



The implication of Brexit for the rest of the EU



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The implications of Brexit for the rest of the EU

Red tape

Labour supply
and
productivity

Optimal
currency
area?

Immigration

Impact on
Europe

No fiscal
union

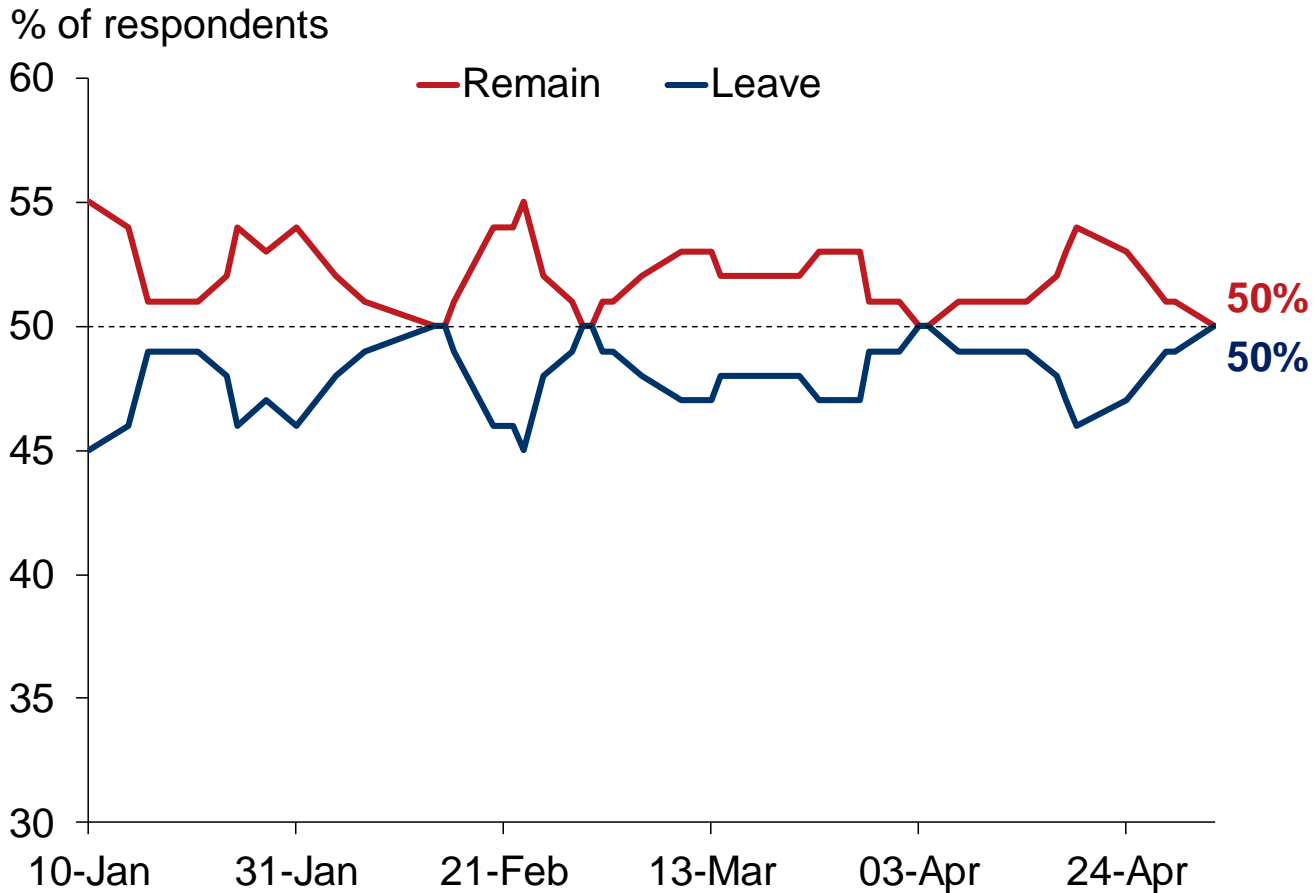
Polls

Impact on
Nordic region

Policy
intransigence

Results will be exceptionally close

UK: Opinion polls on Brexit



Source : What UK Thinks: EU Poll of Polls

Assessing the economic implications of Brexit

9 SCENARIOS

1. **POP BIL: Populist Bilateral**
2. **LIB BIL: Liberal Bilateral**
3. **POP CUS: Populist Customs Union**
4. **LIB CUS: Liberal Customs Union**
5. **POP FTA: Populist FTA**
6. **MOD FTA: Moderate FTA**
7. **LIB FTA: Liberal FTA**
8. **POP MFN: Populist MFN**
9. **LIB MFN: Liberal MFN**

Key:

