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How Brexit is Affecting the United Kingdom's Financial Institutions

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Economic Implications of Brexit: Populism Gone Wrong

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Abstract

"Take Back Control: People's Vote!" was the most prevalent slogan used by the Leave Campaign leading up-to the Brexit Referendum. The attack on the British elites, and immigrants was at the core of the Leave campaign's rhetoric. The surmounting anger that the common British folk felt, being left behind in this globalized and E.U. era, was palpable. The U.K. Independence Party (UKIP) promised the populous that Brexit would bring economic prosperity, prosperity not just to the global elites situated in London, but to common folks all throughout the U.K. The promise was to use the revenues allocated to the E.U. to better and improve conditions here at home: "We send the E.U. £350 a week, let's fund our NHS instead." Are these promises possible? Is Brexit good for the U.K. economy? Short term? Long term? The Leave campaign articulated that Brexit may bring economic disadvantages in the short run, but in the long run, Brexit will prevail and bring economic prosperity to the U.K.. However, in this paper, I will show that this view is incorrect. Brexit will not be able to bring economic prosperity to the U.K. In addition to this, Brexit is more disadvantageous politically. If not careful, U.K. could end in a political quagmire: fighting against the Separatist movement in Scotland, and reigniting the conflict over borders between Northern Ireland and Ireland.

How did we get here? The Leave Campaign and the Brexit Referendum

The role of the U.K. in the E.U. has long been discussed, analyzed and questioned by the British citizens, political thinkers, and politicians alike. Britain, although, a part of the European continent, never could be quite labeled as an "European" state. The U.K. has always had a distinct sense of national identity that differed from the 'European' identity. The differing national identities even within the Kingdom such as Wales, Scotland, and Northern Ireland add to this discourse of a 'non-European' U.K in the E.U.

This longstanding conflict and the question of national identity was settled in 2016 when 51.89 per cent of British citizens voted to leave the E.U., while 48.11 per cent voted to remain.[1] It was a referendum of high voter turnout, of 72.21 percent[2], signaling that the outcome of the referendum holds serious political weight. To consider this, we have to first answer what led to the 2016 referendum outcome. How far did the campaign leading up to the referendum influence the outcome? The overall consensus is that campaign mattered to a significant extent- there was less focus on the Remain campaign and the Leave campaign picked up more media attention, hence, creating an asymmetry of information which affected the outcome. U.K. Independence Party (UKIP)'s strong and coherent message leading up to the referendum greatly influenced the referendum outcome. In contrast to the UKIP's coherent message, weak party cues from Labour and the Conservatives (hence, weaker Remain campaigns) led to the Brexit outcome. However, other factors such as long standing Euroscepticism could help explain the outcome of the

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[1] Clarke, Harold., Matthew Goodwin & Paul Whiteley., Brexit: Why Britain Voted to Leave the European Union (2017).

[2] Clarke, Harold., Matthew Goodwin & Paul Whiteley., Brexit: Why Britain Voted to Leave the European Union (2017).

referendum to a certain extent. The demographic of the Remain and Leave voters also adds to the argument that the outcome of the 2016 referendum was long time coming- the economically marginalised groups were pre-determined to vote in this way. However, the strong campaign by UKIP, weak party cues by Labour and Conservatives as well as an asymmetry of information all added to the outcome of the 2016 referendum.

Media coverage of the EU referendum campaign was dominated by "overwhelmingly negative" reports about the consequences of immigration and its effects on the British economy. King's College London's centre for the study of media, communication and power (CMCP) conducted a study where they looked at more than 15,000 articles published online by 20 national news outlets. They found that immigration and the economy were the most covered issues that were also described as "acrimonious and divisive"[3]. Immigrants and the economy drove the discourse around Brexit.

The political issues that were covered around the time leading up to the referendum were positional issues that were front and center to the Leave campaign. For example: media interest in immigration and the economy more than tripled during the 10-week campaign, rising faster than any other political issue. Immigration alone appeared on 99 front pages, compared with 82 front pages about the economy".[4] Immigration and the economy were closely tied with the Leave campaign and was one of the biggest arguments for leaving, hence, such heavy coverage

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[3]Travis, Alan. "The Leave Campaign Made Three Key Promises – Are They Keeping Them?" The Guardian, Guardian News and Media, 27 June 2016, www.theguardian.com/politics/2016/jun/27/eu-referendum-reality-check-leave-campaign-promises.

[4]Travis, Alan. "The Leave Campaign Made Three Key Promises – Are They Keeping Them?" The Guardian, Guardian News and Media, 27 June 2016, www.theguardian.com/politics/2016/jun/27/eu-referendum-reality-check-leave-campaign-promises.

surrounding the Leave campaign certainly influenced voters leading up to the referendum.[5] Given this climate of heavy coverage around the Leave campaign, the pro-EU campaign was lost in the weeds.

The UKIP party, on the other hand, was successful at staying on message, and conducting a coherent campaign that pushed to Leave. They successfully targeted public concern over immigration and dissatisfaction with established politics, which won them nearly 12% of the vote in the 2015 election. These same issues were again the triggering aspects for the Leave rhetoric. UKIP's populist rhetoric leading up to the referendum struck a chord with the kind of voters that wanted out of the E.U.—the economically marginalized common folks in Britain. These were the voters that felt as though today's world state of heightened globalization has not benefited them. UKIP was successful in understanding that sentiment and capturing that throughout the campaign leading up to the referendum. UKIP consistently put forth an economically populist message and a campaign that was 'for the people'.

Nigel Farage, the leader of UKIP had written in The Express, "We must leave the European Union so that not only can wages increase for British workers but so that living standards and the GDP can start going up rather than declining."[6]

Here, Farage is putting forth a rhetoric that puts the British people first. Even though in this paper, we will see that Frarage's assertions about wages are not necessarily accurate, they were, nonetheless, attractive to the common people. Nigel Farage, the spokesperson of the UKIP

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[5]Travis, Alan. "The Leave Campaign Made Three Key Promises – Are They Keeping Them?" The Guardian, Guardian News and Media, 27 June 2016, www.theguardian.com/politics/2016/jun/27/eu-referendum-reality-check-leave-campaign-promises.

