

Dear Sir Andrew,

I am writing to draw your attention to the serious statistical errors on which *HM Treasury Analysis: the Long Term Impact of EU Membership and the Alternatives* was based and ask you to rule on their validity. I would be grateful for a speedy reply as the government are still citing this seriously flawed study.

In brief: HMT imply that they have calculated the “effect of EU membership” on the UK’s trade with other members; in fact their model calculates the *average over all member states* of the effect of membership of the EU on trade with other members; they nonetheless apply that average to the UK even though the impact of the UK joining was much less than most other countries who removed more substantial barriers, as inspection of Britain’s actual trading performance post entry would have confirmed; and, **most egregious of all, they assume that if we leave it will have the same effect as re-imposing the average trade barriers prevailing in the past, not those which would now apply to the UK which are far lower.** For all those reasons the study seriously exaggerates the potential costs of leaving.

HMT also assumes that any potential gains from leaving are zero. So their analysis is not a cost benefit study but simply an (exaggerated) assessment of the cost of leaving. But I am not asking you to rule on those contentious assumptions as they are not primarily a statistical matter.

1. HMT calculate the “effect of EU membership” on trade and services as 76%¹ (page 165 and elsewhere). They use this as if it is a measure of how much EU membership increased UK trade with the EU relative to had we not joined. In fact, the model they use does not estimate how much *Britain’s* trade with the EU was boosted by membership; it estimates the *average* impact membership has had on all members’ trade with each other over the whole period since they joined. This is never made explicit.
2. There is no reason to suppose that the effect of membership has been the same for all members and good reason to suppose that the impact on the UK would be below the average, because:

¹ They calculate that the average effect of EU membership on trade in goods was 105%; the effect on services was much lower though they do not spell out the figure. The 76% figure represents the average, weighted by UK trade in goods and services – the only point at which actual UK figures enter.

- a. the Six founder members removed very high tariffs and other post war controls which gave them a large and boost to trade with each other which was evident at the time;
- b. the 10 former communist states also enjoyed an apparently large boost to trade with the rest of the EU when they left Comecon (not least because the collapse of the USSR drastically reduced their previous major market);
- c. at the time the UK joined the tariffs we had to remove were more modest than when the Six formed the Common Market. So the boost to UK/EU trade was less and at the time was seen as disappointing. In the decade after joining, no one to my recollection claimed that membership had added anything like 76% to our trade with the EU.

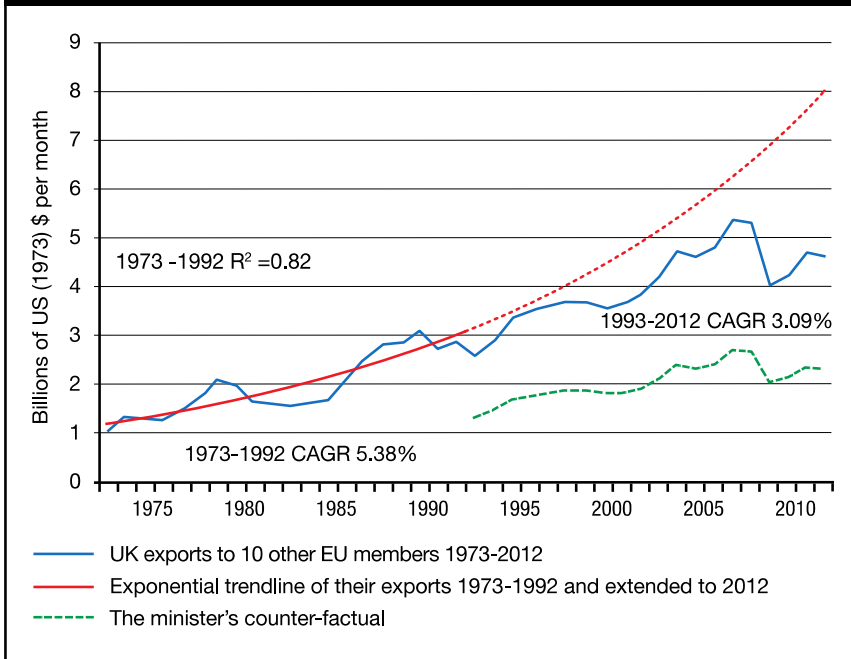
So the true effect of EU membership for the UK may well be significantly below the average estimate of 76% used by HMT.

