

Brexit and its consequences

Economics



‘ What will the EU look like after Brexit?’ it is one of the biggest questions in Europe, since the British referendum in 2016. What makes this question exceptionally important is that we’re dealing here with a new precedent, creating a potential example for the future. Quoting Jan Zielonka ‘[t]he problem is that EU experts have written a lot about the rise of the EU, but virtually nothing about its possible downfall’ (Zielonka 2014: 22). Right after the referendum there was a confusion and disbelief whether the Brexit would actually take place, however the exact date is already scheduled for Friday 29th of March 2019, 11pm UK time. After that, 21 months of ‘ Transition Period’ is planned. This is the time for the businesses and other entities to adjust to the new rules, but also the time for the UK and the EU to work out the new relations. During that period, the UK will negotiate, sign and ratify its own trade agreements, while EU citizens arriving in the UK will benefit from the same rights and guarantees as those who arrive before Brexit.

UK in the European Union

Winston Churchill was one of the first to call for the creation of a ‘ United States of Europe’ and he is considered one of the founding fathers of the European Union, however United Kingdom joined the EU together with Denmark and Ireland on 1 January 1973. UK applied to join the EEC in 1963 and 1967, but it was refused the membership, because the French President of the time Charles de Gaulle considered the UK incompatible with the Community. He warned France’s five partners in the European Economic Community (EEC) that if they tried to impose British membership on France it would result in the break-up of the community. All five have said they would support negotiations towards British entry. Only France opposed. In de

Gaulle's opinion London showed a "lack of interest" in the Common Market and would require a "radical transformation" before joining the EEC. When UK after years of trying finally has become a fully-fledged member of the European Economic Community, Prime Minister Edward Heath was optimistic that Britain's membership of the community will bring prosperity to the country.

Despite the PM's optimism, British scepticism towards the EU can be practically observed since its membership. The UK accessed the EU on the very special conditions, which emphasized the difference of the UK.

Researching the roots of difficulties related to British adjustment to the European Community, it can't be forgotten that the UK was not one of founding members. When it entered, the European integration already had had its own institutional composition, common commercial and agricultural policies and the regulations which didn't take into account the British interests. Therefore it soon became clear that the country could only continue its membership if granted exceptional rights in some areas.

First of all, the country could not be obliged and did not make commitments to join the Eurozone. (EUR-LEX 2016). It has its own monetary policy determined by the Bank of England, which underline a sovereignty of the UK. Another opt-out worth mentioning here is the EU Charter of Fundamental Rights that the United Kingdom did not sign by cause of its incompatibility with British labour law. When the Charter turned into a part of the Treaty of Lisbon, a special protocol had to be annexed declaring that the Court of Justice of the European Union can not consider the British laws inconsistent

with the fundamental rights, freedoms and principles specified in the Charter – in particular concerning issues as defined under the Title IV (Solidarity). According to the relevant protocol, the United Kingdom has also a right to choose to participate in justice and home affairs cooperation on a case-by-case basis. Opt-out is not final, since the country can change its mind and opt back in at any time, but in case it decides to cooperate, it cannot opt-out again (Ibid: 292-295). Originally, there was also an opt-out too, regarding the British government refusal to sign the social chapter of the Maastricht Treaty, covering such areas as worker's pay, health and safety. Ultimately Prime Minister Tony Blair cancelled this opt-out promptly right after coming to power.

Moreover Labour leadership had promised to renegotiate the British conditions of access to the EU secured by the Conservatives. In terms of the renegotiation in 1974, the Labour cabinet achieved results in two main areas: First, with effect from 1st January 1975, the European Regional Development Fund's resources were divided in a way the UK received above average transfers in the first years (European Communities 1974: 10). Second, a principle was adopted whereby European institutions were obliged to find a fair solution in case an „ unacceptable” situation would arise when formulating the common budget.

Reasons of Brexit

The official referendum was held throughout England, Scotland, Wales and Northern Ireland on June 23, 2016, and 51. 9% overall United Kingdom population voted to leave.

Support for Brexit came mostly from a coalition of less-educated, older, less economically successful and more socially conservative voters who oppose immigration.

Figure X

Source: Regional data from the Electoral Commission. Demographic data from Lord Ashcroft Polls. Notes: The geographic breakdown uses actual votes cast in the referendum. All other data on voting patterns is from polling conducted by Lord Ashcroft Polls (2016) on the day of the referendum. See <http://lordashcroftpolls.com/2016/06/how-the-united-kingdom-voted-and-why/>.

