Prof. Dr. Paul J.J. Welfens, President of the European Institute for International Economic Relations (EIIW) at the University of Wuppertal, Schumpeter School of Business & Economics: Jean Monnet Professor for European Economic Integration; Chair for Macroeconomics, (Rainer-Gruenter-Str. 21, D-42119 Wuppertal; Tel +49 202 4391371), Alfred Grosser Professorship 2007/08, Sciences Po, Paris; Research Fellow, IZA, Bonn; Non-Resident Senior Fellow at AICGS/Johns Hopkins University, Washington DC
welfens@eiiw.uni-wuppertal.de, www.eiiw.eu

Welfens has testified before the US Senate, the German Parliament, the European Parliament, the European Central Bank, the InterAction Council, the IMF, the UN. Paul Welfens is one of Europe's most published economists.

Welfens is the author of the book An Accidental BREXIT (90 K downloads English and German editions) and is the co-editor of the BREXIT Special Issue of the Journal *International Economics and Economic Policy* (March 2019; open access) which features papers by Barry Eichengreen, Andrew Mullineux and Jürgen Jerger and Jenny Körner as well as the findings of a Deutsche Bundesbank-sponsored EIIW project on BREXIT-related capital market effects in Europe.

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BREXIT Problems: Policy Consistency Problems 2019

1) The stalemate in the BREXIT process in spring 2019 should not come as a surprise to anyone as the popular voting basis of the entire project is weak: The result which would have been expected in normal circumstances in the EU referendum of 2016 would have been 52.1% pro-Remain, but Prime Minister Cameron did not include a single word on the findings of the Treasury study which were available in early April 2016 - an income loss of 10% was the key finding – in the crucial 16-page government information brochure for voters. This policy of not providing such critical information to the electorate stands much in contrast to the Scottish Independence referendum of 2014 where the government's information brochure warned of a £1400 GBP per capita income loss and "the loss of all the benefits of EU membership". The higher losses projected by the Treasury analysis in the case of BREXIT were suppressed in the brochure of 2016.
2) In the first three months of 2019, the May government has been unable to obtain a majority in Parliament for the EU-UK Withdrawal Agreement including the EU-UK political declarations. As of March 25, the Parliament has adopted a stronger initiative to take charge of the decision-making process in the UK; indicative votes on March 27 show how a majority could be achieved and what changes in BREXIT are needed in order to end the impasse.
3) Since January 2019, opinion polls in the UK show a clear lead for Remain. There is, however, a rather high share of undecided voters. That more than 5 million people signed a petition to the Parliament in March for a revocation of the BREXIT decision is a strong signal that there now is a strong voice in part of the public to end the BREXIT process; moreover, the large demonstration on March 24 in London – with about 1 million protesters calling for a second referendum – suggests that there is a strong wish for a second EU referendum in the UK. Eurobarometer results from autumn 2018 suggest a clear victory for Remain in a second EU referendum in the UK as the share of people holding a Total Positive attitude towards the EU has increased since spring 2016 by 12% while the share with a Total Negative attitude vis-à-vis the EU experienced an 9% reduction so that a second EU referendum could have 60% pro EU voter share (see table below).

