

Ten Myths in the Brexit Debate

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Abstract:

On June 23rd the British electorate will make a momentous decision: whether or not the UK should leave the EU (BREXIT). Two immediate issues immediately arise.

Firstly, there is a great deal of unsubstantiated rhetoric on both sides of the debate. Claims are made with great confidence when in truth we simply do not know. Secondly, the debate is somewhat surreal because the electorate has no way of knowing what the alternative to membership is and especially with respect to trading arrangements in the event of BREXIT. The issues are clouded with uncertainties, risks and a lack of information. The purpose in this SPN is not to make the case for or against BREXIT but to emphasise the uncertainties and offer a critical analysis of some of the claims made in the debate.

Before addressing the arguments in the debate, the paper considers four key issues: the existing position of the UK within the EU; a brief summary of the arguments in support of BREXIT and the case against; a discussion of the economic dimension, and the ambiguous concept of sovereignty where a distinction is made between what might be termed *independent sovereignty*, *effective sovereignty*, and *collective sovereignty*.

Debates on complex and multi-dimensional public policy issues, where facts are scarce, offer fertile ground for the emergence of myths. Several have emerged in the BREXIT debate and are discussed in the paper:

(1) BREXIT would mean independence for the UK and the restoration of a much higher degree of national sovereignty; (2) the UK would no longer be required to make financial payments to the EU budget with the result that more resources could be devoted to public services; (3) a trade deal with the EU would be easy to negotiate within a comparatively short period; (4) trade deals with other parts of the world would be easy and quick to negotiate; (5) any impact of BREXIT on the EU itself would be of no concern to the UK; (6) there would be greater control over UK borders and immigration; (7) the UK would be free of alleged burdensome EU regulation; (8) BREXIT would free the UK from the commitment to ever-closer union as enshrined in the EU Treaties; (9) the European Court of Justice would no longer have authority to over-ride judicial decisions made in UK courts, and (10) the unelected EU Commission determines EU laws.

A fundamental trade-off is the choice between maintaining access to the Single Market versus escaping from the three key elements in any trade deal with the EU: freedom of movement of labour, contributions to the EU budget, and regulation. Given the importance to the UK of access to the Single Market, this trade-off poses a dilemma for those advocating BREXIT as any realistic trade deal with the EU would imply abandoning some of the key issues underlying the BREXIT case. It is also necessary to consider the various risks (both of exiting and remaining) and whether they are judged to be symmetrical around the mean.

A key issue is the impact that a BREXIT would have on the EU itself. In particular, would it influence the future direction of the EU and, if so, in which direction: towards “ever closer union” or towards major reform in some key areas and a greater emphasis on the principle of subsidiarity? The debate has been conducted on the basis that there is a simple binary choice: leave or remain. A third alternative strategy, however, has not been discussed and relates to the future evolution of the EU. This third choice would be to remain a member; join forces with like-minded Member States, and then with partners take a more active role in pressing for fundamental reforms. The rider would be that the UK retains the option of a second referendum if reforms are not forthcoming. Whilst a vote to leave is likely to be irrevocable, a vote to remain would not be.

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1. Nature of the Debate

On June 23rd the British electorate will make one of the most momentous decisions to face the UK in several generations: whether or not to formally leave the EU (BREXIT). It will have momentous implications in several areas: the growth potential of the economy; trade relationships and volumes; inward foreign direct investment in the economy; the issue of sovereignty; the future evolution of the EU itself if the UK decision is to leave, and politics within the UK including the structure of the UK Union itself in the event of an overall vote to leave but with Scotland voting strongly in favour of maintaining membership. There are also potentially important geo-political dimensions to consider not the least being the international strategy of Russia and how it might be affected by any weakening of the EU following a UK exit.

Three fundamental issues about the debate immediately arise. Firstly, there is a great deal of unsubstantiated (and sometimes dishonest) rhetoric on both sides of the debate: dishonest debate in that statements are made that are known to be untrue or must be very highly qualified, and what is clearly uncertain is sometimes presented as a certainty. Claims are made with great confidence when it is clearly the case that we simply do not know. There is also an element in some parts of the BREXIT campaign of what might be termed “the romanticism of a distorted view of the past”: harking back to a distorted view of the UK in the world.

The debate is somewhat surreal because, however momentous the decision will be, and however complex the key issues are, the electorate has no way of knowing what the alternatives to membership are (especially with respect to trading arrangements in the event of BREXIT), or what the full implications are of the decision (either way) that will be made. The issues are clouded with uncertainties and risks and a lack of information. This is a classic case of decision-making under uncertainty. In this sense there is a parallel between the BREXIT debate and

the referendum held in Scotland about whether it should remain part of UK the union: risks and uncertainties dominated the debate and in the end risk averse voters chose the *status quo* by a 10 pp margin.

Secondly, the debate is skewed because of a set of myths in the debate. There is a third major problem with the referendum. Although there are several fundamental issues to consider, and therefore trade-offs to be made, most voters are likely to take a myopic view and vote on the basis of a single dominant issue for them which might be any one of: a misplaced view of what “sovereignty” means; the impact on the economy; immigration; alleged excess EU regulation; alleged interference in judicial procedures by the European Court of Justice; contributions to the EU budget, etc.

The purpose in this article is not to make the case for or against BREXIT but to emphasise the uncertainties in the debate and to focus on ten myths that are distorting the debate.

There are serious fault-lines in the EU structure: a serious democratic deficit; declining popular support for the EU model in several countries and a disconnect between national leaders and the populous; regulation has not always followed the principle of *subsidiarity* (though the costs of this are exaggerated as argued below); and there are significant fault-lines in the euro model. A key issue in this regard is whether reform within the EU is more likely with a BREXIT or the UK remaining as a reforming member.

There are powerful voices in and outside the UK arguing strongly on economic grounds for the UK to remain within the Union: the IMF, OECD, UK Treasury, the Bank of England, several former US Treasury Secretaries; President Obama, NATO, the French Economy Minister (Emanuel Macron), several national leaders, several research agencies in the UK, etc. It is difficult to sustain the idea that these are all motivated by their own vested interests. On the other hand, of course, while the strong majority view of

economists is against BREXIT, this is not a unanimous view. Furthermore, not all voters will vote on the basis of a judgement about the economics.

