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Brexit

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The purpose of this report is to give a better understanding of the ongoing situation between the United Kingdom (UK) and the European Union (EU) revolving around the UK’s withdrawal from the EU, commonly known as Brexit. Reasoning for the departure is highly political and will have major economic impacts on the UK as well as their trading partners. The decision to exit occurred during a referendum vote on June 24th, 2016 with the departure set to occur on March 29th, 2019 (Walker). While analyzing this relationship we found it would be appropriate to research the events prior to and during this period, and make projections of what will happen after Brexit using economic analysis as well as political trends.

Prior to Brexit, in 1950, unification was a long-term necessity for the countries in Europe following the devastation left behind in WW2 (Wilson). The idea of restructuring Europe as one market involved three different communities combining through the Paris and Rome Treaties. The Paris Treaty was proposed by Jean Monnet in 1950 and later signed by French Prime Minister Robert Schuman in 1951.This treaty formed the European coal and Steel Community (ECSC). This removed nearly all barriers for resources such as coal, steel, and iron and was regulated with fixed prices and quotas on firms by the Central Institution (Britannica). This was significant as countries could trade without being taxed or tariffed. The Treaty of Rome in 1957, which was signed by the countries of Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. This brought the European Economic Community (EEC) and the European Atomic Energy Community (EAEC) to the ECSC, which then formed the European Community as a whole. This was officially signed in 1967 known as the Merger Treaty. The purpose of the Rome Treaty was to impose a centralized customs union to alleviate tariffs and taxes on commodities and goods for those that were a part of the union( Britannica). This would lead to economic efficiency through innovation. Although the economic reasons for entering were obvious, the UK’s history of becoming a part of this Union was not as simple.

With the formation of the EEC, the UK decided to decline their invite as they “disliked many of the Supranational and technocratic elements in the treaty” (Ukandeu). This signaled to other countries and particularly France that the UK felt superior to them and did not believe their system would lead to Economic prosperity. The UK wanted to pursue more of a one-world economic system instead of the guidelines and regulations under the EEC (Investopedia). This lack of trust with one another continued in the 1960’s. The hostility between the two nations furthered as countries within the EEC were experiencing economic growth and the UK wanted to join but were unable to as French President Charles de Gaulle declined their entry twice(Wilson). Eventually de Gaulle left office, and the EU decided to expand, leading to the UK gaining entry in 1973 with Denmark and Ireland. Although economic stability had increased since the start of the EEC, there was still an absence of trade regulations and a more defined market structure until 1986.

The Single European Act (SEA) in 1986 was designed as a six-year plan to develop and implement a single centralized market for the European communities from the common market (Moraycsik). Having this type of market structure would remove non-tariff barriers of trade in addition to allowing for the free movement of labor and capital. This is significant as it would allow these resources to reach their full potential and make way for a more efficient market. An important aspect of SEA was the amendment known as the Maastricht Treaty, which went into effect in 1993. Prior to this treaty being implemented an event known as Black Wednesday occurred in Europe. Black Wednesday was the loss of nearly £3.3 billion due to the pound falling below minimum value with the European Exchange Rates after being promised would not occur (Investopedia). This occurrence led to a lack of trust with Europe and the withdrawal of the Pound from the European Exchange occurred in September 1992. The following year the treaty essentially brought all aspects of the aforementioned communities as well as “foreign policy, defence, police, and justice together under one umbrella” (Bloom). This treaty is what formed what is known today as the European Union and lead into the collection of the Economic and Monetary unions and policies as one entity. With the Single market being enforced in 1993, this allowed for country’s to have a free flow of all goods, people, services and capital for any country within the union which was known as the Four Freedoms (Muller). The UK’s biggest concern with this policy is the free flow of people. UK citizens were worried that immigration from European citizens would take their jobs and diminish their economy. With the addition of resources being free-flowing, the Monetary Union allowed for a currency among all those nations within the European Union to be united as the Euro, which was implemented in 1999. However, the UK was exempt as this currency was unable to pass Gordon Brown’s Five Rule Test in 1997, due to the test’s high economic benchmarks for success (Pettinger). Therefore, the UK was hesitant and never fully adopted all that was within the treaty, but still remained among the EU. The Maastricht treaty remained in effect until the Treaty of Lisbon Amended it in 2009.

The relationship between the UK and the EU remained stagnant for the next several years and the Treaty of Lisbon worsened this. The Treaty itself creates the first President of the EU to a two and half year term, as before was in six month intervals. (Phinnemore) The idea of this treaty was to further the efficiency of the EU and to have a larger influence in world affairs. From the UK’s perspective this would diminish their role and lead them to a more sovereign state and this in fact occurred with the idea of a referendum taking place in 2011 (Waterfield).

