No Mr. Ellwood, the single market is not the answer

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Conservative MP Tobias Ellwood has claimed that if the UK rejoined the EU single market, this would help tackle the cost-of-living crisis and solve the Irish border issue.

His claims do not, however, stand up to serious scrutiny. Indeed, most of the economic arguments he deploys to support his argument are misleading or simply false. There are other approaches the UK government could take which would be more effective and would not mean returning control of UK regulatory and immigration policy to the EU.

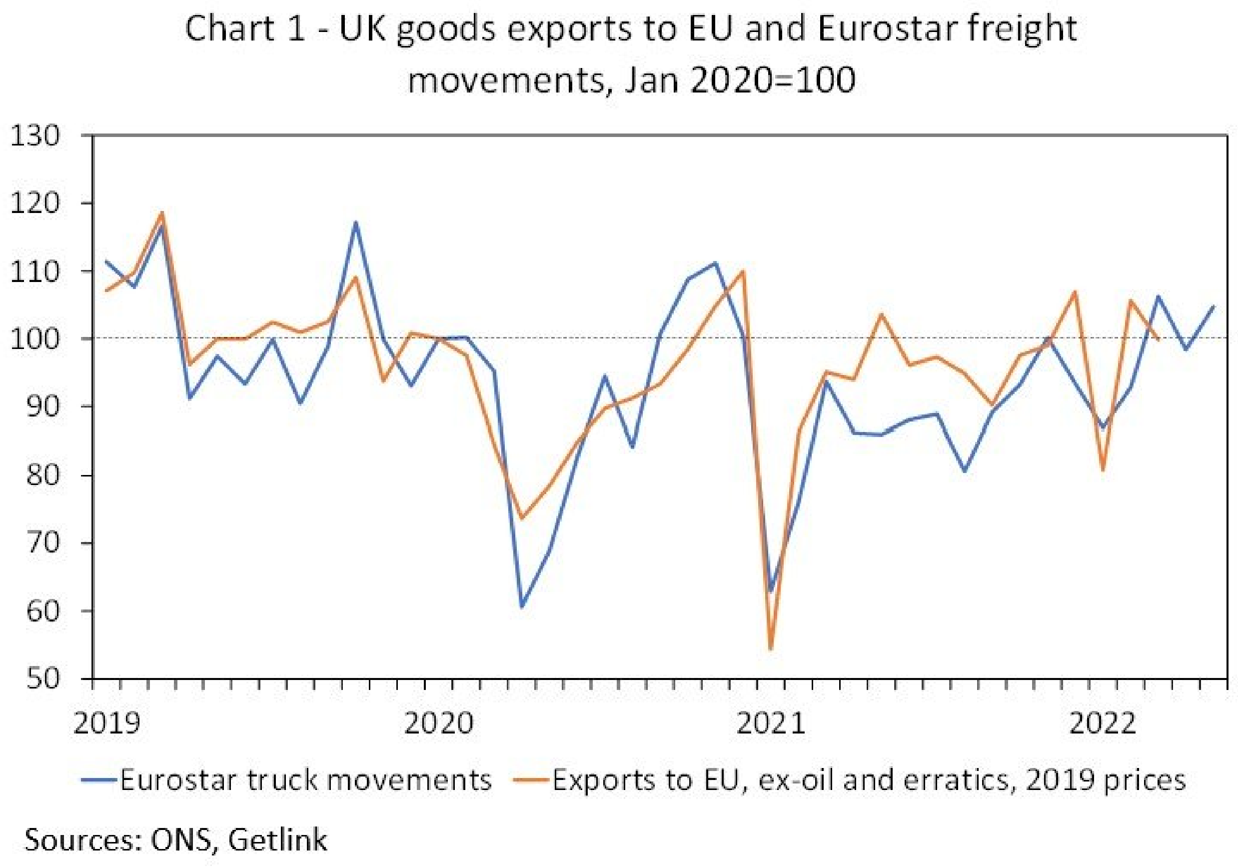
In a recent article, Tory MP Tobias Ellwood claims that if the UK rejoined the EU single market, such a move would strengthen the UK economy by reducing bureaucracy, ease the cost of living crisis and settle the Northern Ireland protocol issue. These are eye-catching claims indeed, but none of them stand up to close scrutiny and the main economic arguments he uses are either misleading or simply incorrect. Let’s examine each one in turn.

