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The economic consequences of Brexit on free movement of goods, services, people, and capital

Master dissertation

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Declaration of authorship

I, Nguyen Kieu Hanh, hereby declare that the dissertation thesis “The economic consequences of Brexit on free movement of goods, services, people, and capital" was written by myself, unless stated otherwise. The literature sources are listed in the list of references.

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Abstract

The aim of my dissertation thesis is to analyze the economic impact of Brexit on four free movements of goods, services, people and capital from perspectives of different literature reviews. I would like to get an appropriate answer to my research question, whether British exit from the European Union will have a negative impact on free movements of goods, services, people and capital in the short and long run. I am fully aware of the fact that the future depends on the decision made by politicians of both parties, especially on future negotiation´s agreements. Both parties will have to decide on alternative further cooperation and taking into account all benefits and detriments of economic consequences. Thus, this thesis is focusing on Brexit impact on four freedoms in connection with the future relationship between the UK and the EU.

Keywords: Brexit, free movement, goods, services, people, capital, economic consequences, welfare

List of abbreviations

ECSC	European Coal and Steel Community
UK	United Kingdom
EEC	European Economic Community
GDP	Gross domestic product
EFTA	European Free Trade Association
ERM	Exchange Rate Mechanism
EU	The European Union
FTA	Free trade agreement
CER	Center of Economic Reforms
BITS	Bilateral Investment Treaties

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Introduction

The UK membership in the European Union has been problematic for many decades. Britain joined the European Community in 1973. In 2016 the United Kingdom let its people decided on the important issue of leaving or remaining in the biggest economic and political integration. Therefore the EU referendum held on 23 June. It took place in the whole UK and Gibraltar. A majority of 51.9% of voters decided in a referendum that the UK should leave the EU. The result from referendum was not completely convincing, because of Scotland and the Northern Ireland. The referendum showed the regional differences in the UK. The regions that have benefitted most from immigration and trade voted in favor of Bremain, whereas the regions where people feel most threatened by immigration and trade liberalization voted for Brexit. Brexit means simply the British exit from the European Union. What are the economic consequences of leaving the EU? This question is at the heart of the Brexit debate among politicians, academics, and ordinary people.

The aim of my dissertation thesis is to analyze the economic impact of Brexit on four free movements of goods, services, people and capital from perspectives of different literature reviews. I would like to get an appropriate answer to my research question, whether British exit from the European Union will have a negative impact on free movements of goods, services, people and capital in the short and long run. I am fully aware of the fact that the future depends on the decision made by politicians of both parties, especially on future negotiation´s agreements. Both parties will have to decide on alternative further cooperation and taking into account all benefits and detriments of economic consequences. Thus, this thesis is focusing on Brexit impact on four freedoms in connection with the future relationship between the UK and the EU.

The first chapter deals with insights of Brexit to understand the background behind British vote for leaving the European Union. To understand this problematic issue, we should know a brief history of UK-EU relationship. In addition, the position of the Britain in the European Union is very specific and to some extent unusual thanks to 4 opt-outs. In the context of Brexit, I will devote one chapter to referendum and the withdrawal process of leaving the EU based on Article 50 of Lisbon Treaty. On 24th June, the Prime Minister David Cameron announced his resignation in favor of the former home secretary Mrs. Theresa May. Mrs. May was against Brexit, but her statement „*Brexit means Brexit, and we are going to make a success of it*" is a confirmation to her attitude of satisfying the Britons votes. She has to decide when to invoke Article 50 of the Lisbon Treaty on the European Union, which will commit the Britain to leave the EU in two years. The Brexit day will be 29th March 2019.

The second chapter is dedicated to insights of the Single market from the very inception to the current situation. To understand the consequences of Brexit on free movement of goods, services, people and capital, we should know the benefits of the Single Market membership.

The third chapter introduced five options of the future relationship between the UK and the EU regarding trading with goods, services, foreign investment and labor mobility.

Last chapter addresses to the core of the thesis, which is the analysis of the economic consequences of Brexit on free movement of Single Market.

1. Insights of Brexit

To understand the background behind the problematic Brexit, this chapter is devoted to a brief history of UK-EU relationship, special UK-EU relationship in forms of 4 opt-outs, causes of the referendum and the Article 50 of Lisbon Treaty.

The UK- EU Relationship

In 1945, the world war II. ended with huge social and economic damages. Afterwards, the whole Europe suffered from political instability, economic downturns and hunger caused by low food production. Many people were dependent on humanitarian help from overseas. This terrifying reality raised a question, whether Europe can avoid another conflict leading to world war. To answer this question, there was a need to prove whose fault it was. There were three options, and some blamed Germany, some people blamed capitalism or nationalism. Each of approach has own solution of the problem. Nationalism was blamed for the war since there was an excess of destructive nationalism of each European nations. This approach suggested a solution, which believes in tightening cooperation among European countries by creating United States of Europe. This term was announced by Winston Churchill in his post-war speech in September 1946 in Zurich. He claimed that„ *What is the plight to which Europe has been reduced? …over wide areas a vast quivering mass of tormented, hunger, careworn and bewildered human beings gape at the ruins of their cities and homes and scan the dark horizons for the approach of some new peril, tyranny or terror. That is all that Europeans, grouped in so many ancient states and nations, have got by tearing each other to pieces and spreading havoc far and wide. At the while, there is a remedy. It is to re-create the European family, or as much fit as we can, and to provide it with a structure under which it can dwell in peace, in safety, and in freedom. We must build a kind of United States of Europe„* (Baldwin and Wyplosz, 2006).
To keep peace in Europe, there must be a strict control of coal and steel, the main suppliers of war machines. According to the Schuman plan six nations – France, West Germany, Italy, Belgium Netherlands and Luxembourg – signed the April 1951 Paris Treaty that created the European Coal and Steel Community (ECSC). The UK refused to take part, since the post-war UK had a “splendid isolation” diplomatic policy, which means avoiding alliances and entanglements. In the 1957 Treaty of Rome was signed by same six nations, which created the European Economic Community known as EEC. ECSC succeeded in recovering from the post-war situation. In the 50´ the economic performance of the Six got back to their track thanks to marvelous growth up to 15% of GDP (Baldwin and Wyplosz, 2006).
The Great Britain has always been skeptical about efforts of deeper integration of the whole European continent since the beginning. The reason behind was supposed to lie in economic and political indifference between the UK and the rest of continent. Moreover, the geopolitical experience and concern of the British for losing its own identity and sovereignty have also effect on the UK reserved attitude. The Great Britain was an imperial power and the winner of two world wars. Therefore it caused isolation and disparity from the continental Europe. The UK liked to think of itself after World War II as the world’s third superpower, although its economy suffered after the war. After World War II, Britain relied on a "special relationship" with the United States, the Commonwealth, and ultimately Europe. This explained why the UK refused to be a part of the European Economic Community (Dinan, 2004).

In response to the European Economic Community, the United Kingdom initiated a new organization called the European Free Trade Association (EFTA) in 1960 based on the principles of The Stockholm Convention. EFTA was a free trade area, which means that there was a non-tariff trade among its countries, but each country kept their external trade policy. The founders were Denmark, Norway, Portugal, Austria, Sweden, Switzerland and the United Kingdom. Later, Finland, Liechtenstein, and Iceland joined. However, EFTA was not attractive for main trading partners such as France and Germany, since they preferred cooperation with EEC. The EFTA was assumed to cooperate with the Sixth of EEC. However, the assumption was not fulfilled. The Sixth had no interest in cooperation with EFTA since EEC countries saw EFTA as an attempt of anti-coalition initiated by the UK (Gowland, Turner & Wright, 2009). In contrast with EFTA, EEC was a customs union, since the inception of the founding countries reduced intra-tariffs among its members and may changed customs duties on imported goods from outside the world, including EFTA countries. The EFTA countries were always one step behind. Therefore EFTA did not succeed as the Great Britain hoped. At the meantime, thanks to trade and cooperation of the Sixth, EEC had a rapid economic growth. The UK realized that it needed to get access to this huge continental market with greater economic potential than in Commonwealth.

At the beginning of the 1960s, there was a radical change of the UK's relationship to the EEC. Process of decolonization, the Suez crisis, independence of former colonies, introduction of trade barriers to British goods by former colonies, gradual break up of the British Empire, rapid economic growth in EEC countries, the US interest in EEC – all these aspects led to the first British application to EEC in 1961 initiated by the Conservative Prime Minister Harold Macmillan. However, at that time French president Charles de Gaulle blocked that application and favored trading with former British colonies instead of trading with the UK. Charles de Gaulle feared about the British dominance in the EEC, the impact on the Common Agricultural Policy, which was very beneficial for French farmers at that time (Baldwin and Wyplosz, 2006).

The second British application in 1967 initiated by the Labour Prime Minister Harold Wilson was also not successful for similar reasons as the first one since French president did not change his attitude. Everything changed rapidly, after Charles de Gaulle's resignation from the presidency in 1970, British negotiations were restarted and completed. In 1973, the U.K. alongside with Ireland, Denmark joined the EEC. Ireland and Denmark represent the largest trading partners of the Britain, therefore their company was logically expected. The Norway refused entry because of their concerns about joining effects on Norwegian fisheries and agriculture since these sectors received more subsidies from national governments than the EEC offered (Gowland, Turner & Wright, 2009). Two years later, the U.K. held the first nationwide referendum in its history voting about leaving the EEC organized by Labour Prime Minister Harold Wilson, because there was an expectation of renegotiating terms and conditions of Common market (The Telegraph, 2015). The referendum ended with a result of 66% people in favor of remaining in the European Community. Labour party was disappointed since the result was 17.3 million to 8.4 million in favor of staying.

