CHAPTER IV

POLITICAL AND ECONOMY IMPLICATION OF BREXIT TOWARD EUROPEAN UNION

After the explanation of the problems between European Union and United Kingdom, and for the reason why United Kingdom left Eropean Union, there are political and economic implications of Brexit toward European Union.

A. Brexit resurgent the ideas of Neo Mercantilism as the principle political economy in European Union

Neo mercantilism as a policy regime that encourages exports, discourages imports, controls capital movement, and centralizes currency decisions in the hands of a central government. The objective of neo-mercantilist policies is to increase the level of foreign reserves held by the government, allowing more effective monetary policy and fiscal policy.

United Kingdom is the largest foreign investment destination in the European Union, according to data from the original UNCTAD, with an average of US $56 billion per year in the period 2010-2014. Other EU countries only had a total capital investment of less than this amount. About 72 percent of investors in studies of EY by 2015 state that access to the EU single market is a major factor in their investment in the United Kingdom. Expected, investors will be looking for access from other countries if the United Kingdom cannot provide entrance to the single market of the European Union.

Uncertain factor will also affect domestic demand and weaken pound sterling currency. This will have implications for EU exports on performance to the United Kingdom, whose value reaches approximately 2.6 percent of total EU GDP in 2014.

It is estimated that the requests of the United Kingdom that are related to the possibility of new import tariffs will be surprising. Activists of the Brexit movement who assess the European Union will want to establish a free trade agreement with the United Kingdom, although the United Kingdom out off the blocks it. (Ashworth-Hayes, 2017).

For Germany, Europe's largest economy, the consequences of Brexit could be grave. Public opinion in the country is divided on the issue. Some fear that the EU would become less liberal if the UK left. Others, resentful of the UK's presumption that it should be allowed à la carte EU membership, are eager to see the British go. When it comes to the economic impact of Brexit, however, Germany has much to lose and almost nothing to gain.

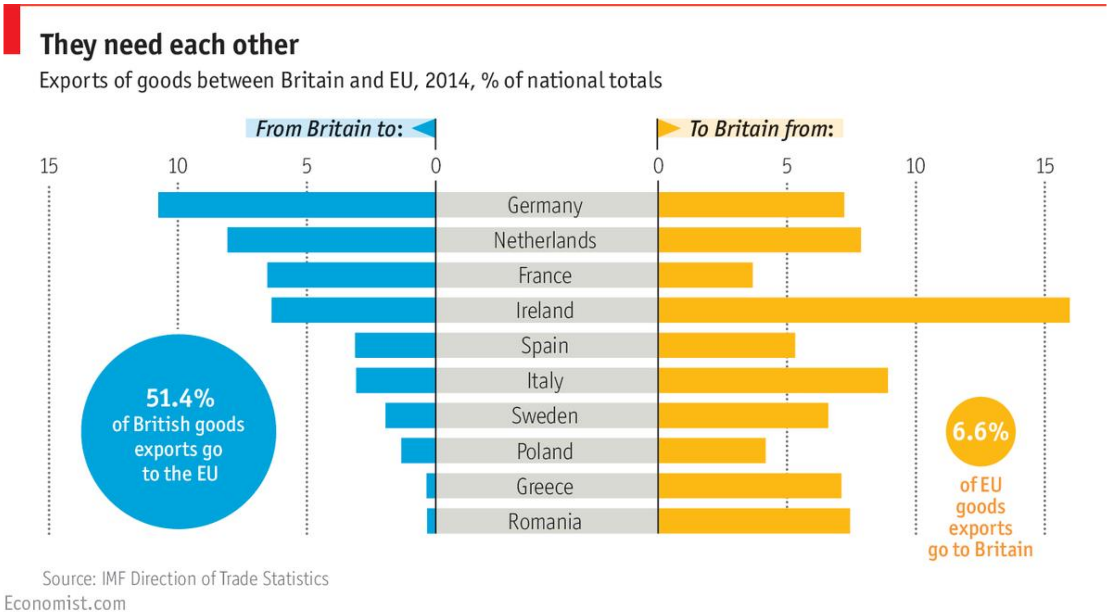

Figure 4.1: Britain and European Union need each other (Image: IMF Diraction of Trade Statistics Economist.com)

To begin with, Brexit would change the way multinational companies make investment decisions. The UK could face an exodus of foreign firms, as companies seek to retain a presence in the EU. However, there is no reason to believe they would necessarily move to Germany; many US multinationals, for example, would likely relocate to Ireland.

