



## What Can the EU Learn from Brexit?

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European integration has advanced through increased cooperation among member states within a framework of supranational institutions. Starting with six member states forming the European Coal and Steel Community in the early 1950s, the European Community has since expanded into the European Union (EU), now comprising twenty-seven member states.

To date, only one major member state has left the European Union. In a referendum held on 23 June 2016, the UK voted to exit the EU, triggering the Brexit process on 29 March 2017 when Article 50 of the Treaty on European Union was invoked. This set a two-year deadline for the UK and the EU to negotiate a withdrawal agreement. After several extensions and the conclusion of a withdrawal agreement in October 2019, the UK officially left the Union on 31 January 2020 (CER, 2024). A last-minute trade agreement was reached just days before the final deadline, preventing a cliff-edge scenario in which trading arrangements would have defaulted to World Trade Organization (WTO) rules, potentially subjecting trade between the EU and the UK to tariffs.

Although the result of the referendum came as a shock to many, the outcome should not have been unexpected. Indeed, in his book

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*Britain and Europe in a Troubled World*, constitutional historian Vernon Bogdanor (2020) reflects on how British politics might have evolved without the European integration process. He notes that the question of how Britain should manage its relationship with the continent and European integration has poisoned British politics since the 1950s and destroyed or, at the very least, shortened the careers of many prominent British politicians. Conservative prime ministers such as Harold Macmillan (1957–1963), Edward Heath (1970–1974), Margaret Thatcher (1979–1990), and John Major (1990–1997) are all part of this group.

In 1981, a group of Social Democrats, disillusioned with the direction of the Labour Party, broke away to form the Social Democratic Party (SDP). This faction was led by prominent figures, including senior ministers Roy Jenkins and David Owen (Bogdanor, 2014). The split highlighted the deep divisions within British political parties over the European issue. The fear of a split within the Conservative Party was also a key factor behind Prime Minister David Cameron’s decision in 2013 to promise a referendum on the UK’s membership in the European Union during his Bloomberg speech, Cameron’s pledge was an attempt to appease the growing Eurosceptic wing of his party and to fend off the threat from the rising UK Independence Party (UKIP) under its charismatic and vocal leader, Nigel Farage (Bogdanor, 2024).

When the referendum was held in June 2016, a narrow majority of 52 per cent voted to leave the EU, leading to Cameron’s swift resignation the following day. His departure marked the beginning of a turbulent period in British politics. Since the referendum, and as of the writing of this chapter in autumn 2024, the UK has seen the resignation of six Conservative prime ministers.

Theresa May succeeded David Cameron and faced the monumental challenge of navigating the UK’s withdrawal from the EU. Her tenure was marked by intense parliamentary opposition and unprecedented defeats over her proposed Brexit deal. After three turbulent years, she resigned and was succeeded by Boris Johnson. Johnson, along with Nigel Farage, had been a leading figure in the Leave campaign. He secured a landslide victory in the 2019 general election with his slogan “Get Brexit Done”. Farage, now leading the Brexit Party—a party that was founded to campaign for a no-deal Brexit—played a crucial role in Johnson’s victory.

By choosing to stand down in many constituencies held by the Conservatives—while battling for seats in Labor Party strongholds—Farage helped the Conservatives secure many seats.

Boris Johnson's leadership was ultimately undermined by his controversial personal style and his pragmatic, sometimes cavalier, approach to laws, rules, and agreements—which led to his resignation in September 2022. Johnson was succeeded by Liz Truss, who advocated for a neoliberal version of Brexit: to jumpstart the British economy, the UK would leverage its newfound freedom by implementing tax cuts and deregulations, aiming to create a “Singapore on the Thames”. However, this vision was poorly received by the financial markets; interest rates soared, and the British pound plummeted. Truss became the shortest-serving Prime Minister in British history, resigning in October 2022 after just a little bit more than two months in office. Her main rival, Rishi Sunak—who had warned of the economic consequences of Truss's policies, but had been ignored—succeeded her.

Sunak's premiership marked the end of 14 years of consecutive Conservative rule. In the general election on 4 July 2024, the Labour Party won a landslide victory, securing 411 of the 650 seats in Parliament. Several factors contributed to the collapse of the Conservatives—including internal party conflicts, a cost-of-living crisis driven by post-lockdown demand surges after the Covid pandemic, and soaring energy prices following Russia's aggression against Ukraine (Griffith, 2024; Politico, 2024b). The UK's weak economic performance since the 2008 financial crisis—with over a decade of stagnant real wages—also played a significant role. Nigel Farage once again had a pivotal impact. In contrast to the 2019 election, Farage—now leading the Reform Party, a limited liability company in which he held a majority share—vigorously attacked the Conservatives over their failure to deliver on their Brexit promise of controlled migration, which had surged significantly since Brexit. Thanks in large part to Farage, Labour was able to win 63 per cent of the seats in Parliament with roughly 34 per cent of the vote.

As of fall 2024, Keir Starmer, leader of the Labour Party, has succeeded Rishi Sunak as Prime Minister. During Sunak's tenure, relations with the EU, previously strained by conflicts, disagreements, and breaches during the Brexit process, began to improve. Starmer—who voted for the UK to remain in the EU and later supported a second referendum on Brexit—is expected to further improve relations with the EU. While upholding

his red lines—no single market, customs union, or free movement—potential areas of increased cooperation could include security policy, a youth mobility scheme, student exchange, and a Sanitary and Phytosanitary (SPS) agreement. At the end of 2024, Starmer seems cautious about committing to closer cooperation (Politico, 2024a). A likely reason for this caution is the desire to avoid bolstering support for Nigel Farage’s pro-Brexit, anti-immigration Reform Party.

Why has Europe and European integration caused such significant political problems in the UK? Why has the UK, unlike any other European country, struggled so profoundly to find its place within the EU?

This chapter begins by examining why the UK initially chose to remain outside when France, Germany, the Benelux countries, and Italy launched the European integration project in the mid-1950s, and why the UK later reversed course and applied for membership. It then addresses the issues that arose due to the delayed entry and the challenges the UK encountered as a latecomer in the early 1970s. The chapter highlights the UK’s key contributions to the European project during the 1980s, particularly through the creation of the Single Market, but also how this progress generated new tensions as the EU moved towards monetary integration. Additionally, it explores how various economic crises fuelled the already present euroscepticism, which was further intensified by large migration flows following the EU’s Eastern Enlargement. After describing the process up to the referendum and the UK’s exit, the chapter concludes by discussing what lessons the EU can draw from the UK’s departure.

