

# The economic impact of Brexit: jobs, growth and the public finances

---

Iain Begg and Fabian Mushövel, European Institute, London School of Economics

## *Summary*

*'It's the economy, stupid', attributed to James Carville, adviser to Bill Clinton*

### **Background**

Most elections turn on whether or not voters have sufficient confidence that the scoundrels they vote into government will at least run the economy well. Even if those in power display the moral or ethical shortcomings that cynical citizens have come to expect from their politicians, they will be supported if their policies avoid episodes of instability, deliver job creation and increase prosperity.

Although the EU referendum is not a routine election, there are good reasons to believe that when it comes to putting the cross on the ballot paper, the likely economic outcome will still weigh heavily on voters' choices. The trouble is that they have been assailed by studies and projections which offer conflicting analyses, making it difficult to judge who is (or is most likely to be) broadly right, who has engaged in sloppy research or made implausible assumptions, and who is doing little more than making unwarranted assertions.

Studies have looked at the overall impact of leaving the EU, the implications for jobs and the effects on the public finances. International organisations, such as the IMF and the OECD, have contributed to the debate, looking both at the impact on the UK, but also at potential risks for the global economy, while the Bank of England has stressed its duty to speak up when it identifies risks, in particular, to financial stability.

While some findings provide clear evidence of gains or losses from Brexit, what others reveal is open to interpretation and will be welcome by some but regretted by others. The claim from George Osborne, the Chancellor of the Exchequer, that house prices will fall, perhaps by as much as 20 percent, may or may not be correct, but it will be good news for those unable currently to step on to the housing ladder, yet bad for those already well up that ladder. There will be many similar distributive effects, whether in relation to income, jobs or other influences on well-being.

This report draws on some of the main contributions to the debate to arrive at conclusions on what can be reasonably relied upon, as opposed to being regarded as either misleading, incomplete or downright wrong. The assessment was greatly helped by a 'brainstorming seminar' at which economists from different backgrounds came together to discuss the strengths and weaknesses of different approaches. The findings reported here also reflect discussions at a separate 'brainstorming seminar' on the likely effects of Brexit on regional economic development. This short overview summarises the main message from these exercises.

## Key messages

### The macroeconomic effects of Brexit: longer term

- There have been many attempts to model the macroeconomic consequences of Brexit, nearly all of which find that there will be a long-term loss of GDP for the UK economy *compared with the status quo* projections of remaining fully in the EU and its single market.
  - It is important to stress that this means lower GDP than would otherwise be the case, not an actual fall in prosperity: if, for example, the UK maintained its trend growth rate up to 2030, the economy would be some 30% larger, and the ‘losses’ envisaged are relative to that projection. A loss of 6% would, therefore, mean 24% growth instead of 30%, but would also mean that the UK economy would be smaller indefinitely.
- The range of estimates is large, from a loss of GDP of nearly ten percentage points (in the least attractive trade and inward investment scenarios modelled by the [Treasury](#), [NIESR](#) and the [Centre for Economic Performance at LSE](#))<sup>1</sup> to a gain of four points ([Minford, for Economists for Brexit](#))<sup>2</sup> – a clear outlier) – see figure 1.
  - The main reason for the differences lies in the assumptions made about shifting from the current access that the UK has to the EU single market to a new regime in which the UK faces restrictions.
  - As well as assumptions, there are methodological disagreements about analytic techniques. When examined by the group of economists, the conclusion was that the approach adopted by Minford stands out from all the others and was considered to be the most questionable. Unsurprisingly Minford is equally critical of his critics.
  - The scenarios least damaging to the UK interest are those that involve the fewest restrictions on the UK’s access to the EU, including being closest to the status quo of EU membership, whereas those that result in new barriers to UK trade or inward investment are the most damaging.

### The macroeconomic effects of Brexit: short-term

- There is a consensus, even including proponents of ‘leave’, that there would be a short-term negative shock to the EU economy from Brexit.
  - However, there is clear disagreement about the likely duration of this effect and whether it would have only immediate limited costs or have permanent consequences.
  - The two main reasons for this short-term effect, explained notably by the [Treasury](#)<sup>3</sup>, are that the uncertainty surrounding the outcome of the referendum has deterred investment and that there would be transitional costs of shifting to a new regime for trade and investment.

