

# To Brexit or not to Brexit: the UK and the EU

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*UK election: to Brexit or not to Brexit?*



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“...as in 1939, we are at a crossroads in our island history...voters will be asked to decide nothing less than what sort of country we want to live in and bequeath to those who come after us”

# Overview

- What are the issues?
  - Economic
  - Non-economic
- The economics of Brexit
- What are the options?
- Conclusions

# Economic issues:

- Worth remembering that being in the EU involves the freedom of movement of: goods, services, labour and capital
- Are we better off in or out?
  - Trade in goods and services (including the City)
  - Investment
  - Migration
  - Regulations: working conditions, fisheries, agriculture, environment
  - Budget contributions
- Note: the answer depends on the “out” options

# 'Non-economic' issues:

- Desire for sovereignty with respect to
  - Migration
    - Economic migration: economic & social impact of workers from the EU
    - Humanitarian migration: Dealing with asylum seekers
  - Trade & investment
  - Regulations
- Need to consider what sort of sovereignty is desired and feasible

# How did we get here?

- Concerns over the EU project (Eurozone crisis, asylum seekers, terrorist threats)
- Long-standing discord in the Conservative party, going back to the days of Thatcher
- Rise of UKIP
- Often fuelled by the popular press
  - ... which of course are highly interdependent...

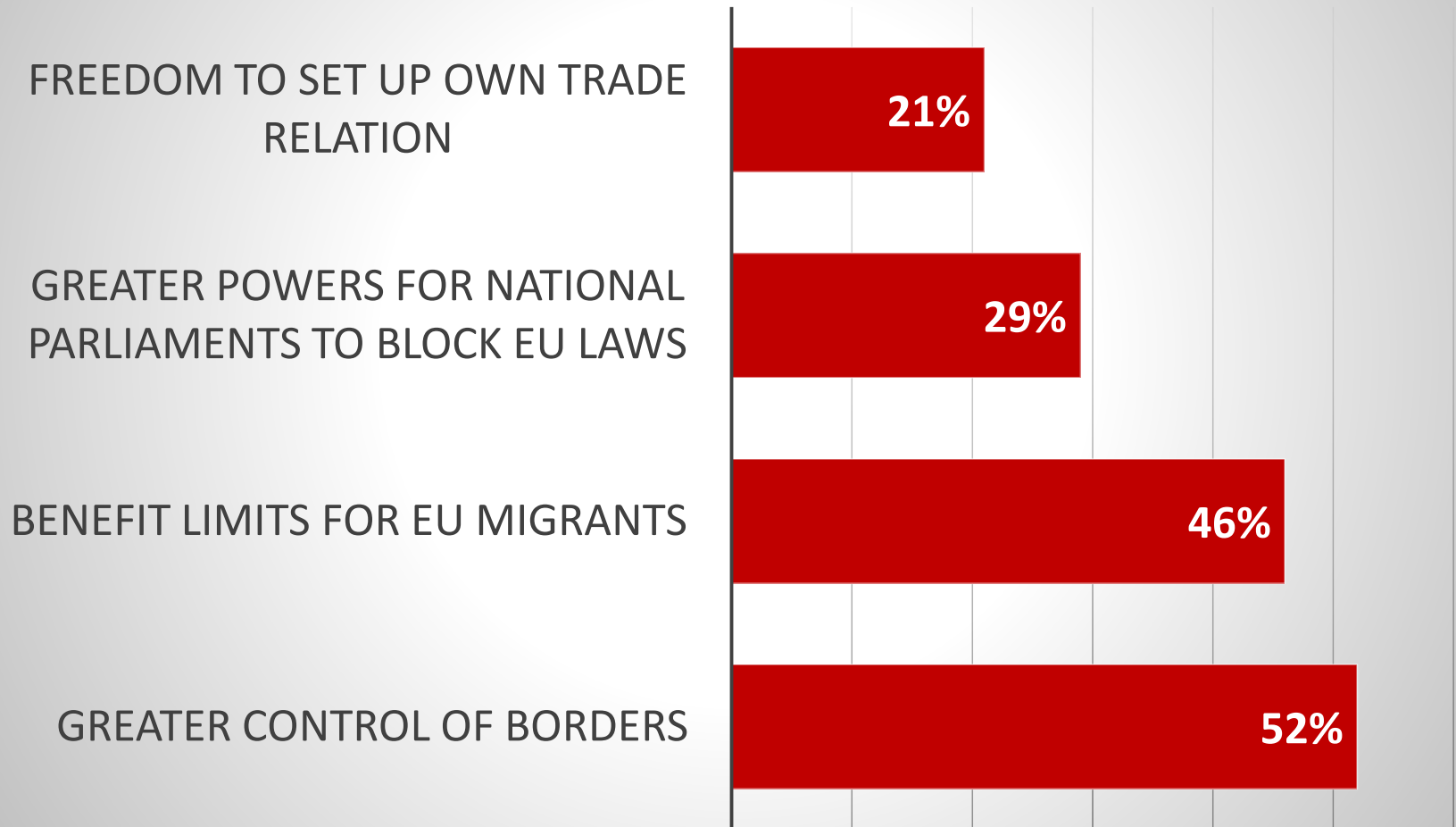
# Some popular narratives...

