

# Prof. Dr. Paul J.J. Welfens

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## **An Accidental BREXIT**

**New EU and Transatlantic Economic Perspectives**

***Presented at Georgetown University, September 12, 2017***

***Walsh School of Foreign Service***

**Intercultural Center**

Book available both as a paperback and as an eBook (London, Sept. 2017)



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## BREXIT aus Versehen

Das Buch beantwortet ganz aktuell die wichtigsten Fragen zum BREXIT: Wie ist das historische BREXIT-Referendum in Großbritannien abgelaufen, welches sind die Hintergründe des anstehenden EU-Austritts und welche Folgen für Deutschland, Europa und die Weltwirtschaft sind absehbar? Die BREXIT-Entscheidung ist für Europa ein Jahrhundertereignis, das die EU schwächt und die Machtgewichte global verschiebt. Die EU hat an Anziehungskraft verloren, sie ist nicht im Einklang mit dem 21. Jahrhundert, das asiatisch, digital und innovationsstark ist. Es zeigt sich, dass indirekt ein Weg von der Bankenkrise zur Anti-Immigrationswelle und zum EU-Austritt führte. Zudem war das Referendumsergebnis stark verzerrt von einer grob fehlerhaften Infobroschüre der Cameron-Regierung, die 10% zu erwartenden Einkommensverlust als Effekt eines EU-Austritts verschwiegen – mit dieser Information hätte sich eine klare Pro-EU-Mehrheit ergeben. Ein zweites Referendum? EU-Reformen? Die EU-Integration kann nur fortgeführt werden von einer Neo-EU, die besser konstruiert ist.

*Paul Welfens hat eine sehr einfühlsame Studie zu den Ursachen – und Folgewirkungen – des Brexit geschrieben, der offenbar Großbritanniens größter vorsätzlicher Wirtschaftspolitik-Fehler seit der Großen Depression ist.*

*Prof. Dr. Harold James, Department of History, Princeton University*

*Im Buch vom Paul J.J. Welfens über den Ausgang des Brexit-Referendum erfolgt eine schonungslose, nüchterne und kritische Analyse, wie dieses Referendum-Ergebnis zustande kam. Welfens listet die wesentlichen kritischen Punkte auf. Jedem, der sich mit dieser Thematik ungeschminkt und offen beschäftigen will, sei dieses Buch zur Lektüre sehr empfohlen.*

*Prof. Dr. Dr. h.c. mult. Friedrich Schneider, Department of Economics, Johannes Kepler Universität Linz*

### Der Autor

Prof. Dr. Paul J.J. Welfens ist Präsident des Europäischen Instituts für Internationale Wirtschaftsbeziehungen (EIIW) an der Universität Wuppertal, dort zudem Inhaber des Jean-Monnet-Lehrstuhls für Europäische Wirtschaftsintegration und des Lehrstuhls Makroökonomik. Außerdem ist er Vorsitzender des Instituts des Bundesverbands Deutscher Volks- und Betriebswirte, Düsseldorf, Non-resident Senior Research Fellow am AICGS der Johns Hopkins University, Washington DC sowie IZA Research Fellow, Bonn. Das EIIW steht für mehr als zwei Jahrzehnte preisgekrönte Forschung. Welfens war u.a. geladener Experte des Deutschen Bundestages, des Europäischen Parlaments, der EU-Kommission, des US-Senats sowie des IWE.



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Welfens



BREXIT aus Versehen

# BREXIT aus Versehen

Paul J. J. Welfens

Europäische Union zwischen  
Desintegration und  
neuer EU



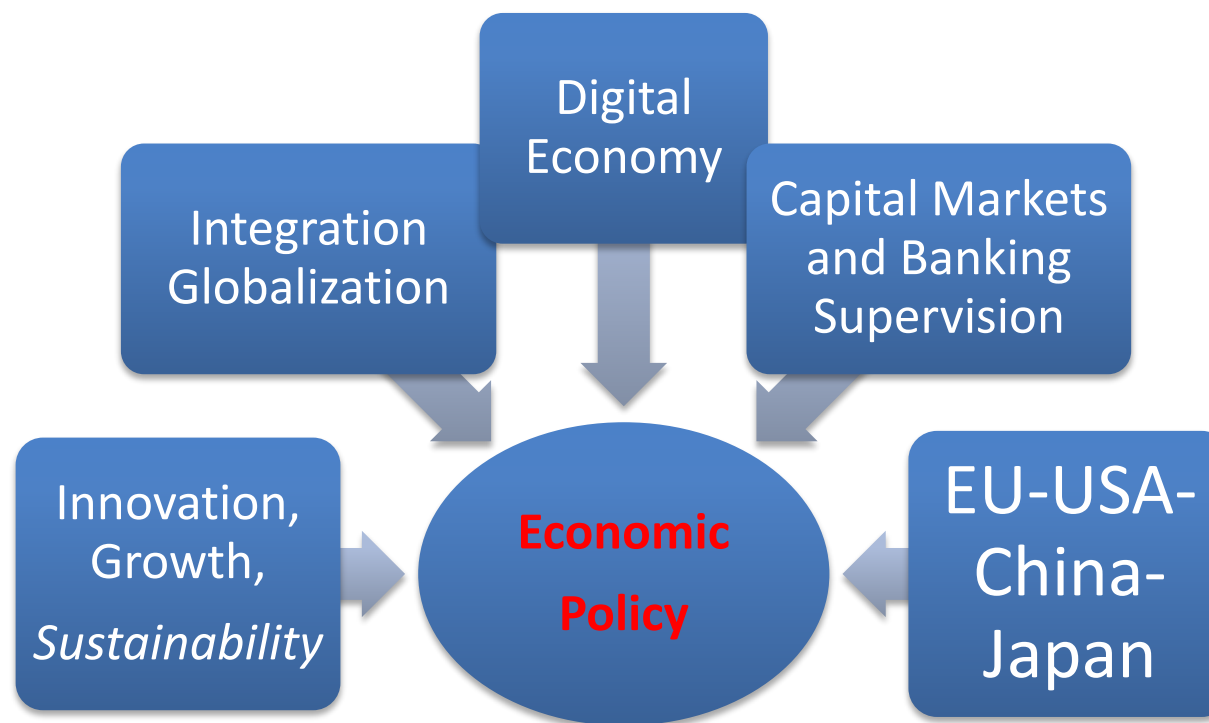
 Springer

## BREXIT aus Versehen, Springer (October 2016)

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About the EIIW (a private, affiliated research institute)/University of Wuppertal (2015: 20 Year Anniversary)

## Research Focus Areas of the EIIW





## 20 Years of EIIW: 2015 – Conference in Berlin and Wuppertal

- Award-winning research; *Euro Crisis anticipated in Oct 2008*  
National / International Networks



## 1. Introduction: Key Aspects

- I) Background to the 2016 Referendum and the Referendum result: 51.9 % for BREXIT while orderly referendum would have been 52% for REMAIN
- II) BREXIT as a historical challenge for the EU and decline of the West
- III) Some current BREXIT perspectives and new aspects for the UK
- IV) Anti-EU immigration view Cameron/May: Burden story v. OECD findings
- V) UK-US: New perspectives; mini TTIP, US will use GE voice in Br.; UK weak partner
- VI) Global Britain: A workable strategy? Not if US undermines WTO, etc.
- VII) Some German perspectives – Berlin as new voice in Brussels, GER/FR
- VIII) Why the current EU breeds political radicalization - reforms needed
- IX) Some conclusions

## 1) Background to the 2016 Referendum

- **Cameron had promised an EU referendum for years – June 23, 2016** facing strong anti-EU group within **Conservatives** and also strong opposition from UKIP (anti-EU party) - the winner at the European elections in 2014
- **Cameron had obtained some concessions from EU in negotiations** in early 2016: services liberalization in EU single market, reduced access of EU immigrants to social welfare system in UK in early years
- Since 2013 a big anti-immigration debate – emphasized by Mr. Cameron - about “**too much EU immigration**”
- **Betting-odds and capital markets anticipated 2016 Remain majority;** result 51.9% BREXIT; new prime minister Mrs. May (interior minister)

## 2016-2019

2017: Snap election in UK: May government lost majority in June (DUP needed)

2018: 2 negotiations finalized: 1) EU exit treaty, 2) Future EU single market access

2019: Finding majority in European parliaments and in the UK?? (Not a likely prospect)



## Key Findings in *An Accidental BREXIT*

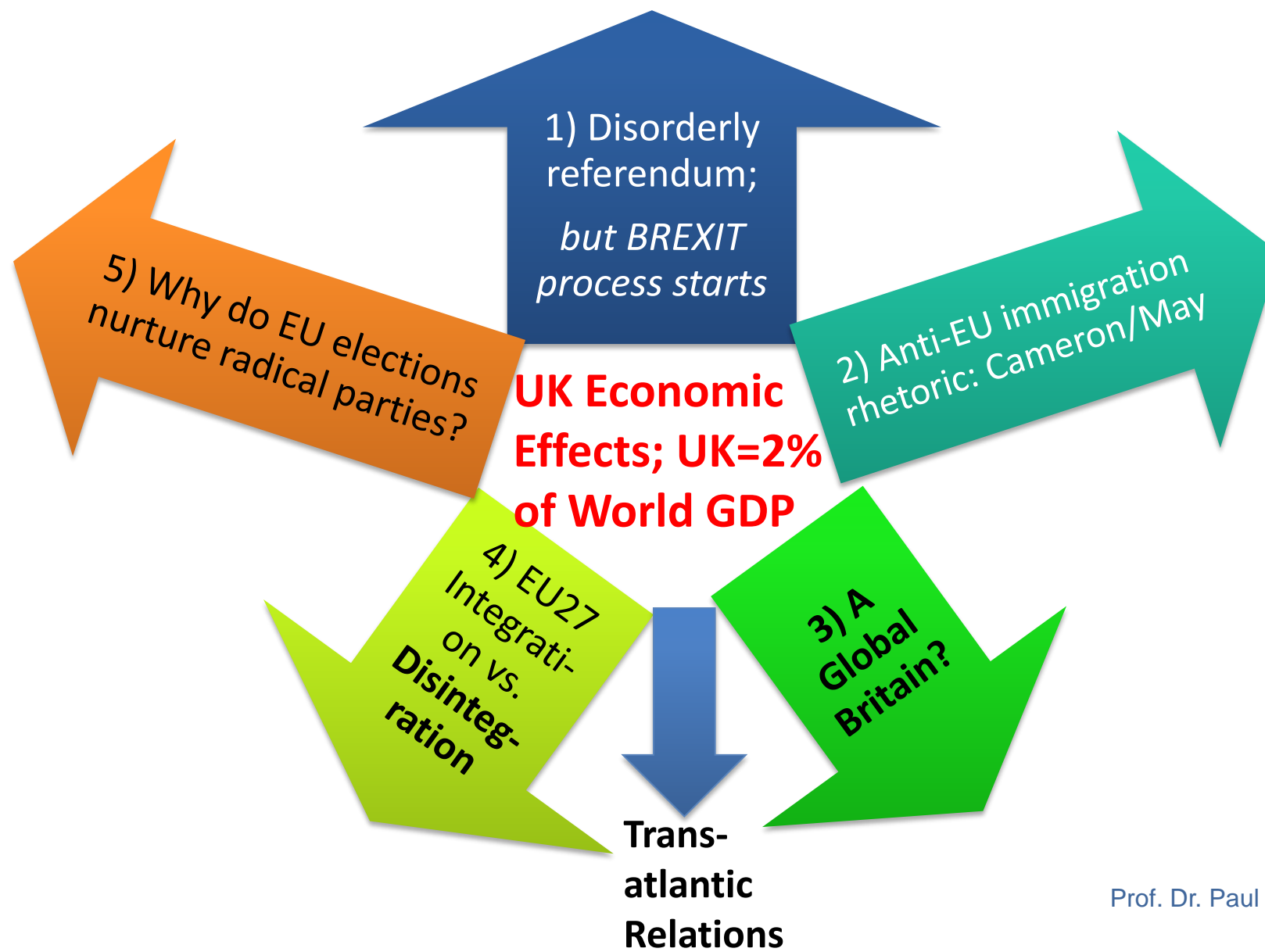
- 1) **Cameron government's info blunder at the UK's EU referendum:** with normal info policy – **informing voters in 16-page government brochure of findings of Treasury Study on long run Benefits of British EU Membership the referendum result = 52 percent REMAIN**
- 2) While Cameron gov. – and also May gov. (see BREXIT White paper 2017) have **emphasized what a difficult burden EU immigration is, the fact is that – according to OECD – immigrants are actually net contributors to British budget**
- 3) The **Global Britain approach of Prime Minister May** – to adopt new free trade agreements after 2018 in order to generate higher output growth - **will not work** (except for FTA with US/JP)

- **4) BREXIT means a considerable welfare loss for UK:**
  - **10% income loss (6% real GDP loss from BREXIT +4 %) according to the Treasury Study;**
  - **massive devaluation losses = 20% of the GBP** which means that the UK's share in world income thus falls equally=lower pol. leverage in (trade) diplomacy and through higher inward FDI share of foreign ownership in UK capital stock up = **GNP growth slowing down**
- **5) Highly unlikely that BREXIT treaties will find a majority in the UK parliament in March 2019;** political crisis in 2019 – which will also weaken the US (given strong US-UK links)
- **6) If there is BREXIT:**
  - **role of France (politically) and Germany (economically) reinforced; smaller countries will seek new positioning (e.g. Netherlands, Denmark facing Franco-German dominance; Poland etc. €?)**
  - **Transitory destabilization of the UK; UK-US FTA; weakening of the EU; new conflicts e.g. about UK subsidization of British steel industry as announced by Mr. Corbyn (Labour Party)**
- **7) 2nd referendum = NO BREXIT?**

## VOTERS DECIDE; but analytical questions on the British EU referendum 2016; criticism of the govt. referendum info, Questions: impact of disintegration

- Info campaign of **Cameron's government on EU referendum 2016** quite different in quality to that of Scottish independence referendum in 2014: Effectively suppressing info - in Cameron government 16-page leaflet sent to all households - that **Treasury Study** shows that BREXIT = a **10 percent income loss; why did this happen?**
- From the UK popularity functions of FREY/SCHNEIDER (Economic Journal (1978), and more recent related papers, one can infer the hypothetical result of 10% info for households: = **52.1 % Remain = weak legitimacy of BREXIT (with 51.9 percent on June 23, 2016).**
- Both the Cameron govt. and the May govt. argue that EU immigration has been a big burden for UK. **OECD shows opposite:** net benefit for UK govt. budget. Why fake info?
- **What reforms for the EU?** *Merkel/Macron reinforcing the Eurozone after Sept. 24, 2017*

## 6 key questions



## 2. BREXIT as a Historical Challenge to the EU

- **1. BREXIT means that the EU will shrink by 18% (GDP) and 12% of the population:** EU nimbus of ever-growing club is destroyed; internal leadership equilibrium Germany-UK-France also – only Germany/France left.
- **2. First EXIT of EU member country of a community that has started in 1957 with 6 countries:** Germany, France, Italy, Belgium, Netherlands, Luxembourg – and has 28 EU member countries at the beginning of 2019.
- **3. BREXIT is a historical step - for the next 100 years** – and raises the question of what other countries will want to follow the UK (e.g. populist AfD suggests this for Germany in its election program).
- **4. EU Commission had not anticipated that BREXIT could come** – poor political management
- 5. BREXIT move stands for a populist UK referendum largely linked to fear of EU immigration and fear of losing British identity – in the context of globalization/rise of China; free movement of labor is one element of the EU single market program (4 freedoms): **SMP = +3% GDP**
- **6. Will the EU27 further disintegrate or adequately reform itself?**

## The World Economy in the early 21st Century

Digital Growth,  
Economies of Scale & Knowledge-Intensive  
Production+; CHINA++

