To reform the EU, Britain must leave

Patrician vision versus plebeian pragmatism

Brian Reading in London

The European Union has been hijacked by 'patricians' – the elite, establishment, bureaucrats, multinationals and corporate interests. The 'plebeians' are rarely consulted. So the 23 June referendum on EU membership – whether

or not it should end in 'Brexit' – represents a giant democratic breakthrough.

To plagiarise Churchill, a British departure from the EU is not the end or the beginning of the end. It is the end of the beginning. Prime Minister David Cameron's effort to seek EU reform as a means of averting Brexit has failed. But Brexit could be the catalyst for reform. If not, the EU is doomed.

We will see the workings of these trends in the run-up to the poll. Adam Smith's 'invisible hand' posited that the pursuit of self-interest could be to the common good. He assumed free markets (my over-simplification). But where markets are constrained by rules set by powerful special interests, and where democratic systems are politically flawed (see, for example, the US gun lobby), self-interest does not serve, but tends to subvert, the common good.

Indeed, self-interest may well decide the outcome on 23 June. Among those who wish to remain, few argue the case for the common good. Most equate a sectional interest with the general interest, as in 'What's good for GM is good for America'. The City of London is no exception. Virtually all big multinationals are against leaving – perhaps fearing higher UK taxes. Nowhere is the leap in the dark so prone to special pleading as on the issue of what happens after a feared or favoured British exit.

One point is crystal clear. The terms of continued EU membership have been marginally changed by pre-referendum negotiations. Britain has been offered minor exceptions, mostly meaningless. The EU remains unreformed. Post-Brexit terms are pure speculation. But so are future laws the EU could impose.

The 23 June poll is not simply a British referendum. The negotiations have tested whether other EU members want the UK to remain in. But theirs are patrician voices, who fear consulting their own plebs.

The patricians are impaled on the horns of a dilemma. Conceding meaningful EU reform is unthinkable. For the patricians to give the UK genuine 'exceptional status' would encourage similar demands by their own plebs. Membership then becomes 'à la carte', not the 'table d'hôte' that ever-closer union demands.

Failure to deliver special status increases the risk of Brexit. Yet delivering credible exceptions would threaten plebeian revolts elsewhere.

My father used to say, 'Blessed is he who expects little, for he will not be disappointed.' Cameron in his negotiations asked little. Even so, he has been largely disappointed. Brexit support may surge. If sustained, exit will follow. But then protracted negotiations of the new relationship will be blighted by the same dilemma.

If Britain leaves, Europe's patricians would be tempted to treat the UK extremely poorly, 'pour décourager les autres'. This tactic would surely backfire. Interdependence works both ways. Barriers to British exports would divert trade. Alternative supplies would cost more or be inferior, otherwise they would have been chosen in the first place.

Britain is already separated from the mainstream EU by its absence from the single currency and from Schengen. Divorce terms would need to be settled, hopefully amicably. Shared common interests suggest Brexit, well handled, would make little difference to the UK. The issue at stake is the EU's future.

We will see a tussle between the visions of patricians and the pragmatism of plebeians. The patricians do not have a good track record, epitomised by the euro debacle. The EU has failed to deliver utopian expectations. It is understandable that everywhere the plebs are revolting.

Brexit could be the ex-post catalyst for EU reform. Some fear that, if the UK goes its own way, the EU could break up. Yet, if Britain stays, and there is no reform, the dominoes would fall faster. British exit provides the sole method of keeping them standing.

Divorce and a new settlement

Brexit's trade consequences would be mild

Brian Reading in London

The European Union is Britain's largest trading partner. In 2015 it accounted for 45% of British exports and 53% of imports. Departing from the EU would presumably diminish these shares. In the absence of a liberal divorce settlement, trade both ways would suffer. But it does not inevitably follow that reduced trade dependence is an

unmitigated disaster. Indeed a case can be made otherwise.

This is not to argue black is white or vice versa. Conventional wisdom is often oxymoronic. In the Brexit debate all supposedly foregone conclusions require rigorous examination.

Proximity powerfully influences trade patterns. Use-by dates and transport costs are important as well as value for money. We don't import freshly baked baguettes from China. Continental drift is rather slow. Brexit will make no difference to distance. In or out, continental Europeans will continue substantially to trade with their near neighbour.

