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# Brexit and Its Impact on New Zealand Economy: A Conceptual Analysis

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*Abstract* - 'Brexit' which means exit of United Kingdom (UK) from the European Union (EU) is not only a European issue but has varied implications throughout the world, especially amongst its trading nations. This conceptual paper first discusses pros and cons of Brexit on UK and EU. This is seen in the light of Brexit impact on trade, unemployment rate and inflation rate. It further discusses some of the immediate implication Brexit might have on New Zealand, which is the EU's third largest trading partner. The discussion is based on the impact post-Brexit may have in terms of trade, employment, GDP and the tourism sector in New Zealand.

*Keywords:* Brexit, European Union, New Zealand, post-Brexit.

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## I. Introduction

'Brexit' is a colloquial term that refers to the exit of United Kingdom (UK) from the European Union (EU). It is created by merging the words 'Britain' and 'Exit', in the same way when Greece left the EU and it was proclaimed as the 'Grexit'. The European Union is a political and economic partnership that involves approximately 28 countries, and was established in post-World War 2, to promote and stimulate economic growth between the European countries with a basic view that countries which trade together would not go to war against each other in the future. It originated with countries like Belgium, France, Germany which were the first members to join in the year 1958. Soon after that, it incorporated many other countries into the union, with Croatia being the latest member to join in 2013. Brexit came into existence around 2016, when a referendum was issued to people who were of legal voting age to have their say on whether they wanted the UK to remain or to leave the European Union. More than 30 million people had their say in this referendum and ultimately decided to leave the EU with a winning vote percentage of nearly 52 percent (Hunt & Wheeler, 2017).

## II. Identification and Evaluation of Brexit

Britain's exit from Europe was triggered by the referendum which was held in 2016 by the then British Prime Minister David Cameron. The majority (52%) of the people voted for Brexit. The current UK government activated article 50 in 2017 which allows Britain to leave European Union by 2019. The UK as an independent nation, has over the years been worried about the fact that EU has been keeping them down and hampering their growth. This is cited as one of the few reasons which prompted many citizens to ask UK to leave the European Union. Pro-Brexit group, Global Britain, mentions such reasons and believes that UK aims to change their EU

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membership with a new economic commerce that includes the entire world rather than just the European countries. Apart from economic reasons, other reasons like migration issues, credit crisis and legal quandaries have ultimately resulted in the call for an exit of Britain from the European Union (Boyle, 2015). For example, one of the main benefits or rather privileges for members who are part of the European Union is the concept of 'free movement' across the borders of such countries. This implies that an individual who is a citizen of any of the 28 member countries of the EU can move around freely without any additional paperwork in the form of visas or entry permits. The majority of voters who voted in favour of Brexit wanted UK to take back full control of their national borders and bring about a reduction in the number of immigrants entering Britain to live and work.

Although, after the referendum results were announced, there has been a change in the Government, the new Prime Minister, Theresa May, is still in favour of Brexit, and thereby activated Article 50 of the Lisbon Treaty, which was drawn for such situations wherein a member country wished to exit the European Union. Theresa May invoked Article 50 on 29th March 2017, which gives them a period of two years to work out the negotiations and agreements for UK to leave the EU officially. This implies that the UK has to decide whether it will leave the EU by 29th of March 2019, although it can be extended further if all the remaining members of the EU agree to the same.

### **III. Economic Impact of Brexit on UK**

Under the European Union, UK had trade regulations that favoured them in various areas. The biggest one was the open market economy where the trade barriers were reduced. But the UK's exit means there are two obvious implications arising that might result in economic repercussions.

