

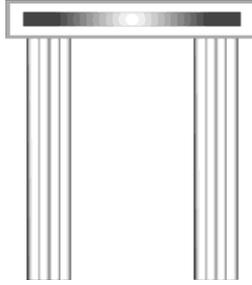


Roger Bootle

**The EU**  
**An Idea Whose Time Has Passed**

**POLITEIA**

A FORUM FOR SOCIAL AND ECONOMIC THINKING



# POLITEIA

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He is a regular columnist for *The Daily Telegraph*. His publications include *The Trouble with Europe* (3<sup>rd</sup> ed 2016) and *The Trouble with Markets* (2012).

# The EU

## An Idea Whose Time Has Passed

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Why the UK should leave the EU is a large subject and one much discussed over recent months. This piece, which summarises some of the themes in *The Trouble with Europe*,<sup>1</sup> will focus on eight key topics:

- The EU's economic record;
- The EU's extension to the east;
- The formation of the euro;
- Comparison with the debate about the UK joining the euro;
- How our relationship would change if we voted to remain;
- The City's fate outside the EU;
- The effect of a Brexit on the EU;
- The Turkish question.

### **The EU economic record**

Most British people are not familiar with the EU's economic record and many suffer from what I like to call 'vorsprung durch technik' syndrome. Exposed for years to advertisements for wonderful German products, they are under the impression that Britain is a failing country, whereas everything that happens across the water, with the exception of some things in the Mediterranean countries, is pretty good.

The facts are rather different. When first formed, the EU was a zone of tremendous economic success. Indeed, that was one of the main reasons why we joined. Mind you, the exception then was not the EU, but the UK. When compared with other industrialised countries around the world, the EU did not do much better, if better at all. But its performance was good compared to ours, and good relative to its members' past performance.

More recently, however, it has done pretty badly. Some might contend that it cannot be expected to do as well as the emerging markets, where there are various reasons for growing fast that cannot be replicated in the

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<sup>1</sup> For a fuller discussion of the themes, see Roger Bootle, *The Trouble with Europe*, Referendum Edition, Nicholas Brealey Publishing, London, 2016.

advanced countries. But the economic record of the EU over the last two decades is poor by comparison with that of almost all industrialised countries – including America, Canada, Australia and, inside the EU, Britain.

Why is this? Recently, it is mainly because of the euro [See below.] There is however, something else. The overall aim and thrust of EU policy tends towards excessive regulation and interference in pursuit of its goal of ever closer union. This has led to a poor allocation of resources. Meanwhile, the EU's own central funds have been spent badly.

Moreover, pursuit of the objective of ever closer union has absorbed the time and attention of Europe's elites, when they should have been occupied trying to address the factors that make for real economic growth.

There is also the matter of very poor EU demographics deriving from the EU's low birth rates. It is tempting to link this to the European Union's institutions, although even I struggle to make this link! But this demographic issue is going to be a major factor holding back the growth of the European economy – unless mass immigration overcomes it. (But if that were allowed by European electorates, it would raise problems of its own.)

For all these reasons the EU is a zone of comparative economic failure, whose share of world GDP has fallen quite considerably and is set to go on falling.

### **The EU's extension to the east**

So, when did thing start to go wrong? I am tempted to say '1957' - with the Treaty of Rome. The ambition for 'ever closer union' is as plain as a pikestaff in the Treaty. Despite repeated denials from many quarters about the objective of forming a European super-state, the fact is that the founding fathers of the European Union believed in precisely that. They wanted to create a European super-state and they intended to achieve this through a project of integration imposed by the European elites on the

peoples below, whom they did not trust. They did not believe in democracy; they thought they knew what was best for European people.

However much of the EU's early years was good, at two key points the EU took a wrong turn; first the extension to the east; second, the formation of the euro. To say that things went wrong with the extension of membership to the east is *not* to say that this extension was a mistake. Indeed it can be seen as the EU's greatest achievement. I am not one of those eurosceptics who believes that the EU is and always has been the incarnation of evil and cannot possibly do anything good for the world. On the contrary, I supported the EU in the early stages; and in the 1975 EU referendum I voted to stay in.

Extending EU membership to the refugee countries from communism was a significant achievement. This set this group of countries objectives to qualify them for membership; and EU membership helped to keep them on the straight and narrow afterwards, helping to reabsorb them into the European mainstream.

So why should this be identified as the first point at which things went wrong? Because no one considered the idea that the fundamental nature of the Union would have to be changed. The mistake was not extending membership to the former members of the communist bloc. Rather, the mistake was to do this while continuing with the same concept of Europe, with the same institutions and the same objectives as earlier, when in essence the goal had amounted to an attempt to reconstruct the Holy Roman Empire.

