

# Prof. Dr. Paul J.J. Welfens

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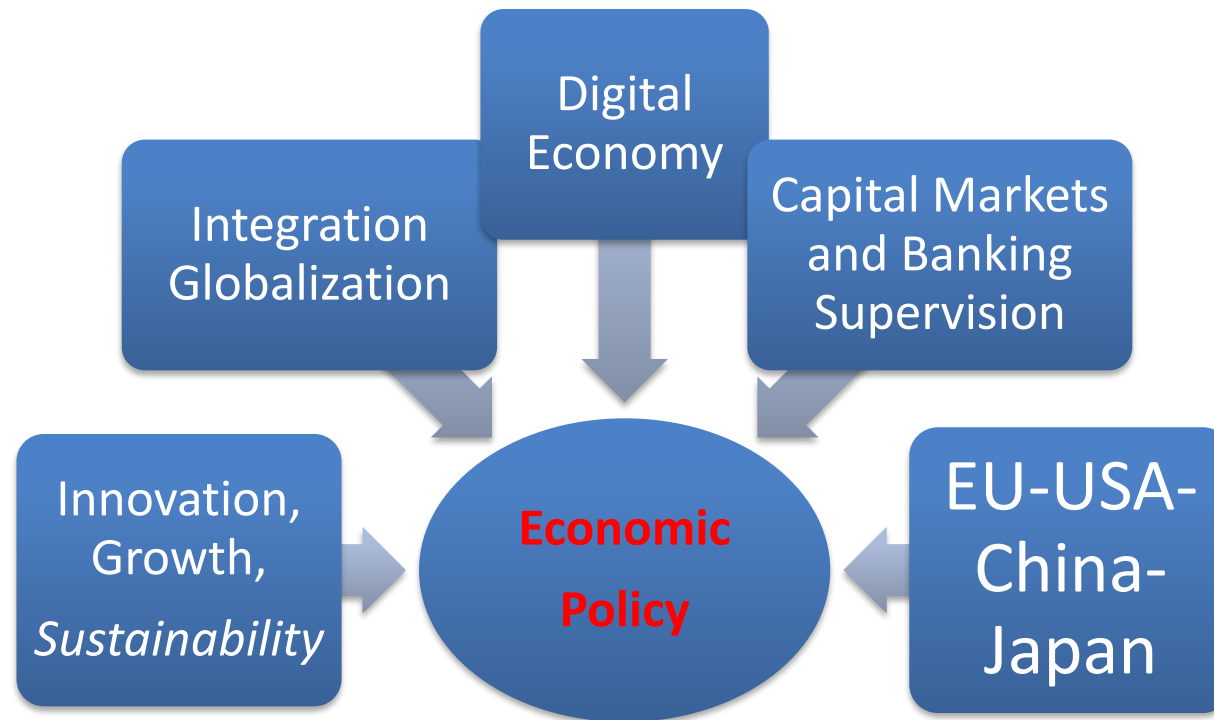
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## **Outsiders Undermining the West? BREXIT, Trump-Economics and Populism in the EU**

***Prepared for the 2017 Meeting of the Convention of  
Independent Financial Advisors, Monaco, May 30-June 2,  
2017 Hotel Hermitage***

About the EIIW (Private An-Institut)/University of Wuppertal (2015: 20 Year Anniversary)

## Research Focus Areas of the EIIW



## 20 Years of EIIW: 2015 – Conference in Berlin and Wuppertal

- Award-winning research; *Euro Crisis anticipated in Oct 2008*  
National / International Networks



Book available both as a paperback and as an eBook (London, 2017, July)



**ISBN 978-3-319-58270-2**

## 1. Some Current BREXIT & Trump perspectives

- Outsiders gaining ground in a western world that lost the pressure from the Cold War
- **US (Banking Crisis), UK (BREXIT), France (islamistic radicalization in part of society/high youth unemployment), Greece (disaster), Italy (slow progress/growth since 1995) all facing too many internal and external problems that could have been avoided**
  - *EXTERNAL = China's massive economic rise*
  - *INTERNAL = quality of political analysis/advisors and decision-making has reduced;*
    - e.g. US deregulation of financial markets under presidents Clinton and Bush Jr.;
    - e.g. EU commissioning a study from CEPR on Transatlantic Trade and Investment Partnership which suggests that benefit is 0.5 percent of GDP – based on trade analysis (plus a bit FDI). This is nonsense since FDI and innovation dynamics have also to be considered = 2% GDP plus for the EU/Germany (see JUNGMITTAG/WELFENS EIIW paper No. 212, presented at the IMF, 2016)
    - e.g. Mr. CAMERON's EU referendum 2016 that he lost due to info blunder of government: did not put the info from Treasury Study that BREXIT means 10% income loss into 16 pages info brochure

## The World Economy in the early 21st Century

Digital Growth,  
Economies of Scale & Knowledge-  
Intensive Production+; CHINA++

**USA under President Trump: Neo-  
protectionism+ bilateralism; against  
EU/ multilateralism (!), pro BREXIT**

*OECD countries face  
reduced growth, less  
stability*

**Globalization and International  
Organizations: good for growth and  
stability (?); Role of WTO, BIS, IMF**

**BREXIT as a historical step:  
Weakening UK and possibly EU27,  
Mercosur, Asean, other „clubs“**



## New Challenges for the West after the Banking Crisis 2007/08

- 1) The West has won the Cold War; Soviet Union/Warsaw Treaty disintegrated in 1991.
- 2) Have the EU and the US managed the post-Cold War setting adequately?
- 3) Fabulous rise of China: Do we understand what means the integration of a BIG Economy and an OLD country into the world economy? China's GDP to double by 2030 (compared to 2016)
- 4) Creation of the Eurozone: great project which, however, has faced Euro crisis 2009-2015 and still (2017/2018) Greek crisis – a tiring crisis non-management with Greece (longest rec.)
- 5) Digital Economy = *new element of modern economic globalization*
- 6) Rising economic inequality: *Do we understand this phenomenon?*
- 7) Globalization requires strong role of Global Organizations/Multilateralism? Trump Administration undermining both – will Mr. Trump be reelected? Probably YES
- 8) BREXIT: Majority in a disorderly referendum in the UK which is heading towards economic slowdown and a declining role in the world economy

## Outsiders gaining ground in a world of overly complex Western systems

BREXIT, Trump election; Mrs. Le Pen's high voters' share; rising populism in Europe and autocratic expansion/religious radicalization

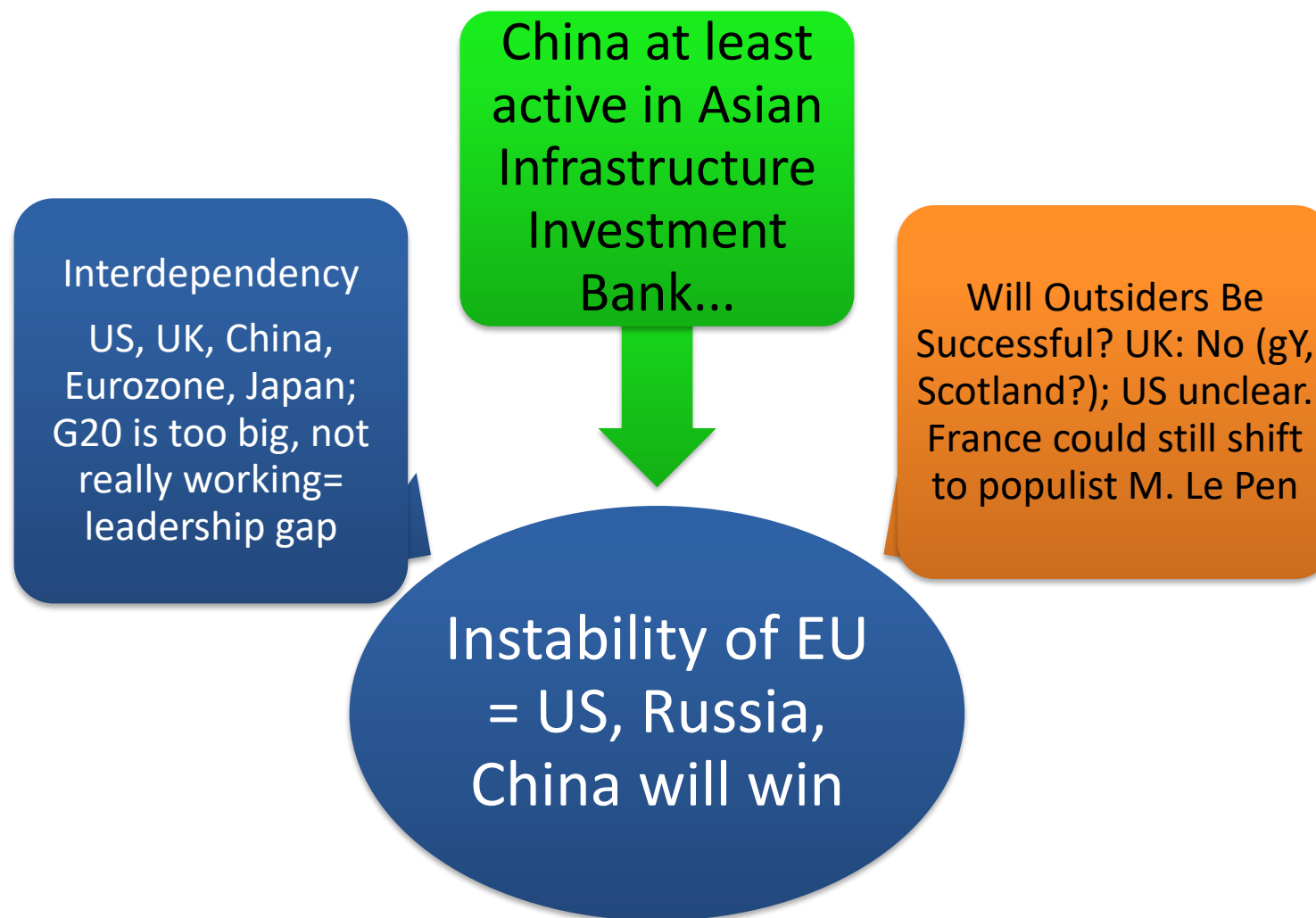
**CHINA's expansion**  
**EU disintegration and disintegration in other world regions following?**  
**„Free Internet“ = Political polarization, bad info quality**



## Lack of Reason in Part of Arab Countries and in the Western World

- **Karl Popper's book The Logic of Scientific Discovery (1934)** – explaining difference between „scientific truth“ and religion not translated into Arab Language
- **Western countries' media society/TV (breaking) News is like Terror Advertisement** = Lack of cleverness of Western policy
- The rise of outsiders in the US, UK, France, Italy, Germany, Austria reflects contradiction between globalization, sufficient information and adequate policy:
  - **US: massive overestimation of globalization indicators (international students, share of foreign tourists in all hotel nights** in US)
  - **UK: lack of adequate economic policy** = contributing to Transatlantic Banking Crisis; anti-EU
  - **France has 30 years of inadequate minimum wage policy** = youth unemployment rate = 3x Swiss unempl. Rate; super dangerous in the era of internet and digital religious radicalization of young men
  - **Eurozone built without reference to optimum currency area literature** (Germany, FR, IT, etc.)
  - **Lack of stable order in the new Europe nurtures the new Russia** = back to 19th century