Strengthening the UK economy:
Ellwood makes a series of claims here, on trade, investment, Brexit’s impact on GDP and on the labour force and the post-Brexit performance of a number of industries. There is a great deal wrong about these claims:

'The OBR calculates, in its current form, that Brexit is reducing our GDP by four percent'.

This is wrong because a) the OBR has made no such calculation – it is repeating an estimate made by other bodies and b) this estimate does not refer to the current effect on GDP, as implied by Ellwood, but to a potential long-term impact on GDP, i.e. over 10-15 years.

But the real issue is that this 4% number is highly contentious, being based on extremely shaky reasoning. As we have noted on several occasions, the economic argument underlying it – that Brexit will lead to lower trade intensity and that lower trade intensity will have a big negative effect on productivity – is simply not supported by the evidence. It is wrong for the OBR to be quoting this highly contentious figure.



'Exports to Europe have shrunk by £20bn'

As we have previously shown, this is misleading. Most of the recorded decline in the headline figure for UK exports to the EU since the UK left the EU customs union and single market is the result of declining sales of oil and movements in erratic items – neither of which is connected to Brexit.

If we instead look at underlying export volumes (excluding oil and erratics), we can see that the level of UK exports to the EU in March this year was basically the same as at the start of 2020 i.e. just before the pandemic. If we look at Eurostar freight movements (a good proxy for UK trade with the EU and not affected by the various changes in data collection methods for trade that have occurred), we see an even better picture. In May of this year, freight volumes were 5% higher than in January 2020 (**Chart 1**). Given that EU GDP in the first quarter of this year was barely higher than the level of the last quarter of 2019, this is not a bad result at all.

Nor are we alone in pointing out that UK exports to the EU have done pretty well since the UK left the customs union and single market – certainly far better than Remainers like Ellwood claimed prior to Brexit. The National Institute for Economic and Social Research – in a notable recantation of its previous view – has accepted that not only have the poor trade numbers predicted before Brexit failed to materialise, but the net trade position with the EU has improved substantially since 2016, by around 2% of GDP. This implies a positive effect on UK growth from post-Brexit trade developments.

'Fishers…can no longer sell their Scottish salmon…farmers undercut by unchecked imports…the City can no longer sell financial services to Europe'

Ellwood's claims about the fates of individual sectors are largely nonsense. Far from Scottish producers not being able to sell salmon in the EU, their sales to the EU in 2021 were up by 29% with worldwide salmon exports at near-record levels. Meanwhile, financial services exports to the EU in the last three months of 2021 totalled £6 billion, basically unchanged from the same period in 2019. Total financial services exports worldwide rose from £13.6bn to £14.8 billion between the two periods. The reference to farmers being 'undercut' by unchecked imports is simply bizarre, especially in the light of his supposed concerns about the cost of living.

'Business investment…is 10% down on 2019'

UK business investment was 9% lower in the final quarter of 2021 compared to the final quarter of 2019. However, this data also tends to be revised up over time and the relative buoyancy of some survey indicators over recent quarters points in this direction too. More importantly, business investment in the eurozone over the same period declined by even more – by 12%. So 'despite Brexit' UK business investment has fared better than in the eurozone.

'European Union workers are turning their backs on the UK, leaving vital gaps in our workforce'

Immigration data have been badly affected by the pandemic and so need to be treated with some caution. But net migration to the UK in the 12 months to June 2021 was 239,000, only slightly down from 260,000 in the previous year (for part of which free movement was still in place and there were not pandemic conditions). A small net outflow of EU citizens was recorded but was swamped by a large net inflow from the rest of the world. Moreover, the labour force survey shows that EU-born individuals in employment were down just 20,000 from Q4 2019 to Q1 2022, while employment of individuals from the rest of the world was up by 440,000 in the same period.

