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# The Future of Policy Advice by Inter-governmental Institutions:
## Lessons from the UK's EU referendum Leave vote

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Prior to the UK's EU referendum held on 23 June 2016, the Bank of England's Monetary Policy Committee (MPC) stated, inter alia, that:

*The most significant risks to the MPC's forecast concern the referendum. A vote to leave the EU could materially alter the outlook for output and inflation, and therefore the appropriate setting of monetary policy. Households could defer consumption and firms delay investment, lowering labour demand and causing unemployment to rise. At the same time, supply growth is likely to be lower over the forecast period, reflecting slower capital accumulation and the need to reallocate resources. Sterling is also likely to depreciate further, perhaps sharply.*[1]

The Bank's Governor reportedly added that there were a range of possible scenarios for the economy in the event of Brexit and these "could possibly include a technical recession" – defined as two consecutive quarters of shrinking GDP.[2]

Brexit campaigners repeatedly accused the Governor of the Bank of England of going beyond his remit in setting out the Bank's view that EU membership was a net benefit to the British economy, and warning of the shock to the economy and financial stability that would follow a decision to leave the EU.[3]

Somewhat earlier, the UK Treasury published a report in which it assessed how much poorer the UK would become in the long run if it left the EU.[4] Its analysis suggested that Brexit would lead to a long-run fall in GDP of 3.8% relative to baseline under the Norway option (UK joins the European Economic Area); a 6.2% fall under the Canada option (UK negotiates a Free Trade Agreement with EU); and a 7.5% fall under the WTO option (UK trades with EU under WTO rules).

Among inter-governmental institutions, both the OECD and the IMF were notably explicit about economic and financial risks involved in Brexit.

In a press release titled "OECD study finds Britons will be paying a heavy 'Brexit tax' for many years if UK leaves EU", the OECD stated that:

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*A UK exit from the EU would immediately hit confidence and raise uncertainty which would result in GDP being 3% lower by 2020, which equates to GBP 2200 per household. The projected hit to living standards would amount in effect to a permanent "Brexit tax" on households*.[5]

In fact, the OECD presented three scenarios: optimistic, central and pessimistic, to assess the longer-term effects of weaker technical progress, migration and capital caused by Brexit. In the optimistic projection, the negative impact on GDP is around 2.7% by 2030, but in the pessimistic scenario it would be more than 7.5%. In the central scenario, UK GDP would be more than 5% below what would be expected if the country remained in the EU. This GDP shortfall was quoted as being equivalent to GBP 3200 per household.

The IMF also explored the potential impact of uncertainty on UK growth during the post-Brexit transition in two illustrative scenarios.[6] In the limited scenario in which uncertainty is relatively moderate and the UK was assumed to negotiate a status similar to that which exists between Norway and the EU, the study found that output would fall by 1.4% by 2019 (compared to the baseline case in which the UK remains in the EU). In the adverse scenario of long negotiations and a default to the trade rules of the WTO, GDP would plunge by 5.6% by 2019 (again compared to the baseline case in which the UK remains in the EU).

Both the OECD and the IMF resorted to a wide range of media communication instruments including speeches by the heads of the institutions as well as press releases for introducing and summarizing more technical reports prepared by their staff (in both paper and electronic forms) to publicize these findings.[7] A number of established newspapers and television news conveyed the key messages in their reports and also reported that they triggered rows with the Brexit camp.[8]

Immediately after the outcome of the referendum was disclosed, in an interview with an economics correspondent of The Guardian, Mervyn King, the former Bank of England governor, argued that exaggerated claims by George Osborne, UK Chancellor, and the Treasury over the Brexit campaign backfired, and that they will need to row back from their claims that left him "baffled." King reportedly said: "(I)t would have been enough to say there would be a great deal of uncertainty, but they went way beyond that, using precise numbers to say how much our living standards might fall." King pointed out that the debate over the Brexit could not be "reduced to a cost/benefit analysis."[9] While he was not explicit about the claims made by the OECD and the IMF, it may be that his comment could apply also to the warnings the two institutions gave in the run-up to the UK referendum.[10]