EEA - European Economic Area

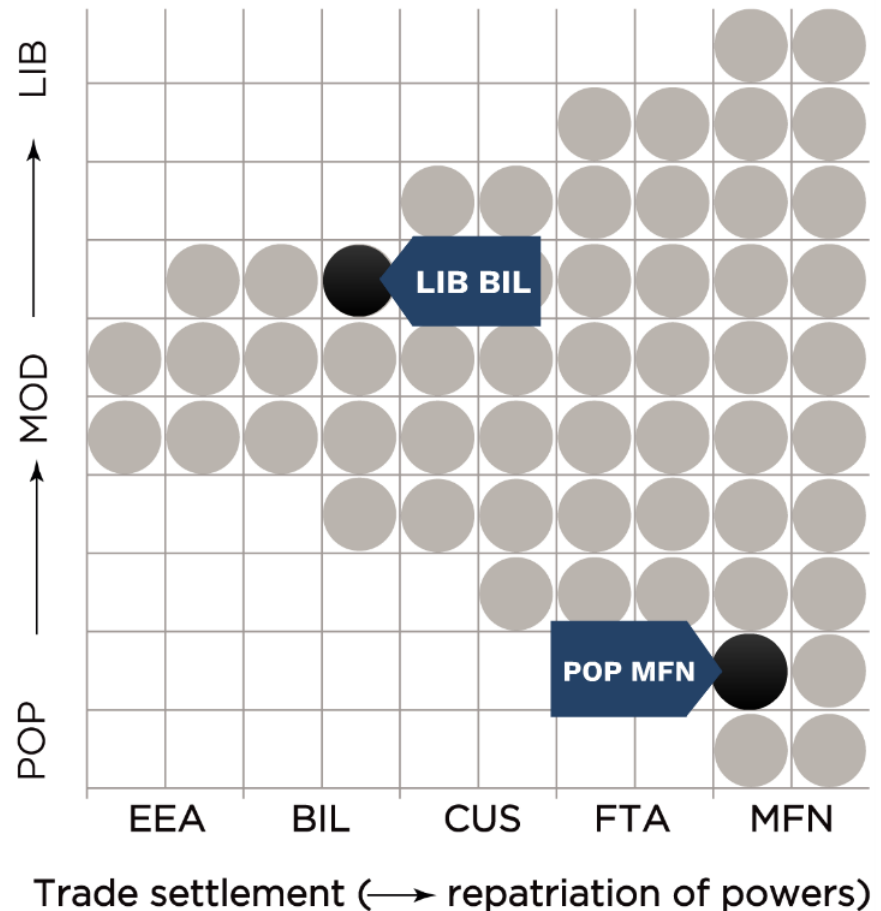
BIL - Bilateral Accords

CUS - Customs Union

FTA - Free Trade Agreement

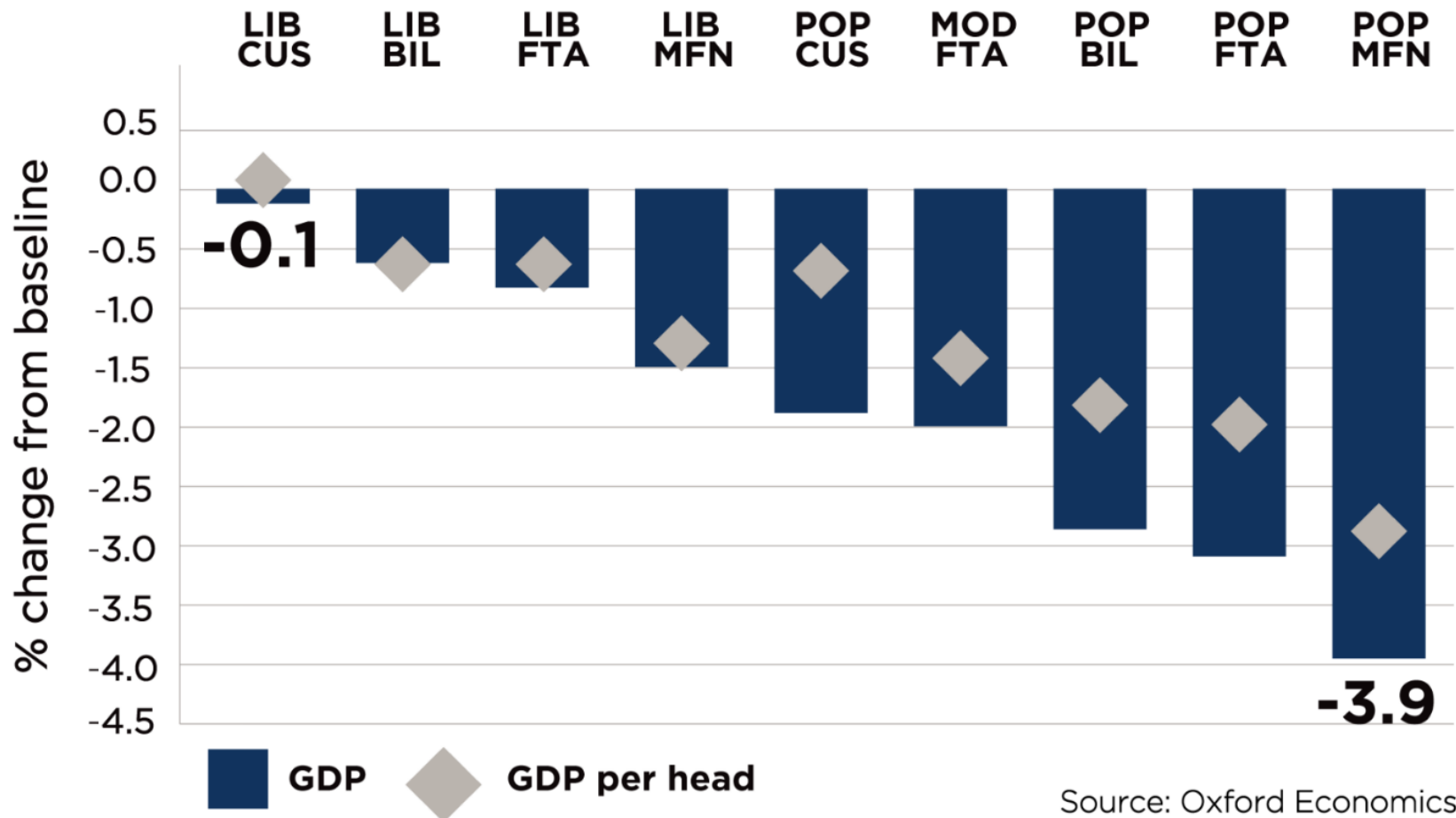
MFN - Most Favoured Nation

Fig. 1. A stylised range of scenarios following Brexit



Assessing the economic implications of Brexit

Fig. 2. The impact of Brexit on real GDP and GDP per capita in 2030



Source: Oxford Economics

Where does growth come from?

Distribution of productivity

- High productivity firms tend to be bigger
- Firms that trade tend to have higher productivity

Why?

- Productivity driven by market size; allows economies of scale
- More competition reduces 'pricing power' which drives innovation

Trading is expensive

- Firms prioritise trade with countries that are large, geographically close, with strong institutions, and sophisticated financial markets.

Immigration

