THE FUTURE OF THE UNITED KINGDOM OUTSIDE THE EUROPEAN UNION

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Abstract
Being a EU member comes with a lot of economic benefits, but with the political cost of giving up some sovereignty. The majority of UK citizens considered the sacrifice too big and on June 2016 voted for UK's exit from the EU. As the EU is the main commercial partner of the UK, the Government will focus its energy to ensure the best possible outcome for the British people in the negotiations. The separation process is complex, will take years to finish and nobody may know for sure what will be UK's future outside European Union.

Key words: Brexit, European Union, referendum, single market, trade agreement

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1. European Union from ideal to reality

The idea of an integrated Europe in economic terms started after the Second World War, out of the desire to avoid further armed conflicts. Currently, the European project is associated with the idea of modernity, progress and unity in diversity. 28 countries and 500 million citizens make up the European Union, the largest trade block, that plays a central role in shaping the global trading system. Within EU's single market, people, goods, services and capital can move as freely as within the territory of a single country. In order to create this single market, hundreds of technical, legal and bureaucratic barriers that were standing in the way of free trade and free

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movement between Member States, were removed. These measures increased the competitiveness of European businesses, lowered the prices and diversified the offer for consumers (European Union). The EU has become the world's largest exporter of manufactured goods and services, and is itself the biggest export market for around 80 countries. Also, it is the main recipient of inward investment and the largest source of foreign direct investment in the world (The World Bank). Schengen Area and the Eurozone are among the greatest achievements in terms of economic integration but the process is far from being over. There are still many obstacles in the integration process: in the area of fiscal policy, financial services, electronic commerce and services.

EU's vulnerability became apparent with the 2007-2008 financial crisis, the Eurozone crisis and the migration crisis. Because of the way Brussels' officials have managed these crises, the confidence in the EU and its leadership dropped sharply. According to the American think tank the Pew Research, over 71% of Greeks and 61% of French have unfavorable opinion of the EU, while almost half the citizens from Germany, Spain and the Netherlands have become Eurosceptic (Pew Research Center). For the European integration process to become complete, the transfer of power from Member States to the EU must continue. However, once the crises began to unfold, governments have pursued national interests and the gap between member countries deepened. Germany has become the undisputed arbitrator of European affairs and managed to wield the power of decision. Apart from this, the excessive bureaucracy and the regulations imposed by EU are other significant aspects that European citizens complain about.

Winston Churchill, the UK prime minister during the Second World War, was one of the founding fathers of the EU. His experiences during the war convinced him that only a united Europe could guarantee peace. Its ideals are reflected best in his famous speech to the students at the University of Zurich in 1946: "There is a remedy which ... would in a few years make all Europe ... free and ... happy. It is to re-create the European family, or as much of it as we can, and to provide it with a structure under which it can dwell in peace, in safety and in freedom. We must build a kind of United States of Europe" (European Union). Although it became a member of the European Economic Community in 1973, the forerunner of the EU, Britain never fully accepted the legitimacy of European control over British institutions in a way that other countries did. It refused to join the Schengen Area, which aimed to eliminate internal border controls, and the Eurozone, in order to give up the pound and adopt the euro. The recession installed after the 2008 financial crisis in Europe has boosted Britain's euroscepticism. The vast majority of UK citizens were dissatisfied with the way the EU has handled the euro crisis and the refugee crisis and wanted the national government to regain the authority (Pew Research Center). Excessive regulations, the country's large contribution to the EU's budget and the large number of EU migrants, are only some of the Britons' discontent to the EU.

2. The need for a referendum

Under the pressure felt by the increased wave of Euroscepticism, in 2013, the Prime Minister and Conservative Party leader, David Cameron has promised a referendum on UK staying or leaving in/off the EU, if the party wins the next elections. Two years later, after a very close fight, the Conservative Party won the elections, obtaining an absolute majority in Parliament. One of the promises made during the campaign, was to negotiate new rules with Brussels on the terms of British membership. The message sent by the UK during the negotiations on February 2016 was that the country is not committed to further political integration into the European Union. He also obtained a guarantee that the UK will not join the euro and we will never be part of Eurozone bail outs or the Schengen border-free area.