The EU is a customs union with a common external tariff, currently 18% on agricultural products and less than 3% on manufactures. But imports of cars and trucks are more heavily protected. A free trade area in a protectionist world is suboptimal. It both creates trade (benign) and diverts trade (malign).

The EU buys British exports and Britain buys from the EU because these products are cheaper and/or better than the alternatives. Proximity lends a hand.

But value-for-money choices can either reflect genuine costs and benefits, or be distorted by tariffs (or exchange rate fluctuations). Brexit would correct some 'artificial' trade-diverting choices. It may substitute others depending upon the divorce settlement.

Other than agricultural products, it is hard to prove whether on balance EU trade creation or diversion is greater. However, Transatlantic Trade and Investment Partnership negotiations open the door to wider free trade and it would be hard to exclude the UK from any deal. Agricultural concessions in the Doha round of World Trade Organisation negotiations offer Britain benefits, regardless of Brexit.

Possible future British trade losses vis-à-vis the EU would not be new. When the euro was born in 1999, the EU's share of British exports was 10% higher, at 55%, than it was in 2015. British non-EU exports grew twice as fast as EU exports between 1999 and 2015. The EU import share fell slightly, down to 53% from 56%.

This is explicable in terms of growth differentials between Britain and the rest of the EU. If import shares in final spending are unchanged, a faster growing economy's trade balance will deteriorate with slower growing partners. During the past quarter century, Britain's final demand has grown faster than the rest of the EU's, and non-EU countries' has grown faster than both.

Britain's EU trade has been a mixed blessing in recent years. In 2010 George Osborne, chancellor of the exchequer, promised to eliminate Britain's budget deficit by 2015. He failed. One excuse, not the whole story, was the euro debacle's impact on UK growth. He now promises to eliminate the deficit by 2020. Anaemic EU growth may be cited as a future alibi. Brexit offers trade diversion to faster growing markets. It may be cathartic, but – as the gardeners say – harsh pruning leads to buds in May.

Brexit's consequences are uncertain. They are certainly frequently exaggerated by those who wish the UK to stay in.

Some say Brexit would condemn Britain to a decade in the doldrums. This is unlikely.

British total exports account for around a third of current price GDP, with exports to the EU roughly 15%. It is ridiculous to claim, as some in the 'remain' camp maintain, that Britain's exit would result in the loss of all of this. Losing say 10% would reduce GDP by 1.5%. This is not so different from public spending cuts in recent years.

Imports from the EU would also fall. Part of both would be offset by trade diversion to non-EU countries. Diverted imports may exceed diverted exports. Unless trade both ways was severely reduced, to the EU's disadvantage especially in agricultural products, the medium-term consequences must be mild. Historians reviewing Brexit in coming years may ask what all the fuss was about.

Lessons of 1776

Flawed reliance on Treasury's so-called facts

Brian Reading in London

George Osborne, the UK chancellor of the exchequer, has claimed as a 'fact' that British departure from the European Union would cost British families precisely £4,300 each by 2030. Osborne is wrong. There are no facts about the future, just good or bad forecasts. His are based on extremely debatable methodology. Anyone relying on the Treasury's so-called facts to guide them in their voting on 23 June will go astray. The prediction by Mark Carney, the Bank of England governor, of a possible recession if the UK quits is similarly faulty.

Osborne's claim to have presented 'rigorous and objective' analysis to reach 'robust' conclusions is exaggerated. The Treasury, in its 200-page analysis of Britain's EU membership published on 18 April, cherry-picked its arguments against Brexit. It ignored reasonable contrary opinions, without demolishing unreasonable ones. It claimed needles in haystacks cannot be there because they have not been found. Even single paragraphs contain contradictions (for example: EU regulations are beneficial and the UK has succeeded in reducing EU regulations.) The Treasury study is demonstrably biased to support government policy.

One big problem is that the analysis explores no more than the consequences of Brexit on British exports and inward foreign direct investment. Properly defined terms of reference would have stated that the report excludes the impact on British imports and outward FDI, as well as the impact on the rest of the EU.

