£82BN REASONS THE EU HELD BACK THE UK

HOW THE EU IS A DRAG ON UK PROSPERITY

…and why we must seek a global future

by Ewen Stewart

GLOBAL BRITAIN

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About the publisher…

Global Britain

A cross-party and non-party research body, Global Britain was founded over twenty years ago to provide the positive business case for the UK to leave the European Union and has published a wealth of research briefs and papers to that end. Now that the argument for an outward-facing, sovereign, democratic UK has been won Global Britain is committed to ensuring that our politicians do not betray the 17.4 million Britons that voted for change, through the publication of further papers that show how Brexit can be delivered.

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FOREWORD

By Rt Hon Esther McVey MP

Brexit gives us a chance to become a modern, outward-looking, free-trading nation once again.

Whilst it will allow us to forge new partnerships around the world, we should of course remember that the EU is one of our closest trading partners. So we must do everything we can to move seamlessly to a new trading relationship with our friends and allies in Europe after we leave.

But we have all been guilty of placing far too much emphasis on our relationship with the EU's Single Market. As this report demonstrates, it has never been central to UK prosperity.

We run a surplus on our trade with America - our biggest national export market - without our two countries sharing a 'single market'. And yet we have a huge deficit on our trade with the EU and it now accounts for less than half of our overall trade. In fact, our goods exports to all the countries we trade with on World Trade Organisation terms have grown almost three times as fast as our trade with the original Single Market countries since it was formed in the 1990s.

Countries outside the EU will account for 90 per cent of global economic growth in the years ahead and Brexit will give us control over our trade policy so that we can adapt and engage with these global players. We will, at last, be able to look beyond the shores of the EU: to forge a free trade deal with countries like the US and to take up Japan's invitation to join the Trans Pacific Partnership. The Trans Pacific Partnership would link us to our Commonwealth partners and we would be the only non-Pacific country with preferential access to this huge market.

It gives me no joy to say that the EU is failing the citizens, businesses and countries of Europe. The EU institutions are so focused on their political vanity projects, such as the Euro, that they've forgotten why they were created in the first place: to look after the needs of the citizens and businesses of Europe.

The EU's share of the global economy has almost halved over the last thirty years and unemployment is rife. Levels of unemployment are five times higher than ours in Greece, almost four times higher in Spain, more than double in France and over 17 per cent in much of the south of Italy. More than one in every three young Italians and Spaniards find themselves without a job and youth unemployment stands at a devastating 44 per cent in Greece.

When we voted to leave the EU, we were choosing to leave the institutions of the European Union because they have been failing, and this report quantifies how much that EU failure has held the UK back.

This doesn't mean that we will be turning our backs on Europe. We will continue to trade with, protect and work closely with our friends in Europe but we shall do this as a sovereign nation, championing free trade around the world.

Unshackled from an organisation that is more concerned about super-state status than economic competence, there are no limits to what our country is capable of.

EXECUTIVE SUMMARY

- The EU is presented by the remain camp and many in the media as beyond criticism. Its advocates talk as if it is the very basis of British and European prosperity – a shining liberal beacon of co-operation against the dark adversarial and illiberal ‘winner takes all’ UK. The case they imply is that the EU is the primary enabler to the UK’s very prosperity. We think this analysis is little short of delusional.

- On the contrary in almost every aspect the EU performance has been dismal underperforming almost every corner of the globe – be it advanced or developing nations –for a very long period of time.

- EU-induced policy, primarily designed to hold the Euro together, has directly led to economic hardship, socially damaging levels of unemployment and a questioning of the very fabric of their societies – leading to a rise in more radical politics and often resulting in people leaving their countries of birth to seek better economic opportunity elsewhere.

- The failure of EU economic policy has not only impacted EU nations but also cost the UK £82bn in 2017 due to lost economic opportunity, as weak demand has negatively impacted UK exports to the Eurozone.

- In 1994 the economies of the US and the future Eurozone were of broadly similar size worth 24.9% and 24.5% of global GDP respectively. Today the US economy is 30% larger than the Eurozone. Simply put, EU economic performance has been the global laggard over the short and long term.

- Since the financial crisis the UK economy has outperformed all the major EU economies. Overall it has grown 19% over that period compared with a 13% rise in the Eurozone. That 6% differential is worth £120bn or just less than the entire NHS budget.

- The UK has materially outperformed the EU in both job creation and levels of unemployment. UK unemployment is at its lowest level since 1974. French unemployment is 2.5x the UK level, Spain 4x and Greece 5x higher.

- Since the EU referendum 750,000 more people are in work in the UK. This contrasts with HM Treasury forecast of 500,000 job losses following a Leave vote – meaning its prediction was 1.2 million out. Wage growth has started to pick up too and is growing in real terms.

- Job growth has been across the board and not just in the ‘gig economy.’ More people work in manufacturing, construction, utilities, IT, health, education and the arts sectors than before the referendum. Moreover the minimum wage is the second most generous in the EU.

- The underperformance of the Eurozone can be laid firmly at the EU's door. Fundamentally, the Eurozone is not an optimal currency area; it lacks fiscal transfers and is weakly controlled with no central Treasury. The structural weakness and disequilibrium of the Euro has led to suboptimal, firefighting policy choices to prop the currency up. The lack of political will and democratic accountability make it near impossible to rectify its flaws. These are structural issues that will not be easily rectified leading to continuing divergent performance, socially damaging unemployment levels in the south and a loss of competitiveness. The problem is the Euro's construction and there is no easy fix. Underperformance is baked in.

- Imbalances are growing, not reducing, be they employment levels, migration trends, fiscal strength, competitiveness and Target2 liabilities.

- EU monetary policy remains extreme. Ten year German bunds yield 10bp. Money is effectively free and such a policy is highly distortionary.

- The big myth remains that the Single Market is central to UK prosperity. It is not. Over the last 20 years UK trade has grown 12x with China, 3.1x with the rest of the world ex-EU, 2.6x with the US and just 2x with the EU. Moreover the UK trades with a modest surplus with the world ex-EU and a £96bn deficit with the EU. Does it not strike the reader odd that UK trade not only is growing faster where it trades generally under WTO rules than with the EU Single Market – and in surplus, not £96bn deficit?

- EU citizens are voting with their feet. An estimated 3.5million have moved to the UK over the last 20 years. Economic failure has directly led to widespread migration away from Italy, Spain, Portugal and most of Eastern Europe. People follow the opportunity and it has generally not be in the Eurozone. Net EU migration has remained positive to the UK since the EU referendum.

- The EU's problems are structural and not cyclical. They are largely self-inflicted. The Euro's structure is the root cause of the problem together with increasingly costly one-size-fits-all regulation that simply does not work for such a disparate Union. The price of preserving the Euro is likely to continue to lead to low growth and poor employment prospects. Italy, as an example, has a smaller economy than 15 years ago. Such dreadful performance is fuelling economic and political dissatisfaction across the EU.

- The question should be why can our policy makers not see that while we must remain friends with our European neighbours the EU project has failed Europe and the right and just thing for Britain is to re-emerge as a true global trading nation while helping European nations rediscover their own strategic advantage?

INTRODUCTION

While the debate concerning the UK's withdrawal from the European Union has been intense it also seems to us to have been very one dimensional, with Remain supporters in particular treating the EU if it was some form of enlightened deity.

