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Jean Monnet Module
The Economics of European Regions: Theory, Empirics, and Policy

October 17, 2019

Brexit and its economic impact

Aims

- To discuss the main features of the European Union
- To find out what is Brexit
- To discuss the implications of Brexit
- To evaluate the ongoing impact on the UK economy

Reference

- <http://eprints.lse.ac.uk/66144/>
- <http://www.kenwitsconsultancy.co.uk/wp-content/uploads/2016/09/BREXIT-2016-Policy-Analysis-from-the-Centre-for-Economic-Performance.pdf#page=50>
- <http://dera.ioe.ac.uk/27171/1/CBP-7213.pdf>
- https://academic.oup.com/oxrep/article-abstract/33/suppl_1/S31/3066076

Candidate countries and potential candidates



The founders



Konrad Adenauer



Winston Churchill



Robert Schuman



Alcide De Gasperi



Jean Monnet



1952 1973 1981 1986 1995 2004 2007 2013

Candidate countries and potential candidates

Country	Area (x 1000 km ²)	Population (millions)	Wealth (gross domestic product per person)
Bosnia and Herzegovina	51	3.8	7 800
Montenegro	14	0.6	10 600
Kosovo under UN Security Resolution 1244	11	1.8	:
The former Yugoslav Republic of Macedonia	25	2.1	10 000
Albania	28	2.9	7 800
Serbia	77	7.2	9 600
Turkey	783	77.7	14 400
The 28 EU countries together	4 272	508.2	27 400

The treaties – basis for democratic cooperation built on law

1952	The European Coal and Steel Community (Common Market for Coal and Steel)
1958	<p>The treaties of Rome:</p> <ul style="list-style-type: none">• The European Economic Community• The European Atomic Energy Community (EURATOM, Civilian use of nuclear power)
1987	The European Single Act: the Single Market (Single market based on the 'four freedoms')
1993	Treaty on European Union – Maastricht (Foundation of the European Union)
1999	Treaty of Amsterdam (Extension of the Community's competencies (qualified majority voting, co-decision of parliament))
2003	Treaty of Nice (Institutional reform in view of the enlargement to 25 members)
2009	Treaty of Lisbon

Treaty of Lisbon

- **Efficient and modern institutions**
 - More **majority** voting – less unanimity
 - **Permanent** President of the European Council
 - High Representative for Foreign and Security Policy
 - European External Action Service
- **Simpler structure**
 - ‘**European Communities**’ → ‘European Union’
- **Democracy and participation**
 - Powers of the European Parliament are **strengthened**
 - Citizens’ **initiative**

Main Characteristics of the EU Single Market

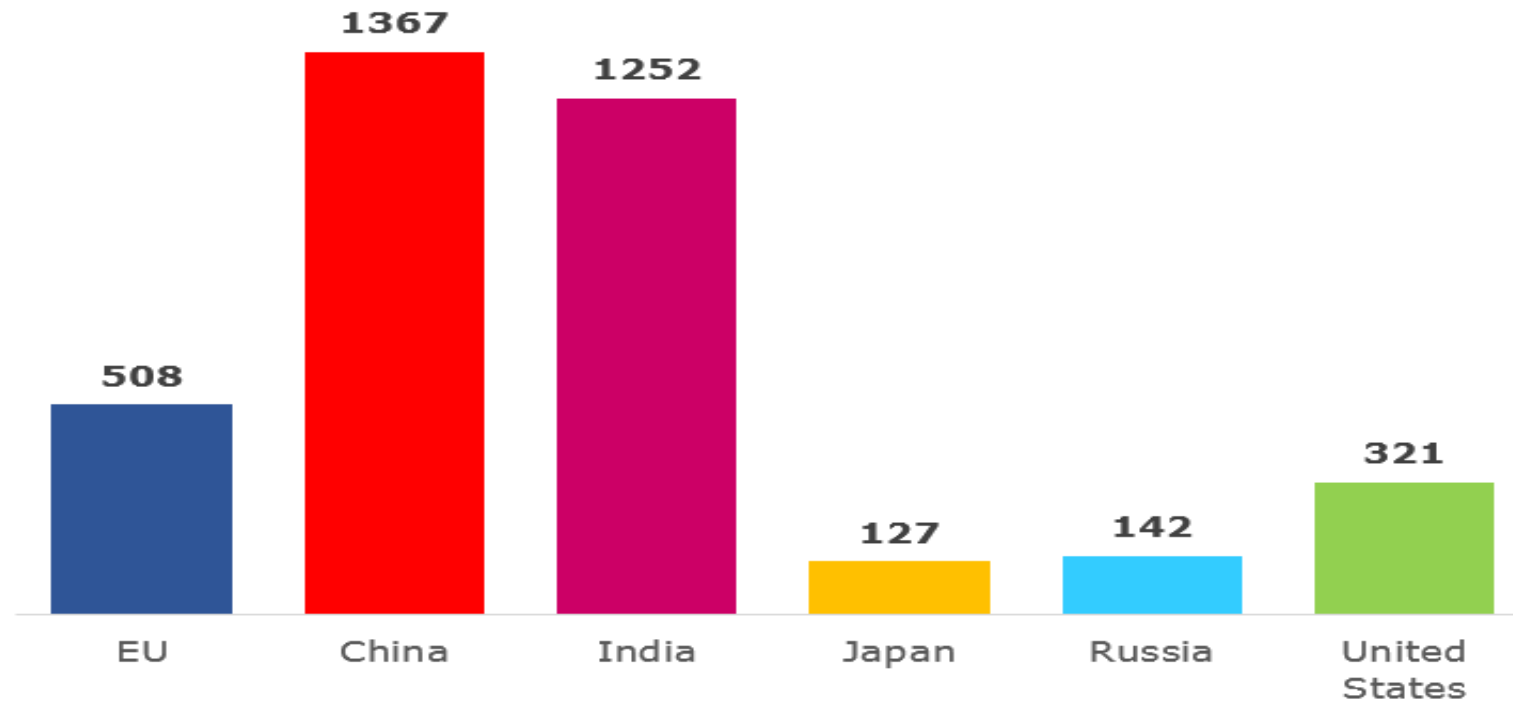
The EU single market is built upon **four key freedoms**:

1. **Free Trade in Goods:** Businesses can sell their products anywhere in the EU's member states and consumers can buy where they want with **no penalty**
2. **Mobility of Labour:** Citizens of EU member states can **live, study and work** in any other country. The aim is to improve the mobility of labour.
3. **Free Movement of Capital:** Financial capital can flow **freely** between member states and EU citizens can use financial services such as insurance in any EU state.
4. **Free Trade in Services:** Professional services such as pensions, architecture, telecoms and advertising can be **offered in any member state**.

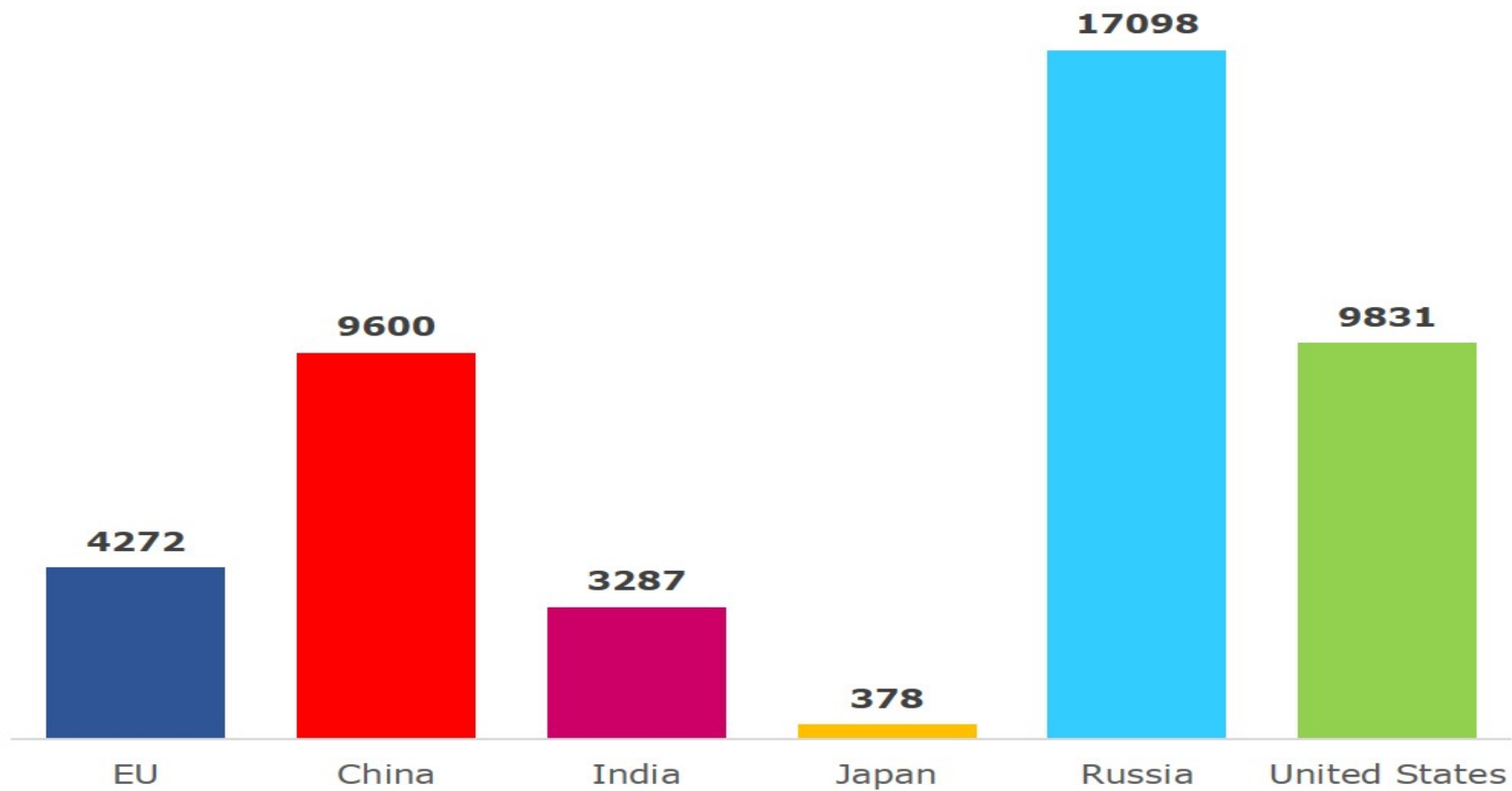
Erasmus+

Every year, more than 400 000 young people study or pursue personal development in other European countries with the support of the EU's Erasmus+ programme for education, training, youth and sport.

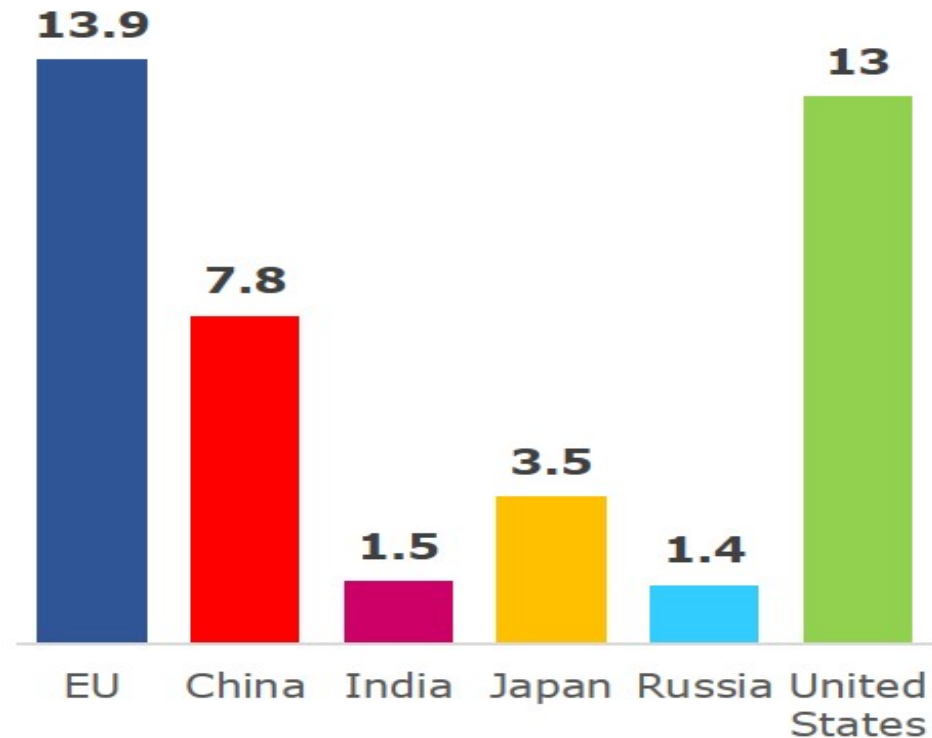
Population in millions (2015)



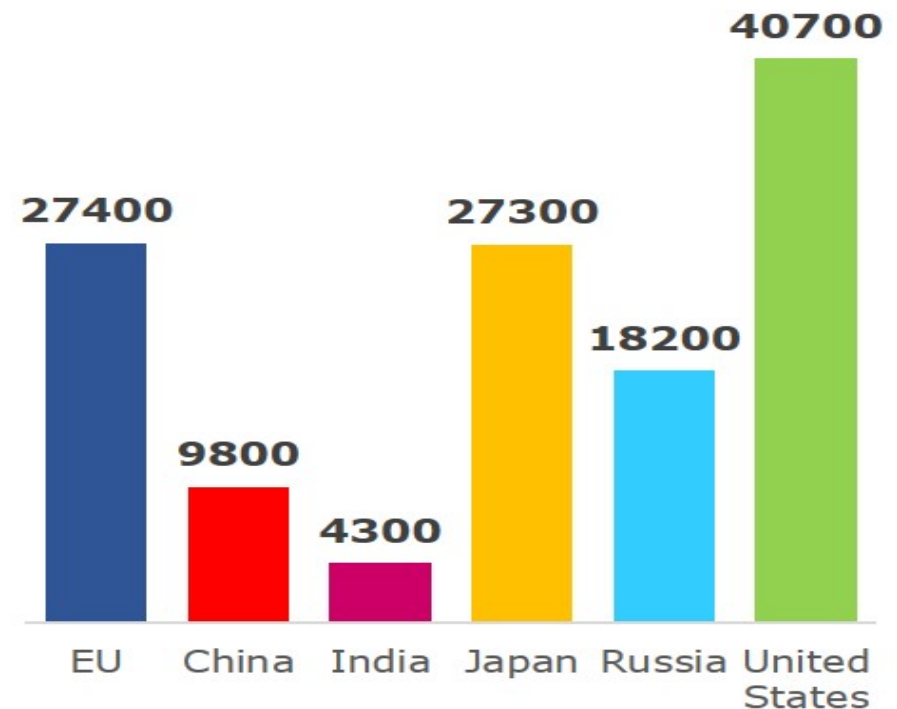
Surface area (x 1000 km²)



