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# The Road to and from Brexit

Jana Bellová\*

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**Summary:** This chapter of the monograph examines the historical, current, and possible future political and economic consequences of the United Kingdom's referendum result to leave the European Union. The article briefly examines the roots of the British involvement in the European project and identifies some of the ideological differences between the UK and continental Europe. The author will also discuss the current position on the UK EU negotiations and the progress they have been making (or as the case may be the lack of progress). This will culminate in an examination of the possible outcomes of Brexit for both the UK and the certain member states of the EU in economic and political terms.

**Keywords:** Brexit, referendum, EU membership, crisis, changes

## 1. Introduction

There is no doubt that the British decision to hold a referendum on its continued membership to the European Union (EU) has caused some shock waves to ripple through member states. Its referendum vote in June 2016 may have set off a tidal wave which will sweep away the EU we know today. It cannot be said that the United Kingdom (UK) has always been a fully committed or positive force within the EU but the idea that it could abandon the EU and head out on its own was not considered likely by many.

This article aims to summarise the underlying forces that have contributed to the UK electorate voting to leave the EU in the 2016 referendum by 52% to 48%. In order to do this effectively it is important to take a brief look at the history of the UK's involvement in the European project. It is also vital to look at the shifting political situation within Europe and the rise of the populist and far right movements and the different crisis's which have fuelled these movements i.e. the financial crisis of 2008 which also raised the question of Grexit (Greece's exit of the EU) and its bailout, the Ukrainian conflict which borders four EU member states, and of course the immigration crisis which still continues today. This will hopefully make the reason for the UK's path to leaving

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\* Ing. Jana Bellova, Ph.D., Faculty of Law, Palacky University Olomouc, Czech Republic. Contact: jana.bellova@upol.cz

the EU clearer from this point it is possible to continue along our journey and start to look at the future and possible political and economic effects for the UK and its EU counterparts.

## 2. The Circumstances

### 2.1. The United Kingdom's Historical Position in Europe

It may surprise some that the UK's referendum in June 2016 was not the first referendum the British have held on its membership to a European organisation. The first referendum was held in 1975 two years after the British entering the European Economic Community (EEC). Then two thirds of the electorate supported staying in the EU. "The United Kingdom being an EU member state since 1973 has always been something of an "insider-outsider" that keeps its distance. Britons place greater importance on the Crown than on EU membership"<sup>1</sup> It is true that the British have always viewed the EU as an economic union rather than a political union. Stephen George (1998) famously describe the UK as an "awkward partner" with the rest of Europe. As a result, a pragmatic and sceptical position about grand projects has been the British political class's approach to the EU, with a narrow focus on the economic costs and benefits of membership. This means that the UK's relationship with Europe has been seen as one of "conditional and differential engagement," in which the ambivalence of the British policymakers has placed the UK within an "outer tier" of the EU<sup>2</sup> This could be at the heart of British dissatisfaction with the EU as they feel they are being pushed into an EU they do not particularly want as stated above there has always been a reluctance by the UK to be fully interconnected with the EU. The British liaison with the European Union has admittedly been difficult. Although they are Europeans, the British still say they travel to Europe when they cross the channel<sup>3</sup> It is true that the British hold themselves apart from continental Europe this may be because they value their "special" relationship with the United States more or the fact that they have had an empire which still gives them special links with many other countries around the world but it is true that countries on continental Europe want a more fully integrated EU to rival the United States. The UK does

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<sup>1</sup> WIELECHOWSKI, Michal, CZECH, Katarzyna. Brexit related uncertainty for United Kingdom economy. *Acta Scientiarum Polonorum. Oeconomia*. 2016, vol. 15, no. 4, pp 171-181.

<sup>2</sup> CORBETT, Steve. The social consequences of Brexit for the UK and Europe. *International Journal of Social Quality*. 2016, vol. 6, no. 1, pp 11-31.

<sup>3</sup> SINN, Hans-Werner et al. R Brexit: The Unintended Consequences. *International Economy*. 2016, vol. 30, no. 2, pp 6-28.

not view the possibility of a federal Europe as the logical or even desired outcome of the EU they are happier with economic co-operation.

## 2.2. Political changes

There is no doubt that the rise in populist politics has helped to increase Euroscepticism too. “Additionally, there are European states in which right wing parties have known an increasingly noticeable ascension in the last years, accompanied by the development of Euroscepticism. In France (National Front), Germany (Alternative for Deutschland), UK (United Kingdom Independence Party). In this line of thought, Brexit could be considered only the most visible symptom of this phenomenon begun in the first years of economic and financial crisis and growing with every other crisis Europe faced<sup>4</sup> There is no doubt as mentioned in the introduction that the EU has been put under tremendous pressure from events which are mainly very complex and emotive for the EU population. These events will be discussed later but they have helped to embolden populist and far right parties to grab hold of these events and use them to pursue isolationist and nationalistic agendas. So the political status quo is changing with the resurgence of these parties.

