ASSESSING THE ECONOMIC IMPLICATIONS OF BREXIT

EXECUTIVE SUMMARY
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The government has pledged to hold a referendum on whether Britain should remain a member of the EU by the end of 2017. Assuming a vote to leave, the government will face an intensive, time-constrained period of just two years in which to conclude a new deal covering trade and market access that will govern Britain’s relationship with the EU for, potentially, decades to come.

The implications of Brexit for the UK economy, business and consumers could be substantial and far-reaching. The possibilities for what kind of a trade deal the government manages to cut are many and varied, but regardless, in the event of Brexit, whichever trade settlement is adopted and whichever scenario comes to pass, there will be a long-term structural impact on the UK and EU economies. Britain is the Union’s second largest economy and almost half of all its overseas investment comes from the EU, as do a similar proportion of its export revenues. As such, business and investment decisions will be affected over both the short and long term. Consumers and the Exchequer too will feel the impact—with the government also facing choices over how best to use funds repatriated as a result of having to no longer contribute to the EU budget.

This research presents a comprehensive, rigorous and impartial assessment of the scale and nature of the impact of Brexit on the UK economy. It explores a range of scenarios based around alternative assumptions regarding the trading relationship that could be eventually negotiated between the UK and the EU, and how the UK government might react to its new-found policy freedom—taking account of the impact of regulatory, migration and fiscal policy choices on economic conditions. The findings are based on a comprehensive modelling exercise using Oxford Economics’ Global Economic Model, the most widely used commercial model of its type in the world, with full analysis of nine potential scenarios.

The results of the research suggest that the economic risks and opportunities presented by EU withdrawal are strongly asymmetric. Certainly, although any upside effects appear to be limited and the worst-case scenarios are not catastrophic, they would impose a significant long-term cost on the UK economy. The worst-case scenario that we model is associated with a decline of almost 4 percent in real GDP compared to a baseline of continued EU membership.
Assessing the economic implications of Brexit

**Best-case:**
Rise in business investment of £2.4 bn

**Worst-case:**
Fall in business investment of £21.1 bn

Decisions made will be critical to determining businesses’ decisions over whether to invest and grow.

A second important finding is that the UK government’s subsequent policy response will be vital in determining the scale of the impact of Brexit. The government’s policy response could go in a number of directions, in relation to trade, migration, regulation and what to do with the fiscal windfall. Broadly, in the scenarios in which it adopts a more liberal, pro-business policy response—limited restrictions on the free movement of labour, more aggressive deregulation, a tax reduction agenda—the level of real GDP holds up better.

Regardless of the policy response, our results also indicate that the UK would be better off maintaining as close a trading relationship with the EU as possible. Scenarios in which the UK fails to agree some type of preferential trading arrangement with the EU lead to, on average, inferior economic outcomes. This comes despite the enhanced regulatory and fiscal freedom associated with this option.

Brexit, if badly managed, would impose significant costs on UK citizens and businesses. In the worst-case scenario, our results imply a loss of income per head of £1,027 by 2030 (in today’s prices). At the other end of the spectrum, the best-case of our modelled scenarios implies a small rise in income per head of £38 by 2030.

Across the board, all scenarios show a degree of trade destruction in which UK trade volumes fall as a share of GDP. This reflects the increased cost of trade between the UK and the EU, which, in turn, encourages firms and consumers, in both the UK and the rest of the EU to consume domestically-produced goods. The scale of the decline in both imports and exports varies markedly across scenarios, with exports falling by as much as 8.8 percent and imports by as much as 9.4 percent in the worst-case scenario, compared to a baseline of continued EU membership.

For businesses operating in the UK the impact on investment is marked. There is a very wide range of effects on business investment—in a worst-case scenario private sector business investment would be £21.1 billion (0.8 percent of GDP) lower in today’s money by 2030 compared to a baseline of continued EU membership. This is equivalent to each private sector organisation in the country investing over £4,000 less than it would otherwise have done. The extent to which investment declines broadly reflects how ‘business-friendly’ a given scenario is—where regulatory changes make domestic firms more competitive and migration controls are less stringent, investment holds up better.

Our modelling illustrates that the benefit that the government initially enjoys from the fiscal windfall could be a false economy. In all scenarios, the government receives an initial fiscal boost of up to 0.5 percent of GDP. However, in some scenarios the extra expenditure that this enables in the short-term is more than offset by the damage to the government’s revenue streams caused by worse demographics and lower productivity. In the worst-case scenario, the UK is forced to reduce spending by 1.7 percent of GDP by 2030—equivalent to half the fiscal tightening undertaken during the last Parliament.

How different business sectors are affected will be determined by both the trade settlement and the government’s policy response, but certain sectors are more at risk. In general, the industrial sector (excluding extraction) is subject to greater downside risks with manufacturing and construction suffering the largest average contraction. Among service sectors, our modelling suggests the financial services industry is most at risk.

Our modelling confirms that the economic implications of Brexit are much more significant for the UK than the rest of the world. Overall the impact on the rest of the EU is very modest. Ireland is found to be consistently the most vulnerable member state, reflecting its stronger trade and investment ties with the UK. Real GDP in Ireland is down by up to 2.2 percent compared to baseline in the worst-case scenario. Our modelling indicates that Ireland would be particularly vulnerable to the UK failing to sign any type of preferential trade deal and reverting to MFN status, irrespective of the UK’s subsequent policy response.

**Best-case:**
Rise of income per person of £40

**Worst-case:**
Fall of income per person of £1,000

This matters for the welfare of the UK population— income per head could fall by over £1,000 by 2030.
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