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# THE BREXIT PUZZLE

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## Resumen

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Este trabajo girará en torno al Brexit. Se analizarán cuestiones relativas al origen del referéndum y las cuestiones que han llevado a que el Brexit se convierta en una realidad a día de hoy. Después de ver los orígenes, este trabajo analizará las tendencias del voto en el Reino Unido y cuáles fueron las principales razones por las cuales el pueblo del Reino Unido se decidió por la salida de la UE. Posteriormente se investigará cuál fue el contexto político previo y posterior al Brexit, además de analizar la importancia que tuvieron los partidos “*anti-establishment*” en las campañas políticas del referéndum. Finalmente se hará un pequeño análisis de las causas y consecuencias económicas, para acabar dilucidando las posibles opciones y modelos de salida de la UE que actualmente tiene el Reino Unido.

**Palabras clave:** Brexit, Unión Europea, Consecuencias, Referéndum.

## Abstract

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This paper will focus on Brexit and the issues surrounding it. The paper will analyse why the referendum originated and what matters have taken the UK to leave the EU. After analysing the inception of Brexit, this paper will briefly go over the voting trends in the UK and will also analyse what had taken the UK’s population to vote to leave the EU. Subsequently, the discussion will go over the prior and posterior political context in the UK and how the anti-establishment movements had an important role in the referendum campaign. To conclude, this paper will go over the economical causes & consequences of Brexit and will highlight the possible choices and scenarios that are available for a UK outside of the European Union.

**Key words:** Brexit, European Union, Consequences, Referendum.

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# 1. INTRODUCTION

## 1.1 Purpose and Motives

The purpose of this paper is to overview the main issues surrounding Brexit and how these have affected the legitimacy of the European integration process. Throughout the paper, the puzzle surrounding Brexit will go through the historical issues that germinated the idea of Brexit, why the referendum actually became a tangible truth and what has been the political context that surrounded the whole question. To further understand the European integration process and why the UK has decided to jump off the boat, this paper will also briefly go over what International Economic Integration actually is and what its different stages are. What is also vital, and will be mentioned in this paper, is how the referendum actually developed and what drove the UK's citizens into deciding to leave the EU. All these matters and the Brexit process itself has been sustained by a certain regulation and legal framework, which this paper also analyses. Finally, the paper will drive into the economic panorama and what the possible outcomes are for both the UK and the EU. All these arguments will illustrate the reader with the current situation in the UK and the EU, in order to be able to assess more clearly, how the European integration process and economic panorama will unfold.

## 1.2 State of question

Brexit is a fundamental issue that anyone should be able to understand and have an opinion about. Its origins and possible outcomes will be crucial for the future developments of the EU's integration process. As the EU and the UK are both essential members of the current international status quo and will be paramount decision makers that will shape the future world order, it is of vital importance that issues regarding Brexit and the EU are displayed clearly. Therefore, with the intention of participating in this worldwide discussion, this paper will humbly try to shove some light onto Brexit and its possible outcomes in both the short and the long-term.

## 1.3 Methodology

The research of this paper was based on a series of articles of very diverse nature. On one hand, this paper has been fuelled by academic publications, which have been retrieve from different sources. These sources have ranged from scholarly literature databases (Google Scholar or Academia.edu), international organisations (OECD, IMF or The House of Commons Library), universities ( Harvard and London School of Economics) and newspapers (Financial Times, The Guardian or Cambridge University Press) to journals of different specialties (Journal of

European Public Policy, Journal of Politics, Journal of Economics, Journal of Management Science of Journal of Foreign Policy). With these sources of information, I have organised and gathered relevant information, in order to be able to write this paper. As Brexit is a very changing and current topic, I had to update the information regularly in order to keep up with the decisions that are being made and to construct an updated paper.

#### **1.4 A brief overview**

The European project has been put through a very tough scrutiny in the last years, the 2008 crisis had planted the seeds and these have germinated into more than palpable problems. The migration crisis, populist trends and Brexit have tested Europe to its most fundamental values. This paper will analyse how Brexit has affected the current European project and how it has shaped its future. With no doubt ever since its creation, the European Union is facing its biggest challenge. There are many fronts the EU has to deal with currently, of course Brexit is one of them, but the renewed and hostile North-American position towards Europe, Erdogan's new approach towards Russia and internal populist tendencies are the biggest issues Europe has to confront in the short-term.

Brexit itself probably affects all of these issues simultaneously, but this paper will focus on three main pillars. In first place, it is vital to understand how the concept and understanding of British sovereignty have slowly constructed the ideological infrastructure for Brexit to happen. Secondly, this paper will focus on how geopolitics and security will mutate after the announcement of Brexit. To finish, this paper's third main pillar will focus on how Brexit has and will reshape the current world trade patterns. All of these concepts will be analysed upon a brief analysis that will pinpoint fundamental concepts such as the withdrawal mechanisms and protocols, possible outcomes and the inception of Brexit. A new Europe has emerged, but the main question is, will European optimism survive?

For 50 years the EU has amplified British influence around the world. Although Great Britain has always worked upon a strong international and foreign affairs agenda, the EU has been an amplifier throughout the Cold War and currently a world full of global challenges and economic superpowers. However, after Brexit the paradigm of British foreign relations will no longer rely on European support. Actually, we could be witnessing one of the first real changes in Britain's foreign policy since the Cold War. Now is when British elites and leaders, remembering Britain's role as world player during the past 50 years, have to confront the truth and construct a

meaningful role in which Britain not only has to reconstruct ties with the European continent but also has to refresh international relations which have, in one way or another, relied on the European Union's infrastructure.

However, Britain has always implemented what I like to call the "*Extra-Wurst*" policy. This German expression tries to describe that (in this case) Britain, beyond the EU, has always maintained a strong soft-power policy (Nye, 1990), in which British values and interests have always prevailed over European interests and in consequence, built the foundations for the inevitable happening of Brexit. Post-Brexit Britain might then be quite an active international player, as are Canada, Australia and New Zealand, with relatively high levels of military spending deployed around the world. But it will not be expected to take a lead as it has recently in Kosovo, Sierra Leone and with France in Libya. It's going to be more of a foreign policy, but not a role in the world. However, this will highly rely on how Germany reacts to Brexit. This panorama can bring two outcomes, on one hand Germany can remilitarise its country and play powerful role in world geopolitics, replacing Britain, or on the other hand and more likely, it will focus on a more unified and strong Europe, which means that the British international role will not be replaced. In fact, after observing the U.S. approach to Britain and the EU, it is very likely that the U.S. supports Britain's new role in the world. But will that be enough? Trump's volatile and erratic behaviour will tell.

## **2. A MULTILATERAL APPROACH TO BREXIT**

In the coming sections, this paper will analyse Brexit and its causes, from different perspectives and points of view. Additionally this paper will make a brief overview of the concept of Economic Integration in order to contextualise the content of this paper and better understand the relationship between this concept and the happening of Brexit.

### **2.1 Inception of Brexit**

Brexit represents the victory of a discourse of national sovereignty, independence, and democracy, and thus separation from the Brussels bureaucracy (McCourt, 2016), considered weak, undemocratic and authoritarian over British interests. However the genesis of Brexit originated within a complex net of issues ranging from the financial crisis to the recent migration crisis and terrorism. Brexit has been the culmination of a long-term process rather than a thought-out strategy designed within the walls of Westminster or Downing Street. The Leave vote

prevailed due several factors, which can be divided into short-term and long-term issues. On one hand short-term issues such as a misleading and populist leave campaign, an irrational xenophobia, a general discontent with the economy and a profoundly Eurosceptic press, where direct causes for the Leave campaign to prevail. However, it is important to see things with perspective and not underestimate the long-term issues that affect the outcome of the Brexit referendum. In a number of important respects, the UK is the least well-integrated EU member state, essentially, the least European country and that this fact likely stems from certain historical features, which arguably constitute the ultimate causes of Brexit. (Dennison & Carl, 2017)

This is not the only measure in which the UK ranks on the lowest positions. Throughout measures such as emigration towards the EU, FDI towards and from the EU, import/export volumes and confidence in the EU, the UK consistently ranks within the lowest three positions (Dennison & Carl, 2017). Although the UK does not rank among the lowest positions in all surveys, the position of the UK in fundamental issues such as confidence in the EU or their FDI relationship with Europe, determines that the UK is one of the least well-integrated members of the EU. Historical reasons such as a long tradition of parliamentary democracy and a nationally established church, and geographical reasons such as the UK being an unconquered island surrounded by waters which have isolated it from cultural changes happening in the continent, are strong reasons for Britain to have a different cultural identity. However, the fact that the UK does most of its economic activity outside the EU is due to three main factors, the universality of the English language, the special relationship with the U.S. and the roots of the former British Empire. Therefore, the short-term matters may have tilted the balance towards the Leave side. But the long-term matters are the fundamental reason for Brexit to be on the table. Gradually, as the EU has approached a political union, the UK has slowly and simultaneously distanced from European values.

## **2.2 Economic integration**

In order to contextualise this paper, it is important to understand the basics of international economic integration. It is crucial to recognise the fundamentals of international economic integration in order to define the contexts and examples of this concept. Four issues mainly affect the current economic panorama, the fall of the USSR, the effect of globalisation, the accelerated technological advancements, which ballast national productive industries, and the regionalisation of economics. Under this umbrella, the international economic integration has evolved into the current world order that is sustained by the WTO, IMF and other international economic



institutions. Of course, many other reasons such as geographic proximity, common political, social and cultural values, together with previous collaboration, all are strong promoters of a long and stable economic integration. However, it is more than evident that Great Britain fails to comply in many of these common values that thrust economic, and thus social, integration.

Economic integration is the very process in which two or more previously separated economies take advantage and benefit from a progressive withdrawal of trade barriers, which will ideally end in the form of a fruitful common market (El-Agraa, 1996). This act of economic coordination can be seen from two different standpoints. On one hand, it may be a way of protecting a nation's interests by collaborating with its regional allies due to a hostile world panorama, which cannot be confronted independently. On the other hand, it can be seen as an approach to regional allies, in which nations are willing to cede sovereignty in order to produce a profounder alliance. It is almost unmistakable to appoint Great Britain in the former rather than in the latter position. The final goal of these policies is to implement cooperation systems for nations to work together for a common objective or simply for the enhancement of trade and competitiveness across their economic systems, resulting in a net increase of mutual welfare and prosperity.