The Remain camp has not looked closely enough as to what the EU is, how it is fractured, where it is going and how it is performing. The reality is of a dysfunctional bloc held up by an untested monetary policy yet still lagging behind global growth. It suffers from growing imbalances and very high levels of unemployment, with many member states experiencing outward migration – all as a direct result of suboptimal policy.

The EU is presented, by those seeking to reverse the UK decision to leave, as beyond criticism. Its advocates talk as if it is the very basis of British and European prosperity. A shining liberal beacon of co-operation against especially the dark adversarial and illiberal 'winner takes all' UK.

The Remain camp initially presented the case that if the UK voted Leave the wheels would fall off (e.g. suggesting an immediate 5% fall in GDP and 500,000 jobs lost – HM Treasury March 2016). Now this has morphed into an even more alarmist prediction following a 'no deal' departure (Bank of England on Nov 18 suggesting GDP fall of 8% and unemployment nearly doubling, rising from 4% to 7.5%) The clear implication is, for the UK, that only the EU institutions enable trade, medical supplies and even aeroplanes to fly. The case therefore is the EU is the primary enabler of the UK's very prosperity.

We think such analysis is little short of delusional.

In the maelstrom following the referendum the Remain camp has sought to liken the EU to an enlightened, cultured and economically successful bloc which must be defended against the barbaric hoards who know not what they do.

Considering the readily available evidence we find this thesis extraordinary and this paper, rather than focussing on the domestic political situation, seeks to provide an up-to-date examination of the European Union. Is it really the highest form of co-operation and economic prosperity that man has ever known, as the current Archbishop of Canterbury once claimed?

This paper, uses only official data points, primarily the UK ONS, and the EU statistical agency, Eurostat data. Their official data shows on almost every matrix that the EU performance has been dismally underperforming against almost every corner of the globe – be it advanced or developing nations – for a very long period of time.

Moreover, for some member states EU-induced policy, primarily designed to hold the Euro together, has led directly to economic hardship, socially damaging levels of unemployment and a questioning of the very fabric of their societies – delivering a rise in more radical politics and often resulting in people leaving their countries of birth to seek better economic opportunity elsewhere.

We believe, as the UK political establishment introspects, that a more balanced view of the EU's performance is required. The EU, far from being the enabler of British prosperity, has caused genuine economic hardship in large parts of the European continent directly through policy induced by the inflexible Euro.

Moreover, the underperformance of the Eurozone has held the UK's own performance back and thus been a drag on UK prosperity. There has been a negative impact on UK GDP growth through lower export growth to the EU as a direct result of weak internal EU demand. We estimate EU policies resulting in low growth, particularly those relating to the stabilisation of the Euro, cost British business £82bn in lost export opportunity in 2017 alone, compared with 20 years ago.

We hope this paper goes some way to better informing public debate by offering a better understanding of the strengths and weaknesses of the European Union's economic and political fabric.

THE EU'S RELATIVE ECONOMIC DECLINE

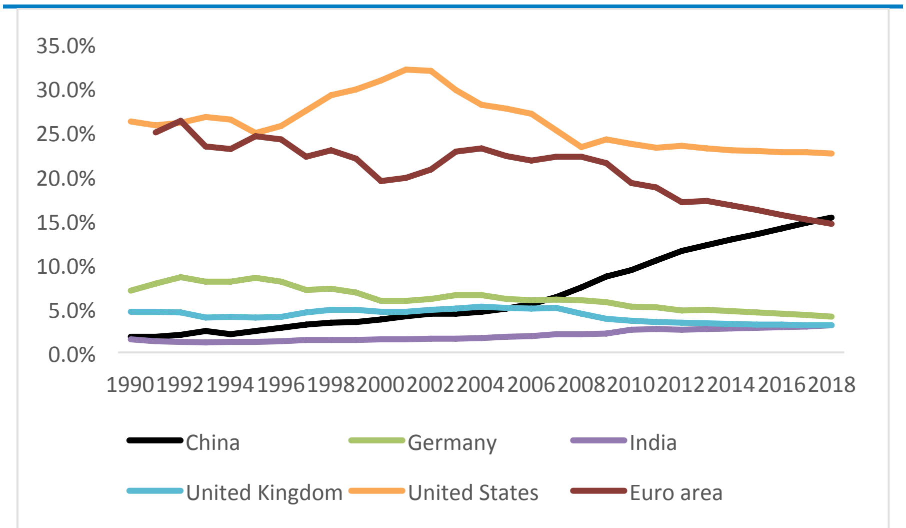
The world is undoubtedly changing. According to the World Bank, as recently as 1996 the major Western advanced economies including Japan accounted for just over 80% of global GDP. China could be virtually ignored, worth a mere 2.8% of global GDP. Today the global share of those key nations has fallen to 58%. **Nowhere has the decline been greater than in the European Union.**

Today, China's share of global GDP is 16.1%, marginally greater in size than the Eurozone. That rapid Chinese expansion is unprecedented in modern history and is subsequently remodelling global relationships.

What is perhaps more interesting however is that while 'catch up' can be expected, as developing economies advance from a low base, not all developed economies have declined equally. **The EU's poor performance is the outlier – not the norm.**

The chart below highlights global GDP share by region or nation since 1990. Intriguingly during the 1990's the Eurozone and US economies were of broadly similar size. For example in 1994 the US economy accounted for 24.9% global GDP, compared with the Eurozone's 24.5%. Today the US economy is some 30% larger having broadly held its global share at 22% of global GDP, while the Eurozone share has declined to 15.1%. The US experience shows advanced economies can perform strongly, that decline is not inevitable and more the product of poor policy choices.

Share of Global GDP %



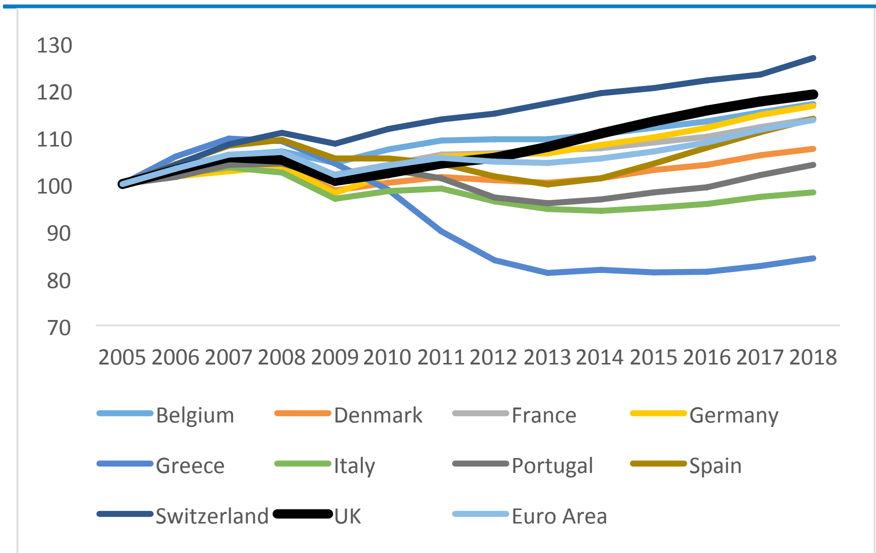
Source IMF

Failing growth, employment and opportunities

The last decade has been a difficult period for the global economy, still feeling the aftershocks of the global financial crisis. Almost all developed nations have seen lower average growth rates compared with the decade before.

However, as can be seen from the chart below, examining the economic performance of the key European nations reveals GDP performance has varied markedly by country. Britain has grown consistently since 2009, albeit at a modest rate. Nevertheless, in contrast to the Eurozone, British performance has been highly positive. Only Switzerland, which of course is not in the EU itself, has performed better.

