

How realistic are the fears about Brexit?

by Charles Chatterjee

1. INTRODUCTION

The UK's decision to leave the European Union, which has been consolidated by parliamentary legislation, has provoked controversies at all levels of society, including political parties and a variety of institutions, but some of these concerns do not seem to have been supported by sustainable evidence. Indeed, a few of the controversies have their bases in human emotions, which have no role to play in dealing with the pros and cons of Brexit.

However justifiable the arguments of the “Remainers” may be, they have lost their case as many of them abstained from voting and in consequence the “Leavers” won their game. The City of London, on the other hand, was in general against Brexit, primarily on the grounds that as a world financial centre it would be losing its reputation and business, but their arguments also fell short of any concrete evidence to justify their claims that Brexit would harm the UK economy. The City provided speculative arguments to the effect that if EU nationals are required to leave, the UK would be short of experts and other human resources, the EU financial institutions might abandon the City of London, and “tit for tat” action might be taken by the EU countries in regard to UK nationals working and residing within the geographical boundaries of the EU. Each of these arguments failed to appreciate three important issues: (a) the British philosophy of maintaining humane policies towards foreigners; (b) the British interest in the EU Economic Area, even after Brexit takes place; and (c) and most importantly, the strength of the British economy, which should be able to withstand all misfortunes that may be inflicted on it by others. This is where balanced negotiations which would protect the economic interests of both the parties must be regarded as essential. The EU needs the UK, even as an outsider, as a trading and investment partner; by the same token, it would be beneficial for the UK if it had the privilege of engaging in trading and investment activities within the single market.

Whether the UK will lose or gain by virtue of leaving the EU is a matter of speculation until Brexit has actually been effected. Meanwhile, the City of London and other institutions may like to assess the inherent strength of the UK, both from financial and non-financial standpoints, which might provide some realistic assurances to citizens rather than painting a dark picture of Brexit primarily on a speculative basis. One should appreciate the negative effect that the UK economy has been experiencing in terms of private foreign investment and even

in the property market. The lesson is simple – if one cannot do any good to anybody, one should not cause any harm to that person.

2. WHAT MIGHT BE THE PROBABLE IMPACT OF BREXIT UPON THE UK AND EU FINANCIAL MARKETS?

In her article entitled “Europe on the Edge”, (London, The London Institute of Banking and Finance, April/May 2017 at p 8) Dr Vicky Pryce clearly pointed out, *inter alia*, that despite the relatively cheerful economic numbers, doubts have occurred in recent years with regard to the EU staying together as one integrated union, in addition to a possible break-up of the “regional political and economic institutional structure, and of the single market” (V Pryce, “Europe on the Edge”). The US President, Donald Trump, has also questioned the political relevance of the EU, and UK politicians may like to meditate on this issue. Can the EU provide any security, or in the event of any attack on the UK what material form of help might the UK receive? If anybody nearer to UK shores could provide assistance that must be the North Atlantic Treaty Organisation (NATO), a non-EU institution, bearing in mind that the Western European Union (WEU) failed.

Pryce further pointed out that the growth of anti-EU anti-austerity movements has required the President of the EU Commission, Jean-Claude Juncker, to engage in a debate about the future of the EU, and in what shape and form it might survive. External interventions in the form of Regulations or Directives may not be tolerated for long by people in some Member States.

In her work, Pryce further maintained that any attempt to tackle the EU's growth problem now may prove to be futile. Whereas the single currency was meant to bring “economic convergence” it, in reality, has led to “greater economic divides.” In support of her argument that some of EU countries have been experiencing financial austerity, Pryce referred (at p 9) to the economic situations in Greece, Ireland, Italy, Portugal and Spain. She concluded her article by saying that: “... the danger is that the EU in its handling of Greece is playing with fire – not just with the future of Greece, but with the Euro project as a whole.”

On the other hand, Paul Wallace, in his article entitled “Europe's Odd Man Out” (London, The London Institute

of Banking and Finance, April/May 2017 at p 9) examined the impact of Brexit on the European Central Bank (ECB), and whether the UK's departure from the EU might affect London's financial standing in the world.

Briefly, the European Central Bank, which was conceived at the Maastricht 25 years ago, was intended to encompass all EU Member States under the umbrella of monetary union, but Denmark and the UK opted out of the plan. The ECB is currently owned by 19 central banks in the Eurozone, and the other nine Members of the EU retain their own currencies. The governors of the 19 Member State central banks sit with the Executive Board on the Governing Council which sets the monetary policy, but the other nine Member States that retain their own currencies are also represented.