One of the old complaints of the British regarding the EU membership was the immigration problem. After EU's enlargement in 2004, the UK experienced a far greater influx of East Europeans than had been anticipated. Total net migration to the UK was running at over 300,000 in 2015, and remains at record levels. Between 2007 and 2013, in the first 12 months of stay, working Bulgarian and Romanian nationals were subject to restrictions on the types of work they could undertake in the UK. These restrictions were lifted on 1 January 2014, but immigration remained a sensitive issue. Over half of the UK immigrants are from the EU, most of them come to work, and only a small percentage to study (Office for National Statistics). Britons started to believe that the high number of immigrants contribute to the unemployment increase, lower the wages of the local workers and risk to become a burden on public services. In the field of immigration, the major gains that Cameron has obtained at the negotiations with Brussels have been to limit full access to in-work benefits by newly arrived EU workers for up to 4 years when they enter the labour market and EU jobseekers who have not found a job after six months, and have no genuine prospect of finding one, can be required to leave (GOV.UK, February 2016).

Pleased with the results of the negotiations, Cameron publicly supported the Remain side, being convinced that United Kingdom will be stronger, safer and better off by remaining inside the European Union (GOV.UK, May 2016). Together with Cameron was Jeremy Corbyn Bernard, the leader of the Labour Party, almost all of the Labour Party parliamentarians and most Conservatives. EU officials and many international leaders have encouraged the UK to remain in the EU, including: the president of US, Chinese president and the prime ministers of: India, Canada, Australia, New Zealand etc. The loudest voices advocating Britain's exit were the U.K. Independence Party, the right-wing political group, the former London mayor, Boris Johnson, member of the Conservative party and Kate Hoey, a well known Labour lawmaker. Their arguments were that the UK should take back control of its fate and spend its money on its priorities. They didn't want UK to give up some of its sovereignty to a powerful multinational body.

On June 23, 2016, more than 33 million Britons went to the polls and the result was very surprising: 52% of the citizens voted UK's exit from the EU and 48% staying. England and Wales have voted to leave, while Scotland and Northern Ireland voted to stay. According to the analysis made later on, Brexit voters fall into three categories: people with a low living standard, older people, and people with a low education level (The Guardian, 23 June 2016).

After a long and intense campaign everyone is waiting to see what will be the consequences of UK's exit from EU. George Soros, the well-known investor who "broke the Bank of England" in 1992, warned that such a decision will cause the value of the pound to decline precipitously and it will have an immediate and dramatic impact on financial markets, investment, prices and jobs. Financial speculators will make large profits at Britain's expense, he said, but most voters will become considerably poorer. (The Guardian, 20 June 2016). Also, 10 Nobel-prize winning economists, who have all been made professor laureates for research stretching from the early 1970s up until last year, showed their concern about the consequences of the UK leaving the EU. They all were in favor of remaining in the EU, warning about the pound to plunge and shares to fall in the event of a Brexit vote. On a long-term, they believed that Brexit would create major uncertainty about Britain's alternative future trading arrangements, both with the rest of Europe and with important markets like the US, Canada and China, which will deeply affect the country's economy (The Guardian, 19 June 2016).

3. Short-term effects of the referendum

The first effect of the referendum was an important change at the political level. In less than a month of the vote, Prime Minister David Cameron announced his resignation. After 6 years in office, he left his place to Theresa May, who became the second woman British prime minister after Margaret Thatcher. She will have the difficult mission to negotiate the departure of UK from EU, however David Cameron assured her of his full support.

From an economic perspective, British decision to leave the EU has created panic among investors, which resulted in a strong depreciation of the sterling. After two weeks of the referendum, the pound reached 1.28 dollars, and declined 11% compared to the euro, to the level of 1.16 euro (X-RATES). Even if George Soros's forecast to fall below 1.15 dollars, did not come true (The Guardian, 20 June 2016), the pound reached its lowest level in 30 years against the dollar.