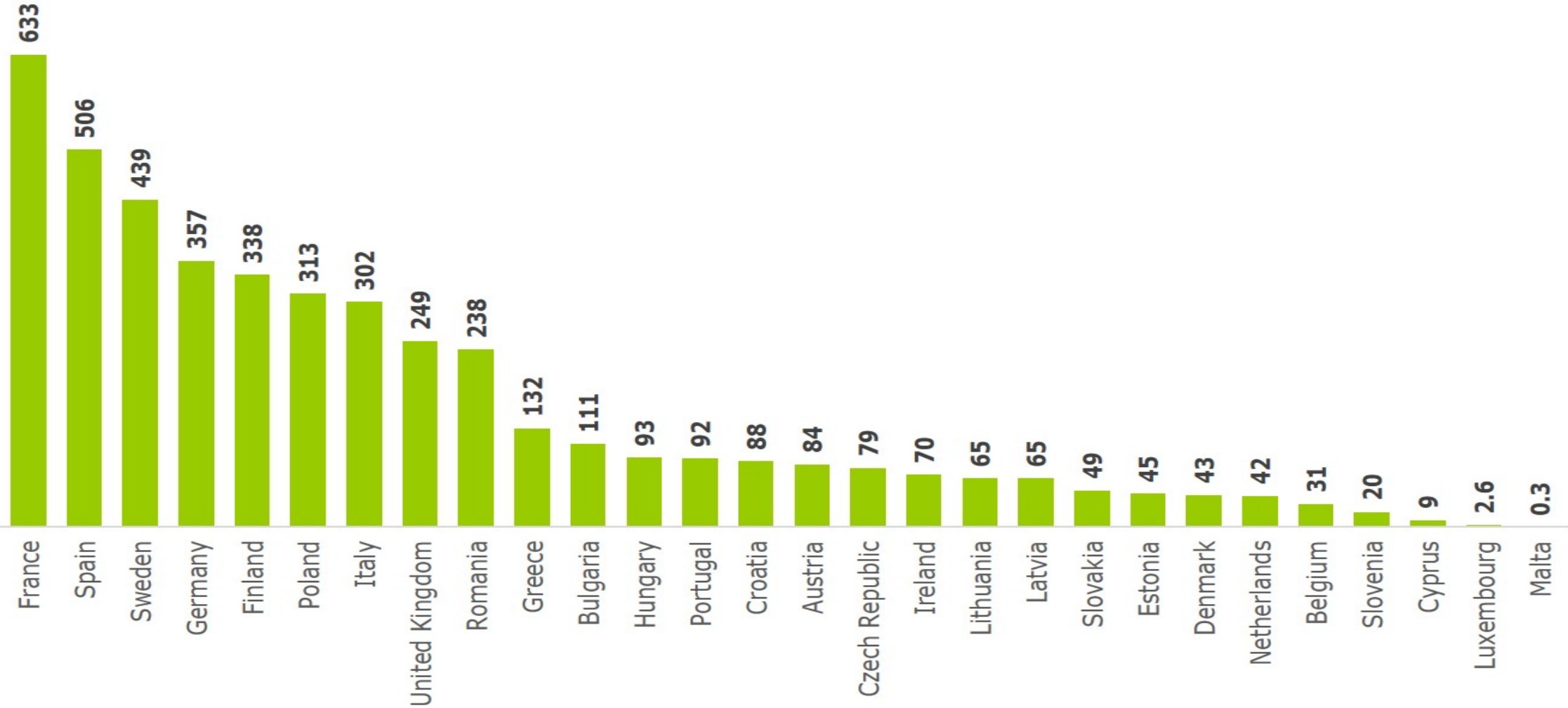
**Size of economy:
GDP in trillions of euro (2014)**



**Wealth per person:
GDP per person (2014)**

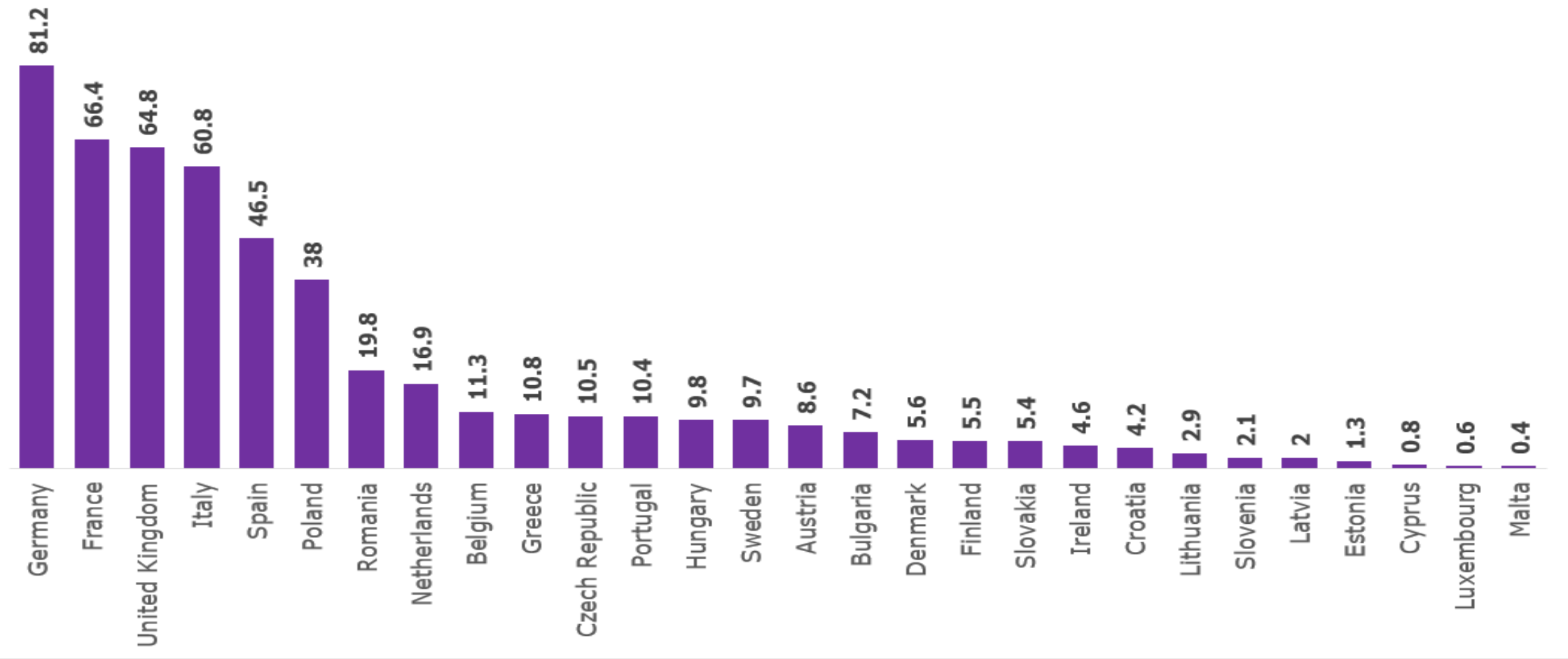


Surface area (x 1000 km²)

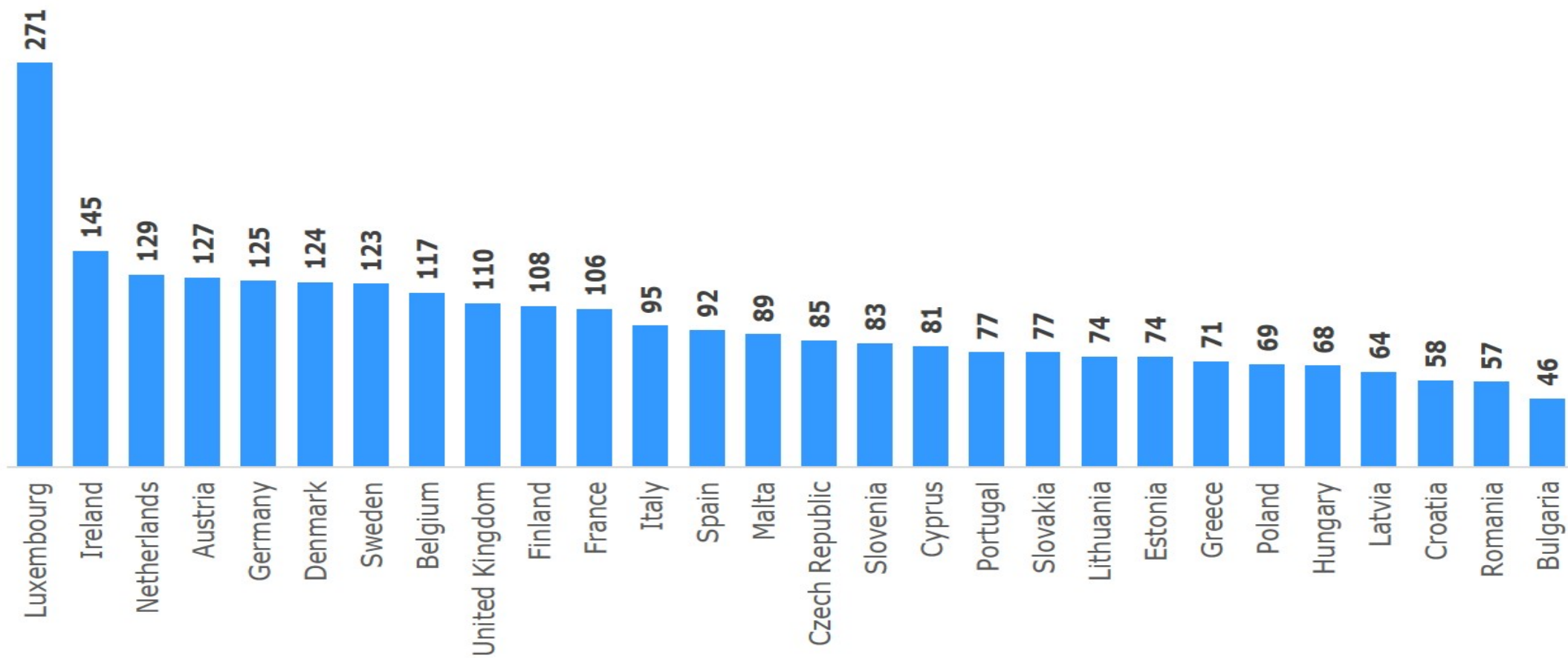


Population in millions (2015)

508 million in total



GDP per inhabitant (2015)



2008: Worldwide financial crisis starts in the United States.

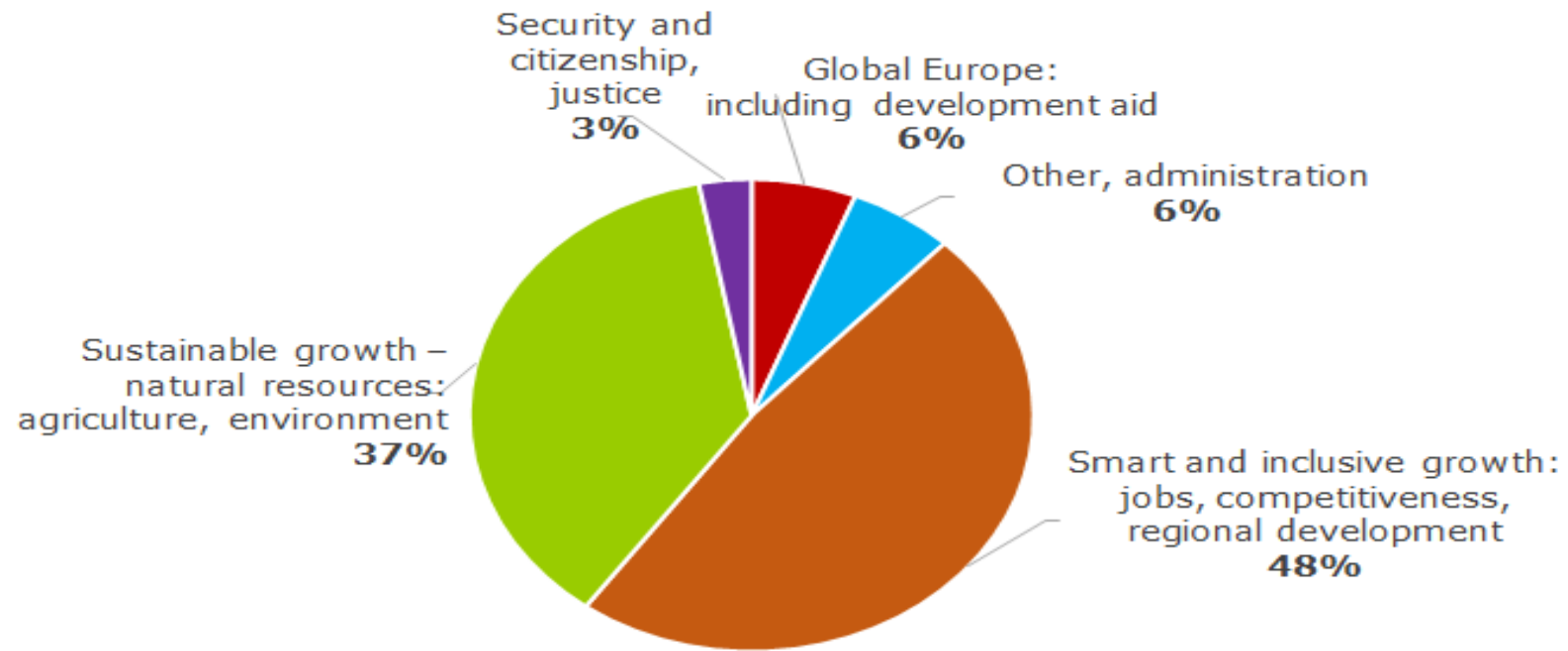
Coordinated response from European leaders:

- **Commitment to the euro and to financial stability**
- **New crisis management tools and reforms of rules:**
 - European Stability Mechanism: fund to help countries in extraordinary economic difficulties
 - New laws for stability of banks
 - Banking Union: EU-wide supervision of banks and a mechanism to close down failing banks
- **Better economic governance:**
 - European Semester: annual procedure to coordinate public budgets
 - Euro+ pact, 'Fiscal compact treaty': mutual commitments to sound public finances