The outcome to the referendum to remain or leave the EU was as much an issue of pure politics as it was an issue of economic or social benefit. In October of 2011, nearly one third of Conservative members of Parliament were in support of a motion for a referendum to remain within or leave the EU. David Cameron’s January 2013 ‘Bloomberg’ speech, in which it was announced that a Conservative government would see that the 2015 General Election would seek to have a new settlement arranged for the UK’s membership within the EU and that a referendum would be held regarding said membership, was mainly a party political strategy. Although Cameron’s intention was to unite the Conservative Party for the General Election by minimizing the chance of a split over the issue of EU membership, after Cameron won the 2015 General Election he was faced with an obligation to follow through with his announcement. Cameron’s earlier position that the EU was in need of fundamental reform prevented him from openly acknowledging the benefits of remaining within the EU as it was, allowing supporters of leaving the EU to make their arguments without significant opposition. Additionally, as Cameron’s stance was heavily reliant on a successful negotiation with the EU over the UK’s membership, when he was able to secure only a relatively small victory, (in the form of an exemption from the “ever closer union” outlined within the EU treaties, among a few other small concessions) he found strong hostility in the press and from many Conservative members of Parliament. With so many Conservative members of Parliament then seeking a Brexit, when Cameron then began a campaign to remain within the EU as a result of strong warnings of the risks inherent in leaving, it only served to damage his credibility in the aftermath of his earlier strategy that was seemingly in support of leaving, were there to not be significant reformation (Menon and Fowler 2016). The day after the referendum, on June 24th, David Cameron resigned from his position as British Prime Minister in order to implement “fresh leadership” on behalf of voters (Balz).

Theresa May was elected the new Prime Minister on July 11th and in October she announced that Britain will begin the Brexit process to officially leave the EU by the end of March 2017. She also announced that Article 50 of the EU’s Lisbon Treaty will need to be invoked in order to do so. On March 13th, 2017 British parliament approved Article 50 and on the 29th, Tim Barrow (Britain’s ambassador to the EU) handed the official signed letter triggering Article 50 to Donald Tusk, the European Council President (Walker).

Thirty million individuals turned out to vote on June 23rd in 2016, resulting in a 71.7% voter turnout. 17.4 million votes were in favor of Brexit, opting to leave the European Union which led the referendum by 51.9% (BBC). This outcome surprised many who previously anticipated the vote would see a high turnout of voters in favor of staying. As a result, many economists have researched why initial predictions were so wrong by studying who these voters were, and what influential factors determined the outcome of the referendum. Much of this research has found conflicting results on what affected the outcome, but agrees on several key factors that played large roles in determining how the votes were divided and the surprising turnout rate. A widely accepted determining factor was the amount of education voters received, while additional significant factors include unemployment rates, demographics including age and sex, and economic views on policy.

A study done by Aihua Zhang for World Development determined that more educated individuals tended to vote to remain with the EU. This was seen to have the greatest effect in England and Wales, where the majority of Leave votes were concentrated. The heat map found in figure 1 shows the correlation between access to higher education and the percentage of Leave votes in England and Wales specifically. Zhang used a multivariable regression analysis to conclude that a 3% increase in the amount of voters who had access to higher education in these two locations would have reversed the referendum outcome (Zhang).

The campaign in favor of Brexit focused much of their advertisement on the possible economic downsides of remaining with the EU, and on the effects of immigration. Zhang’s study also concludes that this campaign had a larger effect on voters who were less educated, which can explain the higher voter turnout for those in favor of leaving. One influential campaign argument for leaving the EU was the amount of money the UK sends the EU without receiving sufficient returns to offset that loss. This campaign was publicized by the conservative Leave campaign in many ways, but included buses that drove around Britain during the time of the referendum reading “We send the EU £350 Million a week”. Ian Begg, professor of the London School of Economics discredited this misleading claim. The number came from the UK’s Treasury estimation of the amount the UK contributed to the EU, which was £17.8bn (£342m a week). However, this number was only hypothetical because it ignored the rebate that Margaret Thatcher negotiated in 1984. This rebate reduced the amount the UK sends to the EU from the 1% of GDP requirement for other EU countries. Instead, the UK sends a fraction of this percentage which can be more realistically estimated to about £280m per week (Begg).

In addition to the effects education had on voters,another major factor that brought 17.4 million people to vote in favor of Brexit was how voters saw economic pain points. Many believed that a Brexit could resolve these problems. Economic positions on controversial topics like immigration played a large role in swaying the Leave votes. A survey done by the British Social Attitudes attempted to find correlations among Brexit voters in order to better understand why they voted the way they did. The survey found that immigration was a large proponent in the division of votes. Of those who voted for Brexit, the survey found 73% were worried about immigration. Additionally, young voters saw immigration to have a positive impact while older voters saw a negative impact (BSA).

Voters opposed to immigration believed Brexit could lead to stricter borders, limiting the amount of immigration allowed into the country. However, as discussed later in the paper, this may not be the case. UKIP, or the UK Independence Party, have very strong anti-immigration views and argued to voters that preventing non-EU immigrants from entering would help prevent terror attacks on the country. In order to remain in the Single Market, the UK would have had to allow EU workers through the border, so a Brexit vote wouldn’t necessarily have lead to more border restrictions. Restricting immigration may even lead to compromising economic growth. For example, the UK’s membership to the EU allows any citizen of the EU to relocate in order to work in the UK without a work visa, which economists report is beneficial for the economy. However, non-UK citizens coming in could use up scarce public resources, like their national health service and welfare (BSA).