4) Surprisingly, in the UK there is still little "positive communication" of the benefits of British EU membership in the political system – the fear of a hard BREXIT and the associated economic costs are the main negative discussion points in the debate. This lack of positive communication means that a second referendum could still be high risk in the sense that an unclear understanding of the benefits of EU membership could allow a confusing campaign to once again result in a pro-BREXIT vote as undecided voters follow some short-term social media influences; or that a pro-EU majority would be rather modest so that the British public remains deeply divided about the EU membership issue which in turn makes it difficult for the political system to bring about a negotiation result with the EU that can find clear majority support in Parliament. The Labour Party is in part largely responsible for this confusing situation since it has not positioned itself to be a pro-EU party although the political history of Labour – with a 2/3^{rds} pro-EU majority in the Wilson EU referendum of 1975 – as well as economic studies showing that workers will suffer most from BREXIT suggest that such a position should be the natural policy stance. It is, however, well known that Jeremy Corbyn has always particularly disliked the EU's Single Market since in his perception it means too much competition for firms. The Labour Party seems to ignore that BREXIT will inevitably mean a militarization of UK foreign policy which in turn would serve as a means to help the UK obtain favorable free trade treaties which otherwise would not be possible to obtain (Defense Secretary Gavin Williamson has announced that the UK's aircraft carrier HMS Queen Elizabeth will sail in its maiden voyage not only to the Mediterranean but also to the Pacific in order to defend the UK's position as a global power; Williamson referred explicitly to BREXIT in his speech in February 2019): Post-BREXIT, the UK is only about 1/5th of the economic weight of the EU28 so that the country's international position at the diplomatic table is clearly weakened. Moreover, if the UK leaves the EU this would not only destabilize the EU but other integration clubs – which have long followed the example of the EU – as well: Mercosur in Latin America, ASEAN and ECOWAS in Africa are obvious cases.
5) If the Labour Party does not quickly adopt a pro-EU position, the EU has no reason to try to keep the UK in the European Union, but it is also clear that the EU negotiation stance vis-à-vis the UK post-BREXIT should be tough in the sense that rewarding the inconsistent and EU-destabilizing BREXIT policy maneuvers of the UK under the May governments would give the wrong signal.
6) BREXIT plus Trumpism could lead to Europe and the world falling back into the late 19th century – with a new Great Powers regime. A post-BREXIT UK would inevitably align itself more strongly with the populist Trump in the US which makes for a political odd couple as the Trump Administration is protectionist with a focus on bilateralism while the May government's Global Britain concept requires more free trade and the reinforcement of multilateralism. The UK could itself also disintegrate with a second Scottish Referendum.
7) Financial markets can be expected to exhibit a very nervous reaction to a hard BREXIT; the FCA, as an important supervisory institution, has warned of potential problems including problems of contract continuity and a lack of clarity over whether UK or EU law would be relevant to certain service providers. Empirical analysis shows that corporate risk premiums in the UK and the Eurozone are raised by a BREXIT event, read so far the EU referendum's BREXIT majority in 2016, the expectation is that the reaction to the possible implementation of BREXIT in 2019 would show the same effect. Higher risk premiums imply higher real interest rates, particularly for the UK; and hence lower investment and output growth. The Eurozone and the US stand to benefit from the anticipated fall of the British Pound's global market share in the global reserve currency market. A rise of the UK

government bond interest rate of 0.3% would be equivalent to an additional burden for government that equals the UK's net contribution to the EU. Implied financial volatilities in the UK, the Eurozone and the US in December 2018 were as high as in the first quarter of 2008. Thus, 2019 could become another year marked by high volatility. The European Systemic Risk Board (ESRB), created in 2010 in the wake of the Transatlantic Banking Crisis as part of the institutional lessons learned, seems not to have worked well in 2018 so that its mandate of macroprudential supervision – analyzing systemic risk in the EU28 – was not really fulfilled. With BREXIT, UK institutions would no longer be part of the ESRB and this reinforces the problems of macroprudential supervision from an EU27 perspective since more than 60% of wholesale banking markets are still based in the UK, and the City of London in particular. Financial market problems in the UK related to BREXIT would thus certainly spillover into investment and trade dynamics of companies in the EU27 area and this in turn would have negative feedback effects on the UK and the US.

8) Germany, as a leading EU economy, is facing an economic slowdown in the context of the Sino-US trade conflicts and anticipated BREXIT problems as well as the expected negative spillover effects in the Netherlands and Belgium (plus Ireland) which together account for even higher exports of German firms. If the UK would face a recession in 2019/20, the Netherlands will have a recession too and other EU countries with important UK trade links could follow (see subsequent tables). Uncertainty is spreading across the EU28, not just in the UK. Millions of households in Europe have already obtained letters from insurance companies which to date were located in the UK but which are now reorganizing and restructuring their business with EU27 clients through newly created subsidiaries in the EU27 which facilitates contract continuity but weakens clients' legal position in terms of ending contracts or dealing with contract contingencies not explicitly covered in the original insurance policy.
9) Germany and France are expected to cooperate more closely to adopt new policy reforms for the Eurozone and the EU. The Eurozone needs its own parliament which should have a full institutional status, not a diminished one like the EU Parliament.
10) Time for reforms is scarce. The rise of China and the challenge of US populism give the EU a crucial strategic role in the future for Europe.