## New World Order Stable and Efficient?

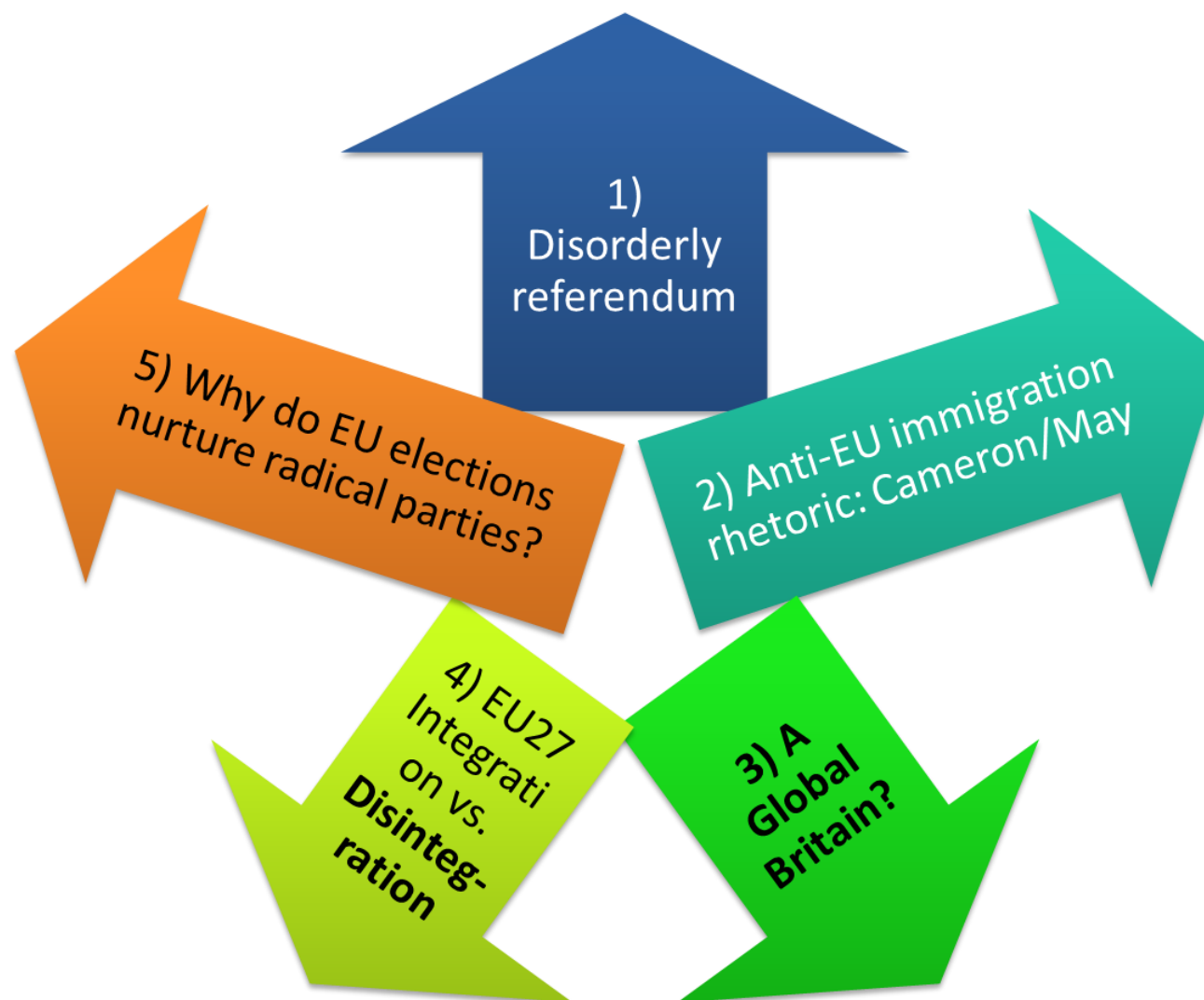


## Outsiders Could Win...

- **Role of international organizations (IMF, WTO, BIS) weakened by President Trump** who also **pro BREXIT; emphasizes bilateralism** (good for US and China)
  - Dangerous in periods with new conflicts (e.g. with rapidly rising Chinese exports; Greece...)
  - Shock after 70 years of pro-EU policy of the US
  - US economic policy not working
- **China has not experience in international leadership** = leadership gap
- **European Commission (and major EU countris) unable/unwilling to embark upon reforms**
  - **Perhaps new German-French initiatives MACRON/MERKEL**
  - **Need to make Eurozone workable = at least 20% of Eurozone GDP as benefit (Euro as reserve currency; free imports of 0.5% of GDP, discounted wealth effect  $2.5\% \cdot i = x40$ )**
  - EU did not anticipate BREXIT: relying on poor Eurobarometer **April 2016: 36 %; 51.9%**  
**June**

- **UK joins the EU in 1973, 1975: First EU-Referendum with 67% pro-EU membership**
- **1993 EU-Single Market** with four freedoms, incl. movement of labor
- **2004 EU Eastern Enlargement: UK, Ireland, Sweden = free migration**
- **2007-09 Banking Crisis; UK not part of the Euro Crisis 2010-15**
- **2013 Prime Minister Cameron announces** that should he be re-elected he would hold a referendum on EU membership – from his point of view, the problem was the rise of UKIP
- **Referendum on 23rd June 2016: Cameron supports Remain** – on the basis of the UK-EU negotiations and agreement on stricter social policies for EU immigrants and agreement on single market deepening (including *Digital, Energy, Services*):
- **However, the result is a majority for BREXIT, new May government that is determined to implement BREXIT & make it a success(???)**

## 5 key questions



Disorderly ref.

Cameron:info pol

Correct result 52.1% Rem

- **Treasury Report: BREXIT would mean -10% income in the long run**
- **Mr. Cameron's 16 pages info brochure had not** a single word on that income loss: COMP. to Scotland referendum of 2014: every Scotsman will lose 1400 P.+benefits of EUmembership UK
- **UK popularity functions suggest** that orderly referendum result would have been 52.1 %

Anti-EU immigr. reth.

Mrs. May = Mr. Cameron

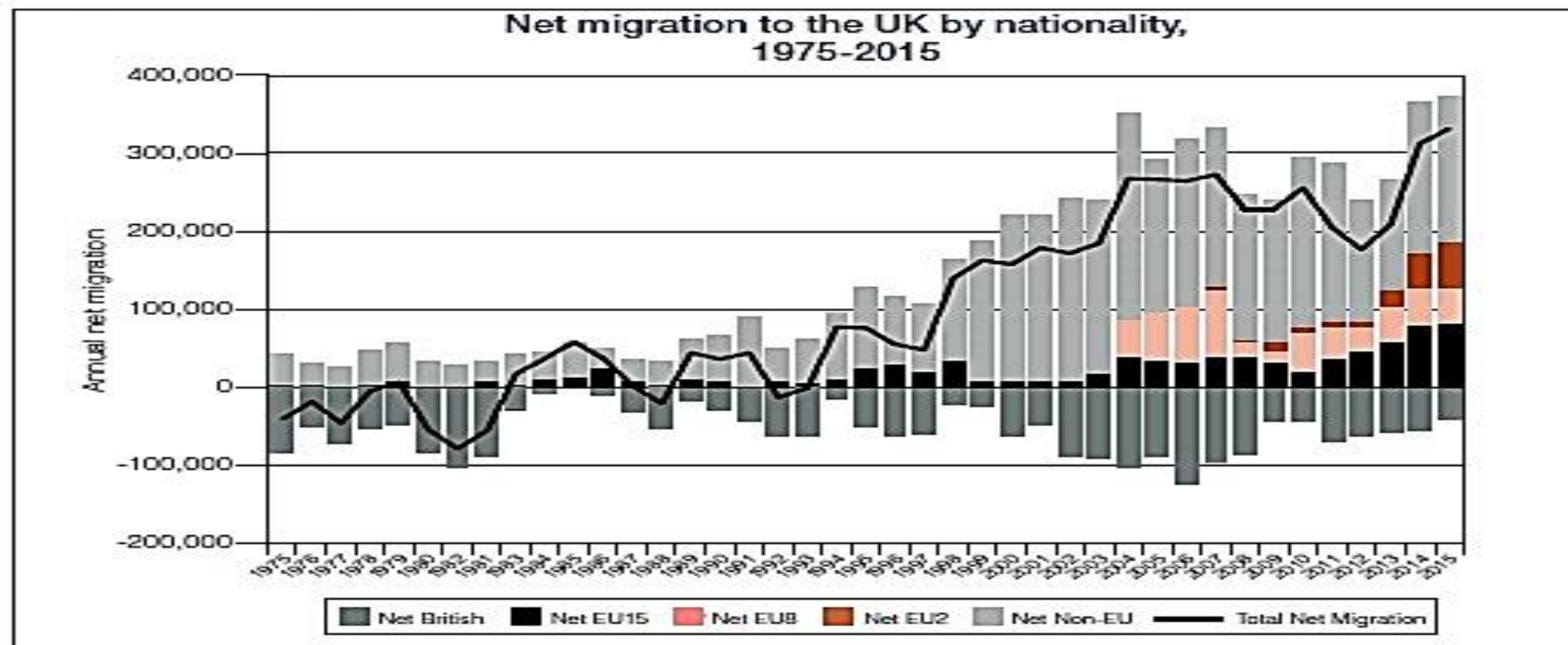
Immigrants as scapegoats

- **Premier Cameron with anti-EU immigration rhetoric = perfidious as OECD** shows that EUi mmigration stands for a positive net budget effect – while Mr. Cameron complained about the burden of EU immigration
- **UK had 11% deficit-GDP ratio after banking crisis, Cameron reduced transfers to local communities/cities by 3.5 percentag points of GDP** within 5 years = underprovision of local public goods = many British voters had the impression that this is all to blame on too much EU immigration
- **Mrs. May has supported the strange rhetoric** of Mr. Cameron and Mrs. May's White paper on the EU exit shows again inconsistent argumentation



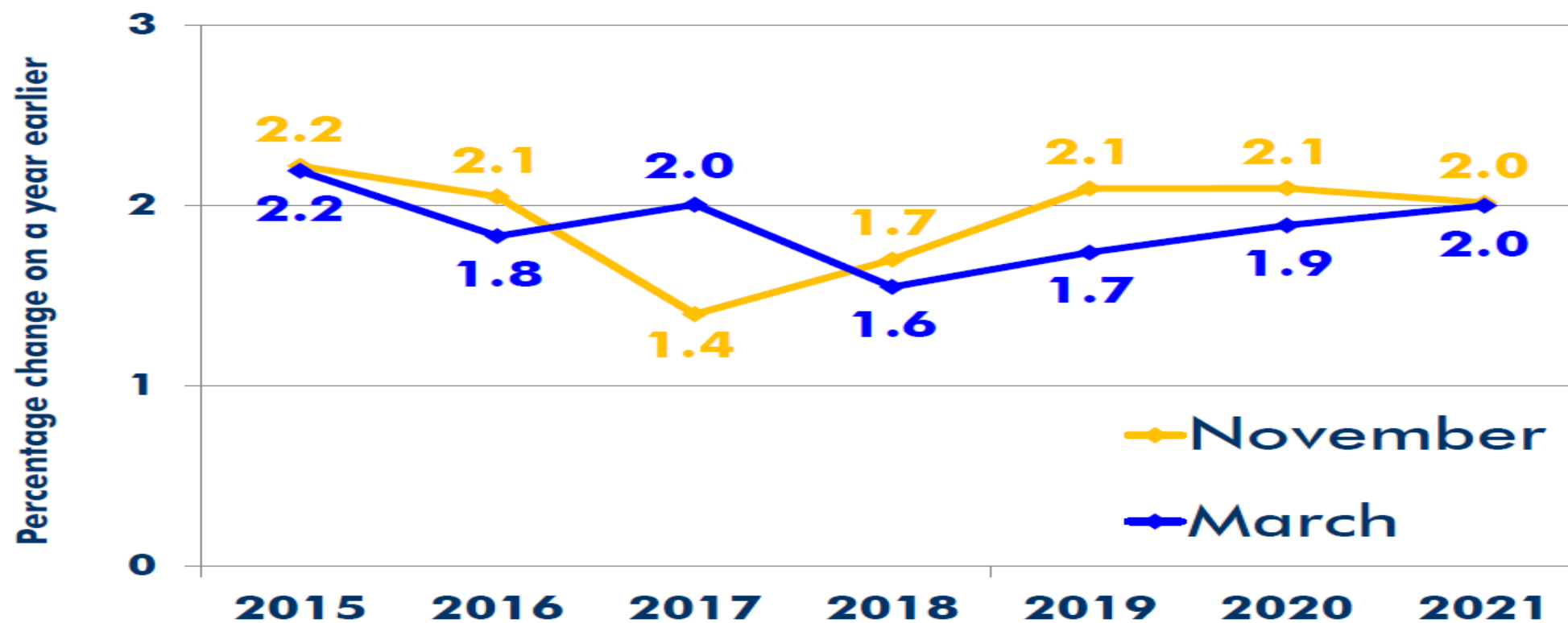
# UK Net Immigration by Nationality

Chart 5.1 – Net migration to the UK



Source – ONS<sup>14</sup>

## UK Annual Real GDP Growth Forecast (March 2017)



Office for  
**Budget  
Responsibility**

## EU Reforms/Why a Small EU (with small budget) Cannot Survive

- **Experts of Forschungsgruppe Wahlen indicate** that voters can identify relevant policy fields at national/regional elections, NOT at European elections
  - **EU budget of 1% too small**; compare to US with 9% at federal level (DC)
  - **Tendency of voters to often vote in favor of radical small parties making them big** (UKIP, FN in 2014, AfD in Germany)= **self-destruction of democracy**
  - **Defense & infrastructure investment in the EU budget/Eurozone budget would be useful**; reduction of overall income tax rates in the Eurozone

