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Executive Summary

Brexit – the economic impact
A meta study

A **plethora of analyses** attempts to quantify the economic impact of a Brexit for the United Kingdom (UK). The **results are rather confusing** – ranging from significant advantages to marked losses. This can be explained by significantly different methods, diverse assumptions, and the different aspects which are included – as this comprehensive meta-analysis shows with a comparative analysis. We cut through the fog of assertions and seek to get to the reality of the situation facing the UK after a Brexit. The more reliable amongst the **many studies surveyed estimates that the net economic cost will remain moderate** (between 1 to mostly less than 5 percent of economic output or income). However, **we challenge this mainstream view**. The **risks of a Brexit are likely to be underestimated** and the economic **damage to the UK could be significantly higher** than the mainstream view suggests.

Net economic damage likely

The authors suggest that pertinent **forward-looking theoretical models are unable to capture the many important advantages of economic integration between the UK and the EU**. They provide a thorough overview of the various advantages that are left out and point out their relevance for welfare and growth. Currently, there is no universally accepted method of estimation available to integrate all of these specific effects in a comprehensive way. The available **backward-looking empirical studies that attempt to do this can be criticised** to some extent. **But they indicate significantly greater risks** for the UK. Overall, **net economic damage around 10 percent of economic output or more cannot be ruled out** in a more pessimistic scenario in the longer run.

Lower economic integration will hurt citizens and businesses

The final effect reflects contradicting influences. On the **positive side**, a Brexit could allow for **less of an EU-induced regulatory burden** and also for **lower welfare losses due to EU protectionism**. However, these effects appear relatively moderate and in most reliable studies they are **outweighed by the disadvantages of lower economic integration** with the EU. The EU is the main trading partner for the British economy – it is the destination for around 45 percent of all British exports of goods and around 38 percent of total exported UK services. Depending on the institutional arrangement between the UK and the EU, a **Brexit would imply higher EU trade barriers**. **Trade transaction costs would rise** and customs clearance requirements would lead to delays for British firms exporting to the EU. Moreover, the **UK would partially lose access to the EU Internal Market** which would particularly affect the freedom to provide services and the right of establishment in the EU. Higher EU trade barriers could also **induce British and foreign companies to shift jobs from the UK to the continent**. The UK (and in particular the City of London) could suffer from relocations, as especially US companies use the UK as a bridgehead for the EU, which would be significantly complicated after a Brexit. Moreover, **EU companies could cut UK firms out of their (just-in-time) cross border value chains** due to higher trade costs and time delays. Finally, in case of a Brexit, the **UK would no longer be able to benefit from future EU trade agreements** and further progress within the Single Market.

Possible strategic misconceptions

Much will depend on what legal basis the UK would continue to do business with the EU and with the rest of the world after a Brexit. With regard to the **negotiation of the institutional relationship with the EU** and the many trade agreements with third countries, there is a **risk of certain misconceptions**:

- While the negotiating position of the UK might seem strong due to its merchandise trade balance deficit with the EU and due to the expectation that the EU would want to maintain good political relations, this optimism might be misleading: The **UK would probably be in a defensive position**, because it would **rely much more on access to the much larger EU market than vice versa**. Moreover, the EU is not likely to offer generous conditions for market access as this precedent could also invite other members to withdraw from the EU.
- There will be **no free lunch for the UK in choosing from different options of future institutional integration with the EU**. The more politically motivated the striving for sovereignty should prevail with regard to regulatory issues, the higher will be the price for the UK in terms of lost market access to the EU.
- Some argue that the UK can liberalise its trade policy vis à vis third countries to the benefit of UK consumers and that at the same time it can secure attractive market access conditions in these countries for UK firms. However, this might appear too optimistic, because the **UK is only able to offer a significantly smaller market than the EU and would be in a defensive position**. Moreover, there is also a certain dilemma for the UK: In order to reap the welfare benefits of free trade, the **UK would have to unilaterally reduce its trade barriers sooner rather than later**. Yet, if it does so, it loses important bargaining chips that are necessary to obtain significant market access in the 'give and take' of bilateral trade negotiations.

Besides all of this, a **big uncertainty** (with possible rating downgrades) in case of a Brexit could **damage the general investment climate in the UK**. This uncertainty concerns not only the possibly substantial negative economic impact but also the uncertain future for institutional arrangements with important trading partners. Overall, a Brexit would indeed resemble a potentially dangerous leap in the dark.

Full study via qr-code or via http://www.iwkoeln.de/brexit-studie

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