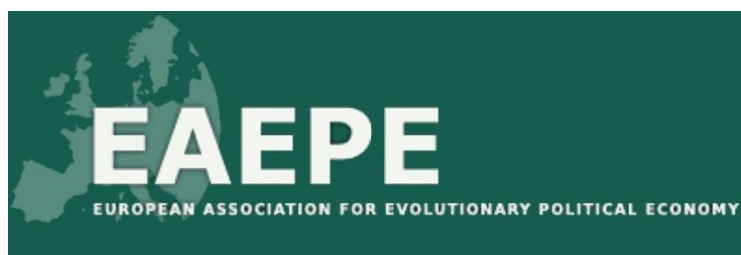




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Brexit: A new institutional economics perspective

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I. Introduction

On 23 June 2016, the United Kingdom (UK) decided to leave the European Union (EU). This British exit (Brexit) was not viewed as likely before the referendum, but it came to be. As news of the Leave camp's win circulated around the world, financial markets in both the UK and the rest of the world deteriorated, while the value of the pound sterling depreciated substantially. Although market conditions seem to have returned to normal after a few months, Brexit is still one of the main concerns of the world economy. For example, at the G20 summit in China in September 2016, leaders showed anxiety about the result and the impact of the UK referendum's creating additional uncertainty for the global economy (G20, 2016, Point 42).

In the context of the EU, Brexit means a severe retreat from the European integration project that began after World War II. The Lisbon Treaty of 2009 established the formal procedure for a member state to leave the EU, but there has been no departure of any member state, except for a region of Denmark, that is, Greenland, in 1985. Now, Brexit suggests that EU disintegration is not only a vague possibility but something to be wary of in the future. Since the UK is the second-largest country in the EU, it will seriously shrink in terms of population and GDP. After a series of severe times, like the euro crisis starting in 2009 and the refugee problem in 2015, the negative effects of Brexit must be minimised. Thus, formal and informal meetings of the remaining countries have been held so that the EU can show its solidarity to European citizens, as well as to the rest of the world. The Rome Declaration in March 2017 lays out the future for the remaining EU 27.¹

The UK is in the same or a more serious situation while dealing with the Brexit negotiation process. Prime Minister David Cameron was replaced by Theresa May, while the three ministers responsible for Brexit are struggling with each other. The general election in June 2017 made things more complicated because of the loss of a majority by the Conservative Party. Some commentators predict hardship for the UK economy after the country leaves the EU, although the economic data since June is not as ruinous as expected.² Even if the conditions the UK economy will face in the coming years are not clear at the moment, the UK government and the Bank of England have to do their best to prevent the economy from diving into recession.

¹ The homepage of the European Council provides information about the meetings on Brexit. See the Rome Declaration (European Council, 2017).

² See, for example, The Economist (2016), Wolf (2016), and so on.

This paper intends to analyse the meanings of and reasons for Brexit, rather than predicting the costs and benefits after Brexit. This theme can be justified for the following reasons. First, Brexit is not a rational choice for the UK, as will be seen. An interesting question is why UK voters chose to leave, despite this irrationality. Second, the referendum was to consult the preference of UK nationals. Without a precise examination what Brexit means for them, it is impossible to offer an appropriate policy to meet their demands. Third, the irrationality provides a good opportunity to reconsider the human model of economic analysis, since the orthodox theory, that is, the neo-classics, assumes rational decision-making by the economic actor.

Concerning the third point above, the UK referendum on EU membership is suitable for examining the rationality of economic actors. Political decision-making is much more complicated than economic decision-making, and it is difficult to assess the relationship between economic conditions and political choice. The general election provided the opportunity to choose not only members of parliament but also the party to govern the nation. The list of policies is long and includes various economic and social issues. Thus, a vote for a candidate can have different meanings from one voter to another. On the other hand, the referendum was very simple, asking voters to say ‘Yes’ or ‘No’ to EU membership. Further, the votes were counted at each constituent area, but the decision was made based on the total number at the UK level.³ Of course, membership in the EU has various meanings, but this is still a simpler criterion than found in other election cases.

This paper will show that the result of the UK referendum was heavily affected by anti-elitism, rather than rational decision-making. For this purpose, we compare the cases for and against Brexit (Ch. II), and suggest the irrationality of the UK’s leaving the EU (Ch. III). Chapter IV conducts a regression analysis of the Brexit vote at the local level, so that we can identify the character of the votes. Ch. V suggests that the rational actor model proposed by the neo-classics is not sufficient to explain Brexit. The alternative explanation based on new institutional economics emphasises anti-elitism, and our analysis examines the factors bringing about such anti-elitism. The economic inequality in the context of globalisation, and the egoism of elites contributed to generating the

³ The full details of the referendum votes can be obtained from the homepage of the Electoral Commission.

anti-elitism leading to Brexit (Ch. VI). After re-examining the appropriateness of the neo-classics model (Ch. VII), the concluding remarks are given in the final chapter.

II. Comparison of the cases for and against Brexit

In order to determine whether Brexit is suitable for the UK economy, it is reasonable to compare the arguments for and against Brexit.⁴ There were five main economic issues in the referendum debates: (1) the contribution to the EU budget, (2) immigration, (3) access to the Single European Market (SEM), (4) the relationship with non-European countries, and (5) economic sovereignty. Opinions on these five issues were opposite between the Leave and Remain camps, and we look at them in turn.

The first point made by Brexiters is that the UK's contribution to the EU budget is an irrelevant cost of membership. Since the UK is the second-largest economy in the EU, its contribution to the EU budget is quite large: 16.6 billion euro (12.9 billion pounds) gross in 2015. It is insisted that if the UK were to leave the EU, this amount could be freed up for other aims. For example, the UK Independence Party (UKIP) insists on spending an extra 3 billion pounds per year on National Health Service (NHS) funding, while more than 10 billion pounds could be saved by leaving the EU (UKIP, 2016). Another critic of the EU calculated the difference between the original planning and the actual expenditure of the EU budget, and found the actual contribution has been constantly larger than the original plan. The conclusion is that 'the direct fiscal cost of EU membership has been going up' (Congdon, 2015, p. 26).

On the other hand, the Remain camp insists that the UK contribution to the EU budget is overstated. Even if the UK is the second-largest contributor to the EU after Germany, it receives a special treatment known as the UK rebate, as well as the expenditure from the EU budget for various policies from agriculture and regional development to R&D. As a result, the net contribution of the UK to the EU in 2015 was 10.9 billion euro (8.5 billion pounds), rather than 16.6 billion euro (12.9 billion pounds). In addition, on the

⁴ For the arguments supporting the UK's leaving the EU in this section, see, for example, Bootle (2014), Congdon (2015), and Vote Leave (2016). For those to remain in the EU in this section, see, for example, HM Government (2016a, 2016b, 2016c), London First (2014), and PWC UK (2016). The analysis by PWC UK (2016) was sponsored by the Confederation of British Industry (CBI), the business organisation of large UK companies. Greenwood (2015) summarises the opinions both for and against Brexit. Outside the UK, the main international economic organisations have expressed the negative impacts of Brexit on the UK. See, for example, IMF (2016), OECD (2016), and WTO (2016).

day the Leave side won the referendum, Nigel Farage, the leader of UKIP, disavowed the pledge to spend 350 million pounds a week on the NHS after the EU departure (*Independent*, 23 June, 2016). In other words, the case concerning the EU budget is exaggerated, even if the UK still contributes to the EU budget.