Selected European GDP Growth Index 2008=100



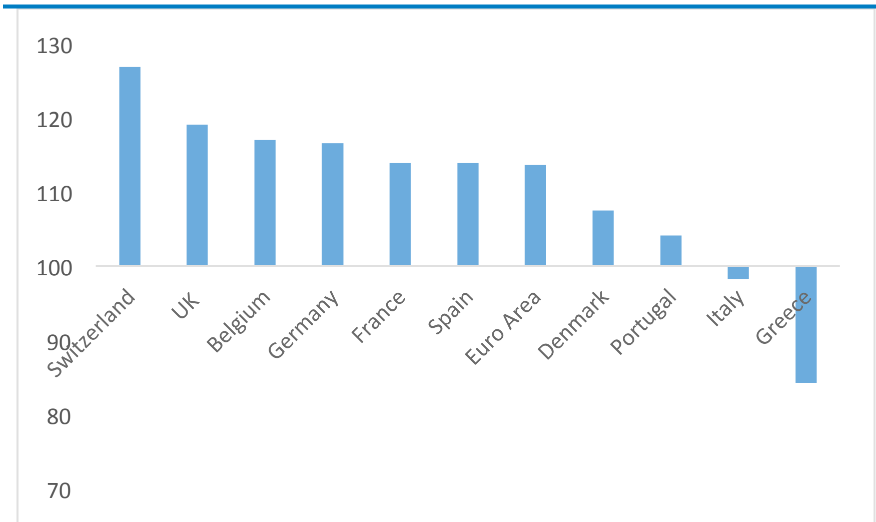
Source Eurostat

Compared with 2005 the UK economy has grown by 19%. This compares with the Eurozone 13% expansion over the same period. A 6% differential may not sound much but it is equivalent to, for the UK, of £120bn of additional growth, or almost as much as the UK's entire NHS budget.

By contrast the Greek economy is a staggering 16% smaller than in 2004 while Italy has failed to grow over the last 14 years. Portugal too has also suffered a near lost generation. Such a poor performance is unprecedented for developed countries in the post war period and has led to significant migration away, economic hardship and a rise in potentially more radical politics.

The chart below shows key European GDP performance since 2005.

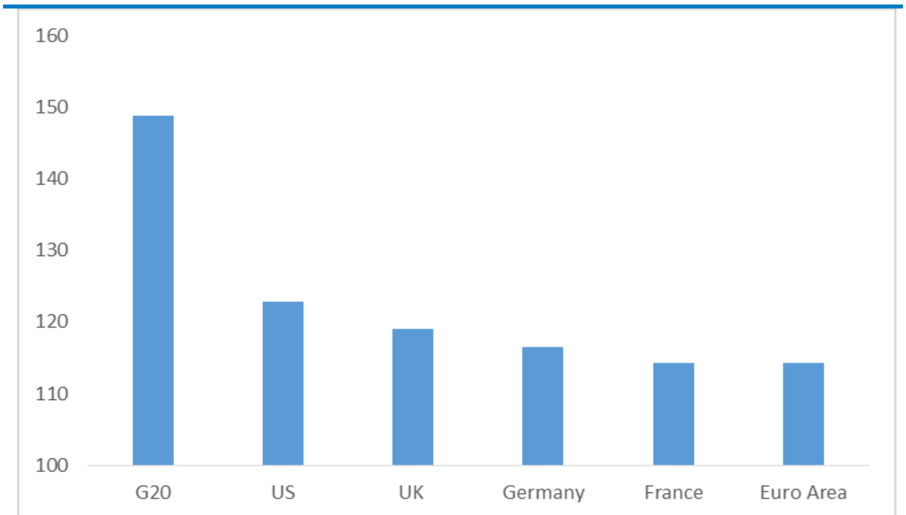
Selected European GDP Growth 2018 compared with 2005 Index 2008=100



Source Eurostat

Looking at the bigger picture Eurozone GDP performance has been lacklustre at best, underperforming the G20 by an extraordinary 30% since 2005 and lagging both the US and UK materially as demonstrated below. EU leaders need to ask, why is this so? We shall explain later that much of the blame lies firmly at their own door with the ill-thought out Euro being the primary destabilising factor, but also increasing EU regulation, inefficient 'one-size-fits-all' policy, over a disparate union that is economically and politically pulling in different directions. Such divergent levels of economic development across the EU make a harmonised response inefficient, to say the least.

Key global GDP Growth 2018 compared with 2005 Index 2008=100

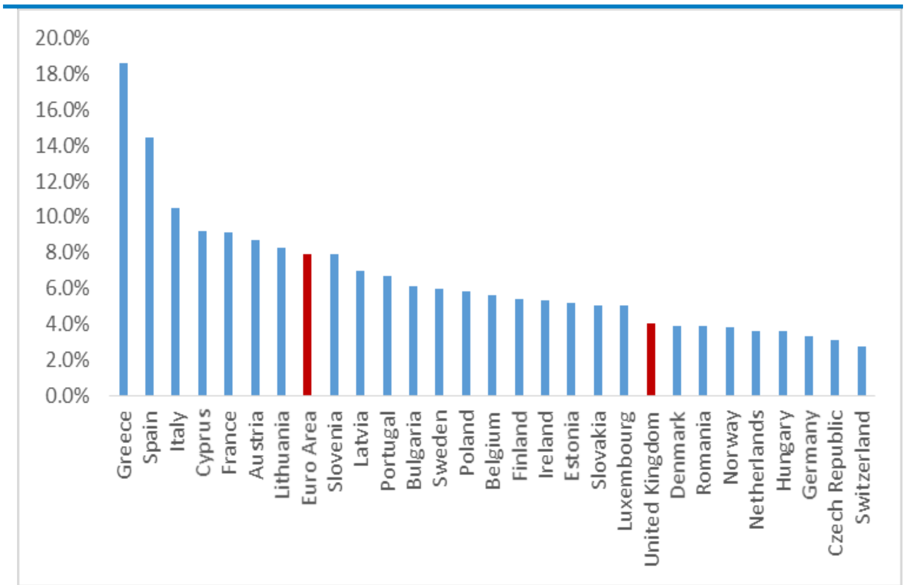


Source Eurostat

The social impact of this economic underperformance has been extremely stark and has been the major factor behind a highly damaging level of unemployment in the Eurozone, particularly amongst the southern European nations.

The Eurozone unemployment rate is approximately double the UK unemployment rate, with French unemployment some 2.5x higher, Spanish unemployment nearly 4x higher and Greek unemployment 5x higher. The figures for youth unemployment are unconscionably far worse.

