

159
OCTOBER
2016

BREXIT: Causes and Consequences

Prof. Alan Riley, Senior Fellow, Institute for Statecraft
Francis Ghilès, Associate Senior Fellow, CIDOB

Europe is at an Inflexion Point of Danger

The vote by the British people to leave the European Union sent shockwaves across the continent of Europe and beyond. It is the most significant event in Europe since the fall of the Berlin Wall in 1989 and may well mark the beginning of the end of the European Union as we have known it. The European Union is not the vigorous entity that the United Kingdom joined in 1973. Then the European Economic Community had the legitimacy of the strong economic growth which characterised the years after the second world war - *les trente glorieuses*. The EU of 2016 by contrast has been hit by a series of extremely damaging blows: the economic crisis of 2008; the self-inflicted damage from failure to deal with the flaws of the euro following the crisis; Russian success in upsetting the post-cold war balance of power in Europe; terrorist attacks from ISIS and immense migration flows into the Union. All of these blows have created powerful anti-establishment, anti-EU constituencies across the continent, not just in the UK. The Brexit vote is likely to empower these constituencies further undermining support for the

EU. In addition, the process of British exit from the Union is likely to fragment Union solidarity, opening up fissures that will be difficult to close.

It is also difficult to be confident that political leaders on both sides of the English Channel are capable of the strategic thinking and heavy lifting required to recast the European project. The most significant step that the EU needs to take is to reform the euro to release Ireland and the states of southern Europe from their debtors' prison. The Union also needs to get a grip

of the migration flows, which means opening a serious strategic dialogue with non-EU states in southern Mediterranean countries. Brussels and Berlin also need to develop an effective response to the multi-headed military, corruption, and disinformation threat from Moscow. Last but not least, the EU has to find a means of keeping Britain, with its own significant resources, global reach and military power close to the Union.

Unfortunately, such a list of formidable tasks may be beyond the modern European political class, particularly since EU enlargement to 28 members made decision-making ever more difficult. Instead, we are likely to see most problems being kicked

The Brexit vote is likely to empower these constituencies further undermining support for the EU and to fragment Union solidarity, opening up fissures that will be difficult to close.

The EU has to find a means of keeping Britain, with its own significant resources, global reach and military power close to the Union.

Britain was never that sympathetic to the European ideal and for decades, the British political class and media played an anti-EU game.

Brexit places a further burden on the EU institutions and the Member States, struggling with the Euro crisis, migration flows, ISIS and Russian aggression.

British economic stability post the Brexit vote is a form of threat to the EU. The more stable the British economy is the more nationalist parties will use the Brexit vote as an argument for saying that there is nothing to fear from leaving the Union.

The unthinkable cannot however be ruled out - the shock of the Brexit vote may galvanise Europe's political leadership to take the steps necessary to save the European project.

down the road until a further rupture occurs. The most damaging event would be the election of Marine Le Pen to the French presidency, although that is more likely to occur at the next presidential elections but one, in 2021, than in 2017. In the meantime, Brexit is likely to see Germany simultaneously strengthened, isolated and burdened. Nationalist forces are on the rise across the continent, fuelled by anti-immigration sentiment: most notably in France, but also in Hungary and Poland, in the Netherlands and Italy, and even in Germany. There is an erosion of support for the EU institutions across southern Europe. The prospect of Brexit will also awaken fears in Central and Eastern Europe of the exit negotiations turning acrimonious, alienating the UK from the EU, and undermining its commitment to the defence of Europe.

The European Causes of the Brexit Vote

Britain's history differs from that of its European neighbours. Its position as an unconquered island nation, a long tradition of parliamentary democracy and an ingrained sense that ultimately it can look after itself, marks it out from other European nations. It was never that sympathetic to the European ideal. It joined in 1973, rather because there did not seem to be any other option than joining the then more

The Brexit Vote is the most significant event in Europe since the fall of the Berlin Wall: it does not augur well for a unified and prosperous Europe.

prosperous Western European democracies. It is also true that for decades, the British political class and media played an anti-EU game, where made up stories on the horrors of the EU were plastered across the front pages of tabloid newspapers. The drip drip effect of forty years of negative media coverage was difficult to reverse in a four month referendum campaign. Britain is not the only European country where politicians agree something in Brussels, then go home and blame Brussels for the decision. But in Britain the game was played with far greater intensity and on a greater scale than in other states.

A more recent distinctive British act, which also had a significant part to play in the referendum result, was the 2003 decision of the Blair government to permit full freedom of movement rights to all the 2004 accession states. As a consequence, on 1 January 2004, full free movement was extended by the United Kingdom (as well as Ireland) to all the 10 accession states, from Central and Eastern Europe, the Baltic States, Cyprus and Malta. All the other Western European Member States except Sweden maintained their Treaty rights to suspend full free movement of workers for seven years. As the UK, Ireland and Sweden were the only three states which provided full free movement the number of people seeking work in the UK from the CEE and Baltic states surged. Clearly, it was a British decision not to exercise their Treaty rights to restrict free movement. Nevertheless, in the EU Referendum campaign it was not difficult for the Leave campaigners to pin the surge of workers into the UK, on the EU, and not the British government.