Immigrants from (new) member states of the EU is the second concern. When the EU allowed entry to formerly socialist countries in 2004 and 2007,⁵ most of the old member states restricted the flow of people for a seven-year transition period. However, the UK opened its borders to those in the first wave in 2004, along with Ireland and Sweden, although the second wave of eastern enlargement in 2007 was restricted. The inflow of people from Central and Eastern European countries (CEECs) has steadily increased (Exhibit-1). The number of total foreign residents in the UK jumped from 5.3 million in 2004 to 8.3 million in 2014. Of this three million increase, immigrants from CEECs account for 1.3 million. In addition, those campaigning for Leave suggest that immigrants from CEECs enjoy the favourable conditions of the welfare system in the UK. Brexit allows the UK to restrict immigration, and to prevent of welfare tourism from CEECs.

(Exhibit-1)

Concerning immigration from the (new) member states, the points to be examined are twofold. First are the alternative possibilities of immigration, and second is the net impact of immigrants on social benefits. As seen in Exhibit-1, the share of foreign residents from new member states of the EU has been constantly increasing for the last decade. However, this is not only caused by the enlargement of the EU, but also by the UK itself. As the increasing trend of immigration as a whole suggests, the demand for foreign workers in the UK is still strong, owing to the demographic trends among British nationals, as well as the relatively strong economic growth for the last half decade. Furthermore, it is worth noting that emigration from the UK is constantly recorded at more than 300,000, mainly for the purpose of work.⁶ This UK emigration leads to a gap in the labour market, and increases the demand of immigrant workers. In addition, there are more immigrants from non-EU countries, like Commonwealth countries, than from

⁵ New member states of the EU in 2004 were the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia, as well as two Mediterranean countries, Cyprus and Malta; those in 2007 were Bulgaria and Romania.

⁶ The data on emigration can be obtained from various issues of *Migration Statistics Quarterly Report* published by the Office for National Statistics, UK.

the EU. Based on these considerations, Brexit does not have a strong basis for support.

Another point concerning immigrants is the impact on social welfare benefits. Brexiters criticise the welfare tourism from the CEECs. However, they fail to give clear evidence of welfare tourism. Indeed, people from new member states have constantly immigrated to the UK for the last decade, but they come to work. Consequently, they have to pay tax and social security contributions. In fact, Dustmann and Frattini (2014) found positive effects of immigration on the UK budget, especially from those of new member states, although the covered period is a little outdated, dating to 2011. Therefore, the argument for Brexit cannot be simply supported by consideration of welfare tourism, but there is also a serious possibility that the UK welfare budget could lose more from Brexit than remaining in the EU.

The third point is UK access to the SEM after Brexit. The single market is the most significant achievement of European integration, and the UK enjoys this benefit, especially in the service sectors. The single passport for financial services allows companies located in the UK to provide financial services throughout the EU without additional regulatory procedures. The Leave camp insists that the UK will be able to maintain favourable access to the SEM even after the exit from the EU. Since the UK is in a trade deficit with the EU, the latter needs the former more than *vice versa*. This is mainly because the EU has an incentive to maintain the same treatment of the UK. In fact, Norway and Switzerland are not member states of the EU, but they can export to the SEM like those within the EU.

The relationships of the EU with Norway and Switzerland are highlighted as examples of access to the SEM. However, precise examination makes clear that the UK will be worse off in the future. Indeed, these countries maintain the closest relations with the EU among the non-member states, but they are still in a less favourable position than the member states (HM Government, 2016b). Both countries have to contribute to the EU budget, and they allow the free movement of people as part of the Schengen Area. These are the two most serious concerns of Brexiters, as seen above. In addition, Switzerland is excluded from the free movement of services, including financial services, which is one of the most important exporting sectors of the UK.⁷ Furthermore, the UK

⁷ If the trade deficit gives the country in question a stronger position for negotiation than those with a trade surplus, as Brexiters insisted, then the UK must be weaker in the service sector trade negotiation.

will certainly **be** excluded from the decision-making process for EU law, which is crucial for the SEM. This means the UK will simply have to follow the regulations of the SEM without any say when it accesses to the SEM. Thus, it is fair to say that UK access to the SEM will be worse after leaving than before.⁸

The fourth point insisted on as a benefit of leaving the EU is a freer hand for the UK to construct relationships with the rest of the world. The global economy does and will grow through greater expansion of emerging economies outside Europe. Through the common commercial policy (CCP), the EU has the exclusive competence to deal with relationships with non-member countries, such as free trade agreements (FTAs). However, negotiations do not always go through smoothly, partly because of internal struggles of interests among the member states and EU organisations. The Leave camp insists that the UK would be able to independently and quickly negotiate and conclude the appropriate trade deals, once outside the EU.

Leaving the EU will not guarantee that the UK will be able to construct better relationships with the rest of the world. The EU has already been negotiating a series of the FTAs, including with big economies like the United States and Japan.⁹ It is unrealistic to assume those countries negotiating trade deals with the EU will put the UK before the EU after Brexit. Rather, they will surely request that the UK agree to the same or a similar deal as with the EU, in which the UK would get no say after the departure.¹⁰ In addition, since the EU possesses the exclusive competence for trade negotiation under the CCP transferred from the member states, the UK is relatively short of appropriate human resources for international trade negotiations. Without the weight of the EU as a whole and the necessary human resources, negotiation with other countries will be much harder for the UK.

The final point is that the UK has been losing power to make and pursue its own economic goals because it transferred its sovereignty to the EU. Even if this argument applies to the economic policy sphere, the UK has not been able to effectively prevent the

⁸ 'A more limited trade deal with the EU would give the UK less access to the Single Market than we have now – including for services' (HM Government, 2016a, p.8).

⁹ The negotiation for the Transatlantic Trade and Investment Partnership (TTIP) was postponed by the Trump Administration, but this does not mean that the United States would offer a favourable trade deal with the UK.

¹⁰ The Japanese government already presented such a request in September 2016 (MOFA, 2016).

decision-making in Brussels from working against its own interests. The EU is increasingly centralising power from trade and agricultural policy to monetary integration, and would go further to integrate tax policy in the future. Excessive EU regulations restrict the competitive capability of EU industries in both manufacturing and services. The supporters of Brexit suggest, 'The system is rigid, very slow, hard to fix when it goes wrong, and very costly' (Vote Leave, 2016, p. 13). Therefore, it is justified for the UK to leave the EU for the purpose of regaining its sovereignty.

Regaining sovereignty through Brexit is an excessive statement, although the member states of the EU more or less lose their sovereignty through the EU integration process. It is often said that the development of globalisation from the 1990s has prevented any country from conducting independent economic policies (Rodrik, 2011). Even if the UK leaves the EU, the restriction of sovereignty would not be changed in the era of globalisation. Rather, the February agreement of 2016 between the UK and the EU permitted the UK to enjoy a relatively free hand for its own economic policy (European Council, 2016). Although this agreement was not realised because of Brexit, it is fair to say that the UK government tried to do its best to maintain its sovereignty. It seems to be an illusion that the UK could regain its economic policy sovereignty through departure from the EU.