Even within those who support Brexit, there is a divide between supporters of the “hard Brexit” versus a “soft Brexit”. Both however were taken together as supporting some form of Brexit, leading to the 52% majority we saw as of the end of the referendum. Brexit as a concept seems to be seen in these two somewhat vaguely-defined but opposed views: that of a hard Brexit or a soft Brexit. In essence, these two terms are mainly defined in terms of the UK’s relationship with the European Union’s Single Market.

The hardest “hard Brexit” would entail the UK completely exiting the Single Market and withdrawing from all EU policies. If the UK were to exit without coming to any sort of deal with the EU, they would then be subject to World Trade Organization rules. Under the WTO’s rules, the UK would be subject to the same tariffs and barriers to trade as any other WTO country. Thus the UK’s cost of trade with the EU would increase, along with reduced access to the EU’s labor and service market for both incoming and outgoing operations in the UK. A Brexit of this kind would result in the greatest increase in overall trade costs compared to any other kind of trade agreement.

A soft Brexit on other hand would allow the UK to remain as a member of the EU’s Single market, similar to other non-EU members of the European Economic Area, such as Norway. This is potentially very beneficial to the UK as the Single Market allows freedom of movement and trade of goods and services within the EEA, and access to this free movement makes the UK itself an overall more attractive location for foreign direct investment. One option for a softer Brexit would be to simply join the existing EEA together with Iceland, Liechtenstein, and Norway. While this soft Brexit would spare the UK from some of the EU’s policies, such as the monetary union, their foreign and security policies, and their Common Agricultural Policy for example, maintaining a greater level of legislative freedom, remaining within the Single Market would not come without some cost. To begin with, by its very nature being a part of the Single Market allows for the free movement of people between participating nations. This is a considerable price to pay for those in the UK concerned about foreign immigration. Additionally, to participate in the Single Market the UK would be required to abide by the EU’s economic rules, including legislation regarding employment, consumer protection, product standards, and environmental and competition policies (Dhingra, et al. 2017). Finally, if the UK were to simply join the EEA, they would be required to essentially pay a fee to remain a part of the Single Market by contributing to the EU’s regional development funds and the costs of any EU institutions they participate in, while no longer having any part in the creation of new EU legislation.

Joining the EEA is not the only form of soft Brexit. There also exists the possibility of the UK negotiating a customized deal for themselves, depending on their desired level of economic integration versus political sovereignty. For example, a simple free trade agreement with the EU would remove most tariffs from the trade of goods, but the free movement of people and services would still be limited. Additionally, a simple FTA would lead to overall higher non-tariff barriers to trade due to the introduction of customs procedures and rules of origin requirements. The UK could include provisions to improve market access to services and reduce non-tariff barriers to trade, but ultimately this still would be inferior to remaining within the Single Market in terms of market access (Dhingra, et al. 2017, Menon and Fowler 2016). In general, negotiating some sort of free trade agreement would allow for far more flexibility in choosing exactly which parts of partial participation in the EU that the UK desires, but the tradeoff of ease of trade versus political sovereignty remains. According to Prime Minister Theresa May in early 2017, the UK’s goal in its negotiations with the EU will be to leave the Single Market while still maintaining free trade with the EU to the greatest possible extent.

The question of whether to pursue a harder or softer Brexit is primarily driven by one specific aspect of Single Market membership: the free movement of people. Those pushing for the UK to leave the EU rallied under the banner of “Vote Leave, Take Control”, that is to say, take control of both the money being sent to the EU, and take control of immigration. However, as the free movement of workers is a core part of the Single Market and in fact a central tenet of the EU as a whole, controlling this flow of workers is not possible as long as the UK were to remain in the EU. For this reason, those wishing to remain had difficulty arguing against this desire to control immigration, as there was no real compromise to be drawn without some sort of withdrawal from the EU.

**The Gravity Model and Foreign Direct Investment**

Brexit has put economic and political issues firmly in the public debate arena. To understand this phenomenon in a thorough manner, it is important to assess not only the historical and socio-economic factors that led up to the formation of the EU, the UK’s petition to join the single market in 1986, and the subsequent referendum in 2016; but also to understand how the economy of the UK changed due to EU membership.

Previous literature on the topic finds that EU membership raised the level of real GDP per capita of the UK to an annual gain equivalent to 10 percent of its GDP –which exceeds the EU membership fee that totals about 1.5 percent of GDP in terms of the net budgetary contribution and net costs (Crafts). Also, the location and size of the European market are the most important determinants of inward foreign direct investment (FDI) for manufacturing and services (United Nations Conference on Trade and Development, UNCTAD), suggesting that EU membership played an important role in determining investment decisions to the UK.

