Economic Dynamics and Integration in Eastern Europe and Asia

Monday 16:00-18:00
M.14.22

Prof. Paul J.J. Welfens / David Hanrahan/Tian Xiong

Bergische Universität Wuppertal
WS 2017/2018
5. EU DISINTEGRATION?
UK referendum on June 23rd, 2016:

“Should the UK remain a member of the European Union or leave the European Union?”

51.9% in favour or Leave (17.4 million v. 16.1 million)
Mr David Green  
Vice-Chancellor  
University of Worcester  
Henwick Grove  
Worcester, WR2 6AJ  
3rd October 2017

David,

I was wondering if you would be so kind as to supply me with the names of professors at your establishment who are involved in the teaching of European affairs, with particular reference to Brexit.

Furthermore, if I could be provided with a copy of the syllabus and links to the online lectures which relate to this area I would be much obliged.

I sincerely hope you are able to provide me with such and I look forward to hearing from you in due course.

Yours sincerely,

CHRIS HEATON-HARRIS MP  
MEMBER OF PARLIAMENT FOR DAVENTRY
“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, 1962

- Still searching?
UK and EU

• 1961 application to join European Communities along with Denmark (incl. Greenland) and Ireland rebuffed by de Gaulle in 1963. → UK too close to US interests, UK not sufficiently committed to European integration
• 1967 de Gaulle says "non" again.
• 1969 new application following change of president in France
• 1972 Treaty of Accession signed
• 1st January 1973 – UK formally joins EC after Treaty of Accession approved in parliament
• 1974/75 renegotiation of conditions of membership under Labour government
• 1975 referendum – 67% in favour of remaining in European Communities….

Support for referendum was low in UK where parliament is sovereign:
“..a device of dictators and demagogues”. - ;Margaret Thatcher, 1975
UK and EU

- 1978 UK remains outside of the exchange rate mechanism of the European Monetary System (EMS)
- 1984/85 under PM Thatcher – UK rebate reduces contributions
- Oct/Nov 1990 under then Thatcher joins the EMS – concerns raised in Europe that Britain’s entry was intended to slow down progress towards monetary union and a single currency
- September 1992 – UK crashes out of EMS after facing huge speculative attacks on Sterling – “Black Wednesday”
- 1992 Maastricht Treaty – UK opt-out on Economic and Monetary Union
- 1992 Maastricht Treaty – UK opt out social chapter (social and employment legislation)
- 1997 Treaty of Amsterdam – UK opt out of Schengen acquis
- 2009 Lisbon Treaty – UK opt out Charter of Fundamental Rights, right to opt-out of legislation regarding JHA
UK and the Single Market

It’s your job, the job of business, to gear yourselves up to take the opportunities which a single market of nearly 320 million people will offer. Just think for a moment what a prospect that is. A single market without barriers—visible or invisible—giving you direct and unhindered access to the purchasing power of over 300 million of the world's wealthiest and most prosperous people. Bigger than Japan. Bigger than the United States. On your doorstep. It's not a dream. It's not a vision. It's not some bureaucrat's plan. It's for real…..

…Europe wasn't open for business. Underneath the rhetoric, the old barriers remained. Not just against the outside world, but between the European countries.

Not the classic barriers of tariffs, but the insidious ones of differing national standards, various restrictions on the provision of services, exclusion of foreign firms from public contracts. Now that's going to change. …

Britain has given the lead.

– Margaret Thatcher, 1988
2013 – Cameron promises an IN/OUT referendum if he wins 2015 election – attempt to sway Eurosceptic Conservatives and negate the challenge of the United Kingdom Independence Party (UKIP). Opinion Polls in UK:

Background to 2016 Referendum

- 2014: Review of Competencies undertaken – no major issues identified
- General Election 2015: Conservative/Cameron victory. UKIP win only one seat.
- June 2015 – February 2016: UK negotiations with EU
  - Results: UK out from ‘ever closer union’, restrictions on welfare to EU immigrants, deepening single market, a reduction of regulation, more competitiveness,..
- Jan. 2016 – government ministers free to campaign for either side, no collective ministerial responsibility
- Feb. 2016 – Date of referendum announced…
Implied Probability of a Remain vote

Main Argument 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 (MIX, 2016)

- 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"
Burden of Immigration?

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

UK Employment Rates

Net Contribution of Immigrant Households in UK

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

Pressure on UK Public Services

Cameron information blunder at the UK’s EU referendum –

• 16-page government information brochure did not contain findings of Treasury Study on Benefits of British EU Membership: BREXIT= 10% income loss: 6% loss from reduced access to EU single market, 4% from non-realization of enhanced EU single market from Cameron’s negotiation with EU.

• Treasury Study published 1 week AFTER brochure mailed to households in Engl. (April 11-13, 2016); results of study known in government.