An essential argument for leaving the EU was Britain's excessive net contribution to the EU budget. The country got too little from the common funds, and had to pay too much to them. The reason of this status was the fact that the founding members designed the framework of the common budget several years before the British enter. The revenue consisted first of mostly customs and agricultural levies, then the VAT-based resource began to prevail. And here the problem emerged, namely, the tax base represented a larger part of GNP in Britain than in other, more prosperous member states.

In order to mitigate its budgetary problems, the UK received regular budgetary correction based on a special formula on an exclusive basis to the UK (European Council 1985). From 1986, the United Kingdom was granted a reimbursement, by reduction in its VAT-based payments, 66 % of the difference between its share in VAT-bases and its share in total allocated

expenditure, applied to total allocated expenditure (European Commission 2008).

The rebate worked for about 10 years, then the factors started to change. Due to the exceptional economic growth by the early 2000s, the British outperformed all of their most important European partners in terms of GDP per capita (Knoema 2016), which in consequence had a positive impact on their contributive capacity. Another issue was the eastern enlargement. Comparing data for 2004-2009 and 2010-2015 the British net budgetary position of the UK deteriorated of approximately €5 billion. The British became the second-third (together with France) most important net contributors of the EU after Germany (European Commission 2016).

The EU definitely can't enjoy a positive public image in the UK. Considering that statistically more than one in five EU officials earn above the UK Prime Minister's salary, an extremely negative public image of the European Union in Great Britain cannot surprise (e. g. Waterfield 2014). Such picture creates an impression that a significant part of their ever-increasing contribution is excessively spent.

Although initially the Brexit campaign was not focusing on the migration issue, by the end of the campaign, it became such a critical problem that it became one of the triggers. Prime Minister Theresa May said one of the main messages she took from the Leave vote was that the British people wanted to see a reduction in immigration. Since 1990's, the number of people migrating to the UK has constantly exceeded the amount of emigrants. Moreover from the end of 1990's the difference was relevant – immigration

in each year exceeded emigration overbalanced by more than one hundred thousand (Hawkins 2016). Here again the eastern enlargement became a problematic issue. Immigration was continuously increasing.

Figure X: Net long-term international migration by citizenship, UK, 1975 to 2015. Office for National Statistics

The United Kingdom was among the few states to open their labour market without restrictions to new member countries' workers. This led to rise of the so-called immigrant-native ratio from circa 8% (1984 -1995) ; to striking nearly 20% by December 2014. According to this data every sixth potential employer is a foreigner.

The overwhelming ratio of immigration had a meaningful influence on a variety of public services, from social and healthcare services as well as education, public transport, the environment and the general transport infrastructure”(Migration Watch 2016).

Another relevant issue is increased competition. This argument is however rather ambivalent as it shows not only the disadvantages of the membership, but also the benefits. Highly competitive market of the EU creates a thread for the less efficient producers, often forcing them to exit, but for these who manage to adjust, opens the door to the biggest markets in the world with hardly any restrictions. Nonetheless some producers claim these restrictions – namely EU regulations also held them back. The elementary issue is that EU membership undoubtedly has changed the shape of the British economy — its competitiveness and openness to other markets. For some it turned out to be favorable, for some devastating.

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Worth mentioning factors are also these finding its roots in British political culture and its fundamental principles. There were elementary differences between the Great Britain and Europe. A good example is the British approach to the rule of law contrasting with the European tradition of absolutism. In the context of integration, relevant is also a recollection of “ Splendid Isolation” - the policy pursued by the British Imperium in XIX century. Its main objective was to restraining from entering into long-lasting European alliances or commitments with the other great powers.

According to the Lord Ashcroft poll conducted on the referendum day on 12, 369 people after they had voted, the leave-supporters highlighted the three main reasons of their vote. 49% of them claimed the principal reason for wishing to quit from the EU was “ the principle that decisions about the UK should be taken in the UK”. 33% found the main reason that leaving “ offered the best chance for the UK to regain control over immigration and its own borders.” Only 13% said remaining would mean no choice “ about how the EU expanded its membership or its powers in the years ahead.” Only 6% were opinion the major cause was that “ when it comes to trade and the economy, the UK would benefit more from being outside the EU than from being part of it.”.

