MAKING SENSE OF THE COSTS AND BENEFITS OF BREXIT: CHALLENGES FOR ECONOMISTS

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“BREXIT MEANS BREXIT” - THERESA

- Political divorce
- Economic separation: multiple dimensions
  - A new trade regime of UK
  - Regulatory evolution
  - Budgetary implications
  - Corporate organisation
- Institutional reconfigurations
- Extended period of uncertainty in all three

THE CHALLENGES TO ECONOMISTS

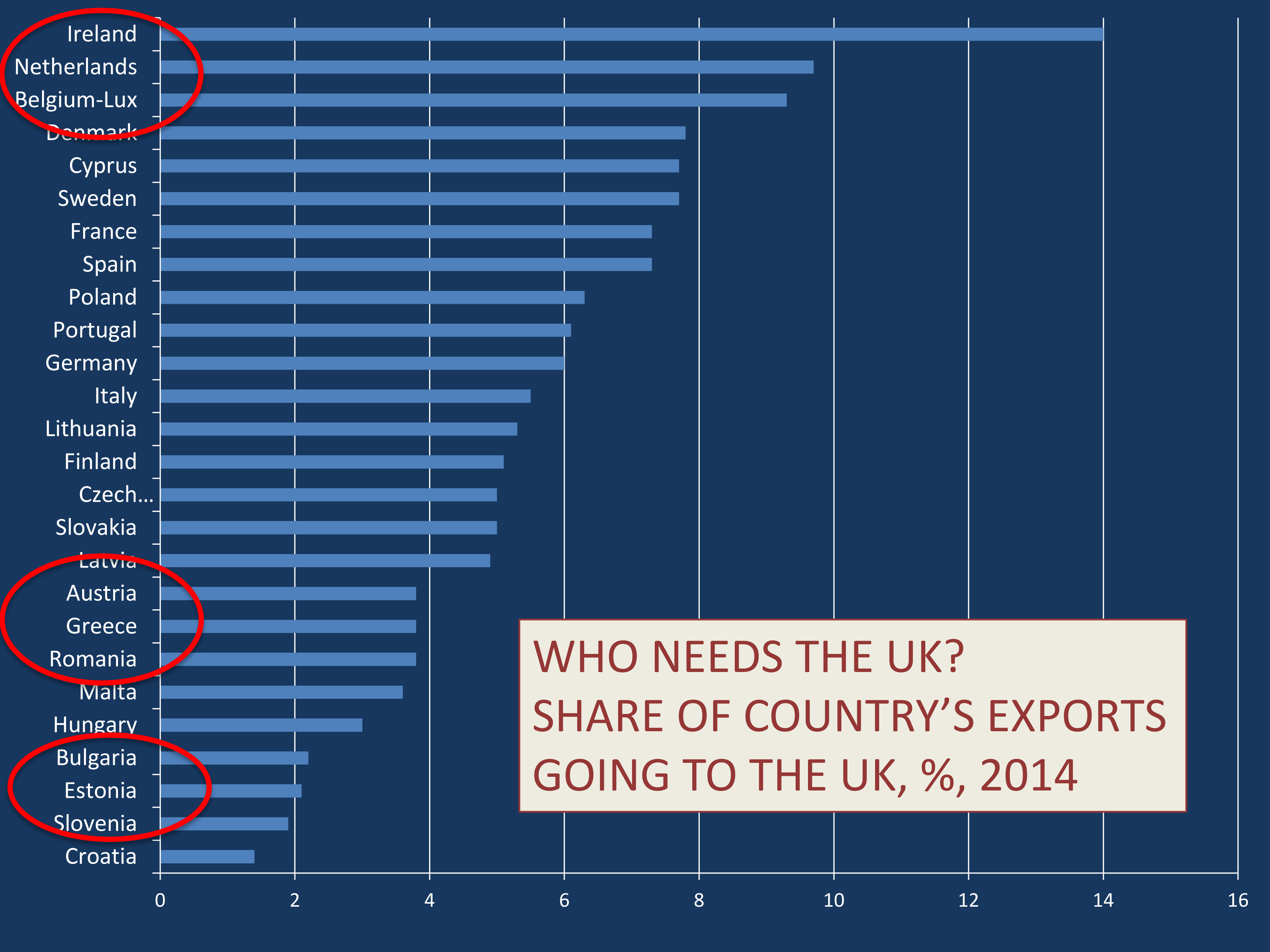
- *Ex-ante* analysis of longer-term consequences
  - Defining the correct assumptions
  - Adopting suitable analytic techniques
  - The reliability (or not) of past empirical regularities
- Short-term forecasts of the unprecedented
- Specifying simulations of plausible evolutions
    - Is leaving the EU the reverse of joining … or asymmetric?
- Explaining the underlying political economy
  - The various uncertainties and endogeneities
  - But also the prospect of behavioural changes