WELFENS (2017): Correct info would have resulted in 52.1% Remain (based on UK popularity functions – Frey/Schneider, 1978)
Referendum Results

Should the UK remain a member of the European Union or Leave the European Union…

• 51.9% Leave to 48.1% Remain

England 53%:47% Leave (including Gibraltar: 96% Remain)
Scotland 62%:38% Remain
N. Ireland 56%:44% Remain
Wales 53%:47% Leave

Greater London, Liverpool, Manchester, Cardiff, Glasgow, Edinburgh, Belfast, Newcastle… all remain.
Who voted Leave?

More likely to vote Leave if

• Male
• Older (45 years of age up)
• Less educated
• Lower income
• Self-identify as “working class”
• Identify as authoritarian
• See UK having changed for the worse over previous 10 years
• See those changes having affected them more than anyone else
• Tabloid reader (Sun, Express, Mail, Star…)

Three groups can be identified: Affluent Eurosceptics, older working class, disadvantaged anti-immigration

Source: Swales (2016), Understanding the Leave vote, NatCen
Developments post-referendum

- Cameron resignation 24th June 2016
- Theresa May becomes PM July 2016
- Court case of Gina Miller – sovereignty of parliament not government
- “Enemies of the People” headlines etc.
- Article 50 - 29th March 2017 → Actual Brexit day 29th March 2019

2017 Snap Election in UK (makes matters worse for PM May)

- Minority government needs the support of the Democratic Unionist Party (Northern Ireland); looks strange for Ireland which fears that neutrality of British government in regard to political developments in Northern Ireland is gone
- Significantly weakened position of UK going into negotiations
Depreciation of Pound v Euro (in % since day of Ref)

Source: Own calculations based on data from Bank of England Statistical Interactive Database, Daily Spot Exchange Rates against Pound Sterling
Brexit means 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 of accessing 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)
Negative Economic Reaction 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 investors bankers want to move out of London (back to New York or relocate some activities to Frankfurt/Paris and Dublin)
### David Davis’ Trade Targets

<table>
<thead>
<tr>
<th>Priority</th>
<th>Country</th>
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</thead>
<tbody>
<tr>
<td>High</td>
<td>China</td>
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<tr>
<td></td>
<td>USA</td>
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<tr>
<td></td>
<td>Canada</td>
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<td></td>
<td>Hong Kong</td>
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<tr>
<td>Medium</td>
<td>Australia</td>
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<td>Brazil</td>
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<td>India</td>
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<td>South Korea</td>
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<td>Low</td>
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<td>Indonesia</td>
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<td>Mexico</td>
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<td>Saudi Arabia</td>
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<td>Singapore</td>
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<td>Turkey</td>
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<td></td>
<td>South Africa</td>
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BREXIT Channels Reducing Real Income in UK

Trade Intensity Sinks (i.e. reduction in specialization benefits)

Less Direct Investment Inflows (Role of MNCs reduced, less technological progress etc.)

Less EU Immigration

Reduced Growth UK (3-10%)

## Estimates of Economic Impact of BREXIT (2030)

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Scenario</th>
<th>Estimate (%GDP)</th>
<th>Estimate Components</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEP/LSE</td>
<td>Dynamic EEA/FTA</td>
<td>-7.9</td>
<td>Budget, trade, productivity</td>
</tr>
<tr>
<td></td>
<td>Static EEA</td>
<td>-1.3</td>
<td>Trade only</td>
</tr>
<tr>
<td></td>
<td>Static WTO</td>
<td>-2.6</td>
<td>Trade only</td>
</tr>
<tr>
<td>HM Treasury</td>
<td>EEA</td>
<td>-3.8</td>
<td>Budget, trade, FDI, productivity</td>
</tr>
<tr>
<td></td>
<td>FTA</td>
<td>-6.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>WTO</td>
<td>-7.5</td>
<td></td>
</tr>
<tr>
<td>OECD</td>
<td>WTO/FTA</td>
<td>-5.1</td>
<td>Budget, trade, FDI, productivity, migration, regulation</td>
</tr>
<tr>
<td>IMF</td>
<td>EEA</td>
<td>-1.4 (2021)</td>
<td>Trade, FDI, fiscal, migration, productivity</td>
</tr>
<tr>
<td></td>
<td>WTO</td>
<td>-4.5</td>
<td></td>
</tr>
<tr>
<td>NIESR</td>
<td>EEA</td>
<td>-1.8</td>
<td>Budget, trade, FDI</td>
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<tr>
<td></td>
<td>FTA</td>
<td>-2.1</td>
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<tr>
<td></td>
<td>WTO</td>
<td>-3.2</td>
<td></td>
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<tr>
<td></td>
<td>WTO+</td>
<td>-7.8</td>
<td>+productivity</td>
</tr>
</tbody>
</table>

Source: Based on Whyman and Petrescu (2017), The Economics of Brexit
Implied Tariff on UK to EU Trade, by Tariff Type

