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# TIGER

TRANSFORMATION, INTEGRATION and GLOBALIZATION ECONOMIC RESEARCH

CENTRUM BADAWCZE TRANSFORMACJI, INTEGRACJI I GLOBALIZACJI

## **TIGER Working Paper Series**

**No. 134**

### **Political Economy of Brexit, or Brexitology**

**Grzegorz W. Kolodko**

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## **Political Economy of Brexit, or Brexitology**

A generation ago, in the second half of the 80s, hardly anyone would predict the fall of real socialism, or communism, as it was known in the West, and the disintegration of the Soviet Union. Quite the contrary; even prominent sovietologists assumed that the USSR may not fall and would last for quite a long time. When things turned out differently and, consequently, Francis Fukuyama prematurely announced the end of history, thousands of sovietologists, especially American and British ones, looking to justify their existence, quickly rebranded themselves as experts on political changes in post-communist part of the world. They became the connoisseurs of the complex issues of political, legal, cultural and social transformations, and mostly the economic and financial ones. On the one hand, that's what was in the greatest demand and, on the other hand, this was quite a profitable business, too.

A whole current of interdisciplinary knowledge quickly emerged and developed. And, obviously, a pseudo-knowledge: *transitology*. What became a prevalent desire of those working in social sciences, especially economics – from humble foot soldiers to luminaries – was the wish to have at least one article or paper about the *transition*, or moving from the socialist economy to the capitalist one or, if you will, from central planning to free market. These days, the literature on the subject is so rich that if it wasn't for the digitalisation, the whole collection would not fit in any traditional library.

History never repeats itself but something similar is taking place now. Undoubtedly, *Brexitology* will emerge, an interdisciplinary knowledge about the determinants, course and numerous implications of the United Kingdom leaving the European Union. These are implications that go far beyond that country and the European integration grouping, and far beyond the foreseeable future. Over time, both negative and positive consequences of *Brexit* will come to be known, though there will be much fewer of the latter ones.

## **Irrationality**

What is most striking is that the *Brexit* decision, though it is vividly referred to as an earthquake, did not in itself cause any real physical damage. No flood submerged fertile farms, no factory burnt down, no bridge came tumbling down, not a single whisky tumbler broke. Meanwhile, what is changing at a shock pace is psychological and political factors:

individual and social expectations as well as national and international fields of choice, which greatly increases the area of uncertainty and makes it even harder to take rational decisions. More than anything, though, there is a need for a drastic change in institutions, namely in legal regulations governing economic processes, from foreign trade legislation to the rules of cross-border movement of people. This clearly shows the fundamental importance of the established rules of play in the modern economy. This very bad time is a very good period for economists, and even a better one for lawyers as, again, there are more questions here than answers.

The most frequently asked questions, of varying calibre, involve short-term consequences of the decision by a slight but nevertheless a majority of the British people who took part in the referendum on 23th of June, voting in favour of leaving the European Union. How much can the GDP fall (because fall it will) on the isles and on the continent? How much will the unemployment rate grow (because grow it will)? Will pound sterling keep on getting weaker and will the Swiss franc get stronger? Will Scotland leave the United Kingdom? How many immigrants from the Eastern Europe will leave Great Britain? Will property prices drop in London? There are more questions like that and they should be by no mean disregarded, but this time I would like to point out to something of much greater consequence: to the prospects of free market economy and to the future of the world.

If it was the tiny Luxembourg, Malta, Slovenia or Estonia that decided to leave the EU, there would be quite a confusion, too, but the Great Britain leaving is a great problem. The most important thing is to understand why the majority voted against what the economic good sense would tell them. This is a question to sociology-minded Brexitologists rather than to economists. Many of the 51.9 per cent in favour of *Brexit* simply did not realise what they were opting for. And an error of a historic magnitude was committed. The scale of demagoguery and stupefying propaganda spread by various politicians and media was so vast that millions of people got tricked into behaving irrationally. Indeed, a rational person is one acting for one's own benefit, considering the available information. And the information was sometimes manipulated or even falsified. After all, we cannot assume that English and Welsh people, unlike Scots and Northern Irish people, the majority of whom voted remain, made an informed vote to their own detriment. They did not know what they were doing and with time they will be sorry. Some of them already are.

The conclusion is obvious. Opinion-forming circles like politicians, intellectuals, journalists and analysts, bear a colossal responsibility. Democracy is a great thing, a value in itself, but one needs to watch out as the majority does not have to be right, if it follows

emotions or simply has no access to full and reliable information on very complex issues, as it's impossible.

Last year's referendum in Greece was uncalled for, so was Britain's suicidal one in June, and the one in Italy in the autumn will be very risky. The voting masses often don't even consider the long-term consequences of their own choices. As the saying goes, we see no further than the end of our nose, so we're not thinking about what this or other decision means for others, far away from here. And when it comes to *Brexit*, it can mean a lot of bad things.

