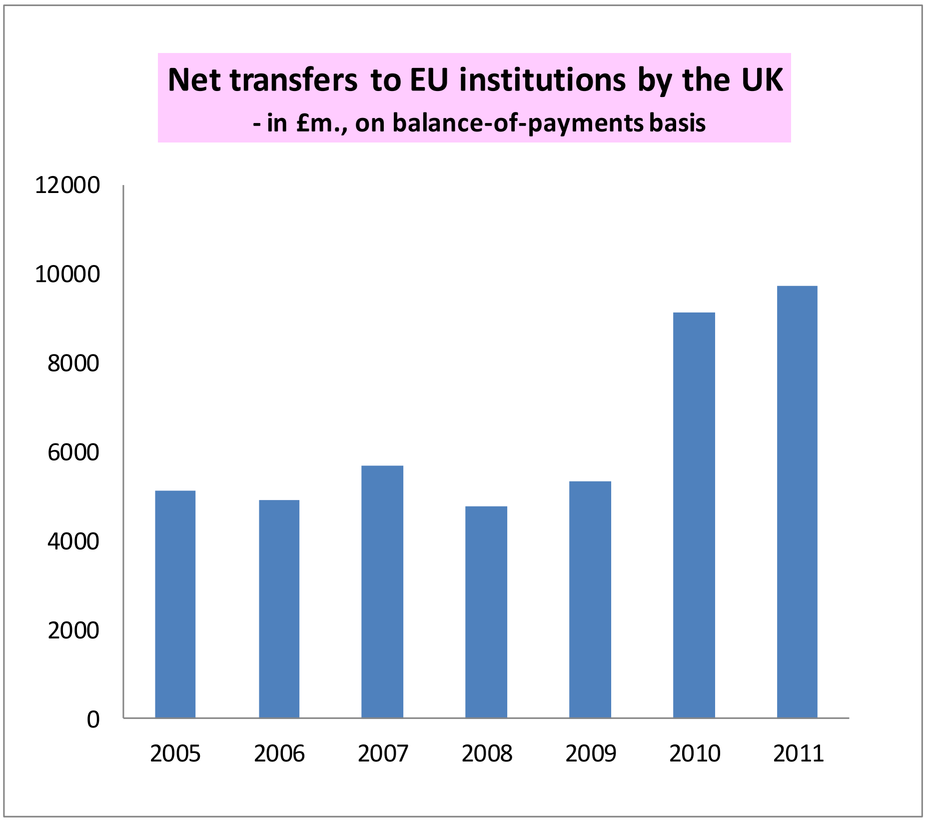
1. The direct fiscal cost

Its membership of the European Union requires the UK government to make certain payments to EU institutions, and entitles it to a number of receipts. How much are these direct fiscal costs and benefits, and what is the net position? That may seem like a simple question which can be answered with a single set of numbers. Surely, when the government spends £100 million, it spends £100 million, and it does so without fuss or ambiguity. In fact, a range of complexities mean that no one figure for many EU financial concepts is exactly 'right'. Like love, the UK's financial contribution to the EU is a 'many-splendored thing'. Again like love, it causes many squabbles.

The cost summarized: no single number is right

The first difficulty is that definite figures relate only to the past, after accounts have been prepared and finalized. If the object is to find out how much the UK is paying at present or will be paying in the next few years, estimates are needed. But these may prove unreliable in the end, because of – for example – the vagaries of the weather (which affect Common Agricultural Policy spending) or the accidents of local politics (which can be important where local co-financing is a condition of Structural Fund disbursements). Another problem is that statistics can refer to different notions of 'the UK'. This may seem strange, but the UK could sensibly in this context be viewed as 'the UK government' or 'the UK as a whole'. If 'the UK as a whole' is taken to be the more relevant, allowance has to be made for private sector receipts and outgoings that arise from the EU treaties and the resulting interactions between the UK private sector and EU institutions. Further, even when the time period has been decided, and the meaning of 'the UK' pinned down, interpretation can be confused by the existence of several alternative sources of information. All the sources may appear to be authoritative, but experience shows that they also conflict for no apparent reason. The analyst has to make a lucky dip.



But we have to start somewhere. The chart above shows the UK's net contribution to the EU, according to balance-of-payment data prepared by the Office of National Statistics. The data remain subject to revision since new details may still be found, but they give the best available official view from the information now at hand. The numbers include transactions between the UK private sector and EU institutions, although they are dominated by government payments in and out.

Anyhow the exercise generates a nice and easy round number. In 2011 the UK paid a net figure of almost £10 billion to the EU. If someone wants a single number *for the direct cost to the UK of its EU membership*, that is a good and perfectly reasonable one to choose. £10 billion is slightly under 0.7% of gross domestic product. To put it another way, for every £140 of output produced in our country, a net £1 is sent to the EU for its purposes and is lost to us. That is a neat and straightforward measure of the UK's direct 'membership fee'.

But at the time of writing (summer 2012) the 2011 figure is to a degree history. To have a more up-to-date view it is necessary to check the latest official forecasts. Every year since 1980 the Treasury has published a *Statement on the Budget of the EU*, for submission to Parliament. The latest such Statement (Cm. 8232) was prepared in December 2011 and gave the numbers in Table 1.1 for the UK's 'net contribution to the EU budget'.

Table 1.1 UK government gross and net payments to the EU, 2005/6 to 2014/15

		£m.		% of GDP	
		Gross payments by the UK government to the EU	Net contributions by the UK government to the EU	Gross payments by the UK government to the EU	Net contributions by the UK government to the EU
Outturn	2005/6	11780	4389	0.9	0.3
	2006/7	12245	3521	0.9	0.3
	2007/8	13746	4185	1.0	0.3
	2008/9	13155	3002	0.9	0.2
	2009/10	13733	4724	1.0	0.3
	2010/11	15593	8119	1.1	0.6
Plans	2011/12	15654	6915	1.0	0.5
	2012/13	16294	7832	1.0	0.5
	2013/14	17593	8530	1.1	0.5
	2014/15	18649	9363	1.1	0.5

Source: H M Treasury *European Union Finances 2011*, pp. 19 - 20

A comparison of the numbers in this table with the chart on the previous page may be a little unsettling, because the table's number for 2011/12 of a net contribution of £6.9 billion is quite a lot less than the chart's figure of almost £10 billion. However, the two answers are consistent. They refer to different time-periods (calendar year and fiscal year), while the table relates *to government expenditure and receipts as such*, unlike the chart which is *about the UK as a nation*. Another qualification is that the Treasury document was prepared in December 2011 and, almost certainly, will eventually need to be updated by later and more accurate information.

