The Effects of Brexit on the European Union's Economic Power and Implications on the British Economy

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Abstract: The Brexit procedure involved several scenarios, mainly because of the difficulties encountered during this process and of the disagreements between European Union and the United Kingdom. The British hesitation led to the three-fold rejection of the agreement by the United Kingdom, while the European Union remained as firm on the terms of the agreement. Also, the United Kingdom refused other scenarios, including the cancellation of Brexit, a new referendum, the remaining in the European Economic Area or within the customs union. Under these circumstances, the Brexit was postponed several times after March 2019, as originally planned, sparking numerous debates about the consequences of this process. The purpose of this study is to analyze the Brexit`s effects on the European Union`s economic power and on the British economy, using a quantitative approach. Estimates of these effects involve several variables, such as the economic environment, the investment attractiveness, trade and labor market, all depending on the future economic relations between the European Union and the United Kingdom. In any case, Brexit will generate positive and negative effects for both sides, affecting the way these two economies influence the international affairs. Also, the United Kingdom`s economy will be more affected by Brexit than the European one, as we believe.

Keywords: economic power; foreign investments; Brexit effects; investment attractiveness

JEL Classification: E22; F02; F16; F50; F53; O52

1. Introduction

There are many academic, economic and political debates about Brexit, especially after recent events. The Brexit is planned for 31st January 2020, with a transition

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period until December 2020. However, the Brexit process is far from complete, leading to numerous predictions regarding the relations between the European Union and the United Kingdom after Brexit and about the resulting effects. The Brexit risks causing economic, social and trade problems between both parties. Moreover, the United Kingdom risks facing an internal crisis, as Scotland, Wales and Northern Ireland plead for independence amid dissatisfaction with the country`s exit from the European Union. On the other side, the European Union seems to be less affected than the British economy and the European Parliament could block the withdrawal agreement due to failure of the United Kingdom to respect the rights of European citizens and due to the absence of a commercial agreement between both sides, which could affect trade, transportations and financial transactions. A Brexit without a trade agreement (HM Government, 2016, pp. 92-93) between the European Union and the United Kingdom will give more sovereignty for the British economy to negotiate its trade agreements, without obligation to respect the European economic policies or to pay contributions to the European budget. But, the British trade with the European Union could be subject to a higher number of tariff and non-tariff barriers. Also, the future trade agreements will be made under the World Trade Organization rules. On the other side, a Brexit with a trade agreement between both sides can reduce the negative effects for both economies.

The purpose of this study is to analyze the Brexit`s effects on the European Union`s economic power and on the British economy. The forecasts of these effects involve several variables, such as the economic environment, the investment attractiveness, trade and labor market, all depending on the future economic relations between the European Union and the United Kingdom. In Section 2, the negative and positive effects of Brexit on the European Union and the United Kingdom are analyzed, summarizing some of the most important studies about this theme. In Section 3, we focus on the consequences of Brexit on the European economic power in order to observe if the Brexit affects the European influence over the world economy and its competition with other economic powers, such as the United States, the BRICS countries (Brazil, Russia, India, China and South Africa), Japan, Canada, Australia and other European and Asian countries. In order to observe these aspects, we use a quantitative approach, comparing the main components of the European economic power. The conclusions of this study are presented in Section 4.

2. The Economic Effects of Brexit

The predilections regarding the consequences of Brexit on the British and European economies involve several variables, depending on the economic relations between sides, the scenarios analyzed and the techniques used to quantify losses and gains. There are numerous studies about the Brexit`s effects, but the economic ones are the most important for our analyze. The Brexit will generate positive and negative effects, but the European Union seems to have more advantages compared to the United Kingdom.

The **benefits** generate by Brexit **for the European Union** are related to financial market. After Brexit, the European Union will lose the London financial market, but could gain a greater freedom of financial regulation; an increasing importance of the Paris and Frankfurt financial markets; a higher homogeneity of the European financial system and an increase in financial stability. Also, the European Union could obtain a greater integration of community and could implement reforms in order to avoid other situations similar to those of Brexit.

On the other hand, the **main economic benefit of the United Kingdom** is the decrease in contributions to the European budget. According to Figure 1, in 2018, the British gross contributions were almost €17.5 million, from which less than 50% came back as receipts. After Brexit, the United Kingdom could benefit from all these contributions. Also, the United Kingdom could obtain some commercial benefits, but rather legislative than quantitative, which means that the British economy could gain greater freedom and control over its own economic, social and trade policies. Moreover, the British financial market will no longer be dependent on the European one.