Our final point of introduction is the issue of finality. A vote to leave would almost certainly be irreversible while a vote to remain can be reversed at any time in the future if, on remaining, the UK does not succeed (in partnership with some other Member States) in getting the reforms that it judges desirable not only for the UK but for the EU as a whole.

Before considering the myths in the debate, the context is set by considering four fundamental issues: the existing position of the UK in the EU; a brief summary of the arguments used in support of BREXIT and the case against; a discussion of the economic dimension in the debate, and the ambiguous concept of sovereignty.

2. The UK within the European Union

The UK has always had a somewhat ambiguous relationship with the EU from its very beginning: it was not a founder member in 1957 and did not become a member until 1973 although, of course, membership was delayed by the veto of President De Gaulle in 1963. The British Conservative Party has been deeply split on the issue of EU membership since the early 1970s even though in 1975 there was a referendum when the voting was two-to-one in favour of remaining in the (then) Common Market. One of the key differences is that the UK has always regarded the EU as essentially an economic project whereas Continental Europe has regarded it as equally a political project (enhanced political integration in many areas).

This ambivalent view is reflected in various special provisions governing the nature of the UK's membership. It receives an EU budget rebate although remains a net contributor. It has opt-outs from the Schengen area (established in 1995), the euro, and financial contributions to support Greece (other than by virtue of being a member of the IMF).

The last-mentioned was reiterated in the recent agreement negotiated by Prime Minister Cameron and it was agreed that the UK would not be required to contribute to any future euro area bail-outs. There were further concessions in the agreement that was reached recently by the Prime Minister. It was established that UK businesses trading in the Single Market could not be discriminated against because of the UK's non-membership of the euro and that the integrity of the Single Market would be respected if the euro area integrates further.

It is also recognised that with the Single Market, different requirements may be needed for those inside and outside the single currency arrangement. Furthermore, discussions that affect all EU member states must involve all EU members and not just those in the euro area. Furthermore, the UK would be exempt from the Treaty commitments to ever closer union.

Finally, a strong binding commitment to these principles is to be incorporated into the EU Treaties at the next opportunity.

Notwithstanding all this, the UK has made significant contributions to the positive development of the EU not the least with respect to widening the geographical coverage of the Union, its strong commitment to the Single Market and reforms that have been made to make it real in practice, and its commitment to liberal approaches with respect to the operation of markets and competition. The UK has also made substantial contributions in areas such as climate change measures, energy, digital services, and the objective (so far not complete) of extending the Single Market to services. It is also significant that the UK was instrumental in achieving the first-ever cut in the size of the EU budget.

The bottom line is that, notwithstanding the different relationship the UK has with the rest of the EU, it has not been a passive member and, contrary to what some supporters of BREXIT claim, its voice has been heard and it has had an influence. It is not correct to say that the UK has no influence and is always out-voted in the Council of Ministers.

3. The Brexit Case Summarised

Before turning to the main theme of this article (various myths in the debate) we should briefly consider the main arguments of the BREXIT campaign:

- The over-arching theme is that the UK needs to restore its own national sovereignty in important areas although, as argued below, the concept of sovereignty is ambiguous and not binary (you either have it or you don't).
- There is a serious democratic deficit within the EU's political arrangements.
- Immigration: the UK needs to have greater control over its own borders and the ability to limit the free movement of labour into the country.
- The costs of making annual financial contributions to the EU budget would be saved and the funds able to be diverted to other projects within the UK and notably public services such as the National Health Service. It is also argued that the budgetary costs will rise over time following the accession of new members from Eastern Europe.
- The EU is allegedly on an inexorable path to ever increasing political integration as seen in the Five Presidents' Report although this relates specifically to the euro area.
- Membership of the EU is restricting (in fact, prohibiting) the UK negotiating superior trade deals with faster-growing non-EU countries such as the US, China and emerging market economies.
- EU regulation across the board has become too extensive, intensive, disproportionate, and onerous to the extent that it has created a sclerotic European economy and has hampered growth in the UK not least through its

disproportionate impact on SMEs. One of the leaders of the BREXIT campaign (Michael Gove, Justice Minister in the government) has argued: "The failure of reform over many years means the EU has become an economic sinkhole" (*The Times*, April 25th, 2016). He argues further that "More EU control over the economy with increased regulation, holds back innovation, slows growth, and reduces the amount of money available for our public services". And yet none of this seems to have been a problem in, for instance, Germany as a member of the EU.

- The European Court of Justice has the power (and allegedly has used it) to over-rule some decisions of British courts of justice and has over-turned some of their rulings. This relates in particular to some areas of human rights.

In the final analysis, this boils down to an alleged case for restoring the UK's national sovereignty over key areas: the economy, regulation, fiscal policy, immigration, and the judiciary.

4. Summary case for Remaining a Member

Many of these arguments are challenged by those who campaign for remaining a member of the EU. They argue that there are significant costs attached to an exit, and many uncertainties surrounding all of the various strategic options after a BREXIT most especially with respect to trade negotiations both with the EU and other countries. Furthermore, there is no agreement amongst the BREXIT campaigners as to what the post-BREXIT strategy would be. In effect, the electorate is being asked to vote against remaining a member without knowing what the alternative would be.

The general case made in the campaign for remaining in the EU may be summarised as follows:

- Virtually all of the modelling by different organisations (the IMF, OECD, Treasury etc.)

identify significant economic costs (both short- and long-term) associated with a BREXIT (see later section).

