

## **BREXIT MANAGEMENT AND ITS IMPLICATIONS IN THE EUROPEAN UNION'S ECONOMIC FRAMEWORK**

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### **ABSTRACT**

*The decision of Great Britain to exit the European Union has taken everyone by surprise. Financial markets, which were optimistic before the vote, reacted immediately to this decision calling for prompt intervention by policy authorities. It's obvious that this decision has to be observed and implemented in the best possible way by all responsible bodies, both in EU and in the Great Britain, however it's of utmost importance to estimate the medium to long term implications in all its economic, political and social aspects. The purpose of this article is to briefly outline some of the reasons and the possible negative effects of BREXIT, from an economic point of view, and to outline some short considerations on the future of the European Union.*

**KEYWORDS:** *BREXIT, European Union, external financing*

**JEL CLASSIFICATION:** E44, Q54, E43.

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### **1. INTRODUCTION**

Even since before the beginning of the 20<sup>th</sup> century, a united Europe in a similar way with the United States has been strong wish of many visionary people. In their minds, the advantages brought by having a common voice and act as one entity in the geopolitical world arena far outweigh the disadvantages of giving up some part of the nation's sovereignty in establishing their own laws and regulations. After the Second World War, in the context of economic and social recovery of most of the European countries affected, this project has been put into practice by important western European countries. One of the strong supporters of the united Europe project was Britain Prime Minister Sir Winston Churchill, which in a famous speech in Zurich in 1946 said "We must build a kind of United States of Europe"<sup>3</sup>.

The European Union roots lies in the European Coal and Steel Community (ECSC, established in 1951) and the European Economic Community (EEC, established in 1957). Great Britain tried for the first time to join EEC in 1961 but was rejected due to a veto by France and again in 1973 when it was successful. The European Union's project has been a successful one in the sense that it brought prosperity to its members in the western world.

Another major moment in the history of the European Union was the fall of the Soviet Union's in the late 1980s. This brought an opportunity for enlargement and also a hope for better day for the eastern countries. This also was successful, but brought some questions whether this is a win-win deal for everybody, as EU has a major social integration and cohesion component. Some countries, including Great Britain felt that being part of the European Union is no longer in their best interests. These worries have been amplified by the recent global economic crisis and also by other global challenges

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such as the Syrian migration phenomenon. This led to a referendum in Great Britain to exit EU, on which the majority of British citizens voted "YES", the so called BREXIT.

This article is structured in 4 parts. After introduction, the second part is dedicated to the brief presentation of the recent events in Great Britain and European Union and the arguments for BREXIT, to put things in perspective. The result of this referendum has taken everyone in the rest of Europe by surprise and it's clear that its implications have not been analyzed in depth by all interest parties. It's clear that the functionality of the European Union and its core principles that are somewhat threatened by BREXIT. It's worth to mention that Great Britain is the first member that leaves EU in all its years of existence and we can't help whether others will follow. The third chapter is intended to outline the steps to be made in the short to medium term by the European Union's institutions, to better address the needs of all its member states and to be closer to the reality. The last chapter is dedicated to conclusions.

## **2. ARGUMENTS FOR BREXIT**

In 2015's elections, the winner David Cameron, which was a strong supporter of the European Union promised the British electorate that to organize a referendum on this issue. In the last years, more and more critics accumulated in the Great Britain to the European Union's model. These critics were generally based on three main arguments: 1) the inward migration flow from eastern European countries, that joined EU more recently, to UK threaten the opportunity of employment or the employment conditions of the British citizens, 2) the European legislation which sometimes negatively affects the UK businesses and profits and 3) the net contributor position of Great Britain to the European Union's budget.

Migration of work force is related to the core principles of European Union as an economic union. It involves the free circulation of goods, financial funds and work force. It's only natural that EU citizens would try to find better jobs in the more developed countries to better provide for their families and for themselves. The economic theory tells us that fair competition has many advantages that far outweigh in the long run the somewhat small and annoying problems of adapting for some. The fact is that most of these European citizens that migrate to Great Britain have good intentions, they get jobs, usually low paid in the beginning, they pay taxes that support the English social system, they spend part of their hard-working money in Great Britain and, most important, they contribute to the added value and profits of the English companies and to the general economic growth of the country. If they didn't, they couldn't find a way to stay in Great Britain for long. Problems with the law should be dealt by the responsible authorities and the principles of non-discriminating an entire group for the actions of some few individuals must apply as in all civilized world.