Several inter-governmental institutions have been tasked for many years to assess events or forces that involve significant risks to the management of the global economy and financial stability with a view to calling the attention of national policy makers, financial investors, economic agents and the civil society at large. These institutions' assessment of risks involved in the scenario of Brexit and its publication in the run-up to the referendum was their legitimate action and should not be considered as an infraction of UK sovereignty or interference in its domestic policy affairs. That said, it is relevant to assess their daunting tasks to conduct analytical work, including numerical exercises, dealing with economic and so-called "non-economic"[11]policy issues and to distill the results of analytical work into effective policy messages in terms of clarity and strength. Such messages are needed particularly for going beyond policy makers and reaching out to the general public in order to influence its opinion and thus help good policy making and execution.

This is not the first time that inter-governmental institutions have been put into difficulty. A notable case is found in the OECD work on the Multilateral Agreement on Investment (MAI) which was negotiated among OECD member countries between 1995 and 1998. The aim was to set out multilateral rules for ensuring international investment in a more systematic and uniform way between countries. However, when a draft of the Agreement was made public, sharp criticism was directed by civil society and a number of developing countries which argued that the Agreement would make it difficult to control foreign investors. A global campaign against it led to a withdrawal of France, the OECD's host country, from its negotiation. This prevented its adoption by the OECD which follows consensus procedures for the adoption of new rules.

In April 1998, the OECD published a report titled "Open Market Matters: The Benefits of Trade and Investment Liberalisation" to argue the case for open market and to discuss market openness and national sovereignty. But it did not prove to be sufficiently effective in diminishing the anxiety of those campaigning against the Agreement.

The OECD has changed greatly since then. It has been more openly encouraging debate to better deal with such global policy issues as economic growth, inequality, employment, financial stability, trade and investment, development, health and social welfare, the environment as well as public and private governance and regional development.

At the IMF also, efforts have been made to strengthen its surveillance activities notably since the debacles of the US and UK housing markets and ensuing global financial and economic crisis.[12]

Despite these efforts made by both the OECD and the IMF, it might be useful to discuss the future role of surveillance by these institutions in the light of their experience with policy advice made in the run-up to the UK referendum.

In a paper "The emotional politics of the EU Referendum: Bregrexit and beyond"[13], Karin Wahl-Jorgensen argues that the emotional politics were at the centre of the referendum. A conclusion I would from this paper is that inter-governmental institutions, policy advisers and economists more generally should carefully reconsider how to act if they wish to influence ordinary people's voting and other political actions in such an environment.[14]

It was suggested that pro-EU voters were more likely to shift position in response to a threat to their standard of living, while most Leave voters remained committed even when told they would personally lose out. According to one report (published on 31 May 2016, based on fieldwork between 14 and 25 April), just 7 per cent of Leave supporters surveyed said they would vote Remain if Brexit left them £500 a year worse off. Leave voters were largely those who are unlikely to change their allegiance for financial reasons.[15]

If this report reflects reality, does it imply that the inter-governmental institutions should have more squarely addressed so-called "non-economic" considerations on top of the assessment of macroeconomic costs of Brexit in making their policy advice? While such task may be beyond the remit of the IMF, should the OECD not have discussed more explicitly major "non-economic" issues involved in the Brexit campaign?[16] After all, unlike the IMF, the OECD deals with a wide range of government policy issues including social and employment affairs, inequality[17], regional development and so on.[18]

Actually, there is an OECD study in which rising inequality is estimated to have had a significantly negative effect on economic growth in the UK,[19] while the OECD report "Policy Challenges for the Next 50 Years" suggests a possible trade-off between trade exposure and economic growth.[20]

If the OECD and the IMF (and also the Bank of England and the UK Treasury) had taken into account lesser inequality as a policy objective of the UK government, their policy advice should have looked more balanced and more carefully presented than it had actually been prior to the UK referendum[21].