At the same time, the EU as a whole – and Germany in particular – would become less attractive to investors. The UK would be free to loosen regulations and lower taxes in order to attract investments for which a foothold in the EU is not necessary. This, too, could reduce investment in Germany.

Second, while some believe that Brexit would cause Frankfurt to rise in importance as a financial center, that outcome is highly uncertain. Today, London is Europe's dominant financial center, even though the UK is not a member of the eurozone. This suggests that proximity to the European Central Bank is not an important factor in the success of a financial industry.

To be sure, the EU would come under growing pressure to use regulatory measures to take business away from London, but whether that would work is an open question. Already, Deutsche Börse and the London Stock Exchange have announced that a planned merger will go ahead, regardless of the outcome of the Brexit referendum.

Even if London's importance as a financial center does decline, some of the businesses will be picked up by centers outside Europe, such as New York or Hong Kong. The business that does migrate to the EU could just as easily be snapped up by rivals to Frankfurt, such as Paris.

Third, German exporters are likely to suffer. In 2015, the surplus from trade with the UK topped €50 billion ($57 billion), with German exports totaling roughly €89 billion, or 3% of German GDP. Only France and the United States bought more German goods. Any disruption to bilateral trade would be felt across the country.

Exactly how trade and capital flows would be affected depends on the exit arrangements negotiated between the EU and the UK. If the UK were to remain, like

Norway and Iceland, part of the European internal market, the economic damage would be limited. Unfortunately, however, this is unlikely.

Non-EU countries that have access to the European Single Market are also required to comply with most European regulations – which is exactly why the UK wants to leave the EU. Moreover, some European decision-makers might want to make sure that Brexit causes as much pain as possible, to deter others from following the UK's example.

By declaring its intention to leave, the UK would trigger Article 50 of the EU Treaty, which stipulates a two-year deadline for reaching an exit agreement. If no agreement is signed before the deadline, EU membership simply expires. A minority of 35% of the votes in the European Council would be enough to block an agreement that minimizes the economic costs of Brexit.

Finally, Brexit would be a severe setback to European integration. The EU's remaining members might agree more easily on common policies regarding internal and external security and foreign policy, however for Germany, it would become harder to champion free trade and oppose protectionism.

Currently, the EU contains a bloc of countries: the UK, Ireland, the Netherlands, the Czech Republic, Slovakia, and the Scandinavian and Baltic countries with favorable views on free trade – that controls roughly 32% of the votes in the European Council. This provides Germany, with its 8% voting share, a pivotal role in economic-policy negotiations. Together with the liberal bloc, Germany can block Council decisions, which enables it to exploit differences between the UK and France and gives it a key role in building consensus.

Should the UK leave, the share of the liberal bloc's vote in the Council would fall to just over 25%, reaching about 34% with Germany just short of a blocking minority. New coalitions can be formed, of course, but German political influence in the EU would surely decline.

Germany, in short, has a strong interest in the UK's continued EU membership. British voters have an opportunity to spare themselves a great deal of economic turmoil, while allowing Germans – and many others across Europe – to breathe a sigh of relief.

The Centre for Economic Performance is an interdisciplinary research centre at the London School of Economics Research Laboratory. It is one of the leading economic research groups in Europe. In a study of the effects of Brexit, CEP found that the most "optimistic" post-Brexit scenario for UK trade, in which the country adopts Norway's model and remains part of the European Union single market, would see average incomes fall by £850 per household. However, at the more pessimistic end of predictions, loss of income from reduced trade and lower productivity could be as high as £6,400 per household, which is similar to the decline in UK GDP during the global financial crisis in 2008-09.

CEP also looked at the effect of Brexit on other countries. It found that all EU members would be worse off, with Ireland suffering the largest proportional losses, alongside the Netherlands and Belgium. Some countries outside the EU, such as Russia and Turkey, gain as trade is diverted towards them and away from the EU.