- Regulations:
  - “3,600 new laws in three years as EU strangles UK firms... it would take 92 DAYS to read all the regulations” (October 2013)
  - “EU chiefs spark outrage over plans to force cattle to wear NAPPIES” (October 2014)
  - “Is Europe going to restrict teens from using Facebook?” (December 2015)
- Migration:



## Share of respondents who wanted:

YouGov Poll, November 2015





# The economics of Brexit

# Sources of economic growth and gains from trade & migration:

- **Increase in investment and / or labour**
  - Importance of predictability / certainty
- **Improving the way we organise our resources**
  - Specialisation
  - Competition
- **Increase efficiency:**
  - firms becoming more productive from economies of scale
  - technological progress / transfer
  - Improved managerial techniques
  - access to better quality intermediates

# Deep integration

- Cutting tariffs is part of the story, but...
- ... these can be offset by government imposing regulatory barriers against foreign goods:
  - Eg. technical standards
- So you need to have rules to ensure this does not happen (eg. mutual recognition / harmonisation)
- This needs to be enforceable in law → EU law → single market in Europe
- This may be especially important with the rise in EU value chains → “factory Europe”
- ... and the way in which the UK is integrated with the EU

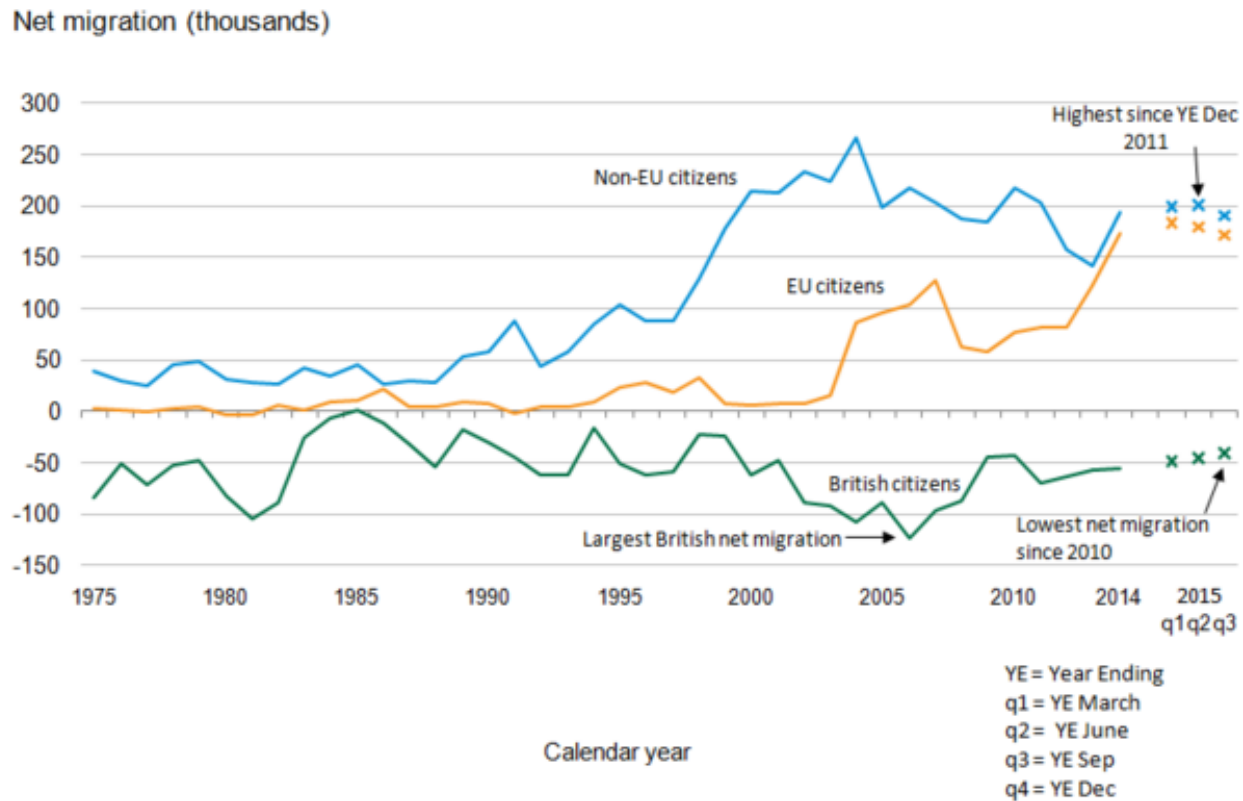
# How important is the EU to the UK?

