

## THOUGHTS ABOUT THE CONSEQUENCES OF BREXIT

By Corrado Pirzio-Biroli

ELO General Assembly

Malta, 29-30 November 2016

Somebody said that Brexit was the tragedy of a Britain that could not make up its mind about Europe, notably because of the ambivalence of its leaders. This attitude was well summarised in an article Winston Churchill wrote in 1930: (quote) “We are with Europe but not in it. We are linked, but not comprised. We are interested, but not absorbed.”(unquote). Things have not changed much since. Before campaigning against Brexit, PM Cameron himself spent three and a half years saying that he was neither for, nor against EU membership. No wonder then that his half-hearted campaign failed.

And yet, since Britain joined the EU in 1973, its leaders repeatedly said they wanted to be at the heart of the European project. But according to LSE Professor Paul De Grauwe, the UK’s main strategy in joining was to prevent the union from becoming too strong. After its failed EFTA initiative, it eventually believed that this could best be done from inside by joining. Accordingly, it kept challenging core fundamental EU values from within and to obtain special status with a number of opt outs from EU law. De Grauwe claims that UK’s leave strategy remains the same: to weaken the integrationist forces by insisting on a special deal whereby Britain maintains many benefits of the union without sharing in the costs. As François Hollande noted, Thatcher wanted to stay in Europe but demanded a check in return. “Now, the UK wants to leave and pay nothing. It’s not possible”- he said. The divorce bill alone will, according to the FT, cost 20-40bn and possibly up to 60bn Pound Sterling.

No country may expect a blank check to rewrite its relations with the EU. The latter will be keen to avoid to be fatally weakened by Brexit. Instead and will therefore wish to demonstrate that withdrawal means loss of the Union’s benefits and involves withdrawal cost. As to the *Brexiters*, who’s main concern was taking back control, they will quickly find out that the concept of exclusive sovereignty in today’s world is a pious wish.

The 23 June referendum result precipitated a constitutional crisis with legal challenges about Westminster’s role vis-à-vis the executive and devolution, particularly there where the majority disagreed with the poll’s outcome, as in Scotland and Northern Ireland. Localism (another aspect of sovereignty) can also increase fragmentation. Apart from institutional aspects, there are many internal British divisions regarding the lack of planning for withdrawal, intra-party divisions, and disagreements between old and young and country and city and those who support the EU and those have cast Brussels or London as the agent of global capitalism.

Expect the most complex break-up talks in history with important constitutional implications and uncertainties for both sides. Theresa May has produced no withdrawal strategy, as she grapples with an internal power struggle between hard and soft Brexiters, and between liberalism and protectionism, and regulation and deregulation. When she eventually tables Britain’s draft withdrawal agreement, the EU will have its own difficulties in seeking an amicable deal while upholding its principles, because of substantial differences of opinion among and within its Member States.

The exit talks will have a substantial impact, not only on the UK internally - torn as it is between the sovereigntists and the (Scottish) independentists -, but also on the EU itself, who will suffer from British amputation and isolation at a time in which populism threatens the EU project.

### **The UK Challenge**

Although the poll's result was not a vote for a hard Brexit, PM May has rejected all other options. She is seeking complete withdrawal from the EU, limits to the UK's access its Single Market and its customs union so long it has full control of immigration, the power to sign its own free-trade-area deals on goods and perhaps some services and controls of UK working rights for EU citizens, with a cut in net immigration by two thirds. May also refuses to continue to submit her country to judgements from the ECJ. This would mean a greater dissociation from the EU than Norway, Switzerland and even Turkey. With such radical approach, one can expect that a "great repeal bill" will retain in UK law existing EU law relevant to cross-border trade with the option of reviewing them afterwards. May's isolationism contradicts her party's traditional internationalism.

In May's view, the British people voted for fundamental change beyond Brexit. For her, that means more than decision-making autonomy, it means pushing for central control of the economy, building a country that works for everyone, promoting strategic foreign investment, reviewing of workers' rights and cracking down on corporate greed. If PM May wins the next elections, withdrawal from the EU may ironically allow Britain to move away from Tory tradition towards a German-style *Sozialmarktwirtschaft*, including co-decision for workers! It remains to be seen whether the British vote was an indorsement for economic nationalism against laissez-faire.