Nevertheless, the **negative effects** of Brexit on the British economy are more numerous than positive ones.

Starting with the **Gross Domestic Product** (GDP), it is seems that, due to the Brexit, (Dhingra *et al.*, 2016a, p. 6) the United Kingdom could lose between £26 billion and £55 billion, while the European GDP will decrease between £12 billion and £28 billion. Several international institutions and banks predict a slowdown in the growth rate of the British economy.

As it can be observed in the table below, the British economy could suffer losses between 1% and 8% in the short term. In the first year, JP Morgan and HSBC estimate that the United Kingdom`s GDP will reduce between 1% and 1.5%, while

Nomura predicts a 4% loss. The loss increases as the period after Brexit increases, and the United Kingdom could suffer a decrease of GDP between 3.1% and 8% in the first five years.

Table 1. Economic Consequences over the UK`s GDP in the short term

Study	Period	Minimum loss	Maximum loss
JP Morgan	1 year	1%	1%
HSBC	1 year	1%	1.5%
Nomura	1 year	4%	4%
Credit Suisse	2 years	1%	2%
Morgan Stanley	2 years	1.5%	2.5%
Deutsche Bank	3 years	3%	3%
Citi	3 years	4%	4%
PricewaterhouseCoopers (PwC)	5 years	3.1%	5.5%
Société Générale	5 years	4%	8%

Source: HM Government (2016), Treasury analysis: the long-term economic impact of EU membership and the alternatives, p. 135.

In the long term, the growth rate of the British economy may suffer losses between 0.1% and 9.5%, according to different estimations, reflected in the table below. The most pessimistic scenario is that of the Centre for Economic Performance, which estimates a reduction of the British GDP between 6.3% and 9.5%. On the other hand, there are optimistic scenarios, which show an increase in the size of GDP from 0.6% to 4%, the most optimistic one being the study conducted by Minford Patrick. Nevertheless, there are more chances that the British economy to suffer a reduction in economic growth rather than an increase due to the Brexit.

Table 2. Economic Consequences over the UK`s GDP in the Long Term

Study	Minimum loss/gain	Maximum loss/gain
Minford, Patrick	-	+4%
Lyons, G.	-0.5%	+0.6%
Open Europe	-2.23%	+1.55%
Oxford Economics	-0.1%	-4%
PricewaterhouseCoopers (PwC)	-1.2%	-3.5%
HM Treasury	-3.8%	-7.5%
National Institute of Economic and Social Research (NIESR)	-2.4%	-9.2%
Centre for Economic Performance	-6.3%	-9.5%

Source: (Begg & Mushovel, 2016, p. 5).

A trade agreement between the European Union and the United Kingdom will reduce the negative consequences for both sides. In this situation, (Felbermayr *et al.*, 2017,

p. 69) the European real GDP could suffer a reduction, on average, of 0.11%, while the British one could reduce with 0.57%. Only Ireland and Malta could record higher losses than the United Kingdom, by 0.9% and 0.71%. On the other hand, without an agreement between the two economies, the losses are higher. The British real GDP could fall with 1.73%, while the European average could be 0.26%. In this scenario, only Ireland could have a higher loss than the British one, of almost 2%.

Despite the effects on GDP, the Brexit could lead to a reduction in the **investment attractiveness** of the British economy, especially because investors will no longer have access to the European common market across the United Kingdom territory. In the absence of an agreement between the two economies, the investors and producers will have to bear higher costs of production and marketing. It is estimates (Dhingra *et al.*, 2016b, pp. 3-4) that the foreign direct investments attracted by the United Kingdom could reduce with 22%. This reduction means that the British real income could suffer a 3.4% fall, almost £2200 of GDP per household. After 15 years, the foreign direct investment flows attracted by the United Kingdom could be reduced (HM Government, 2016, p. 131) by 18% and 26% in the case of a Brexit without a trade agreement. On the other hand, an agreement could attract smaller losses, between 15% and 20%.

