

# BREXIT and the choice of the least-worst option

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# Introduction: to be or not to be

The people of the United Kingdom face a monumental choice on the 23 June 2016. To remain in the EU or to exit. To continue with its membership in a customs union with 27 other European states or to step outside.

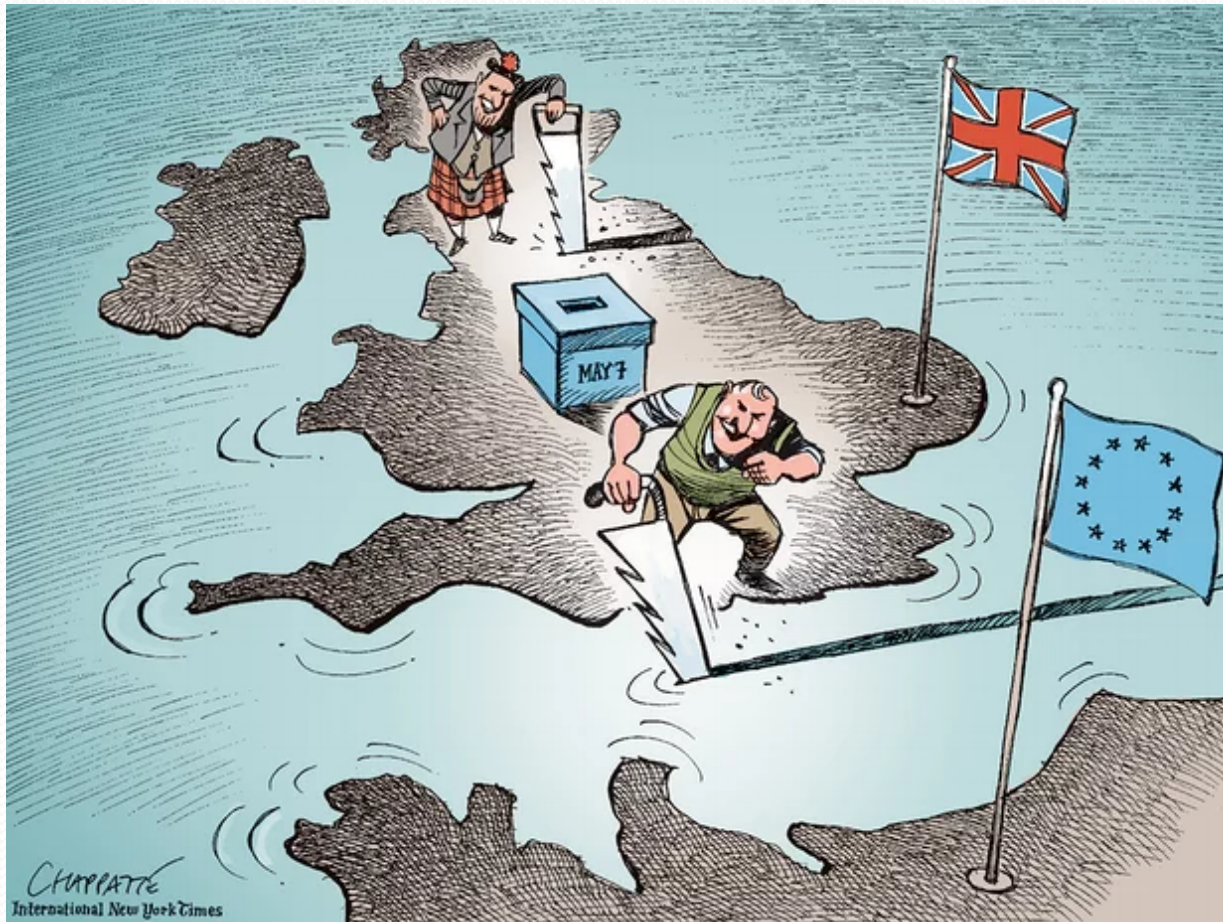
*“To be, or not to be: that is the question:  
Whether ’tis nobler in the mind to suffer  
The slings and arrows of outrageous fortune,  
Or to take arms against a sea of troubles,  
And by opposing end them?” Hamlet, Act 3, Scene 1*

# What is BREXIT?

The term BREXIT is more than a clever play on words echoing the potential Greek withdrawal from the Euro (GREXIT). It is possibly a way to “*soften*” the concept, which after all, is the genuinely epic withdrawal of the UK from the EU.

