

The Aftermath of the Brexit Referendum: Political and Economic Impact in the UK

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1. General Assessment

The UK referendum, held on June 23, surprised the world with an outcome in favor of leaving the EU, as most surveys anticipated that votes to remain would win by a small margin. What was more surprising than the outcome itself was that no specific plan for exiting from the European Union had been prepared by either side of the Brexit campaigns. In the UK, the discussion over the Brexit referendum was formally triggered when then Prime Minister David Cameron mentioned its possibility at his Bloomberg speech in 2013.¹ More recently, the Brexit referendum was one of the most important parts of the Conservative party manifesto for the 2015 general election.² This means that at least three years were available to prepare for the exit from the EU before the actual referendum in June 2016. To the surprise of many observers, even the hardest Brexiteers like

former London mayor Boris Johnson and his campaigners failed to provide a clear set of ideas and specific plans for the exit process after winning the referendum.

Amongst the increasing uncertainty and speculations over how and when to exit from the EU, at least two things became clear: the referendum was facilitated as a policy tool for obtaining control over power within the dominant party, and political leaders failed to perceive the prevailing sentiment of the general public, especially in the working class, who felt they were left behind from European integration and globalization in a broader sense. Apparently, the most significant impact of the Brexit referendum is that the UK's decision to leave the EU has presented a great deal of uncertainty to the global economy and its negative impact is expected to last a long time. At the same time, it is never enough to emphasize the responsibility of political leaders, whose decisions have an enormous impact on the nation's future.

¹ Cabinet Office, Prime Minister's Office, 10 Downing Street and The RT Hon David Cameron MP (2013), "EU Speech at Bloomberg" (original transcript), (January 23).

² Conservative Party Manifesto (2015), "Strong leadership, a clear economic plan, a brighter, more secure future."

It is important to note that the Brexit referendum was just the beginning of the complex and challenging process of the UK's exit from the EU. Interestingly, as the Leave campaign arguably proclaimed before the referendum, the future of the UK and its relations with other countries now apparently depend on the decisions of the British people alone, regardless of possibility of success or vice versa. While statements from the Prime Minister and key figures of the new cabinet are still unclear or mixed at times, the strong determination of the Prime Minister on leading Brexit to success and to pay more attention to the voices of the less privileged should be perceived as a fine start for the developments to come.

2. Political and Economic Impact

New Cabinet

On the day after the referendum, former Prime Minister David Cameron stepped down and passed on the role of undertaking Brexit to his successor. After former Home Secretary Theresa May was elected and appointed as the new Prime Minister on July 23, her new cabinet was promptly formed. Noticeably, the Department for Exiting the EU and Department for International Trade, combining the function of UK Trade and Investment and UK Export Finance, were newly created. Hard Brexi-

Table 1. Major Political Events after the Brexit Referendum

Date	Major Issues
24 June 2016	Brexit referendum result announced (Leave 52%; Remain 48%)
24 June 2016	Prime Minister David Cameron resigns; states that the new Prime Minister and cabinet will be formed by October
30 June 2016	Boris Johnson, leader of the Leave campaign, declares he is not running for election
4 July 2016	Nigel Farage, the leader of UKIP, resigns
11 July 2016	Andrea Leadsom withdraws from the Conservative leadership race
13 July 2016	Theresa May appointed as Prime Minister of the UK
15 July 2016	PM Theresa May visits Scotland and meets with First Minister of Scotland Nicola Sturgeon
20 July 2016	Theresa May visits Berlin and meets with German Chancellor Angela Merkel
21 July~5 Sept 2016	Summer Recess of the Parliament
17 ~21 Sept. 2016	Liberal Democrats Party Conference
25~28 Sept. 2016	Labour Party Conference
2~5 October 2016	Conservative Party Conference
13~15 October 2016	Scottish National Party Conference

Source: Compiled by author.

teers were appointed as Secretaries of these Ministries, along with Boris Johnson as Foreign Secretary, to lead the Brexit negotiations with the EU and set new trade relations with other countries.

