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# POST-BREXIT PROSPECTS FOR BRITAIN



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with the European block. Brexit vote is likely to have severe long-term economic implications for multinationals around the world which use the UK as a base for their operations. Financial firms in the UK will not be able to keep passporting rights if UK chooses a 'hard' Brexit and leaves the single market altogether. If these firms lose 'single passport' to operate in the EU, it may threaten the future of London as the centre of financial services and largest recipient of foreign direct investment (FDI), which is a vital component of the UK's financial health with an estimated stock value of £1 trillion, half of which coming from EU countries. The impact of Brexit is likely to cause at least 22% fall in FDI, according to Dhingra *et al.* (2016). Consequences of this will eventually cascade to the wider economy, damaging UK's productivity and lowering income levels.

Even if a comprehensible deal could be achieved, for example if the UK could negotiate some privileges similar to the privileges currently enjoyed by Norway – Norway is in the European Economic Area (EEA) but not in the European Free Trade Association (EFTA) – the effect will be a decline of around 2% to 3% of GDP (CEP, 2016). If on the other hand, the UK opts for a 'Switzerland scenario' and joins EFTA, the negative effects of Brexit are unlikely to be significantly reduced either. It is in fact extremely unlikely that the UK will opt for the Swiss or Norwegian model because it would have to allow free movement of labour.

The global community has witnessed game changing events in 2016. The shocking 51.8% vote to leave the European Union (EU) in the UK (the so-called Brexit), with a turnout of 72%, the highest since 1992 in any national contest, and the victory of Donald Trump in the United States. Both events have triggered a new wave of uncertainty on both sides of the Atlantic. These outcomes, which are indicative of rising populism across the world, have severe implications for these countries' future economic growth. In this article, we discuss the economic consequences of the Brexit vote for the UK and the implications of Brexit on the UK's legal system.

#### **Economic growth in 2017-2019**

UK's GDP growth will remain fragile in the period 2017 to 2019 as the country's exit from Europe is being negotiated with its former economic partners. The drag in economic growth will mainly come from foreign investment in commercial property, and in sectors aimed at accessing the EU single market, such as automotive and financial services (PwC, 2016). Decline in business investment is mainly driven by the uncertainty about the UK's future trading relationship

#### **Passporting rights**

With regards to the passporting rights, Booth and Scarpetta (2016) note that financial services 'passport' is not a single issue. There are sectors where the passport is more important than in others. For instance, the passport is crucial to the wholesale and investment banking as almost 20% of the banking sector's annual revenue is estimated to be linked to the passport (for example, Deutsche Bank gets a fifth of its revenue in the UK). Passport is however less important for funds as EU clients' assets are already kept in funds domiciled in Ireland and Luxembourg and are simply managed from the UK. Only approximately 7% of assets managed in the UK would be under direct threat from the loss of the passport, according to the estimations in Booth and Scarpetta (2016). In their study, the researchers also add that insurance business is unlikely to be significantly affected if UK loses passporting rights because insurance is a global industry and there is no single market in insurance in the EU. They indicate that 'up to 87% of insurers operating across borders in the EU do so via subsidiaries rather than branches, which are reliant on the passport' (Booth and Scarpetta, 2016: 48).

**Access to the single market and free movement of labour**

The vote to leave the EU was triggered to a large extent by the desire of the British voters to limit the free movement of EU citizens into the UK. The following migration statistics do not justify the vote of the British people to leave the EU.

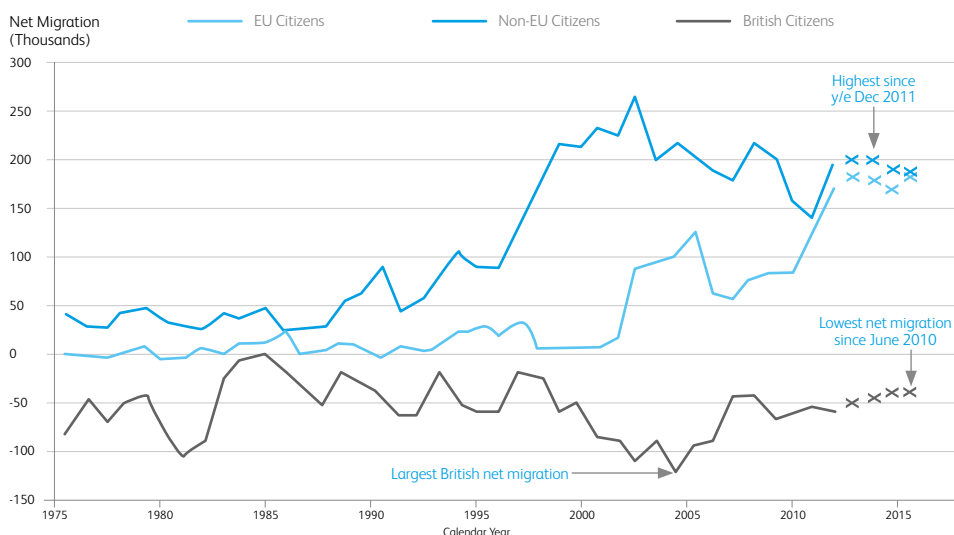
During the twelve months up until March 2015, net migration was estimated to be 330,000, which exceeded the previous highest level estimated for June 2005 of 320,000. In respect of the issue of EU vs non-EU migration, the data from the Office of National Statistics (ONS) shows that net migration for EU citizens was estimated to be 184,000 in December 2015 compared with 174,000 in December 2014. The apparent increase in EU net migration was in fact largely due to the increase in net migration of EU2 citizens (comprising Romania and Bulgaria), while net migration of EU15 (comprising Austria, Belgium, Denmark, Finland, France, Germany, Greece, the Irish Republic, Italy (including The Vatican), Luxembourg, Netherlands, Portugal, Spain and Sweden) and EU8 citizens (comprising Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia) remained relatively stable. As for the non-EU citizens, in December 2015, the net migration number was 188,000, a level in line with the 194,000 non-EU immigrants in the previous year (ONS, 2016).