In addition to the counterarguments against Brexit, the Remain camp points out the concerns caused by Brexit. The size of the EU economy both in terms of the GDP and international trade including services is the largest in the world and therefore indispensable.¹¹ This makes the EU more attractive to foreign direct investment (FDI), which brings huge benefits to the UK economy,¹² while the EU can play a powerful role in setting the standard for global issues like the environment. On the other hand, leaving the EU will put the UK in a less stable position because of the uncertainties caused by the departure and negotiation process. For example, Donald Tusk, the President of the European Council, suggested the negotiation period could be seven years, rather than two years, which is the formal negotiation period to leave the EU set by the Lisbon Treaty

¹¹ The business community of London insists the 'opportunity for London – and British – business is not to leave the EU, but to drive the completion of the Single Market in services' (London First, 2014, p.10).

¹² Sanso-Navarro (2011) estimated the negative impact of UK non-membership to the euro on the inward-FDI into the UK. *The Nikkei*, a Japanese daily newspaper, reports the UK subsidiaries of Japanese companies suggested Brexit would risk production and jobs in the UK even before the referendum. *The Nikkei*, 4 March, 10 June, and 22 June 2016.

(*The Guardian*, 10 June 2016).¹³ During the negotiation period, business will face more difficult conditions in which to make decisions.

In sum, the cases supporting Brexit are less persuasive, as the counterarguments suggest the inadequacy of benefits brought by the UK's departure from the EU. The additional points above mentioned also imply that Brexit is not a rational decision for the UK economy.

III. Irrationality of Brexit

From the above examination of the arguments for and against Brexit, the rational reaction in the referendum should have been 'Remain', but the actual result was the opposite: 'Leave'. This seemingly irrational result should be further considered based on some other information. First, the UK economy was in good condition until the referendum. This is especially impressive, when we compare the UK with the EU or the euro area (Exhibit-2). Both the EU and the UK suffered very greatly in the global financial and economic crisis after the Lehman shock in 2008, but the recovery of the UK was much smoother than that of the EU. GDP growth is robust for the UK, though the decline in 2009 was almost the same as in the EU. The unemployment rate of the UK jumped from 5.6% in 2008 to 8.1% in 2011, but then decreased to 5.3% in 2015. The unemployment rate in the euro area in 2015 was still higher than the level in 2009. Thus, the macroeconomic condition in the UK cannot explain the support for Brexit.

(Exhibit-2)

Closely related to the above point, the good performance of the UK economy was, at least, one of the reasons for the Conservative Party's winning at the general election in 2015. The UK people gave it the mandate not for a coalition but for an independent government. The last government opened the way for the referendum, although the coalition partner, the Liberal Democrats, did not ask the referendum. The majority government elected in 2015 strongly supported EU membership for the UK (HM Government, 2016a). Thus, it is quite strange for UK opinion to support the government on one side, and to oppose it on another side. Of course, the political calculation is more complicated than the decision-making in the economic market, and the unique election system in the UK also

¹³ The uncertainty caused by the referendum postponed investment by the private sector in the first half of 2016, although it was expected that the rejection of Brexit could bring things back to normal (Bank of England, 2016).

makes the situation more confusing. Still, it is interesting to consider the irrationality and the reasons why the people in the UK supported Brexit.

Third, when the above situation is considered from a wider perspective than within the UK, an interesting issue can be raised. From the macroeconomic viewpoint, Brexit is an irrational policy choice for the UK. However, such an irrational response from ordinary people is not exclusive to the UK but can be recognised in other European countries and the rest of the world. The extreme right is attracting more support in Continental Europe, while during the campaign for the American presidential election in 2016, the Obama Administration was severely criticised, despite recent economic growth. The most extreme case of this kind of irrationality is the actual result of the U.S. Presidential election in 2016. Therefore, it is worthwhile to fundamentally reconsider the character of and the reasons for Brexit.

IV. Character of Brexit voters

As seen above, Brexit is surely not a rational choice for the UK economy, and it is necessary to identify who voted to Leave. In order to answer this question, we conduct a regression analysis, which confirms what factors influenced the referendum vote. The inquiry is to check the significant impacts of some independent variables on the dependent variable. Here, the share of the Leave vote is the dependent variable in our regression, and the referendum votes to Leave and Remain can be obtained at the local level of the UK except for Northern Ireland, which, therefore, is excluded from the regression analysis. Indeed, various data are available at the local level, but three factors are worth examining in the context of Brexit: income, the presence of migrants, and the change in migrants at the local level. The data for these variables were obtained from different sources, and the classifications of the local units differ among them. The income data are available at the NUTS 3 level,¹⁴ while the data concerning the vote and immigration are reported at a smaller local area than NUTS 3. Therefore, we aggregate the vote and the immigration data to the NUTS 3 level.

The precise explanation of the variables is as follows. The dependent variable is the ratio of Leave votes to total votes at the NUTS 3 level. Three independent variables collected at the NUTS 3 level are income, migrant presence, and change in immigrants. People's

¹⁴ NUTS is the Nomenclature of Units for Territorial Statistics in the EU, which is used for the purpose of looking at the situation at the sub-national level. NUTS 1 is the largest area, while NUTS 3 is the smallest.

voting decisions are significantly influenced by economic conditions. The disposable household income per head in 2013, the latest available data, expressed in 1,000 pounds is used as the variable for income. Other independent variables are concerning migration, since immigrants were a serious concern in the Brexit debate. One of these is the ratio of the non-UK-born population to the total population at the NUTS 3 level as the migrant presence. This is a proxy for people making contact with and knowing about immigrants. Another is the change of immigrants from 2004 to 2015, representing the migrant change. Immigrants have not flowed into each area equally, and some areas receive more than others. Unlike natural growth of the population, immigrants put some pressure on the local economy and society. The temporary shortage of infrastructure like schools is a typical example, while the downward pressure of local wages can be another. The descriptive statistics values are presented in Exhibit-3.

(Exhibit-3)

The equation for the regression analysis is as follows.

$$SLV_i = \beta_0 + \beta_1 V_i + e_i$$

The dependent variable, SLV_i , is the share of Leave votes to total votes at local i , and β_0 is the constant. β_1 is the coefficients of the independent variables vector, V_i , which includes the three independent variables mentioned above. e_i is the error term.

We conduct simple and multiple regression analysis. The simple regression analysis examines each independent variable on the voting pattern of Leave at the local level, while the multiple regressions analyse the sign and significance of the combined two or three variables. The results are summarised in Exhibit-4. Among the six regressions shown in Exhibit-4, Reg-6, combining all three independent variables, has the highest adjusted R^2 with significance of the coefficient at the 0.1% or 1% level.

(Exhibit-4)

Despite the different specifications of the six regressions, the signs of the coefficients of each independent variable are the same. The income and the migrant presence are negative, while the change in migrants is positive. The statistics significance of each independent variable is at 0.1% or 1% level. The negative sign of the income coefficient

means that the lower the income of the people is, the more they tend to vote to Leave. This suggests that low-income people may not agree with the merits of EU membership presented by the UK government and industry organisations.

The negative sign of migrant presence suggests that the more the people interact with migrants, the less they vote to Leave. The negative campaign by Brexiters against migrants was more accepted by those with less opportunity to exchange with migrants. In other words, once people know migrants through daily life, their prejudice, which might well lead to restriction of immigrants, seems to be reduced. On the other hand, the change in migrants shows a positive sign for the Leave votes. This means that a rapid inflow of migrants is likely to induce people to vote to Leave, which could restrict the inflow. Thus, the actual presence of migrants does not always negatively affect the perception of immigrants, but the rapid increase over the last decade or so causes unacceptable feelings.