The rise of the United Kingdom Independence Party (UKIP) in the UK can be seen as one of the major contributors for the decision of David Cameron to hold a referendum. It is argued that he was worried about a possible challenge to his premiership with in his own party on the one hand and the rapid rise in support for UKIP on the other which would probably weaken their electoral position significantly. David Cameron, the Prime minister of the UK pledged to hold the referendum on the issue after winning the 2015 general election, as growing demand from his own conservative MPs and the UK Independence Party with a plea that Britain had not had a say since 1975 when it voted to stay in the EU in a referendum.<sup>5</sup> UKIPs main policies were based on a referendum to leave the EU and the control of immigration was at the base of this. It also happened to coincide with the refugee crisis which we will go into more detail later. The result was that Cameron took a gamble on the referendum strengthening his electability and silencing opposition in his own party. This gamble probably worked in the very short term as he managed to strengthen his majority in parliament in 2015 unfortunately it was a very short lived success and ultimately ended his political career in 2016 with the referendum result.

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<sup>4</sup> BOGZEANU, Christina. From the treaty of Rome (1957) to forging a new way ahead for the EU. Post-Brexit security and defence. *Strategic Impact*. 2017, vol. 62, no. 1, pp 18-30.

<sup>5</sup> BUKHARI, Syed et al. Brexit: A challenge for United Kingdom and European Union. *Pakistan Journal of Social Sciences*. 2016, vol. 36, No.2, pp 665-674.

It is strange that David Cameron would be replaced by Teresa May as she also supported the remain campaign. It is perhaps a telling fact that those who campaigned so hard for Brexit were not so keen to lead their parties through this period i.e. Boris Johnson of the conservative party and Nigel Farage of UKIP (who stood down from his party's leadership after the referendum). Teresa May has not helped her position as her disastrous decision to hold a snap election in June 2017 left her in a very weak position as she ended up losing seats rather than gaining them. Which has now lead to a further weakening of her authority in her own party. The long established parties in the UK seem to be in turmoil Jeremy Corbyn struggles to fill shadow cabinet posts as very few labour MPs were willing to work with him as his vision was considered too leftist. UKIP seems to have lost favour with the British public as they did very badly in the 2017 election. It seems that uncertainty in British politics has crept in again as both the major parties are facing problems from within. It could lead to another coalition government which cannot be seen as a very palatable possibility. One thing is sure is that the new instability that has crept into British politics is not helpful at a time when there is so much uncertainty with the UK preparing to negotiate their departure from the EU.

### **3. Crisis's which have Shaken the EU**

There is no doubt that there have been a series of crisis's over the last decade or so which have shaken confidence in the EU and caused some to question their continued membership. As stated earlier the UK has always been somewhat of a reluctant member mainly in the EU for the economic benefits of the free market so if doubt is put over the continuation of these economic benefits it is logical that the UK might consider its position more closely. In this section a number of crisis's will be examined. The financial crisis is a good starting point and it probably makes sense to look at Grexit (the term used for Greece's possible exit from the EU) at the same time. The Ukrainian crisis, the European refugee crisis and the numerous terrorist attacks which have been undertaken against EU member states. All these events have had an effect on member states and their positive or negative view of the EU.

#### **3.1. The Financial Crisis**

The idea that the financial crisis came out of the blue is an erroneous one, there were actually a few economists who had been warning against the housing bubble and the problem with sub-prime mortgages and the related risks this posed

to the financial system and society generally. Australian economist Steve Keen predicted such a crash as early as 2005 and Peter Schiff (an American economist) was giving TV appearances in 2006 predicting the crisis but unfortunately these economists were ignored and business went on as usual until the crash of 2008 which originated in the US but would soon sweep to Europe as well. Since the 1990s scholars have noticed the way in which European integration has become contested in the electorate and divisive within parties (e.g. Van der Eijk and Franklin, 1996; Hix and Lord, 1997; Aylott, 2002; Parsons and Weber, 2011). The issue became the “sleeping giant” of the European political space (Van der Eijk and Franklin, 2004). The Euro crisis that began in 2009 has given unprecedented attention to the topic. Public opinion, long generally supportive of the European Project, moved decisively in a negative direction, becoming sceptical of further integration.<sup>6</sup>

The Greek financial crisis arguably originated hand in hand with the global financial crisis, the major difference was that successive Greek governments had been mismanaging the Greek economy by borrowing and spending excessively so it was arguably in a very weak position. The fact that it is part of the Euro Zone made their situation much worse as they had no control of interest rates and there was no possibility to devalue their currency. The Greek financial crisis had two primary causes. First, Greece was undermined by government economic mismanagement, including widespread fraud and an absence of public accountability. Second, Greece’s membership in the Eurozone imposed on it an economic straightjacket that was ill suited to and inconsistent with its political and financial goals.<sup>7</sup>

The Greek crisis and the possibility of Grexit caused a great deal of uneasiness within the EU as countries already struggling from the global financial crisis were not very sympathetic or keen on giving financial help to Greece. The unity of the EU was tested to its full. The rise of populist parties has also undermined the unity of the EU. Nationalist and populist political movements on both the left and the right, drawing strength from economic dislocation, are undermining support for European Unity<sup>8</sup> When the idea of using the European Financial Stability Fund to help bailout Greece British Chancellor George Osborne was very clear that it should not be. Britain’s George Osborne and fellow finance

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<sup>6</sup> De SIO, Lorenzo, et al. The risks and opportunities of Europe: How issue yield explains (non-) reactions to financial crisis. *Electoral Studies*. 2016, vol. 44, pp 483-491.