In order to be able to comply with this integration process, the countries involved will have to create a supra-national institution that is capable of regulating the functioning of the economic relations within the space, regulates the economic and social policies carried out and the requisites that these nations must respect and fulfil to be part of the union. Of course, the level of integration will always be directly related to the country's degree of development and democratic transparency (Scharpf, 2011). To conclude, it is important to understand that international economic integration is different from international economic cooperation. The former implies handing over a certain amount of sovereignty, providing the foundations for further integration processes and the latter only provides the means to an end, where the "deal" focuses exclusively on profiting from commercial relationships.

There are several types of economic integration agreements. These agreements can be divided into two blocks. On one hand there is the functional, also known as step-by-step, integration process, in which nations select which sector will be involved in the integration process. On the other hand, there is the total integration process, in which every sector indistinctively of its nature, will be included in the integration process, creating synergies in this process (Samaratunga & Weerasinghe, 2002). Having this in mind, economic integration broadly varies

in terms of range and expectations. In consequence the different types of integration stages can be identified as follows in increasing order (Balassa, 1961):

- 1. Free Trade Area (FTA):** In this kind of integration, countries abolish mutual tariffs within the group, but keep their right to impose tariffs and other import/export measures upon third countries that are not part of the free trade area. This type of integration could cause a trade problem, in which products from third countries enter a FTA member with high tariffs through another FTA member with lower tariffs on the rest of the world, causing internal imbalances where FTA members could take advantage of the situation and harm other members.
- 2. Customs Union (CU):** The CU recalibrates the issue of trade deflection and obliges all of its members to adopt a common external commercial policy in which, for example, all of the members must impose the same external tariffs on products from the rest of the world and apply the Rules Of Origin (ROO).
- 3. Common Market (CM):** This stage of integration once again goes further. In this case the CM allows free movement of factors (capital, labour...) throughout all of its members, as is the case of the East African Community.
- 4. Economic Union:** Is basically a CM with certain compliance in economic policies and the unification of monetary and fiscal policies. As a consequence, this union will have to create a supranational organism, which will supervise and control these policies (the European Central Bank in the EU).
- 5. Total Economic Integration/Political Union:** Is the full unification of monetary, fiscal, social and counter cyclical policies.

However, Regional Integration Agreements (RIA) differ in a wide range of matters and cannot easily be structured in the previous list. However, this list is one of the best ways to discern the different stages of economic integration within the different forms of RIA's. Nevertheless, RIA's have three common pillars. Firstly, all of these measures are intended to last for a long period of time, limit the action of its members in some economic policies and also provides to create a mutual benefit situation. Second, all of these stages include the elimination of mutual discrimination measures. And third, to some extent, all of these examples include a common perspective or stance to third countries, which are not members of that RIA.

In all of these unions, the member nations must cede a certain extent of their freedom of action and sovereignty in order to participate. The deeper and broader the union becomes, the more sovereignty its members must hand over. This concept will have a special role throughout this paper, mostly because historically Britain has had a very apprehensive and not less questionable attitude, when it came to handing over sovereignty for the European project to prosper, proving the undeniable truth, of how important Britain is for the European project.

The real problem resides in that the ultimate economic integration, implies two important issues. On one side it entails a profound pooling of sovereignty, which many members (even the most advocates to the union) are not ready to give up. On the other side, the ultimate economic integration does not only affect economic matters, it also profoundly affects and shapes how countries within this RIA relate, socially interact and make political decisions. The best example of this complex process of integration is the EU. Union in which one of its most fierce supporters, Germany, is not even ready to accept the creation of a fiscal union (Jones, 2017), due to its complexity and the difficulty of homogenising this union for a Europe with countries at very different speeds. Yet the real question here is, why and what has pushed the British mistrust in the EU and how has this resulted in the culmination of Brexit?

### **2.3 Political Context**

Having discussed long and short-term matters surrounding Brexit, it is worth to briefly go over the pre-Brexit political panorama in the United Kingdom. One could believe that Brexit is the culmination of a series of events in which the UK has continuously questioned the strength of the EU. However, the referendum that took place on the 23<sup>rd</sup> of June of 2016 has been the peak of the rough relationship of the UK with the EU. The start of the modern conflict of the UK with the European Project goes back to the 60's when Charles de Gaulle vetoed the British accession twice. The perception of the UK was ironically low at the time, considering that now the EU has lost one of its most valuable powerhouses. After tensions between France and the UK reduced, in 1973 the UK accessioned the EEC. In spite of this, only two years later a referendum was held by the labour party of the time, asking UK citizens if they thought that the UK should or should not remain in the EEC. With a 67% in favour, remain vote won the referendum. Nonetheless it is important to highlight that during that referendum campaign unlike today, the media and main newspapers campaigned in favour of the remain vote. Another symbolic event was when in 1984 Margaret Thatcher fiercely renegotiated how much the UK had to contribute to the EEC's budget. Furthermore during the 90's and early 2000's, when the Union's intentions of integration reached

further than ever, the UK manifested its dissonance in many stances. In the treaties of Maastricht (1992), Amsterdam (1997) and Lisbon (2007 and where the withdrawal Article 50 was designed) the UK assured its posture against the monetary union, the Schengen Agreements and the opt-out possibility from justice and home affairs measures, within many other singularities the UK has demanded throughout its membership in the EU. These positions, throughout recent history, have been the prelude to what no one really expected to become a tangible truth. Not joining the euro was, more of an economic calculation based on Gordon Brown's 'five economic tests' than an political decision (Begg, 2016), yet the public impact and long term effects would certainly have a political implication.

Analysing a more recent pre-Brexit political panorama, Brexit has been a dormant issue for several years. With David Cameron in Downing Street, he found it extremely difficult to move his party away from the euroscepticism and to avoid polling the idea of leaving the EU, with the rise of UKIP. Internal turmoil shook the conservative party, which had to see how some of its members were ready to fracture the party in order to free the UK from Brussels's burden (Mason, 2016). The internal rebellion of 2011, which laid out a eurosceptic majority that supported the referendum within the conservative party and Boris Johnson's public call for a renegotiation of the EU-UK relationship before a referendum, pushed Cameron in 2013 into promising this renegotiation and referendum before the end of 2017. However, it is believed that Cameron was on one hand very optimistic with the real euroscepticism that lurked over the UK and that he thought that the impossibility of winning an overall majority in the next election allowed the liberal democrats to veto the roadmap. Moreover, after his victory in 2015 there was no space for retreat (Mason, 2016). After this, the eternal eurosceptic campaign became tangible and the real race for referendum had started. Initially the polls stated that the majority of UK's population was in favour of remaining in the EU, but the dull outcomes of Cameron's negotiations in Brussels, his failure to comply with his promises to limit migration flows and the posterior rampant populism carried out by parties such as UKIP, brought profound turbulences to the isles.

Initially, the leave campaigners flagged ideas of economy and sovereignty, but quickly realised how fast immigration issues echoed within the population and changed the campaign roadmap. Although the real effect of immigration is substantially less than the effect portrayed by UKIP and other leave campaigners, immigration does have a reasonable effect upon the British population. One of the main reasons for the migration peaks in the UK are the European

expansions east in 2004/07, which did nothing else but aggravate a situation that leave campaigners would take advantage of in 2016.

Migration has been a strong growth driver in the UK for the last decade or more. What Brexit advocated defended is that precisely that, is not a reason for migration to be positive. In other words, this kind of growth does not always have a positive effect on the native population. Nevertheless, this kind of migration makes a contribution to public finances and fills labour shortages in the industrial and agricultural sectors. The share of migrants in the working-age population doubled between 1995 and 2014. Although this may not have the negative effect that would be expected on the native employment rate, it slightly burdened or even squeezed downwards wage rates (Begg, 2016). The lesson of this is the lesson of politics itself. When it comes to convincing a country, macroeconomic facts, averages and other non-tangible facts are not helpful, even harmful, when it comes to attracting the public towards one or another point of view. It is simply too distant and abstract for the individual to perceive, and other issues such as social housing, health services and school places have a direct effect upon the population, which quickly will point towards migration as the cause of their anguish. This can be considered as a distorted form of Aristotelian democratic degeneration, the Ochlocracy. This term, coined by Polybius during the second century BCE, represents a democracy that is ruled by an uninformed crowd, where the rule of information and facts is put aside (Kamitake, 2007). Yet being an extremely severe term, in one way or another the analogy is suitable, because the outcome itself (Brexit) is not in the interest of all the British people and their future.

The effect of UKIP and Nigel Farage had a significant influence upon the 2015 elections in which UKIP was polling at an all time high since its creation. Farage's disruptive appearances in European and UK media as well as his impact in social media had a significant effect in the 2016 referendum. Along with his strong messages, Farage and UKIP as a whole stated that the British people had not decided upon the new EU in the past referendum, that since the Maastricht treaty the British community had lost control over what they decided years before, falling into the inflexible and distant hands of the government in Brussels. The concept of European political elites has always been a distant issue for UK's population and therefore was easily shaped into an authoritarian, distant and undemocratic/unelected entity that didn't defend British interests and/or values. By all means, UKIP has been part of the populist wave that invaded Europe in the last years. The popular discontent, the special UKIP anti-European-elites brand and their anti-establishment sentiment had been great tools for the party to prosper in such an agitated

atmosphere. While the prior establishment, from Blair to Cameron, stood against the Brexit campaigners, which didn't help at all, one of Cameron's good friends and British political heavyweights, Boris Johnson, publicly came out for Brexit and further legitimised the movement. What has been truly extraordinary is that no matter how different in nature or ideology the European anti-establishment parties were, the mere existence of them in different countries, meant a solid mutual support and thrust for each and every one of them. One of the explanations to this is how empty and contagious these ideologies may be, but the most important remark of these events is how fragile and vulnerable the pan-European welfare state is.