Considering that the result of the Brexit referendum clearly signified a serious level of ine-

quality and division among its population in terms of socio-economic classes, generations, and regions, Theresa May in her inaugural speech has emphasized that the new government should promote a stronger spirit of union not only between nations of the UK, namely England, Scotland, Wales and Northern Ire-

land, but also between all UK citizens.³ The message for unity became even clearer at her final speech at the Conservative party conference held on October 5.⁴ Under the vision of ‘a country that works for everyone,’ Prime Minister May has stressed that she will press on to restore fairness and equality and hear more from the ordinary working class.⁵ Judging by the Prime Minister's determination to lead the Brexit negotiations to success, chances of having another referendum on the same terms have become less than likely at the moment.

Scotland's Independence Movement

Following the awakening outcome of the Brexit referendum, First Minister of Scotland Nicola Sturgeon said that a second Scottish independence referendum is highly likely if the UK exits from the EU. Based on the overwhelming support for 'remain' in Scotland, at 62% against 38% which chose to leave, First Minister Sturgeon stressed that the UK's exit from the EU clearly justifies the request for a second referendum for independence, as it will bring fundamental change to the terms of staying within the UK when voters chose to do so in 2014.

With demand for independence growing stronger in Scotland, the new Prime Minister May paid her first official visit to Edinburgh on July 15, almost right after her inauguration. At the meeting with Sturgeon, Prime Minister May assured that the voice of the Scottish people will be well received in the course of negotiations with the EU and that Article 50

will not be triggered unless a consensus is ripe within the UK while discarding the necessity of another referendum for Scotland's independence.

Being traditionally close with continental Europe, the economy of Scotland has a relatively higher reliance on financial subsidies and policies of the EU including the EU's Common Agricultural Policy and its funding schemes for universities. Nevertheless, the sharp decline of oil prices since 2014 has weakened the confidence of the Scottish economy and the fact that the majority of Scottish exports are destined toward the UK market make it difficult to press for independence in the near future unless a devastating shock strikes the UK economy during the course of Brexit.⁶

Market Reaction

With the Brexit decision increasing uncertainty of the UK economy, the value of the pound dropped sharply on the day after the referendum and fell by over 10% within two months since then. While economic indicators such as the GDP growth rate and unemployment rate in the second quarter were relatively fine and stock markets have recovered within a comparatively short period of time, it is widely expected that the negative impact of Brexit on the British economy will be felt slowly but steadily. Economic performance will also encounter tougher situations towards the start of 2017 when the UK's exit from the EU will become a reality marked by growing volatility in the course of exit negotiations.

³ Prime Minister's Office (2016), "Statement from the new Prime Minister Theresa May." Transcript of the speech (July 13).

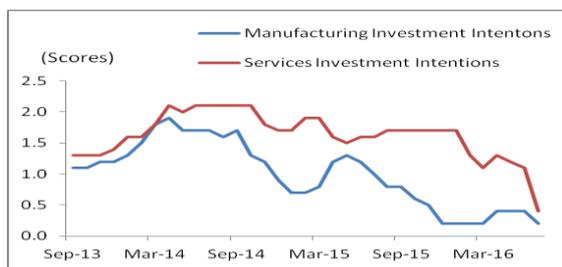
⁴ Bloomberg (2016), "May Looks Beyond Brexit to Portray Herself as Workers' Tribune," (October 5).

⁵ BBC (2016), "Conservative conference: Theresa May's speech in full." (October 5)

⁶ Kiran Stacey (2016), "Support for Scottish independence is growing since Brexit," *Financial Times*. (July 25)

Despite the resilience and flexibility of the UK economy, it is worrisome that continued uncertainty over Brexit clearly dampened the confidence of businesses and negatively affected their investment intentions over the next year, as seen in Figure 1. Due to the shaky business environment in the wake of the referendum, some projects are reported to be scaled back or in some cases deferred.⁷

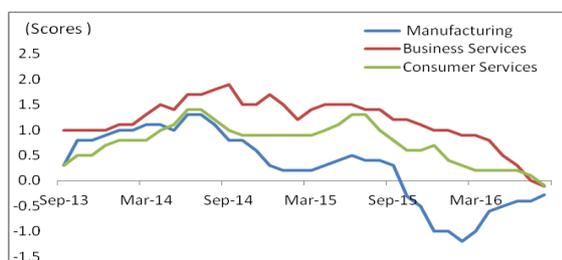
Figure 1. UK Business Investment Intentions



Source: Bank of England (2016 3Q).