Table 1: UK Imports of Goods and Services in 2016

	in Thousands GBP	**in % of UK GDP**
Germany	74,255,231.52	3.78%
United States of America	71,685,352.62	3.65%
China	45,642,855.75	2.32%
Netherlands	41,087,528.8	2.09%
France	38,578,733.98	1.96%
Spain	28,840,545.61	1.47%
Belgium	25,970,640.23	1.32%
Switzerland	23,206,506.57	1.18%
Italy	22,949,738.98	1.17%
Ireland	20,566,268.58	1.05%
EU 27	319,549,668.4	16.28%

Source: EIIW representation of data available from the International Trade Center Trade Statistics

Table 2: UK Exports of Goods and Services in 2016

	in Thousands GBP	in % of UK GDP
United States of America	97,347,748.89	4.958%
Germany	48,293,861.84	2.460%
France	33,306,334.76	1.696%
Netherlands	31,117,694.63	1.585%
Switzerland	26,920,656.2	1.371%
Ireland	26,293,230.01	1.339%
Italy	16,888,888.95	0.860%
China	16,696,970.56	0.850%
Belgium	15,598,175.03	0.794%
Spain	14,520,394	0.740%
EU 27	232,602,612.6	11.847%

Source: EIIW representation of data available from the International Trade Center Trade Statistics

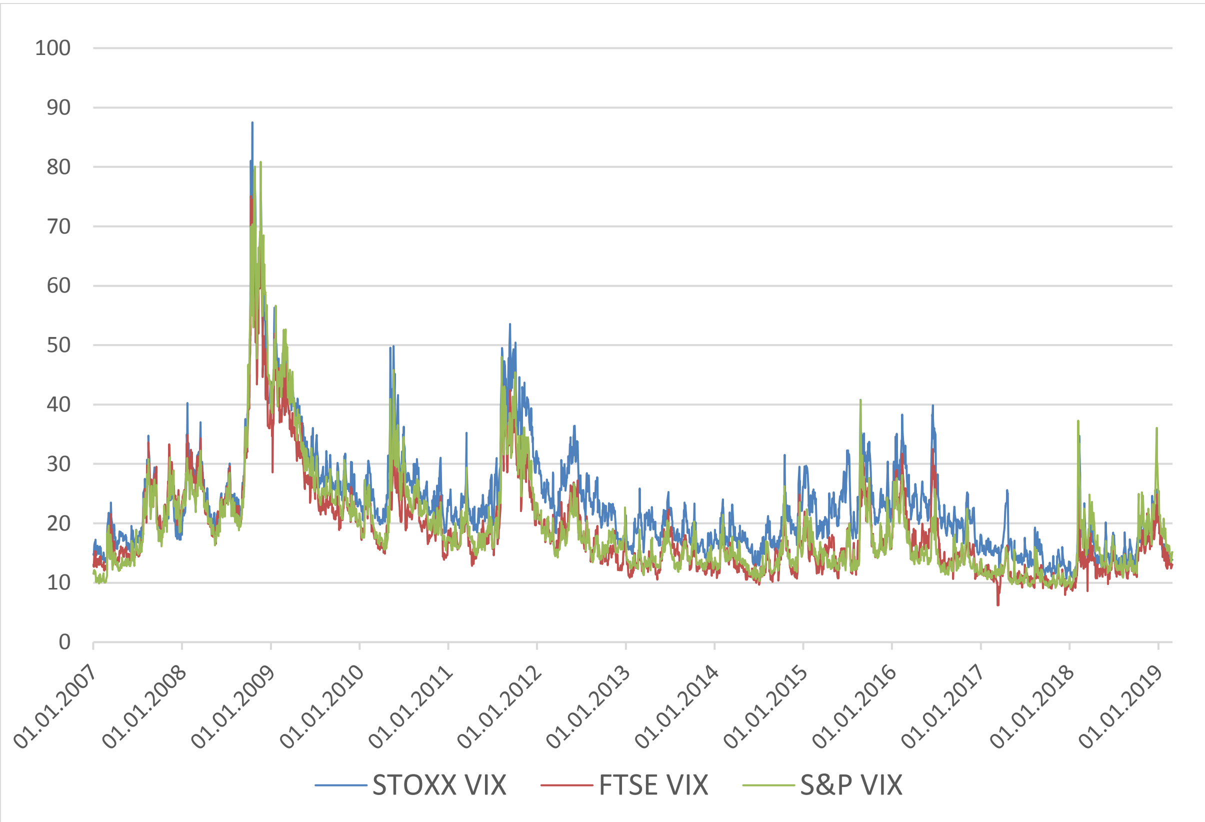
Table 3: Eurobarometer Polls; Spring 2016 and Autumn 2018, Image of the European Union