- A BREXIT would involve the UK leaving one of the biggest Single Markets in the world and one which accounts for almost half of the country's exports. This would almost certainly involve a smaller volume of trade with the EU because any realistic trade deal is likely to maintain the *status quo* with regard to the three key areas of freedom of movement of labour, contributions to the EU budget, and regulation. Some protagonists in the debate argue that, as a major trading nation, it would be hazardous in the extreme for the UK to exclude itself from one of the world's largest home markets with the preferential access and trading conditions that this implies.
- Trade deals both with the country's erstwhile partners and elsewhere would in practice be difficult, uncertain in outcome, and take a long time to finalise. Trade negotiations with the EU are likely to be difficult and restrictive: the EU would want to avoid the moral hazard that would arise if a trade deal was made which gave the UK almost the same trading rights as it had before exiting: the moral hazard is that other members might ask for the same. There might also be an element of punishing the UK for threatening a break-up of the EU. Overall, it cannot be expected that the UK would have the same trading rights outside the EU without being bound by other aspects of the EU as it would as a member (see later section).
- There would likely be a significant negative impact on Foreign Direct Investment (FDI) into the UK. Research undertaken by the National Institute of Economic and Social Research suggests that an exit would lower GDP by around 2.25 percent due mainly to the expected negative impact on FDI inflows.
- Membership of the EU does not have the effect on net migration as the BREXIT campaign

alleges. An exit from the EU could lead to the abandoning of the Le Touquet agreement between France and the UK which would mean that potential immigrants to the UK through French ports would no longer be checked on the French border. Control is therefore likely to be more difficult. Furthermore, most empirical research indicates that net immigration has a positive impact on the economy and its growth.

- Because of the close economic ties between the UK and EU Member States (whether the UK does or does not remain a member) developments and regulation within the EU would have an impact on the UK. The difference would be that outside the EU the UK would have no influence on EU regulation.
- The UK would lose the benefits derived from collective sovereignty in those areas where it is a more appropriate and realistic strategy compared with national sovereignty.
- The City of London (an important export sector) would lose its passporting benefit which allows British and foreign banks located in the UK to export across the EU rather than be forced to locate in other EU countries. London's status as an international financial centre has been built in part on the principle of passporting rights. Although London as a major international financial centre would retain its well-established advantages it is possible that some foreign banks located in London to conduct international business (sometimes on an entrepot basis) may scale back some of their London operations and switch to locations in other EU financial centres.
- The UK is a major recipient of EU research funding which would be lost on exit.
- The Bank of England has identified a possible BREXIT as the UK's main threat to financial stability. A BREXIT would also have potentially serious stability implications for the EU itself and no-one has an interest in this.

- The impact of a BREXIT would not be confined to the UK and the EU. There are geopolitical risks to consider. For instance, Russia might have an interest in a less cohesive Europe as might ISIS.

There is also a special dimension regarding the status of the UK and whether or not Scotland would remain a member of the Union. Opinion polls suggest that Scotland is overwhelmingly in favour of EU membership, and England less so, if not opposed. If the UK as a whole were to vote to leave the EU whilst Scotland voted in favour of membership, it is possible that there could be a second referendum in Scotland which could result not only in a UK exit from the EU but also in a breakup of the United Kingdom.

Before considering the key myths in the debate, a review is made of the economic aspects of the debate and the nature of sovereignty both of which are central issues.

5. The Economic Dimension

A central issue in the debate is inevitably the potential impact a BREXIT might have on the macro economy and especially the level and rate of growth of GDP. As central as it is, this is probably the dimension in which there is greatest uncertainty. A sample of accessible econometric modelling is summarised in table 1, and table 2 summarises alternative simulations made by the UK Treasury dependent on the trade arrangements made after a BREXIT.

However, in all cases there must be heavy reservations. Firstly, there is a high degree of uncertainty most especially with respect to the subsequent trade regime and the trade settlements both within the EU and the wider world. Such uncertainty is likely to have a negative impact on investment at least in the short term: the costs associated with this transition period might not be negligible. Secondly, comparison between the different models is hazardous because of their

different modelling assumptions. Thirdly, different periods are considered (and indicated in table 1).

The key features of the modelling simulations are that all but two indicate negative impacts on the level of GDP most especially in the short run. The GDP impact ranges from -1.0 percent to an extreme -8.0 percent. The two models which produce a positive impact on GDP range from +1.0 percent to +1.6 percent though both have a range that includes a negative impact.

The OECD's modelling suggests that by the year 2020 GDP in the UK would be 3 percent smaller (5 percent by 2030) were it to exit, with the central scenario being that GDP per head would be 0.3 pp lower per annum. The model suggests there would also be a small negative impact on GDP in the EU. Overall, the model produces a loss of output in the short run and permanently lower growth. There would also be significant structural impacts in the long run. The OECD suggests there would probably be smaller capital inflows and larger outflows making the large current account deficit more difficult to finance.

Table 1

IMPACT ON LEVEL OF UK GDP AFTER BREXIT

PWC/CBI	-3.1 to -5.5	Over 5 years
Citi	-4.0	Over 3 years
Deutsche Bank	-1.0 to -2.0	Over 2 years
HSBC	-1.0 to -1.5	Over 1 year
Nomura	-4.0	Over 1 year
Societe Generale	-4.0 to -8.0	Over 5 years
Centre for Economic Performance (LSE)	-1.3 to -2.6	
Oxford Economics	-0.1 to -3.9	
Institute of Economics Affairs	+1.1 to -2.8	
Open Europe	+1.6 to -2.2	
UK Treasury	- 3.8 to -7.5	Over 15 years
OECD	- 3.3 to -5.1	Over 4 years
OECD	- 2.7 to -7.7	Over 15 years

Even in those few models which produce a positive impact within their range of outcomes, the positives are small. The impacts of BREXIT are, therefore, asymmetric: the possibility of small gains versus large losses.

There are several routes through which the projected negative impacts of BREXIT emerge:

- (1) a negative impact on trade volumes most especially with the EU,
- (2) a lower level of investment and a smaller capital stock, not the least because of the uncertainty associated with a delay in negotiating a complex set of trade deals,
- (3) lower levels of inward FDI: Such investment (generally involving companies with high productivity) often involves building new factories, introducing innovation, and the application of high-level technology. In some cases (such as the motor industry) such foreign investment in the UK has transformed parts of the economy. It is projected that FDI will weaken both because of a generally weaker economy and because foreign inward direct investment has been motivated in part as a route for foreign firms to gain access to the EU Single Market.
- (4) a weakening of productivity due mainly to the trade effect, weaker investment, and a lower level of FDI in the UK,
- (5) lower immigration and skill losses.