The table is also more complete than the chart, in that it presents data on gross payments to the EU as well as the net contribution. The difference between the two reflects the EU's various payments to the UK, which include CAP money for farmers and development money for the regions. **At present the gross payments to the EU run at about £15 ½ billion to £16 billion a year, which is roughly £50 million a day. While it is true that about half of that £50 million comes back to the UK, we do not in fact have much discretion about how the returned half is spent. The explanation is that the UK's discretion is constrained by EU treaty commitments. Even with the money that is sent back from Brussels, the British government is not able to take decisions freely according to perceived local conditions for the benefit of the people most immediately affected. So a legitimate statement is that, 'we in Britain pay £50 million a day to European institutions, to be spent by the EU for its purposes'. That is about 1% of our national output. For every £100 of output produced in our country, £1 is sent to the EU for its purposes and is not under our control.**

Another clear message is that the UK's direct fiscal cost of membership has been rising in the last few years. Broadly speaking, the cost from now on will be about ¼% of GDP higher than it was before the end of the Blair premiership in 2007. The next section will consider how the UK's membership fee has been determined. It is quite a long story and some history is needed.

Some history: the original negotiations and the 1984 rebate

How did the UK find itself in a situation in which it has to pay 1% of everything it produces to a foreign institution, the European Commission, to be distributed for the purposes of a club of foreign nations, the European Union? Britain is a proud history with a remarkable history which, by common consent, has made a contribution to modern civilization out of all proportion to its size, natural resources and population. England – the core of Britain – has not been conquered by an invading military force for almost a thousand years. So why is it paying £1 out of every £100 of its output to benefit its European neighbours?

The answer lies in history. Britain received massive support from members of the British Commonwealth in the Second World War, which was one reason why it emerged on the winning side. It also played a leadership role, with the United States of America, in forging the key supranational institutions of the post-war world (i.e., the United Nations, the International Monetary Fund, the General Agreement on Tariffs and Trade [now the World Trade Organization], and so on). But in the first post-war generation Commonwealth nations distanced themselves from Britain, with the self-governing dominions (such as Canada and Australia) adopting more protectionist trade policies and the colonies seeking political independence. The partial closure of the Commonwealth markets restricted the expansion of British exports and imports. Along with other misguided economic policies, it was associated with a poor rate of economic growth by the standards of other European nations. Six of these nations had established the European Economic Community, or so-called 'Common Market', in 1957. By the early 1970s the trading and industrial success of the original six members of the 'Common Market' appeared definite and incontrovertible relative to the UK's failure. When the UK joined the EEC on 1st January 1973, it did so primarily for economic reasons. The dominant consideration in most people's minds was the need to arrest the UK's sharp decline, in output and exports, relative to its European neighbours. Extrapolations of the relative growth performance of the UK and the Common Market countries in the 1960s implied that, by the 1980s, the

UK could be 'the poor man of Europe'. Although public opinion on Common Market membership was mixed, the political elite and the most influential sections of the media were in favour of joining. Indeed, many advocates of Common Market entry were desperate that its application for membership should succeed.

The existing six members of the EEC were well aware of the strength of their bargaining position and extracted a high price from the UK. The original deal back in 1957 had been, essentially, between Germany and France. As Germany wanted European free trade for its resurgent manufacturing industries and France sought financial help for its extensive agricultural sector, Germany agreed to pay money into a European fund. This money would be directed mostly to farmers, particularly French farmers. Because the UK had at the time of EEC entry a small and efficient farming industry by European standards, it was to follow Germany and also to be a significant net contributor to EEC institutions. At first the sums at stake were quite small. Indeed, the UK was a net beneficiary on one – although only one – occasion. (Amusingly, that was in 1975, which happened also to be the year when the British public was consulted in a referendum about EEC membership.) Thereafter the net contribution increased steadily and by the early 1980s the UK was the second largest net contributor after Germany. It was the second largest net contributor, even though a modest abatement (or 'rebate') was applied due to the original treaty provisions.

Table 1.2 UK government payments to the EU and 'the rebate', 1973 - 2010

	£b.				% of GDP	
	Gross contributions	Public sector receipts	Negotiated abatements/ refunds ('the rebate')	Net contributions	Negotiated abatements/ refunds ('the rebate')	Net contributions
Five years to 1978	3.1	1.7	0.0	1.3	0.0	0.2
Five years to 1983	11.4	5.5	2.6	3.3	0.2	0.3
Five years to 1988	21.9	10.6	5.2	6.1	0.3	0.3
Five years to 1993	32.5	13.2	9.8	9.5	0.3	0.3
Five years to 1998	43.7	21.4	8.5	13.9	0.2	0.4
Five years to 2003	52.4	20.2	16.5	15.7	0.3	0.3
2004	11.5	5.4	3.6	2.5	0.3	0.2
2005	13.1	6.4	3.7	3.1	0.3	0.2
2006	13.0	5.8	3.6	3.7	0.3	0.3
2007	13.1	5.3	3.5	4.2	0.3	0.3
2008	13.3	5.7	4.9	2.7	0.3	0.2
2009	14.8	5.5	5.4	3.9	0.4	0.3
2010	13.7	3.3	2.6	7.8	0.2	0.5
Total, 1973 - 2010	257.6	110.1	69.7	77.8	0.3	0.3
Total, 1984 - 2010	243.0	102.8	67.1	73.1	0.3	0.3

Source: Gerard Batten *How much does the European Union cost Britain?* (London: UKIP, 2010) and Office for National Statistics website for GDP data

Official statistics indicated that in the late 1970s and early 1980s the UK had a lower income per head than France or the Benelux countries. So Britain, the victor country of the Second World War, was both relatively poor in the EEC context and a giver of money to loser countries that had now become better-off. Needless to say, this situation disappointed many people in Britain, including Margaret Thatcher, who had become prime minister in 1979. In a series of often awkward negotiations Thatcher secured a much larger rebate for the UK in 1984. Ever since this rebate has been a bone of contention between the UK and its European 'partners', with other countries objecting loudly to what they see as the UK's allegedly special treatment. Table 1.2 above shows the importance of the rebate in mitigating the cost of EU membership to the UK. Over the 1984 – 2010 period the rebate was cumulatively worth £67.1 billion (or about 0.3% of GDP), compared with net contributions of £73.1 billion (also about 0.3% of GDP). So, roughly speaking, the rebate halved the net cost of membership to our country until the last few years, when – as we shall now see – much of it was given away by Tony Blair, the Labour prime minister from 1997 to 2007.