The Brexit negotiations will be affected by British Europhobia (wish to leave) and complicated by continental euroskepticism (EU criticism). They will submerge May's government to the exclusion of anything else, making her wish to have Britain "work for everyone" unattainable.

Among the key issues, immigration controls, access to the single market and passporting rights are prominent. The time available for actual negotiations will be very scarce. If PM May invokes the art 50 clause in March 2017, she will presumably have to go through Westminster to establish a British withdrawal position. Only when the EU has received that, will it get organized to respond. The Council will have to produce guidelines followed by a negotiating mandate to the Commission. This makes it unlikely that negotiations could take place before June 2017. But they will have to be concluded by the end of 2018 in order to leave enough time for ratification by March 2019 (just before European Parliament elections). Because the deal will in fact have to be approved by the European Parliament and by Westminster and will have to be ratified by all member state parliaments. If there is no agreement, that's the end of the story. If there is, one will have to negotiate a transition agreement which may last five to ten years.

As the British government plans to prepare its Brexit strategy, many *Remainers* bear the illusion that Britain may leave the EU with concessions not available to other third countries. Such illusion is based on the conviction that Britain's contribution to common European interests, to European security and to the EU budget is irreplaceable, that the EU benefits from a trade surplus with the UK and would suffer from interrupting supply chains in key industries, and that the EU fears Britain may otherwise adopt the "Singapore model" resorting to tax and regulatory dumping to undercut EU companies. Moreover, London believes that the City's role as a financial hub for Europe is so important, that a hard

Brexit would raise costs for European companies and aggravate the problems of the most indebted banks there. Hence, it is thought that British diplomacy will be able to play on its strengths to divide the EU members during the withdrawal negotiations with offers and promises, such as on immigration/residence and fisheries.<sup>1</sup> But this is far from easy, as the unity of the EU will be difficult to safeguard without a hard Brexit.

### **Consequences of Brexit for Trade in Goods**

The loss of preferential access to the single market will make Britain's huge current account deficit unsustainable, cause a bigger depreciation in the Pound Sterling and a loss of investor confidence. All this risks to deprive Britain, and in particular London, of long-term stability. It would seem that Brexit has devalued the British economy. It will in any case increase uncertainty.

The challenge of Brexit on the international trade front is huge. The EU has concluded 1,139 bilateral and multilateral development and sectoral economic agreements (aviation, fisheries, CFSP...).

The EU represents a far larger market for Britain (44% of UK exports) than Britain for the EU (16% of EU exports). Its market is much more important for EU industry than the UK market, and Brexit offers EU companies the opportunity to shift production from Britain to cheaper locations within the EU. PM May will therefore be under strong pressures from industry to seek to shield some sectors such as the car and pharmaceutical industry from the negative impact of withdrawal, but has to respect the WTO's Most Favoured Nation rule, and the non-discrimination principle (what did May promise to Nissan?).

The recent experience of the Comprehensive Economic and Trade Agreement (CETA) shows that trade agreements that go beyond tariffs are mixed EU agreements for which ratification is needed by up to 35 national and regional parliaments in Europe. It is therefore advisable to limit a FTA with Britain to tariffs on goods and little more.

### **Consequences of Brexit for Trade in Services**

Since accession to the EU, the UK banking system has surged in size with total assets climbing from about 100% to a staggering 450% of UK GDP. Services now represent 80% of UK GDP. Segregation from the Single Market means exclusion from the benefits of any further intra-EU liberalisation, allowing European competitors to grab parts of UK's service market share.

The story is particularly worrying for Britain as regards **financial services**. The latter have expanded exponentially, notably thanks to the EU's "passporting" system, easy cross-border capital movements, and the introduction of the EURO that boosted the financial role of the City of London. Britain will probably try to avoid an equivalence arrangement, not only because it offers limited access rights to non EU countries with rules equivalent to the EU, but also because many EU financial activities include no equivalence provision. It will therefore seek a hybrid financial service model with the EU. But Dijsselbloem, President of the Eurozone finance ministers group made it clear that Britain must choose between the freedom to attract business through lower regulatory standards, and retaining EU market access by fully applying EU regulations and taking on board any future updates. And ECB President Mario Draghi said that Brexit raised a number of EU's own "sovereignty" issues regarding core trading activities, such as clearing of Euro-denominated securities, which he considered would have to be repatriated from London City. The total effects of British withdrawal will partly depend on EU decisions

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<sup>1</sup> See Alex Barker, Financial Times, Nov.2016

taken over the next few years,<sup>2</sup> some of which may be facilitated by Britain's withdrawal, including the planned tightening of EU financial rules vis-à-vis outsiders.