## US Trump Administration

- **Giving up TPP** which is blow to Asia
- **Giving up TTIP (?)**
- **Not appointing economists** – so far – for Council of Economic Advisors
- **Making big promises, delivering not really much**
  - **Reduction of corporate taxation will come**
  - **Further destabilization of WTO** – a strong WTO, however, would be needed much by UK with its Global Britain concept (Secretary General WTO „**making the small big and the big civilized**“)
  - **BIS also is weakened, IMF?** As IMF fears losing US support IMF becomes more inclined to adopt a soft policy

**USA: New Trump Administration since January 2017; first visit of Mrs. May is visiting DC (Pence is vice president)**



## What Is Needed

- **1) Better understanding of big challenges: China's rise in the world economy =** undermining jobs in manufacturing industry in US and UK and...
- **2) Making sure that overcomplex systems are reformed**
- **3) Solve problems;** often not more money needed (Greek crisis/Eurozone crisis)
  - **Constitutional reforms in Greece** – involve Venice Commission/European Council; change the criteria for admissions (OCA approach to be included)
  - **Impose rules on internet communication** (encourage avoiding political polarization)
  - **Raise government-GDP ratio in Brussels/in the Eurozone: Infrastructure exp.+ defense = 4-5%% GDP plus first six month of unemployment** (not youth unemployment which is national problem often linked to national minimum wage) **POSSIBLE after BREXIT**
  - **Have a critical eye on new banking deregulation of banks in UK (due to BREXIT) and US (Trump's policy approach) which is more likely under flex. exchange rates** (Welfens, EIIW paper 238)

## Better Policy Needed

- **China's rise = requiring** more active labor market policy
- **Eurozone = not pushing** for a naive static concept of subsidiarity
- **Organize EU-China-Japan-US-UK-Russia**
- **Get better research** to understand complex global trends, **including digital dynamics**



## Legal Aspects Matter

- **European Court of Justice (May 2017): Free Trade Agreements EU-X based on European Parliament** – only portfolio investment rules and investor dispute settlement needs national (and regional) parliaments' approval: **Could make EU-UK FTA easy (although portfolio investment is a field relevant to London banks...)**
- **Is BREXIT the start of EU disintegration** – leading Europe back to the late **19th century?** (+ China & US): Rather likely unless adequate national and EU reforms

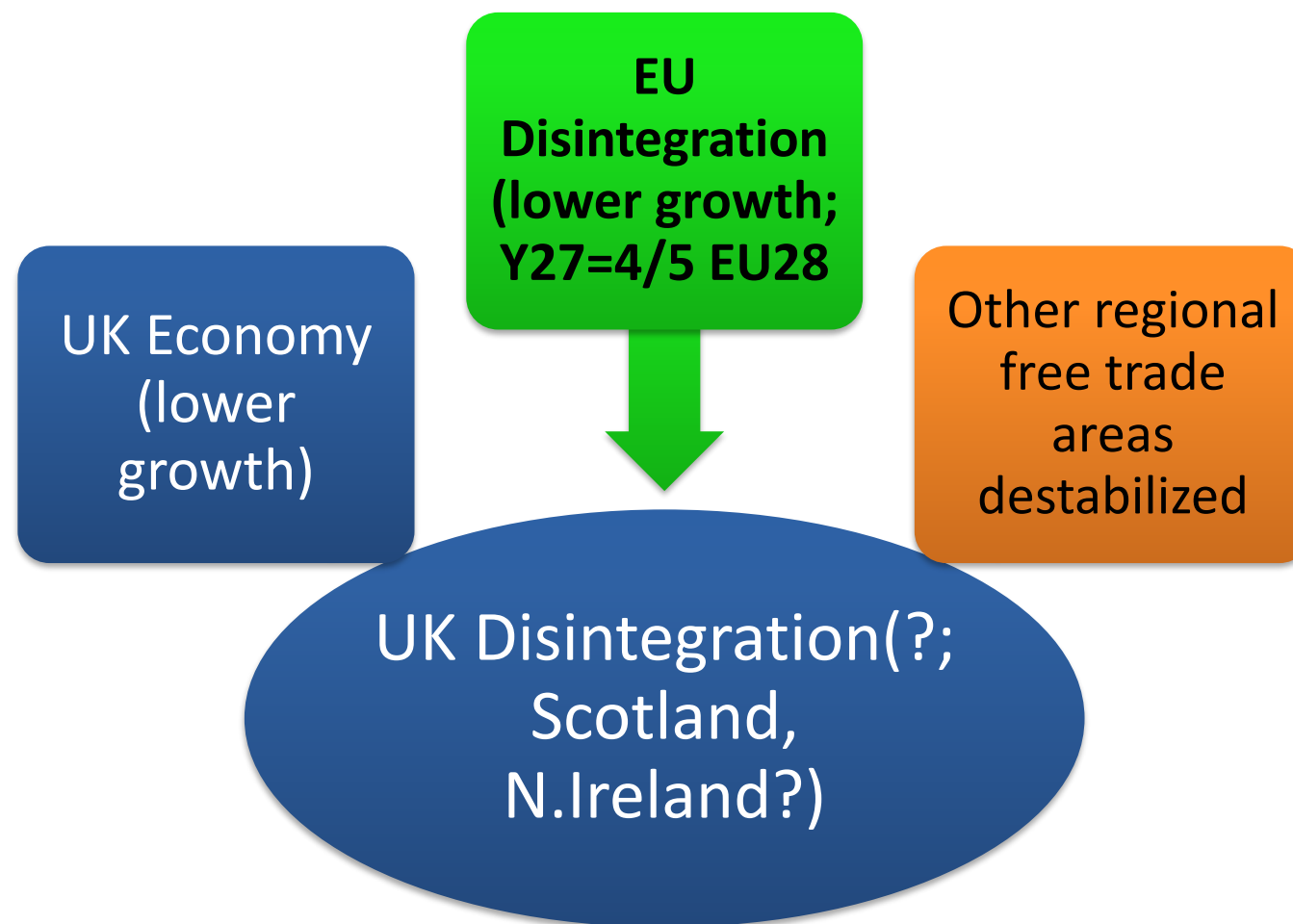
## Mrs. May's Approach = Global Britain

- **Can the Global Britain approach of May government work? (not really)**
  - FTA with US and Japan; not with India or China
  - British exports is almost 13% of UK GDP, exports to US is 2.5% of GDP
  - With weaker EU single market access and some sectoral EU-UK FTAs minimum value-added requirements of 60% for UK will undermine British export position in EU/world

## Further Key Issues

- **Why do European elections with an EU mini budget nurture political radicalism in Europe?**
- **What effects will BREXIT have on regional integration areas and multilateralism in the global economy (e.g. Mercosur, ASEAN and other)?** As regards multilateralism, here the US Trump administration enters the picture
- **Relocation of banks etc. from London to the EU27**, as from 2019 the banks in London without an EU-Pass can no longer serve the EU market from the UK; US Jap. banks +British banks (banks from London), will transfer activities to the EU27 **(US banks often to New York)**

## BREXIT concerns



## BREXIT will create problems in Europe; more so Trump Administration

- 1) UK GDP will reduce by about 6% relative to baseline 2017-2027; and a **higher share of UK capital stock will be owned by foreign investors = negative welfare effect (GNP!)**
- 2) EU GDP growth 1 percent less than without BREXIT; **Eurozone better than UK??!**
- 3) **Loss of EU institutional capital**
- 4) **EU27 = 4/5 of EU28 GDP** = weaker position in globale trade negotiations
- 5) **EU 27 could embark upon more cooperation** in the fields of defense & infrastructure

Many thanks for your kind attention

- **[www.EIIW.eu](http://www.EIIW.eu)**

**EIIW 2015 = 20 years of award-winning research in  
Economics and International Economic Policy**

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**Please support EIIW as an innovative European and global  
competence center;**

**Prof. Welfens has testified before the US Senate, the  
European Commission, European Parliament, German  
Parliament; EIIW with studies for governments, major banks  
and companies, NGOs**

# Appendix

see **BOOK An Accidental Brexit** (Palgrave: July 2017/**BREXIT** aus  
Versehen (Buch; Springer)

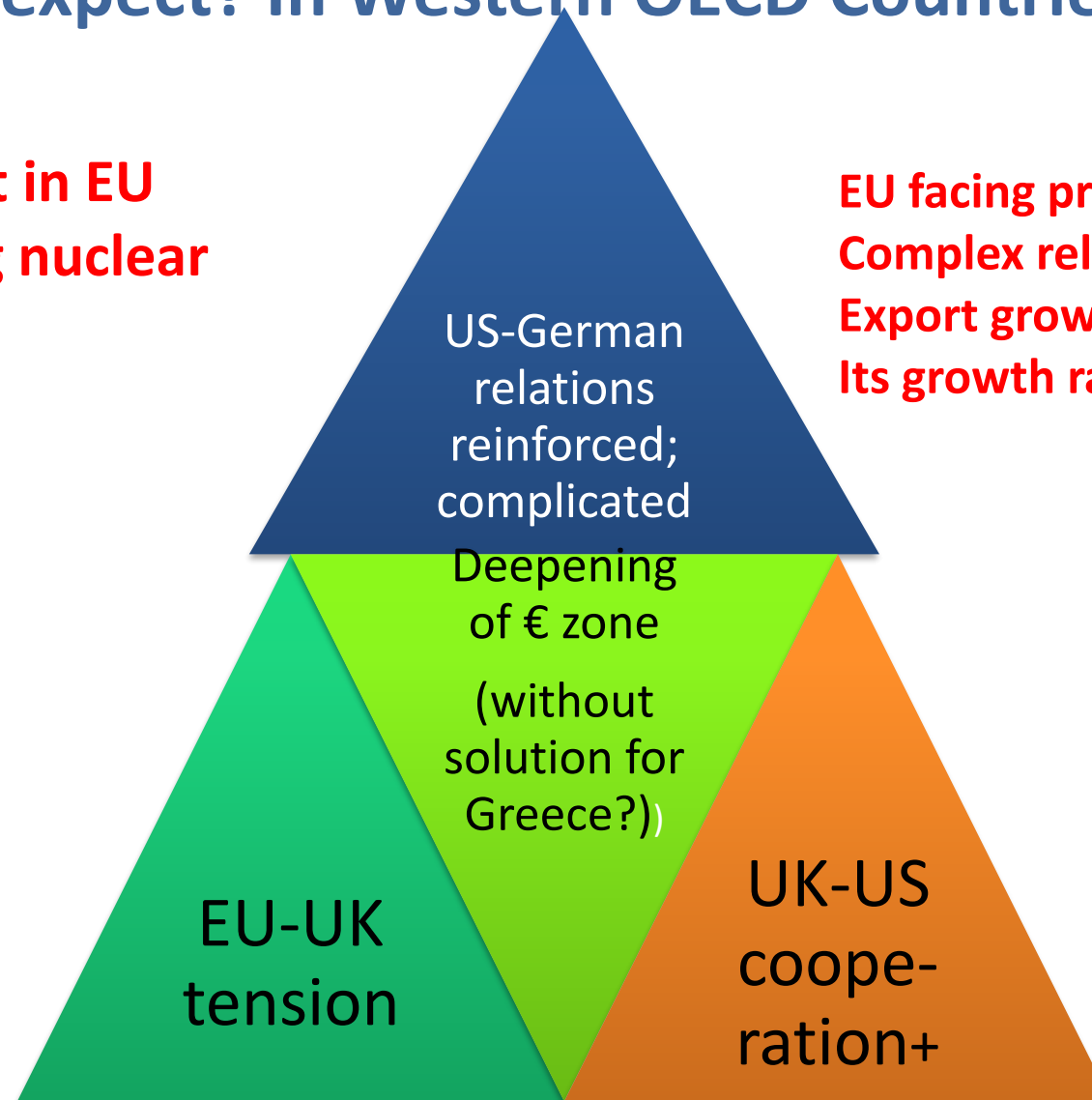




# What should we expect? In Western OECD Countries?

**France gaining weight in EU  
as the only remaining nuclear  
(military) power**

**EU facing pressure from Russia;  
Complex relations with China whose  
Export growth is enormous; so are  
Its growth rates in FDI in Europe since 2016**



