

# BREXIT: CHALLENGES FOR EUROPE<sup>1</sup>

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**Abstract:** *Brexit poses two main challenges for the EU: an immediate challenge, and a longer-term one. The immediate challenge concerns whether the Article 50 negotiations will lead to the signing of an agreement on a mutually acceptable basis, as a cliff edge scenario would cause enormous immediate damage to sectors exposed to international co-operation both in the EU and the UK. In the longer term, Brexit would inevitably force the EU to face a fundamental choice between pursuing further and deeper integration or putting it on hold, or even reversing it in certain areas. Since negotiations on the future relationship between the UK and the EU and those on the EU's next multiannual financial framework (i.e. the so-called MFF 2021-2027) are overlapping, this paper aims at casting a light on the interlinkage of these two processes and on the interests that lie behind them.*

**Keywords:** *Brexit, Multiannual financial framework (MFF), integration, disintegration*

## 1. Introduction

Thursday 23 June 2016, the day when the so-called EU referendum took place and the United Kingdom voted to leave, undoubtedly represents a milestone in the history of the European Union: after decades of continuous deepening and consecutive enlargements, this was the first time people of a sovereign member state decided to leave the integration. Although it is not yet clear what Brexit means or how it will come about (e.g. what form the UK's post-Brexit trade relationship with the EU might take), the withdrawal process by itself is a rare moment of truth in that it brings interests of the different players (member states, Commission, sectors, businesses) to the table and provides opportunity to engage in a stocktaking exercise and consider alternatives for Europe's future.

This paper tries to assess the differences in viewpoints and interests of the main stakeholders for the proper understanding of the Brexit negotiations. Special attention will be paid to the relationship between Brexit and the current MFF negotiations. We conclude the analysis with the presentation of various scenarios for the outcome of the withdrawal process.

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## 2. Neither hard nor soft Brexit is suitable

In this section, we attempt to highlight a matter of significant controversy that is almost impossible to resolve: namely that for the relatively underdeveloped EU member states neither a hard Brexit, nor a soft Brexit could fit in with the Commission's budget proposal for 2021-27. To address this controversy, the analysis is carried out in two strands: the first is an assessment of the different perceptions and interests regarding the UK withdrawal from the European integration, while the second is a bit more creative discursive approach, which examines the possible linkages between Brexit and the next multiannual financial framework (MFF 2021-27) viewed from the EU's periphery<sup>2</sup> perspective.

### 2.1. Interests and negotiating stances

On June 23, 2016, people of the United Kingdom voted for Brexit. The assessment of differences in Brexit-related interests is delivered at four planes: between capital and labour, big corporations and small and medium-sized enterprises, central government and devolved administrations, and the United Kingdom and the rest of the EU (EU27).

It is a fact that Britain's businesses have, since the mid-1990s, gained significant competitive advantage through the use of vast supplies of cheap labour (both skilled and unskilled) entering the country first from the Indian subcontinent and Southeast Asia, then, in the context of the Eurozone crisis and successive Eastern enlargements, from the EU's Southern and Eastern periphery. Since Brexit is supposed to end free movement, i.e. the influx of new cohorts of low-price workers from the EU27, this might consequently lead to an increase in wage level of the domestic labour force. As a matter of fact, in parallel to a general downturn in labour inflow since referendum and unemployment staying at 4 percent (a 43-year low), growth in wages has already begun: regular pay was 3.1% higher in three months ending in August 2018 than in the same quarter in 2017, the highest growth rate since December 2008 (Elliott, 2018).

More generally, an obvious antagonism of interests concerning Brexit exists between the rich and the poor. In the case of a hard Brexit, for example, prices on the property market are likely to grow at a slower pace or even fall (especially in metropolitan areas and great university cities), which is bad news for homeowners who have enjoyed rising prices for years, but a good one for renters and a whole generation who have rightly felt they were cut off from the property ladder by ever increasing and unaffordable prices. Another important aspect is the development of food prices which are prone to fall. As a result of the Common Agricultural Policy and the consequent high tariffs placed on food imports, consumer food prices in the UK are pushed up by approximately 17 per cent above the level they otherwise would be, i.e. outside the EU's protectionist customs union (TaxPayers' Alliance, 2018).