From a **commercial point of view**, following the Brexit, the trade flows between the European Union and the United Kingdom could be reduced due to the changes in the population income and to the increasing prices, as an effect of new tariff and non-tariff trade barriers. The trade between the two economies could reduce between 14% and 19% in the following 15 years if a trade agreement will be signed. (HM Government, 2016, p. 128) Otherwise, the losses could be situated between 17% and 24% compared to the level that would have been achieved if the British economy remained in the European Union. The British exports to the European Union could decrease to a much greater degree. In the absence of a trade agreement, the British exports would be reduced (Felbermayr *et al.*, 2017, p. 79) by more than 40% to most of EU countries, Luxembourg (22%) and France (39%) being the only two exceptions. On the other hand, the signing of a trade agreement would reduce the British exports to the European Union by less than 25%. The exceptions are Poland, Slovakia, Slovenia and Czech Republic, to which the British exports would be reduced by 25%.

Regarding the **labor market**, (Gillham *et al.*, 2016, pp. 29-30) the Brexit could lead to a decrease by 2.9% of the British employment level if the United Kingdom and the European Union will not sign a free trade agreement. In this situation, the British unemployment rate could increase to 8% by 2020. In case of an agreement, the employment level could fall by 1.7%, while the unemployment rate could increase to 7% compared to the 5% forecast if the United Kingdom remained in the European community. These unemployment rates mean an estimated number of unemployed people between 550.000 and 950.000 people. In the long term, by 2030, the labor market situation is improving in the way that the employment level fall between 1.1% and 1.8% depending on each scenario, while the number of unemployed people varies between 350.000 and 600.000 people.

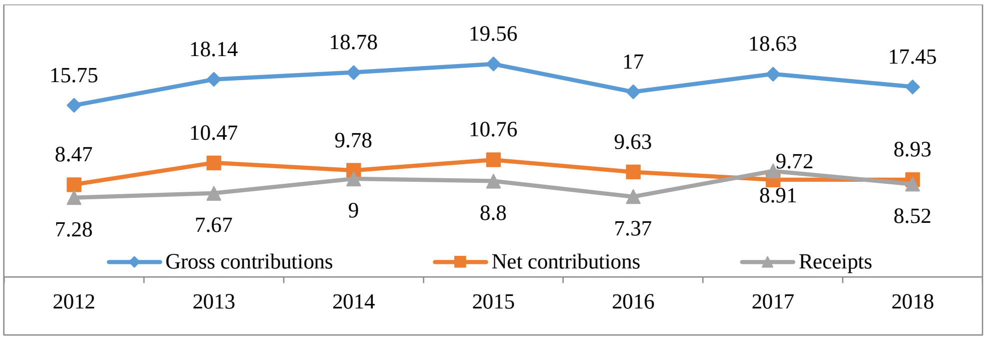

Figure 1. The British Contributions to the European Budget (€ million)

Source: Own representation based on HM Treasury (2019), European Union finances 2018: statement on the 2018 EU Budget and measures to counter fraud and financial mismanagement, June 2019, p. 14.

In terms of **costs incurred by the European Union**, Brexit could become a model for other member states, destabilizing the community and creating a precedent of anti-European sentiment, encouraging Euro-skeptic, nationalist and populist movements. In the same time, Brexit can disrupt the balance of influence within the European community. Thus, the German influence over the other member states may increase, with the risk of tensions between them, but also between Germany and France. Also, the European Union could suffer a loss on the contributions that the United Kingdom paid to the Community budget. By 2015, the gross British contributions to the Community budget increased, exceeding €19 million and the net ones €10 million, as it can be observed in Figure 1. Since 2015, the gross contributions has experienced fluctuations, while the net ones fallen below €9 million. Moreover, in 2017, the British receipts from the European Union exceeding 50% from gross contributions, while in 2018 they remained almost equal to the net contributions.

Also, the Brexit can lead to a decline in the quality of financial regulations and more protectionism. The European financial market could be affected by the loss of the London financial market, one of the Europe`s main financial centers, while the European capital markets will have to compete with it. The United Kingdom used to oppose to the European financial regulation initiative. Leaving the community by the United Kingdom will allow greater freedom of financial regulation, but this freedom can lead to a more regulated, more expensive, more protectionist market and less efficient.

Nevertheless, the Brexit could affect the European economy and the biggest loss of the European Union is about its economic power, its international credibility and its influence over the world economy. The international competition between the European Union and other great powers as the United States, the BRICS countries (Brazil, Russia, India, China and South Africa), Japan and Canada could be affected.

3. The European Economic Power after Brexit

Generally, power is seen as (Kebabdjian, 1994, p. 297) the ability of an economic or political actor to be an important player in the world economy. Also, power can be represented (Aursulesei & Topliceanu, 2019, p. 20) by an actor which imposes his own will and which (Morgenthau, 2013, p. 50) hold and maintain control over another actor, using different methods.