The Single European Act was approved by EEC members in 1985. In spite of the fact that this act committed all member states to make concrete progress towards European unity and integration process, at that time British Prime Minister Margaret Thatcher approved it since the Single European Act enabled a creation of a single internal market of goods, services, labour and capital. This second clause led to overvalue of any EEC law over laws approved by national governments and the loss of British veto. As a result of it, the opposition of EEC raised significantly (Baldwin and Wyplosz, 2006).

Four Opt-outs

The relationship of Britain and EEC was always problematic due to the skeptical attitude and lack of support of the UK in EEC legislation matters. Furthermore, the Britain always used their power to get the better position in the integration process. To demonstrate that fact, the UK has the highest number of opt-outs, which mean exceptions in many legislation making-decision processes. These exceptions lay in Schengen Agreement, Maastricht Treaty, Charter of Fundamental Rights of the European Union and legislation in freedom, security, and justice matters (Gowland, Turner & Wright, 2009).

First opt-out lies in border control matter regarding Schengen Agreement named after the city in Luxembourg, which was signed in 1985. It came into force ten years later in 1995. Schengen Agreement abolished passport controls on borders. Since 2000, it has expanded to take in 22 EU members and four non-EU such as Iceland, Norway, Switzerland, and Liechtenstein. The UK and Ireland opted out. (BBC News)

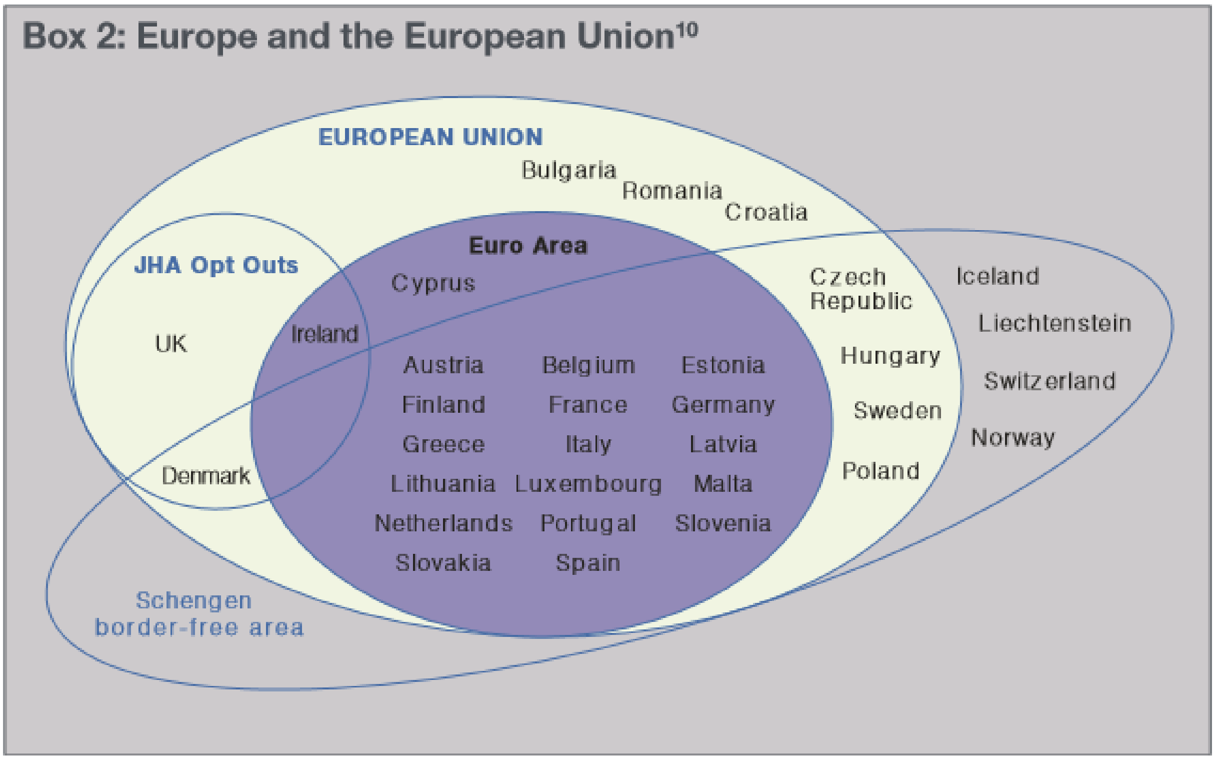
Second, the Maastricht Treaty was approved in 1992. EEC became the European Community (EC), and its member states obliged themselves to have a single currency. The U.K entered to Exchange Rate Mechanism, where the band was tied to other EU currencies, but the pound was artificially kept within the band. This led to a massive speculative attack to British pound at that time. In 1992, the Britain withdrew from ERM because the pound dropped out. As a result of it, the U.K secured the opt-out from having a single currency. Reunion of Germany in 1990, setting off anxiety in other European capitals at the prospect of an EEC under German domination. This provided the impetus for the Maastricht Treaty, signed in February 1992, under which the EEC became the European Community (EC), and it was agreed that the national currencies of the member states would be subsumed in a single currency. During the Maastricht negotiations, the U.K. and Denmark both secured opt- outs (Springford et al., 2016).

Third, the United Kingdom has opted out from Charter of Fundamental Rights of the European Union, since the UK does not want any changes in UK law, British foreign policy, qualified-majority voting, tax and benefits system (Barnard, 2008).

Lastly, The United Kingdom, alongside with Ireland and Denmark have a flexible opt-out from legislation adopted in the area of freedom, security, and justice, including all issues before the Treaty of Amsterdam regarding the Justice and Home Affairs pillar. This allows them to decide whether to opt-in or opt-out of legislation on a case-by-case basis.

The Figure 1 describes well the unique position of the UK in the UK-EU relationship because of existing four opt-outs in term of single currency, Schengen area, Justice and Home Affairs and Charter of Fundamental Rights of the European Union.

Figure 1: Europe and the European Union



Source: Cabinet office of Government of the UK. 2016.

Besides from 4 opt-outs, the U.K started reducing the British financial contribution to the common European budget in 1979. In February 2016, at that time Prime Minister Cameron succeeded in negotiating an agreement between the U.K and the European Union, in which was mentioned four important conditions (CNB).
Firstly, the European Union has recognized that more than one currency can exist in the EU countries. Secondly, the Eurozone will not hinder the further development of the single market for all member states. Non-Eurozone countries will not prevent in the process of deeper integration of the euro area as well. Thirdly, the Britain (other non-Eurozone countries as well) will be able to oppose Eurozone decisions if they do not agree during the EU-Summit. Lastly, the Britain will not have to be more integrated with EU and can apply its own national rules in matters related to its financial system.

Referendum

The U.K. membership in the European Union has been problematic for many decades. It can be seen through many referendums in the history from the first British join to the European Community in 1973. The first referendum ever took place in 1975. The referendum ended with a result of 66% people in favor of remaining in the European Community. From the last referendum in the country, the UK was reluctant to many EU incentives of adopting single currency Euro, when the UK is a member of European single market. In a recent couple of years, the euro-skeptical Britons started to think about leaving the European Union.

In 2016 the United Kingdom let its people decided on the important issue of leaving or remaining in the biggest economic and political integration. Therefore the EU referendum held on 23 June, it took place in the whole UK and Gibraltar. 51.9 per cent of voters decided in a referendum that the UK should leave the EU. More than 30 million people voting, which is equivalent to 71.8 per cent of turnout. Great Britain's decision to leave the EU was surprising for many. England voted for Brexit by 53.4% to 46.6%, and Wales voted in favor of Brexit, by 52.5% to 47.5% of voters. The result from referendum was not completely convincing, because of Scotland and the Northern Ireland. Scotland voted for Bremain by 62% to 38%, while 55.8% in Northern Ireland voted Remain and 44.2% of voters for Leave.

The new Prime Minister May has to decide when to invoke Article 50 of the Lisbon Treaty on the European Union, which will commit the Britain to leave the EU in two years. Moreover, she has to negotiate new free-trade agreements with the EU and other non-EU countries. In the meanwhile, one critical question arose, whether the United Kingdom will keep United since 62% of Scotish people voted in favour of remaining in the EU. In 2014, the Scottish referendum on independence from the UK ended with 55% voting in favor of remaining in the UK. However, after-UK referendum situation opened possibilities of Scotland conducting a second referendum on leaving the United Kingdom and newly applying for its own EU membership (Arnorsson & Zoega, 2016).

Withdrawal process of Article 50

The withdrawal from the EU must be implemented according to the Article 50 of Lisbon Treaty, which is an official clause with 5 paragraphs created as a part of Lisbon Treaty in 2009. The Article 50 allows any member state to leave EU if it wishes in 2 years. The Article 50 requires that *„the Brexit´s agreement has to be negotiated by Article 218(3) of the Treaty on the Functioning of the European Union. Moreover, it shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament."* (Lisbon-treaty).
The qualified majority means that the Brexit agreement has to be approved by 72% of remaining 27 EU member states with at least 65% of the EU population. The new Prime Minister May has already started with the negotiation of the British leave. In this case, the Brexit day will be 29th March 2019 (Arnorsson & Zoega, 2016).