		Total Positive		Change		Neutral		Total Negative		Change		Don't Know	
		2016	2018	16/18		2016	2018	2016	2018	16/18		2016	2018
EU28		**34**	**43**	+	**9**	**38**	**36**	**27**	**20**	-	**7**	**1**	**1**
Belgium	BE	35	41	+	6	33	41	31	18	-	13	1	0
Bulgaria	BG	51	56	+	5	30	23	17	17		0	2	4
Czechia	CZ	26	28	+	2	40	40	34	32	-	2	0	0
Denmark	DK	34	48	+	14	42	36	23	15	-	8	1	1
Germany	DE	29	47	+	18	41	37	29	15	-	14	1	1
Estonia	EE	33	45	+	12	47	45	17	9	-	8	3	1
Ireland	IE	58	64	+	6	27	28	14	8	-	6	1	0
Greece	EL	16	25	+	9	33	39	51	35	-	16	0	1
Spain	ES	30	43	+	13	44	43	23	13	-	10	3	1
France	FR	36	34	-	2	33	38	29	27	-	2	2	1
Croatia	HR	37	39	+	2	43	42	19	18	-	1	1	1
Italy	IT	32	35	+	3	38	36	27	27		0	3	2
Cyprus	CY	27	36	+	9	32	40	41	23	-	18	0	1
Latvia	LV	31	42	+	11	49	47	18	9	-	9	2	2
Lithuania	LT	43	48	+	5	47	45	9	6	-	3	1	1
Luxembourg	LU	45	56	+	11	32	26	22	18	-	4	1	0
Hungary	HU	33	43	+	10	41	38	25	19	-	6	1	0
Malta	MT	41	43	+	2	43	43	13	10	-	3	3	4
Netherlands	NL	33	46	+	13	38	37	29	16	-	13	0	1
Austria	AT	32	40	+	8	30	37	37	22	-	15	1	1

Poland	PL	47	54	+	7	37	36	15	10	-	5	1	0
Portugal	PT	41	53	+	12	39	34	18	12	-	6	2	1
Romania	RO	42	52	+	10	43	37	14	10	-	4	1	1
Slovenia	SI	32	38	+	6	46	43	20	18	-	2	2	1
Slovakia	SK	30	33	+	3	43	49	26	17	-	9	1	1
Finland	FI	33	40	+	7	44	44	22	15	-	7	1	1
Sweden	SE	36	53	+	17	38	33	26	14	-	12	0	0
United Kingdom	**UK***	**31**	**43**	+	**12**	**31**	**29**	**36**	**27**	-	**9**	**2**	**1**

Source: EIIW calculations based on European Commission's Standard Eurobarometer 85, Spring 2016 and Standard Eurobarometer 90, Autumn 2018
*implied referendum result on the basis of Total Positive/(Total Positive+Total Negative)
2016: 46%: 54%; by comparison the EU Referendum on 23 June 2016: 48.1% pro-EU (Remain): 51.9% pro-Brexit (Leave)
2018: 61%:39%

Figure 1: Implied Volatility Index for EA, UK and US (Daily Jan. 2007 – Feb. 2019)



Source: Datastream