[6]Farage, Nigel. "NIGEL FARAGE: Why We Must Vote LEAVE in the EU Referendum." *Express.co.uk*, Express.co.uk, 21 June 2016, www.express.co.uk/comment/expresscomment/681776/nigel-farage-eu-referendum-brexit-vote-leave-independence-ukip.

party, was very forward about his party's Eurosceptic stances throughout the referendum. UKIP's rhetoric had been gaining momentum since the 2015 election and it only got stronger during the time of the referendum. UKIP's populist message and their Leave campaign certainly hit a chord with many voters that were traditionally dissatisfied with the status quo parties such as the Conservatives and Labour.

On the contrary, many social scientists argue that the 2016 referendum outcome was to some extent predetermined. They argue that Euroscepticism has been long standing amidst U.K. politics, and that the 2016 referendum outcome was a long time coming. Social scientists have argued that socio-economic indicators of voters predetermined the outcome of the 2016 referendum. An individual's socioeconomic location provided valuable information as to their likely predisposition towards Britain's continued membership of the EU. And since their socio-economic location is a predetermination that campaigns cannot influence, the outcome was, therefore, not influenced by any campaigns.

They argue that only London, Northern Ireland, Scotland and the university towns were supporters of the Remain vote, and that would have always been the case. While in the other constituencies, the majority voted in favor of Brexit. I concede with the argument that London and university towns were predetermined to vote to Remain as these are highly urban, educated areas that directly benefit from the kind of globalization that the E.U. promotes. In addition, it can be argued that given the history of the Irish conflict—it also makes sense that the Northern Irish were predetermined to vote to Remain. However, the Leave voters, I argue, were not predetermined to vote to Leave and they did so because of the asymmetry of information.

The university towns would always vote Remain as they have access to accurate economic information. The false economic promises of the Leave campaign is much more influential to voters that are uneducated and have very little understanding of the economy.

And as mentioned above, the Leave campaign was more covered by the general media, hence, the populist, yet false, economic messages influenced the less educated, less sophisticated constituencies within the U.K.

An article suggests, “certain groups might have been especially receptive to pro-EU frames, notably Labour Party supporters, people with lower levels of education, and those undecided about their EU referendum vote pro E.U.”[7] Hence, the Leavers were not pre-determined to vote to Leave, they were influenced by the information circulated at the time of the referendum, which was highly populist, and economically inaccurate. In addition to this, the lack of a strong pro E.U. campaign—these messages did not reach the people it should have reached—heavily influenced the Brexit outcome. Instead, UKIP’s strong media campaign reached these voters and in this way, campaign affected the referendum outcome in 2016.

Lack of coherent cues by the two major parties also confused and misled voters. Lack of coherent party cues confused voters and led to the ‘undesired’ outcome. Bartle et al presents the theory that when an issue is highly salient, each political party typically takes a clear position. When this happens, it is difficult to move partisans away from their partisan-consistent position. Hence, both persuasion and framing effects are expected to be small or non-existent.[8] However,

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[7] Bartle, John. Euroscepticism in Contemporary British Politics: Opposition to Europe in the British Conservative and Labour Parties since 1945 by Anthony Forster. Pg.2

[8] Ibid. pg. 3

when it came to EU membership, both the Conservatives and the Labour lacked consistent, coherent party cues.

Party cues have historically been important in shaping voter opinion in the past in the U.K., yet, in the 2016 Brexit referendum, we were presented with an unusual situation where cues from the two major parties were unclear. Longstanding divisions within the incumbent Conservative Party "were reflected in the fact that while 85 Conservative MPs campaigned for 'Remain', 138 declared support for 'Leave'[9]" While an overwhelming majority of Labour MPs remained supporters, the party leader, Jeremy Corbyn, was lukewarm in his support for E.U., at times, he was even known to be critical of the E.U. The Labour leadership position and the Conservative's leadership position was unclear which brewed even more confusion, and added to asymmetry of information.

Campaign mattered to a significant extent leading up to the outcome of the 2016 referendum. There was less focus on the Remain campaign while the Leave campaign picked up more media attention, hence, creating an asymmetry of information. UKIP's strong and coherent message leading up to the referendum drove the Leave campaign further. In contrast to UKIP's coherent message, weak party cues from Labour and the Conservatives led to a weaker Remain campaign. A strong Remain campaign had the potential of influencing Leave voters but weak party cues prevented that from occurring. To answer the question, "how did we get here?" We can decipher that the strong Leave campaign by UKIP, weak party cues by Labour and Conservatives as well as the long standing disenfranchisement of the general U.K. populous all

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[9] Ibid. Pg.4

led to the outcome of the 2016 referendum. The Leave campaign empowered ordinary people. Finally, they were given a voice, and the London elites were made to listen.

Good Deal, Bad Deal? Analysis of Brexit's Economic Implications using the AS=AD model.

Nigel Farage, the leader of the UKIP party led the Leave campaign with a promise of bringing U.K. paramount economic prosperity. He said, "We must leave the European Union so that not only can wages increase for British workers but so that living standards and the GDP can go up rather than declining."[10] Is he right? Will the GDP increase in the U.K., post-Brexit? Here, I examine how Brexit will affect the British GDP figures in the short run.

