London and the EU:

Refocusing to support business growth

June 2014

LONDON CHAMBER of COMMERCE AND INDUSTRY

SUMMARY

Last year London Chamber of Commerce of Industry (LCCI) published a report assessing the value of European Union (EU) membership to London business that found an appetite for transferring powers over specific legislative areas back from Brussels to Westminster.[1] Accordingly, LCCI said that the Prime Minister David Cameron had, in effect, a 'mandate' from business to seek a review of the UK's relationship with the EU.

In the year since, a public debate on the issue has intensified, with the Conservative Party focused on a pledge to renegotiate and hold referendum in 2017, if in government, on the UK remaining an EU member. The other two main Westminster parties have indicated a strong 'staying in' preference, saying a plebiscite would only be necessary if there were future significant transfers of more Westminster powers to Brussels.[2]

The success of the UK Independence Party (UKIP) in the recent elections to the European Parliament indicated the continued reservations that a sizeable number of the British public hold towards the EU.[3] Business will wait and watch what this will mean for the policy positions of Westminster's three main parties.

While it should be noted that the prevalent LCCI view is that the benefits of continued EU membership outweigh the disadvantages, the business voice may be lost amidst the political debate as the UK General Election edges closer, and so the business case relating to EU membership will not be fully assessed.

The most recent poll of LCCI members on the EU revealed that:[4]

- Half of London businesses believe that remaining within the EU under current terms is not desirable
- Over two-thirds believe remaining in the EU but with specific powers returned to Westminster would have a positive economic impact
- Three quarters believe a full withdrawal from the EU would negatively impact on the UK economy

In short, London business interests would best be served by remaining within a reformed and remodelled EU.

LCCI urges the UK's political parties to initiate and sustain a dialogue with the London business community to ensure that party thinking and proposals on engaging with the EU aligns with commercial agendas. This would enable identification of the areas of EU functioning that both believe need to be reviewed and/or renewed – as well as reducing policy uncertainty that can have a chilling effect on business and commercial confidence.

It is for national governments to decide whether any EU reform requires drawn-out treaty changes. However, as the newly elected European Parliament convenes and a new European Commission is established, they, along with UK politicians, have an ideal opportunity to show that they can identify common priorities to drive economic growth and increase employment and greater prosperity in London – and in other EU capitals.

London business would benefit from:

- Single Market harmonisation to ensure a level playing field in goods and services
- Reducing the regulatory burden on small and medium-sized enterprises (SMEs)
- New international EU trade agreements to increase the range of export markets

One notable factor behind the reservations of the British public towards the EU has been around migration. However, EU migrants have been proven to make a positive net fiscal contribution to the UK's public finances,[5] and the free movement of labour across the EU has enabled London businesses to fill skills gaps in their workforce so underpinning economic growth.[6]

London, and the wider UK, benefits from being part of a single market of over 500 million consumers. The challenge is to get the EU to realise the full potential of that market and extend it to other sectors to drive competition and free enterprise. That is the sure way to support businesses, large and small, and secure sustained economic growth.

Recommendation 1: To engender greater business confidence, UK political parties should initiate a dialogue with London business to align emerging party proposals on potential EU reform with British business commercial agendas.

Recommendation 2: To counter perceptions of inconsistency, the European Parliament should investigate European Commission enforcement of EU directives to ensure a level playing field across all member states.

Recommendation 3: To help ease the regulatory burden on small business, the European Commission should make the 'SME Test' a mandatory requirement for all EU legislative impact assessments.

Recommendation 4: To drive economic growth, increased employment and greater prosperity, the European Council should prioritise new international trade deals, especially focusing on the Transatlantic Trade and Investment Partnership.