Campos and Coricelli (2015), identify three main EU-linked channels that benefited the economy of Britain: trade, finance, and foreign direct investment. Within the financial sector for instance, the UK’s share in foreign exchange transactions has increased from 25% to more than 40% in the world market; and the euro accounts for more than one third of the foreign exchange transactions (Lane and Gian). For this paper, we will focus on FDI inflows given its causal role in economic growth through financial markets (Alfaro, Chand and Kalemli-Ozcan); its more resilient and sustainable characteristics; its positive role in the diffusion of management practices; and its increase in competition and technological innovation, mainly because Britain is one of the main FDI recipients in Europe (Nauro Campos and Fabrizion Coricelli).

Theoretically, FDI can benefit the economy of countries in several ways. Arguing that the EU makes it a more attractive place to invest can be challenging to prove with econometric methods. In this sense, the gravity model can serve as an empirical method to assess a variety of effects such as the impact of trade agreements, exchange rate volatility, currency unions, border effects and cultural commonalities (Baldwin, Skudelny and Taglioni). The gravity model analogizes on Newton’s universal law of gravitation to describe patterns of bilateral aggregate trade flows between two countries, proportional to the gross national products of those countries, and inversely proportional to the distance between them (Tinbergen). The model has become the workhorse and tool of international economic relations because: 1) international trade flows are a key element in all manner of economic relationships; 2) the data necessary to estimate it are now easily accessible to all researchers; and 3) a number of high-profile papers have established the gravity models respectability (Baldwin, Skudelny and Taglioni). In this sense, we propose the following econometric model:

where is an outcome variable representing the percentage change in FDI inflows for the host country; and are independent dummy variables representing EU membership (coded 1 if yes, and 0 if no); is the percentage change of GDP for the target country, and is the percentage change of GDP per capita for the country of origin; is the percentage change of GDP for the country of origin; is the percentage change of GDP per capita also for the country of origin; and the natural log of distance between the target country and the country of origin; epsilon is the error term. We aim to estimate the effects of the parameter on EU membership for target countries. We use data on bilateral FDI flows from the UNCTAD[[1]](#footnote-0) website, ranging from 2001 to 2012, data on GDP and GDP per capita from the World Bank[[2]](#footnote-1), and distance information from between target and sender countries from the CEPII[[3]](#footnote-2) database. We analyze the bilateral relations among developed countries (as defined by UNCTAD), 30 countries in total, and perform the final regression with a total of 5,327observations.

We find that among developed countries, EU membership increases FDI inflows by 26% percent as opposed to countries that are not part of the European Union (exp[0.3]-1=0.35), and our result is statistically significant at the 10 percent level. Table 1 and Table 2 display the findings of our summary statistics and regression model, respectively. Our findings show that EU membership heavily attracts FDI, though we do not account for other control variables that could potentially capture more characteristics of these countries’ economies.

Campos, Coricelli and Moretti (2014), who use the synthetic counterfactual method, find that the single market of the EU played a key role in mobilizing FDI to the UK, being the bulk of these benefits constituted during the post-EU membership era. In the absence of the single market, they argue, per capita incomes of EU members could be approximately 12 percent lower on average. Bruno, Campos and Estrin (2016) find that EU membership increases FDI inflows between 14 to 38 percent; and predict that leaving the EU will reduce FDI by 22%. Haskel, Pereria and Slaughter (2007), state that a 10 percent point increase foreign presence in UK industry (an increase in FDI), raises the total factor productivity of that industry’s domestic plant by 0.5%; and the per job value of these spillovers can be valued at about $6,300[[4]](#footnote-3). In combination with our findings, assuming there is a 35% decline in FDI, we could expect a 1.75% decline in total factor productivity[[5]](#footnote-4), which would imply a decline in output not accounted by a decline in inputs.

The UK and EU relationship is a very fluid situation that will take many years to fully develop. This future relationship is being planned out by negotiators in Brussels from the UK and the EU. Both the EU and the UK are represented by four diplomats on each side.

The EU negotiation team is led by Michel Barnier a French politician serving as European Chief Negotiator for Brexit under Article 50 of the Treaty on the European Union. He has given indication that he will take a hard stance on negotiations. Mr Barnier has also made clear that the sequencing of talks is very important. The UK will not be able to negotiate a trade deal until separation terms are agreed upon to keep the EU Single Market intact and the UK settles its debts to the EU. Second in command on the negotiation team is Sabine Weyand a German national selected as Mr. Barnier’s deputy chief negotiator in September. Often called a commission “problem-solver,” she has spent six years in the cabinet of French former EU trade chief Pascal Lamy and over a decade at the commission. She is unlikely to allow UK much ground in trade talks that could weaken the EU Single Market ideal of free movement. Next is Donald Tusk the president of the European Council. He did all he could to make a deal that would keep the UK in the EU. He has told the UK to not expect any cherry-picking of deals during negotiations. He hopes for a “smooth-divorce” and to break up as “good friends”. Mr Tusk has been a proponent of free trade policies and pursues privatization and low taxes to entice foreign investors. Last on the EU side is Didier Seeuws who was asked by Donald Tusk to head the Council’s task force for Brexit negotiations. The council team is tasked to keep the remaining 27 national governments happy and to shape the EU’s longer term strategic relationship with the UK. From 2007 to 2010 he served as Belgium's Deputy Ambassador to the EU and was very respected for his role during the Greek debt negotiations. (Brexit: The People)