### **Festival of stupidity**

Some may count on *Brexit* to automatically set in motion a huge wave of reforms to streamline the international economic relations, especially the functioning of the European Union, which leaves much to be desired, after all. Hope they won't be disappointed, but we can fear that a true festival of stupidity will follow, with ludicrous ideas put on the table. And the ideas that are actually reasonable, rather than improving the functioning, may make it even more complicated and aggravate the situation even more, as is the case of the legitimate demand to greatly reduce the number of EU commissioners. For now, only one will disappear, that from Britain, though their number could be reduced by half. But which half? After all it's not about the number of commissioners as such but rather about the number of areas to be dealt with by the Brussels politics and bureaucracy.

The idea to have a similar referendum in France and the Netherlands, promoted by their local right-wing nationalists is, in the present situation, a political adventurism. Creating several structures within the EU with varying degree of integration means strengthening the decentralist tendencies in a situation that requires support for integration. Instigating nationalism (of course, under the banner of patriotism, also the economic one), when we need more multiculturalism and openness, is grist to the mill of disintegration and conflict.

Under current circumstances, the most far reaching move would be for the countries that still haven't joined the Eurozone, though they are allowed to and obliged to do so under their membership treaty, to declare their willingness to do so. Poland, due to its relatively higher economic and political weight, is the most important one here. This would be a strong impulse for further consolidation of the European integration process, and for strengthening the Eastern European EU member economies by eliminating the exchange rate risk and decreasing the transaction costs. Of course, provided this was to happen under specific conditions, the most important one being that those countries would join the euro with a

favourable exchange rate, that is one that guarantees competitiveness of their export sector. Indeed, if Eastern European countries wish to experience growth at an above-average rate, they must pursue a strategy of export-driven growth.

Another *sine qua non* condition is to overcome the crisis within the Eurozone area, where it's important to further develop the banking union and the supranational fiscal coordination, but what remains crucial is *Grexit*<sup>1</sup>. This syndrome is far from being solved and the Greek crisis will soon come back with a vengeance. To overcome it, we need to substantially cut Greece's foreign debt, approximately by half. This will be decided primarily by Germany and France, which are headed for parliamentary elections next year. Economics can, once more, give in to politics.

If the harmful austerity policy continues, ushering in *Grexit*, if we fail to keep the EU-Turkey agreement on controlling the wave of refugees headed toward Europe from South Asia, Middle East and Northern Africa, if Italians reject the constitutional reform proposed by Prime Minister Matteo Renzi, if Austrians elect a nationalist to be their president, if some other countries will call referenda on their exit from EU, then we won't be able to save the European integration process. After all, things happen the way they do because a lot happens at the same time and one needs to be aware that if *Brexit* is coupled with *Grexit*, this will be the end of the European Union as we know it.

### **A Yet Grander Crisis?**

Therefore, *Brexit* needs to be viewed not only in economic terms and from continent-wide perspective, but also taking account of the overall context and in global terms. If the election in the US is won by Donald Trump, if the relations between Russia and NATO get worse, especially when it comes to countries on its eastern border, if China's economic growth slows down even more, then the future, not only that of Brits and Europeans, will look bleak and we're in for what I dubbed in my book *Truth, Errors and Lies: Politics and Economics in a Volatile World* an Even Bigger Crisis, EBC. We are well on our way there.

I still want to believe in common sense of politicians, who should have a greater capacity to properly identify the needs of their countries and societies and to define ways to satisfy them. The December's climate agreement in Paris shows that the "impossible" is possible if only there's a will and know-how (a trifle, really!). Maybe at the current turn of history they

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<sup>1</sup> On *Grexit* see my comments in: Grzegorz W. Kolodko, "", „Tiger Working Paper”, No. 133, September 2016 (<http://www.tiger.edu.pl/publikacje/working.htm>).

will show far-sightedness and make a stand against all kinds of populism. This, however, requires, on the one hand, abandoning the neoliberal utopia, which is not a panacea for the mounting difficulties, as it cannot be, because it favours conditions for a few to get rich at the expense of the majority. Secondly, it requires ditching the illusion that a bureaucratised state capitalism can be such a panacea. We need to follow the road of new pragmatism, which, through a proper synergy between market institutions and state intervention, takes care, both at the national economy level and in international and global terms, to ensure a triple dynamic balance: economic, social and environmental one.

It is worth realising that the European Union is being closely watched in other parts of the world, where integration processes are far less advanced, for example in South America's Mercosur and in South East Asia's ASEAN, in SADC in the south of Africa and in ECOWAS in the west of it, and now being slowed down and postponed. If the Europeans can't get it right, maybe it's not worth it? It is, as regional integrations are a very good way to creatively adapt to the irreversible globalisation.

I am still convinced (and it's not a belief but rather knowledge, though *Brexitology* will verify it over time) that a well-managed globalisation may be favourable to a harmonious development of the world economy. Liberalisation and integration of national economies into one interconnected and feedback global system is a good recipe for future. If we fail to escape forward at this time, then there's no point in blaming the Brits or Greeks, the Americans or the Chinese. We need to blame the errors of economics and the stupidity of politics, as these are those guilty of the European Union cracking at the seams and of the instability of the increasingly anarchy-prone world.