'The IMF forecasts growth for 2023 as half the advanced economy average'

What Ellwood fails to mention here is that UK growth in 2021 (at 7.4%) was well above the advanced economy average (5.2%)

and the IMF also forecast UK growth to outstrip the advanced economy average this year as well (3.7% versus 3.3%). So he is guilty of cherry picking here, especially as a year of weaker relative growth might not be very surprising after two years of strong outperformance. But in addition we would note that the IMF's forecasting record for the UK is far from stellar – their forecasts from 18 months ago understated UK growth for 2021 by 1.5 percentage points and their 2022 forecast from 18 months ago has had to be revised up by 0.5 percentage points. So their 2023 prognostications should not be assumed as fact.

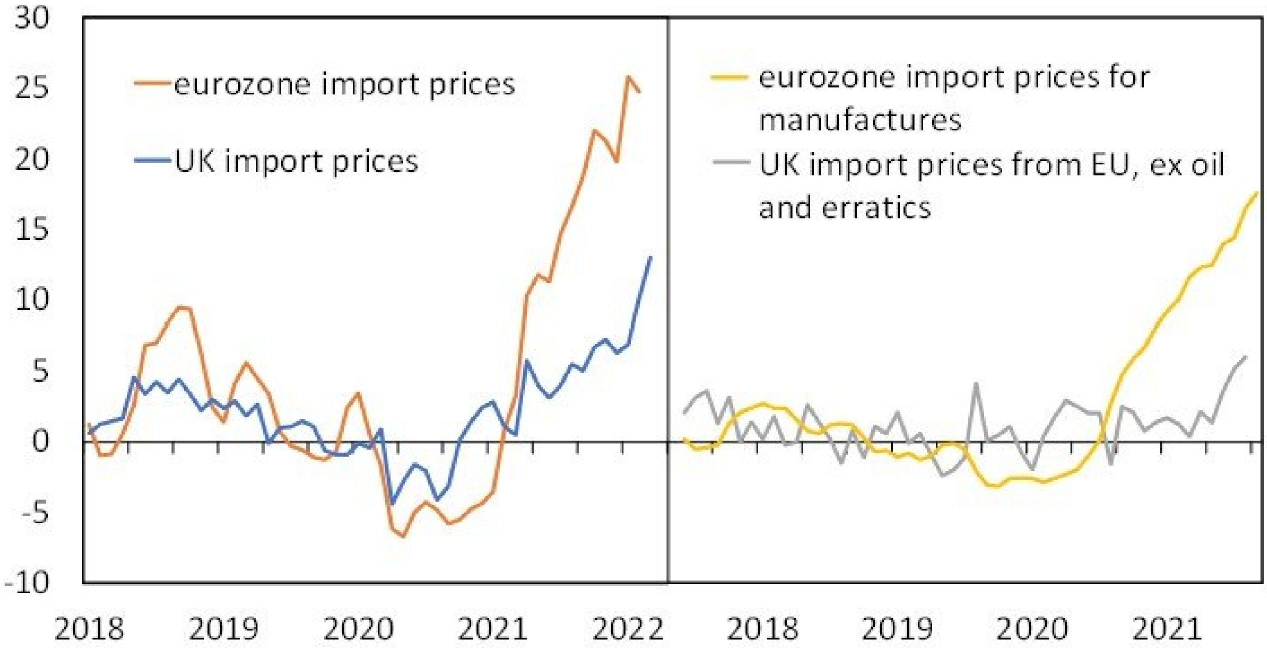
'The single market means the free movement of goods, services, capital and people. It would see £7bn of paperwork and checks go,. '

This £7 billion figure is unsourced but probably relates to HMRC claims from a few years ago which were based (among other things) on the idea that customs declarations would expand by a factor of 4-5 with associated costs. We outlined here why those claims were exaggerated and the evidence so far supports our view – the massive mushrooming of declarations has not occurred.