**USA under President Trump: Neo-  
protectionism+ bilateralism; against  
EU/ multilateralism (?), pro-BREXIT**

*OECD countries face  
possibly lower growth?,  
less political stability!*

**Globalization and International  
Organizations: good for growth and  
stability (?); Role of WTO, BIS, IMF**

**BREXIT as a historical step:  
Weakening UK and possibly EU27,  
Mercosur, ASEAN, other “clubs”**



## Quote from Dean Acheson as retired Secretary of State (West Point speech)

- Pro-Leave campaign group (II) has argued that EU immigration is such a burden that Brexit is necessary and the broader Leave group has argued that post-Brexit UK could again assume a leadership role in the Commonwealth – after Free Trade Agreements have been concluded with India, Canada, New Zealand, et cetera.
  - **(1) There is no Commonwealth that wants such UK leadership**
  - **(2) FTA with India difficult – India will require Visa deregulation; UK anti-imm.**
  - **(3) Dean Acheson (1962) “Great Britain has lost an empire and has not yet found a role. The attempt to play a separate power role apart from Europe, a role based on a „special relationship“ with the US and on being the head of a “commonwealth” which has no political structure, unity, or strength – this role is about played out.”**

**Dean Acheson, former US Secretary of State, in famous speech at West Point, 1962**

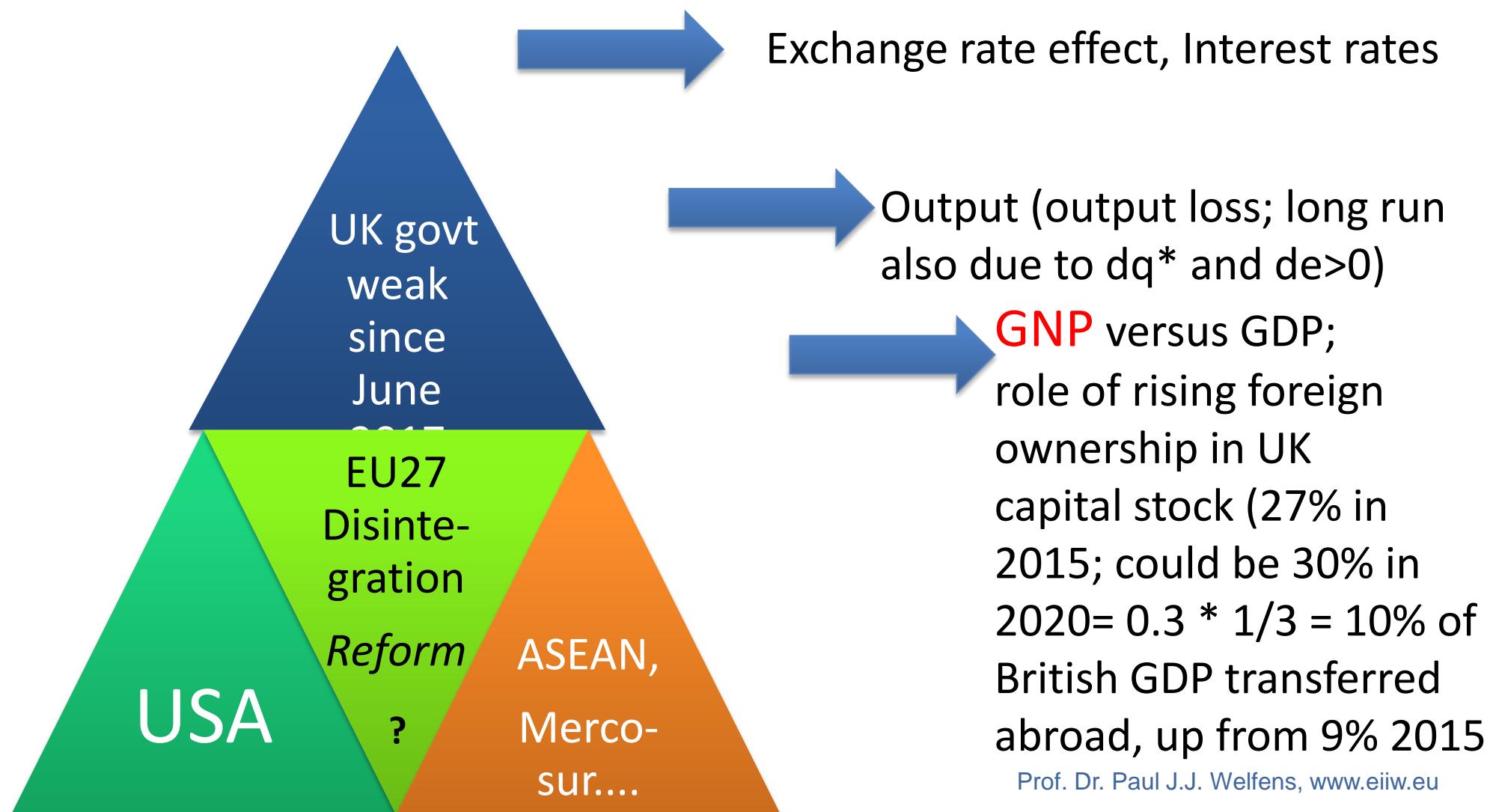
### 3. Some current BREXIT perspectives & key issues: May lost majority in June

- **2016: June 23, historical EU referendum; UK leaving the EU after 45 years on the basis of a disorderly referendum and with many internal splits: Scotland 62 % Remain**
- **UK reinforcing its partnership with the US – under TRUMP (protectionist); UK free trade...**
- **2017: Feb: May's White paper on UK leaving the EU; snap election June 8, 2017 with weakening of May government: Referendum had WEAK legitimacy as the result of an orderly referendum would have been 52.1 percent for Remain**
- **June 26, 2017: Democratic Unionist Party (DUP) supports May minority government; additional transfers for Northern Ireland; pressure for additional transfers for Scotland & Wales**
- **Unclear whether the results of EU-UK negotiations will find a majority in April 2019 in the British Parliament – indeed unlikely: if no majority then “WTO BREXIT” which would mean a very weak access to the EU single market; output reduction in UK about 7 percent in long run: BREXIT= trade effects, FDI & innovation dynamics: output, employment**

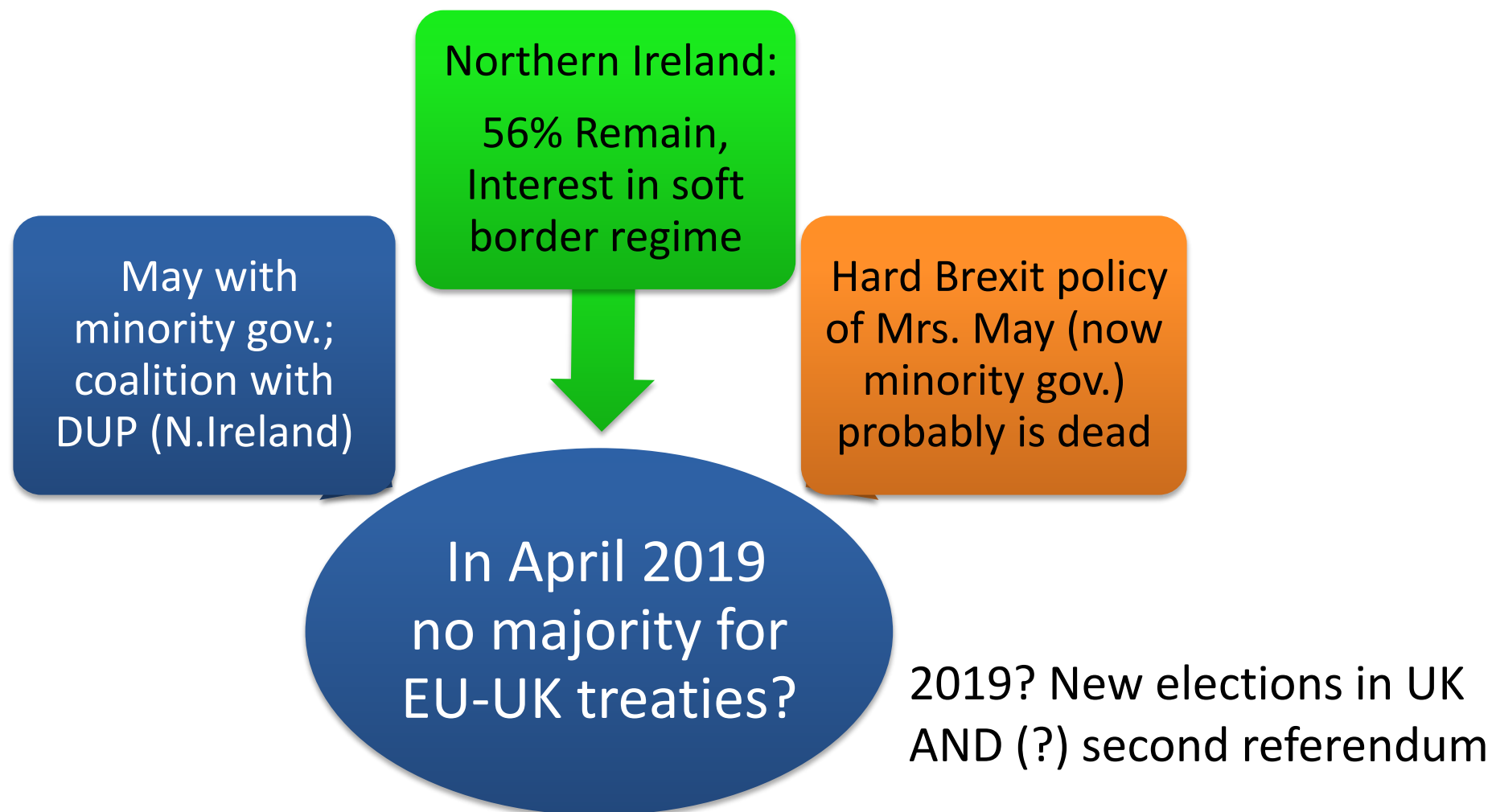
## Two Treaties: EU-UK

- **1) Exit Treaty:** „exit invoice“ which could be about 2% of UK's annual GDP; this Treaty I (with negotiations have started in summer 2017) is about exit cost, status of EU immigrants in the UK and that of UK immigrants in the EU27
- **2) Treaty II concerns Future Access to EU Single Market** (440 million inhabitants)
  - Bilateral Free Trade Agreement
  - Special issue of financial services/banking (equivalence rules)
  - Hard BREXIT (no customs union) – preferred by May government - v. Soft BREXIT
- **This situation has not been anticipated by most observers, and not by Cameron government and not by the EU Commission; and not by capital market participants in 2016**

## Selected Current BREXIT Perspectives (share of profits in UK GDP is about 1/3)



## *1. Snap Election of June 8, 2017: not a stronger, but a weaker May government*



## Analytical Focus on BREXIT

FDI + effects from real devaluation of Pound (Froot/Stein, QJE, 1991)

UK facing trade decline (EU exp=12% of UK GDP); unlikely that UK get favorable conditions in EU market access

Depreciation of EU institutional capital; EU/Eurozone reforms?

Output effects UK and EU27; see TTIP, Trade+FDI/Innovation+Growth model is needed

*Jungmittag/Welfens, EIIW paper 212*

### **UK policy reactions;**

e.g. monetary policy (QE)

