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# BREXIT UPDATE: THE ECONOMIC MYTHS THAT CONCEAL REALITY

## Berenberg Macro Flash

Ahead of the UK referendum about staying in or leaving the European Union (EU) on 23 June 2016, the debate about the costs and benefits of EU membership is often shrouded in myths rather than driven by facts or reasonable arguments. In a series of brief reports, we will contrast such myths with reality in the coming eight weeks.

**Myth 1: Because the UK buys more than it sells from the EU, it would have the upper hand in post-Brexit negotiations**

***Fact: The EU is far more important to the UK economy than the UK is to the EU economy***

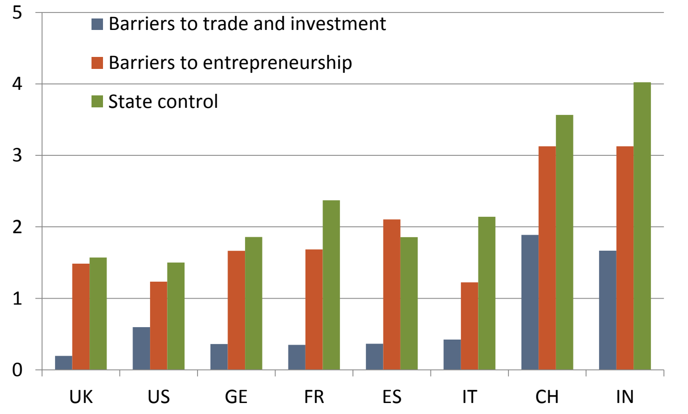
- Whereas the UK earns 15% of its GDP through exports to the EU, the EU-27 earns less than 5% of its GDP through its exports to the UK. And the EU-27 economy is over four times larger than the UK. In all post-Brexit negotiations, the bargaining position of the EU would be much stronger than that of the UK. The EU could use that to restrict UK access to the EU market for services, or to grant such access only if the UK complies with tougher regulations for financial and other services than before.

**Myth 2: The UK economy is burdened by excessive EU regulation**

***Reality: The UK is one of the most lightly regulated economies in the developed world***

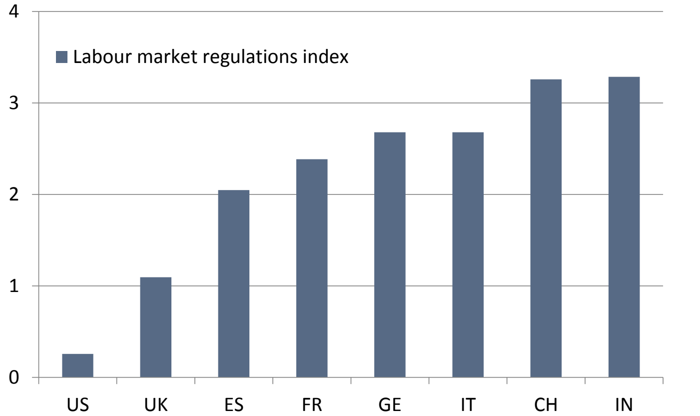
- This is especially true when it comes to areas where the EU influences regulation, such as in labour and product markets. The UK is less regulated than most of its European counterparts and far less regulated than China and India. Although UK labour market regulation is not quite as lax as the US, there is little evidence that this is having a major negative effect. The UK labour market made a strong recovery from the post-Lehman crisis because of its high degree of flexibility.
- Ironically, the key areas where the UK has problematic regulation are unrelated to the EU. The EU is not responsible for the regulations on land and planning that are the root cause of the UK's chronic housing supply shortage. Likewise, the EU was not responsible for the recent introduction of the national living wage which could impact labour demand in the short-run and prevent the market recovering efficiently from a future recession.
- The examples of Germany and the UK show that economies can have full employment and strong trend growth as full members of the EU if they get their domestic policies right.

**Chart 1: Product market regulations index**




*Source: OECD. Scores range from 0 to 6, with 0 representing the lowest level of regulations.*
*Note: Latest data is 2013. US data only available up to 2008*

**Chart 2: Labour market regulations index**



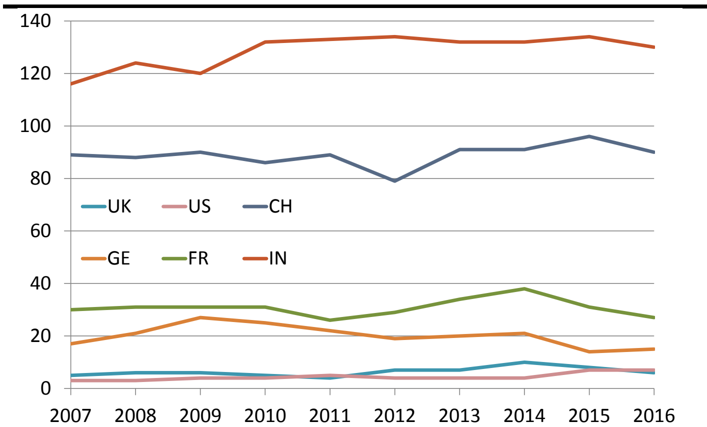

*Source: World Bank. Scores range from 0 to 6, with 0 representing the lowest level of regulations.*
*Note: Latest data is 2013. China data only available up to 2012*

