



Brexit Fears Already Hurting United Kingdom

Adam S. Posen says political haggling over Britain's role in the European Union is already hurting confidence in the UK economy.

Unedited transcript of interview recorded February 22, 2016. © Peterson Institute for International Economics.

Pedro da Costa: I'm Pedro da Costa, editorial fellow here at the Peterson Institute for International Economics and I'm joined by our president, Adam Posen, and we're talking about Brexit. Let's talk about the impetus for this whole debate. There have been so many exits that we've talked about. There's been Scottish independence, Catalonia, Greece and now Brexit is the latest term de jour. What's the real political driving force behind it within Britain?

Adam Posen: I think within Britain, there's two forces. There's an understandable one that the UK populace, a lot of them have always been a little scared of too much centralization in Europe. When they signed up for the European Union, they wanted it as a union of member states and not as an ever-closer union. And so, there's always been some pushback from a lot of British about the concentration of power.

But there's also an uglier and frankly more self-destructive side of late, which is concocting all kinds of fantasies about if the UK left the EU that in some sense, their economy would be unshackled, they wouldn't have so many poor immigrants taking their benefits, they wouldn't be subject to terrible regulations, they wouldn't be forced to open their borders in various ways. All of which frankly is nonsense. And it's just pandering to the same kind of ugliness as Donald Trump in this country.

So, there's both a longstanding understanding of Britain of not wanting to be part of a centralized Europe and then the more recent ugly sort of nationalism.

Pedro da Costa: Got it. So there's the technocratic opposition and the nationalistic one. And so, what are the benefits that the proponents say that they would get and what do you see is the potential cost of an exit from the EU and how is it different from exiting a currency versus exiting the EU, if you can make that distinction?

Adam Posen: Well, I think it's an important distinction to make that people talk a lot about the euro, and the euro has obviously not had a very good run of it lately, but the UK is not part of the euro. The UK has an independent monetary policy. It has the pound, not the euro. So that's not really the issue.

The issue in the EU is the combination of political and economic laws that the EU constitutes. And, the premise, the reason why even Margaret Thatcher 30 years ago was in favor of the UK being part of the EU was that that meant the UK was part of a larger block economically, that it could negotiate trade deals. It wasn't just the UK. It was the UK plus Germany plus France plus Italy, and you could really get advantages.

It was also in foreign policy that they could so-called punch above their weight because

Britain would be a leading role in EU foreign policy but would get to speak for a broader union. And on the narrow economics, it was about breaking down barriers within the single market so that you could have services and goods flowing freely across Western Europe.

The intellectual argument, such as it is, for Brexit on the economic side is that Brussels has actually become a place that puts out lots of bad regulations, crazy regulations about what can be labeled a sausage and what can't be labeled a sausage, what people can do, how many hours they can work. And increasingly, the concern lately has been that low-skilled or low-wage workers from other parts of Europe can come into the UK, vote, collect benefits, and so on.

Pedro da Costa: And we have the crisis in Calais perhaps as a very...

Adam Posen: It's a very vivid illustration of that kind of thing. Now, this is completely wrong on its head. It's sort of similar to in the US again when everybody says, "Oh, it's red tape in Washington that's killing the US economy." Well, the fact is, in Europe, productivity growth in the UK has been much lower than many other European economies, including Spain and Germany, and Ireland. All of which are more constrained by the EU than the UK, which has lots of opt-outs in single areas. And so, the idea that somehow the EU is the barrier to British productivity is just false.

Similarly in the migration issue, it's not even a question of they don't understand the issue. It's they miss the point. Part of the strength of the UK economy for the last 15 years has been lots of immigrants coming from Europe and not just poor Europe. I mean, there are 700,000 French people working in the UK; some in hospitality, some in financial services. There's been Polish people, there's been all kinds of people and this is added on that to UK growth and help balance the UK budget. So, it's a lot of fantasies. In the background...

Pedro da Costa: So the exit would reverse all these benefits presumably.

Adam Posen: Well, it would certainly get in the way of them and it's not clear what you would gain. There is this fantasy that you would not have all these regulations and everything would be wonderful. There's even stronger versions of the fantasy put out there by people like Neil Ferguson that you would change the EU, the Northern Europeans, like the Germans and Swedish would get together with the UK and turn the EU into some sort of libertarian fantasyland. And sorry to keep using the word fantasy, but it really is. It's just nonsensical thinking.

And instead, what's going to happen is if the UK were to go out, they would lose all the additional bargaining power they get by being part of a larger group. They would still have to meet all kinds of EU standards if they wanted to trade with the EU. They want to export anything to the EU. And frankly, if they don't export to the EU, they're in huge trouble. And they would cut off the source of all this talented labor that comes their way.

Pedro da Costa: As a former member of the Bank of England, how would this impact the UK economy? Is it impossible to estimate the hit from Brexit because it is just too uncertain? And what also would be the implications for monetary policy? The Bank of England of course has been hinting a rate hikes since 2014 and they've never come. And so if there was a further

weakening in the economy presumably that would have implications for rates as well.

Adam Posen: You're absolutely right to raise this. But what I think the way to think about this is, Pedro, we should think about it as a self-induced financial crisis or self-inflicted wound. So, what's going to happen, and we're already seeing this in the volatility data, in the stocks, in the interest rate spreads, is that there's going to be all kinds of people who say, "Money in UK is riskier than it once was." Whether it's British or foreigners, they're going to say, "Ha, maybe Tata or Toyota or whoever is going to be less likely to keep their investment here instead of in Ireland or Spain if they're not part of the EU." Maybe there's going to be more volatility because the government in the UK will be untethered and can do all kinds of strange things.

Pedro da Costa: Yeah.

Adam Posen: And so, what's likely to happen, and we've seen this—there aren't many examples similar to Brexit—but we've seen this when countries sort of opt out of integration, what you usually get is a run-up in volatility, a weakening of the currency, and as a result the central bank has no choice but to raise interest rates hugely.

And so, at a minimum, you would expect this to induce a lot of uncertainty in financial volatility ahead of the Brexit. And if it occurred, you would probably see very high interest rates, a fall in the currency, a lot of inflation and a recession. And, whatever you think is going to be the benefits of Brexit, the cost of that recession is going to way outweigh them.

Pedro da Costa: And the recent crisis probably gives us a certain hint of that.

Adam Posen: You're right.

Pedro da Costa: Thank you so much, Adam. I appreciate your time.

Adam Posen: Thanks for having me.