It is important to note that although inflows from the EU have increased much more rapidly compared to the non-EU migration, migrants from non-EU countries account for the larger share of the migration (see Figure 1 adapted from the ONS). Furthermore, EU migration is primarily work-related and, according to Dustmann and Frattini (2014), has contributed £20bn to UK public finance between 2000 and 2011 as tax payments by European migrants far outweigh the cost of welfare.

Although it is early days to assess the consequences of leaving the single market, it is clear that the economic advantages of participating in free movement of people will be lost. Firms may lose access to the wider supply of skills which would damage productivity. The tax revenues collected by the UK government may decrease if some jobs remain unoccupied. Finally, innovation and spread of ideas may slow down. It is also clear that costs will be borne disproportionately across the UK. For example, restrictions on the freedom of movement will be felt more heavily in Scotland which is already facing demographic challenges as its population ages.

**Could the UK choose Norway and Switzerland as a potential exit models?**

Immigration and lack of border controls are increasingly cited as the main reasons for leaving the EU. It is highly unlikely that Norway or Switzerland could serve as models for the UK after an EU exit. Although these countries do operate under slightly different legal arrangements from the UK's when it comes to EU migration, in practice, these countries are fully integrated into the EU's free movement rules.



**FIGURE 1:** Net Long-Term International Migration by citizenship, United Kingdom, 1975 to 2015. Source: ONS



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Furthermore, if the UK chooses the Switzerland scenario to enjoy tariff-free access to the EU in goods, it will still have no passporting rights to operate in the EU; Swiss financial firms still require special permissions to operate in the EU. Thus, the Swiss model is unlikely to be a solution London would want. Those models would not address the issue of EU immigration, as both Switzerland and Norway have far higher levels of EU immigration than the UK as a proportion of their populations. For the UK had the same net EU immigration rate as Switzerland, it would mean nearly 400,000 more EU migrants a year (Eurostat, 2012).

**Uncertainty persists**

The terms of the UK's departure from the EU will be the most important topic for the UK in 2017-2019. Questions will be raised about the precise nature of the separation. Article 50 of the Lisbon Treaty – the legal mechanism that triggers a country's exit from the EU – has never been triggered before, and it is unclear how it is supposed to work in practice. Confusion therefore persists on three main issues: the fragile and complex constitutional settlement of the UK; what kind of country the UK wants to be post-Brexit; and what future relations it wants to secure with the EU. More certainty is required, especially for the City of London because the financial sector dislikes uncertainty as investors are looking to shift investments away from UK to continental Europe and major financial firms (e.g. HSBC, J.P.Morgan) are considering relocating their activities in anticipation of a 'hard Brexit.'

**What does Brexit mean for the international commercial world?**

Brexit has shaken up the international commercial world in a manner that has yet to be fully understood. A regulation of European financial market law prohibits providers of financial service from the third countries (countries outside the EU) from agreeing a place of jurisdiction or arbitration procedure in third countries. Any agreement with London as the place of jurisdiction or arbitration should be amended

in favour of other countries where distinct official powers have the authority to make legal decisions and judgments. This has an immediate effect on the market segments of banking, capital market and insurance law, where London courts are a hub for the majority of disputes in the European judicial area (Hess, 2016). Moreover, judgments in the British courts will no longer be automatically enforceable in the European Union after Brexit, as Article 36 of the Regulation (EU) number 1215/2012 of the European Parliament and of the Council of 12 December 2012 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (Recast) (Brussels I Regulation 1215/2012) only applies to 'a judgment given by the courts of a Member State'.

