



Brexit Sets Dangerous Precedent

Adam S. Posen says the United Kingdom's decision to sever ties with the European Union will hurt the economy and could have frightening implications for rising anti-immigrant populism around the world.

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Pedro da Costa: Hi, I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics. I'm joined by Institute President, Adam Posen, and former member of the Bank of England, very relevantly this morning since we're here to talk about the Brexit vote.

So first of all, what's your immediate gut reaction to the vote and what do you see as the near-term economic implications both for the United Kingdom and for the global economy?

Adam Posen: Well, Pedro, like any reasonable economist, I'm very saddened by the vote because the great consensus was and rightly that this is going to be very damaging to the UK and potentially quite damaging to Europe. For the UK, this creates enormous uncertainty, but it also is a fundamental change in their competitiveness. And I don't think even the very large fall in the pound sterling that we've seen will be enough to make up for that.

I mean they had a role in Europe both as a financial center and almost more importantly as sort of a beachhead for foreign companies, in particular US companies, wanting to export into Europe. And that's frankly going to go away not entirely, but a lot more and a lot faster than many people seemed to think.

Pedro da Costa: We've seen a little bit of immediate reaction.

Adam Posen: Absolutely.

Pedro da Costa: All those from Ford and Tata, right?

Adam Posen: Tata and others. I mean I called it a few days ago saying how the auto industry there is going to go away, not that it's a huge employment, but it matters.

Pedro da Costa: Sure.

Adam Posen: If Tata is a choice of which steel and steel plants to close in the world given the huge surplus in steel, no point in keeping open the ones that don't have direct access to Europe. That decision is going to be made by a lot of people. We've seen bank stocks of British-based banks take a huge hit. As our colleague, Nicolas Véron, has pointed out among others, roughly 30 percent of British banks' business was doing things in euro-denominated clearing. And that will shift back to Europe once UK is out as a single market.

I mean it's going to be bad but also just huge uncertainty over what the nature of the relationship is going to be. We've seen it. We've seen a collapse in housing investment and

business investment in the UK over the last month or so as people realized they might lose the vote. And again, I expect that to continue.

Pedro da Costa: And so as far as what policymakers can and should do, of course this morning, the Bank of England Mark Carney came out with words of reassurance. And he said that the Bank of England stands ready to act. But as you've pointed out in the past, this puts the Bank of England in a difficult position particularly if sterling continues to fall as it has at this point. Could you explain how that works?

Adam Posen: Yeah. I think governor Carney and the Bank said the right things in both what they said and what they didn't say. So, the part that they said affirmatively which was right is if there was some kind of panic or people wanting to get out of the pound or out of British banks, there was plenty of liquidity that foreign currency would be made available. There's no reason for people to panic.

And that as we've argued here from the Institute, there are exceptions. But the world's banking system and the British banking system specifically is much less leveraged, much better capitalized, much better monitored than it was 10 years ago. And so for those reasons, it's right for Governor Carney and the Bank of England to send out a reassuring message.

But notably, he did not say we're going to cut rates. We're going to stimulate. We're going to do that. Because I think, rightly, he wants to be careful about the timing, but more importantly the direction. Normally, you have a recession in the economy and inflation as well. The Central bank acts to offset it. It cuts rates. Well, you got two things working against that right now.

The first is this really big drop in the pound, which I think will be sustained. I think it's a legitimate revaluation down of the pound, is likely to have big inflationary effects. And with so much uncertainty about the British economic policy and politics going forward, the Bank of England may feel it has to raise rates to counteract those inflationary effects in a way that in normal times, absent Brexit, they could say like they did in 2008, "Well, it's a big shift, but it's not going to keep going."

The second thing that, of course, concerns the Bank of England is the same thing that constrains European Central Bank, Swiss National Bank, the Bank of Japan, to a lesser degree the Fed, which is you're basically at zero interest rates. I mean they're above zero. They can cut a bit. But normally if you have a recession, you want to do something equivalent to rate kind of 200 or 400 basis points. And they don't have that much room. They can do more QE as my colleague Joseph Gagnon and I have argued. But they would have to do an awful lot to make up for what 200 or 400 basis points of cuts would be.

And then the exchange rate will partially offset and cushion the blow. I mean that's part of the reason the Bank of England has to wait and see what happens. But I also believe since the exchange rate fall is really driven by real factors this time I'm not sure it's going to do that much good.