Economists make use of a variety of models to explain how national income or GDP will get affected. Of these models, a common one is the aggregate demand - aggregate supply (AD - AS) model. This AS-AD model is derived from the concept of circular flow. Circular flow is a concept in economics that helps explain how national income, output, and expenditure is generated in a given economy.[11] It focuses on the two most vital parts of an economy: its households, and it's firms. Households provide firms with land, human capital, capital, and enterprise. Land owners supply land, household workers provide human capital, and entrepreneurs provide enterprise.[12] Entrepreneurs combine these other factors, and bear the risks

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[10]Farage, Nigel. "NIGEL FARAGE: Why We Must Vote LEAVE in the EU Referendum." *Express.co.uk*, Express.co.uk, 21 June 2016, www.express.co.uk/comment/expresscomment/681776/nigel-farage-eu-referendum-brexit-vote-leave-independence-ukip.

[11] "Aggregate Demand." *Aggregate Demand | Economics Online*, www.economicsonline.co.uk/Managing_the_economy/Aggregate_demand.html.

[12]"The Circular Flow of Income." *Circular Flow of Income - Aggregate Demand | Economics Online*,www.economicsonline.co.uk/Managing_the_economy/The_circular_flow_of_income.html.

associated with production. [13] Now, the function of firms is to supply private goods and services to domestic households and firms, and to households and firms abroad.

The circular flow of income gets its name from the fact that an economy flows from one part to another whenever a transaction takes place. New spending (C) generates new income (Y), which generates further spending (C) which then generates further spending (Y), and so on. Circular flow of income refers to this very circular trend in an economy. The circular flow of income is also useful at explaining how national income, output and expenditure is created over time.[14]

Savings and Investments:

When looking at the income of households and firms, we have to take into account both injections and withdrawals. Households and firms do not spend all of their income, they save part of it. When they choose to save (S) some of their income (Y) instead of spending (C) that income, it reduces the circular flow of income.[15] In conjunction, firms also purchase capital goods, such as machinery from other firms, and this spending is an injection into the circular flow. This process, investment (I), occurs because existing machinery wears out and firms have to invest to make up for the depreciation of machines, or invest in other factors of production to increase their capacity to produce.

The Public Sector:

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[13]Ibid

[14] Ibid

[15] "Aggregate Demand." *Aggregate Demand* | *Economics Online*, www.economicsonline.co.uk/Managing_the_economy/Aggregate_demand.html.

In a mixed economy with a government, the simple model used to analyze the GDP must also take the public sector into account. Especially, in the context of Brexit, where the Leave campaign promised to increase government spending within the U.K. after leaving the E.U., the public sector is an important consideration. On top of saving (S), households and firms also pay taxes (T) to the government (G), and further income is withdrawn out of the circular flow of income.

Government injects income back into the economy by spending (G) in public welfare programs, healthcare, defense etc. This is the most relevant part of the AS=AD graph when looking at Brexit, and its possible economic implications.

International Trade:

Finally, the AS=AD model must be adjusted to include international trade as it is an integral part of any open economy. Open economies trade with one another. If the households of an open economy spend some of their income on goods from abroad, called imports (M), and it causes withdrawal from the circular flow. Foreign consumers and firms will, however, also wish to buy domestic products, and this is called exports (X), which leads to an injection into the circular flow. And (X-M) is the overall trade balance of a country[16]. International trade is another aspect of the economy that is highly relevant in the discussion of Brexit. The Leave campaign promised U.K. voters that leaving the E.U. would increase their trade balance as they could score better deals with other countries outside of the E.U.

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[16] Ibid

Aggregate demand can be illustrated by reference to the circular flow of income, which we just explained above. The AD - AS model provides a framework to show how the level of AD and AS respond to changes in the price level and in turn, how changes aggregate demand and supply affect an economy's national output (income) and its price level.[17] Hence, aggregate demand consists of the amount households plan to spend on goods (C), plus planned spending on capital investment, (I) + government spending (G) + exports (X) minus imports (M).The standard equation is, therefore, **AD = C + I + G + (X – M).** Hence, to understand whether Brexit will increase or decrease the output of the British economy, looking at how each of these factors change in relation to the post-Brexit policies is essential.

Brexit's Impact on Investments (I) in the U.K.:

Financial services firms have moved $1 trillion in assets out of the U.K since the 2016 referendum.[18] A new study published by Ernest and Young predicts that investments will decrease in the U.K. The study tracked announcements made by 222 companies in the financial sector — 20 of which had publicly declared intentions to relocate out of the U.K. These firms announced that they would move operations, staff members and other assets outside of the U.K. and into Europe, mostly Frankfurt, Dublin, and Paris. EY declared that its "Brexit Tracker" estimated financial services firms to have moved almost £800 billion ($1.02 trillion) out of Britain since the 2016 vote.Another study conducted by German business group Frankfurt Main

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[17] Ibid

[18] Taylor, Chloe. "UK Financial Services Industry Moves $1 Trillion in Assets to Europe Due to Brexit, Survey Says." *CNBC*, CNBC, 8 Jan. 2019, www.cnbc.com/2019/01/07/brexit-uk-financial-services-sector-moves-1-trillion-in-assets-to-eu.html

Finance (FMF) also released similar figures, claiming that assets worth 800 billion euros were going to be moved out of London.[19]

Both EY, and the Frankfurt Main Finance (FMF) acknowledge that these estimates were "conservative" in relation to the size of the U.K.'s financial sector as the U.K. banking sector alone is estimated to be £8 trillion. Hence, the loss of $1 trillion is minor when compared to the U.K's overall banking sector which is estimated to be £8 trillion. However, studies show that these numbers can continue to grow as we get closer to the possibility of a no-deal Brexit. A no-deal Brexit means that the U.K. would immediately leave the European Union (EU). Overnight, the UK would leave the single market and customs union—arrangements designed to help trade between EU members by eliminating checks and tariffs (taxes on imports).[20] A no-deal Brexit would hurt the U.K. economy as they would be subject to checks and higher tariffs. Since, the E.U. member states want to set a stringent example of the harsh repercussions that can come from leaving the E.U., U.K. could very likely end up with a no-deal Brexit. This means that the assets exiting the U.K. could be higher than $1 trillion in the future.