There are several other defects. The report asserts, 'There is no precedent for the UK leaving the EU.' Yet it cites alternative precedents. It says, 'No other country has been able to negotiate any other sort of deal and it would not be in the EU's interests to agree one.' No evidence is produced to support where EU interests in negotiating a deal might lie. The UK is the world's fifth largest economy, the fifth largest importer and the largest destination for EU exports, well ahead of the US, Japan and China. The Treasury claims that the EU, because of its size, has a stronger hand in trade

negotiations than the UK acting alone. By the same token the UK has a strong hand in its EU exit.

Brexit opponents frequently argue that UK exports to the EU are a larger share of UK GDP than imports from the UK are as a share of EU GDP. That is always true when comparing any country's export/GDP share to a region or the rest of the world's import share from it. British EU exports must exactly equal EU imports from Britain. Those affected by trade gains and losses do not dismiss them on account of such regional GDP share differences.

The EU is negotiating the Transatlantic Trade and Investment Partnership with the US. The Treasury claims it is a done deal that brings the EU considerable advantages; following Brexit, the UK would be excluded and this would be a cost. None of this is proven. For example, the majority of German multinational companies, but only a minority of German consumers, are in favour. It will be difficult, if not impossible, for Germany to ratify such a deal.

The Treasury argues, correctly, that 'openness' to trade promotes productivity, GDP and income growth. These are the advantages Adam Smith first described in 1776, the year of the American declaration of independence. The 13 states were fully aware of the consequences for trade and capital flows from Britain. They preferred making their own laws rather than obeying those made in London. This decision did not impair their long-term prosperity. The colonies rejected British appeasement offers. They faced severe short-term costs, including the Revolutionary war that they won.

No one today would argue that the American states would have been better off remaining UK colonies. In a few years, long after the flawed Treasury report has faded from memory, no one will claim that the UK would have been more prosperous by staying in the EU.

Avarice of strangers

Don't overstretch current account analysis

Brian Reading in London

The balance of payments – which looms large in the debate over Britain's membership of the European Union – is double-entry book keeping. A current account deficit always equals financial (and capital) account inflows. A floating exchange rate clears the currency market.

Either financial flows or the current account deficit can be in the driving seat at any one time. When financial flows dominate, sterling appreciates and the current account worsens. Sterling has been reasonably firm in the last year or so because capital has been flowing into the UK, seeking a sound home for restless and insecure savers.

What is not so evident is that a sizeable component of these sometimes destabilising foreign capital inflows can comprise, under the UK's statistical system, the category of 'foreign direct investment' – a form of inflow often thought of as being wholly benign to UK economic performance, but which can often turn out to have malign effects.

Britain's record current account deficit last year of 5% of GDP shows how inflows have been the dominating influence, leading to economic imbalance. Whether the UK stays or goes after 23 June, the direction of causation is likely to reverse and sterling will fall (and possibly collapse) in coming months until cheap assets attract sufficient inflows. The current account then would improve.

The statistical measurement of large foreign direct investment flows into the UK – which play a major role in financing the deficit – contains many elements of financial transactions that would not normally be counted as long-term investment.

Referring to such deficit-offsetting inflows, Mark Carney, governor of the Bank of England, erroneously said in January that the UK has to rely on 'the kindness of strangers' to finance this unduly large deficit. Rather than 'kindness', the shortfall is in fact plugged by the 'avarice' of strangers seeking enhanced returns from investing in a dynamic economy.

Most people suppose that FDI is physical investment in new businesses and factories. But this is not how FDI is measured in official British statistics.

Direct inflows are measured by the extent to which they increase foreigners' financial claims on the UK. Other inflows are labelled as portfolio (foreigners' purchases of UK stocks and bonds), banking inflows, trade credit and financial derivatives. The distinctive feature of FDI from all others is the creation of a long-term commitment.

The issue of how the money flows in is difficult to gauge. This can be determined only in retrospect, if and when it flows out again. Any foreign equity purchase of at least 10% of voting share in a UK enterprise (nearly always too small for control over investment plans) is defined as direct investment. Any subsequent retained earnings are allocated to direct investment pro rata with stakes. In some cases loans and trade credit to subsidiaries are included.

None of the FDI data directly measures physical capital investment in the UK through factories, plant, machinery, shops and so on. FDI can increase, diminish or leave unaffected physical capital. The Sunderland car factory established in northeast England by Japan's Nissan has, for example, demonstrably increased jobs and investment in the area and helped the rebirth of the car industry across the whole of the UK. At the other extreme, US food company Kraft took over Cadbury and closed its Bristol factory. Tata of India has invested heavily in Jaguar and Land Rover. But its takeover of Corus, the old British Steel, ended in tears for the UK steel industry.