### **Global Britain-Approach**

**\* US without UK implicit ambassador at the EU**

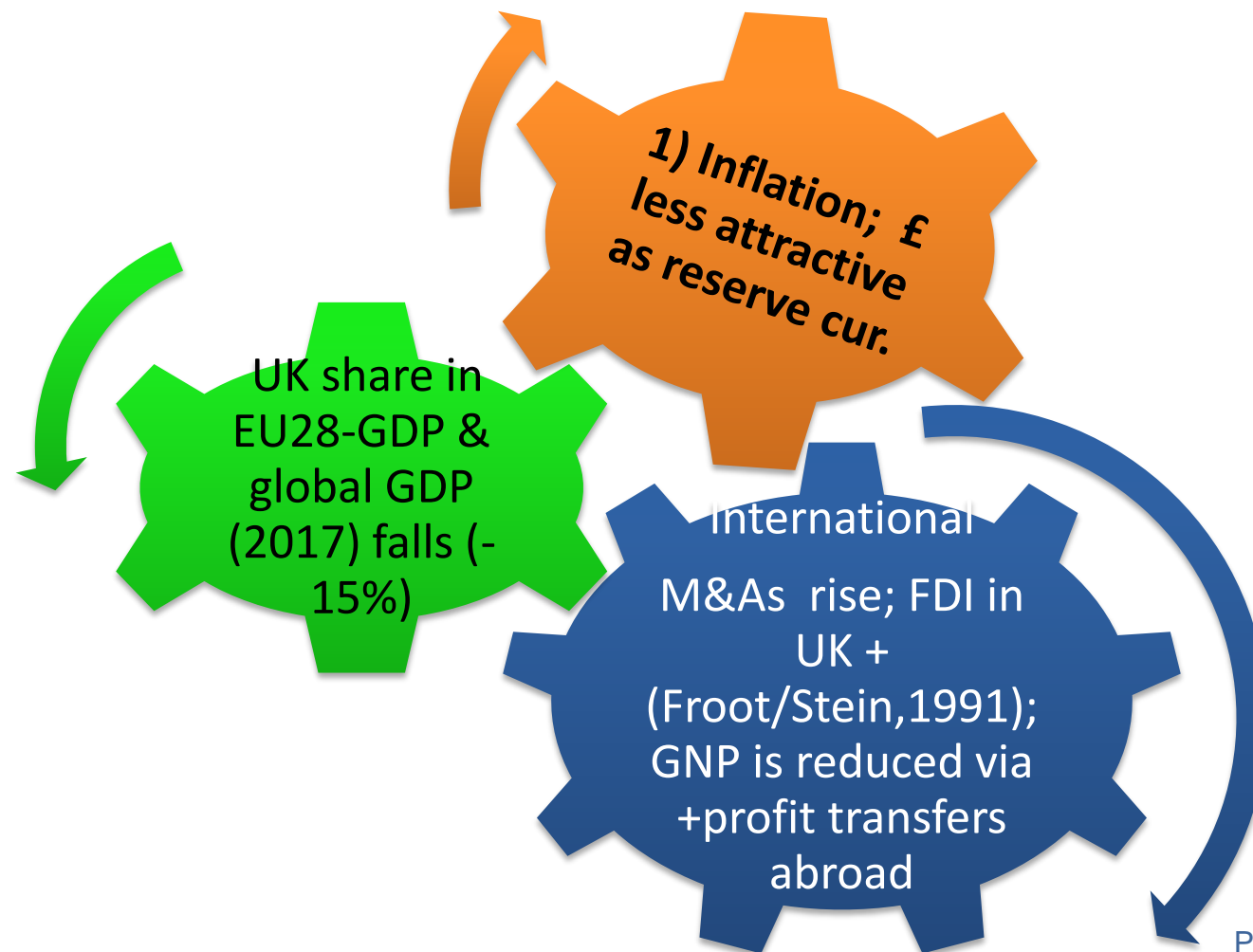
**\* Germany's role + (German EU?)**

**\* EU27 could become more protectionistic: old group of 4 dead Germany, UK, Netherlands Danmark**

**\* New bank deregulation in UK facing lower growth/+US= Next Banking Crisis rather likely**



## After referendum 2016, UK snap election 2017: depreciation



British economy is flexible, **but hard BREXIT facts cannot be overlooked**

## Should one ignore the strange nature of the British EU referendum? EU27 perspective?

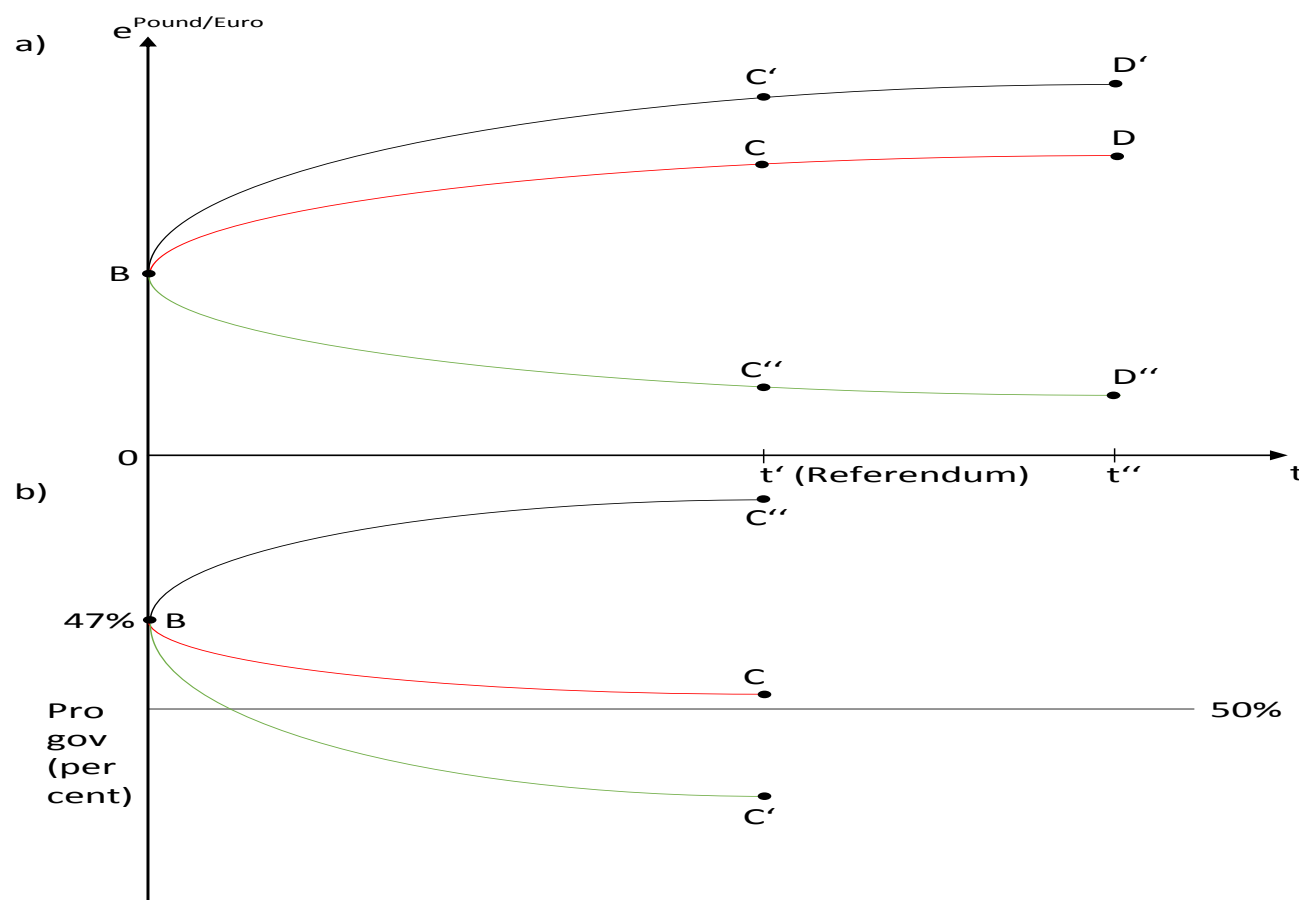
- **So far no discussion about the disorderly EU referendum and the “dishonest” Cameron/May anti-EU-immigration rhetoric. SHAKESPEARE/Hamlet...**
- **Populist forces still growing in Europe: BREXIT itself partly reflecting populist views – Michael Gove (Cameron govt) – Nobody interested in the view of experts (economists)**
- **EU27 strong or weak? (440 million inhabitants); almost equal to Eurozone in the long run; with BREXIT there will be pressure on Eastern European countries to join the Eurozone – otherwise these countries will become rather isolated politically. Raises questions about adequate reforms in the Eurozone: not much to be seen so far (GREECE?/Constitutional reforms? Capital market integration?)**

## 2) Background to the Referendum: Influence of International Capital Markets/Forex Markets on Referendum Outcome in 2016

- **Capital markets had a wrong view of referendum** in the week prior to referendum 2016
- **Appreciation of the Pound = expected Remain victory** = influence on voter (Remain: --) participation and voter BREXIT participation (++)
- How strong would the depreciation of the Pound have to be in the weeks prior to the referendum date to trigger a Remain majority?
- **Can one have free capital flows and an UNDISTORTED national referendum in UK?**  
**Obviously difficult – Problem of Free markets and Democracy/referendum option**

Fig: Exchange rate dynamics (net capital inflow) and voting (Welfens, 2017c): Depending on exchange rate development prior to referendum the outcome is as in b); appreciation in a) brings majority for BREXIT (BC'')

Fig.: Exchange rate dynamics (net capital inflow) and voting



**Is an unbiased referendum possible under free capital flows?  
(NO: 1 week (?) zero transaction?)**

## BREXIT: UK in EU starting 1973? At least in 1975 EU referendum with 67% Remain

- 
- **1993 EU single market, 4 freedoms; 2004 first EU eastern enlargement, but UK, Ireland and Sweden said they would not need transition period in field of free labor movement**
- **2007-09 Banking Crisis (2010-2016 Euro Crisis) which triggers BREXIT....**
- **2013 announcement of Mr. Cameron: There will be EU referendum if he should be re-elected; Cameron wanted referendum mainly to fight UKIP+intra-Tory anti-EU rebels**
- **Referendum June 23, 2016: Cameron for Remain** – he had obtained some EU concessions in Brussels: restrictive UK social policy would be possible for several years vis-à-vis immigrants (e.g. from Eastern EU accession countries); reinforced EU single market in services, electricity market and digital integration.
- ***Why was Mr. Cameron emphasizing the Anti-EU immigration rhetoric? Need for a culprit in the field of underprovision of local public goods = reflecting in turn a staggering cut of transfers to local communities, namely 3.5 percent of GDP within 5 years; need for these cuts reflected the 11% peak in the deficit-GDP ratio in the UK after banking crisis***

## Central Government vs. Local Authorities in the UK and Immigration

- Cameron's government sharply cut the financial allocations to local authorities over a number of years, in the cities and towns of the UK there was increasingly an impression of insufficient local services due to immigration, which was in fact being caused by the cuts in London. Cameron/May created immigration scapegoat



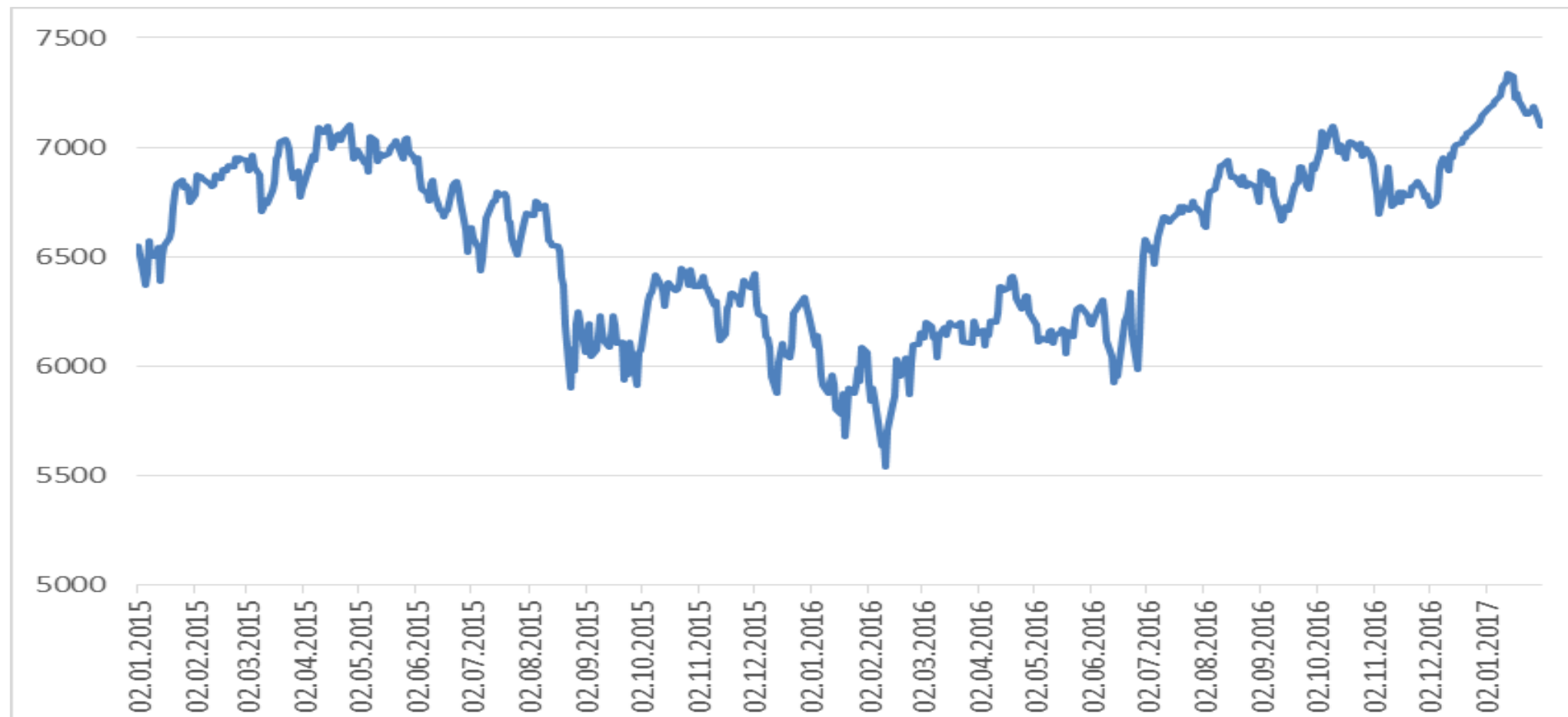


## BREXIT at no cost? UK referendum campaign: LEAVE pointed to “project fear”

- Immediately after the referendum apparently not much negative economic reactions in late 2016?
  - **UK stock market remained at high level**: But this was US effect
  - **Net capital formation weakening in 2017**; output in some sectors has started to decline in 2017 (-10 % production UK automotive; about – 5% in construction); EU27 expansion supports UK's economic development; but Eurozone growth >UK growth since 2017
  - Real wage decline in early 2017 as **inflation rate much higher than anticipated in early 2016** (inflation driven by devaluation)
  - **Foreign investors put investment on hold** in many sectors in 2017; **foreign investment bankers want to move out of London** (back to New York or relocate some activities to Frankfurt/Paris and Dublin)

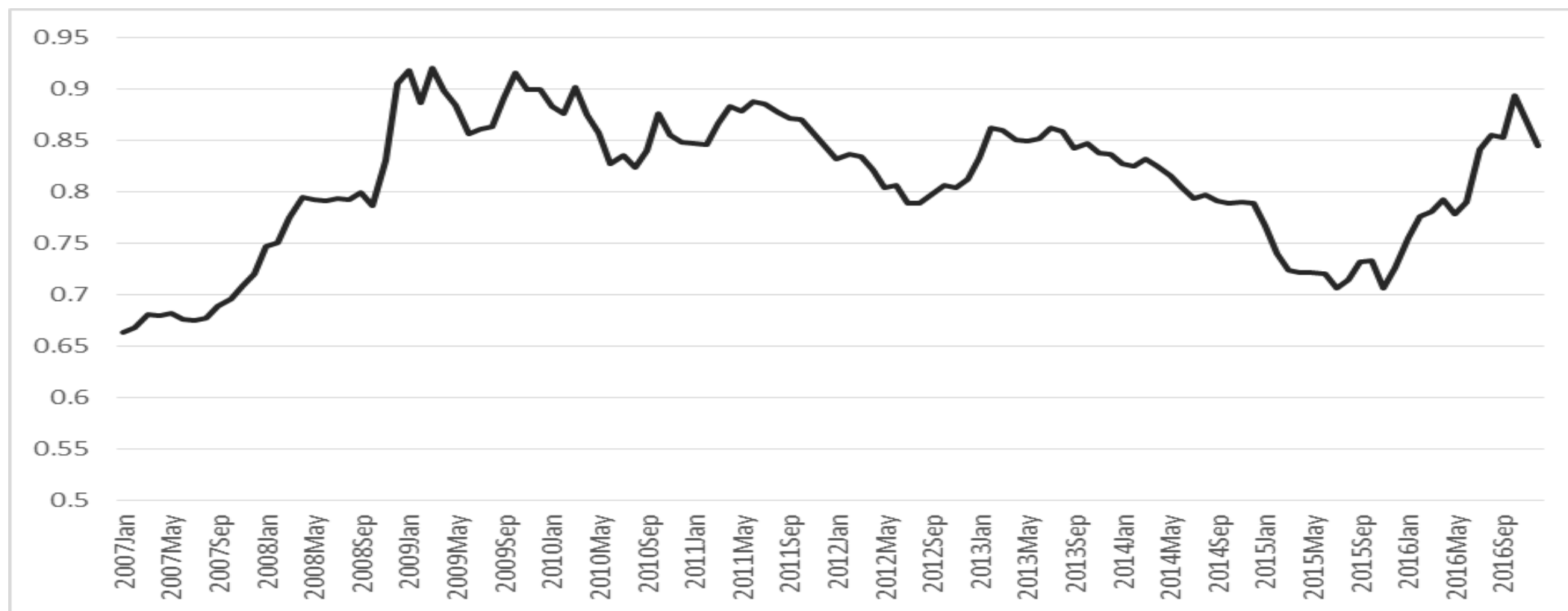
## Stock Market Development in UK (driven by US stock market)

*Figure 3: FTSE 100 (daily)*



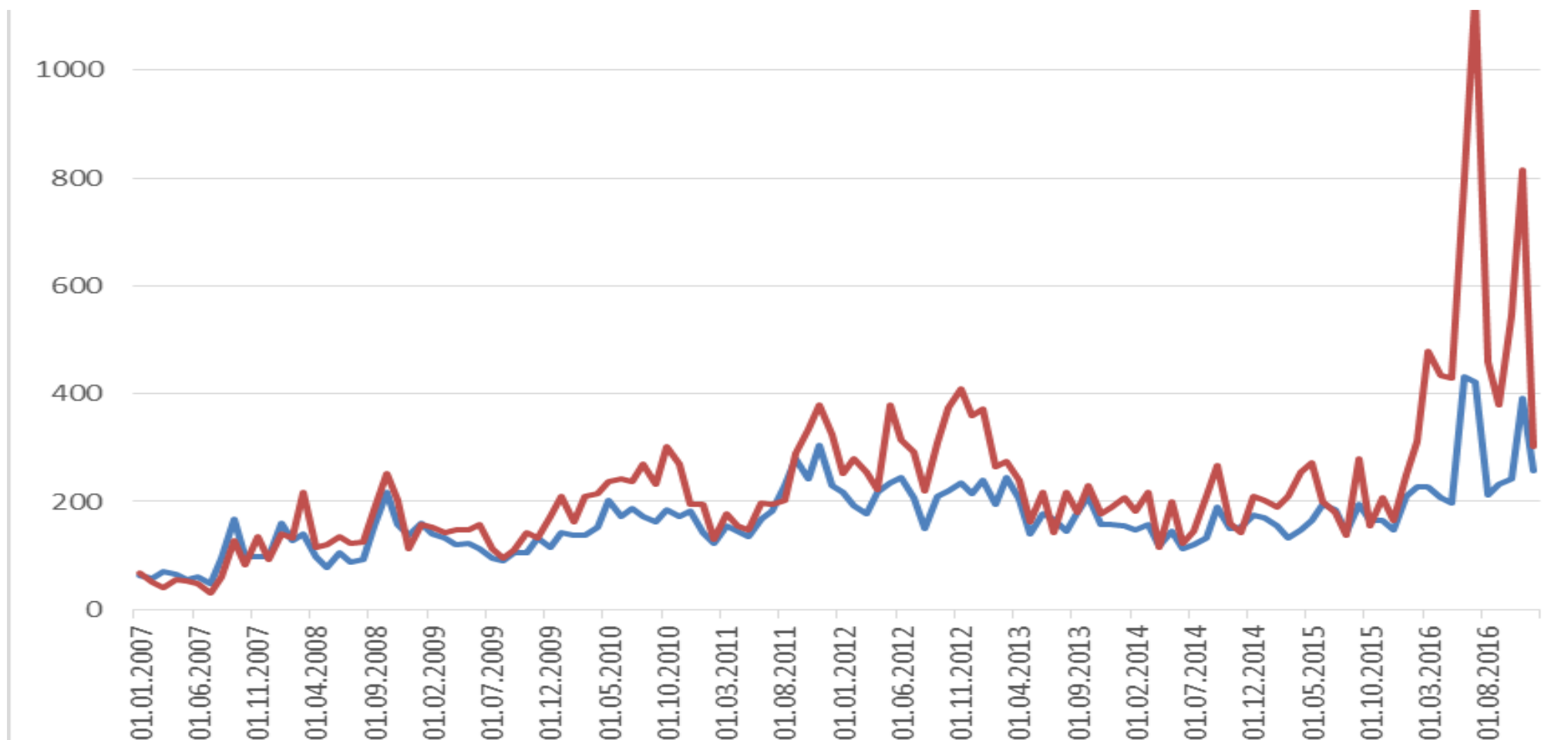
# Pound Exchange Rate

Figure 2: ECB reference exchange rate, UK pound/Euro (monthly)