Table 1 below shows the total number of UK immigrants by country of origin at mid-year 2015. The data were extracted from UN statistics website and are based mainly on official reports of authorities on the countries of origin of their citizens. The first thing that stands out is the large proportion of immigrants – about 8.5 mil. people representing 13.3% of their total population. From 8.5 mil. immigrants, only about 2.8 mil. (34%) are originating from EU countries, the most important being Poland with about 0.7 mil., being the second largest country of immigrant's origin, after India with about 0.77mil. immigrants. Immigrants are an important part of UK population; they help the country economy most of all by being part of their working force and paying all the required social and fiscal contribution to the UK budget. This cannot change soon and nobody, including the BREXIT supporters propose that. However, what's not yet clear is how the immigrants from EU countries will be affected by BREXIT. This depends of both the advantages that they had as EU citizens as compared with the immigrants originating from other non-EU countries, and the negotiations between EU and UK related to BREXIT that will take place in the next years. Normally they shouldn't have to be affected by BREXIT, if they already have jobs in UK and proved they can be good and useful citizens.

**Table 1: Total UK immigrants by country of origin  
 - mid 2015 -**

Country of origin	Number of immigrants	% of total
<b>Total, of which:</b>	<b>8.543.120</b>	<b>100%</b>
<b>EU countries</b>	<b>2.882.836</b>	<b>34%</b>
<b>non-EU countries</b>	<b>5.660.284</b>	<b>66%</b>
India	776.603	9%
Poland	703.050	8%
Pakistan	540.495	6%
Ireland	503.288	6%
Germany	322.220	4%
Bangladesh	230.143	3%
South Africa	218.732	3%
Nigeria	216.268	3%
United States of America	212.150	2%
Other countries	4.820.171	56%

*Source: United Nations, Department of Economic and Social Affairs (2015), authors calculation*

Nevertheless, in the long time, by exiting the European Union, the message is clear: the immigration process will have to slow. Either the British start working and accepting similar conditions as the eastern European workers and other immigrants did, which is very unlikely, or assume important economic losses, as companies will move their business elsewhere. From an economic point of view, this is a big mistake.

In this context, it's also interesting to remember the 1883 poem of Emma Lazarus, that is engraved on the pedestal of the Liberty Statue in New York, USA: "Give me your tired, your poor, your huddled masses yearning to breathe free, The wretched refuse of your teeming shore. Send these, the homeless, tempest-tost to me, I lift my lamp beside the golden door!"<sup>4</sup> Also, Sir Winston Churchill and many other Britain's seemed to have thought this way a few decades ago, after the World Wars, but it seems that they recently reconsider.

The second argument is related with the European legislation and bureaucracy of decision making procedures. Of course it's very hard to fit all the interests of 28 nations in one regulation, but for many it seems that in the last years the EU institutions have somewhat lost the link with their citizens they are deem to serve.

<sup>4</sup><http://www.libertystatepark.com/emma.htm>

An example here that directly affected Great Britain is related with the European Common Fisheries Policy that basically enforces limited quotas for each member state with the goal to preserve the fishing stock in the long run. Critics of these policies have argued overtime that many English fishers are forced to throw away fishes that were caught but have exceeded the allowed quota, and this can have only negative effects as it declines profits and the fish are already dead so no positive results for environment and fishing stocks. Instead other ways can be found, like limiting fishing periods, or by replacing the fish stocks frequently. It's important to mention that these policies have kept outside the European Union some important countries such as Norway or Iceland.