Another paramount issue during the Brexit campaign have been the economic reviews many different actor and institutions have made, trying to enlighten the future of the UK after Brexit. There have been many national actors such as HM Treasury, the Bank of England and the Economists for Brexit initiative, which have participated in this economic analysis. International organisations such as the IMF and the OECD, though having a more neutral and international perspective, have also participated in the process of identifying potential post-Brexit risks. All of these forecasts vary depending on the expected outcome of the negotiations of the UK with the EU. The remain side argues that the participation in the European Union and the Single Market has allowed the UK to benefit from access to a large market without giving up political independence. But the leave campaign defends that the regulations of the Single Market have too much of a liability for the UK's sovereignty and ability to satisfy the wishes of its population, in particular when it comes to immigration. Furthermore, many of these studies have concluded that Brexit would imply a reduction in UK GDP in the long term and all of them concluded that the largest upcoming risk for the UK in 2016 was the upcoming referendum (Daugėlienė & Puskunigis, 2018). Brexit was said to cause a negative shock in the economy, a fall in the sterling's value and a decline in business confidence and investment. It would also create uncertainty about the UK's relationship with the EU, the sixty other countries which are covered by collective EU deals and a further sixty-seven currently under discussion (Begg, 2016). All in all, these arguments did not stop the inevitable from happening and Brexit is now, a reality.

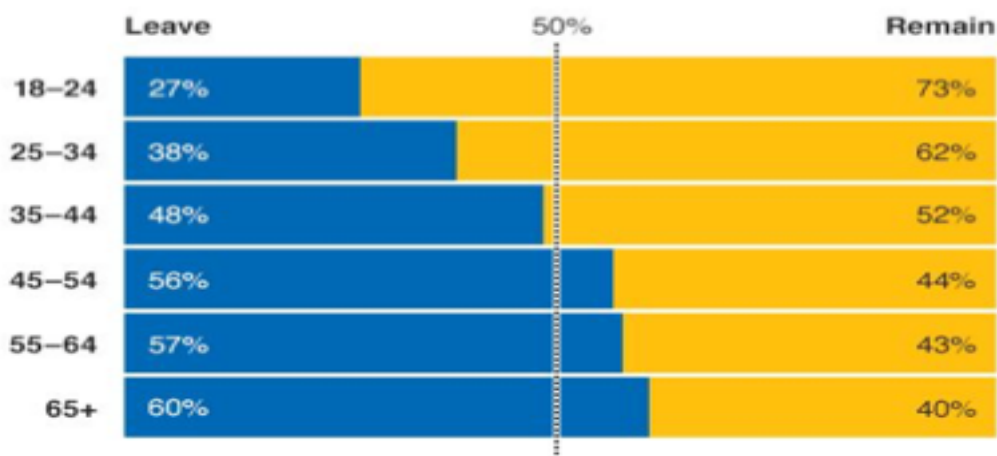
### **3. THE REFERENDUM**

#### **3.1 The final outcome**

This section will briefly overview the referendum's outcome on the 23rd of June 2016. It seemed like a very close call days before the referendum. Newspapers like the Financial Times and trends in the Sterling's value had shown an increase in the Leave vote days before the actual vote

(Financial Times, 2016), but in the end it seemed like the remain vote would prevail. However, in the end the leave side won with a very close outcome, just 50.6%. There have been substantial geographical differences in the trends of the vote. The most significant remain votes emanated from Northern Ireland, Scotland and the inner London area where 72% voted for Remain (Arnorsson & Gylfi, 2016). On the other hand, Wales presented a majority that voted to leave. Withal, the critical voting happened in England, which majorly voted for the Leave side, only in the Greater London area the Remain vote succeeded. There is a significant leave trend in regions, which once had been industrial powerhouses (coal, iron, textile, steel, mining) and nowadays have been deeply affected by globalisation. In some places this trend was a complete puzzle, in Sunderland where a giant Nissan factory exports most of its goods to the EU, more than 60% of the vote supported the Leave campaign (Begg, 2016). Still in Scotland and Northern Ireland, both regions, which vigorously prospered from industrial developments, the trend was completely opposite and resulting in a vote for the UK to remain in the EU. However in these areas, historic disputes with the UK and pro-European sovereignty movements have majorly shaped the referendum vote. Another tangible trend is that most of the regions that have voted to remain, have flourished economically in the last decades. Many of these prosperous regions have gradually substituted industrial activity for the services sector (financial services, IT...) (Arnorsson & Gylfi, 2016). From the demographic point of view, there has been a surprising common pattern throughout the UK. On one hand, the younger population has consistently voted for remain. On the other hand, with regard to education levels, the more educated the individuals were, the higher was the tendency to vote for the UK to remain in the EU (BBC, 2016).

**Figure 1. How different age groups voted**



Source: (BBC, 2016)

The worrying issue here is that these demographic groups (younger population and graduates), which have stood out in favour of remaining in the EU, are rowing due to the generational changes and the rise in higher education throughout the British population. Therefore, it could be possible that in the next couple of years the referendum would have had a very different outcome (Ford & Sobolewska, 2018) if the demographic trends continue the same path. Nevertheless, these forecasts assume very unlikely and profoundly relevant issues. On one hand, that the rest of the factors remain constant and on the other, that the international panorama will favour the EU in the future.

### **3.2 What has truly driven the vote for Remain or Leave?**

There has been a debate on whether voters focus on their attitude towards the EU integration or if the referendum's vote has been an interpretation of the population's dissatisfaction with its current national government or political elites. Both approaches can actually happen at the same time, but it has been found that when the referendum is not legally binding and it intends to build up support in some specific matter, the vote is more likely to reflect the population's attitude towards the current government (Hobolt S. B., 2016).

The amount of public attention and importance of the matter, evidently, directly relates to how the referendum will be seen from the citizen's perspective. The Brexit referendum had a great deal of public attention and therefore a very high turnout, reaching 72.2%. In this case, it is more than expectable that the foundations to decide on whether to leave or to remain, had an intimate relationship on what attitudes UK citizens had towards EU integration. But how do these opinions forge themselves?

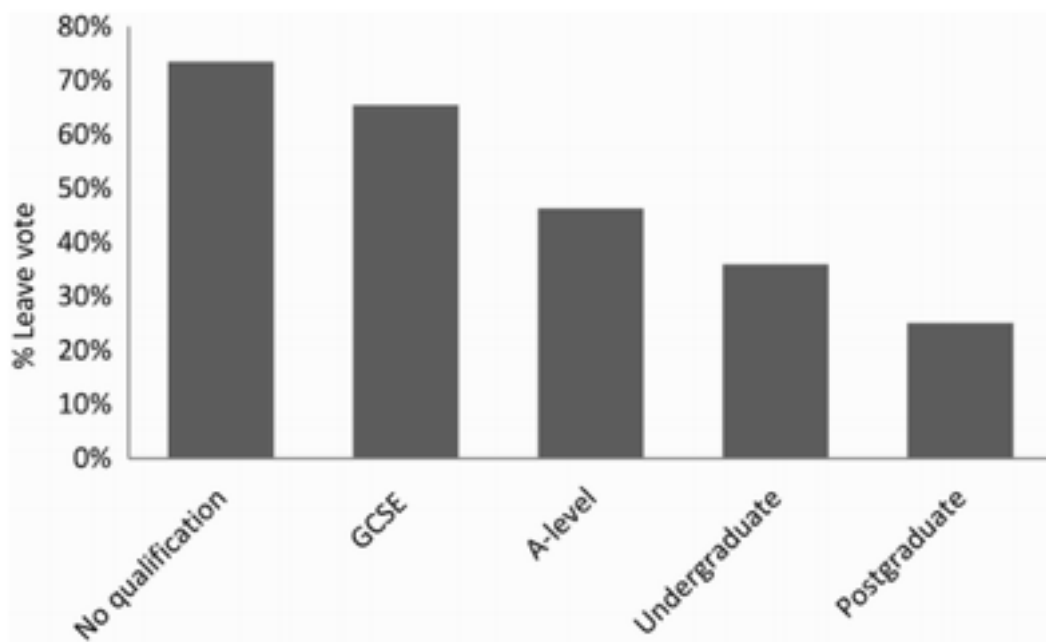
This paper will briefly overview Hobolt's analysis (Hobolt & de Vries, 2016) on what actually affects the support for European Integration in the UK. There are three main pillars that primarily influence on whether a voter will be in favour or against European integration: utilitarian, identity and cue-taking approaches.

The utilitarian point of view states that the liberalisation of trade with the EU mostly benefits highly educated, best employed and higher income individuals. Therefore, the individuals that comply with these aspects will exploit the European Integration process the most. In other words, the young, well-educated professionals in urban centres will work towards international cooperation, immigration and integration, whereas the older, less educated working class will be



disagree with a further deepening in any international integration process. Only a quarter of people with a postgraduate degree voted to leave, whereas over two-thirds of those with no qualifications did so (Hobolt S. B., 2016). In a nutshell, it is expected that the socio-economic situation of UK citizens has had a profound effect on the outcome of the referendum. It is very reasonable, to expect that the importance of education is on the rise in the EU and that the less educated individuals in the UK have very likely had a more Eurosceptic attitude.

**Figure 2. The Education Gap**



Source: (Hobolt S. B., 2016)

Now, demographics are not everything when it comes to Brexit. The British identity plays a crucial role within Euroscepticism. Sharing Sovereignty has always been an issue for the UK and the degree to which this issue worries its citizens is essential when understanding how the UK's population sees European integration process. Handing over sovereignty will affect national self-determination and independence, as in the eyes of the UK has happened after David Cameron's failure in negotiating new membership conditions for the UK. This, together with the UK's national sentiment and opinion of the rest of Europe, which as mentioned before have always shared slightly different cultures, will define the UK's view of the European integration process. The stronger the national sentiment, the more distant the individual will be from the European integration process. This could even result in seeing the European integration process as a direct threat to national cultures and borders (McLaren, 2002). Hence it is very likely that a UK citizen, with a strong national identity, will be associated with the Leave vote. However, the affiliation to

a “European Identity” reduces the probability of voting Leave by as much as 37 percentage points (Hobolt S. B., 2016) and is proof of the strength and influence that a European identity can have. Therefore, it is important to understand that both identities are not mutually exclusive and that the mere existence of any kind of cultural match a UK citizen may have with the EU will be a decisive factor when deciding whether to leave or remain in the EU. There is little space for UK citizens that identify with European values but would still vote for the UK to leave the union.

