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DISCUSSION

Economic Consequences of BREXIT after the British Referendum

Cristian PĂUN
Bucharest University of Economic Studies
6 Piata Romana St., sector 1, 010374, Bucharest, Romania
cristian.paun@rei.ase.ro

Abstract. *The European Union project is strongly challenged today by the historical decision of United Kingdom's citizens to exit from this structure, with all consequences assumed. United Kingdom will be the first nation that will quit this ambitious initiative and the decision is transmitted by the organized national referendum's results in this respect. The population's opinion expressed by a huge number of voting persons should be taken into consideration by British politicians and transposed very soon into political actions that could have a strong and clear economic impact on both sides. This paper will discuss the possible economic consequences of such historical decision, including potential effects on a small country like Romania.*

Keywords*: European Union, European integration, fundamental freedoms, Single Market, Euro, convergence.*

Introduction

The project of European Union is considered by many to be a visionary and a liberal one. The project was initiated to support the peace and cooperation between European countries by including them gradually into an initiative that removed the main barriers against the circulation of goods and services (free trade area, customs union later) and against circulation of capitals and persons (single market much later) (Cini & Solorzano-Borragan, 2010; Wallace et al., 2010). Introduction of Euro strengthened the fundamental movements associated to the Single Market project (Gerhards & Lengfeld, 2015). The integration process was doubled by increasing gradually the number of member states and by adding more and more policy fields in the Treaties signed by them and by significantly increasing the number of EU institutions: in 1957 the Treaty covered only 86 policy fields that significantly increased in the Nice Treaty 2000 to 254 policy fields; number of General Directorates increased from 9 in 1957 to 24 in 1999 (Wessels, 2000 cited in Miller, 2010, p.10). European Union today looks different than in the originating projects, being more focused on redistributive mechanisms and social assistance than internal market issues: in the period 1978 – 2007 European Union adopted 61.271 regulations, 4.162 directives with an average of 2181 / year; 43.9% of this legislation adopted between 1987 and 2006 was addressed to agriculture, 20.8% to foreign affairs and only 19.6% to economy and 1.8% to transportation (see Bertoncini, 2009, p.3 and p.7). United Kingdom is not a founding member of this integrative scheme. The membership of United Kingdom was obtained only in 1973 (after a failure in 1963 due to the veto expressed by France) after sustained efforts to create an alternative to European Communities – European Free Trade Area (EFTA) in 1960 and trying, by doing this, to clear economic decline of the previous decades. The decision to exit now this very complex group of countries represented by the European Union could be argued and counter-argued but this BREXIT started to produce its consequences.

BREXIT economic context analysis

First of all we need to clarify the economic background of British state as a member of European Union. United Kingdom is a sovereign state grouping England, Wales, Northern Ireland and Scotland. This state has a surface of 242.495 km^2 (78th state of the World); a population of 65 million (22nd state of the world); a GDP in PPP of 2.679 trillion \$ (2015 estimates, 9th state of the World) corresponding to a GDP per capita of 41.159 \$ (2015 estimates, 25th state of the World); a nominal GDP in 2015 estimated to 2.849 trillion \$ (5th state of the World, Romania has a nominal GDP estimated in 2016 to 181.944 billion only).

United Kingdom with a capitalization of 2.69 trillion \$ (2015) is *the third capital market* after USA (19.7 trillion \$ market capitalization) and Japan (3.0 trillion \$). This capitalization of British stock market is higher than France (1.3 trillion \$) and Germany (1.19 trillion \$) together. British pound is the 4th traded currency on foreign exchange markets (around 12%). With an average of 5.3 trillion \$ per day, United Kingdom (London in fact) *is the most important FOREX market of the world*. United Kingdom has 3 financial institutions placed in the top 10 FOREX market operators, with a total market share around 16%.

United Kingdom is a *very low corrupted country*: placed 10 from 168 countries according to the Transparency International index. Except Denmark, Finland, Sweden and Netherlands, all other EU countries are placed below United Kingdom in this top being more corrupted: the index of Romania is 46 points, for Bulgaria it is 41 points. By comparison, the index for United Kingdom is almost double – 81 points (Transparency International, 2016).

United Kingdom is one of the freest countries in the world in terms of economic and business environment: according to the Heritage economic freedom index United Kingdom was placed in 2015 on the 10th place, Ireland being the only EU country better placed in this top. France is placed 75th out of 178 countries, Italy is placed 86th in this top or Slovenia on 90th place (source: Heritage Foundation, 2016). In United Kingdom it *is easier to initiate and to develop a business* than in United States and a lot of countries from EU countries: the only EU country above United Kingdom is Denmark, United Kingdom is on the 6th place, United States on 7th place, Germany on 15th place and France on 27th place (World Bank Group, 2016).

