

Britain will be OK – for the time being

Markets
Is Brexit a big economic deal or not? In the short term, unlikely; in the longer term it will be much tougher.



Richard Holden

Prior to the stunning "Brexit" vote, most economists, along with pro "Remain" politicians, warned of the serious consequences from the UK's exit from the European Union.

And after the vote's outcome became clear, the pound plummeted, global stock markets plunged, and there was a flight to safety in capital markets that hammered currencies like the Australian dollar.

Yet some commentators suggested this was no big deal, and certainly not a repeat of the financial crisis of 2008. Someone no less distinguished than the New York Times's Paul Krugman said: "The economic consequences will be bad, but not, I'd argue, as bad as many are claiming." The Australian's Greg Sheridan was completely unconcerned about potential fallout, and even blamed those who were worried, saying: "More than anything else, it is the irresponsibility with which Cameron spoke of the British economy, and of what would happen if Britain left, which has resulted in the rolling of global markets in response to Brexit. The voters didn't believe Cameron, but some of the international markets did."

So, who's right? Brexit: big economic deal or not? Let's start with the short term. Here, there is a relatively small chance of a really bad outcome.

The big concern is that short-term lending markets could dry up. That's what caused the chaos surrounding the demise of Lehmann in 2008. Most banks around the world rely on short-term funding – often rolled over every 24 hours – to finance their operations. If those markets (the so-called "Repo" and "commercial paper" markets) freeze, then there is an effective bank run. In 2008 that broke Lehman, and very nearly others including Morgan Stanley, Goldman Sachs, and Bank of America.

Worryingly, Australian banks rely more on short-term funding than almost any in the world. Will these money markets freeze? Well, that all depends in what investors believe that other investors believe. If confidence generally remains, then there is a virtuous circle of beliefs that lead credit to be continually supplied.

But, as we saw in 2008, seemingly small events, like a money market fund "breaking the buck" (the Primary Fund being in position to pay out slightly less than its obligations), can cause an expectations



Leave takers: Boris Johnson, left, and Michael Gove. PHOTO: GETTY IMAGES

death spiral. The same thing happened in 1998 when a rinky-dink little hedge fund, called Long Term Capital Management, set off a chain reaction that nearly detonated the global financial system.

The short answer about the short term is that we're probably OK. But there is a non-trivial chance of something disastrous happening. Hold your breath this week and next.

Medium term, Brexit makes the likelihood of another recession in the UK disturbingly likely. The Bank of England is already talking about cutting interest rates and providing £250 billion of emergency liquidity to ward off the possibility. Britain's economy – like many around the world – is staging a slow and shaky recovery from the events of 2008. An event like Brexit that shakes confidence, roils markets, and creates massive political uncertainty, makes consumers and investors who are already on the sideline even less likely to consume and invest.

Given how difficult the recovery from the events of 2008 has been, a large step backward into another recession would be a significant blow. And let's not forget that young people who graduate high school and university during economic downturns earn materially lower incomes for the rest of their lives, relative to those who graduate during normal economic times. Brexit

condemns another cohort of young people to a worse future. Ironically, it was young people who voted most strongly to remain part of the EU, with only an estimated 19 per cent of 18-24 year olds wanting to leave. I guess they lost twice.

Long term, Britain's exit from the European Union will lead to less economic integration and less trade with Europe. That's bad news for Britain and Europe. Reasonable estimates put this cost at 6 per cent of GDP by 2030. Given how hard fought even modest amounts of economic growth are to come by these days, this is a material hit. It is also worth remembering that the divorce proceedings will take two-plus years so (under Article 50 of the Lisbon Treaty), New trade and migration agreements will need to be negotiated. Threats will be made, and uncertainty will reign. We don't yet know who will be Britain's prime minister, or even opposition leader. Scotland may leave the UK. And on, and on.

Brexit is sad. The better angels of Britain's nature lost. It is also a vote against the economic interest of Britain, Europe, and the world. Brexit is bad. Just how bad that is, we will see of the coming weeks, and years.

Richard Holden is professor of economics at UNSW Australia Business School.
Twitter: @profholden.

When a new vote means a nightmare

John McTernan

In Scotland, the unexpected Brexit vote had Scottish National Party leader Nicola Sturgeon out quickly. In a measured press conference she set out her response and made very clear to regular observers of Scottish politics that she has no intention of holding a second independence referendum. Read the transcript.

Everything of substance is actually about process. Another referendum is on the table, she says. She will explore all options, she says. The reality is that a new vote is, in fact, her worst nightmare.

Her problem is simply put – the conditions set out in the SNP manifesto for this year's Scottish Parliament elections have been met. The party reserved its right to demand a second independence referendum if there was a "significant and material" change in circumstances – giving Brexit as an example. So, we have had Alex Salmond telling the BBC as the results rolled in: "Scotland looks like it is going to vote solidly Remain. If there was a Leave vote in England, dragging us out of the EU, I'm quite certain Nicola Sturgeon would implement the SNP manifesto."

And, of course, Scotland voted to stay in the EU. So, logically there has to be a second referendum? Not necessarily.

