



SWP



**13th Annual Conference on
“The Taiwan Issue in China-Europe Relations”**

Shanghai, China

October 9 – 11, 2016

A workshop jointly organised by the German Institute for International and Security Affairs / Stiftung Wissenschaft und Politik (SWP), Berlin and the Shanghai Institutes for International Studies (SIIS), Shanghai. With friendly support of the Friedrich-Ebert-Stiftung (Shanghai Office).

Discussion Paper

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Multiple Impacts of Brexit

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In the referendum on Britain's exit from the EU (Brexit) held on June 23, 2016, 51.9% of the voters supported Brexit. The next day, Prime Minister Cameron said that he would pick a day to announce his resignation because he could not be the "captain" to steer Britain in a new direction of development. Cameron submitted an application for resignation to Britain's Queen Elizabeth II on July 13, and Theresa May took office as Britain's new Prime Minister on the same day and appointed new core cabinet members.

After the referendum ended, some people criticized Prime Minister Cameron for using the seemingly democratic but actually careless form of a referendum to decide a country's direction of development. Regardless of why Cameron chose this political "gamble", the impacts of Brexit cannot be underestimated.

I. Impacts on Britain's Economy and Society

Among the multiple proposals of Leave supporters, the economic factor is relatively important. This proposal holds that Britain contributes £350 million to EU's budget every week. Therefore, after Brexit, Britain could save such unnecessary expenditure and use these funds for the wellbeing of the British people such as social benefits and education.

This proposal obviously one-sidedly emphasizes Britain's contribution and ignores the economic benefits obtained by Britain from the EU. According to a research report published by the Confederation of British Industry, the economic benefits of EU membership to the UK could be in the region of 4-5% of GDP or £78 billion a year.¹

Britain's economy and the EU's economy are already highly integrated. Just over 30% of UK exports went to the EU after Britain joined EC, but this ratio has risen to more than 50% and the trade volume has accounted for about 15% of Britain's GDP. Undoubtedly, after Brexit, Britain's export trade will not enjoy the benefits of free flow of goods to EU's common market. Some European think tanks estimate that such losses would be between £18 billion to £50 billion, accounting for 1.1%~3.1% of Britain's GDP.²

¹ Factsheet 2 - Benefits of EU membership outweigh costs.
<http://news.cbi.org.uk/reports/our-global-future/factsheets/factsheet-2-benefits-of-eu-membership-outweigh-costs/>

² Center for Economic Performance, "Brexit or Fixit? The Trade and Welfare Effects of Leaving the European Union", May 2014. <http://cep.lse.ac.uk/pubs/download/pa016.pdf>

Besides, the close relationship between Britain and EU is closely related to the labor market. It is estimated that around 3 million jobs are linked to trade between Britain and EU.³ After Brexit, these jobs might disappear.

After Brexit, the economic relationship between Britain and EU will be alienated and even cease to exist. Although Britain can seek alternative markets or reach a special trade arrangement with the EU, this will not be realized immediately. This means that Brexit's near-term impact on Britain's import and export trade cannot be underestimated.

The international financial industry is one of the British economy's comparative advantages. London as an international financial center enjoys fame internationally. Britain's financial service industry provides about 2.2 million jobs. Brexit will diminish this comparative advantage and seriously affect the U.K.'s reputation as an international financial center. Some people even think that after Brexit, London would lose the status of a global financial center.⁴ It is estimated that Brexit could reduce the financial service industry's contribution to Britain's GDP by 2020 up to \$18 billion — a 10% reduction.⁵

Brexit will also cause a reduction of Britain's appeal to foreign investment. At present, among the developed countries, Britain is the second largest foreign investment receiving country "favored" by emerging economies second only to the United States. According to the statistics, Britain has attracted as much as \$83.2 billion of "greenfield investments" from emerging economies since 2003.⁶ After Brexit, the quality of Britain's investment environment will be reduced, diminishing the appeal to foreign funds and increasing the difficulty of absorbing foreign investments.