The third pillar represents the cue-taking approach. The attitude towards the issue at stake is not always the only or the main decision driver for the individual. Most citizens are more focused on national politics and processes, and therefore will form their judgment depending on many other internal factors related to their current government and establishment. Many UK citizens rely on these internal political leads to form their own opinion about the EU (Hobolt S. B., 2016). The source of these suggestions, in a country like the UK, will mainly come from national political parties. However in the UK, this trend has been extremely difficult to understand, due to the positioning of each party. On one hand, the Conservative Party was internally divided and on the other Corbyn stated that he didn't want to align with Cameron and his EU policy, yet he did state that (with entirely different reasoning) he too supported the Remain campaign. It is no surprise that the middle-class labour affiliates were slightly confused, because they couldn't even clearly understand or identify their party's opinion about Brexit. This means that a middle-class worker, socioeconomically prone to be Eurosceptic, was also confused about his party's point of view about Brexit. This of course, resulted in large numbers of undecided UK citizens, to be easily brought to the Leave side. The only clear message that the UK population received was that Brexit was about the emotional appeal of regaining identity, the right to control borders and to curb immigration, on one side, against the likelihood that Brexit would have a negative economic effect, on the other. In the end the only parties with a clear roadmap were the Liberal Democrats and UKIP, which supported Remain and Leave respectively. The largest effect is found among UKIP supporters, who were 88 percentage points more likely to vote for Leave (Hobolt S. B., 2016). Nevertheless, the rise of UKIP did exemplify to some extent, how the UK's population was disenchanted and intended to punish the political establishment with their referendum vote, accepting the populist idea of a fundamental division between the ordinary people and the corrupt political elites (in Brussels and London).

To conclude, it is important to recognise how opinions and affiliations have been, on one side shaped and on the other shifted, during a heavily intense referendum campaign. Worries and

concerns about immigration, economy, identity, sovereignty and national political trends have been essential issues for this referendum. This section has briefly analysed how and why different factors have affected the referendum vote. Additionally, this section has been crucial to analyse which discourses have been most effective, proving that macroeconomic facts have been much less effective than immigration or identity/self-determination sovereignty factors and that the remain campaign erroneously started a “fear” campaign, only highlighting the risks of exiting the EU, failing to show the positive aspects of remaining. This has resulted in a negative and defensive remain campaign, which has been shadowed by a positive sounding and legitimised leave campaign.

### **3.3 Brexit or Bemain?**

There have been many issues surrounding the Brexit campaigns but these were mainly focused on immigration, national sovereignty and economic aspects. The leave campaigners held that it was unacceptable, that European Laws ruled over British Laws in matters related to economic policies and procedures bound to the European Court of Justice. Furthermore, the apparent inability to control the inflow of eastern European immigrants, turns into yet another legitimised argument for the so called “Brexiters”. However, these individuals held that after Brexit the UK would still have access to the Single Market, hence protecting the City and other EU dependent sectors, a very unlikely scenario.

On the other hand, the Remain campaigners defended that the UK was part of a four pillar deal, which could not be shaped into an *à la carte* union, where the UK only participated in the goods, services and capital markets, but blocked the free movement of people/labour (which the UK actually, partially had already done in not participating in the Schengen area). Although the remaining 27 wouldn't have allowed that to happen, the UK would have still had to comply with EU regulations and legislation to participate in the “three-pillar Single Market” and would have also been required to participate in its budget. In essence, the Remain campaigners defended that Brexit would only add uncertainty to trade, investments and growth, with no tangible reward. Be that as it may, these arguments didn't seem to be convincing enough for the UK's population, which in the end decided to leave the EU.

These arguments and points of view have been extensively analysed throughout this paper. The British identity, its distinguished culture and the effectiveness of some messages and facts over others, have resulted in what we conceive today as a palpable truth called Brexit. The conclusion

to all of this is that the EU currently finds itself in a very delicate position, where on one hand it must carefully define, its future relationship with the UK, an indispensable partner. And on the other it must remain steady, in defence of its own integrity and unity, because the idea of negotiating an attractive deal for the UK may further thrust and legitimise Eurosceptic movements all around Europe. Although some may believe that the populist and Eurosceptic threat in Western Europe is over, the next electoral wave will be the real challenge. Now, after dodging the first bullet in Austria, France, Holland, Germany ... the world's eyes are focused on how European leaders will perform in order to further develop the European Integration process and prosper socioeconomically doing so. Ultimately, the EU must conserve a fundamental trade partner and at the same time, clearly define the lines that are not to be crossed by former members and highlight the positive aspects of being a member of the EU; a highly complex and delicate task. The EU must survive to this existential test and simultaneously it must adopt its new role as world leader in integration, socio-economic well being and cooperation.

### **3.4 Mechanics of leaving the EU**

The British government has initiated a formal withdrawal from the European Union on March 29 in 2017 and until March 30 in 2019 when it will formally leave the EU. Essentially, it is a two year process in which the UK must come to an agreement with the EU in issues such as trade agreements with the EU and its current counterparties, immigration and expatriates, security matters and the amount of money the UK has to pay back to the EU. There are very specific concerns about many of these subjects, which will be evaluated throughout this paper. Moreover, this part will focus on the legislative requisites and protocols that both sides will have to follow during this period of time.

The path towards what we know as Article 50 of the Treaty of the European Union, has been a series of tedious and complex discussions which ended during the Treaty of Lisbon (2007). There have been several informal proposals before the predecessor of this article. The forerunner, Article I-60 TCE, had been preceded by Spinelli's Draft (1984) and the Oreja-Herman's Draft (1994), which have been pointed out for being vague, superficial and far off the idea of an unilateral withdrawal proposal (Circolo, Hamul'ák, & Blaž, 2018). However, it is important to understand several issues around the design of a withdrawal clause within the European Union's integration project. On one side, it is a very delicate issue due to its negative nature. A premature withdrawal clause would too quickly inject a negative essence into the European integration project and it seems like the intention was to further focus on developing integration matters,

rather than focusing on designing an exit clause before even consolidating the EU. On the other side, how ever delicate this issue may be, the design of a withdrawal clause was a complex burden due to the different perspectives and points of view of different members within the union. Just when the EU had designed a sufficiently solid legislative framework, it was time for the withdrawal article to be included, and that time was the Treaty of Lisbon.

There have been many perspectives and approaches on how this withdrawal act should be designed. From a State Primacy, Union Primacy to a Union Control, ranging from a more internationalist understanding, where the member states are seen as sovereign actors with autonomy to decide upon their membership in the union to a more federal perspective, focused on an indissoluble unity where the withdrawal of a state depends on all of the union's criteria (Circolo, Hamul'ák, & Blaž, 2018). So basically there have been three kinds of proposals.

1. Where the member states are seen as an autonomous and sovereign part of a greater bond. From this kind of perspective, each member has the individual authority to decide whether to stay or leave the union, without vetoes or other impediments from the union or its members.
2. The second perspective, the most radical one, proposed an irreversible membership. In this case, once you are part of the union, there is no way out.
3. The third perspective, would be a more federalist approach, in which the membership of a state is a decision shared by all parties.

Like most decisions, the decision of how to shape the withdrawal mechanisms of the EU is a risk-reward relationship. The more radical the proposal, the higher its risk and consequent reward. Thus, the idea of having an irreversible partnership perspective, however attractive it could be for further integration processes, is not a realistic panorama. On one hand, member states wouldn't have ratified such a deal and on the other, it would have been too much of an authoritarian move, within the values of the social-democratic European Union we all know. Ideally, the future of the EU should be oriented towards a more legitimised EU government, where its members gradually ceded more and more sovereignty in favour of a more solid and unified Europe. Most members consider this as a positive move (even if it handles a negative issue), because it made the EU a more accessible and operable union to handle (Circolo, Hamul'ák, & Blaž, 2018), where

sovereignty and individual cultures are protected. However, the risk of not being taken seriously and the possibility inciting a wave of withdrawals has always been present since then. Yet having decided for the most concealing perspective, the EU is giving the UK a hard-time-withdrawal, in order to show the rest of the world how a “you are free to go” clause does not imply a process free of consequences or costs; EU membership has to be valued and protected.

The final version of Article 50 of the Treaty of the European Union is as follows:

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State, which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union.

That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union.

The agreement shall be concluded on behalf of the Union by the Council, acting by a qualified majority (72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States), after obtaining the consent of the European Parliament.

3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.

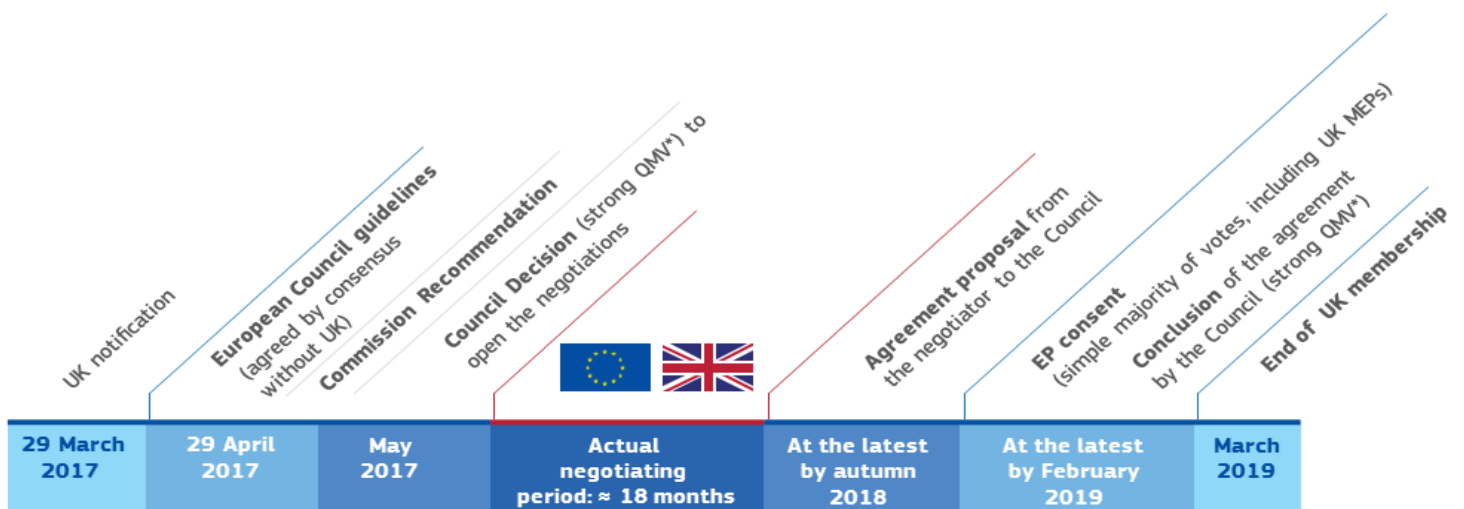
A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.

