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INTERNATIONAL IMPLICATIONS OF THE BREXIT REFERENDUM

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What began outside Reims when General Alfred Jodl signed a document presented to him by General Eisenhower on 7th May 1945 started to unravel in Manchester Town Hall when an anonymous local government bureaucrat on the morning of 24th June 2016 announced that the UK's "leave" campaign had won the Brexit referendum.

The result itself was not in dispute. Despite the fact that 63% of the electorate did not vote for Brexit. That millions of British citizens living across Europe were denied a vote. While the Leave campaign relied on gross distortions of the truth to win the argument, best illustrated by the suggestion that 75 million Turks were heading to the UK or that the British tax-payer contributed £350m to the European Union's budget every week – a sum that would be spent on domestic priorities in the event of the UK exiting the EU.

The campaign was won because the British political elite had failed to make the case for remaining in the UK and securing the commitment of the public to a political project that had defined the European post-war era. An unspoken deal had been broken, it could be crudely described as: the elite enjoy the privilege that their education, networks and professions have provided them, and in return they ensure that a some of these benefits are shared across all social classes. Break that deal and something snaps, in this case Britain's ties with the EU.

Picking through the bones of the referendum result most sensible observers, this one included, reached the conclusion that the Brexit vote was probably never winnable once David Cameron's "re-negotiation" with fellow member states of the EU in March of this year backfired when he returned to London with something much weaker than that which he had hoped for.

The source of its underdoing was twofold. First, within his own circle two of the Prime Minister's closest allies, Michael Gove the then Justice Secretary and Boris Johnson, the Mayor of London, both immediately announced that the deal was not good enough for them to argue that the UK should remain in the EU. Second, from beyond his network the British public did not accept that a politician who rarely had a good word to say about the EU throughout his career, and indeed in key moments of it defined himself by lashing out against it, was now of the view after the re-negotiation that he was now prepared to back Britain's continued membership.

This pincer movement between some of his closest friends and a sceptical public was compounded by the strategy of the Remain campaign and the Prime Minister specifically during the referendum itself. The Prime Minister's advisers were of the view that the playbook from their two most recent, and successful election campaigns, had to be deployed for a third time. From the Scottish referendum campaign in September 2014 they took the lesson that a cross-section of elite opinion is a powerful tool in driving votes for the status quo. From their surprise victory in the 2015 general election campaign they assumed that economic logic (and fear) would convince the electorate not to take a financial risk with leaving the European Union. They were wrong on both counts. Moreover, every national election campaign that David Cameron had ever fought had been with an active and passionate right wing press putting wind in his campaign's sails, until this one, where his friends in the media turned on his campaign to rock it with challenging headwinds on a daily basis. Finally, with Gove and Johnson playing very visible and vocal

roles in the campaign they effectively turned themselves into a government in waiting, despite already having a seat around the Cabinet table. In positioning themselves as an alternative governing platform they were able to turn what Downing Street had hoped was going to be a ragged opponent into a coherent government-in-waiting.

The dynamics of the campaign are obviously unique to Britain. While the Euroscepticism that grew over the previous three decades to such a point that the referendum became a political necessity are hard to find outside of the UK. Even upon entry into the EU in the 1970s the British had always been reluctant Europeans, enduring a decision by the French to block the UK's entry to the then European Common Market in the 1960s and only joining a decade later as the British economy suffered an existential economic crisis driven by the oil price shock, labour disputes and a dysfunctional economy bringing the country to its knees. As the legacy of the Second World War became more remote with the end of the Cold War and the passing of a generation of politicians who lived through a disunited Europe in their youth a new set of British politicians struggled to make the case for Europe. This became more pointed after the collapse of the USSR when the Franco-German alliance sought to push a stronger federal Europe best illustrated by the introduction of the Euro in 1999 (which Britain did not join) and the Lisbon Treaty of 2007 (which the then British Prime Minister was so hostile to that he deliberately avoided appearing in the photo at the signing session) that endorsed the case for ever closer union. More recently the relative success of the British economy as the Eurozone crisis took hold after the global financial crisis of 2008 has

emboldened critics of the European Union. This became a powerful movement when combined with increased hostility to economic migrants who moved to the UK as the right to freedom of movement was taken up by citizens of the Eastern European countries who joined the Union in 2004 and 2007.