## BREXIT is a political adventure against the EU, against the establishment - populist?

- **BREXIT:** political project of the Leave campaign who want “more sovereignty” and total control over immigration for the UK; hardly 10 economists at UK universities who support BREXIT
- Michael Gove (Minister of justice in Cameron’s cabinet) was once asked if he could name economists who back BREXIT: His answer – No, the people have had enough of experts – here, a **new British populist approach was visible, which seeks easy answers and rejects expert opinion**
- BREXIT hardliners (e.g. David Davis as “Exit Minister”) want a **new leadership role for the UK in the Commonwealth and global free trade**
- **WHAT Do Commonwealth Countries want???**

## BREXIT first EU Disintegration: Timeline 1957 to 2019

- 1957: 6 EU-Countries (GER, FR, IT, Benelux) founded the EU, not the UK – as Anne Will claimed in an interview with Merkel in November 2016
- **1973: UK, Ireland, Denmark join the EU (since 1968 Intra-EU free trade in goods)**
- 1993: EU Single Market (2-3 % gain in real income)
- 1999 Start of the Eurozone & ECB
- 2004/2007/2013 EU Eastern Enlargements
- **2016** (23rd June): **51.9% vote for BREXIT**
- **2019: UK-Withdrawal = -18% of EU28 GDP; -13% in terms of population EU27/28, -15% in EU exports**
- **UK EU-Exports account for 13% of GDP; US-Exports 2.5%**
- 2020: End of the first Trump term in USA; **BREXIT & TRUMP =?**

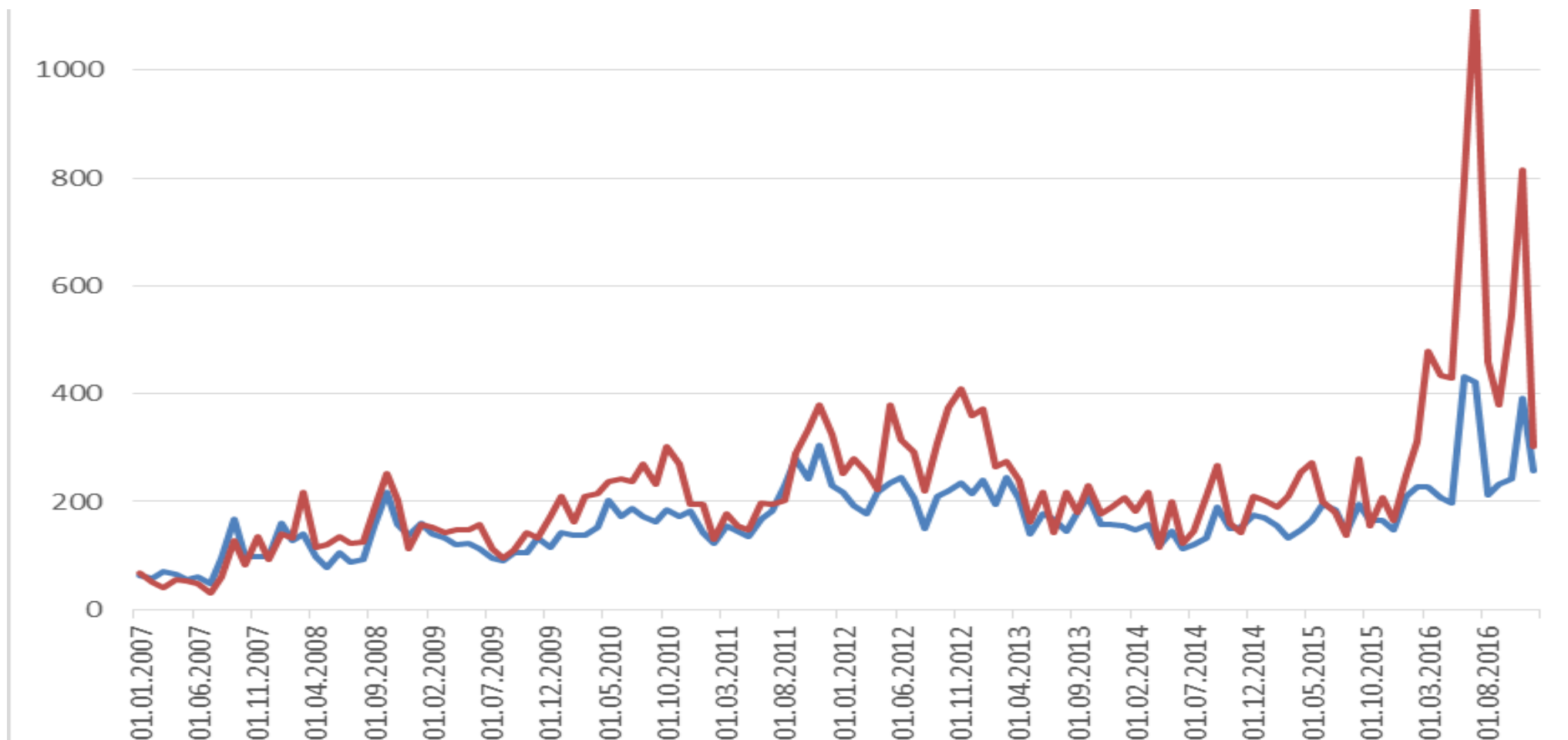
## BREXIT came as a surprise to the European Commission

- **EU depended on Eurobarometer survey results**
- The **Eurobarometer figures** from Spring 2017 were far removed from the anti-EU result in the referendum itself (36 percent of British respondents AGAINST EU, June: 51.9 percent) – thus little warning from the UK (and other countries), methodically weak, policy actors apparently uncritical of the Eurobarometer findings
- **US-EU-Banking Crisis of 2007-09 had damaged trust in politics** in many EU-countries, including the UK – and naturally also in the US upon which the new May government depends to some extent for support

## EU Commission Forecast for UK (Jan. 2017)

• Indicators	2015	2016	2017	2018	2019*
• GDP growth (% , yoy)	2,2	2,0	1,5	1,2	1,0
• Inflation (% , yoy)	0,0	0,7	2,5	2,6	2,2
• Unemployment (%)	5,3	4,9	5,2	5,6	6,0
• Public budget(% of GDP)	-4,4	-3,4	-2,8	-2,5	-2,9
• Public debt (% of GDP)	89,0	88,6	88,1	87,0	88,2
• CA balance (% of GDP)	-4,3	-5,0	-4,8	-3,9	-3%
• <b>UK Office for Budget Responsibility has much more favorable view 2018/2019</b>					

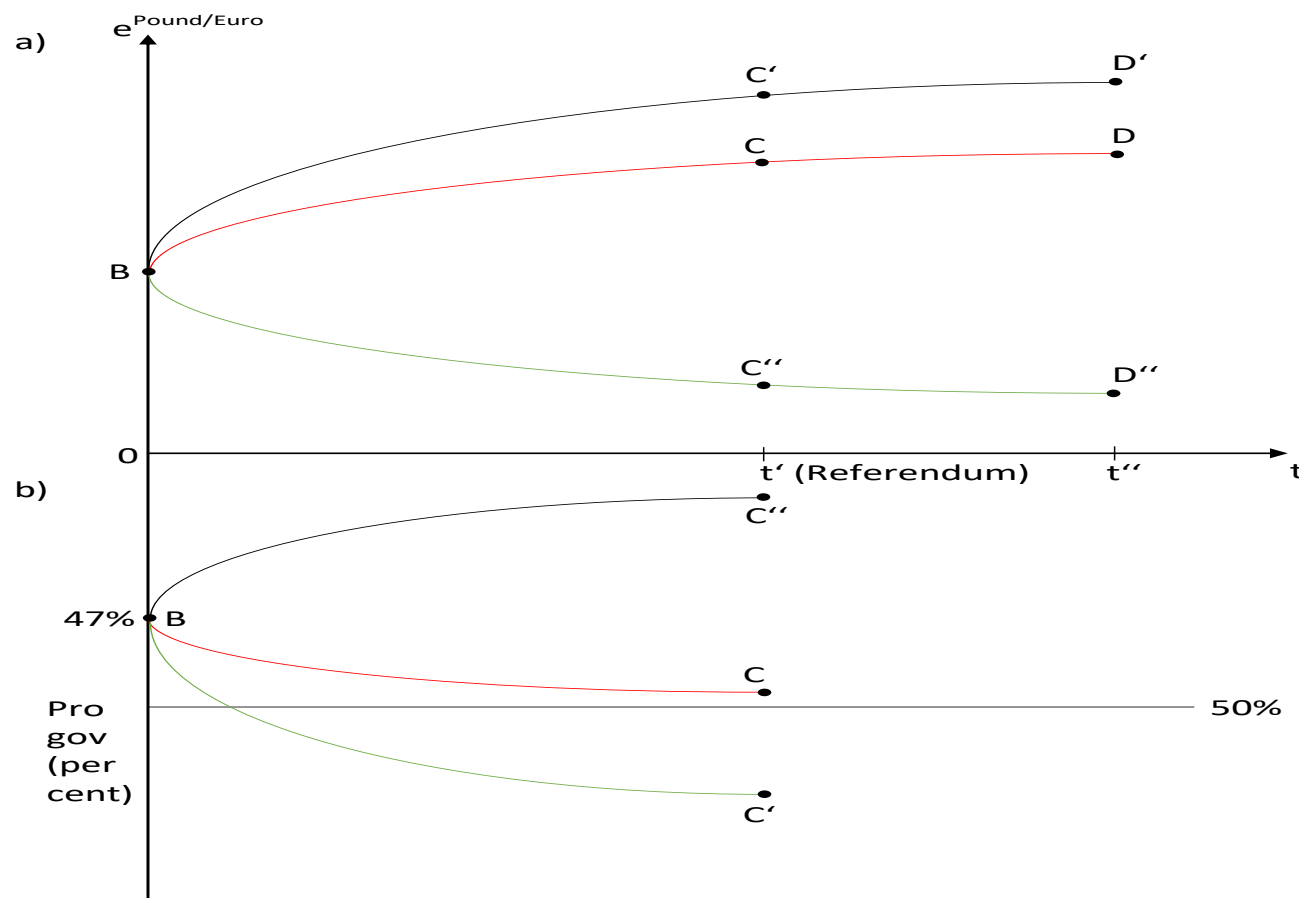
## Economic Policy Uncertainty Index: UK red, EU is blue; BREXIT ref=spike



**Shortly before June 23:** Exchange rate dynamics (net capital inflow) and voting (Welfens, 2017c):

Depending on exchange rate development prior to referendum the outcome is as in b); appreciation in a) brings majority for BREXIT (BC'')

Fig.: Exchange rate dynamics (net capital inflow) and voting





## Naive capital markets in UK in June 2017

- **British capital markets/exchange rate of the Pound showed in last week before June 23 that REMAIN was to be expected (according to investors); thus many undecided people did not make strong critical reflections about BREXIT**
- **General problem of open capital markets and distorting effects on referenda**

## Historical question at the referendum in UK, June 23rd 2016

**“Should the United Kingdom remain a member of the European Union or leave the European Union?”**

## Quote from Dean Acheson (retired US Secretary of State, 1962...)

It is interesting to read the Leave campaign websites and find there the idea that the UK should again strive for a great international role – after BREXIT – in the context of a more active Commonwealth strategy. This leaves open obvious two questions:

- Will a new Commonwealth strategy of the UK be welcomed by other Commonwealth member countries?
- Could a new British Commonwealth strategy create major benefits for the UK?