The UK negotiation team is led by David Davis the Secretary of State for Exiting the European Union or Minister for Brexit. Mr Davis was a high-profile Leave supporter and campaigner in the run-up to the EU referendum. He was first elected to parliament in 1987 as MP for Boothferry he later as served as a government whip in 1992 for pushing through the Maastricht treaty which led to the euro and greater integration of the European Union. After nearly a decade of being out of politics he won the support of Theresa May and was seen as a safer choice than other outspoken Leavers like Liam Fox or Boris Johnson. (Wheatstone) The second in command to Mr Davis is Oliver Robbins who is the top UK official at Brexit talks. He has spent time as director of the civil service and as David Cameron's deputy national security advisor, he then became the senior civil servant in charge of immigration policy at Theresa May's home office. Many Brexit supporters fear that his appointment means that Britain is leaning towards a gentle exit from the EU, believing Robbins sees Brexit as a crisis and not as an opportunity. Since Oliver is Theresa May’s chief advisor on Europe, many have dubbed him the “real Brexit secretary”. (Watt) The next negotiator is Tim Barrow a career diplomat, he was drafted into the role of ambassador to the EU after the resignation of Sir Ivan Rogers. He has spent a long time in Brussels and knows the people and place well. He served as Britain's ambassador in Moscow from 2011 to 2015 and as ambassador to Ukraine before that. Seen as a good choice by most Brexit supporters because of his dealings with Moscow in the past and is not seen as a pro-EU figure. The last negotiator is Sarah Healey who was the Director General of David Davis’s department, second-in-command of the civil service department in charge of executing Brexit. She has spent time as director of many different departments including culture and media, private pensions, and education funding. Has led cross-government work on gender diversity in the Senior Civil Service. (Brexit: The People)

The two parties have had various talks throughout 2017 on how negotiations would take place and officially began negotiations in February 2018. They have agreed to a few key points that will shape the direction of negotiations.

The first key point they agreed upon was to have a transition phase that will last roughly 2 years. This agreement is probably the most important step taken in negotiations so far and lays out the transitional period from the official Brexit day of March 29th, 2019 till December 31st, 2020. This agreement covers many key points including that it will allow for the UK to negotiate, sign, and ratify its own trade deals during this period. The UK will still be included in existing EU trade deals with other countries. The UK will also have its share of fishing catch according to Common Fisheries Policy, without a direct say in its rules, until the end of 2020. Northern Ireland will effectively remain in the Single Market and Customs Union in the absence of other solutions to avoid a hard border.

The second agreement is that there will be no hard border with Ireland. No physical infrastructure or related checks and controls will be put in place on the Ireland and Northern Ireland border. All sides agreed with full implementation of the 1998 Good Friday Agreement. People of Northern Ireland who are Irish citizens can continue their rights as EU citizens. The details related to the EU Single Market and Customs Union in Ireland and Northern Ireland will be fleshed out in the next phase of Brexit negotiations. There is still much more progress that will have to be made on this topic as the UK believes in using technology to ensure seamless border checks. The EU is skeptical of a “digital border” being a possible solution. This will be a very controversial topic during negotiations, but it is clear neither side want a physical border. (The UK and EU Agree)

The third agreement is over the rights of EU and UK citizens. The rights of EU citizens working and living in the UK and the UK citizens working and living in the EU will be respected. This impacts over 4 million EU-UK citizens and protections would apply to spouses and children of EU-UK residents, even after the Brexit date. All citizens will be able to continue working and living in the UK as they have done with their rights enshrined in UK law and enforced by British courts. UK citizens in the EU will also retain their current rights.

The final agreement was concerning the ‘Divorce Bill’. The divorce bill is the amount that the UK will agree to pay for outstanding liabilities after Brexit. No official amount has been agreed upon yet, but UK officials estimate a potential total bill of £35–39 billion that will be paid out till 2064 as pension liabilities fall due. Net payments will be made till 2064, but around half of the total payment will be paid during the transition phase estimated to be about £16.4 billion. This will be followed by net payments of £6.7 billion in 2021, £5.11 billion in 2022, £2.73 billion in 2023, £1.5 billion in 2024, and falling away to £0.18 billion in 2028. The liabilities that remain to be paid out amount to a estimated total of £2.38 billion. These amounts have varied throughout the last few months and might continue to change in the next couple years. (The EU Divorce Bill)

The transition deal was agreed upon by the EU27 at the EU summit last month. With the agreement set in stone the UK and EU negotiations can continue on with trade talks. This takes us to present day which makes getting any concrete information impossible. The UK and EU hope to reach an agreement on the framework for future relations by October of this year. This agreement will layout the passage of withdrawal in the European Parliament and the UK Parliament. To try and guess where negotiations will head in the next few months would be very tough. We will attempt to narrow down possible places Brexit will end by examining Theresa May's comments and closely look at other agreements the EU has made with other countries.

