Brexit: the November 25th agreement

By Catherine Mathieu and Henri Sterdyniak

The United Kingdom will leave the European Union on 29 March 2019 at midnight, two years after the UK government officially announced its wish to leave the EU. Negotiations with the EU-27 officially started in April 2017.

On 8 December 2017, the negotiators for the European Commission and the British government signed a joint report on the three points of the withdrawal agreement that the Commission considered to be a priority[1]: the rights of citizens, a financial settlement for the separation, and the absence of a border between Ireland and Northern Ireland. The European Council meeting of 14-15 December had accepted the British request for a transitional period, with the end set for 31 December 2020 (so as to coincide with the end of the programming of the current European budget). Thus, from March 2019 to the end of 2020, the United Kingdom will have to respect all the obligations of the single market (including the four freedoms and the competence of the European Court of Justice – CJEU), while no longer having a voice in Brussels. This agreement opened the second phase of negotiations.

These negotiations culminated on 14 November 2018 in a withdrawal agreement[2] (nearly 600 pages) and a political declaration on future relations between the EU-27 and the United Kingdom, which was finalized on 22 November 22 [3] (36 pages). The two texts were approved on 25 November at a special meeting of the European Council [4] (all 27 attending), which adopted three declarations on that occasion[5]. The withdrawal agreement and the political declaration must now be subject to the agreement of the European Parliament, which should not be a problem and, what is much more difficult, the British Parliament.

The withdrawal agreement corresponds to Article 50 of the Treaty on the Functioning of the European Union (TFEU). It is a precise international agreement, which has legal value; it must be enforced by the UK courts, under the authority of the CJEU as far as EU laws are concerned. It takes up the points already settled by the negotiations in December 2017: the rights of British citizens in EU countries and the rights of EU citizens in the UK; and the financial settlement. It has three protocols concerning Ireland, Cyprus and Gibraltar. Any disagreements on the interpretation of the agreement will be managed by a joint committee and, if necessary, by an arbitration tribunal. The latter will have to consult the CJEU if this involves a question that one of the parties considers to be relevant to EU law. In July 2020, a decision could be reached to extend the transition period beyond 31 December 2020: this would require a financial contribution from the UK.

A safeguard clause will be applied to avoid the re-establishment of a physical border between Northern Ireland and the Republic of Ireland (the “backstop”): the United Kingdom will remain a member of the Customs Union if no other agreement has been concluded before the end of the transition period, and for an indefinite period, until such an agreement is reached. This agreement must be approved by the joint committee. The Customs Union will cover all goods except fisheries (and aquaculture) products. The United Kingdom will not have the right to apply a trade policy that differs from that of the Union. British products will enter the single market freely, but the UK will align with EU rules on state aid, competition, labour law, social protection, the environment, climate change and taxation. In addition, Northern Ireland will continue to align with single market rules on VAT, excise duties, health rules, etc. Controls could be put in place on products entering Northern Ireland from the rest of the United Kingdom (in particular for agricultural products), but these controls would be carried out by the UK authorities.

Thus, trapped by the issue of the Irish border, the United Kingdom must forgo for an indefinite period any independent trade policy. It will have to align itself with European regulations in many areas, subject to the threat of recourse to the CJEU.

The 22 November Joint Political Declaration outlines the possible future relations between the UK and the EU-27. On the one hand, it clearly corresponds to the goal of the close, specific and balanced relationship that the British have demanded. On the other hand, the UK is making a number of commitments that rule out any possible strategy of being a “tax and regulatory haven”.

Article 2, for instance, states that the two parties intend to maintain high standards for the protection of worker and consumer rights and the environment. Article 4 affirms respect for the integrity of the single market and the four freedoms for the EU-27, and for the United Kingdom the right to conduct an independent trade policy and to put an end to the free movement of persons.

In general, the Declaration states that both parties will seek to cooperate, to discuss, and to take concerted action; that the United Kingdom will be able to participate in Union programmes in the fields of culture, education, science, innovation, space, defense, etc., under conditions to be negotiated.

Article 17 announces the establishment of an ambitious, wide-ranging, comprehensive and balanced free trade agreement. Articles 20 to 28 proclaim the desire to create a free trade area for goods, through in-depth cooperation on customs and regulatory matters and provisions that will put all participants on an equal footing for open and fair competition. Customs duties (as well as border checks on rules on origin) will be avoided. The United Kingdom will strive to align with European rules in the relevant areas[6]. This kind of cooperation on technical and health standards will allow British products to enter the single market freely. In this context, the Declaration recalls the intention of the EU-27 and the UK to replace the Irish backstop with another device that ensures the integrity of the single market and the absence of a physical border in Ireland.

In terms of services and investment, the two parties are considering broad and ambitious trade liberalization agreements. Regulatory autonomy will be maintained, but this must be "transparent, efficient, compatible to the extent possible". Cooperation and mutual recognition agreements will be signed on services, in particular telecommunications, transport, business services and internet commerce. The free movement of capital and payments will be guaranteed. In financial matters, equivalence agreements will be negotiated; cooperation will be established in the domain of regulation and supervision. Intellectual property rights will be protected, in particular as regards protected geographical indications. Agreements will be signed on air, sea, and land transport and on energy and public procurement. The parties pledge to cooperate in the fight against climate change and on sustainable development, financial stability, and the fight against trade protectionism. Travel for tourism or scientific, educational or business motives will not be affected. An agreement on fisheries must be signed before 1 July 2020.

Provisions will have to cover state aid and standards on competition, labour law, social protection, the environment, climate change and taxation in order to ensure open and fair competition on a level playing field.

The text provides for coordination bodies at the technical, ministerial and parliamentary levels. Every six months, a high-level conference will review the agreement.

Negotiations will continue on trade so as to ensure compatibility between the integrity of the single market and the Customs Union and the UK’s development of an independent trade policy.

On the one hand, the text provides for a close and special partnership, as requested by the United Kingdom; on the other hand, the UK pays for this by its commitment to respect European rules; finally, problematic issues still need to be negotiated, including fishing rights, an independent British trade policy, and avoiding the Irish backstop. On 25 November, the European Council wanted to adopt two declarations. The first emphasizes the importance of reaching an agreement on fisheries before the end of the transitional period and making it possible to maintain the access of EU-27 fishermen to British maritime waters. It also links the extension of the transitional period to compliance by the United Kingdom with its obligations under the Irish protocol. It recalls the conditions that the EU-27 had set on 20 March 2018 for an agreement: “The divergence in external tariffs and internal rules, as well as the absence of common institutions and a common legal system, require checks and balances and controls to safeguard the integrity of the EU single market and the UK market. Unfortunately, this will have negative economic consequences, particularly in the United Kingdom … A free trade agreement cannot offer the same advantages as the status of a Member State.” The second Declaration states that Gibraltar will not be included in the future trade agreement negotiated between the UK and the EU-27; a separate agreement will be necessary and subject to Spain’s prior approval. These declarations will not make it easy for Theresa May to win the approval of the UK Parliament.

It is necessary to highlight two points that were barely mentioned in the negotiations. This privileged partnership could serve as a model for relations with other countries. The EU has signed many customs union agreements with its neighbors, the countries of the European Economic Area (Norway, Iceland, Lichtenstein), as well as Switzerland, Ukraine, Georgia and Moldova. Five countries are candidates for entry (Albania, Montenegro, Serbia, Kosovo and Northern Macedonia). Perhaps these partnerships could be formalized in a third circle around the EU?

Does not the commitment to fair competition impose some level of tax harmonization in the EU-27, particularly with respect to the rates and terms of corporation tax? Was the EU-27 right to support the Irish Republic without some quid pro quo? It is unclear how the EU-27 could accuse the UK of practicing unfair competition when it tolerates the practices of Ireland, the Netherlands and Luxembourg. Likewise, the insistence on arrangements that prevent the UK from engaging in unfair tax and social competition contrasts with the EU's laxity both in its relations with third countries and in the control of the internal devaluation policies of certain member countries (e.g. Germany).

On balance, the United Kingdom gets to regain its national sovereignty, to cease being subject to the CJEU, and to no longer need to respect the freedom of establishment of workers from EU countries. In return, it will have no voice in Brussels.

The business community has welcomed the proposal as it avoids the risks of No Deal and announces a free trade agreement between the UK and the EU that would impose few restrictions on trade.

To date, there is no certainty that the UK parliament will approve the deal proposed by Theresa May and the EU-27 negotiators. Theresa May must find a majority for a compromise deal. She will encounter opposition from Conservative hard Brexiteers who are prepared to leave without an agreement so that the United Kingdom can "regain control", engage in trade negotiations with third countries, get out from under European regulations, and begin a policy of deregulation that would make the UK a tax and regulatory haven. But the UK is already one of the countries where the regulation of the goods and labor markets is the most flexible. A sharp cut in taxes would imply further cuts in social spending, contrary to the promises of the Conservative Party. And leaving with no deal would erect barriers to the UK's access to the single market for its products and services. Theresa May will clash with the Irish Unionist Party (DUP), which is opposed to any differences in the treatment of Northern Ireland, as well as with Scottish nationalists, who want Scotland to remain in the EU. She will also have to confront the Remainers (Conservatives, Labour and Liberal Democrats) who, buoyed by some recent polls, are calling for a new referendum. While Jeremy Corbyn is not calling into question the result of the referendum, many Labour MPs could vote against the text, even if they are supporters of a soft Brexit, as the Treaty organizes. They hope to provoke early elections that could allow them to return to power. They claim they will resume negotiations after that, making every effort to obtain a better deal for the United Kingdom, which would allow it to enjoy "the same advantages as at present as members of the Customs Union and the Single Market" and to control migration. But the EU-27 has clearly refused any resumption of negotiations, and some Labour forces want a new referendum … Theresa May's hope is that fear of a No deal will be strong enough to win approval for her compromise.

If, initially, Brexit seemed to weaken the EU, by showing that it was possible for a country leave, the EU has demonstrated its unity in the negotiations. It became clear quickly that leaving the EU was painful and expensive. The EU is a cage, more or less gilded, which it is difficult, if not impossible, to escape.

[1] See: *Joint report from the negotiators of the EU and the*

UK government on progress during phase 1 of negotiations under Article 50 on the UK's orderly withdrawal from the EU, 8 December 2017. See Catherine Mathieu and Henri Sterdyniak, "Brexit: Pulling off a success", *OFCE blog*, 6 December 2017.

[2] https://ec.europa.eu/commission/sites/beta-political/files/draft_withdrawal_agreement_0.pdf

[3] https://www.consilium.europa.eu/media/37059/20181121-cover-political-declaration.pdf

[4] https://www.consilium.europa.eu/media/37114/25-special-euco-final-conclusions-fr.pdf et

[5] https://www.consilium.europa.eu/media/37137/25-special-euco-statement-fr.pdf

[6] The vagueness is in the text: "The United Kingdom will consider aligning with Union rules in relevant areas".

Brexit: Roads without exits?

By Catherine Mathieu and Henri Sterdyniak

The result of the referendum of 23 June 2016 in favour of leaving the European Union has led to a period of great economic and political uncertainty in the United Kingdom. It is also raising sensitive issues for the EU: for the first time, a country has chosen to leave the Union. At a time when populist parties are gaining momentum in several European countries, Euroscepticism is rising in others (Poland, Hungary, Czech Republic, Slovenia, Slovakia), and the migrant crisis is dividing the Member States, the EU-27 must negotiate Britain’s departure with the aim of not offering an attractive alternative to opponents of European integration. There can be no satisfactory end to the UK-EU negotiations, since the EU’s goal cannot be an agreement that is favourable to the UK, but, on the contrary, to make an example, to show that leaving the EU has a substantial economic cost but no significant financial gain, that it does not give room for developing an alternative economic strategy.

According to the current timetable, the UK will exit the EU on 29 March 2019, two years after the official UK government announcement on 29 March 2017 of its departure from the EU. Negotiations with the EU officially started in April 2017.

So far, under the auspices of the European Commission and its chief negotiator, Michel Barnier, the EU-27 has maintained a firm and united position. This position has hardly given rise to democratic debates, either at the national level or European level. The partisans of more conciliatory approaches have not expressed themselves in the European Council or in Parliament for fear of being accused of breaking European unity.

The EU-27 are refusing to question, in any respect, the way that the EU is functioning to reach an agreement with the UK; they consider that the four freedoms of movement (goods, services, capital and persons) are inseparable; they are refusing to call into question the role of the European Court of Justice as the supreme tribunal; they are rejecting any effort by the UK to “cherry pick”, to choose the European programmes in which it will participate. At the same time, the EU-27 countries are seizing the opportunity to question the status of the City, Northern Ireland (for the Republic of Ireland) and Gibraltar (for Spain).