From this huge mistake stem many of Britain's current difficulties with the EU, particularly with regard to migration. In the 1975 referendum this question of migration was not a factor, because at that stage the movement of people was more balanced. The members of the EU as it was then constituted were roughly similar in levels of income per head. Once the Union was extended to the East, taking in countries with both different

cultural and political backgrounds and much lower levels of income per head, substantial net migration emerged as a significant problem.

This, of course, is a continuing issue because the EU has not made up its mind about exactly what it is, or more appropriately, where its borders should be. Already we have seen the EU cuddling up to Ukraine in a preliminary attempt at some sort of relationship which could eventually include full membership at some stage. And next there could be Serbia – and, before long, Turkey. Where will all this end?

### **The formation of the euro**

The next really serious mistake, an unforced error, was the formation of the euro. It did not need to happen. It was not necessary to form a new single currency in order to have free trade or a single market. It should be noted here that NAFTA is not a single market - nor does anyone pretend that the absence of a single currency prevents proper free trade between the United States, Canada and Mexico.

Nevertheless, the EU apparently felt that it had to go through with all that. This is another example of the abiding nature of the EU: it has been driven by politics in general, and by the politics between France and Germany in particular - in this instance, the terms under which President Mitterrand would agree to the reunification of Germany.

This represented a misconception by the European political elite, particularly the French political elite, about where power comes from. Their concern was to eliminate the Deutschmark which would somehow, they believed, tie Germany down and diminish Germany's status and standing within Europe.

Instead, the opposite happened. The combination of the absence of an exchange rate with the habitual German tendencies, good tendencies, to keep costs down, to save a lot and to export very well manufactured goods,

has created a massive current account surplus. Rather than containing Germany, the euro has increased German power within Europe.

People regularly direct too much blame to the peripheral countries. Germany is also part of the problem. If the Deutschmark still existed, the position would have been the opposite of the pseudo-wisdom of the French political elite. The Deutschmark would have gone up against the other currencies of Europe, and so kept the weaker competitors in the game, including us. This would have attenuated the growth of German exports, and it would have reduced the price of imports and boosted workers' real incomes. It would also have put pressure on the German authorities to expand domestic demand.

One need only compare the levels of German growth and its structure before and after the formation of the euro. After the formation of the euro there was very little growth in German income and not much growth in consumption. The opposite was true beforehand. The reason for this was the Deutschmark, the very thing that the project abolished. Exchange rates really, really matter.

### **Parallels with the question of the UK's membership of the euro**

The topic of the euro leads to the question of Britain's non-membership of the single currency and the debate leading to that decision, a campaign in which I was actively involved - to keep Britain out of the euro. Many of those who campaigned for Britain to join the euro are today advocating that Britain stays in the EU.

Why is it that so many good people, and in many cases good economists, good minds, why is it that they got this euro membership issue so wrong? Their mistake was one of perspective and balance. At the time they were focused on the damaging effects of exchange rate changes on business and the costs that resulted. They were strongly of the view, one they advocated keenly, that if exchange rates were eliminated and prices in umpteen different countries could be compared without the use of a calculator, a

wave of prosperity would be unleashed across Europe. Yet for opponents of joining the euro, this factor seemed to be pretty small beer. We thought there were more important things. Events have proved us right. That is one of the important lessons for today's debate (ie perspective and balance).

### **A changed relationship if we voted to stay**

How would Britain stand in relation to the EU if we voted to remain? Things would not stay the same. Britain's relationship has not been made safer, still less transformed, by what the Prime Minister refers to as his 'renegotiation', saying that Britain should now stay in a reformed EU. One may not agree on every point with Boris Johnson, but he did say something of real value when he described what the Prime Minister had achieved as 'two-thirds of diddly squat'.

The fact of the matter is that in order to make the euro work, the countries in the euro-zone are going to have to go on towards some form of much closer relationship, involving fiscal union and political union. That is going to leave Britain in a very awkward position and mean that Britain will be isolated. What the Prime Minister achieved in his deal to protect us on this issue may be a bit better than two-thirds of diddly squat, but not much.

In the long term, it makes little sense to be in a grouping whose very *raison d'être* is ever closer union and the formation of a federal super-state, if you do not subscribe to this objective. Over the long term this would not be feasible. Indeed, if Britain were to stay in the EU, then ultimately we would come under enormous pressure to join the euro.

### **The City's fate outside the EU**

I lingered over the issue of why so many people got the euro membership wrong – a lack of balance and perspective which caused them to lose sight of all-important macro questions – because it is of key relevance to today's debates about the City. Today many in the City are obsessed with 'passporting'. This is the arrangement under which banks from outside the EU based in one EU country can sell their products throughout the EU. The

suggestion now is that if Britain left the EU, overseas banks, Japanese banks, American banks, Swiss banks, European Banks - and even British banks - would have to move a substantial part, or perhaps all, of their operations to the continent or Dublin in order to sell their products throughout the EU.