Theresa May has made two speeches on her vision of Brexit during the Lancaster House Speech in January 2017 and her Florence speech in September 2017. These speeches made it clear that the UK plans to leave the EU Single Market and the Customs Union. Both these speeches also added some clear goals and some more vague ones on what the UK wants.

The Lancaster Speech laid out her plan for Britain to become a “truly global Britain”. She also had a message to the rest of Europe that the Brexit referendum is not the beginning of a greater unravelling of the EU, because it is still in the UK's best interest for the EU to remain strong. Theresa May laid out twelve objectives and ambitions for a new, positive and constructive partnership between Britain and the EU. The first objective is to provide certainty wherever they can during negotiations. This is so that everyone in the UK and the EU have the ability to plan ahead for whatever outcome is reached. The second objective is to build a stronger Britain. This means taking control of their own affairs and ending the jurisdiction of the European Court of Justice. The third objective is to strengthen the union between the four nations of the United Kingdom. The fourth objective is to maintain the Common Travel Area between Northern Ireland and Ireland. This border was formed before either nation was apart of the EU so it is important to create a practical solution that leaves the border open. The fifth objective is to control immigration. They want to be able to control the number of people coming to the UK and not be forced to let anyone from the EU inside their borders. The sixth objective is to guarantee rights of EU nationals in Britain, and British nationals in the EU as soon as possible. The seventh objective is to protect workers rights in the UK. This means that they will translate the European law into their own domestic regulations and build upon them. The eight objective is to pursue a bold and ambitious free trade agreement with the EU. The ninth objective is to sign new trade agreements with other countries so that they can become a Global Britain. The tenth objective is to make Britain the best place for science and innovation. They hope to continue with European partners on major science, research, and technology innovations. The eleventh objective is to continue to cooperate with their European partners in the fight against crime and terrorism. The final objective is to have a smooth and orderly Brexit. This smooth exit is to avoid a cliff-edge for businesses or a threat to stability as they change their relationship to a new partnership with the EU. (The Government's Negotiating)

In Theresa May's Florence Speech she reconfirmed many of her prior commitments and added a few more objectives that they wanted to reach. She made clear that the Brexit referendum will cause shared challenges for all. She wanted the EU to know that Britain will continue to stand with them as allies in defence of their shared values. She also made clear that this decision was one made by the British people. The British people wanted more direct control of their own affairs and have the ability to hold their politicians accountable and not be subject to foreign interests. She continued her speech by re-confirming that they will offer assurance on citizens’ rights, would remain committed to European security, and that there will be no physical border in Northern Ireland. Theresa May also said that there will be a transitional period after the leave date and that that the UK is willing to pay all outstanding debts that they owe the EU.

There is a lot of overlap in these speeches and there are many points that the UK and EU would both agree on. They would like to see certainty and clarity throughout these negotiations so that both sides, especially the UK, are able to know what the future holds. They both also want to see the rights of their foreign nationals protected, cooperation in the fight against crime and terrorism, and continued collaboration on major science, research, and technology initiatives. These points should see majority bilateral approval on the future relationship, but it is unclear how much each can be used as bargaining power. There are however many other points that will be key in determining the future relationship that will be contested throughout negotiations. Many of these key points can be put into two separate groups of defensive interests and offensive interests. (PM's Florence Speech)

**Defensive**:

* Control migration from the EU
* End the jurisdiction of the European Court of Justice
* End applicability of EU regulations
* Pursue an independent trade policy
* Stop obligatory budgetary contributions to the EU
* Exit CAP and CFP

**Offensive**:

* Tariff-free trade with the EU
* Access to the EU Single Market for services
* Seamless and frictionless border
* Voluntary participation in EU programs
* Speed of negotiation (within Article 50 process)

The defensive interests or “red lines” are the key points that the UK would have control under if they wanted to implement a complete hard Brexit. The offensive interests however are the benefits that the UK could only receive through negotiations with the EU. There seems no conceivable way that the EU negotiators would allow all these offensive interests, especially tariff-free trade and access to the EU Single Market for services, without Theresa May relenting on some key points in her Lancaster Speech.

There are many different options that the EU and UK could take that have precedence with other agreements countries have made. These “off the shelf” options are just a few of the many deals that the EU has worked out with countries in the past. Theresa May has stated that the UK will not take any off the shelf options and wants something completely original. However, by examining other options like those of Norway, Turkey, Switzerland, Ukraine, Canada, and the WTO we are able to see what the future could potentially look like after Brexit.

