SPEECH TO THE BRUGES GROUP
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When asked to speak on how the institutions of the European Union are damaging the economy, my first thought was, where to start?

EU institutions have now embedded themselves into just about every aspect of economic life and the associated costs are clearly immense.

Recently we saw David Cameron congratulate himself for helping to restrain the rise in the EU Budget to 2.9%. But the direct running costs of the EU institutions to the UK – currently a net transfer of £8.3 billion a year according to the Treasury – while significant, are a drop in the ocean compared with the costs imposed on individuals and businesses by EU intervention in the market economy.

Of course, many of these costs are very difficult to quantify. They include enterprises that don't get off the ground in the first place; economic activities that develop in other parts of the world where the burden of government is lighter; and so on. We must therefore be guided by economic theory as much as empirical evidence when analysing the impact of the EU.

Yet there are clearly several very substantial costs that can be identified and it's worthwhile briefly running through these – to get a handle on the magnitude of the problem:

CAP and CFP

The negative impact of the Common Agricultural Policy is well known. Not only does it inflate food prices with a disproportionate effect on the poorest consumers; it has a terrible effect on many third world countries that would benefit from exporting agricultural products to EU countries. Perhaps if the CAP were abolished it would be more difficult to justify the Coalition's decision to waste billions more on foreign aid!

Britain has also done very badly out of the Common Fisheries Policy. With its large area of continental shelf, an independent UK would enjoy very substantial stocks – and it would be difficult to manage them more ineptly than the CFP.

However, the impact of the traditional bugbears of the CAP and CFP is increasingly being dwarfed by EU intervention in other sectors and there is only time to mention a handful of the most serious examples.

THE SINGLE MARKET

One is the so-called 'single market', though it certainly isn't a 'free-market'. The idea seemed promising, in the sense that barriers to trade would be removed. This should have created a more specialised division of labour and enabled greater economies of scale. Competition should also have been enhanced. The result should have been much higher output. However, in reality the single market served as an excuse to centralise power and impose burdensome regulations on business through the process of harmonisation. It is far from clear that the benefits from the single market have outweighed the resulting costs.

IMMIGRATION

One aspect of the development of the single market has been the free movement of people across the EU. In free-market economies this is likely to be beneficial as it can lower business costs and enable activity that without enough suitable workers would not be viable. In free societies, private property owners, including employers, are also free to exclude migrants they feel would be unsuitable, for whatever reason.

The situation is very different in modern welfare states where freedom of association has largely been prohibited. Over their lifetimes, low-skilled migrant workers from other parts of Europe may be a drain on the British economy if the benefits they produce and the taxes they pay are less than the welfare they receive. There is also a severe risk of benefit tourism, given the generosity of the UK system for families with children; and there is already evidence of this occurring.

ENVIRONMENTAL POLICY

Another massive risk facing Britain is EU environmental policy - which threatens to hinder severely the economic recovery. In particular, meeting EU climate change targets is likely to cost British business hundreds of billions of pounds over the next decade. Substantial capital investment will be required to construct wind farms and nuclear power stations and this will divert resources from the productive private sector. Worse still, one consequence will be significantly higher electricity prices – the effect on manufacturing industry could be particularly devastating. By raising energy and transport costs, EU policies also threaten to increase ‘fuel poverty’ and reduce the mobility of people on low incomes. This will put pressure on the government to increase welfare benefits and pensions, and raise taxes to pay for it.

This ‘triple whammy’ from EU environmental policies may have a grave impact on the public finances. George Osborne is relying on robust economic growth over the next few years to reduce the deficit, yet EU policies will have a significant negative effect on the wealth-creating private sector.

FINANCIAL REGULATION

A further potentially devastating area is financial regulation, which threatens to undermine the pre-eminent position of the City of London – widely envied in rival European financial centres. The IEA recently examined this issue in *Does Britain Need a Financial Regulator?,* which we published in August this year.