The loss of much of the rebate from 2005

Just before Christmas 2005, as the end of the six-month British presidency of the European Council, Blair agreed that in the EU's 2007-13 budget round, the British 'rebate' would be scaled down. The justification was that the EU had expanded dramatically because of the downfall of communism and the subsequent accession of several East European states. As the new members were generally poor compared with the long-standing West European states, they were deemed deserving of additional 'regional development' money. On this basis, the original arrangements made back in the 1970s and 1980s needed to be reviewed, and the UK rebate in particular came under the spotlight. All the same, Blair was under no obligation to surrender. Initially, the reduction in the rebate was 'spun' in the media as part of a deal whereby the French agreed to a cut in EU farm subsidies as a *quid pro quo*. But in the end Blair gave ground and the French did not. The French agreed only to a non-binding review of EU spending in 2008. Nothing much came from that which was to the UK's benefit.

Blair set out the rationale for the rebate loss at a meeting of the European Parliament on 20th December 2005. The effect of the change was that the new EU budget would 'transfer wealth from rich to poor countries', adding that the result would be akin to 'investing in Eastern Europe'. The British people were not consulted as to whether they wanted to support improving the infrastructure of Eastern Europe, as the subject was certainly not included in Labour's 2005 election manifesto. **Nevertheless, the cost to the British taxpayer in the 2007 – 13 budget round has officially been put at €10.5 billion at 2004 prices. With the completion of the 'phasing in' period at the end of 2011, the UK is now 'participating fully' in financing the cost of EU enlargement. In 2012 and subsequent years the cost will be about £2 billion per annum. It is this loss of rebate that is the principal reason for the increase in the UK's net contribution – the increase amounting to about ¼% of GDP – that was noted earlier.**

In the event of further EU enlargement yet more of the rebate will go. The list of candidate countries varies over time, but discussions of various kinds are under way with Bosnia, Croatia, Iceland, Macedonia, Montenegro and Turkey. Indeed, Croatia is set to become the 28th member of the EU on 1st July 2013. Because Croatia has a small economy, the cost to the UK in terms of rebate loss will be trifling. The situation would be very different if Turkey were to accede. Although enjoying high economic growth, it is poor compared to the EU and has an extensive agricultural base. The cost to the UK taxpayer of Turkish membership would run into hundreds of millions of euros/pounds and would increase the deficit in our public finances. Astonishingly, all three leaders of Britain's largest political parties support Turkish membership of the EU.

The UK's contribution to the EU Budget set in context

The UK's contribution to the EU Budget may seem small relative to our national production and wealth. At about 1% of GDP, the UK's gross contributions are of course heavily outweighed by the 99% of our output which we can use for ourselves regardless of bureaucrats and politicians from other European nations. But so it should be. When the UK engaged in 'the European construction' (to use the phrase often favoured by EU bureaucrats) in 1973, the British public's understanding was that we were 'joining the Common Market'. In other words, the objective was to participate in a free trading area, not to commit ourselves to the building of a European super-state in which our independence would be weakened and lost. The world includes other such areas, often referred to as 'customs unions'. Typically, the only supra-national administrative structure needed is a panel (of judges, usually) to settle disputes in the interpretation of the treaties establishing the customs union. The cost of such panels, and even of the supporting bureaucracy, is trivial, less than a thousandth of 1% of GDP.

The 1% figure is best seen as an accidental outcome of historical forces. In the 1950s Germany was eager to re-establish its international respectability after the horrors of the Nazi period and the Second World War. It sought redemption from its past through intra-European cooperation, initially on the economic front, even though from the outset such architects of 'the European construction' as Robert Schuman and Jean Monnet envisaged an 'ever closer union' which might lead to a pooling of political sovereignty. Germany achieved a spectacular economic recovery in the 1950s, giving it the resources to bribe other European nations – particularly France – to forge industrial free trade in a newly-established customs union. From the start until today Germany has been the largest financial contributor to the key European institutions, a fact which is eloquent volumes about the underlying motives and drivers of events. Britain was welcome at the founder meetings in the 1950s, but stayed aloof.

The British government changed its mind in the 1960s and applied for Common Market membership, only to be rebuffed twice (in 1963 and 1967) by an emphatic 'non' from the French president, Charles de Gaulle. (Germany wanted the UK to join.) De Gaulle's two vetoes increased the UK membership fee. By the early 1970s top British policy-makers were afraid that the UK would be 'left behind' its economically dynamic European neighbours. To them membership of the Common Market seemed absolutely essential and they were prepared to pay a price for joining it. They were prepared to pay a price, even though all that the UK wanted was European free trade and – as has explained – the cost of administering customs unions ought to be tiny. But the membership fee could not be too much, as that would alienate British public opinion. The result was therefore a membership fee – in terms of the direct fiscal cost – which was neither enormous nor trivial relative to GDP, and which was higher than that of any other member state apart from Germany.

The rest of this study will show that the direct fiscal cost is, in fact, only part of the cost of EU membership to the UK. Far more important nowadays are the costs of regulation and waste, which were not even considered in the original negotiations. The important point to remember from the discussion so far is that the UK's status as a net contributor to EU funds goes back to the disappointments and resentments of the original applications back in the 1960s and early 1970s. From a wider historical perspective, the UK – unlike the other big consistent contributor, namely Germany – has no reason to be ashamed of its past or to need to offer 'blood money' to its neighbours. The British interest in Europe has always been commercial and economic, and a customs union or free trade area can operate successfully with a disputes panel with a cost that is negligible compared with the current direct fiscal cost of the UK's EU membership. Bluntly, we should not be paying a membership fee at all.

Appendix 1: How much does the average British household pay to the EU?

We have seen that no single number can denote the direct fiscal cost of the UK's EU membership. Nevertheless, Table 1.1 shows that the gross government cost in 2013/14 is expected to be £17.6 billion, while the net government cost is put at £8.5 billion. Further, various payments are made to and from EU institutions by the private sector. Let us take it that in the next fiscal year the gross cost to the UK is £20b. and the net cost £10b.

In 2011 the UK had 26.3 million households. What, then, is the direct fiscal cost per British household of EU membership? Let us assume that in 2013 the number of households has risen by 1 ½% to 26.7 million. The answer is then,

> **The cost to the average British household of belonging to the EU is £749 a year (£20 billion divided by 26.7 million) or, as near as makes no difference, £750 a year. Sure, we get some of this money back for some regional development spending, but that only benefits the regions that receive the money. Anyhow our government cannot control exactly how it is spent. In most of the UK the average household is £750 a year worse-off because of our membership of the EU.**

But that is not all. The three 'main' political parties have said they want the EU to expand to take in much of the Balkans and Turkey. If so, the cost would rise towards £1,000 a year.