There is enough evidence to indicate that Investments in the U.K will decrease as financial services firms have already moved $1 trillion in assets out of the U.K. and research shows that this number will only increase in the future. In the case of a no deal Brexit, which is a real possibility, a serious portion of the U.K. banking sector will move assets out of the U.K. causing Investments (I) to go down even further.

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[19]Taylor, Chloe. "UK Financial Services Industry Moves $1 Trillion in Assets to Europe Due to Brexit, Survey Says." *CNBC*, CNBC, 8 Jan. 2019, www.cnbc.com/2019/01/07/brexit-uk-financial-services-sector-moves-1-trillion-in-assets-to-eu.html

[20]"What Is a 'No-Deal Brexit'?" *BBC News*, BBC, 19 Oct. 2019, www.bbc.com/news/uk-politics-48511379.

Even economists that support Brexit agree that Investments will go down in the years following Brexit. Billy Mitchell, a Modern Monetary Theorist, agrees with the report coming out from the Office of Budget Responsibility (OBR) that "the weaker path for GDP is mainly driven by lower business investments."[21] However, Mitchell argues that this could be corrected by the government if they use discretionary stimulus to attenuate the decline in real GDP.[22] Otherwise, Mitchell agrees that Investments will indeed go down, but the real question is: will the U.K. be able to offset the decrease in Investments by increasing spending, alone? Simon Wren-Luis, a writer for Mainly Macro, disagrees. He writes, "in the chart below the Bank of England show that business investment has flatlined since the referendum, when the evidence from previous recoveries suggest it should have shown strong growth."[23] I think what Mitchell fails to understand is that the post-Brexit decrease in Investments is unlike past events in the U.K. As the graph shows below, business investment has flatlined since the referendum, and have failed to pick up as earlier times. Given the severity and uniqueness of the post-Brexit decrease in Investments, it is unlikely that government spending alone could offset this decrease.

[21] Mitchell, Bill. "The British Government Can Avoid a Recession from a No-Deal Brexit." *Bill Mitchell - Modern Monetary Theory*, 31 July 2019, bilbo.economicoutlook.net/blog/?p=42816.

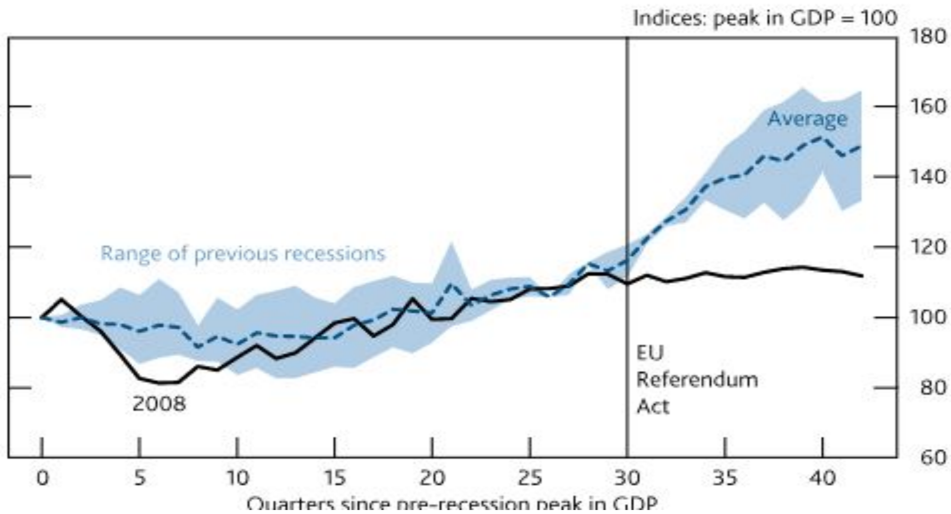
[22]Mitchell, Bill. "The British Government Can Avoid a Recession from a No-Deal Brexit." *Bill Mitchell - Modern Monetary Theory*, 31 July 2019, bilbo.economicoutlook.net/blog/?p=42816.

[23]Luis, Simon Wren. "The Economic Cost of the Brexit Decision That Leaver Voters Do Not Get to See." *Mainly Macro Blogspot*, 12 Feb. 2019, mainlymacro.blogspot.com/2019/02/the-economic-cost-of-brexit-decision.html

Chart 2.3

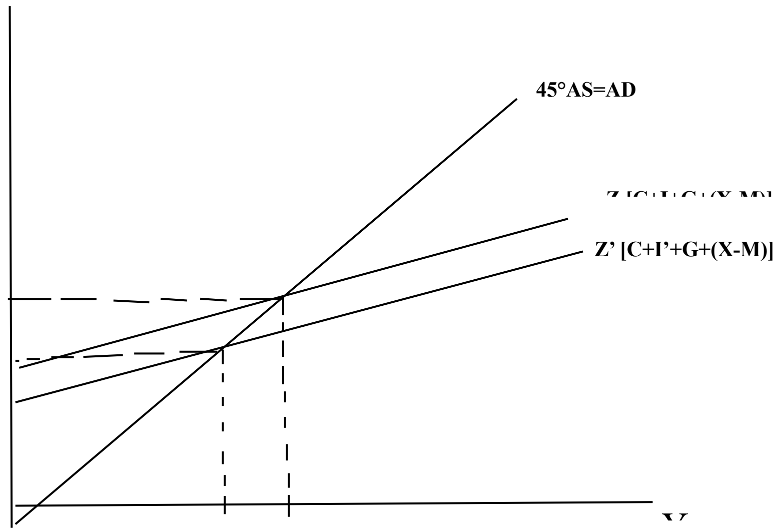
The recovery in business investment has stalled since the EU referendum

Business investment after previous recessions(a)



Hence, analyzing the data currently available that relates to Investments (I), we can confidently assert that investments will decrease in the U.K. and could continue to decrease in the future, in the case of a no-deal Brexit.