Each of the 28 central banks has a capital share in the ECB determined by their country's economic and demographic weights. Based on this criterion one can easily see that the Bank of England is a major owner in the ECB. However, the central banks that do not belong to the monetary union pay a very small amount to help cover the ECB's running costs. The institutional tie between the ECB and the Bank of England is currently very strong, but may not remain so after the UK leaves the EU.

Incidentally, on the European Systemic Risk Board (ESRB), established at the end of 2010, the Governor of the Bank of England is currently second only to the President of the ECB (Mr Mario Draghi), but once the UK leaves the EU the ESRB will no longer have the benefit of the considered views on risks of the Bank of England. Currently, the UK makes up 7.5 per cent of the EU economy, but once the UK leaves the eight remaining "outsiders" will account for less than 15 per cent of the EU-27s output. Unless the ECB revises its schedule of payments for both "insiders" and "outsiders", the financial gap left by the UK would be a cause for concern. On the other hand, unless it forms part of the negotiation scheme, it is doubtful whether the City of London's central counterparties, which currently handle very large amounts of euro-dominated derivatives every day, would be allowed to do so after the UK's formal departure from the EU; however, it is inconceivable that EU would cut-off all financial deals with the City of London, which is an extremely resilient and a world financial centre possessing much experience and knowledge. In the mutual interests of both parties a high degree of financial reciprocity should remain operational, but the UK may not be left with any regulatory power over the EU market.

3. A BRIEF DISCUSSION OF THE UK'S PROSPECTS OF SIZEABLE INVESTMENTS WITHIN THE EU AFTER BREXIT

Investments become most beneficial between like parties – they bring in the benefits of exchange of knowledge and expertise in addition to financial gains. Within the current membership of the EU, the "likes" and "acceptable" partners for private foreign investments would be Denmark, France,

Germany, Italy, the Netherlands and Sweden. British private foreign investments in the other Member States would be almost one-sided from the above point of view. The other important issue which should be borne in mind is the absorption capacity of the recipient states for high technology and knowledge-based investments. The EU Member States will have the privilege of negotiating private foreign investment projects from another Member State, unless one of them considers that the UK has special expertise in that industry, including investments in the service sector.

At this point, it would be apposite to examine the financial profiles of some of the lesser economies within the EU.

Bulgaria

Bulgaria is a country of 7.2 million people which joined the European Union in 2007. She plans to accelerate her economic growth rate of less than 1 per cent to at least 4 per cent over the next 25 years to be in line with the EU average income by 2040. According to the Country Partnership Framework published by the World Bank Group for Bulgaria for the financial years 2017-22:

Bulgaria's initial transition to a market economy during the 1990s was painful, creating legacy issues that the country is still grappling with today. These legacy issues include lower initial income levels with associated higher poverty rates, and weaker institutions compared to other EU countries. Delays in implementation of structural reforms culminated in a severe banking crisis and hyperinflation in 1996-7 and slowed down improvements in living standards. Government debt soared to over 100 per cent of GDP and people lost their savings leaving little room for investment.

The report of the World Bank Group went on to state that currently Bulgaria encounters two inter-related challenges of (a) raising productivity, and (b) addressing issues related to the country's rapid demographic change. Bulgaria's income per capita is only 47 per cent of the EU average, the lowest in the EU. Furthermore, Bulgaria is facing a significant decline in the size of the working age population, putting at risk future growth prospects.

Croatia

Croatia became a member of the European Union in July 2013 at a time when the country was going through a six-year recession. By virtue of joining the EU, Croatia became eligible for EU grant funds and these contributed to the recovery process which started in 2015. The unemployment rate is high at 13.8 per cent; youth unemployment remains at 34 per cent. The poverty level is also high in Croatia.

According to the World Bank Overview for Croatia dated 2017, the country's immediate economic challenges are twofold: (a) to restore macroeconomic stability; and (b) to promote sector productivity and competitiveness to create jobs and growth. Croatia's public sector debt is currently very high.

By virtue of a high level of ageing population, Croatia needs to make efforts to improve her social protection and health systems. On the other hand, the skills of the young work force need to be raised. The same World Bank Overview states that:

There is also a need to continue modernising public services, the judiciary, and the governance of State-owned enterprises (SOEs), including the network industries, to better support the needs of people and firms.

