

# *Research on the Effects of Brexit on the UK Economy*

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**Abstract:** The study aims to explore the various impacts caused by Brexit on the UK economy. The study uses theoretical and qualitative methods for analysis. The Brexit referendum took place in 2016, and the event in 2020. This caused the UK GDP to decrease. The inflation increased sharply due to Brexit and other factors. Unemployment is rising in the countries as the country faces a labour shortage. The trade has decreased with the EU. The export performance of the UK has worsened. The exchange rate has depreciated as the pound has lost its value. The study makes several suggestions, such as greater trade negotiations with the EU, allowing immigration from other countries, strengthening international position, maintaining depreciated currency, and restoring the status of London as a global financial hub. These suggestions can help the UK achieve higher economic growth and recovery from a slowdown due to higher investment and trade flows.

**Keywords:** Effects, Brexit, UK Economy

## 1. Introduction

### 1.1. Research background

The paper aims to examine the influential impact of Brexit on the economy of the United Kingdom. The study will explore the influence Brexit has created on different macroeconomic indicators of the UK economy, such as inflation, unemployment, exchange rate, and trade. The UK economy has suffered since the Brexit referendum 2016 [1]. The news of Brexit affected the economic growth of the UK, led to trade disruptions with other countries, and caused the pound sterling to depreciate. After Brexit has taken place officially, the country's trade performance has suffered significantly. Further, the country is currently facing one of the highest inflation rates among the advanced G7 countries due to a labour shortage, which earlier used to come from other EU countries. Brexit has cost the UK economy 100 billion pounds a year. However, at the same time, Brexit has even led to some positive effects, such as control of the democracy of the country, control of borders, freedom of regulation, control of one's own money, and so on.

The study is important as it will help evaluate how Brexit is responsible for slowing down the UK economy. It focuses on examining if Brexit has proved to be an economic crisis for the country or not. This topic is chosen as Brexit is an important event in the history of the EU which has hampered international trade between the UK and its main trading partner, the EU. The UK economy has always been dependent on trade, but this move shows that it has gone more towards protectionism, which is against the spirit of free trade.

## 1.2. Literature Review

There are numerous research that have undertaken the study of BREXIT and its aftermath on the UK economy. Regarding this, the study by REENEN was conducted before the Brexit event took place to examine the long-run effects of Brexit on the UK economy [2]. The research talks about soft Brexit and hard Brexit and their different effects on the UK economy. The UK will put tariff and non-tariff barriers, due to which the trade costs will arise. These expenses will be larger in the phase of hard Brexit. In the soft Brexit case, the UK forms to be a participant in the EU's only market. At the same time, the supposed benefits of Brexit are better regulations, lower immigration, and new trade deals with other countries. Further studies have been conducted to comprehend the impact of Brexit on UK. The study by Du et al. analyses the effect of Brexit on UK trade [3]. The study using data from COMTRADE found that the trade relationship of the UK with the UK did not undergo any change. The UK-EU Trade and Cooperation Agreement has a huge, detrimental, and statistically considerable impact on UK exports. The UK firms faced export challenges since the UK-EU Trade and Cooperation Agreement came into force. Further, due to this trade agreement, the volume of goods exported by the UK to the EU shrank. This means that there are long-term effects of Brexit on the UK economy.

The study by Gupta et al. analyses the effects of both COVID-19 as well as Brexit on the economy of the UK using data [4]. The study finds that both events have contributed to the country's economic slowdown. The unemployment rate decreased till 2020 but then increased in 2021 and remained on the higher side till then. The GDP was increasing till 2020 but then slowed down after that. Both events have caused the trade to decline. However, there are positive outcomes also seen in the post-Brexit era. The study concludes among all the major macroeconomic indicators, trade suffered the most. Lastly, the study by Mathieu talks about the effects of Brexit on the UK [5]. The research concludes that the impact of Brexit on the GDP varies from -13% to +6% in the long run. The influence of Brexit on the UK economy is mixed, both positive and negative. The economy's slowdown due to the referendum is not as weak as anticipated.

## 1.3. Research Gap

After evaluating all the above studies, it can be seen that the studies have not explicitly described the influence of Brexit on the UK's economic growth and other macroeconomic indicators. Also, very few studies appropriately cover the Brexit impact on the UK economy. The underlying study fulfills this gap by analyzing the impact of Brexit on economic growth, trade, exchange rate, inflation, and unemployment in the UK. Post-Brexit events are evaluated in this paper theoretically.