Difficult negotiations

On 29 April 2017, the European Council adopted its negotiating positions and appointed Michel Barnier as chief negotiator. The British wanted to negotiate as a matter of priority the future partnership between the EU and the UK, but the EU-27 insisted that negotiations should focus first and foremost on three points: the rights of citizens, the financial settlement for the separation, and the border between Ireland and Northern Ireland. The EU-27 has taken a hard line on each of these three points, and has refused to discuss the future partnership before these are settled, banning any bilateral discussions (between the UK and a member country) and any pre-negotiation between the UK and a third country on their future trade relations.

On 8 December 2017, an agreement was finally reached between the United Kingdom and the European Commission on the three initial points[1]; this agreement was ratified at the European Council meeting of 14-15 December[2]. However, strong ambiguities persist, especially on the question of Ireland.

The European Council accepted the British request for a transitional period, with this to end on 31 December 2020 (so as to coincide with the end of the current EU budgeting). Thus, from March 2019 to the end of 2020, the UK will have to respect all the obligations of the single market (including the four freedoms and the competence of the CJEU), even though it no longer has a voice in Brussels.

The EU-27 agreed to open negotiations on the transition period and the future partnership. These negotiations were to culminate at the European summit in October 2018 in an agreement setting out the conditions for withdrawal and the rules for the transition period while outlining in a political statement the future treaty determining the relations between the United Kingdom and the EU-27, so that the European and British authorities have time to examine and approve them before 30 March 2019.

However, both the EU-27 and the UK have proclaimed that "there is no agreement on anything until there is an agreement on everything", meaning that the agreements on the three points as well as on the transition period are subject to agreement on the future partnership.

Negotiations for the British side

The members of the government formed by Theresa May in July 2016 were divided on the terms for Brexit from the outset: on one side were supporters of a hard Brexit, including Boris Johnson, who was then in charge of foreign affairs, and David Davis, then tasked to negotiate the UK's departure from the EU; on the other side were members who favoured a compromise to limit Brexit's impact on the British economy, including Philip Hammond, Chancellor of the Exchequer. The proponents of a hard Brexit had argued during the campaign that leaving the EU would mean no more financial contributions to the EU, so the savings could be put to "better use" financing the UK health system; that the United Kingdom could turn to the outside world and freely sign trade agreements with non-EU countries, which would be beneficial for the UK economy; and that getting out of the shackles of European regulations would boost the economy. The hard Brexiteers argue against giving in to the EU-27's demands, even at the risk of leaving without an agreement. The goal is to get free of Europe's constraints and "regain control". For those in favour of a compromise with the EU, it is essential to avoid a no-deal Brexit – "going over the cliff" would be detrimental to British business and jobs. In recent months, it has been this camp that has gradually strengthened its positions within the government, leading Theresa May to ask the EU-27 for a transitional period during her Florence speech of September 2017, which also responded to the demands of British business representatives (including the Confederation of British Industrialists, the CBI). On 6 July 2018, Theresa May held a government meeting in the Prime Minister's Chequers residence to agree on British proposals on the future relationship between the United Kingdom and the European Union. The concessions made in recent months by the British government together with the Chequers proposals led David Davis and Boris Johnson to resign from the Cabinet on 8 July 2018.

On 12 July 2018, the British government published a White Paper on the future partnership[3]. It proposes a "principled and practical Brexit"[4]. This must "respect the result of the 2016 referendum and the decision of the UK public to take back control of the UK's laws, borders and money". It is about building a new relationship between the UK and the EU, "broader in scope" than the current relationship between the EU and any third country, taking into account the "deep history and close ties".

The White Paper has four chapters: economic partnership, security partnership, cross-cutting and other cooperation, and institutional arrangements. As far as the economic partnership is concerned, the agreement must allow for a "broad and deep economic relationship with the rest of the EU". The United Kingdom proposes the establishment of a free trade area for goods. This would allow British and European companies to maintain production chains and avoid border and customs controls. This free trade area would "meet the commitment" of maintaining the absence of a border between Northern Ireland and the Republic of Ireland. The UK would align with the relevant EU rules to allow friction-free trade at the border; it would participate in the European agencies for chemicals, aviation safety and medicines. The White Paper proposes applying EU customs rules to the imports of goods arriving in the UK on behalf of the EU and collecting VAT on these goods also on its behalf.

For services, the UK would regain its regulatory freedom, agreeing to forego the European passport for financial services, while referring to provisions for the mutual recognition of regulations, which would preserve the benefits of integrated markets. It wishes to maintain cooperation in the fields of energy and transport. In return, the UK is committed to maintaining cooperative provisions on competition regulation, labour law and the environment. Freedom of movement would be maintained for citizens of the EU and the UK.

The security partnership would include the maintenance of cooperation on police and legal matters, the UK's participation in Europol and Eurojust, and coordination on foreign policy, defence, and the fight against terrorism.

The White Paper proposes close cooperation on the circulation and protection of personal data as well as agreements for scientific cooperation in the fields of innovation, culture, education, development, international action, and R&D in the defence and aerospace sector. The UK wishes to continue to participate in European programmes on scientific cooperation, with a corresponding financial contribution. Finally, the United Kingdom would no longer participate in the common fisheries policy, but proposes negotiations on the subject.

In institutional matters, the UK proposes an Association Agreement, with regular dialogue between EU and UK Ministers, in a Joint Committee. The UK would recognize the exclusive jurisdiction of the CJEU to interpret EU rules, but disputes between the UK and the EU would be settled by the Joint Committee or by independent arbitration.

Up to now Theresa May has tried to assuage both the hard Brexiteers – the UK will indeed leave the EU – and supporters of a flexible Brexit – the UK wants a deep and special partnership with the EU. Theresa May regularly repeats that the UK is leaving the EU but not Europe, but her compromise position is not satisfying supporters of a net Brexit. In September 2018, Boris Johnson has been accusing Theresa May of capitulating to the EU: "At every stage in the talks so far, Brussels gets what Brussels wants…. We have wrapped a suicide vest around the British Constitution – and handed the detonator to Michel Barnier. We have given him a jemmy with which Brussels can choose – at any time – to crack apart the union between Great Britain and Northern Ireland"[5]. According to Johnson, the Chequers plan loses all the benefits of Brexit. The Remainers, those in favour of staying in the EU, are campaigning for a new referendum. This is nevertheless unlikely. Theresa May rejects it out of hand as a "betrayal of democracy".

The Conservative Party's annual convention, to be held from September 30 to October 3, could see Boris Johnson or Jacob Rees-Mogg[6] run for head of the Party. They do not have majority support, however, and the polls show Theresa May with greater popularity than her challengers. Barring a dramatic twist, Theresa May will continue to lead the Brexit negotiations in the coming months.

The British Parliament decided last December 13 that it will have a vote on any agreement with the European Union. So Theresa May must also find a parliamentary majority concerning the UK's orderly withdrawal, in the face of opposition from both Remainers and hard Brexiteers, which will require the support of some Labour MPs and will therefore be difficult.

The proposals of the July White Paper were not deemed acceptable by Michel Barnier. In August, Jeremy Hunt, the UK's new Foreign Minister, estimated the risks of a lack of agreement at 60%. On 23 August 2018, the government published 25 technical notes (out of 80 planned) that spell out the government's measures to be taken in case of a no-deal exit in March 2019. Their objective is to reassure businesses and households about the risks of shortages of imported products, including certain food products and medicines. At the time these notes were published, Dominic Raab, the new Minister in charge of the Brexit negotiations, took care to recall that the government does want an agreement be signed and that the negotiators agree on 80% of the provisions of the withdrawal agreement.

If the EU-27 remains inflexible, the British government will face a choice between leaving without an agreement, which the “hard” Brexiteers are ready to do, and making further concessions. Philip Hammond recalled the risks of failing to reach an agreement. But Theresa May is sticking to her line that the lack of an agreement would be preferable to a bad deal. On 28 August, she echoed the words of WTO Director-General Roberto Azevedo, that leaving without an agreement would not be “the end of the world”, but nor would it be “a walk in the park”. In an opinion column in the *Sunday Telegraph* of 1 September 2018, she reaffirmed her desire to build a United Kingdom that is stronger, more daring, based on meritocracy, and adapted to the future, outside the EU.

The negotiations from the EU viewpoint

The EU-27 is refusing that the UK could stay in the single market and the customs union while choosing which rules it wants to apply. It does not want the UK to benefit from more favourable rules than other third countries, in particular the current members of the European Economic Area (the EEA: Norway, Iceland, Liechtenstein) or Switzerland. EEA members currently have to integrate all the single market legislation (in particular the free movement of persons) and contribute to the European budget. They benefit from the European passport for financial institutions, while Switzerland does not.

In December 2017, Michel Barnier made it clear that lessons had to be drawn from the United Kingdom’s refusal to respect the four freedoms, its regaining of its commercial sovereignty, and its termination of its recognition of the authority of the European Court of Justice. This rules out any possibility of its participation in the single market and the customs union. The agreement with the UK will be a free trade agreement, along the lines of the agreements signed with

Canada (the CETA), South Korea and more recently Japan. It will not concern financial services.

During the 2018 negotiations, the EU-27 was not particularly conciliatory about a series of issues: the UK's obligation to apply all EU rules and the guarantee of the freedom of establishment of people until the end of the transitional period; the Irish border (arguing that the absence of physical borders was not compatible with the UK's withdrawal from the customs union, demanding that Northern Ireland remain in the single market as long as the UK does not come up with a solution guaranteeing the integrity of the internal market without a physical border with Ireland); the role of the CJEU (which must have jurisdiction to interpret the withdrawal agreement); the EU's decision-making autonomy (refusing the establishment of permanent joint decision-making bodies with the UK); and even Gibraltar and the British military bases in Cyprus.

Thus, on 2 July 2018, Michel Barnier[7] accepted the principle of an ambitious partnership, but refused any land border between the two parts of Ireland, while indicating that a land border is necessary to protect the EU (this would mean that the only acceptable deal would involve a border crossing between Northern Ireland and the rest of the UK, which is unacceptable to the UK). He refused that the EU "loses control of its borders and its laws". Barnier therefore rejected the idea that the UK would be responsible for enforcing European customs rules and collecting VAT for the EU. He insisted that future cooperation with the UK could not rely on the same degree of trust as between EU member countries. He called for precise and controllable commitments from the United Kingdom, particularly with respect to health standards and the protection of Geographical indications. He wanted the agreement to be limited to a free trade agreement, with UK guarantees on regulations and state subsidies, and with cooperation on customs and regulations.

The UK would have to renegotiate all trade agreements, both with the EU and with third countries. These agreements will probably take a long time to set up, and in any case more than two years. The lack of preparation and the disorganization with which the UK has tackled the Brexit negotiations augurs poorly for its ability to negotiate such agreements quickly. The matter of re-establishing customs controls is crucial and delicate, whether in Ireland, Gibraltar or Calais. Many multinational corporations will relocate their factories and headquarters to continental Europe. The loss of the financial passport is a given. It is on this point that the British could see further losses, given the weight of the City's business (7.5% of British GDP). The United Kingdom will have to choose between abiding by European rules to maintain some access to European markets and entering into confrontation by a policy of liberalization. The EU-27 could seize the opportunity of the UK's departure to return to a Rhine-based financial model, centred on banks and credit rather than on markets or, on the contrary, it could try to supplant the City's market activities through liberalization measures. It is the second branch of these alternative that will prevail.

Choosing between three strategies

So far, the EU-27 countries have taken a position that is tough but easy to hold: since it is the UK that has chosen to leave the Union, it is up to it to make acceptable proposals for the EU-27, with regard both to its withdrawal and to subsequent relations. This is the approach that led to the current stagnant situation. The EU-27 now has to choose between three strategies:

– Not to make proposals acceptable to the British and resign themselves to a no-deal Brexit: relations between the UK and the EU-27 would be managed according to WTO principles; and the financial terms of the divorce would be decided legally. The United Kingdom would regain full sovereignty. There are two reasons to fear this scenario: trade would be disrupted by the re-erection of customs barriers in ports and in Ireland; and this "hard Brexit" would encourage the UK to become a tax and regulatory haven, meaning that the EU would be faced with the alternative either of following along or retaliating, both of which would be destructive;

– Face the issue head on and establish a third circle for countries that want to participate in a customs union with the EU countries in the short term, i.e. the United Kingdom and the EEA countries. It is within this framework that agreements on technical regulations and standards for goods and services would be negotiated. Thus, "freedom of trade" issue would be dissociated from issues of political sovereignty. However, this poses two problems: these agreements would need to be negotiated in technical committees where public opinion and national parliaments such as the European Parliament would have little voice. The fields of the customs union are problematic, in particular for fiscal matters, financial regulations, and the freedom of movement of persons and services;

– Choose the "special and deep partnership" solution, which would entail reciprocal concessions. This would necessarily be able to serve as a model for relations between the EU and other countries. It would include a customs union limited to goods, committees for harmonizing standards, piecemeal agreements for services, the right of the UK to limit the movement of persons, undoubtedly a court of arbitration (which would limit the powers of the CJEU), and a commitment to avoid fiscal and regulatory competition. As is clear, this would satisfy neither supporters of a hard Brexit nor supporters of an autonomous and integrated European Union.