In the World Bank's Overview of April 2017, it was stated that growth strengthened in 2016 to 2.9 per cent and that the recovery was broad-based, but record-high tourism contributed the most to accelerated growth. Labour force participation declined and the employment rate remained at 44.5 per cent, far below the EU average. Reduction of public debt will remain a challenging task for the government of Croatia. The economy is expected to grow by 2.9 per cent in 2017 and around 2.6 per cent in 2018-19, led by personal consumption, service exports, and investments, benefitting from the EU funds absorption. According to the World Bank, although the fiscal outcomes are better than expected, uncertainty created by the new fiscal expansion and domestic policy add to the risk of slowing the pace of structural reforms, which might adversely affect the prospect of achieving sustainability of public debt. The Report maintained that:

Still, high levels of private and public sector indebtedness amid the upcoming monetary tightening and the increased volatility the financial market are set against the country's borrowing requirements. Sustained fiscal consolidation and competitiveness reforms are needed to reduce macroeconomic imbalance and protect the nascent recovery.

The World Bank's activities in Croatia are guided by the Country Partnership Strategy of June 2013, which cover the period until 2017. The Bank aims at transitioning from a focus on projects and lending to a knowledge partnership; it also plans to develop a stronger partnership in advisory services and structural and institutional reforms in order to boost Croatia's economic competitiveness. The Bank's financial engagement places emphasis on the transport sector, in addition to health and social protection sectors. Recently, the Bank has also been engaged with the Ministry of the Sea Transport and Infrastructure and with road companies with a view to modernising and restructuring the road sector. According to the World Bank's Overview:

The Sustainable Croatian Railways in Europe Project implements major investments in infrastructure on international corridors funded by the EU by focusing on overall sector restructuring and the sustainability of the public companies.

Romania

According to the Overview of the World Bank Group, updated on 20 April, 2017, the current Romanian Government has prioritised for 2017-20, among other economic sectors, investment in infrastructure, health care, education, job

creation, and small and medium enterprise development. Although Romania has significantly reduced her macro-fiscal imbalances since 2008, and achieved the highest growth rates in the EU in 2016, the country has one of the highest poverty rates in the EU. In addition to this, Romania still has to do more work on anti-corruption measures.

The Country Snapshot developed by the World Bank Group in April 2017, maintains that the new government formed in January 2017 "... represents an opportunity to promote stability, deepen reforms, and ensure sustainable economic growth." This forecast may be somewhat premature, but one can only hope for the best.

Romania joined the International Bank for Reconstruction and Development (IBRD) in 1972, and since then has received US\$13.5 billion in commitments over 99 projects covering a broad range of sectors. The Country Partnership Strategy for the financial years 2014-17 aimed at accelerating structural reforms with the Bank's support in order to achieve sustainable, equitable growth and enhanced competitiveness. The Bank also provides advisory services to Romania, and in particular reimbursable advisory services addressed to poverty reduction and the promotion of shared prosperity designed to create, inter alia, private sector job creation and the promotion of social inclusion.

The World Bank Group has made a significant financial contribution and contribution through advisory services of various forms, particularly for structural reforms and capacity building. Since 2010, a total of 52 Reimbursable Advisory Services (RAS) agreements totalling US\$83.41 million have been signed. The World Bank's Overview (Economy) dated 20 April, 2017, observed (at p 2) that: "The planned introduction of a minimum social inclusion income programme in 2018 aims to consolidate 3 means-tested programs, doubling the current budget and increasing the adequacy and coverage of benefits."

The primary purpose of examining the economic and financial profile of these three countries is to establish whether any of them would be able to absorb high technology-based British investments. If they are prepared to do so, that could be achieved through appropriately negotiated bi-lateral investment treaties which would cater for the particular national interests of the host country concerned, such as sector-priority industries, capacity building, etc. However, the fact remains that if such EU Member States do not receive funds from, for example, either the World Bank Group or the European Central Bank, British firms will be required to provide financial assistance. On the other hand, could the lesser EU Member States afford to purchase expensive British products even if the Brexit negotiations successfully strike a free-trade deal which would favour British export trade vis à vis the EU?

There is no reason why the UK could not maintain her trade and investment relationship with such EU partners as Denmark, France, Germany, Italy, and Poland – the richer members of the EU – on a bi-lateral treaty basis. The right of

third parties to engage in trade and investment activities may not be denied, and the most important basis for being engaged in such activities is the special expertise that third countries may possess in certain activities. Take for example, the huge British investments currently in operation in Poland. It is unthinkable that after the UK leaves the EU in 2019 these investments will be withdrawn from Poland; however, some of the privileges, namely tariff concessions, might change. The principle of state responsibility of international law and the observance of the compulsory standard of international law known as the International Minimum Standard towards foreign entities and entities in a host country may not be derogated from; abundant evidence exists in support of this statement (eg the BP-Libya arbitration, Texaco-Libya arbitration).