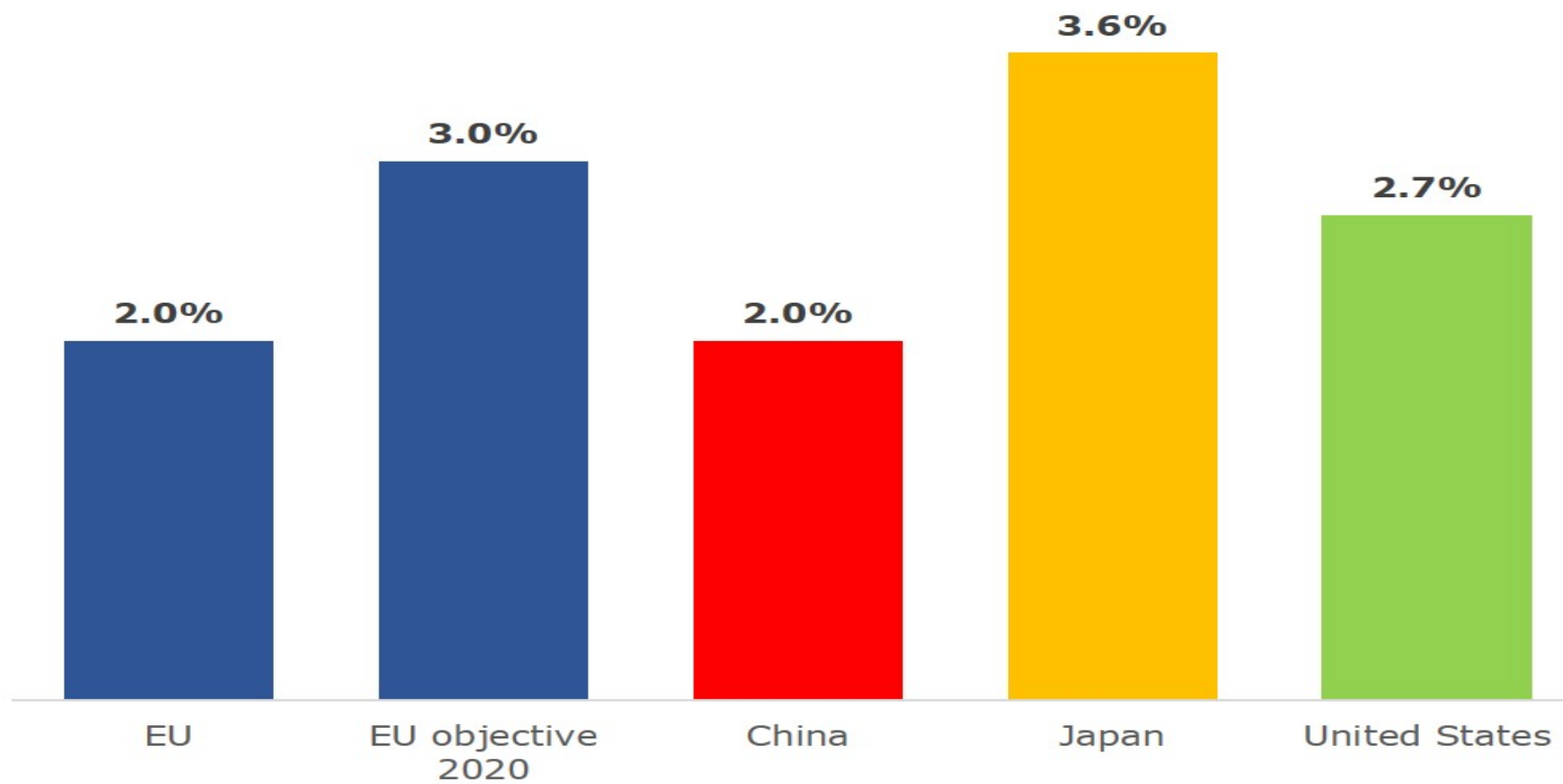
The European Fund for Strategic Investments

- 2015: Europe's economy begins to recover after the crisis, but the level of investment is still low. Investors have money, but little confidence
- New EU fund from mid-2015
- The fund starts with € 21 billion from EU sources
- Investments are made in viable business projects, for example in digital and energy infrastructure, transport, small businesses, green projects and innovation
- Multiplier effect: public money will trigger private investors to follow suit, with up to € 315 billion
- Could create 1.3 million new jobs over three years

2017 EU budget: € 157.9 billion
= 1.05 % of gross national income



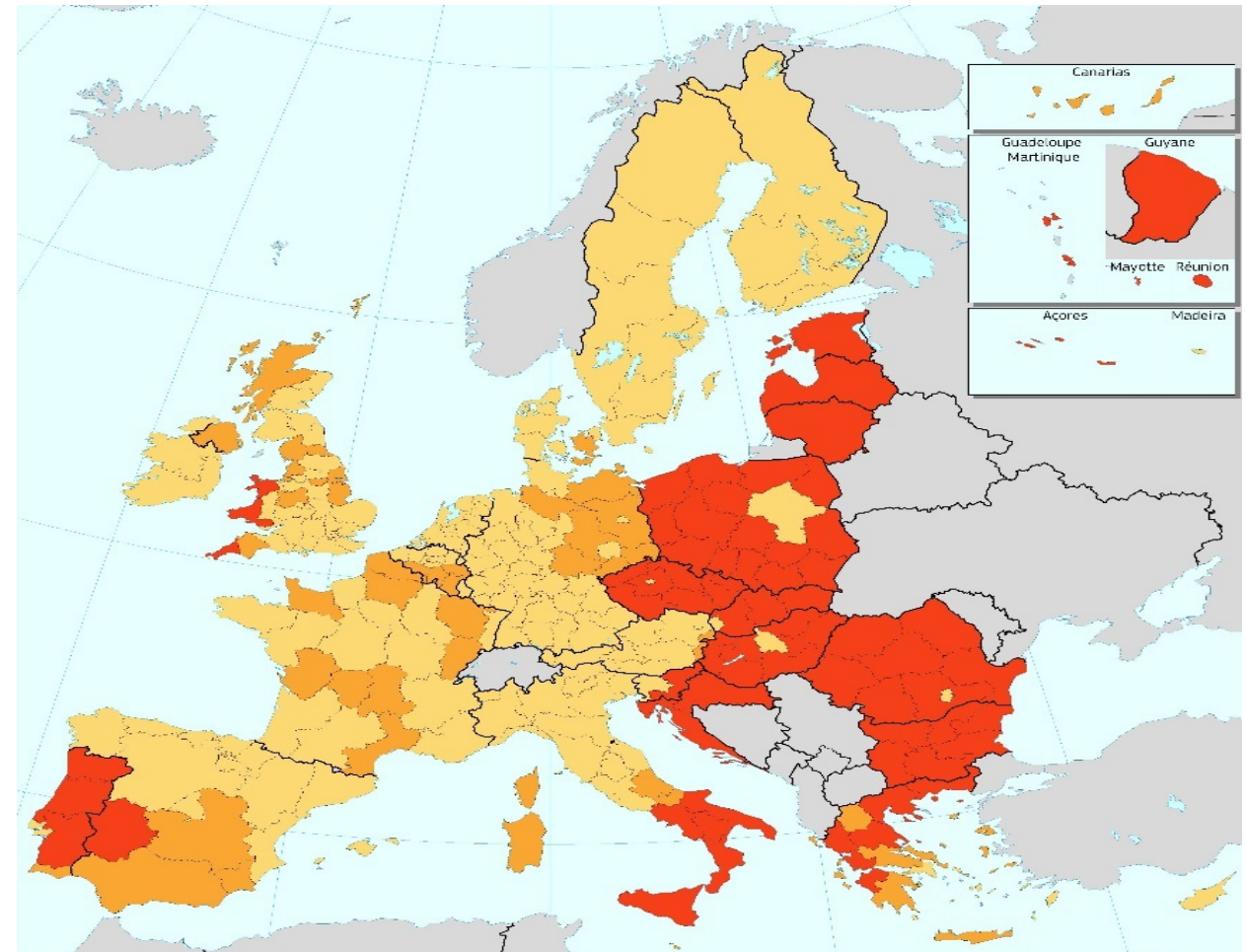
Spending on research and development in 2015 (% of GDP)



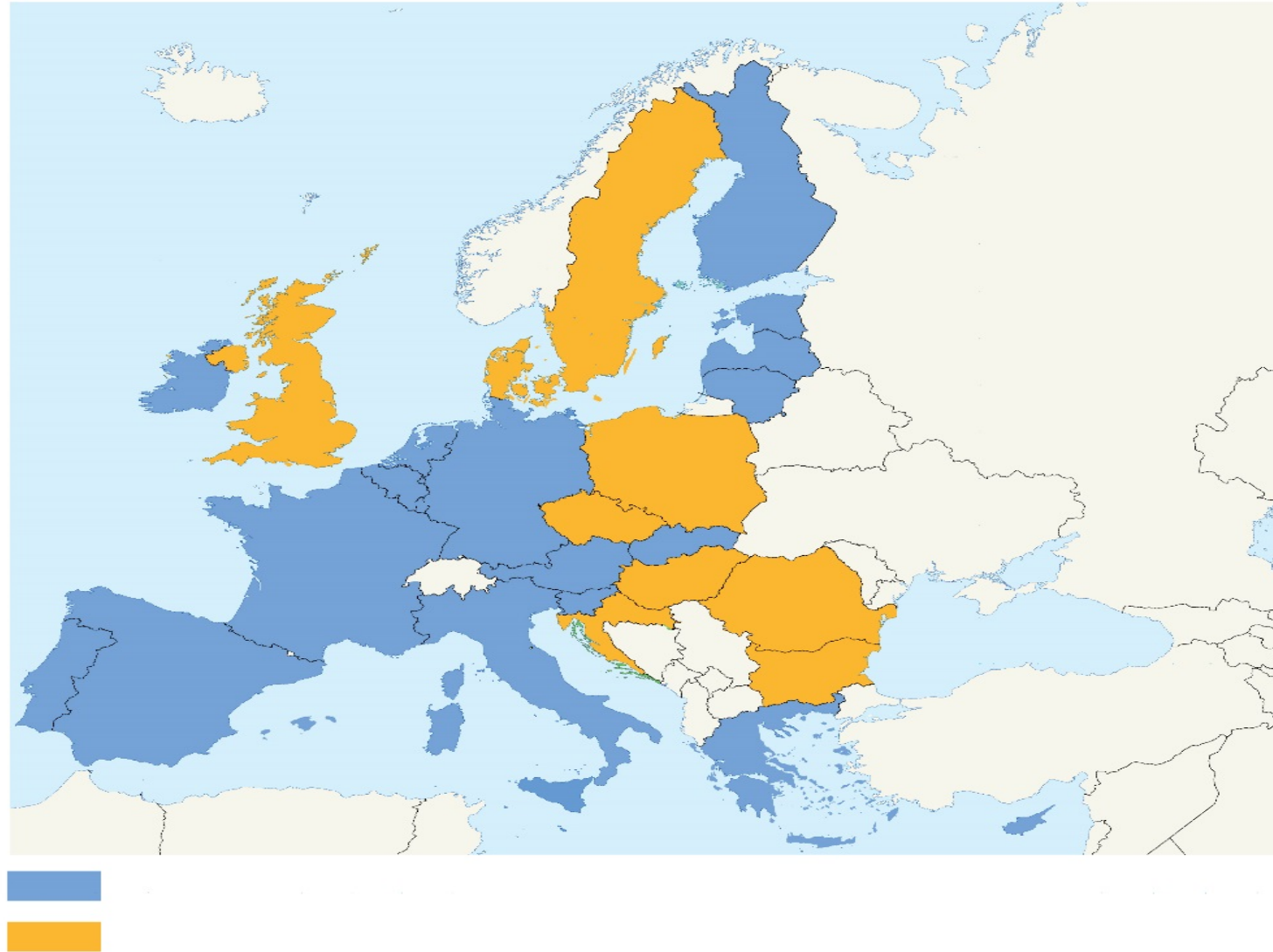
2014-2020: € 352 billion invested in infrastructure, business, environment and training of workers for the benefit of poorer regions and citizens

- Regional fund
- Social fund
- Cohesion fund

- Less-developed regions: GDP per capita under 75 % of the EU average
- Transition regions: GDP per capita between 75 % and 90 % of the EU average
- More-developed regions: GDP per capita over 90 % of the EU average



The euro – a single currency for Europeans



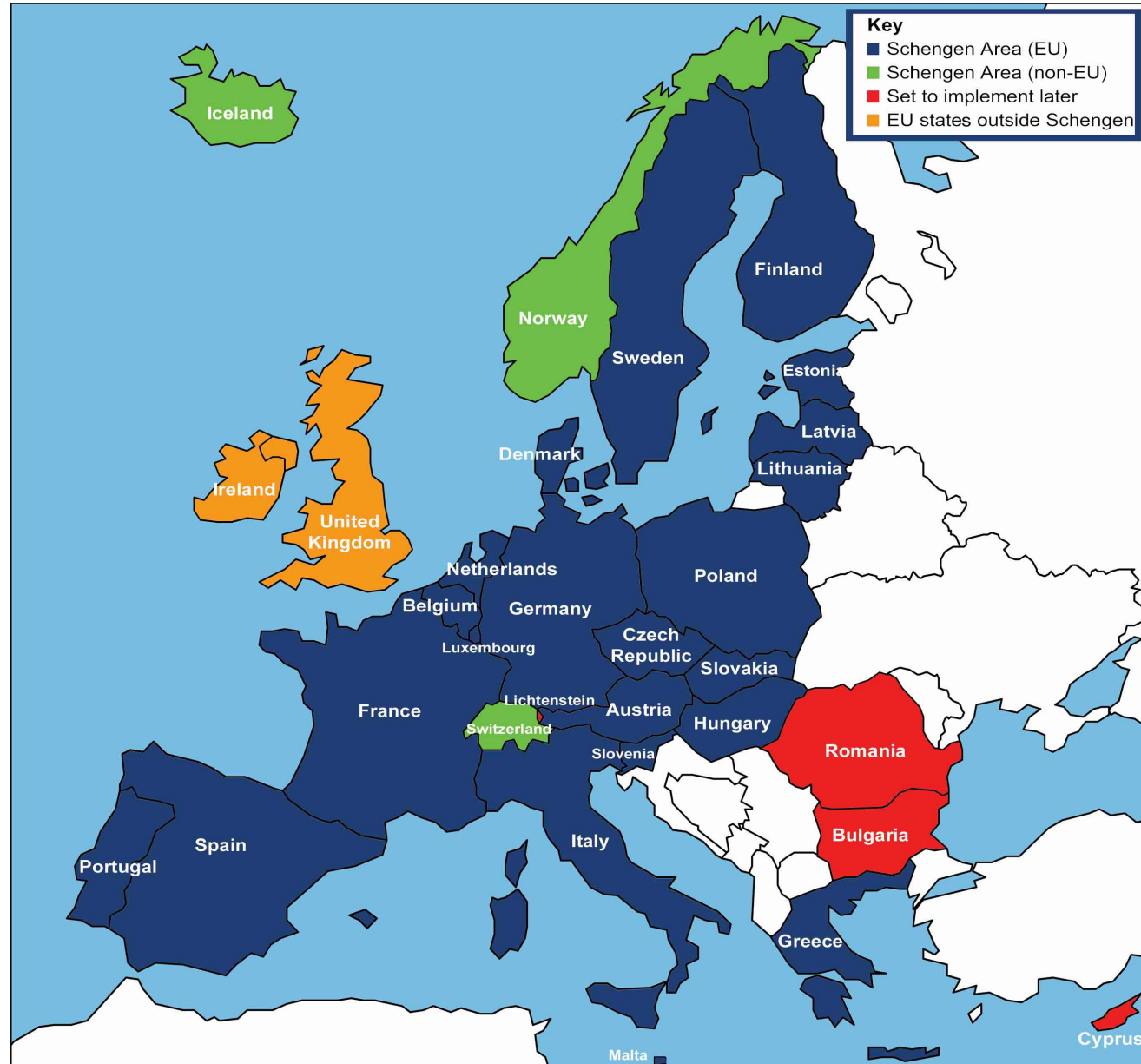
EU countries using the euro

EU countries not using the euro

The 'Schengen' Agreement

- No police or customs checks at borders between most EU countries
- Controls strengthened at the EU's external borders
- More cooperation between police from different EU countries
- Buy and bring back any goods for personal use when you travel between EU countries





EU institutions

European Commission

- 27 Commissioners, representing the European perspective, each responsible for a specific policy area.
- EU's executive branch **proposes legislation**, manages Union's day-to-day business and budget, and **enforces rules**.
- Negotiates **trade agreements** and manages Europe's multilateral development cooperation.