5. If a State, which has withdrawn from the Union asks to re-join, its request shall be subject to the procedure referred to in Article 49.

This discussion directly derives to how the vagueness of the Article 50 in some crucial aspects has been irresponsible and destructive. But it may also imply, that at the time the vagueness and opacity of this clause was considered useful, as it gave the remaining members and negotiators a “grey area” in which to move, providing the EU with more bargaining power and opening the door to special concessions, under the threat of disintegration of the Union (Circolo, Hamul’ák, & Blaž, 2018). These are the main drawbacks to Article 50:

1. As a whole, Article 50 has not included the minimum content a withdrawal agreement should have, in order to conduct an uncomplicated process.
2. It hasn’t been clarified, what role the withdrawing country will have during the process.
3. Within the general framework, there is a lack of clearly defined steps that the leaving member will have to comply with.
4. There is also a lack of conditions the leaving member must comply with in order to start the withdrawal process.

**Figure 3. The Brexit Calendar**



\* **Strong QMV** = 72% of the 27 Member States, i.e. 20 Member States representing 65 % of the EU 27 population.

Source: European Commission

However, apart from the opacities this article may present, the main conclusions about the possible agreement are that there may be a withdrawal with no agreement and that, in one way or another, the EU has certain responsibility of forging an agreement (point two). Furthermore, as a result of the complexity of the process and the qualified majority needed, it is plausible to expect a non-agreement scenario. All in all, for the first time in history Article 50 has granted member

states enough autonomy to, at least legally, scrap the debate on whether a member state should or should not have the competence to proclaim its own withdrawal from the Union.

#### **4. A LOOK INTO THE FUTURE**

##### **4.1 Hard or Soft Brexit?**

Now the priority is, not to analyse the article and grumble about its vagueness, but to make the best of Article 50, interpreting the most of it and to produce a viable withdrawal agreement by applying the most flexible and benign measures. The term Soft Brexit means that the UK will come to an agreement in which it will remain as a close and preferred trade partner with the EU. Even if the UK would no longer be a member of the EU, it would still have access to the Single Market, allowing the UK to trade its goods and services throughout Europe without further restrictions, under a tariff-free basis. This, although being highly unlikely, would heavily benefit the City and its financial firms, which would still be allowed to operate within Europe and market their services. However, this scenario would almost certainly require Britain to accept the four freedoms, one of which (free movement of people) has been the main pillar of the Leave campaign and is one of the main reasons the UK population has opted for Brexit.

On the other hand, Hard Brexit makes reference to a position in which the UK would probably come to no agreement with the EU, it would give up its access to all of the single market and customs union and would very likely fall back on to the World Trade Organisation's rules to trade with the EU. The absence of an agreement would be an absolute catastrophe for both sides. Political, economic, legal and international security disputes would lead to unknown consequences, especially for the UK that would have to recalibrate, not only its international trading position, but also its full geopolitical posture. In both cases the UK would suffer a direct and indirect increase of unemployment.

The leave campaign truly defended that the UK would arrange an attractive deal with the EU, mostly because the EU could not "afford" to lose a trading partner such as a "Global Britain" would be. However, the truth has been utmost disappointing, where the EU hold a relatively much stronger bargaining power and where issues such as the Irish border, have displayed the impossibility of designing an attractive deal, even more so, if compared to previous perks as member of the EU. As has been mentioned before, the EU has a clear position, either the UK is part of the Union or it will be treated as any other (valuable) world trade partner, en EU *à la carte* is not an option. Therefore it is very imaginable, that the UK permanently orbits around the EU as



a “dependent” trade partner. For now, negotiations have come to no tangible conclusion and the private sector is starting to impatient. Several big companies including BP, Nestlé, and Vodafone warned this week that time is running out for clarity on the terms of EU exit and that big investment operations would be held until withdrawal agreements are met (Financial Times, 2018). What is undeniable is that the UK will not allow a non-agreement scenario to happen and will have to push its political hardliners to give in and start negotiating as a stable and united country in favour of the best possible commercial trade-off.

Many of the issues mentioned here are fundamental points that the UK will have to address before the end of this year. Additionally, May’s government will have to design a viable legal framework to substitute the matters that have been the EU’s responsibility in the past decades. Not only the legal matters are directly relevant, EU institution employees, current British members of the Court of justice that have to finish their term and hundreds of further examples manifest the arduous task that the UK has to fulfil in the coming months. The question about EU bound workers is, even if their positions are maintained until the divorce is materialised, how will that affect the EU institutions that are managed, supervised and ruled by UK officers that on one hand obviously have lost their interest in the European project due to its fatal finish with the UK and on the other hand see the inevitable end of their final dismissal coming? For all of these reasons, the most rational recommendation is that both actors come to a detailed and fruitful withdrawal agreement, that not only defines a positive and cooperative future relationship, but protects the individual’s interests throughout the whole process.

However, the main goal of the UK Government after Brexit is to get into grip with immigration control and therefore the hard Brexit scenario currently is the most likely outcome, a soft Brexit (that includes the free movement of people and labour) would exasperate a great deal of UK citizens that mainly voted for Brexit because of immigration issues. Recalibrating a new relationship with the EU and dominating an internally agitated British political environment is an almost impossible mission that Theresa May will have to master skilfully if she does not want to annihilate her political career and legacy.

#### **4.2 An internal hassle**

After David Cameron lost his bet for Brexit, he decided it was time to step back. After his resignation, Theresa May was chosen as his successor and only two days after becoming Leader of the Conservative Party, on 13 July 2016 May was appointed Prime Minister. During her first

term, she tried to hold together a divided nation and party. During this period she was the first leader to visit Trump in the White House, led a controversial support campaign for Saudi Arabia and their intervention in Yemen and of course, commanded the UK's relationship with the EU. Nevertheless, after repeatedly stating that it would not be the case, May announced a general election for June 8<sup>th</sup> 2017. On Brexit May promised that the UK would exit the single market and customs union, but would achieve a profound and fruitful UK-EU agreement, yet the party did not enjoy the public support they thought May had after Brexit. With the expectations of uniting a divided nation for a safe and stable future, and with the intention of strengthening her parliamentary position, the conservative party ended up with a hung parliament. A very delicate and vulnerable position that could only be alleviated through a deal with Northern Ireland's Democratic Unionist Party (DUP), in which the government promised them additional funding for Northern Ireland.

Currently, the UK is facing a complicated national situation. While it has to fight internationally for a good agreement it must also give the impression of a strong and united nation. In spite of these turbulences, the UK's national sentiment should be strong enough to endure this situation. However, very popular platforms and campaigns such as "Best for Britain" speak for the contrary, even more so, when renowned individuals such as George Soros leads one of these initiatives. While warning that world politics could be prelude another financial crisis and calling for a reinvention of the EU, on a meeting organised by think-tank the European Council on Foreign Relations, Soros mentioned three key problems the EU is currently facing (Hodgson, 2018):

- The refugee crisis.
- Territorial disintegration exemplified by Brexit.
- An austerity policy, prompted by the financial crisis that, has hindered Europe's economic development.

On one hand, the Dublin regulation where the responsible Member State will be the state through which the asylum seeker first entered the EU, has been an unfair for Mediterranean countries and Balkan countries, that are more prone to be subjects of migration flows. Additionally, the EU austerity measures have augmented the distance between the EU and its citizens. All these issues have resulted in a wave of populist parties that have used the momentum created by popular discontent, to defy the European project. While having a handful of populist and nationalist

examples throughout Europe, Italy and its recently endorsed Eurosceptic government, is a good example of how migration and austerity have revived the Eurosceptic discourse and the (already publicly discarded) possibility “Italexit”. The EU has to regain its credibility as an attractive future alternative and create a more tangible relationship with its citizens. Although the economic attractiveness of being an EU member is a strong case for the UK, the EU must transform itself into a Union that countries like the UK would like to be part of (Hodgson, 2018).

Back to May’s challenge, she and her cabinet have publicly stated that they have abandoned plans to present a detailed roadmap for a future UK-EU relationship ahead of a Brussels summit on June 28-29 2018. Aside from creating more uncertainty within European leaders and institutions, these news have not been welcomed internally either. The conservative pro-Brexit MP’s and hardliners are starting to be impatient about the outcomes of these negotiations (Gordon & Parker, 2018). Providing that the white paper is published in time, as May promised, it must be approved by parliament, yet another milestone in the way of Brexit’s calendar with the EU. However, a “backstop” to avoid an Irish Hard border is a priority that May is willing to resolve in the next weeks. It has been clear that David Davis and other Pre-Leave politicians in the UK have expressed their discontent about this issue (Hughes & Parker, May at odds with Brexit chief over Irish border plan, 2018). This kind of backstop, even being a “Plan B” for May’s government in case of a no-deal scenario, is not limited temporarily and would tie Britain to the EU’s Customs Union indefinitely, cutting off the possibility for the UK to arrange further trade deals (at least the ones affecting the current Customs arrangement) with third parties. Additionally, avoiding a hard border would also imply close regulatory compliance, from product standards to value added tax and would divide the EU Four Freedoms, something a-priori unconceivable. However, as stated previously, it is a “Plan B” for two reasons. On one hand, May cannot lose Davis because of his attenuating effect within the most Eurosceptic wing in the government and on the other, because the UK (and the EU) have the obligation of coming to a global agreement that will simultaneously avoid a hard border with Ireland.

Another worrying issue is Gibraltar. Having been in several headlines, this issue has not been addressed with the importance it deserves. Although Gibraltar heavily wants to stick to the UK, 96% of Gibraltans voted to Remain due to their combined perks as Tax Haven and member of the EU (O’Grady, 2018). In case of a Hard Brexit, Gibraltar dependence on Spanish products would give the overseas territory a very hard time. In any other case, Spain has been granted with the possibility of vetoing the UK-EU agreement, if it doesn’t agree with the Gibraltar terms and

conditions of the deal. Therefore, Spain would probably need something in return, to allow the settlement of an agreement. A shared sovereignty is something Gibraltans are not considering and under the Gibraltar constitution, the overseas territory can veto any related arrangements. However, under the possibility of a Hard-Brexit and a troublesome economic panorama, Gibraltans could change their minds. On the other hand, under an imminent and attractive Brexit agreement, which is also in the interest of Spain, the Spanish government could give in to European pressures and accept a deal where Gibraltar's situation and sovereignty framework remains unchanged.