2. The costs of regulation

From a constitutional standpoint, the European Union is a monstrosity. Powers have been ceded to EU institutions that place them above the member nations in the constitutional hierarchy. These institutions are, in effect, federal bodies that constitute a 'government' for the EU as a whole. Nevertheless, the member nations have retained the trappings of statehood, and in particular continue to have their own military forces, their own legal systems and their own fiscal prerogatives. Critically, most taxes are raised and most public expenditure is administered at the national level. EEC expenditure was a mere 0.03% of member states' aggregate GDP in 1960, and had climbed to 0.53% of that figure in 1973 on the UK's accession. The ratio has subsequently risen to slightly more than 1% of EU GDP, as we saw in the last chapter. But it is striking that Germany – the main sponsor of European integration – has over the last 20 years been one of the member states most opposed to additional spending in the union's name. At the Edinburgh meeting of the European Council in 1992 Germany actively supported a spending ceiling of 1.27% of aggregate member nations' GDP.[1]

On the face of it the EU has two layers of government, one at the national level and the other for the union as a whole. But the word 'layer' implies, falsely, that a clear and final understanding has been established on the proper relationship between the two. In fact, EU member states are in the dysfunctional situation of having two distinct governments, one in the national capital and the other in Brussels, with their relative powers and responsibilities largely unsettled. The EU bureaucracy has been unable to wrench the key fiscal prerogatives, the powers to tax and spend, from the member states. To compensate for this failure, it has tried to expand its influence by pressing for more European 'laws'. The heart of the process is that the European Commission proposes new 'directives' and 'regulations' to the Council of Ministers. Successive treaties have weakened the power of individual nations to block new EU legislation that they dislike. Particularly since the Single European Act of 1986 the nation states have become increasingly feeble in restraining the EU juggernaut. Over the 55 years of its existence the European Commission has authored tens of thousands of directives and regulations that have the force of law across the EU.

At the last count the EU's various legislative enactments – which are termed the *acquis communitaire* – numbered 120,000. As far as the EU is concerned, the *acquis* is sacrosanct and must be adopted by all new member states without cavil. Directives and regulations are the main expression of EU authority, and nowadays infiltrate every nook and cranny of national life. In the words of Lord Denning over 20 years ago, 'Our sovereignty has been taken away by the European Court of Justice…No longer is European law an incoming tide flowing up the estuaries of England. It is now like a tidal wave bringing down our sea walls and flowing inland over our fields and houses—to the dismay of all.'[2]

The tidal wave of the *acquis communitaire*: a broad-brush cost estimate

The cost of implementing the 120,000 items of legislation is massive. Given the multiplicity, complexity and diversity of the EU's directives and regulations, precise estimates of the cost are implausible. (By 'precise estimates', I mean estimates that claim to be accurate to, say, £1 billion or even £5 billion. The subject simply cannot be pinned down to this degree of exactitude.) Only broad-brush, rough-and-ready numbers make sense. Given the vast scope of the EU's regulatory effort, the present study cannot pretend to offer rigorous new quantitative research. All that can be done here is to refer to other analyses that seem well-intentioned in purpose and well-grounded in fact, and to attempt to summarize what they say.

As we have seen, Germany has always been the nation most committed to European integration. So a 2006 study undertaken for the German parliament by its former president, Roman Hertzog, must be treated with respect. **According to that study, 84% of Germany's new laws come from the EU.[3] Much the same kind of figure must have applied then – and must still apply now – across the EU, including the UK. It is a commonplace that the EU bureaucracy has a vested interest in**

expanding its authority. If an EU commissioner puts forward a figure for the cost of regulation, that figure ought to be taken as unbiased even if it remains unproved. In October 2006 Gunther Verhuegen, the EU commissioner for industry and enterprise, put out a statement which invited the interpretation that the annual cost of EU regulation was 600 billion euros or 5 ½% of GDP.[4] Given that a President of Germany and an EU commissioner would be generally supportive of EU integration, these estimates – more than five sixths of new legislation and a cost of over 5% of national output – are remarkable.

Lord Mandelson is one of the UK's most Europhile politicians. But in a speech to the Confederation of British Industry in 2004 he suggested that EU red tape cost 4% of GDP. Although he then argued that the benefit of the single market (estimated at 2% of GDP) had to be weighed against the burden of regulation, he appeared to accept that overall the UK economy was a net loser from application of the *acquis* to our economy. (Later in this study it will be argued that 'the benefit of European free trade' – the benefit that Mandelson quantified as 2% of GDP – is more or less the same thing as 'the benefit of the single market', and that a free trade agreement between the EU and the UK would be available to us outside the EU. So the cost of regulation, on a reasoned interpretation of statements from the highly Europhile Mandelson, is a net 4% of the UK's GDP.)

The Open Europe think-tank suggests a £20 billion annual cost

The Open Europe thin-tank is often described as 'Eurosceptic', but in May 2012 it produced a report on the UK's trading options which said that staying in the EU was the best choice.[5] So it can hardly be described as vehemently anti-EU. It has carried out two reports on the cost of EU regulation, one in 2009 and the other in June 2010, just after the election of the Conservative/LibDem coalition government. Both were heavily based on the 'impact assessments' of regulatory proposals produced by the British government. As the first such impact assessment were prepared in 1998, the 2009 report dealt with over a decade of regulation. The second exercise in 2010 was entitled *Still Out of Control?: Measuring eleven years of EU regulation*, and was prepared by two Open Europe staff members, Sarah Gaskell and Mats Persson. It was based on studying 2,300 impact assessments and claimed to be 'the most comprehensive and in-depth study to date of the cost of regulation in the UK' for the period in question.[6] One section examined the annual flow of regulations and the costs to which they gave rise. **A key conclusion was that, 'In 2009 the cost arising from regulations [i.e., *all* regulations, including those of UK origin] introduced since 1998 was £32.8 billion', with 59% (or £19.3 billion) being EU-derived. For the purposes of presentation, this was rounded upwards to £20 billion a year.**

That appears to be cut-and-dried, so that £20 billion can be added to the direct fiscal cost as a negative for the UK. However, the Open Europe analysis begged many questions. Official impact assessments are supposed to weigh the benefits of extra regulation against the costs. Using the official calculations in the assessments, Open Europe contended that 'the benefit/cost of the regulations we studied' was 1.58. In other words, the benefits of regulation exceeded cost by a wide margin of almost 60%, tacitly implying that the UK and indeed every other EU country should openly embrace yet more regulation! In qualification, the study found that UK-originated regulations had a benefit/cost ratio of 2.5, dramatically higher than for EU regulation. For EU regulation alone the benefit/cost ratio was said to be a mere 1.02. Given that the overall result for EU regulation was so marginal, there must have been a high likelihood that many EU regulations had costs in excess of their benefits. The Open Europe study was therefore consistent with the widespread popular disenchantment with EU regulation, and a common perception that much of it was (and remains) misguided and wasteful.