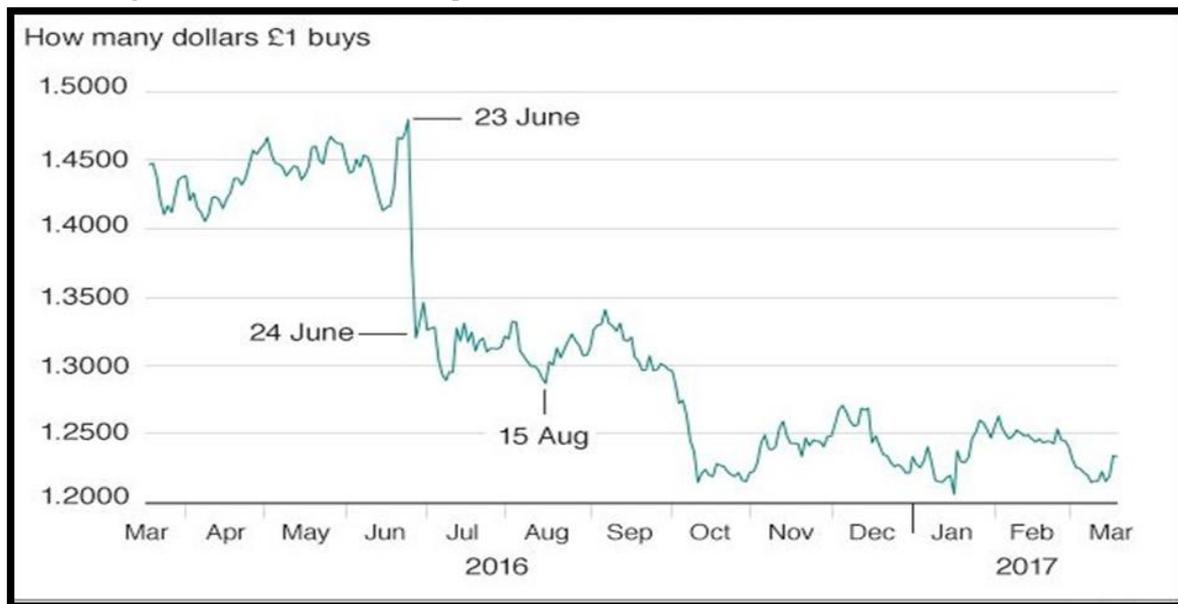
In the first scenario, UK may be able to maintain the same economic and trade relations with other European countries even after Brexit. This might result in a stable economic situation for UK, which means that even after the exit from EU, the trade agreements may have similar advantages as they had before. In this case, the negotiation process for coming out of EU will play a vital role in this scenario given Britain can retain its status quo position. This may mean UK will be part of Europe's single market. They will face some non-tariff barriers imposed to non-EU countries. But it will not have any significant impact in terms of trade with other countries. The trade cost will also reduce, which means UK will virtually be in the same economic zone as they were before. There are predictions that intra-trade cost between EU countries will fall by 20 percent which will also be applicable for UK. This scenario is the one British politicians and economists are optimistic about, but fear that it will surely be affected by the political influence and the negotiation process for Brexit.

The second scenario follows if Britain cannot retain the trade agreements and regulations under EU after their withdrawal is completed in 2019. In this case Britain will have to do trade under WTO (World Trade Organizations) like other countries outside of EU. It means Britain will not have the full access of the single market economy of Europe. The trade barriers will be imposed in both countries engage with the trade. Britain can gain access to reduced trade barriers, but that have to be negotiated with the individual country they are doing trade with. In this case they will lose access to the open market of the EU countries. Political and economic influence over some countries means Britain will have some good trade agreements but that will never equal the reduced cost in trades. The cost for foreign products will certainly increase and it will reduce the buying power of average British people. The cost for imports will increase similarly there will be higher non-tariff barriers with countries they trade with. Britain will also miss out on the deeper integration of the EU economy which will reduce the non-tariff barriers in the future. Britain will also lower their contribution in European communities to save costs but that can eventually mean they will lose their political and economic influence over Europe which they enjoyed in the last few decades.

Members who did not wish to see UK leave the EU, including the former Prime Minister David Cameron and his executives forecasted an instant economic crisis in the UK if they did exit the EU. Some of their main concerns are a big recession being faced with an increase in unemployment rates, decline in the housing market, and emergency budgets being brought to support the economy. But such estimates and forecasts have not been the case with the announcement of Brexit so far. Although the UK Pound had fallen in value in comparison to the US dollar and Euro, the former predictions about immediate economic crisis was not very accurate. On the contrary, reports suggested that the UK economy grew more in the last quarter of 2016, wherein the GDP increased by a total of 0.7% compared to the previous quarter. There were several reasons for this increase in GDP such as increasing consumption by consumers who were expecting a fall in their future income post-Brexit and consumers buying overseas goods before imports become more expensive than what they presently are.