2. European Path to the Single Market

The core objective of European Economic Community was focusing on the development of common market with free movements of goods, service, people, and capital. Free movement of goods was established in principle through the customs union among six member states France, Germany, Belgium, Luxembourg, Netherlands, and Italy. EEC aimed to reach economic integration, which can provide to its citizens and companies access to free markets without national barriers. In 1957, the Treaty of Rome established EEC with the long- term goal of founding a common market. They started with the simplest free trade agreement, which guaranteed non-tariff trade between two or more countries and abolished customs duties in the free-trading area under international law. However, the EEC struggled with the establishment of a single market, since there were many difficulties in removing intangible barriers and the lack of strong decision-making mechanism. Subsequently, The European Customs Union founded in 1968 added a joint customs policy for trade with third countries (Baldwin and Wyplosz, 2006).
The concept of four freedom of movements of goods, services, people and capital is detailed described in the Treaty on the functioning of the EU, known as the Treaty of Rome on establishing the EEC. Each freedom is divided into many components, which could be shown in the following table:

Table 1: Four Freedoms

Four Freedoms			
Goods	**Services**	**Persons**	**Capital**
• Custom duties • Internal taxation • Free movement of imports • Free movement of exports	• Freedom of establishment • Freedom to receive and provide services	• Freedom of establishment • Free movement of citizens • Free movement of workers	• Free movement of capital • Free movement of payments

Source: Lock, T. 2014

European Free Trade Association (EFTA) founded in 1959 competed with the EEC. However, over time, most of EFTA's members have switched over and joined the customs union, because they used to have only free trade with no commitment to a joint customs policy. These countries include Denmark and the UK (1973), Portugal (1986) and Finland, Austria and Sweden (1995).Thanks to the success of the EEA, the Single market made a step forward to deeper economic integration. In addition, non-tariff barriers to the free movement of goods and services were abolished such as physical, fiscal, legal and technical barriers. Iceland, Liechtenstein, and Norway are allied to the Single Market, thanks to their membership in European Economic Area (Vetter et al., 2013).

In the 1980´s, under Margaret Thatcher´s governance, the UK was a major driving force in generating political incentive realization of the plan of a Single European market. In 1985, Lord Cockfield submitted to the Milan European Council a White Paper about completing the Internal Market. The White Paper was accepted and led to the adoption of the Single European Act. The Single European Act came into force in 1987. It included the objective of the internal market in the Treaty of EEC, defining it as ‘an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured. The Single European Act reformed the decision-making mechanism of the EEC. Furthermore, the single market has to be completed by the end of 1992 (Lock, 2014).

Benefit of Membership of Single Market

Membership of the EU, thus a membership of the Single market opens up to many benefits in forms of welfare gains (Vetter et al., 2013)

- Direct cost reductions: Reduction of costs happened thanks to the abolition of the border and national formalities, this lead to increase in intra-EU trade.
- Harmonisation of production and quality standards: This lead to open up market within the EU and decrease in consumer prices.
- Economies of scale: The bigger market, the more potential companies have. Companies that are characterised by increasing economies of scale due to high fixed costs will be beneficiaries.
- The attractiveness of foreign investment from third countries.
- Increase of competition thanks to lower entry barriers
- Simplification of cross-border mobility
- Increase in the labor-force potential: This lies in the fact of free movement of labor across the EU.

Erik Dahlberg (2015) examined the economic effect of the Single European market. He found that the Single market has positive effect overall. First, the Single market has created new trade within the EU without any significant trade diversion in trading with third countries. Moreover, consumers can enjoy more varieties from imported goods. Interestingly, the single market affected innovation, since the competition in manufacturing sector increased leading to convergence of prices. However, the free movement of services does not record any significant indication changes. In terms of free movement of capital, it made FDI´s activities easier. Furthermore, Dahlberg found one fact, that membership of Eastern European countries in the EU raised attractiveness of foreign capital. His findings also mentioned that the average EU mover is relatively skilled. This fact which led to a fall in productivity and wages in origin countries.

3. Future UK-EU Relationship

The impact of Britain´s exit on trade and free movement of good depends on the future relationship between the EU and the UK. There are five possible options for post-Brexit relationships, which are set out into five models below (Irwin, 2015).

Norwegian-style EEA agreement – This model assumes **the optimistic scenario** after Brexit, the UK's trade relationship with the EU are similar to the Norway´s model, where Norway is a member of European Economic Area and European single market. Thanks to that Norway has a non-tariffs trade agreement with the whole EU. Moreover, it can adopt regulations and policies to eliminate non-tariff barriers within the single market. However, Norway is not a member of European customs union, so it does not have common external tariff. According to the Norwegian model, the UK joins the European Economic Area and maintains full access to the single market with free trade. However, the U.K. have to accept the EU standards, policies and regulations. Furthermore, the UK still substantially contributes to the EU budget, and it will not have full control on imposing immigration restrictions. This model is not likely to be adopted since it does not solve the UK political problem with the EU.

Turkish-style customs union – This model is an alternative to EEA membership. However, unlike the EEA agreement, the customs union requires its member states to agree on common tariffs with countries outside the union. Turkish-style custom union assumes nearly no tariff barriers on trade in goods, no contribution to the EU budget and freedom to impose immigration controls. However, this does not guarantee the full access to single market and freedom to carry out some trade contracts independently. This model is not a good compromise for the UK since it has to implement EU external tariffs with no control and access to third markets.

FTA-based approach – In case of leaving the EU, the UK can negotiate a free trade agreement (FTA). As a result, the tariffs levied on British goods would be close to zero, given the importance of the UK economy for the EU. Regarding disadvantage, the FTA would not enable the Britain set its regulations and external policy, since any EU´s FTA agreement resist in some issues such as labour market, safety, health and competition rules (Springford et al., 2016). This model assumes no tariff barriers on trade in goods, freedom to pursue FTAs trade deals independently, no contribution to the EU budget, freedom to impose immigration controls. The model of FTA predicts lower trade costs, lower trade barriers, lower prices for consuming goods which lead to social welfare gains. Currently, the EU is negotiating a major new FTA agreement „Transatlantic Trade and Investment Partnership“(TTIP) with the United States. Moreover, the EU would like to deepen cooperation with Japan through „economic partnership agreement“(EPA). The Brexit would unable the UK to be benefited from the newly negotiated free trade agreements (Dhingra et al., 2015).

Swiss-style bilateral agreement - Switzerland's relationship with the EU is regulated by the free trade agreement of 1972 and some sectoral bilateral agreements. Switzerland has two bilateral agreements, which guarantee free movement of persons, technical barriers to trade, agriculture, land transport, air transport, research, government procurement, Schengen no passport control, interest taxation, antifraud policies, processed agricultural products, the environment, statistics, film promotion, pensions. Both bilateral agreements aimed to ensure liberalization, opening market and further economic cooperation. Switzerland's relations with the EU is problematic due to migration issues. The relationship was suffered after the Swiss referendum held in February 2014, where Switzerland voted in favored of no free movement of persons. This raised a question, of the EU would like to have another similar relationship with the U.K. The UK and the EU agree on a set of bilateral agreements which the UK access to the single market, no tariff barriers on trade in goods and freedom to pursue trade deals independently. In conclusion, this model is not likely to be accepted by the EU (Busch and Matthes, 2016).

Most-Favoured-Nation-based approach – This approach predicts **the pessimistic scenario** that the UK will not succeed in negotiating a new trade agreement with the EU. Therefore the trade between the EU and the U.K will be on principles of World Trade Organisation. This results in higher trade costs and increases in non-tariff barriers (Dhingra et al., 2016). There are three main reasons why trade costs may increase after Brexit. Firstly, because of higher tariff barriers between the UK and the EU. Secondly, since there are higher non-tariff barriers arising from different regulations and border controls between the UK and the EU. Lastly, increase in trade cost could arise from non-participation in future deeper EU integration and eventually abolition of non-tariff barriers within the EU members (Dhingra et al., 2015).

Overall, Norwegian-style, Turkish- style approach and MFN-based approach are not in harmony with the British policy, since these approaches do not guarantee control over the immigration regulations, access to third countries, etc. Whereas the FTA-style approach and Swiss bilateral agreements are possible for the UK, but all depends on the deals. Formally, the whole Brexit´s process is expected to end in 2019. However, the UK has to pursue new free trade agreements and bilateral accords, therefore this process can be prolonged to 2025.

Table 2: Characteristics of five possibilities of UK-EU relationship

	Norwegian-style EEA agreement	Turkish- style custom union	FTA- based approach	Swiss-style bilateral agreement	MFN-based approach
No tariff barriers	Yes	Yes	Yes	Yes	No
Full access to the single market	Yes	No	No	No	No
Influence of EU regulations	Yes	?	No	Yes (partly)	?
Freedom to impose immigration controls	No	Yes	Yes	?	Yes
Freedom to pursue trade deals independently	No	No	Yes	Yes	Yes
Contribution to EU budget	Yes	No	No	Yes (lower)	No

Source: Irwin, 2015

The economist Thomas Sampson (2016) tried to solve the UK´s dilemma of choosing a strategy of negotiation with non-EU countries. According to Thomas Sampson, there are four negotiating principles that could be held to reap the gains from international coordination. These four principles are below (Sampson, 2016).

1. **You get what you give**: This principle suggests that the more countries are willing to give up on their policy control, the greater are potential gains from reaching an agreement.
2. **Where negotiations start from matters**: According to Thomas Simpson any trade deal have a reference point, and the countries will make concessions starting from this reference point. In the UK case, there are two possible reference points. First, suppose that the reference point is the current status quo between the UK and the EU. Second, suppose that the reference point is based on the WTO rules.
3. **Bargain from a position of power**: This strategy suggests that the greater bargaining power, the better outcomes from reaching an agreement. The post-Brexit UK will start from a weaker position since it needs to conduct a lot of new deals, this leaves the UK at a disadvantage. Furthermore, another disadvantage lays in the two-year time limit defining in Article 50. The author suggests two steps that can increase the UK´s bargaining power. First, delaying the triggering Article 50 until the government has decided its post-Brexit objectives and EU leaders are ready to start negotiations. Second, negotiating a transitional deal to cover the period between exiting the EU.
4. **Invest in negotiating capacity**: The principles suggest that the more information the negotiators have, the better outcomes they will get. By current days, the UK has the very little negotiating capacity, since it has not conduct trade negotiations for the past four decades. To compensate this lack of knowledge, the UK is suggested to invest in trade lawyers, diplomatic intelligence, business intelligence and trade economists.

