Fudan School of Business Presentation

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An assessment of the Brexit argument

Not for publication without consent

A strange tale of British illusion and fantasy

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I Brexit – *nostalgia* and dreams versus economic reality

1. The claims made during the British Referendum campaign on remaining or leaving the EU (European Union) relied heavily on deliberate factual untruths and misrepresentations.[1] As a result of the Referendum decision – a narrow majority in favour of leaving - British citizens now face the prospect of leaving the largest developed and progressive single market in the world – possibly if not probably without a negotiated settlement.

2. The negotiations have so far only established that the other 27 members of the EU will not allow Britain to "cherry-pick" benefits. This has been established as a clear red line from the EU negotiating side. Britain must accept the *four pillars*[2] on which the single market *mutual* is based – or leave. The principles underpinning the *four pillars,* particularly those concerning free movement of labour[3] within the EU are sacrosanct. They will not be fundamentally modified to suit Britain. The halting of free movement of EU citizens into Britain which emerged as a source of concern during the Referendum is not negotiable. There is nothing of significance in-between - a reality which Britain will have to face.

3. Britain's Brexit negotiating position is heavily coloured by self delusion and *nostalgia* for a historic past - an observation clearly identified by the EU negotiating team. This has resulted in friction and difficulty over elementary points of negotiation. The position of the ruling Conservative government is seen widely to be flawed by its failure to set out a clear strategy on which it can credibly negotiate a fair and practical settlement.[4] Failure to reach a negotiated settlement – the so called *Hard Brexit* - will result in sustained long term economic damage.

II Blaming the EU for limiting Britain's capacity for growth

4. Negotiations have been overshadowed by a hostile "off-stage dialogue" which has sought to attack and misrepresent the EU. In particular *Brexiteers* blame the EU for Britain's social and economic setbacks. It is implied that the EU is the cause of poverty, joblessness and industrial decline in Britain's industrial heartlands. Specifically it is claimed that the recent weakness of the EU and the Euro zone in terms of economic performance has held back growth potential for Britain. These claims are not supported by the facts.

5. IMF statistics and their interpretation present a subtly different picture. In the period 1997 – 2006 Euro area GDP grew by an annual average rate of 2.3% with non-Euro Britain recording a 3.4% rate of growth over the same period. It needs to be remembered, however, that British growth in the same period was *turbo-charged* by an unsustainable expansion of unsafe credit and mortgage related securitisations in the run up to the global financial crisis of 2008. The EU played no role in this irresponsible credit boom. Austerity in Britain in the period since reflects the huge post financial crash bail-out of the British banking system.[5]

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[11] These untruths are documented facts. Their use as "part of the campaign" has, astonishingly, never been legally challenged.

[2] At the heart of the European Union sit four key principles: the free movement of goods, services, capital and labour. The "four freedoms" were enshrined in the 1957 Treaty of Rome and reinforced in the Single European Act in 1986, the 1992 Maastricht treaty and the Lisbon treaty of 2007.

[3] Though there are fair and reasonable governing access to tax-payer related benefits – an issue which seldom arises because non British EU citizens are in the vast majority of cases contributors to GDP, and not claimants.

[4] The British negotiating team have refused to offer realistic if negotiable terms for financial settlement estimated to be of the order of £50bn. This settlement will cover such things as collective pension commitments and other major inter EU projects.

[5] This is estimated to have exceeded £100bn.

III The economic impact of the global financial crisis

6. In the period 2007 – 2016 EU and Euro area growth weakened in the wake of the Wall Street-made financial crisis. In this period the EU and the Euro area had to address the damage caused by misselling by Wall Street firms of a range of securitised products including the notorious MBSs (mortgage–backed securities). European financial institutions – Britain apart[6] - originated none of these financial products – they only invested in them. Growth in the Euro area fell back in consequence yielding an anaemic 0.3% annual average rate of growth. As British banks addressed the huge task of contracting their overblown balance sheets British economic performance weakened. GDP fell back sharply to record a stronger 1.1% annual average rate of growth over the same period. The bank bail-outs inevitably triggered a sharp deterioration of public finances throughout the EU and the Euro area with economic growth markedly lower for the OECD as a whole.

