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THE POTENTIAL IMPACTS OF BREXIT ON THE UK ECONOMY

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ABSTRACT

The article examines the potential economic effects on the United Kingdom (UK) following its decision to leave the European Union (EU) known as Brexit. The current article starts with analyzing the important impact of the uncertainty caused by Brexit over the economy of the United Kingdom. The key points of the Brexit agreement achieved between the UK and the EU would be also explained. In the last part economic forecasts related to the economy of the UK would be presented and analyzed in order to better understanding how large the economic impact of Brexit could be. Research methods involving both qualitative and quantitative data were mainly used to write the research article and analyze its purpose. The Statistical analysis is introduced to prove the impact of Brexit event on the economic performance of the United Kingdom and also for measuring the effects caused by the uncertainty during brexit transition period on the behaviour of firms' investment decision and the evolution of other variables. The practical importance of the current article is related to it's main subject; Brexit which which is a new form of desintegration and its impact on short and long term on the United Kingdom's economic position. The results obtained could be also used to predict cosnequences of such decisions of desintegration on the involved countries in future scenarios.

Keywords: BREXIT; United Kingdom; European Union; Economic effects; Economic (dis)integration.

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INTRODUCTION

On 23 June 2016, the United Kingdom (UK) citizens expressed their opinions on the future of their country within the European Union (EU) which is called the "BREXIT". This event which is a first in history, represents a turning point in the relationship between Europe and the UK All along it membership. BREXIT refers to the idea of an exit of Britain from the European Union. This idea has been present for decades in a large part of British opinion, Great Britain, which has never been part of the Schengen area and has never adopted the euro currency, has moreover always kept its distance from particular EU treaties since its creation. Mrs. Margaret TATCHER former prime Minister of the United Kingdom has always expressed this mistrust regarding the European authorities.

Bulmer and Quaglia (2018) provided an understanding of the background to Brexit and examined the turbulent relationship between Europe and the UK arguing that the challenges in the UK's relationship with the EU have come from the EU itself: de Gaulle's two rejections of membership (in 1963 and 1965); the policy inadequacies that the European budgetary system and the Common Agricultural Policy have presented for the UK and other conflicts have emerged from many mutual misunderstanding or contradictory values. All this has led to the need of disintegration by the UK.

The separation was done in two stages. On January 31, 2020, the country officially left the European Union, thus ending its participation in its decisions. But it was not until December 31, 2020 that the bulk of the changes took place. The year 2020 was therefore a "transition period", during which the country maintained most of its ties with the Union. However, there were still a few details to settle, because 45 years of living together could not easily have erased. For several years full of twists and turns, the British and Europeans fought hard to agree on what would change when they got divorced... and what they would put off until later.

Before reaching the agreement, Brexit caused a big debate in the UK and divided the country into two large groups in one hand a group of "Brexiters" who a group of people who support the decision to leave the EU and in the other hand there is "Remain" group or "Remainers" who believe in the EU project and are against the Brexit. Brexit was motivated by seeking the economic independence; According to Day (2018) "while there are obvious economic benefits of EU membership for the United Kingdom, such as boosting trade by eliminating barriers, the Leave campaign framed EU membership as a direct hindrance to the growth of the national economy" (p.34).

Minford (2019) provided an analyze which is in favor of Brexit. It argued that leaving the EU leads to the removal of EU protection, which drives down consumer prices and increases competition in the UK's domestic market, and thus the productivity of home industries. With a fully employed economy and a floating exchange rate, any job losses in those industries where higher productivity frees up the workforce will be compensated by extra jobs in other (unprotected) industries where productivity is already high, and demand is expected to increase.

The debate was about the potential consequences of this big decision on the future of the United Kingdom. The debate was intense through many publications issued by universities, government, political parties, companies, think-tanks and observers from the inside and outside the UK, especially from the EU. Therefore, an atmosphere of uncertainty has been shaping and impacting in a negative way the Economy of the UK. Uncertainty has impacted enterprises' financial and investment decisions; consumption behaviors of households was also shacked by Brexit uncertainty.