## 1.4. Research Framework

This research paper has the following logic. Firstly, it is done to examine the influence of Brexit on the UK in the short as well as the long run. Secondly, the paper is written to give policymakers a set-up to frame policies so that the impact on the economy can be corrected. Lastly, the policymakers will be aware of which policies need to be taken to correct which sector of the economy.

## 2. Case description

Brexit is an abbreviation used to mention the British Exit and the cessation of Britain to be a part of the European Union. On 23 June 2016, a referendum was conducted in the UK to determine if UK citizens want to be a part of the EU or leave the EU. 52% of the total votes suggested a favorable position in departing from the EU, while 48.1% of the votes wanted to remain as part of the EU [6]. The process of disassociating the EU started in 2017 when Article 50 of the Lisbon Treaty was

prompted. After several negotiations, the Brexit event finally occurred on 24 December 2020. On this date, the UK and the EU reached the conditions of agreements in three different parts. These agreements include the Trade and Cooperation Agreement (TCA), the Information Security Agreement (ISA), and the Nuclear Cooperation Agreement (NCA). The voters who vote in favor of Brexit are due to factors such as the European debt crisis, terrorism, immigration, as well as the anticipated drag of Brussels' bureaucracy on the UK economy. They argue that Brexit will lead to benefits for the UK in the long term. However, Brexit has raised several profound and unanswerable questions about the future development of the UK [7].

Ever since the UK left the EU formally, a negative and catastrophic effect has been on the economy of the UK. The economy is continuously affected by factors such as supply-chain disruptions, COVID-19, rocketing energy prices, and the Russia-Ukraine war. Primarily, the UK businesses and economy are affected by COVID-19 and Brexit. These simultaneous events have created several impacts on the UK economy, and it is not easy to separate them. Trade has experienced a considerable slowdown following Brexit as well as the pandemic. The UK-EU trade has seen the biggest fall, with exports of the UK falling sharply [8]. Also, the inflation in the country is at its peak, recorded as 6.4% in June 2023. The inflation in the UK is the highest among all the G7 countries. The unemployment rate is also higher, reaching 4.2%, as it has risen since 2022. Also, the exchange rate fluctuations have become rampant in the country. The pound is losing its value post-Brexit. All these factors are disturbing the UK economy. Therefore, it becomes important to assess the role of Brexit in this entire process.

### **3. Analysis of the Problem**

The section describes the various impacts of Brexit on different macroeconomic indicators of the UK economy.

#### **3.1. Impact on Economic Growth**

Brexit has led to the weakening of the economy of the UK. The economy has become smaller than it was before the pandemic. The uncertainty over trade and the erection of tariff barriers have caused investment activities by various businesses to fall in the UK. The country's trade is disrupted with the EU due to the imposition of tariffs and other trade protectionist policies. These factors show that the aggregate demand is now weak in the country. Further, the country is facing labour shortages due to the movement restriction. This is because the UK is not part of the EU, allowing free labour and capital flow between the countries. The labour market disturbance shows that the aggregate supply is now weak. Both factors show a reduction in output and real GDP in the country. Brexit has resulted in the loss of 2-3% of GDP. Brexit has increased costs for the economy and reduced the country's national income as well. Since 2019, the UK has experienced a negative growth rate of -0.4% [9]. Different sectors, namely hospitality, transport, and retail, are the hardest hit.

#### **3.2. Impact on Trade**

The United Kingdom's economy has a significant reliance on international commerce. The Brexit would obviously hamper the trade association between the UK as well as the EU. As a consequence of Brexit, the trade of the UK has shrunk considerably. The exports of the UK have declined considerably, affecting the small UK firms. Despite the economy's rebalancing after Brexit, exports of the UK to other countries have declined considerably. The goods trade has weakened, but the services trade has not. The exports of goods are hampered mostly due to the adoption of trade barriers such as tariffs, which were not in place, while the undisputed service trade shows the strong position

of the UK in various sectors [10]. The UK has entered into new trade agreements with other economies like New Zealand and Australia.