The UK, with its unique history, institutions, and geography, differs from other EU countries in many respects, and this makes it difficult to generalise from the British experience. Of course, the chaotic Brexit process—following the 2016 referendum—clearly illustrates how challenging and costly it is for a member state to leave the EU after many years of membership. But Brexit is perhaps more than just a cautionary tale about the “unwisdom” of leaving the European Union.

Brexit can be viewed as a protest vote, driven by growing mistrust, and as such it underscores the need to address broader economic and social discontent within the EU and its member states. Brexit also has wider implications for how the EU should approach future challenges, such as safeguarding its social model while increasing economic competitiveness, meeting climate obligations, and ensuring security and prosperity in a world marked by war and rising geopolitical tensions. Additionally, the EU must prepare for a future eastern enlargement, which could see

the union grow to 35 members. Tackling these issues in a coherent and unified way will require unprecedented levels of cooperation between member states.

The chapter emphasises that the unity demonstrated by the EU during the Brexit negotiations may serve as a valuable example. The cohesion and solidarity that followed Brexit gave the EU greater confidence in addressing severe crises, including the COVID-19 pandemic and Russia's invasion of Ukraine. This sense of unity should continue to guide the EU as it faces future challenges.

### THE BRITISH RELUCTANCE TO PARTICIPATE IN THE EARLY EUROPEAN INTEGRATION PROCESS

Over the span of just more than 70 years, Europe endured three major conflicts: the Franco-Prussian War (1870–1871), World War I (1914–1918), and World War II (1939–1945). After 1945, Europe lay in ruins once again, raising the critical question of how future wars could be prevented. The proposed solution was European integration. A key milestone in this process was the signing of the Treaty of Paris in 1951, which established the European Coal and Steel Community (ECSC), with France, Germany, Italy, and the Benelux countries (Belgium, the Netherlands, and Luxembourg) as signatories. The ECSC was the result of a plan devised by French diplomat and businessman Jean Monnet, who aimed to create a common market for the coal and steel industries of Germany and France, governed by a supranational “High Authority” dedicated to serving Europe's broader interests. Economic cooperation was intended to achieve the political goal of forming a European federation. This plan, known as the Schuman Plan, was presented by French Foreign Minister Robert Schuman on 9 May 1950. It laid the foundation for the ECSC and, ultimately, the European Union as we now know it (Baldwin & Wyplosz, 2022).

Instead of producing weapons and ammunition for mass destruction, the coal and steel industries would be repurposed for peaceful aims, laying the foundation for Europe's reconstruction. Increased trade and economic integration would unite former adversaries, France and Germany. Growing prosperity, in turn, would make future wars between the two nations unthinkable. Through international oversight and supranational institutions, Germany's heavy industry could be rebuilt without the fear of German rearmament posing a threat.

The reintegration of Germany into Europe was by no means self-evident in the years following the end of the war. For instance, U.S. Treasury Secretary under President Franklin D. Roosevelt, Henry Morgenthau Jr., supported a plan to deindustrialise Germany and turn it into an agrarian economy for the foreseeable future (Baldwin & Wyplosz, 2022). However, the plan was never implemented. Over time, it became clear that the greatest threat to peace in post-war Europe did not come from Germany, but rather from the Soviet Union. Under Joseph Stalin, the Soviet Union had occupied Eastern Europe and the eastern part of Germany.

During Harry S. Truman's presidency, the United States opted to support Europe's reconstruction through extensive economic aid, known as the Marshall Plan. However, to receive this aid, the Americans required the European states to dismantle their trade barriers, thus initiating the process of European integration.

The American leadership expressed a strong desire for the UK to assume leadership in European integration. However, this would have required British participation in the Coal and Steel Community, whose ambition was to create a European federation—a "United States of Europe". The American requests were met with instinctive, almost emotional resistance. During a lecture at Columbia University in the United States in 1952, Anthony Eden, then Foreign Minister under Winston Churchill and later Prime Minister, encapsulated this British reluctance by stating, "This we know in our bones that we cannot do" (Bogdanor, 2020, p. 16).

British reluctance and resistance to becoming involved in the supranational European integration project were evident as early as in the 1950s, and this resistance, ultimately contributed to the outcome of the Brexit referendum in 2016. But how can we understand this deeply rooted reluctance? The historical and constitutional development of the UK has been significantly different from that of other European countries. Above all, the UK has experienced a long and stable evolution of its unwritten constitution. How could the British Parliament, with its near-unlimited power to make laws, reconcile with the supranational "High Authority" of the Coal and Steel Community? This authority, for instance, had the mandate to close coal mines without the approval of member states' parliaments (Bogdanor, 2013).

The British parliamentary system was seen as more democratic. British Members of Parliament (MPs) were directly elected and held the power to

remove the government (or individual ministers) if they were dissatisfied with its policies or the actions of specific ministers. This critique, which became a central British objection to the EU, has persisted over time. The representatives of the Union's institutions were often seen as technocrats and bureaucrats, with unclear mechanisms for their removal or for holding them accountable for their decisions.

As an island nation with geography on its side, the UK had never been occupied by a foreign power. Even when British forces were defeated on the continent, they could retreat to the island, protected by the sea. The Second World War—and the fact that Britain was never conquered and managed to withstand Adolf Hitler's aggression—fostered a strong sense of British self-confidence and optimism about the future. On the continent, the mood was quite the opposite: nations were forced to reflect on how fascism and Nazism had come to power—or how they had cooperated with such regimes. For these countries, it was easier to accept new institutions with more supranational authority and less national sovereignty (Bogdanor, 2020).

The legacy of the vast British Empire, which once covered a fifth of the earth's surface, also endured in the form of the British Commonwealth. In the 1950s, many in the UK felt a stronger connection to Commonwealth countries like Canada, New Zealand, and Australia, where English was spoken and where many Britons had family ties. In contrast, the European continent was home to different languages and was a place where many British soldiers—and soldiers from Commonwealth countries—had lost their lives during the two world wars (Bogdanor, 2013).

After the end of World War II, British foreign policy sought to balance three key relationships: the relationship with the English-speaking United States (which had been instrumental in defeating Nazi Germany and was one of the two global superpowers); the relationship with the Commonwealth countries; and the relationship with the nations on the European continent. Moving closer to the continent and participating in the Coal and Steel Community could potentially upset this delicate balance (Bogdanor, 2020).