Now, decreases in investments (I) mean that the C+I+G+(X-M) line will shift down. All of these circumstances clearly lead to a scenario where the Investments within the U.K. economy will decrease. When Investments decrease, the Z line decreases causing a lower output level (Y) than earlier. A graphical representation of decreasing Investments is shown below:



Given that Financial services firms have moved $1 trillion in assets out of the U.K since the 2016 referendum, and firms continue to relocate assets outside of the U.K., Investment (I) decreases. This causes the Z line to shift down which causes the equilibrium to shift left to E'>E. This means that GDP is decreasing in the economy.

Brexit's Impact on Trade (X-M) in the U.K.:

After Brexit, Britain's trade deficit widened in January by more than expected as imports grew faster than exports.[24] Essentially, the referendum depressed the UK's international trading activity, with some UK businesses choosing to not enter the EU market while others chose to exit. Given the uncertainty following Brexit, most firms consider it risky to enter the U.K. market, and many have already started to relocate elsewhere in Europe. This switch to a 'renegotiation regime' has decreased firm entry into and has increased firm exit from exporting

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[24]Partington, Richard. "How Has Brexit Vote Affected the UK Economy? March Verdict." *The Guardian*, Guardian News and Media, 26 Mar. 2019, www.theguardian.com/business/2019/mar/26/how-has-brexit-vote-affected-the-uk-economy-march-verdict

to the EU for UK-based firms.[25] Brexit has had the largest impact on products facing as threat points (a) higher ad valorem tariffs, (b) tariff rate quotas, and (c) specific duties, causing substantially higher barriers in exporting to the EU.[26] Many firms have already lost export orders as they were cut out of EU based supply chains because of Brexit. A recent study from INET and Cambridge found that firms were either not entering into new agreements to export products because of Brexit or were more likely to exit from such agreements.[27] All of these statistics show that there will be and has been a decrease in U.K.'s trade balance following the referendum. The reason why U.K.'s trade balance will decrease lies in the importance of trade agreement themselves.

Numerous studies have quantified that multilateral and regional trade agreements are crucial for an economy, they help to increase trade. However, more recent theoretical and empirical contributions have emphasized that trade agreements increase trade between signatories not only by lowering tariffs but also by reducing uncertainty over future tariff schedules.[28] Under the E.U., the U.K. had structured trade agreements that did not cause uncertainty or volatility. However, under a no-deal Brexit, the U.K. will not get to enjoy any of these trade privileges.

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[25]Crowley, Meredith. "The Impact of Brexit Uncertainty on UK Exports." *The Impact of Brexit Uncertainty on UK Exports* | *VOX, CEPR Policy Portal*, voxeu.org/article/impact-brexit-uncertainty-uk-exports.

[26]Ibid

[27]Idib

[28] Limão, N, and G Maggi (2015), "Uncertainty and Trade Agreements." *American Economic Journal: Microeconomics* 7(4): 1-42.

In addition to this, analysis of the gravity model of international trade also shows that Brexit will be atrocious to the trade balance of the U.K. The gravity model asserts that, "relative economic size attracts countries to trade with each other while greater distances weaken the attractiveness."[29] Given the gravity model, the best trade partners for the U.K. would have been surrounding European countries such as Germany with a similarly sized economy and a close distance. The Leave campaign has harped on the fact that leaving the E.U. will help them cut trade deals with the U.S., and other economic superpowers. However, given that U.S. and the U.K. are neither of a similar economic size, nor are geographically close disrupts the rhetoric put forth by the Leavers. As Paul De Grauwe puts it: "Britain was the master of the world. Today, however, Britain is a small country. Its GDP is only 15% of the EU's GDP. If it wants to trade with the rest of the world, it will also have to accept rules drawn up elsewhere."[30]

Another impact that Brexit has had regarding trade is on the pound sterling. A prospect of a no-deal Brexit has repeatedly sank the pound sterling. The pound sterling has fallen close to $1.30 against the dollar, while hitting a high of almost $1.34."[31] Some economists assert that this is a good thing. Economists like Paul Krugman and Ashoka Mody have argued that the Brexit induced decline in Sterling is a blessing in disguise. "Their basic argument is that Brexit will hit the City, and it is the City that has created an unbalanced economy and an overvalued

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[29]"Gravity Theory." *Gravity Theory - International Trade Theory* | *Economics Online*, www.economicsonline.co.uk/Global_economics/Gravity_theory_of_trade.html.

[30] Grauwe, Paul De. "Brexit Creates Window Of Opportunities For The EU – Paul De Grauwe." *Social Europe*, 1 Apr. 2017, www.socialeurope.eu/brexit-creates-window-opportunities-eu

[31]Partington, Richard. "How Has Brexit Vote Affected the UK Economy? March Verdict." *The Guardian*, Guardian News and Media, 26 Mar. 2019, www.theguardian.com/business/2019/mar/26/how-has-brexit-vote-affected-the-uk-economy-march-verdict

currency."[32]They argue that reducing the size of the financial sector is necessary if we want to rebalance the economy, and Brexit can achieve this.

However, Simon Lewis argues that the goal of reducing the size of the financial sector and putting an end to an overvalued currency could have been accomplished without Brexit. He writes, "we could instead have imposed much stronger regulations on the UK financial sector (basically higher capital requirements)."[33] This tactic would have avoided all the additional costs that Brexit will impose and with the additional benefit of having a financial sector that was not too big to fail. He concludes, "my fear is that after Brexit the opposite will happen: policymakers will go even easier on City regulation in an effort to make up for the damage Brexit will do. So I'm still finding it hard to see any silver lining in the Brexit decision."[34] The other argument against this Brexit-sterling-silver-lining is that the uncertainty surrounding Brexit could have decreased the sterling, not necessarily Brexit. Therefore, this decrease in sterling did not occur from careful policy imposition, and could lead to an overvalued currency, yet again.