The Norway option would see the UK staying in the EU Single Market and leaving the Customs Union. Norway's situation involves being part of the European Economic Area (EEA) and is one of the two most pointed-to options for the UK to take. Following this policy would allow for many of Theresa May’s offensive interests including tariff-free trade and voluntary participation in EU programs. This however is not a likely route the UK will take with negotiations. This option means the UK would still abide by the EU’s four freedoms, including freedom of movement. They would still be subject to EU regulations, without having a say on what the rules would look like in the future, and they would be subject to the European Free Trade Association Court (EFTA) which follows the European Court of Justice (ECJ). The chances of the UK staying a member of the Single Market are very slim and would be in direct contradiction of what the pro-Brexit supporters voted for.

The Turkey option would see the UK leaving the EU Single Market and the Customs Union, but creating a new customs union with the EU. If the UK took a similar deal to Turkey they would be able to ensure tariff-free trade for goods covered by the new customs union, have the ability to control migration from the EU, and stop their obligatory budgetary contributions to the EU. The downside to this option would be that by accepting the EU’s common external tariffs the ability for the UK to pursue new independent trade policies would be greatly diminished and would require the UK to comply with a substantial amount of EU product legislations. They would also not have access to the EU Single Market for services. The UK is more likely to adopt policies closer to that of Turkey than Sweden, but many key points would still need to be addressed and tailored to fit the UK.

The Swiss option would involve leaving the EU’s Single Market and Customs Union and is also one of the most talked about plans of exiting the EU along with the Norway option. This option includes more than 120 bilateral agreements developed over the last two decades. The Swiss have tariff-free trade with the EU and limited access to the EU Single Market. If the UK were to adopt a system similar to this they would have greater flexibility in negotiating trade deals and limiting the scope of jurisdiction from the European Court of Justice than they would following a Norway plan. However, they would still have to allow for the free movement of labor and citizens and comply with the EU regulations that govern the part of the Single Market they access, without the ability to control those regulations. This option would also lead to a massive loss in opportunity cost from the time it would take to negotiate independent trade deals with other countries. The Swiss plan is unlikely to suit the needs of the UK who want to control migration and not have to deal with decades of negotiations for other bilateral agreements.

The Ukraine option is an association agreement with the EU that provides nearly-full access to the Single Market. An association agreement is a treaty between the EU and a non-EU country that creates a framework for cooperation between the two, often used as a step towards full EU membership. This option would allow the UK to leave the EU Single Market and the Customs Union while still having access to it for financial services and allow for tariff-free trade with the EU. It would also allow for the UK to control migration from the EU and allow them to have the ability to pursue independent trade policy. This association agreement would check off many of the key points the UK is hoping to receive, however these agreements would keep the UK under jurisdiction of the European Court of Justice and the UK would still have to follow EU regulations. Depending on the amount of jurisdiction from the ECJ and scope of regulations, this agreement would open up some interesting avenues of negotiation the UK could take. However, it is unlikely the EU would allow the same privileges to a country leaving the Union as it would a country trying to join.

The Canada option is a comprehensive economic and trade agreement that allows tariff-free trade with the Single Market for industrial goods and agricultural produce. Canada does not have to comply with EU regulations, but there is a mutual recognition where each side accepts the other countries regulations for market access to some services. It can lead its own trade policy but that means custom control and compliance with the “rules of origin” checks. If the UK were to follow this option they would receive all the benefits Theresa May wanted in her defensive interests, but would not have a seamless and frictionless border due to customs checks. This option also only allows for minimal access to the EU Single Market for services, while the UK is looking to have complete access. The Canada option is one the UK would like to replicate in many aspects, but it remains to be seen how much the EU would allow.

The final option is the World Trade Organization (WTO) which would see the UK leaving the EU Single Market and Customs Union with no future trade deal. This option would have the UK revert to trading with the bloc of 27 member states on WTO terms. Both the EU and UK would apply tariffs for trade between the two and with no agreement on regulatory equivalence, there would be no preferential access to the EU market for services. There would also be no way around bilateral agreements to ease the flow of trade. This option would be catastrophic for the UK and unheard of since no major countries trade with the EU on WTO terms alone. This would also be a minor annoyance for the EU who still want access to the financial services in the UK. The UK is extremely unlikely to allow this sort of “hard” Brexit to occur because of the massive economic impact (The Options for the UK's).

The process of negotiations will continue to make projecting the implications of Brexit difficult for all parties involved. The UK will attempt to minimize the economic losses in the short-run and to put themselves in a prime position for the long-run. The EU will also look to keep the Union strong and to deter any other countries from leaving in the future. This involves not letting the UK off too lightly. However, the UK and EU also recognize the importance of remaining close allies and continuing to benefit from close economic ties. We envision the UK and EU taking a plan similar to Canada's, allowing the UK access to the services sector of the EU Single Market. The UK would likely give up power such as continuing the applicability of EU regulations, obligatory budgetary contributions, and not have a complete frictionless border in order to achieve the most economically beneficial option.

