

Brexit: An Historical Perspective

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BUSINESS
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UK Relative Economic Performance

- Very disappointing pre-1973
- Subsequent improvement
- Quite good 1995-2007
- **NB:** supply-side policies under national control were much more important for these outcomes than EU membership

UK Y/HW Growth (% per year)

(Crafts, 2020; The Conference Board, 2020)

| | | | |
|-----------|-------|-----------|------|
| 1700-1760 | 0.25 | 1873-1913 | 1.06 |
| 1760-1780 | -0.01 | 1924-1937 | 0.70 |
| 1780-1800 | 0.46 | 1950-1973 | 3.74 |
| 1800-1830 | 0.29 | 1973-1995 | 2.18 |
| 1830-1856 | 1.11 | 1995-2007 | 2.08 |
| 1856-1873 | 2.06 | 2007-2019 | 0.23 |

Comparative Y/HW Growth (% per year)

The Conference Board (2020)

| | France | Germany | UK | USA |
|-----------|--------|---------|------|------|
| 1950-1973 | 5.29 | 5.91 | 3.74 | 2.57 |
| 1973-1995 | 2.67 | 2.86 | 2.18 | 1.27 |
| 1995-2007 | 1.56 | 1.69 | 2.08 | 2.65 |
| 2007-2019 | 0.65 | 0.65 | 0.23 | 1.30 |

Relative Y/HW (UK = 100)

(The Conference Board, 2020; OECD, 2020)

| | 1950 | 1973 | 1995 | 2007 | 2019 | 2019* |
|---------|-------|-------|-----------------|-------|-------|-------|
| France | 62.5 | 110.9 | 124.8 | 120.2 | 128.1 | 115.9 |
| Germany | 54.5 | 110.1 | 129.2/ 104.6 | 121.6 | 126.5 | 113.3 |
| USA | 151.6 | 147.1 | 122.3 | 120.9 | 130.1 | 122.5 |

Golden-Age UK Policy Errors

- It's supply-side policy that matters through incentive to invest and to innovate
- **Policy was constrained** by pursuit of full employment through wage restraint based on trade-union cooperation
- Key policy concerns include: taxation, industrial relations, industrial policy, nationalization, protectionism

Traditional Criticisms of Postwar British Industry

- Weak and incompetent management
- Debilitating industrial relations
- Seriously inefficient use of inputs
- NB: these were all **nurtured by inadequate competition** in product markets (Nickell et al., 1997; Prais, 1981) interacting with the historical institutional legacy

EU Entry: Impact on UK GDP

- **Based on gravity model** in Baier et al. (2008), UK trade with EU members rose by 33.0% and total UK trade increased by 17.1%
- Using lower-bound elasticity of impact of more trade on real GDP in Feyrer (2019), **increase in Y/P = 8.6%** (similar methodology to HMT, 2003)

NB: synthetic counterfactuals method gives similar result (Campos et al., 2019)

Context of UK Entry

- Joining EU in 1973 came after a long period of protectionism and relative economic decline
- Entry was an important part of increasing competition in UK and an important antidote to bad management and debilitating industrial relations (Crafts, 2012); it was **part of the Thatcher Experiment**
- Explains where a lot of the 8.6% might have come from as (partly) anticipated by Williamson (1971)

EU Membership

- UK joined EEC in 1973 and was subsequently subject to EU rules on state aid and competition policy
- These provided a **'commitment technology'** which reduced UK policymakers' discretion and increasingly they precluded selective industrial policy and a 'public-interest' criterion in mergers policy
- However, horizontal industrial policy which addresses market failures was allowed

Increased Competition and Productivity Performance

- Increases in competition correlated with 1980s productivity growth at sectoral level (Haskel, 1991)
- Openness promoted TFP growth in catch-up model for manufacturing sectors post-1970 (Proudman & Redding, 1998)
- Single Market shock improved TFP in plants exposed to agency problems (Griffith, 2001), raised patenting in close-to-frontier industries (Aghion et al., 2009)
- Entry and exit accounted for 25% Y/L growth in 1980-5 manufacturing rising to 40% in 1995-2000 (Criscuolo et al., 2004)

Increased Competition: Effects via Industrial Relations

- During the 1980s and 1990s, increased competition reduced union membership, union wage mark-ups and union effects on productivity (Brown et al., 2008; Metcalf, 2002)
- Surge of productivity growth in unionized firms in 1980s as organizational change took place under pressure of competition (Machin & Wadhvani, 1989)
- De-recognition of unions in face of increased foreign competition had strong effect on productivity growth in late 1980s (Gregg et al., 1993)
- Multi-unionism in an industry reduced TFP growth by 0.75pp from the 1950s through the 1970s but had no effect thereafter (Bean & Crafts, 1996)

Is Brexit 1973 in Reverse?

- Estimates of medium-term impact on productivity levels suggest that it may be

BUT

- Industrial relations reformed
Market for corporate control improved
Competition policy stronger
Trade costs lower

Reasons to Worry

- Brexit is not a route to better supply-side policy but may be the opposite
- Entry and exit rates have fallen (Lui et al., 2020) while industrial concentration and mark-ups have risen (CMA, 2020)
- Industrial policy is highly exposed to government failure as we saw in the 1970s (Wren, 1996) and is no longer subject to EU rules

Subsidy Control in TCA

- Six principles and subsidy control authority: implementation up to UK
- Weaker than EU state aid but stronger than WTO rules
- Desirable that design of SCA stops return to 1970s; independence, scope and enforcement powers matter
- Consultation outcome not yet known

The View from No. 10

- *'We will back British business by introducing a new state aid regime which makes it faster and easier for the government to intervene to protect jobs when an industry is in trouble'*
(Johnson, 2019)
- 'Red-Wall' Votes Matter!

Conclusions

- EU entry improved supply-side policy and raised productivity
- Key supply-side policy reforms (education, innovation and infrastructure) possible anyway
- Brexit loosens constraints on return to bad policies as well as reducing productivity
- Design of subsidy control authority a litmus test