- The labour market effects of immigration have little overall effect on wages and employment for UK born workers – Wadsworth (2015)

Impact of the Single Market on productivity



Product market competition increased

- Product market mark-ups declined from 38 to 28% - Badinger (2007)
- Price dispersion fell sharply for goods that are traded - Rogers (2007)
- Increased aggregate employment and real wages - Griffith et al. (2007)
- Firm level innovation increases, increased R&D – Griffith (2010)



“Trade liberalisation was a major factor in improving competition . . . It removed weak firms, made management better and improved industrial relations” – Professor Nick Crafts, University of Warwick



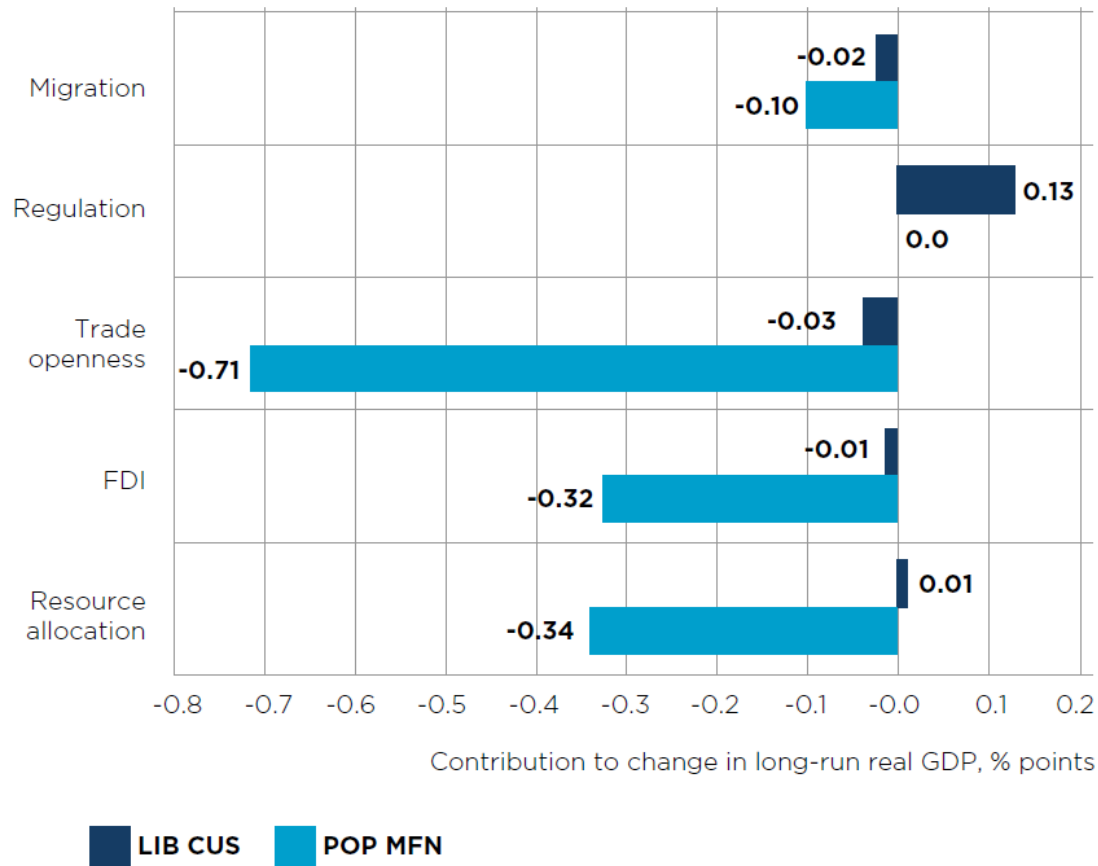
60% of UK productivity over the period 1996-2004 was generated by exporting firms, with exporters experiencing 1.3% productivity growth compared to 0.8% for non-exporters – Harris and Lu (2007).