After Brexit, the trade among the UK as well as the EU is governed by the Trade and Cooperation Agreement, which came into force in May 2021. The trade with the EU decreased in April 2023. The imports from the EU are greater than those from non-EU countries since 2022 [11]. The uncertainty has risen over the future trading with the EU, which is the largest trading partner of the UK. This uncertainty has damaged the country's business environment. This is because the UK ceased to be a member of the EU, due to which trade barriers are not erected. For the businesses and foreign companies for which the UK used to be a European base, this has reduced investment, leading to a fall in economic activity.

### **3.3. Impact on Unemployment**

The labour market is the most affected in the UK due to Brexit. This is because the country is facing a shortage of workforce who used to come from other parts of the EU. Due to the changed environment, the UK has 330,000 fewer workers due to Brexit. Immigration has been reduced to a great extent due to several restrictions imposed by the UK government [12]. These migration restrictions caused the movement of workers to decline in the UK, increasing unemployment in the country. Further, the number of jobs lost in the financial sector has reached 7000. Brexit lowers the workers' welfare in all possible scenarios. Due to the migration barriers, worker welfare is decreased in receiving and sending countries. Workers who never migrated experienced the least loss of welfare post-Brexit [13]. Thus, it can be said due to the increased migration restrictions, unemployment increased, workers' welfare was reduced, and the job surplus was lowered in the country.

### **3.4. Impact on Inflation**

The country faces a huge inflation problem as compared to other advanced countries. The rise in inflation is due to many factors, including Brexit. The various factors include: firstly, the country heavily depends on natural gas for energy production. The natural gas is always imported from other countries. However, the trade is reduced due to the Ukraine-Russia war, which has reduced the natural gas supply for the country. The cost of production has risen, leading to higher inflation. Secondly, the country is currently facing the issue of bad crops due to bad weather conditions [14]. This disrupts the agricultural supply of food. This has again caused food inflation to rise in the country. The third reason for inflation is caused due to Brexit. The country is facing labour shortages, due to which the firms are not able to hire an adequate number of workers required for production. This labour shortage has arisen due to Brexit, as the UK is no longer part of the EU, where the free flow of labour and capital is allowed. The labour shortage peaked at the time of the referendum to become 200,000 per year, and it has now become negative. This has caused wages to grow, meaning higher production costs for the firms. The leftward change in the short-run aggregate supply curve may be attributed to the influence of three distinct variables, leading to higher inflation and lower output.

### **3.5. Impact on the Exchange Rate**

Before Brexit, the UK had never been a part of the Eurozone. The UK has always used the pound sterling as its national currency. The pound sterling has suffered a lot due to the Brexit referendum and the event. It has lost a fifth of its value since the referendum [15]. Since then, the pound's value has fallen 19% to the US dollar. From May 2016 to March 2017, pound sterling fell by 11%. After the Brexit event occurred in 2020, the value of the pound sterling increased. But it lost its value in March 2020, hitting a low of 1.06 against the Euro. However, the pound sterling experienced an

appreciation in 2022. The currency faced uncertainties and volatility throughout this period. This is because of issues other than Brexit as well.

#### 4. Suggestions

Brexit has created different problems for the UK economy due to various uncertainties. A few suggestions are required which can help ease the country's situation. Firstly, Brexit is creating issues due to the uncertainties over trade. The UK left the EU's common market in 2020, and since then, their trade has been governed by the Trade and Cooperation Agreement. It includes preferential trade agreements in trade in goods and services, public procurement, intellectual property, and many more [16]. The trade barriers are now higher than before, but free trade is permitted. The EU has consistently maintained its position as the primary commercial partner of the United Kingdom (UK), and trade costs have remained lower due to proximity. Therefore, it is suggested that there should be more trade negotiations between the parties, which can further eliminate the trade barriers between the countries. This is important because the trade between the countries should remain smooth. The countries should maintain harmonious trade relations, which can help them achieve more certainty over business growth. The countries should encourage their business relationships as the cost of doing less would be less for the UK than other non-EU countries. This will help in increasing aggregate demand, which can help the countries achieve higher economic growth. At the same time, in the 21st century, there are matters of geo-economic risks and commercial opportunity related to the rapid growth of digital trade and services and the stalling of multilateral trade liberalization. Therefore, it is recommended that the UK should align its foreign economic policies with security and foreign policies.