COSTS OF BREXIT

- Trade restrictions
  - Not so much tariffs or quotas
    - More ‘behind-the-border’
  - Transactions costs of trade and investment
    - Also establishing rules of origin and equivalence
- Public finance effects if economy slows
- Disruption of supply-chains and networks
- Skills and labour supply
  - Likely to be damaging for some sectors

BENEFITS OF BREXIT

- Better regulation
  - Tailoring to national circumstances
  - Avoiding over-intrusive ‘Brussels’
- Opportunities to open trade elsewhere
  - Notably growing emerging markets
    - Countering trade diversion of EU restrictions
  - Consumer gains
- Avoiding EU budget contributions


Ireland
Netherlands
Belgium-Lux
Denmark
Cyprus
Sweden
France
Spain
Poland
Portugal
Germany
Italy
Lithuania
Finland
Czech...
Slovakia
Latvia
Austria
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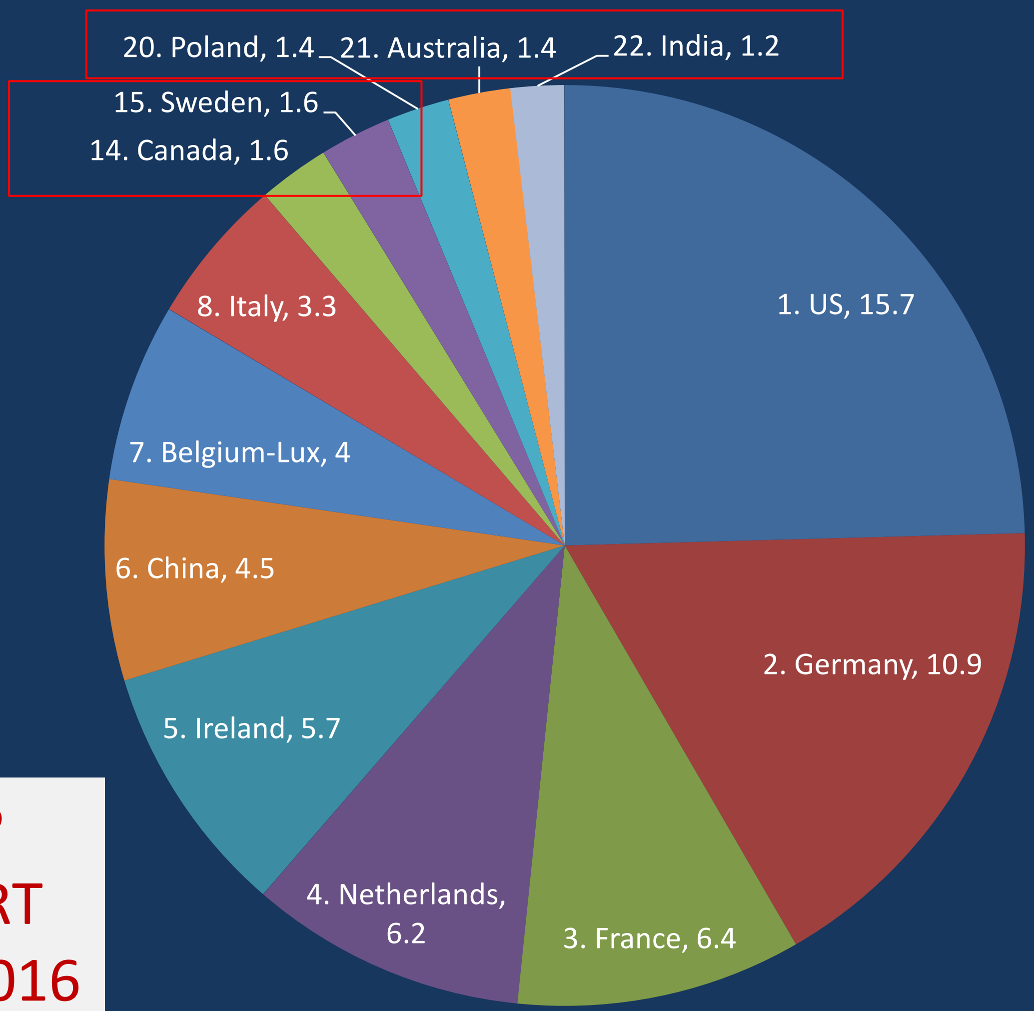
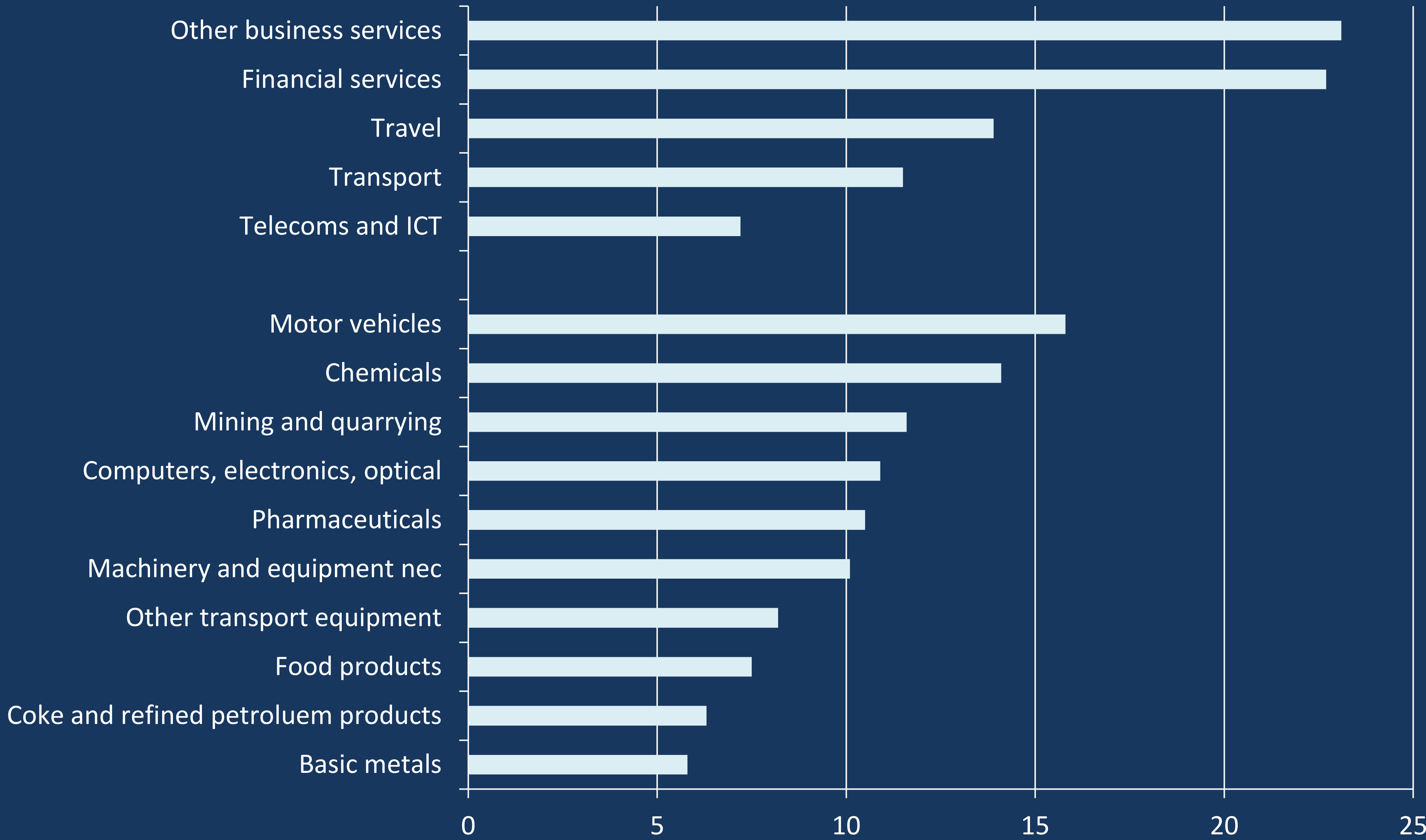
WHO NEEDS THE UK?
SHARE OF COUNTRY'S EXPORTS
GOING TO THE UK, %, 2014

AND WHO DO (SHOULD) WE CARE ABOUT?