Before Britain joined the EC, Britain was called the "European patient" and its economic growth rate ranked last among the developed countries; however, after Britain joined the EC, its economic growth rate ranked first among the developed countries.⁷ According to the British government's estimation, the U.K. economy

³ <https://fullfact.org/europe/uk-jobs-and-eu/>

⁴ Nicolas Véron, "With Brexit London would lose business as a global financial centre", Bruegel, June 6, 2016.
<http://bruegel.org/2016/06/in-case-of-a-brexit-london-would-lose-business-as-a-global-financial-center/>

⁵ Kim Hjelmgaard, "'Brexit' could harm London's status as financial center", USA TODAY, June 22, 2016.
<http://www.usatoday.com/story/news/world/2016/06/22/brexit-could-harm-london-status-financial-center-eu-referendum/86220566/>

⁶ US has attracted \$149 billion of "greenfield investments" from emerging economies. (Courtney FingarIs, "Brexit a threat to foreign direct investment?" *Financial Times*, March 4, 2016.)
<https://next.ft.com/content/6df1db7a-e159-11e5-8d9b-e88a2a889797>

⁷ Chris Giles, "Brexit in seven charts — the economic impact", *Financial Times*, June 27, 2016.
<http://www.ft.com/cms/s/2/0260242c-370b-11e6-9a05-82a9b15a8ee7.html#axzz4CvO0MCal>

could be around 6% smaller in 2030 if it left the EU than if it remained a member. That would be a loss of £4,300 per British family.⁸ It is no wonder that some Britons say they will delay or abandon childbirth.

Scotland said that in case of Brexit, it would remain in the EU or seek independence. Besides, some more pessimistic analysts estimate that in case of Brexit, Scotland might conduct another referendum to get independence, while Northern Ireland and Wales might also leave Britain in some form. By then, the United Kingdom of Great Britain and Northern Ireland would be unworthy of the name, and its status on the world economic stage would certainly suffer a disastrous decline.

In the era of globalization and science and technology revolution, the quality of research and development (R&D) will certainly influence one economy's competitiveness. At present, the EU provides a lot of scientific research funds for Britain's R&D every year. According to an article of Britain's newspaper *The Guardian*, British scientists' cancer, computer systems, nanotechnology and engineering research has for a long time benefited from EU grants. The EU has supported Britain's research with the sum of £126 million over the past decade, amounting to more than 40% of the scientific research funds provided by the British government.⁹ Undoubtedly, after Brexit, Britain will hardly be able to obtain such funds, Britain's R&D activities will suffer a great negative impact, and Britain's economic competitiveness will be affected.

According to the IMF, if Britain can reach an agreement with the EU after Brexit as soon as possible and adopt a trade agreement similar to the Norwegian model, its economy would shrink by 1.4% in 2019, and if both sides cannot reach an agreement soon, Britain's economy might shrink by 5.6% in 2019.¹⁰

The referendum result will also exert some negative influence on the British society's cohesion. Everybody knows that the referendum was won by only a margin of 1.2 million votes, representing less than 2 percentage points above 50%. This means that the strengths of "Leave" supporters and "Remain" supporters were evenly matched. It is no wonder that many people demanded that the first referendum's result be overthrown and a second referendum to be conducted. However, Prime Minister May said there would be no second referendum.

⁸ Jenny Gross and Jason Douglas, "Brexit Would Lead to 6% Drop in U.K. GDP, Government Warns", *Wall Street Journal*, April 18, 2016.
<http://www.wsj.com/articles/u-k-government-says-exit-from-eu-will-cause-economy-to-shrink-6-by-2030-1460968985>

⁹ Ian Sample, "Brexit would threaten world-class British research, major report warns", *The Guardian*, 18 May, 2016.
<https://www.theguardian.com/science/2016/may/18/brexit-would-threaten-world-class-british-research-major-report-warns>

¹⁰ IMF, UNITED KINGDOM: SELECTED ISSUES, June 1, 2016.
<https://www.imf.org/external/pubs/ft/scr/2016/cr16169.pdf>

The well-matched referendum result means nearly one half of Britons have to accept the choice of the other half of Britons. The result is that their future life, jobs and economic income will change greatly. This will certainly exacerbate their resentment and dissatisfaction with Brexit. Therefore, the British society's cohesion and stability will face huge risks in the future.