But closer reading casts some doubt on the rigour of the Open Europe analysis. In fairness, even its authors were far from dogmatic that they had reached the final truth in this conceptually elusive subject. As their work was in effect a compilation of impact assessments, it would not have been feasible without a large body of such assessments to consult. But – of course – the case for a new regulation would fall if the benefit/cost ratio were under one. From the very nature of the analytical process of drawing up impact assessments, a benefit/cost ratio of over one had inevitably to emerge in the vast majority of cases. Gaskell and Persson noted in their 2010 report that, 'The "do nothing" option has not been recommended in a single impact assessment we have come across since last year, which shows an unwillingness among policymakers seriously to consider alternatives to regulation.'[7]

Apparently the government machine has manufactured a large library of impact assessments, but they are not widely read. Cynics might remark that the task of preparing the impact assessments added to the piles in civil servants' in-trays and hence justified the recruitment of more civil servants. The private sector had to pay more taxes to cover the cost of staff who analyzed the effect of regulations which it did not want in the first place. The impact assessments therefore increased the costs of tax and regulations, and added insult to injury. And did they serve any useful purpose? Gaskell and Persson mentioned one instance when an impact assessment argued against the introduction of a new regulation, but was ignored. In their words,

> …the Waste Batteries and Accumulators Regulation 2009, which partially implemented EU Directive 2006/66/EC, was signed off [by a government minister] in April 2009, despite the impact assessment showing that the costs clearly outweighed the benefits. Annual costs were estimated at anywhere from £10.2 million to £17.2 million, while the benefits were estimated to be between £2.1 million and £2.8 million.[8]

In two distressing cases discussed by Gaskell and Persson (the Alternative Investment Fund Management Directive and a regulation on the conditions for frozen poultrymeat) the concerns of some UK government departments were brushed aside by the EU bureaucracy and then steamrollered through the Council of Ministers.[9]

The cost of renewables legislation

One reason for being skeptical about Open Europe's work is that both the 2009 and 2010 reports failed to give sufficient emphasis to sectors known to be suffering particularly severe damage from EU regulations. For example, the third chapter of the 2010 *Still Out of Control?* report gave a table with a list of five government departments, which showed the proportion of the extra regulatory cost for each department represented by new EU-originating legislation as opposed to UK-originating legislation. This was fine and worthy in its way, but it suffered from a glaring oversight. **The report discussed only incidentally the massive impact of EU regulations on the UK's energy and energy-related sectors, particularly electricity generation and chemicals. EU action in this one area has such immense effects as to smother the damage that might be estimated in a few thousands of small miscellaneous impact assessments.**

The three key directives here are the 2001 Large Combustion Plant Directive, the 2003 Bio Fuel Directive and 2009 Renewables Directive. The last of these is the most significant and arguably the most dangerous. The EU bureaucracy has accepted the so-called 'warmist' doctrine that, because of the carbon emissions arising from modern industrialism, mankind is largely to blame for the global warming of recent decades. The purpose of the 2009 Renewables Directive is, explicitly, to move towards a 20% drop in the EU's carbon emissions by raising the proportion of electricity generated by renewables (wind, wave, solar and so on) to 20% by 2020. The cost of electricity generation by means of renewable energy is much higher than that with conventional sources of energy (gas and coal, mostly). For example, electricity from offshore wind farms costs at least three times as much to produce as electricity from a gas-fired combined-cycle power station.

This is not the place for a lengthy discussion of the environmental impact of carbon emissions. It may or may not be proved 20 or 30 years from now that global warming has been caused predominantly by mankind. Whatever the outcome of that debate, several nations are not making major adjustments today to their policies towards energy, electricity generation and the environment. In electricity generation they continue to invest in order to minimize cost. As a result, households and companies in every country in the EU – and not just the UK – will have to pay well above the international price for electricity. Industries heavily reliant on energy usage and electricity consumption will become too high-cost compared with suppliers from other countries. They will stop investing in the UK and other EU countries. As a news story in *The Sunday Times* on 6th February 2011 remarked, 'Leading chemical companies have warned the government that its energy policies will render them uncompetitive, leaving plants to "die on the vine" to quit Britain for lower-cost countries.'[10]

Government departments have of course had to advise ministers on the costs of the UK's adoption of the EU's green agenda. *The Guardian* has received a series of leaks from sources in the Department for Business, Enterprise and Regulatory Reform (formerly the Department of Trade and Industry) on key energy policy issues that have been and remain in dispute. Some leaked documents indicated that the cost of meeting EU targets would be between £5 billion and £11 billion a year. Indeed, according to the documents, the long-term goal of 20% of total energy being from renewables would cost £22 billion.[11] It needs to be stressed that, unlike the cost calculated in impact assessments which are in principle justified by offsetting benefits, these costs are costs, full stop. Because we have chosen methods of electricity generation that are costly and inefficient, we are worse-off without qualification.

Two further points must now be highlighted. **First, the identified cost to the UK of EU membership in this one part of the economy is much the same as the direct fiscal cost discussed in the first chapter. Secondly, as EU regulations affect many other parts of the economy, their cost is additional to the £5 billion to £22 billion that a government department has calculated in the energy, energy-using and electricity cluster of industries. The implications of these two points are brought out more sharply towards the end of this chapter.**

The cost of EU-imposed financial regulation

When Britain joined the Common Market in 1973, it was regarded as a slowcoach in the league tables of international economic growth. Indeed, as the first chapter explained, perhaps the most persuasive argument in the case for membership was that we had to catch up with our allegedly more successful European neighbours. By common consent the reforms of the Thatcher premiership (privatization, financial deregulation, reduction in trade union power, and so on) went far to revitalize the British economy. Indeed, in the 15 years to 2007 the UK had somewhat faster output growth than other EU member states. (See Table 2 .) Particularly dynamic were a group of international financial services industries mostly located in or near the Corporation of London's Square Mile and usually given the collective label 'the City of London'. As Chart 2 shows, the UK's exports of international financial services soared in the 15 years to the Great Financial Crisis, which is usually taken to start in late 2008. But in fact the boom has its roots much earlier, in the trend for financial business to go 'offshore' in the 1960s.[12] Offshore financial business – business that to a large degree avoids the regulations and taxes of any one specific nation – has been growing rapidly for about 50 years.