<sup>7</sup> KINDREICH, Adam. The Greek Financial Crisis. [online]. Available at: <<https://www.econcrises.org/2017/07/20/the-greek-financial-crisis-2009-2016/> (2009-2016) 20/7/2017>

<sup>8</sup> IRWIN, Neil. How Germany Prevailed in the Greek Bailout. [online]. Available at: <<https://mobile.nytimes.com/2015/07/30/world/europe/how-germany-prevailed-in-the-greek-bailout.html>>

ministers from outside the Eurozone have expressed outrage that the blocs leaders were considering tapping an EU-wide rescue fund to save Greece from default next week. Britain is not in the euro, so the idea that British taxpayers are going to be on the line for this Greek deal is a complete non-starter.<sup>9</sup> So there seems to be a rift starting between the Eurozone members and those that are outside the Eurozone which was brought about directly by the Greek financial crisis. It is understandable that those outside the Eurozone would not want to use the money which was meant for the whole of the EU (not just the Eurozone) to bail out Greece. Especially as there was a feeling that the Greeks financial crisis was self-inflicted it was not a natural catastrophe or something that could not be foreseen. But at the same time it is not exactly fair as the UK had a vested interest in that Greece would not go bankrupt as many of its banks had leant heavily to Greece and the UK could certainly do without bailing more of its banks out. Initially the British banking exposure to Greek debt looked much worse but as of July 2015 things had improved. Overall the UK has £7.7bn tied up in loans to Greek banks, businesses and customers. The majority of that is in the form of exposure from UK banks, which stands at £5.3bn, according the Bank of International Settlements. That is down considerably from the £9bn exposure UK banks had in 2009.<sup>10</sup> Either way the Greek debt crisis has led to a more fragmented EU and has started to raise the question of the Eurozone's sustainability and the EU further continuance.

### **3.2. The Ukrainian crisis**

Talks on a comprehensive association and free trade agreement had already been launched in 2007. After the 12th EU summit in September 2008, French President (and EU Council president at the time) Nicolas Sarkozy set the goal of striving for an association with Ukraine, using the military clash between Russia and Georgia as an opportunity to give more attention to Ukraine's desire to join the Union.<sup>11</sup> But in hindsight it is difficult to assess how wise it was of the EU to seek further links with the Ukraine as it was likely to have negative effects on EU-Russian relations. However the Ukrainian-Russian crisis has caused uncertainty over the EU's ability to deal with such situations with a unified front as there were

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<sup>9</sup> SPIEGEL, Peter, CHASSANY, Anne-Sylvaine. *UK attacks EU emergency aid plan for Greece*. [online]. Available at: <<https://www.google.cz/amp/s/amp.ft.com/content/190a906-2a3f-11e5-8613-e7aedbb7bdb7>>

<sup>10</sup> BROAD, Mark. *What impact would Grexit have on the UK?* [online]. Available at: <<http://www.bbc.com/news/business-33165580>>

<sup>11</sup> BÖHLKE, Ewald, et al. *The Failure of the EU's Ukraine Policy*. [online]. Available at: <<https://dgap.org/en/article/getFullPDF/24624>>

significant problems reaching a consensus within the EU and then sticking to it. On the margins of an EU summit aiming to show Europe's resolve in the face of Mr Putin's increasing aggression, Mr Fillon captured the growing lack of unity in the West's stance even as Russian-backed Syrian forces over-ran the stricken city of Aleppo. Echoing the rhetoric of Donald Trump, the US president-elect, Mr Fillon said: "I have, simply, a lot of respect for Russia." Mr Fillon was speaking moments after meeting Chancellor Angela Merkel of Germany, a strong advocate of the EU's sanctions-led policy against Moscow.<sup>12</sup> So this seems to emphasize the problem of coming to a consensus and then maintaining that consensus. Which leads to some countries questioning their continued membership to a bloc that cannot stick together in critical situations. It must also be a little worrisome for the Baltic states who fear Russia's expansionist agenda in the region too.

### 3.3. The Refugee Crisis

Between 2015 and 2016, the European Union experienced an unprecedented influx of refugees commonly described as the "European refugee crisis". More than 1.3 million refugees crossed the Mediterranean and Aegean Seas trying to reach Europe, as per the refugee agency of the United Nations, UNHCR. Thousands of refugees lost their lives, drowning on the treacherous sea passages. Germany has been a magnet for those who make it, absorbing more refugees than any other country in the EU. In 2015, the country famously adopted an "open border" policy. That year, it took in 890,000 refugees and received 476,649 formal applications for political asylum – the highest annual number of applications in the history of the Federal Republic.<sup>13</sup> But other countries were not so keen to welcome this new influx of refugees. Hungary notably took swift and draconian measures to secure its boarder erecting wire fencing. Hungary's Prime Minister Victor Orbán defended his actions. Orbán said the razor-wire fence erected on Hungary's southern border with Serbia was essential to defending the Schengen zone's external borders. He denied that the emergency was a refugee crisis, but one of mass migration.<sup>14</sup> So there seems to be a mixed message coming from the EU, on the one hand Germany is welcoming (although later they changed their policy under internal pressure), refugees and on the other Hungary is trying

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<sup>12</sup> BARKER, Alex, et al. *European consensus on tackling Putin under strain*. [online]. Available at: <[www.ft.com/content/4f8b3c58-c2e0-11e6-9bca-2b93a6856354](http://www.ft.com/content/4f8b3c58-c2e0-11e6-9bca-2b93a6856354)>