AMONG TOP 25 UK EXPORT MARKETS, 2016

PRINCIPAL UK EXPORT SECTORS 2015, £ billion



FINDINGS OF ECONOMIC ‘EXPERTS’

- Overwhelming consensus on likely GDP loss
  - Substantial reliance on gravity models
- But:
  - Contingent on which post EU model emerges
    - Already some options being excluded
  - Extent of loss more varied than is comfortable
    - Loss of 2pp to 9pp of GDP by 2030
- Small minority arguing there will be gains
  - Even advocacy of unilateral trade liberalisation
    - Aimed at benefitting consumers

THE ECONOMIC STORY SINCE JUNE

- Treasury projections of short-term confounded
- Credible explanations for resilience … so far
  - Fall in £ helped, but now feeding into higher inflation
    - Eroding real incomes
- Mixed signals: business on relocation from UK
    - Competition not just from EU; also rest of world
    - Likely to gather pace after Article 50 is triggered next week
- Projections of lower growth in next 2 years
  - Estimate of £12 billion annual public finance cost
    - Exceeds today’s net cost of EU membership

RECORDS OF FORECASTERS: BoE

Year forecast	February 2017	November 2016	August 2016	May 2016
2017	2.0	1.4	0.9	2.3
2018	1.6	1.5	1.8	2.3
2019	1.7	1.6		

“The upgraded outlook over the forecast period reflects the fiscal stimulus announced in the Chancellor’s Autumn Statement, firmer momentum in global activity, higher global equity prices and more supportive credit conditions, particularly for households.

Domestic demand has been stronger than expected over the past few months, and there have been relatively few signs of the slowdown in consumer spending that the Committee had anticipated following the referendum”.

“I think, near-term, the data, the evidence we’ve been accumulating since the referendum, has surprised to the upside….

Has that led us to fundamentally change our view on the fortunes of the economy looking forward over the next several years? Not really. This is more a question, I think, of timing than of a fundamental reassessment of the fortunes of the economy”

Andy Haldane

Chief Economist, Bank of England

“The impact of the vote, by the UK to leave the EU…., on growth has yet to be felt. Growth in each of 2016-Q3 and 2016-Q4 was 0.6%, in line with growth rates in the preceding two years suggesting that the economy has maintained momentum since the referendum. In particular, retail sales rose markedly in H2-2016 and most measures of business confidence and orders in 2016-Q4 remained firm.”

“Nevertheless, growth remains unbalanced” (!!)

European Commission, 2017

WHAT ABOUT BUSINESS INVESTMENT?

WINTER 2017

"Although expected to rise in 2017 compared with 2016, business investment is projected to slow throughout 2017 as rising uncertainty deters businesses from investing at recent rates"

AUTUMN 2016

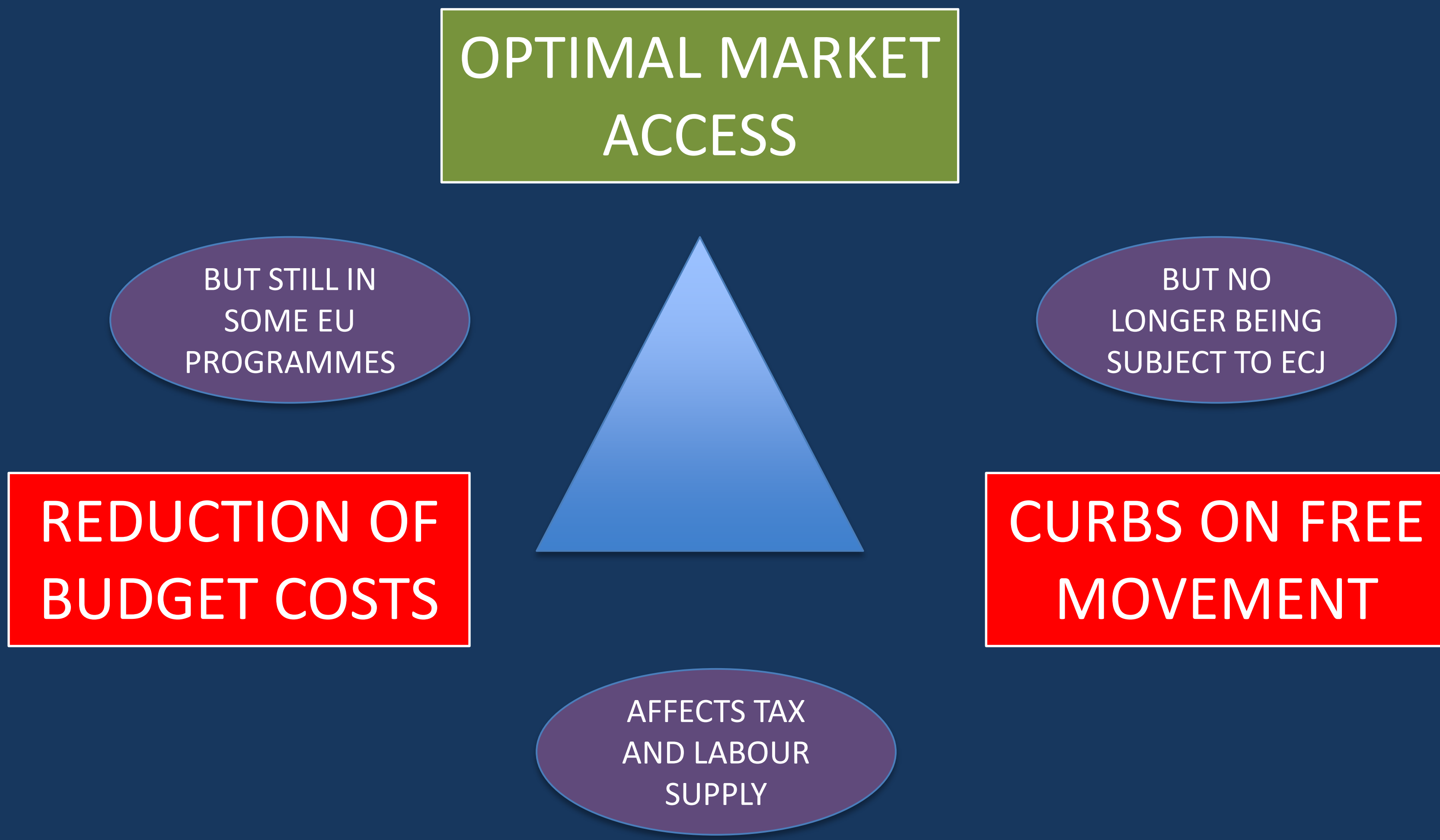
"business investment is expected to decline sharply throughout 2017 and fall by 2.2%."