In a paper "Brexit and the impact of immigration on the UK" published immediately before the UK referendum, Jonathan Wadsworth et al. reported that "the areas of the UK with large increases in EU immigration did not suffer greater falls in the jobs and pay of UK-born workers" and that "the big falls in wages after 2008 are due to the global financial crisis and the a weak economic recovery, not to immigration". [22] This report does not seem to have had a significant impact on the voting decision of Brexiters. The inter-governmental institutions, which are intended to be neutral and objective, should have played a more important role in informing voters about such basic facts relevant to the Brexit debate, not focusing solely on mechanical estimates of macroeconomic costs of Brexit.

The making of solid policy advice by the inter-governmental institutions based on their assessment of so-called "non-economic" as well as economic forces working in the policy-making process, with better amalgamation of professional expert resources in economic, social and other policy areas, should go hand in hand with far more effective dissemination of their policy messages through their interaction with the general public.

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[1] Bank of England, Monetary Policy Summary, 12 May 2016, http://www.bankofengland.co.uk/publications/minutes/Documents/mpc/mps/2016/mpsmay.pdf.

[2] The Guardian, "Brexit could lead to recession, says the Bank of England", 12 May 2016, https://www.theguardian.com/business/2016/may/12/bank-of-england-keeps-interest-rates-on-hold-as-brexit-fears-bite.

[3] FT View, "This is no time to attack the credibility of the Bank of England", The Financial Times, 29 June 2016, http://www.ft.com/cms/s/0/8ef26a24-3de3-11e6-9f2c-36b487ebd80a.html#axzz4DL0lw6M9.

[4] See HM Treasury "Analysis: the long-term economic impact of EU membership and the alternatives", April 2016,

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517415/treasury_analysis_economic_impact_of_eu_membership_web.pdf.

[5] OECD, "OECD finds Britons will be paying a heavy "Brexit tax" for many years if UK leaves EU", Press Release, 27 April 2016, http://www.oecd.org/newsroom/oecd-study-finds-britons-will-be-paying-a-heavy-brexit-tax-for-many-years-if-uk-leaves-eu.htm.

[6] IMF, "If the U.K. leaves the EU: substantial negative effects" in IMF Survey Magazine "Uncertainty Clouds the United Kingdom's Economic Prospects", 17 June 2016, http://www.imf.org/external/pubs/ft/survey/so/2016/car061716a.htm.

[7] For example, OECD website: http://www.oecd.org/unitedkingdom/the-economic-consequences-of-brexit-a-taxing-decision.htm and Angel Gurría, OECD Secretary-General, "To Brexit or not to Brexit: A Taxing Decision", London, 27 April 2016, http://www.oecd.org/about/secretary-general/to-brexit-or-not-to-brexit-a-taxing-decision.htm as well as "IMF Executive Board Concludes 2016 Article IV Consultation with the United Kingdom", IMF Press Release No. 16/286, http://www.imf.org/external/np/sec/pr/2016/pr16286.htm and IMF Magazine, 17 June, 2016, http://www.imf.org/external/pubs/ft/survey/so/2016/car061716a.htm.

[8] For example, see: The Guardian, "Christine Lagarde urges UK to stay in the EU", 17 June 2016, https://www.theguardian.com/business/live/2016/jun/17/eurozone-finally-approves-75bn-greek-loan-business-live?page=with:block-5763bbfbe4b0a88a1c8731bf#block-5763bbfbe4b0a88a1c8731bf, and the BBC, "EU referendum: OECD warning of 'Brexit tax' sparks row", 27 April 2016, http://www.bbc.com/news/uk-politics-eu-referendum-36148316.

[9] Phillip Inman, "Mervyn King: Treasury's exaggerated Brexit claims backfired", The Guardian, 27 June, 2016, https://www.theguardian.com/business/2016/jun/27/mervyn-king-brexit-treasury-claim-backfired-osborne. The relevance of claims based on precise numbers was criticized in a more provocative manner by Anne Pettifor Anne Pettifor, "Brexit: economists dangerously irrelevant", Blog "Prime", 24 June, 2016, http://www.primeeconomics.org/articles/brexit-economists-dangerously-irrelevant.