A fundamentally different view is given by a group of eight respected economists led by Professor Patrick Minford. They argue that the UK would be better off economically by 4 percent in terms of GDP, a fall in prices of 8 percent, and enhanced export competitiveness of 5 percent. Their main argument is that the Treasury's analysis omits a major option for a post-BREXIT trade strategy of eliminating the current Common External tariff and abolishing all UK tariffs. They advocate free trade under WTO rules. A possible problem with this universal free trade strategy is that there is no guarantee (or even likelihood) that other countries would similarly reduce their tariffs applied to UK goods and services.

The UK Treasury model

The most detailed and comprehensive modelling has been conducted by the UK Treasury (*HM Treasury analysis: The long-term economic impact of EU membership and the alternatives*) published in April 2016. Although all the simulations produce negative impacts on GDP (in both the short- and long-run), the size of the impact depends crucially on the type of trade model that is adopted after a BREXIT. Three alternative regimes are considered:

(1) *The European Economic Area model* as adopted by Norway (and Iceland and Liechtenstein). If the UK were to become a member of the EEA this would give full access to the EU Single Market and, as such, would be the least disruptive and less costly of the three alternatives. However, it could prove to be difficult politically as it would also involve (as is the case with Norway) accepting the free movement of labour, payments to be made to the EU budget, and the adoption of the majority of EU product regulations. But avoiding these is precisely what those advocating leaving the EU emphasise as the main advantages of BREXIT. It would also imply having to accept these requirements without having any influence on future EU regulation.

(2) *Negotiated bilateral trade agreement* as adopted by, for instance, Switzerland, Turkey and Canada although Switzerland has since (and after a referendum) withdrawn from the arrangement because of the detailed terms set by the EU especially with regard to free movement of labour. This may also imply that the EU would be unlikely to accept this model for any country in the future.

(3) *World Trade Organisation* implying the adoption of WTO requirements across the board with respect to all countries.

The Treasury suggests that no country has been able to negotiate any better deal.

According to the Treasury simulations, over a fifteen year period there would be significant economic costs attached to each of these three as summarised in table 2. Most disruption would be caused by any

arrangement that meant the UK leaving the Single Market.

In conclusion, there is a general consensus that, at least in the short term, the impact on the economy is likely to be negative not the least because of the general uncertainty and most especially with regard

to negotiating trade deals both with the EU and the rest of the world. Such uncertainty is likely to weaken both investment and trade. A key issue, over which there is more dispute, is the potential impact on the longer term performance of the economy.

Table 2

Economic impact dependent on post BREXIT trade arrangements

	EEA model	Negotiated Bilateral deals	WTO option
GDP level (%)	-3.4 to -4.3	-4.6 to -7.8	-5.4 to -9.5
Impact on tax	-£20 billion	-£36 billion	-£45 billion

6. The Sovereignty Issue

Inevitably, a dominant issue in the debate centres on the issue of sovereignty in decision-making: at what level decisions are made. The BREXIT campaign argues that this is an overwhelming issue and that far too many decisions have been transferred away from the national level and towards the EU. Apart from the issue of principle, the problem is compounded by the so-called “democratic deficit” in the EU.

And yet, as important as this issue is, it is an ambiguous concept. In truth, there is a hierarchy of sovereignty in all countries ranging from small local parishes, through regional authorities, national governments, inter-government structures (such as the EU and NATO), to global institutions such as the WTO and the United Nations. The key issue is always which concept of sovereignty is to be applied for which decisions: the criteria must be effectiveness and efficiency as well as applying principles of democracy which normally means that, other things being equal, decisions should be made at the lowest feasible level (known in the EU as the *subsidiarity principle*).

A distinction needs to be made between what might be termed *independent sovereignty*, *effective sovereignty*, and *collective sovereignty*. In some areas

independent sovereignty (national governments make decisions) may not be effective (and hence are not the most appropriate level of decision making) because, in an increasingly interdependent world, there are negative externalities. This means that decisions made by one country have impacts on other countries and vice versa, and that the power of a decision may be weakened because other countries make a different (offsetting) decision. In such cases *effective sovereignty* is limited: a country may have *independent sovereignty* but its decisions are less effective. Noel Malcolm in *Sense and Sovereignty* establishes that sovereignty and power are not the same. A good example of this (amongst many that could be cited) is the response to the banking crisis where reforms to bank regulation were deemed to be most effective if conducted at a global level.

In many areas *collective sovereignty* (where a group of governments agree to cooperate in decision-making) is more effective than *independent sovereignty* simply because of the spill-over effects and the weakness of national governments to adopt effective measures in the absence of similar actions by other countries. Whilst no one country gains all that it wants, each can gain more *effective sovereignty* through cooperation and a collective approach. This can also avoid the problems of competitive non-neutrality as between countries which, in some areas, can lead to a “race to the bottom” where all

countries end up being worse off and regulation is ineffective.

The key point is that when considering questions of effectiveness and efficiency in decision making, it is not always the case that independent national sovereignty is the optimal approach. In an increasingly interdependent world, where externalities can be powerful, there is an imperative in some areas to share sovereignty. Recent examples of the benefits of *collective sovereignty* are bank regulation, the approach to defeating terrorism, avoiding “unfair” competition both within the EU and from outside, measures to address climate change, and some areas of product regulation. The EU has also been more successful than national governments in the areas of roaming charges for mobile phones and in the airline industry through its measures to allow more freedom for airlines to choose their routes.

The UK government has conducted a *Balance of Competences Review* and sought evidence from various stakeholders as to whether the balance between national and EU decision-making has been appropriate. The overall conclusion, with some notable exceptions, was that most EU regulations and imposed standards were “fit for purpose” and that the balance between national and EU regulation was appropriate. It further concluded that “there is no advantage in altering the current balance of competencies”.

The key is to apply more rigorously the principle of subsidiarity.

7. Ten Myths in the Brexit Debate

Debates on important public issues, where facts are scarce offer fertile ground for the emergence of myths. Several have emerged in the BREXIT debate and are discussed in the following sections:

1. BREXIT would mean independence for the UK and the restoration of much higher degrees of national sovereignty.
2. The UK would no longer be required to make

financial payments to the EU budget with the result that more resources could be devoted to public services (the National Health Service is usually highlighted) or other tax-financed domestic projects.