Easing the cost-of-living crisis:

Ellwood seems to be implying that rejoining the single market would reduce import prices from the EU and so put downward pressure on inflation. Presumably this reflects the notion that Brexit border 'bureaucracy' has driven import prices up. But there is no evidence for this. In the year to March, UK import prices were indeed up by 13%, but eurozone import prices were up almost twice as much – by 25%.

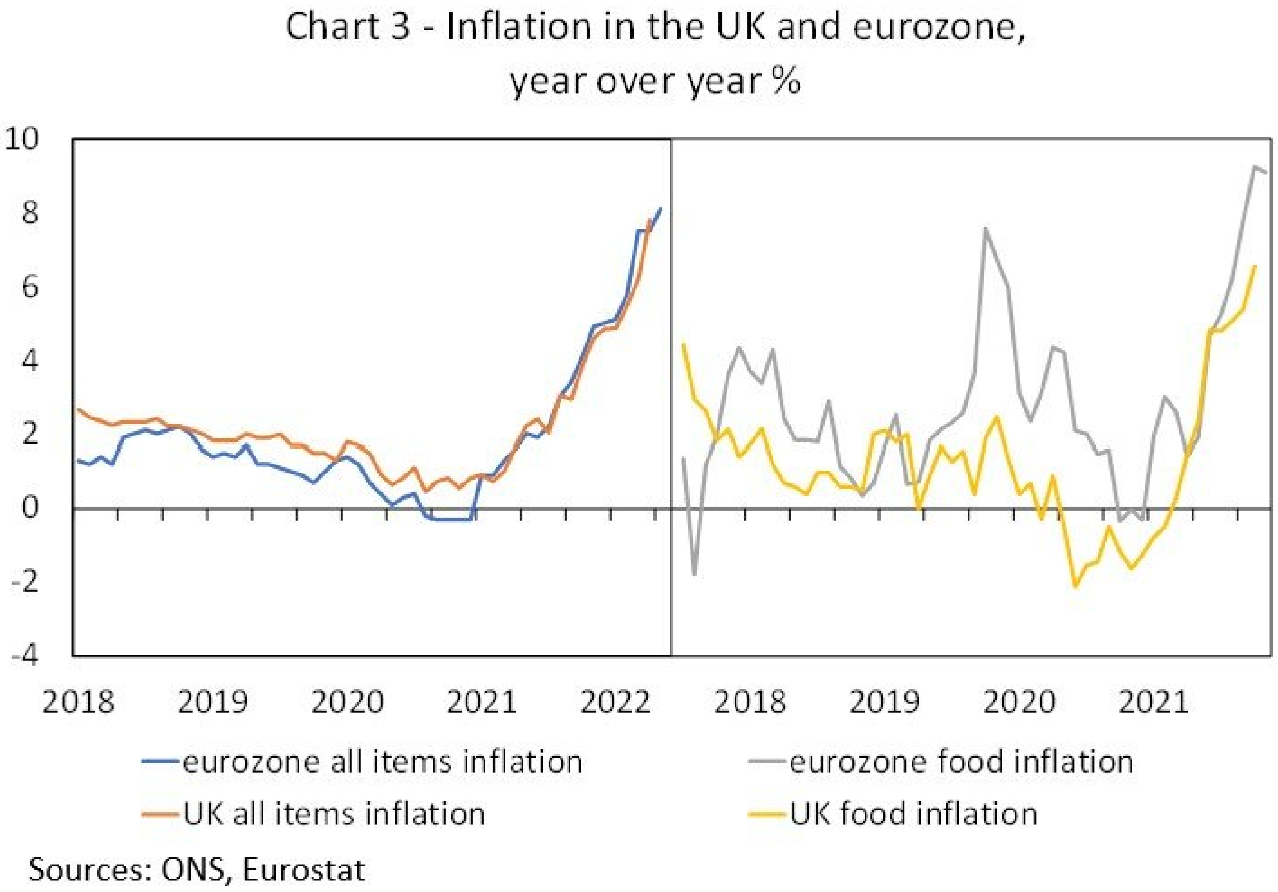
Chart 2 - UK and eurozone import prices, year-over year %