4. Consequences of Brexit on Free Movement of the Single Market

Free Movement of Goods

The principle of the free movement of goods is established in the Treaty of Rome from 1957. After a decade, in 1968 The EC Customs Union enters into force. Later on, the principle of mutual recognition. This principle means that goods that are legally sold in one EU member state also to be marketed in any other member state without further testing or adaptation to national rules. The Single European Act (SEA) enters into force in 1987. The Maastricht Treaty established the single market and all trade barriers are were abolished within the EU area through harmonisation of product standards. In 1994, the European economic area agreement came into force. As a result, the single market was expanded to several non-EU countries (The Kommers, 2017).

In the area of free movement of goods and services, the consequences of Brexit depends purely on the further conditions of negotiation with the EU. Since trade is a key element for both partners, they will both try to negotiate the best favorable trading condition. In the context of trade, exports and imports are divided into two components: goods and services. Goods and services are regulated by different world trade regulations. Trade in goods is primarily regulated by the General Agreement on Tariffs and Trade (GATT) within the WTO, while trade in services is regulated by the General Agreement on Trade in Services (GATS) (House of Lords, 2016). Undoubtedly, over 50 years the UK trade has rapidly increased thanks to the membership of the GB in a Single market, which ensure four freedoms of movement to its participants, since there are three tools to boost trade: elimination of tariffs on goods, establishing the right of companies and people to sell their goods, services, labour and capital in any EU member-states – well-known so called „four freedoms", creation of minimum common regulatory standards for all member-states (Springford et al., 2016). What are the consequences of Brexit on UK-EU trade? In other words, which benefits the UK will lose in case of leaving the Single Market.

EU membership reduced radically tariffs and trade barriers between the UK and EU countries, which led to increased trade in goods and services. The UK exports were only 30% to the EU in 1973. By recent years, over 50% of UK exports went to EU countries. The UK's trade with the EU is accounted mainly by trade in goods. Especially, in 2015 it was accounted for around 60% of all UK exports to the EU, and almost 77% of total UK imports from the EU. Moreover, more than 50% of UK´s exports and imports come from or go to seven EU member states namely Germany, Netherlands, France, Ireland, Belgium, Italy and Spain. Altogether, the EU is the largest UK´s trading partner. In 2015, 47% if UK´s exports went to the EU area and 54% of UK´s imports went from these EU member states. All in all, both EU and the UK are beneficial from trading and to some extent they are dependent on each other. However, The UK is more dependent on the EU than EU does, since approximately 13 % of UK GDP is linked to exports to the EU whereas only approximately 3% of GDP of EU member states is in relation with exports to the UK (The Kommerse, 2017).

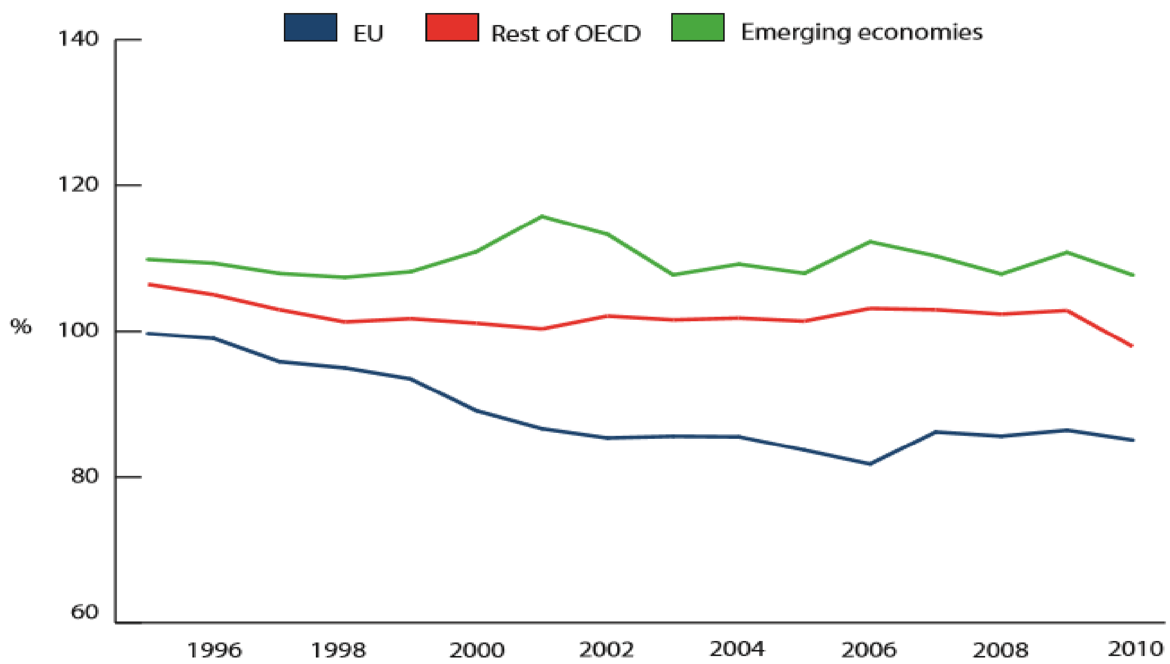
According to **Swati Dhingra et al. (2016)**, the post-Brexit increases in trade costs between the UK and the EU can be divided into three parts:

- a higher setting of tariffs on imported goods from the EU
- a higher setting of non-tariff trade barriers arising from different regulations, standards, border controls, etc.
- Missing the next trade trains since the UK does not participate in the future process of EU deeper integration and the reduction of non-tariff barriers within the EU.

Regarding trade costs, the World Bank carried out and analysis of costs of trading between the UK, the EU countries, the rest of OECD countries and eight emerging countries including China, India, South Africa, Russia, Nigeria, Brazil, Malaysia and Indonesia with which the UK trade. According to this analysis, the UK´s trade with OECD countries is more costly than with EU countries. The reason behind this stems from the fact of existing many trade barriers. Trade barriers with OECD countries are equivalent to 98 per cent of the value of the goods traded in comparison with the 85 per cent of EU´s value of traded goods.

Additionally, based on Méjean and Schwellnus foundings, trade costs among EU member states have been decreasing approximately 40% faster than costs of trade among other OECD countries (Méjean and Schwellnus, 2009).

Figure 2: Trade costs between Britain and the EU, OECD countries and emerging countries from 1996 - 2014

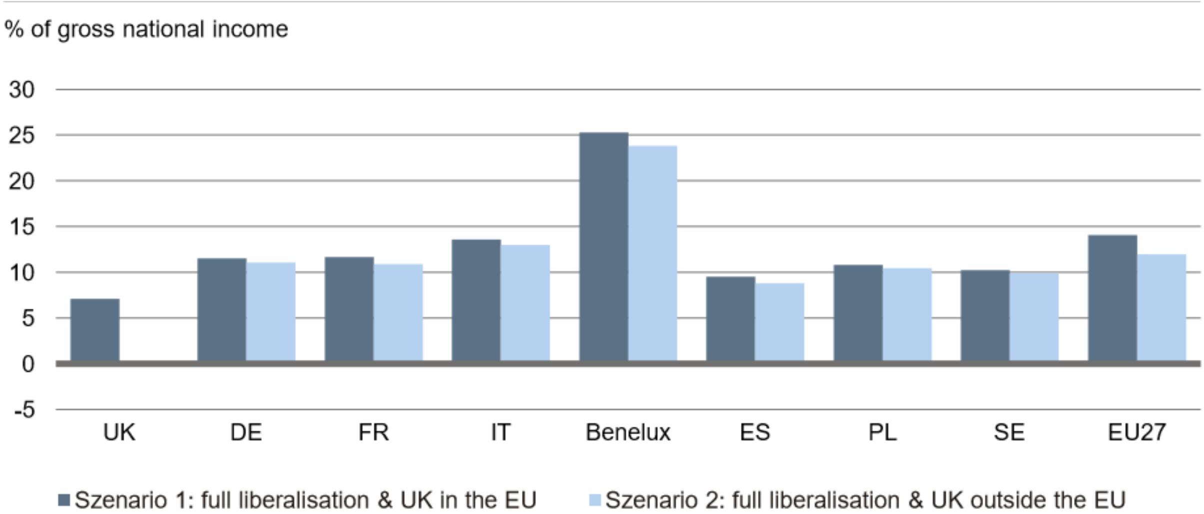


Source: Springford et al., 2016. CER analysis of World Bank ESCAP database.

EU membership guarantees for its members preferential trading access to 55 markets outside the EU. The EU is currently negotiating new trade agreements with non-EU countries. It succeeded in concluding agreements with South Korea, Peru, Colombia and the Central America. Furthermore, it was successful in starting trading with the Singapore, Canada, Japan, Malaysia, Vietnam, Thailand, India, and MERCOSUR countries. Thanks to these new trading accords, the EU is expected to record the economic growth and increase of EU employment. If the Britain left the EU, Britain would lose not only its free access to the internal market but also the value-added generated by new agreements between the EU and third countries. These lose could result in the economic upturn, lower productivity, increase in tariff, job cuts and lower welfare.

In 2011, in the economic paper of BIS, the Department for Business Innovation and Skills had researched with two scenarios. The scenario 1 illustrates the situation when all tariff and non-tariff trade barriers that still exist in the Single Market would be eliminated. This situation might be interesting since it can show us the maximum potential that can still be reached by having Single Market without any trading barriers. The scenario 2 illustrates a complete liberalisation in the whole EU but excluding the UK. This scenario resulted in the additional growth of the UK of approximately 7% of GDP in case of a complete Single Market liberalisation, whereas the Britain outside the EU and with no access to a Single market would suffer from the stagnation of approximately 0.3 % (Vetter et al., 2013).

