No.34

Eyes of IIMA Institute for International Monetary Affairs

2016.4.25

BREXIT may push down the UK GDP by 6% in the long-run？
Estimates of HM Treasury of the UK

Ayako Yamaguchi, Lead economist
Institute for International Monetary Affairs

In the United Kingdom, a national referendum to ask whether the UK should remain a member of the European Union (EU) is scheduled on June 23. Prior to that, HM Treasury of the UK published on April 18 a report analyzing the long-term economic impact of the case if the UK leaves the EU.

The report presents three alternatives for the UK trade policy after leaving the EU which include (i) membership of the EEA (like Norway), (ii) negotiated bilateral arrangement with the EU (like Canada) and (iii) membership of the World Trade Organization without any specific agreement with the EU (like Russia or Brazil) and estimates long-term economic impact until 2030 for each alternative using a gravity modelling approach. According to the estimates (please refer to the table shown below), if it leaves the EU, the UK will have lower GDP by 3.4% in the least (alternative (i)), and by 9. 5% at the maximum (alternative (iii)) than remaining in the EU. Even with the alternative (ii), GDP will be lower by 6% and GDP per household by £4,300 (about ¥670,000). Although the obligated contribution to the EU budget associated with the membership of the EU was one of the reasons that the “Leave group” cited, the tax receipts would be lower by up to £45 billion, worsening the fiscal balance by far more than the contribution to the EU.

In the first place the UK has been enjoying the benefit of free trade in the European single market as a member of the EU. Currently 80 % of the UK’s trade has been made with the EU and over 50 countries that have concluded some kind of trade agreement with the EU. If the UK leaves the EU, it will have to negotiate a new agreement with the EU and other related countries. 44% of the UK exports go to the EU while only 8% of the EU exports is destined to the UK. If the UK is to independently negotiate to conclude a trade agreement with the Non-EU countries, it will be unavoidable that the UK will have a weaker bargaining power than as a member of the EU. As a result of exit, the attractiveness of the UK as a destination of investment may decrease with a risk of resulting withdrawals of foreign capital companies from the UK.

In the recently published World Economic Outlook, the IMF included the British exit from the EU (BREXIT, as is often referred to) as one of the seven risks threatening the world economy.

In addition to the comment of President Obama who is visiting the UK to encourage the British people to remain in the EU, there has been a number of news from academics, politicians of the EU's member states that warn that the BREXIT will have a huge negative impact both on the UK and on the EU.

In the UK, heaps of debates have been made, and opinion polls show a competing result between Yes and No. Exit supporters have accused the chancellor of scaremongering with the report. Their main claims for exit are to retrieve the sovereignty from the EU by leaving it and reduce the pressure from incoming immigrants. Prime Minister David Cameron by himself supports the remaining but even within the Conservative Party he leads there has been an active campaign by the Leave groups. Although there is a strong adverse wind blowing to the Remain group, including the continued threat of terrorism in the Continental Europe and reported tough going in the negotiations over the support to Greece, it is strongly desired that the British people make a sober and calm decision at the referendum..

Annual impact of leaving the EU on the UK after 15 years (difference from being in the EU)

	EEA	Negotiated bilateral agreement	WTO
GDP level (%) - central -	-3.8	-6.2	-7.5
GDP level (%)	-3.4～-4.3	-4.6～-7.8	-5.4～-9.5
GDP per capita - central -	- £ 1,100	- £ 1,800	- £ 2,100
GDP per capita	- £ 1,000～- £ 1,200	- £ 1,300～- £ 2,200	- £ 1,500～- £ 2,700
GDP per household - central -	- £ 2,600	- £ 4,300	- £ 5,200
GDP per household	- £ 2,400～- £ 2,900	- £ 3,200～- £ 5,400	- £ 3,700～- £ 6,600
Net impact on receipt	- £ 20billion	- £ 36billion	- £ 45billion

(Source) HM Treasury