A first impact of this depreciation was felt by the tennis players who participated in the tournament in Wimbledon. The referendum took place during the great Grand Slam tournament, which began on June 27 and was completed on July 8. As the prizes are paid in euro or dollar amounts, players lost between several thousand and several hundred thousand Euros, depending on the performance achieved. However, the biggest losses generated by the collapse of the pound were felt by overseas companies which got less benefit for the profits earned in the UK. The risk is that during the further period of uncertainty, while the UK will negotiate the terms of leaving the EU, these companies will move to other locations or will stop future investments. Given that the current account deficit came at the end of 2015 to the highest level since 1948, 100 billion pounds, 5.2% GDP (The World Bank), UK is more dependent than at any time in history on inflows of foreign capital.

Another effect of the Brexit vote was a powerful drop in stock markets in Europe and, implicitly, in London. FTSE 100 Index, the index of the first 100 companies with the highest market capitalization on the stock exchange, recorded in the first 5 days after the referendum a decrease of 5.62% (Financial Times). Shares of some of the biggest banks in the

Kingdom: Barclays, Lloyds Banking Group and RBS fell 30%, and have not recovered to the level before the referendum (London Stock Exchange). In the panic created, the demand for gold increased. Seeking safety, investors focused on precious metals, considered to be feasible long-term investments. On July 8, the gold prices recorded the highest level since March 2014, reaching 1,365.40 dollars/ounce (KITCO).

To prevent UK going into recession, Bank of England adopted a very ambitious set of monetary measures. A first action was to reduce the reference rate at a record low of 0.25%. Banks' gains come from the difference between what they pay for funding and what they charge for loans. In order to encourage banks to provide loans at lower interest rates in the real economy, the Bank of England, offers loans, at close to Bank Rate, amounting up to 100 billion pounds. Furthermore, authorized the printing of 60 billion pounds to buy government bonds in order to reduce their yields and cause investors to diversify their portfolios (Bank of England). But pension funds are directly affected by this decision because the vast majority of their investments are represented by government bonds. Starting this year, companies are obliged to provide workplace pension to all employees over 22 years old and the ones who earn at least £10,000 a year (GOV.UK). According to consultancy Mercer, the largest 350 English companies, listed on the stock exchange, recorded in August 2016 a combined pensions deficit of 189 billion pounds, with 50 billion dollars higher than the last month (MERCER). More and more companies are faced with the decision to cease providing dividends or to waive certain investments in order to redirect the cash into pension schemes. Wanting to offer them support, the Bank of England allocated 10 billion pounds to buy corporate debt issued by UK companies who make a genuine contribution to the UK economy. This measure aims to reduce the cost of borrowing for companies and to stimulate them to issue new bonds.

4. Long-term effects of the referendum

One of the main risks of UK's economy after the Brexit vote is inflation. The depreciation of the pound will raise the prices of imported goods and the Bank of England's liquidity injection may also generate inflationary pressure. The mission of the Bank is to maintain price stability, and not to exceed an inflation rate of 2%. However, in the current context characterized by uncertainty, The Bank of England's Monetary Policy Committee estimates that at the end of 2017 inflation will exceed the 2% limit. In order to achieve a sustainable return of inflation to the target, a further reduction of the reference interest is forecasted, until the level of 0.1% (Bank of England). Increasing inflation will entail reduced consumption, investment and employment levels. As the uncertainty regarding the trading arrangement with the European Union will continue, the negative impact on the UK's economy will be stronger.

According to the latest editions of the Global Financial Centres Index released on March 2016, London is the world's leading financial centre. It surpassed New York in terms of business environment, human capital, taxation, reputation, infrastructure and financial sector development (Long Finance). However, the exit from the EU threatens it to lose this status. Many financial institutions outside Europe are located in UK's capital, from where they run free operations on the European market, based on a "passport" system. Once leaving the EU, some financial companies may decide to transfer part of the jobs or activity outside the country. Options could be Frankfurt, Paris or Dublin. On July 7, 2016, six major US banks: Goldman Sachs, JPMorgan, Morgan Stanley, Bank of America and Citi, along with Britain's Asia-focused Standard Chartered pledged publicly to the British finance minister George Osborne that would work together to help London retain its position as the leading international financial centre (GOV.UK, July 2016). The market reacted after this statement, the pound stopped the fall, but the danger has not passed. The banks' representatives did not promise to keep their employees in the UK. In order to prevent that from happening, UK has to retain access to the EU single market and make sure the so-called "passport" rules stay in place. The process is lengthy, and the uncertainty over whether they will need to get new EU banking licenses, may determine the investors to relocate their activity to other markets.