7. Austerity and other forms of *restructuring* within the EU and the Euro zone have their parallels in Britain. The Conservative government has relied entirely on *austerity* in a bid to *stabilise* the economy. The EU and the Euro zone has been singled out as the *cause* of current British austerity which will be put into reverse once exit has been achieved. There is absolutely no evidence to support this. But the current economic picture reveals some striking differences.[7] The British economy is now weakening according to the IMF as Brexit looms whilst the EU and the Euro zone are recovering strongly. Britain has recorded a rather slower 1.7% annualised rate of growth in Q2 2017 compared with a more confident 2.3% gain in the same quarter for the Euro zone. Brexit will further weaken growth and worsen the state of Britain's public finances.

IV Post-Brexit economic renaissance – an assessment of fundamentals

7. Inaccurate representations of Brexit statistics on payments to and from the EU have been used to promote a fantasy that more will be available to support British public services once Britain leaves. These are designed underpin the argument that Britain will enjoy a period of economic renaissance. The gross annual figure of £13.1bn in payments to the EU in 2016 ignores the fact that around 40% (or £4.5bn) of that sum in any case returned to Britain in 2016. These EU *claw-back* payments take the form of support grants for agricultural, regional, social and economic development, university research and other private sector support.

8. This support will not be provided by a post Brexit Conservative cost-cutting government faced with huge additional pressures on public finances. The current budget balance at -3.3% is one of the highest in the OECD. It is forecast to rise further if growth and tax revenues weaken further. The balance of funds - £8.6bn - paid by Britain contributes to the operation of EU institutions and project support elsewhere within the EU. These projects are designed to promote EU wide economic development and shared prosperity. The impact of Brexit on the EU will therefore be damaging though undoubtedly more so for Britain.

V The Brexiteers promise a land of milk and honey

9. Britain, unshackled from budget and single market obligations, will grow and prosper – so the claim goes. The chronic and worsening balance of trade with the EU and the rest of

[6] CDMs (collateralised debt obligations or similar) which were extensively used by Northern Rock a British bank which failed when the LIBOR markets froze in 2008. Northern Rock was subsequently nationalised.

[7] Data is constantly changing. In the British case, however, key indicators of performance such as retail sales, residential house sales and private sector investment have all trending lower in 2017.

the world will magically disappear. How this will happen is never explained. The worsening trade deficit is a reflection of Britain's relative weakness in terms of productivity and comparative advantage. There are no *anti British* EU rules which cause this. The suggestion of trade unfairness or bias against British interests is without foundation. It is aimed at defaming the EU.

10. British citizens are told that current falling value of the pound will open new opportunities for *import substitution* which will thrive once Brexit is achieved. No mention is made of the impact on inflation as the price of imported good rise and ultimately the impact on rising interest rates on investment and growth. There is no recognition of the long decline of British industry and British exports during the post war years driven by *financial short-termism* and *de-industrialisation.*

11. Britain's great exporting industries have been in steady decline. In 2016 the country accounted for 2.5% of global trade compared with 25% in 1950. How these long term trends will be reversed is not explained. No mention is made of the long term failure of British financial institutions to provide adequate patient capital to ensure that British firms can innovate and remain competitive The British economy is heavily skewed and reliant on London-based financial services at the expense of manufacturing and other industrial activity. The import substitution claims predicated on Brexit cannot be credibly argued or substantiated.

VI Where does the balance of the argument realistically lie?

12. There is little doubt that Britain is far better off "in" the EU than "out". The lessons of history need to be remembered. In 1974 the then Conservative Prime Minister Edward Heath decided to seek membership of the EU after several earlier re-buffs.[8] He did so in the passionate conviction that this would fundamentally alter British poor economic prospects - "the sick man of Europe" as Britain was then referred to - for the better. Have things changed as he hoped they would.[9]

13. Britain's membership has brought with it very significant benefits, which have not been debated or even recognised. British economic under-performance has attracted very large volumes of FDI (foreign direct investment) – the largest of any OECD country. This has greatly improved industrial productivity and strengthened industry-university networks, supply chains, industrial *clusters* and innovation. What once flowed strongly into Britain because of its EU membership will inevitably move elsewhere after Brexit. The recent and on-going dispute between Boeing (American) and Bombardier (Canadian) both of which have manufacturing subsidiaries in Britain is a portend of likely future difficulties if Britain leaves the EU. The moves by Airbus Industrie – a European public corporation with subsidiaries in Britain - in challenging Boeing's actions is key to understanding the balance of economic power in a key high-tech sector of economic activity. Economic growth will

[8] In 1963, De Gaulle vetoed the British application to join the EEC declaring: "*l'Angleterre, ce n'est plus grand chose*" ("England is no big thing"). From this moment on, British efforts to join the EEC intensified. The French assessment nevertheless represents a deep understanding of the reality that Britain the lacked the political will that the French saw as being vital in building a strong social market economy in Europe.

