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### The many ways in which Brexit affects us all

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Why is Brexit important? For one it could affect the economic lives of people the world over. Also, because the leave vote is a challenge to the way economic policy has been run in the last thirty years or so.

For the second time in a decade, markets around the world went out of kilter. The financial crisis of 2008 caused a lasting economic recession. We have yet to fully come out of its effect. Now, Brexit threatens dire consequences. The leave vote was perhaps a reaction to the policies that spawned the 2008 crisis. This Fact Sheet explains how.

It is hard to assess Brexit's effect just yet. There are too many unknowns about the way UK might exit the EU. They have still to set in motion Article 50 of the Lisbon Treaty, the two-year post nuptial. There is one view that this may have happened already<sup>1</sup>. Another view, perhaps meant to calm the markets, says that Brexit may not happen at all<sup>2</sup>. Once it invokes the Article, Britain will have no say on the terms of separation. A majority members' vote decides. In fact, UK wants to not invoke Article 50 until it reaches an outline agreement with EU<sup>3</sup>. Again, that will be up to EU members. There is the question of the British parliament approval of the Brexit vote.

Brexit's most important fallout comes from whether or not UK remains part of the single market. Most EU members think that, if agreed, this is a case of eating your cake and having it too. Britain would keep the benefits of a member state without sharing its

<sup>1</sup> Politico EU, Could Article 50 have been triggered already? Nicholas Hirst, 30 June 2016, <http://www.politico.eu/article/could-article-50-have-been-triggered-already-brexit/>

<sup>2</sup> Pakistan Today, Top US diplomat Kerry says Brexit may not happen, 29 June 2016

<sup>3</sup> The Economist, Article 50 ways to leave your lover, 2 July 2016, <http://www.economist.com/news/briefing/21701543-there-no-deal-offer-will-satisfy-both-brexiters-and-voters-article-50-ways-leave>

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burden. This will only encourage others to also leave. EU is convinced that movement of labour is an important part of the single market.

UK could conceivably begin a parallel trade deal with EU or use Norway's option to join the European Economic Area. EEA imposes some of the conditions that caused the leavers to vote out, so it is not clear how that would help. The former would take a long time to conclude as it will require parliament's approval from each EU member<sup>4</sup>. For now, we must hold our breath.

Other than its effect on the economy, Brexit has important messages for policy makers. They would do well to take heed.

## **Effect of Brexit depends on how the separation unfolds:**

The Economist lists three possible scenarios<sup>5</sup>:

- The benign option in which UK remains closely attached with EU. A quick outline agreement will make clear the contours for the future.
- The middle way in which uncertainty forces investors to put off capital investment.
- The worst case in which trade talks stall. Uncertainty creates friction within UK and all around.

In the first scenario, economies will get back to normal in a few months. The second case has UK growth reduced by 1 or 2 points. While the third creates uncertainty among the banks from where there is no saying where it might end.

There is too much at stake for UK, EU, and the world for EU negotiators to allow things to deteriorate to the last level. Hence their insistence for early resolution.

## **Effect of Brexit: What the savants say**

In the run up to the vote, experts predicted a range of ramifications on the world economy. At the very least, a vote for

<sup>4</sup> Ibid.

<sup>5</sup> The Economist, Managing Chaos, discussion in this section is adapted from here with some interpretation  
<http://www.economist.com/news/briefing/21701539-how-brexit-will-affect-growth-britain-europe-and-wider-world-managing-chaos>

exit would cause loss in confidence and uncertainty. They forecasted lower economic growth rates not just in UK and EU as well as a possible worldwide economic downturn. Market volatility could likely force liquidation on some firms. Businesses would put off investment and hiring decisions. Exit could cause a contagion for others to leave<sup>6</sup> and a worldwide move for sub-nationalism<sup>7</sup>.

Some of these forecasts have come to pass. However, markets soon recovered with the FTSE at 6,500 on 1 July 2016<sup>8</sup>. By that date, the pound has lost 10% in value and the Euro is off by 2%<sup>9</sup>. There was some evidence of foreign investors pulling out investment from the UK<sup>10</sup>. It is too early to judge the effect on growth rates and on other factors, but experts agree that these are inevitable.