In order to quantify the power, different indicators can be used; most of them being economic, such as: (Morgenthau, 2013, pp. 151-189; Goldstein & Pevehouse, 2014, pp. 47-49) population, economic capabilities, industrial production, the GDP size, (Glassner & Fahrer, 2004, pp. 261-269) demographic characteristics, trade, commercial surplus and labor force. Also, other indicators can be added in terms of culture, transport, political values, communication, technology and military, all of them being intangible indicators.

For our analysis, we focus on the economic dimension, selecting only quantitative indicators in relation to the main effects of Brexit. Thus, as we shown in Section 2, the most effects of Brexit on the European economy and the British one are related to GDP, trade, investments and labor force. In order to analyze the influence of Brexit on the European economic power, we use only these indicators for 2018 from the World Bank statistical database. Our analyze is focus on the position of the European Union compared with other international economic powers, giving 10 points for the best positioned economy worldwide and then decreasing for other economies. Then, for all European indicators we will extract the British economic performances and see if the influence of the European Union is changing. For before Brexit scenario, the United Kingdom will not be scored with points. On the other hand, for after Brexit scenario, we will give 10 points for the best positioned economic power worldwide and then decreasing, take into account also the British economy. This is way, the final scores may differ and the world economy structure will suffer mutations.

In 2018, the European Union was the second economy of the world, having a GDP at purchasing power parity (PPP) of almost $22.5 trillion, behind China and before the United States. Almost $3 trillion belonged to the United Kingdom. Also, according to Table 3, the European Union was the world biggest exporter and importer, over than $8 trillion each, twice more than China and the United States. The British exports and imports was almost $900 billion. Moreover, the European Union recorded a trade surplus of $590 billion, while the Russian surplus exceeded $160 billion, and Chinese one was almost $100 billion. On the other hand, the United Kingdom and the United States recorded a trade deficit of $50 billion and $630 billion. For these performances, the European Union receives 9 points for GDP size and 10 points for each indicators related to trade.

Table 3. The European economic performances in 2018 ($ trillions) *$billion

GDP (PPP)		Exports		Imports		Trade balance*	
China	25.40	EU-28	8.71	EU-28	8.12	EU-27	642.05
EU-28	22.45	EU-27	7.86	EU-27	7.21	EU-28	591.86
US	20.54	China	2.65	US	3.13	Russia	164.49
EU-27	19.39	US	2.50	China	2.55	China	102.92
India	10.50	Japan	0.93	Japan	0.93	S. Korea	82.13
Japan	5.42	**UK**	0.86	**UK**	0.91	Switzerland	81.19
Russia	4.05	S. Korea	0.72	India	0.64	Brazil	17.31
Brazil	3.37	Canada	0.55	S. Korea	0.64	Japan	3.98
UK	3.06	India	0.54	Canada	0.58	Israel	1.49
Mexico	2.50	Russia	0.51	Mexico	0.50	S. Africa	1.16
Turkey	2.31	Mexico	0.48	Switzerland	0.38	Turkey	-16.09
Canada	1.78	Switzerland	0.48	Russia	0.34	**UK**	-50.19
World	**136.30**	**World**	**25.14**	**World**	**24.53**	**World**	**609.87**

Source: own representation based on The World Bank, World Development Indicators, last update 20th November 2019.

Looking at data from the table above, we can observe that the leaving of the European Union by the United Kingdom will not affect too much the European economy. The European Union could remain the biggest exporter and importer, having the highest trade surplus. Only in terms of GDP based on purchasing power parity the European Union could be surpassed by the United States with more than $1 trillion, while the European trade surplus may increase.

In these circumstances, the European Union will receive 10 points for trade indicators, while for GDP size will be scored with 8 points. Also, the United Kingdom positions worldwide will be scored with 2 points for GDP size and 6 points each for exports and imports. Even if the European Union will not be affected too much due to the Brexit regarding to GDP and trade, the big changes could happen regarding foreign direct investments.

According to Table 4, in 2018, the European FDI net inflows were almost $50 billion, less than the United Kingdom ones. In other words, the British economy attracted more foreign direct investment than the European Union, which was influenced by the negative FDI net inflows of Cyprus, Finland, Luxembourg, Belgium, Hungary and the Netherlands.

Based on the World Bank statistical databases, the last two had the biggest negative values of FDI net inflows in 2018, $73 billion for Hungary and $239 billion for the Netherlands. In this situation, the European Union receives 7 points.

