

## **Why Brexit?**

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### **Summary**

A lot of ink has been spilt on arguments about whether the UK should leave the European Union or remain. Academics, policy makers, business managers, farmers, the larger public and the media seem to be in turmoil over the issue. Since the referendum date has now been set for 23<sup>rd</sup> June 2016, the debate is likely to become even more intense. Although agriculture and rural development issues have not been part of the negotiations that UK Prime Minister, David Cameron, recently conducted with the EU member states, the prospect of Brexit is creating substantial anxiety amongst UK farmers, and also those concerned with rural economies and environments. However, the Brexit question clearly concerns the whole of the UK economy and society and beyond agriculture and the rural economy, there is a much bigger picture that must be considered. As academics we try always to consider the evidence, but the problem with Brexit is that evidence is either missing or speculative at best. Answers to whether the UK would be better off outside the European community are invariably "it depends". Considered as a real option, and given the uncertainty following a Brexit decision, a rational decision to leave can only be based on non-economic foundations.

## **Brexit, agriculture and rural areas**

Recently, several reports have focussed on the potential impact of Brexit on agriculture (e.g. Agra Europe (2015), the Farmer Scientist Network (2016), Buckwell's report for the Worshipful Company of Farmers (2016), and Matthews (2015, 2016)). Perhaps not surprisingly, all conclude that given the number of "unknowns" and the uncertainty that surrounds the 'in' or 'out' decision, the answer to the question as to how beneficial (or not) Brexit will be to the UK agri-food industry, agriculture and the rural economy more generally, is that "it all depends". It depends, critically, on the concomitant trade negotiations between the UK and EU and between the UK and the rest of the world, and on the international regulations which will necessarily be associated with these new trade agreements. Moreover, it depends on what kind of domestic agricultural and rural development policy (or policies across the four countries) would replace the EU Common Agricultural Policy (CAP). It is specifically the "fear of the unknown" and the government's lack of a "Plan B" for agriculture in the case of EU exit that make UK farmers and agribusinesses very anxious about the coming referendum (Farming News, 5 February 2016).

Under the CAP, UK farmers benefit from subsidies under both Pillar 1 and Pillar 2. In 2014, CAP payments allocated for UK agriculture and rural development accounted for £3.5 billion of which the majority (75%) was for Pillar 1 (direct aid and market support) (Farmer Scientist Network, 2016). Indeed, Pillar 1 subsidies in the form of Basic Payment (formerly Single Farm payment) are particularly important, with some types of farm (e.g. beef and sheep) heavily dependent on these subsidies, which on average account for 35-50 percent of their gross income. Some argue that without these subsidies most UK farmers would be forced to give up farming. For example, Gardner (2015) stresses that 'only the most efficient (top 10%) will be able to survive'. Moreover, withdrawal of direct payments would also lead to a reduction in the value of land which in turn may impoverish those farmers who use land as collateral for bank loans. However, Buckwell (2016) points out that caution is needed when considering such an analysis, as Gardener's study (2015) is based on a hypothetical scenario of total elimination of direct aid or a phasing out period of five years. Buckwell dismisses the idea that a British Agriculture Policy (BAP) would immediately and totally eliminate direct payments, but agrees that their form, the eligibility criteria and time-span would all need to be decided. He continues by arguing that 40 years of EU membership did not necessarily lead to an increase in UK agricultural output nor farmers' real income. Instead, CAP subsidies have become capitalised into land values and rents. Hence, the effects of Brexit on agricultural output and farmers' income may not be as severe as expected, at least in the medium and long-run.

Moreover, given that the CAP direct payments are de-coupled from production, it is more likely that the impact of any cuts in agricultural production will be relatively small, with production changes depending on the UK openness to trade with countries in the EU and beyond.

As with any policy changes there will be always winners and losers. Most of these effects may also be short-lived, but so far more complex analysis and modelling of the economic effects of agricultural subsidy removal are scarce. Boulanger and Philippidis (2015), apply a computable general equilibrium (CGE) model under the assumptions of nationalisation of the UK's payments to the EU, a free trade agreement with the EU and adoption of the existing EU external tariff on non-EU trade, shows that Brexit could contribute to a small UK real income gain (i.e. 0.6 percent of per capita GDP). However, this becomes a loss of 0.7 percent of UK per capita real income if trade costs increase because of the lack of single market access. More interestingly, Boulanger and Philippidis (2015:841) point out that in this case and if "only agri-food trade and (extrapolated) CAP budgetary implications" are considered, then withdrawing from the CAP budget (i.e. not paying CAP-type payments to UK farmers) "would be unequivocally beneficial to the UK". However, this is a simplistic and partial account of the implications of Brexit. Obviously the UK would be better off if it could avoid contributing to the costs of the CAP (and other EU membership fees), while continuing to benefit from free EU trade. But this scenario cannot be considered at all likely as access to the EU single market would not be allowed without continued agreement to the majority of the single market rules, and contributions.