United Kingdom has *a very competitive economy* at the moment of BREXIT: with an average score of 5.4 this state is in top 10 most competitive countries in 2015-2016 (place 10, Germany – 5.5, Netherlands – 5.5, Finland – 5.5 and Sweden – 5.5 are the only EU countries above United Kingdom). The other founding countries are significantly less competitive than United Kingdom: France is on position 22, Italy on position 43, Belgium on position 19 and Luxembourg on position 20 in this top (source: World Economic Forum, 2016). Finally, in United Kingdom *the rule of law is better* than in United States or 3 founding members of European Union: United Kingdom is placed on 12th position compared with United States – position 19, Italy – position 30, Belgium – position 16, France – position 17 (World Justice Project, 2016).

BREXIT was initiated by a state with mentioned features and economic characteristics. The economic situation of United Kingdom in the moment of accession in the European Union (1973) was totally different than it is today: the accession stopped a clear and sustained economic decline for a few decades after the World Wars but the position in the European Union did not strengthen or boosted the economic growth later. This is explained by the fact that economic freedom benefits are cut by a lot of social direct and indirect costs paid by all member states to this altered European Union project. There is a clear decline in the confidence and satisfaction of citizens in the European Union project in the last decade (not only in UK): in UK the decline of this satisfaction was from 54 to 44 between 2004 and 2016, in Germany from 58 to 50, in France from 69 to 38 etc. (source: Pew Research Centre, Global Attitude Survey, 2016). More and more Europeans are less convinced by the existence of net benefits from this complex project developed by main European countries.

United Kingdom contributed in 2014 to the budget of European Union with 11.3 billion Euro (0.52% of United Kingdom's GNI). United Kingdom received from European Union only 6.98 billion Euro (0.32% of United Kingdom's GNI). 63% of EU funds sent to United Kingdom in 2013 were addressed to agriculture and 23% to job creation and economic growth (source: European Commission Budget Report, 2016).

The participation to BREXIT referendum was very important: the total number of voters was 33,551,983 Britons of which 17,410,742 Britons voted to quit the EU (51.9%) and 16,141,241 (48.1%) Britons voted to remain in the European Union. The difference between this two options is significant: 1,269,501 voters in the favour of BREXIT.

In conclusion, United Kingdom has a very performant and competitive economy, with one of the most developed and sophisticated financial systems. The financial support of European Union is insignificant for British economy (0.3% of GNI is financed by this support). The massive support for BREXIT could be partially explained by this context. The consequences for affected sides (EU countries and United Kingdom) should be explained by this context too.

BREXIT consequences for United Kingdom

The exit option of United Kingdom is not clearly defined yet. It is not clear if the exit will be a hard or a soft one. This exit will be the result of strong negotiations between politicians from both sides. The exit could be limited to political and decisional issues or could be extended to economic aspects (participation to Single Market, fundamental freedoms etc.). The possible consequences could be synthetized as following:

[1] An economic decline due to higher trade and investment barriers for British companies with business developed across European Union: The exports of British companies in European Union are around 50% from total export volume and, if we include the non-EU countries that signed a free trade agreement with EU, the weight increases to 63.6% (source: International Monetary Fund Direction of Trade Statistics, 2014). The trade between European Union and United Kingdom is more important for European Union than opposite. Countries like Ireland, Italy Poland, Portugal and Spain have a strongly imbalanced trade with United Kingdom exporting more than they import from the British market. In case of Germany the situation is opposite. The trade balance is in equilibrium with countries like France and Netherlands (source: Thomson Datastream 2014). The total export to GDP ratio for United Kingdom is around 29% (2014). The United Kingdom is concentrated on a few European Union countries. Exit from the Single Market could significantly increase the cost of trade and extend the supply chain for British companies. The most sensitive will be the export of financial services provided by British financial intermediaries such as insurance policies, financial portfolio management, audit, stock

market financing etc. (the trade balance in this case is very imbalanced, financial services provide around 8% of British annual GDP).

[2] A decrease in the volume of investments due to higher uncertainty: EU 27 is the most important investor in the British economy (around 46% of total FDIs). The most significant investors in the United Kingdom's economy are Netherlands, France and Germany and among top sectors we find retail and wholesale, mining, utilities and transportation with very significant EU participation (for example, 90% of investments in utilities sectors are coming from EU investors). Vital sectors from United Kingdom are dependent upon this EU participation. In fact, United Kingdom is today the major host for EU foreign investments, so many European companies will be significantly affected by any change in the business perspective.