[9] Debates and decisions about the EU in Britain have historically been dictated by short-term desires for electoral success and immediate economic gain. This is strikingly illustrated by comments made by David Cameron (the then Prime Minister) in 2016 whilst in office. Cameron's vision of the EU has always been depressingly limited. His ambition for it amounts to little more than expanding the EU as a "consumer market" to the exclusion of wider citizen-driven social market ambitions.

weaken, inflation and interest rates will rise - along with unemployment – with investment declining.

VII The end of the FDI bonanza

14. A legitimate fear is that "the goose that lays the golden eggs" will go elsewhere. This needs to be put in context. The long term decline of Britain's domestic industrial base has stimulated a spectacular inflow of FDI (foreign direct investment). In the period 2010 to 2015 non-British ownership of companies has risen dramatically in value from around £168bn to in excess of £1tr currently.[10] This has come from non-British owned or domiciled companies seeing Britain as a *soft* entry point into EU markets. It includes well known multinational companies like Nissan, Toyota, Honda, (Japanese) BMW, Volkswagen both German (autos), Thyssen Krupp, (German), Tata, (Indian) autos and specialist steels Boeing, (American) (aerospace) – and food manufactures Nestle (Swiss), General Mills and Kraft (American) amongst many others.

15. Significantly Airbus Industrie, a European aerospace company, a major force in the global civil aircraft industry with several subsidiary plants in the UK will almost certainly migrate back to the EU in the event of Brexit. Elsewhere Siemens (German), Hitachi (Japan) and Bombardier (Canada) are constructors of railway units and related infrastructure along with aircraft wings will be adversely impacted by any interference in supply chains. The major foreign-owned car manufacturing plants in Britain including the French controlled Nissan –a Japanese car manufacturer - have made it clear that their business operations will be serious damaged if membership of the single market and the customs union is adversely affected by Brexit. The writing is clearly on the wall![11]

VIII Why have these businesses migrated to Britain?

16. The EU single market connection is the key factor which explains these movements of capital. First there are important gaps in the British market which can easily be exploited because local competition is not strong. Second British owners and investors have been keen to sell out. Third British membership of the EU guarantees access to the single market. The consequences of Brexit will cause those firms who trade into on the single market and depend upon British membership of the customs union to leave.

17. Elsewhere there is a huge pent-up demand in the British economy for improvements in infrastructure (of all types) including power stations the railway network and the road system. Britain will depend critically on technical, financial and skilled manpower support in the realisation of these projects at the moment it seeks to leave the EU.[12] Immigration of EU citizens into Britain is viewed as a major socio political concern with demands for strict caps on future inward migration. This is widely viewed as unattainable given the scale of "skills and attitude shortages" in Britain and the pressing needs of the NHS (National Health Service), and the agricultural and hospitality industries.

XI The pervasive myth of sovereignty

[10] Though "stock" and "flow" cannot be directly compared this capital stock figure represents a significant proportion if compared with current British GDP of £1.82tr.

[11] These companies are not only concerned about trading opportunities into the EU they will be adversely affected by shifts and reorganisations of supply chains in the post Brexit period.

[12] The examples of the Hinckley Point nuclear power station project and the planned high speed rail network are examples of skill and capital vulnerability.

18. Few myths have exercised as much power over the British imagination as the Red Banner tabloid[13] rendition of the fairytale of *sovereignty.* By *taking back control* the man-in the-street is promised that Brexit will return sovereignty to the British people. Once again laws will be made by the British Parliament implying that laws are passed elsewhere in the EU and forced upon the helpless, unwilling British people. The myth is without foundation. The British government is consulted through its membership of the EU Council of Ministers (and Heads of State). It is actively involved at every stage in the process of EU-wide law making.

19. This is defined strictly by the principle of *subsidiarity* which ensures the primacy of the *bottom-up* relationship between the EU and its member states. The European Parliament which represents all citizens of the EU debates and deliberates upon these EU matters. Nothing is imposed on anyone. The British Parliament – like Parliaments in other EU countries - debate domestic policy and pass laws on the basis of majority voting.