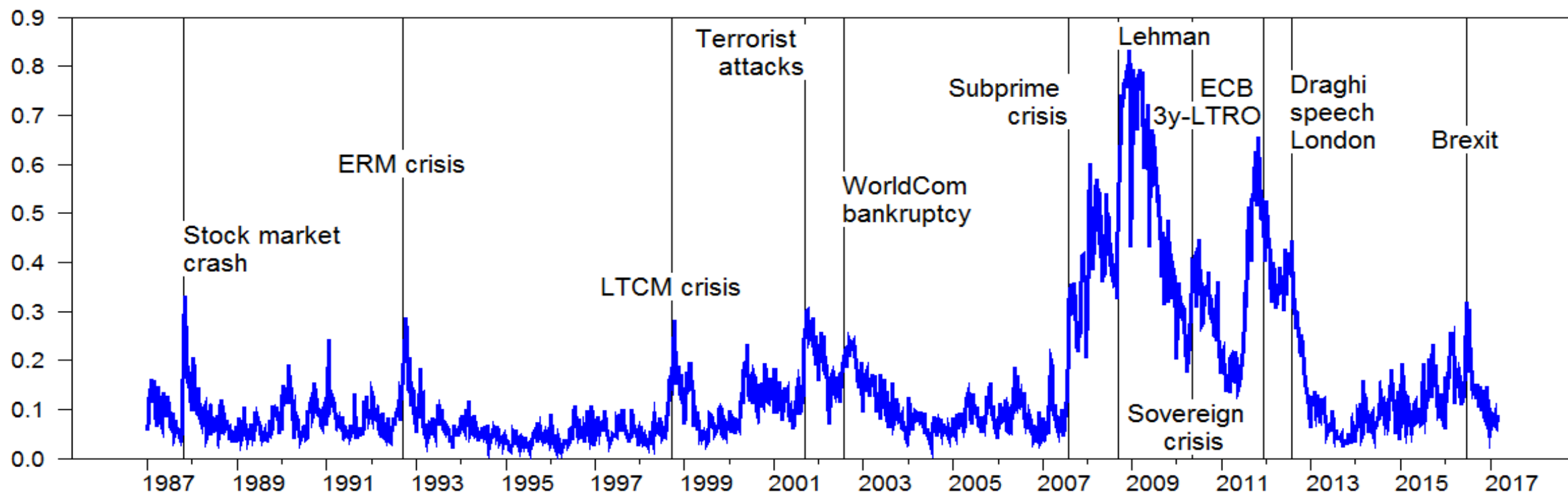


Source: ECB Statistical Data Warehouse

## Economic Policy Uncertainty Index: EU blue, UK red)



## CISS indicator (Compositive Indicator of Systemic Stress; ECB)



Notes: weekly data, 2 Jan 1987 to 7 April 2017.



## BREXIT 2016 has weak legitimacy if one considers Cameron's info policy

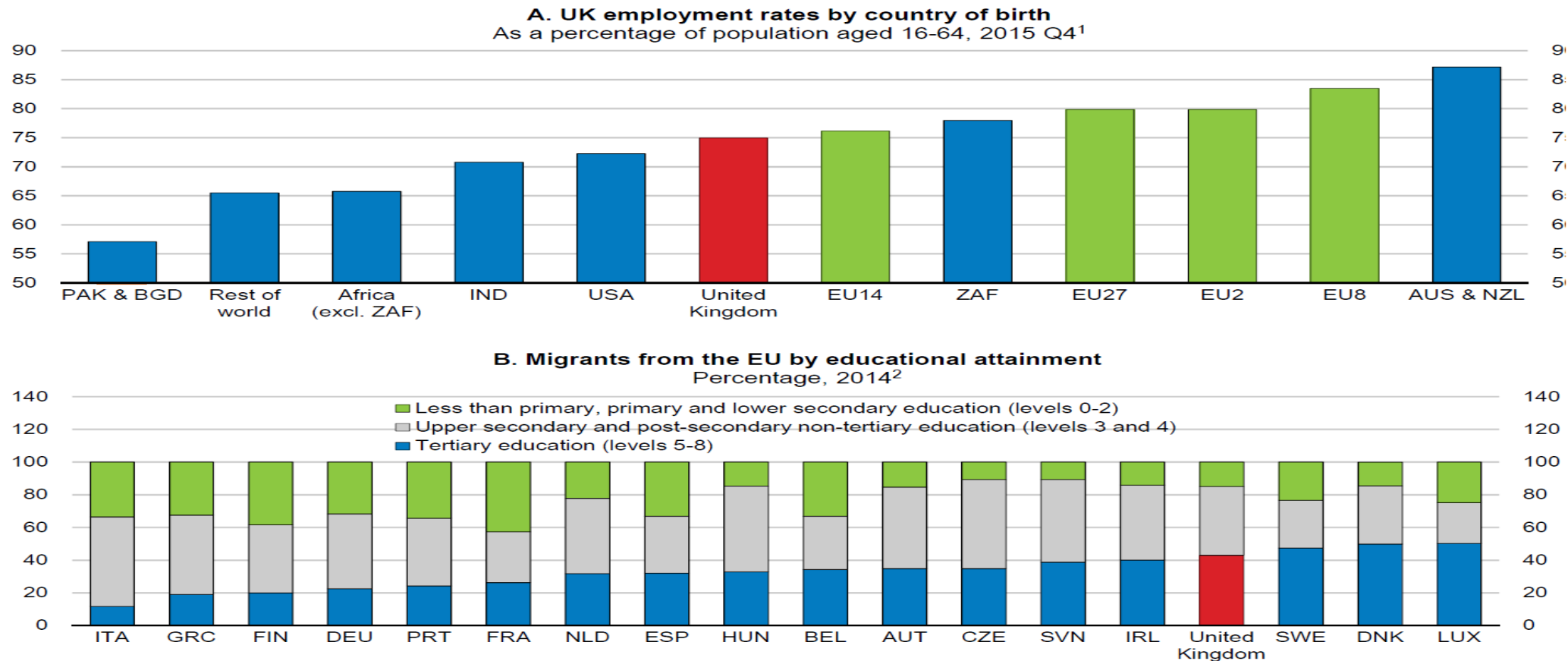
- **Mrs. May has argued there is a strong legitimacy for BREXIT – this is not convincing at all...**
- 16-page info brochure of Mr. Cameron mailed to households in England April 11-13 (1 week before Treasury Study published) had not a single word on the Treasury Study findings. WHY?..
  - **normal UK government info policy – 1800 Pound per capita in UK (Treasury St.)= Remain majority**
  - **compare to Scotland ref. 2014: Cameron Info for Scots that 1400 Pound income loss/per cap. IF..**
- **EU immigration issue: conjecture of Mr. Cameron/Mrs. May that EU immigration has for many years been a big burden for the UK...**
  - **Is EU referendum in the end more about British identity?**
  - **Will expectations of BREXIT voters – typically low education level - be correct that UK's global power and economic position will be better after Brexit? Cameron's Minister of Justice, Michael Gove said: people are fed up with view of experts – this, however, is an unconvincing view in an advanced Western country**



## EU Immigration into the UK

- Mrs. May in the White Paper 2017 emphasized: **A decade of EU immigration burden...**
- However, OECD shows that immigrants in the UK = **net contribution to the gov. budget**
- **Employment rates of EU immigrants higher than UK average;**
- ***Bank of England: only one group of workers facing lower wages in the context of EU immigration - unskilled services worker***
- **Immigrants in the UK not only workers, also entrepreneurs** that create new jobs (such jobs roughly sufficient to absorb all immigrants in the work force)  
**(US: 40% of the Fortune 500 firms were created by immigrants or first generation descendents)**
- But **May government** in White Paper on Brexit (2017, Feb.): **Burden of EU immigration**

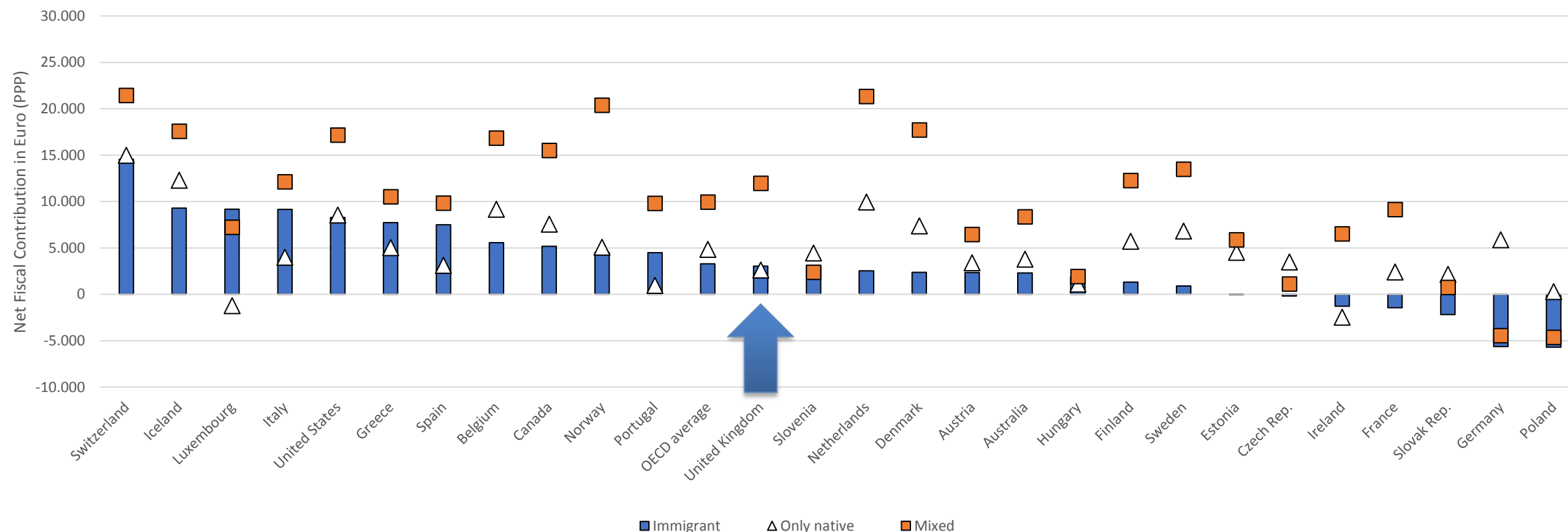
# EU Immigrants in UK – a burden? (OECD data contradicts rhetoric of UK govt.)



Source: OECD (2016a), The Economic Consequences of Brexit: A Taxing Decision, OECD Economic Policy Paper, No. 16, OECD Publishing: Paris

# Net Contribution of Immigration on National Budget: Positive in UK – according to OECD (for EU immigrations++)

Average net direct fiscal contribution of households by migration status of the household head, 2007-2009 average, EUR (PPP adjusted)

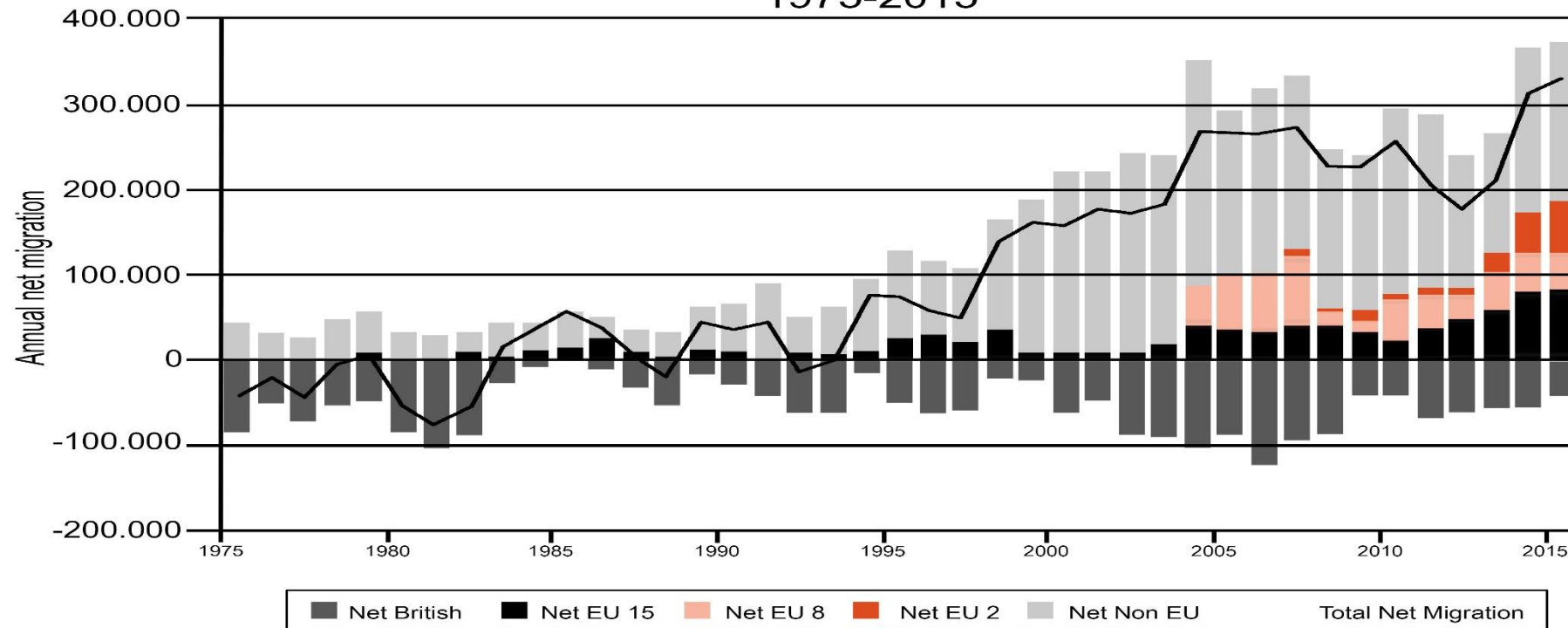


Source: OECD International Migration Outlook 2013

February 2017: **UK White Paper on Brexit**: chapter Controlling Immigration – text: EU immigration stands for a decade with high burden; the following graph from White Paper shows that non-EU immigration was the key challenge. **Contradiction**

Chart 5.1 - Net migration to the UK

Net migration to the UK by nationality,  
1975-2015



Source - ONS<sup>14</sup>

HM Govt. White Paper: The United Kingdom's exit from and new partnership with the European Union, February 2017.  
Colour added by PJJW for clarity

## 4. Transatlantic Perspectives

- **UK traditionally (1973-2016) the EU country that would be the US voice** at the EU negotiation table – will this be France or Germany (with Germany there could be dispute about Germany's high current account surplus)?
- **UK for US multinationals/big banks as a gate to the EU single market; US foreign investors stand for 7 percent of UK output**, US Banks in London very strong; with single EU passport of banks City of London is banking center for EU28 – highly unlikely that this should be still possible in the future/BREXIT
- **Crucial for US governments 1973-2016: UK+Germany+Denmark+Netherlands = pro-free trade group** in the EU that helps to prevent protectionist policy of Europe – how important this perspective is for president Trump is unclear

## Mrs. May's Government Weakened after Snap Election 2017

- She needs the support of the Democratic Unionist Party (Northern Ireland); **looks strange for Ireland which fears that neutrality of British government is gone**
- **There is a potential new/post-BREXIT Irish conflict that initially had been solved with the help of the US President Clinton** (Good Friday Agreement, signed in 1998; UK/Ireland and the second element was an agreement between the parties in Northern Ireland)

*“This above all: to thine own self be true, And it must follow as the night the day, Thou canst not then be false to any man.”* William Shakespeare, Hamlet (Act I, Scene 3) –to be considered by Mrs. May and strictly by Mr. Boris Johnson (350 mill.Pounddisinformation: weekly UK contribution to the EU; correct is about ½; see details in Welfens book)