French and German ownership (sometimes through state-owned companies) of UK transport, services and utilities business has been blamed for price hikes faced by British consumers. Foreign companies can exploit control of UK enterprises to avoid UK taxes. Distorted transfer mispricing between related enterprises and parent companies can shift profits offshore at the expense of the investment recipient.

Analysing balance of payments and foreign direct investment data has a role in the debate about Britain and Europe.

But no one – including the governor of the Bank of England – should overstretch the arguments.

Treasury adopts Newton's theory

Exaggerated forecasts of UK downturn

Brian Reading in London

The UK Treasury this week has produced a report saying a vote to leave the European Union on 23 June would produce 'an immediate and profound economic shock creating instability and uncertainty which would be compounded by the complex and interdependent negotiations that would follow'. The document says this would increase unemployment by around 500,000 and reduce GDP by at least 3.6%. Average real wages would be lower,

inflation higher, sterling weaker, house prices would be hit and public borrowing would rise, it says.

Having looked at the methodology, I could hardly stop myself laughing. It is as bad as or worse than using Newton's gravity theory as an instrument of economic forecasting. I am not surprised that the estimable Charlie Bean, the former Bank of England deputy governor called in by the Treasury to review the assessment, put his name to it. He has used and contributed to forecasts based on the same methodology.

Undoubtedly the referendum adds to uncertainty. Yet inspecting the chart for growth and uncertainty – based on a Treasury-constructed 'composite index of uncertainty' – I find the Treasury's conclusions of a causal link between heightened uncertainty and lower growth deeply flawed.

In the two cases studied – the early 1990s recession and the steep downturn in 2008-09 associated with the financial crisis – either there is no correlation or, more likely, the causality runs in the opposite direction, with falling growth generating uncertainty rather than the other way around. Following the 2000 bursting of the dotcom bubble, uncertainty peaked and UK GDP rose 3%.

To suggest a two-year period in which GDP could fall by either 3.6% (in a 'shock scenario') or 6% ('severe shock scenario') must be a gross exaggeration.

The scale and impact of the uncertainty have been analysed using a vector autoregression (VAR) model to identify the effect of increased uncertainty on economic activity. However the VAR model, and the application of the NiGEM global economic model developed by the National Institute of Economic and Social Research, are both suspect.

The period analysed using VAR starts in 1998 and covers the 2008-09 recession. The Treasury's 'composite index of uncertainty', based on survey evidence including the number of references to uncertainty in the media, implied volatility for the FTSE 100 and of sterling and so on. I have no objection to this.

But all current uncertainty is attributed to the referendum. A future level of uncertainty is simply assumed. Moreover, the Treasury is basing its findings on acceptance of its own flawed predictions for the long-term effects of Brexit to 2030. Surely 23 June cannot be the only factor the Treasury believes affects uncertainty? Or that there is no uncertainty about its own forecasting record?

The effects of uncertainty on growth is based on another model which has seven other variables – including VIX for the FTSE 100 and S&P 500. Again I would question the validity of such criteria, since we all know the stock market can amplify and distort expectations about actual economic developments.

British membership of the exchange rate mechanism was significantly responsible for the UK's 1990 recession, while the global financial crisis led to the 2008-09 recession.

It is mystifying why the Treasury has allowed itself to be misused in what appears a blatantly political way. The forecasts seem about as accurate as the predictions by John Major, then prime minister (relying on Treasury advice), in early September 1992 on the harmful consequences of sterling devaluing or leaving the ERM.

Just over a week afterwards, sterling was outside the ERM. The consequences were almost entirely benign. I suggest that, if the UK leaves the EU after 23 June, history will repeat itself.

Why we shouldn't heed Brexit myths

Learning from lemmings – and the Queen

Brian Reading in London

'**Cry havoc and let slip the dogs of war.' Act 3, Scene 1, William Shakespeare's Julius Caesar. If we are to believe it, 'Brexit' does just that. In the European Union referendum campaign, neither the Remain nor the Leave camp has** a monopoly on hyperbole. Whether in defence or economics, both are exaggerating.