For most of this period the activities centred in the City of London were subject to UK financial regulation, often on a so-called 'light touch' basis from the Bank of England. It also needs to be said that – certainly until the 1980s – the prevailing philosophy was of 'self-regulation under the law'. In other words, people employed in the Square Mile's various activities had to obey the law (i.e., the law that punished theft, taking money on false pretences, fraud, embezzlement and so on), just like people employed in any other walk of life. No external regulatory authority was imposed on them by the state. Instead they each had their own regulatory structures, often buttressed by a compensation fund to deal with customers who had a legitimate claim on them because of wrong-doing. The City's ethical standards may have left much to be desired, but – relative to other financial centres – London was well-regarded. Indeed, the dynamism of the UK's international financial services sector from the 1960s owed much to the perception that, despite the absence of external regulators, London firms provided fair, reliable and honest services to their customers.

The tradition of self-regulation under the law began to break down in the 1980s, even though the Financial Services Act of 1986 endorsed the creation of so-called 'self-regulatory organizations' (or SROs). A more fundamental change occurred in 1997 and 1998 when a newly-elected Labour government decided to wind up the SROs and to establish the Financial Services Authority. The FSA was to be an over-arching, omni-competent regulator for all types of financial activity, from derivatives trading to household insurance. From then on external regulation, rather than self-regulation, became the norm in the UK's financial sector. However, for most of its existence so far the FSA has taken its cue from the long-established 'light touch' mantra, while regulation was very much a British matter. Indeed, whatever the reservations that may have been felt about the concentration of regulatory power in the FSA, the most spectacular phase of the City's boom came in the opening years of the twenty-first century. Large fortunes were made by well-placed and fortunate individuals in particularly dynamic sectors. Globalization and advances in information technology enabled teams of traders, underwriters and analysts to process enormous volumes of transactions and information, to make big profits for their firms, and to earn enormous bonuses for themselves.

The Lisbon Treaty and the City of London's industries

Unhappily, the City's prosperity is now threatened. No doubt some of its difficulties are self-inflicted, with the later years of the boom being marked by behavioural lapses and excesses, sometimes at customers' expense. However, a big problem is the shift of financial regulation from the UK to the EU. With top UK policy-makers' attention being focused on the market turmoil of 2008 and 2009, they seem to have overlooked that the Lisbon Treaty added financial regulation to the list of the EU's 'competences'. When in 2009 Gordon Brown signed the Lisbon Treaty and David Cameron clarified that a newly-elected Conservative government would not seek to amend it, they were handing financial regulation from the relevant UK agencies to their EU counterparts. More succinctly, they were surrendering to foreigners a number of important powers to guide and support the most rapidly-growing part of the UK economy. (To those uninitiated in these matters, a 'competence' is a policy area for which the Council of Ministers – not one of the national governments – is responsible, because directives and regulations passed by the Council take effect in that area.)

An article in the *Financial Times* of 8th November 2011 reported on some of the resulting misunderstandings.[13] In its words, describing an exchange which seems to have occurred a few weeks earlier,

> Sir Mervyn King is not known as a man given to shouting. But during a meeting this summer in the genteel surroundings of London's Threadneedle Street, the Bank of England governor let fly.
> The visitor sitting across from him – a silver-haired Frenchman whose meticulous dress and proud demeanour appeared straight out of Gaullist central casting – was threatening to rein in the governor's new powers to set capital rules for Britain's banks. Sir Mervyn was having none of it. As his voice rose, his interpreter grew increasingly startled – particularly as the Frenchman refused to back down…The object of the governor's ire was Michel Barnier, the 60-year-old former French foreign minister named two years ago as European internal market commissioner – a perch giving him oversight of the continent's financial industry. Arguably, no European Union job is of more consequence for the UK. That a stalwart from French president Nicolas Sarkozy's UMP party came to lord it over the City of London may one day go down as one of Britain's most important diplomatic failures in Brussels. After an initial British panic, relations with Mr Barnier were mostly marked by a tense but cordial truce…That detente, however, has collapsed.

It would be hard to imagine a more complete breakdown of the normal Anglo-French courtesies, but the point was that – in Barnier's eyes – the Lisbon Treaty had made it his job to regulate UK banks' capital standards. The matter was no longer contentious between Britain and France by themselves, as it might have been only 40 or 50 years ago, because the whole subject had been subsumed under a treaty that the governments of both nations had signed. That treaty in effect reduced both nations to the level of regions in one European super-state.

In the early years of the City boom hastily-formed industry associations, which epitomized the spirit of self-regulation under the law, would approach the Bank of England if they were anxious that a new product or service might be unacceptable to government. That meant of course unacceptable to the British government of the time. The relevant official would usually give a quick 'yes' or 'no', often – it has to be said – on an informal basis that would today be regarded as unacceptable. Nowadays the position is quite different. Despite King's fury in his exchange with Barnier, the truth is that ultimate regulatory authority over the City of London has passed to bodies that are subordinate to the European Commission and are building-blocks of the entire 'European construction'. The European Banking Authority may have its offices in London and, in that sense, be conveniently situated for the senior executives and compliance officers of London-headquartered banking groups. Nevertheless, the EBA works with the European Commission to a degree that would have been unthinkable for the Bank of England in the 1970s or 1980s. The European Securities and Markets Association is based in Paris, even though Paris's trading and underwriting volumes in securities are only a fraction those of London. The third of the European supervisory agencies arising from the Lisbon Treaty, the European Insurance and Occupational Pensions Authority, is located in Frankfurt. As the British people have by far the largest pension assets of any European nation, and since London pension fund management dominates the European pension industry, the Frankfurt location seems bizarre.