Council of the European Union

- EU's main decision-making body, comprised of ministers of 27 Member States, representing Member State's point of view.
- Decides on **foreign policy** issues.
- Council presidency rotates among Member States every six months.

European Parliament

- Voice of European citizens – members elected for five-year terms.
- With the Council, **passes EU laws and adopts EU budgets.**
- Approves EU Commissioners.

European Court of Justice

- Highest EU judicial authority.
- Ensures all EU laws are interpreted and applied correctly and uniformly.
- Can act as an independent policy maker but unlike the U.S. Supreme Court, the ECJ can only deal with matters covered by the Treaties.

The European Central Bank

- The European Central Bank (ECB) is the central bank for Europe's single currency, the euro.
- The ECB's main task is to maintain the euro's purchasing power and thus **price stability** in the euro area.
- The euro area comprises the 15 European Union countries that have introduced the euro since 1999.
- The ECB operates **independently** from Member State governments.

Brexit

- The UK's decision to leave the European Union
- On June 23rd 2016 the UK voted in a referendum to leave the European Union.
- Prime Minister **David Cameron** resigned the morning after the vote
- A few weeks later, **Theresa May** was elected leader of the Conservative Party and new Prime Minister.
- Article 50 was invoked in March 2017, there is a maximum period of **two years** before the UK finally leaves the European Union (under negotiation).
- The terms of the UK's new economic relationship with the EU remain **uncertain**.

- <https://www.youtube.com/watch?v=NgVhRVrANhA>

Immigration by nationality, 2014

Table 1: Immigration by nationality, country of birth, and country of last residence, 2014

	Thousands			%		
	Nationality	Country of birth	Country of last residence	Nationality	Country of birth	Country of last residence
United Kingdom	81	68	0	12.8%	10.8%	0.0%
European Union	264	256	287	41.8%	40.5%	45.4%
EU 15	129	121	155	20.4%	19.1%	24.5%
EU A8	80	81	79	12.7%	12.8%	12.5%
EU Other	55	54	53	8.7%	8.5%	8.4%
Non European Union	287	308	345	45.4%	48.7%	54.6%
Old Commonwealth	37	39	59	5.9%	6.2%	9.3%
New Commonwealth	90	99	95	14.2%	15.7%	15.0%
Other foreign	160	171	191	25.3%	27.1%	30.2%
Total	632	632	632	100.0%	100.0%	100.0%

Note: See Background to Table 1 in the Appendix. Source: [ONS Long-Term International Migration Estimates 2 series \(LTIM calendar year\)](#)

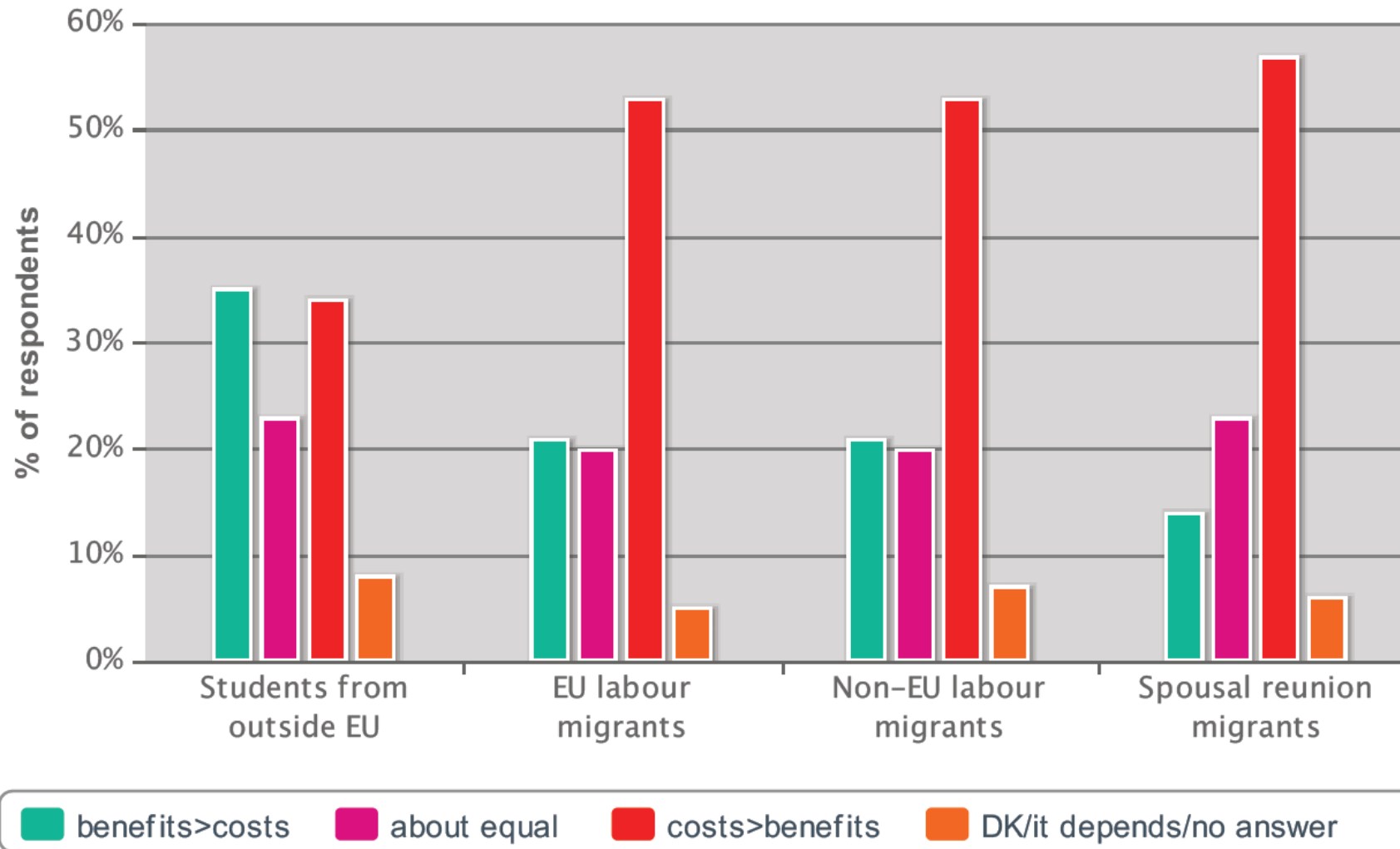
Public opinion on immigration

- Public in general are:
 - **Negative:** approximately $\frac{3}{4}$ of people in Britain favour reducing immigration.
 - attitudes on immigration **Salient:** immigration is consistently one of the top two most important issues
- Public attitudes to **EU free movement** are negative:
 - 51% of the British public want to end the free movement of people in the EU
 - 59% want to stop EU migrants from accessing the NHS for free
 - 68% favour reducing EU migrants' access to welfare benefits
 - 47% think the EU is 'undermining Britain's distinctive identity'

Source: British Social Attitudes, Curtice, *How Deeply does Britain's Euroscepticism Run?* 2015

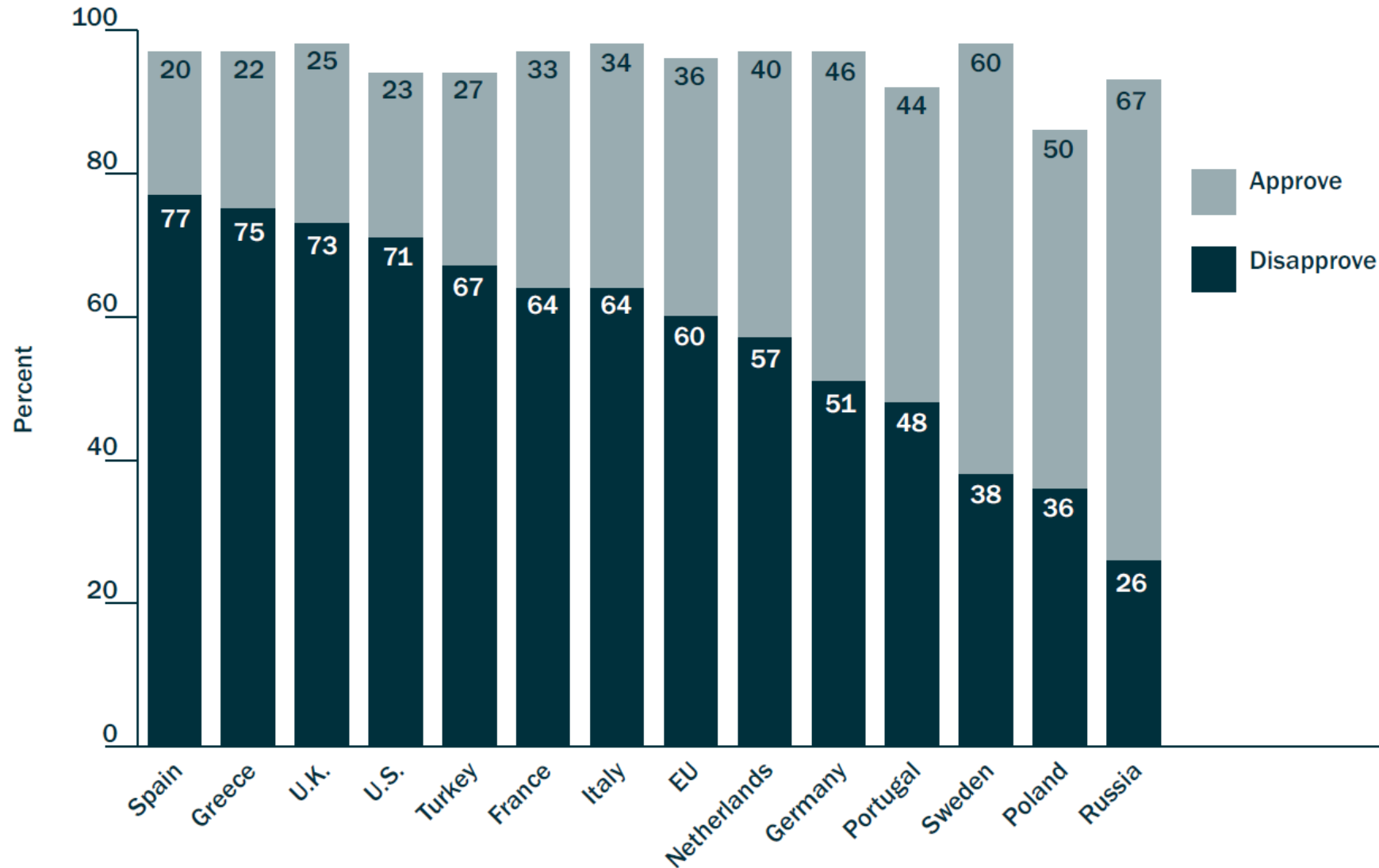
Perceived costs/benefits of different migrant types, 2013

Chart provided by www.migrationobservatory.ox.ac.uk



Source : British Social Attitudes survey 2013

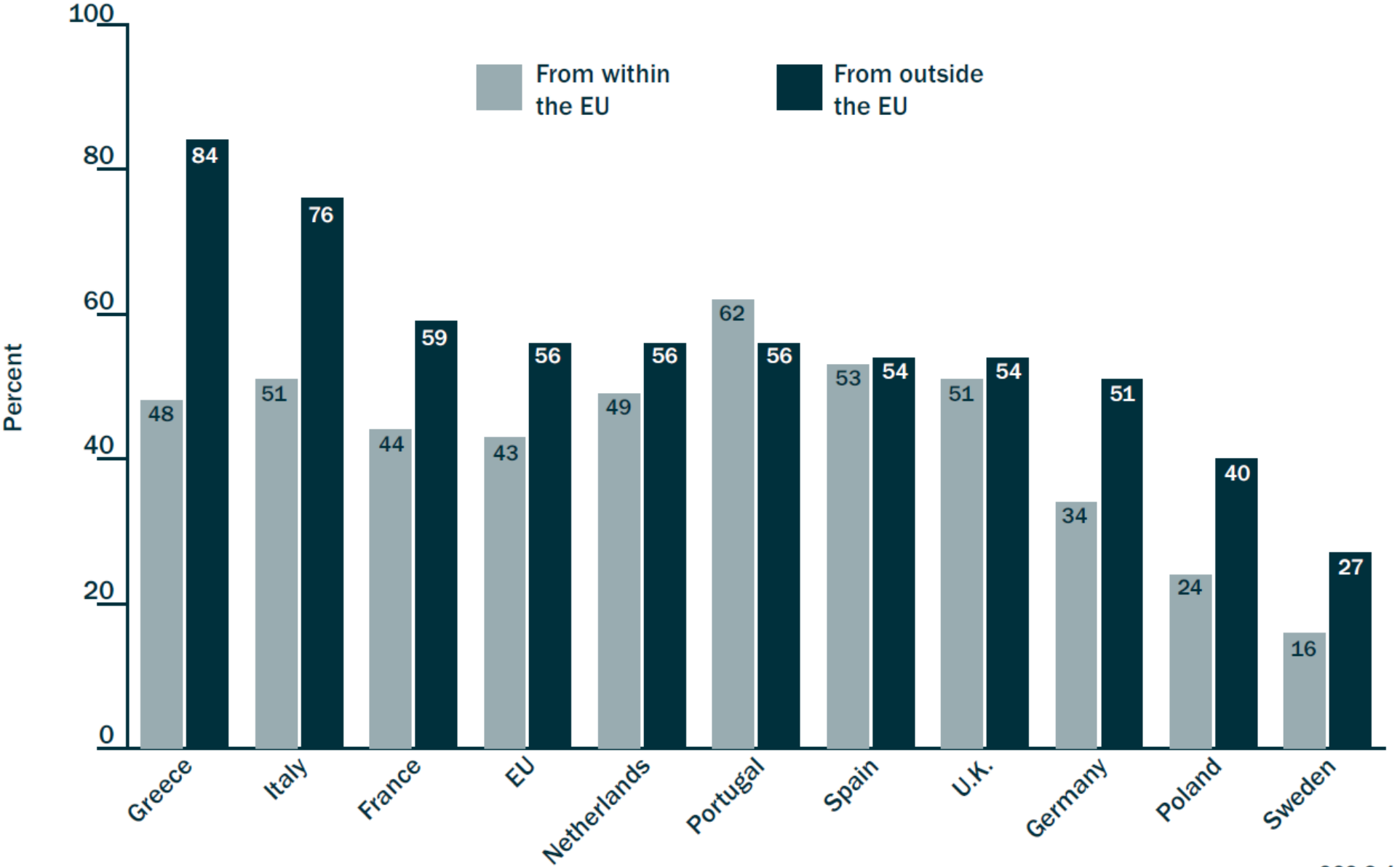
Chart 1: Government's Handling of Immigration



