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Irexit: Making the worst of a bad situation

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Irexit: Making the Worst of a Bad Situation

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Joseph Francois, World Trade Institute

WP18/12

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Irexit: Making the Worst of a Bad Situation*

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July 11, 2018

Abstract

Relative to the rest of the EU, Ireland is especially vulnerable to the fallout from Brexit, both economically and politically. With increasing frustration over the reaction from Brussels, some are suggesting that an Irish exit from the EU would benefit the nation. A key argument for this is that it would allow for reintegration with the UK, thus preserving one of its largest trading partners. Using a structural general equilibrium model, we estimate that such a move would worsen the impacts of Brexit by as much as 250%, with low-skill workers disproportionately affected. This is due to the fact that while the UK is one of Ireland's single-nation trading partners, when compared to the EU27 as a group, it is much smaller.

JEL Classification: F13, F17, F53

Keywords: Irexit; Brexit; Computable General Equilibrium

*All errors are our own.

1 Introduction

Few countries have responded to the UK's decision to exit the European Union with as much concern as Ireland for clear-cut reasons. First, the UK's role in Irish trade is larger than that of any other single EU nation. In 2016, the UK received 11% of Irish exports, second only to the US (26%), and provided 22% of Irish imports, with the US in second place at 17% (Central Statistics Office, 2017). Added to this is the two nation's complicated and at times bloody history, a past which had been largely laid to rest in 1998 by the Good Friday Agreement which established power sharing in Northern Ireland and an open border on the island of Ireland. This co-existence, however, has come under threat from Brexit as it is difficult to imagine how the open border can be maintained short of a customs union between the UK and the EU. It seems remains extremely unclear that such a soft Brexit can be agreed to, with current discussions going so far as to propose shifting the border from between Ireland and the North to between the island of Ireland and the rest of the UK, a move which would in essence remove Northern Ireland from the United Kingdom. Given such fundamental issues and just a year to go before the UK formally exits the EU in March 2019, the prospect of a hard Brexit involving reinstatement of most-favoured nation tariffs, border checks, and non-tariff regulatory barriers seems disturbingly possible.

This suggests a rather grim economic forecast for Ireland, with a recent structural general equilibrium study by Thelle, Jeppesen, and Rytter Sunensen (2018) indicating that a hard Brexit could result in a 5.3% loss to Irish national income (GDP is predicted to fall by 6.1%, however, here we focus on national income due to the large role foreign multinationals play in Irish GDP). To put this in context, the long-run losses for the UK are expected to run as high as 9.5% (Dhingra, et al, 2016). As shown in Table 1, the Irish loss is driven by steep declines in trade, particularly in that with the UK (although there are knock-on effects for Irish-EU trade as well due to the UK's place in Irish global value chains (GVCs)). Furthermore, the losses are particularly severe for low skill workers because of increased barriers to agricultural trade (where GVCs involving the UK are especially important).

One consequence of this economic crisis is that, as in many other countries over the past two years, there has arisen a push towards nationalism. In Ireland, the most visible aspect of this is a growing movement supporting Irish exit from the EU – Irexit. With Dublin speeches by notable Brexiteers including Nigel Farage, the pro-Irexit camp has called for the nation to reject EU control, especially given what is seen as the likelihood for the EU-UK negotiations to overlook the particular vulnerability of Ireland. While this viewpoint is still firmly in the minority, with a European Movement Ireland (2017) poll in April of last year showing that only 16% of Irish support exiting the EU, polls prior to the Brexit referendum or the 2016 US election show that nationalist movements can do much better in the voting booth than polls would suggest. In particular, given that Ireland rejected the Treaty of Lisbon in 2008 (before passing it in a second referendum a year later) and a continuing popular belief that austerity following the 2009 Euro crisis inequitably impacted the Irish in order to save the currency zone, dismissing the Irexit supporters out of hand is unwise.

In order to provide an underpinning for the discussion, we extend the Thelle, et al. (2018) hard Brexit baseline (where the UK reverts to most favoured nation (MFN) tariffs) to consider three Irexit scenarios, the results of which are in Table 1.[1] Column 1 shows annual projected

[1] We use the same data and modeling assumptions they do, which in short is WHAT. See their work for specific details.

losses in 2030 from a hard Brexit in which Ireland remains part of the EU. Column 2 alters this by also considering a hard Irexit, one in which Ireland reverts to MFN tariffs with both the EU and the UK. Column 3 again considers a hard Irexit from the EU but a modest free trade agreement with the UK in which trade mimics a Norwegian-EU level of integration. Finally, column 4 considers a deep agreement between Ireland and the UK that maintains the current level of integration between the two countries (which, given Ireland's small size, likely means that London dictates policy, i.e. that Ireland has rejoined the UK). Note that this latter one is the only situation which resolves the issues surrounding the border with the North and satisfies the constraints of the Good Friday Agreement.

In short, any version of Irexit worsens the Irish situation. As one would expect, the best economic outcomes are found when barriers between Ireland and the UK are at their lowest under the deep integration of column 4. There, the joint Irish/British hard exit results in a national income loss of 7%, 1.5% worse than when Ireland remains in the EU. The rationale here is clear: as shown in Figure 1, although Ireland trades more with the UK than any other *single* EU nation, Irish trade with is dominated three to one by *total* Irish-EU trade. As trade barriers rise between Ireland and the UK, Irish losses grow, with uncoordinated exits in column 2 yielding losses 2.5 times greater than those if Ireland remains in the EU.