Mostly, the important European acts are adopted within the European Parliament where all states are represented, however lately, with the adoption of Lisbon Treaty, some of important decisions are adopted through delegated acts solely by the European Commission. Of course, this involves consultations with all member states at expert's level via many committees, working groups and taskforces, but some important decisions are no longer taken by direct representatives of EU citizens. The reason indicated for this is the need of operativity. Once a rule is passed, all member states need to enforce it directly or to start adopting measures for its implementation. Other problems lie with the loss of connection by the EU Parliament members with their citizens, due to all sort of different reasons. Some even argue that the European Union should stick only to ensure the principles on that it was founded, mainly the free circulation and the cooperation between member states, and limit as much as possible the adoption of rules that affect everybody. This would involve a process of reverse sovereignty of European members from EU to the specific countries. One size doesn't seem to fit all situations in this case.

Finally, the net contributor position of Great Britain shouldn't be a surprise for anyone. The European Union have been established by a strong goal in social cohesion between citizens of member countries. The mechanism relies on the distributions of funds within EU, for development purposes, and by contributions.

The EU funds allocations programs are negotiated every 7 years and for deciding the allocation of EU funds, the main consideration is the number of residents in each country, while for deciding the contributions paid by each country, the main indicators are the Gross National Income (GNI) and the VAT collections of each participant. In this way, the more developed countries contribute more to the EU budget and the less developed countries receive more funds from the EU budget. In time this should ensure a gradual catching up process by the less developed countries, while keeping a relatively small pressure on the budgets of the most developed countries.

**Table 2: Current and Capital account of European Union's institutions vis-à-vis member states**

*mil. €*

<b>PARTNER/TIME</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>5 years' yearly average</b>
Belgium	-683,0	-702,6	-828,1	-407,3	-1.065,0	-737,2
Bulgaria	-638,2	-1.212,4	-1.412,3	-1.644,4	-2.129,2	-1.407,3
Czech Republic	-1.196,2	-2.800,9	-3.225,6	-3.003,0	-5.913,0	-3.227,7
Denmark	1.016,1	1.326,2	1.442,7	1.196,7	1.074,3	1.211,2
Germany	12.735,9	15.832,5	16.563,9	20.771,9	18.518,8	16.884,6

mil. €

PARTNER/TIME	2011	2012	2013	2014	2015	5 years' yearly average
Estonia	-335,2	-760,2	-748,7	-445,4	-180,9	-494,1
Ireland	-585,1	-440,0	-53,1	-24,2	-377,1	-295,9
Greece	-3.859,1	-3.893,1	-4.732,1	-4.506,9	-4.365,7	-4.271,4
Spain	-1.014,8	-2.529,7	-1.552,7	1.320,9	-3.974,6	-1.550,2
France	5.715,9	7.687,6	7.609,9	8.131,4	4.806,0	6.790,2
Croatia	-102,5	-92,0	90,9	-30,5	-146,8	-56,2
Italy	7.763,5	6.416,6	4.885,9	6.850,0	4.250,1	6.033,2
Cyprus	-5,1	31,4	-47,2	-99,3	28,4	-18,4
Latvia	-706,1	-936,3	-795,8	-773,5	-747,4	-791,8
Lithuania	-1.279,7	-1.438,2	-1.363,9	-1.441,4	-442,8	-1.193,2
Luxembourg	-1.263,6	-1.383,6	-1.278,1	-650,3	-1.228,6	-1.160,8
Hungary	-4.110,4	-2.981,2	-4.693,5	-5.584,1	-4.775,9	-4.429,0
Malta	-61,4	-60,4	-76,7	-163,2	-14,5	-75,2
Netherlands	4.303,7	4.188,8	4.686,9	6.980,7	6.046,5	5.241,4
Austria	1.082,6	1.311,5	1.506,0	1.802,4	1.282,7	1.397,1
Poland	-10.186,7	-11.096,6	-11.227,8	-12.550,1	-8.582,8	-10.728,8
Portugal	-2.338,7	-4.496,3	-3.934,6	-2.849,0	-1.049,4	-2.933,6
Romania	-1.278,2	-1.836,8	-3.924,7	-4.225,7	-4.919,4	-3.237,0
Slovenia	-385,5	-486,0	-422,0	-676,1	-462,5	-486,4
Slovakia	-1.032,6	-1.464,2	-1.164,2	-787,2	-2.953,8	-1.480,4
Finland	914,3	851,7	876,6	1.123,7	646,7	882,6
Sweden	1.803,4	2.390,0	2.621,1	3.402,9	2.777,1	2.598,9
United Kingdom	7.594,1	10.396,1	11.419,3	9.497,5	15.433,8	10.868,2