It is not surprising that one well-informed observer of trends in financial regulation, **Anthony Belchambers, chief executive of the London-based Futures and Options Association, should have commented to the *Financial Times* that 'Red tape, ill-informed tax initiatives, protectionist policies and high "pass on" costs will damage the international reach of the City'.[14] About 20 directives – on such matters as bank capital, transactions taxes and market infrastructure – are in 'the Brussels pipeline', as it has been termed. Their final implementation will fall not to British regulatory institutions, but to the EBA, the Paris-based ESMA and the Frankfurt-based EIOPA, all acting in coordination with the European Commission.**

A possible objection at this point might be that, if the globalization of trade and finance has been a relentless trend over the last 60 years, the internationalization of financial regulation has been an inevitable accompaniment of that trend. London could not forever expect regulation to remain light, informal and local, as it once used to be with the Bank of England in the UK before the 1986 Single European Act. But globalization and internationalization do not mean that countries can forget about their national interest. It cannot be overlooked that EU authorities have advocated 'a financial transactions tax', to be levied like VAT on an EU-wide basis. This tax would fall disproportionately on the UK, because London is Europe's principal centre for wholesale financial transactions.

There is little doubt that the governments of other European nations – including the German and French governments – have supported the tax because it would be at the UK's particular expense. Indeed, the Commission has prepared analyses which, frankly and openly, acknowledge that jobs in London would be destroyed. According to one of these analyses, the FTT would cause 70% to 90% of trade in derivatives – in which London is the largest global player – to leave the EU. However, it asserted, '[s]uch disappearance could be seen as positive if the activities targeted are considered as harmful', particularly as only 0.03% of the European labour force would lose their jobs as a result.[15] But 0.03% of the European labour force is about 50,000 jobs and most of these are in fact in the City of London, which employs under 400,000 people.[16]

Again, no single number can be readily calculated for the cost of EU-imposed financial regulation. Official data show that in 2011 the UK's exports of 'financial services' as such amounted to £50.8 billion, although arguably should also be made for insurance (on which the UK earns a large surplus) and the legal, accounting and consultancy back-up for financial work. If insurance and back-up earnings are added on, the figure is probably nearer £80 billion, equivalent to over 5% of the UK's GDP. These industries have stopped growing in the last five years, as Chart 2. demonstrates.

Is EU regulation to blame for that growth halt? Obviously, over the last five years the global financial crisis has been the main culprit. But no one in the UK can ignore the kind of rhetoric that has come out of the European Commission, and the governments of Germany and France, in the last few years. Moreover, EU regulation is only now beginning to take over from national regulation. Unless the UK leaves the EU, over time the City of London will become as fully subject to Brussels direction as the UK farming and fishing industries. Bluntly, key policy-making individuals in Germany, France and other continental European countries do not like the financial services industry at all. They resent the UK's past success in these activities. The key individuals hardly bother to hide their aversion to financial activity or their desire to handicap or even expel the most complex and highly-paid financial industries from the EU. While the UK remains a member of the EU, expulsion from the EU means expulsion from the UK.

Let us be clear what we are talking about here. The Lisbon Treaty has led to the surrender, to hostile European politicians and bureaucrats, of regulatory control over industries in which the UK had been particularly dynamic and successful, and which account for about 5% of UK GDP. A case can surely be argued that the regulatory follow-through of the Lisbon Treaty will check the growth of the UK's international financial services sector and may even cause it to contract. **What is the cost of that to the UK in terms of lost opportunities for highly-paid employment, profits and tax revenues? Given that the value added in the international financial services industries runs at perhaps £40 billion to £75 billion a year, that they had been growing at 15% a year and now face stagnation, and that use of the same resources will be less productive elsewhere, the UK's loss from EU-imposed regulation might be estimated at £1.7 billion in the first year, but increasing with time. The capital loss to the UK – on assumptions which discount the loss aggressively (i.e., make it smaller than it otherwise would be) – might be £50 billion.[17]**

An overall assessment: the cost of regulation rising to 5% of GDP

It is time to bring together the main points of this chapter. The first chapter established that the direct fiscal cost to the UK of EU membership now runs at about 1% of GDP.[18] This chapter has discussed the costs of regulation from several angles, with comments on both broad-brush estimates of the costs in the round, and on more specific studies, including studies on particular sectors. **Curiously, the broad-brush estimates were often from sources that were supportive or even enthusiastic about EU integration. Nevertheless, they arrived at numbers for the total cost of EU regulation – like 2% to 4% of GDP – that are appreciably higher than the direct fiscal cost to the UK of its EU membership.**

Open Europe's 2010 report *Still Out of Control?* was then considered. It offered a ballpark number, no less than £20 billion, of the annual cost of EU regulation. That is about 1 1/3% of the UK's GDP. However, Open Europe's exercise was heavily dependent on official impact assessments prepared by the British government and was only as analytically robust as these assessments. On closer examination the *Still Out of Control?* report had overlooked the severity of the EU's regulatory impact in just one conspicuous and very important area, namely the impact of the EU's renewables and environmental agenda in the energy industries (i.e., electricity supply and energy-using business such as chemicals). A UK government department had put the resulting costs at between £5 billion and £22 billion a year, depending on the assumptions used. A fair surmise is that the cost of the EU's employment directives cannot be much less than that of the renewables and environmental directives, although they have not been discussed in the present study in much detail. It is a fair surmise simply because of the volume and articulacy of complaints from affected British businesses.

On top of that are, for instance, the burdens of the 1999 Landfill Directive (costed at £1.1 billion a year by local government sources), the 2006 Water Framework Directive (which forces the water industry to deliver water quality standards that are needlessly high, at fantastic cost), and the 2009 Data Retention Directive (which requires telecommunications companies to keep immense amount of customers' internet data, at much cost to them, possibly for later police and national security use).[19] These are just examples. Indeed the entire 120,000 of EU legislative

enactments have effects, mostly negative, destructive and deleterious, on output and employment. So more specific investigation of specific directives and regulations, and their impact on particular sectors and companies, are likely to arrive at a number that in the aggregate is similar to the 2% to 4% of GDP.

While exact quantification of the cost of the vast body of EU interferences is impossible, both the broad-brush approaches and the more nitty-gritty specific analyses suggest that each year the UK is losing between 2% and 4% of GDP a year because of EU regulation. **The number has undoubtedly been rising over time and, on that basis, must now be closer to 4% of GDP than 2% of GDP. Given that the regulatory onslaught is gaining momentum all the time, the figure must be expected to increase in the next few years. We are therefore talking of the cost of EU regulation moving towards 5% of GDP.** As that cost is much higher than the direct fiscal costs, it ought to receive at least as much media attention. In fact, it receives much less. No doubt supporters of greater European integration might object that talk of the ever-increasing momentum of regulation is gratuitous and unnecessary. Again a quote from Gunter Verheugen may be apposite. In his words,

> There are 27 commissioners, which means 27 directorate-generals. And 27 directorate-generals means that everyone needs to prove that they are needed by contstantly producing new directives, strategies or projects. In any case, the rule is more and more, more and more, all the time.[20]

Evidently, one of the EU Commissioners has accepted here the dysfunctional character of the organization of government, or rather of misgovernment, in the EU. The Brussels bureaucracy, thwarted in its hopes of taking control over public spending and taxation, takes upon itself the task of regulating more and more areas of life. Unlike national parliaments, the EU's Commissioners are not elected and do not have democratic legitimacy. Nevertheless, the range of EU competences is expanding constantly, at the expense of the power of national governments and legislatures. This is the practical meaning of the phrase 'ever closer union' in the preamble to the 1957 Treaty of Rome which founded the EEC (or 'Common Market').