**“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, in famous speech at West Point, 1962**

## Main Arguments 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

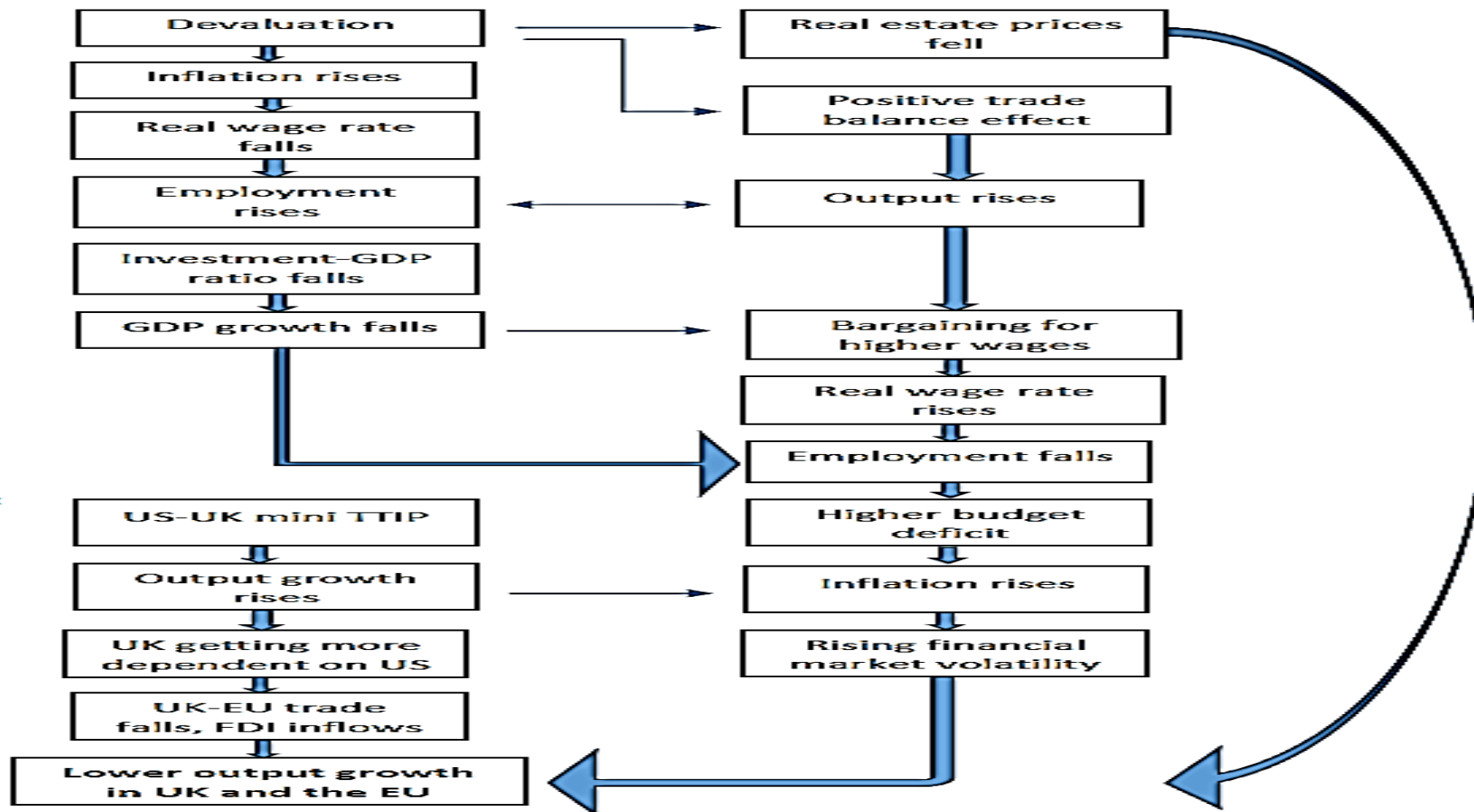
- **membership is essential for the UK's economic fortunes, as half of the UK's exports** go to the EU "single market";
- **EU membership serves as a launchpad for the UK's global trade;**
- Brexit would mean losing out on the benefits of the prospective U.S.-EU comprehensive free trade agreement, **the 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"

# Post-Referendum Economic Developments in the UK

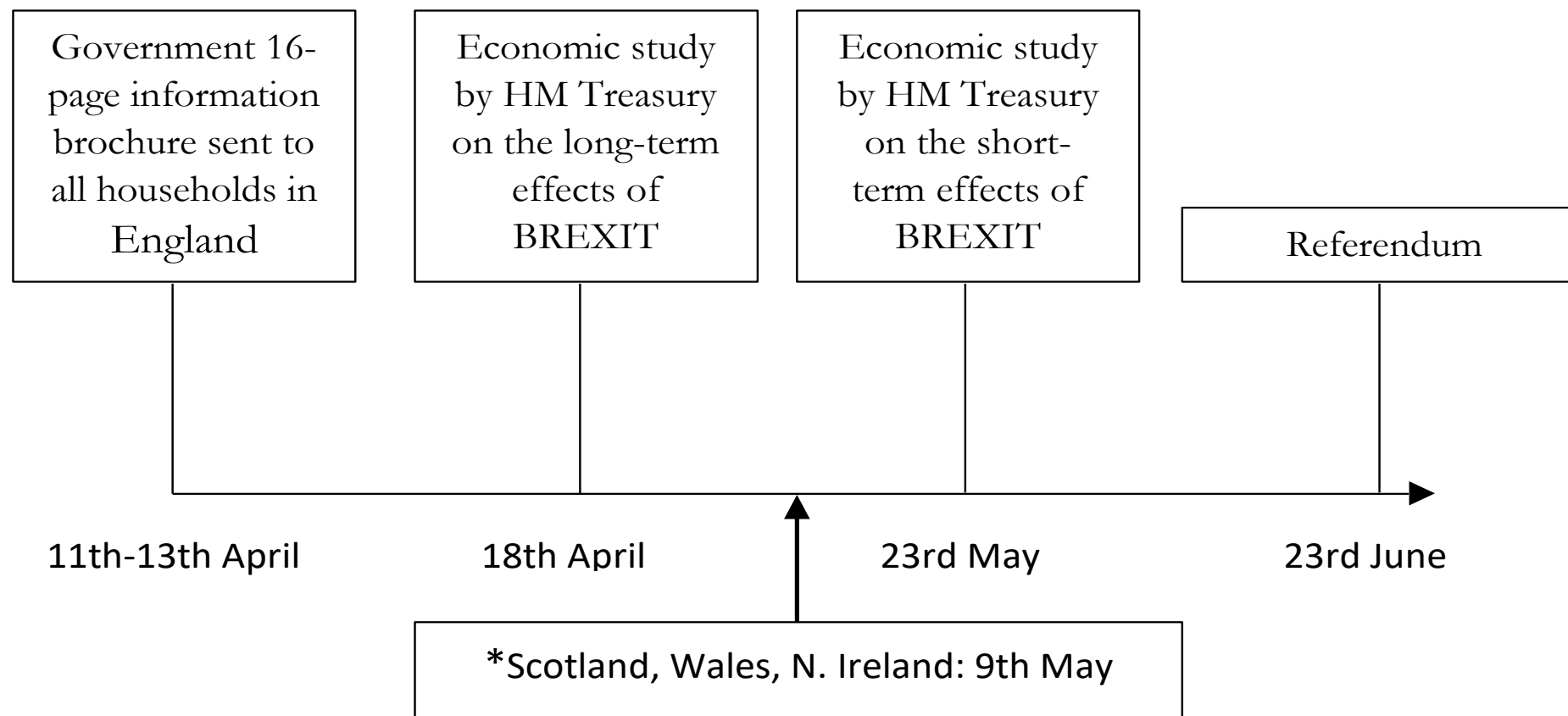
2016:

2017/18:

2019 Brexit:



## Government Referendum Information: A Timeline



## Analysis of PAIN/YOUNG (2004): Links between FDI and Exports

In a modified NiDEM model, a 10 percent rise in the stock of foreign direct investment (FDI) in the UK leads to a rise in British exports by 0.75 percent, which is explained by the authors in a simple way:

- The subsidiaries of foreign multinational companies raise the level of quality for many goods.
- Moreover, subsidiaries will bring a greater variety of tradable goods.
- By implication, one may conclude that to the extent that BREXIT reduces the stock of FDI relative to GDP, the British current account position will further worsen and the Bank of England will face pressure to raise the stock of reserves considerably.
- Counter-argument related to the expected strong real depreciation of the British Pound after BREXIT: following the argument of FROOT/STEIN (1991), it is clear that higher foreign direct investment flows will come to the UK since in an imperfect capital market framework the ability of foreign investors to successfully bid to take over British firms – on the basis of a leveraged acquisition – is reinforced.



## Global rank of UK GDP (Nominal in billions of \$USD and by Purchasing Power Parity PPP in billions of Current International Dollars 2016)

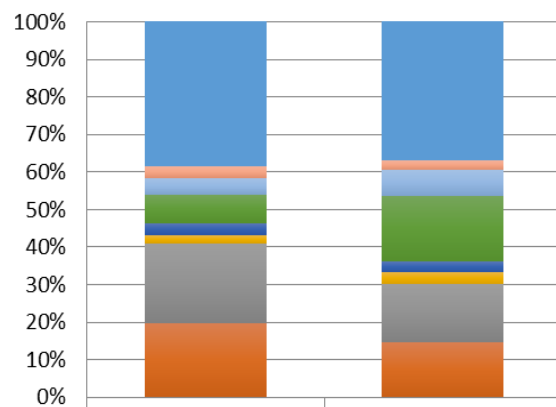
Ranking	Country	Nominal GDP (in Billions \$US
1	United States	18,561
2	China	11,391
3	Japan	4,730
4	Germany	3,494
5	United Kingdom	2,649
6	France	2,488
7	India	2,250
8	Italy	1,852
9	Brazil	1,769
10	Canada	1,532

Ranking	Country	GDP by PPP (in Billions of Current International Dollars, 2016)
1	China	21,269
2	United States	18,562
3	India	8,720
4	Japan	4,932
5	Germany	3,979
6	Russia	3,745
7	Brazil	3,134
8	Indonesia	3,027
9	United Kingdom	2,787
10	France	2,736

Source: IMF, World Economic Outlook Database, October 2016

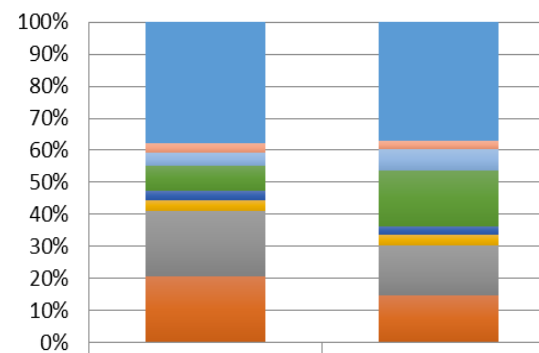
# UK and EU27 in the World (GDP in Percentage of World PPP and Population)