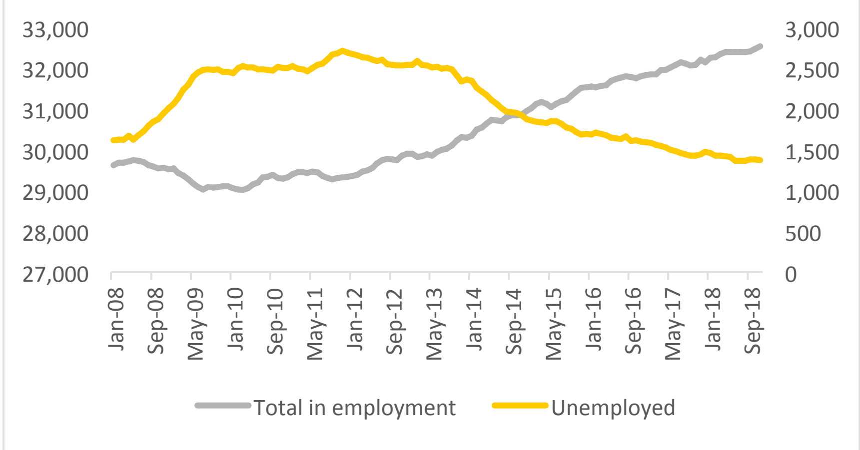
European Nation Unemployment % workforce 2018



Source Eurostat

The very poor employment record of the Eurozone is in marked contrast to the UK's performance, where job creation has been extraordinary. It should be recalled that HM Treasury forecast a 500,000 immediate rise in unemployment if the UK voted to leave the EU. As can be seen from the chart below the reality has been that unemployment has continued to fall, to the lowest recorded since the mid 1970's while the total in employment has never been higher at 32.5m – some 750,000 more than on the eve of the EU referendum. Current Uk employment figures mean the HM Treasury's forecasts have proven to be a staggering 1.25million people out.

UK – total employment and unemployment (thousands) total in employment RHS, unemployed LHS

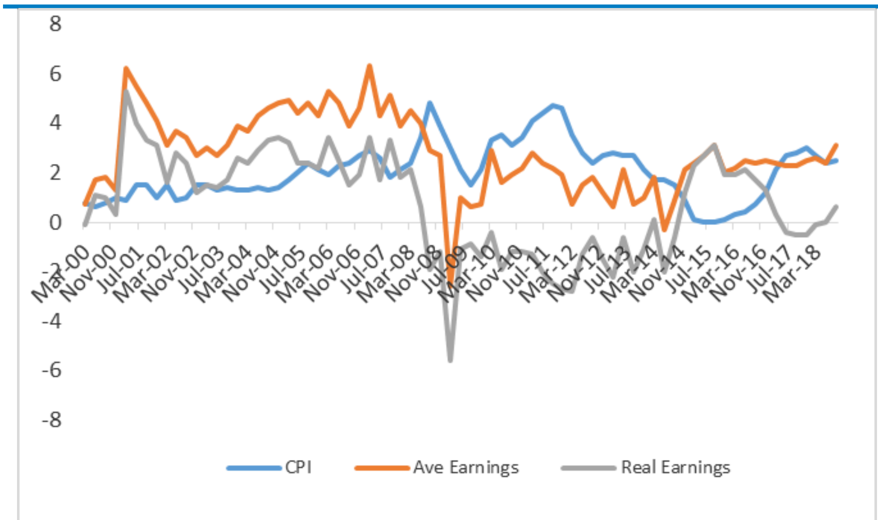


Source ONS

Moreover UK employment growth has been achieved across a very wide number of sectors, and not just in the so-called 'gig' economy. Total employment has grown in manufacturing, construction, utilities, IT, health, education and arts sectors since the EU referendum. Over that time period employment has been flat in financial services and only agriculture and retail trades have seen small overall declines.

Since the financial crisis, wage growth for the UK has been weak. Here too. However, there are positive signs, as is demonstrated by the chart below, with real wage growth picking up materially over the last 12 months and back in positive territory.

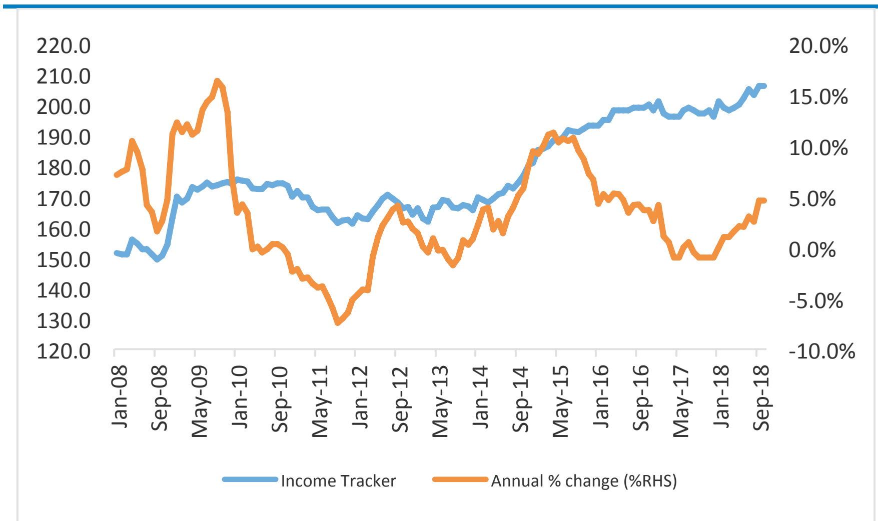
UK Real Earnings Growth



Source ONS

The ONS real wage data is also backed up by the Asda Income tracker, which monitors average disposal income. The latter's series, illustrated below, also highlights just how robust the UK consumer has been, in contrast to numerous warnings from Government agencies.

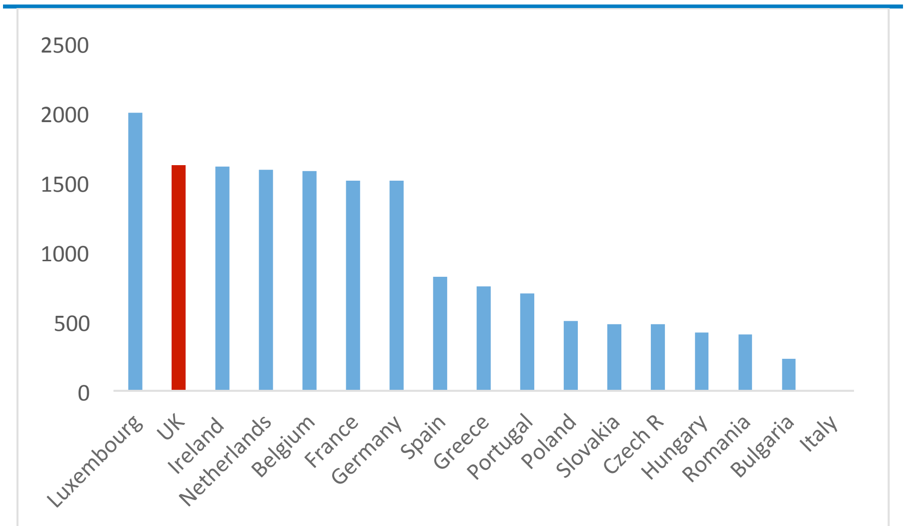
Asda Income Tracker



Source Asda Plc

Moreover, if we contrast varying national levels of minimum wage the UK is currently second only to Luxembourg in terms of minimum wage level, with a UK rate of £8.21 an hour from April 2019, equivalent to €1622 per month for a 40 hour week. UK wages remain highly attractive in a EU context and are a major pull factor in attracting EU migrants.

Minimum Wage by EU nation € per month



Source Eurostat and Walbrook Economics

THE EURO – THE CATALYST FOR UNDERPERFORMANCE

The Euro was launched with much fanfare. The UK was to be in ‘the slow lane’ being ‘left out’ as some put it. However, many, including this author, warned that to merge national currencies into one bloc risked building and exacerbating imbalances while withdrawing the major stabilising influence of currency value adjustment as the lever to regain competitiveness. Unfortunately our concerns have come to pass as Europe’s economies are not unified and if anything have diverged further as a direct result of the Euro.