<sup>13</sup> TRINES, Stefan. *Lessons From Germany's Refugee Crisis: Integration, Costs, and Benefits*. [online] Available at: <<http://wenr.wes.org/2017/05/lessons-germanys-refugee-crisis-integration-costs-benefits>>

<sup>14</sup> TRAYNOR, Ian, *Migration crisis: Hungary PM says Europe in grip of madness*. [online] available at: <https://www.theguardian.com/world/2015/sep/03/migration-crisis-hungary-pm-victor-orban-europe-response-madness>

to keep them out. And other countries have had heated discussions over whose responsibility the refugees are. Big fault lines have opened up across the European Union – both east-west and north-south – because of the migrant crisis. Many migrants want to get asylum in Germany or Sweden, but those countries want their EU partners to show “solidarity” and share the burden... For months tensions have been escalating between Greece and some of its EU partners. They accuse Athens of deliberately waving through migrants who ought to be registered as soon as they enter the EU. The row with Austria got so bad in February that Greece withdrew its ambassador to Vienna.<sup>15</sup> Very much like the financial crisis the refugee crisis has a tendency to fuel populist and far right parties so that the homogeneity of the EU is at stake. The refugee crisis rather than leading to solidarity which was called for by Germany and Sweden has ended up dividing states some bitterly (in the case of Greece and Austria).

Another example that shows the lack of unity in the EU is the EU's policy to have quotas for member states. The idea was to share the burden equally among member states rather than see three or four states flooded with refugees. This was not a popular policy and one which the UK government refused to take part in although it did agree to take 20,000 Syrian refugees over the course of the parliament. This works out far less than other countries that are governed by the quota system. Some Eastern Bloc countries were also unhappy that they were forced into the quota system. Eastern European states opposed the scheme for two reasons: because they said refugee admissions should be a sovereign national decision; and because many of their voters are virulently opposed to Muslim immigration. Britain is exempt due to its historic opt-out on justice matters. The Commission has blamed national governments for failing to offer enough places for migrants.

But the statistics back up the testimony of aid workers and EU officials who say the scheme has flopped migrants have no desire to be “relocated” to poor eastern European states when they would rather go to Germany or Sweden. Indeed, under current offers of places, there are 5,989 spaces unused, including 40 in Slovenia, 480 in Romania, 1,298 in Bulgaria and 100 in Poland.<sup>16</sup> Again I think this demonstrates the lack of unity in the EU but these kind of policies tend to create friction as the countries that are forced to accept the measures (Hungary, Slovakia and the Czech Republic) feel bullied and those who have accepted the quota feel the other countries are not doing enough so it could cause some ill feeling. If you add to this that the policy is not really working because

<sup>15</sup> LEWIS, Linda. *How is the migrant crisis dividing EU countries?* [online]. Available at: <<http://www.bbc.com/news/world-europe-34278886>>

<sup>16</sup> HOLEHOUSE, Matthew. *EU to fine countries 'hundreds of millions of pounds' for refusing to take refugees.* [online]. Available at: <<http://www.telegraph.co.uk/news/2016/05/03/eu-to-fine-countries-that-refuse-refugee-quota/>>

of the above mentioned free spaces in Romania etc. it can cause frustration and alienation from the EU institutions. Although in this case the UK had an opt-out populist leaders like Nigel Farage use it as an example why the UK should leave the EU. UKIP leader Nigel Farage has said the EU was “mad” to accept so many refugees and claimed “Isis are using this route to put jihadists on European soil”. Speaking in the European Parliament, he said the EU should stop boats arriving, as Australia did. He told European Commission President Jean-Claude Juncker that unless he gave back control of the UK borders, Britain would vote to leave the EU.<sup>17</sup> There is no doubt that the refugee crisis was a major contributing factor to why the British electorate chose to leave the EU. Populist politicians like Nigel Farage painted a picture that the UK would be forced to accept more refugees and this coupled with the free movement of labour in the EU would mean the UK would be flooded with refugees and immigrants.

### **3.4. Terror Attacks**

It is true that the UK has had a lot of experience with terror attacks in its recent history. The IRA carried out a number of terrorist acts in the 1970, 80s, and 90s and even into the early 2000s ranging in ferocity but although the IRA did occasionally target mainland Britain with horrific effects (1974 12 army personnel and family members are killed, 1982 11 soldiers are killed by 2 bombs in London’s royal parks, 1984 Brighton Hotel bombing which killed 5 people and came close to killing Margaret Thatcher the Prime Minister at the time) Despite these experiences it is fair to say that the British public is more alarmed by the more recent IS terrorist attacks. Perhaps the first major attack on the UK by the IS was the bombing of the London Underground and a bus on 7/7/2005 which killed 56 people and injured 700 was a massive shock to the British population. Populist politicians started to blame the UKs and the EUs immigration policy for allowing so many immigrants from Syria, Iraq, and Afghanistan into the country.