Source: Eurostat

Table 2 above shows the evolution of current and capital account from the balance of payments statistics of European Union's institutions vis-à-vis each member state for the last 5 years. It reflects both the member's contributions to the EU and their benefits (in the form of EU funds). Positive values indicate that EU institutions were financed overall by that particular member state and negative values indicate that EU institutions financed the member state. We can easily see that United

Kingdom is the second largest net contributor, with an average net contribution in the last 5 years of approximately 10.9 bn. €/year, exceeded only by Germany who recorded an average of about 16.9 bn. €/year. On the other pole, the main beneficiary of being part of EU is Poland (being the main beneficiary in the last 5 years with an average of about 10.7 bn. €/year) followed by Hungary (4.4 bn. €/year), Greece (4.3 bn. €/year) and Romania (3.2 bn. €/year).

This redistribution of wealth between members have been a core principle ever since the establishment of the European Union and it somehow made sense after the second World War to help the western European countries rebuilt (they also benefit from the US Marshall plan in the beginning) and to help the ex-communist countries rebuilt after the fall of the Soviet Union. It's a way of ensuring a strong and lasting prosperity for all members, to fight the social differences and poverty between individuals in all Europe.

### **3. WHAT'S NEXT FOR EU AND THE REMAINING 27 MEMBER STATES**

The immediate and obvious impact of BREXIT is that EU should expect to lose almost 10 bn. € per year in net funding from UK, which will definitely be a challenge for all other member's states. It remains to be seen what solutions will be found, but it's clear that some budget cuts or increasing in overall contributions will be needed if Great Britain exits EU.

The European Union should clearly reanalyse its institutions role in the welfare of individuals to lower the bureaucracy and increase the transparency of its decision process. The role of the European Union in the beginning was only to ensure a functional economic union, that is to establish a free trade area and free circulations of goods, financial funds and work force. However, in the last decades, this role has been extended, and now EU as an entity has important responsibilities in the welfare of Europeans among other like protection of the environment, health, food and so on. Perhaps not everyone agrees with all these extra responsibilities that have been established overtime. This can be evaluated to some extent, however the sole purpose for which eastern European countries tried so much to join EU is welfare. This welfare can be achieved by economic cooperation overtime, as this leads to the general optimization of resources inside the economic area, but social cohesion and the catching up process have been an integrated part of the European framework ever since the second World War. In fact, the European Union has even a dedicated fund program for cohesion, The Cohesion Fund, which aims to „reduce economic and social disparities and to promote sustainable development”<sup>5</sup> and is addressed to member states whose GDP is below 90% of all member states average. With all these efforts, this process didn't go so well in the last years.

Table 3 bellow shows that between 2005 and 2015 the standard deviation of GDP/capita in the 28 member states that form the European Union has increased slightly. This indicator reflects the amount of variation or dispersion of a set of data values or far these values go from the average. If the catching up process would have been successful, these discrepancies would have lowered. However, all EU member states have recorded a somewhat improvement in GDP during this period.

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<sup>5</sup>[http://ec.europa.eu/regional\\_policy/en/funding/cohesion-fund/](http://ec.europa.eu/regional_policy/en/funding/cohesion-fund/)

**Table 3: Standard Deviation of EU28 member states GDP\*/capita**

*EUR*

TIME	STDEV
2005	14.297
2006	14.650
2007	15.152
2008	14.723
2009	13.842
2010	14.290
2011	14.347
2012	14.081
2013	14.177
2014	14.466
2015	15.133

*Source: Eurostat, authors calculation*

\* the values for GDP were extracted from Eurostat as Chain linked volumes (2005)

It's obvious that further efforts are needed to achieve cohesion between member states. The truth is that this can be an issue of some developed member states, as they are required to support cohesion of others, the benefits for them being so visible in the short run. In the long run, having developed economies all around you ensures not just access to strong economic markets, but also pace and stability. This was the reason behind the Marshall Plan for Europe and for the European Union in its early days.