The economic, political and cultural differences across the bloc are enormous, but can be seen as an advantage. Variation from language, different legal systems, wage levels, economic development and attitudes to saving; differing maturity of capital markets and industry structure, retirement age and social protection – to name but a few – are what has made Europe such an attractive continent. It was that very competition of ideas and differing attitudes that has often spurred development. It is clear Berlin is as different to Bucharest as Brussels is from Brindisi.

To thus meld such a disparate group together was at best naïve and at worst a deliberate act, regardless of consequence, to forge a European state. The founders must have been aware that the currency could only survive, in the long term, with much greater economic convergence, coordination and quite probably EU sovereign bonds together with much larger fiscal transfers[1].

The Euro was the anvil to that end and now its members are faced with remaining in a divergent sub-optimal group in semi-disequilibrium, accepting ‘ever closer union’ – or leaving, which for a Eurozone member is fraught with short-term difficulty.

Today’s EU is armed with a very powerful central bank and a legal structure that is supreme. What it lacks however, which is critical to any true nation state, is a centralised Treasury and demos. The UK, for example, has a central Treasury, unified legal structure and shared economic and cultural experience over many hundreds of years with a highly developed political, military and diplomatic reach that provides its demos.

Put simply, in the UK one pays ones taxes to a central exchequer and the money can be and is distributed throughout the kingdom. London may subsidise Newcastle and Newcastle may subsidise rural Northumberland. There may be mumbling and groaning but the system is broadly accepted. Moreover, as the UK has been unified over the centuries it has developed what is close to an optimal currency area.

No such system is even close to existing in the EU. The Eurozone most certainly is not an optimal currency area for the reasons of economic, linguistic and cultural difference described. Critically however it has no central Treasury. Taxes paid in Bologna, if they go anywhere, go to Rome not Brussels. Indeed within the EU there are 28 separate Treasury’s with just 1% of EU GDP paid to the centre and half of that goes on agricultural subsidy.

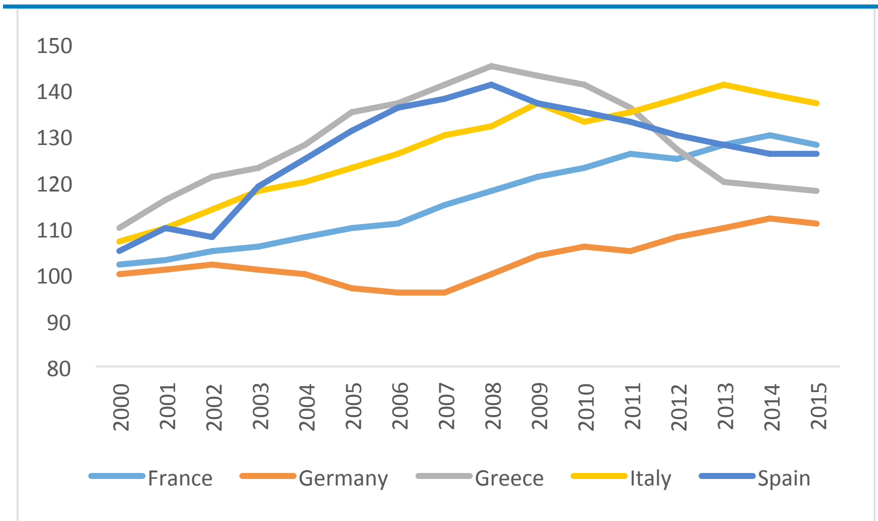
[1] Indeed, Guy Verhofstadt makes regular claims about how “more Europe” is needed to solve the EU’s problems.

In theory the EU's currency is backed by the European Central Bank, and as with all central banks the ECB has unlimited firepower – but it suffers from very weak political will and virtually no fiscal power to transfer treasure, or issue bonds, across the Union. The lack of a central treasury, or the ability to create EU bonds, is a primary factor behind its instability.

Further, and this is well documented – swapping national currencies for a central one withdraws the principal safety valve – that of currency devaluation. Historically, for example, Italian Lira weakness, against the Deutsche Mark, offered a safety net. The chart below, looking at unit labour costs, for selected EU countries demonstrates the problem clearly. The unit labour cost differential between Italy and German, for example, is over 20%. Little wonder Italy finds it hard to compete.

Historically, devaluation of the Lira would have offset that imbalance. Today no such opportunity exists. Thus the only way Italy can now compete with Germany is through either a wholesale improvement in productivity, which over short periods is very difficult to achieve, or a brutal downward re-adjustment of wages and prices. That is unfortunately what has happened in much of the Eurozone already, little wonder the Italian economy has barely grown in a decade.

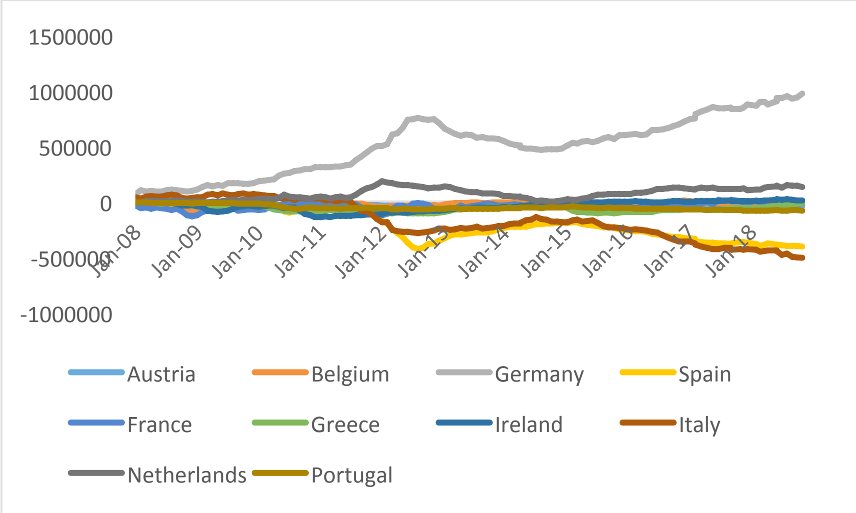
Unit Labour Costs



Source OECD

Moreover, as is demonstrated by the chart below, the imbalances are growing. Target2 effectively highlights with clarity the balance of payments crisis within the Eurozone with Germany, in particular, funding the 'southern Europeans,' currently to almost €1tn Euro's.

Key Eurozone Nation Target2 Liabilities €m



Source ECB

We have not argued the Euro will break. Political will to maintain its existence remains extremely strong and central bank action, with strongly negative real interest rates, and ECB effectively buying, for example, Italian bank debt with its own credit may be unstable, but in extremis the firepower is theoretically unlimited. The price however over this structural weakness and lack of demos is political incohesion and that is visible politically in many European counties such as Italy and Greece in particular, but also through protests and strong gains for 'the populists' in France, Netherlands, Germany, Spain, Poland and Hungary in particular.

The Euro will probably survive so long as mainstream parties control Brussels, which remains overwhelmingly likely in the short and medium term, but the inevitable price for that survival is further federalisation, continuing monetary experimentation, asymmetric and weak growth – and migration away from the south. That is not a recipe for contented government and it seems extraordinary to us that as Italy has lost a generation, Greece has literally become a weak client state and now Germany, despite the cost of borrowing being close to zero, flirts with recession again. Quite why so many in the remain camp should wish to be so associated with this clear and obvious failure is a mystery.