Some experts have since moderated their views<sup>11</sup>. The short term effects weren't quite as bad as earlier estimated. Yet, they estimate a 30% chance that the US economy will be in recession within the next year. A contagion of exit by others is the likely other big risk. Morgan Stanley forecasts a possible downturn in Europe<sup>12</sup>. Concerns for breakup of the euro would make markets further nervous. World Bank President says that access to capital for developing countries will be difficult as investors seek safer havens<sup>13</sup>.

Central Banks helped ward off some of the immediate effects. Their ability to continually do so is limited because of already very low interest rates.

## How will Pakistan fare?

GoP is of the view that Brexit will not affect Pakistan anytime soon<sup>14</sup>. Nothing could be further from the truth. There are several possible direct and indirect effects of Brexit on Pakistan:

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<sup>6</sup>A good summary is available in Washington Post blog, Why Brexit would be a history-defining, irreversible mistake, Lawrence Summers, 21 June 2016. Many other experts voiced similar views.

<sup>7</sup> Al Jazeera, Brexit: What does it mean for the rest of the world? Ahmed Rashid, 29 June 2016

<sup>8</sup> London Stock Exchange, <http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/indices/summary/summary-indices.html?index=UKX>

<sup>9</sup> X-Rates website <http://www.x-rates.com/historical/?from=EUR&amount=1&date=2016-06-09>

<sup>10</sup> Richard Branson: Investors pulling out of UK after Brexit vote, The Guardian, <https://www.theguardian.com/business/2016/jun/28/richard-branson-investors-pulling-out-of-uk-after-brexit-vote>

<sup>11</sup> Washington Post, Why Brexit is worse for Europe than Britain, Lawrence Summers, 24 June 2016, <https://www.washingtonpost.com/news/wonk/wp/2016/06/24/whats-crucial-to-know-the-morning-after-brexit/>

<sup>12</sup> Washington Post, Some possible Brexit consequences, 24 June 2016, Robert J. Samuelson

<sup>13</sup>Huffington Post India, Prolonged Brexit Uncertainty Will Impact All Nations Including India, 30 June 2016

<sup>14</sup> Dawn, Brexit may not have any immediate economic impact on Pakistan, says FO, 27 June 2016. <http://www.dawn.com/news/1267649>

- **Trade:** Pakistan's export will suffer a twofold blow. Consumer demand in UK will dampen with loss in economic growth. Because of decline in exchange rate, the GBP value of our export, as for all other countries, will increase and further affect demand. That will bring down exports.

It is still unclear if Pakistan will lose its GSP plus privilege in Britain, and if so, when. That will be a decision of the UK government. UK was a strong advocate for Pakistan's GSP plus case in Brussels. GoP must lobby with them. At over USD 1.5 Billion, UK has a share of over 7% in our total export<sup>15</sup>.

If UK's exit from EU triggers the forecasted economic downturn, world trade will take a hit. Pakistan's export to other countries will also decline. The probability of this last fear is modest.

- **Investment:** In recent years, FDI from Britain fell in line with the overall trend for FDIs to Pakistan. UK FDI was USD 460 Million in 2007-08. It fell to 157 Million in 2014-15 and will likely fall further in 2015-16<sup>16</sup>. UK capital investment overall would likely be on hold so FDI to Pakistan is not expected to pick up soon. Currently, UK's annual FDI to Pakistan is 7% of total.
- **Remittances:** Workers' remittances from UK was about USD 2.5 Billion in 2015-16. This is 13% of total remittances. A slowdown in the UK economy could reduce the pace of inflow<sup>17</sup>. This will happen if unemployment increases. That, in turn, depends how soon negotiators restore confidence.
- **PSX:** Soon after Brexit, the PSX 100 index fell about 1700 points. It has since recovered about 700 points<sup>18</sup>. There are no reports yet of flight of investment from Pakistan. In the near term, there certainly will be less or no inflow of investment into PSX.
- **ODA:** UK provides large sums in grant annually to Pakistan. Actual amount disbursed was GBP 338 Million in 2013 and 266 Million in 2014<sup>19</sup>. Annual allocation is far more, but remains unspent. Because of economic slowdown, UK may reconsider its overall assistance envelope for developing countries. There is moderate possibility of this happening.