EU Withdrawal is in contradiction with the City's open philosophy on immigration. Loss of passporting would result in higher costs, lower liquidity, more trapped capital and less efficient capital markets, which is bad for everybody. Putting a mutually acceptable alternative regime in place will take years, reduce the access of UK licensed firms to the European market and trigger costly restructuring operations. The EU will not tolerate that certain financial markets related to the EURO remain, not only outside the Eurozone as currently, but outside the Single Market area as well. If a small tax change in New York five decades ago led to a major financial business shift to London, a much bigger event such as Brexit could cause a bandwagon out of London.

### **Legal Aspects**

Ironically, while the main goal of Brexiteers was to restore UK sovereignty, the June referendum displaced British democracy from the parliamentary to the popular, not to say populist level. In addition, PM May's strategy aimed at withholding Parliament's right to set national priorities for the negotiations, further reducing Westminster's role to the advantage of the Executive.

But she did not count on the High Court which ruled that Art. 50 cannot be invoked, nor a withdrawal agreement reached without going through a Westminster vote. The ruling means that the PM has abused her power and can no more control the Brexit process alone. She therefore appealed to the Supreme Court, which can be expected to confirm the High Court ruling, unless it decides to refer the whole matter to the European Court of Justice (ECJ). On Nicola Sturgeon's prodding, the Lord Advocate, who is Scotland's top law officer, will intervene in May's Supreme Court appeal to argue that the Brexit process cannot begin without a vote at Holyrood, the Scottish Parliament, and that as legislation will be required at Westminster tripping Art. 50, the consent of the Scottish Parliament should be sought before that.

If the Supreme Court considers that the use of art. 50 amounts to law making and forces PM May to introduce primary legislation<sup>3</sup> in Westminster (instead of a non-amendable motion), MPs and peers could attach conditions to their approval of Art. 50 including the publication of her negotiating strategy. In any event, the process would become quite divisive and time consuming. A Common motion has been planned demanding to see the strategy before art. 50 is invoked.<sup>4</sup>

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<sup>2</sup> For instance, if the MS accept the mandatory Common Consolidated Corporate Tax Base proposed by the Commission for big companies with global revenues exceeding €750m a year, companies in Europe would have to abide to a common set of rules, filing tax returns for all their activities ; they would thus be able to offset profits in one MS against losses in another, remove obstacles such as double taxation and increase certainty by providing a stable, transparent, EU-wide system of corporate taxation, eliminate mismatches between national systems, allow deduction for R&D costs, provide an allowance for equity issuance to discourage taking in more debt, remove transfer pricing and preferential regimes and adopt robust anti-abuse measures to stop companies shifting profits to non-EU countries and reduce tax-avoidance, boost investments and economic growth and reduce costs of compliance activities.

<sup>3</sup> At present, the sole example of primary legislation is The European Communities Act 1972, which confers precedence to EU law.

<sup>4</sup> The UK government's goal of starting talks to leave the EU by the end of March next year may have been pushed back after the UK's High Court unanimously ruled that both the Commons and the House of Lords must approve plans to trigger art. 50. May's appeal to the Supreme Court to know what sort of parliamentary consent

The intention of PM May to avoid Britain's submission to ECJ rulings is wishful thinking, at least until the actual Brexit. EU's senior judge Lenaerts has warned that the treatment of art. 50 notification and its irrevocability or not within two years, the exit path to be followed, and any unforeseen legal disputes over exit terms may actually be submitted to interpretation by the ECJ. And even if the UK's Supreme Court did not refer the question to the ECJ, the latter could become involved. Certain experts believe, Britain remains bound by commitments made even after the Treaties cease to apply to it and that she might consequently face years of litigation even after Brexit.