The regression analysis at the local level confirms the character of those voting for Brexit. First, Brexit voters tend to be low-income people, rather than high-income elites who insist EU membership is a benefit for the UK. Second, the people with scarce contact with immigrants are more likely to vote for Brexit than those with more exchanges. It is highly possible that the Brexit vote may well have been influenced by prejudice against immigrants. At the same time, the people facing a rapid inflow of migrants voted more to Leave than others. The impact of migrant inflow will be considered in the latter part of this paper.

V. The neo-classical perspective

The viewpoint of neo-classical economics has very limited scope and power to explain Brexit, since neo-classics is based on rational decision-making by economic actors fully using the available information.¹⁵ According to the neo-classics line of explanation, decision-making producing an irrational result is caused by lack of sufficient information in the real world. In fact, there are some examples of this kind in the Brexit debates. It is not easy to follow and judge all the information concerning the costs and benefits of Brexit. The costs estimated by the Remain camp, including the UK government, are based on a sophisticated simulation model, but they seem to be very complicated and to

¹⁵ Hodgson (1988) provides a good criticism of the limits of the neo-classics model of economic actors.

out of reach of ordinary people. Therefore, the information given by the Remain camp might well be quite difficult to incorporate in the rational decision-making of normal voters.

At the same time, those insisting on the departure of the UK gave simple reasoning. For example, they merely raised the gross contribution of the UK to the EU budget, rather than the net one. This makes the costs seem larger than they actually are. Another example of the Brexit side not telling the full story concerns the negotiating position, which will surely differ between the merchandise trade and the service trade. As a result, voters were more likely to make a mistake in the referendum. Hence, the explanation for Brexit using the neo-classics has to rely on insufficient or incorrect information in the real world. However, the irrational judgement caused by insufficient information does not seem to fully warrant that more than 17 million people voted to leave the EU.

In addition, the relationship between the Brexit vote and the existence of immigrants further confirms the irrational vote, rather than a vote based on the real facts. Since the Brexiters provoked fear of immigrants, areas with a higher share of immigrants were more likely to vote to leave the EU. However, our analysis in the last chapter gives the opposite result. The lower the immigrants' share of the population in an area, the more it voted to leave the EU. This result means that prejudice about immigration partly lead people to follow the Brexit campaign, rather than the actual experience of their lives.¹⁶ This also confirms the inappropriateness of the rational agent model of the neo-classics.

VI. The new institutional economics perspective

VI-1. Anti-elitism behind the Brexit vote

An alternative to the neo-classics explanation of Brexit should be looked for, and our suggestion is anti-elitism, which is anger and the distrust of the elites. The Brexit vote is anti-elitism, because those insisting the UK should stay in the EU were public and private establishments. They included the UK government and the Bank of England, CBI, and London First. Here, it is important to recognise that anti-elitism is not an organised ideology like Marxism or Liberalism, but is still an ideology in the Northian sense.¹⁷ This ideology was expressed through the formal institution, that is, the

¹⁶ This does not mean that immigration has nothing to do with the voting pattern, but more precise consideration is necessary to clarify the effects. Later, we return to this point.

¹⁷ 'By ideology I mean the subjective perceptions ... all people possess to explain the world around them' (North, 1990, p. 23). See also Hodgson (2006) and Williamson

referendum.

A referendum is a rare formal institution to collect the opinions of the entire nation. Ordinary economic actions like purchasing goods in a market can be easily adjusted in a daily life. However, the second chance of the referendum on the same issue is rarely given, and people should seriously consider the possible result. Thus, even if the Brexit vote is irrational, anti-elitism is not necessarily a short-term feeling. Rather, it is constructed on fundamental and deep thoughts, and the feelings behind the referendum votes should be included in consideration of policy-making. As seen in the following, anti-elitism is the anger and distrust created through long experience. Thus, the important task is to examine what factors contribute to anti-elitism.

VI-2. Factors creating anti-elitism

We propose that two factors create the anti-elitism expressed through the referendum: economic inequality in the context of globalisation, and the egoism of the elites themselves. We look at them in turn.

VI-2-1. Economic inequality

As the analysis in the Chapter IV suggests, low-income people played the decisive role in the vote for Brexit. Here, it is worth recalling that low incomes at present are the result of dynamic development over the last decades in the UK. As the new institutional economics insists, the cognition of people to see and understand the world has been adjusted through experience over a long period. Thus, it is worthwhile to point out that low incomes affecting anti-elitism are the result of the diverging process over the last decades. Then, we further consider this issue with special attention to globalisation, since it is enhanced by the EU.

Over the last two or three decades, the UK has experienced economic inequality with a diverging trend.¹⁸ The Gini-coefficient of the whole population worsened in the late 1980s from something like 0.25 to more than 0.35, and the level has been maintained for the last two decades (Exhibit-5). The Gini-coefficient of the retired also worsened from 0.20 to 0.30 in the same period, and a worsening trend can be seen again from 2009.

(2000).

¹⁸ Economic inequality with a divergent trend is a worldwide phenomenon. As *The Capital in the 21st Century* (Piketty, 2013) came to be a best-seller around the world, economic inequality has been attracting attention from a wide variety of perspectives. See also Atkinson (2015), Stiglitz (2016), Tachibanaki (2016), and so on.

Here, it is worth mentioning that some retired people experienced worsening of economic inequality twice in their lives. The first time was when they were in their late 30s, working in the late 1980s. In those days, the EU integration process showed new revival under the SEM programme, as well as the single currency debate. Since then, they worked for two decades, and retired in the 2010s, when another worsening tide came for them. Thus, it is reasonable for older people to have a negative attitude against EU membership, as seen in the opinion poll.¹⁹

(Exhibit-5)

The absolute level of economic inequality is more remarkable than the trend of the Gini-coefficient (Exhibit-6). The income after tax doubled between 1992/93 and 2014/15 for most categories of income group. For example, income for those at the 50% point grew from 10,100 pounds to 20,000 pounds, while that for the top 10% increased from 21,100 pounds to 42,300 pounds. The most impressive increase can be recognised for the top 1% from 45,300 pounds to 108,000 pounds. The comparison suggests the relative changes for the last two decades are almost same, but the absolute differences between those at the middle and the top undeniably widened. In 1992/93, the differences between those at the 50% point on one hand, and the top 10% or 1% on the other hand are merely 16,400 pounds and 35,200 pounds, respectively. However, they became much wider in 2014/15 at 22,300 pounds and 88,000 pounds. Despite the income growth of the bottom half of people for the last two decades, the top-level earners' incomes grew much faster.

(Exhibit-6)

The economic inequality confirmed above could be caused by various factors, as Atkinson (2015) insists. He lists technological advancement, the development of financial services, the change of wage norms, the shrinking role of trade unions, the decline of redistribution policies, and globalisation. These are closely related with each other, and we cannot deal with all of them. Rather, it is worth seeing the relationship between economic inequality and globalisation in the context of the Brexit referendum. This is not only because the elites insist the European project has been bringing economic

¹⁹ Concerning the opinion poll, see, for example The Economist's 'Brexit' poll-tracker (<https://www.economist.com/blogs/graphicdetail/2016/06/britain-s-eu-referendum>). One of the reasons the young people show support for the EU is that even if economic inequality is at a high level, they are familiar with this level of inequality, which has not dangerously worsened,.

benefits but also because the EU is one of the most powerful drivers advancing the globalisation trend at the European level through the SEM, and the single currency.