[1] LCCI (2013): *Help or hindrance? The value of EU membership to London business*, at www.londonchamber.co.uk/research/EUreport
[2] Reuters: *Clegg dismisses Cameron's EU strategy as 'wishful thinking', 9 May* 2014; Ed Miliband: *Europe needs reform but Britain belongs at its heart*, Financial Times, 11 March 2014
[3] UKIP won 27% of the vote and gaining 24 MEPs; while Labour won 25% of the vote and 20 MEPs, the Conservatives 23% and 19 MEPs and the Liberal Democrats 7% and one MEP
[4] The paper is based on a survey of LCCI members, assessing London businesses' sentiment on the UK's relationship with the EU over the last year, and in-depth member interviews
[5] Dustmann, C. and Frattini, T. (2013): *The Fiscal Effects of Immigration to the UK*, University College London, p. 27
[6] For more information on the impact of EU migration on London businesses, please see LCCI (2013): *Let them come? EU migration and London's economy*, at www.londonchamber.co.uk/research/EUmigration

EU BAROMETER: WHERE LONDON BUSINESSES STAND

To test business sentiment towards the EU, LCCI has run a quarterly *EU Barometer* survey since March 2013, asking what impact different scenarios of UK relationship with the EU would have on Britain's business and economic prospects. The *Barometer* has also been run nationally by the British Chambers of Commerce (BCC) over the last five quarters, allowing us to compare the sentiments of businesses in London with the rest of the UK.[7]

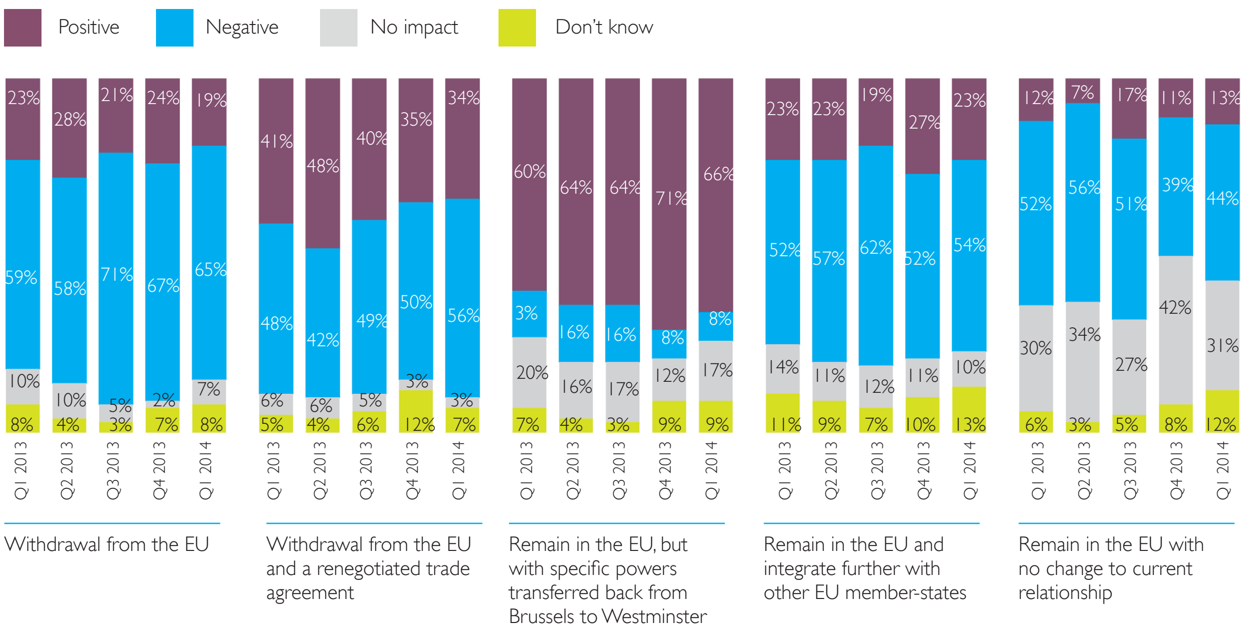
It is clear from the results (see Figure 1) that the status quo of EU membership without reform is not an option that would serve London and the UK's economic interests. Over the last five quarters, an average of just under half of London companies believe that remaining in the EU with no change to the current relationship would have a negative economic impact on the UK. A slightly larger proportion (55%) felt negatively about further integration with the EU. This compares to 34% of businesses nationally, suggesting that firms in the capital are more hostile to further integration.