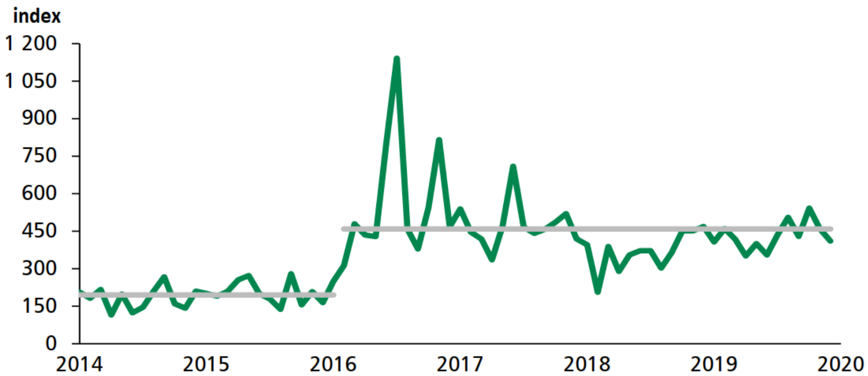
Uncertainty was based on two scenarios; the first was described as a "Soft Brexit" which means that a deal would be reached which will maintain access of UK to the European single market. The second scenario is the "Hard Brexit" or no deal which was the worst scenario for UK's citizens and officials. Coutts et al. (2018) concluded that much of works providing predictions contains analytical faults, and a processing of evidence that leads to overrated costs of Brexit also the short-term forecasts which have turned out to be wrong have further damaged confidence in economists' contributions to public debate.

1. ECONOMIC IMPACT OF UNCERTAINTY

The beginning of the 2016 referendum campaign has immediately increased economic uncertainty in the UK, which then spread to British economy. Uncertainty simply means the lack of certainty or confidence of an event. In accounting, uncertainty refers to the inability to forecast consequences or outcomes because there is a lack of knowledge or bases on which to make any predictions.

Before the referendum, UK was one of the strongest economies among the major advanced countries. However, starting from 2016, the UK's real GDP was less than that of the euro zone or the United States.

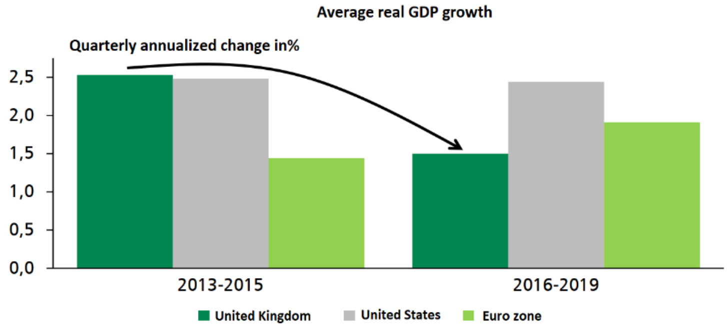
Figure 1: UK- Index of Uncertainty of public policies



***Source**: www.policyuncertainty.com*

Despite the fact that the Brexit was not yet occurred, the uncertainty surrounding the future of UK-EU relationship was high. The economic policy uncertainty index (EPU) recorded an unprecedented increase at the moment of the referendum in 2016 and since then has been maintained at relatively high levels in comparison to historical levels. These concerns would have already implicated a change in the behavior of firms and households, some of which have been contributing to the slowdown in UK economic activity observed since 2016.

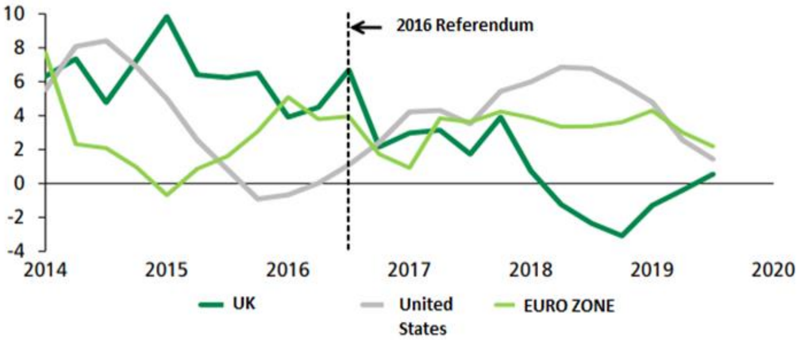
Figure 2: Average real GDP growth between 2016 and 2019



Sources: *Office for National Statistics, Bureau of Economic Analysis, Eurostat*

Short-term macroeconomic forecasts by the Bank of England were too pessimistic it assumed that the referendum results would create greater uncertainty in markets and reduce consumer confidence more than it did. Uncertainty escalated from the beginning of the 2016 referendum campaign and has remained high since that time. We can see in figure 3 that growth has clearly decreased since 2016 in the United Kingdom.