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<sup>15</sup> TDAP trade statistics.

<sup>16</sup> BOI, Pakistan foreign investment into Pakistan

<sup>17</sup> SBP Country wise workers' home remittances

<sup>18</sup> Pakistan Stock Exchange, Market summary, and Trading Economics data,  
<http://www.tradingeconomics.com/pakistan/stock-market>

<sup>19</sup> DFID, Statistics on International Assistance 2015, Table 6, Page 32,  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/482322/SID2015c.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482322/SID2015c.pdf)

The above are the direct effects of Brexit. A spillover to other economies will increase its effect on Pakistan, as it would for the rest of the world. This is the time for everyone to act wisely.

### **Other Brexit Lessons:**

Just why did UK want an exit? Even a brief look at the profile of ‘leave’ voters, shows a division along education and age<sup>20</sup>. College graduates voted overwhelmingly to stay, as did the young over the old. Almost all of England voted leave, while London, Oxford, and Cambridge wished to stay.

The lessons are not hard to see though they may have been lost in the emotions of the campaign. There is evidence that the voters had little idea about EU and suffered from a ‘lack of factual knowledge’<sup>21</sup>. The leave campaign broad stroked the issues of globalization, technology, and immigration. There wasn’t a rational debate about why some people coped well with open markets while others are left behind.

Those that cannot deal with a changing social order need protection. Economies must invest in people. Their exclusion has more, or equally, to do with policies at home than with open borders. Policy orthodoxy since the 1980s, that prioritizes markets over people has put these discussions beyond debate. So while policy wonks warned of dire results from leaving EU, the leave voters felt that their ‘opportunities were closed off long ago’ and it made no difference to them<sup>22</sup>. As can be seen in the profile of Trump voters in USA, this is a lesson for all countries.

It is safe to say that exclusion caused some to vote leave. In which case, it is ironical that those behind the immigration hysteria are the leaders that profess market fundamentalism.

Pakistan will do well to take note. Economic policy in Pakistan follows two dictates. First, it satisfies guidelines of multilateral institutions. Second, it serves elite interests. The resulting duality in society is cause for potential instability. Logic no longer works when fear and despair drive emotions. The eighteenth amendment is a step in the right direction though it has yet to show results.

Eventually, the deal that gets done will balance EU’s desire to inflict a cost on leavers against economic loss from total separation. It is in the interest of EU to retain trade links

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<sup>20</sup>Dawn EU voting map lays bare depth of division across Britain, Tom Clark, 25 June 2016 (by arrangement with the Guardian, UK)

<sup>21</sup> Foreign Affairs, Brexit’s False Democracy, Kathleen R. McNamara 28 June 2016

<sup>22</sup>Ibid.

with UK. In the coming years, economic consequences may not be as dire after all. But uncertainty about the outcome stays. And markets don't like uncertainty.

That Brexit and the 2008 crisis began in two centres of capitalism is a paradox. It is equally odd that a complex and significant vote on Brexit was decided by a most uninformed campaign imaginable in one of the oldest democracy. To begin with, the referendum was a 'reckless gamble'<sup>23</sup>. With no discussion on the social and economic context of resurgent nationalism, economies could repeat past mistakes. That may be Brexit's biggest lesson.

Does the West know what it is doing? Capitalism and democracy have brought great progress to the world. They are now being sapped in the countries that found them. Europe and the West are lapsing to a period of exclusion and differences. There is also an 'inward turn' worldwide<sup>24</sup>. We must all take note.

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<sup>23</sup> Foreign Affairs, Brexit's False Democracy, Kathleen R. McNamara 28 June 2016

<sup>24</sup> Huffington Post India, Brexit and The Global Distrust of Difference, Ali Khan Mahmudabad, 30 June 2016

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