Withdrawal from the EU is the scenario that would have the most negative economic impact for our members. On average over the past five quarters, almost two thirds (64%) of London businesses believed full withdrawal from the EU would negatively affect UK business interests. This sentiment increased over the course of last year in particular. Fewer than one in five (19%) London businesses believed withdrawal would be a positive development, compared to 12% nationally – the lowest on record. London businesses' feelings on withdrawal with a renegotiated trade agreement were more nuanced. Nevertheless, only a third (34%) felt it would have a positive impact in Q1 2014 and 56% thought otherwise.

The only scenario that would have an overall positive impact on the UK's economy and businesses is remaining in the EU but with specific powers transferred back to the UK. The Prime Minister's preferred position has gained increasing support from London businesses over the course of the year, as an average of two thirds (65%) believe that this option would have a positive effect on business and the economy.

Although support for this position has been gradually declining, **remaining in the EU but with some transfer of powers is also the option viewed most positively by businesses across the UK** – 54% believed this would have a positive economic impact in the last quarter.[8] Yet, there is a growing proportion of businesses nationally who are uncertain about how this option would impact them and the economy – 19% selected 'don't know' in Q1 2014 in comparision to under a tenth (9%) of London businesses. One reason for this may be that London firms may be more confident about the outcome of a possible renegotiation process.

Figure 1: London businesses' views on the economic and business impact of different relationships with the EU



<u>Recommendation 1:</u> **While London businesses are against a potential UK exit from the EU, they do support a renegotiated relationship. To increase business confidence, UK political parties should initiate a dialogue with London business to align emerging party proposals on potential EU reform with British business commercial agendas.**

[7] For the BCC's *Business EU Barometer*, please see http://www.britishchambers.org.uk/policy-maker/europe.html
[8] BCC: *Business uncertainty over EU on the rise as voters head to Euro-polls*, Press Release, 20 May 2014

TOWARDS A TRUE SINGLE MARKET FOR GOODS AND SERVICES

As economic conditions remain challenging for businesses across Europe, the EU has an important role to play in promoting growth and jobs through the European Commission's business policy competences.

The EU's main area of economic competence relates to the functioning of the European single market, which is aimed at ensuring the free movement of goods, services, capital and labour across member states. It gives UK companies access to the largest consumer market in the world – comprised of over 500 million consumers – making the EU effectively an extension of the domestic market. This brings considerable economic benefits. During its first 20 years of operation, the single market is estimated to have raised EU GDP by at least 2.2% (or €518 per person) and created 2.75 million additional jobs across Europe.[9]

The single market is meant to remove barriers to competition and ensure a level playing field for companies across EU member states through harmonised legislation. However, its uneven implementation can distort this and puts UK businesses at a competitive disadvantage. As state parliaments are responsible for incorporating EU directives into national law, this gives scope for flexibility to suit national circumstances but also inconsistency between member states. The lack of a level playing field in some areas creates unnecessary costs, particularly for SMEs, which may be deterred from trading across borders. As a result, many smaller businesses still do not feel the full benefits of the single market.

One area of uneven implementation is public procurement. Some London businesses believed the UK government applied EU regulations stringently, whereas other member states are able to limit the impacts for domestic companies. Perhaps for this reason, a third (33%, a 15% increase over the last year) of London firms wanted powers over public procurement legislation to be transferred back to Westminster (see Figure 2). New EU Procurement Directives, finalised in April 2014, aim to simplify procurement rules and increase access for SMEs, but their effectiveness across member states will need to be closely monitored.