Figure 3: Potential additional growth of EU countries in case of removing all trade barriers in the Single Market



Source: Vetter et al., 2013

On January 17th, the new Prime Minister Theresa May made her speech of the UK leaving the European Union. Theresa May declared that *„both sides in the referendum campaign made it clear that a vote to leave the EU would be a vote to leave the Single Market. So we do not seek membership of the Single Market. Instead, we seek the greatest possible access to it through a new, comprehensive, bold and ambitious Free Trade Agreement."* She claimed that the Great Britain would maintain the trade interest in the Europe. The UK will surely negotiate tariff-free trade and eliminate non-tariff trade barriers within the Europe. In the effort to become a Global Britain, it will try to pursue new Free Trade Agreement with non-EU countries and old allies including the United States, China, Brazil, and the Gulf States, Australia, New Zealand and India (The Telegraph, 2017).

The benefit being a member of EU lies in the existing 55 free trade agreements and a complex system of trade preferences. The Brexit supporters would argue that the UK can get benefit from conducting new deals on its own rule without EU intervention and the UK can finally become an independent player in the international field. However, these benefits mean also increase in the cost of negotiating new agreements and decline in UK´s bargaining power. Outside of the EU, The UK might have to face difficulties in negotiating new trade deals with non-European countries from scratch. Some non-European countries would probably be willing to conduct FTAs agreement with the Britain, but some countries would not (Springford et al., 2016).

Post-Brexit outcomes which reduce trade or increase the cost of trade between the UK and the rest of Europe. This result will be damaging for both sides. However, more severe for the UK´s economy, since it more dependent on it exports to the EU member states. Swati Dhingra et al. (2016) estimated the effects of Brexit on trade and the UK's contribution to the EU budget. As a result, Brexit will cause a fall in income of between 1.3% and 2.6% in the short term for the UK. In the long run, the impact of Brexit on productivity would be equivalent to the decline in income increases to between 6.3% and 9.5%.

Free Movement of Services

The principle of the free movement of services was established in the Treaty of Rome in 1957. In 1974, the principle of non-discrimination of a citizen of a member state was approved. This means that any citizen can set up a business in another member state and provide a service within the Community. These principles are known as Reyners and Binsbergen rulings. The principle of mutual recognition of higher-education professional qualifications was adopted in 1989 to give the citizen the possibility to provide services in other EU member states. Additionally, the principle of country of origin was added to enable the service provider providing services anywhere in the single market area when he/she met the regulation of his/her country. (The Kommers, 2017).

The free movement of services consists of two types of freedom. First, the right to freely provide services across borders. Second, the right to establish a business in another member state. Once a company is established in one EU member state, it can sell services into other EU countries, without needing to establish a branch or subsidiary there. This is well-known as „passporting"(The Kommers, 2017). In 2012, the Market Observatory (SMO) found 16 new obstacles in freedom of services, which is equal to 19% of the total obstacles splitting by sectors. New obstacles occur in number portability for consumers, high roaming/Internet surfing fees, financial services, consumer credit.

British exit will bring a great uncertainty to the trade in services. Different from the characteristic of goods, services are intangible products, therefore trade in services and cross-border establishment pose specific problems in the field of international regulations. Moreover, in recent years, trade in services has recorded faster growth than trade in goods. In comparison with trade in goods, trade in services is affected more by non-tariff barriers regarding regulations of the provision of services in different EU member states (ICAEW and Europarl, 2017).

Trade of services and cross-border establishment could be problematic following Brexit since the character of trade in services makes its trade accords challenging. According to the paper published by the European parliament (2017) trade agreement has to respond to specific regulatory problems and specific barriers to trade have to be identified in order to have the effective trade in services and establishment. There are three barriers stem from the character of trade in services. First, barriers may stem from mere differences between legal regulations. Second, barriers to trade in services usually address to the service supplier, which leads to the disability of meeting the domestic requirement. Third, trade in services usually requires the establishment of a branch at a certain place. This is the heart of the debate about immigration (Europarl, 2017).

The EU is the biggest market for British services. The UK´s service exports to the EU accounted for more than 117 million euros in 2016. In total, the service exports to the EU and rest of the world was approximately 418 million euros. Roughly 28% of all UK´s service export go to the EU member states. In 2016, three major type of services are commercial, other business and financial.

Table 3: The UK service exports and balance to the EU in 2016, million euros

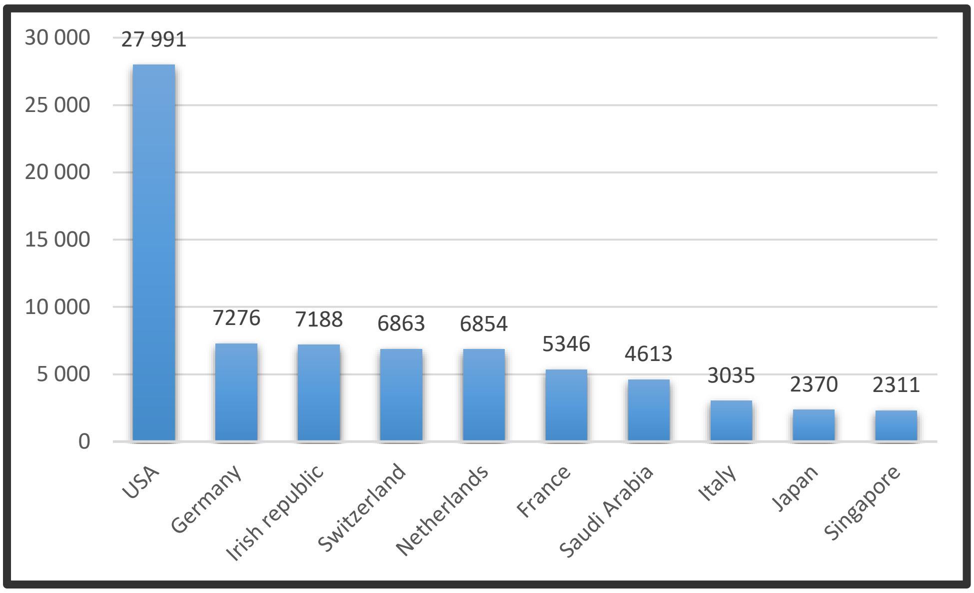
Type of service	**Service export**	**Service balance**
Commercial services	116 987.6	30 509.5
Other business services	31 615.0	10 852.6
Financial services	30 373.9	25 370.8
Travel	15 182.7	-18 179.7
Transport	14 535.7	-383.6
Telecommunications, computer, and information services	10 333.2	2 968.2
Insurance and pension services	5 159.6	5 158.3
Charges for the use of intellectual property	5 164.4	2 425.2
Manufacturing services on physical inputs owned by others	1 783.2	1 223.4
Personal, cultural, and recreational services	1 145.9	617.4
Maintenance and repair services	1 040.8	601.9
Government goods and services	704.9	-929.3
Construction	653.4	- 145.8
Total services	117 692.5	29,580.2

Source: Eurostat, database [bop_c6_q], 2017

In terms of financial services, the Prime Minister Theresa May declared in her speech on January 17th 2017 „That Agreement may take in elements of current Single Market arrangements in certain areas – on the export of cars and lorries for example, or the freedom to provide financial services across national borders – as it makes no sense to start again from scratch when Britain and the remaining Member States have adhered to the same rules for so many years." Her position in the matter of freedom provides across-border financial services is completely clear (The Telegraph, 2017).

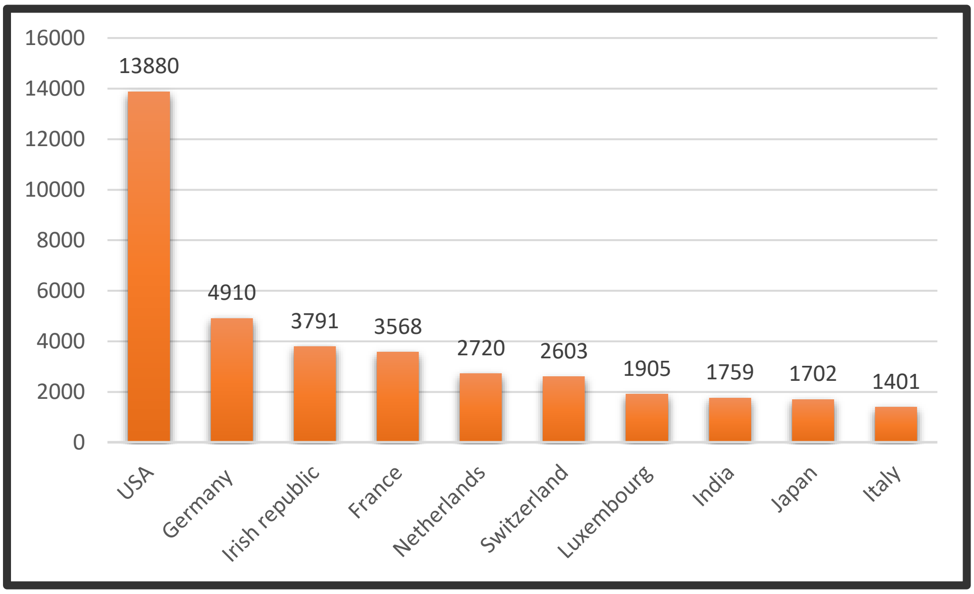
According to the Global Counsel (2015), the exit of the United Kingdom may impact on the location, liquidity, and cost of financial services in Europe if London´s position of financial center is negatively affected. This would lead to higher costs for all businesses, banks, households across Europe. Since London is not only a European financial center, but also it has a great international importance. Brexit can put London´s international position in danger, because much European business, European banks will relocate to other member states (Irwin, 2015).

Figure 4: Top 10 UK service export destinations in 2015, million euros



Source: Office for National Statistics, Pink book 2016

Figure 5: Top 10 nations for UK imports in 2015, million euros



Source: Office for National Statistics, Pink book 2016

In case of Brexit, UK service providers could find it more difficult to sell their services to EU countries. Moreover, there would be the increase of costs of doing business in the EU because of the existence of non-tariff barriers. According to Busch and Matthes, 2016, the British service sector and the financial services sector would be likely to suffer more from a Brexit in comparison with the manufacturing sector, since GATS rules on services are less liberal than WTO rules on goods. The concrete consequences depend on the negotiated relationship between the UK and the EU (Busch and Matthes, 2016).