Q3.3

Source: Transatlantic Trends Immigration 2014

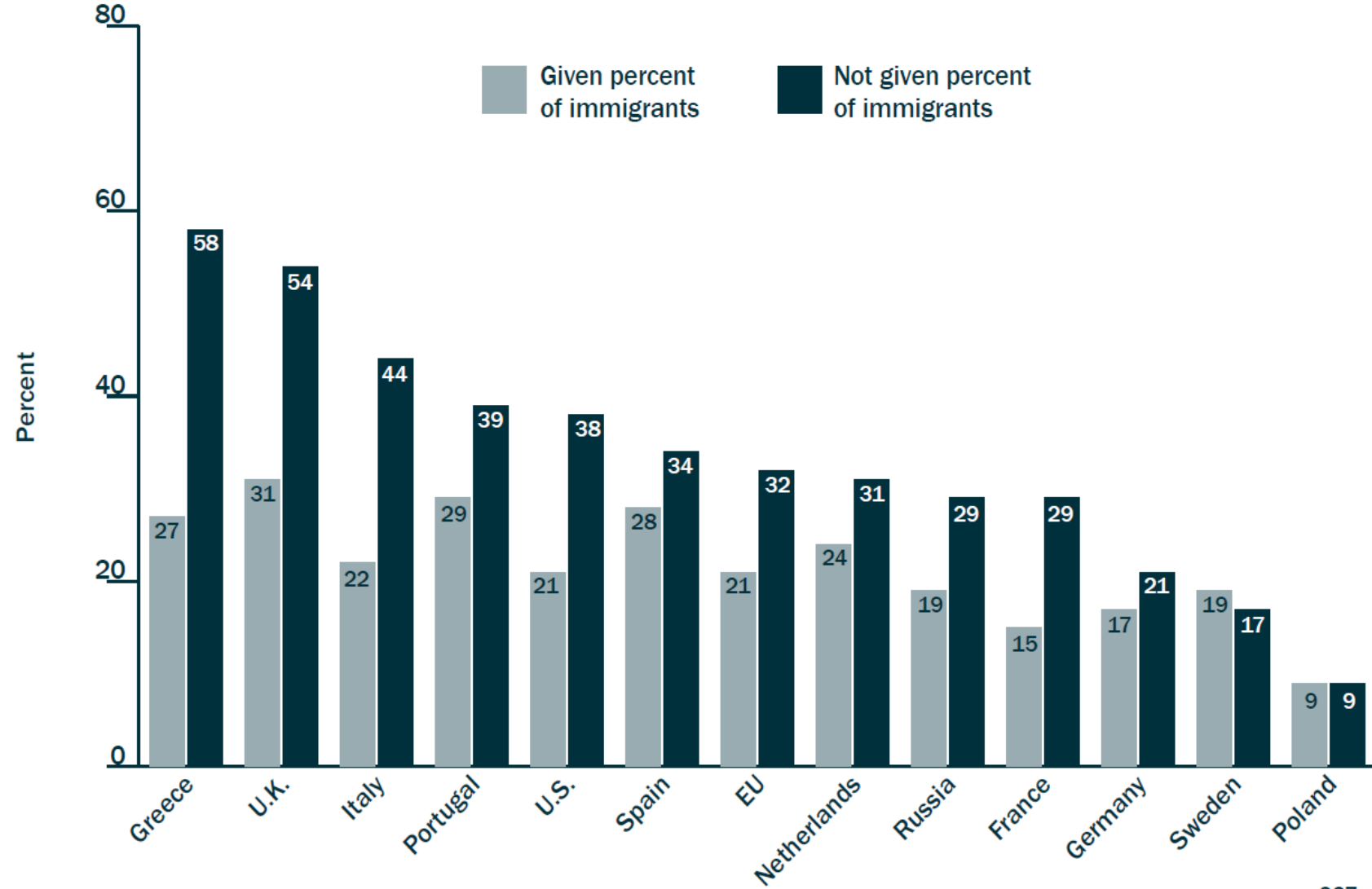
Chart 4: Concern about Immigration



Q29.3-4

Source: Transatlantic Trends Immigration 2014

Chart 3: Too Many Immigrants in Our Country



Q27a-b

Culture and economics

- Many Britons perceive the **EU as a cultural threat**:
 - 40% think the EU is 'undermining Britain's cultural identity'
- Britons also have a **weak sense of European identity** (only 16%)
- But they are **unpersuaded** that leaving makes economic sense
 - Impact on Britain's economy if Britain leaves the EU:
 - Positive 24%, negative 40%
 - Among those who think positive 72% support leaving, among those who think negative just 6% support leave
- **Concern about identity** is the strongest predictor of 'leave'

Source: British Social Attitudes, Curtice, *How Deeply does Britain's Euroscepticism Run?* 2015

- <https://www.youtube.com/watch?v=VQjYGFLawFw>

Major Export Markets for UK Goods and Services

			Export Sources	
	Country	Value £ million	% of Total UK Exports	Cumulative Percentage (%)
1	United States	37 364	12.7	12.7
2	Germany	30 730	10.5	23.2
3	Netherlands	22 367	7.6	30.8
4	France	19 089	6.5	37.3
5	Irish Republic	18 145	6.2	43.5
6	China	15 511	5.3	48.8
7	Belgium & Luxembourg	12 317	4.2	53.0
8	Switzerland	10 318	3.5	56.5
9	Spain	9 299	3.2	59.7
10	Italy	8 808	3.0	62.7

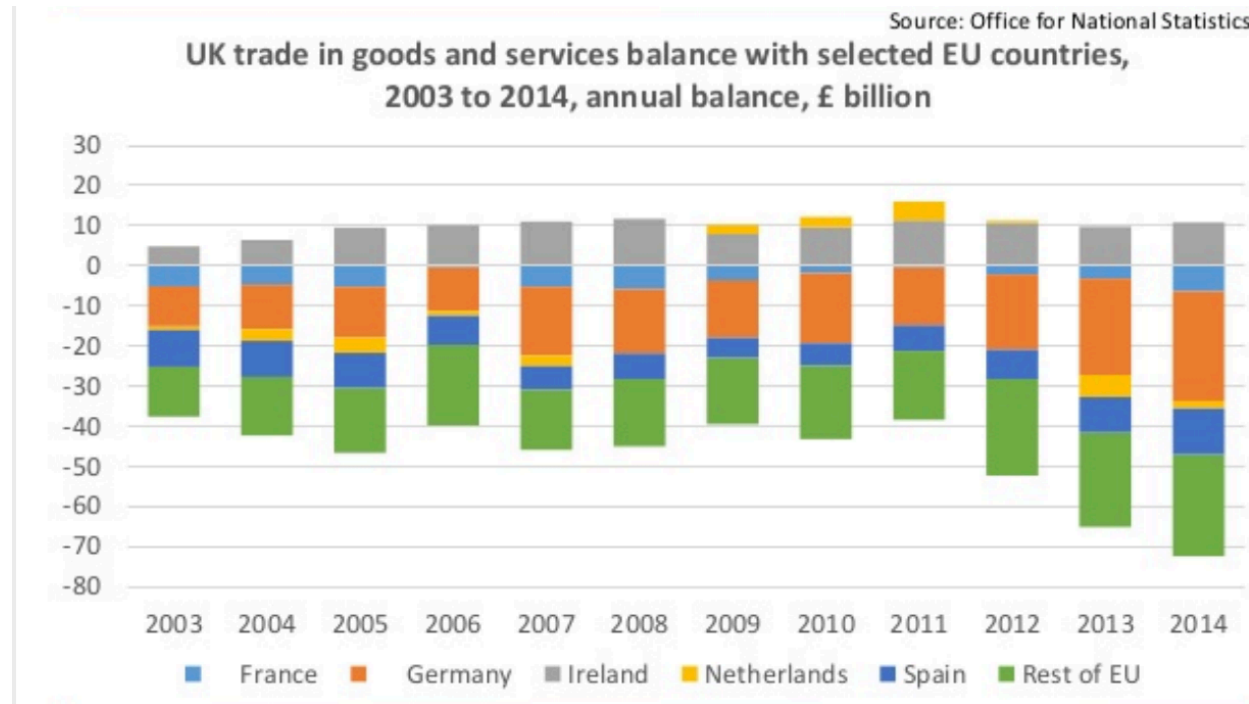
- Nearly a quarter of total UK overseas trade in goods and services is done with the United States and Germany.
- **Seven of the top ten** export markets for Britain are with European Union countries.
- This emphasizes the importance of a **trade agreement** after Brexit.

Major import sources for the UK economy

Import Sources for the UK				
	Country	Value £ million	% of Total UK Imports	Cumulative Percentage (%)
1	Germany	60 820	14.6	14.6
2	China	36 900	8.9	23.5
3	Netherlands	33 160	8.0	31.5
4	United States	28 283	6.8	38.3
5	France	25 274	6.1	44.4
6	Belgium & Luxembourg	21 443	5.1	49.5
7	Norway	18 489	4.4	53.9
8	Italy	16 581	4.0	57.9
9	Spain	13 813	3.3	61.2
10	Irish Republic	11 911	2.9	64.1

- Germany is the **biggest** source of UK imported products,
- Germany is the world's biggest exporter of manufactured products and UK consumers have a **high income elasticity** of demand for them.
- China is now the second biggest source of imported products for the UK.

UK Trade Balance in Goods and Services with the EU



- The UK runs a trade surplus with Ireland
- **Large trade deficits** with countries such as Germany and Spain.

Hard and Soft Brexit

- **Hard Brexit (No deal)**

- Means that the United Kingdom leaves the EU Single Market and trades under **World Trade Organization** rules
- Under WTO rules, each member must grant the **same market access**—including charging the **same tariffs**—to all other members as the most favored nation

- **Soft Brexit**

- Involves the option of staying in the **Single Market** (like Norway)
- As a member of the European Economic Area (EEA), Norway has a **free trade agreement** with the European Union, which means that there are no tariffs on trade between the two

A Future Outside of the EU – the Norway Option

- The so-called Norway option allows for the **free movement of goods, services, capital, and people**
- But Norway has **no formal input into shaping the rules** of the single market although all new rules must be adopted
- **Annual fee** is paid by Norway for access to EU single market
- Under the Norway option, all UK banking and financial service regulation would be ‘mutually recognised’ as good enough, and thus all EU members would have to automatically grant full **access to UK-based firms**
- Norway option does **not include free trade in food**, or participation in EU agriculture subsidies (CAP) or in the EU’s regional policy, and nor does it require Norway to adopt EU trade policies with respect to non-EU nations.

A Future Outside of the EU – Joining EFTA

- EFTA is the European Free Trade Area
- EFTA membership provides the UK with **less access to the Single Market** beyond goods trade
- Switzerland is the most prominent EFTA member and is required to strike **bilateral treaties** with the EU to secure access to the Single Market for **specific services** only.
- In 2014 the Swiss voted in favour of **restricting migration**. The EU has made it clear that this is incompatible with access to the Single Market.
- Switzerland makes a **smaller per capita contribution** to the EU budget than Norway in the EEA, to reflect the lower level of market access.

Outside of the EU – WTO Option & Unilateral Trade

- WTO is the World Trade Organisation
- UK will be completely **out** of the EU single market.
- It will face the EU's **external tariff** on goods and services in the absence of a comprehensive free trade agreement
- Gains in having **more control over migration policy** and freedom to trade with rest of the world including establishing free trade agreements with emerging countries
- Democratic control of UK laws and regulations

What trade deals will replace EU membership?



EU Countries likely to be most affected by Brexit

Country	Trade with UK measured as % of GDP	% of investment from the UK	Comment
Netherlands	7.6%	27.6%	Closely aligned in many EU policy debates; favours liberalisation of EU
Ireland	11.8%	7.5%	Most deeply integrated with the UK, only country with (soft) land border
Germany	2.8%	2.4%	High total value of trade, UK leaving increases political power of French
Spain	2.5%	6.0%	Around 800,000 UK expats living in Spain, big tourism and trade linkages

Possible Short-Term Impact of Brexit on the UK Economy

Impact	Comment
Weaker exchange rate (depreciation)	Sterling fell against US dollar and Euro in wake of Brexit vote Higher prices for imports Over 50% of UK imports come from EU, about half of which are intermediate goods such as component parts
High current account deficit	External deficit of more than 5% of GDP requires strong net inflows of capital on the financial account – perhaps to achieve this harder post-referendum because of macroeconomic uncertainty
Short run real GDP growth	Expected to take two years to negotiate EU exit terms after Article 50 There was a dip in confidence but the real economy stabilized fairly quickly helped by the depreciation in sterling
Housing market	Fall in confidence may lower mortgage demand Possibility of decline in overseas demand although weaker pound increases real purchasing power of US dollars in UK property market
Unemployment	Unemployment tends to be a lagging indicator of the economic cycle – a year after Brexit the unemployment rate fell to a new low of 4.6%

Micro Impact of UK leaving the Single Market



MICROECONOMICS

Point 1

The EU is a customs union and leaving it may lead to higher import tariffs on EU exports.

Higher import prices increase costs for UK firms who then experience lower profits. Consumer welfare would suffer

The assumes that the UK is unable to negotiate a wide-ranging free trade deal with the EU before Brexit is finalized



MICROECONOMICS

Point 2

Some UK firms and industries might suffer from a decline in net inward migration from EU

In sectors such as hospitality, technology and construction, EU workers have helped overcome skills shortages.