Figure 3: Effects of uncertainty on UK's firm's investment



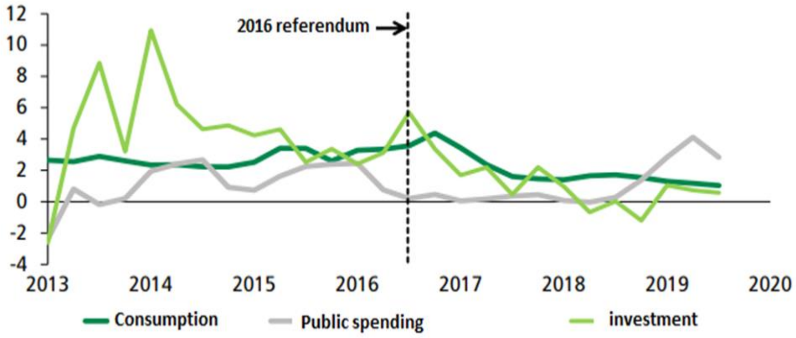
Source*: Office for National Statistics*

Firms are usually sensitive to the political-economic environment when making new investment plans. Given the uncertainty surrounding future relations between the United Kingdom and the European Union, firms tended to choose a cautious strategy and suspend renewal of their investments until they are confident that the investments made will be beneficial. Business investment has stopped growing since the Brexit referendum. According to Bloom (2016) "this Brexit-induced slowdown is partly driven by firms pausing new investment and hiring projects until the future status of the UK is clear – if uncertainty is high and will soon be resolved, it pays to wait to see what the future brings" (p.2). Uncertainty pushed many companies to think about moving their assets, offices, or businesses operations out of Britain and to the rest of Europe. Uncertainty has affected business investment of the UK British companies. Businesses are not the only ones concerned by the bad news phenomenon. Uncertainty about future income flows since it can be related to employment opportunities has made households to postpone consumption.

GDP of the UK was expected to shrink by 1.23% and 2.53% under a soft and hard Brexit respectively. In comparison, for the EU-27, the decline in GDP would be much smaller: 0.16% and 0.35% respectively soft and hard Brexit. Changes in non-tariff barriers (NTBs) represent the highest proportion of the total negative impact, and changes in FDI also have an important role;

they contribute around one third of the decrease in GDP and private consumption in the UK and the EU. After a calm period in 2018, uncertainty has been increasing during 2019. This was because all year long, a lot of attention was turned to the Brexit. Initially, the official date of exit from the EU was to be March 29, 2019, two years after the British government mentioned Article 50[4] of the Treaty on European Union.

Figure 4: Effects of uncertainty on UK's domestic demand



Source: *Office for National Statistics*

Given that the British Parliament was unable to adopt the deal negotiated between Mrs. Theresa May's government and the EU, the risks of a no-deal Brexit increased significantly in late winter 2019. To avoid this possibility, an initial rescheduling of the Brexit deadline took place date to April 12. Again, in a parliamentary deadlock, a second postponement was requested by the British, until June 30, but the EU instead granted a delay until October 31. The ongoing impasse led to a further extension to January 31, 2020, and a general election, which took place on December 12.

The approach of the first Brexit deadline caused major fluctuations in the economy. Firms have been preparing for the EU exit, mostly by storing up inventory to avoid post-Brexit complications.

Household and businesses confidence has been relatively low for most of the year. The PMI[5] indexes fell below 50. The drop in the manufacturing index is quite normal, given that such a decline has occurred in most economies due to the rise in trade tensions. However, the U.K. was experiencing more problems with its service sector.

The UK's vote to leave the EU has generated a high, broad, and sustained increase in uncertainty. When compared to previous uncertainty shocks, the Brexit stands out for its continued high level of uncertainty. Moreover, the anticipation of the Brexit gradually reduced the investment rate by around 11% in the three years following the June 2016 referendum; increased and persistent uncertainty may have slowed down the companies' response to the Brexit vote.

Many economic researches argued that the Brexit process is estimated to have reduced UK productivity levels by 2-5% in the three years following the referendum; companies may be spending several hours a week on planning and making future adjustments to Brexit.