One of the factors contributing to people's anger against elites is that the benefits generated by globalisation over the last quarter century are unbalanced, and the EU is the most important actor to advance economic liberalism. Even if globalisation improves the economic efficiency of a country as a whole through more efficient allocation of resources and more enhanced competition, the realised benefits are not always harmoniously distributed amongst the people. Some sectors see a comparative advantage, while others fare worse based on globalisation because of stagnation or reduction of wages, and job losses.

The uneven distribution of the benefits of globalisation is not a simple theoretical prediction, but an actual fact. According to a figure showing the average weekly earnings (AWE) in May 2016 reported by the ONS (2016), for example, the AWE of the textile manufacturing sector was the lowest at 383 pounds, while those of the chemical manufacturing sector and of the financial services sector were 740 pounds and 1,081 pounds, respectively. It should be noted that such a divergence results from adjustment through contraction and expansion along with globalisation. This basic logic is one of the forces leading to economic divergence. Without the appropriate policy support for those suffering, social discontent could be easily become more serious.

Here, the character of the labour market is significant for the adjustment to globalisation. The UK is well known to regulate the labour market very little, especially compared with Continental Europe (Sapir, 2006). This seems to reduce the social costs caused by globalisation through the smooth reallocation of resources including the labour force. At a glance, both the low unemployment rate and the quick recovery from the global depression after the Lehman shock prove the capability of the UK labour market to adapt to dramatic changes. However, this is only part of the adjustment process, and we should keep in mind that biased adjustment causes a heavy burden for labour.

The biased burden sharing can be confirmed by the unsupportive responses of the UK government. The UK has been advancing globalisation ever more but not giving the public support for the necessary adjustments. According to Rodrik (1998), contrary to the general perception, the expansion of international trade does not restrict the role of the government in question, but needs to increase the macroeconomic importance of the

government.²⁰ He confirmed that the share of the government expenditure in GDP generally increases along with the development of the share of international trade, that is, exports plus imports, of GDP. Since international trade is likely to fluctuate more than domestic demand, the national government should provide a buffer for the fluctuations caused by the international economy. Thus, a complementary, rather than substitutable, relationship between trade and the government is necessary for the smooth development of globalisation. However, the UK took the opposite approach, especially after the global depression of 2008.

If Rodrik's hypothesis is correct, then the UK experience of the last decade has intensified social strain. Along with Rodrik's method, we look at the relationship between trade and the government of the UK for the last two decades (Exhibit-7). The Exhibit shows the relationship, and the government size in GDP clearly followed trade expansion from 1997 to 2009. However, the UK reduced the share of government expenditure in GDP from 21.8% in 2009 to 19.4% in 2015 despite the fact that UK trade increased its five-year average share of GDP from 50.4% to 58.3% in the same period.²¹ Even if the UK government succeeded in ideologically enacting the retreat of the welfare state (Milton, 2016), the consequence was a shift of social costs to individuals. Wage stagnation and the increase of economic inequality can be easily translated into distrust of elites who insist on the benefits of globalisation.

(Exhibit-7)

The UK government's unsupportive response to globalisation can be confirmed through additional evidence. In 2007, the EU launched the European Globalisation Adjustment Fund (EGF) to support those made redundant through globalisation pressure.²² The EGF is not so large in size that it can fully support all those suffering, but most member states of the EU still apply it to receive financial help for people who lost their jobs. There were 159 applications from 2007 to 2015, and the EGF offered 576.7 million euro for 135,712 redundant people and young people not engaged in employment, education, or training (NEETS) as a whole. Here, the surprising fact is that the UK has never applied

²⁰ North et al. (2009) also insist the state can and should become larger to support the competitive market, rather than reduce its size, which differs from the declaration of neo-liberalism.

²¹ The data are obtained from the OECD database, and calculated by the author of this paper.

²² The data and information concerning the EGF can be obtained from its website.

the EGF at all. Since some advanced member states with relatively low unemployment rates, like Germany and the Netherlands, have also applied the EGF, non-application by the UK is quite distinguished. The UK is very reluctant to support weak people who are suffering from globalisation, and these people may well be against remaining in the EU.

The character of the labour market should be further examined in the context of globalisation through immigrant workers, since the Brexit vote was influenced not by their actual presence, but by the change of immigrants' number (Reg-3,5, and 6, Exhibit-4). Immigrants may influence wages in both negative and positive ways. If the immigrant workers are competitive with native workers, the wages of the latter are very likely to decline. This is simply because the labour market cannot maintain the increased labour supply at the same wage level, and workers have to adjust their wage to a lower level. However if the immigrant workers are complementary to the combination of capital on the one hand, and the labour force, especially skilled workers scarce in the host country, on the other hand, the immigrants could contribute to increasing productivity, and to enable the host economy to grow more rapidly. As a result, both natives and immigrant workers can enjoy higher wages.²³ The actual labour market is likely to be a mixture of these characteristics, and the empirical analysis needs to assess the impacts of immigrant workers.

Concerning the UK, Nickell and Saleheen (2015) conducted an empirical study of the impact of immigration on wages, and they confirm three findings. First, immigration flow reduces wage level at the local level. Second, those who suffer most work in semi/unskilled services such as in care homes, restaurants, and bars. Finally, the source of immigrants has indifferent effects. That is, those from the EU do not show any different impact than those from non-EU countries. Thus, globalisation of labour movement significantly but unevenly influences low-wage people. This reflects the voting pattern confirmed by our regression analysis. If locals experience a combination of low income and a rapid inflow of immigrants, they tended to vote more for Brexit.

Multinational enterprises (MNEs) also influence jobs and the workers' conditions in the context of globalisation. In general, the foreign direct investment (FDI) conducted by MNEs is positively assessed for the host economy, since it brings not only tangible assets like financial capital resources but also intangible ones like technology, know-how, and

²³ In the context of EU integration, this argument is presented by Zimmermann (2004, 2009).

skills into the host country. Therefore, one of the main reasons for the UK to remain in the EU is the location advantage for the inward-FDI, which can be realised through EU membership. However, we should not forget the negative impact of MNEs, that is, job losses through divestment. According to Ando (2015, 2017), the largest European MNEs conducted divestment from both the host and the home countries in Europe. The total losses in the EU were more than 37,000 jobs between 2004 and 2015, and the UK suffered the most with 8,500 job cuts attributable to divestment. Thus, globalisation through MNE activities also brings social pressure and stress.

VI-2-2. Egoism of the elites

Anti-elitism is further reinforced by the egoism of the elites themselves. If hard work and rare talent are appreciated, this may well justify that the top earners receive a much higher income than ordinary people. However, if this is not the case for those with higher income, the reaction may well be negative feelings and distrust against them. Unfortunately, many examples show that the high level of income cannot be easily justified based on the feelings of ordinary people.

The financial sector is one of the strongest advocates for the EU membership, while the top earners in this sector seem to be treated very favourably within the industry itself and by the government. The Lehman shock in 2008 severely and negatively damaged the global economy. Facing the financial crisis, the UK government provided public money to prevent deterioration of the financial system. The financial sector in the UK cut nearly 50,000 jobs in 2009 and 2010. However, total bonuses in the financial sector increased from 11.6 billion pounds in 2008/09 to 14.6 billion pounds in 2010/11. On the other hand, the non-financial sector reduced total bonuses from 22.4 billion pounds to 21.0 billion pounds during the same period.²⁴ Moreover, although the UK government has held 72% of the shares of the Royal Bank of Scotland since 2009, and it was in its eighth straight year of losses, the chief executive officer (CEO) doubled his income from 1.8 million pounds in 2014 to 3.8 million pounds in 2015 (*Financial Times*, 26 February 2016).