20. But there is another aspect of the sovereignty argument. The scale of *internationalisation* of the British economy – in significant measure a consequence of domestic economic weakness not strength - means that a very large proportion of British industrial activity is produced by entities which are domiciled and controlled from outside Britain. As British registered subsidiaries they are subject to British corporate and commercial law but the locus of their ownership and power lies elsewhere. The British government has limited *soft* power over the management of these businesses. Decisions are not taken in Britain. How, one is bound to ask, do these facts affect the sovereignty argument?

X The source of the illusion of sovereignty

21. Nostalgia and the imperial past is a deep and enduring current in British life and culture. It fuels in a very fundamental way the illusion of sovereignty. As it has already been reported – sovereignty is a concept that has changed in very fundamental ways for all countries over the past three quarters of a century. Apart from shared post Second World War duties and obligations deriving from multilateral commitments the globalisation of the world economy has transformed conceptions of sovereignty. It is hard to understand, specifically, how the British people can speak of sovereignty in the context of these developments. Very specifically it is hard to understand the attachment to purest concepts of sovereignty when so much of Britain's industrial base is controlled by corporations headquartered outside Britain.

22. Looking more widely Britain operates in a globally inter-connected world. The *rules of the game* are set by international intergovernmental institutions and treaties, by global corporate institutions and their supply chains. Parliamentary sovereignty has been fundamentally re-shaped everywhere. The norms of sovereignty have fundamentally changed. The idea of *taking back control* is delusional. Within the EU there are natural safeguards which have the effect of protecting the sovereign concerns the Brexiteers speak about. The deep economic and political underpinnings of the EU – the four pillars of the single market are an example - are the best protection the British people have from the vagaries of *footloose-here-today-gone-tomorrow* globalised capitalism. But the force of this argument is entirely ignored in discussions about national sovereignty.

XI Trade deals, the EU and the Britain - the facts

[13] This is a reference to the powerful "little Englander" political "grip" of the popular lower class press.

23. British business benefit from easy uncomplicated access to the single EU market of 500 million consumers – the largest in value in the world. The EU facilitates trade further afield with deals providing preferential access for EU members to many global markets. British business benefits from being able to trade easily within the single market and also with many other countries. The EU is the top trading partner for 80 countries compared with 20 for the US.

24. Brexiteers argue, fancifully, that the UK would be able to significantly increase access to global markets with no explanation as to how this could possibly be achieved. Switzerland – commonly cited as a country the UK should look to emulate – has far more limited success in terms of trade deals which are negotiated through the European Free Trade Association (EFTA). As a member of the EU Britain doesn't just benefit from more deals but also from better quality deals as member of a partnership of 28 countries. EU trade deals are regarded as the Gold Standard in terms of Social, Environmental and Health & Safety safeguards.[14]

25. With the weight of a 500 million person market, the EU can negotiate better deals for member states – more comprehensive in scope than those signed by countries outside the EU. The EU-South Korea deal is a good example of this, scrapping almost 99% of tariffs in just 5 years and including far-reaching liberalisation of trade in services. The South Korea-Australia trade deal in comparison will take almost 20 years to reach the same level of tariff reduction. Britain benefits from preferential access to many global markets and should be urging the EU to go further faster. There has been progress, with deals concluded with Singapore, Ecuador, Canada and Vietnam and agreement to start negotiations with New Zealand and Australia now under way. The EU needs to put greater effort into extending trade deals. But the evidence of benefit to Britain is overwhelming. The EU and its trade deals currently account for 60% of UK trade. This are expected to rise to 88% if all trade deals currently under negotiation are completed and Britain remains in the EU. There can be no serious doubt: Britain is definitely better in the EU than out.

XII Fantasy and xenophobia

26. Anti-European sentiment in Britain driving Brexit has two principal strands. The first strand is a fundamentally xenophobic in nature. It is fuelled by a powerful distain that British leadership elites are obliged to take part in a continuing process in which Britain is required to reach consensus with other members of the EU in the formulation of EU policy and legislation. The British elites are no longer *telling others what to do* but are expected to debate and reach *collective decisions* with their partners about these matters. *Taking back control* is thus a short hand for saying that the British want to be free from these constraints. The elites alone will settle these matters because it is an historic habit to do these things over the centuries. These sentiments, with no foundation in modern reality, have strongly shaped the Brexit mind set.

27. A second powerful anti-European sentiment derives from the *forgotten* generation of mainly working class voters who feel that they have been betrayed by *those in power*. The betrayers have been relentlessly portrayed in the Red Banner tabloid newspapers – lower class but widely read – as the European *foreigners* - at our gate if not within our midst.