A fall in UK net payments to the EU could fund increased investment in better technical training for UK workers



MICROECONOMICS

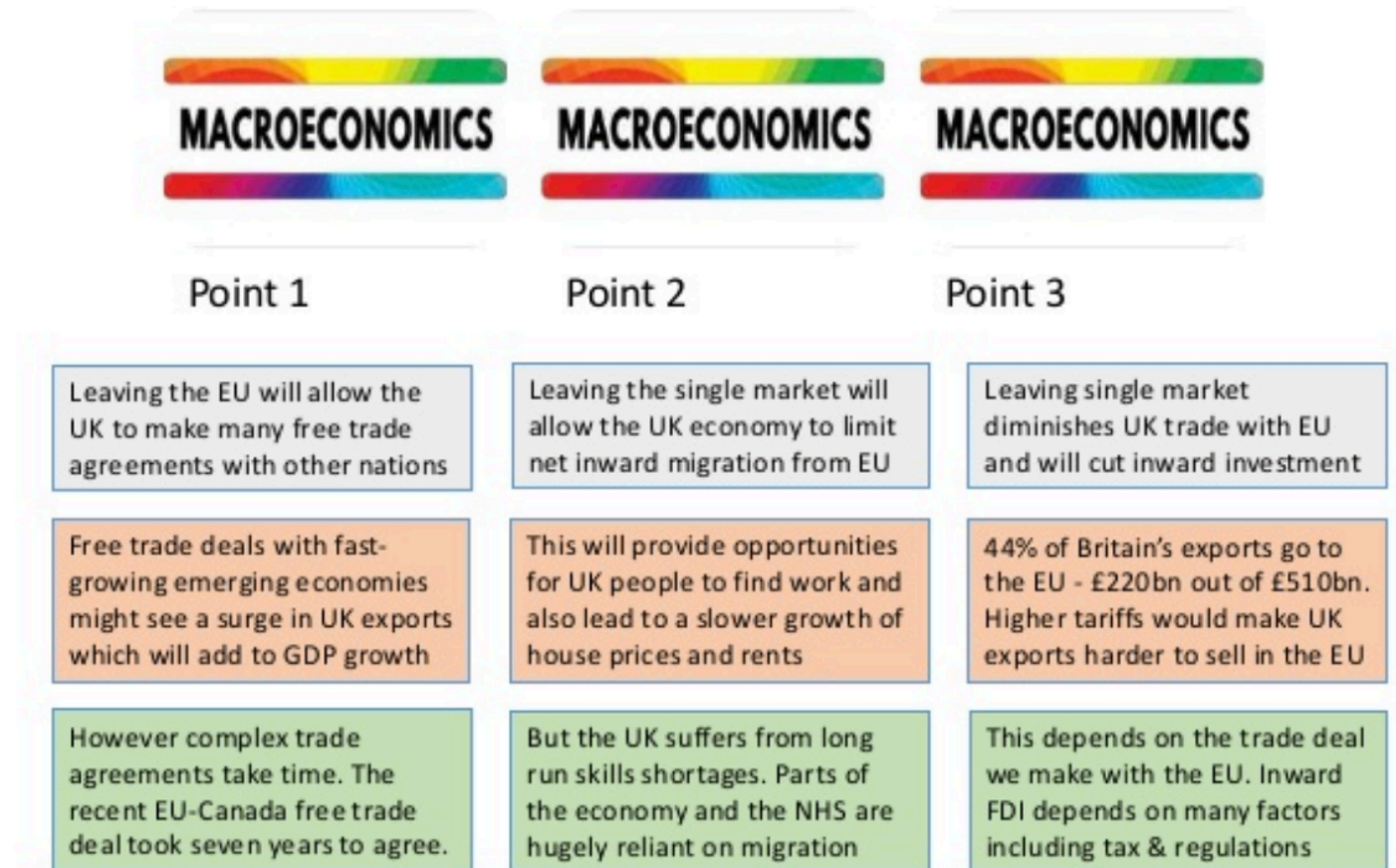
Point 3

Leaving the EU might cause delays at borders as UK firms comply with EU rules

Many products cross borders several times. Just in time delivery requires minimal border delays, costs will rise

Most UK exporters already comply with EU regulations. Post Brexit, businesses will have less red tape to deal with

Macro Impact of UK leaving the Single Market



Brexit: Some “it depends on” evaluation points

Post Brexit	Depends on scope / scale / timing of trade deals with EU and other countries. How strong will the UK's bargaining power be in discussions with EU27?
Will some owners of labour and capital successfully achieve their own Brexit from the UK once the terms of trade with the EU become clearer?	Depends on whether UK can keep significant numbers of highly-skilled EU workers post Brexit in industries in which the UK has comparative advantage + staffing the NHS
	Depends on the impact of Brexit on UK universities - in 2012, universities generated an annual output of £73 billion, contributed 2.8% of GDP and supported over 750,000 jobs
	Depends on the ability of UK manufacturing businesses to modify their existing supply-chains and their success in pivoting export sales to non-EU countries
	Depends on the extent to which the UK government is able to replace existing EU funding in areas such as research, farm support and workplace training initiatives
	Depends on the the impact of higher trade costs from being outside the EU on UK productivity and innovation - the long-run dynamic effects might be bigger than the static effects e.g. on consumer prices

Was the EU good for Britain?

The EU was good for Britain

The UK had the slowest growth in prosperity in the G7 before EU membership ...

Annual average increase in GDP per head (%)



... but has had the fastest growth since

Annual average increase in GDP per head (%)



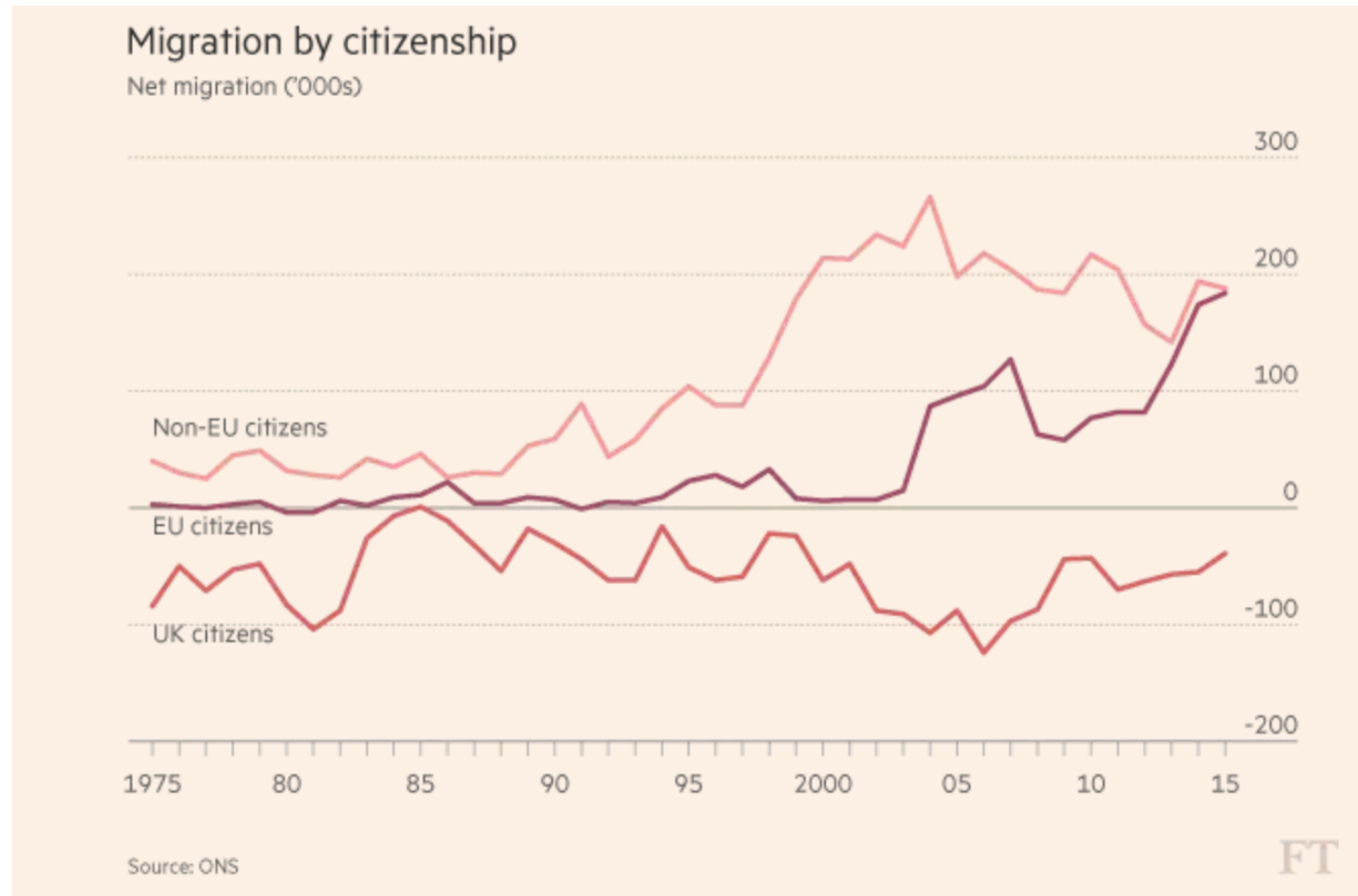
Source: The Conference Board

FT

Margaret Thatcher's reforms or the EU?

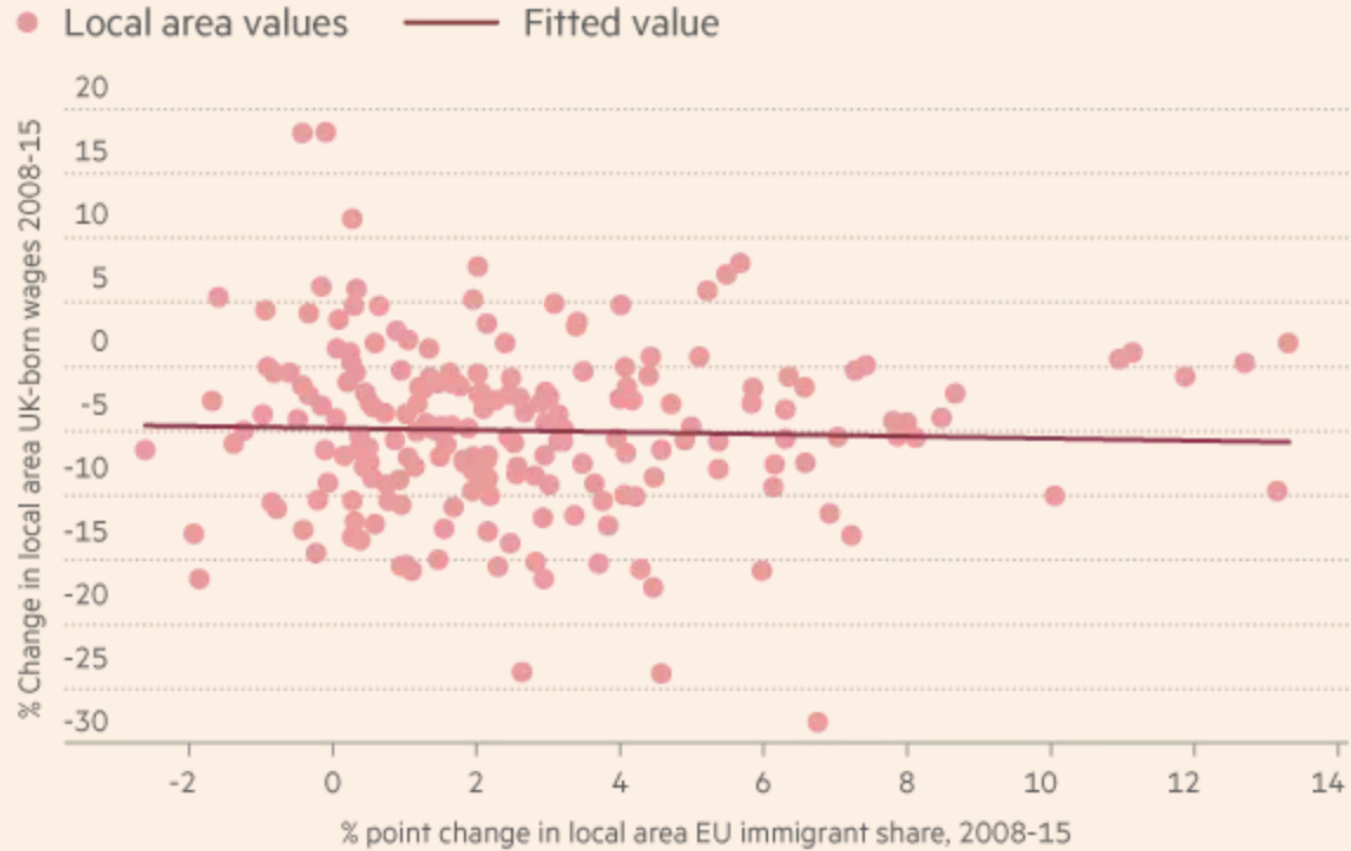
The EU directly raised UK prosperity by about **10 per cent**, largely due to **increased competition** and better access to the **single European market** (Nick Crafts, University of Warwick).

Can Britain cut migration significantly?



Do migrants reduce UK wages?

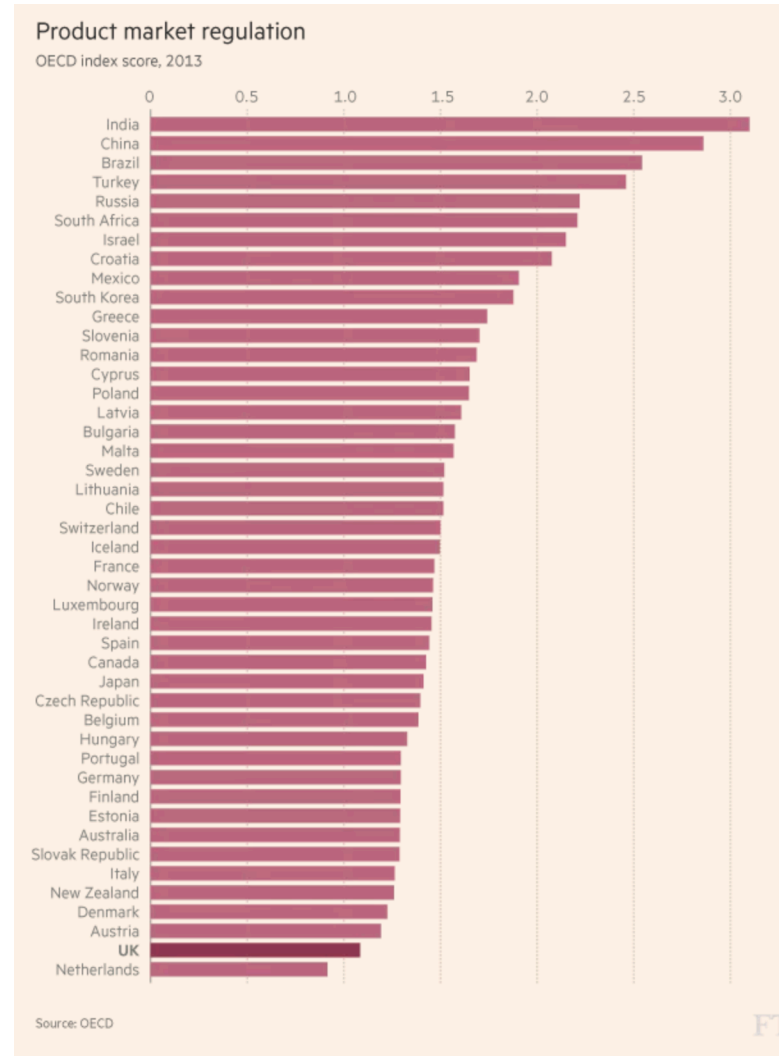
Wages of UK-born and EU immigration



Sources: CEP, LSE

FT

Were EU regulations a yoke around the neck of the UK economy?