Can the UK replicate the advantages of access to the SM

- What the EU single market offers is a large, geographically close markets, with good institutional arrangements governing trade and a strong EU wide financial market system.
- The EU accounts for just under 50% of the UK's trade, and has trade agreements in place that together with the EU trade account for 60% of UK trade. If the EU is successful in its current trade negotiations, almost 85% of UK trade would be with countries that have some form of trade agreement with the EU.
- This degree of preferential market access would be difficult to replicate outside the EU
- Free trade agreements are not the same as single market
 - Only includes specifically what's included in the agreement
 - Does not automatically include new industries

Impact of Brexit on UK productivity

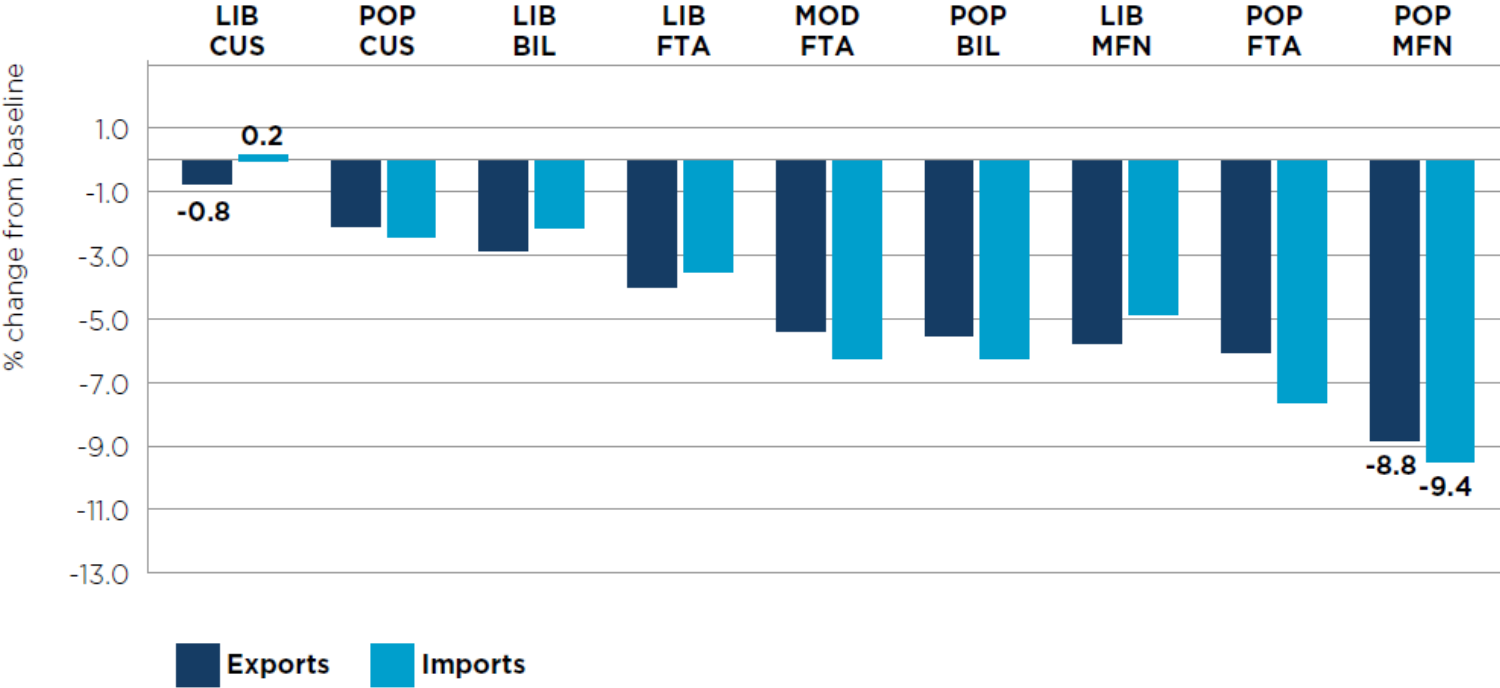
Fig. 8. Decomposition of the change in UK productivity in the best and worst of our scenarios, LIB CUS and POP MFN respectively, in 2030



