

Brexit: Implications for the EU and the world

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Six months after the historic vote of the UK people to leave the European Union, the political and economic shock still reverberates in Britain and the rest of the EU. In order to untangle the deep relationship between Brussels and London after more than 40 years of integration, the UK and the EU-27 are faced with many difficult trade-offs. Despite common economic interests to minimize insecurity and keep trade relations as open as possible, the political dynamics in the UK and the rest of the EU point in a very different direction – towards long and protracted negotiations resulting in a hard divorce.

The long and complex Brexit procedure will further turn the EU and the UK inwards

First, it is imperative to think of Brexit not as an event, but rather a process of many layered negotiations that may well stretch out beyond 2020. According to EU law, any member state may leave the European Union, starting with a notification to the European Council of its intent. The UK government has announced this notification until the end of March 2017. Although the UK Supreme Court is set to rule in January 2017 whether an Act of Parliament is necessary in the UK to trigger the exit procedure, neither Houses of the UK Parliament are likely to block or even significantly delay the exit notification in light of the political mandate from the referendum. This notification will kick off negotiations on an ‘exit agreement’, which are limited to two years (extension by unanimity is possible), i.e. until early 2019 just before the next European parliamentary elections. This time limit is extremely ambitious for the complex exit negotiations, and is also marred by the fact that both national elections in both France and Germany in 2017 will severely hinder the negotiations in the first year.

More importantly, the exit agreement does not cover the most important question for post-Brexit Britain, which is the future economic and political relationship to the EU-27, in particular in relation to the single market. A second, so called ‘status agreement’ is therefore needed, which is at least legally not directly tied to the exit agreement. If the latter comes into force first, the UK would fall back to a WTO-status in regards to the EU, which would entail severe economic consequences, such as the reintroduction of tariffs. To avoid these, further negotiations on a transitional agreement with the EU alongside the exit agreements are likely to be necessary. Negotiations for a full and comprehensive EU-UK trade agreement could last even longer. In comparison, the Comprehensive and Economic Trade Agreement between the EU and Canada (CETA), taken from the start of the preliminary talks in 2006 to the ratification planned for 2016/17, took a whole decade to negotiate.

But these are not the only negotiations the UK in particular has to engage in. In case it leaves the EU’s customs union – which is most likely after the UK government sets up a new Department for International Trade – requires it to renegotiate its tariffs within the WTO and each of its member states. This is only the foundation for new free trade agreements to replace and supplement the 41 EU trade agreements it loses access to. Further difficult negotiations the UK government is confronted with are the arrangements with the Republic of Ireland on the border to Northern Ireland, with Spain on Gibraltar and internally on Scotland. In short, for the politically foreseeable future, the EU as a whole and the UK government in particular

will be largely occupied by the different layers of Brexit negotiations, severely limiting resources to tackle other important international challenges. This was exemplified by Theresa May's first programmatic speech as prime minister to the Conservative Convention in October 2016, in which the EU negotiations were the only issue of foreign and security policy she mentioned – with not a single word on Russia, Libya, Syria or any other external challenge uttered.

The political dynamics point towards a 'hard Brexit'

The most crucial and defining question the EU and the UK will have to agree upon in these complex negotiations is their future relationship. Economically, the case should be clear. The uncertainty created by the Brexit referendum makes investment and other planning decisions concerning cross-border trade between the UK and the EU more difficult, including for international investors who have traditionally used the UK as a gateway to the single market. Overall, the EU remains the UK's largest trading partner, accounting for 47 percent of the UK's exports and 45 percent of its imports in August 2016. On the other hand, the importance of the UK to individual EU member states varies from largely insignificant (e.g. Central and Eastern Europe, Southern Europe) over important trading partner (e.g. third largest export market to Germany) to single most economic partner (Republic of Ireland). Overall, it would therefore be in both sides' economic interests to avoid prolonged uncertainty and keep the UK as far as possible in the single market.