### **4.3 Migration**

Migration has been a fundamental driver in the happening of Brexit, however, how will Brexit change immigration trends and how have past EU policies affected the UK's perspective of EU originated immigration? In 2003 the Blair government allowed all the 2004 accessioning states (Central Europe States, Eastern Europe States, Baltic States, Cyprus and Malta) to have full free movement rights in the UK. Although the UK could have limited (at least temporarily) the influx of Eastern European immigrants, it didn't, giving place to one of the main arguments for the Leave campaigners in 2016. The Eurozone and Mediterranean States Debt crisis after the 2008 collapse only sharpened this situation. In one way or another, the UK was acting as an employment shock absorber for the fiscally rigid European policies (Riley & Ghilès, 2016). This caused that individuals who thought Britain should have many fewer EU migrants were 32 percentage points more likely to vote for Brexit compared to those who wanted more migrants (Hobolt S. B., 2016). Equally, expectations about the consequences of Brexit had very significant effects. However different the voting trends had been in the referendum, it is clear that regions that had experienced an upsurge of foreign workers, expecting a change, heavily voted to Leave. To this we can add the refugee crisis, which even without rational arguments, alarmed most of the British population. When in 2015 Germany unilaterally withdrew from the Dublin regulation, the UK's population developed greater hostility and distrust towards the European migration policies, germinating further detachments between the EU and the UK's population's opinion.

Nonetheless, seen from the positive point of view, once Brexit has materialised and labour migration to the UK becomes more complicated, the EU could use this labour reallocation process in its own favour. In other words, the new labour flows would point towards other EU member states and the EU could orientate this process towards a further and more profoundly integrated European labour market, generating a more cohesive and unified European society.

Withal, the EU must curb and contain migration flows, which have been the source of much of its internal ailments. Ultimately the solution would be depicted into a strategic agreement with non-EU Mediterranean states and a tight maritime migrant mafia control. The problem is that the EU takes only a small part in European social policy. Because of relatively small EU budget, which amounts only 1% of total accumulated budgets in the Member States, the EU cannot perform redistribution policy like can individual countries (Daugėlienė & Puskunigis, 2018).

Anyhow, how does this affect the amount of talent that the UK is receiving? Ever since the Brexit vote, this has been a crucial issue to understand. Two years after the referendum, it is clear that the UK has become a substantially less attractive labour destination. Although the economic growth panorama may partially blanket this effect, to what extent will the lack of EU professionals arriving in the EU affect the UK's ability to access the labour skills it needs? This kind of structural affection is not easily apparent in only two years; however, this trend is starting to become visible. The real mystery is if the UK labour market will be negatively affected through this lack of labour reservoir or will this situation create a new opportunity for the UK's professional environment? Over the last year alone, migration to the UK from the EU has fallen 26%, while more people are leaving the UK for the EU than were previously. The most alarming example is Ireland, which historically has been a net labour exporter for the UK and over the last year, Irish migration has reduced by 37% (Graff, 2018). Additionally, the results of Graff's research revealed that 44% of the surveyed recruiters state that the UK has become a less attractive for EU candidates. This can be viewed as an opportunity for workers of the UK and other parts of the world that could meet this demand. Another perspective may be that in the long-term, large enterprises decide to locate outside of the UK due to the shortage of professional expertise.

Along with these trends, it is important to understand how this has changed the world's viewpoint towards the attractiveness of the UK as a labour destination. Even if the UK remains as a net importer of talent from the world, only in the last year, this influx has been reduced by 20% (Graff, 2018). This is not due to new migration requirements, but the result of the world having a less positive view of the UK as a viable host. This issue can be exemplified with London, which has historically been a net talent importer. Now the trend has inverted and the domestic migration into London remains unchanged (Graff, 2018), therefore not filling the apparent breach of the last years. This could create a structural labour problem in the UK, resulting in the lack of talent for

its highly complex industries and in the long-term, a fall in wages due to the fall in demand. But what impact will these consequences have economically for both sides?

## **5. THE ECONOMICS OF BREXIT**

### **5.1 The Economic odyssey**

The economic failures of the EU are evident. The Eurozone has failed to endorse a profounder economic union. As any other issuer of currency, it should be able to pool debt and fiscal stabilizers. One of the main reasons for this is that Germany is not ready to share these mechanisms with some Eurozone countries. The solution to this has been a rigid and contractive fiscal policy, and relying on sovereign/bank debt. These policies have directly affected the popular support for the EU. However, this may not directly affect the UK, which has its own currency and stabilising mechanisms, but as mentioned above, it does directly affect the UK in terms of labour migration and makes the Single Market less attractive, as well as less prosperous.

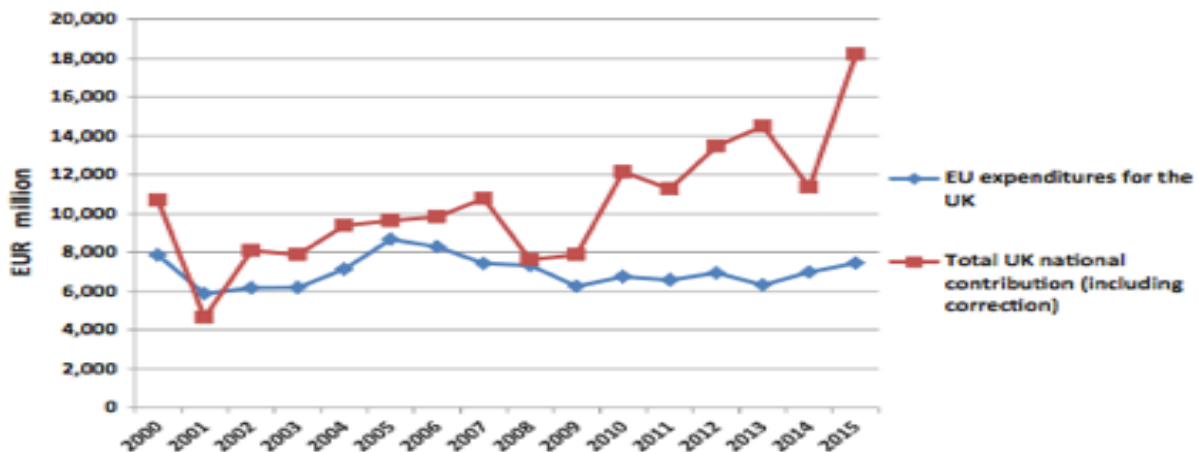
The EU is currently the greatest trade partner of the UK. IN the past, the EU has been a growth driver and a cost reducer for the UK and its trade relations. However, now Brexit will define how this situation will end. The importance of the EU's relation with the UK, one of its main trade motors, is a profoundly worrying issue and the negative outcome of Brexit will not only affect the UK, troubling spillovers will also affect the EU. The past trade relationship between the EU and the UK eliminated much of the costs a hard-border implies (border controls, rules of origin checks, cross-country differences in regulations over things like product standards and safety, and threats of anti-dumping), which in the likely case of a Hard-Brexit would need to be resumed. The EU has created a very deep trade relationship with the UK. When the UK joined the EEC in 1973 one third of UK trade was with the EEC. In 2014, the 27 other EU members accounted for 45% of the UK's exports and 53% of their imports. Furthermore, EU exports comprised 13% of UK national income (Dhingra, Ottaviano, Sampson, & Van Reenen, 2016). This situation augmented UK's trade opportunities and allowed the country to specialise in certain export-products. Also the access to a wider range of products at a more competitive price, all together created a net increase in living standards in the UK. The effects of trade have been discovered for a long time, at least since David Ricardo outlined the static effects of trade (Ruffin, 2002). However, in recent decades, trade has proven to be an amplifier for the population's wellbeing and enhanced issues such as productivity and innovation. In one of LSE's studies called the "The consequences of Brexit for UK trade and living standards" baseline estimates imply that, after accounting for fiscal savings, the effect of Brexit is equivalent to a fall in UK income of between

1.3% and 2.6% – that is, a decline in average annual household income of between £850 and £1,700 per year. In conclusion, what is certain is that, whatever the economic future may bring, Brexit and its consequent trade reduction (or less efficiency) would imply a net reduction in the UK’s population living standards. Actually, the Single Market has outperformed the raise in UK income levels predictions made in 1970 by proponents of EU entry.

This, mainly due to the increase of trade and fiercer competition on productivity, has been one of the great successes of the EU since the UK’s accession. 30 Trade tariffs for Britain were eliminated after a 4.5-year transition period: each year they were reduced by 20% until got totally lifted in July 1977 (Daugėlienė & Puskunigis, 2018). EU membership has contributed to British prosperity since the UK joined the EEC. UK GDP per capita doubled, increasing more than in other non-EU English speaking countries over the same period, including in the United States (Dhingra, Ottaviano, Sampson, & Van Reenen, 2016). Internal policies are partly the reason, but geographical proximity and legal access to the biggest market in the world is the main reason for it. Smaller economies have succeeded even more under the EU’s Single Market umbrella. For example, Ireland, has nearly quadrupled its GDP per capita since it joined in the 1970’s.

After years of protectionism and slow growth, joining the EC favoured productivity and competition, resulting in a very positive economic panorama. However, quickly issues related to UK’s budget contribution to the EU became a problem. The UK said it was contributing more than it received. This problem was negotiated and controlled by Margaret Thatcher, who negotiated a long-term agreement with the EC and came to a sufficient net reduction in the UK’s net contribution. Still, the UK’s contribution peaked again and the total contribution exceeded 18 billion euros per year in 2015.