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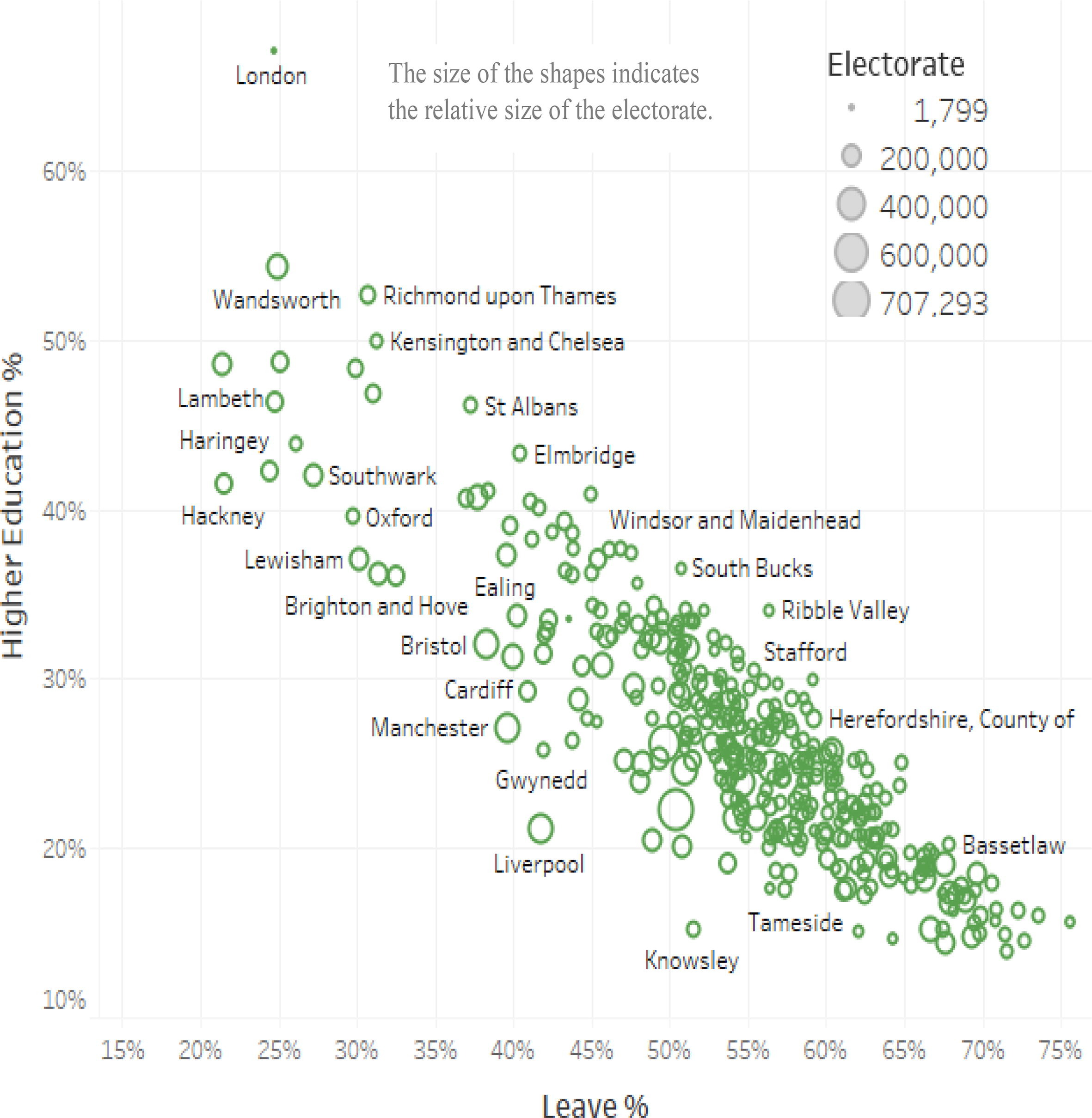
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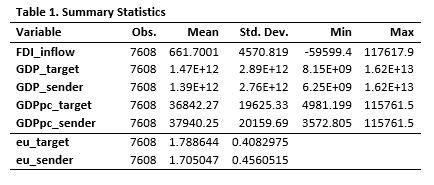
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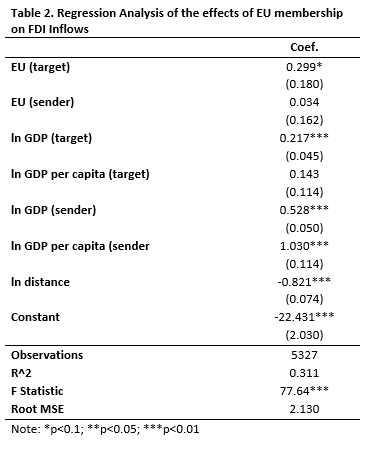
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Figure 1:







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2. <https://data.worldbank.org/> [↑](#footnote-ref-1)
3. <http://www.cepii.fr/cepii/en/bdd_modele/bdd.asp> [↑](#footnote-ref-2)
4. Calculated in 2018 prices. Original article estimates this value at €2,400 in 2000 prices (or $4,300). [↑](#footnote-ref-3)
5. (35\*0.5)/10 = 1.75 [↑](#footnote-ref-4)