[10] Wolfang Munchau, a columnist of the Financial Times, in his article of 25 September 2016 wrote: "… scare stories have added to a generalised loss of confidence in the economics profession and its reputation of independent judgement. With that loss also goes respect for international institutions such as the OECD and the IMF, all willing participants in the anti-Brexit scare".

[11] L. Alan Winters argues that, on close examination, the so-called "non-economic" objectives of agricultural support such as income distribution through income stability, the preservation of rural communities, family farms and the environment, and national security turn out to be economic and its objectives are "amenable to measurement in money terms", see Winters, A., (1990), "The so-called non-economic objectives of agricultural support", OECD Economic Studies 13, pp. 237-266, https://www.oecd.org/eco/outlook/34318482.pdf.

[12] On recommendations to improve the surveillance activities of the IMF as well as the OECD and the BIS, see Kumiharu Shigehara and Paul Atkinson, "Surveillance by International Institutions: Lessons from the Global Financial Crisis" (OECD Economic Department Working Paper No. 860, May 2011) http://www.oecd-ilibrary.org/economics/surveillance-by-international-institutions_5kgchzchkvd2-en?crawler=true.
See also IMF Independent Evaluation Office, "IMF Performance in the Run-up to the Current Financial and Economic Crisis: Issues Paper for an Evaluation by the Independent Evaluation Office", 2010 http://www.ieo-imf.org/ieo/files/completedevaluations/Crisis-%20Main%20Report%20(without%20Moises%20Signature).pdf.

[13] See "EU Referendum Analysis 2016:Media, Voters and the Campaign", Section 8 "Voters", http://www.referendumanalysis.eu/eu-referendum-analysis-2016/section-8-voters/the-emotional-politics-of-the-eu-referendum-bregrexit-and-beyond/.

[14] In his New York Times article of July 27 2016 "Why Voters Don't Buy It When Economists Say Global Trade Is Good", Gregory Mankiw refers fairly extensively to a study by Edward Mansfield and Diana Mutz. According to them, "trade preferences are driven less by economic considerations and more by an individual's psychological worldview." They also report that this isolationist, nationalist, ethnocentric worldview is related to one's level of education. Noting theses observations, Mankiw argues that "(I)n the long run, therefore, there is reason for optimism. As society slowly becomes more educated from generation to generation, the general public's attitudes toward globalization should move toward the experts'. The short run in which we find ourselves now, however, is another story". See Mansfield and Diana Mutz, "Support for Free Trade: Self-Interest, Sociotropic Politics, and Out-Group Anxiety", University of Pennsylvania, Annenberg School for Comminications, Departmental Discussion Papers, July 15 2009, http://repository.upenn.edu/cgi/viewcontent.cgi?article=1338&context=asc_papers.

For a more recent study on the relevance of the theory of sociotropic voting in Western Europe, see Italo Colanntone and Piero Stanig, "The Trade Origins of National Protectionism: Import Competition and Voting Behavior in Western Europe", Bocconi University, https://drive.google.com/file/d/0B3Q0uNVpd9TfSGZ5VHBUcnAwSE0/preview?pref=2&pli=1.

See also Wouter den Hann et al., "Brexit and the economics profession: Are academic economists out of touch with voters and politicians?", VOX, 12 August 2016, http://voxeu.org/article/cfm-survey-july-2016-brexit-and-economics-profession
and Charles Grant, "How Leave Outgunned Remain: The Battle of the 'Five MS' ", Centre for European Reform, 25 June 2016, http://www.cer.org.uk/insights/how-leave-outgunned-remain-battle-five-ms?ftcamp=crm/email//nbe/Brexit/product.

[15] Ipsos MORI, "Two thirds of Britons think their standard of living won't be affected by Brexit", 31 May 2016, https://www.ipsos-mori.com/researchpublications/researcharchive/3740/Two-thirds-of-Britons-think-their-standard-of-living-wont-be-affected-by-Brexit.aspx.