## THE TURNAROUND

The delicate balance began to shift in the late 1950s, pushing Britain towards Europe and away from the Commonwealth. This shift had two primary causes (Bogdanor, 2020). First, the British economy was

stagnating, while the six nations of the Coal and Steel Community enjoyed stronger economic growth. Between 1950 and 1973—spanning the creation of the Coal and Steel Community, the European Economic Community, and later the European Community (EC)—these countries achieved an average annual growth rate of 4.2 per cent, compared to Britain’s 2.4 per cent (Baldwin & Wyplosz, 2022). One reason for the higher growth on the continent was the more intensive post-war reconstruction, as the war had destroyed more infrastructure and production capacity there. However, a more compelling explanation lies in Britain’s persistent labour market conflicts, the government’s weak stance on trade unions, and poor management practices in British businesses, which resulted in low productivity and competitiveness (Aldous, 2024).

The second reason for the shift was political. Over the course of the twentieth century, Britain’s global influence steadily declined, and it was no longer regarded as a great power. This decline was starkly revealed during the Suez Crisis in 1956, when Egypt’s President Abdel Nasser nationalised the Suez Canal, a vital route to Commonwealth nations in the Far East. Britain, along with France, responded by launching a military expedition to reclaim control of the canal. However, the United States opposed the mission, prioritising its relationship with the oil-producing nations of the Persian Gulf. The joint British-French effort ended in failure. In the wake of the Suez Crisis, France concluded that Europe must unite and become independent of the U.S. Europe was too weak and needed to unify to regain global influence. The British, however, took a different path and sought to strengthen their “special relationship” with the United States.

Emboldened by their economic successes, the six countries of the Coal and Steel Community sought to advance political integration through the creation of a defence community. However, when the proposed defence treaty was never ratified, the six nations reverted to their earlier strategy of economic integration. The idea was to first link member states economically, and then, once they were deeply interconnected through trade, agreements, and shared institutions, to gradually move towards political integration.

In the 1957 Treaties of Rome, signed at Capitoline Hill in Rome by the members of the Coal and Steel Community, economic integration was expanded beyond steel and coal to other sectors. The four freedoms were established, allowing goods, services, labour, and capital to move freely across borders within the European Community. To ensure fair



competition, rules were introduced to regulate competition and restrict state aid by member countries. The EC also became a free trade area and a customs union, applying uniform tariffs on imports from non-member countries. Additionally, a common agricultural policy was introduced.

The economic successes of the European Community (EC) countries made it increasingly clear that Britain's position outside the EC would come at a cost. Efforts to negotiate a free trade agreement between Britain, other European nations, and the EC failed after Charles de Gaulle became president of France in 1958. In response, Britain established the European Free Trade Association (EFTA) alongside the Nordic countries—Denmark, Norway, and Sweden—as well as Switzerland, Austria, and Portugal. EFTA was a much looser arrangement compared to the EC. Membership in EFTA required only the removal of trade barriers between members, allowing countries to maintain independent trade policies. Consistent with British preferences, EFTA had no supranational institutions and no ambitions for deeper integration among its members.

The increasingly integrated European Community (EC) bloc grew faster than the less integrated European Free Trade Association (EFTA) bloc. This outcome puzzled economists at the time. Classical trade theory, based on comparative advantage, explained why countries specialised in producing goods and services where they had an advantage—like Germany producing cars and France producing wine. Both nations would then benefit from trade: Germany would export cars and import wine—France would export wine and import cars. However, this was not the primary type of trade expanding during the early integration process. Instead, intra-industry trade flourished: Germans bought French cars, and the French bought German cars. To explain why intra-industry trade occurred, a new trade theory emerged, developed by economists like Paul Krugman, who would later win the Nobel Prize in economics for his work.<sup>1</sup>

The new trade theory demonstrated that the removal of trade barriers would initially lead to a sharp increase in competition, causing weaker companies to fail. The surviving firms grew larger and more sustainable as productivity improved through better utilisation of economies of scale in a larger, more integrated market. Consumers benefited from lower prices and a wider variety of goods and services. The theory also predicted

<sup>1</sup> Seminal papers are Krugman (1979, 1980). For a textbook treatment, see Feenstra and Taylor (2021) and Baldwin and Wyplosz (2022).

that the benefits of trade—higher productivity, lower prices, and greater product variety—would increase as more countries joined the integrated market. Since the EC bloc was larger and more integrated than EFTA, joining the EC became increasingly advantageous, making EFTA more fragile. As EFTA members left to join the EC, the EC became even more attractive, while EFTA's appeal weakened. This domino effect eventually led to all original EFTA members, except Norway and Switzerland, leaving the bloc.<sup>2</sup>

Conservative Prime Minister Harold Macmillan submitted the first British application for EC membership in 1961. It was believed that exposing British firms to competition from the continent, while gaining better access to the larger EC market, would revitalise Britain's stagnating industry. However, Macmillan's plans were blocked in 1963 when French President Charles de Gaulle vetoed the application in the Council of Ministers. De Gaulle's opposition stemmed from a deep divide between Britain and France over the Common Agricultural Policy (CAP). Britain, with its relatively small agricultural sector, had long relied on cheap food imports from Commonwealth countries like New Zealand and Australia. The British government supported its agriculture through direct subsidies funded by taxes, sustaining domestic production while enabling consumers to access affordable imports. On the continent, the agricultural sector was much larger. French farmers were guaranteed high prices and protected from the low prices of the world market by high tariffs—a system enshrined in the EC's Common Agricultural Policy. At the heart of the conflict was the fact that British voters, primarily consumers, sought low living costs, while French voters—farmers and landowners—wanted protection for their livelihoods (Bogdanor, 2020).

In the early 1960s, it became clear that the cost of British membership in the EC would be substantial, requiring significant adjustments. Beyond accepting a system of supranational governance that would diminish its sovereignty, Britain would also have to adopt the Common Agricultural Policy (CAP). Living costs would rise as more expensive European food replaced cheaper imports from the world market. Additionally, Britain would be compelled to impose tariffs on imports from Commonwealth countries, with which it had long maintained strong ties. Despite these

<sup>2</sup> See, Baldwin (1999).

challenges, the decision to seek membership was deemed necessary in light of the prevailing economic and political conditions.