Having all this in mind, it is small wonder that in terms of income stratification these are the poorest (i.e. the lowest and the second lowest) deciles, spending relatively more on food and housing, who would most benefit (and gain an extra £36 and £44 a week

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<sup>2</sup> EU periphery consists of countries entering the EU in 2004, 2007 and 2013 (except for Malta and Cyprus), plus Greece, Spain, Portugal and Ireland.

respectively) from a clear Brexit (Leave Means Leave, Labour Leave and Economists for Free Trade, 2017).

The next type of conflict to be dealt with is between large corporates on one hand and small and medium-sized enterprises (SMEs) on the other. As the former are more likely to participate in international trade, for them unfettered access to the European single market is of fundamental importance. However, EU legislation and directives have to be observed by the latter, too. While regulations impose costs of compliance on all types of businesses, these costs do not fall equally on them. SMEs have to deal with relatively higher pro rata costs than big companies for several reasons. First, these costs are mostly fixed, hence more difficult to be absorbed over a lower turnover base than a larger one. Second, as SMEs generally are more price takers than price makers, unlike big companies, they can hardly pass onto their customers the costs incurred in complying with EU regulations (Chittenden, Ambler, 2015).

The third type of incompatibility of interest exists between London and the devolved administrations of Scotland, Wales and Northern Ireland. Sensibilities arise from the fact that Brexit presents a fundamental constitutional challenge to the United Kingdom as a whole. The devolution settlements were agreed after the UK had become an EU member, and the devolved legislatures only got legislative competence in the devolved areas – such as support for agriculture and fisheries, state aid for industry, public procurement, environmental standards, management of radioactive waste, and some transport issues – as long as the rules created by them were compatible with EU law (UK Government, 2017). So, in practice, the responsibility for these policy areas has largely been excised at EU level for the last couple of decades. However, if there were no changes to the devolution settlements, the whole responsibility for the above mentioned areas would automatically fall back to the devolved jurisdictions at the moment of Brexit, which could potentially lead to regulatory divergence, and thus – by altering the competitive neutrality – undermine the integrity of the UK’s internal market (UK Parliament, 2017).

This is why the UK government was half-compelled, half-inclined to abuse of its exclusive competence to conduct international negotiations (i.e. negotiating on behalf of the devolved), and to arrange matters in a way that powers – which were, in the context of Brexit, to be repatriated from the EU to the UK and might have gone to Belfast, Cardiff and Edinburgh – would, at least temporarily, be diverted to London. The European Union (Withdrawal) Act 2018, first proposed under the title of “Great Repeal Bill” in 2016, which – apart from providing for repealing the European Communities Act 1972, is destined to secure legal continuity by transposing directly-applicable already-existing EU law into UK law – does, in the topic of devolution, apply a temporary ‘freeze’ on the devolved administrations “*in specified areas, so that in those areas the current parameters of devolved competence are maintained*” (Department for Exiting the European Union, 2018). This means that the devolved institutions will temporarily be able to modify retained EU law only in ways that remain consistent with the underlying directive. This also limits the power of the devolved governments by making it impossible for them to retain a piece of EU law that has been modified by London, even if their consent is generally needed for such modification to happen. Freezing powers will expire two, the regulations themselves five years after Brexit day, if not revoked earlier.

All this power re-centralisation to London, made in the name of dealing with correcting deficiencies, international obligations and the ability to implement any withdrawal agreement, caused much disappointment amongst the devolved who originally believed they were going to get their rights back faster. The situation is all the more

delicate as there are no such things as devolved “English Parliament” or “English Government”, the UK parliament and the UK government also operating as parliament and government for England. On top of this duality, in the case of certain devolved competences, there are clear differences in interests between England and the rest of the UK. In agriculture, for example – flowing from differences in natural endowments (the share of “areas of natural constraint” being 85 percent in Scotland, 81 in Wales, and 70 in Northern Ireland, while only 17 percent in England), but also from differences in farm and production structure (England being dominated by large, productive farms largely present in profitable horticulture, while small farms being predominant in Wales and Northern Ireland, and big but extensive ones in Scotland) – farmers in the devolved nations are much more dependent on CAP subsidies (between 75 and 87 percent of farm income coming from CAP) than in England (around 50 percent) (Keating, 2018).

