
DISCUSSION PAPER

How Europe sees Brexit

Andrew Duff

Over the years, the rest of the European Union has got very used to being lectured at by British prime ministers. So the deeply critical tone of Theresa May's speech at Lancaster House (17 January) when she spoke about the EU's failings – and her unseemly boastfulness about Britain – shocked nobody.¹ There were nevertheless some important clues in her speech about what in the Brexit negotiations will be really difficult issues to resolve; there were also ambiguities and provocations.

The speech served to enlighten the rest of Europe about the kind of strategic partner they can expect Britain to be once it has left the EU. Breaking up the European Union is not a popular move. Britain is expecting a lot of its former partners when it suddenly announces that, having broken up the EU it wants "a new and equal partnership between an independent, self-governing, Global Britain and our friends and allies in the EU". At the heart of the new arrangement, May proposes a "new, comprehensive, bold and ambitious free trade agreement" with its erstwhile partners. Cheerfully, she assumes that what is good for the UK is good for the EU also. That assumption, however, may be wide of the mark.

May's objective is an agreement that allows British banks and businesses "the freest possible trade in goods and services", "the maximum freedom to trade and operate", and "the greatest possible access" to the EU's large market. But what seems eminently rational to her seems less so when viewed from the mainland. On a recent trip to Berlin, none of my very rational German interlocutors understood why, if May's market ambitions are so important, she is insistent on leaving that very same market. I was asked why Britain's second woman prime minister is so intent on undoing the single market created by its first woman prime minister. It took Philip Hammond, Chancellor of the Exchequer, to explain in front of incredulous audiences both in Berlin and Davos that what is economically damaging to Britain is also politically necessary for Britain.

European solidarity at risk

There have been some strong reactions to Theresa May's speech. The German government, in particular, is insistent on preserving solidarity among the 27, and it knows that unity is best preserved in the face of a common foe. The sense of British betrayal is palpable. The UK is seen to be up to its old tricks in playing off one EU member state against another. As an insurance policy against such perfidy, Brexit means that the UK can no longer expect to be comfortably accommodated in the embrace of the EU, I was told by a top official. "You will find that interests now matter, and deals will be made only where there are joint interests".

One reason for Germany's growing hostility to British interests – or at least the refusal to see British and German interests as mutual – is that much of the British media, and most British bankers and politicians continue to insult the euro and the eurozone. Brexit is seen, rightly, as a terrible distraction from getting on to tackle the EU's more

important, real problems. It is resented that Britain has drifted away in recent years from playing a respectable part across the spectrum of EU affairs and has become preoccupied with its own national problem. Frustration at how the UK exploits its numerous opt-outs from core areas of integration is never far from the surface. Britain's recent refusal to join in the building of a European banking union or to lift a finger to settle Europe's refugees have aggravated the worsening relationship between Berlin and London.

It is not this prime minister's fault that she cannot hope to recuperate Britain's European reputation in one speech, coming as she does after decades of Cameron's disgrace, Brown's disgruntlement, Blair's fickleness and Major's obstructionism. Nevertheless, May's claims in her speech about Britain's preeminent contribution to Europe's security and global standing are greeted with some cynicism in Berlin. German fears are accentuated by the advent of President Trump and the presumed likelihood that the UK will prefer to snuggle up to the Americans rather than help to build the European pillar of Western security.

Leaving the single market

It seems possible that the UK has never really understood what the European Union is. The British tend to treat the EU as a club to wander in and out of, at will, as commercial interests dictate. For Germans, on the contrary, the single market is a dynamic process that determines ever-deepening economic and political integration. So it is not enough for Britain, in leaving the single market, to take a photo of it and commit to stick for ever to the EU's current rules. Instead, those who are no longer members of the single market but who desire easy access to it must commit to engage with and respect those who make and enforce the internal rules of the game.