II. Impacts on the EU's Economy

Britain is the second largest economy in the EU. Therefore, any change in Britain's internal or foreign affairs will exert great or small influence on the EU. The main impacts of Brexit on the EU's economy include:

First, it will lower the EU's economic status. According to purchasing power parity, the EU is the second largest economy in the world. Brexit will reduce the EU's economic aggregate and lower its status on the international economic stage accordingly.

Second, it will deal a blow to the course of European economic integration. Since the Greek debt crisis and the refugee crisis broke out, some European countries' a Eurosceptic mindset has been on the rise. Brexit will certainly fuel this complex, thus undermining the momentum of European economic integration and dealing a heavy blow to the efforts made by EU to build the banking alliance, the energy alliance, the capital alliance, the digitization alliance and the political alliance.

Third, it will affect the European Investment Bank's credit rating. The European Investment Bank has made major contributions to European economic development. Up until now, the European Investment Bank has a very high credit rating and enjoys a very high reputation on the international capital market. Britain's capital share in this institution is 16.1%, roughly the same as that of Germany, France and Italy.¹¹ Theoretically, in case of Brexit, its share will be apportioned among the other countries; however, in reality, gaming and bargaining related to it will certainly augment various uncertainties and thus affect this institution's credit.

Fourth, it will undermine the momentum of the EU's economic recovery. The EU's economy is recovering, but the momentum is weak. In case of Brexit, the risks facing the EU's economy will be further augmented, and the momentum of economic recovery will be seriously affected.

Fifth, it will affect EU members' investments in Britain. In the EU's common market, EU members enjoying the convenience and advantage of free capital flow have invested heavily in Britain. After Brexit, this convenience and advantage will disappear, and EU investments in Britain will notably decrease. Besides, with the

¹¹ <http://uk.reuters.com/article/uk-britain-eu-ratings-idUKKCN0WC1VJ>

drop of the British pound's value, EU enterprises' profit denominated in euro will decrease. This is not conducive to EU enterprises' investments in Britain.

III. Impacts on the Course of European Integration

The achievements of the European integration process are praised by all: The EU has realized free flow of personnel, goods, services and capital, which is undoubtedly a model of human society's solidarity.

However, the Eurosceptic mindset has been all over Europe, and Britain's Brexit referendum was the outbreak of this complex.¹² Some people worry that a chain reaction in several EU member states vying to leave the EU might emerge after Brexit and thus put an end to the EU. Several English words mocking exit from Europe even emerged on the Internet, such as Departugal, Italeave, Czechout, Oustria, Finish and Slovakout. Chinese netizens also imitated them and changed the names of the European countries with a strong Eurosceptic complex into 熄蜡 (Greece), 扑逃牙 (Portugal), 意大离 (Italy), 法滚 (France), 解克 (Czech Republic), 奥地离 (Austria) and 分栏 (Finland).

Although Britain's referendum will not cause other countries to follow it immediately and will not produce a domino effect of exit from the EU, the momentum of the course of European integration will certainly be undermined. Therefore, the leaders of the EU and its member states will not only try to reduce the side effect of Brexit to the lowest level and draw lessons from the bitter experience, but also seriously summarize their experiences, lessons, successes, failures, gains and losses on the road of integration; not only make efforts to publicize the great achievements of European integration, but also appropriately set the speed and momentum of promoting European integration. Needless to say that a prosperous and stable Europe is in the interest of all sides.

The EU's leading forces are Germany and France. It would benefit both Germany and France if Britain remains in the EU. Germany hopes Britain to restrict France and obstruct France's "independence" in EU, while France hopes Britain to curb Germany's "condescending" attitude. Particularly, on issues such as the EU's defense and energy, France urgently hopes to cooperate with Britain. This shows that the balance of forces within the EU will change after Brexit and the game between Germany and France will show new characteristics.

