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The economic risks of an outbreak of Brexit-style votes

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Stock market fears that a Leave vote would lead to a sharp drop in global growth appear to have calmed. The conclusion now seems to be that Brexit might be bad for the UK but for the rest of the world it is close to a non-event.
Really? With the eurozone still struggling to coalesce around a strategy to preserve the currency union, and populist pressures building everywhere, it is highly likely that similar episodes will erupt, and disrupt, on the continent.

A widespread resort to knife-edge votes to address complex, nation-defining economic questions with international implications would be a concern even amid strengthening global growth. But the situation is just the opposite — and in this context such mechanisms are a recipe for instability and disaster.

The debt-laden Chinese economic machine is sputtering, with recent large credit injections producing only tepid growth. An ageing Europe is starting to look more and more like Japan. Japan looks like, well, Japan: anaemic. US growth is solid but hardly inspiring. Indeed, pre-Brexit Britain has been one of the brighter spots among advanced economies. So much for that now.

A problem across the advanced world is that measured productivity has been extremely low. One can debate why this is so and whether it is permanent. I do not agree with those who say the era of innovation is over: rather, the world is in the grip of a debt supercycle that began in the US, moved to Europe and now has China in its grip. But this slow growth period will not go on forever — that is, unless misguided policies are put in place to make it permanent.

The biggest economic risk from the Brexit vote is that it turns out to be the start of a vicious cycle of low growth and populist policies that lead to still lower growth and even more populist policies across the west. Not all populist prescriptions are bad right now; redistributing income through taxes and transfers is a logical reaction to growing inequality. Retreat from the liberal global trading order is not.

US workers, for example, concerned about stagnant wages, could face far worse if the US abandons decades of support for global trade, a position that has become far more mainstream in US political debate. Most Americans would find themselves paying significantly higher prices for many goods, meaning their wages will buy much less.

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Political systems need to accommodate increasingly complex economic realities — but it is crucial to get the mechanisms right. In the case of the Brexit vote, the question of process is even more important than the outcome. If 52 per cent of the UK electorate feels EU integration is inimical to Britain's long-term social and economic interests, the voices of those voters need to be heard. Yet one can question a process that rode roughshod over the views of the minority (the young, for example) and provided no formal outlet for reconsideration. If other countries follow the UK's lead, the outcome will be chaos.

Political scientists in general have long been sceptical about excessive reliance on direct democracy, where individual voters can decide on narrowly defined single questions. Representative democracy allows for horse-trading across different issues. It provides, in theory if not always in practice, a vehicle for taking tough stances — possibly unpopular but ultimately in a nation's best interests — on complex problems.

Not everyone agrees that referendums are destabilising. Several leading Swiss political theorists would beg to differ. Professor Bruno Frey, for example, argues that the threat of referendums helps break up coalitions of entrenched politicians engaged in monopoly behaviour inimical to public interests. He also argues that referendums produce healthy debate and a more informed electorate. But Switzerland has very different traditions from the UK's and long familiarity with the referendum process. The Swiss votes of recent years — say, the 2014 referendum on whether the central bank should hold more of its reserves in gold — have been clinical and easily reversible compared with the Brexit mess.

No one knows what the vote means for the UK in the long run. Even if it causes a recession in the short term, it is always possible the alternative would have been worse. Remember that Gordon Brown, as chancellor of the exchequer, was vilified by some for manoeuvring to keep the UK out of the euro even though it had joined the EU. Years later, as the euro crisis unfolded, he began to look like a genius. Maybe the same will happen to leading Leavers, although that point has not yet arrived.

Regardless, one cannot be happy about the way we have reached this point, and we can only hope that if other European nations follow the UK's lead, they will put in more checks and balances. One fears, however, that this will not happen. Instead, opportunistic politicians who aim to disrupt the system for ideological reasons or personal advancement will seize on referendums as the option that sets the lowest hurdle.

If global stock markets want to be blasé about the coming wave of political uncertainty amid a retreat from globalisation, that is their business. But policymakers should understand the magnitude of the economic risks. There is certainly no room for complacency.

The writer is professor of economics at Harvard University and author of the forthcoming 'The Curse of Cash'