[1] See: *Joint report from the negotiators of the EU and the UK government on progress during phase 1 of negotiations under Article 50 on the UK's orderly withdrawal from the EU*, 8

December 2017.

[2] See Catherine Mathieu and Henri Sterdyniak: Brexit, réussir sa sortie, *Blog de l'OFCE*, 6 December 2017.

[3] HM Government: "The future relationship between the United Kingdom and the European Union", July 2018.

[4] The expression is in the original text: "A principled and practical Brexit". Translations of the summary note in the 25 languages of the EU are available on the web site of the Department for Exiting the European Union. The French version uses the term: "Brexit vertueux et pratique".

[5] Opinion column by Boris Johnson, *Mail on Sunday*, 9 September 2018.

[6] Favourable to a hard Brexit – from Eton-Oxford, a traditionalist Catholic who is opposed to abortion, public spending and the fight against climate change.

[7] See Un partenariat ambitieux avec le Royaume-Uni après le Brexit , 2 July 2018.

The minimum wage: from labour costs to living standards. Comparing France, Germany and

the UK

By Odile Chagny, IRES, Sabine Le Bayon, Catherine Mathieu, Henri Sterdyniak, OFCE

Most developed countries now have a minimum wage, including 22 of the 28 EU countries. France has long stood out for its relatively high minimum wage, the SMIC. But in 1999, the United Kingdom introduced a minimum wage, and the British government’s goal is to raise this level to 60% of the median wage by 2020, which would bring it to the level of France’s SMIC and among the highest-ranking countries in the OECD. More recently, in 2015, Germany also introduced a minimum wage.

Note that gross pay is a legal concept. What matters from an economic point of view is the cost of labour for a firm as well as the disposable income (including benefits and taxes) of a household in which employees earn the minimum wage.

In OFCE Policy Brief no. 34 we present a comparison of the minimum wages in force in 2017 in these three countries, using standard cases, from the viewpoint first of the cost of labour and then with respect to employees’ standard of living.

It appears that the cost of labour is slightly higher in Germany than in France, and much more so than in the United Kingdom, and that the reforms announced in France for 2019 (reducing contributions) will strengthen France’s competitive advantage vis-à-vis Germany. The cost of labour at the minimum wage is therefore not particularly high in France (Table).

Table. Labour cost, gross wages and net wages for an employee paid at the statutory minimum wage in force in April 2017

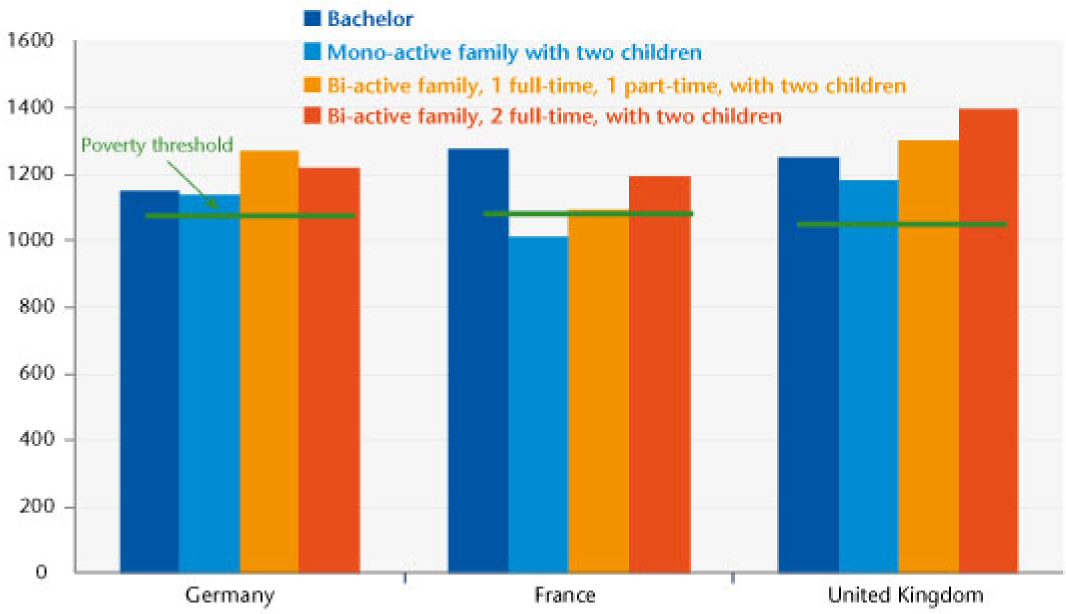
	Germany	France	United Kingdom
Hourly labour cost	10.84 €	10.68 €	9.26 €
Employer SC rate	22.7 %	9.4 %	5.54 %
Gross hourly wage	8.84 €	9.76 €	8.77 €
Employee SC rate	20.8 %	23.3 %*	4.82 %
Net hourly wage	7.01 €	7.49 €	8.35 €
Net wage / labour cost	64.7 %	70.1 %	90.2 %
Net hourly wage (PPA)	7.31 €	7.49 €	7.82 €

(SC = social charges).

Source: Authors' calculations.

With regard to disposable income, a comparison of different arrangements for working time and family situations highlights different logics in the three countries. In Germany, the underlying rationale is to protect families from poverty, regardless of the parents' working situation. In France, in contrast, a family with two children has to have two people working full-time at the SMIC to escape poverty, as the tax-benefit system seeks to encourage women's integration into the labour market. France is thus the only one of the three countries where a mono-active family with two children, one of whose parents works full-time at the minimum wage, falls below the monetary poverty line (Figure).

Figure. Living standard of a bachelor and of a couple with two children aged 7 and 9 (mono-active or bi-active), in current euros, per month, in April 2017



Source: Authors' calculations.

From the point of view of the relative position of minimum wage earners in relation to the general population, our study highlights the rather favourable situation of the United Kingdom. The living standard there is comparatively high: all the families considered in our typical cases have a standard of living above the poverty line, on the order of 30% higher for a family where both parents work full-time at the minimum wage. The gain from taking up a job is, as in France, high, while it is low in Germany in all the configurations.

Finally, our analysis is contributing to the debate about the establishment of a Europe-wide minimum wage. A policy to harmonize the minimum wage in Europe, as this is conceived by the European Federation of Trade Unions and supported by France, cannot be thought of solely in terms of labour income, but also needs to take into account the goals targeted in terms of living standards, especially for families.

Brexit: Pulling off a success?

By Catherine Mathieu and Henri Sterdyniak

Will the EU summit of 14-15 December 2017 usher in a new phase of negotiations on the exit of the United Kingdom from the European Union?

British Prime Minister Theresa May wants to make Brexit a success and to arrange a special partnership between the UK and the EU, a tailor-made partnership that would allow trade and finance to continue with minimal friction after the UK leaves the EU, while restoring the UK's national sovereignty, in particular by regaining the ability to limit the immigration of workers from the EU and by no longer being subject to the European Union Court of Justice (EUCJ). For the EU-27 countries, on the contrary, it must be made clear that leaving the EU incurs a significant economic cost, with no significant budgetary gain, that those who leave must continue to accept a major share of European rules and that they cannot claim the benefits of the single market without bearing the costs. Other Member States should not be tempted to follow the British example.

This post examines the negotiating positions of the EU-27 and the British government and the divisions in the UK in the run-up to the European summit. The negotiations, which have been going on for almost six months, are difficult and cover numerous issues: citizens' rights, financial regulations, the Irish border and the future partnership between the United Kingdom and the EU-27.

Will the EU summit of 14-15 December 2017 usher in a new phase of negotiations on the United Kingdom's departure from the European Union? As we approach the summit, the stakes are high for the British. On 23 June 2016, a majority of the British people voted in favor of leaving the EU, but it was not until 29 March 2017 that Theresa May officially notified the British decision to leave by triggering Article 50 of the Treaty on the European Union. This article stipulates that, "A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union." The triggering of Article 50 opens a two-year period to negotiate the exit of the UK on 29 March 2019.

The negotiations have been going on for almost six months. They are difficult and cover numerous issues. This is the first time a country has asked to leave the EU, and neither the UK nor the EU-27 want to lose out. For the British government, the key goal is to establish a future commercial and financial partnership with the EU. Theresa May wants to make Brexit a success and to arrange a special partnership between the UK and the EU, a tailor-made agreement that would allow trade and finance to continue with minimal friction after leaving the EU, while restoring the UK's national sovereignty, in particular by regaining the ability to limit the immigration of workers from the EU and by no longer being subject to the EU Court of Justice. For the EU-27 countries, on the contrary, it must be shown that leaving the EU incurs a significant economic cost, with no significant budgetary gain, that those who leave must continue to accept a major share of European rules and that they cannot claim the benefits of the single market without bearing the costs. Other Member States should not be tempted to follow the British example.

The EU-27 position and the divisions in Britain

On 29 April 2017, the European Council set out its negotiating lines and appointed Michel Barnier chief negotiator on behalf of the EU. In the EU’s view the negotiations need to focus initially on an “orderly withdrawal”, i.e. exclusively on three points: the rights of European citizens in the UK; a financial settlement for the British departure; and the border separating the Republic of Ireland and Northern Ireland. The EU-27 has taken a tough stance on each of these three points and is refusing to discuss any future relationship between the EU and the UK before these are settled. It has banned any bilateral talks (between the UK and an EU member country) and blocked any pre-negotiations between the UK and a third country on their future trade relations. This has placed the United Kingdom in a difficult position, as companies (British and foreign) want to remove any uncertainties about UK-EU trade conditions after March 2019, and are threatening to cut their investments in the UK, or even to relocate within the EU-27, if this uncertainty is not removed.

The EU is in a strong position, since trade with the EU is five times larger for the UK than trade with the UK is for the EU. Moreover, the EU demonstrated its unity in the face of the British exit (as it did during the Greek crisis). In both cases, firm positions prevailed. More conciliatory lines did not come out in the European Council or in the European Parliament, as if the partisans of such positions were afraid to be accused of breaking Europe’s unity.

The British, in contrast, are split into four positions that divide the ranks of both Conservatives and Labour. Among the supporters of staying in the EU, the Remainers, some, like Tony Blair and Michael Heseltine, who are very much in the minority, still hope that, in the face of difficulties, the United Kingdom will give up on leaving the EU. Lord Kerr, who drafted Article 50, has pointed out that the decision to trigger the article is reversible. But it would be contrary to British democratic tradition not to respect the popular vote.

A new referendum could be organized, but in view of the polls there is no guarantee that a vote would have a different result today than it did on 23 June 2016.

For most Remainers, Brexit will indeed take place, and what is needed now is to minimize its economic cost. Some Remainers, especially in Labour, are currently advocating a “soft Brexit”, which would allow the UK to remain in the single market. But, given the conditions imposed by the EU-27 (respect for the “4 fundamental freedoms” – free movement of goods, services, capital and labor – and maintaining the CJEU’s authority), Brexit would then ultimately simply deprive the United Kingdom of having a voice in the decisions that it would have to implement. Proponents of a soft Brexit are also in favor of a transition period (provided for by the Treaty, subject to the unanimous agreement of the EU countries), which would postpone for two years the UK’s exit and avoid the risk of it leaving the EU on 29 March 2019 without a negotiated agreement.

The most ardent Brexiteers are willing to run the risk of a “hard Brexit”, i.e. leaving with no agreement with the EU. The UK would no longer have to contribute to the EU budget (about 0.5 GDP point per year in net terms), and it would have the status of a third country under WTO rules. The United Kingdom would then renegotiate trade agreements with all its partners, including the United States. Border controls would be reinstated. Proponents of a hard Brexit are not in favor of a transitional period, which they feel would only delay the moment when the United Kingdom “would regain control” and prevent it from negotiating agreements with non-EU countries. In the case of a hard Brexit, the risk is that the multinationals would relocate their factories and head offices to continental Europe, that in general it would become less attractive to invest in the United Kingdom and that a large part of the euro zone’s banking and financial activities would leave London for Paris, Frankfurt, Amsterdam or Dublin.

London could, however, play the card of tax competition (in particular by cutting the corporation tax rate) and become a regulatory paradise, especially in financial matters. However, it would be very difficult for the United Kingdom to free itself of international constraints (agreements such as COP21, on the fight against tax optimization, on the exchange of tax and banking information, or Basel III). The financial conditions for the UK's departure would be subject to a judicial settlement. For more ardent free marketeers, Brexit would help to strengthen the UK's laissez-faire model. However, it is unlikely that the United Kingdom, whose legislation is already very liberal, would enjoy a substantial growth shock induced by even more liberal reforms.

