

Brexit and geopolitical uncertainty



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What will be the impact of Brexit?

On the economies of the UK and on the EU 27?

- Brexit will inflict economic losses on both sides
- The losses will be considerably larger for the UK than for the EU27
- Only in very pessimistic scenarios will EU27 losses be large
- Economic effects flow through several channels
 - trade in goods and services; investment; immigration; productivity; fiscal costs
- How easy will it be for the UK to negotiate “deep” Comprehensive Trade Agreements (CFTAs)?

For financial stability in Europe?

- Brexit will adversely impact the UK financial services sector
- The EU27 will benefit from the relocation of financial activities
- Significant financial instability is unlikely

What are the implications of Brexit for the UK?

“An unprecedented geopolitical shift. The only thing comparable in my lifetime is the end of the British Empire.”

Lord Peter Hennessy, Leading British historian

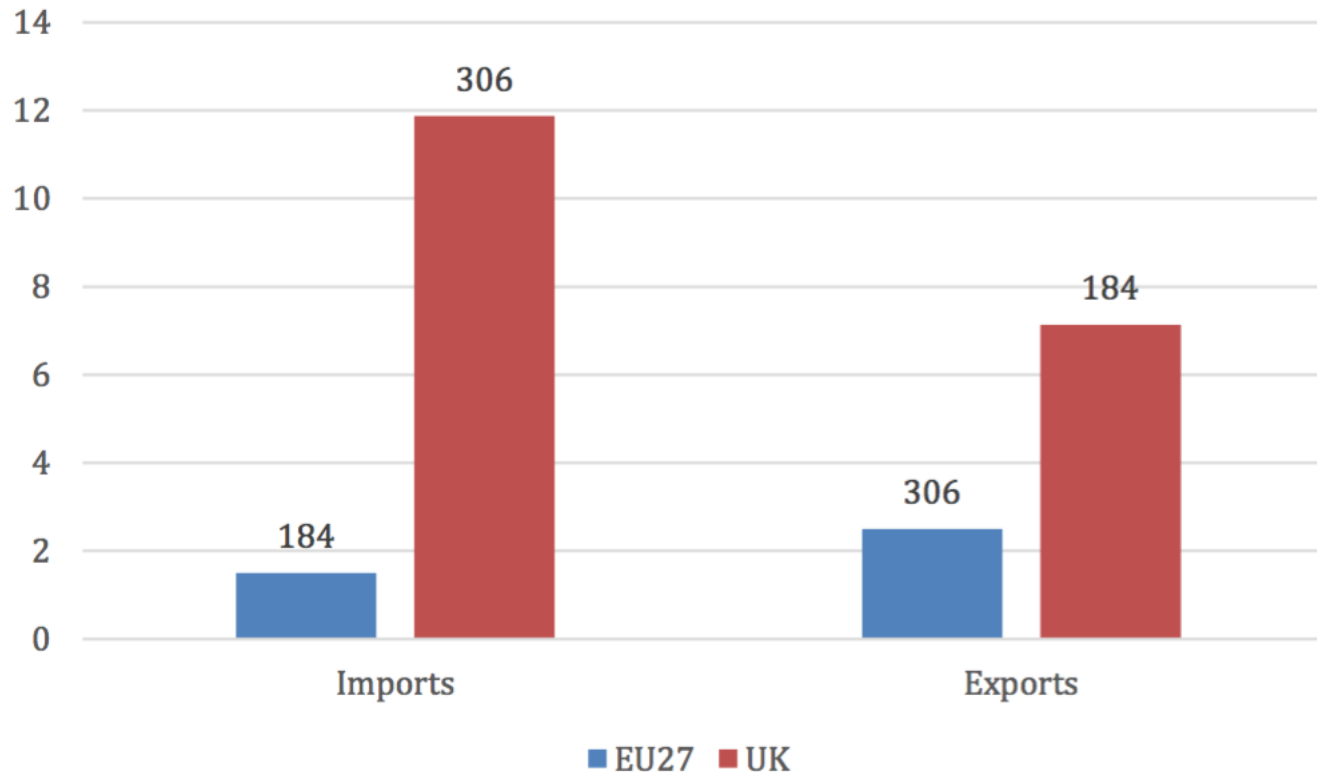
- **The outcome of Brexit negotiations is uncertain**
 - final agreement requires approval of the UK, a qualified majority of the other member states (20 out of 27) and the European Parliament
 - time-limit for negotiations is 2 years, but can be extended with *unanimous* agreement of all member states
 - if no negotiated agreement can be reached, the UK would exit and be treated like any other third country. Theresa May: *“No deal is better than a bad deal”*
- **... but some things are clear**
 - The political imperative of “taking back control” (of immigration) point towards a “Hard Brexit” scenario and greater economic costs for the UK