**“Brexit means Brexit and  
we will make a success of it.”**

**Global Britain Approach...**  
***Can it work?***

## Some Global Britain Problems

- **US under Trump in favor of protectionism and Bilateralism;**
- **US is undermining multilateralism: BIS and WTO (and...); *undermines UK's Global Britain approach of many more new British FTAs***
  - ***The UK will look for support from other countries in order to maintain WTO – what the Trump Administration wants is unclear/pro-protectionism; in 2017 it has stopped TTIP and TPP, it has restarted the NAFTA negotiations to GET A BETTER DEAL – this is possible, but it undermines the willingness of partner countries to consider long term cooperation with US as Trump's opportunistic behavior creates a new confidence problem on the side of US partner countries (US NATO leadership less credible, can cause many new international problems – costly for the US; lack of US REALISM)***
  - ***Part of Leave Campaign in the UK has argued: UK could be a renewed Commonwealth leader***



## Quote from Dean Acheson (retired US Secretary of State, 1962...)

Commonwealth approach of Leave Groups leaves open obviously two questions:

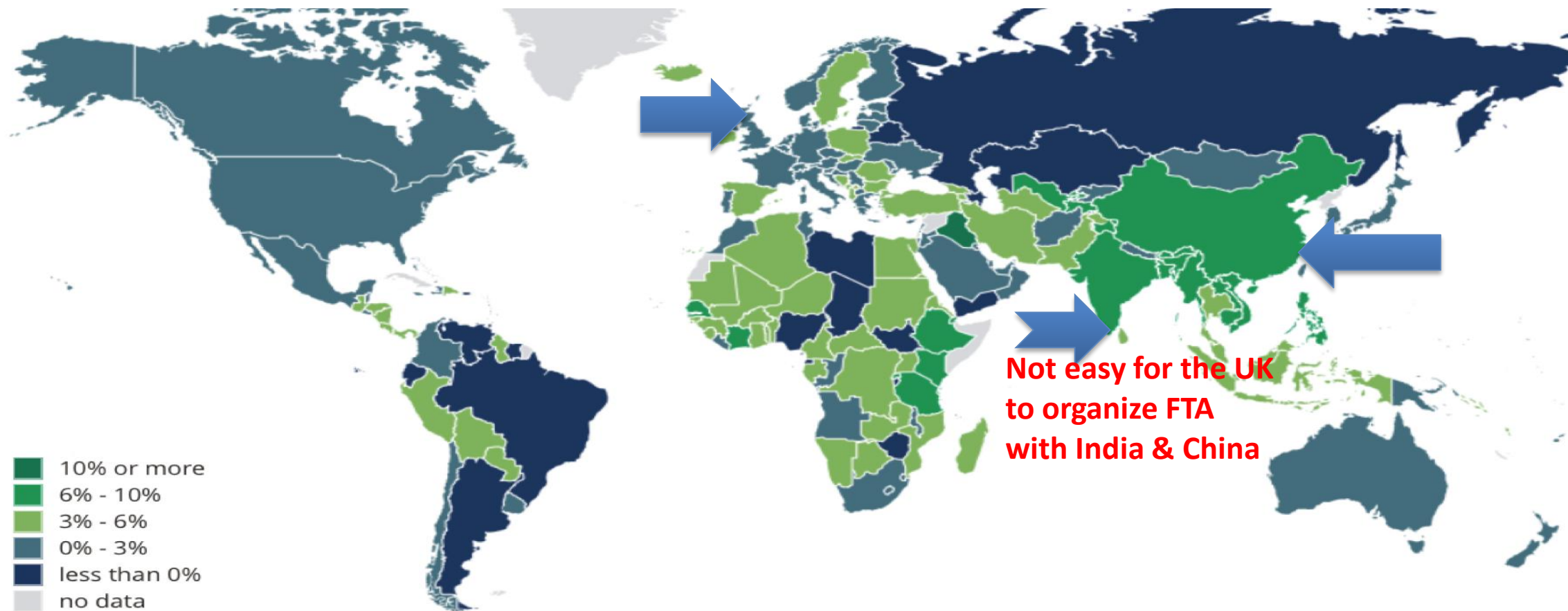
- Will a new Commonwealth strategy of the UK be welcomed by other Commonwealth member countries?
- Could a new British Commonwealth strategy create major benefits for the UK?

An old answer from the US (1962) is an adequate answer after BREXIT referendum:

**“Great Britain has lost an empire and has not yet found a role. The attempt to play a separate power role apart from Europe, a role based on a „special relationship“ with the US and on being the head of a “commonwealth” which has no political structure, unity, or strength – this role is about played out.”**

**Dean Acheson, former US Secretary of State, in a famous speech at West Point, 1962**

## Global Growth Map (change of real GDP in percent; 2016); UK>Eurozone before 2017; UK seeks FTA with countries with high growth...possible?



## David Davis' long list of potential new FTA partners

- US – ok
- India – will not be easy to achieve: **issue is visas for more Indians working in UK**
- China – very doubtful= phasing out much of UK manufacturing industry; Hong Kong...
- New Zealand, Canada, Australia: yes, but economically of limited importance
- Japan (low priority)– EU2017 has negotiations with Japan; considerable progress

**CAN GLOBAL BRITAIN approach easily generate new growth dynamics so that BREXIT economic pain will not be felt? Probably NOT**

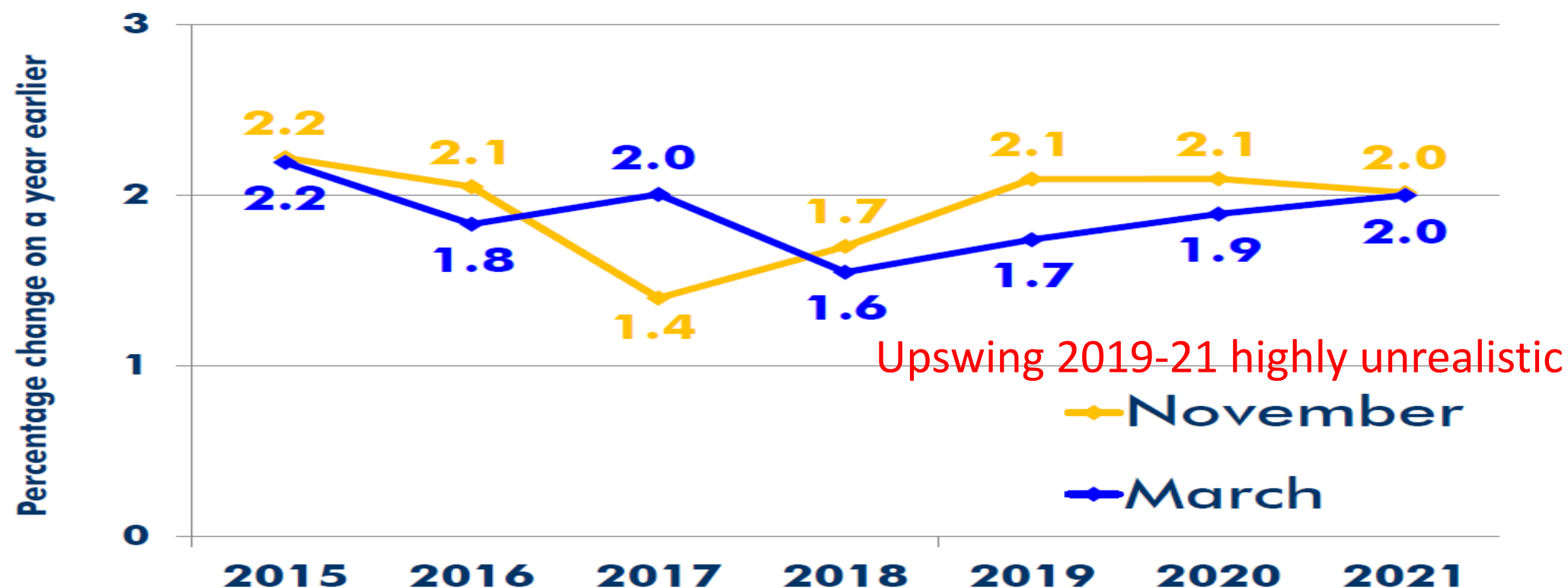
## More on the UK Perspectives: BREXIT means which Brexit?

- **1) hard BREXIT** = 2019 exit without customs union/EU single market membership; worst case is WTO default position
- **2) soft BREXIT**
  - = **bilateral agreements, some UK contribution to the EU budget** in exchange for sectoral free trade agreements –
  - **plus possibly equivalence agreements for banks in the field of EU regulation** so that banks in London enjoy the privilege to access the whole EU financial market from the UK
  - **Special agreements for UK/Ireland border regime in Northern Ireland;** and credible agreement among parties in Northern Ireland to stick to the 1998 Good Friday Agreement (brokered in part by US President Clinton)

## UK Economic Growth Perspectives

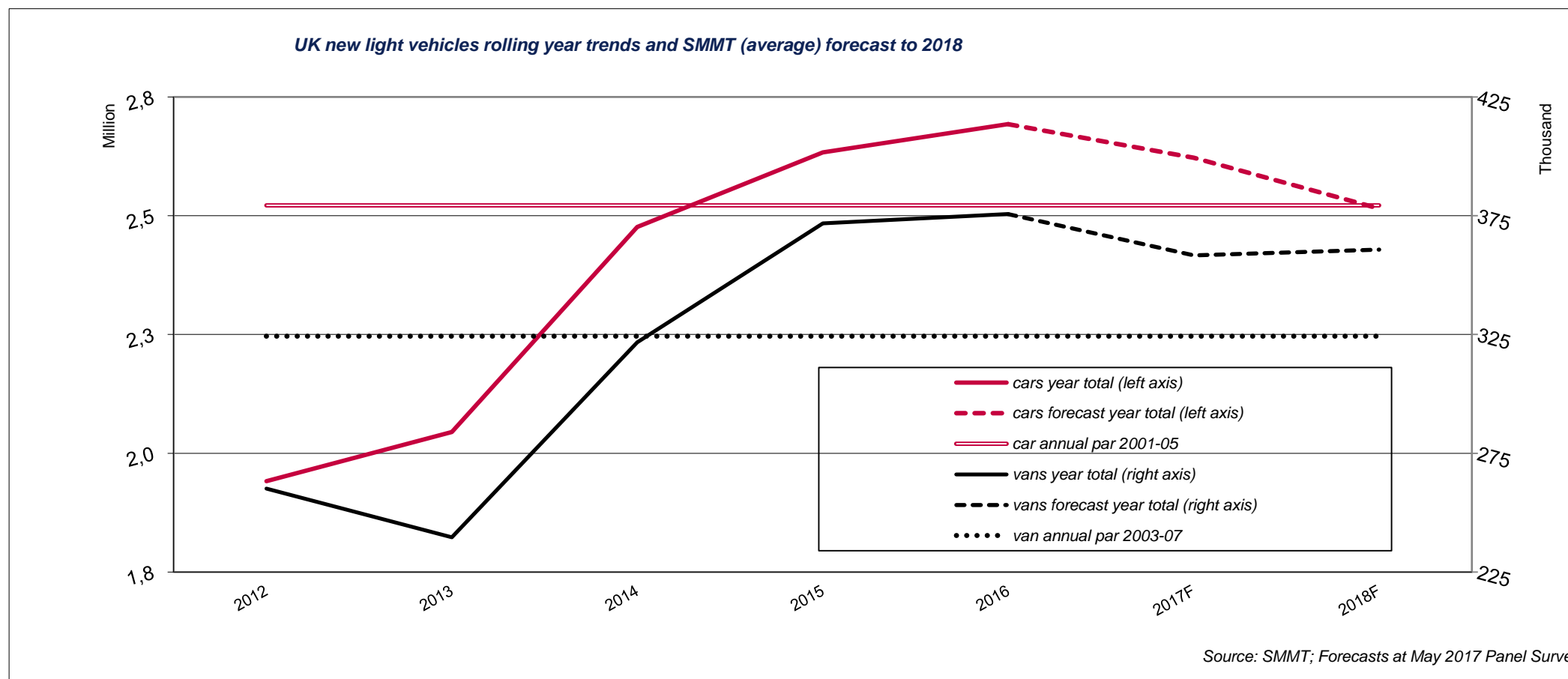
- **With almost 3% inflation rate in 2017, real income growth of workers is weakening;** and trade unions are weak in the UK. Hence consumption growth will decline
- With political uncertainty in the UK continuing and very difficult negotiations between the UK and the EU27, the **British growth rate will decline 2018/2019** (despite the real devaluation of the Pound - **raises net exports in the medium term, but makes imports of high-tech/knowledge-intensive products more expansive for UK exporters which thereby face declining international competitiveness** in the long run)
- **Net immigration from EU countries will decline due to uncertainty** of the status of immigrants – and due to the anti-immigration rhetoric in the UK; weakens UK growth
  - **immigrants are not only workers, they also are entrepreneurs** (in the UK have created more jobs than there are immigrants); in the US 40% of the Fortune 500 firms were created by immigrants or first-generation children.
  - **Return to nationalism is linked to Banking Crisis which showed to the people in the EU: only national governments can act/powerful enough to prevent disaster**

# UK Annual Real GDP Growth Forecast (March 2017)



Office for  
**Budget  
Responsibility**

# SMMT April 2017 forecast UK new car and van registrations 2017 - 2018



**Source: Society of Motor Manufacturers and Trades (SMMT), Forecast new car and van registrations, April 2017**



**5) USA & UK:** Premier May hopes that President Trump will support the UK (politically, through Free Trade Agreement); Mr. Trump pro BREXIT 2016





## The UK and the US

- Trump Administration will support UK and UK seeks US BREXIT support by US
  - **US-UK FTA in 2019 = ¼ of a TTIP project** (US exports to UK=1/4 of US exports to EU28)
  - UK will have to seek a new international role and a new role in Europe; US: UK should follow the US
- **US undermining multilateralism which undermines Global Britain project**
- US is losing EU pro-free trade **quadruple group UK-Germany-Netherlands-Denmark**

## The UK and the US

- UK no longer the US voice in Brussels; US likely to use Germany as a main partner in the EU: **will reinforce fear of German EU in Europe**
- Nato could be more difficult to organize if EU27 countries reinforce military cooperation (and joint policy efforts/cooperation) that so far have met resistance by UK
- US will follow UK in reducing corporate tax rates; UK will follow US policy of banking deregulation – not least due to reduced output growth in the US 2018-2020 = in t+x **the next Transatlantic Banking Crisis in a few years**; *could be avoided only if the EU27 and the UK agree upon joint regulation of banking and financial markets in Treaty; not very likely*
- *While stricter regulation is in place in 2017 than in 2007 in Western OECD countries there could be strong **roll-back (deregulation) in US/UK: Strong European deregulation wave would be the result**; a new big transatlantic banking crisis could emerge: Could be bigger than 2007-09; could undermine democracy in the West!*

## BREXIT as a Problem for the UK, Europe and the US (the West)

- **Slow growth in the UK will stimulate government to adopt a new banking deregulation** wave (+ lower corporate tax rates) in 2019
- **US already has started to dismantle the Dodd-Frank Act in 2017** under Trump Administration
- **US-UK banking deregulation will generate high pressure for parallel banking deregulation in the EU** (see ARTUS/VIRARD, 2006 explaining the mechanism)
- **Excessive banking deregulation in the West** will generate the Next Western Banking Crisis (NWBC) – the cost of which could exceed that of the crisis of 2008/09
  - Role of IMF with FSAP (Financial Sector Assessment Policy) and of BIS (Bank for International Settlements/Basel III Rules) not strong enough to maintain adequate prudential supervision for big banks – certainly not if Trump Administration weakens BIS
  - Avoiding BREXIT thus would have considerable benefits for the West/world economy

## Vicious circle from “foreign” (US&UK) banking deregulation

Excessive banking deregulation= banking crisis 2007/08= in UK new Cameron anti-immigration rhetoric= BREXIT

BREXIT dynamics will lead to new banking deregulation

UK deregulation + US dereg. (weakening Dodd-Frank)= next banking crisis in Europe

## 2018/2019 critical transition years

- Considerable political uncertainty in UK;
- After 2017 - and elections in France and Germany - new EU reforms likely
- High likelihood that the EU-UK treaty will not get a majority in the British Parliament in March/April 2019 - default is “WTO BREXIT”
- **WTO-BREXIT could cause a high devaluation and high financial market volatility; Liquidity problems in EU27 as certain specialized financial services from UK (dealing with risk and special services for SMEs) are no longer easily available in EU27**
- (EU27 faces need to encourage in 2017/2018 the creation of new services in the Eurozone; will Germany/France/other EU countries launch an adequate initiative? Germany's Ministry of Finance not really on a cooperative path with France so far; Berlin afraid of increasing French economic influence)