Concluding: “ Remain” voters believed staying in the EU would be more beneficial for the economy, international investment, and the UK’s position globally. “ Leave” voters from the other hand expect first of all the immigration system to be improved. They also base their support for Brexit on factors such wider scope of control over British laws, and generally the

better quality of life (<http://lordashcroftpolls.com/2016/06/how-the-united-kingdom-voted-and-why/>).

EU position towards Brexit

The problem of Brexit emerged as something absolutely new for the European Union. Since its creation there was no such precedent. No other nation state has ever left the EU. In fact Greenland, one of Denmark's overseas territories, held a referendum in 1982, after gaining a greater scope of self-governance, and voted to leave. After a period of negotiation Greenland quit the European Union, however this case is not even slightly comparable to the current situation concerning the United Kingdom.

Section 1 of Article 50 states that “ any member state may decide to withdraw from the Union in accordance with its own constitutional requirements”. Here both parties are facing a problem, as there is disagreement as to what the UK's “ constitutional requirements” are in this regard.

The EU's proposals for future EU-UK relations include among the others “ as close as possible a partnership with the UK”, “ balanced, ambitious and wide-ranging” future free trade agreement. The EU offers as well a trade in goods covering all sectors and maintaining zero tariffs. Considering that this proposals seem to be surprisingly beneficial for the UK it would be highly unlikely that the EU won't expect anything on return. The European Parliament (EP) has already passed a non-binding Resolution on the negotiations, highlighting it will not support any agreement giving the UK similar benefits to EU membership. The President of the European Council,

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Donald Tusk, has stated the EU would not compromise with the UK on the rules for the free movement of people while allowing the UK to retain its current level of access to the single market.

The European Council will assess progress in ongoing issues and the framework for future relations at the summit on 28-29 June.

Possible implications of Brexit:

Brexit already impacts not only the international relations within the EU, but also within the United Kingdom. The results of the “ Brexit” referendum were computed on a UK-wide basis, which blurs the striking regional differences visible in the figure below.

The disparity between the regions raises question regards the future of Scotland in the UK and the relations between Northern Ireland and Ireland. One of the key issues is the problem of the land border between the UK and the Republic of Ireland. Both sides agree that they want to avoid a return to a “ hard border” - that involves no physical infrastructure, such as customs posts or a network of surveillance cameras. However the agreement on this proved complexed and there are still many uncertainties how it would work in practice. There were also heard voices of Northern Irish officials calling for a unification with the Republic of Ireland. Scotland, however, which was the supporter of remaining in the EU may try again to gain independence.

Prediction of immediate economic crisis if the UK voted to leave turned out to be far-fetched. Indeed the pound dropped the day after the referendum - but it has now regained its losses against the dollar. According to George Soros the consequences of Brexit may be comparable to the financial crisis

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of 2007-2008, however the UK economy estimated to have grown 1.8% in 2016 and continued to grow at almost the same rate in 2017. Inflation rose after June 2016 but has since eased to stand at 2.5%. Unemployment has continued to fall and annual house price increases have fallen from 9.4% in June 2016 at 4.9% in January 2018, according to official ONS figures. Despite quite positive figures, still up-to-date is a thread in that leaving the EU would have a destabilizing impact on the British economy in the short run and consequently in the long run - make the country poorer.

The possible outcomes of the agreement for the UK could be joining Norway, Iceland, and Liechtenstein and remaining the part of the European Union's Single Market. The UK and EU could also sign a free trade agreement to manage their trade and economic relations. Without an agreement on trade, the UK would operate with the EU under World Trade Organisation regulations, which could presuppose customs checks and tariffs on commodities together with longer border check for travelers. This would be unfavorable for both sides as the EU is the UK's most important trading partner. In 2015 it accounted for 44% of UK goods and services exports (£222 billion) and 53% of UK imports (£291 billion). The UK imports more from the EU than it exports to it, so this solution would not only affect the market, but also British consumers themselves. Another option could be a membership of the European Economic Area (EEA). The EEA option would be the closest to EU membership and would largely maintain access to the EU single market but would mean accepting free movement of people and contributions to the EU Budget.