**GDP in Percent of the World  
PPP (Current International Dollars)**



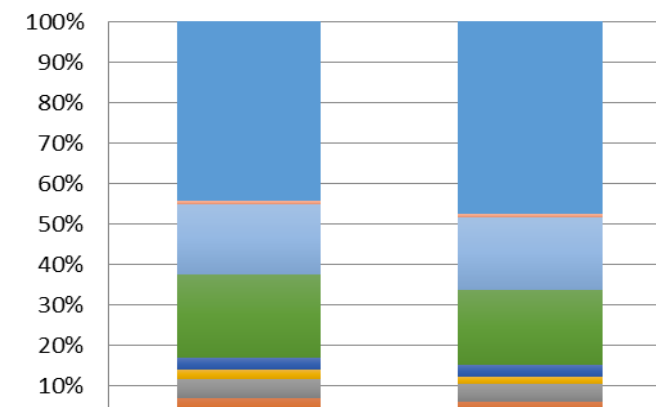
	2000	2015
Rest of the world	0,384284805	0,370242209
United Kingdom	0,031717584	0,023810925
India	0,043559422	0,070029499
China	0,076629087	0,173486138
Brazil	0,03259953	0,028008183
Russian Federation	0,020701713	0,031343429
United States	0,212788741	0,157921176
European Union excl. UK	0,197719117	0,145158442

**GDP in Percentage of the world  
PPP (Constant 2011 International Dollars)**



	2000	2015
Rest of the world	0,377207391	0,371867909
United Kingdom	0,030883581	0,023272514
India	0,042258977	0,069686145
China	0,074341363	0,172635537
Brazil	0,031626287	0,027870859
Russian Federation	0,032770769	0,032453473
United States	0,206436037	0,157146891
European Union excl. UK	0,204475596	0,145066672

**Population  
in Percentage of the World**



	2000	2015
Rest of the world	0,44263462	0,473867549
United Kingdom	0,009630128	0,008866406
India	0,172265664	0,17845597
China	0,206468236	0,186646045
Brazil	0,028744672	0,028291535
Russian Federation	0,02397153	0,019613993
United States	0,046139315	0,043750493
European Union excl. UK	0,070145835	0,060508008

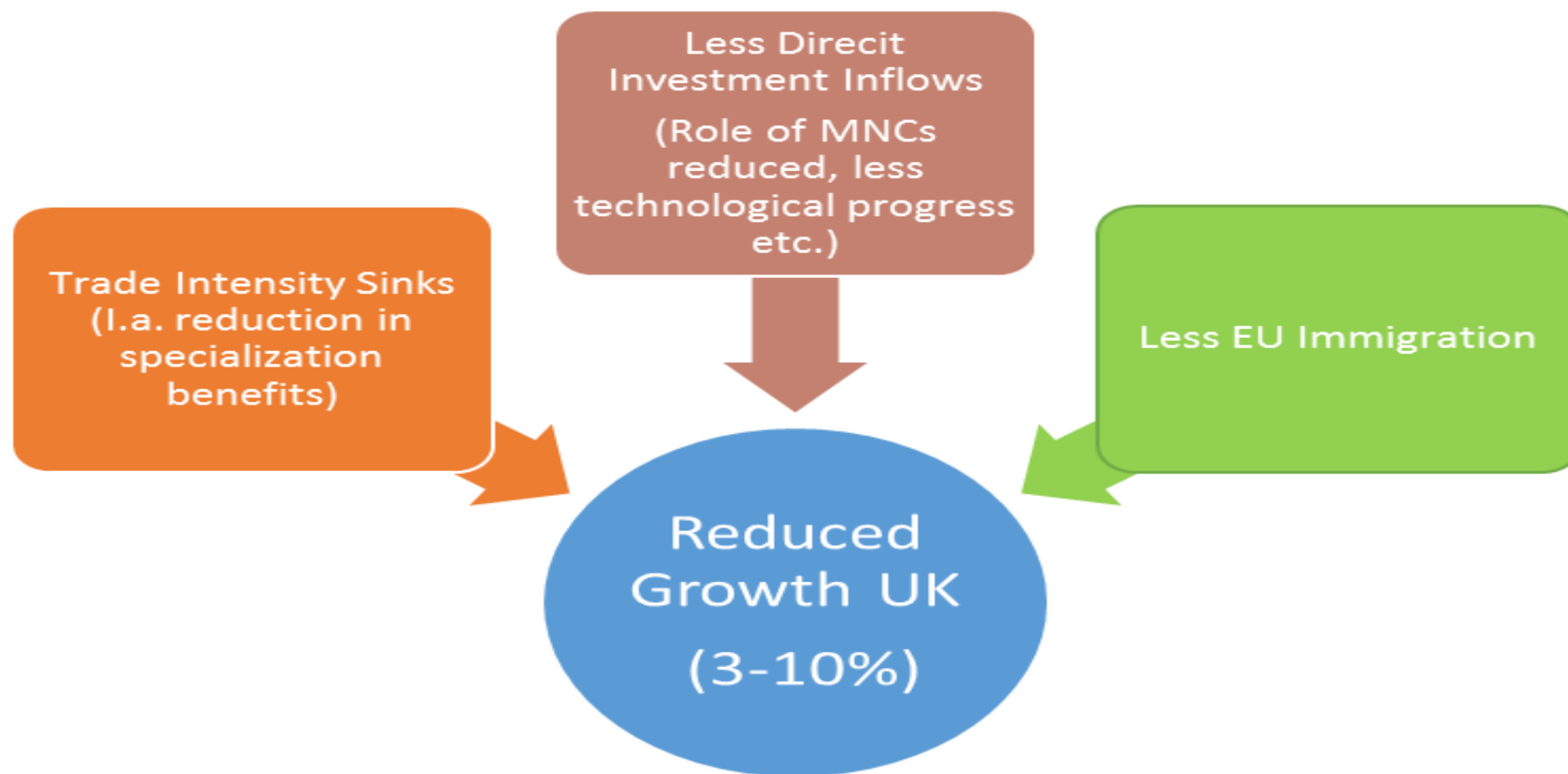
Source: World Bank, World Development Indicators, retrieved on 09.01.2017 17:08

## The GDP Share Generated by US Subsidiaries in Europe (and Selected European Countries)

Country	2009	2010	2011	2012	2013	2014
EU	3.00%	2.98%	3.01%	3.22%	3.01%	3.16%
France	1.94%	1.90%	1.91%	1.87%	1.87%	1.94%
Germany	2.55%	2.50%	2.46%	2.36%	2.36%	2.47%
UK	6.58%	6.31%	6.09%	5.84%	5.84%	5.75%

Source: BEA database and WDI database. EIIW calculations: note, data is taken from all Majority-Owned Bank and Non-Bank

## BREXIT-Effect Channels Reducing Real Income in the UK



## Actual and Adjusted Results Based on an Adequate Information Policy by Cameron

	Actual Result	<u>Simulation I Corrected Result</u>	<u>Simulation II Corrected Result</u>
		<p>Basis Info: -6% real income with BREXIT = minimum information from Cameron government which one should expect to receive as a voter from the HM Treasury analysis.</p>	<p>Key info from the Treasury study: -10% growth effect (-6% plus -4% as a result of non-participation in EU Single Market deepening due to BREXIT) plus effect of 3 percentage point increase in income tax</p>
UK Remains in the EU	48.1%	50.4%*	52.1%*
UK Leaves the EU	51.9%	49.6%*	47.9%*

(\*Calculated on the basis of popularity elasticities in Frey/Schneider "A Politico-Economic Model of the United Kingdom")

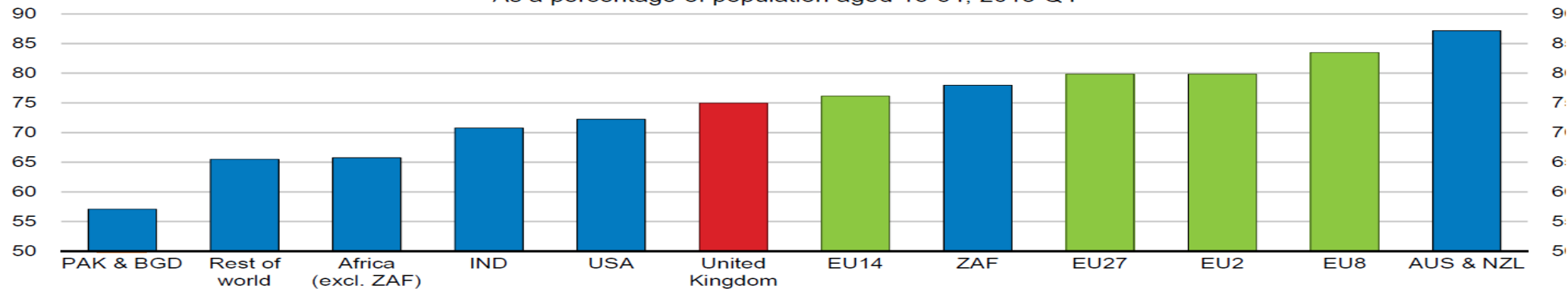
## Central Government vs. Local Authorities in the UK and Immigration

- Cameron's government sharply cut the financial allocations to local authorities over a number of years, in the cities and towns of the UK there was increasingly an impression of insufficient local services due to immigration, which was in fact being caused by the cuts in London. Cameron/May created immigration scapegoat