What are the Post-Brexit trade options for the UK?

1. Leave the EU and apply to join the European Economic Area (EEA) ***'Soft Brexit'***
2. Negotiate a new Comprehensive Free Trade Agreement (CFTA) like the agreement Canada has with the EU (CETA)
3. Leave the EU without any trade agreement and apply, as a separate country, to join the WTO ***'Hard Brexit'***

Implications of Brexit for the UK

Bilateral trade of goods, in % GDP (label: value in billion Euro)

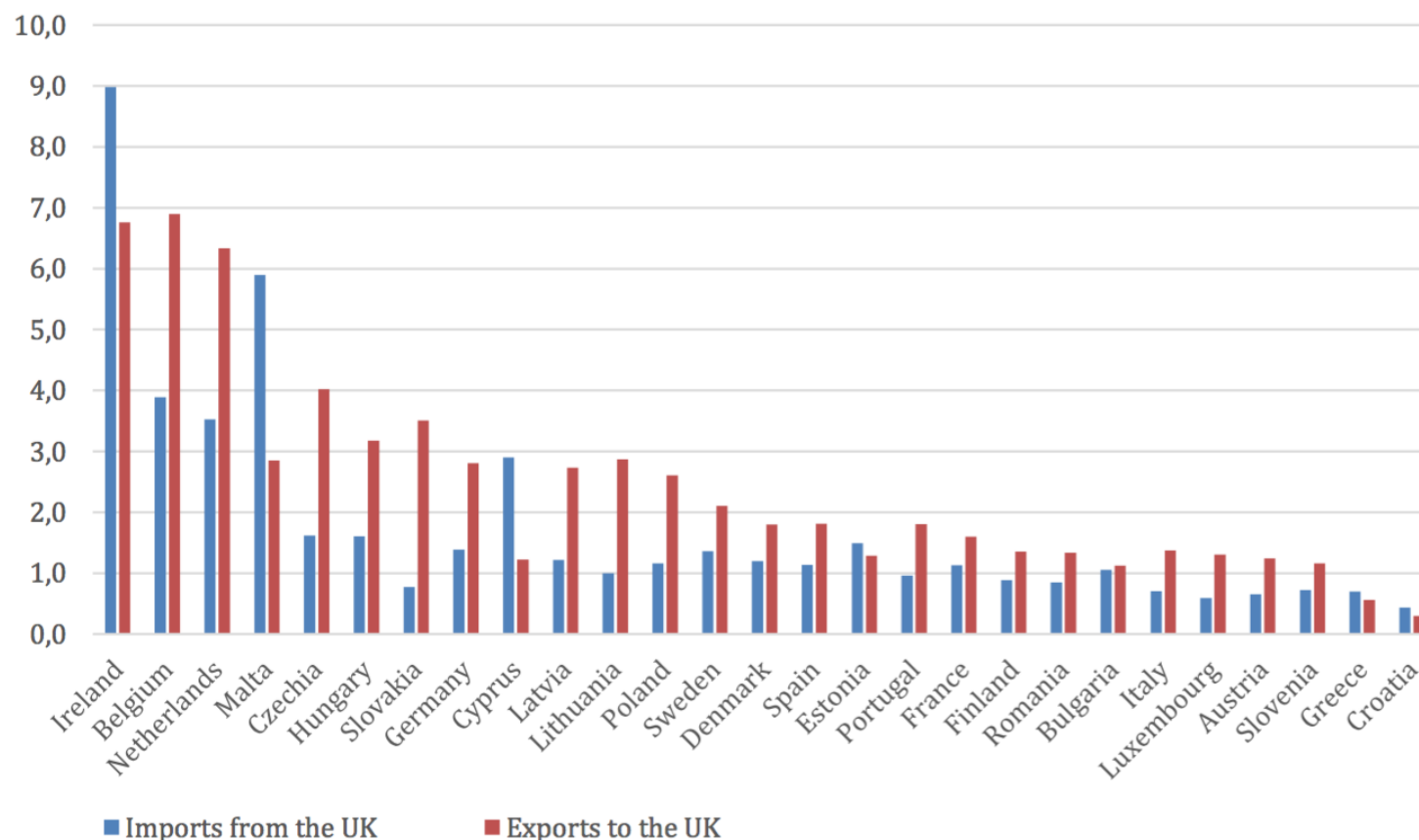


Source: Centre for European Policy Studies, *An Assessment of the Economic Impact of Brexit on the EU27*, March 2017, Brussels.

- UK trade with the EU27 is a much bigger % of the UK's GDP than that of the EU27
- 'Legacy costs' of the divorce are estimated to be in the range of €20-40 billion
- At least 759 treaties currently in the EU treaty database need to be renegotiated

Implications of Brexit for the EU27

Goods Imports and Exports of EU 27 with the UK, % GDP



Source: Centre for European Policy Studies, *An Assessment of the Economic Impact of Brexit on the EU27*, March 2017, Brussels.

- Dependence on the UK is much higher for smaller EU member states that have close historical ties to the UK and/or geographic proximity (Ireland, Cyprus, Malta, Belgium, Netherlands)

Implications of Brexit for the EU 27

Costs

- EU budget: UK withdrawal is likely to leave a 'hole' of about €9 billion annually
- Partially offset by
 - a *continuing* UK contribution for a high degree of market access as part of a CFTA *or*
 - from *tariff revenues* if the relationship is based just on WTO membership terms