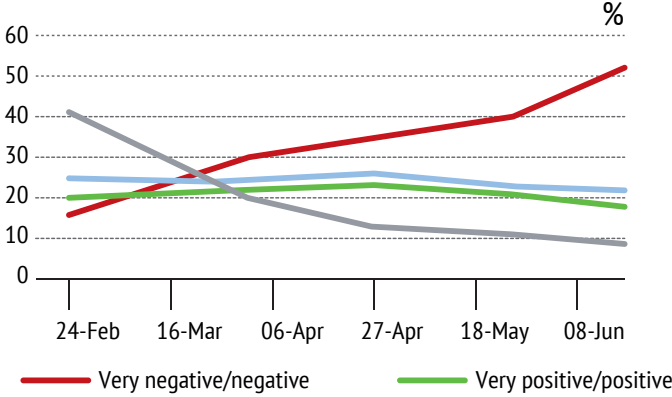
However, while these circumstances may well be unique. The consequences of them are not. The result of the referendum created a precedent which until the morning of the 24th June had never been acknowledge: the European Union has an exit door.

How Britain leaves the European Union is a complicated question. The new British Prime Minister, Theresa May, is now wrestling with this challenge on a daily basis. How should she frame the invoking of Article 50 in March of next year, the time-limited (two years) process by which Britain is expected to complete its exit negotiations. At what point can it start the process set out in Article 218 of the European Union to re-establish a new relationship with the Europe, and on what terms, with whom and based on model be it a Norwegian, Swiss, Canadian or hybrid version. These issues are important. But there is a wider issue for those who follow European politics and care about the stability of the world's largest trading block, home to some of the world's most advanced technologies, best universities, largest businesses and richest cultures, where might Brexit hit next?

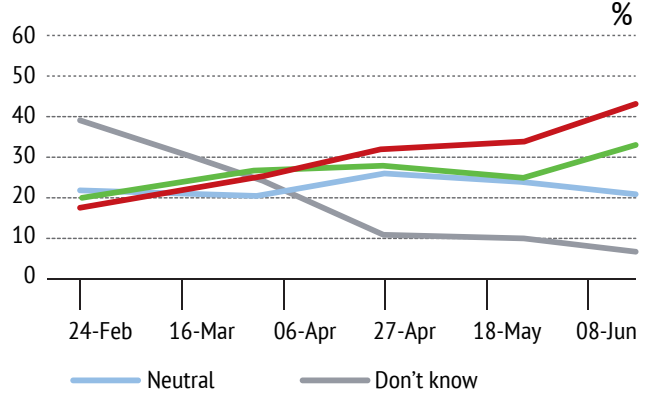
In the aftermath of the referendum result the European political elite performed a sharp U-turn. In the search for certainty and stability there were breathless calls for the British government to start the Article 50 process immediately. Admittedly this was encouraged to some extent by (what turned out to be) threatening rhetoric from David

TIME FOR A NEW CAMPAIGN MANUAL?