As the EU's unity was weakened after the Britons vote, so may be the unity of the United Kingdom. The Scottish National Party, which won the parliamentary elections in 2011 and 2016, claims vehemently the Scottish independence from the United Kingdom. Their belief is that Scotland will be a much stronger country if it will take charge of its own destiny. On September 2014, the SNP organized a referendum in which citizens were asked "Should Scotland be an independent country?". The oil and gas reserves in the North Sea were the strongest argument used by SNP leader to support the cause. However, the Scottish citizens rejected independence by 55% to 45% thus remaining in the component of the United Kingdom. After the UK vote to leave the EU, the new prime minister of Scotland, current leader of the SNP, Nicola Sturgeon, has called into question the issue of independence. Since Scotland voted in favor of remaining in the EU, with 62% votes for and only 38% against, the government claims separation from the UK and staying in the European community. In this respect, is organizing a national survey to see how Scots feel about Europe, the Brexit vote and Scottish independence. According to Kantar TNS survey, despite the decision of the UK to leave the EU, most Scots have kept the option of sticking with Britain. But the score is very tight, given that 41% voted for independence, 47% against and 12% were undecided (KANTAR UK INSIGHT). The percentage of those undecided could tip the balance in case of a referendum.

UK's exit from the EU is likely to weaken the entire process of European integration and create a domino effect. UK's example has been welcomed enthusiastically by many nationalist parties' leaders which have called in-out referendums in their own countries. Marine Le Pen the leader of France National Front, Geert Wilders the leader of Netherlands' Party for Freedom and Matteo Salvini the leader of Northern League from Italy, are militating for each member country to have the right to choose its way and to win its freedom. In the current climate of fear and uncertainty, Euroscepticism and the popularity of these parties is in constant growth. There are speculations that Russia financially supports a number of European nationalist parties in order to increase people's discontent to the EU and get allies among European political classes. France National Front confirmed that it has borrowed 9 million euro in 2014 from First Czech-Russian Bank for the presidential election campaign in 2017, given the fact that no French bank was willing to offer the loan. UK's exit from the EU and the uncertainty generated by this decision seems to serve the interests of Russia. A Europe focused on internal problems will be less attentive on Russia's inequities. UK and Germany were the most vocal countries regarding the sanctions imposed by EU over Russia's annexation of Crimea and involvement in the conflict in east Ukraine. It is possible that without Britain as an influential member, EU will have a friendlier attitude towards Russia. As the EU's power diminishes, the sphere of Russian influence in Europe could increase and the Eurasian Economic Union could become a major competitor.

5. UK after referendum

UK's case is not unprecedented. In 1985, following a referendum, Greenland left the European Economic Community, the forerunner of the European Union. As part of the Kingdom of Denmark, Greenland was forced to join the EEC in 1973, together with the mother country, although 70% of the islanders opposed. The rules imposed by the EEC on the fishing industry have disgruntled the population, given that fish exports were the country's main source of income. As an autonomous region of the Kingdom of Denmark, Greenland obtained the right to decide its own fate, and so, in 1985, 52% of the citizens were in favor of leaving the European organization. Thus, it became one of the 25 EU's overseas territories which are not EU members but depend constitutionally on member countries. The new treaties negotiated with Brussels were on the benefit of both sides: the island obtained the right to manage its fisheries sector and to have access to European markets for fish exports, and the European ships were granted the right to fish in Greenland's waters for an annual payment. Besides the grants awarded by Denmark, the EU has provided funds amounting to 217.8 million euro for educational projects for the period 2014-2020 (European Commission). Yet, three years were needed and more than 100 meetings with European officials, for Greenland to negotiate its departure. A small country with 56,000 inhabitants, with one important industry and a GDP of 2.5 billion US dollars at the time it quit the EEC, cannot be compared to the UK. The departure of UK from the Union is a much bigger stake, so it is expected that the negotiations will be much tougher, and will take more time.