- Share of EU in UK's trade close to 50%, which is approx. 15% of GDP
- 3.7M jobs associated with UK export to the EU:
  - 40% of these in turn linked with EU exports to the world (ie UK is part of EU value chains)
- In comparison, 4.5M jobs associated with UK exports to ROW:
  - 15% of these linked with ROW exports to the world
- Top 5 countries using UK inputs in their exports are all EU countries
- The way in which UK is integrated with EU countries compared to non-EU countries appears quite different

# Migration:

Figure 3: Long-Term International net migration by citizenship

UK, 1975 to 2015 (YE September 2015)



Source: Office for National Statistics, UK;

<http://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/bulletins/migrationstatisticsquarterlyreport/february2016>

# Impact of UK being in the EU?

- CBI (2013) concludes that net benefits to the UK economy are around 4-5% of GDP, = ~£3,000 per household per year, but may be higher as hard to pin down intangibles such as innovation
- Recent work by Campos et.al (2014) suggest:
  - 1960's saw the decline of UK GDP relative to other EU economies. This decline stopped from 1973 onwards
  - Productivity gains for UK linked to more intra-industry trade, foreign direct investment, and benefits from financial services specialisation
- A small minority of studies report negative benefits. These tend to be more narrowly focussed
- Most studies show that the net impact of migration to the UK economy is positive (eg. Dustman & Frattini, 2014)
- UK net contribution to EU budget is approximately 0.8% of total government expenditures.

# Economic impact of exit:

- Majority of empirical estimates suggest a net cost to the UK economy (Ottaviano et.al, IFO, Global Council, CBI)
- Static estimates of losses up to around 3-4% of GDP, and dynamic estimates of losses up to 14.5%
- Hard to find many studies suggesting possibility of net gain (Mansfield, Minford, Open Europe); and where there is a gain typically very modest
- Estimates depend critically on:
  - What is assumed in the model, especially the counter-factual
  - Whether you allow for long run effects on investment
- Note: during the 2008/09 financial crisis, UK GDP fell by ~7%.

# Implications of exit:

- Possible negative effects from:
  - decline in trade, investment, and migration
  - also possibility of macro effects (Citi Bank): depreciation of currency (ie imports become more expensive) → increase in inflation → rise in interest rates
- Possible positive effects from:
  - Reductions in regulatory burden
  - Improved trade agreements
  - The ability to limit immigration
  - Budgetary savings



# What are the outside vs inside options?



# Key questions: The Counterfactual?

- Cameron's deal will not change the future very much, so UK-in-EU after June will look much like pre-June (a scenario itself subject to uncertainty)
- But we need to compare UK –in-EU with a “counterfactual” OUT scenario – but what?
- What kind of relationship would be possible between a non-member UK and the EU?
- What kind of relationship is possible with non-EU countries?

# Cameron's deal has limited impact

- UK exempt from 'ever closer union' – but could have vetoed
- Member State can refuse in-work welfare payments to migrants here for less than 4 years and limit some benefits to children abroad . Needs Council of Ministers approval – lasts 7 years (£200m cost saving? )
- If 55% of EU parliaments vote against proposed legislation it will be referred to European Council (PMs & Presidents) – hard to see decisions being taken against this much opposition in first place.
- Efforts promised to reduce regulatory burdens
- UK won't have to pay for Eurozone bailouts; any financial regulation that may affect non Eurozone countries can be referred to European Council (PMs & Presidents)
- Is it legally binding?
  - Judges can always “interpret”
- <http://eulawanalysis.blogspot.co.uk/2016/02/the-draft-ukeu-renegotiation-deal-is-it.html>

# What are actual mechanics of leaving?

- UK formally notifies EU under Article 50 of its intention to leave then 2 years to negotiate a new deal on UK-EU relations.
  - “The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.” Para 3.
- By unanimity 2yrs can be extended meanwhile UK in EU.
- Huge body of national law will need to be revised – esp where UK law reflects EU regulations as opposed to directives
- 2 years of negotiations with EU to decide what “out” actually implies in terms of trade relations
- EU officials insist 50+ EU FTAs with 3<sup>rd</sup> countries will need to be renegotiated as they will not apply to UK
- [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/503830/54538\\_EU\\_Series\\_No2\\_Print\\_ready.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/503830/54538_EU_Series_No2_Print_ready.pdf)

# Changing UK law

## **EU Regulations** - *directly applicable rules*

Need to “Renationalise” 5,896 full EU regulations and 6,399 technical regulations where laws agreed in Brussels apply directly with no UK law to implement.