Free Movement of People

Along with the free movement of goods, services, and capital, the free movement of people is one of the elemental brick of Single market from the very inception. The principle of the free movement of persons was established in the Treaty of Rome in 1957. In 1968, restrictions on the movement of workers and their families were abolished. Additionally, in 1985, the Schengen agreement was signed by five countries including Germany, France, Belgium, Netherlands, and Luxembourg. They agreed on the elimination of border controls. In 1990, free movement of economically non-active persons was established. For example, self-sufficient, students and retirees can move freely across the EU.

The Maastricht Treaty formally introduced „EU citizenship" in 1993, which guarantees EU citizens the right to reside anywhere in the EU area. Anyone having the nationality of an EU Member State has also become a citizen of the EU. Furthermore, in 2004, the free movement of persons was extended to the right of free movement for EU citizens (The Kommers, 2017). According to Articles 18–25 TFEU and Directive 2004, the EU citizens have the following rights (European Parliament, 2017).

- *To reside in any Member State for up to three months if they have a valid identity card or passport*
- *To reside for more than three months in any Member State if working, self-employed, studying or having sufficient resources and comprehensive sickness insurance*
- *To acquire permanent residency in another Member State after living there continuously for five years*
- *To have their family members accompany them in another Member State, subject to certain conditions*
- *Not to be deterred from going anywhere in the EU*
- *Not to be discriminated against in another Member State on the basis of nationality.*

The immigration became a controversial issue since 2004 because migration from the EU8 countries was much larger than the UK had expected. The EU8 countries are a group of eight of the ten countries that joined the European Union during its 2004 enlargement. The countries were: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia. The reason behind this stems from the fact that income disparities in the UK in comparison with these countries were too large, which made the UK an attractive destination for EU8 immigrants. EU8 immigrants worked at minimum wages, but still better than at their home. The EU rules enabled them to have the same access to benefits public services as Britons. Overall, this led to a misunderstanding of immigration of Britons, that immigrants took British jobs (CER, 2016).

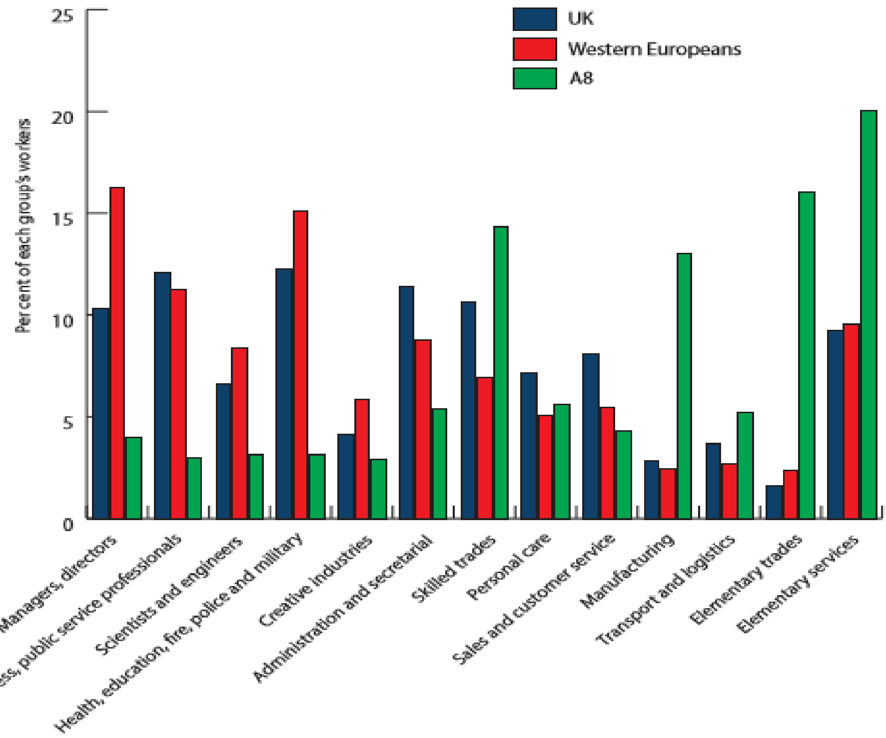
Immigration was supposed to be the reason behind the British exit vote. It was a radical vote to take back the control over British immigration policy since Britons were against free movement of workers in the EU. The general understanding of immigration says that an increase of immigration rates raises output in the economy since more people will be working in Britain. However, when immigration decreases wages or increases the unemployment rate, the average British worker could be worse off, even though the country´s GDP is higher overall. The UK is indifferent in making the decision of their priorities, whether having a good economic result or caring for individuals, whose welfare worse off because of immigration. Even though that the UK has never agreed on the Schengen agreement, which means that it has never given up border controls for EU citizens. However, the UK is a member of the Single market, which means that the freedoms of movement of goods, capitals and services and people do apply. This enables EU citizen entering the UK and searching for work.

Another theory according to the report written by the UK's Office for Budget Responsibility (OBR) claims that the net migration has a positive impact on the British economy. Their calculations concluded that, the high migration variant would increase the UK's budget surplus by about £4.5bn by 2019-20, whereas the low migration variant would reduce it by the same amount. That means the "high migration" would increase 0.8% to economic growth. The "low migration" would decrease economic output by 0.8%. Furthermore, they found that EU migrants contributed more to the UK´s budget by taxes than they have received in the form of benefits and public services (European movement, 2016). According to the Centre European Reform, migration from EU8 countries did not reduce the wages in the UK. Moreover, high-skilled immigration from Western Europe is likely to slightly increase Britons' productivity and wages. However, these effects on Britons´ incomes are small. Many studies on migration issue provided by Lemos and Portes, Gilpin, et al., Portes and French found immigration overall had only small effects on native employment and average wages. However, their studies did find an evidence of the small increase in wage inequality (CER, 2014).

Regarding migration, we have to distinguish, whether EU immigrants are complementary or substitution to British workers. In case if immigrants are on average complementary, it makes economic sense to let them in, as it will raise the productivity, and thus the average income of the host population. On the second hand, immigrants are competing, it reduces wages and increases unemployment. However, competition and specialisation happen simultaneously. Both effects are in considering.

Figure 6 below shows the proportion of Britons, western Europeans ad EU8 Europeans in different works. Group western Europeans are referred to the old EU15 and countries of EEA such as Norway, Liechtenstein, and Iceland. Group EU8 are referred to Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia. Skill qualification is shown on the horizontal axis, where higher-skilled and better-paid jobs are on the left, and the lower-skilled jobs on the right. Western Europeans tend to be employed in higher-skilled works such as managers, professionals, scientists and creative industries. In these industries, western Europeans occupy the largest share of employment, which means that high-skilled immigrants are rather complementary since they bring with them the knowledge that increases the British productivity. On the contrary, the biggest share of skilled trades, low-skilled manufacturing, construction and services jobs are mainly occupied by EU8 nationals (CER, 2014).

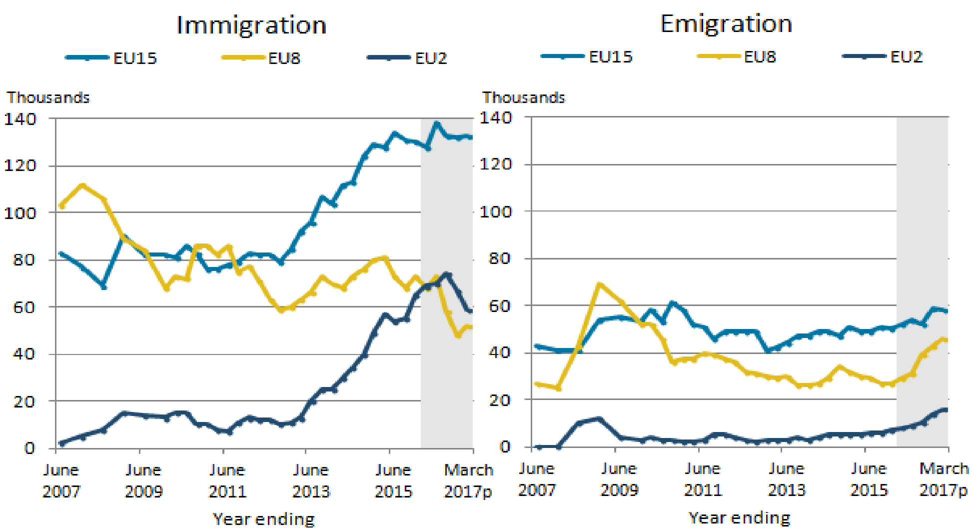
Figure 6: Proportion of the UK´s immigrants



Source: Centre for European Reform, 2014.

Figure 7 shows the trend of UK´s immigration and emigration from EU15, EU8, and EU2 countries. EU2 comprises Bulgaria and Romania. Immigration rate from EU15 and EU2 tend to grow over time by 2017, whereas the number of EU8 immigrants to the UK decreases. By contrast, emigration stays stable over time.