First, let's deal with security. Since 1945 there have been at least 20 small and bigger wars in Europe plus civil wars and numerous uprisings and unrest. Wars have been confined and localised.

The EU's genesis dates back to the European Coal and Steel Community in 1951, followed by the Rome treaty which established the European Economic Community in 1958. The 1993 Maastricht treaty created the EU. British membership dates from 1973. It is hard to believe that non-membership until then increased the risk of a major European war and membership thereafter has reduced it. Likewise, to suppose that UK secession would be followed by civil war between EU member states seems far-fetched.

What are we to make of Russia? Under Vladimir Putin, it has become a rogue state. Following the Crimea invasion, his aggressive intentions are clear. Nationalism unites when things go wrong at home. But Brexit would not make the least difference to European resistance to such threats; within Nato, British participation in that resistance is certain.

A divided opposition might generate appeasement, making a major conflict more likely, as with Hitler. But, again, Brexit makes no difference to such divisions. If the EU falls apart following Brexit, the imperative to co-operate in many different fields will be enhanced, not diminished.

Next, let us look at the economic arguments. The Observer newspaper has polled some 3,500 'top' UK economists on the effect of Brexit. About 600, 17% replied. Nine out of 10 said British departure would damage growth. But the majority is not always right. That's a myth – another exaggeration.

Following the 2007-08 financial crisis, Queen Elizabeth asked, 'Why did nobody see it coming?' Those who did not see it coming – central bankers, finance ministers, most official and private forecasters (except the Bank for International Settlements) – immediately agreed: the event was indeed unforeseen!

In fact, some economists (and I count myself among them) did see it coming. Quite a few of us were alarmed by sub- prime mortgages and collateralised debt obligations which turned toxic debt into triple-A packages. But the overwhelming majority of the 'great and the good' were seduced by the belief that the 'great tranquility' or the 'goldilocks economy' would last forever. Some even argued that securitisation would eliminate systemic risk. Sweet dreams.

Similarly, a letter to the Times from 364 economists in 1981 claimed that Chancellor of the Exchequer Geoffrey Howe's austerity budget during an inflationary recession was a disaster. The media supported them. Michael Foot, the Opposition leader, declared Howe's budget would drive up unemployment to more than 3m.

In fact, Howe's budget was a victory for monetarists over the conventional Keynesians who had ruled the roost since the 1930s depression. These nightmares turn out to be just that, no more than bad dreams. The economy recovered.

Economists are not always wrong. In May 1930, 1,028 US economists signed a petition against the Smoot-Hawley Act raising tariffs on 20,000 imports to record levels. Republican President Herbert Hoover refused to veto the Act. US imports fell by half, exacerbating global depression.

This is not an argument always to distrust conventional wisdom. But often the term is oxymoronic. One must be sceptical, and use one's own judgment and experience in making up one's mind. Lemmings jump over cliffs. They must be right when all others are doing so. Mostly they are wrong.

Vote Brexit, profit from lower pound

How to correct the current account deficit

Brian Reading in London

Remainers say a Leave victory will be apocalyptic. Stay in the European Union after the 23 June referendum, and the outlook is rosy. Brexiteers claim a positive scenario on leaving. Nobody sees that the prospects are dire whichever

way the vote goes.

The British economy is unbalanced. This inhibits growth. Recession looms in the next two years. The issue is which option – 'in' or 'out' – is more likely to address unsustainable disequilibrium. My conclusion: 'Brexit' is a better way to address Britain's imbalances. Remaining in the EU would make them worse until the next crisis.

UK Treasury forecasts, indeed almost all official forecasts, promise stable growth if a Brexit defeat restores confidence. The Treasury's forecasting models remain Keynesian, paying lip-service to monetary factors. Financial balances and balance sheets are thought of as inconsequential. Treasury officials failed to forecast the 2008 crisis and subsequent recession. Perversely, they are sticking to discredited models.

The 2008 crisis was caused by households' excessive deficits and unsustainable debt leading to deleveraging and depressed demand. Fiscal profligacy then shifted the excessive deficits and unsustainable debts to the public sector, borrowing demand from the future.

Retrenchment inevitably followed, with prudence subtracting the demand previously borrowed. Central banks took up the running with monetary profligacy. The aim was to encourage households and companies to borrow and spend again.