Figure 1: The effect of Brexit on living standards across countries

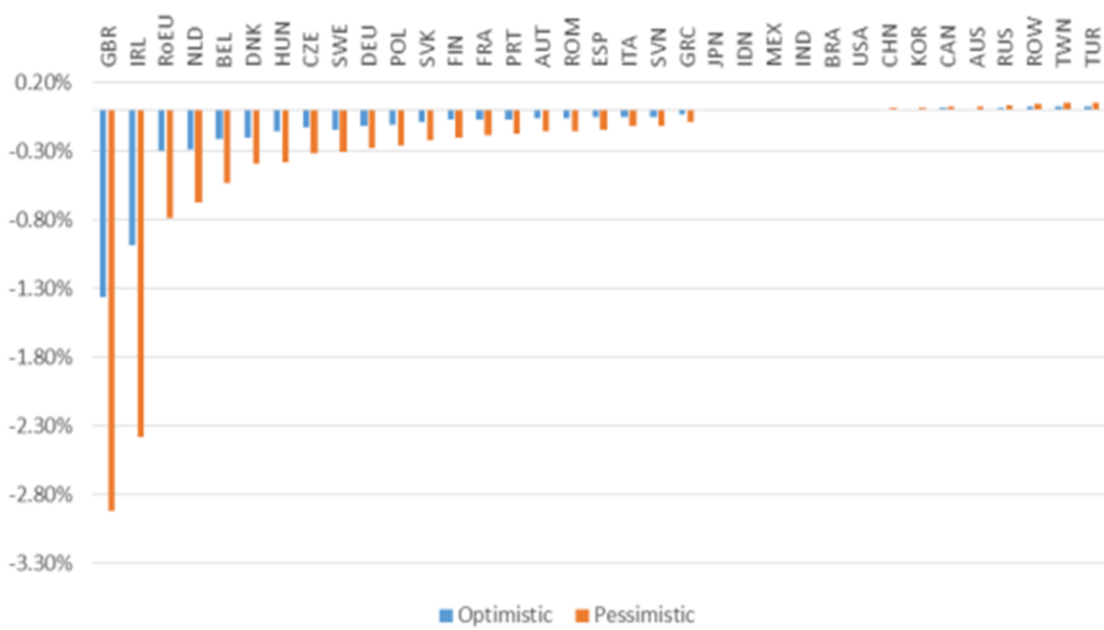

Figure 4.2: The effect of Brexit on living standards across countries (Source: Center For Economic Performance).

The CBI, which has voiced strong support for EU membership, has used the data from PwC to repeat its warning that businesses will be left vulnerable to trade obstacles and a shaky economy outside of the bloc.

"The savings from reduced EU budget contributions and regulation are greatly outweighed by the negative impact on trade and investment. Even in the best case this would cause a serious shock to the UK economy," said Carolyn Fairbairn, director general of the CBI.

The longer-term outlook is brighter though. PwC estimates that average income per capita would still rise considerably by 2030, increasing by up to 39% on current levels compared to a 41% rise if we remain in the EU, once the immediate uncertainty fades.

In it's latest global growth forecast, the International Monetary Fund warned that Brexit could cause "severe regional and global damage". If Britain voted to leave, this would disrupt established trading relationships and cause "major challenges" for both the UK and the rest of Europe, it said.

The ratings agency Moody's has said that the economic costs of Britain leaving the European Union would outweigh the benefits and may put the UK's Aa1 credit rating at risk.

The agency said if Britain voted to leave the EU it would lead to heightened uncertainty which would result in "modestly weaker" economic growth over the medium term. The agency also said it was unlikely that the UK's existing arrangements with the EU in areas such as trade would be replicated in full and any efforts to introduce trade barriers by remaining EU states would hurt many UK industries, such as car manufacturing.

The Centre for Economic Performance is an interdisciplinary research centre at the London School of Economics Research Laboratory. It is one of the leading economic research groups in Europe.

In a study of the effects of Brexit, CEP found that the most “optimistic” post-Brexit scenario for UK trade, in which the country adopts Norway’s model and remains part of the European Union single market, would see average incomes fall by £850 per household.

But at the more pessimistic end of predictions, loss of income from reduced trade and lower productivity could be as high as £6,400 per household, which is similar to the decline in UK GDP during the global financial crisis in 2008-09.

CEP also looked at the effect of Brexit on other countries. It found that all EU members would be worse off, with Ireland suffering the largest proportional losses, alongside the Netherlands and Belgium. (Breene, 2016)

Other EU Member States have to fill at least half of a number of shortcomings from the loss of the contribution of the United Kingdom to the European Union funds. Total United Kingdom contribution to the EU budget for the year 2016 is 19.4 billion euros, including cutting tariffs and import taxes. United Kingdom received around 7 billion euros of agricultural and regional subsidies. Germany, the largest EU

Member States, will inevitably have to provide extra cash to cover this gap. Germany, Ifo Institute, estimates funds required reaching 2.5 billion Euros. Uni Credit declared there will be a number of shortcomings in the eurozone but it will be resolved. Trade, financial sector and uncertainty factors are expected to lead to a more difficult financial conditions and delay investments. The European Union will lose an estimated gross domestic product (GDP) by 0.5-1.0 percent of current of 1.6 percent. (Harap, 2016)

