Economic consequences of a Brexit

Miguel Jiménez

It is well known that what moves people to vote one way or another on European issues is usually more related to their sentiments regarding the European project (or even in matters of national politics), than the question itself. As regards the Brexit referendum, the question is very wide open (stay or leave), and it doesn't seem likely that the outcome will be made any clearer by the agreement signed with the European Council or even through economic arguments. The campaign has more to do with more nebulous questions such as "Brussels bureaucracy", "immigrants abuse" of the British welfare system or fears of the consequences that could arise from a Brexit (U.S. might pay less attention to its traditional ally, new referendum demands from Scotland or the uncertainty related to new trade agreements). Perhaps one of the defeats already suffered is that the idea of participating in the common European projects is not being actively used by those in favor of remaining in the EU.

The economic arguments in favor of a Brexit are weak. The savings from the contribution made to the EU budget would be very small (0.5% of GDP), and it remains to be seen if the new relationship with the EU would not entail some kind of contribution. The positive effects caused by less economic regulation on growth are uncertain and possibly small, given that the UK already has a very liberalized economy and the regulations imposed through its membership in the EU don't carry as much weight.

The costs of a Brexit have been well documented in numerous studies published in the last few months, although its impact is tough to assess, which is being used by the camp in favor of exiting the EU. In the medium to long term we could see a drop in foreign trade with the rest of Europe and a decline in foreign investment flows, which will greatly depend on the type of agreements signed after the exit (not only with the EU, but also with third countries with which the EU has negotiated in name of its member countries). The likely decline in immigration flows from a Brexit could also have a significant impact on labor supply, and therefore growth, in a country with a very low unemployment rate. Most of the studies say a Brexit would cost between 1 to 3% of GDP in three to four years, although a recent study for the CBI (business association) raises this number to 5%. However, a few studies show that a Brexit would entail growth gains for the UK.

Regardless of the costs over the medium term, the uncertainty regarding the economic impact of a Brexit and the negotiation of new trade agreements (could take at least two years), may have a significant impact on activity, the exchange rate and financial stability in the short term, as the Bank of England pointed out this week when it said a Brexit is the greatest domestic risk facing the country this year. The City's new status after a hypothetical Brexit may be driving these doubts, but we must also bear in mind that, despite the UK's economic success compared to the rest of Europe over the last two decades, this growth has been achieved with a persistent current account deficit, which in turn reflects very weak productivity growth. The fact is that this economy has largely grown thanks to resource accumulation (capital and qualified labor, partly foreign), a situation that could be in jeopardy due to the new situation.

It is very difficult to predict the outcome of the referendum at present, with a slight advantage going to those who favor remaining in the group, but the campaign in favor of a Brexit is more energetic. In any case, the uncertain outcome and its eventual impact is not helping a Europe that currently has much bigger fish to fry.