Although the referendum has essentially only a consultative role, British lawmakers are determined to implement the decision of the people. The formal procedure for beginning the exit implies triggering Article 50 of the EU's Lisbon Treaty, but according to the Prime Minister, this will not happen before the end of this year. The treaty stipulates that any state may decide to withdraw from the EU, but must follow a few steps. Firstly is required to notify the European Council of its intention, and in at least 2 years, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal. The term may be extended if the European Council, in agreement with the Member State concerned, unanimously decides to extend this period (The Lisbon Treaty). Negotiations are expected to last more than two years and to be very tough, not to encourage other countries to follow the UK model. UK hopes to regain control of the immigration and also have free access to the single market, but the European leaders oppose. They demand UK to respect all four freedoms: of goods, of capital, of services and of people, in order to have access to the single market.

There are many other things the UK's Government must take into consideration in the negotiation process. What will happen with the two million UK citizens that are resident in the EU and the three million EU citizens that are resident in the UK? Will they have the same rights as now? Will the regulations imposed by EU and adopted by UK as a member state, be changed when the country will leave the Union? What will happen with the funds the EU allocated to the UK's economy? Will the Government make these payments in the future? What will be the future relationship of UK with the EU? The British leaders will have to find an answer as fast as possible to all these questions, for prolonging uncertainty is not good for the economy.

After the results of the referendum were announced, over 4 million unhappy citizens signed a petition to demand the holding of a second referendum. The Ministry of Foreign Affairs offered an official response and ensured citizens that the referendum will not be repeated. Government will focus its energy on UK's exit from the EU in order to ensure the best possible outcome for the British people in the negotiations (Petitions UK Government and Parliament). Theresa May, said bluntly that "Brexit means Brexit" and that UK will make a success of it, without trying to remain within the EU. The Prime Minister asked the parties and the citizens for support, to build a better Britain together (Independent). The exit from EU doesn't represent the exit from Europe, it will certainly remain for a good while the largest trading partner. But what might be the best option post-Brexit for UK, in terms of relations with EU? What economic and political consequences each option has?

One option would be joining the European Free Trade Association (EFTA) with Iceland, Norway, Switzerland, and Liechtenstein. This is an intergovernmental organization set up for the promotion of free trade and economic integration to the benefit of its members. The EFTA member countries have signed free-trade agreements with 38 countries and are currently engaged in negotiations on with 11 more states (The European Free Trade Association). UK was one of the founders of this agreement in 1960, but ceased membership after joining the European Community in 1973. In order to join, UK must obtain a positive vote from all four members, but in Norway opinions are divided. Norway's European affairs minister does not like this option, fearing that UK will dominate the entire group. Other Norwegian politicians agree on UK joining their little organization, hoping this will provide them a chance to renegotiate their own terms with the EU. In this alliance UK will have access to the single market through the European Economic Area (EEA).

The European Economic Area (EEA), brings together the EU Member States and three EFTA members — Iceland, Liechtenstein and Norway — in a single market, referred to as the "Internal Market". The EEA Agreement provides for the inclusion of EU legislation covering the four freedoms — the free movement of goods, services, persons and capital — throughout the 31 EEA States. The EEA Agreement does not cover the following EU policies: Common Agriculture and Fisheries Policies, Customs Union; Common Trade Policy; Common Foreign and Security Policy; Justice and Home Affairs and Monetary Union (European Economic Area). By joining the EEA Agreement, UK will have access to the single market, but will not have a say about the EU rules that will have to comply with, will have to participate to the EU budget and allow free movement of persons. As the Brexit vote can be interpreted as a vote against giving up UK sovereignty to the EU, joining EEA would be a betrayal of the referendum.

If it will decide not to take part in the EEA, but have access to the single market, UK will have to negotiate bilateral deals with the EU, just like Switzerland. Switzerland has signed over 120 sectoral bilateral treaties with the EU containing basically the same disposals as those adopted by the other EEA countries on free movement of persons, goods, services and capital. However, bilateral relations have been badly affected by the anti-immigration referendum organized in Switzerland on 9 February 2014. The Switzerland - EU treaty stipulates: regulation without representation, contribution to the EU budget, free movement of persons, and limited access to the single market. Switzerland has no agreement with the EU on free trade in services, meaning that its financial firms do not have a „passport" giving them the right to sell services across the 28-nation bloc. Swiss financial institutions often offer their services on the EU market through subsidiaries based in London. UK is a major exporter of services, and the biggest financial center but without the „passporting" system, it may lose this status. It is very possible that some operations would shift to a location inside the single market, and many jobs be affected. Surely „passporting” will be a very important issue in the negotiation process.