The Farmer Scientific Network's report (2016) also assumes that direct payments will continue in their current form (of Basic Payment) but at a lower level than hitherto. Indeed, the report highlights that Pillar 1 rather than Pillar 2 payments are most likely to be subject to changes in the case of Brexit. The latter are conditional on "contractual arrangements which have a number of years to run" and "environmental and conservation lobbies are also likely to press hard for the retention of Pillar 2 (ibid: 12). Buckwell (2016) also supports the idea that most of the elements included under the rural development programmes will continue under a national policy. Clearly, in the absence of a national 'Plan B', nobody can predict how exactly what a British Agricultural Policy (BAP) would look like. Brexit maybe perceived by the UK Treasury as a good opportunity to reduce farm subsidies, forcing UK agriculture to become more competitive. However, as Buckwell (2016) notes, it is more likely that the details of a UK agricultural and rural policy will diverge across the devolved administrations of Scotland, Wales, Northern Ireland and England, as farmers across these countries would be

affected differently. Unfortunately, very little (if any) research has been carried out on how Brexit will affect rural businesses, beyond agriculture, or food consumers in general. Businesses which rely on seasonal labour, mostly provided by migrants from the new EU member states, have expressed alarm regarding Brexit. As most UK food is imported, consumers may end up paying higher or lower prices for their food, depending on the new trade agreements the UK would be able to negotiate. Consumers, in general, do not necessarily buy British products and they expect to have access to a full range of fresh agricultural products all year around. Some may argue that Brexit maybe an opportunity for the UK to increase its self-sufficiency in food, but Hubbard and Hubbard (2013) highlight the dependence of British agriculture on imported inputs. While there is also little doubt that UK agriculture would survive and could even prosper without support, the transition would be painful, and would impact on many farmers and related businesses in rural Britain. The likely outcome would be a phased introduction of a new UK farm policy (Buckwell, 2016) while any possible gains to the rest of the economy could only be realised both slowly and as least painfully as possible for those affected. However, the Brexit question clearly concerns the whole of the UK economy and society, with ramifications throughout Europe and beyond. Although much of the EU's budget (a third), and a considerable part of its activities and policies, directly concern agriculture and the rural areas, the issues and questions regarding Brexit extend far beyond these specifics. Hence "any voting decision has to take account of a much wider range of considerations" (Farmer Scientist Network, February 2016). What are the other major issues about Brexit?

### **Wider Brexit Issues**

The main elements of the exit debate and decision are: Trade, Regulation and Economic performance; Immigration; British Constitution; Influence. Since these are all inter-related in complex and only partially understood mechanisms and processes of socio-economic and political life, there are no simple answers. This paper addresses the first three.

The 'baseline' question is whether EU membership has already been good or bad for Britain's economic performance. The various answers cannot be considered as "facts" and are perhaps better termed as 'factions'. Two possible answers to the question are both positive. [The Confederation of Business Industry](#) suggests that the "net benefit of EU membership to the UK could be in the region of 4-5% of GDP or £62bn - £78bn a year, approximately the economies of the North East and Northern Ireland taken together."

[The Economist](#) (12.04.2014) reports research<sup>1</sup> which suggests that EU membership has boosted incomes in the UK by 25% since our entry, compared with the most probable counterfactual conditions (what would otherwise have happened).

*Trade, Regulation and Economic performance.* There are already some more or less coherent guesses about what the UK economy would be like outside the EU compared with what it might be if the decision will be to stay in. The critical factors involve:

- the trade deals the UK might be able to negotiate as an independent state versus those which will apply if we remain in the EU;
- the associated levels of regulation and intervention to which the UK therefore is obliged to subscribe;
- the consequences for inward investment in the UK.

The association between trade relations and regulation is critical: the UK manages to replicate its present trading status both within and outside the EU, the more it will have to subscribe to the regulations and protocols which these associations require, and *vice versa*.