3. The EU would be willing to conclude a comprehensive trade deal which would give the UK almost the same access to the Single Market as if it were a member of the EU.
4. Trade deals with other parts of the world would be easy and quick to negotiate because, as the UK is a large economy and trading nation, potential partners would have strong incentives to conclude mutually beneficial deals.
5. Any impact of BREXIT on the EU itself would be of no concern to the UK.
6. There would be greater national control over the country’s borders with the size of immigration being more controlled, and the UK could choose the type (e.g. skills) and nationality of immigrants rather than the bias towards inflows from the EU.
7. The UK would be free of stifling EU regulation and so-called “red tape”.
8. BREXIT would free the UK from the commitment to ever-closer union as enshrined in the EU Treaties.
9. The European Court of Justice would no longer have authority to over-ride judicial decisions made in UK courts.
10. It is the unelected (albeit nationally appointed) European Commission that determines laws that members are required to adhere to.

As always in myths, there may be some elements of truth in them but which need to be heavily qualified. Each is discussed in the following sections.

7.1. BREXIT would mean independence for the UK and the restoration of much higher degrees of national sovereignty

This is the dominant overarching issue for many in the BREXIT campaign. Whilst, on the face of it, BREXIT would enhance *independent sovereignty*, the

extent of this and the net costs/benefits are certainly not clear-cut. As already argued, the concept of sovereignty is ambiguous and in an increasingly interdependent world, where negative externalities can emerge, the power of *independent sovereignty* is limited. Secondly, any realistic trade deal with the EU would almost certainly mean the UK being required to adhere to the bulk of existing EU regulation, and the free movement of labour, and would be required to make significant payments to the EU budget as a *quid pro quo* for access to the Single Market. Thirdly, and because of the close political and especially trading links between the UK and the EU, whatever happens in the EU, and whatever future regulations that might be adopted, would directly or indirectly have a significant impact on the UK economy: in other words, negative externalities would still apply.

The UK would also lose at least some of the benefits of *collective sovereignty*.

Many of the alleged benefits of BREXIT with respect to independence and the regaining of *national sovereignty* would likely be blocked through the conditions imposed in any realistic trade settlement with the EU.

7.2. The UK would no longer have to make financial payments to the EU budget

This is also a major issue. The UK is one of the countries making net contributions to the EU budget. The UK currently makes gross payments of £13 billion pa after the rebate is taken into account and receives £2.5 billion from the CAP and a further £2 billion for regional development. There are additional receipts of £1.4 billion for the private sector. Overall, therefore, the net annual contribution is around £7 billion. Net contributions are currently less than one percent of total UK government expenditure, and 0.35 percent of GDP.

The claim made by the BREXIT campaigners is that this net figure would be a saving which could be used either to lower taxes or (more likely) to spend on projects chosen by the UK government. The area most often mentioned is the National Health Service.

However, there are serious flaws in this argument. Firstly, (as with Norway) any realistic trade deal with the EU would involve the UK continuing to make payments to the EU albeit lower than with membership. Secondly, almost certainly the government would compensate farmers for the loss of CAP receipts. Thirdly, there would also be claims to replace EU payments towards regional development in the UK. Fourthly, there would be pressure on the government to also compensate other sectors currently in receipt of EU funding.

Finally, and probably most importantly, if, as most models suggest, there is a negative impact on GDP, tax receipts would be lower implying a larger budget deficit or the need to either raise tax rates or reduce public spending. For every 1 percent fall in GDP, £7 billion is lost in tax receipts. The Treasury modelling suggests that, over a period of fifteen years, the net negative impact on tax receipts amounts to £20 billion (EEA trade model), £36 billion (negotiated bilateral agreements), and £45 billion (WTO arrangement). It is not clear, therefore, that exit would lead to a net saving in government expenditure or free tax resources for domestic use.

7.3. A trade deal with the EU would be easy to negotiate within a comparatively short period

As an historic trading nation, the negotiation of trade deals after an exit would be important in determining the economic impact. Trade deals will be needed at two levels: with the EU and the rest of the world. The argument made is that, because the UK is a large and growing economy, post-BREXIT trade deals would be easy and quick to negotiate and quickly because potential partners would have strong incentives to conclude mutually beneficial deals. One of the problems in the debate is that the alternative trading regime is crucial to the impact of a British exit and yet it has not been clarified what the alternative trading arrangement would be which implies voting when the alternative is not known. The UK would be exiting the EU, but what would it be entering?

In the event of BREXIT, there are broadly four options for negotiating trade deals: applying the rules of the European Economic Area (EEA), national bilateral deals; applying World Trade Organisation (WTO) rules, and unilateral free trade: abandoning all import tariffs. If the WTO option is applied, the UK would lose its preferential access to the EU Single Market and would be subject to the EU's Common External Tariff which averages about 3 percent though is higher in some cases (e.g. 10 percent for cars, 20 percent for Scotch whiskey, 12 percent on clothes and 70 percent on some beef products).

It is also emphasised that, whilst over 40 percent of UK exports go to the EU, member states' exports to the UK are also significant. In which case, the argument goes, the EU will be anxious to quickly conclude a deal with post-BREXIT Britain in order to support member states' exports and industries. The UK currently sells 44 percent of its exports to the EU while, in aggregate, only 8 percent of EU exports are to the UK. Trade is more important for the UK than it is for the rest of the EU shown also by the fact that only 3.1 percent of the EU's GDP is dependent on exporting to the UK whereas 12.6 percent of UK GDP is dependent on exports to the EU.

Notwithstanding these imbalances, because the UK is a major market for the EU, the argument is that the EU would be anxious to secure an early deal. There are, however, reasons to question this.

- Although the UK has a balance of trade deficit with the rest of the EU, around 50 percent of the deficit is with two countries. The majority of member states have a balance of payments deficit with the UK. If the argument is that net exporters to the UK (e.g. Germany and the Netherlands) would want to secure a deal, the symmetric argument would be that other countries would not be so enthusiastic. Trade deals need unanimous acceptance within the EU: any country or the European Parliament would have the power to block any proposed deal.
- The EU would be anxious to avoid a particular moral hazard. A BREXIT would almost certainly

awaken latent demands in some other member states to have a referendum on membership or some aspects of it. This would be especially the case if the trade deal were to afford the UK almost the same access as it currently has as a member but without the normal conditions. This is likely to mean that the EU could take a tough stance in trade negotiations. The EU could drive a hard bargain to avoid such a contagion.