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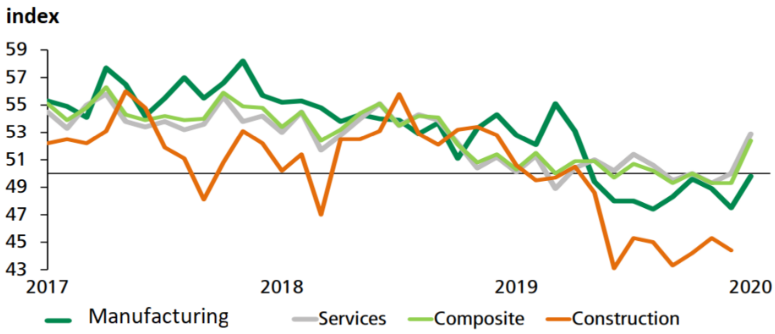
4 Article 50 is a clause in the European Union's (EU) Lisbon Treaty that outlines the steps to be taken by a country seeking to leave the bloc voluntarily

5 The Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors

Figure 5: UK PMI indexes all fell below 50 during 2019



***Source** : https://ec.europa.eu/eurostat*

In fact, Firms that consider Brexit a downside are expected to face concrete difficulties for their companies due to divergent regulations, lower labour mobility, limited access to trade and the post-Brexit adjustment of their businesses. Managers are making policy adjustments in the wake of increased Brexit uncertainty, lowering investment rates and hiring.

2. POTENTIAL IMPACT OVER THE ECONOMY OF UK AFTER THE BREXIT

After the Brexit Agreement Signed on December 24, 2020, between the European Union and the United Kingdom, the new "trade and cooperation" agreement between the two parties entered into force on January 1, 2021.

The UK left the European Union permanently. And it has become clear that the Brexit is already driving broad economic change. And there seems to be no end in sight. Although, this new agreement would not achieve the same degree of cooperation as when the UK was a member of the EU, it goes far beyond conventional free trade. So, it took almost five years and two prime ministers and created a huge rift in British politics. But finally, Brexit is over. UK has reached a deal with the European Union. It's more than just trade, though it covers everything from food to immigration, from fishing to counter terrorism.

Some of the main things that are going to change. First off, there is the impact on trade and business. The UK will leave the EU single Market and Customs union for some companies that will mean adapting to new rules and potentially doing more paperwork as well. But the UK government says under this deal it will avoid any trade tariffs. That means that companies trading between the UK and the EU will not have to pay extra fees. In fact many firms, facing years of uncertainty after the Brexit referendum, expressed relief that the deal appears to avoid the trade and economic disruption that a “hard Brexit” on World Trade Organization (WTO) terms was expected to cause. (Congressional Research Service Reports.2021)

Immigration which was one of the main issues debated in the run up to the Brexit referendum, and this New Deal does what many Brexit supporters wanted by ending the free movement of workers coming into the UK. Instead starting on first of January, UK will have a points-based immigration system. That means foreign citizens will have to satisfy some criteria in order to come and live in the UK, but it will be made easier for workers and skilled persons doing a job in which the UK has a shortage.

Fishermen from EU countries have access to British waters, but under the new deal the government declared that EU's fishing rights will be reduced and then after a few years we'll be able to negotiate the arrangement each year. The UK's annual membership fee for the EU will end, but there are some bills UK do still own that will have to pay off. And if it wants to join any EU schemes like scientific research, then that will also come into cost.

Trade

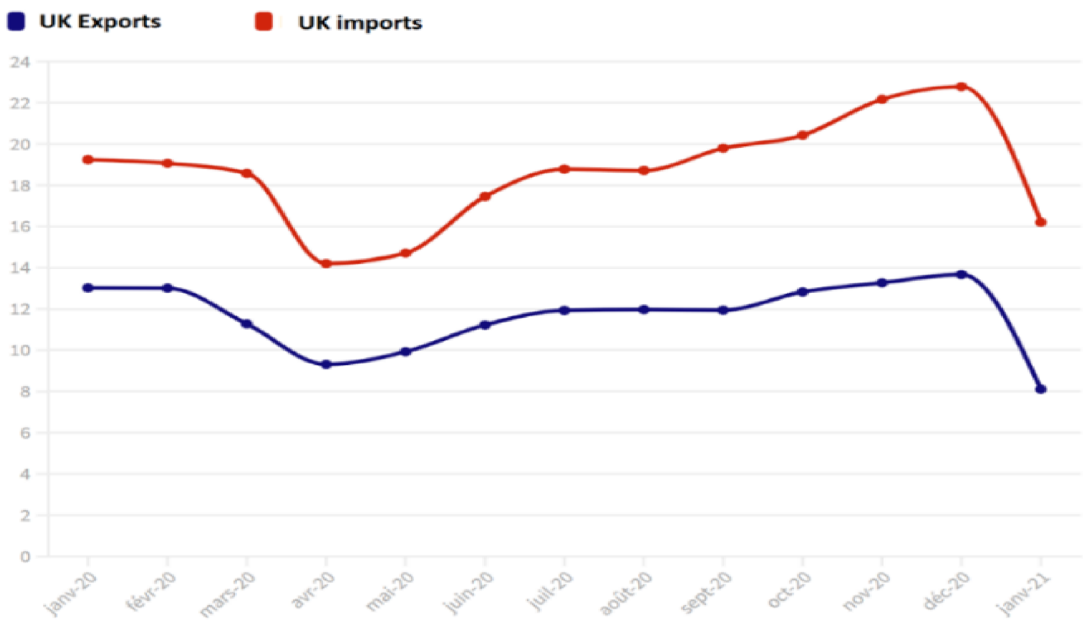
According to many observers and researchers, EU membership had an enormous positive impact on trade and, as a result, the UK's trade would be in bad situation outside the EU.