A third option would be for the UK to leave the single market and conduct trade relations under WTO rules, like the US, China etc. As of July 2016, the WTO has 164 members comprising all major economies and most minor ones. The principals of "national treatment" and "most favored nation" (MFN) are the cornerstones of WTO trade law. All WTO members are charged the same tariff, the only exceptions are the countries that choose to set up a free trade agreements and the ones that give preferential market access to developing countries (World Trade Organization). Because of the MFN tariffs, the cost of export of UK firms will increase. Moreover, since the WTO has made less progress in comparison to EU in liberalizing trade in services, this would mean reduced access to EU markets for UK service producers (Dhingra S., Sampson T, 7). Such a measure would give the UK more sovereignty, but will surely increase cost of doing business with Europe. EU is the UK’s main commercial partner, 44% of UK’s exports go to the member countries and over 3 million UK jobs are linked to exports to the EU (GOV.UK, June 2016). Under this scenario free labour mobility between the UK and the EU would cease, but it is still uncertain what the impact on the economy will be. In terms of a trade agreement with the EU, UK turned to Canada for advice. After 7 years of negotiations, Canada elaborated a free trade agreement with the EU called the Comprehensive Economic and Trade Agreement (CETA). Even though it has not been applied yet, this agreement is seen by UK as a model, a starting point for discussion.

Regardless of which option UK will choose, it will have the possibility to negotiate its own trade deals with non-EU countries, As a rule, a powerful bloc of countries, such as EU, is negotiating from positions of power and gets better results than an individual country, but UK hopes to prove otherwise. Immediately after the referendum, the Prime Minister of Australia, Malcolm Turnbull, called for a free trade deal with Britain, which brought a dose of optimism among UK’s officials. Preliminary trade discussions were held with other countries from the Commonwealth, respectively India and New Zealand, and the prospects are encouraging. At the G20 summit in China on 4-5 September the leaders from Mexico, South Korea and Singapore said they would welcome talks on removing the barriers to trade with UK.(GOV.UK, September 2016)

UK will seek to seize any opportunity that arises, but its main objective is to focus on the most important trading partners besides the EU: the US and China. A commercial agreement between the UK and US, it's not going to happen anytime soon, because the US is focusing on negotiating with the big bloc, the European Union. President Barack Obama has not ruled out such an agreement, but UK will not have priority, will be "in the back of the queue" (The White House). Regarding China, it has an open attitude toward discussing and signing a free trade agreement with Britain, as the Chinese Commerce Ministry spokesman Shen Danyang said. Although UK cannot sign any deals before the EU exit, it will certainly have many informal discussions until then. However, UK's experience in the field of negotiations is limited, given that until now negotiations were held at EU's level. To achieve the ambitious goals it has set, the government is planning to hire 300 experts able to conclude these trade agreements.

6. Conclusion

British vote to leave the EU generated panic among investors, the pound reached its lowest level in 30 years against the dollar and the stock markets experienced a powerful drop. To prevent UK from going into recession, Bank of England adopted a set of monetary measures, which brought short-term peace. The British Prime Minister David Cameron resigned, leaving to Theresa May the difficult mission to negotiate UK's departure from EU. As the uncertainty regarding the trading arrangement with the European Union will continue, the negative impact on the UK's economy will be stronger. Rising inflation, reduced consumption, reduced investment and rising unemployment are just some of the challenges the UK economy is exposed. The Government will focus all its energy to ensure the best possible outcome for the British people in the negotiations, but the process is predicted to be very difficult. According to British government's estimates, it could result in 10 years or more of uncertainty as the UK renegotiates new arrangements with the EU and over 50 other countries around the world (GOV.UK, June 2016). Take the Switzerland's example, join the European Economic Area or go alone as a member of the World Trade Organization are some of the options the UK has outside the EU. It is imperative for the UK to take a decision as fast as possible because uncertainty is very dangerous.

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