## Legal Aspects Matter

- **European Court of Justice (May 2017): Free Trade Agreements EU-X based on European Parliament** – only portfolio investment rules and investor dispute settlement needs national (and regional) parliaments' approval: **Could make EU-UK FTA easy (although portfolio investment is a field relevant to London banks...)**
- **Is BREXIT the start of EU disintegration** – leading Europe back to the late **19th century?** (+ China & US): Rather likely unless adequate national and EU reforms are undertaken

## 6. May's Global Britain Approach – Will It Work?

- **Global Britain approach (David Davis in 2016; Premier Cameron Feb. 2017)**
  - **Use new political freedom after 2019 to engage in many new Free Trade Agreements** = higher growth for the UK = not feeling any BREXIT pain
  - **British exports are almost 13% of UK GDP, exports to US are about 3% of GDP**
- **Can the Global Britain approach of May government work? Not really**
  - **FTA with US and Japan; YES; *but not with India* (Visa issue) or *China* – (British industry would collapse)**
  - **With weaker EU single market access and some sectoral EU-UK FTAs, minimum value-added requirements of 60% for UK will undermine British export position in EU/world**
  - **Relocation of banks etc. from London to the EU27**, as from 2019 the banks in London without an EU-Pass can no longer serve the EU market from the UK; US, Japanese, and British banks (banks from London) will transfer activities to the EU27

## Weakening of Multilateralism; **Multilateralism = making the small big and the big (countries) civilized said the WTO Secretary General in late 2016**

- What effects will **BREXIT** have on **regional integration areas and multilateralism** in the global economy (e.g. **Mercosur, ASEAN and others**)? Weakening of other regional integration clubs – ASEAN, following EU example, has started single market 2016
  - As regards multilateralism, here the US Trump Administration enters the picture in a negative way
  - If there is **weakening of Mercosur or ASEAN or EU there could be more regional conflicts and higher military expenditures** in many countries (including UK and some EU countries) and hence lower growth of per capita consumption
  - UK might benefit from EU28 free trade agreement (ie with Japan – **the latter being more interested in FTA with the EU after President Trump has announced that TPP is dead.**



## 7. Current EU Is Unstable

- **Why do European elections with an EU mini budget (1 percent of GDP) nurture political radicalism in Europe?**
  - 1) some Eurozone problems still lingering on
  - 2) basic idea is that the supranational policy layer should not assume responsibilities where the EU member countries could do the “job” themselves = principle of subsidiarity; **STATIC VIEW...**
    - *voter turnout at EU elections has been strongly declining over decades = weak intensity of EU political competition = weak efficiency of supranational policy process*
    - *Forschungsgruppe Wahlen (political sciences/voting behavior expert group) found that German voters understand the topics at Germany's regional and national elections, but have no idea about the EU competences/topics and therefore indicate a rather high willingness to vote for radical small parties at European elections (recall: 7 percent for right-wing populist AfD in 2014; in UK and France radical parties were winners at European elections, namely UKIP and Front National): More public expenditures and fiscal policy at EU layer could help to overcome the problems of voter confusion*
    - *Theory of Fiscal Federalism suggests that infrastructure exp., defense, some redistribution should be at the supranational level; will Germany/France launch an initiative in this direction in 2018? NO?!!!*

## Current EU Setting ...

- **Means that EU becomes source of political radicalization/expansion of populist parties** in France, Germany and other countries
- **Eurozone unable to have an efficient stabilization policy:** IMF says that 1% GDP shock in the USA and the Eurozone will have a reduction of consumption in the Eurozone that is 3 times as high as in the US
- **EU countries unable to cope with China challenge**
  - **FDI asymmetry:** e.g. China's FDI faces almost no restrictions in the EU, but EU firms in China face considerable restrictions with respect to majority ownership; EU Commission should become much more active
  - Major sectors in Germany dissatisfied with EU trade policy – “very weak“, lobbying in Berlin for a more nationalistic foreign trade policy which in turn undermines the EU; in France a similar line of reasoning is likely – **this, however is not success-promising strategy for the EU to be a leader in economic globalization**

## 10. Conclusions for 2019

- 2019: my view: **NO majority in the British Parliament** for Treaty 1 (Exit Bill) and Treaty 2 (UK access to EU single market); **UK new elections** in spring 2019 = labor government wins
  - **EU-UK customs union could result from this**; problem with immigration in the EU unsolved
  - **Massive Pound appreciation**
  - **Not excluded: referendum II on EU membership**; UKIP returns, crisis of the Conservative Party
- **Alternative is BREXIT implementation:**
  - Could lead to second Scottish independence referendum: Remain or joining the EU
  - New problems in Ireland
  - UK GDP reduced by about 0.6 percent for a about a decade, EU GDP reduced by about 0.1 p.
  - China and Russia will strongly benefit in the global power game (EU27=4/5 of EU28); other EU countries could follow the BREXIT path
-

## A Historical Note on European US Political Relations

- The US has supported EU integration over decades – good for Europe, good for the US
- **This tradition seems to be interrupted by Trump Presidency**
- 1953: Jean Monnet as the president of the European Coal and Steel Community (founded in 1952: forerunner of the EU) visited the US – and was welcomed by President Eisenhower; Mr. Juncker, the EU Commission President declared in 2017 that he will visit the US but was not sure that the US president would meet him...
- **The EU Commission should adopt crucial reforms**, but the initiative will have to come from Germany/France/Italy – **Merkel & Macron** could launch a new initiative?? With BREXIT and a rather ineffective Trump Administration plus lack of EU reforms= **crisis of the West:**
- **2019 will be decisive year: 100 years after Versailles, year 1 of BREXIT, new president of the ECB and year 3 of Western Confusion**

# *Many Thanks for your kind attention*

- more in EIIW paper No. 238
- [www.eiiw.eu](http://www.eiiw.eu)
- 2015 = 20 years of award-winning research at EIIW

## Appendix: Historical EU-Focus in a BREXIT context

- **Goal of the EU:** Guarantee peace, growth and prosperity via free trade; common external customs policy as competence of the **European Commission** (also European Court of Justice and European Parliament – directly elected since 1979). For the USA: creation of a European partner in the “West”
- UK wanted to join in the 1960s, but De Gaulle said no; it joined 1973 and was active about 45 years in the EU; **UK is the seat of two EU institutions** (EBA: supervision of banking and the EMA (European Medicines Agency) : supervision of medical products; recent study what economic effects the relocation of both institutions would have for Austria: IHS, 2017)

## Historical EU-Focus in a BREXIT context

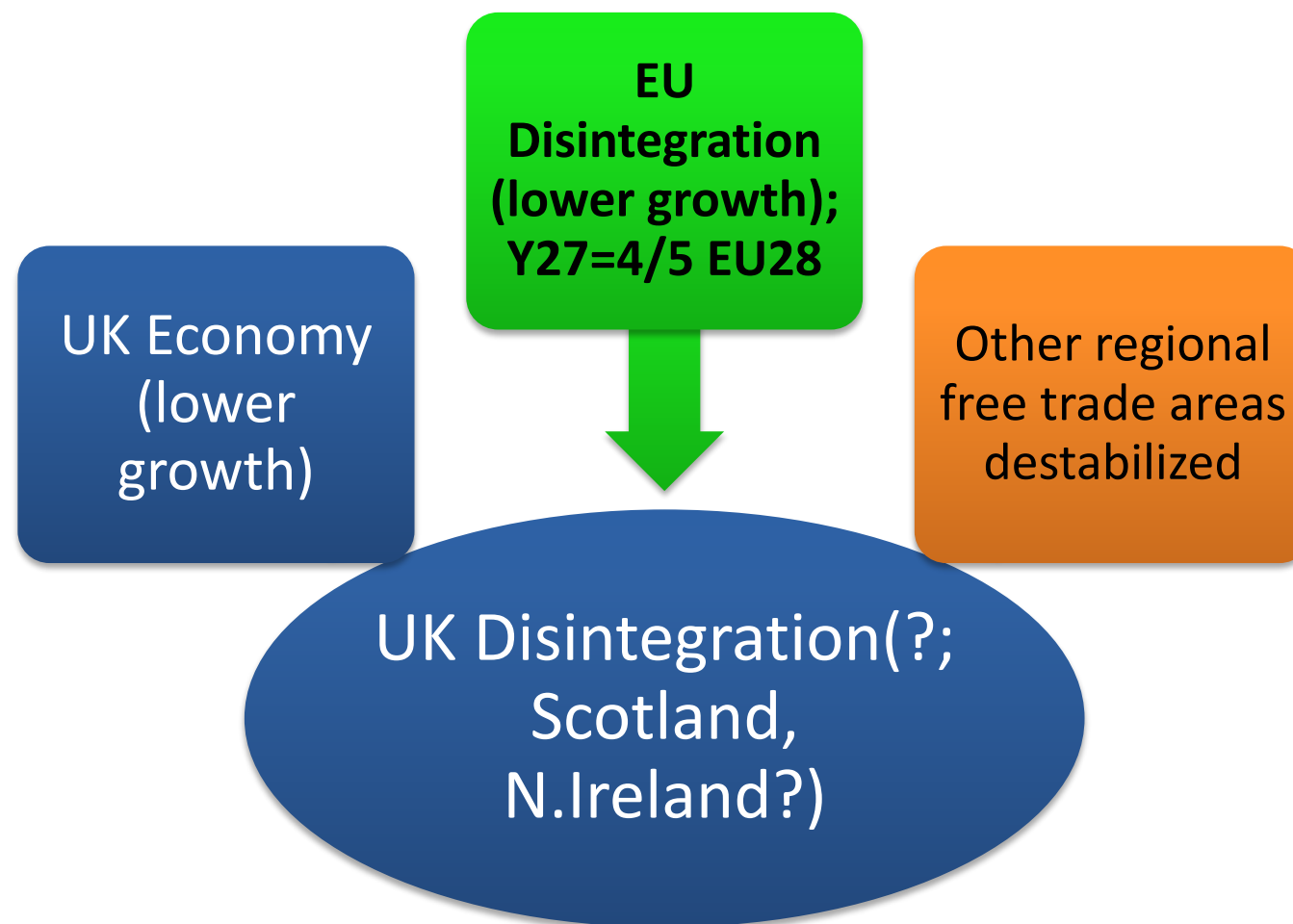
- **Later in the EU:** community competition policy, subsidy controls, framework regulations/the liberalization of networks etc.; from 1993 the EU Single Market, spurred on by UK initiatives
- **EU-related knowlegde low in the UK according to Bertelsmann study:** just 49% correct responses by British respondents to basic EU-related questions, Poland (which joined the EU decades after the UK): 53%, Italy: 80%, Germany: 81%
  - The EU Commission is partly to blame for the low level of EU-related knowledge in the UK
  - British governments have not invested in knowledge building on EU matters – except for Blair government (project with schools)

## BREXIT to be expected March 29, 2019 and the years 2017/2018

- **Considerable political tensions UK – EU** over the exit costs and the EU-UK Treaty on access to the EU27 single market to be expected
- **Partly hard BREXIT likely: Political options:** Possible is some quasi-passporting/equivalence rules for part of the London banking sector while EU27 gets a free trade agreement in the automotive sector (here the EU27/Germany have surplus position; UK interested more in financial services exports to EU27; **60 percent value-added requirement for UK after 2019. I for duty-free access of EU automotive products to EU single market** = cost disadvantage for UK producers whose existing EU production networks are devalued
- **BREXIT is negative signal to EU integration and negative signal to other regional integration schemes: MERCOSUR, ASEAN** (ASEAN single market has started in 2016, modeled on the EU)



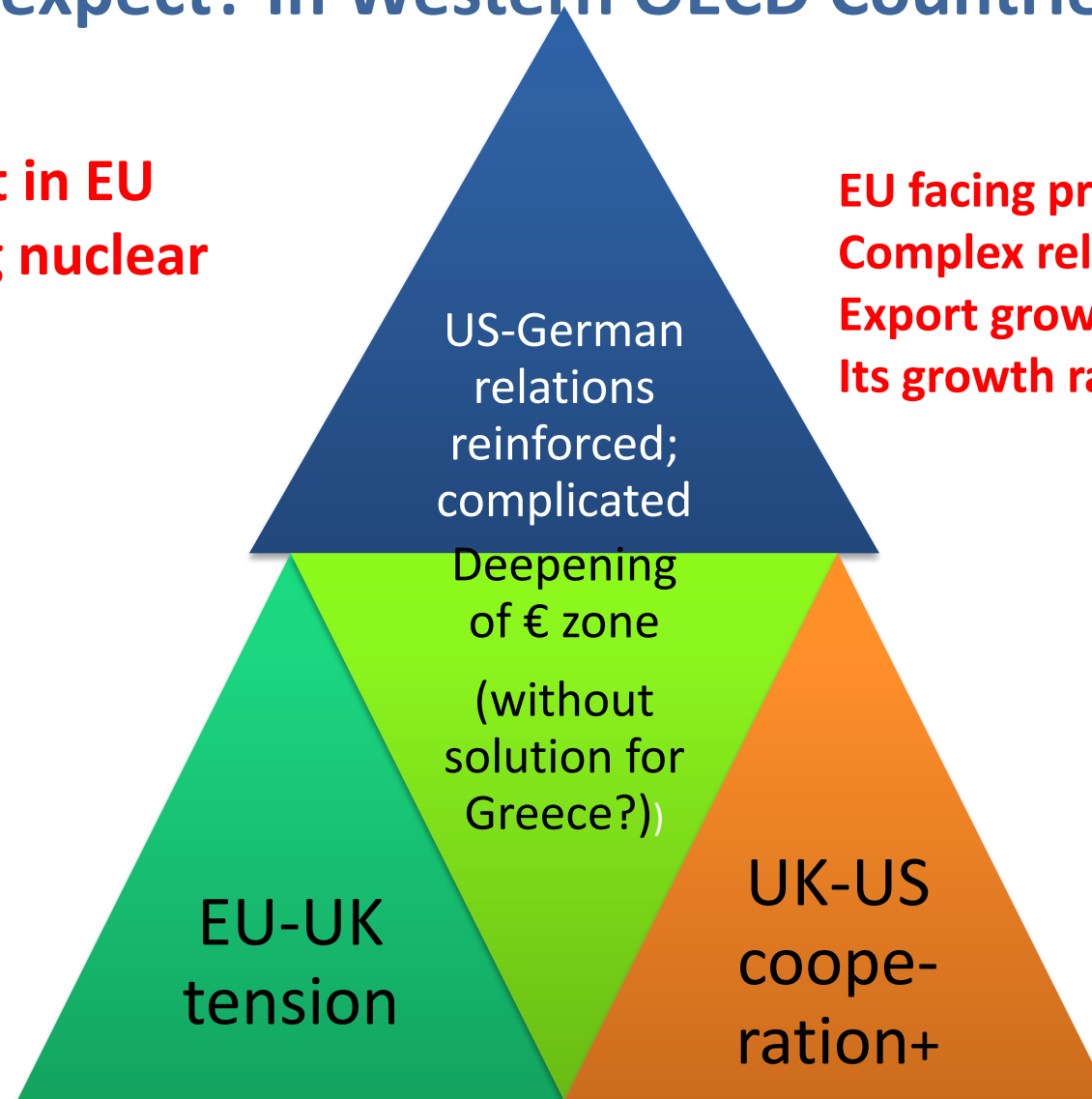
## BREXIT concerns



# What should we expect? In Western OECD Countries?

**France gaining weight in EU  
as the only remaining nuclear  
(military) power**

**EU facing pressure from Russia;  
Complex relations with China whose  
Export growth is enormous; so are  
Its growth rates in FDI in Europe since 2016**



## BREXIT is a political adventure against the EU, against the establishment - populist?

- **BREXIT:** political project of the Leave campaign who want “more sovereignty” and total control over immigration for the UK; hardly 10 economists at UK universities who support BREXIT
- Michael Gove (Minister of Justice in Cameron’s cabinet) was once asked if he could name economists who back BREXIT: His answer – No, the people have had enough of experts – here, a **new British populist approach was visible, which seeks easy answers and rejects expert opinion**
- **BREXIT hardliners (e.g. David Davis as “Exit Minister”) want a new leadership role for the UK in the Commonwealth and global free trade**
- **WHAT Do Commonwealth Countries want???**