Although the referendum has no constitutional character, but is merely advisory, If the parliamentary debate becomes intractable (or goes against the referendum result) a new election may become inevitable. It remains to be seen what the British PM may do then, run on a remain manifesto as was the case for her previous election, or change tack. The referendum process is particularly problematic for the EU and national parliaments, because it may make it more difficult for EU members to respect EU law when the outcomes of a national referendum risks jeopardizing it.

Britain will have to table a withdrawal agreement without knowing the EU position beforehand and negotiate, not as a EU member, but as a 'third State'.

The challenge is enormous as Britain will have to reach an agreement within two years to legally exit the EU together with an interim agreement to cover the period between actual Brexit and the full application of the final deal on a UK-EU FTA or other formula. This will have to be followed by negotiations for re-entry into the WTO as a separate member, separate 53 trade agreements with countries which have trade agreements with the EU, and finally a cooperation agreement with the EU regarding the Common Foreign and Defense Policy, as well as counter-terrorism and other police and judicial matters related to internal security.

Brexit opens a Pandora Box on the legal front. The UK will have to decide which parts of EU law to keep and which to reject, with antitrust, financial regulation and pensions among the many problems. Until March 2019 EU law will continue to apply and Britain will continue to formally participate in EU affairs, but will in practice be marginalized.

A comprehensive review of European legislation will require immense British human resources and appears impossible within the stipulated two-year period from the art. 50 trigger. EU law is part of UK law. Repealing or amending certain UK laws could create havoc with the British constitutional framework. The more so as key pieces of legislation are written into the devolution statutes for Scotland, Wales and Northern Ireland, and could therefore put Westminster on a collision course with the devolved assemblies. If Scotland's views were ignored, this would provoke outrage there and may provide grounds for a new Scottish referendum. Ignoring Northern Irish views may even be worse if Brexit led to the closing of the 310-mile border with Ireland, an essential component of the Belfast or

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is required is unlikely to overturn that ruling (and if it did, the matter might end up before the ECJ). Despite the rhetoric of "the people" versus "the establishment", it is unlikely that May can deny the Commons and the lords the right to debate to discuss the kind of Brexit the UK should aim for. If the Supreme Court forces her to introduce primary legislation (as was the EC Act of 1972), MPS and Peers would have the right to amend it and also to attach conditions to approve art. 50 such as the publication of UK's negotiating strategy (a motion to that effect was tabled by Ed Milligan and Nick Clegg).

“Good Friday” agreement of 1998<sup>5</sup> which allowed to overcome the Irish partition of 1922 with provisions based on the European Court of Human Rights. Reintroducing customs and immigration controls along that only land border between Britain and the EU, could reawaken Irish nationalism.

### **Options of future UK relations with the EU**

There are six options for UK relations with the EU after Brexit: the Norwegian, the Swiss, the Canadian (CETA FTA), an Association Agreement Ukrainian-style (so far vetoed by NL), the WTO (World Trade Organization) and a classical Free Trade Agreement (FTA) according to WTO rules. The Club of Bruges has proposed a seventh option of an EEA-minus in which, unlike Norway which is part of Schengen with its free movement of people, the UK would retain some control of immigration and (unlike Norway or Switzerland) have the right to be consulted on all new single market regulation.

But former MEP Duff has suggested an eighth options, examining more closely the Association Agreement signed by the EU and the Ukraine (albeit not yet ratified by the Netherlands), with a FTA-tariff-free access for goods at its core, technical equivalence (which is already met by the UK) together with common antidumping, competition and procurement policies. The agreement also includes sections on political cooperation and allows to be part of Europol and of Common Foreign and Security Policy (CFSP) missions. While that agreement does not include freedom of movement of people, it does include visa and permit provisions for workers with job offers, as against economic refugees. Such Association Agreement includes also an institutional machinery with joint summits, a joint parliamentary committee and a judicial tribunal with three judges - for the Union, the ECJ and a neutral one. Such a template might suit the Brexit situation, respect the legacy of a 44-years integration story and avoid to leave the British in exile (provided they accept a role for the ECJ).