Having all this in mind, as well as the prospect of phasing out direct payments by 2027, drafted in UK’s new agricultural Bill of September 2018 (UK government, 2018), there is room for thinking that UK policymaking is influenced by the needs of agriculture in England, rather than those in devolved nations. Consequently, it would be a most critical step towards creating a climate of trust if the existing population-based method of allocation of funding to the devolved (the so-called ‘Barnett formula’) were replaced with a more appropriate, needs-based funding arrangement. Only in such a way could the devolved be compensated for the loss of EU funding, caused by Brexit in the long-term. No wonder: a report to the House of Lords found the impact of Brexit on UK’s devolution settlements to be incontestably “*one of the most technically complex and politically contentious elements*” of the whole withdrawal process (UK Parliament, 2017).

Finally, there are differences in interests between the United Kingdom and the EU27 who are being represented by the Commission in Brexit negotiations. Normally, there should not be any major conflicts, as both sides are supposed to serve the interests of their electorate, hence focus on protecting jobs and businesses. By contrast, enduring differences in negotiating parties’ main objectives and, consequently, their negotiating stances make the achievement of this logical and coherent set of goals, at the least, challenging. What is it all about?

The British, given their confidence in the long-run potential of their economy, prioritise a bespoke agreement, “*securing the freest and most frictionless trade possible in goods and services between the UK and the EU*” (UK Government, 2017). But the main purposes (and promises) of Brexit – i.e. taking back control over laws, borders, and money, which consists of ending the jurisdiction of the European Court of Justice in, the free movement of workers to, and the substantial funding of the EU budget by the UK – seem to be in stark contradiction to the European Council’s guidelines for the negotiations. The latter do not only say that – departing from the integrity of the single European market and the inseparability of the four freedoms (i.e. the free movement of goods, capital, services, and labour) – they consider “*cherry picking*” any attempt aiming at an “à la carte” divorce, but rather argues that “*a non-member of the Union ... cannot have the same rights and enjoy the same benefits as a member*” (Consilium, 2017). In other words, the Commission cannot let the UK profit from leaving the EU with an advantageous deal, because if Brexit is not deterrent enough, regarding its consequences for the British economy, to stop other member states from reconsidering their own situation within the integration, this could lead to further disintegration, and eventually to the end of the European project.

## 2.2. MFF 2021-27 and Brexit

On May 2, 2018, a draft proposal for the Multiannual Financial Framework (MFF) covering the next seven-year period (2021-2027) was published by the Commission. The very essence of the MFF is to design the structure of, and set ceilings for the annual EU budgets of the forthcoming (post-2020) seven-year period. In other words, it determines the yearly amount of funds that can be spent on each and every of the common policies and programs (adding up in the so-called headings). According to EU tradition, annual limits to spending under the different budget headings are expressed in two forms: as commitments (i.e. legally binding promises to spend money) on the one hand, and payments (i.e. actual amounts authorized for disbursement from the EU budget in a given year) on the other hand.