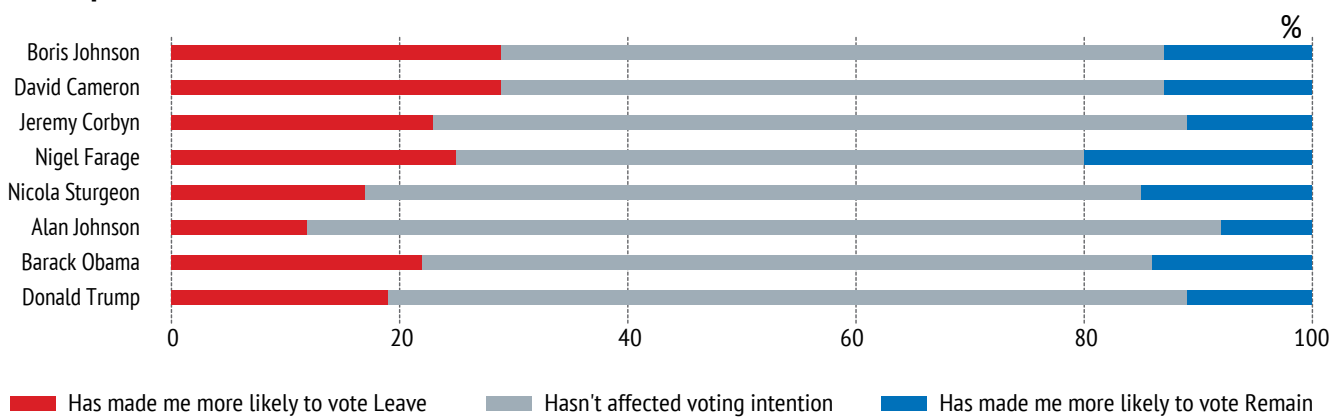
Attitudes towards Remain



Attitudes towards Leave



Role of personalities



Source: Electoral Reform Society.

Cameron during the referendum campaign that he would institute the procedures to quite the EU shortly after the result should the public opt to leave. Cameron’s swift resignation put the brakes on this process as he rightly felt he should not be tying the hands of his successor. President Hollande was the most forthright calling initially for a rapid exit process. While the President of the European Commission, Jean-Claude Juncker, (perhaps reflecting in part the fact that the British government had sought to block his appointment) seemed to be taking a similar approach before advocating a more

measured stance. It finally took Angela Merkel to install some calm over the situation when she made clear that, within reason, the UK could move at its own speed especially as its new Prime Minister found her feet. This shift from encouraging the UK to head out of the room at speed to allowing a more leisurely pace reflected on the politicians coming to understand the sheer complexity of the challenge the British people had embraced but also accepting that should anyone make a wrong move the danger of “Brexit contagion” across Europe became more pronounced.

While the political reaction caught the attention it was the response of the financial markets that probably had as much influence on pressing the pause button. The impact in the UK was obvious, with FTSE 250 (more exposed to the British economy than its more international FTSE 100) down 7% on the day after the Brexit poll. Sterling followed a similar path against the Euro and the Dollar. Yes, since those heady days in June the financial markets have returned to pre-referendum levels. But at the time when markets had not seen such turbulence since the collapse of Lehmans it is no surprise that the politicians sought to de-escalate a fraught political environment.

Beyond the UK the impact was just as profound and meaningful. The sharpest immediate reaction befell the Italian banking system, something of a modern sick-man of Europe ever since the beginning of the Eurozone Crisis. The uncertainty flowing out of Europe's financial centre in London had a swift impact on Italian banks who relied on London's deep capital pools to shore up their balance sheets. If those pools were going to become shallower in the weeks that followed then the liquidity of Italian banks was going to become more challenging.

Concurrently with these market reactions and moves by political leaders there was the public to take into account. Perhaps not surprisingly support for the European Union amongst all main European countries rose in the weeks after the Brexit vote. In the immediate aftershock of the decision the public shied away from further uncertainty. But, that does not mean that the consensus for the status quo on continental European has increased. Far from it. As the European political class returned from their long summer

break Chancellor Merkel and President Hollande formed a troika at the invitation of Prime Minister Renzi on the island of Ventotene, a symbolic location chosen as it was home to the well-known anti-fascist internee Altiero Spinelli who wrote whilst in captivity during the Second World War a call for European unity which in time came to be seen as a blueprint for European federalism. The symbolism of the location was not lost on anyone. The back to school agenda was focused on Italian priorities like signing off the bailout for Italian banks and further measures to tackle the migration crisis. But the issue of Brexit overhung much of the debate. The discussion has clearly shifted from how best to encourage the UK to leave the EU as quickly as possible to making sure that they do it on terms that do not lead to contagion elsewhere.

Each leader had to strike a difficult balance given strong, if diverging domestic opinion in their own home political markets. Given his shaky position in not only the polls but the likelihood of him even being selected by his own political party to represent them at the Presidential election next May President Hollande had the most complicated Brexit calculus to consider.

Even without the shadow of Brexit President Hollande would be in a perilous position. The Eurozone crisis has continued to undermine the French economy, much needed structural reforms are as distant as ever and the impact of horrific terrorist attacks have undermined national confidence and introduced new levels of security across French cities. Hollande himself has been an uninspiring leader and relied on younger members of his government, notably Prime Minister Manuel Valls and his Finance Minister Emmanuel

Macron to make the running. Even they have failed to be impressed by the President, with Macron leaving the government in September of this year to consider running a bid for President, while Prime Minister is still said to be considering doing the same.

