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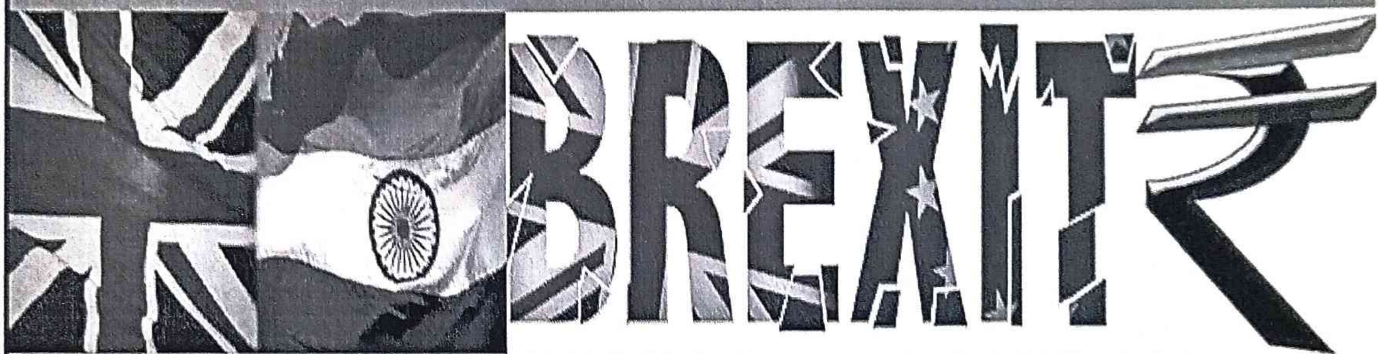

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BRITAIN'S EXIT FROM EUROPEAN UNION - AN OVERVIEW.

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Introduction

Nearly 52% of British voters in the June 23 referendum on European Union (EU) membership answered that the United Kingdom (UK) should leave the EU. Among a complex pattern of supporters and opponents of Brexit, the vote pitted Prime Minister David Cameron, who led the campaign to remain, against many members of his own Conservative Party, including in his Cabinet. Prime Minister Cameron subsequently resigned and Theresa May took over as the UK's new prime minister on July 13, 2016.1 The vote was the culmination of a decades-long debate in the UK about the country's EU membership. The UK joined the precursor to the modern EU in 1973, but has long been considered one of the most "euroskeptic" members, having "opted out" of several major elements of European integration, such as the euro currency and the passport-free Schengen Zone.

Brexit need not cause a dramatic makeover in all aspects of the U.S.-UK relationship, however. NATO remains the preeminent transatlantic security institution, and the UK will remain a leading member of NATO. Despite recent U.S. concerns about the possible effects of cuts to UK defense spending and reductions in the size and capabilities of the British military, U.S. defense planners have long viewed the UK as one of the most capable European allies in terms of well-trained combat forces and the ability to deploy them. Observers also note that the United States and the UK have long tended to have similar outlooks on issues such as the use of force, the development of military capabilities, and the role of NATO. Close cooperation with the UK on NATO issues can be expected to continue, including with regard to the joint deployment of additional forces for 3 HM Government, The Process for Withdrawing from the European Union, February 2016, p. 9. Economic Implications of a United Kingdom Exit from the European Union Congressional Research Service 3 the reassurance of Poland and the Baltic States (and the deterrence of Russia), and in operations to combat the Islamic State.

Impact of Brexit on UK and EU Economies

Economic Studies Recently, the Organization for Economic Cooperation and Development (OECD), the World Bank, and the International Monetary Fund (IMF), the Bank of England, the UK Treasury Department (HM Treasury), among others, have issued assessments of the economic impact of Brexit. International Monetary Fund A June 2016 IMF analysis projected that the rate of economic growth in the UK will slow to 1.6% in 2016, or about 0.5% below earlier estimates. The IMF attributes this drop in its estimates to uncertainty about the nature of the UK's long-term economic relationship with the EU and the rest of the world, which it considers to be the largest near-term risk to the UK economy.19 Also, the IMF estimated that by 2019, Brexit could reduce UK GDP by 1.4% under the most optimistic assumptions and by 5.6% under the most pessimistic assumptions.20 The IMF also concluded that Eurozone members that had close links with the UK in trade and finance would be the most affected by Brexit, with Ireland, Malta, Cyprus, Luxembourg, the Netherlands, and Belgium likely being the most affected.