Presumably, PM May will wish to negotiate with the EU a Comprehensive Free Trade Agreement: either a Canadian-style CETA agreement which makes no reference to EU law, or, less likely, a Ukrainian-style DCFTA agreement which does rely heavily on EU law for defining market rules. In either event, she will wish to combine a CFTA with a strategic partnership to cover non-trade aspects.

If negotiations hit on time constraints, it would be theoretically possible to opt for EEA, or even for Customs Union first, and go for FTA later.

### **Impact of Brexit on the EU**

Britain’s withdrawal has raised the specter of a EU disintegration domino effect. There are populists in quite a few European countries that seek to follow in the UK’s footsteps and destroy the EU from inside. Some member states such as the Visegrad 4 group, who have actually issued a demand for a looser bloc, may wish to take advantage of the treaty revision to try and renationalise decision-making. In some European countries politics is polluted with illiberalism, Islamophobia and anti-immigrant nationalism. In most EU member countries, Euroscepticism has been gaining ground.

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<sup>5</sup> That agreement underlines that the people of the Irish island are allowed to resort to their right to self-determination. Which means that trying to force Northern Ireland, which voted to remain (56%) without its agreement would contradict the Irish peace process. Moreover, as those born in Northern Ireland are allowed to chose their nationality (British, Irish or both), could there after Brexit be people there that are both EU citizens and not ? How could the current internal Irish border, with daily crossings of some 30,000 people remain invisible as stipulated in 1998 ?

Brexit may pave the way towards a multi-tier Europe, for instance with a single market with the four free movements for most members, a leading federalist group based on most members currently part of EMU, a reinforced cooperation in defence and security for their NATO members and association agreements for others. The latter could thus opt out of some EU policies, for instance accepting the free movement of labour, but not that of people.

The impact of Brexit on the EU budget will be small due to the effects of the UK rebate (which should have been abolished since the last accession by much poorer countries) and the potential contribution the UK would have to make to access the EU market for goods. An EU-UK FTA would actually produce additional customs-revenue resources to the EU budget, considerably reducing the “net loss” from the UK withdrawal. Similarly, the financial savings a withdrawal would produce for the UK are negligible.

On the other hand, the effects of Brexit on the EU - economic, political, legal and institutional - compel the EU 27 to engage in some significant legal and constitutional reforms, offering a window of opportunity for changes in the EU constitutional charter and quasi-constitutional laws of the Treaties. Despite growing Euroscepticism and weak political leadership and the related reluctance to amend the Treaties, the prospect of a Constitutional Convention<sup>6</sup> offers to the EU a chance to break the current deadlock on a number of political, economic, financial and budgetary issues. In the absence of the British the EU, or a number of its members, might thus try to push on the accelerator and achieve what they could not achieve with Britain as member. The choice of the EU’s Brexit negotiators such as Michel Barnier for the Commission and Guy Verhofstadt for the EP points in this direction. A EU Treaty revision is anyway necessary. This may help reduce the inter-governmentalism that has prevented the EU from moving forward in the areas of greatest demand by its citizens such as internal and external security.

It would thus become possible to incorporate into EU law past intergovernmental agreements concluded in the context of the Euro-crisis such as the Fiscal Compact and the Treaty on the transfer and mutualisation of contributions to the Single Resolution Fund for banks (as proposed in the Five Presidents’ Report of June 2015) as well as to tackle other reforms considered indispensable to strengthen the European Economic and Monetary Union (EMU), the banking union and eventually harmonise our fiscal and social policies.

Moreover, it should be possible to achieve further progress on security and defence integration, i.a. to show the EU is still alive and kicking despite Brexit. Since the election of President Trump with his isolationist instincts and lack of enthusiasm for NATO, as regards the Common Security and Defence Policy (CSDP) it is essential to try and include in Brexit negotiations a political dual-track process to act to implement NATO’s joint Declaration according to which the EU must start taking responsibility for its own defence. This means deepening EU defence integration including no-go areas for the UK such as the creation of autonomous EU military headquarters in Brussels, laying the foundations for a

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<sup>6</sup> Unless the European Council otherwise decides by simple majority and obtains the consent of the EP, the ordinary revision procedure stipulates the convening by the European Council of a Constitutional Convention of representatives of the national parliaments, the EU Heads of State or Government, the EP and the Commission.