The top executives in other sectors are also criticised for their high incomes in spite of a large number of job cuts or unsatisfactory results. The retiring CEO of AstraZeneca, a pharmaceutical giant, received more than 9 million pounds in payment in 2011 despite

²⁴ Data on job cuts are from the European Restructuring Monitor database, and those on bonuses are from Healey (2014), p. 2.

the unfavourable performance due to the patent gap (*The Telegraph*, 16 July 2012). One of the top earners in 2014 was the CEO of Royal Dutch Shell, a petroleum company, with 24 million pounds in payments (*The Guardian*, 12 March 2015), while he led the restructuring plan to reduce jobs by 10,300 in 2015 and 2016 (*The Guardian*, 14 December 2015; 15 April 2016). The board members of Smith & Nephew, a medical equipment company, decided to pay themselves 2.1 million pounds in 2016, even though the company did not achieve the sales target set in 2015 (*Alliance News*, 15 April 2016). These cases were viewed unfavourably by ordinary people, while some shareholders opposed the decisions about the payments for executives. Such objections are sometimes called the ‘Shareholders’ Spring’, although votes at shareholder meetings were not compulsory for executive payments.

In addition, the unfair behaviour of the elites is also made clear by the so-called Panama Papers, which reveal information about the users of the tax haven in April 2016. The Panama Papers show that many top leaders, as well as MNEs, make use of tax havens to reduce their tax burden. Such treatment is neither available nor necessary for most ordinary people. Among the cases in the Panama Papers, the most impressive concerns David Cameron, the (former) prime minister of the UK, who denied the illegality of holding and selling the funds of his late father. In the context of Brexit, the point is not the lawfulness, but the fairness for the voters considering the trustworthiness of the elites. His involvement could not help the opposition against Brexit.

Brexit is not a rational choice for the UK economy as a whole, but low-income people tended to vote against remaining in the EU. The main explanation is the anti-elitism of lower-income people, who have suffered economic divergence through the development of globalisation as well as the unfairness of the elites themselves.

VII. Reconsidering the neo-classical line of explanation

The previous chapter suggests the Brexit vote was a result of anti-elitism, which has been created through experiences of increasing economic inequality due to globalisation. From this consideration, the Leave vote also seems to be explained by the neo-classics model of economic actors making rational decisions. This is because the economic benefits of the EU are mainly macroeconomic in nature, but they are not always equally distributed at the microeconomic level. Those left behind and negatively influenced by globalisation might well vote to leave the EU to reverse the trend, and this seems to be a rational decision for them. As a final question, we should consider to what extent such

an explanation of Brexit can be verified.

In order to say the Brexit vote is a rational choice by the people with lower income, who have suffered inequality in the context of globalisation, an additional and significant assumption must be satisfied. That is, the voters have to believe that Brexit could improve economic conditions at the expense of top earners, who were the main opposition to Brexit. This assumption should be considered in two different situations after Brexit. First, if the economic situation is improved by Brexit, and second, if the UK economy declines after Brexit. We consider these consecutively.

The first situation, that is, the improvement of the UK economy based on Brexit, is not generally assumed in most analyses before the referendum, but some economists predict favourable changes after Brexit. Bootle (2014) is one of the supporters, insisting that Brexit could create a better economic situation for the UK. He insists the EU puts political purposes before the economic ones, and the economic effects of the EU, especially of the single currency, are exaggerated. Furthermore, he suggests the future relations of the UK with the EU after Brexit would not be as seriously damaged as the opposing group suggested, since the worst case scenario, that is, WTO status, is the same as the present relationship between the EU and the United States or Japan. However, leaving the EU could make both the manufacturing and the service industries less regulated, allowing them to more freely operate their businesses. As a result, the UK economy would be able to increase productivity more than within the EU.

The main argument for the favourable economic impacts of Brexit is that, while most conditions the UK enjoys under EU membership would not seriously change, the UK will be free from over-regulation by the EU. Indeed, unchanged access to the SEM may well be gained through UK departure negotiations,²⁵ but less regulation than within the EU cannot be justified to support improvement of the conditions for low-income people. This is mainly because history tells us that deregulation often leads to not less but more power for big companies over their workers. As seen before, the 1980s are remembered not only for the worsening of economic inequality but also as the age of deregulation.²⁶ Without

²⁵ Since a hard Brexit became the basic position of the UK government, the assumption of maintaining the same access to the SEM could not be fulfilled (HM Government, 2017). This certainly makes the argument that Brexit would improve the UK economy more fragile and unreasonable.

²⁶ It is noteworthy that Bootle (2014) emphasises the strength of the UK financial sector even after Brexit, but he ignores economic inequality.

changes to legal institutions, the labour side cannot realise better distribution of income after deregulation. The positive impacts of Brexit on the UK macroeconomy will not automatically improve economic conditions for non-elites. Thus, it is not reasonable of low-income economic actors to vote for Brexit as a rational choice.

Concerning the second situation, the decline of the UK economy, the Remain camp has already criticised Brexit from various perspectives. However, it is quite difficult to judge the actual impacts of Brexit, because many other factors influence the UK economy, even after the referendum. Indeed, some economic indicators, like retail sales, are not as negative after the referendum as expected, but it is worth pointing out that the UK government and the Bank of England have already started to minimise the negative effects of Brexit. Extending the time limit for the reduction of the budget deficit, and cutting interest rates, are typical examples used to reduce the negative reactions to Brexit. Still, we should consider what the worsening of the UK economy would do to the non-elites' economic conditions.

Once we assume the worsening of the economic situation after Brexit, it is quite difficult to expect a positive turnaround for low-income people. Since the labour market would be expected to become looser under such conditions, it is unreasonable to expect workers to be able to turn the balance of power more favourably toward themselves. This means the depressing pressure on wages would be heavier than otherwise. Therefore, the assumption that Brexit will improve the conditions for non-elites at the expense of elites can be easily rejected in the case of the negative impact of Brexit on the UK economy.

From the above consideration, we can conclude that the neo-classical model is not suitable for the explanation of the UK referendum. This is mainly because the neo-classics are not able to explain Brexit based on the rational judgement of the people who have suffered for several decades. Rather, it is more natural for most people to look at the situation of the UK through an anti-elitism lens when making their decision.

VIII. Conclusion

Brexit is one of the most serious issues for the UK, as well as for Europe and the world, but the decision seems not to have been made based on rational calculations. As low-income people tended to vote for Brexit, anti-elitism played a decisive role. Economic inequality in the context of globalisation, and the egoism of elites, contributed to people's distrust of the elites, who strongly insisted the UK should stay in the EU. This finding

is also a strong criticism against the neo-classics human model, which assumes rational decision-making.

The result of the analysis summarised above is helpful to assess the policy responses to Brexit. The British government decided to start the negotiation of Brexit with the EU in March 2017, and to withdraw from the SEM (HM Government, 2017). Indeed, the details of the terms and conditions of the UK departure will be negotiated between the UK and the EU, but the government of Theresa May shows clear difference from the previous one. For example, George Osborn, the former chancellor, suggested a corporate tax cut just after Brexit, while Phillip Hammond, the new chancellor intends to extend the budget tightening. In addition, the prime minister herself also suggested a change to shareholders' power over the payment of board members. From our analysis, these can be assessed as appropriate policy changes to deal with the anger of ignored people more carefully than before.