After the referendum, hiring activity among professional and financial services had slowed and companies' intentions to employ over the coming six months had fallen (Figure 2). In parallel, growth in business and financial services turnover had decreased over the past three months, reflecting heightened uncertainty and reduced demand for professional and financial services (Figure 3).

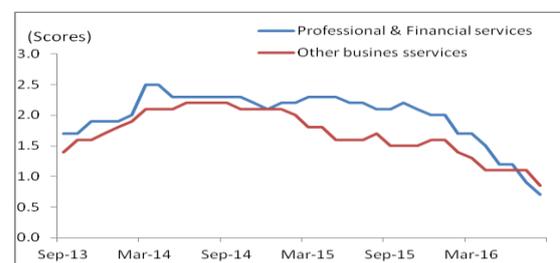
Figure 2. UK Businesses' Employment Intentions



⁷ Bank of England (2016), Agents' summary of business conditions, 3Q.

Most notably, confidence in the financial services industry has fallen as the possibility of securing passporting rights for UK financial companies diminished as the government hinted that the financial services industry would not be favored during Brexit negotiations. Adding to this, the financial industry has been warned that it should prepare for turbulence in the process of exiting from the EU.⁸

Figure 3. Business and Financial Services Turnover



Source: Bank of England.

3. The State of the Brexit Negotiations

Exit Procedure

Since there is no precedence of an exit from the EU, important issues including when and how to withdraw from the EU and the entailed conditions are left undefined. Accordingly, the single most serious problem with Brexit is the uncertainty surrounding its exit procedure and terms of negotiations.⁹ The only regulation dealing with the exit of a Member State from the EU is Article 50 of the Treaty on the European Union. While Article 50 stipulates that

⁸ The Telegraph (2016), "Philip Hammond warns Britain's economy heading for post-Brexit 'rollercoaster' ride as he drops pledge for budget surplus by 2020, (October 3)

⁹ European Parliament (2016), Article 50 TEU: Withdrawal of a Member State from the EU, Briefing, (February).

a State wishing to withdraw from the Union shall notify the European Council of its intention, it does not provide details including the deadline, the form of notification, and the contents to be included in the notification. Fundamentally, the UK government should begin the exit process when it considers appropriate by notifying the EU of its intention and the EU and Member States cannot force the UK to do so in a legally binding way.¹⁰

THE TREATY ON EUROPEAN UNION (ARTICLE 50)

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

*3. The Treaties shall cease to apply to the State in questions from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
(...)*

Source: C 326/43, Official Journal of the European Union, 26. October 2012.

¹⁰ Jeroen Jansen et al. (2016), "Article 50 TEU: When to pull the trigger?" DLA PIPER (August 15).

As Article 50 states that a withdrawal of a Member State shall be preceded 'in accordance with its constitutional requirements,' it is controversial whether the UK government should acquire approval from the Parliament where the majority of members intended to remain in the EU.¹¹ Recently, at the Conservative Party Convention, Prime Minister May said the UK will begin the formal procedure of Brexit by triggering Article 50 by the end of March 2017, a step forward to her previous remarks in July that it would not take effect within this year so as to prepare the government for negotiations.¹² While this confirmation on Brexit timing has solved a big uncertainty, many important issues are still left unanswered including the UK's post-Brexit relations with the EU and other countries.

Clearly, the exit negotiations should be accompanied by contents for a new post-Brexit agreement between the EU and UK as Article 50 stipulates that the negotiation and conclusion of an agreement should 'take account of the framework for its future relationship with the Union.' Since any time lapse between the two agreements, one for withdrawal and the other for arranging future relations with the EU, will exacerbate the level of uncertainty, it is plausible that the two agreements be concluded simultaneously.¹³

¹¹ Adam Lazowski (2016), "Procedural steps towards Brexit", CEPS Commentary, CEPS.