It is argued that" EU membership has increased welfare in the UK, because in general, it has created more trade than diverted. Therefore, the trade creation caused by the EU is going to be partially disrupted by Brexit" (Garcia Izu, 2017, p. 38).

The Brexit is turning UK's trade upside down. The UK was importing more goods from outside the EU than from the single European market for the first time, according to official statistics. This phenomenon was observed for the first quarter and is unseen since the publication of these data began in 1997, the National Statistics Office points out. The UK imported 53.2 billion pounds' worth of goods from countries outside the EU, compared with 50.6 billion from those in the European single market, which the country left on Jan 1.

Although, the UK is not part of the EU customs union, then exporters may still face additional costs to accomplish the required paperwork to justify the origin rules. EU is also offering more restricted access to financial services and other markets to companies based outside the single market. The economist Paul Krugman, Brexiters claims that leaving the single market and customs union could impact positively UK exports to the rest of the world are wrong. He considers the costs of Brexit might be around 2 per cent of GDP. According to Dhingra et al. (2017) "in all our scenarios we find that lower trade due to reduced integration with EU countries is likely to cost the UK economy far more than is gained from lower contributions to the EU budget" (p.35).

Figure 6: Effects of uncertainty on UK's overseas trade



Source: *Office for National Statistics*

Foreign Direct investments

Leaving the EU could affect the attractiveness of the UK to foreign investors. There are at least three reasons why FDI in the U.K. may have been boosted by EU membership - and thus why it could be reduced after the Brexit.

1. The free movement of capital which is one of the "four freedoms" at the structure of the EU's single market which has been an advantage making it easier for investors from other EU member states to invest in the U.K.
2. Membership of the EU single market makes the UK an appealing export platform for multinational firms. Thus, they can take advantage of the UK's relatively attractive business environment, while trading freely within friction free trade scheme with the rest of the EU members.
3. Operating from an EU country is particularly attractive for large companies that have complex supply chains or networks of subsidiaries established in different EU countries.

The value of many assets has already been impacted by investors' concerns about the repercussions of Brexit. Wider uncertainty about future economic and policy developments has been linked to an increase in sovereign and corporate bond yield spreads (Baker et al. 2016a), as well as increased asset price volatility (Kierzenkowski et al. 2016).

The Brexit will likely have a negative impact on inbound FDI. Therefore, leaving the EU will reduce inward FDI to the UK by about 22 percent. According to Simionescu (2018), "the Brexit will negatively affect the number of FDI projects, but also the new and safeguarded jobs generated by these FDI projects" (p.18). However, economic observers argue also that in case of an UK economy that grows faster outside the EU with a still competitive exchange rate could prove just as attractive to foreign investors. Foreign-based companies are setting up production facilities in the UK to increase their profits by producing goods they can sell in the UK and other countries, using the skills and capabilities of a well-trained and flexible workforce. (Baimbridge & Whyman, 2017)

Impact on Services Sector

The United Kingdom's economy is highly dependent on the service sector, which is the engine of the economy, employing over 81% of the labour force and contributing over 71.3% of GDP.

Table 1: Composition of UK's economic activity by sector.