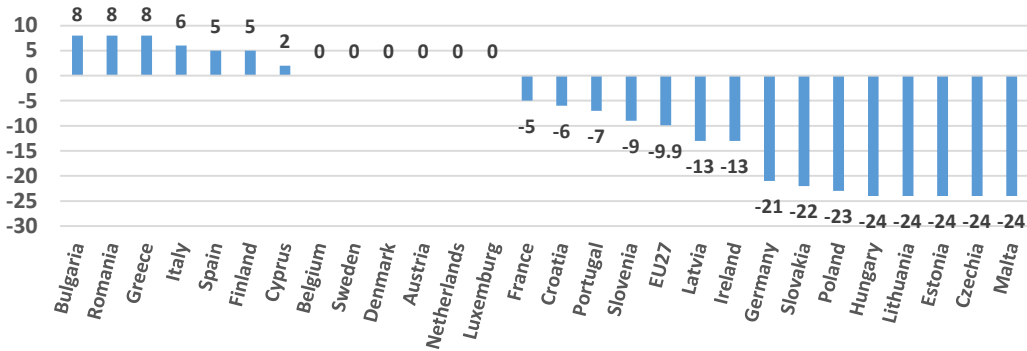
The draft also deals with the revenue side of the EU budget by proposing changes to the structure of the so-called Own Resource System (ORS), and the way in which its components are calculated. Although, unlike MFF regulations, decisions on ORS apply indefinitely rather than for specific MFF periods, now a need arises to reshape the ORS for the post-2020 period with Brexit making redundant the British rebate, as well as the related correction mechanisms. Both MFF and ORS are decided by the Council acting unanimously; but while a decision on the MFF demands the consent of the European Parliament (EP), in the case of the ORS, the EP has only a consulting legislative role. If there is no agreement, everything goes on according to the rules of the previous budgetary cycle, which means that one twelfth of the budget appropriations for the previous year may, as a maximum, be spent each month for any chapter of the common budget.

As for the Commission's basic document (European Commission, 2018a) with regard to the next MFF, there are two important and interrelated issues that deserve attention. First, Commission's proposals are based on the assumption of a hard Brexit as they do not include a contribution from the United Kingdom. Second, while there is no significant change in the size of the budget, its structure is transformed: significantly more funds will be available under headings deemed to support investment in modernization (research/innovation/digitization, youth/education, climate and environmental protection), and in programs which are politically unavoidable (migration/border protection, security policy). Meanwhile – as the press release accompanying the Commission's proposal (European Commission, 2018b) states – a moderate reduction of approximately 5 percent would apply to both the Common Agricultural Policy (CAP) and Cohesion Policy (CP), compounded by a proposed increase of national co-financing rates. In the view of the Commission, the hole in the budget resulting from the United Kingdom's departure should be plugged partly by new resources (drawn from the relaunched Common Consolidated Corporate Tax Base, revenues of the EU's Emissions Trading System, and contributions calculated on the amount of non-recycled plastic packaging waste), and partly by savings (e.g. from halving the amount member states can keep when collecting customs duties) and redeployments from existing (i.e. CAP and CP) programmes (European Commission, 2018a).

The point is that the decrease of 5 percent in funds available for the CAP and CP is calculated in current prices, but in practice a change of a quite different order of magnitude is to be expected. Concerning cohesion spending, countries in EU's periphery, especially those of Central Europe and the Baltic region having entered the EU in the 2004 enlargement round, would be badly affected: in their case, allocations available within the cohesion policy framework could, in real terms, typically be reduced by between 22 and 24

percent (Figure 1). However, it is to be remembered that all these member states belong to the bottom half of the ranking for their average GDP per capita, and not less than 4 Hungarian and 5 Polish regions happen to be among the 20 poorest in Europe (Eurostat, 2018).

Figure 1 Planned changes in Cohesion Policy allocations by Member States (%) for 2021-2027



Source: Lemaitre (2018).

With regard to agricultural subsidies, the proposed 5 percent reduction in current prices for the period of 2021-27 (vis-a-vis the period of 2014-20) corresponds to a decrease of more than 16 percent in real terms at a yearly average. And, by the end of the next MFF, the support level could fall by more than 28 percent below to what it was 20 years earlier (i.e. from €1.3 bn in 2007 to €44 bn in 2027) (Carles, 2018). At this point of the analysis, it should be recalled that EU rules concerning the single market and the Common Agricultural Policy (CAP) were applied rather selectively in countries acceding to the EU since 1995, and especially most ungenerously in countries of the several rounds of Eastern enlargement. At the time of the so-called the EFTA enlargement, due to the already existence of the single market, farmers in the new member states (Austria, Sweden and Finland) became immediately (i.e. from the very first year of membership) eligible to receive all CAP support. By contrast, agricultural direct subsidies were fully extended to the new member states of Central and Eastern Europe (plus Malta and Cyprus) only at the end of a 10-year transitional period. In addition, by the time their payments reached 100 percent of the level they were eligible to apply for under normal regime (i.e. by 2013), CAP reform containing successive reductions in direct support had already been under way. This tendency is to be accelerated in the future, if Commission’s proposals for post 2020 CAP are accepted.