Forecasts of effects of the UK Leaving the EU

The consequences of Brexit for UK trade and living standards

Swati Dhingra, Gianmarco Ottaviano,
Thomas Sampson and John Van Reenen

HOPEBREXIT

The costs of reduced trade far outweigh the fiscal savings in both scenarios. In cash terms, the cost of Brexit to the average UK household is £850 per year in the optimistic scenario and £1,700 per year in the pessimistic scenario.

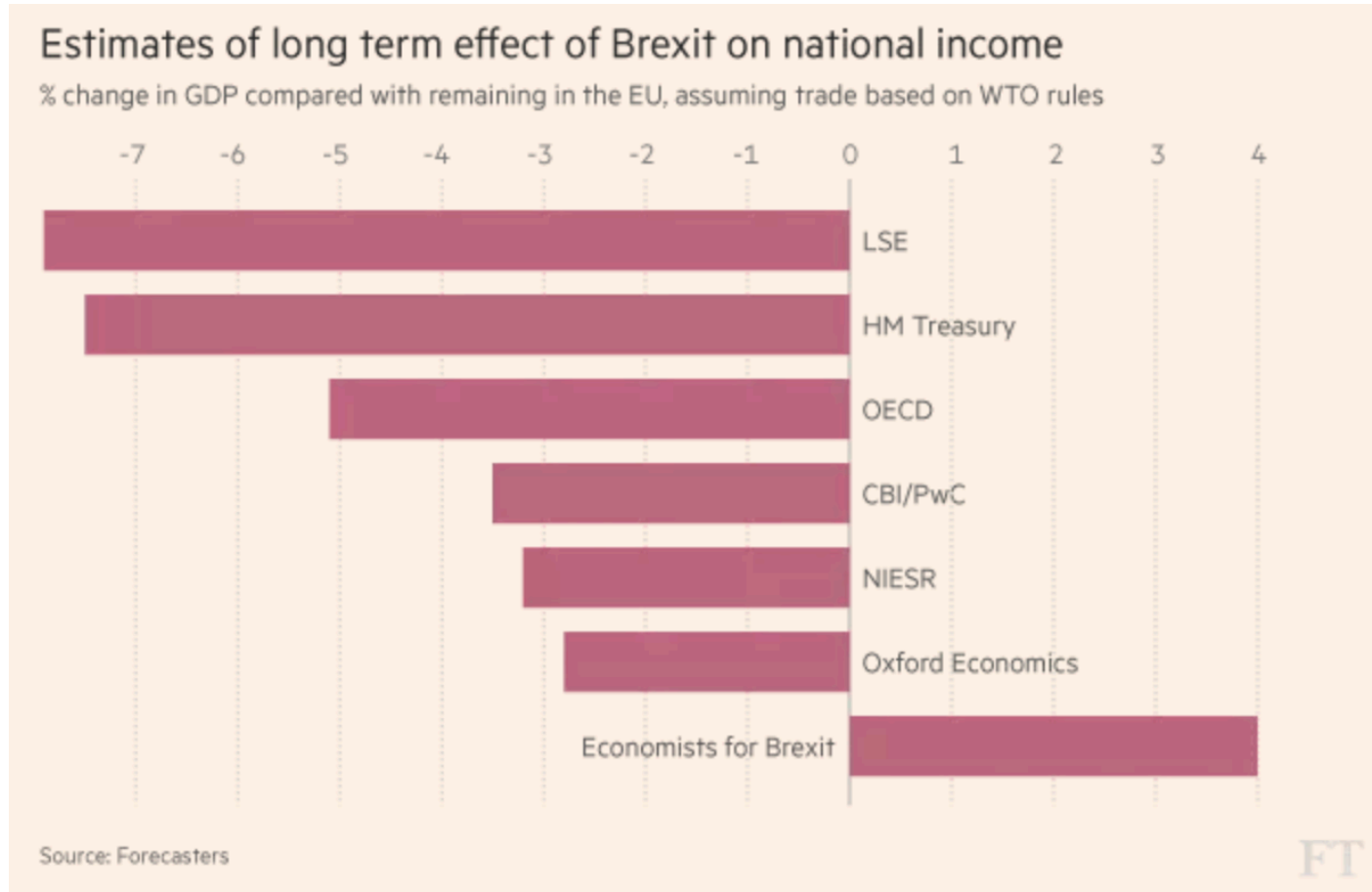
Table 1: The effects of Brexit on UK living standards

	Optimistic	Pessimistic
Trade effects	-1.37%	-2.92%
Fiscal benefit	0.09%	0.31%
Total change in income per capita	-1.28%	-2.61%
Income change per household	-£850	-£1,700

Source: CEP calculations (see Dhingra et al, 2016, for technical details).

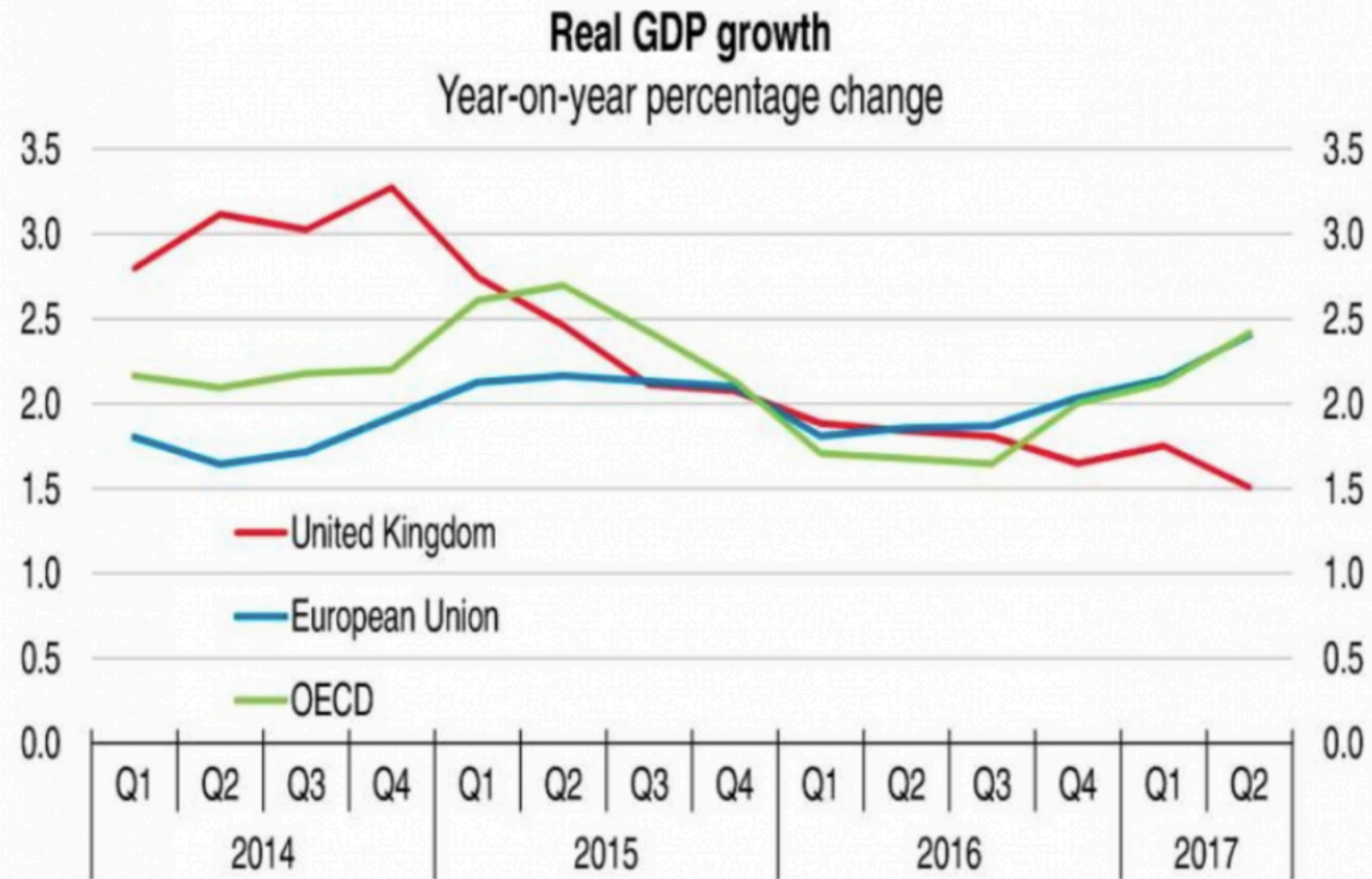
Notes: *Optimistic scenario:* Increase in EU/UK Non-Tariff Barriers (+2%) + exclusion from future fall in NTB within EU (-5.7%), saving of 17% of 0.53% lower fiscal transfer. *Pessimistic scenario:* MFN Tariff + increase in EU/UK Non-Tariff Barriers (+6%) + exclusion from future fall in NTB within EU (-12.8%), saving of 0.31% net fiscal transfer.

Long-term effects of Brexit



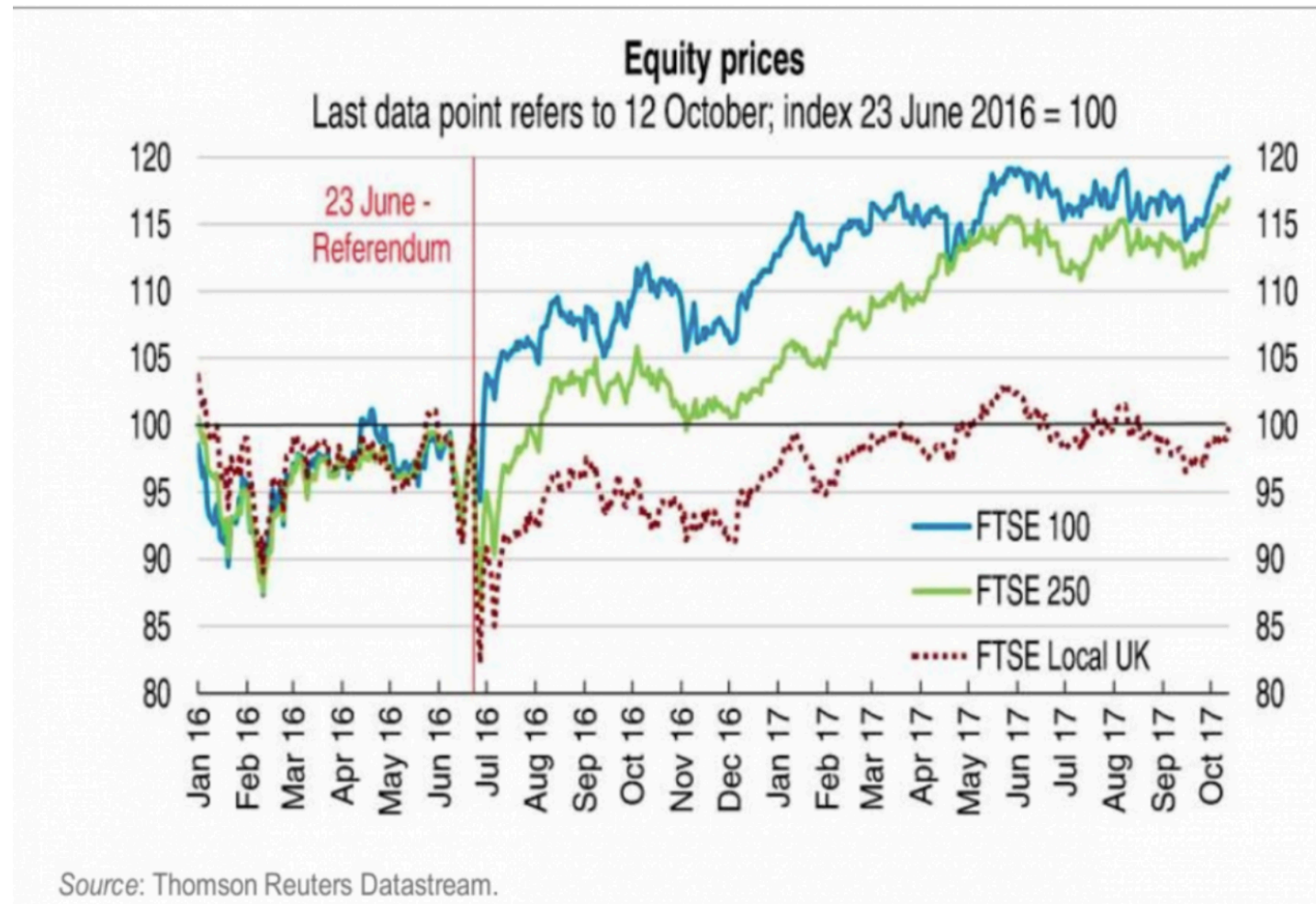
How has the Brexit vote affected the economy?
Some evidence