As mentioned above, the UK Pound faced a steep deterioration since the Brexit vote, and was being traded at a value of about 15 percent lower than the US dollar and about 12 percent lower than the Euro. This proved to be somewhat of a double-edged sword for the UK, since it helped the exporters' ship out their products in higher numbers, but at the same time it also made overseas vacations more expensive for British tourists. In the same way, it increased the costs for importers with the decrease in value of the Pound. So, they had to shell out more money, thereby increasing manufacturing costs in important sectors like the automobile industry which depended on parts being imported from neighbouring countries. Figure 1 below shows the continuous decline in the value of the Pound compared to the US dollar for the past year post-Brexit vote (Bowler, 2017).

Figure 1 - Value of Pound Compared to the US Dollar



Source – Bowler (2017)

Furthermore, the Bank of England rose to the occasion and decided to undertake compensatory action after the Brexit vote, and took one step to help in boosting the economy. To be more specific, they decreased the interest rates by almost half the amount, from 0.5% to 0.25%, which was the first of its kind since 2009. This was one of the main factors why the forecasts about the immediate economic crisis post Brexit vote did not happen. Other notable mentions in the economic sector post-Brexit vote include the balance in imports and exports in the trading sector, the unemployment rate falling steadily instead of an immediate downfall and wages growing faster than inflation albeit in smaller gaps.

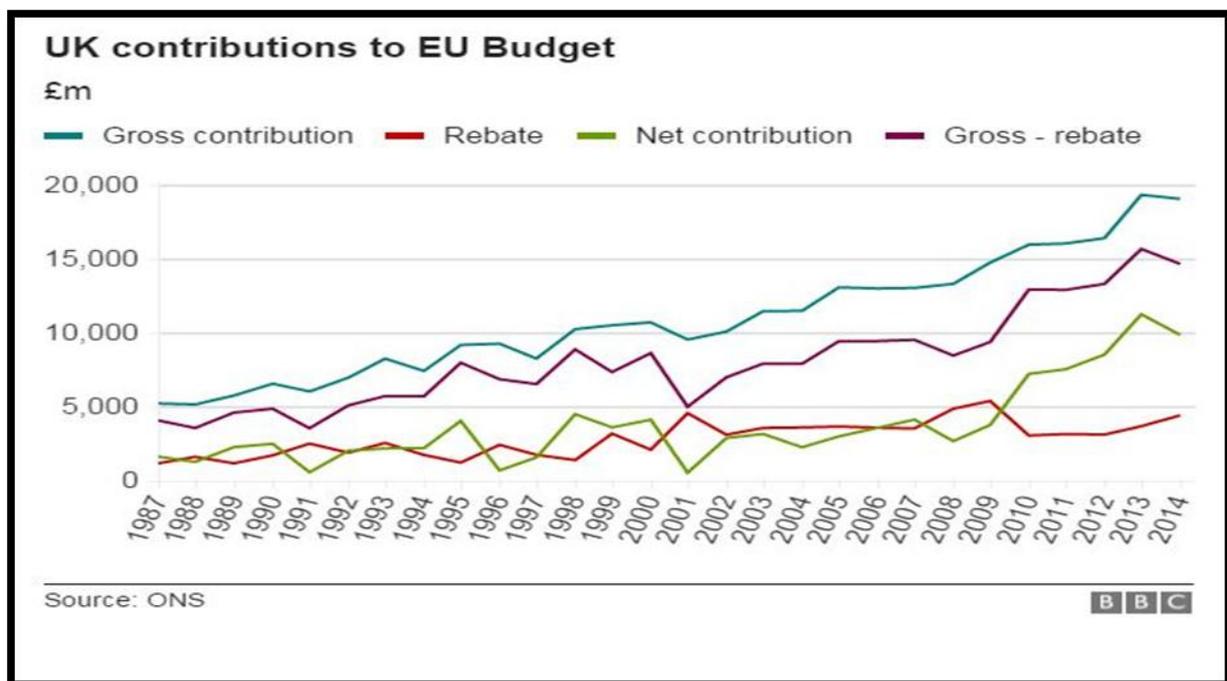
#### IV. Economic impact of Brexit on EU