The British government is evolving an intermediate position. In 2016, when Theresa May was a minister in David Cameron's government, she called for voting to stay in the EU, but she is now aiming to make Brexit a success: the UK must become a champion of globalization ("A global Britain") and of free trade, in the British liberal tradition, which must turn its face towards the open sea. The country also has a trade surplus vis-à-vis its non-EU partners, primarily with the United States, and has maintained historical ties with the Commonwealth countries, while it has a large trade deficit with the EU countries (although it runs a surplus in services).

Theresa May has taken note of the EU-27 position that the UK will not be able to remain in the single market if it does not respect the four "fundamental freedoms". She is nevertheless trying to maintain privileged trade and financial relations with the EU by setting up a specific free trade partnership. Since the UK wants to be able to regain control of its borders, manage the entry of workers from the EU, and no longer submit to the EU Court of Justice, and unlike the EFTA countries refuses to submit to standards on which it will have no say in exchange for free access to the European market, Theresa May is proposing that a “specific and in-depth partnership” be established between the UK and the EU. In addition, since her September 2017 speech in Florence, she has called for a two-year transition period from March 2019 to March 2021.

Theresa May held early parliamentary elections in June 2017 in an effort to strengthen her Tory majority in Parliament. In fact, Labour’s attacks on austerity and on Tory positions favouring a reduction in welfare benefits led to the loss of the Tory majority. Theresa May had to reach an agreement with the Democratic Unionist Party (DUP), a Northern Ireland pro-Union party that is conservative on social affairs, but opposed to austerity and to any compromise with the Republic of Ireland. Theresa May has therefore entered the Brexit negotiations with a weakened and divided majority, with some of her ministers (David Davis, Secretary of State for Brexit Negotiations; Boris Johnson, Secretary of State for Foreign Affairs; Liam Fox, Secretary State for International Trade) declaring themselves ready to take the risk of leaving without an agreement.

On 15 November 2017, the UK Parliament finally passed the EU Withdrawal Bill, called the “Great Repeal Bill”, ending the application of EU law in the UK and giving the government the task of transposing (or not) European laws and regulations (i.e. 12,000 texts) into British law. However, it was agreed that any agreement signed with the EU will be submitted to Parliament, with the latter’s refusal implying an exit with no agreement.

The state of negotiations on the eve of the 14-15 December summit

Five rounds of negotiations were initially planned in 2017, from June to October. The objective was that, by the European summit of 19-20 October, sufficient progress was to be made in negotiations on the three points set in April so that the

EU-27 countries would agree to start negotiations over the future partnership. On 19 June in the first round, David Davis accepted the EU's request for sequencing. Thus, only the three points desired by the EU-27 have been discussed, while for the UK government (and the country's businesses), what is crucial is the future partnership. At the end of the fifth round, on 12 October 2017, the EU's chief negotiator Michel Barnier declared that the negotiations on the financial aspects were deadlocked and that he could not propose to the October 19th European summit that discussions be started on an agreement. Barnier hoped, however, that progress would be made in time for the 14-15 December EU summit. On 20 October, however, the European Council nevertheless agreed to the possibility of a transition agreement and proposed that preparatory talks be held for the December summit, which would therefore be crucial.

With regard to the rights of citizens, especially the 3.2 million EU citizens living in the UK, Theresa May proposed that all EU citizens who had settled in the UK by 29 March 2017 could obtain a residency status that guarantees them the same rights as British citizens in terms of employment and social rights. This would be automatic for those who have resided there for more than 5 years, and for the rest when they reach 5 years of residence. The nnegotiations hit stumbling blocks on the reference date (March 2017 or 2019?), on maintaining the right to family reunion and especially on supervision of the application of the agreement by the EUCJ, which the EU-27 is demanding in order to ensure that the UK does not tighten its regulations, but which the UK cannot accept (it could, however, agree to the establishment of an arbitration tribunal).

On the issue of the Irish border, both parties have agreed to preserve the peace agreement in Northern Ireland and to maintain the absence of a land border, so as not to put obstacles to the lively trade between the two parts of the island or to freedom of movement between the two areas (30,000 people a day cross the border), which is difficult if the United Kingdom is no longer in the single market or in the customs union. The Republic of Ireland is refusing any hard border, and threatens to veto any agreement that would erect additional barriers between the Republic and Northern Ireland. It is asking for special status for Northern Ireland, which would keep it in the customs union. The DUP, working in a contrary sense, opposes Northern Ireland staying in the customs union after Brexit, or at least any agreement that would not apply to the whole of the United Kingdom; the British government, desirous of maintaining the integrity of the United Kingdom, must refuse to allow Northern Ireland to be subject to EU regulations with a border between Northern Ireland and the rest of the UK. The DUP proposes setting up an invisible border, which will require great creativity. On this point, the EU-27 believes that it is up to the UK to make acceptable proposals. Faced with the difficulties of reconciling the irreconcilable, the two parties could agree to postpone the issue to the end of negotiations on their future partnership.

On the issue of the financial settlement, the positions seem to have drawn closer. On the EU side, some 60 billion to 100 billion euros were mentioned as a British contribution to the European expenditures already committed, while the United Kingdom did not want to tackle the issue of a financial settlement independently of negotiations on the future agreement. In September 2017, however, Theresa May made it clear that the UK would honour its financial commitments to the EU, namely its share of spending in 2017-19, its commitments for 2020, the investment expenditure committed beyond that, and its share of the pensions of European officials. The United Kingdom is to pay between 45 and 50 billion euros. As part of the negotiations on the future partnership, the UK government could commit to possible future contributions to the functioning of the single market.

Although none of the three initial negotiating points are really resolved today, it seems that the EU-27 will agree that negotiations on the future partnership can begin in 2018. This will require the EU-27 countries to agree on a common position, which will mean postponing the beginning of a new round of negotiations until March 2018. It is likely, and desirable, that the European Council meeting of 14-15 December accepts the British request for a two-year transition period in order to eliminate the risk that it could leave without an agreement in March 2019.

It will then be necessary to come to an agreement on the future partnership between the EU-27 and the United Kingdom. The EU-27 must not give in to the temptation to punish a departing country by applying only WTO rules to it, which would also harm EU exports to Britain, especially as the EU has a current account surplus of 130 billion euros vis-à-vis the country. Similarly, industrial cooperation agreements (Airbus, arms, energy, etc.) can hardly be called into question. It seems impossible for the EU-27 to accept that the UK remains in the single market and chooses which rules it wishes to apply. The minimum would be a trade agreement, modeled on the Canada-EU Comprehensive Economic and Trade Agreement (CETA). The most promising outcome for both parties would undoubtedly be to reach an agreement for a balanced commercial partnership that would serve as a model for creating a third circle in Europe, which could eventually make it possible to bring on board Norway, Iceland, Switzerland, Ukraine, Turkey, Morocco and other countries, and which would avoid leaving third countries to face a choice between keeping their national sovereignty and the benefits of trade liberalization.

Growth and inequality in the European Union

By Catherine Mathieu and Henri Sterdyniak

"Growth and Inequality: Challenges for the Economies of the European Union" was the theme of the 14th EUROFRAME Symposium on Economic Policy Issues in the European Union held on 9 June 2017 in Berlin. EUROFRAME is a network of European economic institutes that includes DIW and IFW (Germany), WIFO (Austria), ETLA (Finland), OFCE (France), ESRI (Ireland), PROMETEIA (Italy), CPB (Netherlands), CASE (Poland) and NIESR (United Kingdom). Since 2004, EUROFRAME has organized a symposium on an important subject for the European economies every year.

This year, 27 contributions from researchers, selected by a scientific committee, were presented at the symposium, most of which are available on the conference web page. This text provides a summary of the studies presented and discussed at the symposium.

As DIW President Marcel Fratzcher pointed out in his opening remarks, the rise in inequality over the last 30 years has meant that inequalities that were previously subjects of study reserved for researchers in social policy have now become subjects for numerous economists. Several questions were posed: why this rise in inequality? Is the increase in inequality in each country a necessary consequence of the reduction in inequality between countries, in Europe or at the global level? What are the macroeconomic consequences of this increase? What economic policies could avoid this?

Income inequality: the facts. Mark Dabrowski (CASE, Warsaw) –

“Is there a trade-off between global and national inequality?” – stresses that the growth of inequalities within each country (especially in the United States and China) goes hand in hand with the reduction of inequalities between countries, as both are fuelled by commercial and financial globalization. However, some advanced countries have succeeded in halting the growth in internal inequalities, which shows the continuing importance of national policy.

Oliver Denk (OECD) – “Who are the Top 1 Percent Earners in Europe?” – analyses the structure of the 1% of employees earning the highest incomes in the EU countries. They represent between 9% of total payroll in the United Kingdom to 3.8% in Finland (4.7% in France). Statistically, they are older than the mass of overall employees (this is less clear in the East European countries), more masculine (this is less clear in the Nordic countries), and more highly educated. They are more numerous in finance, communication and business services.

Tim Callan, Karina Doorley and Michael Savage (ESRI Dublin), analyse the growth in income inequality in the countries most affected by the crisis (“Inequality in EU crisis countries: Identifying the impacts of automatic stabilisers and discretionary policy”). In these five countries, Spain, Greece, Ireland, Portugal and Cyprus, primary income inequalities have increased due to the crisis, but thanks to automatic tax and social transfers, inequalities in disposable income have remained stable in Ireland and Portugal and (to a lesser degree) in Greece.

Carlos Vacas-Soriano and Enrique Fernández-Macías (Eurofound) – “Inequalities and employment patterns in Europe before and after the Great Recession” – show that income inequality decreased overall in the EU before 2008, as new entrants caught up with the older members. Since 2008, the Great Recession has deepened inequalities between countries and within many countries. The growth of internal inequality is due mainly to rising unemployment; it is striking traditionally egalitarian countries (Germany, Sweden, Denmark); and it is mitigated by family solidarity and social protection, whose roles are nevertheless under question.

Modelling the growth / inequality relationship. Alberto Cardiac (University of Cattolica del Sacro Cuore, Milan) and Francesco Saraceno (OFCE, Paris) – "Inequality and Imbalances: An open-economy agent-based model" – present a two-country model. In one, the search for external surpluses leads to pressure on wages and a depression of domestic demand, which is offset by export earnings. In the other, the growth of inequality leads to a downward trend in consumption, which is offset by the expansion of credit. The result is an endogenous debt crisis when the household debt of the second country reaches a limit value.

Alain Desdoigts (IEDES, University of Paris 1 Panthéon-Sorbonne) and Fernando Jaramillo (Universidad del Rosario, Bogota) – "Learning by doing, inequality, and sustained growth: A middle-class perspective" – present a model where innovations can be applied in production only in sectors with a sufficient size, hence those that produce the goods purchased by the middle class (so neither in the luxury goods sector nor in the low-end goods sector). Growth is therefore stronger as the middle class expands. Redistribution is favourable to growth if it is made from the rich to the middle class, and unfavourable if it goes from the middle class to the poor.

Inequality, financialisation, monetary policy. The article by Dirk Bezemer and Anna Samarina (University of Groningen) – "Debt shift, financial development and income inequality in Europe" – distinguishes between two types of bank credit: credit for financial and real estate activities, and credit for non-financial enterprises and consumption. They explain the growth of inequality in the developed countries by the growing role of credit that finances finance to the detriment of credit that finances production.

The article by Mathias Klein (DIW Berlin) and Roland Winkler (TU Dortmund University) – "Austerity, inequality, and private debt overhang" – argues that restrictive fiscal policies have little impact on activity and employment when private debt is low (because there is a full Barro effect); they have a restrictive effect on activity and increase income inequality when private debt is high. Therefore, fiscal restraint should be applied only once private debt has been reduced.

Davide Furceri, Prakash Loungani and Aleksandra Zdzienicka (IMF) – "The effect of monetary policy shocks on inequality" – point out that the impact of monetary policy on income inequality is ambiguous. An expansionary policy can reduce unemployment and lower interest rates (which reduces inequality); it can also lead to inflation and raise the price of assets (which increases inequality). Empirically, it appears that a restrictive policy increases income inequality unless it is caused by higher growth.

Inequalities and social policy. Alexei Kireyev and Jingyang Chen (IMF) – "Inclusive growth framework" – advocate for growth indicators that include trends in poverty and in inequality in income and consumption.

Dorothee Ihle (University of Muenster) – "Treatment effects of Riester participation along the wealth distribution: An instrumental quantile regression analysis" – analyses the impact of Riester pension plans on the wealth of German households. They significantly increase the wealth of the participating households at the bottom of the income distribution, but these are relatively few in number, while this mainly has wealth redistribution effects for middle-class households.

Inequality, poverty and mobility. Katharina Weddige-Haaf (Utrecht University) and Clemens Kool (CPB and Utrecht

University) – “The impact of fiscal policy and internal migration on regional growth and convergence in Germany” – analyse the factors for convergence of per capita income between the old and new German Länder. Convergence has been driven by internal migration, investment subsidies and structural funds, but fiscal transfers in general have had no effect. The 2008 crisis favoured convergence by hitting the richest regions in particular.