This is where Sturgeon's natural caution is brought to bear. She knows the second vote is the last – this is not playground games where best of three becomes best of

£15 billion more is spent on public services in Scotland than is raised in taxes.

five – let alone, best of seven. Lose the second vote and it's all over, red rover. The reason "significant and material" change was used by the SNP was that it wanted to see support for independence running at around 60 per cent for at least two years – in other words numbers that predicted an unlosable plebiscite.

The oil price has crashed and there is no sign of it returning to the previous level of \$105 a barrel that was used in the SNP Independence White Paper. Revenues for last year (2015-16) fell to £130 million. That is a drop from £2.2 billion the previous year – and a stark contrast to the £7.5 billion projected by the SNP.

What does that mean for Scotland? £15 billion more is spent on public services in Scotland than is raised in taxes.

The clincher is the currency. The option of an independent Scotland using sterling was always implausible. But the idea of being in the EU and sharing the pound with a rump UK outside the EU is frankly impossible. And EU membership requires adopting the euro. While that would be a valid currency option, it would go down like a cup of cold sick with voters.

What Sturgeon needs is a way through. That is why she has only talked about process. She will be holding well-publicised meetings. Writing letters that will be leaked to the press before being posted. The usual tactics of the Scottish government, but with one aim: to approach a referendum, but never reach one – like a political version of Zeno's Paradox.

Sturgeon knows that the power to hold a referendum is held by Westminster. She wants the next Tory leader to veto a second Scottish referendum – that gives her a grievance that she can burnish. The last thing she wants is actually to be given a definitive second vote – she knows she'd lose it.

John McTernan, a Daily Telegraph columnist, is a former adviser to prime ministers Tony Blair and Julia Gillard.

AFR01A1 A039

This easy divorce is a poor sign for democracy

Referendum
Brexit is not some sort of victory for democracy, only 36 per cent of British voters backed it and they will probably have a good deal of regret.



Kenneth Rogoff

The real lunacy of Britain's vote to leave the European Union was not that British leaders dared to ask their populace to weigh the benefits of membership against the immigration pressures it presents. Rather, it was the absurdly low bar for exit, requiring only a simple majority. Given voter turnout of 70 per cent, this meant that the leave campaign won with only 36 per cent of eligible voters backing it.

This isn't democracy; it is Russian roulette for republicans. A decision of enormous consequence – far greater even than amending a country's constitution – has been made without any appropriate checks and balances.

Does the vote have to be repeated after a year to be sure? No. Does a majority in Parliament have to support Brexit? Apparently not. Did Britain's population really know what they were voting on? Absolutely not. Indeed, no one has any idea of the consequences, both for the UK in the global trading system.

Mind you, citizens of the West are blessed to live in a time of peace: changing circumstances and priorities can be addressed through democratic processes instead of foreign and civil wars. But what, exactly, is a fair, democratic process for making irreversible, nation-defining decisions? Is it really enough to get 52 per cent to vote for breakup on a rainy day?

In terms of durability and conviction of preferences, most societies place greater hurdles in the way of a couple seeking a

divorce than Prime Minister David Cameron's government did on the decision to leave the EU. Brexiters did not invent this game; there is ample precedent, including Scotland in 2014 and Quebec in 1995. But, until now, the gun's cylinder never stopped on the bullet. Now that it has, it is time to rethink the rules of the game.

The idea that somehow any decision reached anytime by majority rule is necessarily "democratic" is a perversion of the term. Modern democracies have evolved systems of checks and balances to protect the interests of minorities and to avoid making uninformed decisions with catastrophic consequences. The greater and more lasting the decision, the higher the hurdles. That's why enacting, say, a constitutional amendment generally requires clearing far higher hurdles. Yet the current international standard for breaking up a country is arguably less demanding than a vote for lowering the drinking age.

With Europe now facing the risk of a slew of further breakup votes, an urgent question is whether there is a better way to make these decisions. For one thing, the Brexit decision may have looked simple on the ballot, but in truth no one knows what comes next after a leave vote. What we do know is that, in practice, most countries require a "supermajority" for nation-defining decisions, not a mere 51 per cent. There is no universal figure like 60 per cent, but the general principle is that, at a bare minimum, the government ought to be

demonstrably stable. A country should not be making fundamental, irreversible changes based on a razor-thin minority that might prevail only during a brief window of emotion. Even if Britain's economy does not fall into outright recession (the pound's decline might cushion the initial blow), there is every chance that the resulting economic and political disorder will give some who voted to leave "buyers remorse."

What should Britain have done if the question of EU membership had to be asked? Surely, the hurdle should have been higher; for example, Brexit should have required, say, two popular votes over at least two years, followed by a 60 per cent vote in the House of Commons. If it still prevailed, at least we could know it was not just a one-time snapshot of a some of the population.

The British vote has thrown Europe into turmoil. A lot will depend on how the world reacts and how the British government manages to reconstitute itself. It is important to take stock not just of the outcome, though, but of the process. Any action to redefine a long-standing arrangement on a country's borders ought to require a lot more than a simple majority in a one-time vote. The current international norm of simple majority rule is, as we have just seen, a formula for chaos.

Kenneth Rogoff, a former chief economist of the IMF, is Professor of Economics and Public Policy at Harvard University.
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