In 2017 there have been 4 serious terrorist events. 22nd March (Westminster attack 6 killed 49 injured) 22nd May (Manchester Arena bombing 22 killed 250 injured) 3rd June (London attack 8 killed) 25th August (3 policeman injured by a man carrying a 4 foot sword near Buckingham palace). All these have put further pressure on the UK to become more protectionist especially when populist leaders use these events for their own political purposes. Nigel Farage while giving interviews in America stated “the problem with multiculturalism is that it leads to divided communities. It’s quite different to multi-racialism. That’s fine

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<sup>17</sup> THOMPSON, Theo. *Migrant crisis: Farage says EU ‘mad’ to accept so many*. [online]. Available at: <<http://www.bbc.com/news/uk-politics-34197707>>

that can work very happily and extremely well. But we've finished up with much divided communities. "I'm sorry to say that we have now a fifth column living inside these European countries."

Mr Farage attacked protesters in Fifth Avenue in New York and in wider America, saying: "Frankly, if you open your door to uncontrolled immigration from Middle Eastern countries, you are inviting in terrorism."<sup>18</sup> So as populism starts to spread the ideas that the terrorist attacks are the result of immigration policy it then leads people to question the role of the EU on immigration and as the EU seems to be determined to pursue its current open boarder policy this starts to alienate people to the EU. The following comments from Marine Le Pen and others support this. Marine Le Pen, the French far-right leader, has joined anti-immigration politicians in linking the London attack to migrant policy, despite the attacker being British. Poland's Prime Minister, Beata Szydło, also drew a link between the attack and the EU's migrant policy, saying it vindicated Warsaw's refusal to take in refugees under the EU's quota scheme. "I hear in Europe very often: do not connect the migration policy with terrorism, but it is impossible not to connect them," Szydło told private Polish broadcaster TVN24.<sup>19</sup> Again this contributes to the UK government and the UK electorate getting frustrated at the intransigence of the EU. If you combine this with all the other pressures discussed in this section it perhaps indicates the UK's strengthening resolve to exit the EU.

## 4. Consequences

Despite the leave campaigns arguments that the UK would be better off leaving the EU a more objective look would surely throw some doubt on their claims. On the other hand, they also exaggerated the positives, suggesting that the UK would retain the £350m it paid to Brussels each week, which was less than half of that, given the rebates the UK receives back from the EU. Nevertheless, their message was 'regain control', and be unencumbered by EU regulations and the EU courts as well.<sup>20</sup>

<sup>18</sup> OPPENHEIM, Mary. *Nigel Farage blames multiculturalism for London terror attack*. [online]. Available at: <<http://www.independent.co.uk/news/uk/home-news/nigel-farage-london-terror-attack-multiculturalism-blame-immigration-lbc-radio-ukip-mep-leader-a7645586.html>>

<sup>19</sup> HENLEY, John, JAMIESON, Amber. *Anti-immigration politicians link London attack to migrant policy*. [online]. Available at: <<https://www.theguardian.com/uk-news/2017/mar/23/anti-immigrant-politicians-link-london-attack-migrant-policy>>

<sup>20</sup> COOPER, Carey. *Eight reasons Leave won the UK's referendum on the EU*. [online]. Available at: <<http://www.bbc.com/news/uk-politics-eu-referendum-36574526>>

## 4.1. The financial sector

London is one of the major financial centres in the world and is probably only second to New York in size and importance. It is thus not surprising that if you split the referendum vote down into regions that London was one of the regions that voted to remain in the EU. Because of its size and know how much of European finance passes through London and contributes to about 8% of the UKs total GDP. The British decision to leave the EU causes more uncertainty and speculation in this sector making it more volatile. The losses for banks and other financial service providers, however, were major: there have only been a few trading days in which the share price of some euro area banks plummeted by as much as it did following the Brexit referendum.<sup>21</sup> The uncertainty surrounding Brexit and any possible trade deals is not good for the banking sector. The UK should also remember that a significant amount of financial business is done with its European neighbours. According to Open Europe, around a fifth of the UK banking sectors annual revenue is estimated to be tied to the EU. And many EU banks are also highly reliant on the relationship: Deutsche Bank receives 19% of its revenue from the UK.<sup>22</sup> So although London relies on its European neighbours for business it is not a one way street the UKs European neighbours also benefit from the current arrangement. But no one knows what the post Brexit situation will be, will the UK be allowed to trade its financial services freely? Will there be any extra added costs? These questions cannot be answered at the moment.

There is also another important consequence of the UK leaving the EU. The UK has had quite a privileged position within the EU concerning the influence it has had on the financial sectors regulation and direction. The UK is one of the biggest promoters of the free market and due to its influence the more protectionist policies of France and other Southern European member states has been held back. In the long run, a Brexit would change the European Union's characteristics significantly, shifting power away from countries where liberal economic policy dominates. This change has institutional consequences as the liberal country bloc consisting of the United Kingdom, the Netherlands, as well as the Scandinavian and Eastern European countries loses its blocking minority in the EU Council. Germany would no longer represent the pivotal swing player. Economic policy would shift away from its market anchor.<sup>23</sup> So in effect the UK has excluded itself

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<sup>21</sup> FICHTNER, Ferdinand, et al. Brexit decision puts strain on German economy. *DIW Economic Bulletin*, 2016, vol.6, no. 31, pp 359-362.

<sup>22</sup> BOWMAN, Louise. How Brexit killed CMU? *Euromoney*. 2016, vol. 47, no. 57, pp 58-63.

<sup>23</sup> SINN, Hans-Werner et al. R Brexit: The Unintended Consequences. *International Economy*. 2016, vol. 30, no. 2, pp 6-28.

from being the major driving force behind EU policy in this area. It is possible that EU policy will start going in a direction which is not supported by the UK and may have negative effects on the UK's financial sector.