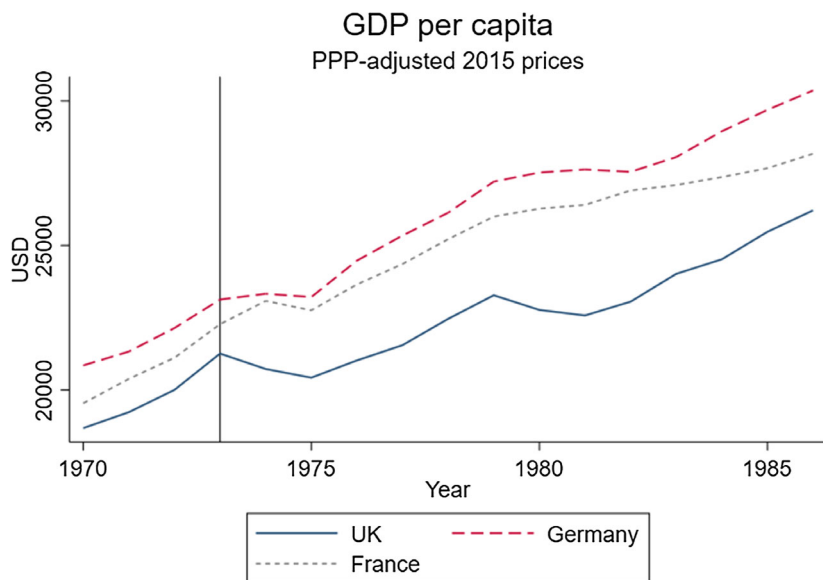
## DISAPPOINTMENT

Britain's membership in the EEC was finally secured in 1973 under the leadership of Edward Heath, the most pro-European Conservative prime minister to date. Georges Pompidou, who had succeeded de Gaulle as France's president, expressed his belief that Britain had become more "European" under Heath's leadership (Bogdanor, 2020, p. 27). However, as a latecomer to the community, Britain faced challenges in advocating for significant reforms.

A key obstacle was the so-called "Luxembourg Compromise", which France had secured under de Gaulle after boycotting Council of Ministers meetings for six months in what became known as the empty chair policy. As a result, no substantial changes affecting a member state's vital interests could be made without unanimous agreement. This effectively neutralised any threat that free trade-oriented Britain might have posed to the Common Agricultural Policy.

Britain's entry into the EEC did not deliver the anticipated boost to its economy. Figure 4.1 shows GDP per capita, a common measure of wealth, for the UK, France, and Germany from 1970 to 1986. The vertical line marks Britain's entry year in 1973. At that time, the UK had slightly lower prosperity compared to France and Germany. Following the entry, the gap between Britain and its continental counterparts widened. It was not until the late 1980s that Britain began to close this income gap.

Why did not Britain's entry into the EEC bring the expected economic benefits? Several factors played a role (Bogdanor, 2020). By the time Britain joined in 1973—over a decade after Macmillan's initial attempt in 1961—the post-war economic boom had ended. Large United States deficits from ambitious welfare programs and the costs of the Vietnam War had triggered rising inflation. The collapse of the Bretton Woods system, which had maintained fixed exchange rates, added further instability. Additionally, the Yom Kippur War in the Middle East led to a spike in oil prices, fuelling inflation. Labour disputes in Britain worsened, culminating in the turbulent winter of 1978–1979. Many Britons were also dissatisfied with the terms of membership, facing higher food



**Fig. 4.1** GDP per capita development in U.S. dollars from 1970 to 1986 for the UK, Germany, and France, adjusted for purchasing power parity at 2015 prices. The vertical line marks the UK's accession to the EEC in 1973 (*Source* OECD, n.d.)

prices due to costly European imports, and questioning how much they contributed to the EEC compared to what they gained.

Before Britain joined, changes were made to how tariff revenues from the Common Agricultural Policy (CAP) were distributed. These funds were allocated based on the size of each member state's agricultural sector. As Britain had many consumers but few farmers, it contributed significant sums, which were then used to support countries with larger agricultural sectors, such as France (Bogdanor, 2020). The issue of Britain's high net contribution was not resolved until 1984, when Prime Minister Margaret Thatcher successfully negotiated a rebate in the Fontainebleau Agreement.

Opening the British market to continental competition proved more challenging than anticipated. French and German firms had already adapted to the intense competition within the common market, which had forced them to become more efficient. British companies struggled

to keep pace with their continental rivals. This disadvantage was further exacerbated by Britain's entry into the EEC during a period of rising inflation and economic downturn, unlike the period of growth that had characterised the earlier years of EEC membership.

Despite these challenges, the 1975 referendum showed that a large majority of Britons still wanted to remain in the EEC. However, the pro-European sentiment in 1975 was not stronger compared to 2016. Instead, the campaign to leave in the 1970s was associated with more extreme politicians, such as Barbara Castle and Tony Benn on the left, and Enoch Powell on the right. Voters placed greater trust in their party leaders and centrist politicians, who advocated for remaining (Bogdanor, 2020).

By the late 1970s, significant political changes were underway. Labour could no longer manage the escalating conflicts in the labour market, paving the way for the Conservatives and their new leader, Margaret Thatcher, who had replaced Edward Heath. When Thatcher won the 1979 election, she began implementing a programme aimed at weakening the trade union movement, carrying out major privatisations, and reducing the state's role in the economy. As shown in Fig. 4.1, the British economy also began to recover during the 1980s. Although Margaret Thatcher later became increasingly critical of the federalist aspects of European integration, she initially started her political career as an enthusiastic supporter of Britain's membership in the European Economic Community (EEC). She also paved the way for deeper European integration, playing a key role alongside Commission President Jacques Delors in the creation of the Single Market.

The goal of the Single Market was to establish a truly unified market with the free movement of labour, capital, goods, and services. Since the Treaty of Rome in 1957, member states had worked to remove obstacles such as tariffs and import quotas that hindered trade between them. However, these barriers were increasingly replaced by non-tariff barriers, such as national standards and regulations, which made it more difficult for companies from other member states to compete with domestic firms. While some regulations were justified on the grounds of safety or worker protection, others were used to shield domestic industries from foreign competition. Approximately 300 such trade barriers were identified, and they could not be eliminated without introducing majority voting in the

Council of Ministers. If the national veto remained, individual countries—under political pressure from home—would always seek to retain some of these barriers (Bogdanor, 2014).