While the single market has been growing gradually across sectors, it is far from complete. Further liberalisation is yet to be extended sufficiently to sectors such as services, telecommunications, energy and transport. The economic and business benefits of its completion are significant: it is estimated that the complete elimination of all remaining barriers to trade inside the EU over a period of ten years could generate national income gains of around 7% of UK GDP.[10]

Further liberalisation of the single market in services in particular holds much untapped potential. While services constitute 71% of the EU's overall GDP, they make up only 24% of the EU's trade.[11] As a world-leading centre for the financial and business services and growing technology and creative sectors, London would stand to benefit significantly. LCCI welcomes the 2006 Services Directive as the right framework to extend the removal of legal and administrative barriers to trade to the services sector. It was estimated to bring 1.8% of additional EU GDP,[12] but these benefits are yet to filter through to SMEs.

Case study: Telecommunications

The single market for telecommunications (telecoms) is not fully complete and can be improved in a number of ways. There is still *"a patchwork"* level of implementation of existing measures across the EU, according to the Director of Global Public Affairs at a large telecoms company, which operates in all 28 member states: *"a forensic effort by the European Commission on recalcitrant members is needed to ensure open competition."* The current regulatory inconsistency and lack of wholesale access mean that business customers miss out on the full productivity benefits of technology, while the lack of competition means a loss of innovation and productivity through the supply chain and across the wider economy.

A new package of regulations to complete the telecoms single market is currently making its way through the legislative process.[13] These measures *"will put in place a better regime for wholesale network access products and be the vital building blocks for fair competition in business grade communications on a pan-EU basis,"* according to the interviewee. The principles of efficiency and a level playing field should be driven by greater convergence of regulatory systems for media and telecoms services, as highlighted in a recent EU Green Paper,[14] as well as extended internationally through ongoing trade negotiations.

There is a swathe of new legislation in the pipeline to extend the single market to new sectors, but it will only succeed in increasing trade volumes if the Commission and member states make a sustained effort to expedite implementation and enforce regulations effectively across all member states.

Recommendation 2: To counter perceptions of inconsistency, the European Parliament should investigate the European Commission's enforcement of EU directives to ensure a level playing field across all member states.

[9] HM Government, Centre for Economic Policy Research (2012): *Twenty Years On: The UK and the Future of the Single Market*, p. 9
[10] Department for Business, Innovation and Skills (2011): *The economic consequences for the UK and the EU of completing the Single Market*, BIS Economics Paper No. 11, p. 23
[11] European Commission (2013): *Services: tapping the potential for growth and jobs*, p.9; BCC (2010): *The European Union in 2020: A business view*
[12] BIS Policy Paper (2014): *Cut EU Red Tape: Report from the Business Taskforce*
[13] For more information, please see https://ec.europa.eu/digital-agenda/en/connected-continent-legislative-package
[14] European Commission (2013): *Preparing for a Fully Converged Audiovisual World: Growth, Creation and Values*, Green Paper COM(2013) 231

The main purpose of EU legislation is to facilitate the functioning of the single market by harmonising member state legislation and removing barriers to competition. As previously discussed, when fully implemented, product standardisation and competition regulations bring benefits to businesses in terms of opening up market access and creating a level playing field across national boundaries. However, **all regulations present additional compliance burdens for businesses, and in some cases, these costs may outweigh any potential benefits.** It is estimated that the 100 most costly EU regulations cost the UK economy £27.4 billion per year.[15]

EU-led employment law in particular presents little benefit to businesses in terms of market access but high costs in terms of compliance. As a result, 65% of London businesses selected it as the top EU competence they would like to see transferred back to Westminster, according to LCCI's *EU Barometer* (see Figure 2). The two costliest pieces of EU legislation relate to employment law. The Temporary Agency Workers Directive (AWD) – regulating their working terms and conditions – has an estimated cost of over £530 million a year. By far the most costly law, however, is the Working Time Directive (WDT) – which regulates employees' working hours, rest breaks and annual leave – costing UK firms £4.1 billion a year.[16]

Small and medium-sized firms are a major source of growth and job creation in London, the UK and across the EU. Yet, **SMEs are disproportionately affected by new regulatory burdens,** as they lack the capacity and resources to absorb the increased costs associated with additional red tape.