Elizabeth Jane Casabianca and Elena Giarda (Prometeia, Bologna) – “From rags to riches, from riches to rags: Intra-generational mobility in Europe before and after the Great Recession” – analyse the mobility of individual incomes in four European countries: Spain, France, Italy and the United Kingdom. Before the crisis, this was strong in Spain and weak in Italy. It declined markedly after the crisis, particularly in Spain; it remained stable in the United Kingdom.

Luigi Campiglio (Università Cattolica del S. Cuore di Milano) – “Absolute poverty, food and housing” – analyses absolute poverty in Italy using an indicator based on food consumption. He shows that poor families bear particularly high housing costs, which cuts into their food consumption and health care spending. Poor families with children are tenants and were hit especially hard by the crisis. Social policy should offer them better protection through targeted transfers in cash or in kind (health, education).

Georgia Kaplanoglou and Vassilis T. Rapanos (National and Kapodistrian University of Athens and Academy of Athens) – “Evolutions in consumption inequality and poverty in Greece: The impact of the crisis and austerity policies” – point out that the crisis and austerity policies have reduced GDP and household consumption by about 30% in Greece. This has been accompanied by an increase in inequality in consumption, which the paper documents in detail. It analyses in particular the effect of VAT hikes. Families with children were especially hard hit.

Labour market. Christian Hutter (IAB, German Federal Employment Agency) and Enzo Weber (IAB and Universität Regensburg) – "Labour market effects of wage inequality and skill-biased technical change in Germany" – use German data to estimate a structural vector model for analysing the link between wage inequalities, employment, neutral technical progress and technical progress favouring skilled labour. The latter raises labour productivity and wages, but also wage inequalities, and it reduces employment. Wage inequalities have a negative impact on employment and overall productivity.

Eckhard Hein and Achim Truger (Berlin School of Economics and Law, Institute for International Political Economy) – "Opportunities and limits of rebalancing the Eurozone via wage policies: Theoretical considerations and empirical illustrations for the case of Germany" – analyse the impact of wage increases in Germany on the rebalancing of current account balances in Europe. They show that these play a role not only through a competitiveness effect, but also through a demand effect by modifying the wage / profit distribution and by boosting consumption. They must therefore also be supported by an increase in public spending.

Camille Logeay and Heike Joebges (HTW Berlin) – "Could a wage formula prevent excessive current account imbalances in euro area countries? A study on wage costs and profit developments in peripheral countries" – show that the rule "wages must grow in line with labour productivity and the inflation target" should have had stabilizing effects in Europe both on the competitiveness of the member countries as well as on their domestic demand. This nevertheless assumes that companies do not take advantage of this to boost their profits and that no country seeks to increase its competitiveness.

Hassan Molana (University of Dundee), Catia Montagna (University of Aberdeen) and George E. Onwordi (University of Aberdeen) – "Reforming the Liberal Welfare State: International Shocks, unemployment and household income shares” – construct a model to show that a free market country, such as the United Kingdom, could improve the functioning of its labour market by reducing flexibility to move towards a flexi-security model: higher unemployment benefits, restrictions on redundancies, greater spending on training, and support for hiring. By boosting labour productivity, this strategy would reduce the structural unemployment rate and increase the share of profits.

Guillaume Claveres (Centre d’Economie de la Sorbonne, Paris) and Marius Clemens (DIW, Berlin) – “Unemployment Insurance Union” – propose a model for European unemployment insurance that would cover part of the expenses of unemployment benefits. This could reduce fluctuations in consumption and unemployment resulting from specific shocks. This assumes, however, that it would apply only to cyclical unemployment, which is difficult to define.

Bruno Contini (Università di Torino and Collegio Carlo Alberto), José Ignacio Garcia Perez (Universidad Pablo de Olavide), Toralf Pusch (Hans-Boeckler Stiftung, Düsseldorf) and Roberto Quaranta (Collegio Carlo Alberto) – “New approaches to the study of long-term non-employment duration via survival analysis: Italy, Germany and Spain” – analyse involuntary non-activity (people who would like to work but have given up looking for a job and lost their rights to unemployment benefits) in Germany, Italy and Spain. This is particularly important and sustainable in Spain and Italy. They caution against measures to encourage redundancies, job insecurity and incentives for undeclared work.

Taxation. Markku Lehmus, (ETLA, Helsinki) – “Distributional and employment effects of labour tax changes: Finnish evidence over the period 1996-2008” – uses a general equilibrium model with heterogeneous agents to evaluate the impact of the reduction in the taxation of employment in Finland from 1996 to 2008. He shows that this explains only a small share of the rise in employment (1.4 points out of 16%) and of the rise in income inequality.

Sarah Godar (Berlin School of Economics and Law) and Achim Truger (IMK and Berlin School of Economics and Law) – “Shifting priorities in EU tax policies: A stock-taking exercise over three decades” – analyse the evolution of taxation in the EU states: from 1980 to 2007, taxation became less progressive with lower marginal rates of income tax and corporation tax, and preferred treatment of capital income. The crisis of 2008 and the difficulties with the public finances temporarily slowed this trend; an increase in revenues was, however, often sought by raising VAT.

Alexander Krenek and Margit Schratzenstaller (WIFO) – “Sustainability-oriented future EU funding: A European net wealth tax” – argue for the introduction of a European household wealth tax, which could help finance the European budget.

The macroeconomic consequences of inequalities. Bjoern O. Meyer (University of Rome – Tor Vergata) – “Savings glut without saving: Retirement saving and the interest rate decline in the United States between 1984 and 2013” – explains 60% of the decline in the interest rate in the United States, despite the decline in the overall household saving rate, by demographic factors (the differential rise in life expectancy), the slowdown in labour productivity gains and the increase in income inequality.

Marius Clemens, Ferdinand Fichtner, Stefan Gebauer, Simon Junker and Konstantin A. Kholodilin (DIW Berlin) – “How does income inequality influence economic growth in Germany?” – present a macroeconomic model in which short-term income inequalities increase the productivity of each asset (incentive effect), but reduce overall consumption (savings effect); in the long term, they have a negative impact on the formation of the human capital of young people in the working classes. Hence an exogenous increase in income inequalities first has a negative effect on GDP (demand effect), then positive (individual incentive effect) and then again negative in the long term (human capital effect). The effect is always negative on household consumption and positive on the external balance.

Britain’s referendum of 23 June 2016: The leap into the unknown

By Catherine Mathieu

On 23 June 2016, the British people decided (by 52% to 48%) to leave the European Union. After having long criticized the functioning of the EU and the constraints that it placed on the United Kingdom, on 19 February 2016 David Cameron obtained an agreement intended to allow the UK to remain in the EU – but it was not enough to convince the voters. In an OFCE Policy Brief (No. 1 of 13 July), we analyze how the British people’s concerns went beyond economic issues and that what counted was their desire to maintain (or regain) their political sovereignty.

The departure from the EU is, in the words of David Cameron, “a leap into the unknown”, and all that is possible now is to develop scenarios based on hypotheses about the outcome of the negotiations to be undertaken with the EU: from a rosy scenario in which both sides want to maintain as much as possible of the existing relations, to a dark scenario where the EU wants to set an example and the UK becomes a tax and regulatory haven.

As of early July, the UK clearly had not yet decided to formally leave the EU (by triggering Article 50), and will probably not do so before September. The resignations of the Brexit camp's leaders and continuing changes in the political situation are leaving a fog over the establishment of negotiations: the pound has lost more than 10% against the euro and 12% against the dollar, and may not stabilize until the UK's situation is clarified. It seems that we are entering into a grey scenario where the various shades are still unknown.

In the short term, depending on the hypotheses adopted, the impact of a Brexit could be slightly negative for the British economy, on the order of 0.2 point of GDP in 2016 according to the National Institute of Economic and Social Research (NIESR), but this could reach several percentage points of GDP after two years depending on the scenario, with the UK Treasury entertaining the gloomiest prospects (-3.6% to -6%).

In the long term, again depending on the hypotheses adopted, the economic impact of the UK's exit would be decidedly negative, especially according to the British Treasury, but the assumptions of a sharp decline in British trade are undoubtedly exaggerated.

Brexit: What are the lessons for Europe?

By Catherine Mathieu and Henri Sterdyniak

The British vote to leave the European Union is aggravating the political crisis in Europe and in many European countries. Leaving the EU has become a possible alternative for the peoples of Europe, which may encourage parties advocating national sovereignty. The United Kingdom’s departure automatically increases the weight of the Franco-German couple, which could destabilize Europe. If Scotland leaves the UK to join the EU, independence movements in other regions (Catalonia, Corsica, etc.) could seek a similar outcome. But the fragility of Europe also stems from the failure of the strategy of “fiscal discipline / structural reforms”.

The departure of the United Kingdom, a fierce advocate of economic liberalism and opponent of any increase in the European budget and in the powers of Europe’s institutions, as well as of a social Europe, could change the dynamics of the debate in Europe, but some East European countries, the Netherlands and Germany have always had the same position as the UK. The departure will not, by itself, cause a shift in European policy. On the other hand, the liberalization of services and the financial sector, which the UK has been pushing for, could be slowed. The British Commissioner, Jonathan Hill, head of financial services and capital markets, should be promptly replaced. This will raise the sensitive issue of British EU officials, who in any case can no longer occupy positions of responsibility.

This will also open up a period of economic and financial uncertainty. The reaction of the financial markets, which do not like uncertainty and are in any case volatile, should not be accorded an excessive importance. The pound sterling has of course rapidly depreciated by 10% against the euro, but it was probably overvalued, as evidenced by the British current account deficit of around 6.5% of GDP in 2015.

According to Article 50 of the European Constitution, any country that decides to leave the EU should negotiate a withdrawal agreement, which sets the exit date[1]. Otherwise, after two years the country is automatically outside the

Union. The negotiations will be delicate, and must of necessity deal with all the issues. During this period, the UK will remain in the EU. European countries will have to choose between two attitudes. An understanding attitude would be to sign a free trade agreement quickly, with the goal of maintaining trade and financial relations with the UK as a privileged partner of Europe. This would minimize the economic consequences of Brexit for both the EU and the UK. However, it seems difficult to see how the UK could simultaneously enjoy both complete freedom for its own economic organization and full access to Europe's markets. The UK should not enjoy more favourable conditions than those of the current members of the European Free Trade Association (EFTA – Norway, Iceland and Liechtenstein) and Switzerland; like them, it should undoubtedly integrate the single market legislation (in particular the free movement of persons) and contribute to the EU budget. The issue of standards, such as the European passport for financial institutions (this is now granted to the EFTA countries, but not to Switzerland), etc., would be posed very quickly. The UK may have to choose whether to comply with European standards on which it will not have a say or to be subject to regulatory barriers. The negotiations will of course be open-ended. The UK could argue for a Europe that is more open to countries outside the EU. But how much weight will it have once it's out?

A tough attitude intended to punish London so as to set an example and deter future candidates from leaving would instead require the UK to renegotiate all trade treaties from scratch (i.e. from WTO rules) so as to encourage multinational companies to relocate their factories and headquarters to mainland Europe and close British banks' access to the European market in order to push them to repatriate euro zone banking and financial activity to Paris or Frankfurt. But it would be difficult for Europe, a supporter of the free movement of goods, services, people and business, to start erecting barriers against the UK. The euro zone has a current account surplus of 130 billion euros with the UK: does it want to call this into question? European companies that export to the UK would oppose this. Industrial cooperation agreements (Airbus, arms, energy, etc.) could only be challenged with difficulty. A priori it would seem unlikely that London would erect tariff barriers against European products, unless in retaliation. Conversely, London could play the card of setting up tax and regulatory havens, particularly in financial matters. It could not, however, avoid international constraints (agreements such as at COP21, on the fight against tax avoidance, on the international exchange of tax and banking information, etc.). The risk would be to start a costly game of mutual reprisals (one that it would be difficult for Europe, divided between countries with different interests, to lead).

Upon leaving the European Union, the United Kingdom, a net contributor to the EU, would a priori save about 9 billion euros per year, or 0.35% of its GDP. However, the EFTA countries and Switzerland contribute to the EU budget as part of the single market. Again, everything depends on the negotiations. It would seem that the savings for the UK will be only about 4.5 billion euros, which the other Member countries will have to make up (at a cost of around 0.5 billion euros for France).

Given the uncertainty of the negotiations (and of exchange rate trends), all assessments of Brexit's impact on other EU countries can only be very tentative. Moreover, this will necessarily have only a second-order impact on the EU countries: if tariff or non-tariff barriers reduce French exports of cars to the UK and of British cars to France, French manufacturers can supply their national markets while facing less competition and can also turn to third countries. It is nevertheless useful to have an order of magnitude: in 2015, exports from France (from the EU) to the UK represented 1.45% of GDP (respectively 2.2%); exports from the UK to the

EU represented 7.1% of British GDP. A priori, an equivalent impact on UK / EU trade will have 3.2 times less impact on the EU than on the UK.