If that wasn't bad enough the shadow of Frexit has been cast by Front National leader Marine le Pen. Having taken over from her father (with whom she is now estranged) le Pen has embraced the Brexit result. While not explicitly calling for a referendum on France's membership of the European Union she is actively campaigning to leave the Euro and has called for a looser set of treaties across the EU, regardless of the details one thing is clear is that such a plan would de facto be incompatible with membership of the European Union as it is currently established. Le Pen's far-right offer combining economic nationalism, a strong anti-austerity message and a vision of a France that is well, more French in her eyes, has been embraced by working class communities and led to Hollande's Socialist party haemorrhaging support amongst voters his party could traditionally have relied on. As the elections approach with le Pen currently in a strong second place she will look to frame Brexit as an exemplar of a different approach, one where the status quo can be challenged and the country can be set on a new course.

There are two principal barriers to this progress. The first is the criteria to introduce a referendum in France, requiring 20% of French members of parliament and 10% of the electorate. The second is the election itself. It seems difficult at this stage to see how Hollande or even another Socialist candidate could return to the Elysee Palace, with the centre-right party currently polling around a third of voters. Equally, le Pen is unlikely

to win either with a repeat of what happened in 2002 expected when her father made it to the second round of the contest (the top two candidates go through to a run-off) before a grand coalition of the mainstream left and right backed the conservative Chirac after the Socialist Jospin had come third to Jean-Marie le Pen in the first round. Martine le Pen will be more interested not in the destination of this journey, one where she is likely to fall-short, but the process itself. If she can generate enough momentum in the election campaign, picking up support from the left and the right, she will generate such anxiety amongst the elite that both parties will offer concessions to this body of opinion. On a practical level this may mean restrictions on freedom of movement with reform of Schengen or similar. Equally, much needed reform of the European Union, for example on agricultural subsidies will become even less likely if the consensus for the European ideal in France is weakened as a result of Brexit.

Similar challenges exist in Italy. Arguably some view these as self-inflicted given the fact that Matteo Renzi has decided to hold his own referendum in early December. The poll is designed to resolve judicial questions about the Italian constitution, principally in reducing the powers of the Italian Senate. However, with the opposition Five Star movement recently winning major Mayoral contests in Rome and Turin the Italian Prime Minister is facing a formidable opponent as they lead the charge against him in the referendum. Brexit has inspired the insurgent political movement, itself aligned with UKIP in the European Parliament. With the elite European consensus being challenged in the UK it is easy to see how it could spread to Italy. Renzi himself has said that he would resign as head of the government (though