All of these analysis lead to a scenario where the (X-M) within the U.K. economy will decrease, landing us at (X-M)'. When (X-M) decrease, the Z line decreases causing a lower output (Y) than before. E'>E is the new level of output in the economy.

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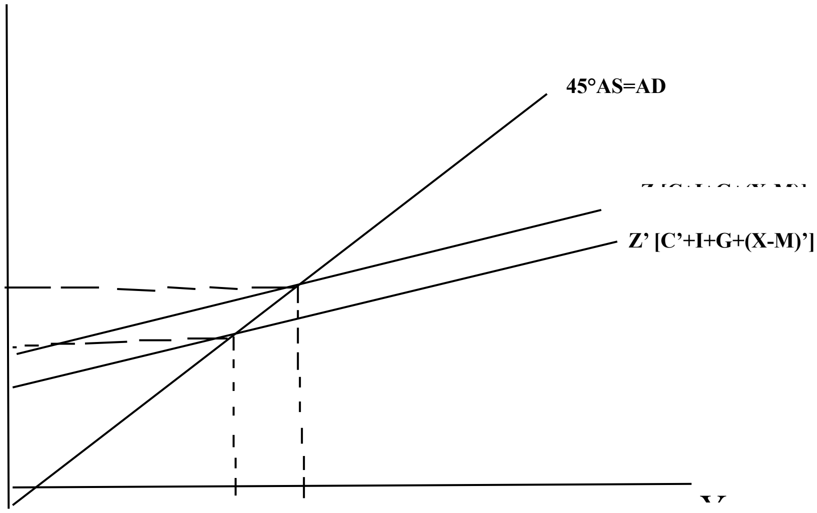
[32]Luis, Simon Wren. "Brexit and Sterling." *Mainly Macro Blogspot*, 14 Oct. 2016,

[33] Ibid

[34] Ibid



Brexit’s Impact on Consumer Spending (C) in the U.K.:

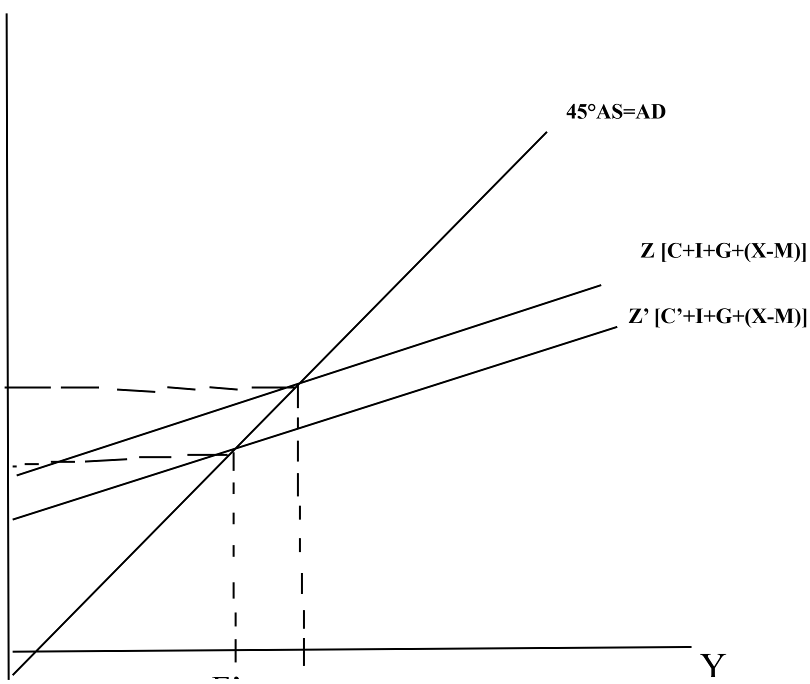
Thus far, we have shown that Brexit has caused a decrease in Investments (I), and has caused a negative trade balance (X-M). These decreases in trade, and investments, negatively affect consumer spending. As financial services firms relocate outside of the U.K., they are not taking the U.K. workers with them. This means that many U.K. workers will continue to lose jobs, which would lead to a decrease in consumer spending.

The collapse in sterling immediately after the vote made everyone worse off as inflation increased. According to one study, by the third quarter of 2017 the average consumer was worse off by £400 as a direct result of paying higher prices for imported goods following that depreciation.[35] John Springfield at the Centre for European Reform calculated that GDP was 2.3% lower in September 2018 as a result of the Brexit vote. That roughly translates into the average household losing almost £2000 worth of resources. This £2000 hit per household means

[35]Luis, Simon Wren. “The Economic Cost of the Brexit Decision That Leaver Voters Do Not Get to See.” *Mainly Macro Blogspot*, 12 Feb. 2019,

an overall decrease in consumer spending, but also lost of public spending and investment. This figure of £2000/ household is broadly consistent with the estimates that the Governor of the Bank of England gave in May, using a different method.[36]