According to the OECD[2], the fall in EU GDP will come to 0.8% by 2023 (against 2.5% for the UK), whereas remaining in the EU, participating in the deepening of the single market and signing free trade agreements with the rest of the world would lead to a rise in GDP for all EU countries. But how credible is this last assertion, given the euro zone's current poor performance and the cost for the economic and social cohesion of European countries of opening the borders? But if Europe is functioning poorly, then leaving should improve market prospects. The UK's foreign trade would suffer a contraction, which would hurt its long-term productivity, but despite its openness the British economy's productivity is already weak. The OECD does not raise the question of principle: should a country give up its political sovereignty to benefit from the potential positive effects of trade liberalization?

According to the Bertelsmann Foundation[3], the reduction in EU GDP (excluding the UK) in 2030 would range from 0.10% in the case of a soft exit (the UK having a status similar to that of Norway) to 0.36% in the worst case (the UK having to renegotiate all its trade treaties); France would be little affected (-0.06% to -0.27%), but Ireland, Belgium and Luxembourg more so. The study multiplied these figures by five to incorporate medium-term dynamics, with the reduction in foreign trade expected to have adverse effects on productivity.

Euler-Hermes also reported very weak figures for the EU countries: a fall of 0.4% in GDP with a free trade agreement and of 0.6% without an agreement. The impact would be greater for the Netherlands, Ireland and Belgium.

Europe needs to rebound, with or without the United Kingdom…

Europe must learn the lessons from the British crisis, which follows on the debt crisis of the southern European countries, the Greek crisis, and austerity, as well as from the migrant crisis. It will not be easy. There is a need to rethink both the content of EU policies and their institutional framework. Is the EU up to the challenge?

The imbalances between EU Member countries grew from 1999 to 2007. Since 2010, the euro zone has not been able to develop a coordinated strategy enabling it to restore a satisfactory level of employment and reduce the imbalances between Member states. The economic performance of many euro zone countries has been poor, and downright catastrophic in southern Europe. The strategy implemented in the euro zone since 1999, and strengthened since 2010 – "fiscal discipline / structural reforms" – has hardly produced satisfactory results socially or economically. On the contrary, it gives people the feeling of being dispossessed of any democratic power. This is especially true for countries that benefited from assistance from the Troika (Greece, Portugal, Ireland) or the European Central Bank (Italy, Spain). The Juncker plan that was intended to boost investment in Europe marked a turning point in 2015, but it remains timid and poorly taken up: it was not accompanied by a review of macroeconomic and structural policy. There are important disagreements in Europe both between nations and between political and social forces. In the current situation, Europe needs a strong economic strategy, but it has not been possible to agree on one collectively in today's Europe.

There are two fundamental reasons for this morass. The first concerns all the developed countries. Globalization is creating a deeper and deeper divide between those who benefit from it and those who lose[4]. Inequalities in income and status are widening. Stable, well-paid jobs are disappearing. The working classes are the direct victims of competition from low-wage countries (Asian countries and former Soviet bloc countries). They are being asked to accept cuts in wages, social benefits, and employment rights. In this situation, the elite and the ruling classes can be open-spirited, globalist and pro-European, while the people are protectionist and nationalist. This same phenomenon underlies the rise of France’s National Front, Germany’s AFD, UKIP, and in the US the Republican Donald Trump.

Europe is currently operated according to a liberal, technocratic federalism, which seeks to impose on people policies and reforms that they are refusing, sometimes for reasons that are legitimate, sometimes questionable, and sometimes contradictory. The fact is that Europe in its current state is undermining solidarity and national cohesion and preventing countries from choosing a specific strategy. The return to national sovereignty is a general temptation.

Furthermore, Europe is not a country. There are significant differences in interests, situations, institutions and ideologies between peoples, which render progress difficult. Because of the differences in national situations, many arrangements (the single monetary policy, the free movement of capital and people) pose problems. Rules that had no real economic foundation were introduced in the Stability Pact and the Budgetary Treaty: these did not come into question after the financial crisis. In many countries, the ruling classes, political leaders and senior civil servants have chosen to minimize these problems, so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social welfare, wages and regulations have been deliberately forgotten. How can convergence towards a social Europe and a fiscal Europe be achieved between countries whose peoples are attached to structurally different systems? Given the difficulties of monetary Europe, who would wish for a budgetary Europe, which would take Europe further from democracy?

In the UK-EU Agreement of 19 February, the UK has recalled the principles of subsidiarity. It is understandable that countries concerned about national sovereignty are annoyed (if not more) by the EU's relentless intrusions into areas that fall under national jurisdiction, where European intervention does not bring added value. It is also understandable that these countries refuse to constantly justify their economic policies and their economic, social or legal rules to Brussels when these have no impact on the other Member states. The UK noted that the issues of justice, security and individual liberties are still subject to national competence. Europe needs to take this feeling of exasperation into account. After the British departure, it needs to decide between two strategies: to strengthen Europe at the risk of further fuelling people's sense of being powerless, or to scale down the ambition of European construction.

The departure of the United Kingdom, the de facto distancing of some Central European countries (Poland, Hungary) and the reticence of Denmark and Sweden could lead to an explicit switch to a two-tiered EU. Many national or European intellectuals and politicians think that this crisis could provide just such an opportunity. Europe would be explicitly divided into three groupings. The first would bring together the countries of the euro zone, which would all agree to new transfers of sovereignty and to build a stronger budgetary, fiscal, social and political union. A second grouping would bring together the European countries that do not wish to participate in such a union. The last grouping would include countries linked to Europe through a free trade agreement (currently Norway, Iceland, Liechtenstein and Switzerland, and later the UK and other countries).

Such a project would, however, pose many problems. Europe's institutions would have to be split between euro zone institutions operating on a federal basis (which need to be made more democratic) and EU institutions continuing to operate in the Union manner of the Member states. Many countries currently outside the euro zone are opposed to this kind of change, which they feel would marginalize them as “second-class” members. The functioning of Europe would become even more complicated if there were both a European Parliament and a euro zone Parliament, euro zone commissioners, euro zone and EU financial transfers, and so on. This is already the case for instance with the European Banking Agency and the European Central Bank. Many questions would have to be decided two or three times (once in the euro zone, again at the EU level, and again for the free trade area).

Depending on the issue, the Member country could choose its grouping, and things would quickly head towards an à la carte union. This is hardly compatible with the democratization of Europe, as soon there would be a Parliament for every question.

The members of the third grouping would then be in an even more difficult situation, with the obligation to comply with regulations over which they had no power. Should our partner countries be placed in the dilemma of either accepting heavy losses of sovereignty (in political and social matters) or being denied the benefits of free trade?

There is clearly no agreement between the peoples of Europe, even within the euro zone, on moving towards a federal Europe, with all the convergences that this would imply. In the recent period, the five Council Presidents and the Commission proposed new steps towards European federalism: creating a European Budget Committee, establishing independent Competitiveness Councils, conditioning the granting of Structural Funds on respect for budgetary discipline and the implementation of structural reforms, establishing a European Treasury and a euro zone minister of finance, moving towards a financial union, and partially unifying the unemployment insurance systems. These developments would reinforce the technocratic bodies to the detriment of democratically elected governments. It would be unpleasant if these were implemented, as is already partially the case, without the people being consulted.

Furthermore, no one knows how to proceed with convergence on tax and social matters. Upwards or downwards? Some proposals call for a political union in which decisions are taken democratically by a euro zone government and parliament. But can anyone imagine a federal authority, even a democratic one, that is able to take into account national specificities in a Europe composed of heterogeneous countries? What about decisions concerning the French pension system taken by a European Parliament? Or a finance minister for the zone imposing spending cuts on Member countries (as the Troika did in Greece)? Or automatic standards on public deficits? In our opinion, given the current disparity in Europe, economic policies must be coordinated between countries, not decided by a central authority.

Europe needs to reflect on its future. Using the current crisis to move forward towards an "ever closer union" without more thought would be dangerous. Europe must live with a contradiction: the national sovereignties that peoples are attached to have to be respected as much as possible, while Europe must implement a strong and consistent macroeconomic and social strategy. Europe has no meaning in itself, but only in so far as it implements the project of defending a specific model of society, developing it to integrate the ecological transition, eradicating mass unemployment, and solving the imbalances within Europe in a concerted and united manner. But there is no agreement within Europe on the strategy needed to achieve these goals. Europe, which has been unable to generally lead the Member countries out of recession or to implement a coherent strategy to deal with globalization, has become unpopular. Only after a successful change of policies will it regain the support of the peoples and be able to make institutional progress.

[1] See in particular the report of the French Senate by

Albéric de Montgolfier*: Les conséquences économiques et budgétaires d'une éventuelle sortie du Royaume-Uni de l'Union Européenne [The economic and budgetary consequences of a future withdrawal of the United Kingdom from the European Union],* June 2016.

[2] OECD, 2016, *The Economic Consequences of Brexit: A Taxing Decision*, April. Note that to treat leaving the euro as a tax increase does not make economic sense and represents a communication that is unworthy of the OECD.

[3] *Brexit – potential economic consequences if the UK exits the EU*, Policy Brief, 2015/05.

[4] See, for example, Joseph E. Stiglitz, 2014, "Le prix de l'inégalité", *Les Liens qui libèrent*, Paris.

The national living wage: a new means to boost low wages in the United Kingdom

By Catherine Mathieu

On 1 April 2016, a national living wage (NLW) took effect in the United Kingdom. This may come as a surprise to France, where the UK labour market is considered the epitome of a deregulated market. This new minimum wage, the NLW, adds 50 pence to the existing minimum hourly wage (the National Minimum Wage, NMW) for those over age 25, meaning a rise from £6.70 to £7.20, or 7.5%. This follows a 3.1% increase in the minimum wage in October 2015 for those over age 25 (from £6.50

to £6.70), for a total increase in one year of 10.8%. This sharp increase in the minimum wage does not represent a sudden change of course by the government. The Conservative election platform for the 2015 parliamentary elections already promised a raise in the minimum wage and pointed towards the introduction of a living wage. The announcement that the NLW would be established was made in July 2015, during the presentation of the budget by George Osborne, Chancellor of the Exchequer, following the Conservatives' election victory. This is simply the first step in an effort to raise low wages, as the government has a target of increasing the NLW to 60% of the median wage by April 2020 (up from 55% at present), to about 9 pounds.[1]

This boost for low wages is part of a broader strategy of the British government: first, the government says it wants to "reward work"; not only has the minimum wage been increased, but eventually employees at the minimum wage level will no longer pay income tax (this was one of the Tories' campaign promises in 2015). Furthermore, the government is taking measures to reduce taxes on business, including a symbolic cut in the corporation tax rate, which will be only 17% in 2020 (instead of only 20% currently), which will offset the increase in wages, at least for some companies (those that are most profitable). Finally, the government has set an ambitious target for reducing the public deficit, i.e. from 5% of GDP in 2015 to a balanced budget in 2020, in part by lowering public spending, particularly on social welfare. Raising the minimum wage would thus seem to be intended to offset, at least partially, a future reduction in benefits.

The UK's process for setting the minimum wage is well codified. Every year the government revises the minimum wage on October 1st, based on the recommendations of the Low Pay Commission (LPC), an independent body composed of academics and representatives of employee trade unions and employers. The UK has had a minimum wage only since 1999. It was implemented according to the recommendations of the Low Pay Commission at levels that matched the low wages of that time, after broad consultation with the business sectors concerned. The implementation of the minimum wage failed to spark waves of protests from employers, nor did it have a significant impact on employment, according to various assessments by the LPC over the years. The minimum wage level was initially low, and included separate rates for adults and young people. The LPC is mandated to produce an annual report on low wages and to make recommendations to the government on adjusting the minimum wage so as to ensure that low wages do not have significant adverse impacts on the employment of the employees concerned. The government has now also charged the LPC with monitoring the implementation of the NLW and proposing future adjustments, which will take place every year in April.

The NLW applies only to those over age 25. The minimum wages of young people remain at the level set last October. There are currently five minimum wages: for apprentices (£3.30 per hour); for age 16-17 (£3.87 per hour); age 18-20 (£5.30); age 21-25 (£6.70); and over 25 (£7.20). These differences are substantial; the analyses by the LPC since 1998 have argued for lower wage rates for young people, so as to prevent them from being squeezed out of the labour market because of high salaries. This gap has won acceptance, unlike the situation in France, on the grounds that it promotes the growth of “odd jobs” for young people. The employment rate of British young people (15-24 years old) is very high (51.4% at end 2015, against 27% in France and 31% in the euro zone), and it is up significantly (it was 46.8% at end 2010).