The issue of Brexit is always discussed based upon the impact it might have on the UK economy. However, Brexit will have a similar impact on other trading countries in Europe as UK is one of the largest economy in Europe which might shift its trading scenario with other countries in Europe. Countries like Ireland, Belgium and Netherlands will suffer the most as UK is their largest trading partner. The trade barriers will be a huge issue for these countries as the rise of cost of products and services will have an impact on the general citizens living in those countries. On the other hand, there are other countries in Europe who are not part of EU who might gain because of the probable shift in trade towards those countries. For example, countries like Russia and Turkey will benefit the most from this. As Russia has a huge reserve of natural gas and the primary supplier of natural gas in Europe, it will have a stronger grip on the European economy.

They will try to take the opportunity to get in the single market of the Europe. As EU will surely look to fill up the void, countries like Turkey might take the opportunity to join the EU. The supply of natural resource is crucial for European countries so Turkey and Russia might use it as a tool for negotiation to get themselves in a barrier-free market. The investments for Eastern European countries will increase and the migration shift towards the other countries in Europe might also increase. In terms of politics, Russia may try to increase their influence in Europe and their economic integration with other European countries will be a vital element for this issue.

The UK is one of the 10 member countries in the EU who contributes and pays more into the European Union budget than what they receive. Even though they get their money back from the EU in the form of rebates and grants, it is not to their benefit. For instance, as can be seen from the figure 2, below which shows the UK's contribution and the rebates they receive from the EU, officials statistics show that the gross rebates they received from the EU was about 4.6 billion Pounds, which was almost half in terms of their contribution, i.e. 8.8 billion Pounds. It can also be seen that this contribution of 8.8 billion Pounds was almost twice the amount that the UK contributed in 2010 (Reuben, 2016).

Figure 2 - UK's contribution and rebates from the EU



Source – Reuben (2016)

So, in terms of understanding and deciphering these numbers, what does it mean for the EU? It implies that the EU would be losing a main source of cash inflow for their budgets and administrative running. Furthermore, over the years UK, being the second largest economy in the EU is a major import and export player in international trade. Nearly 45% of all their exports have been towards their other EU members and counterparts. This again has significant implications for EU's economic activities. They may face severe losses in the form of international trade and hence, one of their first action plan would be to negotiate a deal with the UK during the Article 50 Process for a quick and mutually beneficial free trade agreement between both concerning parties. Apart from these economic implications for the EU, one of the other main problems they might face post-Brexit is the balance of political power within the EU. The withdrawal of UK from the EU could see a surge in power of Germany's position and make them a dominant power in the EU, which some smaller countries would be weary of. The UK also has global power and spends a lot on defence more than any other EU country, which would in turn affect EU's global role. Being their strongest military power, the UK brings to EU's table a diplomatic network and intelligence capabilities, which are indeed at the foundation of the EU's foreign

policies. Post-Brexit, without such resources and assets from the UK, the EU would not be as influential as they were previously with the UK and their military support under their sleeves and could further down the line, see a declining trend in the future development of EU's military capabilities.

#### **IV. Impact of Brexit on New Zealand**

Even though, geographically New Zealand (NZ) is far away from the EU zone, in terms of trade, NZ is a big trading partner of EU. EU is NZ's third largest trading partner. And in terms of history and culture, UK has been a big partner of NZ. NZ's dairy products and wine have been primarily exported to EU especially to Britain. The quota free and lower tariff actually helped flourish trade in EU. But with Brexit, UK may take steps to help their local business putting barriers on imports. It will eventually make the NZ's dairy business expensive. British farmers have been the primary supplier of meat in Europe, if they face subsidy cuts due to Brexit, this might result in a push towards the European country. That means there would be more demand for meat products in Europe and if Britain negotiates any kind of free trade with Europe, NZ's farming products will suffer in Europe. Brexit also means the immigration rules will not be unrestricted towards New Zealanders. The exchange rate of currency and other economic factors will also have an impact on this situation in the future.