4. SOFT OR HARD BREXIT?

There are numerous issues that have to be negotiated during the Brexit process, bearing in mind that neither a “soft” nor a “hard” Brexit would benefit any party. Interestingly enough, these two terms have remained undefined. The EU may not benefit from a so-called “soft” Brexit primarily because from a political standpoint it might be a total “give-away” to the UK, which EU must avoid so that it does not encourage any other existing Member State to follow suit on similar, if not the same, terms and conditions. The negotiations should be fair, equitable and balanced which means, in effect, that they should be based on the principle of reciprocity. In addition to contributing to various policy-making issues, one should be mindful of the financial contributions that the UK government has made to the EU and the promotion, in particular, of the financial sector of the EU through its participation in the European Central Bank and investments in various industries. The UK has always been a strong trading partner of the EU.

The flow of students from other EU Member States into UK universities, particularly at post-graduate levels, and for the purpose of learning the English language at various language schools in the UK, was much higher than the corresponding flow of the UK citizens seeking education in the EU at any level. In addition, under the free movement principle, Britain also opened her doors for EU nationals to enter the financial world of the City of London, enabling them not only to acquire training and knowledge but also to invest where it would be viable to do so.

5. CONCLUSIONS

How will Brexit impact the UK and how justifiable are the fears about it? There are two probable approaches to this question; Brexit might impact the UK very significantly, or the UK should not worry too much if there are no “acceptable deals” for the UK. In dealing with either of these two questions, one should reflect on the strengths and weaknesses of the UK from an objective standpoint.

Despite the country’s colonial past, the UK economy, particularly since the industrial revolution, has grown from

strength to strength. Real economic policy consolidation, with its various permutations, began in the 1950s; however, the seeds of economic growth based on knowledge started as early as the 16th century. By virtue of being a knowledge-based economy, the country’s strengths flourished not only in science and arts, but also in business and commerce. The UK is an international leader in various sectors of the economy, particularly in banking and finance, and is the home of insurance. Furthermore, the UK holds very strong positions in shipping, technology and agriculture, and possesses a world-leading digital economy. Once a leading textile-producing country, the UK has become a textile importer, indicating a capacity to diversify the economy when necessary.

The UK economy is nurtured and promoted by her universities and other higher education institutions, which provide new ideas to the business world. Both sides work together to provide expertise and training to university graduates. In passing important business-related legislation, the government in power seeks as a matter of policy the opinions of such expert non-governmental institutions as the Institute of Directors, the Confederation of British Industries and the British Bankers’ Association.

When considering the economic and financial strengths of a country, the factors to be considered should include the quality of infrastructure; the nature of the markets and the extent to which they are regulated; consumer protection policies; and the system of providing protection to private foreign investors, be they corporate entities or even individuals. The UK investment climate is welcoming, and there are no examples of “taking” of foreign properties by governments over the past 100 years, if not more. This country has not derogated from the principle of state responsibility – a cardinal principle of public international law. Confidence in the UK economy developed over many centuries makes it inconceivable that private foreign investors and corporate entities, financial or otherwise, would not carry on investing in the London Stock Exchange, banks or other finance houses regardless of whether Brexit takes place with a “deal” or “no deal”. The argument applies equally to large foreign industries.

Most importantly, Britain has an enviable and unparalleled judiciary which has the confidence of foreign business entities in its impartiality, independence and the rule of law generally. Furthermore, Britain’s commercial arbitration system has proved to be so attractive for centuries that it is also inconceivable this will be disturbed during the post-Brexit era.

Then there is the fear of expulsion of EU nationals who have been residing and/or working in the UK under the free movement of people policy of the European Union. On this issue, one should not de-rail oneself from the country’s historical immigration precedents. Britain has always welcomed foreign citizens of various backgrounds, particularly since the end of the First World War. Perhaps Britain, prior to her accession to the EEC, failed to realise the inevitability of migration from the EU and other parts of the world; the truth of the matter is that nobody wants to live forever in poverty

and in undemocratic regimes. But, based on the UK practice, it may safely be assumed that the UK government will not ask EU nationals living in the UK to leave; it is for the EU to consider this issue seriously so that the UK nationals currently residing and/or working in various EU Member Countries are not required to return to the UK, with the resulting problems this would create between the UK and the EU and each of the EU Member States.

There is no reason why the UK, as a very strong commercial country, may not continue doing businesses with the remaining EU Members on a bi-lateral treaty basis, even if the UK leaves the EU without a deal. It is also worth remembering that a departure from the EU would allow the UK to regain trading and other commercial activities with over 50 British Commonwealth markets, quite a number of which are very

large and strong and able to absorb British advanced technology and knowledge. Negotiators may like to remember that the EU needs the UK as much as the latter needs the former.

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