[14] The EU has developed wide ranging protections for its own citizens and citizens in other countries in the negotiation of trade deals. It has confronted multinational enterprises over a wide range of trade and trade-related matters. These include food standards, tax avoidance and the domination and manipulation of specific markets. Microsoft, Google and Monsanto and Pharma are examples where the EU has challenged the power of multinational corporations.

Immigration has thus become a powerful and deeply disturbing political force. The effect has been to deflect attention away from the clear failures of British economic and social policy over many decades. The unemployed poor of many parts of Britain but most notably in the northern crumbling British townships have no sense of *belonging.* The EU has been singled out as the creator of their poverty and lost status. The reality is false. EU institutions have created vital protections for citizens throughout the whole of the EU. Directives on Employment and related Social Rights including the Environment are examples. Yet these matters have been wilfully concealed in the debate.

XIII What of the EU and its future – a final thought

28. The EU and the Euro area are far from perfect as man-made institutions. There is much further work to be done if the objectives of the social market economy are to be advanced. But the honest assessment must be that the EU reflects a fundamental realism about how best the European region and its people can best manage the complex economic, social and political global environment in which it operates. Its achievements - across a wide front - have been impressive but not flawless. It has however brought greater economic and political benefits to many millions of EU citizens.

29. Time for Britain to wake up to the reality of its place in the world. It could choose to play a much more positive role in strengthening the EU from within. It has instead chosen to pursue a course of self harm whilst destabilising the EU. Time for Britain invest its talent and focus its energy on helping to build a better and more secure place for all citizens of the EU. The vision of a unified Europe is the right vision. Britain should ensure that it plays its part in progressing this worthwhile project – not abandoning it for mostly fanciful ideological reasons.

XIV Major unresolved Brexit issues

30. Britain faces a number of major challenges which have yet to be addressed. The financial obligations of the divorce settlement for the EU have yet to be crystallised. Nothing will move forward until definite progress has been made on this front. The rights of all EU Citizens in Britain and how these will be honoured also needs to be agreed. Likewise reciprocal rights for British Citizens living and/or working in the EU will have to be agreed. These negotiations will need to take account of the serious skill shortages in Britain if essential services are to be maintained. The particular problems of the British NHS and shortages of senior medical experts and nurses many of which are met by citizens from other EU countries will have to be addressed. The unique problem of the British farming industry which relies heavily on seasonal workers from the EU to harvest the land presents a serious challenge to British farmers. The loss of financial support to British agriculture from the (CAP) the Common Agricultural Policy will need to be addressed. The British government will finally have to accept that these matters will be subject to the continuing scrutiny of the ECJ (European Courts of Justice).

31. There remains also the intractable problem of Northern Ireland and the Good Friday Peace Accord. The erection of a border between North and Southern Ireland (the Irish Republic which is a member of the EU) will be illegal under the Good Friday agreement. There is no credible evidence that this can be resolved: the two economies are closely integrated through supply chains.[15] A likely Scottish Referendum on it remaining part of the

[15] One possible outturn is that Northern Ireland may, through Referendum, seek to join the Irish Republic and terminate its membership of the United Kingdom

United Kingdom if the huge challenges of Brexit are not satisfactorily resolved will certainly re-surface. Finally it is fanciful to believe that Britain will be able to negotiate and agree free trade agreements with other countries. The “transitional arrangements” it seeks with the EU and access to the Single Market and the Customs Union will automatically delay the launch of parallel free trade negotiations with other countries.

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Key economic facts and figures on the British Economy 2016

All in current value US dollars and British Pounds

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Total Imports	**$707bn**	**£548bn**
EU Exports	**$287.6bn**	**£223bn**
EU Imports	**$375.3bn**	**£291bn**
Non EU Exports	**$372bn**	**£288bn**
Non EU Imports	**$331.5bn**	**£257bn**

Key inferences – the EU is the biggest single market for British exports. Brexit will threaten a significant proportion of exports if a "soft" Brexit is not secured. Prospects for a soft Brexit are low - less than 5%

"Soft" means – retaining access to the Single Market which entails recognition of the four pillars

"Hard" – means reverting to basic WTO terms which would entail tariffs against British exports but nobody is yet sure of how damaging these might be.

MFN (most favoured nations) principles would prevent the EU from enforcing disproportionate tariffs against Britain.

A more serious issue is likely to be disruption to British exports to Europe which would be subject to customs scrutiny and delays

Population 65.64m

Per Capita Income $42,651

Government Debt 123.2% of GDP

Household Debt 152.5% of GDP

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