- For the same reason, it is likely that, in return for privileged access to the Single Market, the EU would demand from the UK a commitment to free movement of labour, payments to be made to the EU budget, and the acceptance of the bulk of existing regulation. No country has successfully negotiated a significant trade deal with the EU without it agreeing to these three conditions. Switzerland attempted to re-negotiate its deal after a referendum where immigration was a central issue. The EU refused to amend the conditions. Norway makes payments in order to be part of the Single Market: on a per capita basis the level is around 83 percent of the amount currently paid by the UK. The figure is around 40 percent in the case of Switzerland though the trade deal is not as wide as is the case with Norway. As put in the Treasury document: "To allow the UK to access the Single Market without agreeing to the rules of the Single Market would put their [other Member States] own businesses and consumers at a disadvantage".
- The UK is the world's largest net exporter of services. In practice, trade deals (both with the EU and other areas) are unlikely to comprehensively cover services. A key issue is whether there would be a greater chance of progress in this area were the UK to remain a member.

Overall, a free trade agreement is not the same as a single market. A trade deal with the EU would leave the country at risk to non-tariff barriers.

Overall, therefore, trade with the EU is considerably

more important to the UK than is EU trade with the UK. In that respect, the bargaining power may be uneven. As the share of EU trade with the UK is considerably greater than UK's exports to the EU, it is not feasible to imagine that the UK could in any way dictate terms.

There is possibly a more sinister possibility. If the UK were to exit, this would be a serious outcome for the Union: confidence in the project would be weakened, there is likely to be a resurgence of anti-EU sentiment in some Member States, and there is likely to be some instability in the area. Some have argued that it would be an existential crisis for the Union. In these circumstances, could it be that the EU might seek retribution and be unwilling to offer a generous deal? A BREXIT would be viewed as a hostile act and this would be likely to influence the way the EU's approach to trade negotiations with the UK.

7.4. The UK would be free to negotiate superior trade deals with the rest of the world

One argument put forward by those favouring BREXIT is that, because the EU negotiates as a bloc with other countries, membership impedes the UK from striking its own trade deals with the rest of the world. This is compounded by the fact that the EU is negotiating on behalf of 28 countries whose interests may diverge and that decisions must be unanimous. Exiting the EU would mean the UK losing the free trade agreements with more than fifty countries. In fact, the EU has been a moving force in three successful global trade talks: the Kennedy Round, the Tokyo Round, and the Uruguay Round. The EU has a substantial bargaining weight and it is unlikely that the UK acting alone could match this, and the process would take many years before final settlements were reached. At the moment, the EU has trade deals with 90 countries (excluding the US), and is currently negotiating trade deals with others. It is unlikely that the UK negotiating alone could achieve better outcomes. Apart from other considerations, there is the practical issue of the feasibility of conducting trade negotiations with a large number of countries simultaneously.

With respect to the US, President Obama (supported by Presidential front-runner Hilary Clinton) has said that it chooses to negotiate trade deals with regional blocs rather than single countries and that its priority is with the EU. He has argued also that any deal with the UK would take between five and ten years to finalise and that, in any case, the UK would be placed "at the back of the queue". It is also unlikely that the US Congress would give priority to the UK when there is also a trade agreement to consider with the EU.

The overall assessment, therefore, is three-fold: trade deals (both with the EU and elsewhere) are unlikely to be as easy as is sometimes assumed, are likely to take many years to finalise, and any realistic deal with the EU is likely to involve a loss of at least some of the sovereignty gains that the BREXIT campaign assumes will emerge from leaving the Union.

With respect to timing, some supporters of BREXIT argue that trade deals could be negotiated without undue delay because all parties would have an incentive for a speedy outcome. Against this, the UK House of Lords European Union Committee has argued in a recent report that deals could take up to nine years and that the past pattern across the world is between four and nine years. On the other hand, negotiations with the EU could take a considerably shorter time not the least because of existing trade patterns and that the UK has very similar regulation to the EU. However, if, after exit, the UK were to abandon some aspects of EU regulation there is a danger that non-tariff barriers against the UK might increase over time as UK and EU regulations diverge.

It is worth quoting the world's most experienced trade negotiator – Pascal Lamy, former Director General of the WTO until 2013. Writing in *The Times* (May 3rd, 2016):

„Trade negotiations are a world of hard-bitten talks, where even close allies set aside diplomatic niceties for national advantage.....In a competitive global market place, they [national governments] will seek any advantage they can get....

Let me be clear: this [relying on WTO rules] would be a terrible replacement for access to the EU Single Market. Though tariffs have fallen, they are still high enough to hurt businesses and therefore jobs....There has not been a single WTO deal in 23 years and the most significant agreements are being negotiated between regional blocs.”

existential crisis the likes of which has not been experienced before. As suggested above, all of this would affect how the EU would approach trade negotiations with the UK.

Because the UK has important ties with members of the EU, these developments are almost bound to have a negative spill-over impact on the UK. In an interdependent world shocks in any one part of the system have implications for all parts: positive and negative externalities.

7.5. Any post BREXIT impact on the EU itself would be of no concern to the UK

Inevitably, the debate focusses on the impact an exit would have on the UK. However, it is necessary to consider the potential impact it would also have on the EU because this would also affect the UK. The idea that any effect on the EU itself would be of no concern to the UK is an unlikely proposition. As argued in different parts of this paper, there is a close relationship (especially in trade) between the UK and the EU and this is the case whether or not the UK is a member. Proximity is a powerful factor in determining the geographical pattern of trade.