It is evident that no privileged British access to the EU's internal market will be possible post-Brexit unless a new regulatory system is put in place to replace that which Brexit destroys. A new apparatus is needed to verify that British and EU trading, health and safety standards are equivalent and their rules of origin procedures sound. This applies even to trade in farm products after the UK has liberated itself from the shackles of the Common Agricultural Policy. It applies to trade in 'British-made' cars whose manufacturing supply chains spread across continental Europe and beyond. Once outside the Common Fisheries Policy, regulations will have to be agreed with the EU to define the notion of a 'British fish'. Because the EU is the much larger and well-established market, these rules, and many more besides, will be EU rules first and British rules only second. In most sectors, British business is the weaker player. And all these rules need to be operational before any new tariff rates and tariff quotas are applied to UK EU trade. Free trade agreements are legally complex and politically fraught: this one will be no different.

In pitching for Britain's partial membership of the customs union, the prime minister may have been trying to simplify things for the sake of her riven government and party. But she has complicated matters enormously for the EU27. Full membership of the customs union would mean the tidy adoption of the EU's common commercial policy and external tariffs. A bespoke "completely new customs agreement", even becoming "an associate member of the Customs Union in some way", will force the 27 to open up for review their own internal pact, thereby exposing competing interests. The effect of Brexit is to throw up in the air the EU's own internal market settlement. Whereas the EU28 could act as a trading bloc when it negotiated a deal with Canada, the disintegration of the bloc and the reformation of the 27 to negotiate against the UK as a third country, formerly the EU's second largest economy, is a different matter altogether.

Undoing the budget

Theresa May's speech has not calmed nerves in Brussels that were badly jangled by the resignation of UK ambassador Ivan Rogers. The EU institutions are disappointed that she made no gesture towards easing the way to a financial settlement of the costs of Brexit. Instead, she seems to take it for granted that the UK can pick and choose which of the EU's activities it will continue to participate in, and at what price: "There may be some specific European programmes in which we might want to participate. If so, and this will be for us to decide, it is reasonable that we should make an appropriate contribution." Even in sectors where the UK has a strong hand to play, such as security intelligence and science R&D, it will still be the *demandeur*.

The EU's frequent budgetary quarrels are always divisive. Although Brexit will relieve the EU27 of the burdensome British rebate (and of the rebates on the British rebate claimed by several other member states), Brexit will also deprive the EU budget of a significant net contributor. Germany knows it will be under more pressure from the poorer states to pick up the tab.

Little Britain

Despite differences of opinion about the future of the EU, Germany has always considered Britain to be an important, natural economic ally, more liberal than the French and more disciplined than the Italians. So while Germany is not surprised by Britain's apparent lack of budgetary generosity, it is outraged by Theresa May's use of the threat that, if thwarted in the Article 50 process, the UK might "change the basis of Britain's economic model". If the deal on offer were to be "punitive" for political motivations, she said, the UK would erect protectionist barriers against mainland Europe, depriving mainland business of easy access to the financial pool in the City of London, and engage in active tax competition and deregulation against the interests of its erstwhile partners. Such a unilateral change of tack by Britain would serve to cut off EU businesses from the British market. "Important sectors of the EU economy would ... suffer", she almost relished. "No deal for Britain is better than a bad deal for Britain."

That May thought it wise to make such explicit threats to the EU from which it is seeking a divorce has upset those, notably German finance minister Wolfgang Schäuble, who champion the cause in G7 and G20 of open, social market economies. Leaving Berlin I was left in no doubt at all that Germany is willing to walk away from the Article 50 talks without a deal unless the British are cooperative.

Now the letter

The prime minister hopes that her speech was sufficiently political and substantive to warrant a political and substantive response from the European Council once she has formally invoked Article 50. Maybe more detail will emerge, and some ambiguities will be cleared up, during the parliamentary proceedings at Westminster that will precede the posting of May's 'Dear Donald' letter. Moreover, the letter itself could contain more specifics about the nature of Britain's desired future relationship with the EU27. But the European Council has a wide degree of discretion as to how it responds to the letter. It is unlikely to deal with all the points raised in May's speech when it issues its first formal Brexit guidelines.