Figure 7: EU immigration to and emigration from the UK by citizenship from June 2007 to March 2017



Source: Office of National Statistics, Migration Statistics Quarterly Report: August 2017

The impact of Brexit will depend on the post-Brexit migration policy and also the further type of cooperation between the UK and the EU. Both will influence Britons living

anywhere in the EU and the migrants living in the UK. If Britain wants to maintain the full access to the Single market, it will have to sign up to free migration and make a contribution to development funds (Baldwin, 2016).There are two possibilities of having full access to the Single market. First, maintaining membership of the European Economic Area like in case of Norway, when the contribution to EU budget is reduced by 9 % compared to current one. Second, negotiating a set of bilateral agreements like in case of Switzerland and paying 45% of current contribution to the EU budget (Springford, 2016). These two options would maintain the inflow of labor that employers demand. Moreover, it provides workers to fill newly created work. Higher-skilled workers will bring technical expertise and knowledge which lead to higher productivity (CER, 2014).
According to the Centre for European Reform (2014), as a consequence of Brexit, the government would redirect EU immigrants through Britain's current system of immigration for non-EEA migrants. This system evaluates the non-EEA migrants by their qualifications, skills, and capital into tree tiers. Tier 1 allows the access of high-skilled immigrants if they met all conditions. The quota for Tier 1 is 500 people a year. For example, entrepreneurs must hold £200,000 in a bank account, investors must show they can invest £1 million or more in the UK and scientists, engineers or artists have to have excellent qualifications and have a successful career. If the UK left and not increase the quota, it would receive less high-skilled immigrants. Tier 2 allows skilled migrants with university degrees enter to the UK. They have to earn more than £20,000, and the employer must have advertised the job to UK residents and found no one suitable. The quota for Tier 2 is around 30000 people a year. Upon exit, if the UK did not increase the quota, Britain would have fewer skilled immigrants than it currently receives do. Currently, Tier 3 is closed, since low- skilled immigration is not desirable for the UK. However, it could be opened after leaving the EU.

In the Theresa May´s speech from January 17th, 2017, the Prime Minister wants three things regarding migration: control of immigration, protection of rights for EU nationals in Britain, and British nationals in the EU and protection of worker´s rights. First, control of immigration lies in better monitoring and managing British immigration system. The Britain will continue to attract international students and especially high-skilled immigrants. Second, May wants to guarantee the rights of EU nationals in Britain, and Britons living in Europe, as soon as possible. Third, the Government will protect the rights of workers' set out in European legislation and the UK will build on them

Free Movement of Capital

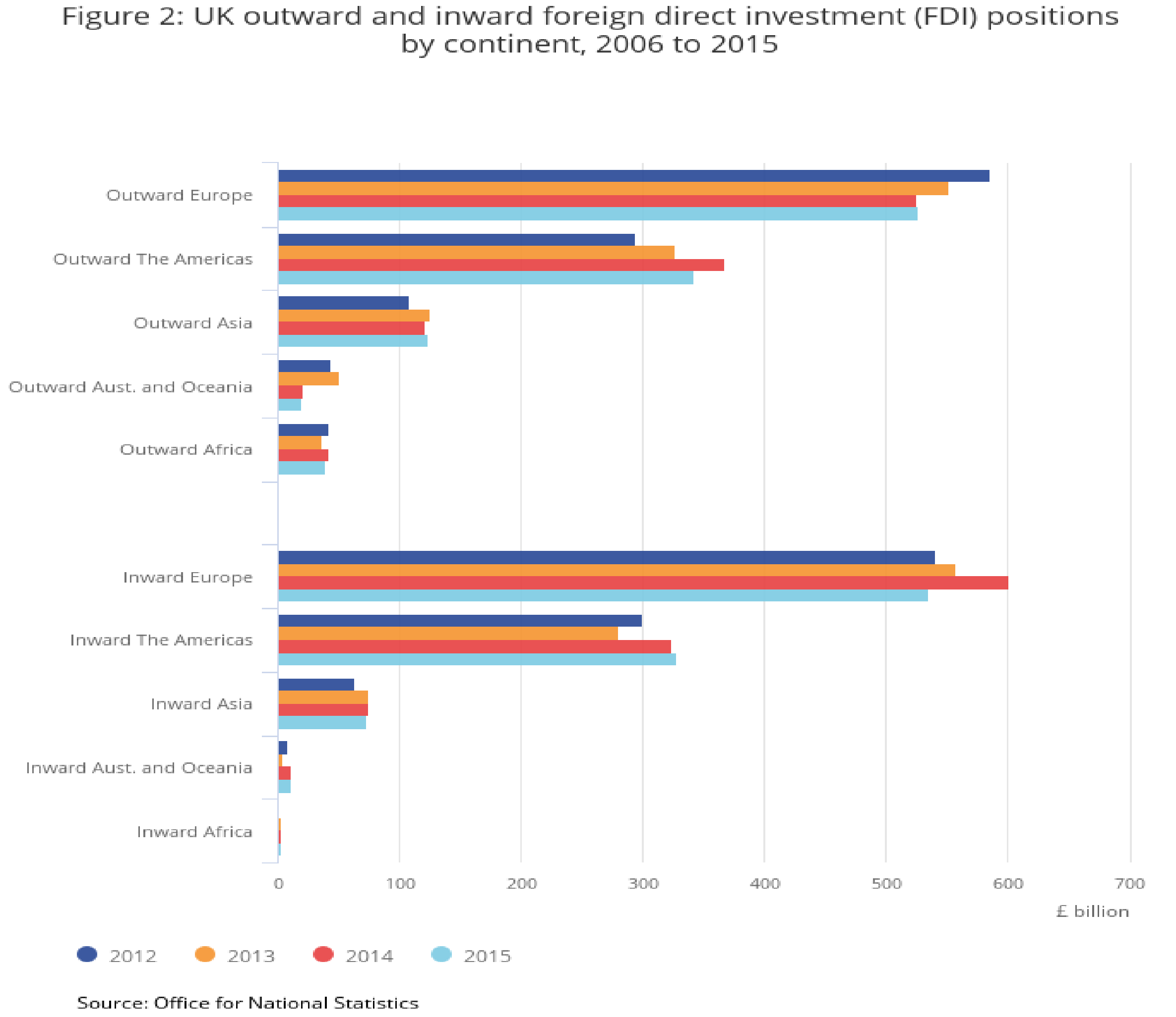
Alongside with free movement of goods, service, and people, the principle of the free movement of capital was also established in the Treaty of Rome in 1957. In the beginning, the free movement of capital was viewed as supportive to the other freedoms. In 1986, The Single European act abolished restrictions on the movement of capital (The Kommers, 2017). The proportion of FDI accumulated in EU countries has risen to around 50 per cent since 1997. Currently, the UK enjoys the position a one the largest FDI destination from EU countries and USA. It has been successful at attracting foreign investment, since the UK met all qualification of FDI attractiveness, including infrastructure and access to raw materials, communication and transport links, skills and wage costs of labor and openness of the market. Therefore, the UK is the biggest recipient of FDI in the EU. However, foreign capital is also more mobile than domestic capital.

According to studies of National Board of Trade, they found a positive effect of FDI on the Single market. The free movement of capital attracts more investment in Europe. According to National Board of trade any country has announced that it will join the EU and the Single market, their inflow of FDI has experienced a huge boom. Furthermore, as a result of another study, membership of the Single market is the main driver for FDI activities growth in Europe. Additionally, eastern EU countries are more attractive than eastern non-EU countries, since they have joined the single market with all free movement (CER, 2014).

Figure 8 illustrates the UK international position continues to be dominant in European and American countries. In 2015, outward FDI in Europe and the Americas accounted for 50.1% and 32.6% of total UK´s outward FDI. In 2015, two countries the Netherlands and Luxembourg maintained the UK´s largest FDI destination, accounting for £126.4 billion and £92.8 billion. However, outward FDI within the Americas has experienced a small decline of £24.7 billion. In spite of decrease, the USA remained the largest destination for UK international investment positions within the American countries in 2015, accounting for £237.3 billion.

In case of inward FDI, Europe, and the Americas also remained the dominant sources for the UK´s international investment positions. In 2015, inward FDI accounted for 56.3% and 34.5% of total inward FDI. FDI from European countries experienced a decline by £65.6 billion since the largest decline was from the Netherlands. By contrast, the inward FDI position from the Americas experienced an increase, accounting for £3.9 billion. The USA continued to hold a position of the largest FDI sources for the UK (ONS, 2017). Inward FDI flows in the UK in the EU comes mainly from few western European countries, including France, Germany, Spain, Ireland, Netherlands and Luxembourg (Irwin, 2015).

Figure 8: UK outward and inward foreign direct investment (FDI) positions by continent, 2006 to 2015

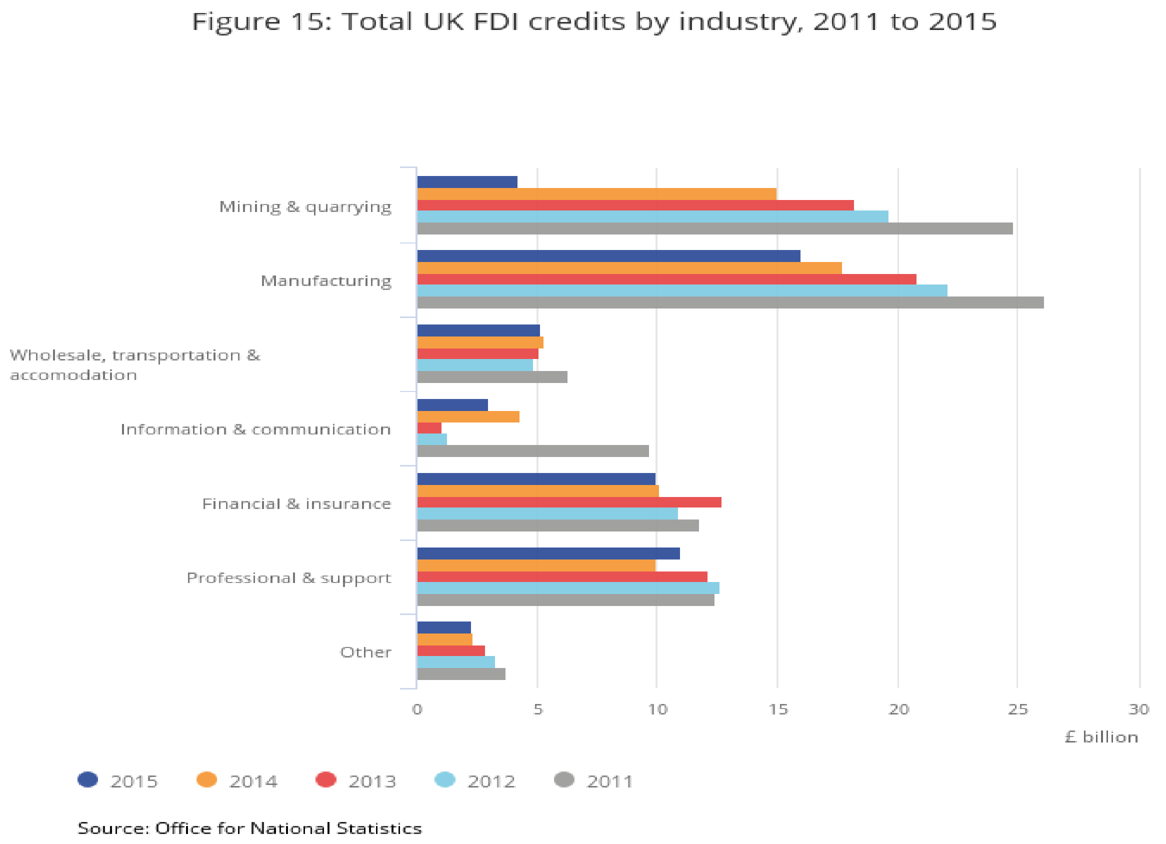


Source: Office for National Statistics, Foreign direct investment involving UK companies: 2015