Another area where the UK has been using its influence to shape financial policy in the EU is with the EU's policy on the Capital Markets Union (CMU). The idea of the CMU was to stimulate the inter-EU investment and the UK would have been a major contributor to this and may leave the EU struggling to fill the gap. Brexit could create a transitional problem for CMU because so much buy-side capacity, liquidity and capital markets expertise is in London... UK negotiators were at the core of the CMU scheme.<sup>24</sup> So there are now serious questions being raised about the viability of the CMU initiative which was originally intended to focus on member states. It is possible that the CMU will survive and change its scope to become a global initiative (which could possibly be good for the UK). But without the UK supporting it and driving it along will there be sufficient will and motivation from other member states to continue with the CMU this just adds to the number of uncertainties facing the UK and the EU following Brexit.

Another area of the finance sector that could be affected by the UK's decision to leave the EU is the trading of the euro. Despite not participating in the currency union, London is the most important trading place for euros. The value of euro/dollar trading in London is twice as high as that on the continent. It would be very difficult for the European Central Bank to tolerate that in case of Brexit.<sup>25</sup> On top of this many major banks have already made plans to relocate at least part of their operations to countries inside the EU. The biggest winner of the Brexit vote among European financial centres seems to be Frankfurt. Seven of the twelve largest investment banks with significant operations in London plan opening an office or moving their operations to Frankfurt ... three of the remaining global banks look to expand to Dublin.<sup>26</sup> To what extent these banks will move from London and to what extent they are just preparing themselves for the worst case scenario is hard to tell. But any plans or actual moves from any major company from London is not good. So London could well lose its status as one of the major finance centres of the world.

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<sup>24</sup> BOWMAN, Louise. How Brexit killed CMU? *Euromoney*. 2016, vol. 47, no. 57, pp 58-63.

<sup>25</sup> SINN, Hans-Werner et al. Brexit: The Unintended Consequences. *International Economy*. 2016, vol. 30, no. 2, pp 6-28.

<sup>26</sup> DJANKOV, Simeon. *Investment banks are already leaving London. Other jobs will follow*. [online]. Available at: <[www.blogs.lse.ac.uk/brexit/2017/06/07/investment-banks-are-already-leaving-london-other-jobs-will-follow/](http://www.blogs.lse.ac.uk/brexit/2017/06/07/investment-banks-are-already-leaving-london-other-jobs-will-follow/)>

## 4.2. The Automotive Industry

Since Brexit the automotive industry has also been highlighted as a possible loser of the Brexit vote. The European Automobile Manufacturers Association (ACEA) has been pointing out future problems that could affect its members. Vehicle manufacturers currently operate some 300 assembly and production plants in Europe. They often manufacture engines or transmissions in one country and assemble the final vehicle in another. The European Single Market provides for a high level of economic and regulatory integration in this respect. This level of integration, ACEA says, reflected in how the automotive industry has strategically set up its business operations in terms of supply chains, production sites and distribution networks. The ACEA also points out that the EU is the UK's biggest trade partner. More than half of all cars and 90% of all commercial vehicles built in the UK last year were bought by customers in Europe.<sup>27</sup> So if the UK is unsuccessful in negotiating a trade deal with the EU then automobile manufacturers may see their costs rise as parts and complete vehicles could all be subject to taxation. So yet another area of doubt hangs over another industry. This could affect the company's decisions to invest further in the UK or may even motivate the companies to relocate their production lines outside the UK in a similar way that is happening with the finance sector.

## 4.3. Exchange Rate Fluctuations

Another more immediate result of Brexit has been the fall in the value of pound sterling. This makes it more expensive for UK consumers to buy products from abroad. The full effects of this have not filtered through yet but could put a big strain on the UK's economic performance. It is true that this may be offset initially by British products becoming significantly cheaper abroad and thus stimulating exports (for example Salmon exports have hit record levels since Brexit). Sales of British salmon helped the UK to export a record value of food and drink in the first half of the year, according to industry figures.

Exports of the fish jumped more than 53% by value to £408m, the Food and Drink Federation (FDF) said. UK food and drink exports rose 8.5% to £10.2bn, helped by the fall in the pound after last year's Brexit vote.<sup>28</sup> Another positive side effect is that the UK has seen a significant increase in tourism as it has suddenly become much cheaper to visit. Visitor numbers are up sharply, with tourists

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<sup>27</sup> LEGGETT, Dave et al. ACEA and CLEPA warn of European Brexit damage. *Aroq – Just-Auto.com (Global News)*, 2017, vol. 2017, no.3, 31

<sup>28</sup> SCOTT, Thomas. *Salmon sales surge as UK food exports hit record high*. [online]. Available at: <<http://www.bbc.com/news/business-40963631>>

coming to the UK and spending increasing amounts because sterling has fallen by more than 13pc since the Brexit vote last year. Overseas residents made 3.7m visits to the UK in April, a jump of 19pc compared with the same month of 2016.<sup>29</sup>

But a weaker currency isn't always good news for business and trade. Yet, despite a possible boost to manufacturing exports and some valuation gains, the depreciation of the pound since the Brexit vote must reflect expectations of slower growth for the U.K. economy in the next few years and beyond. While some groups may gain from Brexit, the message from the foreign exchange and asset markets is clear: The overall size of the economy will eventually shrink relative to what it could have been if the United Kingdom had voted to stay in the EU.<sup>30</sup>