If we have a look at the data which have already been published by Eurostat (i.e. for the period of 2014-17) concerning expenditures from the current MFF (2014-20), we can see that peripheral countries can typically draw on a much higher proportion of the cohesion and agricultural money than on those available under the competitiveness (especially research/innovation) headings (Table 1). This means that the Commission is vainly trying to reallocate an ever-growing share of the budgetary resources towards programs representing modernity and progress, and allegedly more effective in this respect than the cohesion and agricultural policies, if the EU periphery is not competitive enough to win masses of those grants.

To sum up: given that disparities in wages and living standards among member states of the East and West of the EU have remained significant, and there is, since the 2008 crisis, a widening gap between the North and the South too, Commission’s proposals concerning

EU budgetary spending on cohesion and agriculture for the next MFF (2021-27) do not seem to set an example of solidarity, as, if accepted and codified, they would further reduce rather than increase the funding for programs which can relatively more easily be made good use of by the less developed.

Table 1: Peripheral countries' share in EU budget expenditure on different common policies (2014-17)

Common policies (1)	Periphery countries (P) (2)	P without Spain (3)	P (4)	P without Spain (5)	P (6)	P without Spain (7)
Competitiveness for growth and jobs	13,6%	8,2%	1,00	1,00	-	-
Horizon 2020	10,7%	5,8%	-	-	1,00	1,00
Economic, social and territorial cohesion	64,8%	56,3%	4,77	6,88	6,06	9,70
Common agricultural and fisheries policies	35,1%	26,3%	2,58	3,22	3,28	4,53

Note: Periphery (P) consists of 15 countries of which Spain is just one. Spain is relatively bigger and more successful in obtaining money from different EU policies (for instance Competitiveness, especially from Horizon 2020) therefore columns 2 and 3 underscore how small the Periphery share would be without reckoning Spain in it. Columns 5 and 7 show how many times the Periphery (without Spain) can obtain more money from CAP or CP than from Competitiveness or Horizon 2020. Results are considerably higher than in columns 4 and 6 respectively (with Spain).

Source: European Commission (2018c).

What may make it even more difficult for the EU periphery to accept Commission's draft proposals for the next MFF is the prospect of a 'hard Brexit'. The latter can obviously cause serious damages to existing trade relations between the United Kingdom and the EU27. Namely, supply chains (e.g. in the automotive industry) and the whole agri-food business could be hit very hard, as some member states of the EU periphery depend heavily on exports to Britain directly or indirectly (e.g. through the German automotive industry).

Interestingly, it is unlikely that a 'soft Brexit' would for the peripheral countries be any more acceptable than a hard one, if it meant the United Kingdom could continue to have access to the European single market without having to continue with its huge annual financial contribution to the common budget – one of the core issues of the referendum. As a matter of fact, at the time of previous enlargements and/or deepening of the integration process, less developed countries of the periphery used to seek and receive significant compensation from the common budget in exchange for further market liberalization.<sup>3</sup>

<sup>3</sup> E.g. accessions of Spain and Portugal in 1986 were threatened by a Greek veto if the integration did not adopt special programs to protect its farmers from the impending competition coming from the new entrants. The Integrated Mediterranean Programs, designed to help southern regions of the then Community (including the whole of Greece) to adjust to the new situation, were based on provisions that would later become the core of the Cohesion policy. By the same token, the Cohesion Fund was created in order to counter a threat carried out by four governments of the integration periphery (namely those of Spain, Portugal, Greece and Ireland) to veto the Maastricht Treaty unless a new financial instrument was

That is, with such a soft Brexit, a traditional principle would be harmed, and the interests of the periphery would be damaged.