¹² After Britain's referendum ended, PVV leader Geert Wilders called on the Netherlands to hold a referendum on the Netherlands' exit from EU. FN leader Marine Le Pen called on France to hold a referendum on exiting EU. International media even invented two words: Nexit and Frexit.
FN leader Marine Le Pen called on France to hold a referendum on Frexit.

IV. Impacts on the World Economy

Britain is the world's fifth largest economy (its 2015 GDP was \$2.8 trillion) with a land area of 244,100 square kilometers and a population of 64.1 million, accounting for 2.4% of the world GDP.¹³ Besides, the British pound is an international reserve currency. Therefore, Brexit will also exert certain influence on the world economy.

First, it is not conducive to world economic recovery. At present, the world economic recovery is not robust. The Brexit referendum augmented a market panic, so the world economy will face greater uncertainty. Managing Director of the IMF Christine Lagarde thinks Brexit is a “concern” not only for Britain, but also for the world.¹⁴ Chair of the Board of Governors of the Federal Reserve System Yellen also said that among the factors influencing the Federal Reserve System's interest rate hike, the result of the Brexit referendum was an important factor that must be considered.¹⁵

Second, it might weaken the stability of the exchange rates of major currencies in the world. Around the time when the result of the Brexit referendum was announced, the international financial market underwent huge fluctuations. After the referendum result was announced, the exchange rate between the pound and dollar dropped to 1.32 dollars to 1 pound, the lowest point since the 1980s.¹⁶ At present, the market is still quite pessimistic about the pound's prospects. Since the Brexit negotiations between Britain and EU have not officially begun, huge fluctuations are likely to occur in the exchange rates between the pound and other major currencies in the world for the foreseeable future.

V. Impacts on the International Situation

Although Britain has not joined the Euro zone and the Schengen area, its influence on European affairs has been huge up until now. After Brexit, such influence of Britain will certainly be weakened a lot and its say in the course of EU decision-making will disappear.

Britain is a permanent member of the United Nations Security Council, the fifth largest economy in the world, and the second largest economy in the EU. Britain has not only more than 200 nuclear warheads, but also very strong soft power.

¹³ <http://databank.worldbank.org/data/download/GDP.pdf>

¹⁴ <http://www.cnbc.com/2016/06/17/there-are-downside-risks-to-the-uk-voting-to-withdraw-from-the-eu-lagarde.html>

¹⁵ Janet L. Yellen, Semiannual Monetary Policy Report to the Congress Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C. on June 22, 2016. <http://www.federalreserve.gov/newsevents/testimony/yellen20160621a.htm>

¹⁶ “Markets after the referendum: Britain faces Project Reality”, *The Economist*, June 27, 2016. <http://www.economist.com/blogs/buttonwood/2016/06/markets-after-referendum>

Besides, the pound is an international reserve currency, occupying an important place in the international monetary system. Therefore, Britain's status in the international situation cannot be underestimated. In other words, any change in Britain's internal or foreign affairs will exert great or small influence on the international political and economic situation.

Though the bilateral economic relationship between Britain and the EU will be affected after Brexit, their bilateral military relationship will not change substantially. Moreover, because Britain will still be a member of NATO after Brexit and it is NATO instead of EU that provides security guarantees for Europe, NATO's ability to provide security guarantees for Europe will not change after Brexit and European security will not face greater danger.

The United States has exerted influence on the EU through Britain for a long time. At the same time, as the United States' ally, Britain is also acting as the United States' "mouthpiece" in the EU. Therefore it will be in the interest of the United States for Britain to remain in the EU. If Britain exits the EU, the United States' influence in the EU will be affected to some extent, but such influence will not fundamentally change the relationship between Britain and the United States. In fact, to maintain its international status, Britain will enhance its relationship with the United States.

After the Cold War, the framework of international forces increasingly showed the characteristics of one superpower and several major powers, i.e. the United States is still a superpower playing a critical role in international affairs, while forces such as the EU, China, Russia and Japan have become more powerful and prosperous. The strength of the EU will be weakened after Brexit, but Britain is still a European country. Therefore, Europe's position among the "one superpower and several major powers" will not change fundamentally, and the framework of international forces will not undergo any major adjustment.