To ensure Britain could capitalise on London's role as Europe's financial hub, Margaret Thatcher aimed to eliminate barriers that hindered the export of British financial services. For this reason, she signed the Single European Act on behalf of the UK in 1986. This Act not only established the Single Market but also introduced majority voting in the Council of Ministers. In doing so, however, she weakened Britain's national sovereignty—an irony, given her later iconic status among Eurosceptics and Brexit supporters.

### THE 1992 ERM CRISIS: GROWING EUROSCEPTICISM

The preamble to the Single European Act included provisions for further European integration, aiming towards an economic and monetary union and the introduction of a common currency, the euro. The question of whether the UK would participate in this monetary union soon became a source of new tensions.

Discussions around a common currency began as early as 1970 with a report prepared under Luxembourg's Prime Minister, Pierre Werner. In 1979, the European Monetary System (EMS) was established. The EMS aimed to create a system of fixed exchange rates within the community, with the ultimate goal of introducing a common currency. This shared currency would provide stability and increase Europe's influence on the global stage. The common currency was also a logical extension of the Single Market. A unified currency would reduce transaction costs in trade by eliminating currency exchange costs, and the reduced uncertainty over future exchange rates would lower risks in commercial decisions, such as investment. Consumers could more easily compare prices, enhancing competition in the product market.

However, a common currency also required a common central bank with a unified monetary policy. A European central bank would face challenges in managing so-called asymmetric shocks. It would need to consider the economic conditions across all member states; for instance, lowering interest rates to counter a downturn in one member country could lead to overheating in another.

In the UK, the issue of monetary integration was particularly sensitive—should Britain give up the pound sterling? Margaret Thatcher was

firmly opposed, but others in her government were more pragmatic. Geoffrey Howe, her deputy prime minister, did not want to dismiss the euro outright, fearing that doing so would isolate Britain and diminish its influence. Others, like Chancellor of the Exchequer Nigel Lawson, argued for taking an initial step towards the euro by joining the European Exchange Rate Mechanism (ERM), where member states would keep their exchange rates stable for a time before adopting the common currency. The idea was that a fixed exchange rate would serve as an anchor to extinguish or at least control the high inflation that had plagued the British economy since the 1970s and 1980s. By pegging the pound to the strong German Deutsche Mark (DM), the British government would be forced into fiscal discipline. Firms and trade unions would also need to take responsibility for wage-setting, preserving the competitiveness of British companies in the process (Bogdanor, 2014, 2016).

The conflict between Thatcher and her closest ministers intensified as she increasingly opposed the economic and monetary union, which she viewed as a covert attempt to establish a European superstate. This conflict weakened Thatcher's position, and a month before her resignation, she was forced to agree to Britain joining the ERM. John Major, who was then Thatcher's Chancellor of the Exchequer, succeeded her as Prime Minister. Through skilful negotiations, Major managed to secure an opt-out for Britain from the requirement to adopt the euro when the Maastricht Treaty was signed in 1992.

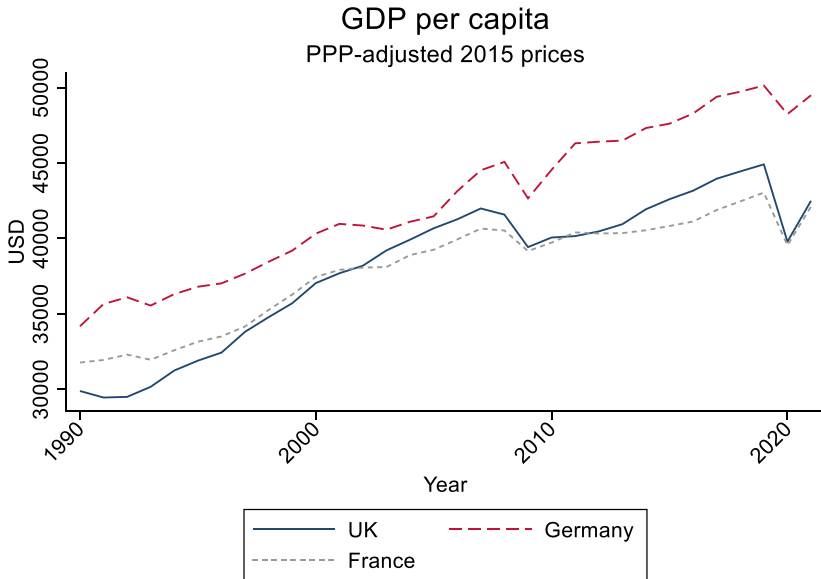
The UK entered the ERM in October 1990, but it soon became clear that the pound was overvalued, leading to widespread currency speculation. Speculation against the pound (and other European currencies) was exacerbated by uncertainty surrounding the ratification of the Maastricht Treaty, as well as the German reunification in 1990, following the fall of the Berlin Wall in 1989. Reunification created inflationary pressures, prompting the German central bank, the Bundesbank, to raise interest rates. In response, the Bank of England was forced to increase its rates from an already high level to prevent the pound from falling below the official exchange rate of 2.95 Deutsche Marks per pound. Through extensive intervention in the foreign exchange market to maintain the pound's value, the central bank lost a large portion of its foreign currency reserves. On September 16, 1992, known as Black Wednesday, the Bank of England was forced to capitulate, and the pound was allowed to float freely on the currency markets. The UK subsequently plunged into a financial and economic crisis.

In parallel with an earlier conflict over free trade in the 1870s, the ERM crisis sparked a civil war within the Tory party, with Eurosceptics now taking the lead. At the first party conference following the ERM crisis, former minister under Margaret Thatcher and former party chairman Norman Tebbit delivered a fiery speech to the delegates. He posed three questions: “Do you want to be citizens of a European Union?”; “Do you want a common currency?”; “Do you want other countries to control our immigration policy?” The delegates responded with a resounding “No!” to each of the questions (Bogdanor, 2020, p. 95). In this way, the ERM crisis set in motion the process that would eventually culminate in the Brexit referendum of 2016.