The political dynamics, however, point in the exact opposite direction. Not only will the complex negotiations lead to years of prolonged uncertainty, the red lines emerging on both sides all but rule out a full participation of the UK in the single market or even a privileged access like Norway or Switzerland have. In the analysis of the May government, the two main factors who drove the Leave vote were concerns on migration and sovereignty. As first guiding principles Prime Minister May has therefore proclaimed limits on free movement of people and a rejection of any kind of binding rule making or court oversight by European institutions on the UK. Both are core principles of the single market. At the same time, the UK government has left it open, in how far it aims to retain membership in the EU's customs union or privileged access to the single market.

For the EU-27, including and in particular the German government, the preservation of the EU as a whole stands paramount over bilateral (economic) relations vis-à-vis the UK. Unanimously EU leaders have therefore made clear that the four freedoms of the single market are indivisible and that full participation in the single market requires full implementation of its rules. Taken together, the most likely outcome of EU-UK relations are therefore not a privileged access to the single market like Norway or Switzerland, but rather a form of 'hard Brexit' that may preserve tariff-free trade in goods but not include the continuous abolishment of non-tariff trade barriers as well as the full four freedoms, including the passporting rights and free trade in services that form the basis for the role of the City of London as one of the world's financial centres.

Moreover, there is a clear danger that the strong political difference of interests concerning market access will spill over to cooperation in other policy fields, in particular foreign, security and defence policy as well as justice and home affairs. In these two policy areas both the UK and the EU-27 have a clear interest to continue cooperation, such as on EU military operations or the fight against international terrorism and organized crime. In fact, even after the Leave vote the UK has actively made use of its opt-in rights in justice and home affairs to voluntarily take part in EU regulation for as long as it remains a member. These joint interest should be separated as much as possible from the economic negotiations in order not to further damage the European security architecture.

No immediate Domino Effect in sight, but Brexit leaves the EU weakened

Finally, the historic vote by one its largest members to leave the European Union raises the fundamental question of the stability of the whole European project. On first sight, the motivation of the UK public to vote for against EU membership are present in most, if not all other EU countries – a perceived lack of control on migration, rising mistrust in political and economic elites as well as a rejection of the primacy of European law. Euro-Sceptic and anti-EU forces are therefore on the rise across the Union. In the immediate aftermath of the UK referendum, Marine Le Pen (Front National, France), Geert Wilders (PVV, The Netherlands) and, more cautiously, Norbert Hofer (FPÖ, Austria) have called for similar plebiscite in their countries, while the Five Star Movement in Italy has called for a referendum on membership in the Eurozone. In each of these are national elections in the next two years with the respective parties expected to make significant gains.

In the short to medium term, however, the EU 27 is stable enough to hold together. First, the long divorce process with London works to the EU's advantage, as at least until 2019 it will be completely unclear how the status of the UK outside the EU will actually look like and which parts of market integration it may keep. Secondly, while David Cameron gambled with the UK's EU membership in the expectation that he will be able to win the referendum, mainstream parties from other member states will now be much more careful to follow his steps. Besides the calls for a referendum in France and the Netherlands in particular, it is highly unlikely that any other mainstream party will support this call. Thirdly, despite growing skepticism towards the EU across the continent it is no accident that Britain, who has been on the fringes of integration ever since the Maastricht treaty, is the country to vote for leaving the EU. In over 40 years of EU membership, the UK political elite and population kept a purely utilitarian approach to European integration, valuing EU membership purely through a cost-benefit approach that turned negative due to the Eurozone and refugee crisis. In particular in countries like France and the Netherlands, however, the EU remains a fundamentally political project that retains value as such. And finally, the economic costs facing the UK in the event of hard Brexit which are currently starting to impact its currency may well serve to underline the value of the single market as the heart of EU integration to others.

This precarious stability should not be seen as a strong fundament for the crisis-battered European Union. The leave vote in the UK has not only delivered a warning shot to Brussels, it has also highlighted how hard it will be for the Union to ever win back citizen's support enough to engage in structural reforms needed within the Eurozone and the Schengen system. Despite the common assessment that the status quo is unsustainable, national governments also strongly disagree what kind of reforms are necessary to rebuild the foundation of the EU. For the EU, the tough Brexit negotiations should therefore not distract from the core challenges that lie ahead in fixing the economic and monetary union, managing the refugee crisis and thereby regaining its' citizens trust.