[3] Possible trade diversion: If United Kingdom will replace existing efficient trade flows with EU partners with trade flows located in United Kingdom or outside United Kingdom but not EU locate that are less efficient (in terms of trade) this will negatively impact the economic system and, finally, British consumers' wealth;

[4] A better control on migration and a better fit migration policy: Today the migration policy in United Kingdom is highly regulated by European Union provisions. A higher control on migration flows could improve the migration policy in order to block low educated migrants and to facilitate highly educated ones. Poland, Lithuania, Germany, Ireland, France and Italy are the main providers of workers to United Kingdom. The migration to United Kingdom is mainly intra-EU migration, a different situation than majority of other EU 27 states where migration is mostly extra-EU. United Kingdom can set now a better fit migration policy according with its economic priorities and requirements.

[5] More economic freedom for the business sector: Economy of the United Kingdom is less corrupted and freer country than majority of EU 27 countries. United Kingdom could gain from this situation by enforcing internal effort to liberalize the markets and to improve the easiness of starting and developing businesses. Encouraging local entrepreneurship by promoting a liberal regulatory business framework doubled by a smart, flexible and reduced fiscal business regime is recommended. The liberal vision of United Kingdom was often blocked by EU member states (especially France, Italy or Spain) and any proposal to reform different EU policy areas has been systematically debated and refuted by the other partners (example: common policy on agriculture, environmental policy, social policy, etc.).

[6] Cost saving with the net contribution to EU budget: Britons pays more to European Union budget than they receive from it (the difference is around 4 billion Euro per year). This cost saving is not significant either of UK economy and UK public expenditures (the amount is less than 0.1% from UK's GNI). The majority of EU allocation was concentrated in other regions than England (Northern Ireland benefitted the most from EU allocations; in fact, participation of UK to EU project redistributed a lot of resources from England to other UK's regions and other member states). The main problem with this allocation of funds from European Union (around 7 billion Euro) was with the mismatching between UK needs and EU priorities.

[7] International position of UK: United Kingdom will lose the umbrella of European Union that started to negotiate important trade and investment agreements with United States, Japan or China. Specialists are considering that will be harder for United Kingdom to negotiate alone these kind agreements that are absolutely necessary in a more globalized world. In fact, United Kingdom is the 5th economic and political power of the world alone, no other EU-27 country above it. This position entitles United Kingdom with a hard bargaining power with all states or institutions. United Kingdom kept strong connections and links with former Colonial territories that today became highly developed economies, such as Canada or Australia. The relationship with such states was sometimes altered by that EU membership. European Union is seen as a very protectionist structure (especially in the field of agriculture, consumers' protection, environment protection etc.) This protectionism significantly affected the international relations and agreements signed with other partners over time. United Kingdom, a more liberal state and less protectionist, could easier and quicker sign such agreements alone than in combination with countries deeply interested to protect their own producers from global competition. United Kingdom is more competitive than any EU 27 state and a higher exposure to international competition would foster the economic development. This BREXIT could be the opportunity for United Kingdom to be reconnected at the global economic system in better terms.

[8] A shift in the economic development model: European Union became highly concentrated on fake development incentives: subsidies paid to sensitive economic sectors (agriculture, SMEs, R&D activities), monetary expansion (quantitative easing mechanism promoted by European Central Bank) or fiscal incentives for selected sectors. By leaving European Union, United Kingdom could change the economic development model adopted by European Union for decades that hampered the markets in the favour of social objectives using complex, costly and inefficient redistributive mechanisms. This could improve the economic structure and competitiveness and could add more economic growth and wealth for this nation. EU Single Market benefits today are completely compensated by a

lot of costs paid by each EU citizen and entrepreneur in the form of taxes, inflation and accumulated debt. This failed EU economic model based on the concept of "social market economy" has clear limitations for an economy like the United Kingdom.

Possible other consequences could be added (not necessarily directly linked to United Kingdom): internal instability for United Kingdom due to the fact that other regions than England (Wales, Northern Ireland and Scotland) voted differently regarding BREXIT and consider that is better for them to remain inside European Union, other countries could ask for the vote of their population regarding the membership to this union, a different treatment for existing EU members (non-Euro members, non-Schengen members etc.), difficulties to be represented in the international institutions and forums and security and defence problems for both sides. Unfortunately, this BREXIT could generate more nationalist and ethnic tensions and violence that finally could destabilize entire Europe (this is the worst scenario). If this BREXIT will simply end in a shift between EU politicians and local politicians without any significant reform (including EU too), the efforts will be in vain. If the EU interventionism will be replaced by a local one (with the same or higher intensity and inefficiency), BREXIT will not produce an improvement in the wealth for Britons. The British society is highly divided today and, even if the number of votes between sides (for and against BREXIT) is significant, the tensions exists.