With a floating exchange rate and falling interest rates, the British economy recovered and grew rapidly throughout the 1990s, up until the global financial crisis of 2008, as shown in Fig. 4.2. However, John Major did not receive credit for the recovery and lost the 1997 election to Labour’s Tony Blair. Since the 1950s, Labour had been opposed to participation in the European integration process, partly because they associated European integration with capitalism, as Christian Democratic parties were strong on the continent after the war. There was also a suspicion that Europe’s supranational institutions could obstruct Labour’s plans to nationalise British steel and coal industries, hindering the introduction of socialism. Labour began to shift its stance during the presidency of Jacques Delors at the European Commission in the 1980s. Delors advocated for the Single Market to serve not only business and commercial interests but also to have a social dimension, with expanded rights and health protections for workers (see also Ann-Christine Hartzén’s chapter in this volume).

During Tony Blair’s tenure as Prime Minister, the issue of Europe diminished in importance. However, after the accession of Eastern European countries to the EU in 2004 and 2007, migration became an increasingly significant political issue. When the original six countries signed the Treaty of Rome in 1957, large migration flows were unlikely, as the member states were industrial nations at roughly the same level of development. After the Eastern enlargement, significant wage gaps existed between old EU countries like the UK and France, and new EU members such as Romania and Bulgaria. The UK became a popular destination for migrants from Eastern Europe. English was (and is) a global language which is relatively easy to learn. Furthermore, after Margaret Thatcher’s deregulations, the British labour market offered plenty of jobs, especially





**Fig. 4.2** The development of GDP per capita in U.S. dollars from 1990 to 2021 for the UK, Germany, and France. GDP per capita is expressed in purchasing power-adjusted 2015 prices (*Source* OECD, n.d.)

in low-skilled service roles, construction, and agriculture. Unlike several other EU countries, the UK did not apply the seven-year transitional provisions that allowed member states to limit migration from Eastern Europe. As a result, the number of EU migrants far exceeded earlier expectations. Since the UK, due to the EU's principle of free movement, lacked the ability to regulate immigration from other EU countries, the rising migration from Eastern Europe became an increasingly contentious political issue.

In 2010, David Cameron became Prime Minister, and the Conservatives regained power after three consecutive election losses. The global financial crisis of 2007–2008 had swept across the world, but decisive actions by governments and central banks prevented the collapse of the global economy. In response to the crisis, the Conservative government implemented austerity policies, significantly cutting public spending

and investment.<sup>3</sup> A few years after the financial crisis, the Eurozone crisis emerged, primarily affecting Southern Europe. While the Eurozone crisis did not directly impact the UK, which was outside the euro area, it had indirect effects. The near-depression-like downturn in Southern Europe created new migration flows, with unemployed Greeks, Spaniards, Portuguese, and Italians heading north searching for work.

The crisis in Southern Europe also highlighted the fragility of the European integration project, a point which the Eurosceptic faction within the Conservative Party capitalised on. For instance, British Foreign Secretary William Hague described the Eurozone as a “burning building with no exit” (The Spectator, 2011). Eurosceptics argued that the ERM crisis of the early 1990s was not a failure, but rather a stroke of luck, as leaving the ERM ensured Britain stayed out of the eurozone. Although John Major had secured an opt-out from the euro, Parliament still had the option to adopt it.

In 2015, the Syrian refugee crisis erupted, and terror attacks occurred in Paris and Brussels. These attacks were often linked to the refugee wave in the political debate, despite a lack of clear evidence supporting this connection (Politico, 2016). The already heated debate over immigration intensified, further fuelling support for UKIP under Nigel Farage.

It was against this backdrop that David Cameron, in his 2013 Bloomberg speech, promised a referendum on the UK’s membership in the EU (Bogdanor, 2020, 2024). After successfully keeping the United Kingdom together in the 2014 Scottish independence referendum, Cameron sought to secure the British public’s approval to remain in the EU under renegotiated terms, hoping to finally resolve the European issue. However, the gamble failed, and the result of the June 2016 referendum was that the UK would leave the EU.

## POST-BREXIT: A MORE UNITED AND EFFICIENT EU

After the initial shock from the result of the British referendum, significant uncertainty arose within the EU. Would other member states follow the UK’s example, and if so, which? Could the EU maintain a united front in the upcoming negotiations with Britain?

<sup>3</sup> Fetzter (2019) shows that the austerity policies implemented in the UK following the financial crisis may have influenced the outcome of the 2016 Brexit referendum.

However, it soon became clear that the remaining member states recognised the importance of safeguarding the Single Market and the EU's decision-making process. While bilateral agreements with the UK could offer short-term gains, the long-term costs would be substantial if the EU were to disintegrate or even collapse.

Brexit reminded EU member states of the value of the Single Market and prompted them to act efficiently in unity (see also the chapter by Nicholas Aylott in this volume). Michel Barnier, who became the EU's chief negotiator and, thereafter French Prime Minister, successfully fostered cooperation between the EU's major institutions. He also kept member states, and their parliaments informed with an unprecedented level of transparency (Laffan & Velde, 2023). With the 27 member states united and backed by the economic power and institutional resources of the union, the EU emerged as the stronger party in the negotiations (de Rynck, 2023).

Economic analyses, largely grounded in new trade theory, indicated that the costs for the UK of leaving the Single Market and Customs Union could be substantial (Chen et al., 2017; Felbermeyer et al., 2017). However, this information appeared to have limited influence on the British side, particularly among ardent Brexiteers. The economic forecasts came from experts, but trust in experts had eroded after the financial crisis. This sentiment was famously articulated by Conservative politician Michael Gove on June 3, 2016, when he declared on Sky News, "People in this country have had enough of experts".

A long period of globalisation and technological development had generated greater wealth but also growing inequalities, often with a strong regional dimension.<sup>4</sup> Large sections of the British population were dissatisfied and felt that Brexit could not worsen their situation.<sup>5</sup> Others argued that any short-term economic pain was a price worth paying for regained sovereignty, believing that the economic benefits of Brexit would emerge in the long term (see, for instance, Hannan, 2023).

<sup>4</sup> Autor et al. (2013) examine the effects of globalisation on the labour market and the distribution of wealth of by studying the impact of U.S imports from China. Autor et al. (2020) demonstrate how increased import competition from low-wage countries had consequences for the outcome of the 2016 U.S. presidential election, when Donald Trump was elected President of the United States.

<sup>5</sup> Colantone and Stanig (2018) shows that support for Brexit was higher in regions that had been more severely affected by economic globalisation.