Because of this, any developments in the EU will have spill-over effects (positive, but more dangerously, negative externalities) on the UK. It is generally agreed that a UK exit would significantly weaken the EU: it is difficult to imagine the exit of the second largest member not having a negative impact. The EU would suffer a loss of prestige and global influence, there could be a destabilising resurgence of anti-EU rhetoric and extremist parties, and it would create a lot of uncertainty. Trade is likely to weaken and an exit of the UK would have a significant impact on the EU budget which in turn would require adjustments and redistributions to be made. An exit would also transform the mentality of the project in that the principle that exits have become feasible might itself awaken or reinforce separatist movements in other member states. Furthermore, it would change the balance of power within the Union and in particular enhance the dominant role of Germany. Some analysts have also argued that it would create an

7.6. There would be greater control over UK borders and immigration

Many of those who favour the UK exiting the EU would place the control over borders and the size and pattern of immigration as the major issue. There are several fears behind this: access to welfare payments without making tax contributions, taking jobs away from British workers, squeezing real wages, the potential impact on culture, and claims on resources such as housing and the Welfare State. There is also concern in some quarters about the overall size of the UK's population most especially in the context of more countries (with relatively low per capita incomes) becoming members of an ever-widening Union. With respect to the last-mentioned, countries such as Albania, Turkey, Macedonia, Serbia and Montenegro are mentioned.

However, again the position is not as simple as often portrayed. Firstly, the evidence indicates that immigration has been beneficial to the economy because of the skills that immigrants often have. The OECD has suggested that immigration has contributed around half of economic growth since 2005. It is generally the case that immigrants to the UK tend to be young, while emigrants tend to be older such as British retired people choosing to live in sunnier climes! Secondly, and contrary to popular opinion, immigrants make net contributions to the UK budget. Thirdly, it is sometimes the case that immigrants are taking jobs that indigenous workers are not prepared to take and many of these are in public services such as the NHS. Within the NHS a significant proportion of staff are from other

countries. Some sectors of the economy (such as road haulage, some parts of agriculture, and the construction industry) are reporting difficulties in recruiting indigenous workers. Fourthly, there is no compelling empirical evidence that immigrants take jobs from British workers or that they have any significant negative impact on real wages.

There is also provision in the deal negotiated by the British Prime Minister for emergency limits to be imposed on immigration if there are serious strains on the social security system, employment, or pressure on public services.

With regard to access to welfare payments, again this is exaggerated. The European Court of Justice ruled in the Dano case that there is a national competence in determining residence requirement for eligibility for certain social benefits.

Regarding possible inflows from countries who subsequently become EU members, with the exception of Turkey the countries are small and have small populations and, in any case, the UK could exercise a veto on accepting any new member.

Some analysts advocating BREXIT argue that outside the EU the UK could establish its own immigration policies and often advocate the Australian points system allowing the UK to choose who can enter based, for instance, on skills. A potential problem with this is that it could be interpreted as being discriminatory against individual Member States. It is almost certain that, if this interpretation were to be made by an EU country, there would be a collective rather than national retaliation against the UK.

7.7. The UK would be free of burdensome EU regulation

The BREXIT case with respect to regulation is that there is too much of it, it is disproportionate, it is a serious infringement of sovereignty, and that it weakens the economy and has a negative impact on growth partly because, it is alleged, it limits innovation. It is also alleged that, acting alone rather than as a group of 27 countries, UK regulation could become more responsive to changing conditions. In practice,

the bulk of EU regulation focusses on requirements to support the Single Market, consumer protection, and protection of workers' rights.

A point of perspective is that the UK has less regulation than most other countries, and most regulation is "home grown". The OECD has observed that the UK has less regulation than any other G7 country and second only to the Netherlands across the OECD area. The EU has evidently not prevented the UK from becoming one of the least regulated countries in the industrialised world especially regarding the labour market.

Several reservations are made against the critique of EU regulation and the case that this should be a major argument in favour of the UK leaving the EU:

- The UK has agreed to most of the EU's regulation and would in any case choose to have similar regulations even if it were not a member.
- Whilst no country would ever agree to all aspects of EU regulation, there are benefits to set aside any costs regulation imposes: instead of focussing on alleged costs alone, a cost-benefit approach is needed when making judgements about. In other words, regulation is not always a dead-weight cost.
- As already argued when considering the issue of sovereignty, some regulation is more effectively and efficiently conducted beyond nation states not the least to limit the extent of regulatory arbitrage between countries.
- Much of EU regulation is designed to support the Single Market and competitive neutrality both of which are underlying principles that the UK strongly supports.
- In practice, some EU regulations are "gold-plated" by the British regulatory authorities.
- There are significant benefits from having a common set of regulations rather than 28

different sets of national rules which are likely to distort trade and add to traders' costs as they may require to adhere to different standards dependent on the country they are exporting to.

- Many industrial and manufacturing processes involve complex supply chains with inputs sourced from different EU countries. Such structures could become problematic if the UK had a different set of regulations than the EU.
- The bulk of regulation in the UK is in practice "home grown" and when it is not the country would likely create a similar regulation. The House of Commons library has calculated that less than seven percent of primary legislation and 14 percent of secondary legislation has had a role in implementing EU laws.
- There is a further perspective: if EU regulation hampers growth and innovation, the obvious question is why this seems not to have affected, say, Germany.

There is an important perspective to make about a post-BREXIT position. If the UK were to leave the EU it would still need to trade on a substantial scale with EU countries. As argued in a previous section, it is likely that any trade deal negotiated with the EU would require the UK to adhere to the bulk of EU regulation. In which case, in practice exit would not be a route towards escaping from EU regulation. In this sense there is something of a trade-off between the type of access to the Single Market that the UK would want, and the objective of maintaining national control over regulation.

It is also necessary to consider the direction of travel in EU regulation. The EU is likely to move towards a less intrusive regulatory regime. A commitment to proportionality has emerged and the Commission has established a Better Regulation programme. For instance, in the area of bank regulation the EU has established a dialogue with stakeholders by issuing a Call for Evidence from all stakeholders focussed on identifying the costs and proportionality of bank regulation. A paper outlining the Commission's

response to the submitted evidence is expected in the summer of this year. There seems to be a genuine commitment to regulatory reform. The Commission President has also made public statements recently to the effect that EU regulation is interfering too much in peoples' lives and that this is part of the disenchantment with the EU that seems to have merged in the populous of some member countries. The 2014 Commission appointed its first Vice President charged with keeping regulation under review and this is likely to lead to the repeal of unnecessary regulation, a greater focus on proportionality, and a review of the subsidiarity principle.