The study found that the EU agenda is, in practice, creating greater uniformity and a higher level of regulation. It is undermining competition between different forms of investment market that have different regulations. All methods of transacting investments, whether through an exchange or not, will be subject to the same framework of regulation. This will not only raise costs and undermine the discovery of new approaches to regulating markets; it will also prevent market innovation.

It is also worth noting that many particular EU financial regulations require a Financial Services Authority-style monopoly regulatory authority – in other words the kind of agency that proved so disastrous in the run up to the credit crunch.

THE EURO
The drive towards EU financial regulation may be partly connected to the Euro project, which represents a further threat to the UK economy. It is still unclear to what extent British taxpayers will end up bailing out Greece and the other PIGS. There is also the problem that many continental banks may be essentially bankrupt, although they have colluded with their governments to cover up many of the problems, while the European Central Bank has effectively bailed them out with cheap money. Clearly the results of these policies, whether Japan-style stagnation or high inflation, will have significant implications for the UK, particularly given the distorted trade patterns produced by membership of the EU.

ECONOMIC THEORY
So how can these damaging EU policies – and I could have mentioned many more – be explained?

On the theoretical side, the economic calculation argument developed by Austrian economists Ludwig von Mises and Friedrich von Hayek is especially relevant. And as Hayek explained in his 1945 paper, 'The Use of Knowledge in Society', free societies in which economic activities are coordinated by market prices are able to exploit the dispersed and subjective knowledge held by all the individual participants in the market.

This information is not available to central planners under various forms of socialism. And this knowledge problem also applies to bureaucrats attempting to regulate activity or set tax rates. They inevitably get it wrong and the result is the wholesale misallocation of resources.

In addition, public choice theory - the economic theory of politics - tells us that public officials tend to act in their own self interest. They seek to maximise their incomes and status by expanding their budgets and their influence over policy.

The theoretical lenses of Austrian economics and public choice theory provide powerful explanations for the damaging impact of EU institutions on the British economy. Yet they also apply to national governments.

It's important to remember that some of the most damaging government interventions are home-grown – the planning system, dating from 1947, is perhaps one of the worst. And it's naive to think that an independent Britain would suddenly become some sort of free-market paradise (though at least this outcome would actually be possible!). It is therefore necessary also to focus on the ideological and cultural issues that influence the extent to which political processes are favoured over markets.

CULTURAL DIFFERENCES

There is certainly a pronounced cultural difference in attitudes to free markets between the 'Anglo-Saxon' countries and the continent. The classical liberal tradition is very weak on the continent – where the dominant political ideologies have historically been far more authoritarian and/or totalitarian than in the UK – and the dominant modes of thinking within the institutions of the EU arguably reflect this.

As an aside, there were those in Britain who welcomed EU enlargement as a way of restraining its institutions; acting as a brake on centralisation and so on. But freedom is arguably even more of a stranger to the political culture of central and Eastern Europe. While there have been some promising developments in a couple of countries – notably Estonia and Slovakia, enlargement has also – according to some commentators - involved former communist judges and bureaucrats joining the EU institutions and bringing with them the socialist mindset. Arguably it has also meant the influence of the one country with a strong free-market tradition – Britain – has been diluted.

So what are the economic consequences for the UK of the anti-market, command and control culture of the continent, as exported by the institutions of the EU?

I would argue that one particularly pernicious aspect is that this culture has now infected Britain's own institutions as over the years they have implemented more and more EU directives. This became particularly apparent in the New Labour years, with the increasingly hostile attitude towards small businesses and the introduction of a huge number of new 'criminal' offences for failing to comply with the tidal wave of regulations.

RELATIVE DECLINE

These cultural and ideological issues should be placed in economic context.

The EU as a whole is suffering from rapid relative economic decline – and this applies to the UK as well – a rapidly declining share of global GDP and world trade.

Britain desperately needs to rediscover free markets if it is to thrive in an increasingly competitive world. A systematic programme of deregulation is required to cut business costs and turn the UK into a fertile environment for enterprise and innovation. Public spending – now accounting, on some measures, for 53% of the economy, must be cut back dramatically, together with the borrowing and taxation that funds it, if Britain is to become competitive in terms of its tax rates.