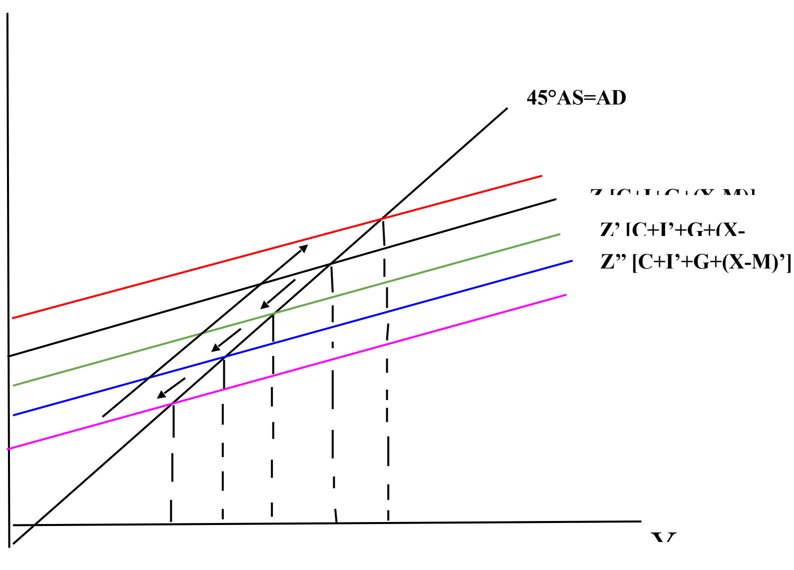
These various data regarding loss of household income prove that post-Brexit consumer spending (C) has and will continue to go down. This decrease in consumer spending puts us at a new C’ and a new equilibrium E’>E. The decrease in output (Y) shows that decreases in (C) induced by Brexit will decrease the GDP.



[36]Ben Chu Economics Editor @Benchu_. “Brexit Has Already Cost Each UK Household around £900, Says Mark Carney.” *The Independent*, Independent Digital News and Media, 22 May 2018,

Brexit's Impact on Governmental Spending (G) in the U.K.:

Brexit's Impact on Government Spending is the trickiest to figure out. This is because the party in charge currently—the Conservatives led by Boris Johnson—have had a history of taking drastic austerity measures. As we see in the graph below, the decreases in C, and I, and X-M will significantly lower the output level (Y) of the British economy. For the economy to go back to the natural state E or further right to E'''' signaling growth post-Brexit, either taxes will have to go down or governmental spending will have to go up drastically. Only such a dramatic increase in government spending could offset the compounding decreases in output (Y) caused by lower C, I, and X-M values.



Bill Mitchell, a strong Brexit advocate argues that if the British government increases spending then there will not be a long-term decrease in output (Y). [37]

[37]Mitchell, Bill. "Austerity Is the Problem for Britain Not Brexit." *Bill Mitchell - Modern Monetary Theory*, 9 Jan. 2017, bilbo.economicoutlook.net/blog/?p=35140.

However, Mitchell himself concedes that Britain will suffer, if the fiscal austerity mindset continues and the disruptions that will, in the short-run, accompany Brexit will be made worse by on-going austerity.[38] He concludes, that austerity is the problem for Britain, and not Brexit.

However, given the way this government runs its fiscal policy, i.e. austerity, Britain has already lost a lot of public resources. If Brexit had not happened, Britain would still have tens of thousands more police officers and nurses. This is not a forecast, but an estimate of what Brexit has already cost the U.K. As a result of Brexit, Springfield, an economist, calculates that GDP loss would amount to taxes being lower by £17 billion a year.[39] This means serious cuts in government spending, unlike what Mitchell is proposing will happen.

Mitchell uses the Office of Budget Responsibility (OBR)'s GDP 'stress test' chart to show that the direction of GDP under this 'stress test' is upwards. Hence, closing the gap between their March 2019 forecast of growth and the No-deal Brexit scenario. He believes that there will be short term decline in output (Y) but if proper measures are taken by the government to offset the decreases in C+I+(X-M), or in other words, use discretionary stimulus to attenuate the decline in real GDP, then the U.K. economy will survive and thrive post-Brexit.

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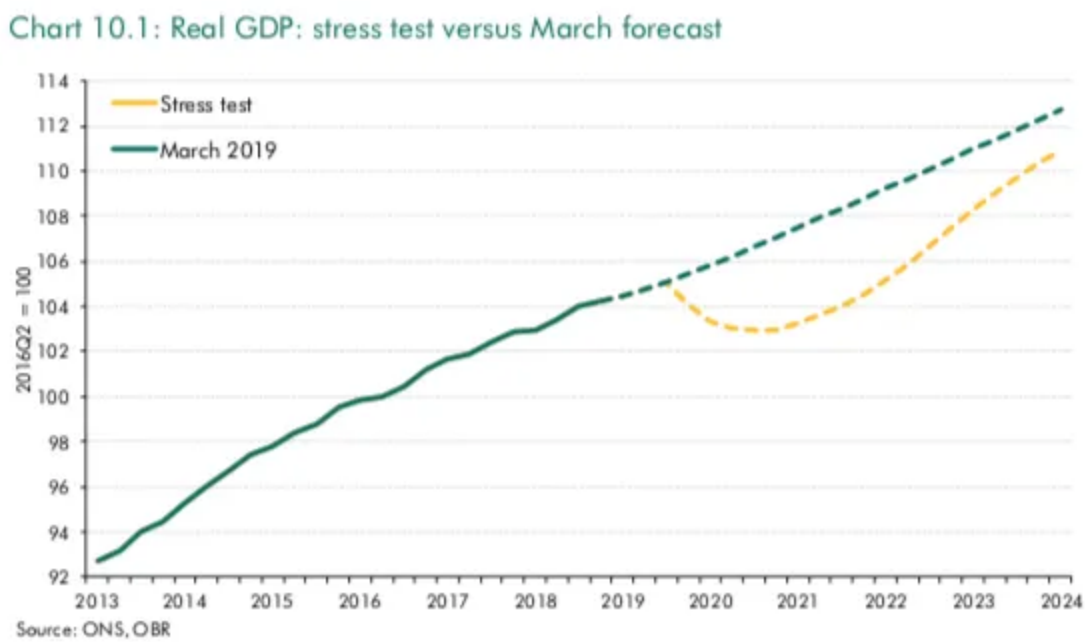
[38] Ibid

[39] Luis, Simon Wren. "The Economic Cost of the Brexit Decision That Leaver Voters Do Not Get to See." *Mainly Macro Blogspot*, 12 Feb. 2019,



However, for this to occur, Mitchell proposes that the Boris Johnson government ought to announce sooner rather than later (among other things):

1. Some large public infrastructure projects, preferably tied in with a Green New Deal conception.

2. Some major welfare reforms to bring the 22 percent of the population out of poverty.

The first incentive, Mitchell argues, will provide some increased certainty to business investment and deliver some massive, long-term upgrades to public infrastructure (as well as the employment boost and local multiplier effects).[40] The second is likely to be translated into both increased consumption spending (households) and increased savings.