Once the United Kingdom will leave the community, the European FDI net inflows could become negative at almost $8.66 billion. Practically, the European Union will disappear from the top ten world`s destinations of FDI net inflows. In the same time, the United Kingdom will be the fourth destination of FDI net inflows, for this performance being rewarded with 7 points.

Thus, in the after Brexit scenario, the United Kingdom will receive the points belonging to the European Union.

Table 4. The European Investments Indicators for 2018 ($ billions)

FDI net inflows		**FDI net outflows**		**FDI net**	
US	258.40	Japan	159.10	Japan	133.22
China	203.50	EU-28	139.42	Switzerland	114.88
Brazil	88.32	China	96.47	EU-27	90.34
UK	58.65	EU-27	96.30	EU-28	89.43
EU-28	49.99	Canada	52.59	S. Korea	24.44
Canada	45.42	Switzerland	47.20	Russia	22.59
India	42.12	**UK**	43.12	Canada	7.18
Mexico	36.87	S. Korea	38.92	**UK**	-0.92
Japan	25.88	Russia	31.38	S. Africa	-0.92
Israel	20.79	Brazil	14.06	Turkey	-9.41
S. Korea	14.48	India	11.42	Israel	-14.67
Turkey	13.04	Mexico	10.46	Mexico	-26.70
World	**1204.40**	**World**	**850.92**	**World**	**-353.58**

Source: own representation based on The World Bank, World Development Indicators, last update 20th November 2019.

But this situation is not valid for foreign direct investments net outflows, where the European Union was the world second investor after Japan with $139.4 billion, even if Estonia, Latvia, Cyprus, Malta, Belgium, Hungary and the Netherlands had negative FDI net outflows. If we cut the British FDI net outflows, the European Union could be surpassed by China, both with almost $96 billion. In this scenario, the European Union will lose $43 billion and 1 point. The last, but not the least, in 2018, the European Union was the world third economy after Japan and Switzerland regarding net foreign direct investments with $89.4 billion, receiving 8 points, while the United Kingdom recorded a negative value of almost $1 billion. Neither after Brexit, the European worldwide position will not be changed nor the points. But, the European net foreign direct investments may increase.

As regarding the European labor market, the Brexit will reduce the European labor force, but also will improve the unemployment. According to Table 5, in 2018, the European Union has almost 249 million people as labor force, about 34 million being from the United Kingdom. This makes the European Union the third world economy related to labor force and population, for these indicators being scored with 8 points. After Brexit, the European labor force could be reduced with 34 million people and the European population with almost 66.5 million. But, this scenario does not affect the European position worldwide.

In the same time, the European unemployment exceeded 17 million people, of which almost 1.35 million came from the United Kingdom. Practically, in 2018, the

European Union had the world second biggest number of unemployed people, after China, with almost 34.7 million people, according to the World Bank. These two economies are followed by Brazil (13.2 million), India (13 million) and the United States (6.49 million).

This is the reason why the European Union and these economies do not appear in the Table 5, where are presented the other economic powers in the world with one of the lowest levels of unemployed people. Among them, the United Kingdom is positioned on the fifth place, reason for why the British economy is scored with 6 points. After Brexit, the European unemployment may decrease with 1.35 million people, but it will remain among the highest levels in the world

Table 5. The European Population and Labor Market in 2018 (Million People)

Population		**Labor force**		**Unemployment**	
China	1392.73	China	785.97	Israel	0.16
India	1352.62	India	512.35	Switzerland	0.24
EU-28	513.21	EU-28	249.16	S. Korea	1.07
EU-27	446.72	EU-27	215.06	Canada	1.20
US	327.17	US	164.95	**UK**	1.35
Brazil	209.47	Brazil	105.37	Japan	1.64
Russia	144.48	Russia	73.53	Mexico	1.88
Japan	126.53	Japan	67.09	Russia	3.49
Mexico	126.19	Mexico	56.64	Turkey	3.55
Turkey	82.32	**UK**	34.11	S. Africa	6.13
UK	66.49	Turkey	32.58	US	6.49
S. Africa	57.78	S. Korea	28.30	EU-27	15.66
World	**7594.27**	**World**	**3456.04**	**World**	**171.11**

Source: own representation based on The World Bank, World Development Indicators, last update 20th November 2019.