Secondly, the UK economy is suffering due to labour shortages, the leading contributor to the country's inflation problem. This problem occurs due to Brexit as the free movement from the EU countries is now restricted due to border controls by the UK. After Brexit, the UK ended all free movements and regained control of its earlier open borders. The country then introduced a points-based immigration system [17]. The focus is on acquiring skilled workers, globally the best talents with English requirements. This way, the UK filtered the skilled workers from the entire pool of immigrants who matched their domestic labour market requirements. Despite these filtering and welcoming doctors, scientists, butchers, and bricklayers, the country is still short of workers, so the firms lack an adequate workforce. Therefore, in this case, it is suggested that the country should relax its tight norms of allowing only highly skilled and globally talented workers. This way, even semi-skilled and slightly less skilled workers can participate. These workers can be trained later to match the job industries' requirements. Also, the migration from non-EU countries should be encouraged. These include Asian and African countries, which can help fill the labour market gap in the UK.

Thirdly, the country should take steps to support the international system. In an era of heightened distrust, it is important to restore the international system. The UK should plan an active and coordinated role in addressing the issues, which will help revive a global approach and restore global norms. The UK needs to reset its global role after Brexit, for which it is suggested that the country should create a secretariat within G20 [18]. It should focus on promoting global rules, coordinating multilateral climate progress, and many more. The country can work in partnership with other countries, which can help create an effective and rule-based international system. This is required as coordinated approaches amongst countries are needed to create an interconnected world. This suggestion can help the UK create a prominent position in the world, which can help it to recover its economy.

Fourthly, the UK should focus on maintaining a lower exchange rate only. The value of the pound against the Euro and dollar has eroded mainly. However, the exchange rate fluctuates and has become volatile due to rising uncertainties caused by Brexit. But, it can be said that the country should

maintain a lower exchange rate. This can be done by setting lower interest rates by the Bank of England. This can lead to several advantages to the UK economy. The country will be able to enhance its export performance as the exports will not be competitive. The trade can be well-built and developed with non-EU countries as well. Also, this will ensure stability in the exchange rate, which can bring certainties to the business environment. The increase in net exports will boost the aggregate demand, which will help increase the country's economic growth.

Lastly, it is known that London is the global financial centre. This is because more than 50% of international trade was used to be conducted in pounds at the end of the 19th century. London depicted a modest role as a banker to the UK government in the early 20th century. Brexit has led to uncertainty of the continuing status of London as a global financial centre. The position of London has eroded marginally since Brexit. London remains strong in FX trading, but a decline is seen in euro interest rate swap trading. The ties of London to the EU have become loose due to the shifting of euro repo clearing to Paris from London [19]. In this light, it is suggested that the UK should take steps to revive London's position as a global financial centre. This is important as this will encourage more businesses to enter the country. The domestic and overseas investments will increase, leading to higher economic growth for the country.

Thus, following these suggestions can help the UK economy overcome the problems of Brexit.

## **5. Conclusion**

### **5.1. Key Findings**

The study finds that Brexit has led to the slowdown and weakening of the UK economy. The GDP of the country is lost by 2-3%. Inflation has risen significantly in the country due to a shortage of workers as the movement is now restricted between the EU countries and the UK. Unemployment has risen in the country. The pound has weakened against the dollar and Euro and has become much more volatile. Lastly, the trade is severely affected. Trade with the EU countries has decreased mostly. The country is signing trade deals with more countries. The suggestions are, firstly, more trade negotiations with the EU as well as other economies to increase trade as the UK economy is heavily trade-dependent. Secondly, the immigration rules should become less stringent to welcome more workers from other countries as well. Third, the UK should increase its international cooperation and strategic presence to gain a superlative position. Fourthly, the country should take steps to restore the position of London as the financial hub, and lastly, the country should maintain a weaker pound to boost trade.

### **5.2. Research Significance**

The topic is important because Brexit is an essential event in world history that has shaken the entire world. Due to this, the UK economy has seen a large number of ups and downs. This study highlights the influence of Brexit on the UK economy post-referendum and leaving. The study is important as it can help policymakers understand which areas should be focused on to strengthen the UK economy again.

### **5.3. Limitations**

The study has several limitations. Firstly, the study is entirely theoretical and lacks all types of quantitative analyses. Secondly, the study is focused only on a small aspect and does not include any impact on the world economy. Thirdly, the study does not use primary data for analysing any impact of Brexit on households. Through this, the study allows future researchers to take up primary data analysis to study the impact on households' behaviours.

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