**<u>Myth 3: If the UK left the EU, it could easily expand its trade with faster growing economies like China and India</u>**

***Fact: China and India are less open and less business friendly than the UK's EU neighbours***

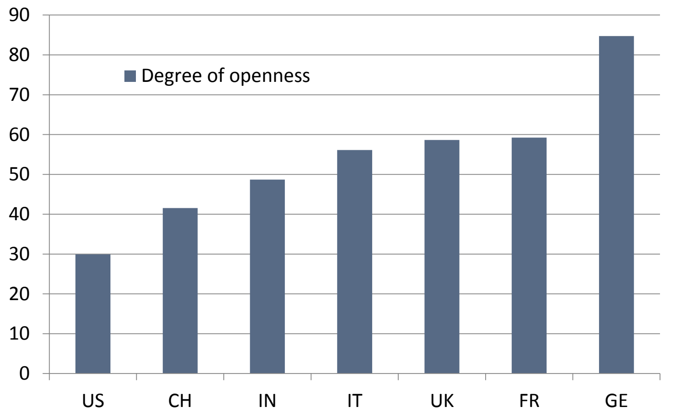
- In terms of ease doing business, China and India perform badly compared to the UK and its key EU trading partners. Most EU countries are far more open too.
- Germany exports more than three times what the UK exports to China. Being a member of the EU does not constrain the opportunity to export to fast-growing markets.

**Chart 3: Ease of doing business ranking**




*Source: World Bank*

**Chart 4: Degree of openness**




*Source: World Bank. Degree of openness is measured as the sum of exports and imports as a % of GDP*
*Note: Latest data is 2014*

**Myth 4: Leaving the EU would lead to a bonfire of red tape**

***Reality: The UK would need to keep most EU regulations if it wanted access to the single market***

- Trade agreements between willing countries are intended to reduce the costs of doing business across borders. One way is through tariff reduction or complete tariff removal. Another is through the harmonisation of product and business regulation.
- The trust that one country's goods and services can be bought and sold in another's without checks and approvals brings down costs of business and boosts efficiency. Principally, that is how the single market works.
- For whatever parts of the single market the UK wanted to access after a Brexit, the UK would need to adhere to the EU common standards. The UK would not be able to influence those standards, since that is the exclusive right of EU members.

**Myth 5: A Brexit would allow the UK to set trade agreements with many more countries than it currently gets through EU membership**

***Reality: This is true in principle, but the scope for this would be limited***

- If the UK wanted to set up a series of free trade deals with the maximum number of countries as quickly as possible, the quickest and easiest way would be to access the single market of the EU-27 (the 2nd largest economic area in the world).
- That would put the UK in league with its North American cousins. The US has access to around 20 markets and Canada has access to 40 markets (including the EU) via their free trade agreements.
- However, if the UK stays in the EU, then it maintains preferential access to the other 27 EU members plus 53 other markets where the EU already has trade agreements.

**Myth 6: The UK government has a high level of debt because of the cost of the EU budget**

***Fact: The UK's net contribution to the EU is less than 0.5% of GDP***

- The UK's net contribution to the EU budget is almost trivial. Furthermore, if the UK had stuck to the fiscal rules set out in the Maastricht Treaty in the years before the financial crisis, UK government debt would be lower today.
- If the UK wants to maintain access to the EU Common Market after a Brexit, it would have to contribute to the EU budget, just like EU-non members Switzerland and Norway do today. Once outside, the UK may find it more difficult to negotiate a "rebate" such as the one which it has today.

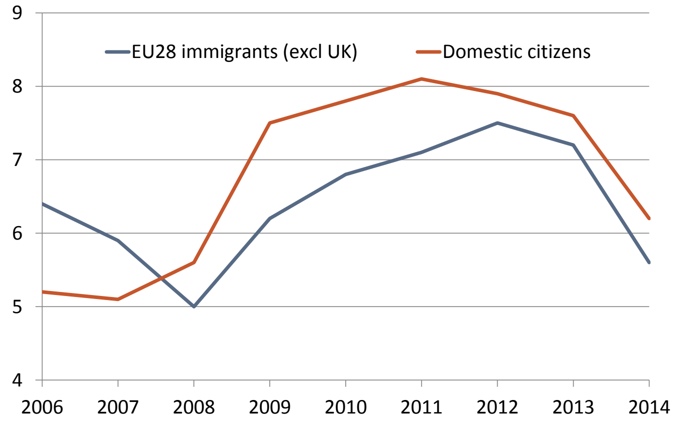
**Myth 7: EU immigrants are a drain on the UK economy**

***Fact: EU immigrants are more economically active than natives***

- In the UK, the unemployment rate for EU-27 immigrants is lower than the unemployment rate for natives.
- Leaving the EU and joining the single market via a Swiss or a Norway style agreement would require the UK to keep an open border to migrants who would have the same rights as a native.

- Under Cameron's new EU deal, the UK could hit an emergency brake on welfare payments. It might not bring down the numbers too much, but it will ease the stress on public services budgets.

**Chart 5: UK unemployment rate for domestic citizens versus EU immigrants**




*Source: Eurostat. Note: 2015 data not available*

*For more information of the possible impacts of a Brexit on the UK economy, please see the following [report](report).*

*Also, please see '[Britain beware: the power of trade diversion](Britain beware: the power of trade diversion)'.*



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