Although the UK was expected to be more adversely affected by Brexit than the EU, smaller EU countries geographically closer to the UK—such as Ireland and Belgium—were projected to experience greater economic impacts compared to larger EU countries farther away (Simon et al., 2017). Despite these asymmetric effects, and despite significant fractions in several member states advocating for following the UK's exit, the EU countries remained united throughout the lengthy and complex Brexit negotiations (Laffan & Velde, 2023). An important lesson from Brexit is the reminder of what the EU can achieve when it stands together.

A comparison with the EU's handling of the Eurozone crisis in 2012 is revealing. During that crisis, the European Commission was largely sidelined, with decision-making shifting towards the larger member states in the Council of Ministers, notably Germany and France (Brunnermeier et al., 2016). Under pressure from Germany, the Commission was forced to cooperate with the European Central Bank and the International Monetary Fund, together forming the so-called “troika”. The crisis led to near-depression levels of unemployment in countries such as Greece and Spain and sparked a sharp confrontation between Mediterranean countries and northern Eurozone states like Germany and the Netherlands.

The unity and cohesion that emerged in the wake of Brexit gave the EU newfound confidence in addressing subsequent crises. During the COVID-19 pandemic, the EU remained resolute, launching significant support measures, including the landmark NextGenerationEU (NGEU) program, with the Recovery and Resilience Facility (RRF) as its centre-piece. A substantial portion of these programmes was financed through joint borrowing—an unprecedented move that would have been inconceivable, and, likely, unachievable had the UK remained in the EU (see also the discussion in Nicholas Aylott's chapter in this volume). The RRF also provided the EU with a new mechanism to exert influence over member states that violated the rule of law and other fundamental EU values. Furthermore, the EU demonstrated an (almost) unified front against Russia's invasion of Ukraine, adopting joint sanctions packages and even collectively financing military aid to Ukraine (Engelbrekt, 2024).

## COULD THE UK REJOIN A REFORMED EU?

Almost a decade after the Brexit vote, the European Union is experiencing a different type of crisis. Unlike the Euro crisis or the Covid crisis, this is a slow process which, in the long run, may impair the European way of life, lower Europeans' living standards, and diminish Europe's stance in the world. Europe is suffering from anaemic economic growth and low productivity, and it is losing its international competitiveness.

In 2024, within the span of just four months, two groundbreaking reports on the European economy were released, both calling for fundamental reforms of the EU. The first, authored by former Italian Prime Minister Enrico Letta (2024), focused on the Single Market, while the second, by former European Central Bank President and Italian Prime Minister Mario Draghi (2024), addressed European competitiveness.

Somewhat ironically, these reports echo arguments made by Vote Leave during the Brexit debate leading up to the 2016 referendum. Brexiteers emphasised the potential benefits for Britain in strengthening ties with the dynamic U.S. economy and forging new partnerships with fast-growing countries in South Asia. They framed this vision as a bold, forward-looking strategy, contrasting it with remaining in a stagnant and over-regulated European Union.<sup>6</sup> This narrative resonated with a British public that had, for decades, been exposed to a largely negative portrayal of the EU by the British press.<sup>7</sup>

On the continent, the slow growth of the European economy was seen more as an inconvenience than a crisis. The EU continued to benefit from trade with countries outside the Union. Still, the cornerstone of the European integration project remained the Single Market, with its primary goal of deepening integration among member states. The EU boasted the world's largest integrated market, and from this perspective, declining relative economic performance was perhaps less of a priority.

This situation has since changed. The EU can no longer rely on growing world trade within a stable, multilateral, rules-based system, and European firms are facing stronger international competition from both Chinese and U.S. companies, often supported by state subsidies.

<sup>6</sup> See, for instance, Hannan (2016).

<sup>7</sup> An iconic example is the front-page headline of the large tabloid *The Sun* on 1 November 1990: "Up Yours Delors". There are numerous other examples of the British press portraying the EU in a negative light (see Wring, 2016).

Following Russia's invasion of Ukraine, the EU is confronting a significant security threat from Russian revanchism and expansionism under President Vladimir Putin. The sanctions imposed on Russia have resulted in European industries losing access to a cheap energy source in the form of natural gas, further undermining their competitiveness.

There is in late 2024 a sense of urgency. Higher growth is essential to fund investments in decarbonisation, crucial for the EU's ambitious plans to combat climate change, and in digitalisation to close the technology gap with the U.S. and China, particularly in emerging fields like Artificial Intelligence (AI). Furthermore, increased growth is needed to finance investments in resilience, security, and defence as the EU faces new geopolitical risks in a world where it can no longer rely solely on the U.S. security umbrella. Robust growth is also vital for sustaining social welfare systems across the EU and for creating jobs for its citizens.

As highlighted in Mario Draghi's report (2024), boosting the European economy and increasing international competitiveness require Europe to make more efficient use of its resources, with a particular emphasis on increasing productivity. Strengthening international competitiveness is also a key priority in Ursula von der Leyen's agenda for her second term as President of the European Commission, which began in September 2024. If the EU succeeds in transforming itself into a more productive, resilient, and less regulated economy, could this prompt the UK to seek a closer relationship with the EU? In a world marked by increased regionalization rather than globalisation, if the UK's economic development is hindered by post-Brexit challenges, might the UK—as it did in the 1960s and 1970s—reconsider its stance?

As of 2024, economic research on Brexit has transitioned from model-based predictions to empirical analyses examining how the UK's economy has been affected by leaving the EU. However, empirical research on Brexit faces significant challenges. One issue is that the UK has only been outside the Single Market and Customs Union since 1 January 2021. Another is that the withdrawal process after the 2020 Trade and Cooperation Agreement (TCA) coincided with the pandemic lockdowns. Nevertheless, research has made some progress. Springford (2022) employs a statistical analysis to create a “synthetic UK” based on a group of developed countries with close economic ties to the UK.<sup>8</sup> This synthetic UK

<sup>8</sup> A growing body of literature addresses the economic consequences of Brexit as more data becomes available. Portes (2022) summarises the effects on goods trade, services

provides an indication of how the economy might have evolved had the referendum outcome been different. He finds that, compared to the projected development of the UK's GDP had it remained an EU member, the country's GDP was approximately five per cent lower in 2021. From the increase in non-tariff barriers on UK-EU trade, the Office for Budget Responsibility (OBR, 2024) estimates that the TCA will reduce long-run productivity by four per cent relative to remaining in the EU. These estimates suggest a significant cost of Brexit, but not the cliff-edge that was a concern during the Brexit debate.