3. It is surely good practice to compare the output of a complex model with the raw data it purports to describe, particularly if the model generates an implausible figure. HMT do not appear to have inspected the actual data for UK trade pre- and post- entering the Common Market. The charts below² show that Britain's trade³ with the other 10 EU members post 1973 did outstrip its trade with 8 similar developed countries for a while (though this coincided with rapid development of North Sea Oil most of which went to the EU), then grew in line. Even so, the cumulative extra growth with EU member states over 40 years was only 30%, not 76%.

² Charts taken from *Myth and Paradox of the Single Market* by Michael Burrage, Civitas 2016.

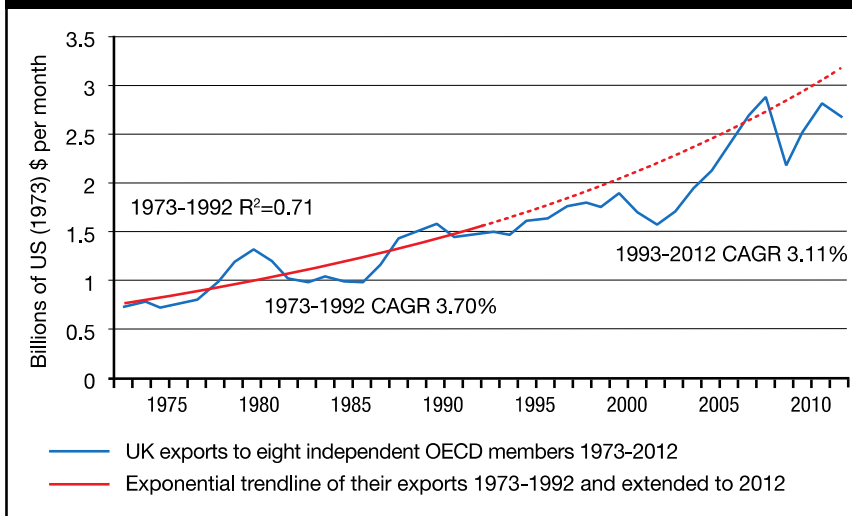
³ The charts, which were the only ones readily to hand, show UK exports whereas HMT is analysing trade i.e. the sum of exports plus imports.

Figure 5: UK exports to 10 other EU members 1973-2012



Source: OECD, *Monthly Statistics on International Trade*, Dataset: trade in value by partner countries www.oecd.ilibrary.org/statistics (now discontinued in favour of quarterly, but this is based on monthly to 2012)

Figure 6: UK exports to eight independent OECD members 1973-2012



Source: OECD, *Monthly Statistics on International Trade*, Dataset: trade in value by partner countries www.oecd.ilibrary.org/statistics (now discontinued in favour of Quarterly, but I continued up to 2012 in Monthly)

4. HMT then make a particularly egregious error. They assume that the boost to UK/EU trade which resulted from entry (be it 76% or 30%) would be reversed if we left the EU and resumed trading on WTO

terms⁴. It is highly unlikely that trade patterns created by removal of barriers would be entirely reversed even if the original barriers were restored: the persistence of trade links with former colonies suggests that there is a strong hysteresis effect.

Far more important, if we left, past barriers would not be restored. The boost to our trade when we joined was the result of removing tariffs then averaging about 7.5%. Yet if we left now we would not face a tariff of 7.5% since the EU's external tariffs have come down dramatically. The EU's current external tariff on the goods we export to the EU would average 2.4 %⁵. So roughly speaking the effect of restoring WTO tariffs on leaving would be one third of their effect of joining⁶.

In fact, since HMT are using the average "effect of EU membership" on all members they are implicitly assuming that we will go back to suffering the average trade barriers experienced by all other members – almost certainly even higher than those we removed on joining the EU. This is surely indefensible?

I would be grateful for your ruling on this as soon as possible.

Yours sincerely

Rt Hon Peter Lilley MP

⁴ They use the 76% figure (i.e. a reduction in trade of 43%) as the upper estimate and a lower limit of over two thirds this trade loss if UK reverts to trading on a WTO basis. They assume "that at the lower end of the range only half the trade effect of going from the EEA case [when the effect of re-establishing borders is assumed to be immediate] to the ... WTO rules comes through in 15 years." Para 3.17 page 127.

⁵ Trade Policy Research Centre, Discussion Paper, Ronald Stewart-Brown and Ben Lodge March 2014.

⁶ Of course HMT's model estimates the impact of removing tariffs plus non-tariff barriers that prevailed between members and the rest of the EU before they joined. Non-tariff barriers have also come down significantly and are set to come down further as a result of the recent Bali Trade Facilitation Agreement.