V. Impacts on China

From October 19 to 23, 2015, upon the invitation of Queen Elizabeth II, President of China Xi Jinping undertook a state visit to Britain. During the visit, China and Britain released the *UK-China Joint Statement on Building a Global Comprehensive Strategic Partnership for the 21st Century*, and ushered in a "golden period" of lasting, open and win-win UK-China relationship. China sincerely hopes that Brexit will not weaken the driving force behind this partnership.

The economic and trade relationship between China and Britain is quite close, so Brexit will exert a certain influence on the economic and trade relationship between China and Britain. In fact, the influence of the June 23 referendum on the RMB's exchange rate has already emerged. For example, on June 23, 2016, the

exchange rate between the pound and RMB was 9.7242; on June 27, the exchange rate between the pound and the RMB was 8.9194.¹⁷

Britain will certainly try to seek alternative markets after Brexit. Therefore, the trade relationship between China and Britain can be expected to further develop. In other words, Brexit might cause the effect of trade diversion for the EU, but might create the effect of trade creation for China. Moreover, because Britain will not be limited by the “exclusive competence” of common business policies determined by the Lisbon Treaty after Brexit, China can discuss with Britain the feasibility of signing a bilateral free trade agreement. If China can reach this agreement with the fifth largest economy in the world, its important significance and demonstration effect will be obvious.

Brexit will cause unfavorable changes to Britain’s economic and trade relationships with other countries, and thus harm its investment environment. For example, foreign investors will be unable to take advantage of the “bridge” relationship between Britain and the EU market and the “springboard” effect, which will affect Chinese enterprises’ investments in Britain. However, because other advantages in Britain’s investment environment still exist, Chinese enterprises should continue to attach importance to Britain as a place of investment.

Britain’s comparative advantages in the field of international finance will also be affected by Brexit. This means cooperation between China and Britain in this field will face more uncertainties, while the course of promoting RMB internationalization in Britain will also be restricted in some aspects. However, because Paris and Frankfurt are trying to replace or catch up with London’s status in the field of international finance, cooperation between China and the EU in this field will not regress.

China respects the British people’s choice. After the British referendum ended, Spokesperson of the Ministry of Foreign Affairs Hua Chunying said: China always views and develops its relations with the UK and the EU from a strategic and long-term perspective, and supports the development path of Europe’s own choice. We hope that the UK and the EU can reach an early agreement through negotiation. A prosperous and stable Europe is in the interests of all parties. China is willing to join hands with the UK to maintain and press ahead with bilateral relations, and make new headway in pragmatic cooperation. China hopes that the UK and the EU can reach an early agreement through relevant negotiations and go through the transition period smoothly. Regarding the EU and the integration process of Europe, China’s position is consistent. We support the European integration

¹⁷ <http://www.pbc.gov.cn/zhengcehuobisi/125207/125217/125925/index.html>

process, and are happy to see Europe play a positive role in international affairs. We have faith in the prospect of China-EU relations.¹⁸

Roderic Wye, a research fellow at Chatham House, writes in an article titled “China Would Not Abandon UK After Brexit”: “China is generally reluctant to encourage the break-up of established orders and is uncomfortable with the uncertainty that such actions can generate. Somewhere in the background is China’s own sensitivity that a Brexit might be used as a model for a potential break up of China, or might encourage Taiwan, and even Hong Kong, to go their own way.” This criticism is rational to some extent, because some people in Taiwan and Hong Kong really have the intent of splitting the motherland.¹⁹ Of course, their intent cannot be achieved.

¹⁸ “Foreign Ministry Spokesperson Hua Chunying’s Regular Press Conference on June 24, 2016”, Website of the Ministry of Foreign Affairs, June 24, 2016. http://www.fmprc.gov.cn/web/fyrbt_673021/t1375085.shtml

¹⁹ Roderic Wye, “China Would Not Abandon UK After Brexit”, 21 June, 2016. <https://www.chathamhouse.org/expert/comment/china-would-not-abandon-uk-after-brexith#sthash.Lqj2Qire.dpuf>