[Open Europe's report](#) (2015) estimates that "UK GDP could be 2.2% lower in 2030 if Britain leaves the EU and fails to strike a deal with the EU or reverts into protectionism. In a best case scenario, under which the UK manages to enter into liberal trade arrangements with the EU and the rest of the world, whilst pursuing large-scale deregulation at home, Britain could be better off by 1.6% of GDP in 2030," most of which (1.3%) is estimated to come from decreased regulation. The report continues, "However, a far more realistic range is between a 0.8% permanent loss to GDP in 2030 and a 0.6% permanent gain in GDP in 2030, in scenarios where Britain mixes policy approaches."

There is no doubt that Open Europe has conducted its modelling of possible Brexit alternatives with care and diligence. However, the effects of the prolonged uncertainties during transition to UK independence, especially on investment (both domestic and inward) and hence on exchange rates and international financial markets, are not well enough understood to model or even project with any confidence, and hence have to be largely ignored. The Open Europe model projects "that the impact on FDI is not as significant as is often assumed" (p 81). This is not surprising, since their model is constrained by a fixed exchange rate – so capital inflows are required to balance any increase in the trade deficit. In reality, both exchange rates and capital inflows would adjust. More importantly, the model cannot capture the 'short term' transitional costs, especially of investment disruption.

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Yet these consequences will be critical, driving the pace and direction of adaptation, innovation and adjustment to the new conditions, and hence of critical importance for productivity and income growth. The benefits, on the other hand, stem very largely from the assumed reduction in regulations. Open Europe estimates, on the basis of Government assessments of regulatory costs, that the costliest 100 regulations impose a direct cost on the UK economy of £33.3bn/year (p. 54).

The most costly five of these regulations make up 57% of this total (£19bn), and are:

1. *The UK Renewable Energy Strategy* – Recurring cost: £4.7bn a year
2. *The CRD IV package (Bank regulation)* – Recurring cost: £4.6bn a year
3. *The Working Time Directive* – Recurring cost: £4.2bn a year
4. *The EU Climate and Energy Package* – Recurring cost: £3.4bn a year
5. *The Temporary Agency Workers Directive* – Recurring cost: £2.1bn a year

How many of these would any UK government be prepared to eliminate following Brexit? Counting the cost of regulation is only one part of the necessary judgement - there are also benefits of regulation to consider. Furthermore, Open Europe notes that, in the event that the post-Brexit trade agreements for the UK involve joining the European Economic Area (EAA), then 93 of these regulations would continue to apply. On this option, and with these important caveats in mind, it seems highly improbable that the UK can expect to be better off out. This is especially the case in the short term, during the prolonged uncertainty about the sort of post Brexit trade agreements we might be able to negotiate. These negotiations, and associated transition period could well be prolonged, and are unlikely to be concluded, even in principle, much before 2020.

The economic case for Brexit, as exemplified in the Open Europe report, relies heavily on the UK pursuing neo-liberal free market and de-regulation policies, so perhaps we might expect that most economists would expect Brexit to be a good thing for Britain. However, a report by [Chris Giles and Emily Cadman, FT, 03.01.2016](#), says: "There are few issues that unite UK economists but Brexit is one of them: they overwhelmingly believe [leaving the EU](#) is bad for the country's economic prospects. In the FT's annual poll of more than 100 leading thinkers, not one thought a vote for Brexit would enhance UK growth in 2016. Almost three-quarters thought leaving the EU would damage the country's medium-term outlook, nine times more than the eight per cent who thought the country would benefit from leaving. Less than 18 per cent thought it would make little difference." Perhaps these economists have more faith in the lessons of history than in the speculations about possible futures. Otherwise, they appear to be relying on the principles of economics, i.e. that trade and transactions costs both matter, so exiting from a customs union must necessarily increase the costs of trade

(and the costs of re-negotiation of trade relations), which can only damage economic performance, at least in the short term. The only offsets are a) the rather small budgetary transfers which might be avoided by Brexit, and b) the gains from de-regulation. The extent of the EU budget, and hence the necessary transfers, is fixed by treaty to be no more than 1.3% of GDP, and has been agreed to 2020 to be substantially less than this. Furthermore, there is already an [EU commitment](#) (European Commission, undated) to rationalizing regulation to improve the performance of the Single Market. Hence the potential gains to exit are necessarily limited. Perhaps more importantly, exit can only increase the uncertainty about future trade and investment relations, which increases the costs of business and trade, and reduces performance. The [Economist](#) (29.04.15), explaining why and how Britain might leave the EU, concludes: "What is clear, however, is that any referendum will invite a prolonged period of uncertainty, both before and (especially) after the event. That alone should create plenty of political and economic turmoil in Britain, regardless of the referendum vote itself." Exit would be a prolonged process of negotiation of terms, and re-negotiation of remaining and new agreements, during which time growth and prosperity could only be compromised, for all except lawyers and bureaucrats.