NZ's former PM was quite optimistic about making new trade deals with UK which might help to overcome these difficulties. These trade deals might help NZ to get non-tariff advantages in the UK market and probably be separated from other European countries. The effects will not take place until 2019 so it gives more time for NZ policy makers. But the Brexit will surely slow down the British economy, which means NZ will have lesser tourists from UK. But most importantly NZ export will suffer a lot as it will go down by NZ \$190 million a year.

Although there have been numerous discussions and debates about the pros and cons of Brexit and how it would affect the various economies surrounding it, there is absolutely no doubt that the NZ's economic, finance and commerce sectors would also be included in that list. For example, the NZ economy being an export driven one would be greatly affected by the cut down in export numbers post-Brexit. The UK has been one of NZ's biggest export markets for red meat accounting for almost half of their total exports in meat products and this is driven by the fact that the UK exports its agricultural and dairy products to the EU. But after Brexit, there is a possibility that the UK's export to the EU might drop and internal consumption might decrease the demand for NZ products in the British market. Furthermore, the British is one of the biggest investors in NZ in terms of business activities and investment in properties, and all these may change with Brexit which would lower the investments in NZ (Beckford, 2016). Another key point to be noted which could have a significant impact on the NZ economy is the number of tourists coming to NZ from the UK annually which could take a stumble if the value of the pound decreases post-Brexit. There is a distinct possibility for this to happen, and with the fall in value of the pound, a sizable number of the British might not travel much to NZ, thereby decreasing the country's revenue in the tourism sector.

The challenges will be immense for NZ in the wake of Brexit, but with challenges being faced it is also crucial to understand that challenges do present opportunities in the near future. Other economies that are linked to the UK, would also be facing the same if not more challenges like NZ. NZ can gain confidence in the fact that before the UK joined the EU, about 90% of its imports from NZ was to UK which again fell quite dramatically when they agreed to join the EU. So, optimists can be happy in the fact that once the UK leaves the EU, NZ can grab hold of a wealth of opportunities to get back the lost numbers and increase the exports to the UK as how it was before they joined the EU. Also, recent speculations do suggest that once the UK leaves the EU, they would be open to trade agreements globally. This may create more opportunities for Australia and NZ. NZ's dairy products as well as lamb and meat are renowned worldwide, and they have been in demand in the European market, so all in all, the signs are promising and can benefit NZ in a lot of ways if utilised properly (Medows, 2016). But in order to gain maximum benefits from this scenario, it is very important that new trade agreements are drafted as quickly as possible between NZ and the UK as well as NZ and the EU.

## V. Conclusion

Brexit shows that the democracy voice of general people always matters and it should be respected. Before the referendum the mainstream media and different polls showed it will not be successful. But the results proved otherwise, showing the world that the people in UK want to create an independent zone for their own economy. As there are arguments for Brexit and against it, there is no definitive answer what will happen in the coming years. As policymakers and media have been proven wrong before, Brexit may create a vacuum in the EU which might not get replaced making catastrophic impacts in terms of politics or economy in the European zone. But if UK can negotiate and keep their integration with Europe it will surely benefit people from both sides. The ultimate result of Brexit will weaken EU and might encourage other countries to have such referendum to come out of EU. But how this scenario unfolds remain to be seen.

The impact of Brexit on the NZ economy in the short term seems to be very limited for the time being. The economic relations between the two countries now are highly volatile and are liable to high degrees of change and unpredictability, which has in turn lead to delays in terms of investment, trade and consumption decisions. The extent of these impacts is highly reliant on time and depends on conditions which remain unpredictable and the degree of such volatility. For example, the decrease in value of the Pound against the NZ dollar is bound to create problems for traders in NZ looking to capture export contracts with the UK. Furthermore, lower economic development in the post-Brexit UK, if it occurs would ultimately affect consumer consumption and the demand for NZ products may also be negatively affected. Looking at the long-term impact of Brexit, the main factor would be the time taken to negotiate new trade deals with both the EU and the UK.

Overall, the impact of Brexit on the New Zealand economy is highly undefined at this present stage, and New Zealand, as one of the most stable economies, appears to be in a relatively safe position to handle any shock that it may face in the process. But apart from New Zealand, the UK itself and other members of the European Union are bound to be affected in more than one way, and only time will prove and show the world how much of an effect that would be.

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