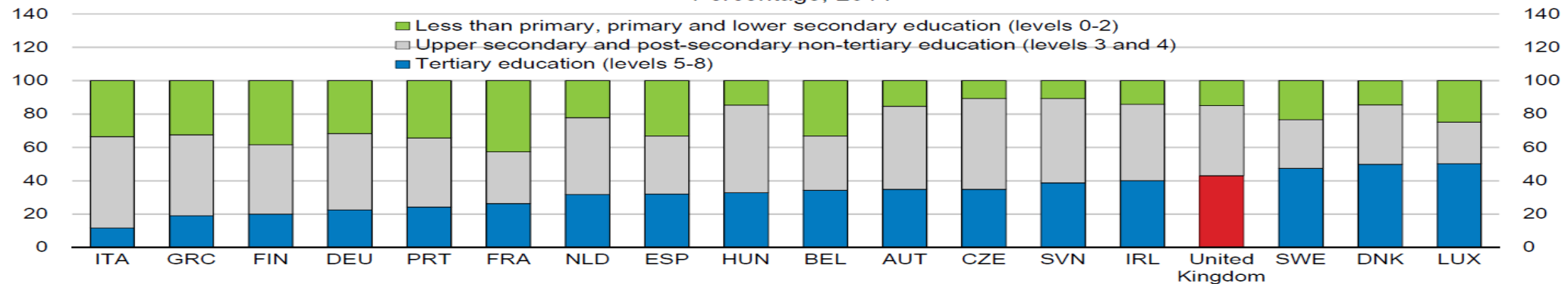


# EU Immigrants in UK – a burden? (OECD data contradicts rhetoric of UK govt.)

**A. UK employment rates by country of birth**  
As a percentage of population aged 16-64, 2015 Q4<sup>1</sup>

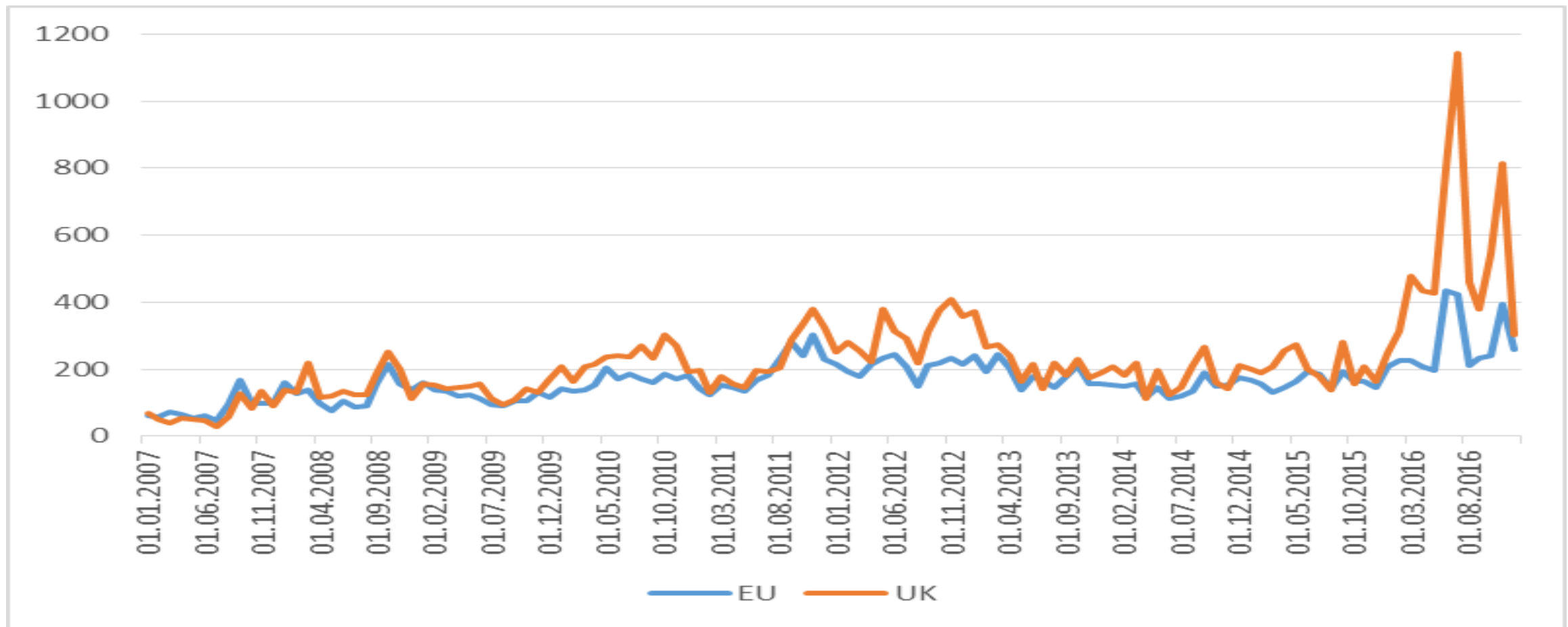


**B. Migrants from the EU by educational attainment**  
Percentage, 2014<sup>2</sup>



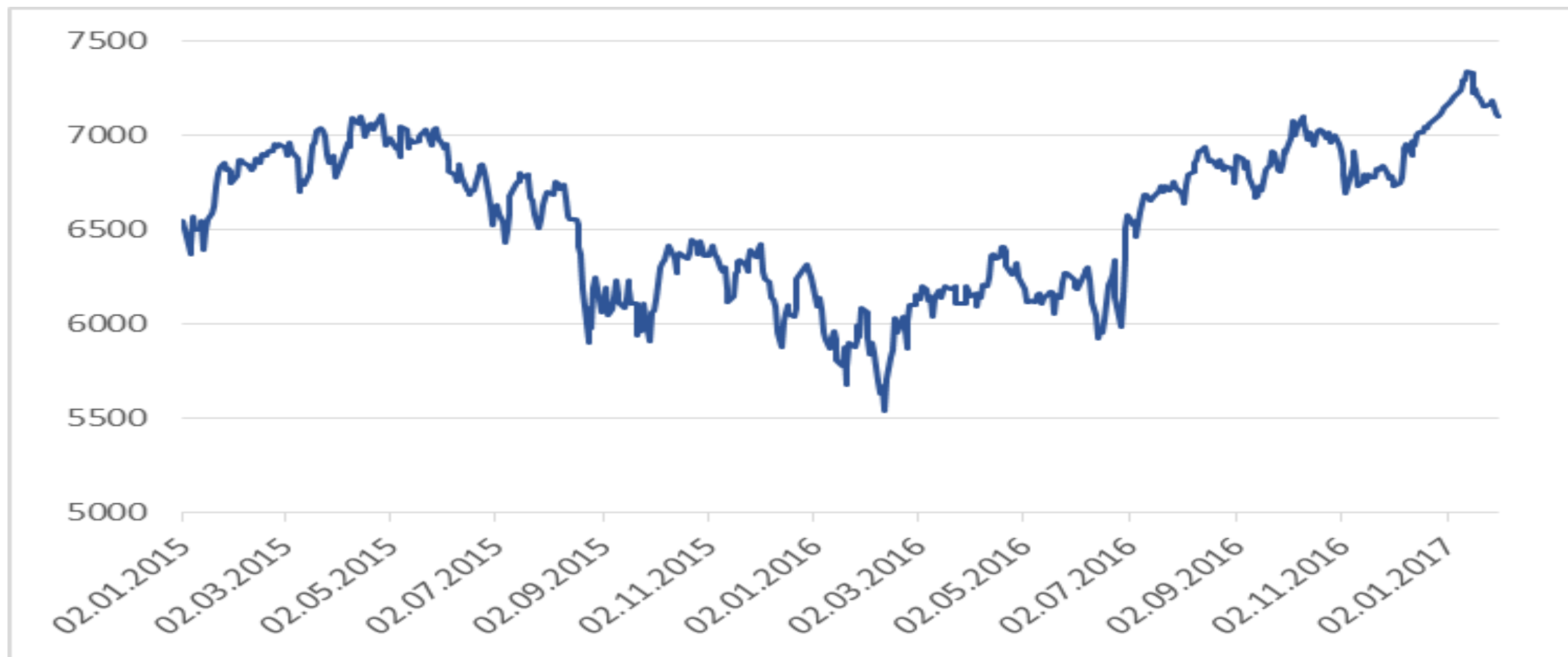
Source: OECD (2016a), The Economic Consequences of Brexit: A Taxing Decision, OECD Economic Policy Paper, No. 16, OECD Publishing: Paris

## UK Economy: Uncertainty Rises (Economic Policy Uncertainty Index (EU Blue, UK Red), alternative is the CISS Index of the ECB)

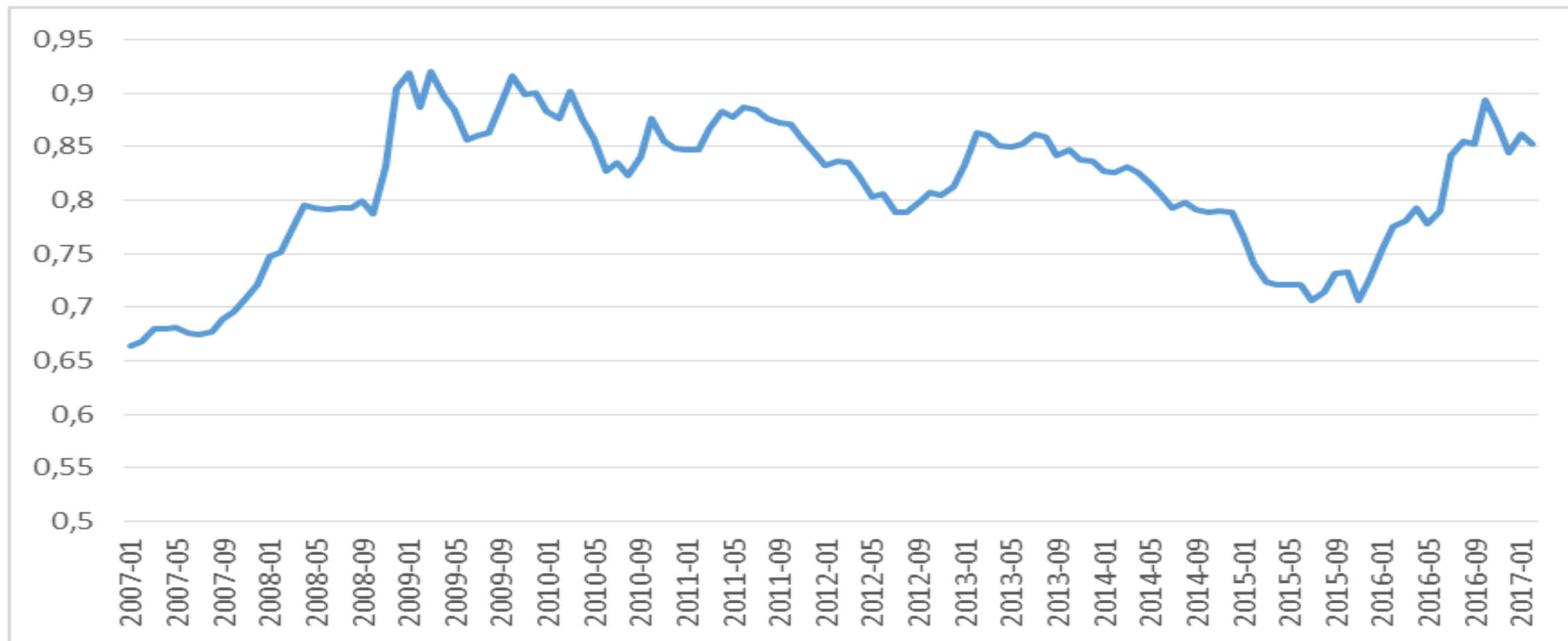




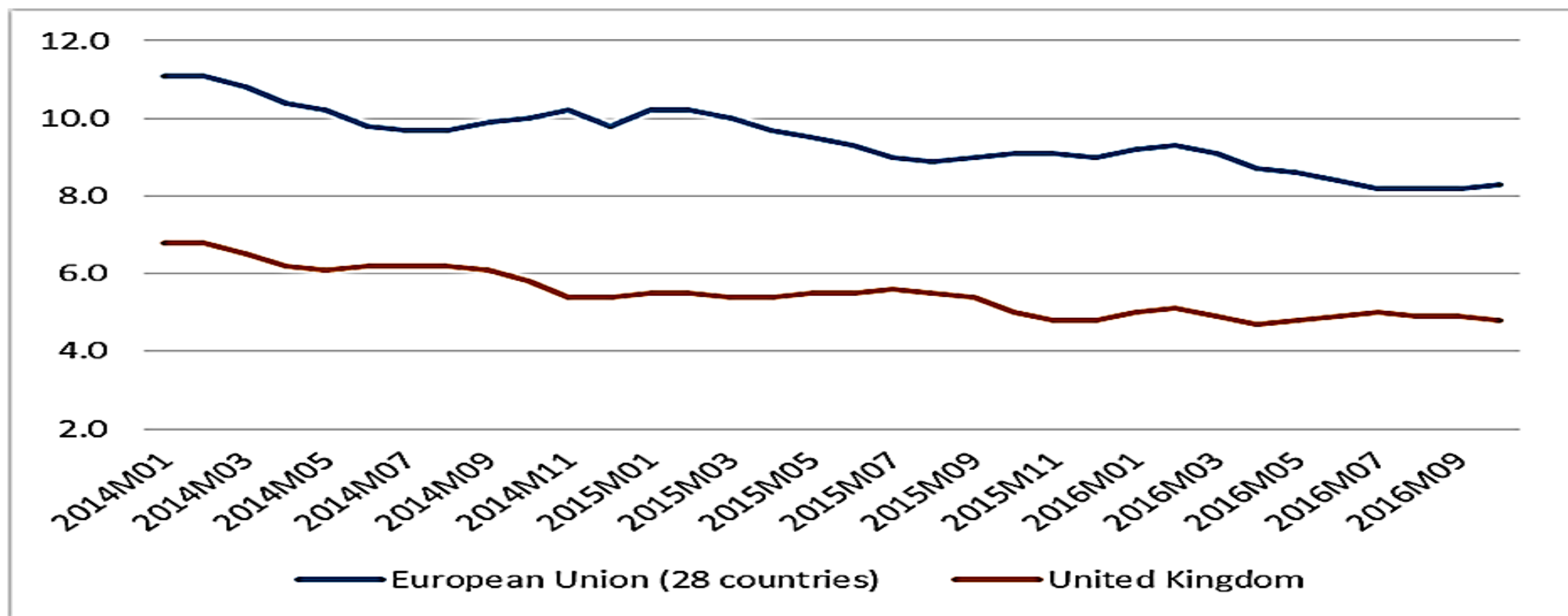
## Share Price Index (FTSE 100 Daily) – Influenced by US Stock Markets



## Exchange Rate Pound/Euro – Depreciation against the Euro (ECB Reference Exchange Rate (monthly))



## Harmonized Unemployment Rate (%) monthly data



Source: Eurostat

## Can BREXIT Be an Economic Success and What Effects Can Be Expected for the EU27?

- **The immediate impact of the referendum result has been a strong devaluation of the British Pound: about 15 percent by January 2017.**
- Output growth in 2016 has not reduced much although investment dynamics have weakened. One should not overlook that the Bank of England cut the interest rate.
- Moreover, the government has announced a reduction in the speed of consolidation so that firms will anticipate higher government consumption in the medium term and households could expect lower tax rates for some time.
- 2017 will bring a higher inflation rate and since this was not anticipated there will be a quasi Phillips-curve effect, namely reduced real wage rates which will in turn encourage firms to hire more workers: unemployment will fall temporarily
- Mrs. May's BREXIT speech of January 2017 – making clear that there will be a hard BREXIT – is a signal to domestic and foreign firms to reduce investment.