Relationship of United Kingdom with European Union after BREXIT

It is clear for everybody that United Kingdom will not be placed elsewhere in the world. After the BREXIT this country will maintain the same strong economic relations with European countries due to the clear benefits for both sides. The yet unknown framework of this relationship will be soon negotiated, keeping on the table all interests and arguments. If we look to different existing economic agreements, there are several solutions for negotiating this relationship (all these options are open after the vote on BREXIT): [a] Adopting a *Free Trade Agreement* (FTA) meaning that UK will negotiate with EU independently the terms of it, including common standards and regulation for traded goods and services. Freedom of capital and persons will be limited in such case (similar with initial European Free Trade Agreement – EFTA). This agreement will remove all trade barriers and each side will be free to deal independently with other non-EU countries their own trade policy. The access to Single Market will be completely blocked in this case for United Kingdom. Each side will keep its control over internal regulation. This alternative will keep a very limited cooperation between the sides in the field of exporting activities only, the other fields being submitted to be blocked by specific barriers (Baldwin & Wyplosz, 2009); [b] Signing for a *Custom Union Agreement (CUA)* that will keep no barriers for trade between both sides and a common trade policy with third parties with limited power to influence the common tariff. This agreement will produce approximately the same effects like FTA in terms of access to Single Market, control on capital and migration, independence to deal with third parties etc. The only difference will consist of the common tariff applied by third parties and a common origin for traded (exported) goods and services. This solution has limited benefits for United Kingdom (Gilbert, 2012); [c] A *Bilateral Agreement (BA)* combining the FTA features with negotiation of access to Single Market for specific sectors. Control of migration will be limited in this case, but for specific sectors the free movement conditions for working people will be allowed. United Kingdom will not contribute to the European Budget with anything (the same like in the case of FTA or CU). A common set of regulations will be adopted for specific sectors. Both sides are free to pursue their own trade policy with third parties and to apply their own tariffs to them (excepting those selected sectors) (Nacewska-Twardowska, 2014); [d] Joining the existing *European Economic Area (EEA)* that will provide a full access to Single Market for United Kingdom but will keep the contribution to EU Budget and no control over migration (free movement of persons is compulsory to be applied in this case). This situation is less desirable for United Kingdom because there are not significant changes in terms of obligations but United Kingdom loses the existing political control to negotiate and to influence the regulations applied to Single Market operations. The members of EEA apply all regulations adopted by EU without participation to the decisional process but paying for the budget of EU. United Kingdom is not independent to negotiate separately agreements with third parties (Eriksen, 2008).

United Kingdom decided to continue separately from European Union project. Due to the high internal and social tensions accumulated after the vote on BREXIT (secessionist pressures, racists and ethnical violence), another scenario is possible: a significant change in the population view on this matter after few months and a political decision to neglect the BREXIT referendum and to keep the things unchanged. Because the option of United Kingdom on the nature of relationship with EU after BREXIT remains unclear, it is difficult for everybody to estimate the real cost of implementing this decision. It is very probable that a better estimation of these costs compared with benefits will conduct to a complete rejection of BREXIT idea in few months.

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Concluding remarks

BREXIT vote was historically for democracy and for the European Union project. BREXIT vote was a clear signal that the European Union needs to be reformed and to be reoriented to the people needs. The idea to create a European identity based on multiculturalism approach failed. The welfare state promoted by European leaders failed. The migration policy promoted by European Union failed. A lot of EU common policies need to be restructured. This is the hidden message in the vote on BREXIT. It is clear that the BREXIT should change both sides due to its consequences. The politicians hardly supported this initiative and now they are called to provide a convenient solution for the future. The economic aspects will prevail in this case. The existing companies that developed business in the UK and European Union, British workers located outside UK and European workers located in UK, trade and financial flows, all of them should count for further negotiations. If politicians fail and significantly hamper or harm these parties in their deal, they will lose political support for many years. It is a huge political cost that should be reconsidered by both sides. A call for a desperate solution or for an immediate decision to be implemented is undesirable in such conditions. Due to the complexity of potential effects, a BREXIT decision and its feature should be hardly weighted. Any vanity or personal sentiment should be removed from this discussion. Otherwise, the politicians will wrongly decide and will push the sides on a one-way path without many recovery options later. BREXIT was something very serious and was backed by existing and increasing lack of confidence in the European Union project at the level of regular potential beneficiaries.

The development and the finality of this initiative significantly depend on the quality of politicians called to negotiate and to implement such historical decision. Withdrawal of a country from such complex integrative mechanism will be not a simple one and will generate significant costs for both sides. It is totally wrong to consider this BREXIT without any cost or with insignificant costs for European Union. Only the cost associated with the failure of this project is huge. European politicians need to adopt a precautionary attitude and to understand the real resorts of this BREXIT.

A large majority of Britons decided for themselves to go in another direction than European Union. Where to go, how to go there and when to start to go? Any option is open at this moment. Including the option to remain in the European Union.

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