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[40]Mitchell, Bill. "The British Government Can Avoid a Recession from a No-Deal Brexit." *Bill Mitchell - Modern Monetary Theory*, 31 July 2019, bilbo.economicoutlook.net/blog/?p=42816.

The recent elections between Boris Johnson and Jeremy Corbyn showed that Boris has little interest in major welfare programs and increasing public spending like Corbyn. Boris' election platform was "Get Brexit Done" while Jeremy Corbyn's was, "Not for the Few, For the Many." Hence, if Corbyn had been elected, Mitchell's argument could have worked. However, under Boris' government, the likelihood of him "bringing people out of poverty", and increasing public spending are miniscule.

Billy Mitchell writes, "the OBR assumes that facing a recession that the Government does nothing of a discretionary nature (stimulate via fiscal policy) but what responsible government would not act?" The simple answer to his question is: a Conservative government under Boris Johnson. The Conservative party in the U.K. has had a long history of taking drastic austerity measure, exemplified during the era of Margaret Thatcher. Hence, the likelihood of Boris creating a Green New Deal is low.

Billy Mitchell is making the argument he makes because he is a Modern Monetary Theorist. To Mitchell, increasing government spending is not an economic burden problem, unlike the opinions of many Conservative politicians. Hence, to think that the newly elected Conservative government under Boris Johnson will create some sort of major welfare reforms to bring the 22 percent of the population out of poverty is naively optimistic and out of touch.

To conclude, it is less likely that government spending will go up by the amount it needs to for Brexit to not have negative economic implications. Jeremy Corbyn's campaign for the 2019 election revolved around increasing government spending as he vouched to increase welfare programs, increase funding for the NHS, increase public sector jobs. However, Boris Johnson's campaign had no undertones of increasing welfare programs, and he won, he won by a landslide.

Conclusion

Nigel Farage, the leader of the UKIP party had written in The Express, “We must leave the European Union so that not only can wages increase for British workers but so that living standards and the GDP can start going up rather than declining.”[41] Yet, wages are declining. Households, on average, are £2,000 poorer today than before the referendum. There is overwhelming evidence which shows that the Leave campaign espoused incorrect and misleading economic information during the referendum. They said, “trade would increase, investments would increase, and there were no talks of a possible recession.” However, as it turns out, the trade balance has decreased, investments have decreased, both of which have caused consumer spending to decrease, all three of which will continue to decrease. And there is a looming recession awaiting the British people. Even the Leave economists agree that the economy will experience decreased output levels of over 2% in the short run[42].

However, the Leave economists argue that increased government spending could offset the possibility of a recession in the U.K. Johnson’s government would have to (1) create some large public infrastructure projects, preferably tied in with a Green New Deal conception. (2) create some major welfare reforms to bring the 22 percent of the population out of poverty. But this was not Boris Johnson’s platform in the most recent elections, hence, the possibility of a majority Conservative Parliament to increase spending by such a radical amount seems unlikely.

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[41] Farage, Nigel. “NIGEL FARAGE: Why We Must Vote LEAVE in the EU Referendum.” *Express.co.uk*, Express.co.uk, 21 June 2016, www.express.co.uk/comment/expresscomment/681776/nigel-farage-eu-referendum-brexit-vote-leave-independence-ukip.

[42] Mitchell, Bill. “The British Government Can Avoid a Recession from a No-Deal Brexit.” *Bill Mitchell - Modern Monetary Theory*, 31 July 2019, bilbo.economicoutlook.net/blog/?p=42816.

To conclude: the economic implications of Brexit have proven to be negative. The Leave campaign espoused economically populist messages, though appealing to many voters, turned out to be poorly researched, misleading, and incorrect. The landslide victory of the Conservatives in the most recent election shows that such economically populist messages still resonate with many British voters, mostly Northerners, that have felt behind in a globalized economy that is not working for them.

In addition to Brexit having negative economic implications, Brexit turns out to be more politically disadvantageous for Britain. After the Scottish National Party performed well in the most recent elections, they have turned their focus back into holding an independence referendum. Because they voted to stay in the E.U., SNP argues that U.K.'s decision to leave the E.U. is at odds with the desires of the Scots. Hence, there is a strong possibility of yet another Scottish Independence Referendum. Brexit could also open the floodgates to the Irish conflict, it could reignite the conflict over borders between Northern Ireland and Ireland. Because of Brexit, there is a real possibility that these United Kingdoms will just end up being Wales, and England.

The biggest takeaway from Brexit should be one of questioning our current economic institution. Many that voted to leave Brexit were poor, un-educated Northerners that despised the London global elites. When Tony Blair came to power in 1998, he announced that, "we live in a classless society." Much to Mr. Blair's surprise, class war is back in Britain and elsewhere. The current economic institutions have increased the wealth divide, favored the wealthy, leaving the poor behind. Surely, decades of such a model would bring political unrest and political conflict as we see with Brexit.

Economic disenfranchisement of the general U.K. populous, in part, led to the outcome of the 2016 referendum. The Leave campaign empowered ordinary people. Finally, they were given a voice, and the London elites were made to listen. After the 2016 referendum, many economists have been primarily focused on analyzing the economic implications of Brexit. Many have lost themselves in the quagmire of net profits and net loss.

In amalgamation to such analysis, we ought to answer bigger questions: how did we get here, and how can we reorganize our institutions to create an economy that works for everyone: not just the few, but the many.

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