European Defence Union of the willing with coherent defence structures and capabilities (as suggested this year by a European Parliament report) and proposing a European Defence Fund to boost innovation and industrial cooperation. This dual-track process involves the revision of the CSDP governance model and a new partnership between CSDP and the UK as a third party. It would notably involve a privileged cooperation with the UK as regards defence market access (without co-decision), its participation in missions and operations and a cooperative forum in coordination with the European Defence Agency with DE, ES, FR, IT, SW (Letter of Intent of July 2000).

This road can of course be travelled only if the UK is ready to take it. So far its strategy has been to prevent a European defence identity by assuming a leadership role with France (St. Malo agreement) with the hidden intention to lead to a dead alley. But despite opting for withdrawal, the British Government has recently criticized Franco German plans to proceed with the creation of EU defence headquarters and pooling defence capabilities. German Defence Minister von Leyen has warned the UK not to interfere trying to prevent Europe from strengthening its defence integration.

### **To conclude**

By claiming that the “want their country back” the Brexiteers want to segregate Britain from the Union’s unique territory of freedom. But at least some European leaders seem to be looking at the opportunity to use Brexit to get their own act together, that is to “get their Union back.”

Brexit is not the beginning of the end of the EU. Instead, it may hopefully be the end of current EU crisis management, not to say paralysis, provided the EU reacts with a deepening of the Union.

The notion of a ‘soft Brexit’, characterised by the maintenance of current regimes governing the free circulation in areas handpicked by the UK, while removing the Commission’s and ECJ’s control over the respect of the internal market rules, seems groundless.

The only ‘softening’ mechanism that would be available in this regard would be to agree on transitional arrangements lasting as long as required to define the new framework of relations between the EU and the UK. Actually, the longer the interim period, the softer will the Brexit be. These arrangements, however, will only be feasible if the UK is willing to accept a continuation of the current legal and institutional set-up of the EU single market as long as needed until a final settlement is agreed upon. After the transition would follow an Association agreement, if not the EEA or simply a customs union like that between the EU and Turkey, or, most probably a hard Brexit.

The UK government’s goal of starting talks to leave the EU by the end of March next year may have been pushed back after the UK’s High Court unanimously ruled that both the Commons and the House of Lords must approve plans to trigger art. 50. May’s appeal to the Supreme Court to know what sort of parliamentary consent is required is unlikely to overturn that ruling (and if it did, the matter might end up before the ECJ). Despite the rhetoric of “the people” versus “the establishment”, it is unlikely that May can deny the Commons and the lords the right to debate to discuss the kind of Brexit the UK should aim for. If the Supreme Court forces her to introduce primary legislation (as was the EC Act of 1972), MPS and Peers would have the right to amend it and also to attach conditions to approve art. 50 such as the publication of UK’s negotiating strategy (a motion to that effect was tabled by Ed Milligan and Nick Clegg).

The divorce process will be complex and long. After the Art. 50 notification, the EU will have to adopt negotiating guidelines, which will be as detailed, or more likely limited as the request. According to Chief EU Brexit negotiator Michel Barnier one will have to resolve, not only Britain’s departure bill (including past commitments), but also the status of agencies in London, the status of Gibraltar, Irish



border issues, acquired cross-border rights of EU and British companies and citizens, and define the objective of future relations with a transition, with or without a transitional treaty. The move through Brexit, transition and a trade deal may take five to ten years. The EU's Brexit negotiators actually aim at reaching an exit deal within one year, leaving one year for ratification and implementation. But it is understandable if an agreement within the two-year deadline proves impossible.

The EU-British divorce will hopefully be accomplished in the most fair and amicable fashion, because this is in the mutual interest. But it should not distract the EU from respecting its founding principles and laws and from taking the decisions necessary to pursue its integration. These should not be held up pending next year's elections in France, Germany, Netherlands and elsewhere.

As John Bruton said, this means that both sides have to wish for the best possible option and prepare for the worst. In any event, speed is of the essence, for otherwise the risk that the scare of populist nationalism will spread both in the UK as within the EU will grow.

Corrado Pirzio-Biroli