Impact of Brexit on UK Financial Relations

Brexit is creating uncertainty in international financial markets, which is affecting the value of the British pound and UK business investment. In response to these concerns, foreign investors reportedly have sold the pound in favor of other safe-haven currencies, such as the dollar, the yen, and the Swiss franc.31 Concerns over Brexit also may be steering some investment funds toward the United States, which puts additional upward pressure on the value of the dollar. For the UK, a depreciated pound makes the UK's exports less expensive in relative terms, which traditionally is expected to boost exports. Similarly, an appreciation in the value of the dollar makes U.S. exports more expensive and imports cheaper. Whether the UK will experience an actual increase is questionable. Some analysts argue that the UK's exports consist of high-valued-added products and that demand for these products is not very responsive to price changes. Also, given the importance of EU trade for the UK, a slowdown in EU economic growth and continuing slow growth in emerging markets may offer little boost to UK exports.32 Over the long term, a higher valued dollar may reduce foreign demand, which eventually would ease upward pressure on the dollar. In the interim, emerging economies and other countries are wary of a stronger dollar, because they fear it could have a negative contagion effect on their economies by drawing away much-needed capital.33 Uncertainties about the impact of Brexit on international capital markets apparently were among a number of factors that led the Federal Reserve on June 18, 2016, to postpone raising U.S. prime interest rates. Federal Reserve Board Chairman Janet Yellen indicated at that time that, "It [Brexit] is a decision that could have consequences for economic and financial conditions in global financial markets. If it does so, it could have consequences in turn for the U.S. economic outlook that would be a factor in deciding on the appropriate path of policy. So, it is certainly one of the uncertainties that we discussed and that factored into today's decision."

Impact of Brexit on UK Trade Relations

A Brexit vote does not immediately affect the UK's terms of trade with the EU and other countries, but could in the future. The status of UK trade relations going forward depends on the terms of the UK's negotiated withdrawal from the EU, as well as subsequent UK negotiations with the EU.41 The process for exiting the EU will take some time to negotiate, and there is much uncertainty surrounding it. Thus, Brexit's impact on UK trade relations is unclear. In terms of trade negotiations, Brexit likely would return authority to the UK to set its own external tariffs and its trade policy more broadly, an authority that currently resides with the EU.

UK Relationship with the EU

Brexit presents a question as to what extent, if at all, the UK would retain access to the Single Market for goods and services and what trade-offs could this access entail. Observers have put forward a number of possible scenarios for the UK's trade relationship with the EU post-

Brexit.42 These scenarios vary in their level of access to the Single Market, obligations to implement EU rules and regulations, opportunity to participate in EU decisionmaking, and requirements to contribute to the EU's budget, not to mention their political feasibility and timeline to negotiate.

Status of U.S.-UK Trade and Economic Relations

Brexit's impact on future U.S.-UK trade and economic relations will be closely watched in light of the relationship's magnitude (text box). In 2015, the UK was the United States' largest services trading partner, second largest foreign direct investment (FDI) partner, and seventh largest goods trading partner. The UK accounts for roughly one-fifth of overall U.S.-EU trade and investment.

Impact of Brexit on the Global Economy According to recent analyses by the World Bank, the global economy is slowly recovering from the 2008-2010 recession. The economic performance of the United States is one of the few bright spots of the global economy; the unemployment rate fell below 5% in June 2016, and GDP growth is expected to continue in the 2% to 3% range. Uncertainties concerning the economic and financial impact of Brexit began affecting movements in exchange rates prior to the results of the referendum, which, in turn, began affecting the global economy. An appreciation in the value of safe-haven currencies, especially the dollar, can affect a broad range of economic activities. The dollar serves as the de facto global reserve currency, which facilitates many international economic and financial activities. For instance, the global banking system is based on dollars, which thus serve as an invoicing currency for many commodities, including oil and gas. (As an example of the effects of appreciation on safe-haven currencies, the recent appreciation of the Japanese yen is frustrating efforts by the Bank of Japan, which has been engaging in quantitative easing to stimulate economic growth and boost exports through a lower-valued yen.) In its June 2016 assessment prior to the Brexit vote, the World Bank forecast global growth in 2016 at 2.4%, about equal to that experienced in 2015, but 0.5% below its January 2016 forecast. The assessment indicated that the global economy, although recovering slowly, faces a number of challenges, including uncertainty associated with Brexit

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