The economic effect of Brexit on the UK economy might be thought of as a slow puncture—it takes time before it is noticed, but once noticed, it is hard to detect when and where the problem emerged. Still, the public in Britain seems to have sensed the negative effect of Brexit on the economy, as opinion has shifted since the 2016 referendum. In August 2024, a YouGov poll (YouGov, 2024) showed that 53 per cent of respondents supported rejoining the European Union, while only 33 per cent were opposed. However, support for holding another referendum may be more tempered, as the political and social disruption of the 2016 referendum still lingers in the public memory.

The EU is not the same union that Britain chose to leave in 2016. With ongoing reforms, the EU will continue to evolve. In his report, Mario Draghi estimates that the scale of investment needed to revitalise the EU economy and enhance its competitiveness would have to be nearly five times greater than that of the Marshall Plan, which helped rebuild Europe over seventy years ago. While private sector contributions could cover some of these costs, a substantial portion would still need to come from common EU-wide funding. Enrico Letta's report argues that the Single Market should be expanded to include strategic sectors such as energy, telecoms, and finance, which were excluded from its original framework. National governments would need to cede further sovereignty, mirroring the transformative reforms led by Margaret Thatcher and Jacques Delors in the mid-1980s when the Single Market was first created.

The European Union is also preparing for further Eastern enlargement, with Ukraine, Moldova, Georgia, and the Western Balkan countries as potential new members (see Mats Öhlén's chapter in this volume).

trade, international value chains, the labour market, and immigration. Dingra and Sampson (2022) conduct a similar review. Gudgin (2022) offers a critique of Springford's (2022) methodology of using a "synthetic UK" to estimate the economic costs of Brexit.

Enlargement will require enhancing the EU's functionality, including reforming the decision-making process with a broader use of qualified majority voting in the Council of Ministers.

Becoming part of an even more federal EU would be hard to accept for Brexiteers who fought to “take back control” of their money, laws, and borders.<sup>9</sup> Despite strong pro-European sentiment among some Labour MPs and widespread support for closer ties, Labour Prime Minister Keir Starmer is likely to proceed cautiously, avoiding significant changes to the UK's current relationship with the EU (as of autumn 2024). Notably, Reform Party leader Nigel Farage successfully unseated three Conservative Prime Ministers—David Cameron, Theresa May, and Rishi Sunak—over Brexit-related issues (Bogdanor, 2024). In conclusion, the UK is unlikely to rejoin the European Union in the foreseeable future, even if the EU advances its reform agenda.

It is worth noting that the UK has yet to fully capitalise on its regulatory freedom post-Brexit. The EU-UK Trade and Cooperation Agreement (TCA), signed in December 2020, includes provisions that regulate how the UK and the EU can diverge in terms of regulation, especially concerning fair competition and level playing field commitments. However, the TCA primarily focuses on maintaining a level playing field in sectors where there are established regulations and competitive implications, such as environmental policy, labour laws, and competition rules. It is less clear how the TCA applies in emerging sectors, where the regulatory framework is still evolving.

For example, in Artificial Intelligence (AI), the EU has adopted a risk-based regulatory approach, while the UK has opted for a more outcome-based, technology-neutral strategy. Should the UK's more flexible regulatory framework—supported by its world-class universities and London's financial hub—prove more successful in fostering innovation, it could serve as an inspiration. The emergence of regulatory divergence in new emerging sectors could present a new set of challenges for the EU, potentially weakening its appeal if other countries see the UK's path as a model.<sup>10</sup>

<sup>9</sup> The slogan “Take back control” is widely associated with Dominic Cummings, the campaign director for Vote Leave during the Brexit referendum.

<sup>10</sup> In the 2024 Global AI index (Tortoise Media, 2024), the UK is ranked highest of all European countries. Only the U.S., China and Singapore are ranked higher.



## WHAT CAN THE EU LEARN FROM BREXIT?

While the UK's decision to leave the EU was shaped by specific factors, its broader implications touch on challenges that resonate across Europe. What can the EU learn from Brexit and how can these insights shape its path forward?

### *Address Broader Economic and Social Discontent*

It is difficult to generalise why a country would choose to leave the union. The case of the UK with its unique history, institutions, and geography differs from other EU countries in many ways. However, Brexit still offers more than a singular case study. It can be seen as a protest vote driven by growing mistrust, which arose from the economic fallout of the financial crisis—characterised by stagnant real wages—and the long-term effects of globalisation and technological change, which eroded job security and deepened inequality. From this perspective, understanding Brexit is not just a matter of analysing one country's departure, but rather a vital lesson for the EU in addressing broader economic and social discontent across the continent.

### *Reforms for the EU Are Urgent to Increase Growth and Productivity*

If the new reform agenda of the European economy falters—if decarbonisation and the green transformation become a drag on growth rather than a catalyst, and if member states cannot agree on the necessary levels of cooperation, coordination, and investment—the EU's appeal may weaken. In a scenario of continued stagnation, the EU will face a “trilemma”: it will struggle to address climate change, bolster resilience and uphold security, and safeguard its social model simultaneously. The potential failure to deliver on core values—prosperity, equity, equality, peace and stability—could jeopardise European integration itself, further emboldening far-right Eurosceptic parties, which have gained significant ground in both the European Parliament and national legislatures in recent years.

### *EU Member Countries Must Cooperate on a Larger Scale Than Ever Before*

To raise productivity and increase growth in an increasingly competitive global environment, EU member countries must therefore cooperate on a larger scale than ever before. The unity demonstrated by the EU during the Brexit negotiations offers a valuable lesson. The cohesion and solidarity that followed Brexit gave the EU greater confidence to address subsequent crises, such as the COVID-19 pandemic and Russia's invasion of Ukraine. This renewed sense of unity should guide the EU in tackling its future challenges, including safeguarding the EU's social model, fulfilling climate obligations, and providing security and prosperity. Moreover, the upcoming Eastern enlargement, which could see the union expand to 35 members, will require reformed institutions to function effectively.

### *Encourage the UK to Find Its Place Within the European Community*

Finally, while the UK is not expected to seek re-entry into the EU in the foreseeable future, the evolving nature of the union could provide opportunities for renewed cooperation. In an expanded EU, with potentially different types of membership, the EU should encourage the UK and other European countries to find their place within the European community. However, this must be achieved without compromising the union's core principles, ensuring that any future relationship remains anchored in the values that bind the EU together.

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