Britain has no need to suffer the regulatory burden

The argument of this chapter may seem unduly alarmist, even over-cooked. If the cost of the EU regulatory apparatus is heading towards 5% of GDP, does not that imply a similarly-sized burden for all EU countries? And how can such a large group of nations – nations that belong to the continent which pioneered scientific rationality and industrial civilization – be so foolish as to accede to regulations that destroy jobs and prosperity? Is this not madness on a gigantic scale? Further, if excessive regulation is impoverishing Europe by as much as 4% or perhaps even 5% of GDP, why are nations on the European fringe still keen to join the EU? The answer – as in so much that conditions modern public policy in European nations – is to be sought in history.

In the 20th century Europe was the main theatre of two horrific world wars, with the principal European landed power – Germany – the loser on both occasions. Although Germany made a good recovery from the Second World War before the main EU institutions had emerged, Germany's guilt and its desire for reinstatement as a leading nation have been the main driving forces behind European integration. But the citizens of Germany are not alone in wanting a European continent that is stable and peaceful. For example, the Baltic republics were for a few decades rubbed off the map of Europe after the Soviet Union invaded them in 1940 to carry out the secret protocol of the 1939 Molotov-Ribbentrop pact. They were small nations, but over 30,000 Latvians, 35,000 Lithuanians and 60,000 Estonians were summarily deported and often killed.

In much of Europe – and particularly in weak nations such as the Baltic republics – the stability and prosperity of the last few decades are attributed to the 'European construction', meaning the EEC from 1957 and the EU from 1993. Both Germany and the smaller nations, and to a degree all the member states of the EU, have been prepared to invest in the process of integration, and to overlook its flaws and costs. They see European integration as a stage-like and inevitable historical progress in which they must participate. But Europe's past is littered with the debris of utopian historicist doctrines. The overburdening of the European economy by excessive regulation is – in other words – another example of how the doctrine that 'the ends justify the means' is leading to a major disaster.[21]

The puzzle here is why the citizens of the UK, or at any rate so many influential members of its policy-making elite, feel that their country must be involved. Its own history and traditions are very different from those of the continental European nations; it has no need to apologize for its past, to invest in European integration or to feel particularly vulnerable to renewed geopolitical trauma in its neighbours. As it happens, the dysfunctional characteristics of EU integration, and especially of the attempt at economic and monetary union that pivots on the introduction of the single currency, have now themselves become a potential cause of tension and upheaval. **The UK has no need to suffer from the enormous burden of the 120,000 directives and regulations that constitute the *acquis*. We do not have to lose 4% or so of our GDP, with the toll rising over time, to participate in the great historical drama of 'ever closer union'. On the contrary, the move 'towards ever closer union' is a process to which the overwhelming majority of our citizens are opposed. The citizens of other European countries may be able to persuade themselves that a regulatory burden costing 4% or 5% of GDP is desirable and necessary for larger reasons of European 'destiny'. But most people in Britain are not interested in this destiny, whatever it was, is or may become. We should not allow a foreign bureaucracy to squander such a big chunk of our national output for a purpose that most of us in fact despise.**

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[1] Rodney Leach *Europe: a Concise Encyclopaedia* (London: Profile Books, 2nd edition, 1998), p. 20.
[2] Lord Denning, Introduction to *The European Court of Justice: Judges or Policy Makers?* (London: Bruges Group, 1990).
[3] The 84% figure was given in the newspaper *Welt am Sonntag* in January 2007 in an article by Hertzog.
[4] Civitas *EU Facts* (London: Civitas website, updated 27th July 2011).
[5] Open Europe Briefing 'Leaving the EU would raise more questions than answers', 12th June 2012.
[6] Sarah Gaskell and Mats Persson *Still Out of Control?: Measuring eleven years of EU regulation* (London: Open Europe, 2010), p. 5.
[7] Gaskell and Persson *Still Out of Control?*, p. 17.
[8] Gaskell and Persson *Still Out of Control?*, p. 17.
[9] Gaskell and Persson *Still Out of Control?*, p. 18.
[10] Danny Forston 'Chemicals cry for help', *The Sunday Times*, 6th February 2011. See also Christopher Booker 'This lady has made Britain power mad', *The Sunday Telegraph*, 22nd July 2012. The 22nd July Booker article said at one that 'according to the government's own figures' the Climate Change Act 'will cost us up to £18 billion every year until 2050'.
[11] David Campbell-Bannerman *The Ultimate Plan B: a positive vision of an independent Britain outside the European Union* (Cheltenham: The Freedom Association, 2011), p. 30.
[12] Own article in *The Spectator*
[13] Alex Barker 'Barnier vs. the Brits', *Financial Times*, 8th November 2011.
[14] The quotation is also from the Alex Barker article on Barnier in the *Financial Times* on 8th November 2011.
[15] Jack Grimston 'EU admits tax on bankers may cost 50,000 City jobs', *The Sunday Times*, 9th October 2011.
[16] The precise definition of 'the City' is difficult. Nowadays it is predominantly a provider of complex wholesale financial services to international customers, although the headquarters operations of UK-focussed organizations tend also to be located in London rather than other UK cities. I discussed the definitional issues in a Lombard Street Research report on *Growth Prospects of City Industries* for the Corporation of London, published in April 1998. The 'City' is usually said to employ between 350,000 and 500,000 people.
[17] Basis of calculation – Tim Congdon *The City of London under Threat: the EU and its attack on Britain's most successful industry* (London: Bruges Group, 2009).

[18] To recall, the concept under consideration is the payment made by the British government and private sector to EU institutions, and over which we have no subsequent control.

[19] On the cost of EU regulation for the UK water industry, see – for example – Christopher Booker 'Keeping us short of water is now government – and EU – policy', *The Sunday Telegraph*, 13th May 2012.

[20] Gunter Verheugen 'The EU has no vision of where we are heading' *Der Spiegel*, 9th February 2010.

[21] Isaiah Berlin