## 5. The Current Situation with Brexit Negotiations

At the time of writing the current negotiations between the EU and the UK look far from promising. The EU is insisting that three conditions are met before negotiations on trade can begin. Firstly they want to agree on the rights of EU citizens living in the UK after Brexit and the rights of UK citizens living in EU member states. Secondly the UK and the EU have to agree the divorce bill and the third condition is the EU wants a decision on the Northern Ireland-Ireland border. After the third round of negotiations at the end of August 2017 the chief negotiator for the EU was still pessimistic about the progress being made. Michel Barnier said Thursday that the three-day talks in Brussels with his British counterpart David Davis, and their respective delegations, had secured “useful clarification on a number of points,” but insisted that both sides remain far from agreeing a final deal ahead of the U.K.’s departure from the EU. “We did not get any decisive progress on any of the principal subjects,” Barnier told reporters, referring to the key issues citizens’ rights and the U.K.’s Brexit bill. He admitted, however, that talks on the Irish border – the third issue of contention in early stage discussions – had been “fruitful.”<sup>31</sup>

It is true that the EU is taking a very strict position and they can as they are in the stronger position and can wait it out. But the UK government seems unable to

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<sup>29</sup> WALLACE, Tim. *Tourists splurge in Britain to make the most of weak pound*. [online]. Available at: <<http://www.telegraph.co.uk/business/2017/06/16/tourists-splurge-britain-make-weak-pound/>>

<sup>30</sup> GOURINCHAS, Pierre-Olivier, et al. Brexit: Whither the Pound? *FRBSF Economic Letter*. 2017, vol. 2017, no. 11, pp 1-5.

<sup>31</sup> GILCHRIST, Karen, *No ‘decisive progress’ in third round of Brexit talks, top EU negotiator says*. [online.] Available at: <<https://www.cnbc.com/2017/08/31/no-decisive-progress-in-third-round-of-brexit-talks-top-eu-negotiator-says.html>>

accept the solution of the three fundamental conditions without discussing future trade agreements. The UK government seems to believe that the EU will give in at some point and start negotiating trade and the three fundamental issues at the same time, or that they might be able to by-pass negotiators somehow. Both Barnier and Juncker have been steadfast in their insistence that talks on future trade cannot begin until the divorce bill has been settled but the Times reports there may be sympathy for Britain among some member states. “Mr Juncker says it’s ‘crystal clear’ that we can’t talk about the future relationship before solving divorce issues, but this is a decision to be taken by the EU 27, not the commission,” a government source claimed. “Some heads of state say it’s ‘common sense’ to have a discussion about both.” The belief within May’s government is that it is impossible to make “sufficient progress” on preliminary issues like the divorce bill without at the same time addressing what the future UK-EU relationship will look like.<sup>32</sup>

There have been rumours that Teresa May has agreed to pay 46 billion euros as a divorce settlement but wants to keep it a secret from her own party as it may cause a back bench revolt, in any case she cannot afford to have divisions within her own party derailing any progress that might be made in Brexit negotiations. The Mail on Sunday understands that the Prime Minister has been advised that Britain is likely to have to fork out up to €50 billion – £46 billion at current exchange rates – as the only way to break the deadlock of the Brexit talks. But anticipating a backlash from her party’s anti-EU wing, Mrs May hopes to wait for the Tories’ Manchester conference to conclude on October 4 before announcing the details.<sup>33</sup> So it is very hard to predict what Teresa May really plans to do but obviously such speculation in the press is not helping the UKs or the Prime Ministers position. Things at this stage are still very uncertain and perhaps are in a confused state.

## 6. Possible Effects on the EU

According to the Office of National Statistics (ONS) Britain imports most from the following countries in the EU: Germany, the Netherlands, France, Spain, Belgium,

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<sup>32</sup> PAYNE, Adam. *Theresa May set to defy the EU and negotiate directly with European leaders on Brexit*. [online]. Available at: <<http://uk.businessinsider.com/may-set-to-defy-the-eu-and-talk-to-european-leaders-about-trade-negotiations-2017-8>>

<sup>33</sup> OWEN, Glen. *PM’s desperate bid to keep £46billion EU divorce bill secret as she fears fury at Tory conference if she reveals what No 10 expects to pay*. [online] Available at: <<http://www.dailymail.co.uk/news/article-4847688/PM-s-desperate-bid-46bn-EU-divorce-bill-secret.html>>

Italy and Ireland.<sup>34</sup> It is also true that the UK imports more from the EU than the EU imports from the UK. So you could argue that the trade relationship is more important to the EU than the UK. However you have to bear in mind the EU economy is much bigger and less reliant on the UK than the UK is on the EU. UK-EU exports are a bigger part of the UK's economy than the EU's. Although fewer of our exports are now going to other EU countries, these exports are still just as important to our economy. The £240 billion exports of goods and services to other EU countries were worth about 12% of the value of the British economy in 2016. It's been at around 12-15% over the past decade. Exports from the rest of the EU to the UK were worth about 3-4% of the size of the remaining EU's economy in 2015. The exact number depends on whether you use the £290 billion figure from UK data, or £390 billion from EU data.<sup>35</sup> But breaking down the figures by country (table1) helps to identify more clearly the EU's trading partners inside and outside the EU. The table excludes the UK from the EU data as if it had left the EU.