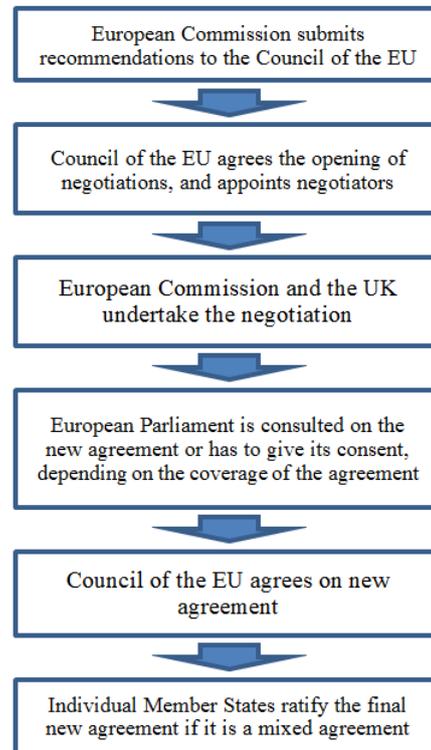
¹² Brexit: Theresa May to trigger Article 50 by end of March, BBC, 2 October 2016.

¹³ Adam Lazowski (2016).

Figure 1. Withdrawal Agreement from the EU



Figure 2. New Agreement with the EU



Source: HM Government (2016) revised.

Considering the unprecedented and complex nature of such negotiations, however, it is doubtful whether the two parties can complete negotiations within the two-year period.¹⁴ If the UK leaves the EU without concluding a new agreement by the end of this term, the two parties can extend the period only if all 27 EU Member States agree to the extension. If any Member State vetoes the extension, the UK leaves the EU immediately at the end of the two-year period and the UK's trade relations would be governed by WTO rules¹⁵.

¹⁴ Confederation for British Industries (CBI, 2016), "Two Futures: What the EU referendum means for the UK's prosperity." (April)

¹⁵ HM Government (2016), "The process for withdrawing from the European Union."

Priorities and Prospects

While the UK and EU have not yet begun formal negotiations, the biggest question is the formation of their post-Brexit relationship. In the earlier stages of the Brexit decision, this leads many observers to look to the possibility of adopting the Norway model, by remaining a member of the European Economic Area, or the Switzerland model, which is based on tailored bilateral agreements but still allows the free movement of people in principle. Considering that one of the key issues of Brexit was the call for stronger control over immigration, it is less likely that the UK will follow these existing models as they would not bring about any significant change in that area. Rather, the negotiations are expected to be comprehensive, resulting in a new UK model.

Until recently, the two most critical issues of Brexit were access to the EU single market and the free movement of people. The UK government has asserted that it will find an optimal solution through negotiations while the EU has been clear that there will be no cherry-picking among the fundamental rights of the EU and that the free movement of people should be guaranteed in order to benefit from access to the EU single market. At the Conservative party conference, however, the Prime Minister has given the impression that the priority is on stronger control on immigration at the expense of securing access to the EU single market.¹⁶

While the EU has made it clear that the UK cannot access the single market without guaranteeing the free movement of people, the

EU's position on Brexit has yet to be completely unified. As the outcomes of the upcoming referendum and elections in major Member States are expected to set the tone and course of Brexit negotiations for the EU, i.e. Italy's referendum on constitutional reform in November 2016, France's presidential election and Germany's general election in 2017, it is important to keep a close eye on the political and economic changes in EU Member States.

Meanwhile, although the UK cannot begin formal trade negotiations with a third country while it is still a member of the EU during the Brexit negotiation, it is necessary to prepare for the possibility of negotiating a new trade agreement with the UK. Amid uncertainties, an adequate level of informal talks in this regard would be beneficial. **KIEP**

¹⁶ Financial Times (2016), "Theresa May sets Brexit course away from EU single market." (October 3)