The reality must be a potential “*leap in the dark*”; or at best a journey in to the unknown. Voting to leave is more risky than voting to remain, because nothing is currently lined-up to fully re-place the EU.

# BREXIT or not..?



# The Role of Referenda

Clement Attlee, the UK Labour Prime Minister of the mid-1940s to the early 1950s described referenda as “a device for dictators and demagogues” although he was actually referring to the over-use of plebiscites in the first half of the twentieth century. In any case, this is the second important vote in the UK recently and follows the **Scottish Referendum** in 2014 in which 55% voted in favour of remaining part of the UK with a turnout in excess of 90%.

# Risk and Uncertainty

Risk is the term often being used in the debate but it is actually a matter of uncertainty. If the issue was one of risk then an effective way to decide would be spinning a coin. The outcome is always correct 50% of the time; but it is never the right result for the correct reason since a coin has **no memory**.

That is why this referendum reveals more about the unfortunate state of British politics. A referendum in this case shows a lack of political leadership.

# The Economists' Toolkit

The centrality of economics in the BREXIT debate has spotlighted the importance of cost-effective decision-making. An initial look inside the **Economists' Toolkit** is a potentially useful exercise, in order to identify if there are any insights.

1. Cost Benefit Analysis;
2. Game Theory;
3. Prospect Theory;
4. Public Choice Theory.

# Cost Benefit Analysis

The concept of **Cost Benefit Analysis** was first used in the United States of America in the 1930s when evaluating scarce water resources. It has many practical applications ranging from showing why cardboard egg boxes are so valuable to major infrastructure decisions such as the location of national airports.

The decision rules involve the Internal Rate of Return (**IRR**), Net Present Value (**NPV**) and Terminal Value (**TV**). Furthermore, the Social Discount Rate (**SDR**) is then applied.

# Hypothetical Sensitivity Analysis

Decision	Socio-Economic Net Costs (€ billions)	Geo-Political Net Costs (€ billions)	Other Cultural Net Costs (€ billions)
EXIT	10	5	2
REMAIN	12	3	1

# Estimated Scenario Outcomes

Item	REMAIN	EEA	Bi-Lateral Agreements	WTO
GDP (per cent)	Baseline	(-)3.8%	(-)6.2%	(-)7.5%
GDP per capita	Baseline	(-)£1,100	(-)£1,800	(-)2,100
GDP per household	Baseline	(-)£2,600	(-)£4,300	(-)£5,200
Net impact on receipts	Baseline	(-)£20 b	(-)£36 b	(-)£45 b

# A Game Theoretic Approach

In **Game Theory** the simplified approach can be presented as a **Game of Chicken** or alternatively what Evolutionary Biology terms the **Hawk-Dove Game**. In the game there is a **no-win situation** because the “*winner-takes-all*” in which the result tends to be unstable in the long-run.

As a result, the negative connotations of the **least worst option** is not so bad as this outcome is potentially unavoidable.

# The Hawk-Dove Game

A potential for **no-win** situation

		<i>Player 2</i>	
		Hawk	Dove
<i>Player 1</i>	Hawk	-1, -1	2, 0
	Dove	0, 2	1, 1*

\* Also specified as 0, 0; or a “war of attrition”  
when the resource cannot be shared

# The Other Contending Approaches

**Prospect Theory** uses advances in behavioural economics to describe that people value gains and losses differently. That is, there is a loss-aversion effect such that anyone evaluating a decision would try to avoid any losses.