### Chart 1: Trading partners

Excluding trade between EU countries	Including trade between EU countries
1. The US (17%)	1. Germany (13%)
2. The UK (16%)	2. France (8%)
3. China (8%)	3. The USA (7%)
4. Switzerland (7%)	4. The UK (7%)
5. Turkey (4%)	5. Italy (5%)

As is clear from the chart, the UK would be the EU's second biggest trading partner outside the EU and fourth biggest trading partner if other EU countries are included. So despite the fact that the UK imports more from the EU than the EU does from the UK strictly speaking the UK is more reliant on the EU trade than vice versa. But some countries will be affected more than others if in the EU if no trade agreement is reached. Germany would possibly be the biggest loser as it exports most to the UK out of the EU countries but some industries would be affected more than others. The German automotive industry, which counts the UK as a major export destination, will be the most affected: German producers of wood, paper, and leather goods, as well as those of pharmaceuticals and chemicals products will also feel the impact.<sup>36</sup> According to the German

<sup>34</sup> Further information available at: <http://visual.ons.gov.uk/uk-trade-partners/>

<sup>35</sup> For further information see: <https://fullfact.org/europe/uk-eu-trade/>

<sup>36</sup> FICHTNER, Ferdinand, et al. Brexit decision puts strain on German economy. *DIW Economic Bulletin*, 2016, vol.6, no. 31, 359-362

statistics office<sup>37</sup> (Statistisches Bundesamt) the UK was Germany's third biggest export market and ran a trade surplus with the UK of 50 billion euros. Showing that the UK is a very important partner to Germany.

Another country that may suffer more than Germany is Ireland. Ireland has built up trade with the UK over the decades and many businesses are tied up with the success of the UK and it would be difficult to unravel these links. Brexit, said Mr Bruton, might deal Ireland's economy an even heavier blow than Britain's. The first blow has already fallen, says Fergal O'Brien of IBEC, a business lobby group. As sterling has weakened, exports to Britain have become less competitive, and imports from Britain cheaper. Britain takes two-fifths of Irish-owned firms' exports, and a similar share of all agricultural exports. Beef and dairy farmers are struggling, and several of Ireland's mushroom farms, which export four-fifths of their produce to Britain, have already closed. The pain will worsen as sterling's fall and Brexit-induced business uncertainty hit demand in Britain, says Mr O'Brien.<sup>38</sup> So Ireland would be happier if a trade agreement was reached with the UK after Brexit as it would limit the damage to its own economy. But Ireland does not have much influence as it is one of the smaller members of the EU.

## 7. Conclusion

The UK has always been on the outer limits of European integration perhaps the history of the UK has made it more conservative and less willing to give up control to a supranational organisation. The UK never really shared the dream of its continental neighbours for closer political integration. The financial crisis, the refugee crisis and the recent terror attacks in the UK and those carried out on other member states have also given rise to far right and populist politics which has further eroded the British electorate's confidence in the EU.

Although some EU member states may feel it will strengthen the EU not to have such a negative difficult state as a member there are many cons to the UK leaving. Politically it will leave a vacuum and may shift the balance of power in the EU to protectionist policies, this may be difficult for some states to swallow especially the Eastern European and Scandinavian states who have often sided with the UK to form a minority bloc to veto some policies or initiatives they did not agree with. This may cause other countries to question their membership to

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<sup>37</sup> For further information see: <https://fullfact.org/europe/uk-eu-trade/>

<sup>38</sup> SWENSON, Adam. *Ireland may suffer the most from Brexit*. [online]. Available at: <<https://www.economist.com/news/europe/21709354-making-it-one-few-european-countries-wants-be-kind-britain-ireland-may-suffer>>

the EU or at the very least cause more fragmentation and uncertainty within the EU. Also generally we have seen a shift in the political landscape to far right extremism and populism as personified by UKIP in the UK and the National Front in France other EU countries have also seen the rise of such parties. The election of Donald Trump has also caused some fear that the US may become more protectionist cutting off the expansion of EU markets in this area. There is also a fear that this will cause the EU to become more protectionist as a result (not a good time for the UK to leave).

The economic consequences of the UK leaving may be dramatic mostly affecting the UK and may hit the financial sector hardest followed by the automobile manufacturing sector, but other countries like Ireland and to a lesser extent Germany will also feel the economic consequences. But it is impossible to accurately predict the benefits or the costs until the final agreement is worked out.

The negotiation over the UK's departure from the EU has already started alarm bells ringing as the EU seems unwilling to discuss trade with the UK until their three conditions are met. The UK seems unable to grasp this simple fact and is equally determined to try and negotiate trade and the three conditions at the same time which further strains EU relations and seems to indicate that an agreement is unlikely to be reached on time or at all as the third round of negotiations has already showed little progress. But again it is very difficult to predict what politicians will actually do and what goes on behind closed doors. If the press is to be believed some progress might have been made on the UK's divorce settlement. But this could trigger a further political melt down in the UK as Theresa May is likely to face stiff opposition from her own party if the divorce settlement is considered too high. The only thing we can be sure of at the moment is more uncertainty and uncertainty is not good for anyone.