Oxford Economics (2016) has just published its own report on the consequences of Brexit, which concludes that in its best-case scenario (of nine) that the UK's GDP would be just 0.1% lower by 2030 and income per head could actually rise by £40. But the benign outcome would only be achieved if the Government did not cut European Union net migration substantially. The only rational conclusion is that the economic case for Brexit is highly uncertain, only marginal at the very best, and relies heavily on major de-regulation and reduced government intervention. At the least, this will require the enthusiastic endorsement of the population. Considered as a real option, a rational decision to leave has to be based on non-economic foundations.

*Immigration.* Perhaps the most disturbing feature of the Brexit debate (and vote) is the inevitable concatenation of immigration issues with those of the UK membership (or not) of the EU. This is exacerbated as Europe (as a whole, and including the UK) is currently severely challenged by the appalling refugee crisis stemming from the civil wars in the Middle East and North Africa. It is a clear moral and social responsibility of large, rich and relatively stable countries to do what they can to remove the causes of civil unrest and war in less fortunate countries, and to ease the burdens and improve the prospects of the refugees they generate. These responsibilities are independent of UK membership of the EU. Indeed, the UK capacity to deliver on these responsibilities is more likely to be enhanced through collaboration with EU partners.

It is also clear that rich and successful countries will unavoidably attract economic migrants, while economic depression, civil instability or tyranny, and poverty will inevitably drive people to seek better lives elsewhere. The only real surprise is that migrations are not far greater than they are, given the wide inequalities between countries. The cultural and social ties which bind us to our roots and our histories are clearly strong and only to be broken by the most extreme of circumstances, or by the most adventurous and, then, only those with the capacities and capabilities to move. By the same token, 'invasion' by foreigners and incomers is also typically resisted by most of us, whoever we are; the more so the less secure and the more threatened by economic and social circumstances we already feel. Terrorist incidents (as recently witnessed so starkly in Europe) can only exacerbate the distrust and fear, and stoke latent xenophobia. These fundamental forces will continue to operate regardless of the UK membership of the EU.

UK membership of the EU implies a general commitment to the free movement of labour (people) within the Union by citizens of member states. Within the Schengen area (not including the UK), the EU has gone further and dispensed with border controls or monitoring of such movement (although the refugee crisis is a major challenge for this agreement). There are currently 2.2 million Britons living in other EU countries, which more or less balances the 2.4 million EU citizens living the UK. The British mainly go to Spain and Ireland, while the two biggest groups coming here are Polish and Irish ([Hansard, 04.02.2014](#)). According to the [University of Oxford's Migration Observatory](#) (21.02.2014), less than 5% of EU migrants are claiming jobseekers allowance, while less than 10% are claiming other working age benefits. Nevertheless, the danger is that voters in the referendum will be confused and incoherent on these issues. This is exacerbated by both the fact that immigration generally features much more strongly in peoples' minds as an important issue (in distinct contrast to membership of the EU), and also by the current refugee crisis and associated terrorist threats. The current divisions within the Brexit lobby over whether or not to focus on immigration are hardly reassuring that the debate and the vote will not be seriously compromised as a consequence. As Open Europe (*op cit.*, p. 6) notes: "In order to be competitive outside the EU, Britain would need to keep a liberal policy for labour migration. However, of those voters who want to leave the EU, a majority rank limiting free movement and immigration as their main motivation, meaning the UK may move in the opposite direction." This perspective is strongly echoed by the Oxford Economics report (*op cit.*).



## Conclusions

The majority of economic analysis, and the opinions of many commentators, suggest that the UK could survive, and might even prosper as an independent country outside the EU. The economic costs of exit might not be great, and there could even be a modest benefit in the longer run, under some assumptions. However, Britain's future prospects outside the EU would depend critically on: a) the independent trade relations and agreements that we will be able to negotiate b) the regulations we would be obliged to adopt because of these agreements, or would wish to choose independently; c) the costs of transition. In short, the less regulation we choose, and the looser the formal ties through trade agreements, the greater the potential longer run economic benefits. However, there are also greater risks that uncertainty and consequent investment flows will not generate these potential benefits, while the abandonment of regulation will generate further unestimated and unanticipated consequences and costs. Exiting the EU will neither solve the refugee crisis, nor the issue of immigration from outside the EU. Economic migration to the UK will continue to depend on the relative prosperity of the UK and its attitude to immigrants. Finally, there is a risk that a vote to leave might also result in the disintegration of the UK. We might well substitute *ever greater discord* for *ever closer union*.

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