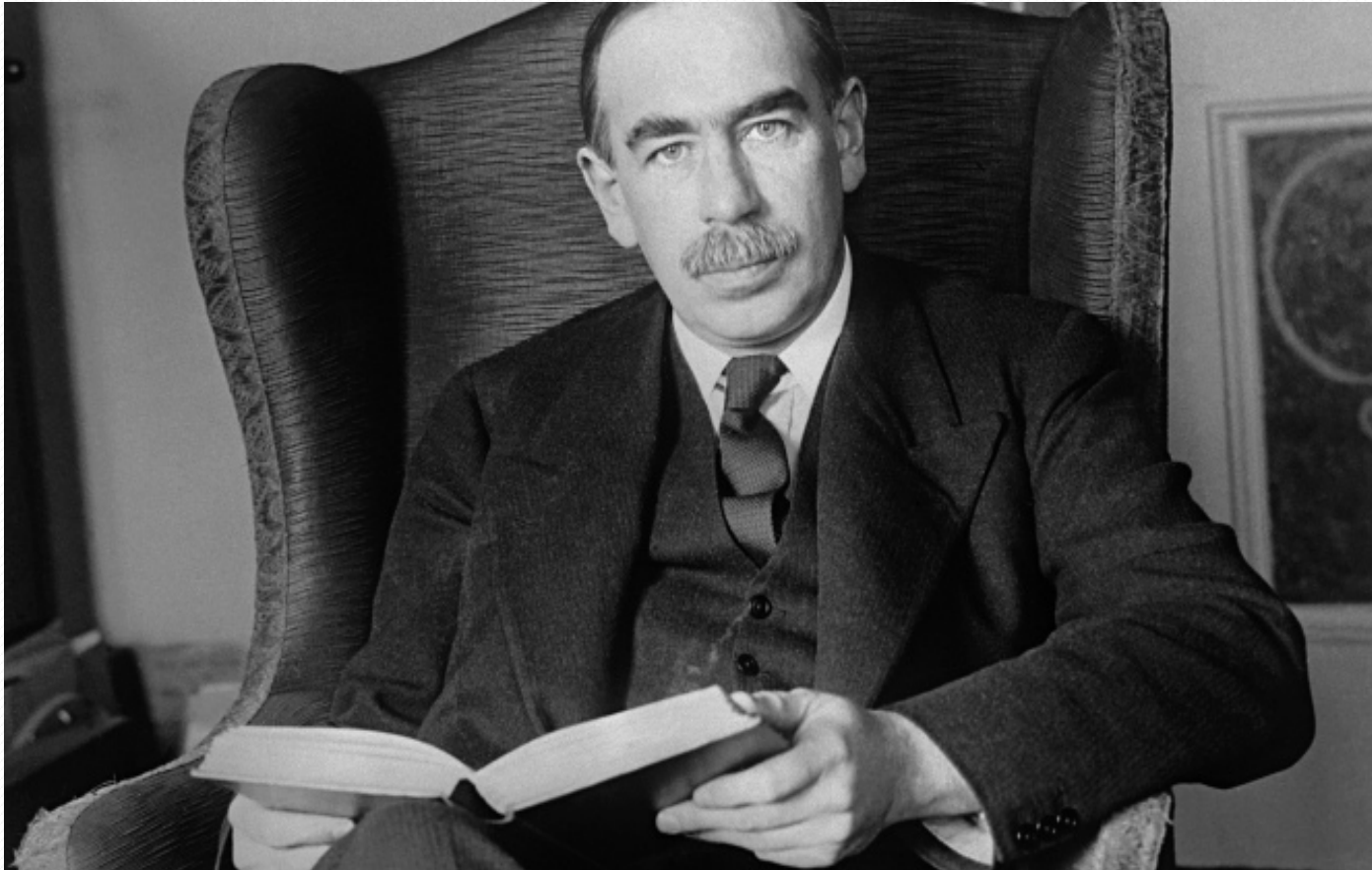
**Public Choice Theory** uses economic rationality to study the operations of government decision-making. It suggests that in order for any government to solve the problem of Public Goods then we need *selfless* politicians. This is why governments fail.

# In the balance..?

Overall, there may be **net** costs of **exiting**; notably (1) reduction of global diplomatic influence, (2) loss of potential co-ordination regarding Public Goods and (3) lower impact in science and technology.

Alternatively, there may be **net** costs of **remaining**; notably (1) loss of national legal sovereignty, (2) reduction in any UK border control and (3) no “wriggle-room” when determining Monetary Policy. So, really which *is* the **least-worst option**?

# John Maynard Keynes



# The Keynesian View...

John Maynard Keynes was the prodigious Liberal thinker of the twentieth century. He was a towering intellect and one of the greatest economists of all time. Although Keynes died seventy years ago it is possible to imagine what might say about BREXIT. In 1946, he worked himself an early death following the **Bretton Woods** agreement of 1944 ensuring the economic institutions of the IMF and the World Bank were established suggests he would **remain**.