This influx was reinforced by the economic crisis. As the Eurozone failed to deliver growth across its 19 members, and the economy of debtor nations contracted sharply, more people arrived from southern Europe and Ireland. The British economy rapidly righted itself after the crisis, as the UK was in control of its own currency, and debt and could deploy effective fiscal stabilisers. However, London then found that because of the Eurozone's addiction to fiscally rigid economic policies, the UK was also acting as the employment shock absorber for Frankfurt.

The sheer volume of people moving to the UK from the CEE states, and from southern Europe appears to have been a major factor in driving the Leave vote. It is noticeable, in parts of the country, such as London and the major cities, where there had long been foreign communities, the British were much more relaxed about immigration and voted heavily to stay in the Union. However, in parts of the country which had recently seen a surge of new foreign workers, they voted heavily to leave. The Leave vote also surged in parts of the country where there was very little new or historical immigration, but where voters feared that immigration might also soon arrive in their neighbourhoods.

So even these specifically British causes of the referendum leave vote were heavily influenced by European actions and developments.

There are also a number of common worries, concerns and anger about the European Union across the continent and which in the UK reinforced the Leave vote.

The most obvious is the failure of the Eurozone to either reform itself so it has the same capability as any other sovereign issuer of currency to pool debt, and provide the transfers and fiscal stabilisers to run a single currency zone. Or organise a soft Euro exit strategy for the states with whom Germany principally is not prepared to pool debts and fiscal transfer policies. The 'kicking the can' down the road with sovereign and bank debt, combined with endless fiscal contraction policies imposed by Frankfurt and Brussels have enormously undermined support for the Union, and not just in the UK

Technically of course, one can say that the UK is not a member of the Eurozone and therefore of what concern is it to London? However, as explained above, extremely damaging fiscal policies in Frankfurt and Brussels, have a direct impact on the UK, flooding Britain with more people looking for work. Equally it reduces the value of the single market to the UK, as Eurozone fiscal rigidity squeezes economic growth.

More broadly, the sight of proud European nation states being subject to fiscal policies which crushed their economic prospects and blighted a generation did not go down well in London. Watching this economically illiterate drama over much of the last decade, and its harmful economic effects has seriously damaged the legitimacy of the whole European project. A significant part of the British business and intellectual classes, who were naturally pro-EU, began to rethink their support for the Union.

This same process of euro de-legitimisation of the EU is also underway across the continent. This ranges from nationalists from the French Front National, to the Italian Five Star Movement and German ADF generating ever increasing political support on the back of the eurozone's failures to a draining of business and intellectual support for the Union.

The China factor

A further factor is the unwillingness of the political elites and the Brussels institutions to recognise the downside of globalisation and particularly their elites to act on China's trade piracy. In 2001, China joined the World Trade Organisation (WTO). Beijing was supposed to commit to opening up its markets, ensuring fair and non-discriminatory market access, establish a robust rule of law system and an open and commercial banking system. It did none of this. The Chinese market is in fact more difficult to access today than a decade ago.

Meanwhile Chinese state owned banks provide advance loans on no rational commercial basis to state owned enterprises. The aim instead is to maintain employment and avoid social and political stress, whatever the negative consequences there are for any other part of the global economy. The consequence can be seen across a range of manufactured goods. For example, since 2004, global steel capacity has surged 57%, 91% of that increase is Chinese. China, now, is responsible for 50% of global production, and produces ten times more than the US. Similarly, it is responsible for 50% or more of global production of flat glass and aluminium.

Both the EU and the US have been reluctant to challenge China, and take effective trade defence measures to protect their own industries and people. Although the US have been more robust in deploying anti-dumping duties than the EU. It passes belief that the EU even now is considering granting China market economy status, despite that country's unwillingness to comply with WTO standards and its dumping on global markets.

The failure of the EU to recognise and deal with Chinese unwillingness to comply with WTO standards and apply robust trade defence measures in response has had a damaging effect on industrial employment across Europe. There is unfortunately a significant degree of truth in Marine Le Pen's argument that the European working classes have been abandoned by the European elites. This sense of abandonment also played a part in the willingness of working class communities across the UK to come out and vote to leave the EU as it explains their decision to throw their lot in with the FN in France.

An additional European generator of votes for the leave campaign was the perceived threat of greater migrant flows into the UK. Technically of course, the EU is not in the Schengen area, and has its own borders. Therefore, the German decision in the summer of 2015 to abandon the Dublin Regulation, which required asylum seekers to apply for asylum in the first EU state they arrive in, and welcome

in Middle Eastern migrants did not affect the UK. However, the unilateral nature of the German act to abandon the Regulation and the subsequent attempt to force Schengen members to accept migrants did not only generate greater hostility against the EU and Germany across the continent, but also further undermined British support for the EU. Perceived bullying by Germany of other EU states, and the fear that one way or another EU bound migrants would end up in the UK played into the hands of the Leave campaign.

So while there are specific British features to the referendum vote, there is a growing common European concern, anger and indeed hostility to the European project far beyond British shores. It is anchored in the euro and the economic crisis, but includes a failure to tackle the downsides of globalisation and the failure to develop a common and effective response to migrant flows.

