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11.1.2018

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Erroneous Presentation of BREXIT: A Response to Philip Hammond & David Davis

On January 10, 2018, British Chancellor of the Exchequer, Philip Hammond, and Secretary of State for Exiting the European Union, David Davis, published a contribution in the *Frankfurter Allgemeine Zeitung* "Imagination and Ingenuity Towards a Bright Future" (p. 8, translation: PJJW). This op-ed article, intended for a readership comprised of both the German public and policymakers, stressed how important cooperation is to both Germany and the UK as "two of Europe's biggest economies". The two ministers describe how the future economic relations between the UK and the EU27 should be determined on the basis of a broad EU-UK free trade agreement, which should also include financial services. It is also suggested that an agreement on cooperation in the area of banking supervision be reached, while the UK is presented as a driving force behind intensified and tighter banking supervision in the wake of the "Global Financial Crisis". Hammond and Davis paint a less than accurate picture.

1) Germany and the UK, following the depreciation of the Pound in 2017, are (on the basis of Gross Domestic Product) the largest and third largest economies of the EU, respectively.
2) The financial crisis of 2007-09 was in reality not, as claimed, a "Global Financial Crisis", rather it was a Transatlantic Banking Crisis, the roots of which can be traced back to the inadequate regulation of banks in the US and the UK. Neither Japan nor China, nor indeed the ASEAN countries, were significantly affected by the Transatlantic Banking Crisis. The slipshod use of facts by Hammond and Davis is conspicuous and it certainly does little to inspire confidence.
3) The concept of including financial services in an EU-UK free trade agreement is absurd, as control and liability would take divergent paths: The vision of the UK is for banks and insurance firms in London to be subjected to British regulation, however the burden of the costs of inadequate regulation of London-based banks, which engage in extensive business in the Eurozone and EU27, respectively, would – as occurred in 2007-09 – be borne in large part by the EU27 countries. Regulatory cooperation between the EU and the UK would not be supported by a comparable foundation, the UK is already following, according the internal government discussions within the May cabinet, the Trump approach of 2017 which is to engage in a new wave of banking *de*regulation; the proposed British deregulation would likely begin to be implemented from the very moment BREXIT is completed. It is also unlikely that any such cooperation between the UK and the EU/Eurozone in terms of banking regulation would be based on close British collaboration with the European Central Bank, which is responsible for regulating the largest banks in the Eurozone. On the contrary, the post-BREXIT UK will become somewhat of a vassal state of the US and would, in the event of a conflict of interests, align itself

rather with the deregulatory strategy of the Trump administration. Moreover, it is clearly unreasonable to suggest EU-UK regulatory cooperation when the default position of the May government in London is that the United Kingdom would no longer accept the jurisdiction and authority of the European Court of Justice (ECJ). Without the ECJ as a legal backstop, cooperation is impossible.

4) The banking crisis, instigated by excessive deregulation in the US and the UK, is itself, indirectly, one of the primary impulses behind the pro-BREXIT majority in the referendum of 2016 – a little known connection which gives food for thought: As a result of the banking crisis, which in the UK started with a run on Northern Rock in 2007, the deficit ratio in the UK rose to 10%. In a desperate attempt to reduce the high ratio of government deficit to gross domestic product, the Cameron government, by implementing massive cuts to central government transfers to local authorities – an incredible 3.5% of GDP in five years – contributed in many towns and cities to a critical underprovision of local public services. As Cameron had already been employing anti-EU migration rhetoric since 2012, the situation resulted in many British voters seeing EU immigrants as being the reason behind the ensuing lack of public services – the consequence was that firstly, EU migrants were unjustly turned into a scapegoat for cuts and, secondly, that the topic of the EU single market and a rejection of the free movement of workers became a rallying call for the BREXIT supporters.

The depiction of Hammond and Davis is indeed as erroneous as it is “imaginative”. It is part of a historic British development, on the basis of a questionable referendum – which enjoyed little legitimacy – which could lead the United Kingdom out of the European Union. In his 16-page information brochure for voters prior to the BREXIT referendum, Prime Minister Cameron did not include a single word on the implications of the most important findings of the Treasury study regarding British membership of the EU: BREXIT would mean a 10% loss of income. Had the voters received this crucial information, UK popularity functions (see Frey/Schneider in Economic Journal, 1978) suggest that the result in the referendum would actually have been 52.1% for Remain in the EU and not, as the official result of the vote on June 23, 2016, was, 51.9% for Leave. The suppression of information by a chaotic Cameron government prior to the EU referendum is all the more conspicuous as prior to the 2014 independence referendum in Scotland, the same Cameron government was sure to include in an information brochure for voters that a vote for independence would mean a loss in income of £1,400 GDP per capita as well as the loss of the benefits of EU membership for Scots (!). Only two years or so later prior to the EU referendum, the threatened loss of income– according to the Treasury assuming an EU-UK free trade agreement – was £2,500, but strangely, this was not deemed worth mentioning in the government information brochure which was sent to households in 2016.

Adam Smith, founder of modern macroeconomics, whose face can be seen on every £20 note, would almost certainly turn in his grave at the defective referendum and the course of BREXIT since. It was left to the Chairman of the UK Statistics Authority, Sir David Norgrove, to correct in an open letter the false and misleading claims of Boris Johnson regarding funding opportunities for the UK’s National Health Service. On 17 September, 2017, Norgrove – following Johnson (as Foreign Secretary) having repeated the misleading claims of the referendum campaign in a newspaper article – wrote that Johnson, in confusing gross and net contributions to the EU budget, was engaging in “a clear misuse of official statistics”. The weekly British contribution to the EU of £350 million per week will not be available for the NHS as Johnson suggested. The government in London will, of course, have to replace the EU payments to British cities, firms and universities – just less than half of the given figure will in reality be readily available. BREXIT is damaging to the UK and the EU, it is not a sensible approach for the EU27 member countries, against the background of a questionable referendum and the relevant economic relationships, to readily meet British demands. Philip Hammond and David Davis are seeking to mislead the public not only in Germany, but in the UK and indeed across the EU, with their misrepresentation of BREXIT. This approach is certainly not conducive to EU-UK negotiations.