[16] Following Winters (see Endnote 11 above), it might have been useful to examine whether Brexit would be an efficient way in achieving its so-called "non-economic" objectives such as enhancing job security and reducing inequality.

[17] In the UK House of Lords debate on the EU referendum, Justin Welby, the Archbishop of Canterbuy, argued that widening inequality was the most pressing issue in the UK, http://www.archbishopofcanterbury.org/articles.php/5745/archbishop-speaks-in-lords-debate-on-eu-referendum.

[18] Note that the Independent Evaluation Office (IEO) of IMF is examining the IMF's involvement in social protection issues across its main lines of business—surveillance, lending, and capacity development. See "IMF and Social Protection: Issues Paper for an Evaluation by The Independent Evaluation Office (IEO)" (May 2016) where it is stated that:"(W)hile not an explicit part of its mandate, the IMF has addressed social protection issues" (page 1), http://www.ieo-imf.org/ieo/files/whatsnew/SP__Issues_Paper.pdf.

[19] Increased inequality between 1985 and 2005 was estimated to have knocked about 9 percentage points off the 1990-2010 growth rate of GDP growth as a result of rising equality between 1985 and 2005. See Federico Cingano, "Trends in Income Inequality and its Impact on Economic Growth", OECD Social, Employment and Migration Working Papers No. 163, 2014, http://www.oecd-ilibrary.org/docserver/download/5jxrjncwxv6j.pdf?expires=1470362560&id=id&accname=guest&checksum=5A3A0A6F45116FC94028385DC6A91C3D.

See also OECD Directorate for Employment, Labor and Social Affairs, "Focus on Inequality and

Growth: Does income inequality hurt economic growth?", December 2014, https://www.oecd.org/social/Focus-Inequality-and-Growth-2014.pdf.

[20] The OECD report notes that: "(T)he empirical analysis in Braconier shows that rising trade exposure is associated with lower labour shares of GDP, suggesting that (more mobile) capital benefits more from globalisation than (less mobile) labour. However, the role of rising international trade in explaining widening earnings and income differentials within countries remains open to dispute and compensating mechanisms, for example in terms of efficient adjustment of the skill composition to changes in relative wages, may explain part of the difference between these analyses. Indeed, most cross-country empirical analyses suggest that rising trade exposure explains little of recent increases in inequality.

While the overall impact of rising exposure to trade on aggregate wage differentials and employment may be limited, the social costs relating to the restructuring of production along new trade specialisation patterns may be much bigger. Trade reforms lead to reallocation of resources across sectors, occupations and firms as specialisation patterns respond to changes in relative prices. For instance, Levchenko and Zhang (2013) show that if factors of production are immobile across sectors, the integration of China, India and the Central and Eastern European countries into the world trade system may have increased aggregate welfare in the rest of the world by 0.4%, but factor incomes in individual sectors may fall or rise by more than 5%."

See OECD, "Policy Challenges for the Next 50 Years", OECD Economic Policy Paper No. 9, 2 July 2014, page36, http://www.oecd-ilibrary.org/economics/policy-challenges-for-the-next-50-years_5jz18gs5fckf-en.

[21] According to a most recent study, trade-induced increases in inequality of disposable income in the US erode about 20% of the gains from trade, while the gains from trade would be about 15% larger if redistribution was carried out via non-distortionary means. See P. Alonse et al., "Globalisation, Inequality and Welfare" (September 2016), http://scholar.harvard.edu/files/antras/files/agi_latest_draft.pdf.

[22] See CEP Brexit Analysis No.5, Centre for Economic Performance, The London School of Economics and Political Science, 11 May 2016, http://cep.lse.ac.uk/_new/publications/press1.asp?index=5053. See also Marco Alfano et al., "Immigration and the UK: Reflections After Brexit", September 2016, http://www.dagliano.unimi.it/media/WP2016_402.pdf.