GDP growth has slowed

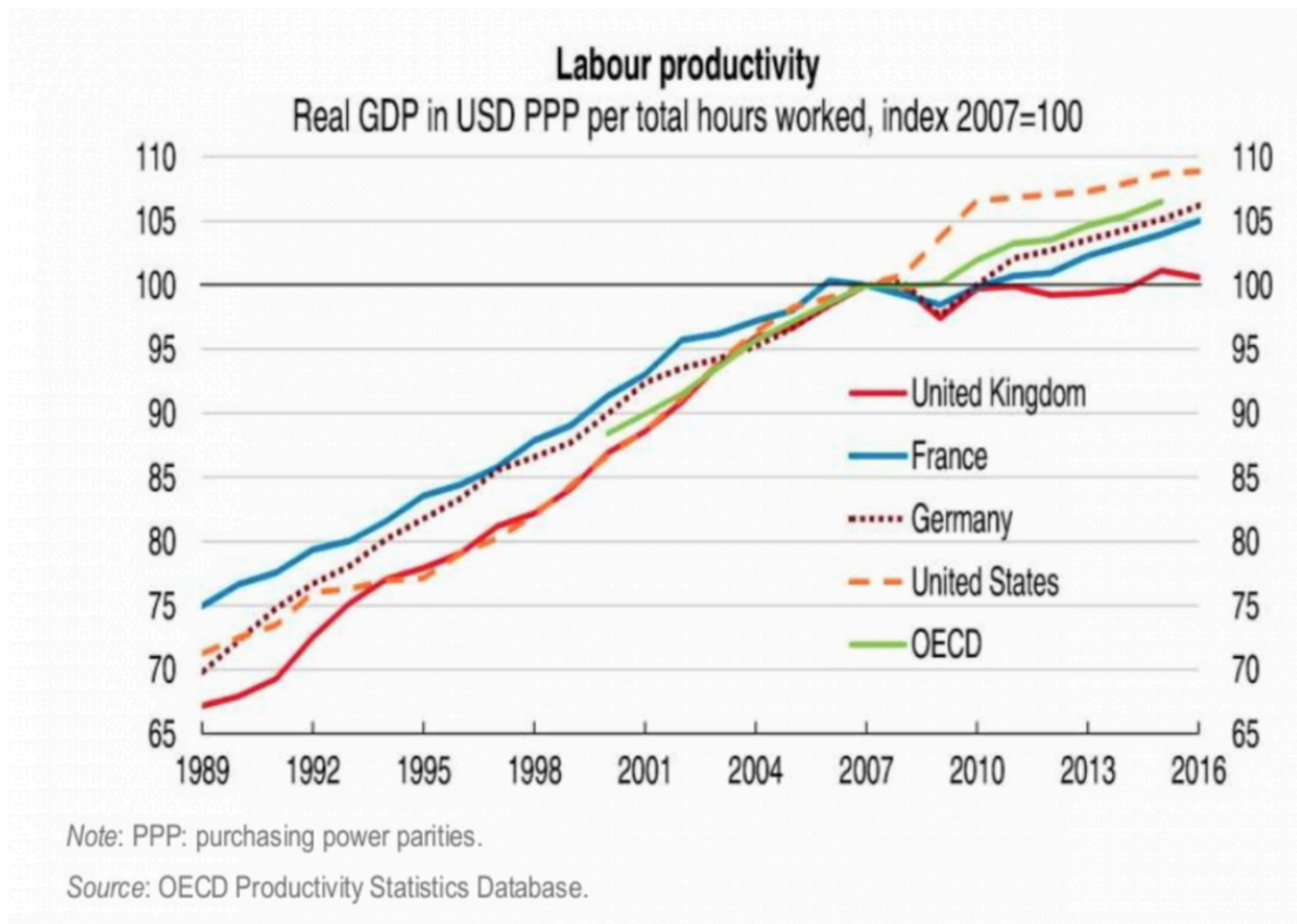


Source: OECD Economic Outlook: Statistics and Projections Database.

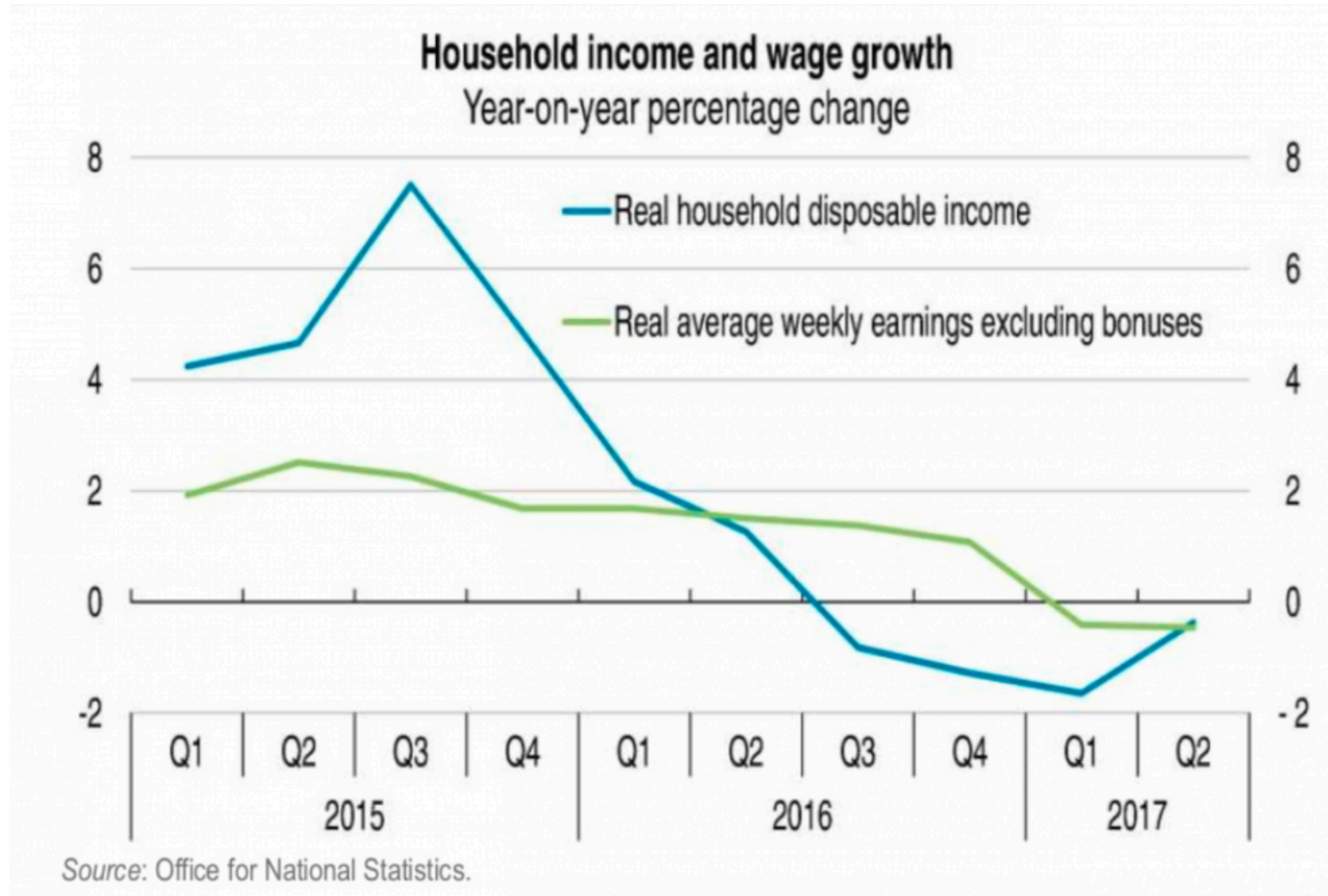
Valuation of UK-oriented firms are lower



Labour productivity is at a standstill



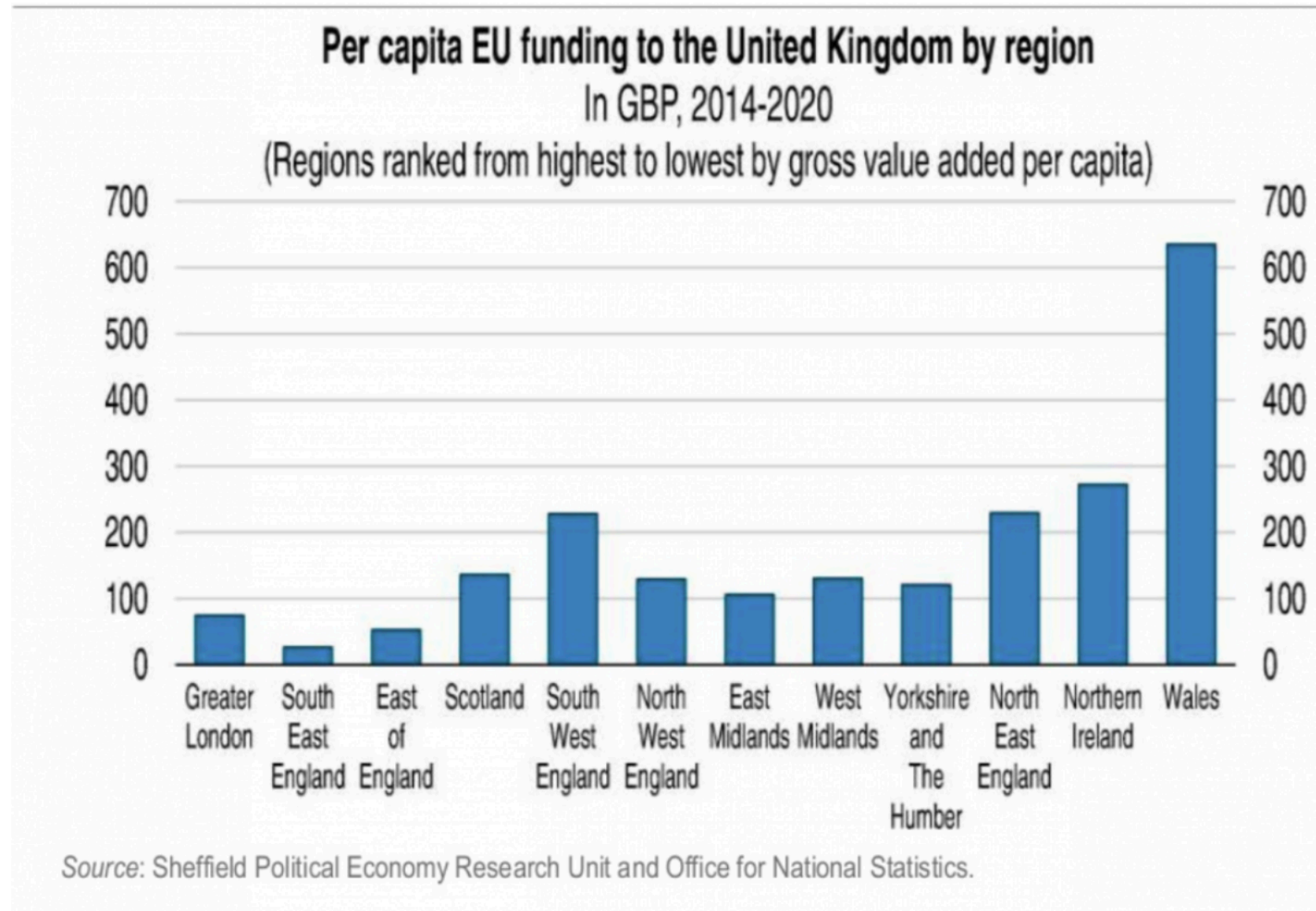
Higher inflation has reduced real incomes



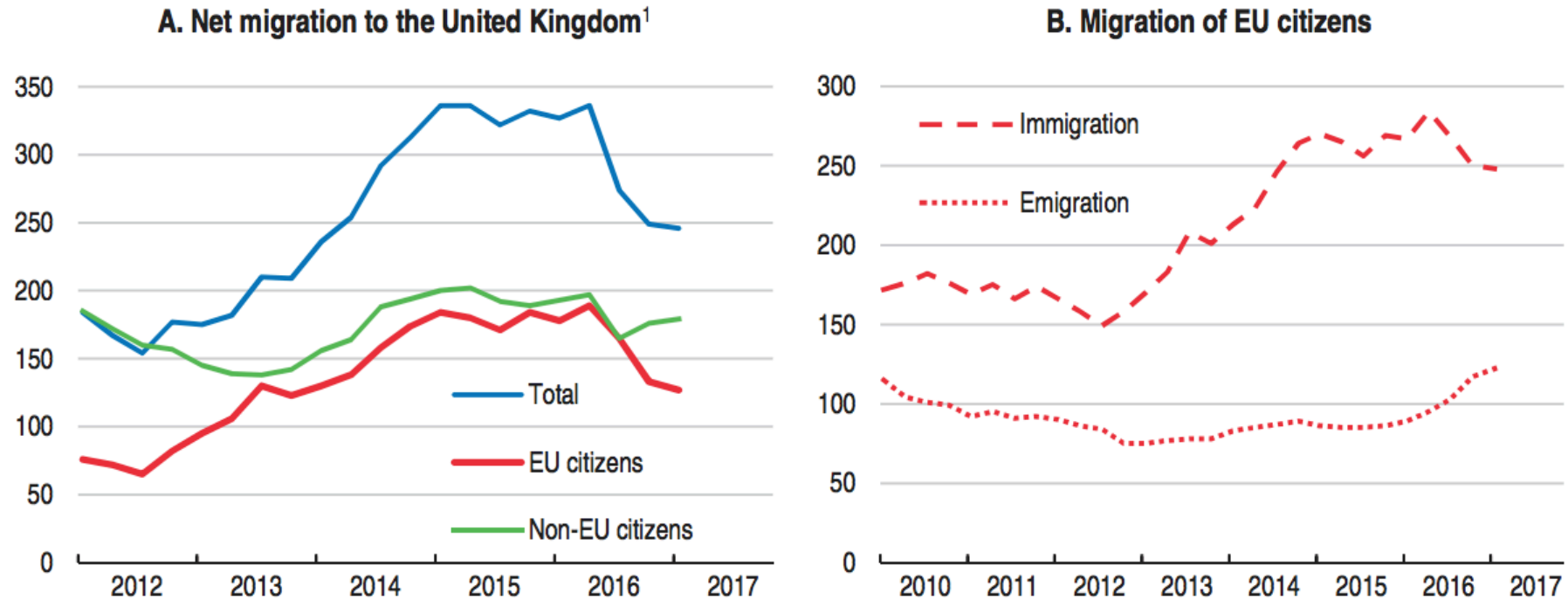
Sterling's fall may not restore competitiveness



Lagging regions rely more on EU funds



Lower immigration from EU



1. Net migration is the difference between immigration and emigration.

Source: ONS (2017), "Migration Statistics Quarterly Report: August 2017", Office for National Statistics, August.

What has happened until now

- The Parliament has voted (twice) against the negotiated deal with the EU
- The Parliament has voted against a no deal
- The PM has asked the EU for a short extension (29th June 2019)
- The EU has to concede the extension by unanimity (all 27 countries)
- If a deal is not agreed by 29 March 2019 or an extension is not conceded: the UK will be leaving the EU without a deal
- The main issue being the Irish backstop:

<https://www.youtube.com/watch?v=1cfl5on5n84>

Today

Brexit: EU and UK reach deal but DUP refuses support

🕒 21 minutes ago | 📄 4541

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Brexit



Conclusions

- We have briefly looked at the history of the European Union
- We have identified the main characteristics of the European Union
- We have discussed what is Brexit and the future possible scenarios for the UK outside the EU
- We have analysed the way Brexit is already affecting the UK economy