# Zhou Enlai



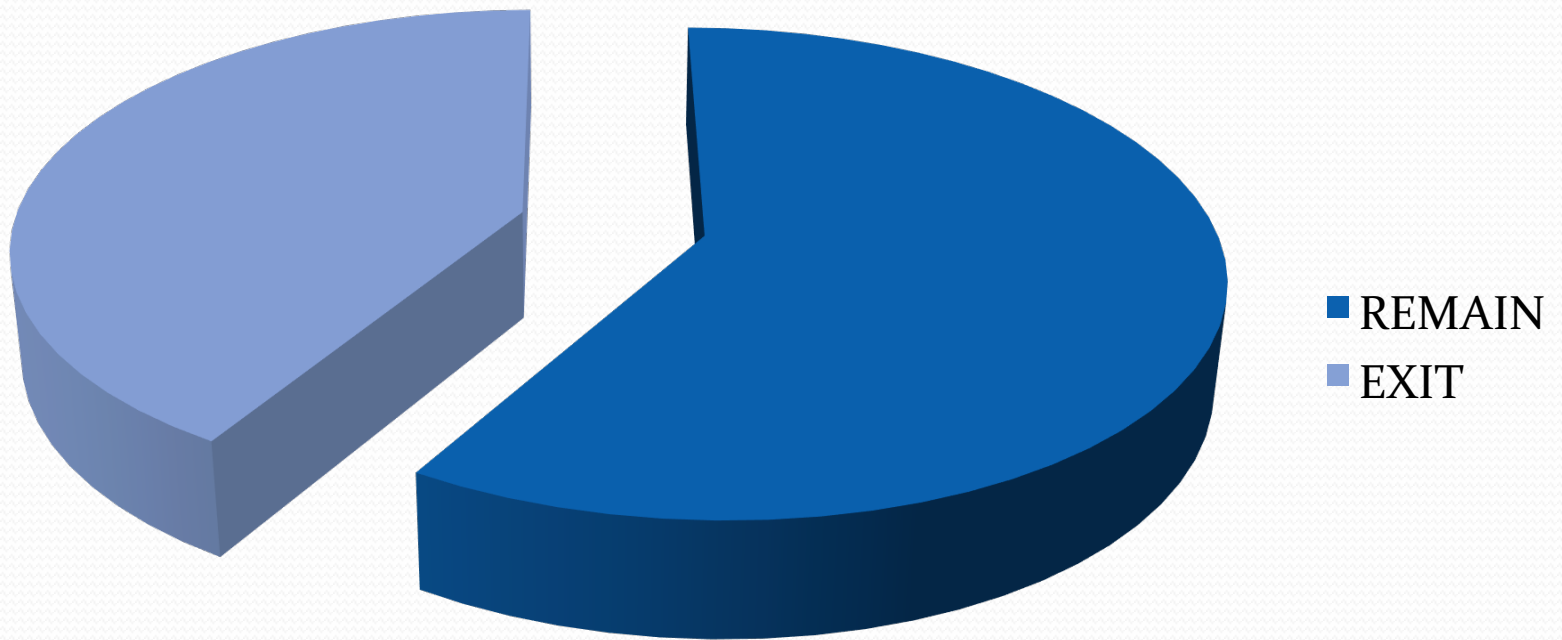
# The Long View...

Whether the Chinese Premier Zhou Enlai was referring to the **French Revolution** of 1789-1799; or the **Civil Unrest** in 1968, when he famously replied it was “*too early to say*” in 1972; the quote remains a perfect summary of the long view in history.

In addition, the **counterfactual** nature of a decision like BREXIT means it will be “*too early to say*” for quite a while and it will never be known definitively if the correct decision has been made or not.

# A Huge Gamble?

**POPULAR BETS (%)**



# Tentative Conclusions

The true alternative for the UK electorate in this referendum is honestly **NOT** really a choice between “*outrageous fortune*” or a “*sea of troubles*”. However, the two sides of the debate are so deeply entrenched that it appears that neither outcome is actually desirable *i.e.* a matter of the **least-worst option**.

The referendum may not be the last word, but leaving may well invoke the **Law of Irreversibility**. Once out, the UK will be out for a very long time...

# Final thoughts...

1. The BREXIT debate has made UK politicians even more narcissistic than their usual predisposition.
2. Nevertheless, the **Scottish Referendum** makes for a **natural experiment**; that is one region deciding whether or not to break from a union.
3. Also, what about the rest of the EU? This whole debate surrounding BREXIT must have caused **anxiety** and **uncertainty** throughout the EU; which in itself is a travesty and a betrayal of our common European heritage.

# BREXIT or not..?