There are also questions about what would happen to Britain's position as global financial centre. A vast majority of existing financial services regulation is derived from the EU. It is expected, therefore, that a significant amount of this legislation would remain post-withdrawal. Most of City firms opted for remaining in the EU. That is no wonder, considering that banks located in the City of London will most likely lose the right to trade across EU without country-by-country approval, so-called passporting. The scope of connection between the UK financial services sector and other economies in the EU is crucial, so any changes could have a large-scale effect. The nature of the trade agreement will have significant implications for other sectors, including the automotive sector. Given the high number of possible outcomes of the negotiations on the future UK-EU trade relationship, the effect of the eventual deal on numerous sectors of the UK economy is currently hard to predict.

There is also a case of the "Brexit bill," described as a financial settlement the UK owes Brussels due to its exit. One of the major arguments of "Leave" supporters was that the money paid as a EU contribution could be rather spend within the country. A large financial settlement would however delay these plans. The UK and EU have agreed for a British contribution to the 2019 and 2020 EU budgets and pay extraordinary through 2020. The "Brexit bill" is estimated by the British Government for £35 billion to £39 billion. This may be too optimistic though, as The Financial Times estimated that the final bill could oscillate between €55bn to €75bn. Theresa May stated the UK would "honor commitments we have made during the period of our membership" and offered to make an "ongoing contribution" to any

educational, cultural and security programs Britain might continue to participate in.” Although her declaration didn’t manage to mitigate the domestic tensions over the bill, it helped to moderate the tension from the EU.

The most exposed to Brexit feel immigrants and foreign employees. The latest report of the Commission ensures that any EU citizen already living and working in the UK won’t be affected and will be able to carry on working and living in the UK after Brexit. The current plan assumes that people from the EU will be able to move to work in the UK during a “ transition period”. There is however a dispute whether they will enjoy the same rights as those who came before. The UK calls for some restrictions on access to benefits or to vote in local elections. The EU wants them to have the same rights as now. What happens after the transition period is yet anyone’s guess, although it is broadly expected that there will be a work permit system in imitation of that for non-EU nationals.

As reduction of immigration was one of the fundamental arguments for the Leave-votes Prime Minister Theresa May said this will be a focus of Brexit negotiations. Her objective is to down the net migration to a “ sustainable” level, which she defines as being below 100, 000 a year. At present it is estimated to have fallen by nearly a third from the time of the referendum to 244, 000 in the year to September 2017 and it’s the biggest decline since records began in 1964 (official ONS figures).

Out of concern for its citizens The UK government wants to maintain visa-free travel to the UK for EU visitors after Brexit hoping this will be bilateral

and UK citizens will continue to be able to visit EU countries for short periods without official permission. British living abroad also worry they could lose residency rights and access to free emergency health care.

Without question the education sector won't remain unaffected. Universities are concerned that the Government will not have to provide student loans for EU students. The loss of funding for EU students would surely influence the amount of EU students in the UK and this could have a negative impact primarily on fee income for universities, but also on the culture and diversity of universities. From the other hand some argue that Brexit due to Brexit there would be more places for UK students and charging EU students higher fees could even increase fee incomes.

Worth mentioning possible implication is a so called " domino effect". The Italian finance minister, Piercarlo Padoan, predicted a British exit might pressure France to leave the EU in the presidential elections in 2017. In his opinion the domino effect already exists, concerning the anti-European parties gaining disturbing amounts of supporters, for example in France and Italy, but in fact majority of the EU members have strong Eurosceptic movements, which influence is growing. In some countries, there is a risk that it could lead to referendums on EU membership.

Conclusions

The ideology of the European Union assumed it will more than a group of cooperating countries. For the UE member states it is essential to give up a significant part of their sovereignty into supranational institutions and this is what historically and traditionally is in contradiction with the British

fundamental principles. Britain has been cautious about the European Union's projects, which could threaten the UK's sovereignty. The country never opted into the European Union's monetary union, as well as remained outside the Schengen Area. Great Britain, with its imperialistic roots could probably never fully adapt their ambitions and regional interests to the frame of an "ever closer union". Only 9% of remain voters claimed their vote was based on "a strong attachment to the EU and its shared history, culture and traditions."

For a few decades, Britain has profited from greater openness to world markets, boosting the economic dynamism. However the differences and disagreements prevailed and the Great Britain is going to be a precedent case in leaving the European Union. Undoubtedly Brexit will bring serious economic and social consequences for both parties, in fact rather more severe to the UK than to the EU.