The immediate task of the heads of government will be to define the mandate they give to the Commission for the negotiation of the Article 50 withdrawal agreement. The European Council will need much more time to agree on a second mandate for the Commission to open negotiations on a new free trade and customs agreement with the UK (under the provisions of Article 218 TFEU). So there will be no quick, simple or straightforward transition from full British membership of the single market to the new patchwork regime. All that has been agreed so far is that non-membership must be inferior to full membership. For the bluff optimists in the Tory cabinet, reaching a new free trade agreement might look easy, but for the EU27 it will more or less be a question of starting from scratch.

Clarity

May's London speech and her subsequent visit to the World Economic Forum in Davos have left several important matters unclear. One of those concerns timing. In her speech May said that she wanted to "have reached an agreement about our future partnership by the time the two-year Article 50 process has concluded". This has led some to think she expects the full trade deal to have been done by the time the UK leaves the EU. She must know this is an unrealistic objective even were the European Commission and Council to drop their current, excessively legalistic embargo on beginning negotiations on a trade deal until after the UK has formally left the EU.

What must certainly be agreed before Brexit is a definition of the framework for the future relationship, as Article 50 indeed prescribes: in fact, the Article 50 process will be much facilitated if Britain's final landing zone can be agreed well before the two year period is up. The meeting of the European Council in December 2017, after the

Bundestag elections, would be the first and best opportunity to agree on the outlines of the future relationship. But as my German interlocutors reminded me, the more the British want a bespoke deal and the less they can buy off the peg, the longer such a political agreement will take to reach.

A second point for clarification concerns the role of the European Court of Justice, for which Theresa May harbours an advanced antipathy. She needs to recognise that although the CJEU will cease to have direct jurisdiction in the UK once Brexit has happened, she cannot ignore the Luxembourg judges altogether. The Court will continue, for example, to be a presence in the lives of UK citizens resident in EU states and UK business established there. Rights acquired as a legacy of EU citizenship and contracts secured after 45 years of integration under EU secondary law will not simply evaporate on Brexit; nor will the UK's continuing obligations to the EU budget until the accounts are formally closed perhaps many years hence.

The European Court of Justice may well be asked by the European Parliament to check the compatibility of any new UK treaty with EU law. And the CJEU will be a party in the arbitration of any trade dispute between the UK and the EU27 – although there are ways of putting the Court at arms' length from international litigation by creating special judicial tribunals of mixed composition (as is the case with the EU's recent association agreements). Theresa May needs to concede that, much as she may dislike the EU Court, she will not seek to negate or evade its indirect sway.

More work is needed on the question of the transitional arrangement. The prime minister wants "a phased process of implementation" in which business can prepare for the new legal, trading and regulatory relationship. But a transitional period will be necessary in order to phase out existing commitments as well as to phase in new ones. The sequencing and length of these temporary adjustments will differ from sector to sector. Their negotiation will not be an afterthought but integral to making a success of Brexit for the UK and to limiting collateral damage for everyone else. It would be senseless for the UK to fall out of the customs union before a new customs agreement is in place.

For Europe, Brexit starts here

Prime Minister May's speech marked the point at which Brexit became a reality for the rest of Europe. Nobody now can be in denial that Brexit truly means Brexit. Britain's decision not to seek membership, alongside Norway, of the European Economic Area may still look crazy but it is now established craziness. The coincidence of the May speech in the same week as the inauguration of the American nationalist phenomenon which is Donald J. Trump reinforces the sense that the Anglo-Saxons are no longer part of Western Europe's post-War liberal consensus. May's first visit to Washington will be watched with great concern.

At any rate, the EU institutions are increasingly well-prepared for the opening of the Article 50 negotiations on the technical aspects of Brexit. They are still ill-prepared for the big strategic decisions they now face about how to treat the UK as an ex-member state over the longer term. The smaller European Union badly needs a deep reflection about whether Brexit is to leave it weaker or, conversely, stronger.

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The views expressed in this Discussion Paper are the sole responsibility of the author.

1 <https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech>

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