---

1

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/517415/treasury\\_analysis\\_economic\\_impact\\_of\\_eu\\_membership\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517415/treasury_analysis_economic_impact_of_eu_membership_web.pdf) ; <http://cep.lse.ac.uk/BREXIT/default.asp>; <http://www.niesr.ac.uk/eu-referendum-niesr-research>

<sup>2</sup> <http://www.economistsforbrexit.co.uk/>

<sup>3</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/524967/hm\\_treasury\\_analysis\\_the\\_immediate\\_economic\\_impact\\_of\\_leaving\\_the\\_eu\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/524967/hm_treasury_analysis_the_immediate_economic_impact_of_leaving_the_eu_web.pdf)

- Other short-term effects could derive from currency volatility and financial market reactions. The [Bank of England](#)<sup>4</sup>, in particular, has warned that Brexit could result in financial instability that could have damaging macroeconomic effects because of the financial openness of the UK.

### Jobs

- To the extent that there is a loss of GDP, it will also, in macroeconomic terms, mean a lower level of employment in the UK economy.
- Demand from other EU countries constitutes around 12% of final demand for UK goods and services and this translates into around 3.3 million jobs.
  - It **does not**, as some campaigners wrongly imply, mean that those jobs are necessarily at risk from Brexit.
  - Nevertheless, there are some sectors of activity in which job losses are likely, and others where Brexit could see an increase in jobs, in both cases depending on what replaces the current arrangements. Some job losses are likely in the City of London, as many of its representatives have made clear, while major exporters (such as the manufacturers of cars) could be forced to retrench if obstacles to exporting to the EU increase.
  - Equally, there are some import competing industries which can be expected to see job increases if exit from the EU means that they become more competitive, either because a new trade regime raises the costs of imports or because they can then avoid regulations that impair their competitiveness.
- The UK economy has become increasingly reliant on the service sector, both as the main engine of job creation and as a source of export demand. Between 1997 and 2013, according to [ONS data on final demand](#)<sup>5</sup>, the proportion of services in total UK exports rose from 28% to 41%, with rapid growth in key service activities, such as financial and business services. These sectors are now as important to the overall UK export effort as the major manufacturing sectors of cars, aerospace, computers & electronics and pharmaceuticals.
  - It follows that the outlook for UK access to export markets in services will be crucial for future job creation: the digital and creative industries have been identified in various studies as especially important. These are UK priorities for extending the single market, but progress in this direction might lose momentum if the UK leaves.
- The regional distribution of jobs could be influenced by shifts in the destination of foreign direct investment into the UK, a pattern already seen following the 2008/9 recession when Wales, Northern Ireland and the more northerly English regions lost ground.

### The public finances

- The direct effect of Brexit on the public finances will be to allow the UK to save on its current payments into the EU budget.
- Any savings from direct contributions to the EU budget would be erased if Brexit results in a GDP loss of as little as one percentage point and the public finances would be worse if the loss were greater, despite no longer paying into the EU.

---

<sup>4</sup> <http://www.bankofengland.co.uk/publications/Documents/speeches/2015/euboe211015.pdf>

<sup>5</sup> <https://www.ons.gov.uk/economy/nationalaccounts/supplyandusetables/datasets/inputoutputsupplyandusetablessummarytables>

- Based on the 2014 data most often quoted, the saving would be around £280 million per week, not the £350 million so often claimed, because what the UK ‘sends to Brussels’ is an amount from which the UK rebate has already been deducted. Using the hypothetical gross payment figure is misleading. On the most generous assumptions, only the lower figure of £280 million would be available to spend on the NHS or other priorities.
  - Some groups in the UK, notably farmers and universities that succeed in obtaining research grants from EU programmes, would potentially lose from Brexit.
  - Parts of the UK that benefits from EU regional policy would also lose fiscally: the most affected are West Wales & the Valleys and Cornwall & the Isles of Scilly.
  - It would be an open question for a post Brexit UK government whether (as has been hinted at by Leave campaigners) to replace these various flows, amounting to some £6 billion per year (around £115 per week), with domestic spending.

### The economic effects of migration

- Migration from the EU (as opposed to refugees from beyond the EU, analytically a very different phenomenon, with little to do with EU membership) can have both positive and negative economic effects.
- There is little doubt that the inflow of labour from the EU has had a beneficial effect on the supply of labour and that many public services, in particular, rely on EU workers. EU citizens of working age are significantly more likely to be in employment than their indigenous counterparts and make a positive contribution to the UK’s public finances.
  - Despite the often quoted statement by Stuart Rose of the Britain Stronger in Europe campaign, there is no statistical support for the proposition that the inflow of EU migrants has resulted in lower wage levels.
  - Migrants from some origins do remit some of their income to their home countries and this can be regarded as a loss for the UK economy.
- In some localities, migration undoubtedly puts pressure on public services and housing.