Source: Oxford Economics

Impact of Brexit on UK imports and exports

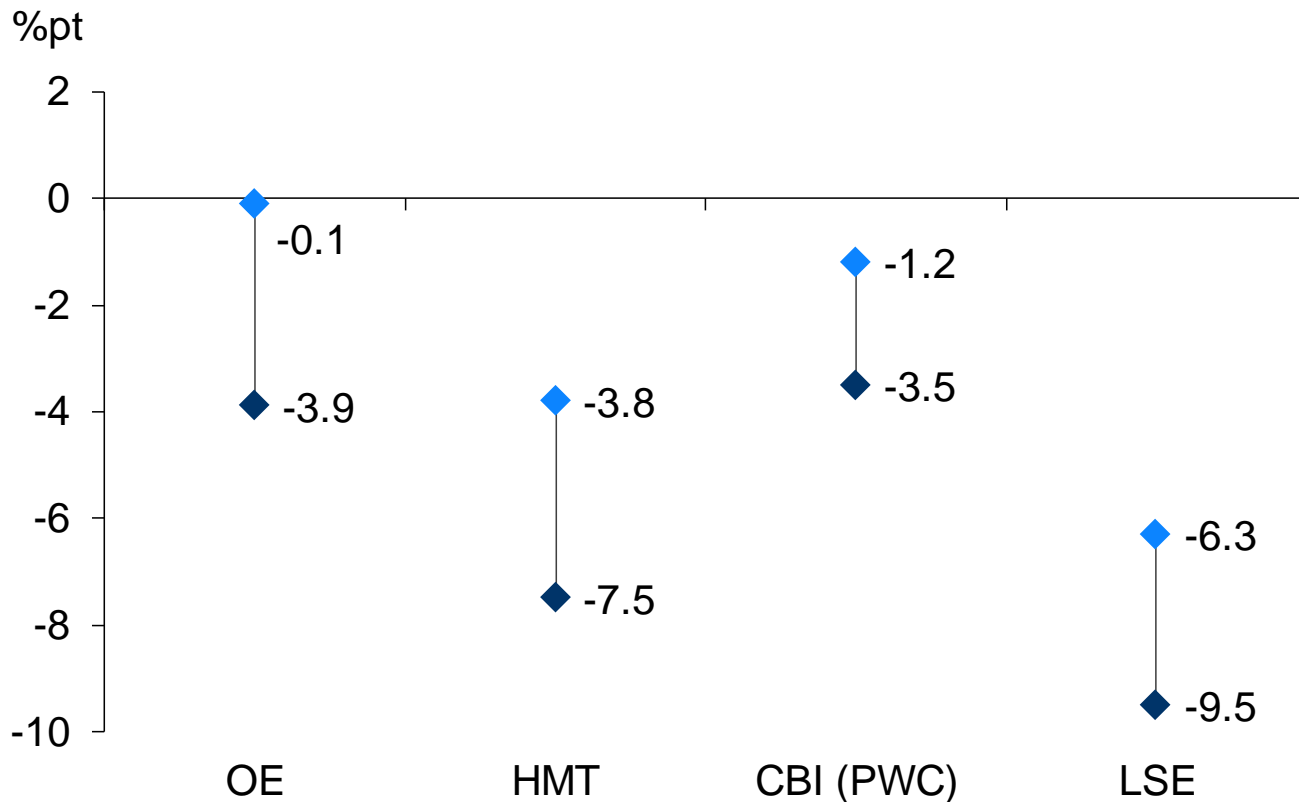
Fig. 9. Trade destruction following Brexit in 2030