To minimise the regulatory burden on SMEs, the Commission introduced an 'SME Test' to implement the 'Think Small First' principle of the 2009 Small Business Act. As part of the Commission's regulatory impact assessment, the Test includes consultation with SMEs and representative organisations, a cost/benefit analysis of the impact on SMEs and use of mitigating measures where appropriate.[17]

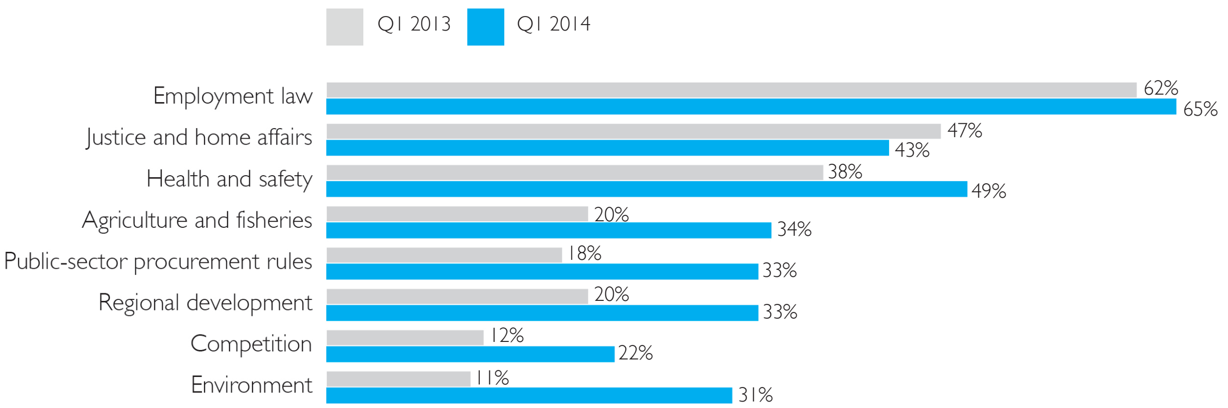
While the SME Test is a welcome means of analysing the effects of legislative proposals and ensuring the impacts are proportionate, it is still not a consistent part of the assessment process. One report found that 43% of SME-relevant impact assessment reports are not fully conducting the test.[18] **The SME Test should be mandatory in all impact assessments of new legislation and where the Test shows that the costs to SMEs will exceed the intended benefits, the Commission should introduce amendments or exemptions for SMEs, or abandon the proposals, in compliance with the 'Think Small First' principle.**

Case study: Working Time Directive

The WTD restricts working hours to 48 hours a week. This particularly affects organisations with small numbers of employees that would need to employ additional staff to comply. Although the Government secured a provision in the UK regulations allowing individuals to opt-out, there are no exemptions for small or micro businesses.

Certain sectors are also disproportionately affected. For example, food processing companies deal with perishable goods and depend on short turnarounds. The Sales Director of a small food exporting company said: *"we pack goods for export and food with a short shelf life needs to be airfreighted, so we are governed by airline schedules. We cannot put the food away until the next day, we have to work until the food is packed and despatched."*

Figure 2: Competences that London businesses believe should be transferred from Brussels to Westminster



Recommendation 3: To help ease the regulatory burden on small business, the European Commission should make the 'SME Test' a mandatory requirement of all EU legislative impact assessments.