## BREXIT first EU Disintegration: Timeline 1957 to 2019

- 1957: 6 EU-Countries (GER, FR, IT, Benelux) founded the EU, not the UK – as Anne Will claimed in an interview with Merkel in November 2016
- **1973: UK, Ireland, Denmark join the EU (since 1968 Intra-EU free trade in goods)**
- 1993: EU Single Market (2-3 % gain in real income)
- 1999 Start of the Eurozone & ECB
- 2004/2007/2013 EU Eastern Enlargements
- **2016** (23rd June): **51.9% vote for BREXIT**
- **2019: UK-Withdrawal = -18% of EU28 GDP; -13% in terms of population EU27/28, -15% in EU exports**
- **UK EU-Exports account for 13% of GDP; US-Exports 2.5%**
- 2020: End of the first Trump term in USA; **BREXIT & TRUMP =?**

## BREXIT came as a surprise to the European Commission

- **EU depended on Eurobarometer survey results**
- The **Eurobarometer figures** from Spring 2017 were far removed from the anti-EU result in the referendum itself (36 percent of British respondents AGAINST EU, June: 51.9 percent) – thus little warning from the UK (and other countries), methodically weak, policy actors apparently uncritical of the Eurobarometer findings
- **US-EU-Banking Crisis of 2007-09 had damaged trust in politics** in many EU-countries, including the UK – and naturally also in the US upon which the new May government depends to some extent for support

## EU Commission Forecast for UK (Jan. 2017)

| • Indicators  | 2015 | 2016 | 2017 | 2018 | 2019* |
|---|------|------|------|------|-------|
| • GDP growth (% , yoy)  | 2,2  | 2,0  | 1,5  | 1,2  | 1,0   |
| • Inflation (% , yoy)   | 0,0  | 0,7  | 2,5  | 2,6  | 2,2   |
| • Unemployment (%)  | 5,3  | 4,9  | 5,2  | 5,6  | 6,0   |
| • Public budget(% of GDP)   | -4,4 | -3,4 | -2,8 | -2,5 | -2,9  |
| • Public debt (% of GDP)  | 89,0 | 88,6 | 88,1 | 87,0 | 88,2  |
| • CA balance (% of GDP)   | -4,3 | -5,0 | -4,8 | -3,9 | -3%   |
| • <b>UK Office for Budget Responsibility has much more favorable view 2018/2019</b> |      |      |      |      |       |

## Main Arguments for Leave (MIX, 2016)

- the EU has eroded national sovereignty by shifting control over many areas of decision-making from national leaders to Brussels;
- **the EU lacks democratic legitimacy and accountability** because many of its decisions are made behind closed doors by non-British and/or unelected officials;
- EU bureaucracy and regulations stifle the UK's economic dynamism;
- the UK would be better off freed from the EU's rules and regulations and able to focus more on expanding ties to growing and dynamic emerging economies elsewhere;
- **the UK's contributions to the EU budget are too expensive (0.4% of UK GDP)**
- **high levels of immigration** to the UK from Central and Eastern Europe mean fewer jobs and lower wages for British citizens; and
- Brexit would have a minimal effect on security cooperation and defense issues because the UK would remain a leading member of NATO.

## Main Arguments for Remain

- **membership is essential for the UK's economic fortunes, as half of the UK's exports** go to the EU "single market";
- **EU membership serves as a launchpad for the UK's global trade;**
- Brexit would mean losing out on the benefits of the prospective U.S.-EU comprehensive free trade agreement, **the Transatlantic Trade and Investment Partnership (T-TIP);**
- the EU has many shortcomings, but the UK is "better off fighting from the inside";
- EU membership gives the UK a stronger voice and more influence in foreign policy;
- the EU has important transnational security dimensions, and Brexit would "divide the West," weakening its ability to deal with threats such as terrorism and Russian aggression; and
- Brexit is a "leap in the dark," with uncertain consequences and no clear vision of what a post-EU future would look like"



## Cameron Negotiation Results – February 2016

- The UK would not face the obligation to cooperate in the EU under its traditional mantra of “an ever closer union” – a wording found in the Treaty of Rome in 1956. To some extent this revisionist position of Mr. Cameron is strange, since joining the EU in 1973 meant, of course, subscribing in some way to this historical motto regarding EU integration, while prospects for the twenty-first century – with ongoing US dominance, soon shared with China – will make closer European cooperation in many fields really useful.
- The EU assured that the decisions of the **Eurozone would not amount to a discrimination of interests of non-Eurozone EU member countries** (here, the UK certainly felt some political support from Denmark, Sweden and some Eastern European countries. The Eurozone has experienced serious problems in the Euro Crisis foreseen by this author with regard to Portugal, Spain, Greece and Italy in the book manuscript *Transatlantische Bankenkrise*/Transatlantic Banking Crisis in October of 2008. Not anticipated by the Commission, national governments or experts.

## Cameron Negotiation Results – February 2016 contd.

- **Reinforcing the EU single market: digital, energy, services**
- The EU agrees that improving international competitiveness is an important task and that the EU regulatory burden should be reduced; it is, however, not clear what the EU could really do – beyond leaner regulations in some fields – to improve international competitiveness, since the power to set national framework conditions for the business community and to finance innovation support schemes lies primarily with EU member countries themselves - not with the EU.
- **The UK should get the right to exclude EU immigrants in the UK from full access to the British social welfare system for several years.**

# Post-Referendum Economic Developments in the UK

2016:

Devaluation

Real estate prices fell

2017/18:

Inflation rises

Positive trade balance effect

Real wage rate falls

Employment rises

Output rises

Investment-GDP ratio falls

GDP growth falls

Bargaining for higher wages

Real wage rate rises

Employment falls

2019 Brexit:

US-UK mini TTIP

Output growth rises

UK getting more dependent on US

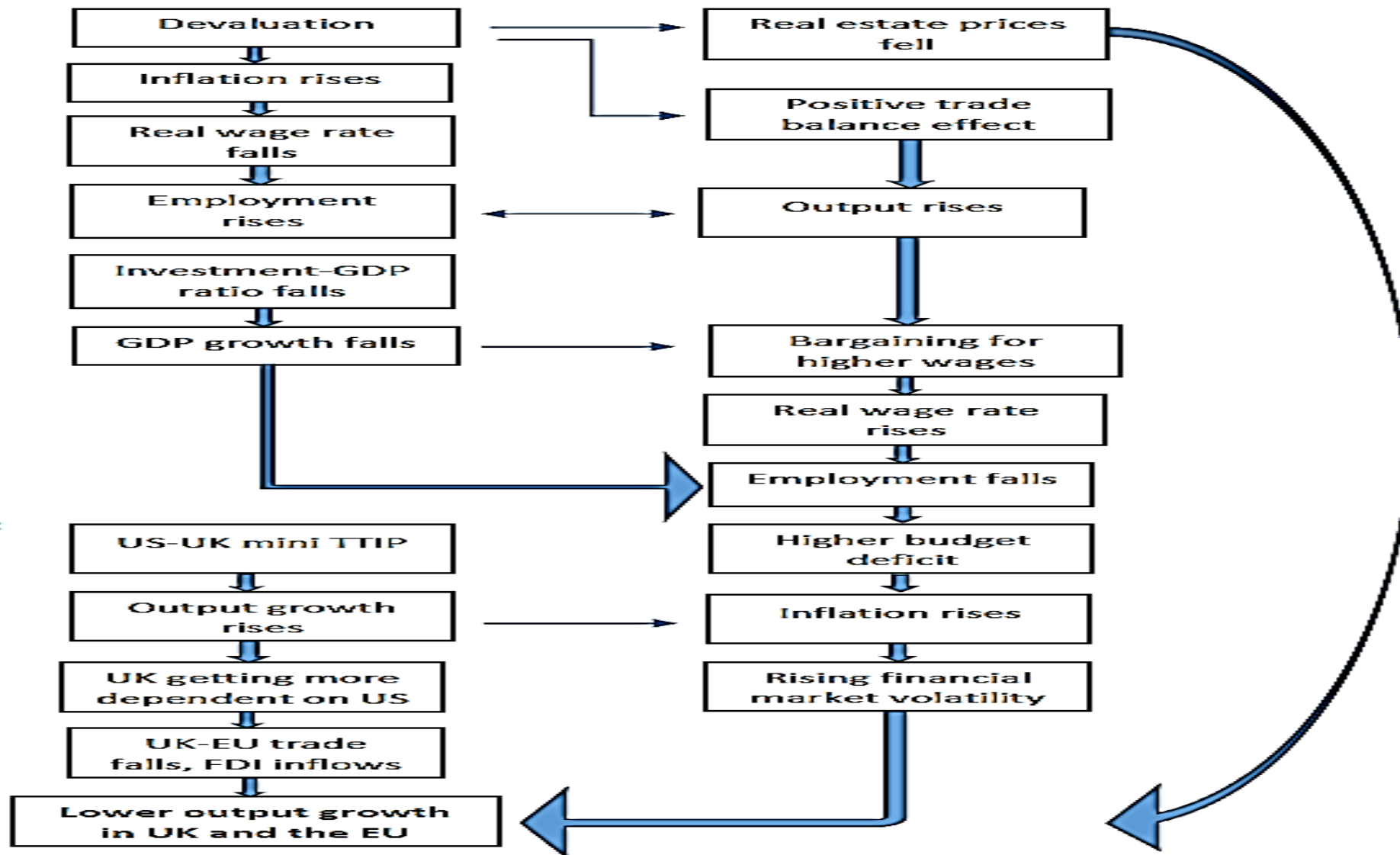
UK-EU trade falls, FDI inflows

Lower output growth in UK and the EU

Higher budget deficit

Inflation rises

Rising financial market volatility



## UK Government Review of Competences (Recurring themes)

- Subsidiarity and proportionality crucial to EU competence in all areas
- A need for greater democratic accountability of EU institutions
- ECJ had too wide a scope over the interpretation of competences
- Accountability could be improved by giving national parliaments a greater role
- Contributors also commented that the UK has often been successful in shaping the EU agenda including UK's influence in directing reforms of the enlargement process
- Other reports highlighted how EU programs benefit the UK including funding opportunities offered by the EU for UK universities in light of the importance of education as an export industry to the UK.
- But respondents also called for further progress in many areas. The need for less and better EU regulation was a common theme in all reports
- Importance of the EU focusing on the areas where it adds genuine value

## Analysis of PAIN/YOUNG (2004): Links between FDI and Exports

In a modified NiDEM model, a 10 percent rise in the stock of foreign direct investment (FDI) in the UK leads to a rise in British exports by 0.75 percent, which is explained by the authors in a simple way:

- The subsidiaries of foreign multinational companies raise the level of quality for many goods.
- Moreover, subsidiaries will bring a greater variety of tradable goods.
- By implication, one may conclude that to the extent that BREXIT reduces the stock of FDI relative to GDP, the British current account position will further worsen and the Bank of England will face pressure to raise the stock of reserves considerably.
- Counter-argument related to the expected strong real depreciation of the British Pound after BREXIT: following the argument of FROOT/STEIN (1991), it is clear that higher foreign direct investment flows will come to the UK since in an imperfect capital market framework the ability of foreign investors to successfully bid to take over British firms – on the basis of a leveraged acquisition – is reinforced.

## Global rank of UK GDP (Nominal in billions of \$USD and by Purchasing Power Parity PPP in billions of Current International Dollars 2016)

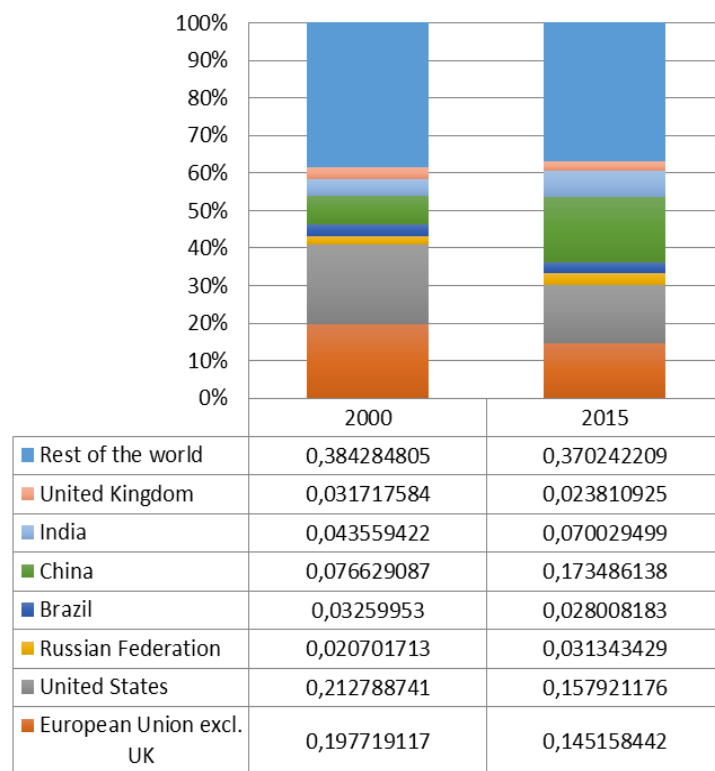
| Ranking | Country        | Nominal GDP (in Billions \$US |
|---------|----------------|-------------------------------|
| 1       | United States  | 18,561                        |
| 2       | China          | 11,391                        |
| 3       | Japan          | 4,730                         |
| 4       | Germany        | 3,494                         |
| 5       | United Kingdom | 2,649                         |
| 6       | France         | 2,488                         |
| 7       | India          | 2,250                         |
| 8       | Italy          | 1,852                         |
| 9       | Brazil         | 1,769                         |
| 10      | Canada         | 1,532                         |

| Ranking | Country        | GDP by PPP (in Billions of Current International Dollars, 2016) |
|---------|----------------|---|
| 1       | China          | 21,269  |
| 2       | United States  | 18,562  |
| 3       | India          | 8,720   |
| 4       | Japan          | 4,932   |
| 5       | Germany        | 3,979   |
| 6       | Russia         | 3,745   |
| 7       | Brazil         | 3,134   |
| 8       | Indonesia      | 3,027   |
| 9       | United Kingdom | 2,787   |
| 10      | France         | 2,736   |

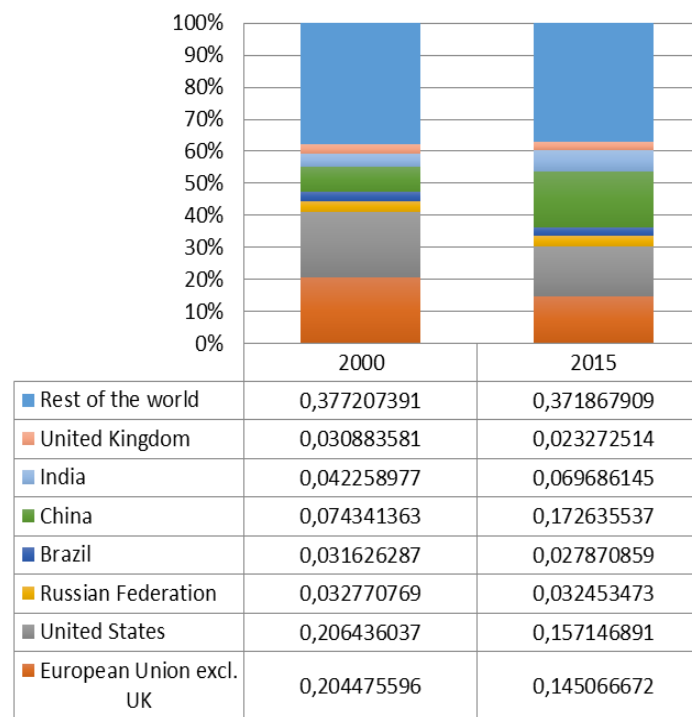
Source: IMF, World Economic Outlook Database, October 2016