Source: Oxford Economics

Forecasts of Brexit's Impact on the UK economy

UK: Range of estimates of impact of Brexit on level of GDP in 2030

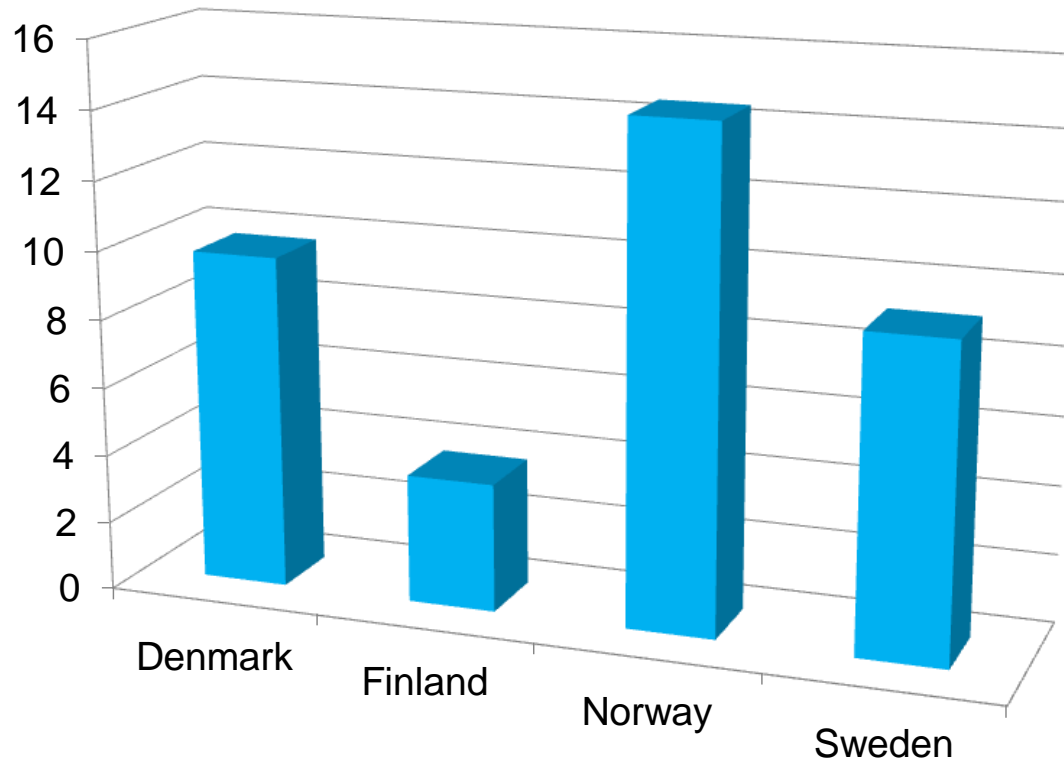


Sources : Oxford Economics, HM Treasury, CBI, LSE Centre for Economic Performance

