and Scotland, need to address.

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