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Opening remarks by the Director

Good morning.

I am delighted to welcome you to the National Institute this morning for the release of our quarterly Economic Review. It is now just over six weeks to the referendum that has been called by the Government on the question of whether the UK should remain in the EU. Accordingly this May Review contains a set of articles and commentaries on various aspects of the UK's place in the EU. And, as well as our standard assessment of the UK economy and its prospects, we provide an econometric assessment of the risks (or rewards) and the balance of those risks posed by a UK exit from the European Union.

Let me talk about both of these two aspects of the Review but in reverse order. First, I want to make some brief comments about the nature of the econometric modelling exercise that has been undertaken by my new colleagues here at the Institute, led by Simon Kirby and Monique Ebell. The Institute both developed and now maintains the NiGEM model, which is widely used by the official and private sector here and abroad, to help formulate judgements about developments in the economy. The model allows us first to formulate a benchmark assessment of the economy, both in the near term and several years ahead, and then allows us to examine the magnitude of any risks to that assessment that may arise from a decision to leave the

EU.

There are a number of aspects of those risks that the model is well suited to capturing and the exercise undertaken by the modelling group accomplishes that in a number of ways:

- There is likely to be a short run but persistent escalation in risk should the referendum lead to the UK seeking to leave the EU. This escalation in risk is likely to lead to a number of developments in the exchange rate, asset prices, as well as monetary and financial conditions, which will pose difficult questions for policymakers;
- In terms of the academic research, there are well-identified risks that arise from a break and re-set in trading relations that may have an impact on goods and services, as well as foreign direct investment (FDI);
- We can also, as a result of other information and analysis, use the model to assess the balance of risks arising from any central case for example the likely impact on productivity, innovation and the fiscal position.

Quite famously, George Box said: "Essentially, all models are wrong, but some are useful". The model maintained by the Institute, NiGEM, falls into the useful category. The advantages of the NiGEM model for these purposes is that the analysis we provide can also think simultaneously about a monetary and fiscal policy response, so that the projected outcomes on macroeconomic indicators such as output, inflation, and consumption are conditional on those policy responses. But also for the longer run analyses, the model - because it is global in nature - allows for the possibility of re-orientation of trade to other parts of the world, so that the projected outcomes are conditional on a private sector response from the traded sectors at home and abroad.

Many of the off-model issues connected with the question of a UK exit from the European Union are what economists tend to term Knightian uncertainty. For example, it is hard to predict what future trading relationships will be, or what the immigration rules will be but also we do not know what economic and political reactions of other countries might be, how the City will be treated, or whether there may be moves by groups within other countries also to leave the EU. That is to say there is a lump of issues about which it is quite hard to gain numerical measure but that we know are thrown open by a possible exit from the EU. Accordingly, the Institute is exploring the quantitative aspect of these issues with a provisional NIESR economic uncertainty index, a version of which is shown in page 111.

But naturally the analysis of these issues lends itself to more qualitative analysis of a number of interconnected and quite complex issues and so the first half of the Review comprises five papers after the commentary: Britain's Influence in the EU by Anand Menon and John-Paul Salter of King's College London; Immigration, Free Movement and the EU Referendum by Jonathan Portes from the Institute; Free Movement of Services, Migration and Leaving the EU by Catherine Barnard and Amy Ludlow of the University of Cambridge; EU membership, Financial Services and Stability by Angus

Armstrong from the Institute and The EU Budget and UK Contribution by Iain Begg from the LSE. The Institute is grateful that much of our work and, in particular, that of two of the Institute's senior staff, Angus Armstrong and Jonathan Portes, has been supported by the ESRC's UK in a Changing Europe programme.

Jagjit S. Chadha
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