In the most competitive developed economies, public spending makes up around 30-35% of GDP, which is far, far lower than the UK figure. In China and Hong Kong, public spending may be somewhere in the region of 25% of GDP. Britain clearly has a long way to go - the recent Comprehensive Spending Review – if it goes to plan - will only cut public spending to the same proportion of the economy it was in 2007 – still way above 40% of GDP.

The problem is that as the socialist-dominated EU institutions play a larger and larger role in the government of the UK, it will become increasingly difficult for British politicians to undertake the much needed supply-side revolution to restore the country's economic dynamism.

We face a nightmare scenario in which a declining Britain finds herself trapped within institutions that offer little possibility of reform – and saddled with other countries which for demographic reasons alone, are likely to decline still more rapidly than the UK.

Free-market Europhiles – and there are one or two around – may hope that the EU institutions themselves can reform; that they can adopt economically liberal policies, reverse the tide of controls and restore the region's competitiveness. Indeed there are now some free-market think tanks in Brussels that hope to push them in that direction.

But recent developments do not augur well. The EU's response to one of the worst economic crises since World War 2 has not been to liberalise. Instead, it has used the crisis to justify further centralisation, intervention and control. And even in these very difficult times, there has been little apparent effort to boost recovery by cutting the costs imposed on businesses. The economically devastating environmental policies seem to be going ahead more or less as planned.

If the EU institutions haven't reformed now, under such extreme economic duress, then when, one might ask, are they going to reform?

Once again, the key problem is the political culture, and that seems highly unlikely to change quickly enough to address the region's long-term economic problems. Those that think the EU institutions can be adequately reformed for the better are surely discounting the inertia of long-held traditions and ways of thinking – as well as the powerful vested interests within the institutions that obtain benefits from further centralisation and control.

ONE SIZE FITS ALL

A further and arguably crucially important aspect to the economic effects of the EU is the attempt to harmonise conditions across the Union. In the context of rapid relative economic decline, countries need the opportunity to experiment with political structures and institutions that foster economic success. History is replete with examples of evolution and emulation leading to economic development. It can be contended that Western Europe's success during the 18th and 19th centuries – that great leap forward with no historical precedent – was aided by the region's division into small political units that could copy each other's success.

A good recent example is the success of small Asian countries such as Hong Kong, Singapore and Taiwan. They developed institutions and policies - including low taxes and light-touch regulation - that encouraged economic growth. This was, of course, noticed by the Communist Party in China, which began to emulate aspects of their policies in the late 1970s. When Gross Domestic Product is adjusted for differences in purchasing power, China is now the second largest economy in the world, and may overtake the United States within the next decade or so.

The EU institutions, by imposing a one-size fits all approach, clearly to a large extent undermine the process of evolution and emulation, which depends on a number of competing political units. It is also worth pointing out that the institutions and policies that foster economic success differ from culture to culture. For example, we have yet to observe a successful development model in sub-Saharan Africa. But even in Europe there are substantial cultural differences, for example between north and south, and west and east.

Of course, within the EU there is some flexibility when it comes to some aspects of economic policy. Countries such as Ireland and Estonia achieved very high growth rates in the years before the financial crisis. They achieved this through low tax policies and limited regulation (to the extent that they had domestic control over regulation).

However, the flexibility that allowed these countries to thrive within the EU is now under threat. The EU is using the debt crisis of Greece and the other PIGS to justify greater supranational control over fiscal policy. When it comes to both tax and regulation, member states’ room for manoeuvre is getting smaller and smaller.

CONCLUSION

In conclusion, it seems highly unlikely that the reforms needed for the UK to reverse its long relative economic decline can be implemented while the country remains part of the European Union. A radical programme that embraced free markets would run in direct opposition to the command and control mentality that dominates the EU’s institutions, and which reflects the vested interests of bureaucrats and politicians, as well as the deep-seated socialism of continental political culture. The economic damage done by the EU therefore goes far beyond the obvious costs of membership. Inside the EU, Britain’s economic future looks bleak.