Furthermore, Brexit means a loss in European legal culture. Civil law tradition and legal practice, *inter alia*, of the Court of Justice of the European Union (CJEU), are faced with the concept of common law. These judgments to a great extent are based upon previous court rulings whilst common law is developed through judicial interpretation unlike the civil law tradition of continental Europe. This means that 'the power of argument of British lawyers will represent a loss, and the dogmatic but equally pragmatic approach of common law for achieving feasible solutions will leave gaps' (Hess, 2016: 2).

**What does Brexit mean for international commercial arbitration?**

International arbitration is safe from the legal uncertainty created by Brexit as EU legislation does not apply to international arbitration; this aspect has never been regulated or harmonized at the EU level. Brussels I Regulation on jurisdiction, recognition and enforcement of judgments in civil and commercial matters has excluded arbitration from its scope of application. The New York Convention on the Recognition and Enforcement of Foreign Awards remains in place even within the EU. The most important advantage of arbitration is its enforceability, whereas enforcement of court judgments abroad may not be straightforward



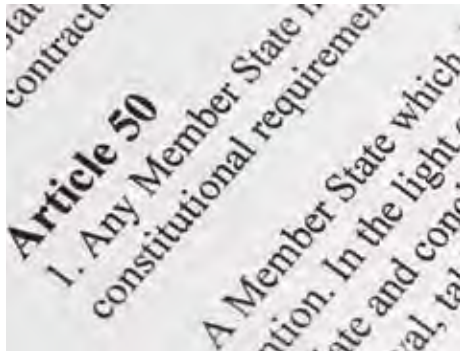
*In the long run, however, London as a preferred place of arbitration may be affected by any decline in London's position as a global business centre post-Brexit*



in the absence of a specific enforcement treaty. Jurisprudence of the CJEU has impact on international arbitration in the EU. After Brexit, English courts will not be bound by CJEU's case law (Murray, 2016); anti-suit injunctions that prevent a party from pursuing abusive court proceedings in an EU Member State will be dispensed by English courts (see Allianz SpA and Others v West Tankers Inc, Case C-185/07). However, some argue that injunctions are already permissible under the Brussels I Regulation (Cannon, 2016). And like Swiss courts, English courts will not be bound to sanction an arbitration award that is contrary to EU public policy. English law is usually chosen for reasons unconnected with the UK's present membership in the EU; English law is used because of its well developed and reputable case-law, and its transparency and predictability, providing freedom of contract, and a pro-business approach.

In summary, the impact of Brexit on international arbitration practices will be minimal. In the short-term, it is unlikely that the use of arbitration and of London as a preferred place of business will change. In the long run, however, London as a preferred place of arbitration may be affected by any decline in London's position as a global business centre post-Brexit.





	Europe	Asia/Pacific	Emerging
USD	1.1099	-0.0329	-2.88%
JPY	102.7350	-3.88	-3.64%
USD	1.3715	-0.1301	-8.66%
USD	0.7386	-0.0251	-3.29%
CAD	1.3019	+0.0289	+2.27%
CHF	0.9733	+0.0104	+1.08%
CNY	6.6110	+0.0348	+0.53%
JPY	114.0650	-7.7546	-6.36%
GBP	0.8086	+0.0475	+6.25%

**Conclusion**

Britain’s exit from the EU will constitute a significant loss for the EU, and although there are certain areas which will not be affected by the Brexit vote – such as international commercial arbitration – Brexit will also have serious consequences for the UK’s economy, especially for the City of London, as mentioned in this article. The Centre for Economic Performance (2016) and the National Institute of Economic and Social Research (2016) estimates that the UK economy will be between 1% and 3% smaller by 2020, and between 2% and 8% smaller by 2030, than if the UK has chosen to stay in the EU (Dhingra et al. 2016; Ebell and Warren, 2016). A 1% drop in GDP is a fall of £19 billion, equivalent to £720 for each household currently in the UK. Although it is possible that losses for the UK might be mitigated (e.g. if EU leaders negotiate a good deal for the City of London recognising the risk to financial stability across the EU as a whole) – it is clear that the risk to economic growth of an exit strategy driven by immigration control are serious.

If the EU does not offer the UK favorable exit terms, it is difficult in the current global macroeconomic and political climate to predict what leverage Britain will have with its European neighbours. Indeed, the strong reluctance on the part of continental Europe to acknowledge the crises of immigration facing the EU may be driving the desire to be harsh on the UK in order to deter other EU exits. If this is the case, the UK economic model may change. As suggested by the British Prime Minister Theresa May, Britain may aggressively cut taxes and red tape, if it does not secure favourable fast-track trade deals with the EU (FT, 2017).

At the time of writing, it appears that Britain will not seek continued single market membership but will rather try to negotiate a free-trade agreement with the EU. This ‘smart’ Brexit approach has already generated a negative reaction from some EU leaders who are invoking European values, and the indissoluble link between free movement and trade agreements. The UK will need to exert outstanding negotiating skills – and possibly a degree of luck - to secure its ambitious Brexit plan.

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