## **EU Directives** - *agreements that MS will adopt laws*

“At least 15 per cent of the UK statute book is based on 978 EU directives and 656 related technical directives.”

FT Feb 29 2016

<http://www.ft.com/cms/s/0/a697f642-debd-11e5-b072-006d8d362ba3.html#axzz41ZaE7GSj>

# What are the “out” scenarios? Can the UK stay in the Single Market (which most Eurosceptics want) without being in the EU?

## ■ Models:

- Norway EEA (rejected EU membership, now in EEA)
- Switzerland “Bilaterals” (rejected EEA membership)
- EU-Turkey “Customs Union” (long-term disappointed applicant)
- EU-Canada FTA (“CETA”) still being finalised

## ■ Or just the WTO?

<http://openeurope.org.uk/intelligence/britain-and-the-eu/what-if-there-were-a-brexite/>

# EEA option:

- EEA = European Economic Area
  - Is a free trade agreement between the EU and Liechtenstein, Norway, and Iceland (EFTA minus Switzerland)
  - Allows for the free movement of goods, service, capital **& people** with the EU + Schengen agreement
  - in exchange for access to EU single market, EEA members must apply all EU rules, including social acquis, (except ag & fish rules) ***with no say in their design***

# EU-Switzerland Bilateral Agreements

- Swiss govt. long wanted to join EU, but voters say no
- Swiss want market access and must use EU norms to be able to access EU market – **with no voice**
- Bilateral agreements give Swiss free access in exchange for adopting **EU** rules in own laws
  - Swiss in Schengen and free movement of Labour
  - But don't have free access in most services
  - If Swiss don't adopt the laws, EU can deny Swiss trade benefits
  - Several agreements but Swiss have to accept all of them
  - recent immigration cap vote led to EU refusing Swiss access to R&D funds



# EU-Turkey model

- Customs Union agreement (excludes agriculture and services)
- Must apply all EU external tariffs AND all internal market rules (standards etc) with no say
- But both sides can still use (threaten) anti-dumping – impossible inside EU
- Must try to sign FTAs wherever the EU does
  - if TTIP signed US will initially get free access to Turkey but not vice versa
- Seen as way to improve Turkish regulatory regime

# EU-Canada CETA – abolishes tariffs and reduces some NTBs

- Took 7 years to negotiate! Still not final
- Not as comprehensive as EEA etc eg. *no labour mobility* but does include services
- No general harmonisation of standards. Limited “mutual recognition” of some regulations and conformity assessment.
- Food safety rules said to be unaffected
- Some doubts in Paris and Berlin
- [http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152806.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf)

# EU-UK just under WTO rules

- No preferences for UK into EU or vice versa
- Some renegotiation of our WTO status might be needed
- EU offers UK market access on same terms as WTO members who have no free trade deal, currently EU, US, Japan, China. (And vice versa) – **EU tariffs on cars 10%**
- UK good may held up by technical inspections
- In future EU can adopt regulations that might create non-tariff barriers
- EU can use anti-dumping tariffs against UK and vice versa
- Nom access to European Court of Justice if obstacles
- No free movement of labour

# Trade relations with 3<sup>rd</sup> countries

- UK currently gets preferential market access to most countries (not US, China Japan) via c. 50 EU Free Trade Agreements
- EU officials say these would not apply to UK after BREXIT and would need 5-10 yrs to renegotiate
- BREXITERS say they would and we would get more and better deals with US, China...on our terms
- Chinese PM & President came to UK seek UK influence for EU-China FTA
- UK currently has influence at WTO via EU

# What deals could UK expect after BREXIT?

- Politics would matter
- UK bargaining position not strong because EU will want to deter other exits
- UK could probably secure EEA style deal. But not Swiss bilaterals: EU already cooling on Switzerland deal.
- Brexiters hope for unspecified special deal
- UK would lose all influence over EU rule setting
- But UK would have to accept many (most?) EU rules and regulations to secure wholly barrier free entry for its goods and services, maybe including labour movement
- It would see financial service rules in EU set by others
- Would the UK be able to sign better agreements (eg. TTIP) than the EU?

## Conclusion: Sovereignty may come at a price

- Counterfactual hugely speculative: realisation of gains would depend on a guarantee of superior policies being available and adopted if out
- Direct economic gains or losses may be modest but there is a high degree of uncertainty
- Indirect impact much bigger *but very hard* to estimate
- How much EU market access would we lose?
- What would be the “sovereignty cost” of remaining in the EU vs “gains” from Brexit?
- What sort of sovereignty would be possible?
- Eg. UK could opt out of free movement of labour – but EU would demand a price in market access