Figure 2: Implied Tariff on EU to UK Trade, by Tariff Type

WTO Implied Tariffs on UK to EU Exports by Product Group

Figure 3: WTO Implied Tariffs on UK to EU Exports by Product

Sectors Facing Largest Reductions in Trade

Figure 8: Sectors with Trade Reductions over 20%

Goods Imports and Exports of EU27 with UK (% of GDP)

Source: CEPS (2017), An Assessment of the Economic Impact of Brexit on the EU27, study commissioned by the European Parliament Committee on Internal Market and Consumer Protection, DG for Internal Policies
Projected Fall in Trade

Figure 6: Projected Fall in Trade (Median Elasticity Scenario)

Loss in GDP per capita (2030) by EU Member State and type of Brexit

Source: CEPS (2017), An Assessment of the Economic Impact of Brexit on the EU27, study commissioned by the European Parliament Committee on Internal Market and Consumer Protection, DG for Internal Policies
### Table 1: A Cost-Benefit Analysis of BREXIT for the UK (assuming no UK-EU deal is reached)

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Avoiding annual net contributions to the EU of 0.4% of Gross Domestic Product (GDP)</td>
<td>Capitalized at an interest rate of 3% gives a present value (long-term) of <strong>13.3%</strong> of annual national income</td>
</tr>
<tr>
<td>2) Effect of UK imports from the EU burdened with tariffs after BREXIT: 0.25% of Gross Domestic Product</td>
<td><strong>8.3%</strong> of UK Gross Domestic Product (2016)</td>
</tr>
<tr>
<td>3) Reduced profits for UK firms due to lowering net prices (before EU tariffs) in the Single Market</td>
<td><strong>8.3%</strong> of UK Gross Domestic Product (2016)</td>
</tr>
<tr>
<td>4) Reduced output in the UK of 6% in the long term due to worsened access to the EU single market</td>
<td>6% of Gross Domestic Product (2016) according to the UK Treasury analysis (2016) on the advantages of British membership of the EU: assuming a UK-EU deal (in the no deal scenario: <strong>7.0%</strong> of UK Gross Domestic Product)</td>
</tr>
<tr>
<td>5) Macro feedback effect from 4), which would lead to a 1% reduction of income in the EU27 which, in turn, causes an associated further reduction of 0.2% of income in the UK. of 1%</td>
<td><strong>0.2%</strong> of UK Gross Domestic Product</td>
</tr>
<tr>
<td>6) Non-realization of the benefits due to single market deepening which was negotiated by Cameron with the EU at the beginning of 2016</td>
<td><strong>4%</strong> of UK Gross Domestic Product (according to the UK Treasury analysis (2016) on the advantages of British membership of the EU)</td>
</tr>
<tr>
<td>7) Effect of a raised share of foreign ownership of the UK's capital stock as a result of the real depreciation of the Pound from 27% in 2016 to 40% in 2030</td>
<td><strong>4.3%</strong> of UK Gross National Income</td>
</tr>
<tr>
<td>8) Unilateral abolition of tariffs on agricultural products</td>
<td><strong>1%</strong> of UK Gross Domestic Product</td>
</tr>
<tr>
<td>9) UK-USA “mini-TTIP” agreement</td>
<td><strong>2%</strong> of UK Gross Domestic Product</td>
</tr>
<tr>
<td><strong>Total Effect in % of Gross National Income</strong></td>
<td><strong>-15.8%</strong> (net) of UK national income</td>
</tr>
</tbody>
</table>
Politico-Economic Challenges


Source: EIIW calculations based on OBR forecasts
No Deal Scenario?

- No-Deal in 2018/19 means WTO rules (World Trade Organization): UK will have access to the EU Single Market like the US or any other ‘third country’
- Rabobank study 2017: UK -18% GDP; Netherlands -4% GDP compared to no Brexit
- EIIW calculations - -16% income loss (incl. positive effects of a UK-US FTA and benefits of zero import tariffs on agricultural products)
- UK to have a decade of growth which is lower than otherwise would have been

UK Government will try to counter stagnation via
- Reduction of Corporation Tax
- Deregulation (threat of another banking crisis....)
Fall-out

• 1) **Break-up of free trade group** DE/UK/DK/NL – solid bloc against protectionism → danger of more protectionism in the EU

• 2) **EU27 4/5ths of economic weight of EU28 = reduced negotiating power of EU27** – negative for all member states

• 3) The power of large countries increases (even if Scotland would join): in weighted votes in the Council of the European Union = benefits for DE; FR; **but even bigger gains for Spain and Poland** (see KIRSCH, 2018)

• 4) If the UK should disintegrate and Scotland join EU, there would be support for separatism – Italy, Spain, France..

• 5) **EU reforms are unavoidable** – without sound reforms the EU in the long term will disintegrate -
Problems

• Rights of EU/UK citizens

• Northern Ireland border

• UK settlement of financial obligations (ca. €50 billion on offer?)

PM May in Brussels December 4th - will “sufficient progress” be made?

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