What might be the Economic Effects of Brexit?

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Draws extensively on joint work with Swati Dhingra, Gianmarco Ottaviano, Tom Sampson

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Background

- In-Out Referendum by end of 2017 (PM pledge Jan 2013)
- Polls evenly split (51%-49% Mail on Sunday, 5/9/13)
  
EU still our major trade partner (non-EU is 25% of world GDP, yet our trade is twice this proportion)

Notes: Data covers trade with Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and Sweden.
The main Issues

• Net Fiscal transfers ~0.53% of GDP (HMT). Depends on deal – e.g. EEA vs Switzerland

• **Trade**
  • Foreign Direct Investment
  • Immigration
  • Regulation
  • Psychological benefits of “Sovereignty”
Trade

Foreign Direct Investment

Immigration

Regulation
Trade Effects

• Benefits of trade
  – Lower prices, more varieties
  – Specialisation in areas of comparative advantage
  – Competition
  – Innovation & productivity growth
• How would trade change with EU & non-EU relative to counter-factual?
• What would the new level of tariffs & non-tariff barriers
• A forward looking question: how much would the UK lose/gain from not being part of the ongoing deepening of the internal market?
  – Service liberalization, future trade deals

- Conventional static trade model which focuses on benefits of specializing in areas of comparative advantage
  - 35 sectors
  - 40 major countries in the world
  - Estimate relationships in model
  - Simulate what happens to welfare as UK-EU trade barriers change
- Takes into account how thins change – e.g. If EU-UK trade barriers rise, UK trade with other countries increases
Calculating the costs of greater trade barriers (Ottaviano et al, 2014)

• Simulate model under two main scenarios:

  – **Optimistic** (UK like EFTA; ¼ of non-tariff barriers; future barriers within EU fall 20% than RoW)

  – **Pessimistic** (MFN tariffs; 2/3 of non-tariff barriers; future barriers within EU fall 40% than RoW)
Table 1: Estimates of the welfare changes if UK leaves EU

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<th>Welfare Changes due to UK Withdrawal from the EU</th>
<th>% of GDP</th>
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Notes: Welfare measured by change in real consumption in the UK.
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| Pessimistic Scenario (MFN Tariffs)             |         |
| Due to Increase in EU/UK Tradable Tariffs (MFN EU Tariffs) | -0.14% |
| Due to Increase in EU/UK Non-Tariff Barriers (+5.37%)        | -0.93% |
| Due to Future Falls in EU/UK Non-Tariff Barriers (-10.54%)   | -2.55% |
| Due to Fiscal Benefit                                | +0.53%  |
| **Total Welfare Change**                           | **-3.09%** |

Notes: Welfare measured by change in real consumption in the UK.
Extensions to basic model

- Leaves out effects due to competition, selection, scale & varieties
  - Major advances in “Big Admin Data” over last decade show that these are BIG
  - Look at actual trade liberalisations & EU history (Baier et al, 2008; Feyrer, 2009).
  - Quantitative analysis suggests a **doubling or tripling** of static effects (Sampson, 2014; Bloom et al, 2015)
- Incorporate these using past empirical evidence
Table 2: Estimates of the welfare changes if UK leaves EU from trade cost, STATIC + DYNAMIC

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<th>Implied changes in UK incomes from leaving the EU and joining the EFTA</th>
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<td>Implied change in UK’s bilateral with EU</td>
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<td>Implied change in per capita income in the UK</td>
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Future trade agreements

• Nothing stops UK from promoting trade with Asia & Africa
• Wouldn’t have to “pool” our preferences with EU who have different preferences
• BUT much weaker bargaining power as offer of access to UK markets tiny compared to EU wide market
Trade

Foreign Direct Investment

Immigration

Regulation
FDI

• Strong evidence that FDI brings large benefits directly and via spillovers (e.g. technology & management)
• After Brexit, UK less attractive location because access to rest of EU markets is now weaker
• Magnitude of this effect hard to quantify, but Head & Mayer (2015) look at car industry. Calculate Brexit would mean ~12% loss of car production in UK
Trade

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Immigration

Regulation
Table 3: Growth in immigrant share has no effect on unemployment

![Scatter plot showing UK-born unemployment rate against % change in county immigrant share 2004-2012. Data points are scattered across the graph with a red line indicating the fitted value.]

Source: Annual Population Survey
Immigration

- Immigration has positive effects similar to trade
- May be additional dynamic effects on productivity especially as EU immigrants to UK on average better educated
- Fiscal effect positive (Dustmann & Frattini, 2014). immigrants work more, use less benefits & more educated than natives (~£15bn from EEA)
  - Native Jobs
  - Native Wages (maybe small negative on bottom 20% and increase in middle 40%-80%)
  - Public services (e.g. Polish students & schools)
Trade

Foreign Direct Investment

Immigration

Regulation
Regulation

• Obtaining equal access to EU requires adopting same product and service regulations

• Labour market regulations.
  – Can cause losses of welfare (e.g. French evidence)
  – But UK already has one of most flexible labour laws in OECD. Gains from relaxing more likely to be miniscule
Conclusions

• Need to refine models of how trade has welfare impacts
• Incorporate other effects that are harder to model (dynamics, FDI, immigration, etc.)
• But current estimates suggest serious losses for little gain
Some Further reading