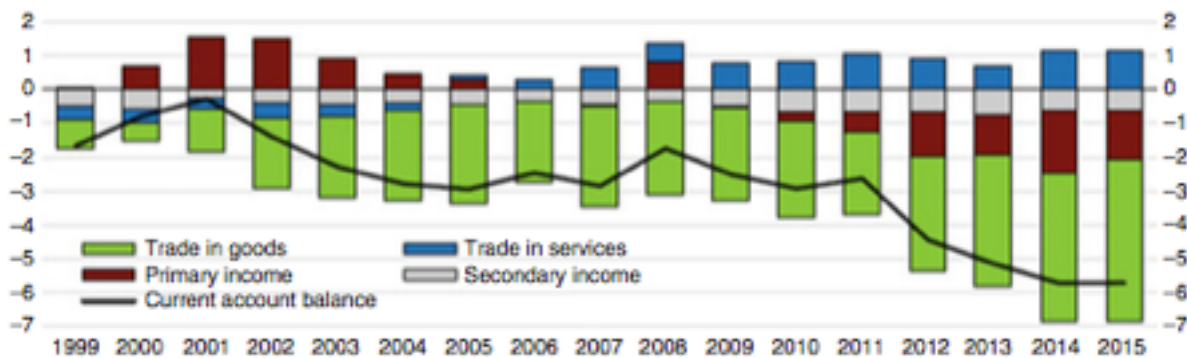
**Figure 4. UK contribution and EU expenditures relationship**



Source: European Commission Database

Even if the UK's net contribution constantly increased from 2010 to 2015, the EU expenditures for the UK remained very constant and didn't reward the UK's efforts. In 2015 the UK was contributing 10.7 billion euro more than it was receiving from the EU Budget, a tough argument for Remain affiliates to defend.

**Figure 5. UK Account Balance with the EU**



Source: OECD

This figure illustrates the strong negative relationship the UK's account balance had with the EU. In all areas except for services (since 2005), the UK had a considerable disadvantage and negative position. The positive services position is of course created by London's financial services industry, which is among the most powerful ones in the world, along with New York and Hong Kong.

The UK has a deficit in the total goods trading position with Europe, however in terms of services the UK has a surplus, mostly due to the financial services the London City offers. Exports to the EU represent a 12% of the UK GDP, where 45% of UK exports go to the EU and the exports of financial services amounts to 2.5% of GDP in the UK, in comparison with only a 0,5% of GDP as an average in EU peers (Daugėlienė & Puskunigis, 2018). The EU is the destination of some 40% of UK financial exports, down from around 50% in 2000 (Kierzenkowski , Pain, Rusticelli, & Zwart, 2016). Indeed, UK overall exports of financial services took off in the 2000's, but the UK financial industry remains dependent on the EU market, as the absolute size of UK exports has risen.

These percentages imply that, at least in a Hard-Brexit outcome, the UK will suffer important cost increases due to new imposed tariffs and other probable trade frictions a Hard-Brexit would



burden the UK with. Although the UK's export volumes to the EU are an asset the islands should not risk, another important issue refers to the amount of FDI flows the UK receives worldwide.

Fortunately for the UK, the EU originated FDI does not have the importance the USA originated FDI has in the UK. This fact is the very reason, for which the UK is extremely interested in maintaining a good relationship with North America and currently, with Trump. The EU accounted for only 19% of net FDI flows into the UK in 2014, whereas the US accounted for 55%, a much more considerable amount (Daugėlienė & Puskunigis, 2018). However, in 2014, EU countries accounted for 48% of the stock of FDI in the UK. This compares with 24% from the US and 28% from other countries. Trends may change very often; therefore it is important to make a difference between the stock of FDI and the FDI that arrived in 2014. This time, for the UK's relief, it not only has a guaranteed powerful source of FDI, but it also is the preferred FDI destination for most of the EU nations. This means that while the UK has a strong bargaining power when referring to FDI, in this case, Europe will be highly interested in maintaining the UK as a viable destination for FDI. However, once again, the EU can use this situation in its own favour and conduct these investment flows towards other FDI friendly nations in the EU. Due to its size and diversity, the EU will consistently enjoy an advantageous negotiating position with regard to the UK. All in all, cutting the UK's access to the Single Market would notably reduce the amount of EU FDI and would, in the long-term, reduce the amount of available capital stock. This situation would end further affecting trade, corporate structures in the UK and would eventually block many R&D initiatives.

As an overall conclusion, some of the main economic outcomes of Brexit would be the following:

- The danger of massive capital outflows or a profound reduction in inflows would threaten public finances and the possibility of keeping up with a current account deficit of 4.1% of GDP in 2017.
- By 2020 UK GDP could have reduced by 3%, whereas EU GDP would be reduced by 1% (Kierzenkowski, Pain, Rusticelli, & Zwart, 2016).
- Brexit will deeply affect immigration and FDI, generating the loss of potential talent influx, managerial excellence and corporate know-how.
- The consequences of Brexit will surely, in one way or another, damage trade and investment in the long-term. Therefore, as growth is mainly powered by these factors, the UK will weaken its technical progress, productivity and innovation.

- The savings from cutting the UK's contribution to the EU's budget will be around 0.3% of GDP per year. However, a lower GDP growth would limit the amount of fiscal savings available, reducing the possibility to use EU budget savings to relax fiscal policy (Kierzenkowski , Pain, Rusticelli, & Zwart, 2016).
- According to the OECD, by 2030 UK GDP will be a whole 5% smaller because of exiting the EU. Nonetheless the impact the rest of the EU would experience is substantially lower due to the small UK share in global trade and the diversity/size of the EU.

A Hard-Brexit scenario would shape a future UK-EU relationship under FTA or WTO rules, both models are a conceivable possibility. The FTA model would be more open and accessible than the WTO scenario, yet in both cases, the return of tariffs is almost certain. This would produce many negative effects, among which inflation (mostly for imported goods) and administrative costs would be the most tedious and direct repercussions. It would reduce competitiveness, productivity and create thousands of further frictions with the EU. The outcome would simply result in the net decay of economic circumstances of both sides. But what kind of model could forge this future relationship and would also diminish negative backlashes?

## **5.2 Possible Scenarios**

On one extreme the UK could not come to an agreement with the EU and operate under the WTO rules. This scenario, under a Most Favoured Nation bound, would be the worst outcome of all. The impact would be negative for both sides, but dramatic for the UK. On the other extreme, the UK could continue to be part of the European Economic Area, being part of a very integrated model with the EU (accepting all four freedoms and also providing funds for part of the budget).

There are several studies on how the different Brexit agreements could affect the economy and living standards of both the UK, the EU and third countries.

However, the EU as a whole may experiment a substantially less intense consequence, but some EU Member States with a close relationship to the UK will be profoundly affected. Ireland due to its close ties with the UK and, Malta and Luxembourg are strong candidates because of their close financial ties with the UK's financial sector.

When the UK officially leaves the EU the main direct costs will be driven by three main factors (Ries, et al., 2017): immediate changes in tariffs on goods, immediate changes in Non-Tariff

Barriers (NTB) on goods and services and increasing NTB's over time due to exclusion of the UK from further EU market integration.

The following list of scenarios is very diverse, however, after May's declarations on the 17<sup>th</sup> of January 2017, when she declared that she would not pursue European Economic Area membership but instead aim for a comprehensive FTA, oft Brexit expectations dissipated quickly. However after the 2017 election and her consequent loss of power in parliament, Soft-Brexit considerations are back on the table.

## **5.2.1 Hard Brexit scenarios**

### **5.2.1.1 Scenario 1: WTO**

The UK's trade with the EU and the rest of the world would be guided by WTO rules and tariff schedules. The UK would automatically be ousted of any agreement with the EU and all the EU trade agreements with third nations. This means that the UK would need to comply with the importing countries' Most Favour Nation (MFN) tariffs. However, in that case the UK would be subject to non-discrimination rules and it could design its own economic policy and design its own MFN tariffs. The problem to this would be the time and effort the UK would have to invest in designing these new treaties, period during which the UK would be extremely vulnerable in commercial means. Additionally, the UK would suffer further costs and Non-Tariff Barriers due to its different regulatory standards with the EU. This is a very unlikely scenario, because both sides recognise the importance of each other's trade capabilities and the advantages of reaching an intermediate agreement.

### **5.2.1.2 Scenario 2: UK–EU Free Trade Agreement (FTA)**

This is a very likely possibility. The EU and the UK have a very high level of integration and very many deals to work upon. Both sides will construct a deal deriving from previous agreements; there is no need to start from the beginning after a more than 40-year relationship. This deal could cover sectors such as trade in goods, agriculture and services. Of course, due to a further EU integration process the costs related to a different regulation and legal framework will, in the long-term, increase the trading costs but in a softer manner than in scenario 1. Even though much of the UK-EU trade would be tariff free, the UK would have to comply with EU regulations and comply with EU rules to avoid trade deflection, accepting the Rules Of Origin condition (ROO).

However, this FTA would not provide the same perks the Single Market members would have. An important issue for the UK here would be the conditions for financial services to operate and offer their services in the EU. This would be a costly issue and the EU would need to grant these UK based companies a special license, which even though would not grant the same conditions as Member State financial institutions would enjoy. The importance of this sector for the UK's economy is more than clear and the decision to what extent the agreement will affect this industry, fully depends on the EU's intention to penalize the UK and to some extent, empower the financial services industry in Frankfurt, which currently is experiencing a strong momentum. It is also unclear if in this scenario the UK would still be able to enjoy the preferential agreements the EU currently has with third countries or if it would have to design new deals.

### **5.2.1.3 Scenario 3: TTIP that includes the United States, the UK and the EU27**

After leaving the EU, the UK could become a third partner in a possible TTIP. The UK and EU currently trade with the US on WTO MFN rules and the TTIP would drastically change that, at least with regard to tariffs on goods and agriculture. However, the current Trump administration and its rampant protectionism and anti-globalisation measures have put serious doubt or even completely discarded, the possibility of a TTIP deal. The remaining conditions under this scenario would be very similar to those in scenario 2.

Nonetheless, the US and UK relationship is very positive and the statement of President Trump to make of Brexit "a great success" (Ries, et al., 2017) still allows the possibility of a UK-US FTA deal to be a conceivable plan. The thing here is that Trump and his populist tendencies, ideologically identify with Brexit and that will not change. However, Trump wanted to use this (such as he has used the North Korea-US summit and the G7 summit) to thrive his own brand. The question is, after the recent political successes (no mind how hollow and superficial) Trump has landed, will he still need this "special relationship" with the UK? This relationship only was a political strategy and not an economic interest for the US. Therefore, after observing Trump's anti-economic integration moves and his recent, but geopolitically insignificant, successes, it seems like he wouldn't give in to a UK-US FTA. In case the UK turns its back to the EU, the UK must play its cards well and offer the US a good deal.