7.8. The UK would be free of the moves towards ever closer union

Several provisions in EU Treaties commit Member States to "ever closer union". In 1993, the so-called Copenhagen criteria laid down that EU members were committed to "political, economic and monetary union". In truth, this is a somewhat ambiguous reference to ever increasing union of "the peoples of the EU" rather than among member states. The UK already has exemptions from monetary union. In addition, a key feature of the British Prime Minister's recent negotiations (considered in other sections of this paper) is that the UK will not be committed to "ever closer union", and that a Member State cannot be discriminated against by virtue of it not being a member of the euro area.

7.9. Freedom from the European Court of Justice

The European court's alleged interference in UK courts' decisions has become a sensitive issue because it is viewed as a fundamental erosion of national sovereignty. Overall, there is a view that in some areas EU law prevails over UK law and judicial judgements.

This aspect of the BREXIT debate is hampered by a frequent confusion between the European Court of Justice and the European Court of Human Rights (ECHR). Many of the complaints made about the EU's

court are misplaced as they refer to decisions of the ECHR which is not in fact an EU court but was established in 1959 by a wider group of countries with the UK being a signatory. Many of the complaints raised in public debate (e.g. a European court interfering in UK judicial decisions, most especially over human rights) are misdirected and are not relevant to the EU.

The role of the European Court of Justice is to adjudicate in disputes where cases arise that a Member State is *prima facie* acting in contravention of EU law.

In fact, when judgements have been made involving the UK the country has been on the “winning side” in the great bulk of cases. A high profile case is when the ECJ found in favour of the UK over France in the case of French discrimination against British beef imports. It is a myth to believe that the jurisdiction of the British courts has been seriously undermined.

The ECJ adjudicates in cases involving Single Market infringements and this is generally in the interests of the UK.

7.10. The unelected European Commission determines EU laws

The Byzantine structure of decision making in the EU is not widely understood in the UK (if it is in any country) which offers ample scope for myths about who makes what decisions. In particular, there is a widely-held view in public debate that it is the unelected EU Commission that makes all important decisions. This is an emotive issue in the BREXIT debate and part of what is referred to as the “democratic deficit” though, in truth, this issue is wider than just the role and power of the Commission.

The decision making powers of the Commission are indeed substantial most especially with regard to the way that Council of Ministers’ decisions are interpreted and implemented. However, major policy decisions are made by the Council of Ministers either at Prime Ministerial level or at the level of the relevant government ministers. It is, therefore,

elected national governments that make high-level decisions either on a majority or qualified majority basis. In a limited number of cases national governments have a veto (e.g. over membership of the EU and in key trade negotiations).

In some areas, opt-outs have been given to some countries in some areas, sometimes on a time-limited (but possibly renewable) basis. For instance, the UK has an opt-out over membership of the Schengen area and, following the Prime Minister’s recent negotiations, the commitment to “ever closing union”. Other Member States have also been given opt-outs in various areas. And of course, the UK (and some other Member States) is not part of the euro area.

This means that, to some limited extent, the EU has already applied a “variable geometry” approach. The EU can be flexible enough to accommodate diversity especially when vital national interests are at stake. But it could go further.

With respect to decisions made by the Council of Ministers, in only a small minority of cases has the UK found itself on the “losing side” in voting on key issues.

8. An Alternative Strategy for the UK

As noted at the outset, the referendum is important but complex as it has many different strands. The outcome of the vote will have an important impact on the economy and other aspects of society. Earlier sections have also emphasised the enormous uncertainties most especially with regard to post-exit strategies. Voters face the classic problem of “decision-making under uncertainty”.

Although many voters will focus on a single issue (whether that be immigration, the notion of sovereignty, the budgetary costs of membership, etc) such a myopic approach, whilst perhaps understandable, is not the best way to approach the decision. A far more nuanced approach is needed to weigh up the various costs and benefits according to how each voter sees them. Those who judge that it is in the country’s interest to remain a member nevertheless

recognise that the EU is far from perfect and that there are problems that need to be addressed. Equally, those in favour of BREXIT recognise that there are costs and risks associated with an exit.

Trade-offs exist at two levels: between the different issues, and with respect to the type of trade deal to be negotiated. A fundamental trade-off is the choice between maintaining access to the Single Market versus escaping from the three key elements in any trade deal with the EU: freedom of movement of labour, contributions to the EU budget, and regulation. Given the importance to the UK of access to the Single Market, this trade-off poses a real dilemma for those advocating BREXIT as access would imply giving up on some of the key issues underlying the BREXIT case.

It is also necessary to consider the various risks (both of exiting and remaining) and whether they are judged to be symmetrical around the mean. Any assessment of risks needs to consider both the probability of the risk occurring, and the costs if it does occur. In the Scottish referendum, the risks and uncertainties were recognised. My own judgement at the time was that the risks were not symmetric: the probability and costs of the downside risks to exit from the UK were almost certainly greater than the benefits from the upside risks. This seems also to have been the judgement of the Scottish electorate

when the vote was 55:45 to remain part of the UK. Applying behavioural economics (where people put a higher valuation on possible losses than the prospect of equal gains) it is perhaps not surprising that risk-averse voters opted for the *status quo*. In the BREXIT debate, there could be a precise parallel with the Scottish referendum.

A key issue is the impact that a BREXIT would have on the EU itself. In particular, would it influence the future direction of the EU and, if so, in which direction: towards “ever closer union” or towards major reform in some key areas and a greater emphasis on the principle of subsidiarity. This could be an important dimension for voters to consider.

The debate has been conducted on the basis that there is a simple binary choice: leave or remain. A third alternative strategy, however, has not been discussed at any length and relates to the future evolution of the EU. This third choice would be to remain a member (perhaps on a temporary basis); join forces with like-minded Member States, and then with partners take a far more active role in pressing for fundamental reforms. The rider would be that the UK retains the option of a second referendum if reforms are not forthcoming. Whilst a vote to leave is likely to be irrevocable, a vote to remain would not be: it would always be an option to have a second referendum.

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