The Cost of Brexit

On January 1, 1973, the United Kingdom joined the European Economic Community (as the European Union was known then). The belief was that by joining the Community, the UK would be able to strengthen its trading ties with other member states in Europe and enjoy substantial gains from trade, which would result in greater economic growth going forward. However, the decision was politically controversial, with many in the UK fearing that membership would limit the country's national sovereignty. A 1975 referendum reaffirmed Britain's commitment to staying in the Community, with 67 percent of the electorate voting in favor of continued membership.

Fast forward to June 2016, and the UK held another referendum on membership in the European Union. The core issue was the same as that which produced the 1975 referendum: A significant proportion of the country felt that membership in the EU was negatively affecting the country's national sovereignty. Flash points included (1) surging immigration from EU member states in eastern Europe, such as Poland, and concerns that expansion of the EU to include Turkey would lead to even more immigration; (2) the growing power of the EU bureaucracy in Brussels; and (3) the inability of Britain to make its own trade deals while a member of the EU. Those who wanted to leave argued that Britain would be economically better off in the long run if it exited the EU. Those who wanted to remain argued that by exiting, Britain would suffer substantial economic harm from the loss of easy access to the EU's large single market. In the end, the "leave" campaign won the referendum over "remain" by 51.89 percent of the vote to 48.11 percent. This narrow victory did little to ease political tensions in the country, but the ruling Conservative government, which itself was deeply split on the issue, now had to negotiate an exit deal with the EU.

Negotiating an exit deal that minimizes the economic dislocation of exit while satisfying those in the leave camp who want to quickly sever ties with the EU proved to be anything but easy. Facing political chaos, the country requested an extension beyond the original March 29, 2019, exit date in order to try and broker a deal that could pass muster in the UK Parliament. The EU agreed to extend the deadline until October 31, 2019. and then January 31, 2020, when Britain formally exited the EU. However, the precise terms of any post-Brexit trade deal between Britain and the EU are still being negotiated and may not be known until the end of 2020. Notwithstanding this, it has already become apparent that whatever the long-run impact is of exiting the EU, in the short run, the uncertainty surrounding the form and timing of Brexit has already imposed economic harm on the UK economy.

One early study from a Bank of England economist suggests that between the June 2016 referendum and the end of 2018, the cost to the UK had been running at £40 billion a year, which implies a loss of about 2 percent of GDP by the end of 2018 compared to where the country would have been. The study suggests that a primary reason for lower economic growth in the UK was the stagnation of business investment due to the uncertainty surrounding Brexit. Of primary concern to many UK-based businesses is how their access to the EU's single market will be affected by any Brexit deal, given that tariffs on exports to the EU rates might rise after Brexit.

Another estimate from economists at Standard & Poor's suggests that by the end of 2018, the UK economy was around 3 percent smaller (a loss of £66 billion) than it would have been had the decision been to remain in the EU. The S&P team suggests that in addition to lower business investment, a depreciation in the value of the British pound following the referendum contributed to higher inflation in the UK, which put a damper on household spending, depressing demand in the economy. The S&P study also noted that while currency depreciation would normally be expected to boost exports, no such effect was observed in the UK case. One explanation for this may be that businesses in other EU countries were unwilling to increase their purchases of UK goods and services, even at lower prices, given the uncertainty surrounding Brexit.

In February 2020, a study by Bloomberg Economics calculated that Brexit would cost Britain £200 billion in lost economic growth by the end of 2020, implying that the British economy would be 3 percent smaller than it might have been had the country not voted to leave the EU. The study also noted that by the end of 2020, Brexit will have cost Britain more than its payments to the EU over the 47 years since it originally joined the trade group.

Looking forward, there is ample anecdotal evidence that many firms with substantial UK assets will move some production out of the country if the final Brexit deal is not to their liking and the country loses preferential access to the EU single market. Among those threatening to relocate facilities to mainland Europe or reduce UK investments are automakers Honda, Nissan, Land Rover, and Ford; the consumer electronics companies Sony and Panasonic; Dyson, the innovative British consumer products company; aircraft-maker Airbus; and banking giant JPMorgan.

Case Discussion Questions

1. What have been the benefits of the EU to the British economy? What do you think have been the costs?
2. Why did a majority of people in Britain apparently feel that it was in the best interest of the nation to exit the EU?
3. There is evidence that the uncertainty surrounding the precise nature of the post-Brexit trade deal between Britain and the EU has lower economic growth rates in Britain. Why do you think uncertainty over trade has this effect on growth?