[15] Open Europe (2013): *Top 100 EU regulations cost the UK economy £27.4 billion a year – and costs outweigh benefits in a quarter of cases*
[16] Ibid.
[17] For more information on the SME Test, please see http://ec.europa.eu/enterprise/ policies/sme/small-business-act/sme-test/index_en.htm
[18] Eurochambers (2013): *SME Test Benchmark 2013: Assessment of the Commission's application of the SME Test*

SUPPORTING BUSINESS EXPORTS

The EU is a customs union and free trade area, with no customs duties or quotas on goods travelling within the EU and a common external tariff to non-members. Because of this, **the EU remains the UK's main trading partner.** EU countries comprise around 48% of the UK's total trade in goods and services; in comparison, only 5.6% of the UK's total trade is with China, while 1.5% is with India.[19]

With the UK economy still largely reliant on domestic consumption, **increasing exports would provide a sustainable path to growth, and this is an area where the EU can make a significant difference.** There are a number of existing EU programmes that promote exports; for example, funding for trade missions within the framework of the Enterprise Europe Network or within the Mission for Growth initiative.[20]

More importantly, the EU secures access to global markets on behalf of members through its competence to negotiate free trade agreements (FTAs) with third countries. As a trade bloc of 28 nations and 500 million consumers, the EU holds much greater clout in international negotiations than individual member states. The EU currently has FTAs with nearly 50 countries, including South Korea, Mexico, Chile and South Africa, and it is negotiating agreements with more than 80 countries, including important trading partners for the UK such as the USA and India, and growing economies such as Brazil, Malaysia and Singapore.

Yet, trade negotiations are prolonged and technical processes, with many competing interests at stake, so it may be tempting to exclude contentious areas from the negotiations. For example, the USA has been unwilling to include the area of financial services regulation in the TTIP discussions, or to allow European businesses to get the same level of access to US digital telecoms market as US businesses receive in the EU. **So that bilateral trade negotiations do not to descend to 'lowest common denominator' outcomes, member states must put their full support behind the European Commission and remain committed to a comprehensive negotiation which covers a broad range of policy areas.**

Case study: Transatlantic Trade and Investment Partnership

The ongoing negotiations between the EU and the United States for a Transatlantic Trade and Investment Partnership (TTIP) hold enormous economic potential. Once completed, UK businesses stand to benefit from a reduction or removal of tariff barriers, mutual recognition of regulations opening up market access, and less costly and time-consuming customs processes when moving goods across the Atlantic. Raising the threshold below which no customs duties are payable would make it cheaper and faster small businesses to trade internationally.

TTIP is estimated to deliver economic gains as a whole to the EU of €119 billion per year, of which around 80% will stem from the removal of non-tariff barriers, particularly significant for SMEs. The Director of a transportation company advocated for TTIP: *"a EU-US trade agreement will reduce the cost of doing business in the US and open new opportunities, particularly for SMEs and private consumers."*

To secure full access to future bilateral agreements between the EU and other countries, the UK would need to remain a full member of the EU. The UK is stronger in international trade as a member state of the EU, at bilateral and multilateral level. Should the UK leave the EU, the Government might need to renegotiate trade terms with both EU member states and current EU trade partners, bringing uncertainty to UK businesses in the transition period. This would also affect foreign direct investment (FDI) into the UK. Access to the single market is a major reason why international companies choose to invest and locate in the UK, with 43% of inward investment projects choosing the UK for their European headquarters. If the UK no longer offered this access, many international firms might choose to scale down their UK presence or locate elsewhere.

Recommendation 4: To drive economic growth, employment and greater prosperity, the European Council should prioritise the completion of new international trade deals, especially focusing on the Transatlantic Trade and Investment Partnership.

[19] HM Revenue and Customs (2014): *Summary of Import and Export Trade with EU and Non-EU Countries - Annual 2006 – 2013*
[20] For more information, please see http://een.ec.europa.eu/ and http://een.ec.europa.eu/events/missions-growth
[21] House of Lords (2014): *The Transatlantic Trade and Investment Partnership*, p. 14
[22] UKTI (2013): *The UK – number one for European headquarters*

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