- Loss of competitiveness
 - from threatened reductions in tax and regulatory burdens by the UK to compensate for Brexit losses

(Theresa May: Jan 2017 Mansion House Speech '*Global Britain*')

Benefits

- Switch of inward FDI from UK to EU27 and improvements to human capital stock from returning UK migrants

Will Brexit undermine financial stability?

- The UK is a key node in the global financial network
 - important *economies of scale*
 - positive *network externalities*
- It is likely that financial firms' ability to operate across jurisdictions post-Brexit will be curtailed to some degree
- The complexity of financial institutions is likely to increase post-Brexit, making life harder for national supervisors, even if there is a generous agreement on regulatory equivalence
- But, financial stability benefits could arise from a less concentrated banking system throughout Europe

Financial sector implications of Brexit

- For Banking
- For Asset Management
- For Insurance and Reinsurance
- Passporting

NUMBER OF FIRMS WITH FINANCIAL SERVICES PASSPORTS TO AND FROM THE UK

Legislation	Passports Outbound	Passports Inbound
MiFID	2,250	988
AIFMD	212	45
UCITS	32	94

Source: CFA Institute, *Brexit: What it means for Investment Management*, 2017.

Starting points for discussion

- Which EU27 countries are best placed to benefit from the opportunities opened up by Brexit?
- How likely is a ‘hard Brexit’ and how badly will it hurt the UK?
- Is there likely to be a Brexit contagion effect among other EU 27 countries?
- How badly has Brexit damaged the legitimacy of the EU project and the EU’s international influence?