### 3. What sort of Brexit is likely to emerge?

To understand what has happened with British withdrawal so far, and why, it is important to see that the interests of the economic-political-media-scholar/adviser elite, the Establishment in both Britain and the EU27, would be very adversely affected by any sort of Brexit. The latter is commonly perceived as a dangerous precedent, a first chapter of a potential disintegration of the European Union. Therefore, since the beginning of the exit process, there has been a consistent endeavor of both elites to soften/ignore the main claims of the Leave campaign (i.e. regaining control over laws, borders, trade and money), and demean and discredit politicians and experts working for a clean Brexit (i.e. the UK leaving both the single market and the customs union). This is no wonder if we keep in mind that, in Britain, the withdrawal negotiations and the whole process is overseen by a prime minister who voted Remain, and her cabinet where two third of the ministers did so.

Prospects for a clean Brexit have dimmed right from the very beginning of the withdrawal (so-called Article 50) negotiations, as the British team agreed to adopt the phased approach advocated by the Commission. This meant that talks could not start on future relationship between the EU and the UK until there was not sufficient progress on the main withdrawal issues (i.e. citizens' rights, exit bill, the Irish border, and some others)<sup>4</sup>.

Chances for a correct deal were further weakened in December 2017, when the negotiating parties published the so-called Joint Report, containing a backstop clause which would ensure unrestricted flow of trade and people through the land border between Northern Ireland and Ireland even in the absence of an agreement on future relations. The backstop meant that Northern Ireland would remain in the EU's trading and regulatory system, which would compromise the integrity of the UK's internal market.

The Chequers Plan, a key white paper presented by the UK government in July 2018, can be seen as the ultimate blow to a clean Brexit. According to the plan, the United Kingdom should continue to respect the EU regulations for goods (including agri-foods), state aids and competition policy without having a say over them, and would remain under the jurisprudence of the European Court of Justice (at least for the interpretation of the European case law) forever. The publication of the Chequers Plan provoked the resignation of both foreign secretary Boris Johnson, and Brexit secretary David Davis, two of the few Brexiteers in the Theresa May cabinet.

In the light of the above, it is not surprising if, according to the present situation, in late October 2018, chances for a very soft Brexit are gaining ground. The United Kingdom's withdrawal from the EU is likely to take place only after a protracted transition period, if ever. During the transition, the country would, as a quasi-member state, virtually remain subject to every law and regulations of the European Union (single market, customs union, etc.) without being able to have an impact on them. Such a protracted

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established to help the less developed member states in their efforts to meet the criteria of the would-be single market (Brunazzo, 2016).

<sup>4</sup> Nobody seemed to be bothered by the impossibility of the mission to agree on the openness of the Irish border without knowing what sort of trade relations would link the two sides of the border.



version of Brexit would certainly suit to the most influential actors of the European economy, but leave millions of British voters frustrated and unsatisfied. Therefore, it cannot be ruled out that the process gets complicated, slowed down or even interrupted because of unforeseen changes in UK home affairs. This might lead to Britain leaving the bloc without a deal and falling back on WTO rules for trade with the EU, or sorting out a Canada-style free trade agreement following an agreed extension of the Article 50 negotiations.

## 4. Conclusion

The withdrawal of the United Kingdom from the European Union seems to be a complex and difficult process in itself. As a matter of fact, negotiations are overlapping with those, not less complex and complicated, about EU's Multiannual Financial Framework for the post-2020 period. Today, nobody can with certainty predict the outcome of either of the processes. However some sort of solution will sooner or later appear on the horizon in both cases. Only one thing is sure: either hard or soft Brexit takes place, countries of the EU periphery had better to wait for the end results of the withdrawal negotiations, and only then when the Brexit process will have unfolded to enter the substantive part of the discussion over the proposals for the 2021-27 MFF.

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