Pedro da Costa: Yeah. Could you talk a little bit about the political and geopolitical implications of this move? Of course, this is thoroughly unexpected and it was welcomed in quarters far and

wide by the sort of nascent populist right that we're seeing in many countries including the United States. Could you talk about the implications of the vote for the momentum there?

Adam Posen: I think it is very frightening because it's an analogy I used before the vote which, I think, unfortunately is valid, which is, you had Mussolini come to power with the fascists in 1920s Italy. And he did some nasty things, but he didn't do what we all now recognize was terrible. And so that gave some legitimacy to frankly -- explicitly to Hitler's election campaigns in 1930 and 1933 that (a) you could vote for such a person, (b) that such a person had a chance of winning, and (c) that at least it seemed initially that wouldn't be the end of the world if you voted for that

And so I fear that this success in electoral terms for the lead campaign in Britain will create similar sort of legitimization for whether it's Marine Le Pen and the Front National in France which is a racist anti-Europe movement. Their counterparts in Poland and Hungary, the horrible people in Greece who were beating up foreigners, and then, of course, for some of the supporters of Mr. Trump in the US.

I think the other piece that has to be seen is there are a lot of people saying, "Ha! We showed the experts. We showed the elites. We showed the establishment." In literal terms, of course, Democrats, not Party Democrats, people in democratic societies have the right to say I don't want to listen to you, have the right to make their decisions, but they also therefore have the right to be wrong. And this is, to me, is a very tragic event because a lot of the votes were driven by not just disregard for the economics. That's their choice. But by what we call nativism that it's my ethnicity, my nationality, little England, not big UK, not Europe.

Pedro da Costa: Britain first.

Adam Posen: Britain first which is code as we know for a lot of things that for some people it's outright racism, for other people it's intolerance, for other people it's just resistance to change. Again, they're allowed, but we shouldn't pretend that just because they voted for it it's a good thing. It's a very bad thing.

Pedro da Costa: Sure. And there are also even implications for the United Kingdom itself, right?

Adam Posen: Yeah.

Pedro da Costa: Our colleague, Jacob Kirkegaard, was arguing that it might not hold together in a ten-year time span. How would that come apart?

Adam Posen: I think a lot of people recognize that. But Jacob deserves credit for being out in front and pointing out that a particular source of problem is the border between Northern Ireland and Ireland. That you've had an incredibly porous border as it should be to allow for the peace process in Ireland or the peace settlement and to allow the Northern Irish people to feel both part of the UK, but tied to Ireland.

That's now going to have to become a real border. And that's not only going to have big economic effects on a lot of people including most of Northern Ireland people who are very poor. But it will disrupt the political settlement. And we've seen [inaudible 0:08:42] come

out and say this means we got to reopen the question of unifying Ireland. We know in Scotland the First Minister has come out and said this reopens the question of referendum for Scottish independence because Scotland voted enormously to stay in the EU and was overwhelmed by the votes in Middle England.

The UK can't really hold together if once you go down this road of saying I'm here for my own little narrowly defined ethnicity and locality. It is a United Kingdom of four nations. And you go down that route both in practical economic terms putting pressure on you, but also political principle. It's not going to hold. This is -- this is really sad.

Pedro da Costa: Yeah. And lastly but importantly, I wanted to ask you about the practical implications. I mean, I think, people are very worried within Europe and outside people with family there. How is this going to affect travel and visas and working arrangements? Do you think it will be a slow kind of drip for figuring out how this is going to work?

Adam Posen: I think in some ways it's going to be a slow drip for your standard American tourist or even for your standard European visitor to the UK. It's not going to change because the UK has been outside of the so-called Schengen Agreement. You show a passport to get in and out.

But for the literally millions of people who either are European Union migrants living and working in the UK or working part-time being employed by companies that have relations with the UK and just people who have made their lives there, this is going to create huge uncertainty.

And again, it is similar in scary ways, although I hope far less so than the Trump statements about Mexican-Americans and others and people undocumented, but long-time resident people in the US. That if you really want to push this policy you're going to have to send incredibly intrusive police around and military around rousting human beings out of long-standing familial relationships and economic relationships part in society on a very large scale.

I am not expecting the UK to do that. But I do think that the fear of that kind of thing until this gets resolved for the couple million Europeans working in the UK is very real. And it's a very damaging effect not just on economics but on that society.

Pedro da Costa: Adam Posen, thank you so much for joining me on this momentous and somber morning.

Adam Posen: Very somber. Thank you, Pedro.