In its March 2016 report, [2] the LPC drew some initial conclusions on the possible impacts of the NLW. In April 2016, about 1.8 million employees (out of 29 million salaried jobs) benefited from the NLW, while in 2015 one million adults over age 25 earned the minimum wage. The NLW represents an increase in the annual salary of 680 pounds (for the average working hours of the persons concerned, 1360 hours per year, 26h15 per week). The impacts will vary greatly depending on the sector. It is in the service sectors that low wages are most common (40% of jobs are paid the minimum wage in cleaning companies, 30% in the hotel-café-restaurant sector, and 34% in hairdressing). According to the LPC, this year the implementation of the NLW will impact payroll by around 0.7 billion pounds over the full year, i.e. 0.1% [3]; raising the NLW to 60% of the median wage will cost another 2.4 billion pounds, which by April 2020 will represent 0.4% of the total annual payroll. These figures include a diffusion effect on the first 25 percentiles of wage-earners. The impact of introducing the NLW on wages paid will be close to 4% in the cleaning sector and 3% in the hotel-café-restaurant and hairdressing sectors. Assuming a similar diffusion effect, the Bank of England [4] also estimated that the NLW would lead to a gradual increase in payroll of less than 0.5% in five years. About 3 million people would receive the NLW in 2020.

In July 2015, the Office for Budget Responsibility estimated that by 2020, the introduction of the NMW could result in the loss of 60,000 jobs, according to average assumptions of the elasticity of employment to its cost of – 0.4 [5], while also forecasting that over that same period the UK economy would create 1.1 million jobs. The national living wage is coming into force after several years of growth and job creation that has reduced the unemployment rate (by the ILO definition) to its pre-crisis level (5.2%), meaning that any job losses in certain sectors should be very manageable.

Criticism of the NLW is currently coming from two camps: first, the trade unions are accusing the measure of further widening the gap between the wages of young people and adults; and second, employers, particularly in low-wage sectors, are warning of the risk of expanding the informal economy if the NMW is effectively increased to 9 pounds per hour by 2020, although the current level of the NLW is generally considered acceptable.

These adjustments in the British minimum wage have led the UK to join the ranks of the OECD countries with the highest minimum wage levels, although it remains behind France, for example (Figure 1). The new national living wage still leaves the British minimum wage lower than the French minimum wage (the SMIC, which represents 60% of the median wage). At £7.20, or 9 euros, the hourly rate of the British national living wage is currently almost 7% lower than the level of France’s SMIC. After taking into account employer social contributions, the hourly cost of the NLW is also below the SMIC, because, even though France has enacted important exemptions from employer social contributions (Fillon exemption, Responsibility Pact, CICE credit, prime zero charge) on low wages, social contributions are also very low in the UK. Take the case of an adult over age 25, unmarried and childless, who works 35 hours per week (Table). The hourly cost to the employer is 9.48 euros in the UK against 10.43 euros in France; the hourly cost to the employer falls to 9.21 euros in the UK if the employee works 26h15 per week, which represents the average working time of employees on the minimum wage in the UK. If we now consider the salary received by the employee, net of employee social contributions and income tax, the NLW is higher than France’s SMIC, especially if the employee works more than 30 hours per week, which makes them eligible for the Working tax credit, which is more generous than France’s *prime d’activité* credit. On the other hand, French employees are entitled to a much more generous public system of pension and unemployment benefits.

The establishment of the national living wage in the UK thus represents an effort to catch wages up in sectors where low wages and part-time and precarious work are most common. This increase, in its current form, will have only a marginal macroeconomic impact on the British economy.

Table. Minimum hourly wage in the United Kingdom and in France, April 2016 (case of an adult over age 25, single and childless)

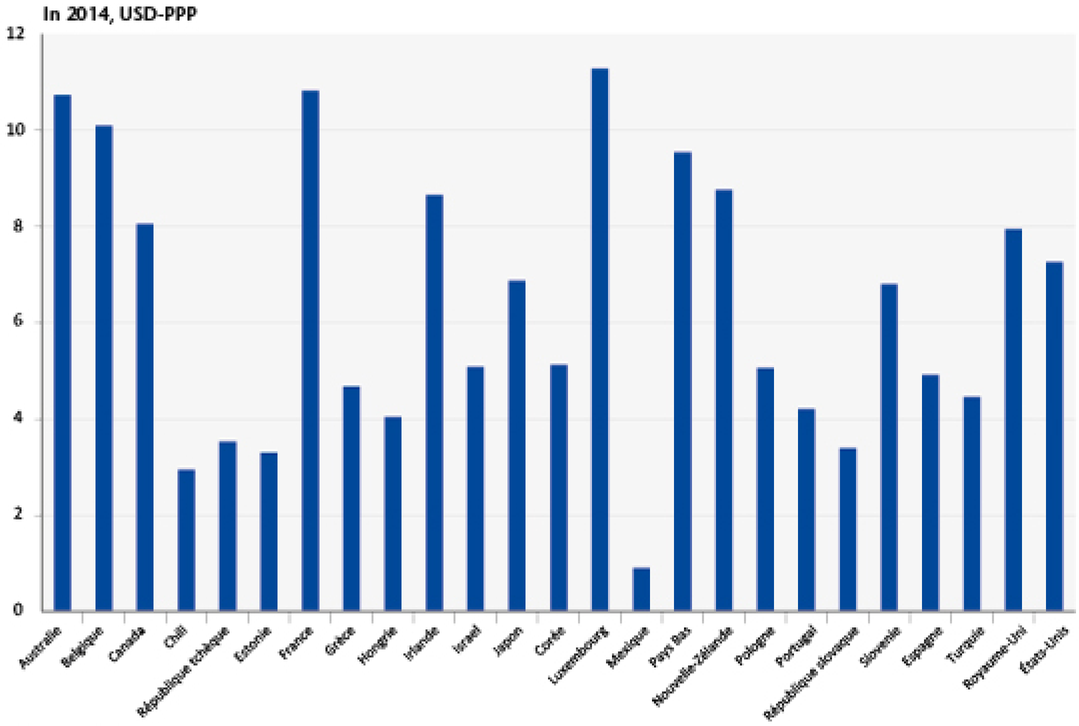
In euros*

	United Kingdom NLW, 26h**	United Kingdom NLW, 35h***	France 35h****	Difference UK-Fr 35h
Gross hourly wage, euros	9,0	9,0	9,67	-6,9 %
Rate of employer social charges	2,4 %	5,3 %	8,6 %	
Rate of employee social charges/CSG	2,1 %	4,6 %	22,9 %	
(Income tax) - (Working tax credit or French PA credit*****	0 %	3,2 % – 11,7%	-7 %	
Hourly cost (employer)	9,21	9,48	10,43	-9,6%
Hourly gain (employee)	8,80	9,35	8,13	15 %

Note: * Based on an exchange rate for the pound sterling at start April 2016 of 1.25 euros. If the average exchange rate for 2015 is used, which is similar to the average exchange rate since 1999, the gross British wage would currently be 2% higher than the French rate.
** Average working time of an employee on the minimum wage, which does not give a right to the Working tax credit for an unmarried person over age 25 without a child.
*** Based on an average working time of 35 hours per week.
**** I would like to thank Henri Sterdnyiak, who provided me the apparent contribution rates for France. The employer contribution rate takes into account the Fillon exemption, the Responsibility Pact, the CICE credit and the "prime zero" charge.
***** *Income tax - Working tax credit / Income tax - PA credit.*

Source : Author's calculations.

Figure. Hourly minimum wage rates in the OECD countries



Source : OECD.

[1] As the aim is to reach 60% of the median wage, this figure of £9 is simply indicative, based on the projections of wage increases performed in March by the Office for Budget Responsibility (OBR). The OBR is an independent body that has been responsible since 2010 for performing the medium-term macroeconomic forecasts used for drawing up the UK budget and

for analysing the UK public finances.

[2] See National minimum wage, *Low Pay Commission Report Spring 2016*, March 2016.

[3] Given the low levels of working hours and hourly wages, workers on the minimum wage earned only a quarter of the average salary at end 2015. The minimum hourly wage represented only 42.8% of the average hourly wage (£6.70 against £15.70).

[4] See Inflation report, Bank of England, August 2015.

[5] This elasticity corresponds to the median of the empirical estimates made using British data. Job losses rise to 110,000 if we use the hypothesis of an elasticity of -0.75 but are only 20,000 for an elasticity of -0.15.

A new EU arrangement for the United Kingdom: European lessons from the February 19th agreement

By Catherine Mathieu and Henri Sterdyniak

Following the demand made by David Cameron on 10 November 2015 for a new arrangement for the United Kingdom in the European Union, the European Council came to an agreement at its meeting of 18 and 19 February. On the basis of this text, the British people will be called to the polls on 23 June to decide whether to stay in the EU. This episode raises a number of questions about the functioning of the EU.

– The United Kingdom has challenged European policy on matters that it deems crucial for itself and largely got what it wanted. Its firmness paid off. This has given rise to regrets on this side of the Channel. Why didn’t France (and Italy) adopt a similar attitude in 2012, for instance, when Europe imposed the signing of the fiscal treaty and the implementation of austerity policies? This is a cause for concern: will what has been accepted for a big country be tolerated for a smaller one? The UK’s threat to leave is credible because the EU has become very unpopular among the population (especially in England), and because the UK is independent financially (it borrows easily on the capital markets) and economically (it is a net contributor to the EU budget). A country that is more dependent on Europe would have little choice. This raises worries: won’t we see other countries follow suit in the future? Will Europe be able to avoid becoming a Europe á la carte (each country taking part in the activities that interest it)? But is a model based on forced participation preferable? Europe must allow a country to abstain from policies that it deems harmful.

– The United Kingdom will therefore organize a referendum, which is satisfactory from a democratic perspective. The most recent referendums have hardly yielded favourable results for European construction (France and the Netherlands in 2005, Greece in July 2015, Denmark in December 2015). The British will be limited to choosing between leaving the EU (the February agreement clearly rejects the possibility of new renegotiations if the referendum results in a majority in favour of an EU exit) or staying with a reduced status; the possibility of the UK remaining in the EU and seeking to strengthen its social dimensions, as advocated by some of the Labour Party and the Scottish Nationalists, will not be offered. Too bad.

– The United Kingdom is explicitly exempted from the need to deepen the EMU or from an "ever closer union" or "deeper integration", all formulas contained in the treaties. The proposed arrangement clarifies that these notions are not a legal basis to extend the competences of the EU. States that are not members of the euro zone retain the right to take part or not in further integration. This clarification is, in our opinion, welcome. It would not be legitimate for the Union's powers to be extended continuously without the consent of the people. In the recent period, the five presidents and the EU Commission have proposed new steps towards European federalism: creating a European Fiscal Committee; establishing independent Competitiveness Councils; conditioning the granting of Structural Funds on fiscal discipline; implementing structural reforms; creating a European Treasury department; moving towards a financial union; and partially unifying the unemployment insurance systems. These moves would strengthen the technocratic bodies to the detriment of democratically elected governments. Wouldn't it be necessary to explicitly request and obtain the agreement of the peoples before embarking on such a path?

– The exit of the United Kingdom, a certain distancing by some Central and Eastern Europe countries (Poland, Hungary), plus the reluctance of Denmark and Sweden could push towards an explicit move to a two-tier Union, or even, to take David Cameron's formulation, to an EU in which countries are heading to different destinations. The countries of the euro zone would for their part accept new transfers of sovereignty and would build a stronger fiscal and political union. In our opinion this proposal should be submitted to the people.

– At the same time, the draft agreement provides that the Eurogroup has no legislative power, which remains in the hands of the Council as a whole. The UK has had it clarified that a non-member state of the euro zone could ask the European Council to take up a decision on the euro zone or the banking union that it believes harms its interests. The principle of the euro zone's autonomy has thus not been proclaimed.

– The United Kingdom has had it clarified that it is not required to contribute financially to bail out the euro zone or the financial institutions of the banking union. This may be considered discomforting vis-à-vis the European principle of solidarity, but it is understandable. This is because the establishment of the euro zone has abolished the principle: "Every sovereign country is fully backed by a central bank, a lender of last resort", which is posed by the bailout problem. The UK (and its banks) are backed by the Bank of England.

– The United Kingdom has had the principles of subsidiarity reviewed. A new provision states that parliaments representing 55% of the Member States may challenge a law that does not respect this principle. The UK has had it noted that the issues of justice, security, and liberty remain under national competence. It is a pity that countries devoted to their specific social systems and their wage bargaining systems have not done the same.

– It is understandable that countries concerned about national sovereignty are annoyed (if not more) by the EU's relentless intrusions into areas under national jurisdiction, where Europe's intervention does not bring added value. It is understandable that these countries are refusing to have to incessantly justify to Brussels their economic policies or their economic, social or legal regulations when these have no impact on other Member States. Europe must undoubtedly take these feelings of exasperation into account.