Composition of economic activity by sector	Agriculture	Manufacturing	Services
Jobs by sector (% of total employment)	**1,0**	**17,7**	**81,3**
Added value (in % of GDP)	**0,6**	**17,4**	**71,3**
Added Value (annual growth in %)	**-1,1**	**-0,2**	**1,8**

Source: *World Bank, 2017*

The City of London is considered as "wall street" of UK it is the beating heart of the UK economy as it generates 13% of UK's total GDP. Although the Brexit took effect on 1 January, the future of the City of London the world's leading financial marketplace is still to be decided. For UK financial services, the bilateral negotiations have only just begun. And this key sector for the UK economy is at risk of further chaos.

Following the uncertainty of a large reduction in financial transactions with the EU more than 400 UK financial firms have relocated their operations, workers and £1 billion (€1,150 billion) of assets to financial markets in the European Union. Moreover, it is estimated that 7,400 jobs have been moved abroad from the UK or created in new EU markets such as Paris, Frankfurt, Dublin, or Amsterdam - far below the initial fear that up to 50,000 jobs would disappear from the city. According to Boleat (2018), "to be able to continue providing services to their clients those institutions that rely on passporting will already have taken all the necessary steps to relocate functions to the EU 27, a process that can take between months and years" (p.2). International companies are less likely to use London as an English-gateway into the EU economy. Barclays relocated 5,000 clients to its Irish units, while Goldman Sachs, JP Morgan, and Morgan Stanley switched 10% of their clients. Bank of America has also moved 100 bankers to its Dublin office and 400 to Paris. The largest beneficiary was Dublin with 135 relocations, followed by Paris with 102, Luxembourg with 95, Frankfurt with 63 and Amsterdam with 48 relocations.

The number of relocation operations is expected to increase over time according to the same research as Brexit just started, in other hand bankers in UK claims that many relocations of operations have been delayed by travel restrictions introduced to combat the COVID-19 pandemic.

CONCLUSION

Brexit transition has been far from smooth. The exit from the European single market, which took effect on January 1, has had a strong negative impact on trade, with port blockages already under pressure from the pandemic and travel restrictions in January. In addition to this, multiple red tape, additional and sometimes unexpected costs, and taxes have impacted cross-border trade.

Therefore, taking in account the effects of the Covid-19 pandemic and the adjustment time to the new arrangement, the measurements of the impact of Brexit on growth remain unclear. The UK's economy has been one of the most affected by the Covid-19 crisis with a GDP down by -9.9% in 2020 (-6.8% in the euro zone). The inventories built up at the end of the year, which are leading to inventory depletion, as well as the lock-down at the beginning of the year, adding to the difficulty of understanding how big the Brexit-related contraction is. According to Sampson (2017) the research literature demonstrates a high degree of consensus that in the long run Brexit will make the UK poorer as it raises new barriers to trade, foreign direct investment, and immigration. However, there is considerable uncertainty about the scale of this effect, with plausible estimates of the cost ranging from 1-10% of UK per capita income.

As a result of the new No-tariff barriers, the UK will be no longer the gateway to the EU for non-EU countries and will suffer a drop in FDI inflow because of this reduction of influence. For financial services, but also for other manufacturing like Japanese car makers who are planning to move their production to the EU. Growth rates will be much slower because of lower productivity gains and a smaller increase in the working population due to fewer migrants from the EU. These expected losses are not likely to be covered by the trade agreements that the United Kingdom has signed or will sign with third countries, which should reproduce conditions similar to those of their agreements with the EU. Emerson (2016) stated that the claims that the UK could get better and faster free trade deals with third countries can is simplistic ambitious idea.

UK's officials are looking to counteract the loss of the European market by being more open to the rest of the world, as Mr. Boris Johnson said when presenting his vision for the United Kingdom in 2030. For the time being, London has reached " Continuity Agreements " with some

EU partners (including Switzerland, Chile and South Korea) accounting for 13 per cent of its total trade, a free trade agreement with Japan, which accounts for 2 per cent of British trade, and others are being negotiated with Australia, New Zealand and the United States. Hallett (2019) by using "reverse engineering" the costs of Brexit argued that staying outside with comprehensive free trade agreements with the EU and beyond on a bilateral basis would add small benefit as the UK economy stills linked to EU markets and the risk of coalition behaviour by EU companies with little investment in productivity or comparative advantage would be the only real defense for the UK.

Finally, as Dhingra and Sampson (2019) emphasized, it will be very difficult to make up for losing access to the EU market and to find trade partners who can share the same high standards of quality that the UK has always maintained. Those agreements are less likely to make up the negative impact of losing the European market access and would be far less valuable to the UK. This is because the main factors that influence trade are cultural and, especially, geographical proximity.

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