In order to observe if the Brexit will affect the European influence on the world economy, we sum up all the points accumulated at all 10 indicators analyzed. This procedure will be applied for all the world economic powers. In this way, we can observe if the world power structure will be modified by Brexit and how the European Union is worldwide positioned compared with the other economic powers. For example, the European Union cumulates 79 points in 2018, while after Brexit its economic power will reduce. The European score after Brexit is 70 points, as it can be observed in Table 6.

Table 6. The European Points Before and After the Brexit

The European Union	**Before**	**After**
GDP-PPP	9	8
Export	10	10
Import	10	10
Trade balance	10	10
FDI inflows	7	0
FDI outflows	9	8
FDI net	8	8
Population	8	8
Labor force	8	8
Unemployment	0	0
TOTAL	**79**	**70**

Source: own calculations.

The European best scores are related to trade, where the European Union is the world leader. After Brexit, the European GDP and the FDI outflows could reduce, also the scores, while for the FDI inflows the European economy could disappear from the top ten world`s destinations of FDI net inflows and will lose all 7 points.

Table 7. The Economic Powers` Ranking

Position	**Before Brexit**		**After**		**Position**
1	EU-28	79	China	73	1
2	China	72	EU	70	2
3	Japan	61	Japan	60	3
4	US	50	US	50	4
5	India	42	UK	40	5
6	Russia	42	India	39	6
7	South Korea	40	Russia	38	7
8	Canada	35	South Korea	36	8
9	Switzerland	33	Canada	32	9
10	Brazil	32	Switzerland	31	10
11	Mexico	25	Brazil	31	11
12	Israel	17	Mexico	19	12
13	Turkey	13	Israel	16	13
14	South Africa	9	Turkey	9	14
-	UK	-	South Africa	6	15

Source: own calculations.

The world economy structure will be modified due to the Brexit, as it can be seen in Table 7. The economic powers` ranking was achieved taking into account only ten indicators. Thus, taking into account the GDP size, trade, investment inflows, population, labor force and unemployment, the European Union is the world leader, having 79 points and followed by China (72 points), Japan (61 points) and the United States (50 points). In this scenario, the British economy is not taken into account because it is considered part of the European Union. After Brexit, the ranking of world economic powers changes.

China becomes the world leader with 73 points, while the European Union loses 9 points and falls on the second place. Mainly, the European Union`s fall is caused by the losses incurred regarding to FDI net inflows. In after Brexit scenario, the British economy is analyzed separately by the European Union and has 40 points, being the fifth world economic power. In these circumstances, the Russia falls two positions. Also, due to Brexit, almost all economies lose points, starting with European Union (9 points) and Mexico (6 points) and following by Russia, South Korea and Turkey with 4 points. On the other hand, China wins 1 point due to Brexit and the United Kingdom reaffirms itself as a great world power. In other words, almost all of the world economic powers will be affected by Brexit. Only for the United States the world position neither the points will not be changed due to the Brexit.

4. Conclusions

This study is focus on the analyze the Brexit`s effects on the European Union`s economic power and on the British economy, using some variables such as the economic environment, the investment attractiveness, trade and labor market. Also, the purpose of this study is to observe the Brexit effects on the European influence over the world economy and its competition with other economic powers, comparing the main components of the European economic power. We believe that we achieved these purposes. We are aware that our study can be extended to more countries and more indicators, using more up-to-date statistical information. This deficiency can be solved in future research based on the methodology developed in this study.

Brexit is capable to generate positive and negative effects for both economies, affecting the way that the European Union and the United Kingdom influence the world economy. But, we believe that the Brexit will affect the British economy more than the European one. The European Union seems to have more advantages compared to the United Kingdom. The biggest lost of the European Union is about its economic power and its influence on the world economy. As we observed from the specialized studies, the negative effects of Brexit are more numerous than the positive ones and the European Union seems to be less affected than the British economy. The United Kingdom risks facing an internal crisis due to the Brexit and there are more chances that its economy to suffer a reduction in economic growth rather than an increase. Our quantitative analyze about the the Brexit effects on the European influence over the world economy and its competition with other economic powers shows that the European Union will be affected.

The European economy could lose the leader position. Mainly, its fall is caused by the losses incurred regarding to FDI net inflows, but also by the reduction of GDP size and FDI net outflows. On the other hand, the British economy has the chance to reaffirm itself as a great world power. Brexit will affect almost all world economies, only United States will not change its world position. Also, China is the only one benefiting from Brexit and has the chance to take the lead of world economy.

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