Trade links with the UK are fairly small

UK imports from Nordic Countries

% source country GDP

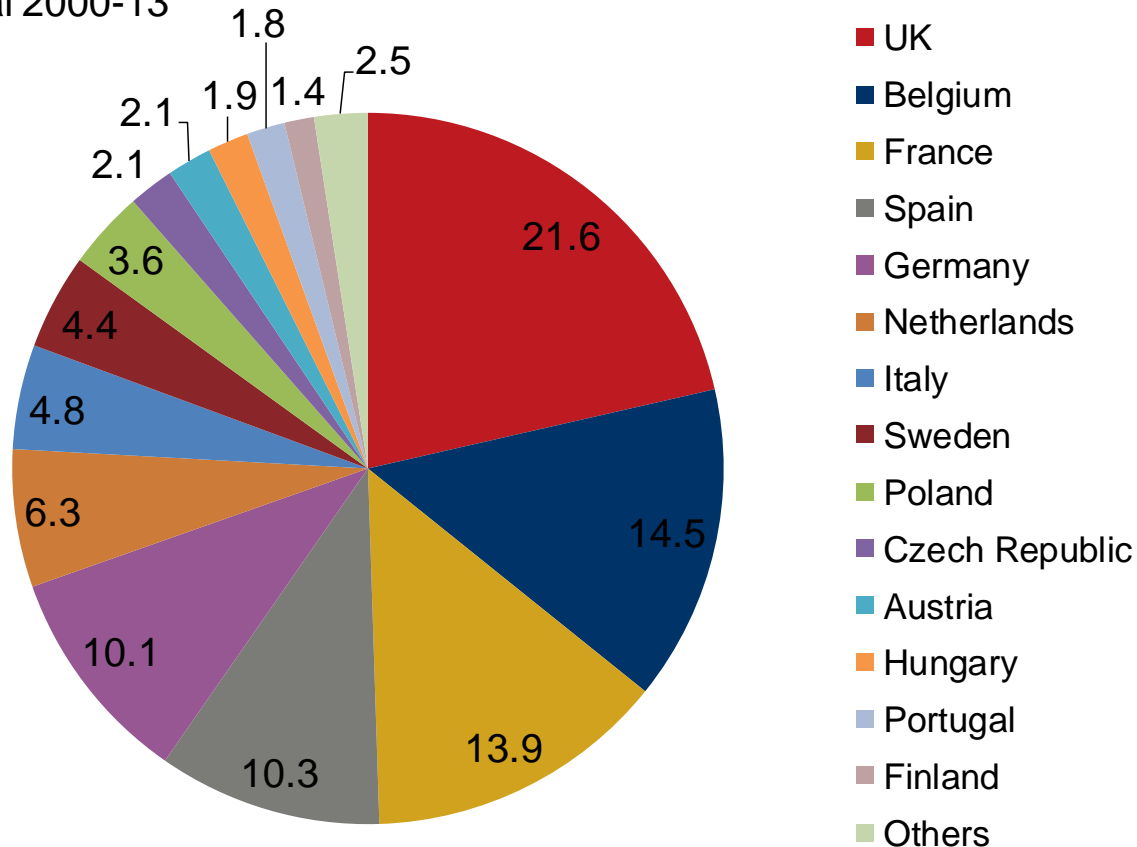


Source : Oxford Economics/Haver Analytics

The UK has been the biggest destination for inward FDI

Foreign direct investment into the euro area

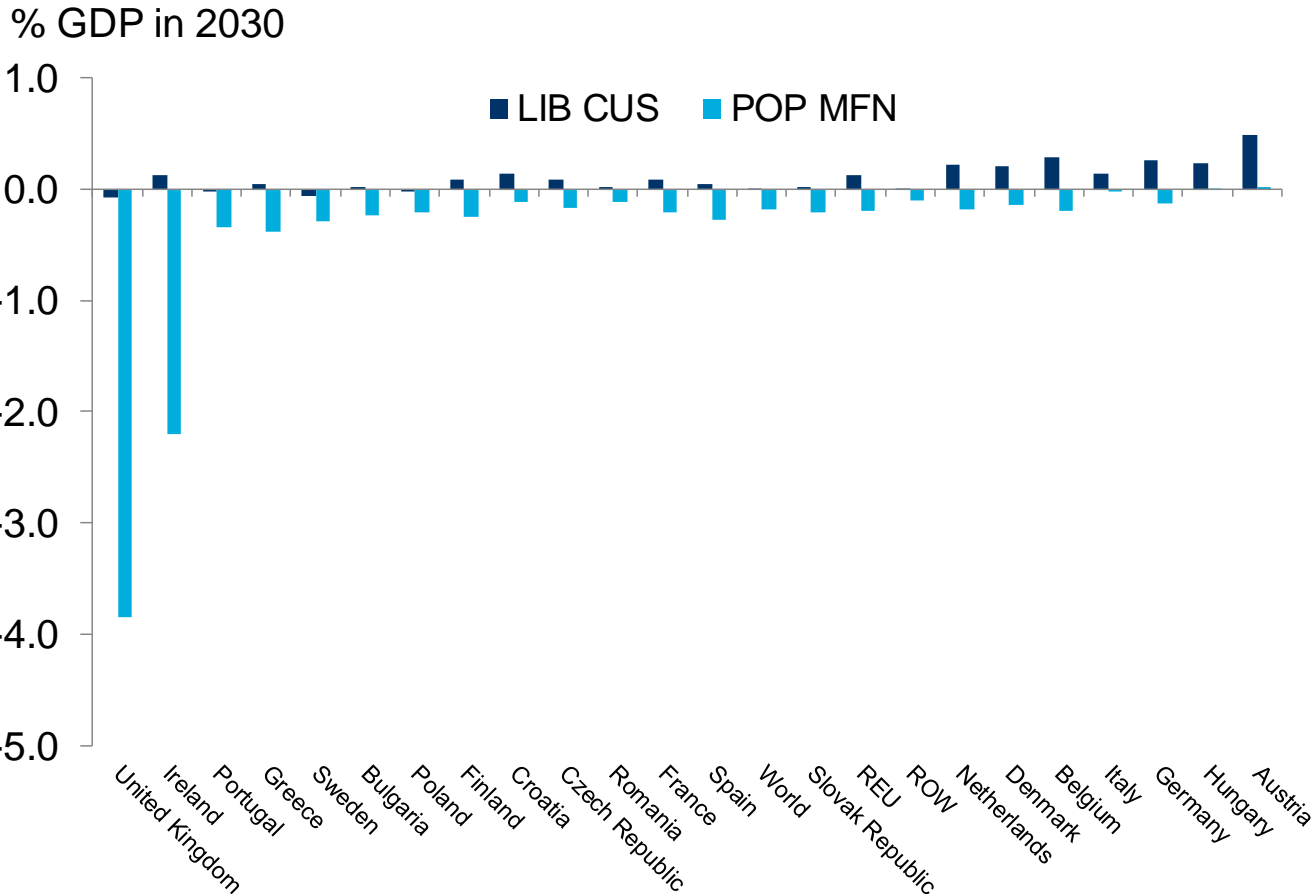
% total 2000-13



Source : Oxford Economics/Haver Analytics/OECD

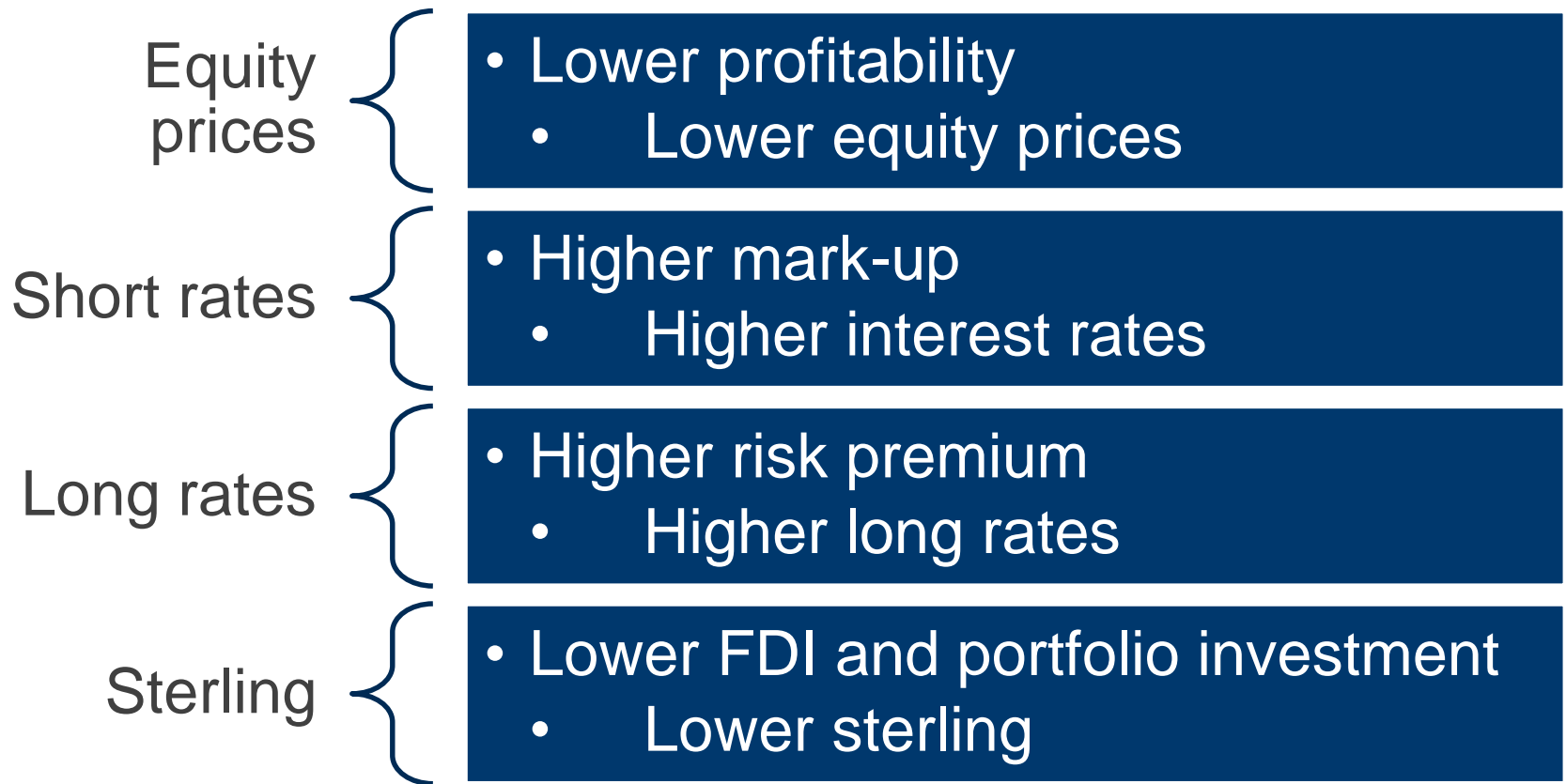
Without a confidence shock, the impact of Brexit is small

Impact of Brexit on the rest of the world



Source : Oxford Economics

Asset market implications of lower trend productivity



Euro area's three fundamental design flaws

Not an optimal currency area

- One size monetary policy doesn't fit all
- Lead to unsustainable construction blooms in Greece, Ireland and Spain
- Fiscal revenues became over reliant on property taxes

A monetary union but not a fiscal union

- Losses in the banking sector transferred to sovereigns
- Placed sovereign debt levels on unsustainable trajectories

Lack of banking union

- National micro prudential polices followed at the expense of macro prudential polices
- Failure to recapitalise bank's lead to funding problems and financial market fragmentation