It's worth mentioning the negative role that the global economic crisis has had in this. As expected, the economic crisis leads to the aggravation of the problem of mankind (Huidumac-Petrescu & Popa, 2014) and European Union didn't make an exception here. The problems in Greece only seemed to have challenged the ECB and EU resources to the limit. It is hard to explain to the German people that they need now to pay for the reckless management of fiscal policy of some other country just because that country belongs to the European Union and Euro Area. From an economic point of view, the decision to help Greece was supported by the fact that bankruptcy of a Euro Area (EA) country might be seen as the bankruptcy of the entire Euro Area by investors, and this make some sense as the monetary policy is common. A similar problem appeared in Germany as in the UK, the extension and transfer of sovereignty from individual countries to the European Union. However, UK never belonged to the Euro Area, so they didn't have this issue. European Union is still struggling with the effects of the global financial and economic crisis when BREXIT came up, recording a modest 2.2 % GDP increase in 2015, as compared with 2014. The crisis revealed weakness in the European Union's economic model. Although many member states joined together in a monetary union and all EU countries needed to observe all EU regulations and directives, when things started to go wrong, there were no safety mechanisms to be put into work immediately. This way, tough bilateral and multilateral negotiations needed to be organized in order to come with solutions. It took too much time and as a result, the negative effects of the global crisis were felt much more that they should of have, as compared with the US for example (Huidumac-Petrescu & Popa, 2016).

These weaknesses were partly addressed by the European Union's institutions by establishing new rules and mechanisms such as the Single Supervision Mechanism (SSM), the Stability and Growth Pact (SGP) and early warning procedures such as the Macroeconomic Imbalance Procedure (MIP).

However, these are far from being exhaustive and even with these, some countries feel that these mechanisms are lowering the sovereignty even more. In these authors opinion, EU must keep this line of increasing the cooperation and help between member states in order to better manage future negative events, with all costs, including the possibility of some members to leave.

#### 4. CONCLUSIONS

A united Europe has been the dream of all of us since before the twentieth century. With the development of China and India and the issues related with Russia, it's clear that the only chance for Europe to have a future as an acting player in the economic and geopolitical arena is to be united, to have a single voice. The exit of Great Britain from the European Union was unexpected and will definitely have strong repercussions in the years to come.

In the short run we can measure these effects by the net amounts received from Great Britain by the European Institutions, of about 10 bn. €. In the long term, however, thing is rather tricky as this event can prove to be only the beginning of the downfall of this dream.

After the fall of the Soviet Union, for many eastern European countries, the European Union has represented a dream of liberty and a better life in general. Joining EU was the goal of all these countries and politicians were forced to care about this in their decisions. After the last big enlargement wave (in 2005, 10 countries and in 2007, 2 countries) the European Union faced with one of its biggest challenges in meeting its core objectives related with Member States cohesion. This stressed out resources of all developed countries, but these countries also benefit from the creation of new markets for their products, which were unavailable before. They also benefit from a cheap and fairly good quality labor force, although China started to developed also and it's playing a role more and more important. The main argument that the European Union represented a win-win deal for all its members is that prior to the financial crisis, the European Union achieved an overall growth.

The crisis however proves to be an even more greater challenge for keeping alive the main European Union principles. It eroded the core elements of beliefs in the positive externalities of assisting other neighboring countries to overcome their problems and start to develop. These core principles have to be kept at all costs, even if further livings will happen.

Immediately after we could say that the crisis is over, other crisis, more of a geopolitical nature consisting of large waves of immigrants from Arab countries arise.

All these lead to the decision of Great Britain to exit the European Union and follow a different path in the future. In time we'll see if that was an inspired decision or not for them, but the next steps of the European Union are very important. If EU maintains a coherent position and maintains its principles, things might be ok in the long period. The alternative could be very costly.

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