Central Bank of the United Kingdom also stated there is a slowdown impact out of the European Union. In addition, the possibility of a referendum in Scotland may also affect economic growth. On the other hand the economist supports pro Brexit said that leaving the EU can boost economic growth although initially will indeed go down. The OECD and the IMF stated the United Kingdom out of the European Union will hit the European Union and impact other countries. The leadership of the central bank of the United States Federal Reserves/The Janet Yellen said last week if the referendum could affect the global economy and financial markets. When stations out of the European Union also affect the prospects of the US economy, the Britain economy growth is slow. (Harap, 2016)

Some eurosceptics who preach the free market are trotting out mercantilist arguments for leaving the EU.

The euro also weakened 2.6 percent against the U.S. dollar. In contrast to round the abstract capital markets, gold prices rise to record precisely five percent and Japan's soaring yen currency 4.2 percent against the U.S. dollar and seven percent against the Euro. Germany, the largest member state of the Union is not, will inevitably have to provide extra cash to cover this gap. Germany, Ifo Institute, estimates funds required reaching 2.5 billion euros.

Uni Credit declared there will be a number of shortcomings in the eurozone but it will be resolved. Trade, financial sector and uncertainty factors are expected to lead to a more difficult financial conditions and delay investments. The European Union will lose an estimated gross domestic product (GDP) by 0.5-1.0 percent of current of 1.6 percent. The member states of the European Union experienced a trade balance surplus of about 100 billion euros in trade with the United Kingdom. While the larger United Kingdom export value of 20 billion euros rather than the value of imports. Similar conditions also apply in the field of financial services.

B. European Union as regional forum receive political impact that will lose the capacity in global political arena

Regionalism as a political ideology focuses on the national or normative interests of a particular region, group of regions or another subnational entity. These may be delineated by political divisions, administrative divisions, cultural boundaries, linguistic regions, and religious geography, among others. Brexit makes the relations between EU and Britain can not do the cooperation like the old times.

Regionalists aim at increasing the political power and influence available to all or some residents of a region. Regionalist demands occur in strong forms, such as sovereignty, separatism, secession, and independence, as well as more moderate campaigns for greater autonomy (such as states' rights, decentralization, or devolution).

2016 could become a year marked by political populism. Weak economic activity and low productivity growth mean that real wages and consumption are likely to continue to be disappointing. When reality is coming short of expectations, there are grievances to be exploited. Donald Trump, Jeremy Corbyn, Alexis Tsipras, Nigel Farage, Marine Le Pen, Bernie Sanders, Pablo Iglesias Turrión and many others are taking advantage of stagnating living standards and increasing economic insecurity.

A number of factors are reinforcing populism and discontent. Job security is undermined by global competition, digitalisation and robotisation. New work opportunities ahead are more likely to be short-term contracts, part-time jobs, self-employment without full social benefits and full job security. The so-called "Uber" class of insecure workers is a new reality to be dealt with. The demands for education, expert knowledge and social skills have taken a quantum leap upwards and increased the threshold for people seeking to enter the labour market. Unionisation is on the retreat. Increased insecurity in labour markets, the weaker negotiation power of the unions and low productivity are setting narrow limitations for wage negotiations and real wages.

In a period when most advanced economies needs strong governments to implement far-reaching structural reforms, voters are favouring short-termism and asking for simple solutions. To restore political trust, governments needs to deliver real wage increases, more jobs and better welfare. This can only happen if growth is revitalised by reforms to increase labour market flexibility and to improve the business climate.

There is a clear risk that the fear of political populism will undermine the way leaders deal with long-term challenges and thereby creates a vicious negative spiral where disappointment further weakens trust in governments.

There are about 3 million other EU citizens living in the United Kingdom, while there are 1.2 million citizens of the United Kingdom that are scattered in a number of EU countries. Britons, the term for citizens of the United Kingdom, blaming the migrants is related to a number of issues such as unemployment, low wages, and the destruction of the education system as well as the health of even a traffic jam. This made the immigrant citizens concerned, but the number of immigrants became one of the “mainstays” for fortress pro-Brexit for elections caused the sound. They contend the number of immigrants was already too much, mainly from Eastern European countries who are members of the European Union.

They argued the immigrant flow can be dammed if the United Kingdom out of the European Union because it will not be bound to the principle of free movement as defined economic bloc. The main character Brexit supporters ask Australia immigration policy model, that only allow people with special abilities that are needed for the United Kingdom to enter and stay in the country. (Stone, 2016)