The issues that have not been fully analysed are pointed out in these final remarks. First, the relationship between economic inequality and globalisation is not sufficiently investigated. Second, since distrust is more subjective than economic inequality and globalisation, it is quite difficult to measure. Third, Brexit cannot be the solution for economic inequality in the context of globalisation, nor for the anger caused by it. Thus, under the severe conditions during and after the Brexit negotiation, what policy can the UK government undertake? Fourth, the same question has to be answered by the remaining EU side as well. This is especially significant for liberal countries like the Netherlands, but more difficult without the UK than with it. The last but not least important issue is how the model should be constructed with economic actors influenced not only by rational thinking but also by the irrational feelings like distrust and anger. Answering these questions is not an easy task, but a challenging one for the future.

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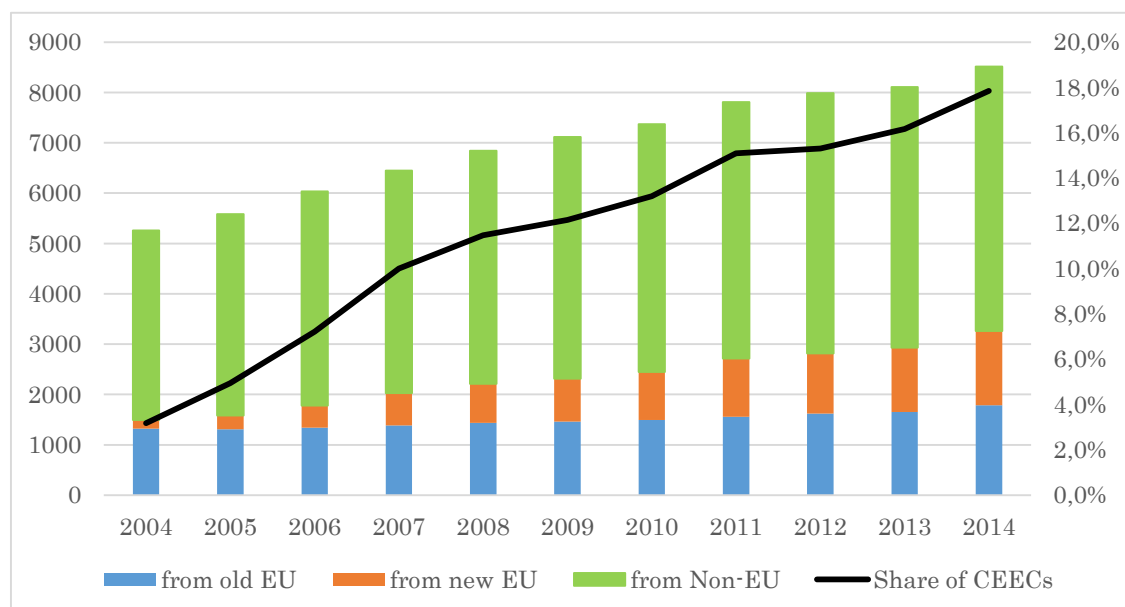
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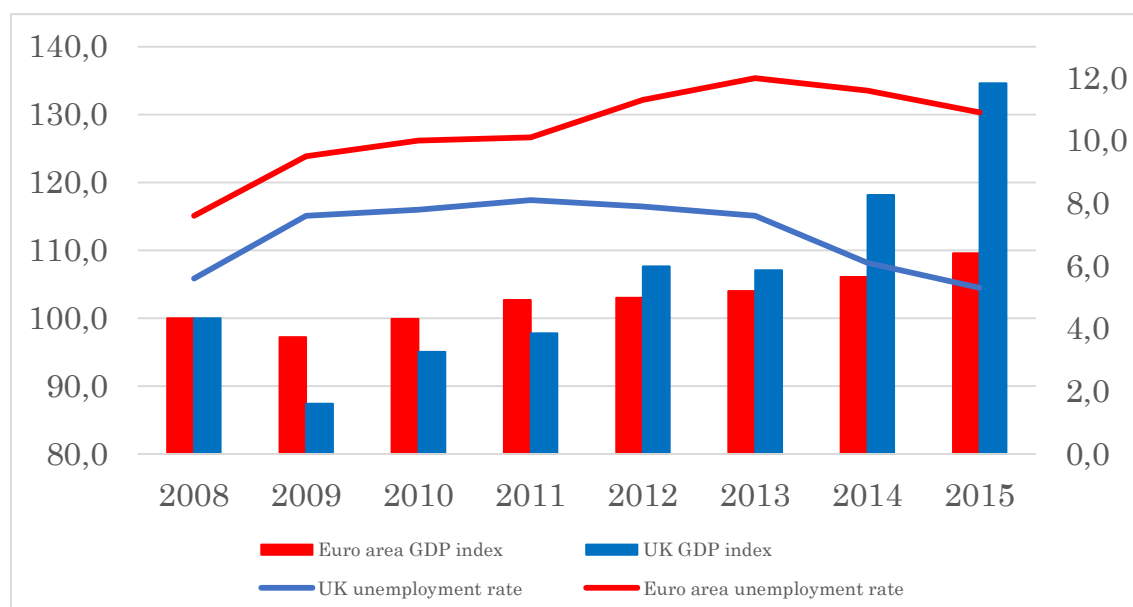
Exhibits

Exhibit-1 Foreign residents in the UK (1,000 persons, %)



Source: Office of National Statistics

Exhibit-2 GDP index (2008=100, left-hand side) and unemployment rate (% , right-hand side) of the UK and Euro areas



Source: Eurostat

Exhibit-3 Descriptive statistics values

	Leave	Income	Migrant presence	Migrant change
Observation	165	165	165	165
Average	0.518	1.750	0.129	0.719
Max	0.723	4.358	0.539	2.750
Min	0.214	1.174	0.016	-0.200

NOTES

Leave: Ratio of “Leave” votes to total votes

Income: Disposable household income per head in NUTS3 in 2013 (1,000 pounds)

Migrant share: Rate of non-UK-born residents to total population in NUTS3 in 2015

Migrant change: Rate of change in migrants from 2004 to 2015

Source: Leave vote: Electoral Commission

Income: Office for National Statistics (ONS) Regional Gross Disposable Household Income (GDHI) NUTS3 tables

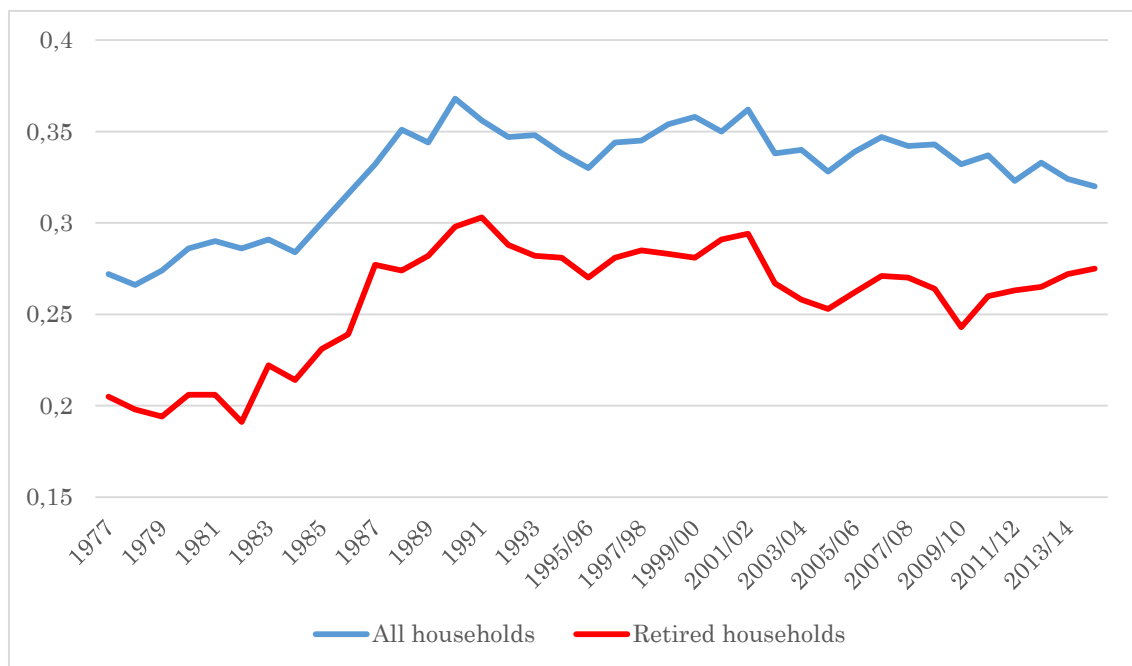
Migration dataset: Local Area Migration Indicators, UK