The success of the policy was to drive a wedge between inflated asset values and underlying economic fundamentals. The Office for Budget Responsibility's March 2016 budget forecast assumed household debt would climb back to near its pre-crisis peak, ensuring continued moderate growth while the budget deficit was eliminated. This can't and won't work.

The large UK current account deficit is the problem. This represents foreigners' financial surplus, the extent to which they lend the UK their excess savings to pay for their surplus products. As long as foreigners run a surplus, the domestic UK economy must run up debts. If the British government cuts its borrowing and spending by retrenchment, households or companies must borrow and spend more to maintain demand and growth.

Without a reduced current account deficit, the debt problem cannot be solved by transferring the borrowing elsewhere in the economy. There is a limit to building up foreign debts.

One way to reduce the current account deficit is to depreciate the currency to increase exports. The other means is to engineer a recession so imports fall. Greece, Spain and Portugal know this to their cost.

If Britain remains in the EU, this will encourage more financial inflows and buoy sterling. Monetary profligacy will continue. Domestic debt will rise further. The damage will be horrific. Monetary profligacy is undermining pension funding and banks' balance sheets.

The inflection point comes when the current account deficit gets so large and domestic debt so onerous that confidence evaporates – which could have an explosive effect on the pound. What is needed, though, is a gradual sterling depreciation. Brexit would produce just that effect.

The currency may spike down in the first reaction to a Leave victory. But once the financial markets realise that Brexit does not bring the UK's immediate and inevitable departure from the EU, sterling will bounce back as short-sellers take profits.

Fickle foreign investment is more of a curse than a blessing. One of the major reasons for the record peacetime current account deficit is a collapse in Britain's foreign investment income – reflecting Britain's superior economic performance relative to the anaemic EU recovery.

The pound's depreciation will increase the sterling value of foreign income, another factor helping to correct the current account. Policy-makers and the electorate should welcome, not fear, sterling depreciation. Brexit is the way to achieve it.

Another threat for Cameron

Panama papers: the Marconi connection

Brian Reading in London

The 'Panama papers' affair may not just be embarrassing for David Cameron's premiership, at a time of challenge over the European Union referendum. It could prove fatal.

There are some fascinating parallels with the story of the Marconi affair in 1912 that rocked the Liberal government of Herbert Asquith, UK prime minister in 1908-16.

The UK prime minister has been hit by revelations that his deceased father Ian Cameron set up an offshore fund in the 1980s with the help of Mossack Fonseca, the Panama law firm that had 11.5m documents leaked to the press. Cameron has suffered significant damage from association with information unveiled by an international consortium of investigative journalists exposing the offshore holdings of 140 politicians and officials, including 12 current and former presidents, monarchs and prime ministers, many with dubious reputations.

After days of obfuscation, Cameron admitted on Thursday night that he and his wife in January 2010, four months before he became prime minister, personally profited from a sale of £31,500 in shares in Blairmore Holdings, a trust operating offshore and unregulated in the Bahamas. The fund was brought back onshore to Ireland in 2012, and Cameron has insisted it was not a tax-avoidance vehicle. Cameron said he had paid income tax on the dividends but that there was no capital gains tax because the profit on the 2010 sale was less than the couple's tax allowance.

There is no suggestion of illegality in the Cameron family's dealings, in contrast to the Marconi affair, which involved corruption at the highest level. Both began with leaks, in 1912 by the alternative magazine Eye Witness (renamed New Witness), founded by Anglo-French writer Hilaire Belloc with G K Chesterton as a contributor. Its equivalent today would be Private Eye, the UK satirical magazine renowned for decades of revelations of governmental ill-dealings.

The Asquith government was about to award a lucrative contract to the English Marconi Company, subsidiary to the American Marconi Company, to establish the Imperial Wireless Chain. Sir Rufus Isaacs, attorney general – brother of Godfrey, Marconi's managing director – was privy to the secret. Rufus bought shares in the American parent, as did David Lloyd George, chancellor of the exchequer, and Lord Murray, Liberal party treasurer.

Insider trading was not then illegal but this was high-level corruption. A parliamentary inquiry, voting on party lines, exonerated the ministers. A criminal libel suit was brought against New Witness, which lost the case but won a moral victory with damage fixed at a derisory £100. The establishment whitewash was back page news compared with the struggle over Irish independence, industrial unrest and the outbreak of the first world war. The scandal became a footnote in history.