At the heart of these losses are the impacts on trade. As shown in the last two rows, while an Irexit might permit retaining some integration with the UK, trade with the EU falls by approximately 45%. Even in the best case scenario, trade diversion to the UK is unable to overcome these losses. Furthermore, in each case the fall in wages is most severe for low-skill workers (who, perversely, are generally perceived as those most supportive of the current global trend towards nationalism). Note that all of these assume that Ireland and the UK (either jointly or individually) are able to maintain their current agreements with the rest of the world. As this is unlikely, particularly for Ireland given its small size, these projections are likely too rosy relative to the likely end result of Irexit.

Thus, the numerical projections are clear-cut – Irexit in any form is likely to make a bad situation worse, particularly for the most vulnerable members of Irish society. Note that even the best scenario here in which Ireland remains in the EU yields an Irish outcome likely to be far worse than for the EU overall where the projections of Emerson, et al. (2017) indicate annual losses of well below 1% of GDP, further showing the relative vulnerability of Ireland. As such, our hope is that these projections can inform discussions in Ireland and Brussels and push the debate in a direction that avoids some of the worst economic, political, and social consequences of Brexit.

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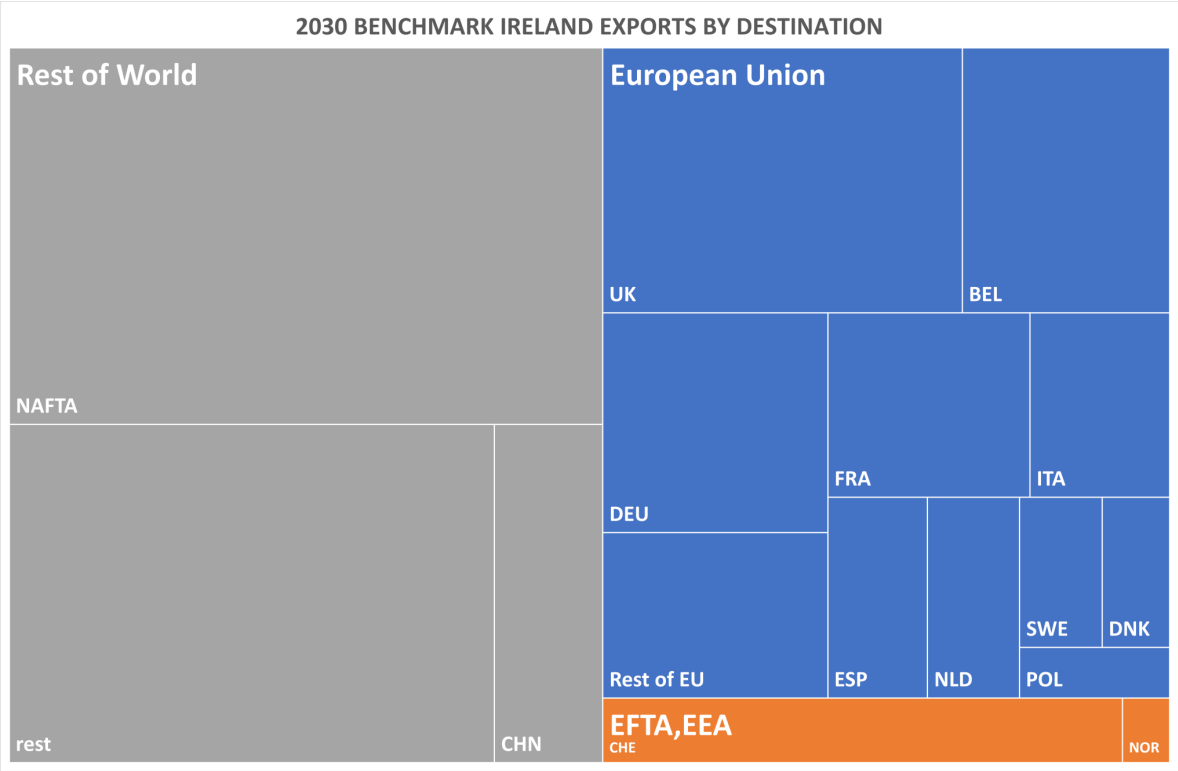
Table 1: Projected Changes for Ireland

	(1) Remain in EU	(2) Uncoordinated Exit	(3) Shallow IE-UK Integration	(4) Deep IE-UK Integration
GDP quantity index, % change	-6.15	-13.74	-8.10	-6.75
Real national income, % change	-5.28	-13.31	-8.33	-7.04
Real wages low-skill and agr. workers, % change	-7.58	-17.25	-10.23	-8.36
Real wages medium-skill workers, % change	-5.15	-11.08	-6.37	-5.13
Real wages high-skill workers, % change	-5.68	-12.51	-7.32	-5.98
Import value, % change	-7.16	-21.20	-13.48	-11.79
Export value, % change	-6.71	-19.60	-12.54	-10.96
Exports to UK, % change	-51.11	-50.20	4.88	18.48
Exports to EU26 % change	-1.85	-46.18	-45.43	-45.38

Authors' calculations for 2030 annual losses. All scenarios assume a hard Brexit.

Figure 1: Irish Exports



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