Is such an unstable, suboptimal and weak structure something the UK should really be wishing to tie its future to? If that were how the Common Market had looked in 1972 we surely would not have wanted to join.

Monetary Policy – extreme response fails to revive the patient

All major central banks, since the financial crisis, have adopted non-conventional monetary measures. Base rates collapsed to near zero and asset purchase (Quantative Easing) were adopted by the Fed, Bank of England, Bank of Japan, ECB and others. The policy response adopted by the Eurozone was and remains, however, the most extreme of the developed Western economies by far. Effectively Eurozone base rates are negative 40bp or 115bp lower than the UK and almost 3% lower than the US.

10-year German sovereigns yield 0.1%, a paltry return indeed and effectively making the price of long-term money near free. A moment's thought should easily explain why this is such a novel and potentially toxic policy. Current base rates and sovereign bond yields are outlined below.

Base rates and yields on 2, 5 &10 year Sovereign debt %

	Base rate	Bond Market (yields %)		
	%	2 yr	5 yr	10 yr
Australia	3.00	1.81	1.97	2.28
US	2.50	2.49	2.50	2.66
Hong Kong	2.15	1.61	1.66	1.85
Canada	1.17	1.86	1.88	1.96
UK	0.75	0.68	0.83	1.20
Japan	0.07	-0.15	-0.16	-0.01
Sweden	-0.15	-0.42	-0.08	0.40
Greece	-0.40			4.34
Italy	-0.40	0.43	1.76	2.72
Singapore	-0.40	1.85	1.88	2.02
Portugal	-0.40	-0.38	0.43	1.70
Spain	-0.40	-0.24	0.32	1.40
Ireland	-0.40		-0.14	0.85
Belgium	-0.40	-0.59	-0.07	0.71
France	-0.40	-0.50	-0.01	0.65
Netherlands	-0.40	-0.73	-0.33	0.32
Germany	-0.40	-0.64	-0.38	0.10

Source Trading Economics

While it is fair to say the Bank of England also adopted an historically unprecedented policy, as the UK has recovered so this has gradually been unwound. 10 years after the financial crisis, for German bunds to still yield a mere 10bp for 10 year money is a sign of extreme weakness and central bank concern.

Despite effectively making the long term return of holding cash near zero this has not materially stimulated EU economies. If anything it has distorted asset prices and increased imbalances across the Union creating inefficient asset allocation, very poor employment growth prospects and low growth. Quite how the EU normalises monetary policy remains to be seen, but the danger remains in order to float questionable Southern European assets monetary policy is inappropriate throughout the Eurozone.

What can be said is that that both at the short and longer end of the yield curve monetary policy is at a 300 year extreme. Never before have German Bunds yielded so little, effectively pricing long term money as free.

TRADE – BUSINESS FOLLOWS THE MONEY NOT THE TRADE DEAL

There is a persistent fallacy that regulators and states create the environment for trade. While it is true poor policy choices and trade wars can indeed stifle trade the reality is we live in an increasingly low tariff free trading environment globally. The EU trades with all nations, ***trade deal or no trade deal***, outside the tiny number of extreme cases under sanction like Syria or North Korea.

Of course there is the odd spat (such as the 2005 "bra wars" with China[2]) but by and large global trade flows freely with increasing mutual regulatory recognition. Thus, while policy makers write pages on the alleged billions of benefit derived from government-to-government trade deals the harsh reality is it remains the case the surest way to sell a good, or a service, is to provide something someone wants at the right price.

This may seem pretty basic, because it is. Listen however to the policy makers and regulators and they would have you believe it is the trade deal that did it. Yes, low barriers (tariff and regulatory) are important but it is far more about innovation, productivity, marketing, trust, the rule of law, and the like, that leads to a successful transaction. This may sound somewhat 'folksy' but as we shall demonstrate below it is backed up by the actual trade results that the UK has achieved over the last 20 years.

Today, Britain has a trade agreement with the EU. That is a statement of the obvious as the UK remains, for the next six weeks at the very least, a full member of the EU. Thus the UK currently is a full member of the Single Market, which means full regulatory alignment with EU standards and rules – and fully immersed in the EU's Customs Union, which means no tariffs in goods.

It is argued that that full regulatory alignment is such an advantage that it must be preserved at all costs. This is the economic basis of the claim that the UK needs to be fully aligned post BREXIT. It is a beguiling argument but it holds very little water in reality.

Membership of economic blocs superficially provides access to a 'big' market. The unfortunate reality is this access, over the last 20 years, for the UK, has not proven to be a motor for UK export growth. Quite the contrary.

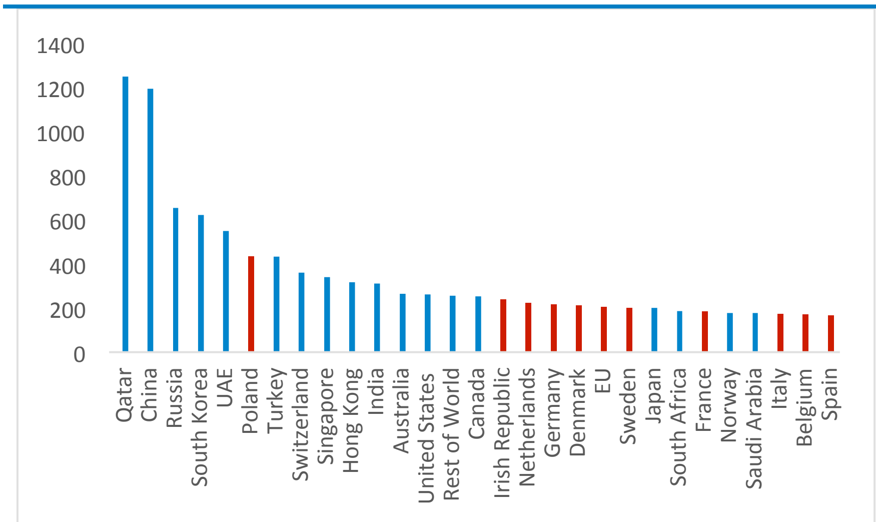
As is demonstrated from the chart below, membership of the Single Market has not led to a boom in UK-EU trade. Quite the opposite. Looking at the UK's 30 largest trading partners over the last 20 years, EU nation trade growth with the UK has materially underperformed against UK trade with almost all other key nations.

The US, China, Russia, Australia, Hong Kong and Singapore, all countries where the EU has failed to sign trade deals, all have seen far greater trade growth with the UK than the so-called home market of the EU. Indeed looking at the UK's most significant trading partners below the UK trades under WTO terms very effectively with China, Russia, UAE, Hong Kong,

[2] https://www.telegraph.co.uk/news/1497669/Bra-wars-truce-declared-as-EU-and-China-agree-trade-deal.html

USA and Australia. In each case the WTO arrangement has provided stronger export growth than with the EU, over the last 20 years.