The Consequences of the Brexit Vote

The broader scale and shape of the impact of the Brexit vote will not be clear for some time. Three months after the vote we have very little idea of the shape of future British-EU relationships or an outline of any Treaty or trade agreement

London found that because of the Eurozone's addiction to fiscally rigid economic policies, the UK was acting as the employment shock absorber for Frankfurt.

between London and Brussels. However, there are a few clear consequences.

First, a vote by a Member State to leave, is an immense shock to the Union's self-image, global standing and sense of durability of the European project. If one Member State can vote to leave, so potentially can others: there is nothing inevitable about an ever-expanding and developing European Union. It can be rolled back. Because, particularly of the euro crisis, that sense of EU fragility already existed, the Brexit vote will now further weaken the Union's credibility, legitimacy and political capacity to act.

Second, it also places a further burden on the EU institutions and the Member States, struggling with the Euro crisis, migration flows, ISIS and Russian aggression. Dealing with complex Brexit negotiations reduces the resources available to deal with all these crisis and increases the complexity of managing these crises as they begin to feed off one another. This interaction between crises can be seen in the use by nationalist forces, such as those of the Front National in France to deploy the Brexit result in a broader attack against EU and euro zone membership. It galvanises anti-EU forces across the continent, with the prospect that the EU is indeed toppling and it will only need a few more events like the Brexit vote to end the Union.

Third, while we do not know the shape of any EU-UK deal, the EU has potentially lost its most economically liberal

member. The effect of Brexit here is likely to result in slower development of the single market. Projects like the Energy Union will also lose a major champion. There is also a further interaction with rising nationalism in Europe, in that with the loss of the UK some of the single market gains may well vanish. Rising nationalist parties are likely to demand more protection for local industries. Without the UK available to weigh in the balance against such protectionism, the capacity of the northern European free traders to defend the single market is in doubt.

A further threat to the single market flows directly from British withdrawal. As explained above, the UK has some degree acted as an employment shock absorber for the Eurozone and has soaked up workers from CEE states. If the UK no longer provides a broad right to work on its territory for EU nationals, those workers will be looking across the rest of the Union instead. A further danger therefore arises that for rising nationalist parties, increased flows of EU nationals into their labour markets becomes a major political issue. Nationalist parties, rather like UKIP in the United Kingdom, seek to not just attack the EU for its failures in dealing with migration flows, but also for the increased flows of EU workers into their states.

A vote by a Member State to leave is an immense shock to the Union's self-image, global standing and sense of durability of the European project.

It could be argued that the damage to the UK from Brexit will provide greater reassurance and support for the EU, or at least the recognition that there are dangers of leaving the Union. This may well not be the way Brexit works out.

The UK unlike the 19 Eurozone states remains a currency sovereign. It can borrow at fine rates on twenty year terms in its own currency, allowing infrastructure and industrial funding to generate new sources of growth; the City of London can pivot toward deep regulatory competition against the European Union and the significant fall in the currency provides the UK with the means to obtain a major competitive advantage in international markets. This gives London the option of developing a major funded economic programme to offset the damage caused by the uncertainty of the Brexit vote. As a consequence, Britain could engage in negotiations over the next few years with the EU, with limited economic damage, whilst the economy maintains a stable level of economic growth.

British economic stability post the Brexit vote is a form of threat to the EU. The more stable the British economy is the more nationalist parties will use the Brexit vote as an argument for saying that there is nothing to fear from leaving the Union.

The Brexit negotiations themselves may well generate significant divisions within the Union, which then may well feedback into the other European crises. For instance, if some of the CEE states want to see a more generous deal with the

UK, concerned about maintaining Britain engaged in security and defence co-operation, and some Western European states led by France, seek a less generous deal, there could be further east-west fissures. These are already present given concerns over the constitutional and human rights decisions of governments in Hungary and Poland. Brexit would only reinforce those fissures.

What Future for Europe?

In October 2016 post the Brexit vote, facing further euro crisis, Russian military manoeuvres on the Ukrainian/Russian border, Turkey opening the door to greater migrant flows and a continuing ISIS threat, the EU is under immense pressure.

The likelihood is that despite these multiple crises the Union will continue to kick the can down the road, try to manage the increasingly unmanageable until there is a significant political rupture. This certainly has been the experience of the last decade with the euro crisis. The unthinkable cannot however be ruled out - the shock of the Brexit vote may galvanise Europe's political leadership to take the steps necessary to save the European project. This would involve reforming the euro or providing a soft exit for some Eurozone states; providing a credible growth package of finance and policy measures to drive economic growth over the next decade; tackle the downsides of globalisation; develop a coherent external migration strategy with adjacent states, and develop a coherent and robust Russia policy.

This is all on top of engaging in a multi-year parallel negotiation with the UK on a separation and trade deal.

Just listing the challenges and recalling the failures of the Union over the last decade does not give much reason for hope. Perhaps, however, the last gift Britain can provide the Union is of Brexit, as a shock sufficient to reform itself and save a unique form of international co-operation that for most of the last five decades served Europe and Europeans so well.