Sources: ONS, Eurostat

This is of course largely to do with soaring world prices for energy and food (neither of which has anything to do with Brexit). If we just look at prices of goods imported by the UK from the EU, excluding oil and erratics, we find they grew quite slowly during most of 2021 – with no initial hike visible due to the UK leaving the single market. Since late 2021 they have risen, and in March were 6% higher than a year ago. But in the eurozone, import prices for manufactures are up 17% on a year ago (**Chart 2**). This presumably has nothing to do with Brexit – again, global forces (and the depreciation of the euro) are at work here.

If we look at relative inflation performance we also see no evidence that leaving the single market has contributed to the cost-of-living crisis in the UK. All items inflation in the UK and the eurozone is currently very similar and has followed an almost identical path over the last 18 months. Meanwhile food inflation – supposedly where Brexit has had its biggest 'negative' impact – is actually somewhat higher in the eurozone than in the UK (**Chart 3**).



Settling the Northern Ireland Protocol issue:

Here we assume Ellwood means that the UK, by dynamically aligning with EU agri-food and other product regulations, would remove the regulatory border that has come into existence in the Irish Sea. Regardless of the merits of this idea (see below), this would not in fact solve the issue as a customs border would remain – as it does between Norway and Sweden because Norway is outside the EU customs union. Completely removing the border issue would require the UK to join the EU customs union as well, thereby extinguishing the UK’s independent trade policy and cancelling recent trade deals with Japan, Australia, and New Zealand.

Conclusion:

We can see from the above analysis that Ellwood’s article is a sloppy effort which is at best poorly researched and at worst deliberately misleading. Rejoining the single market would not give the UK economy a significant boost, would do nothing for the cost-of-living crisis and would be at best a partial fix for the Irish border issue.

Moreover, rejoining the single market would come with considerable costs. A financial contribution from the UK of several billion would be demanded (as is paid by Norway) as would free movement of people. Aligning permanently with EU regulations on agri-food would reduce the chance of meaningful future trade deals with fast-growing emerging economies and (eventually) the US and would lock the UK into a range of damaging regulations that harm agricultural productivity (such as on gene editing).

Ellwood acknowledges that the UK would need to accept 'some' EU regulations but this is again misleading. It would need to accept hundreds of regulations a year, spanning all forms of economic activity (goods and services), with no vote and no voice in the making of them. The economic costs of these (often poorly designed) regulations are far higher than the supposed savings in border costs on trade with the EU. One think-tank estimate put their cost at £20 billion per year while the EU's own estimates in the past put the costs as high as 4-6% of GDP (i.e. up to £140 billion).

Accepting this large and growing corpus of costly regulation makes no sense, especially given that the EU has been a stagnant market for UK exporters for many years. UK export volumes to the EU have grown by less than 0.5% per year since 2007, while UK sales to the rest of the world have grown by 3% per year. Many EU regulations also impinge negatively on the UK's competitiveness in these expanding rest of the world markets, markets which now account for a clear majority of UK exports.

If the government wishes to take action to boost the economy and ease the cost-of-living crisis, there are far better ways than by surrendering control of its immigration and regulatory systems to an overseas body in return for chimerical gains.

It could start by removing barriers to imports from high quality agricultural producers like Australia and New Zealand – recent trade deals are too timid and trade barriers against these economies only benefit EU suppliers, not UK farmers or UK consumers. It could also move faster to remove the inherited burden of EU regulation, so much of which is still in force, instead of dragging its feet via interminable consultations. And of course it could act directly to cut the impact of soaring world energy prices by boosting domestic energy production and slashing the taxes and green levies that make up such a large chunk of the costs of these items for households.