Growth in UK exports of UK largest trading partners Indexed 1999=100

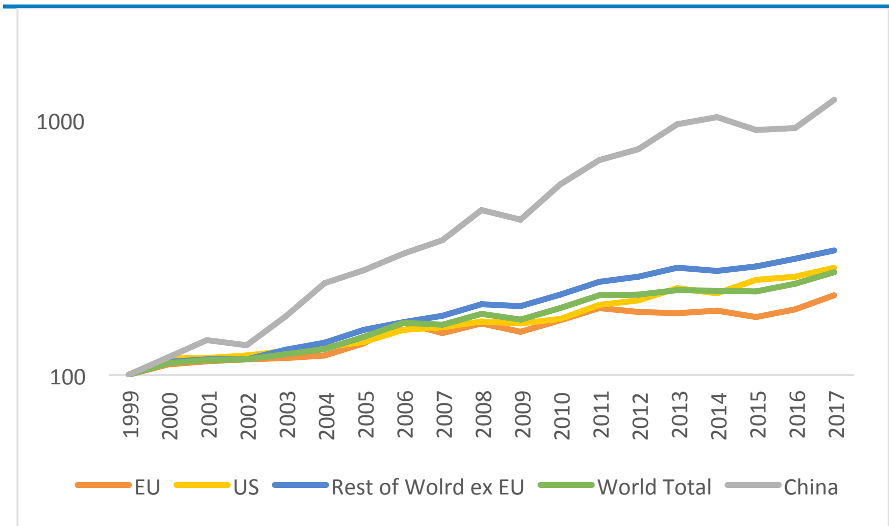


Source Pink Book 2017

Moreover, looking at UK trade with every nation, the chart below demonstrates that trade with the EU has underperformed ***all other regions*** over the last 20 years. It is thus a fallacy to believe that it is critical to be in the Single Market to either trade or enjoy growth in trade. The truth is any country can trade with any other nation so long as they comply with local regulations. The UK has been highly adept at doing that, hence the material growth in trade where it has no formal trade deal in stark contrast to the lacklustre performance where she does have a deal.

Over 20 years trade with China is up almost 12x; with the rest of the World ex-EU it is up 3.1x, with the US it is up 2.6x, globally it is up 2.5x – but has only doubled (2x) with the EU.

Growth in UK export markets indexed 1999=100 (logarithmic scale)



Source ONS

WHY IS EU TRADE GROWTH SO WEAK?

The real reason the UK's growth in trade with the rest of the world was been so much better than the EU is that the EU economy has stagnated with largely self-inflicted economic policies designed to prop up the ailing Euro which have directly created economic disequilibrium, weak demand and low growth. Other countries have performed economically much more strongly hence subsequent trading opportunities for the UK have been better.

Ultimately, while the EU introspects and misfires with policy responses designed to prop up the sub-optimal Euro it is highly unlikely EU growth will exceed global growth. The Euro, without near full federation, for which there is little public will amongst the peoples of Europe, will simply stumble from one crisis to the next with remaining substantial imbalances. The ECB can probably keep the show on the road with unprecedented monetary action – but with disequilibrium and poor outcomes. Underperformance is baked in. Current economic projections generally expect this outcome to continue.

This underperformance has been extremely damaging to both the EU and UK. For the EU, accelerated decline, mass unemployment and enforced austerity within the straightjacket of the single currency have come at a huge social cost.

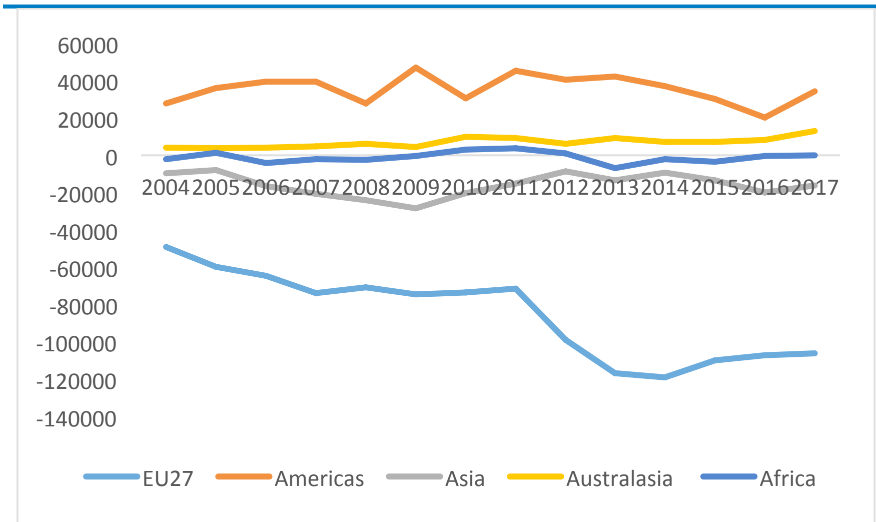
For the UK the cost has been more in lost export opportunity. The UK's poor trading performance with the Eurozone has not been for the want of trying, it has been because the Eurozone is in relative decline and experiencing lack of demand.

The sheer scale of the lost opportunity that the EU's economic failure has cost the UK can be gauged by comparing the trade the UK enjoys with the EU now with what it could have been if the Eurozone economy had grown at the same rate as the US over the last twenty years. We estimate UK-EU trade would have been around £355bn last year – not the £274bn it achieved[3]. In other words the EU's economic failure over the last twenty years cost the UK £82bn in lost exports in 2017, or around 3.5% lost GDP each and every year. Far from being the catalyst for UK prosperity the EU has been a dragweight.

This lost EU demand is a major factor behind the UK's massive £96bn trade deficit with the EU. It largely explains why the UK trades at a small surplus with the world, ex EU, but performs so disastrously with the EU. The UK consumer has continued to prosper and has continued to buy BMW's and drink French wine. Unfortunately demand for UK products in the EU has been weak as the EU economy has stalled. EU consumers simply have had a much tougher time than British ones.

[3] The maths – UK exports to US in 1999 of £42bn growing to £112bn in 2017 = x 2.67. UK exports to EU in 1999 of £133bn growing to £274 in 2017 = x2.06. Had £133bn exports to EU grown at the same rate as the US i.e. x 2.67 it would have been £355bn.

UK Current Account trade balance by region £bn



Source Pink Book 2018

POPULATION TRENDS – EUROZONE CITIZENS GET ON THEIR BIKE

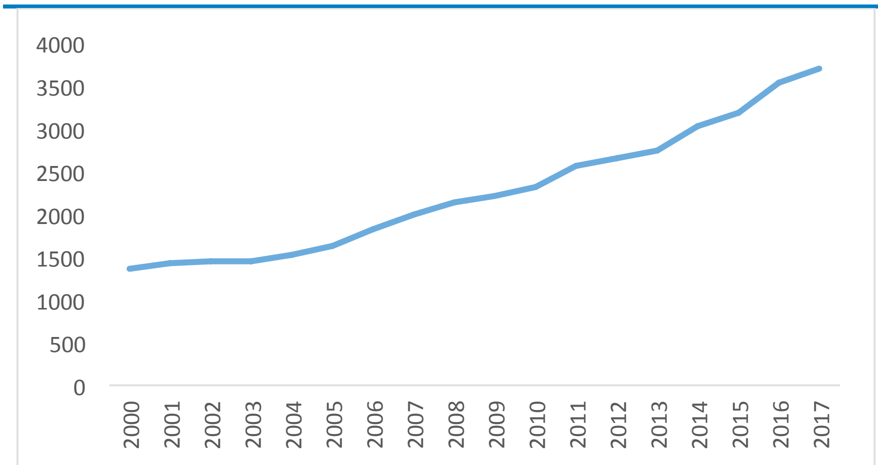
Global Britain does not take a position on whether migration is a net positive, or negative, for the UK. While we have published a number of papers that have considered the issue our corporate view is that it should be a question for the British electorate to be decided through the UK parliament. It is, however, beyond doubt that the UK has become one of the primary locations for intra EU migration.