Figure 9 represents the situation when foreign direct investment is divided by industrial group. For example, mining and quarrying, manufacturing, wholesale, transportation and accommodation, information and communication, financial and insurance, professional support and other.

In 2015, the UK´s FDI credits experienced a decline across all industries. This is notable in mining and quarrying, manufacturing, and information and communication industries, where credits fell by £20.6 billion, £10.1 billion and £6.7 billion. FDI in the manufacturing industry is the most sensible since manufacturing capacity is relatively easier to relocate. This fact lies in its capital demanding. Manufacturing is more capital intensive than other sectors (CER, 2014).

Figure 9: Total UK FDI credits by industry, 2011 to 2015



Source: Office for National Statistics, A review of UK foreign direct investment statistics: winter 2017

As a consequence of Brexit, the FDI will fall. There are three reasons. First, the UK could not enjoy a membership of the Single market, which brings benefits to the UK in the form of small trade costs and being attractive for multinationals. Second, if the UK left the EU, co-ordination and transfer costs within headquarters and local branches in a supply chain of multinationals increase. Third, FDI will be affected by the uncertainty of future trade agreement between the UK and the EU (Swati Dhingra et al., 2016). Overall, according to the finding of CER, Brexit is supposed to have a negative impact on inward FDI. Their empirical analysis showed that Brexit would reduce FDI inflows to the UK by around 22%. This leads to decrease of productivity and real incomes by 3.4%.

According to World Bank Group Trade & Competitiveness Global Practice (2016), Brexit will affect investments slightly differently in short and long term. In the short term, British exit will cause a negative effect on inward FDI into the UK. Based on findings of survey prepared by Ernst and Young (EY) in 2015, 72 percent of investors in the UK sees access to the European single market as a reason, why their investment go to the UK. The outflow of efficiency-seeking FDI could be because of pound devaluation. Upon referendum, the pound devaluated to its lowest level since the mid-eighties. Currently, the UK gain a significant importance for investment flows from developing and emerging countries. As a consequence of Brexit, these investments may also tend to relocate because of the uncertainty of the market. Inward FDI going to service sector is very vulnerable, therefore Brexit might have a great impact on them, especially financial services. This fact can put London at risk. Currently, London accounted for nearly 50 percent of share in global perspective. World Bank Group Trade & Competitiveness Global Practice claims that Oher European financial centers including Frankfurt and Paris or Some financial centers in emerging economies such as Dubai, Singapore, and Hong Kong could benefit from this. Another consequence of Brexit lies in the trade negotiation. Brexit compels the UK to re-negotiate or negotiate new trade deals on the movement of capital and investment issues. Presently, the Britain has 106 existing Bilateral Investment Treaties (BITS). The whole process of negotiating is very time consuming (Patterns, 2016).

In the long run, it can lead to the disruption of UK´s FDI flows. This situation will happen if Scotland holds the referendum on its independence, the UK would lose the oil and gas reserves from the Scotland. According to the statistics, 90 percent of the UK´s natural reserves are in Scotland. This lead to a huge decrease in natural-resource and market seeking FDI in the long term. According to the report from World Bank Group Trade & Competitiveness Global Practice (2016), in the long term, there might be the impact on outward FDI and global FDI as well. Outward UK investments in other EU countries will face the uncertainty since these FDI are not bound by EU policies and regulations. Moreover, in spite of the fact that global FDI is resistant, hard Brexit can negatively influence flows of FDI because of investor´s insecurity (Patterns, 2016).

According to Centre for European Performance, if the UK let the EU but still being a member of the EEA, the impact on foreign investment into the UK might be less severe, especially the impact on investment in manufacturing might not be that serious. By contrast, the impact on services would be more severe because of its vulnerability. The vulnerability occurs in international services, because it employs a large number of highly skilled people, who are expensive to recruit and difficult to move. Therefore foreign investment would not be able to migrate immediately overnight.
Centre of European Performance claims that FDI in services that serve the domestic market would be less influenced by Brexit. However, FDI in internationally-traded services would be more affected. The UK´s FDI will be at risk of losing its attractiveness. As a result, businesses and financial activities would relocate from the UK to other EU countries. On the other hand, if the UK negotiate agreements with the EU under WTO rules, it would be the worst scenario regarding foreign investment. Since under WTO rules, both manufacturing (especially car industry) and service sector have to face the negative impact under WTO rules. As a consequence of Brexit, British business and investment in Europe will be at risk, because of the high share of UK investments in the EU area. The EU is home to approximately half of the UK's outward FDI (Springford et al., 2016).

Similar to trade negotiation´s difficulties, the negotiation about foreign investment has to face the similar problem. Centre of European Performance sees a risk of struggle to have better access to two biggest emerging economies such as China and India since the UK has small bargaining power (Springford et al., 2016).

Conclusion

As a consequence of Brexit, the trade would be reduced, and costs would increase between the UK and the rest of Europe. Brexit will cause a fall in income of between 1.3% and 2.6% in the short term. In the long run, the impact of Brexit on productivity would be equivalent to the decline in income increases to between 6.3% and 9.5%.

Trade of services and cross-border establishment could be problematic following Brexit since the character of trade in services makes its trade accords challenging. Free movements of services was not fully guaranteed because of existing many obstacles. For example, number portability for consumers, high roaming/Internet surfing fees, financial services, consumer credit. In case of Brexit, UK service providers could find it more difficult to sell their services to EU countries. Moreover, there would be an increase of costs of doing business in the EU because of the existence of non-tariff barriers. The financial services sector would be likely to suffer more from a Brexit in comparison with the manufacturing sector, since GATS rules on services are less liberal than WTO rules on goods. Overall, British exit will bring a great uncertainty to the trade in services, but the concrete consequences depend on the negotiated relationship between the UK and the EU.

The consequences of Brexit on free movement of people, especially on immigration, depend on the post-Brexit migration policy and also the further type of cooperation between the UK and the EU. Both will influence Britons living anywhere in the EU and the migrants living in the UK. The government would redirect EU immigrants through Britain's current immigration system for non-EEA migrants. This system evaluates the non-EEA migrants by their qualifications, skills, and capital into three tiers. The UK will allow the access of high-skilled immigrants (entrepreneurs, investors, scientists, engineers, artists) and immigrants with the university degree. Upon exit, if the UK did not increase the quota, Britain would have fewer skilled immigrants than it currently receives.

As a consequence of Brexit, the FDI will fall in both short and long term. There are three reasons in short run. First, the UK could not enjoy a membership of the Single market, which brings benefits to the UK in the form of small trade costs and being attractive for multinationals. Second, if the UK left the EU, co-ordination and transfer costs within headquarters and local branches in a supply chain of multinationals increase. Third, FDI will be affected by the uncertainty of future trade agreement between the UK and the EU. Overall, according to the finding of CER, Brexit is supposed to have a negative impact on inward FDI. Their empirical analysis showed that Brexit would reduce FDI inflows to the UK by around 22%. This leads to decrease of productivity and real incomes by 3.4%. In the long run, it can lead to the disruption of UK´s FDI flows. This situation will happen if Scotland holds a referendum on its independence, the UK would lose the oil and gas reserves from the Scotland. According to the statistics, 90 percent of the UK´s natural reserves are in Scotland.

As a result of my dissertation, outside of the EU, the UK will have to face difficulties in negotiating new trade deals on movement of goods, services, capital and investment with non-European countries from scratch, because of the decline in UK´s bargaining power. Given the literature review, I have drawn a conclusion that the economic consequences of Brexit on free movements of the Single market will depend on the negotiation of future relationship between the UK and the EU. There are five possibilities of future relationship. Only two of them guarantee the full access to the Single market. First, maintaining membership of the European Economic Area like in case of Norway, when the contribution to the EU budget is reduced by 9 per cent compared to current one. Second, negotiating a set of bilateral agreements like in case of Switzerland and paying 45% of current contribution to the EU budget. These two options would maintain the inflow of labor that employers demand. Moreover, it provides workers to fill newly created work. Higher-skilled workers will bring technical expertise and knowledge which lead to higher productivity. Overall, Norwegian-style, Turkish- style approach and MFN-based approach are not in harmony with the British policy, since these approaches do not guarantee control over the immigration regulations, access to third countries, etc. Whereas the FTA-style approach and Swiss bilateral agreements are possible for the UK, but all depends on the deals. Formally, the whole Brexit´s process is expected to end in 2019. However, the UK has to pursue new free trade agreements and bilateral accords, therefore this process can be prolonged to 2025.

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