– As regards the banking union, the draft text is deliberately confusing. It is recalled that the "single rule book" managed by the European Banking Agency (EBA) applies to all banks in the EU, and that financial stability and equal competitive conditions must be guaranteed. But at the same time, it says that Member States that do not participate in the banking union retain responsibility for their banking systems and can apply special provisions. Moreover, countries that are not members of the euro zone have a right of veto on the EBA. This raises the question of the very content of the banking union. Will it make it possible to take the measures needed to reduce the scale of speculative financial activity in Europe and steer the banks towards financing the real economy? Or is the objective to liberalize the markets for the development of financial activity in Europe so as to compete with London and non-European financial centres? In the first case, what was needed was to clearly take in hand the market in London, telling it that membership in the EU requires close monitoring of financial activities. And that its departure would allow the EU to take capital control measures to limit speculative activities and encourage banks in the euro zone to repatriate their activities.

– Likewise, Belgium, Luxembourg, the Netherlands and Ireland would have needed to be told that EU membership means the end of tax avoidance schemes for the multinationals.

– The United Kingdom has had a declaration passed affirming the need both to improve regulations and repeal unnecessary provisions to improve competitiveness while at the same time maintaining high standards of protection for consumers, labour, health and the environment. This compatibility undoubtedly amounts to wishful thinking.

– The text recognizes that the disparity in wage levels and social protection in European countries is hardly compatible with the principle of the free movement of persons in Europe. This has long been an unspoken part of European construction. The United Kingdom, which was one of the only countries not to take interim measures to restrict the entry of foreign workers at the time of the accession of central and eastern European countries in 2004, is now demanding that such measures be provided for in any future accessions. The draft agreement states that a European person’s stay in a country other than his or her own is not the responsibility of the host country, meaning that the person either must have sufficient resources or must work.

– The question of the right to family benefits when children are not living in the same country as their parents is a tangled web. In most countries, family benefits are universal (not dependent on parental contributions). Both principles cannot be met at the same time: that all children living in a country are entitled to the same benefit; and that everyone working in a given country is entitled to the same benefits. The United Kingdom has won the right to be able to reduce these allowances based on the standard of living and family benefits in the child's country of residence. But fortunately this right cannot be extended to pension benefits.

– Most European countries currently have mechanisms to promote the employment of unskilled workers. Thanks to exemptions on social contribution, to tax credits and to specific benefits (like in-work credits or housing benefits in France), the income that they receive is largely disconnected from their wage costs. The British example shows that these programmes can become problematic in case of the free movement of workers. How does a country encourage its own citizens to work without attracting too many foreign workers? Here is another of the unspoken issues of open borders. It is paradoxical that it is the United Kingdom that is raising the question, while it is near full employment and is claiming that the flexibility of its labour market allows it to easily take in foreign workers. In any case, the UK was granted that a country facing an exceptional influx of workers from other EU Member States can obtain the right from the Council, for seven years, to grant non-contributory aid to new workers from other member countries in a graduated process over a period of up to four years from the start of their employment. The UK has also had it clarified that it can use this right immediately. This is a challenge to European citizenship, but this concept had already been chipped away for the inactive and unemployed.

The European Union, as currently constructed, poses many problems. The Member States have divergent interests and views. Because of differences in their national situations (the single monetary policy, freedom of movement of capital and people), many arrangements are problematic. Rules without an economic foundation have been introduced into fiscal policy. In many countries, the ruling classes, the political leaders, and the top officials have chosen to minimize these problems so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social conditions, wages and regulations have been deliberately forgotten.

The UK has always chosen to keep its distance from European integration, safeguarding its sovereignty. Today it is putting its finger on sensitive points. To rejoice at its departure would be irrelevant. To use this to move mindlessly towards an "ever closer union" would be dangerous. Europe should seize this crisis to acknowledge that it has to live with a contradiction: national sovereignty must be respected as much as possible; Europe has no meaning in and of itself, but only if it implements a project that supports a specific model of society, adapting it to integrate the ecological transition, to eradicate poverty and mass unemployment, and to solve European imbalances in a concerted and united manner. If the agreement negotiated by the British could contribute to this, it would be a good thing – but will Europe's countries have the courage to do so?

The British elections: border questions (2/2)

By Catherine Mathieu

David Cameron has put the economy at the forefront of his electoral campaign, making the British economy's good performance a trump card in the Conservative programme (see "The UK on the eve of elections …"). But, according to the polls, when May 7 comes to a close no party will be able to govern alone. While in 2010, the uncertainty was whether the Liberal Democrats would choose to ally with the Conservatives or the Labour Party, this time there is even greater uncertainty, as several parties are likely to be in a position to swing the outcome. The Liberal Democrats have lost popularity following five years of participation in government and are likely to receive less than 10% of the votes, behind the nationalist United Kingdom Independence Party (UKIP, with about 12% of voting intentions), which calls for the United Kingdom to leave the EU and won the last European elections. Faced with rising euro-scepticism, particularly in the ranks of his own Conservatives (the "Tories"), David Cameron has promised to hold a referendum on the UK's membership in the EU by the end of 2017 if he becomes Prime Minister again. As for Labour, if it is able to form a coalition government, it could ally with the Scottish National Party (SNP). But Labour has excluded this possibility in the face of attacks by David Cameron, who has raised the spectre of the fragmentation of the UK among the British electorate, which has barely recovered from its fright at the possibility of seeing Scotland become independent in the September 2014 referendum. Labour would nevertheless benefit from the support of the SNP and could form a coalition with the Liberal Democrats. The Lib-Dems have drawn several red lines with respect to entering a coalition government: less fiscal austerity if they ally themselves with the Conservatives or more fiscal restraint if they join with Labour, except in education where the Liberal Democrats want more resources than the two major parties.

Economic and social programmes of the main parties: similarities, with some slight differences …

The Conservatives are welcoming the rebound in growth and employment, and have halved the public deficit relative to GDP in 2018/2019. They feel they have “put the house in order” and now want to “repair the roof while the sun is shining”. They say they want this to benefit everyone. They therefore want to increase spending on the health system (NHS), maintain spending on education and increase the number of places in university. They are committed to continue to raise pensions by at least 2.5% per year. They will make significant public investments in transport. They will not increase VAT, income tax, or social contributions. On the other hand, they will further reduce the cap on income assistance so as “to make work pay”.

The Conservatives want to promote apprenticeships, encourage business, regulate the right to strike, cut paperwork, and get disabled people into the workplace. They wish to control and reduce immigration from the EU (bringing it down to “tens of thousands” per year instead of “hundreds of thousands” now). The right to social benefits will be cut back (it will be necessary to have resided in the country for at least four years to qualify for tax credit and child benefit, and social housing will be reserved for British citizens). They want to provide cheap energy to households by developing energy savings and renewable energies, especially nuclear.

The Tories have set themselves the goal of bringing the public deficit into a small surplus (0.2 percent of GDP) through a combination of cutting public spending and social spending and combatting tax evasion and avoidance (taking action on non-domiciled status – “non-doms” – and the taxation of multinational firms).

For Labour, “Britain only succeeds when working people succeed”. A national renewal is needed so that “the economy works for working people”. Labour is denouncing the increase in inequality and in precarious jobs and the fall in the purchasing power of working families.

But the Labour Party is also proclaiming their commitment to reducing the public deficit every year. Their goal is to bring the current account deficit (excluding investment) into balance by 2018-19, which would mean a public deficit of 1.4% of GDP. This goal is less ambitious than that of the Conservatives and would be met in part by higher taxes. The maximum marginal rate of income tax would rise from 45% to 50%. A tax would be introduced on “mansions” (properties worth more than 2 million pounds). Labour has pledged to maintain the most competitive corporate tax rates in the G7. This rate, which was cut to 20% in April, would nevertheless be raised by one point. The levy on banks would be increased (900 million expected). Labour also wish to reinstate a lower 10% starting rate of tax, to be financed by the abolition of the allowance for married couples. They want to eliminate the very unpopular tax on vacant rooms (the “bedroom tax”). Like the Conservatives, they would remove the tax advantages for “non-doms”.

Labour, however, want to cut government spending, except on health, education and international development. They propose an increase in NHS funding in order to reduce waiting times. They have pledged to raise the hourly minimum wage to GBP 8.00 in 2019 (from the current level of 6.50 pounds, which is set to rise to 6.70 in October 2015). They propose to regulate zero-hour contracts (at least for employees who have worked regularly for more than 12 weeks). On the other hand, they do not question a cap on income assistance. Labour also say that they will control immigration and limit the right of immigrants to social benefits (by requiring at least two years' residence in the country). They want to implement an industrial strategy to develop a green economy. They propose reducing the role of shareholders in corporate management and creating a British Investment Bank to help finance small businesses.

The Liberal Democrats call is for a "stronger economy, fairer society". They want to make the UK a world leader in terms of future technologies. They want to increase spending on health and education. They also want to increase the availability of childcare and parental leave. Above all, they want to develop green taxation and make the transition to a low-carbon economy. They aim to balance the current budget, like Labour, but this would occur a year earlier (2017-2018). This would be achieved by limited spending cuts, but also by increasing taxes on the wealthy, on banks, on big business and pollution and by fighting tax avoidance. They too propose a mansion tax.

… and a number of unknowns

The Institute for Fiscal Studies (IFS) has published two notes: "Post-election austerity: Parties' plans compared ", *IFS Briefing Note BN 170*, 22 April, and "Taxes and benefits: The parties' plans", *IFS Briefing notes BN 172*, 28 April. In these notes the IFS attempts to estimate the proposed measures, but underlines the lack of detail in the different programmes. The Conservatives are planning more spending cuts, while Labour and the Liberal Democrats are planning a less rapid reduction in deficits and consequently in public debt. Under the Tories, the public deficit would fall from 5% of GDP in 2014-15 to 0.6% in 2017-18, to 1.1% for the Liberal Democrats, to 2% for Labour, and to 2.5% for the SNP. The public debt would decline from 80% of GDP in 2014-15 to 72% in 2019-20 under the Conservative plan, compared with 75% for the Liberal Democrats, 77% for Labour and 78% for the SNP. The three parties have announced that they will pursue the goal of deficit reduction but without specifically detailing how they would do this. The Conservatives, for instance, would not increase taxes; they would have to make an 18% cut in spending on non-protected sectors, that is to say, defence, transportation, social assistance and justice. They do not spell out how they would make large savings on social welfare spending while excluding pensions and the NHS. At the end of April, the Liberal Democrats injected into the debate the idea that the Conservatives would consider reducing family allowances, which David Cameron has denied he will do, but suspicion remains just a few days before the election. All the parties have committed not to increase the main VAT rate, income tax or health insurance contributions, but all of them are also counting on a great deal of revenue from the fight against tax avoidance.

Scotland-Europe: two key issues in the elections

Two issues make this vote unique and have given rise to a very specific political configuration. First, the Scottish National Party (SNP) is continuing to call for Scotland's independence, despite the outcome of the referendum in September 2014 (55% no). As a centre-left party that is currently in power in Edinburgh, it could win 55 of the 59 Scottish seats, at the expense of the Labour party, and thus be in a pivotal position for securing a future majority. It is calling for a new referendum on Scottish independence, but also for an end to austerity policies on public and social welfare spending.

UKIP is calling for the UK to leave the EU. David Cameron has promised to hold a referendum on this before the end of 2017 if the Conservatives prevail. In any case, Cameron is opposing any extension of Europe's economic or political powers; Europe must above all be a single market that needs for free market policies to be maximized; he rejects any European regulations on financial services as well as any solidarity between countries, any increase in the EU budget, and any increase in the British contribution ("I am not paying that bill"). He wants the UK to have the possibility of limiting the social rights of EU immigrants, which would be the main point in any

Conservative negotiations over keeping the United Kingdom in the EU. David Cameron will not come out for keeping the UK in the EU until these demands are taken into account. Labour has denounced the UK's loss of influence in Europe caused by its isolationism, but it is also demanding less Europe: the UK should remain free to set its own immigration policy and social policy. According to Gordon Brown, leaving the EU would transform the UK into a "new North Korea", without allies and without influence. Labour would hold a referendum if Europe wanted to impose unacceptable measures on the UK. The Liberal Democrats are very attached to Europe. They want to defend business in Europe, along with the Transatlantic Trade and Investment Partnership (TTIP), eliminate unnecessary institutions such as the European Economic and Social Council and the sessions of the EU Parliament in Strasbourg. They want to maintain freedom of movement in Europe but reduce immigrants' rights to benefits. They will vote no on a referendum for leaving the EU. Currently, 35% of the British people would vote for leaving the EU and 57% against (but 38% want to stay while reducing the EU's powers). The large corporations and even more so the City want to remain in a big market. As was the case during the Scottish referendum, some corporations (e.g. HSBC[1]) are threatening to move their headquarters if the UK leaves the EU. The richest and best-educated part of the population also wants to stay in the EU.

The UK's economic and political development is thus now subject to three uncertainties: the risk that there will be no clear majority in Westminster; the return of the Scottish debate; and the debate on leaving the European Union.

[1] But HSBC is also challenging the increase in taxes on banks as well as the regulations inspired by the Vickers report, which would require ring-fencing the activities of the commercial banks.