There are numerous reasons for this, from the opportunities presented by the English language to a relatively open and welcoming social environment, to strong employment creation, to fairly high wages and to opportunity. There are also negative reasons, from the migrants' perspective for leaving their home countries. The most prominent of these is lack of opportunity at home. With unemployment rates in the teens in numerous EU countries, minimum wages often significantly less than half the UK, and a lack of opportunity, many have been compelled to leave the country of their birth.

It is a tragedy that large parts of the EU are failing to generate sufficient wealth to support the next generation and while there are a number of factors behind this failure we believe the rigidity of the Euro and loss of the devaluation safety valve have been the primary cause of this failure. Given these factors the UK has been a prime attraction for European citizens relocating.

Moreover, BREXIT has not altered this trend, with a positive flow continuing, as is demonstrated below.

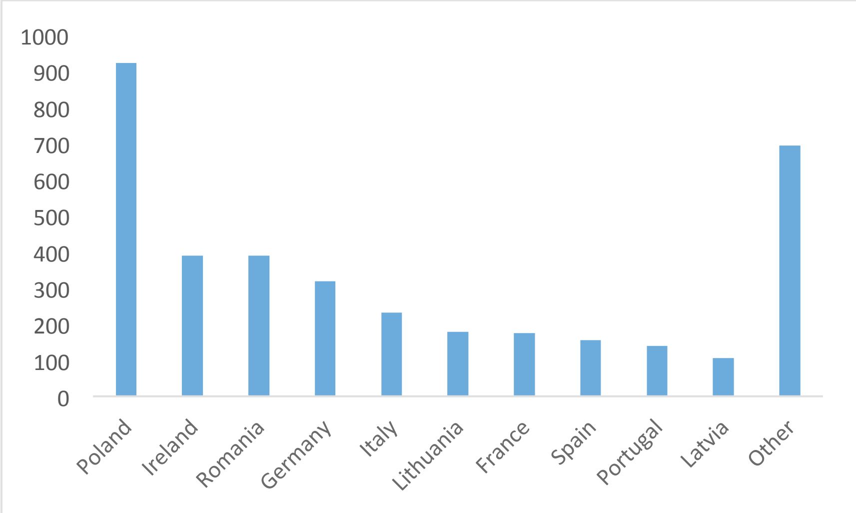
EU population resident in UK (thousands)



Source ONS & Oxford Migration Observatory

The numbers of migrants from the key EU countries are outlined below.

Country of birth of EU migrants in UK (thousand)



Source ONS & Oxford Migration Observatory

One of the largest factors for migration would appear to be economic failure in large parts of southern Europe, while relative opportunity in the UK compared with Eastern Europe has encouraged many millions to move to a non-Eurozone member on the geographic periphery of the EU.

Ultimately those arguing the EU is a land of milk and honey need to address why so many EU citizens choose the UK as their home? Might it be a question of relative success?

CONCLUSION: IS THERE LIGHT AT THE END OF THE EU TUNNEL?

We have demonstrated that the EU economies remain highly divergent and if anything are still diverging in terms of GDP growth, employment prospects, Target2 liabilities, labour costs and economic opportunity. On any measure be it employment creation, GDP growth, monetary normalisation, political demos, fiscal transfers and migration the UK has materially out-performed the EU over the short and longer term.

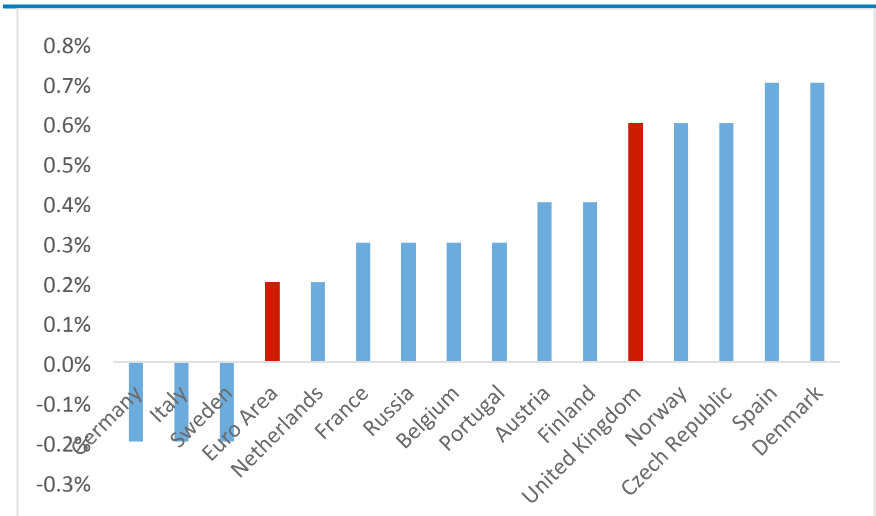
While this paper has not discussed the consequences of regulation on growth, which we view as a significant drag, what is clear is the common factor behind EU under-performance has been the Euro – the single currency.

The Eurozone has a powerful central bank and regulatory muscle but is weakly constituted as it lacks sufficient fiscal transfers or central treasury. Most critically the one-size-fits-all monetary policy, largely designed to re-float the southern economies, is far from an optimal currency area. Worse, the inability to devalue takes away the critical adjustment mechanism for those uncompetitive economies. This leaves wage deflation as the only effective route out for many EU nations, which has led to severe social consequences.

Ten years after the financial crisis the US has materially recovered. The UK too has grown satisfactorily even while major challenges remain, largely relating to controlling the public finances given a weakened fiscal position.

Unfortunately, despite strongly negative real interest rates, 10 year bunds[4] yielding a paltry 10bp and ECB support for questionable Italian and Spanish banking debt, the Eurozone continues to flirt with recession. Last quarter both Germany and Italy recorded, GDP of -0.2%, as indicated by the chart below.

Last Quarter GDP Growth %



Source Trading Economics

[4] German ten year bunds as priced on 19 February 2019

The problem is structural not cyclical. While the process of underperformance is likely to continue to be gradual we can see little way out for the Eurozone. Our belief is that with political will the Eurozone will survive, but quite how the Eurozone is transformed into a competitive optimal currency area is not obvious. The Euro's flaws almost certainly ensure continuing social pain without very major reform, for which there is little support.

There is no demos to create the fiscal transfers and central Treasury that a nation requires. Popular demand for such an outcome is negligible. For Italy and Portugal to regain competitiveness, when the safety valve of devaluation is removed will require a very long period of time and come with a large political and social cost. Italy's economy is smaller today than 14 years ago. Will, for example, Italians put up with another 14 years of negligible growth and their banking sector on life support?

How can the escalating scale of Target2 imbalances be normalised? Can Germany really continue to finance the Eurozone? For Britain the opportunity is different. She did not join the Euro and the people voted to leave the EU all together. As a result, with political will, exiting the EU should have been and could still be relatively straightforward.

But the broader question is why so many British policymakers have been blind to the huge underperformance of the Eurozone and its growing imbalances and social pain. While the UK introspects over the imagined cost of "*no deal*" perhaps a greater understanding of the risks of remaining in such a dysfunctional EU would have been more appropriate.

Why have our policy makers not understood that the EU's failure has directly resulted in significant migration into the UK, lost UK export opportunity – which we estimate at £82bn pa – and sustained a substantial trade deficit? How can they be so insular as not to see that while we must remain friends with our European neighbours the EU project has failed Europe and the just and right thing to do for Britain is to re-emerge as a true global trading nation while helping European nations rediscover their own strategic advantage?

4 March 2019

GLOBAL BRITAIN