Exhibit-4 Impact of income and immigrants on voting “Leave”

	Reg-1	Reg-2	Reg-3	Reg-4	Reg-5	Reg-6
Income	-0.118 (0.001 > p)	-	-	-0.082 (0.001 > p)	-0.106 (0.001 > p)	-0.072 (0.001 > p)
Migrant presence	-	-0.443 (0.001 > p)	-	-0.284 (0.001 > p)	-	-0.271 (0.001 > p)
Migrant change	-	-	0.066 (0.001 > p)	-	0.042 (0.01 > p)	0.038 (0.01 > p)
Adjusted R ²	0.233	0.215	0.091	0.297	0.266	0.324

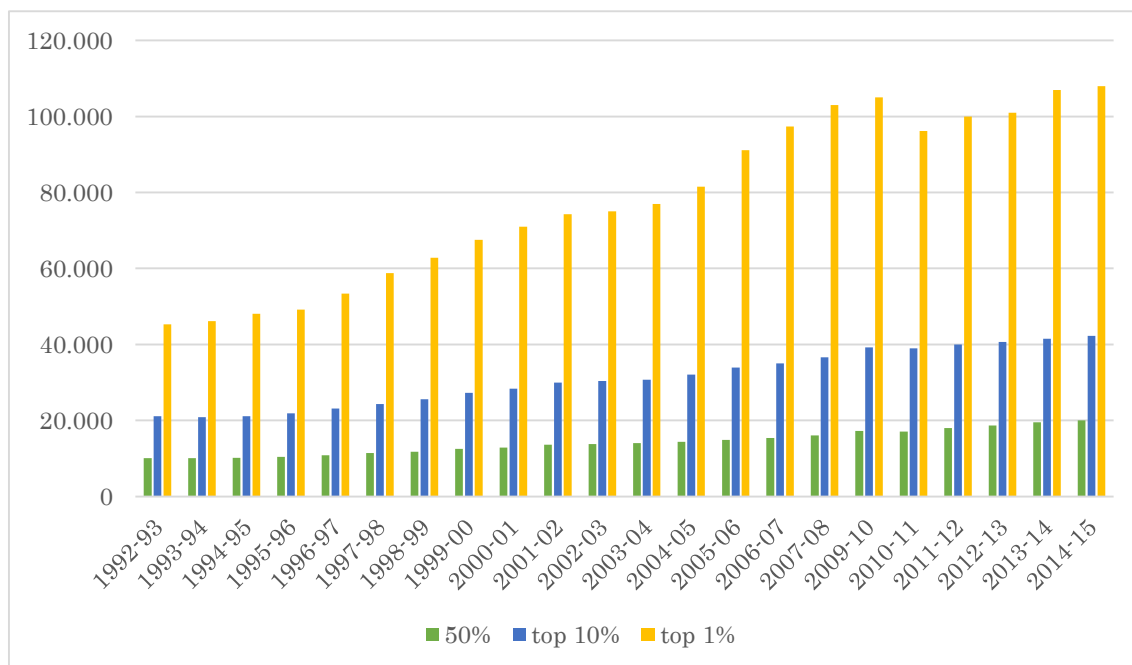
Source: same as Exhibit-3

Exhibit-5 Long-term trend of Gini co-efficient in the UK



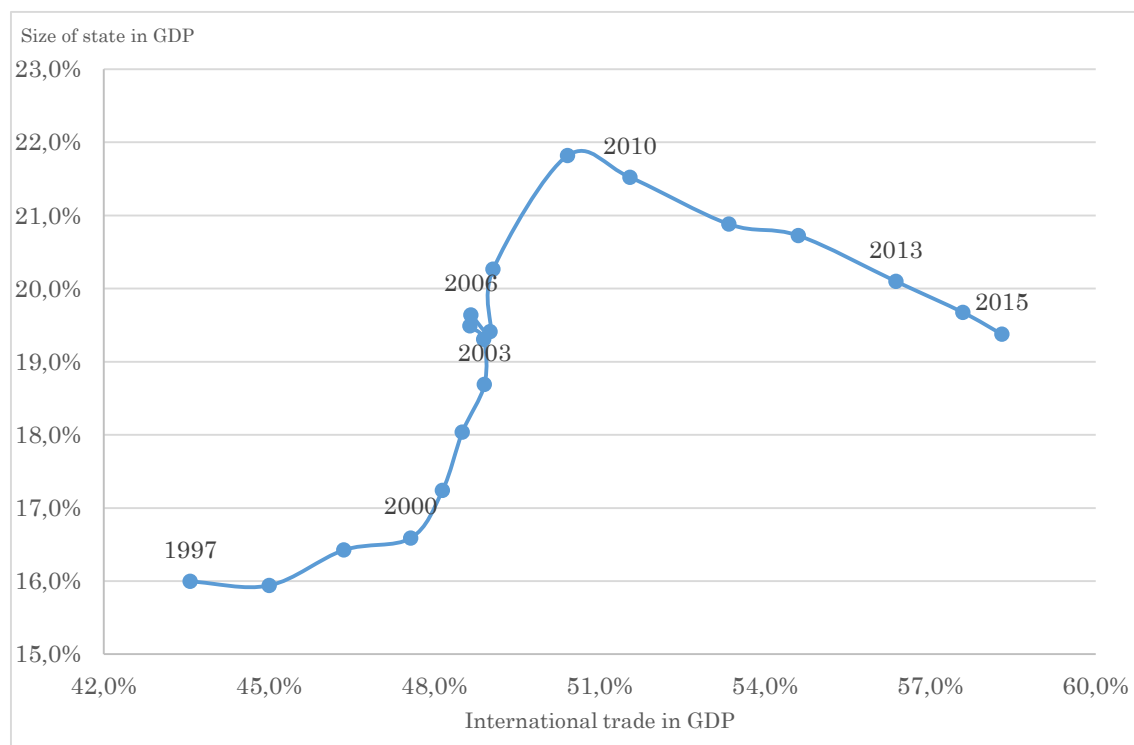
Source: Office of National Statistics

Exhibit-6 Economic inequality in the absolute term, after-tax income (pound sterling)



Source: Office of National Statistics

Exhibit-7 International trade* and size of state (% in GDP)



*: International trade (sum of exports and imports of goods and services) in GDP, 5 year average of between year T-6 and year T-1

Source: calculating from the ONS data