## **5.2.2 Soft Brexit scenarios**

### **5.2.2.1 Scenario 4: The Norwegian model**

In this scenario the UK would become part of what is known as the European Economic Area (EEA) where it would still remain within the Single Market but it would exit the Customs Union. Then the UK would become part of what Norway, Iceland and Liechtenstein currently are, the so called “Norwegian Model”. Being part of the Single Market, the UK would have to adopt EU regulations regarding free movement of goods, services, people and capital. This would on one hand, deeply favour London’s City and allow the UK to pursue its own trade policies, but on the other hand would not comply with one of the Brexiteer’s main arguments, the limiting of immigration flows. Additionally, a great deal of UK exports to the EU would have to comply with the ROO in order to enter the European Market, rising several new Non-Tariff Barriers.

Furthermore, the UK would have to contribute to part of the EU’s budget. Another disadvantage of joining the EEA would be that the UK would have to comply with many EU regulations over which it has now influence or say.

#### **5.2.2.2 Scenario 5: The Swiss model**

The Swill model implies that the UK remains in the Single Market but only for goods and not services. This would very negatively affect London’s financial hub and would therefore affect the only industry the UK does not have a negative balance in with the EU. NTB’s for goods would stay relatively low, but the ones for services would thrive. Also, further requirements and licenses for financial services to operate in the EU would wind up an unsustainable situation. The financial sector and London City would disappear from the UK and settle in Frankfurt. And to make matters worse, the UK would have to contribute to the EU’s budget.

#### **5.2.2.3 Scenario 6: Customs union covering goods only**

This scenario would keep the UK within the Customs Union with the EU, covering goods and not services. This would avoid tariffs on traded goods and the UK would have flexibility in designing trade deals for the services sector. Like others, this scenario would not be problem free for the UK. Although it may provide flexibility (and additional costs) for the services sector, the UK would have not authority to set its trade policies (regarding goods), it would be subject to EU regulations and would neither have decision power upon the design of these regulations. Additionally the UK would probably not enjoy the current preferential trade deals the EU has with third countries.

Nevertheless, the UK would leave the EU and it would retrieve its sovereignty on issues such as social policies, immigration and the Common Agricultural Policy. It would not be required to be part of the four freedoms. This scenario would also mean avoiding increasing tariff and non-tariff costs in goods. To conclude, in this scenario the UK would also not be required to contribute to the EU's budget. This outcome would be very similar to Turkey's relationship with the EU. However, this deal was designed to be a prelude for Turkey's posterior inclusion in the EU, therefore the EU may not accept that the UK comes to a similar agreement. All in all, here the UK would not be able to design its full trade policy and strike FTA's with third countries, but it would reduce tariffs and NTB's with the EU one of its main and most important trade partners.

While both sides have still not come to an agreement and the world still doesn't know how the future relationship of the UK will be with the EU, what is certain is that the EU has lost one of its most powerful and economically liberal members. This may have a negative effect upon the Single Market and can slow down further integration processes due to the loss of attractiveness of the EU. However, EU leaders must make sure to push for an inverse effect, where the EU strengthens and pushes for further integration and a more attractive EU. Furthermore, somehow the UK's stability is a kind of political threat for the EU. Nationalist and populist parties in Europe could use the Brexit vote, as an argument for saying that there is nothing to fear from leaving the Union (Riley & Ghilès, 2016).

## **6. CONCLUSION**

To conclude, it is important to mention two rising threats or at least, sources of instability for the EU and the UK. On one hand the recently initiated "trade war" with the US's closest allies and the alarming shadow of the Chinese economy. After the Trump administration has rejected the Paris agreements, the Iran deal and imposed tariffs on its most traditional allies, the world geopolitical panorama is becoming highly turbulent. In between all of this May's cabinet is not sure on how to position the UK within all this. On one hand the US is becoming an unstable and unreliable partner, and on the other the UK has started an irreversible divorce process with its closest ally for the last 40 years. After the Trump administration imposed tariffs on European steel and aluminium imports, the EU is playing hardball. Additionally, Canada has assured that this action will not be free of a measured and proportionate retaliation. It also seems that the UK has positioned itself with the EU, Downing Street confirmed that the UK would not seek its own exemption from the policy, and was fully signed up to a EU-wide approach (Hughes & Parker,

May tells Trump that tariffs are ‘deeply disappointing’, 2018). The EU has stated that it will retaliate with tariffs on 2.8 billion euros, or about \$3.3 billion, worth of American imports. Among the items on the list: Harley-Davidson motorcycles and bourbon. However, Trump’s policies and their threat of a post-war order that has sustained peace for over 70 years, are just what the long-stagnant European integration project needed to awaken and react.

On the other hand, China’s trade policy is an unattended threat for Europe and the UK together. After China joined the WTO in 2001, it hasn’t complied with any of its demands (non-discriminatory measures, open markets, rule of law...). China has flooded many markets and is now responsible for 50% of global steel production, ten times more than the US. The situation is very similar in the Flat Glass and aluminium markets. These supply waves are having a disastrous effect within the EU and US, but both have been reluctant to challenge China, and take effective trade defence measures to protect their own industries and people (Riley & Ghilès, 2016). This has had a damaging effect on industrial employment across Europe and has fed the abandonment feeling of much of Europe’s working classes. This sense of abandonment also played a part in the willingness of working class communities across the UK to come out and vote to leave the EU. It is vital that Europe reacts to these trends, actively protects its working class and once and for all creates a true bonding sentiment with the European population.

In a multipolar world like the one we live in, the UK needs to make sure that it has a safe and reliable relationship with the EU. Global influence and bargaining power of the UK are greater when combined with those of other European economies, therefore a sealed bond between both actors is a vital happening to safeguard the future and economic stability of the EU and UK. The UK has to decide if it wants to maintain close economic cooperation, its engagement in security and defence matters with the EU. IN the end, this is a political question, that May and the UK parliament have to answer swiftly. The EU will have to agree among its members to put aside punitive motives and reach an agreement in which the UK gets control over immigration matters and also has an attractive economic relationship with the EU. None of the sides are interested in a tensions escalation in Europe. Both the UK and the EU have to acknowledge that both of them have a stake in economic and political stability in Europe and that a mutual understanding is vital for both of their geopolitical strength.

Even if Britain was among the conceptualists of the European Integration project, it took the UK a long time to become a member of this European movement. However, even if this membership

boosted much of the UK's growth and prosperity, disagreements with the EU still existed, particularly through issues of EU Budget contributions and immigration. Although these disagreements finally ended up in what we know as Brexit, the future steps for European integration are not lost at all, it just needs to reform itself and accept the UK as what it has always been, a European partner with its own way of seeing the world and interpreting its existence. Churchill believed, however, that Britain was not part of Europe but should support it from outside and that the French and Germans should create it, may be its time for Churchill's statement to become a tangible reality.

Even if national identity has played a great role in the Brexit referendum, it is important to understand that this concept is going through a slow but sure extinction process. The nation-state sentiment is dying all over the world. What had been created in the late 19<sup>th</sup> and 20<sup>th</sup> century is condemned to die in the next decades. Robert D. Kaplan forecasted it in his book "The Revenge of Geography", geographically imposed borders and historically justifies rigid societies couldn't permanently be identified with a constant nation-state feeling. Social, geographical and cultural borders are disappearing in a more and more globalised world and many of the worlds nationalist movements (Catalonia, Bavaria, Lombardy, Veneto, Scotland...) a tangible proof of the constant transformations of national identities. But, is the UK an exception? Probably Brexit and the rest of national/populist movements throughout Europe and Trump in the US are the last convulsions of a dying nation-state feeling. However, only time will tell.

Furthermore, Euroscepticism is defeated but not dead and buried. Although France, Holland, Spain, Germany and Austria have defeated these menaces, now is when the EU must keep up and demonstrate the world and the European population that European Integration is worth it. Italy and its newly endorsed Eurosceptic government is the proof of the burden the EU must overcome in the next years. Furthermore, what is vital during this process is that the EU comes to a friendly agreement with the UK and strengthens the EU's capacity of becoming a promising and prosperous union for all of its members. Surprisingly, EU member states have remained impressively united throughout the Brexit negotiations and have shown that the European project is strongest when challenged. Slowly but surely, though not free of reservations, Macron and Merkel, the main European leaders, have shown promising signs of wanting further European integration. Even if Germany wouldn't be ready to pool debt or create a fiscal union, Merkel has recently signalled Germany's intention of supporting a banking and capital markets union, as well as a "European Monetary Fund" with special new short-term emergency credit lines



(Stelzenmüller, 2018). Also Germany is in line with France in issues such as European defence and immigration issues, which are fundamental milestones Europe will have to achieve.

Also, after Brexit the loss of confidence in the European project would be conceivable. Considering the Italian Eurosceptic government and the surge of anti-establishment parties all over Europe, who would have thought that support for the EU is now higher than ever? According to a recent Eurobarometer survey, if a referendum on EU membership were held today, 83% of Europeans would vote to remain in the bloc; and a record-high 60% regard EU membership as a “good thing” for their country (VERHOFSTADT, 2018). This makes us think the Brexit has not undermined the European integration project and that European social revolts are not about ending the EU, but about how to improve it. The EU has failed to connect with its citizens and its rigid fiscal policies and austerity addiction have had very negative long-term consequences. However, seeing the truth and the dangerousness of the EU’s current geopolitical situation, it is more vital than ever to unify the European people and defeat internal divisions, such as the imaginary curtain that separates eastern from western Europe.

In conclusion, after having discussed the origins of Brexit, how the vote has been shaped by the different campaigns in the UK, how Europe is suffering a hassle and the economic panorama Europe and the UK are going through, there is only one clear conclusion. The UK and the EU must find a viable formula to come to an agreement that will promote prosperity and not tensions. The UK has understood that the US is not a reliable partner and that its proximity to Europe and the EU’s policies of collaboration and compromise are the safe bet. The EU and the UK must ally to confront the new world order, where Brexit and Trump only represent part of the world’s menaces. Both will have to confront future migration waves, terrorism, a new kind of aggression Russia is spilling over the entire globe and China’s growing destructive selfishness. However, this time Europe has been preparing for 50 years, there’s nothing like a crisis to prove that European unity (including the UK) is here to stay.

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