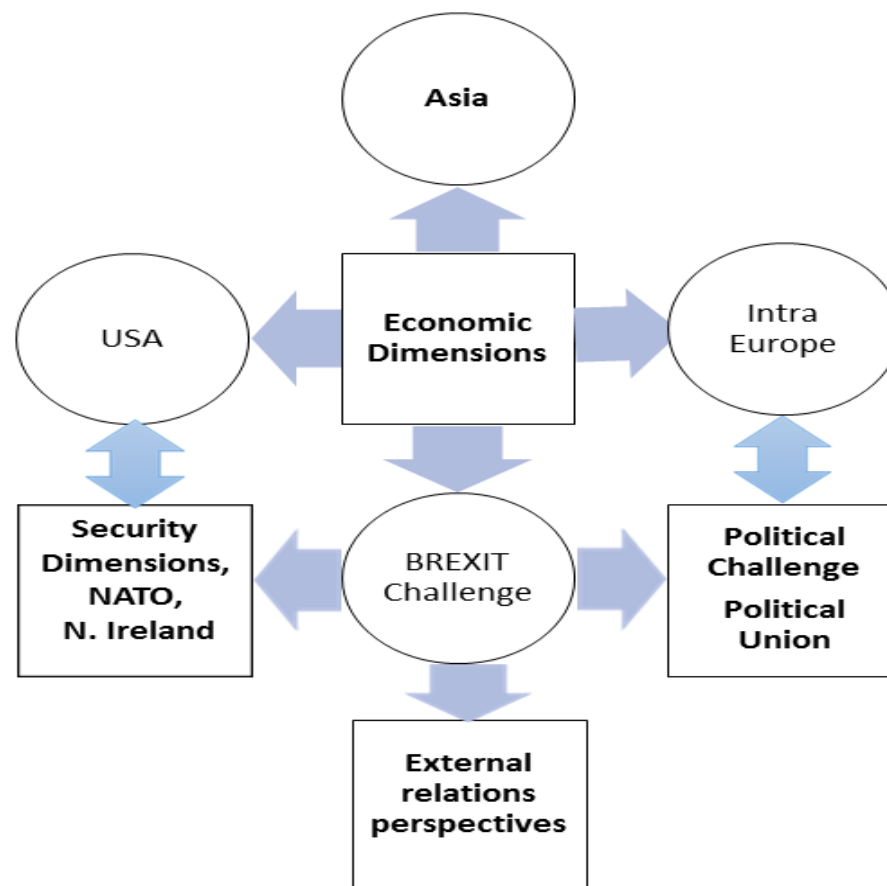
## Global Britain Approach

- **Ok with FTA with US, Japan; not China, not India**
- **Difficult if WTO undermined by US (Trump)**
- **Growth rates will be lowered by BREXIT – will it exceed those of Eurozone/EU27**
- **The UK will want to adopt lower corporate tax rates AND banking deregulation (*and US to follow under Trump Administration*)**

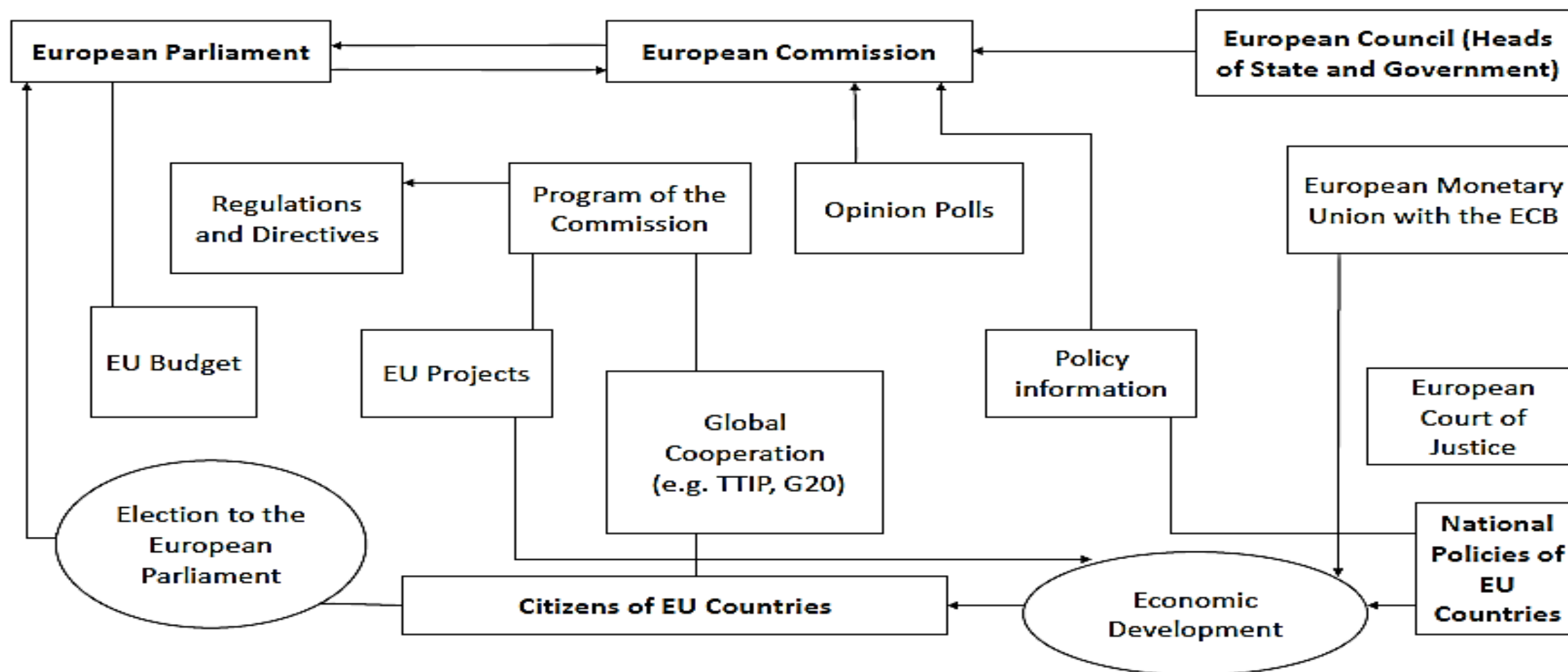
## Necessary EU Reforms

- Too much EU regulation = bad for growth
- Budget (1% of GDP) is too small: Forschungsgruppe Wahlen says: Voters do not understand EU role = leading to many votes for small radical parties (AfD UKIP, Front National)
- Budget should be rather 5-6% of GDP; US (DC) is 9% plus 21% for social expenditures (Theory of Fiscal Federalism); principle of subsidiarity? MORE EU in infrastructure, defence and for short-term unemployment (not youth unemployment)
- EU is not well positioned for the 21st century
- Will there be adequate EU reforms
- Or further X-Exits and destabilization of Mercosur/Asean?

# Politico-Economic Challenges for the United Kingdom



# Institutional Structure of the EU and European Government





## Life Expectancy and Child Mortality in the UK, Germany, France and the US

	Life Expectancy at Birth (Average, 2014)	Child Mortality (No. of deaths of Children under 5 years of age per 1,000, 2015)
United Kingdom	81	4
Germany	81	4
France	82	4
US	79	7

Source: data.worldbank.org

## Income Redistribution in the EU - Cologne Institute of Economic Research (net transfers in percent of net income 2009)

Ireland	61.7	-6.9	U.K.	39.5	-23.8	Cyprus	33.8	+2.7
Finland	53.9	-20.6	Bulgaria	38.9	+1.0	Malta	29.3	-13.2
Denmark	50.1	-36.4	Portugal	38.3	-10.8	Slovakia	27.4	-1.7
Sweden	45.8	-23.4	Latvia	37.8	-5.1	Luxembourg	26.5	-11.6
Germany	45.7	-17.3	Hungary	37.1	-9.3	Spain	23.0	-4.3
Belgium	45.2	-19.5	Slovenia	36.0	-19.5	Lithuania	22.9	-5.1
Cz. Rep.	42.3	-15.5	Austria	35.7	-18.4	Poland	17.3	-11.8
Estonia	42.2	-9.2	Netherlands	35.4	-38.4	Italy	13.2	-8.7
France	39.8	+2.6	Romania	34.3	-4.8	Greece	11.1	-15.3

**XX** 20% of the population with the lowest income

**XX** 20% of the population with the highest income

*Legend: Most citizens pay taxes and social contributions and receive transfers from the state. The net effect however differs. In Germany, the net transfer share of the 20% of the population with the lowest income amounts to 46% of net income. The 20% with the highest income pay out 17% of their net income.*

*Taxes and social contributions: Income taxes and employee contributions to social insurances. Transfers: Pensions, unemployment benefits, illness and family benefits, other social benefits; Data source: Eurostat*

Source: Judith Niehues: Staatliche Umverteilung in der Europäischen Union, in IW Trends 1/2013

# A Window of Opportunity for Europe (McKinsey Global Institute, 2015)



## Increasing competitiveness

Implementing European best practice in three key areas can deliver growth aspirations

**75%** can be achieved by national governments

## Reforms Needed in Several Key Countries

- **Greece:** a new and better constitution
- **Germany:** should focus on reducing its very high current account-Gross Domestic Product (GDP) ratio, which for several years has exceeded the critical 6 percent ratio fixed in the new stability benchmarks of the European Union.
- **Italy:** major problems with regard to raising productivity and growth, and this is partly due to insufficient inflows of multinational companies' foreign direct investment (FDI). Education sector reforms (e.g. 60% of students do not complete studies). Lack of Italian multinational firms to promote growth of real gross national product. Labor market reforms required.
- **France:** also facing problems in the education system and a lack of vocational training dynamics as well as an excessive – nationally uniform – minimum wage rate.

## Key Findings on the Long-Term Costs of BREXIT According to Various Government Scenarios (GDP=Gross Domestic Product)

	European Economic Area	Bilaterally negotiated access to single market	WTO-member access to single market
<b>GDP (%) central est.</b>	-3.8%	-6.2%	-7.5%
<b>GDP (%) (Estimated range)</b>	-3.8% to -4.3%	-4.6% to -7.8%	-5.4% to -9.5%
<b>Per capita GDP central est.</b>	£1,100 \$1,342	£1,800 \$2,196	£2,100 \$2,562
<b>Per capita GDP (Estimated range)</b>	£1,000 - £1,200 \$1,342 - \$1,464	£1,300 - £2,200 \$1,586 - \$2,684	£1,500 - £2,700 \$1,830 - \$3,294
<b>GDP per household central est.</b>	£2,600 \$3,172	£4,300 \$5,246	£5,200 \$6,344
<b>GDP per household (Estimated range)</b>	£2,400 - £2,900 \$2,928 - \$3,538	£3,200 - £5,400 \$3,904 - \$6,588	£3,700 - £6,600 \$4,514 - \$8,052

\*central refers to the mid-point of the estimated range \*\*expressed in 2015 Pounds Sterling. Source: HM GOVERNMENT (2016c), HM Treasury Analysis: the long-term economic impact of EU membership and the alternatives, London, April 2016, p. 138