# UK and EU27 in the World (GDP in Percentage of World PPP and Population)

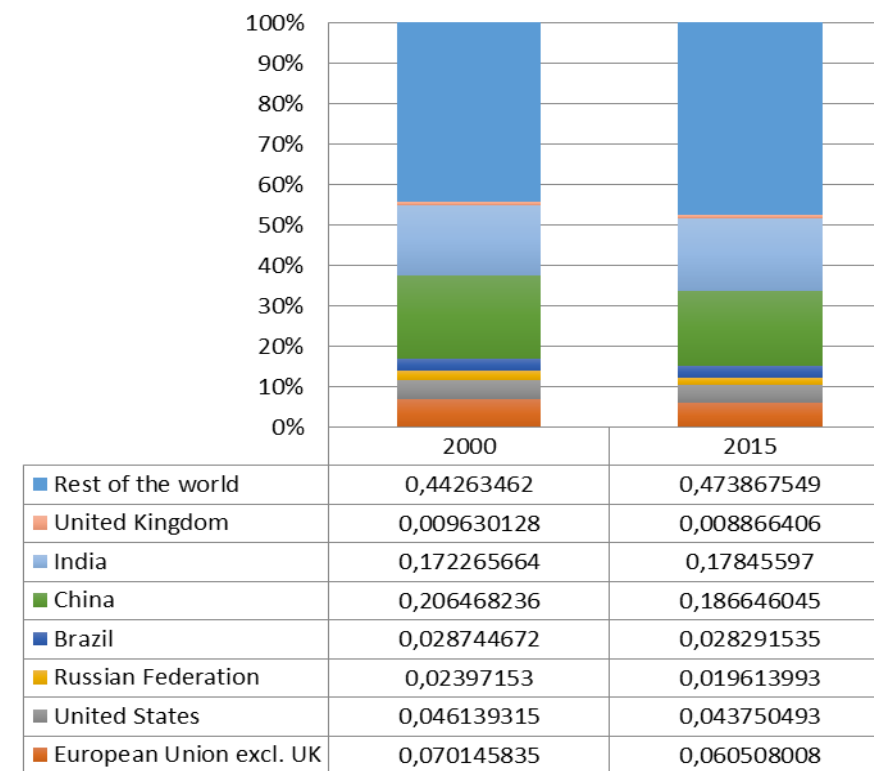
**GDP in Percent of the World  
PPP (Current International Dollars)**



**GDP in Percentage of the world  
PPP (Constant 2011 International Dollars)**



**Population  
in Percentage of the World**



Source: World Bank, World Development Indicators, retrieved on 09.01.2017 17:08

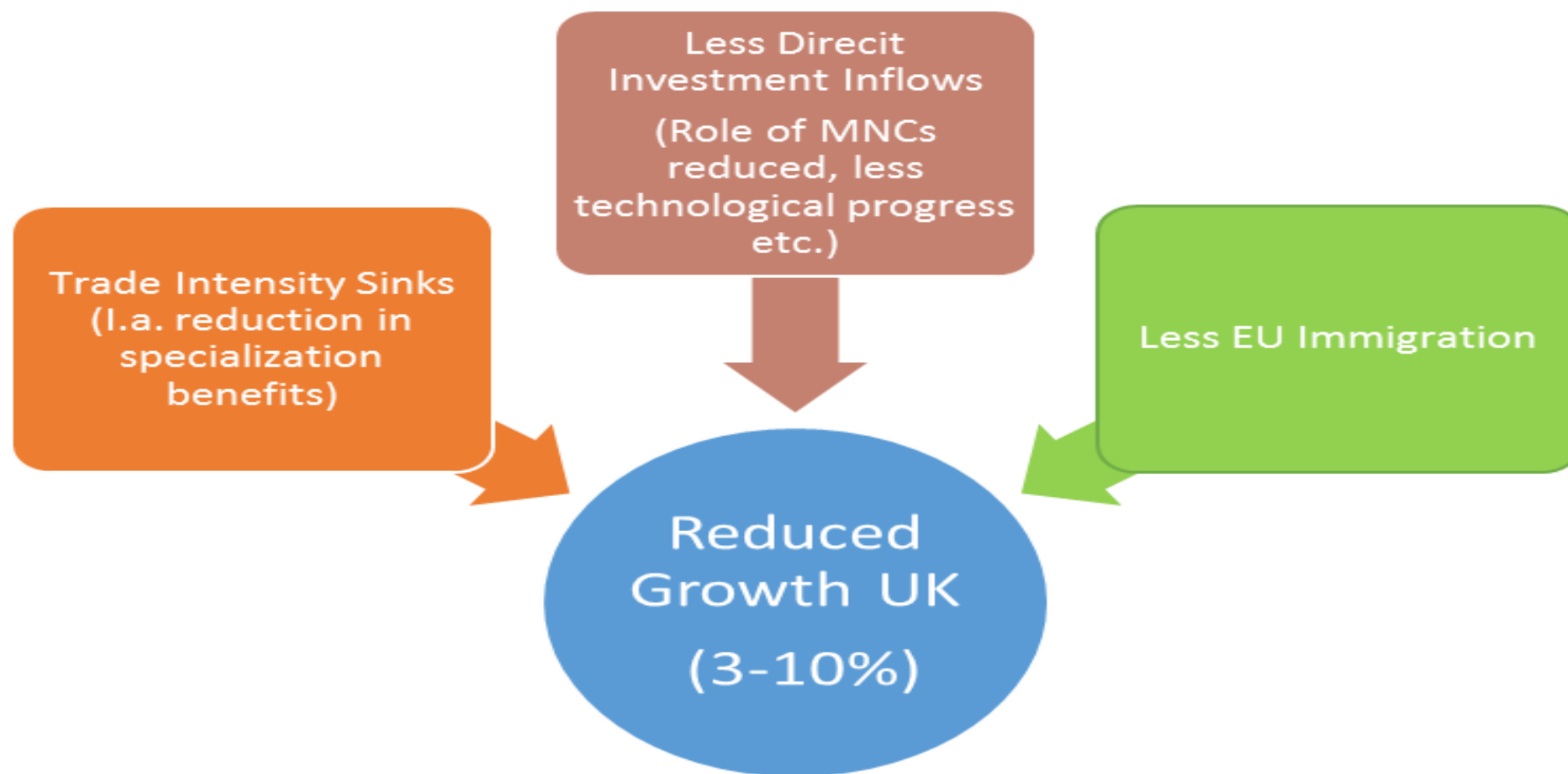
## The GDP Share Generated by US Subsidiaries in Europe (and Selected European Countries)

| Country | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  |
|---------|-------|-------|-------|-------|-------|-------|
| EU      | 3.00% | 2.98% | 3.01% | 3.22% | 3.01% | 3.16% |
| France  | 1.94% | 1.90% | 1.91% | 1.87% | 1.87% | 1.94% |
| Germany | 2.55% | 2.50% | 2.46% | 2.36% | 2.36% | 2.47% |
| UK      | 6.58% | 6.31% | 6.09% | 5.84% | 5.84% | 5.75% |

Source: BEA database and WDI database. EIIW calculations: note, data is taken from all Majority-Owned Bank and Non-Bank



## BREXIT-Effect Channels Reducing Real Income in the UK



## Actual and Adjusted Results Based on an Adequate Information Policy by Cameron

|                      | Actual Result | <u>Simulation I Corrected Result</u>  | <u>Simulation II Corrected Result</u>  |
|----------------------|---------------|---|--|
|                      |               | <p>Basis Info: -6% real income with BREXIT = minimum information from Cameron government which one should expect to receive as a voter from the HM Treasury analysis.</p> | <p>Key info from the Treasury study: -10% growth effect (-6% plus -4% as a result of non-participation in EU Single Market deepening due to BREXIT) plus effect of 3 percentage point increase in income tax</p> |
| UK Remains in the EU | 48.1%         | 50.4%*  | 52.1%*   |
| UK Leaves the EU     | 51.9%         | 49.6%*  | 47.9%*   |

(\*Calculated on the basis of popularity elasticities in Frey/Schneider "A Politico-Economic Model of the United Kingdom")

## Weak Aspects of the Referendum Campaign

|  | Voter Mobilization | Voter Winning |
|--|--------------------|---------------|
| Timing of the Treasury study on the costs of BREXIT – Totally Inadequate | 0                  | Very Low      |
| Pro-EU argumentation   | Weak               | Weak          |
| Consistency  | Low                | Medium        |
| Mobilization of government   | Low                | Medium        |

## Cost of BREXIT?

- EBELL/HURST/WARREN (2016) – NiGEM approach
- The authors focus on four shock elements that are therefore linked to BREXIT:
  - A permanent decline of the UK's export market share in EU27
  - An increase in tariffs
  - A permanent reduction of foreign direct investment inflows to the UK
  - The repatriation of the UK's net contribution to the European Union's budget
- Result: a 2.7 percent real output decline (about 80 percent of this effect due to reduced UK market share in the EU single market).
- **Decline of output relative to the baseline scenario** (a case in which there is no BREXIT) is a strong decrease of investment in 2017 - by -15 percent - followed in by declines of -12.8 percent, -8.1 percent and -4.6 percent in 2018, 2019 and 2020, respectively. Exports reduce in 2017 by 6.1 percent, in 2018 the effect is -17.5 percent and in 2019 it is -23.1 percent.

- There is an effective real exchange rate depreciation of 16 percent in 2017 and it stays like this until the end of the simulation horizon in 2030.

BUT approach chosen ignores some additional crucial aspects of BREXIT which tilt the balance much more towards negative output and consumption effects in the long run.

- **Their considerations do not include budget or tax effects of potential extra BREXIT- related payments of about €40-60** (\$49-73) billion (about 2 percent of the UK's annual national income)

## Post-BREXIT UK will lead to more subsidization (costly for taxpayers)

- Some form of EU-UK free trade treaty will force the UK to extend the associated tariff reduction to other countries – think of a sectoral automotive EU-UK free trade agreement that would give, via WTO membership, free imports to automotive producers in third countries so that their market share in the UK will rise via higher British imports – the negative current account effect for the UK will be larger than assumed in the authors' modeling.
- Steel demand in the UK reduces as more cars are imported from the EU and the rest of the world after 2019 (the BREXIT implementation year) and hence the British government might start to spend ever larger amounts in the form of subsidies intended to save ailing British steel mills leading to higher tax rates: the latter have a negative real income effect.
- Moreover, if there are EU immigrants who should decide to leave the UK, there will be additional negative real income effects for the UK.

- **With a lower ratio of inward foreign direct investment to GDP and a lower number of researchers than in the baseline scenario** – the latter reflecting the reduced scientific cooperation of UK researchers with EU27 researchers after BREXIT – there could be a considerable dampening effect on UK innovation dynamics (for more on this mechanism, see the empirical analysis of JUNGMITTAG/WELFENS, 2016).
- **If the Froot-Stein effect of a depreciation-induced FDI inflow** is strong enough to raise the share of foreign ownership in the British capital stock, the so-called golden age per capita consumption – this is the long-run per capita consumption in a growth model - will be reduced

## Prime Minister Cameron's Chatham House Speech, Nov. 2015

- The problems of the Eurozone which should be solved by the countries in the monetary union in the interests of all EU member states.
- The problem of the EU's competitiveness internationally in light of the dynamic rise of new, large suppliers, meaning countries, in the world economy.
- A lack of democratic accountability in politics in Brussels and a divide between the respective national electorates and the politicians at EU-level, which is felt especially strongly by the British electorate.
- Cameron added: "The issue is one of scale and speed, and the pressures on communities that brings, at a time when public finances are already under severe strain as a consequence of the financial crisis. This was a matter of enormous concern in our recent general election campaign and it remains so today... Unlike some other member states, Britain's population is already expanding. Our population is set to reach over 70 million in the next decades and we are forecast to become the most populous country in the EU by 2050. At the same time, our net migrating is running at over 300,000 a year. That is not sustainable."



## Anti-EU Immigration Rhetoric of Mr. Cameron Since 2013

- Too much EU immigration = a burden on the UK
- **Mrs. May was responsible as Minister of Interior in charge of immigration: She has supported Cameron on anti-EU immigration**
- There was no burden for the UK government, the net effect on UK budget is positive, says the OECD.
- **The main purpose: finding a scapegoat for diverting attention from the massive cuts in government transfers to local communities/cities: 3.5% of GDP in 5 years** – cuts needed after Banking Crisis (11% deficit-GDP ratio)
- **Banking Crisis = BREXIT!?**

## A Global Britian

- David Davis' list (2016) of priority targets for trade agreements (2017: David Davis is Exit Secretary)
- **High Priority:** US, Canada, China+Hong Kong
- **Medium Priority:** Australia, Brazil, India, South Korea
- **Low Priority:** Japan, Indonesia, Mexico, Saudi Arabia, Singapore, Turkey, South Africa

Realistic opportunities for growth?

## Can BREXIT Be an Economic Success and What Effects Can Be Expected for the EU27?

- **The immediate impact of the referendum result has been a strong devaluation of the British Pound: about 15 percent by January 2017.**
- Output growth in 2016 has not reduced much although investment dynamics have weakened. One should not overlook that the Bank of England cut the interest rate.
- Moreover, the government has announced a reduction in the speed of consolidation so that firms will anticipate higher government consumption in the medium term and households could expect lower tax rates for some time.
- 2017 will bring a higher inflation rate and since this was not anticipated, there will be a quasi Phillips-curve effect, namely reduced real wage rates which will in turn encourage firms to hire more workers: unemployment will fall temporarily
- Mrs. May's BREXIT speech of January 2017 – making clear that there will be a hard BREXIT – is a signal to domestic and foreign firms to reduce investment.

## Global Britain Approach

- **OK for FTA with US, Japan; however, not China, not India**
- **Difficult if WTO is undermined by US (Trump)**
- **Growth rates will be lowered by BREXIT – will it exceed those of Eurozone/EU27?**
- **The UK will want to adopt lower corporate tax rates AND banking deregulation (*and US to follow under Trump Administration*)**

## Necessary EU Reforms

- Too much EU regulation = bad for growth
- Budget (1% of GDP) is too small: Forschungsgruppe Wahlen says: Voters do not understand EU role = leading to many votes for small, radical parties (AfD, UKIP, Front National)
- Budget should be rather 5-6% of GDP; US (DC) is 9% plus 11% for social expenditures (Theory of Fiscal Federalism); principle of subsidiarity? MORE EU in infrastructure, defense and for short-term unemployment (not youth unemployment!)
- EU is not well positioned for the 21st century
- Will there be adequate EU reforms?
- Or further X-Exits and destabilization of Mercosur/ASEAN?

## Problems in EU: Subsidiarity rules and EU reforms/Decline of the West?

- **Germany is unlikely to push for a higher EU budget – outside defense**
- Other EU countries might also be quite hesitant (e.g. NL)
- **Question of whether Eurozone problems can be solved** (GREEK problems: more an issue of constitutional reform – Venice Commission: Council of Europe could help – rather than anything else)
- **Many new challenges ahead:** Weak UK and inconsistent US policy plus lack of EU and national reforms (e.g. France: minimum wage) = relative decline of the West = rise of China's power in the next decade
- **Will political developments increase influence in markets?**

[www.eiiw.eu](http://www.eiiw.eu)

- Thank you for your attention!

## 17 Sept 2017: Letter from Chair of UK Statistics Authority Sir David Norgrove to Boris Johnson. £350 million figure from campaign “a clear misuse of official statistics”



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Chair of the UK Statistics Authority, Sir David Norgrove

Rt Hon Boris Johnson MP  
Foreign Secretary  
Foreign and Commonwealth Office  
King Charles Street  
London  
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17 September 2017

Dear Foreign Secretary,

I am surprised and disappointed that you have chosen to repeat the figure of £350 million per week, in connection with the amount that might be available for extra public spending when we leave the European Union.

This confuses gross and net contributions.<sup>1</sup> It also assumes that payments currently made to the UK by the EU, including for example for the support of agriculture and scientific research, will not be paid by the UK government when we leave.

It is a clear misuse of official statistics.

Yours sincerely



Sir David Norgrove

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<sup>1</sup> For further detail on official statistics relating to the UK's financial contributions to the EU, see [Sir Andrew Dilnot's letter of April 2016 to the Rt Hon Norman Lamb MP regarding UK contributions to the EU.](#)



## 15 Sept. Boris Johnson Op-Ed in the Daily Telegraph (ca. 4,000 words)

“Well, in so far as they doubt our resolve, I believe they are wrong; and I am here to tell you that this country will succeed in our new national enterprise, and will succeed mightily. Those 17.4 million people – they weren’t fools, you know. They weren’t stupid. They weren’t as bad as some would have you believe. They were right; and even if you think they were wrong, I hope you agree that it is our duty, as democrats, to fulfil the mandate they gave us.”

Seen as putting PM Theresa May under pressure from BREXIT hardliners within her cabinet – influencing May’s Florence speech days later on September 22, 2017.