YET: this week's Bank survey finds investment intentions have rebounded since the referendum

SPRING 2016

"Business investment is projected to continue to rise at around 4% in 2016 and 2017…. Low borrowing costs, better access to finance, strong corporate balance sheets, improving corporate profitability and previous rises in demand should underpin [it]"

TRILEMMA OF WHAT UK WANTS



A BUDGETARY 'QUADRILEMMA'

PROMISES MADE TO UK VOTERS:
£350 MILLION PER WEEK FOR NHS

LOSS OF UK CONTRIBUTION TO EU BUDGET

...BREAKING A PROMISE ALREADY EXAGGERATED

...UNLESS UK STILL PAYS A BIT ....

SOMEONE ELSE HAS TO PAY, OR SPENDING HAS TO FALL

INDIRECT BREXIT EFFECTS ON TAX REVENUES FROM GDP CHANGES

NEGOTIATION OF NEXT EU MULTI-ANNUAL FINANCIAL FRAMEWORK

MAKES TOXIC MIX WORSE

EVEN TOUGHER THAN USUAL

FOUR TESTS FOR A 'GOOD' BREXIT

PROSPERITY

- Effect on GDP per head
  - Productivity growth
  - Resilience & balance
  - Specialisation
- Change in public finances
  - Balance of effects

FAIRNESS

- Shifts in (in)equality
  - Wages
  - Access to housing
  - Public services
- Results of lower migration
- UK citizens abroad

Tensions between the tests

Timing of effects

Who wins or loses?

OPENNESS

- Market access
  - Trade with rest of EU
  - With rest of world
  - Investment
- Flows of knowledge/ideas
- Global skills pool

CONTROL

- Effective say in decisions
  - Migration, trade etc.
- Democratic processes
  - Westminster
  - Devolved authorities
  - Accountability

WHICH TAKES US TO SOME 'WILDCARDS'

May 2017
Marine wins

Most fanciful:
UK MPs topple
Theresa

End 2017
It's Schulz…

Vladimir or Donald
do the unforeseen

A major investor
quits the UK

Late 2018
The Scots rebel

AWKWARD QUESTIONS FOR ALL OF US

- Economists’ analyses of Brexit:
  - Were they flawed and potentially misleading?
  - Or correct but with the timing awry?
- In the light of the emerging evidence:
  - Do we have the tools to provide answers?
    - Modelling a significant regime change?
    - Forecasting in so uncertain an environment?
- Did ‘project fear’, perversely, swing the result?

“Politics are likely to defeat economics in Europe, as they clearly have in the UK”

John Kerr

http://ukandeu.ac.uk/

http://blogs.lse.ac.uk/brexit/

YOUR OPINIONS….

1. Will Brexit damage:
    1. The UK economy?
    2. The EU27 economy?

2. Is a lose-lose outcome the most likely?
    1. Could it be a ‘car-crash’?

3. In relation to Brexit: did the economics profession:
    1. Provide worthwhile and objective analysis?
    2. Mislead the public and distort the referendum result?