Yes, passporting is important. If Britain does leave and continued passporting rights are not negotiated, there could be the loss of some business to the continent and Dublin. Banks would have to comply with the regulations. Some jobs, and some bits of business would move outside the UK. The question is how much and whether passporting is the *only* factor that banks would consider.

Just as with the question of euro membership, getting this right depends on balance and perspective. Passporting is not the only relevant issue. The City does not take sufficient account of the antipathy in Brussels and Frankfurt to Britain's financial services industry. There are many senior officials in the European Commission and members of the European Parliament who want to clamp down on financial services in general and the City in particular. Yet the prevailing idea in the City is that if Britain cooperates with the EU and votes to stay in then they would reciprocate in a similarly accommodating manner, effectively agreeing to bowl underarm. In fact, the EU's agenda is very different, one in which removing London's competitive edge, its lead and advantages would be welcomed.

So this issue isn't only about current regulations directed against the UK, London or financial services. It is about what damage might be done by further regulations in future. This scenario is not imaginary. Already a proposal exists for a financial transactions tax which, though currently stuck in the regulatory long grass, may soon re-emerge.

If the EU imposed a Financial Transactions Tax how would it look if the likes of Goldman Sachs, Morgan Stanley or UBS had transferred all their operations to Frankfurt or to Paris? In Paris, of course, they would be

welcomed by Mr Hollande's wonderful tax rates; meanwhile, Frankfurt would offer its usual array of entertainment after 5.30. How would the managers of Goldman Sachs look at their decision under which, because of *passporting* rights, they had transferred everything to Frankfurt or Paris?

Surely, what these banks are going to do is the bare minimum they've got to do in order to comply with the regulations, but they are going to keep as much of their operations as possible in London.

### **The effect on the EU of Britain leaving**

The effect of Brexit on Britain may not be at all difficult – Britain will sail through it pretty well. However, the effect on the EU may be problematic. Brexit could cause some serious difficulties for the EU. There could be ructions over the EU budget, to which the UK contributes about 9 per cent of the total and difficulties on migration, given that after Germany Britain is the second favourite home for migrants both from inside the EU and outside it. A tighter policy by Britain would prompt many of those migrants to go to other countries.

Moreover, there could be other difficulties with anti-EU movements in other countries - in France, the Netherlands, and Sweden - requesting referendums. There could be pressure on the euro – particularly given that the Greek crisis is far from over. Indeed, concern about the effects of Brexit on the rest of Europe has led some to suggest that Britain should desist from a Leave vote in order not to cause problems. However, as someone immersed in European culture and who wants Europe to do well, it seems clear to me that a large part of what stands between Europe and success is the EU. If Brexit causes problems for the EU, that could be all for the good. It could set in train a series of events leading to the reform of the EU, and to the sort of relationship with Europe with which Britain could be comfortable.

What sort of relationship would that be? The alternative to the EU would not be a return to atomistic nation states just competing with each other or

even hating each other. Rather than ever closer union, the free movement of people, a political union and so on, Europe might take a different turn, a Europe of nation states, based around free trade but also friendship and cooperation; perhaps even very close co-operation in fields like the environment and possibly even defence.

### **The Turkish Question**

This raises the question of Turkey. I regard Turkey as the litmus test of whether Europe is on the right track. Turkey is strategically a very important country; part European, part Asian. There are strong grounds to believe that Turkey must be included in a future European association. Therefore the fundamental question is about the form that such a European association should take for Britain (and other countries) to be comfortable with Turkey as a full member.

That form is not the European Union that exists today, with free movement of people, giving 80 million Turks the right to live and work in other EU member countries, including Britain, with ever closer union and the progress towards fiscal and political union with Turkey. In taking that path, the EU has put itself in a difficult dilemma; to keep Turkey hanging on without delivering, which is a dangerous course; or to bring Turkey in as a full member, which is also dangerous in a different way. That would be disastrous politically, culturally and socially and would be opposed by the people of Europe, with any number of consequences.

The problem is not Turkey, it is the EU. The problem is the concept of European association embodied in the EU.

Once we have left – perhaps to be followed by others and/or by a radical reform and reshaping of the EU - we can think seriously about what sort of European association of sovereign, nation states should take its place. I am sure that such an association should include Britain - and Turkey.

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Many people are perplexed by claims that the EU brings, or does not bring, substantial benefits to Britain's economy. There are, says Roger Bootle, uncertainties either way.

Nonetheless, as *The EU: An idea whose time has passed* explains, the economic evidence indicates that the Eurozone is failing as an economic project, but is also unable to reform because of the political aims of EU leaders.

Roger Bootle, Executive Chairman of Capital Economics and one of the country's leading economists, considers the economic record of the EU, the mistakes which have weakened the project and the continuing flaws of the euro. Britain, he argues, would sail through Brexit economically, well equipped to take advantage of fresh opportunities in the longer term. And, even if Brexit caused difficulty for the EU, it would set in train a chain of events that could only be to Europe's benefit.