### Who is likely to gain or lose overall?

- There may well be opportunities for the UK to cut costly regulations, although some of the amounts claimed exaggerate the likely benefits.
  - However, it is too easily forgotten that regulation also has benefits and, that, contrary to the general image, an absence of regulation can also be costly, whether for consumers or, in some instances, businesses.
  - In some instances the UK has chosen to ‘gold-plate’ regulations making them more onerous than required by EU rules.
- International organisations, such as the [IMF](#) and the [OECD](#)<sup>6</sup> have warned that the balance of risks for the UK economy is negative and will have lasting effects.
  - These International organisations have also highlighted the likely adverse consequences for EU partner countries and the prospect that Brexit could be a negative shock for the global economy, derailing its fragile recovery from the crises of recent years.

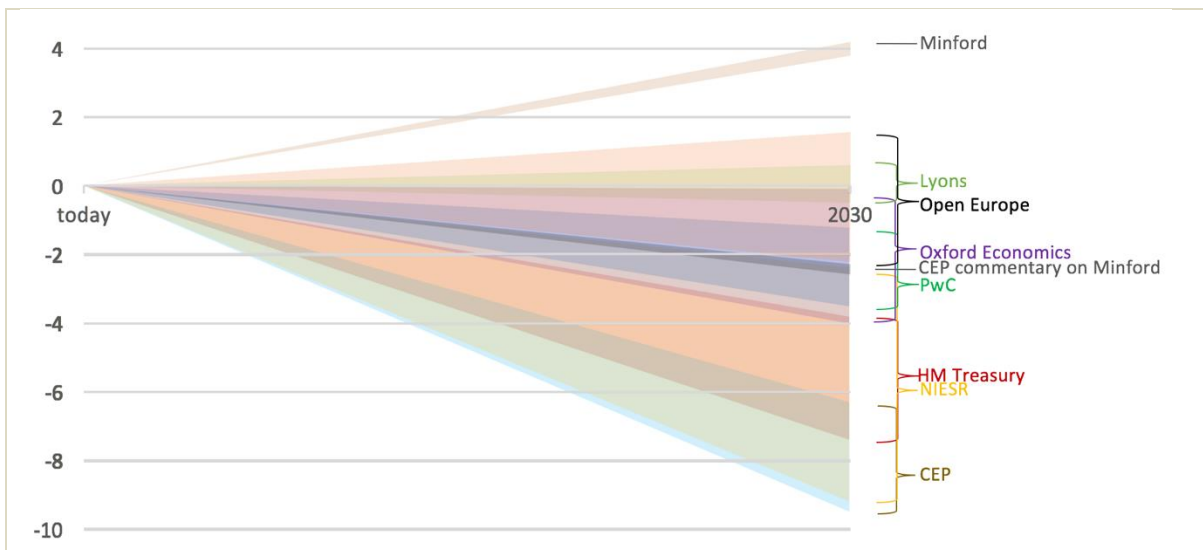
---

<sup>6</sup> <http://www.imf.org/external/np/ms/2016/051316.htm>  
<http://www.oecd-ilibrary.org/docserver/download/5jm0lsvdkf6k.pdf?expires=1465484306&id=id&accname=guest&checksum=9B47FC2E5D75FDB8F41939F908C45039>

- Similar sentiments were expressed by Federal Reserve Chair, [Jan<sup>7</sup>et Yellen<sup>8</sup>](#).
- There is considerable uncertainty around who would gain or lose domestically from Brexit, again depending on the contours of whatever new economic governance framework replaces EU membership. The outcome could differ according to locality, region, social group or sector of employment, among many possible cleavages. There are indications that Brexit could accentuate inequality: for example, research by the [NIESR](#) suggests the burden of Brexit would fall more heavily on low-income households.
- Macroeconomic data can be hard to relate to individual circumstances: when all is said is done, none of us is average...

**Figure 1 ‘Funnel’ chart of post-Brexit projections**

(all outcomes relative to a projected annual growth of 2.1% per annum up to 2030)



Key:

HM Treasury	-7.5 to -3.8	National Institute of Economic and Social Research (NIESR)	-9.2 to -2.4
Centre for Economic Performance (CEP)	-9.5 to -6.3	CEP commentary on Minford	-2.6 to -2.3
Open Europe	-2.23 to +1.55	Lyons, G.	-0.5 to +0.6
Oxford Economics	-4.0 to -0.1	Minford, P.	+4.0
PricewaterhouseCoopers (PwC)	-3.5 to -1.2		

<sup>7</sup> <http://www.niesr.ac.uk/publications/eu-referendum-and-fiscal-impact-low-income-households#.V1qr-4-cHIV>

<sup>8</sup> <https://www.federalreserve.gov/newsevents/speech/yellen20160606a.htm>