The bigger picture today is the EU referendum struggle. If Cameron's credibility is eroded, 'Brexit' becomes more likely. If the UK leaves, his stay in 10 Downing Street will probably end, too. His ally George Osborne, chancellor of the exchequer, would go down with the sinking ship. Boris Johnson, the London mayor and eurosceptic prime minister-in- waiting, may be preparing to move in. But don't count on it happening.

The lesson of previous removals of Conservative prime ministers in office – Harold Macmillan in 1963, Margaret Thatcher in 1990 – has been that not the leader of the insurrection, but a comparative bystander (Alec Douglas-Home and John Major in these two cases), takes over.

A mugwump, a fence sitter, who keeps out of the fray, has a better chance. If the Panama papers turn sour for Cameron, the next UK prime minster may be a surprise.

Leave does not guarantee leave

Referendum shows limits of British democracy

Brian Reading in London

If the Brexiteers win the 23 June referendum, we still won't know the next day whether the UK will leave the EU. The 2015 Referendum Act does not bind the government to the outcome. Parliament is sovereign, not the administration. Even if the government accepts the result, it still has to get the necessary legislation through both houses of parliament. As the then Labour government advised of the 1975 referendum on whether to stay in the Common Market, 'The British parliament in Westminster retains the final right to repeal the Act which took us into the Market on January 1 1973.'

If the result in three weeks is a landslide on a high turnout, the government could perhaps push exit through parliament. But such an outcome is unlikely. Following a marginal victory on a low turnout, Prime Minister David Cameron could not get a Leave Act through, and probably wouldn't try.

The referendum issue has driven a wedge between MPs and voters – revealing Britain's own democratic deficit. Opinion polls have Remain and Leave running neck-and-neck, at a little more than 40% each of the popular vote.

Don't knows are 15% to 20%. But most MPs do not reflect this grass roots opinion. The 650 members are split 70% Remain, 20% Leave and 10% unknown.

This shows some democratic shortcomings behind the UK's first-past-the-post electoral system. At the 2015 general election the Scottish National party with 4.7% of the vote won 56 seats. The Liberal Democrats got 7.9% of the vote and eight seats. The UK Independence party collected 12.4% of the vote and one seat.

The referendum is a single constituency first-past-the post system. In 2015 SNP and Lib Dems' combined votes were 3.9m, while UKIP got 3.6m votes. If all SNP and Lib Dem supporters vote Remain, and all UKIP supporters vote Leave, Remain gets only 300,000 more votes than Leave. But the corresponding MPs from these three parties are 64 to one against 'Brexit'.

Tory MPs are split 50% Remain, 40% Leave and 10% unknown. Party members seem to be split 40% Remain and 60% Leave. The disparity between the MPs and the party membership is greater higher up the party hierarchy. The Cabinet is split between 23 who wish to remain against seven Leavers. Career prospects, patronage and bets on a Remain victory all accentuate the cleavage with the grass roots.

The Labour wedge between party and people is in some ways still greater. Remain is supported by 215 MPs and Leave by seven, with 10 unknown. Yet Labour voters seem split 70% Remain to 30% for Brexit.

A simple calculation supports the poll findings of a close race. If each party's 2015 votes are allocated according to their Remain/Leave shares, the result will be 49.5% for Remain against 50.5% for Leave. Compiling MPs' known preferences reveals a quite different result: 453 for Remain and 147 for Leave, with 50 unknown.

In the event of a pro-Brexit vote on 23 June, Cameron's game plan must be, on the plausible assumption that his prime ministership survives, to pay lip-service to the result and start negotiating divorce terms without seeking parliamentary approval for a UK departure.

To do otherwise would split the Tories and lose the parliamentary vote. Negotiations could take two years or more. They would probably be onerous. The 2016 referendum result would be deemed invalid because the public did not and could not know the consequences.

Another referendum would be called. Elite casualties, as at Agincourt 600 years ago, would litter the bloody field.

Leave would win the referendum battle but not the fifty years European war.

The public were told by both sides their decision was the most important in our times. They would be furious to discover it solved nothing. Not much of a victory for democracy. But then it takes a referendum to show the system we have is pretty threadbare.