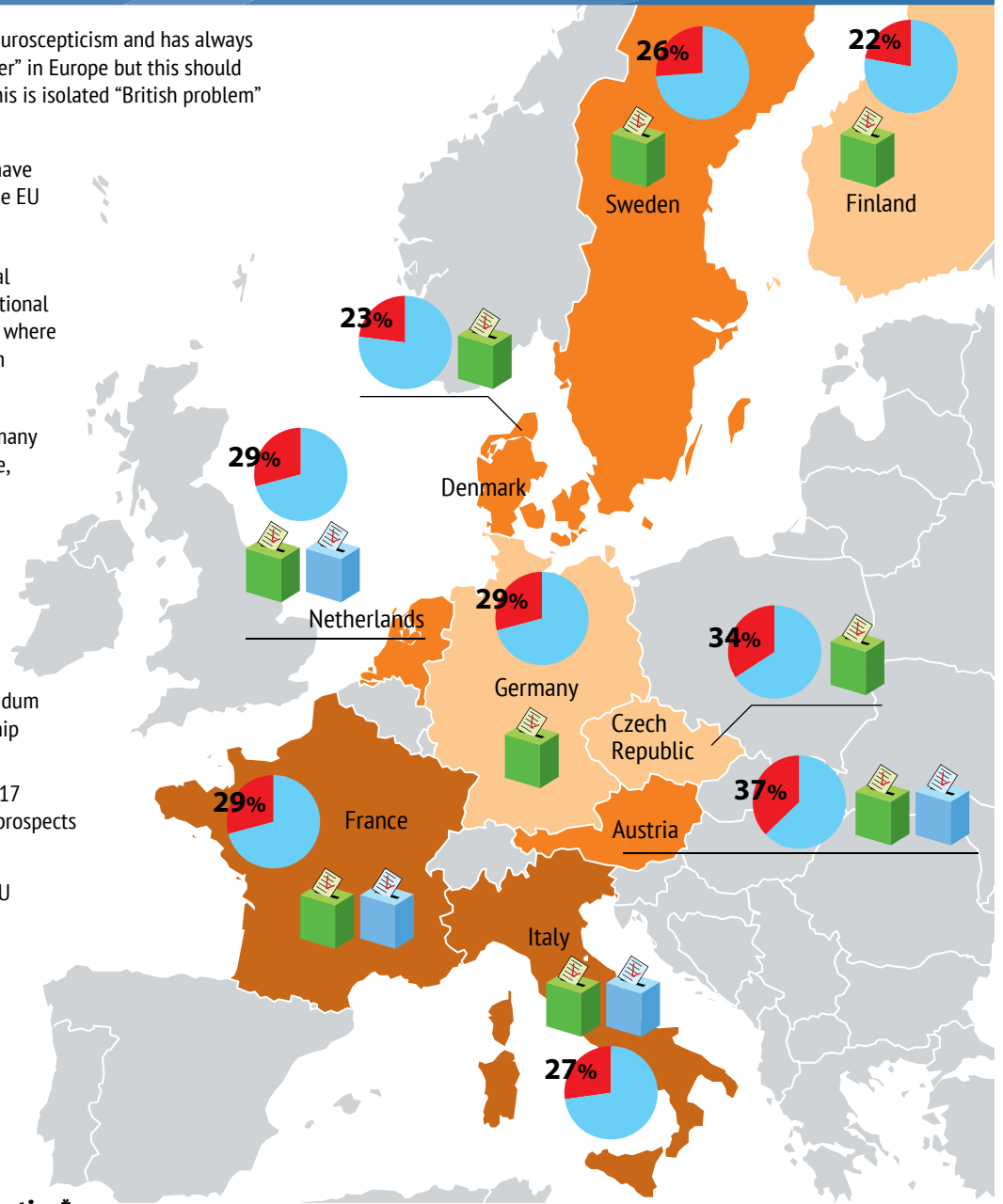
POLITICAL CONTAGION TO THE REST OF THE EU?

The UK has a distinct history of Euroscepticism and has always played the role of “difficult partner” in Europe but this should not lead to the conclusion that this is isolated “British problem”

Eurosceptics across the EU have polled well and many countries have a latent lack of enthusiasm for the EU institutions

The upcoming French Presidential elections and the Italian constitutional referendum are both flash points where Eurosceptic parties could perform well or capitalise on the result

Voters for populist parties have many similar characteristics: often male, poorly educated and/or manual workers



Polling of Eurosceptic parties*

28%	35%	9%	18%	17%	29%	20%	8%	11%
National Front	Freedom Party of Austria	Alternative for Germany	Party for Freedom	Sweden Democrats	Movimento 5 Stelle	Danish People's Party	Perussuomalaiset	Občanská demokratická strana
France	Austria	Germany	Netherlands	Sweden	Italy	Denmark	Finland	Czech Republic

Sources: GC judgement, Eurobarometer, Forsa, Voxmeter, Taloustutkimus, Demoskop, Sanep, BVA, Gallup, SWG, IPSOS *July 2016.

significantly not head of his Democratic Party) if he was to lose the referendum. If he does stand down it is conceivable that his government could fall too (an all too commonplace occurrence in recent Italian history) and with wind in Five Stars sails its President Beppe Grillo or another prominent figure could become Prime Minister. With Five Star standing on a platform of radical direct democracy, anti-corporate and crucially favouring a consultative referendum on Italy's membership of the Euro it is easy to see how Brexit contagion could move down to the heel of Italy.

At the heart of modern Europe in Berlin the German chancellor does not face such acute challenges as her neighbours in Rome or Paris. As recent regional elections have confirmed her position has been most impacted by the aftershocks of how she handled the migration crisis of last summer rather than the impact of Brexit. The success of Alternative für Deutschland (AfD) in these polls may well inspire some form of Brexit contagion in Germany. While the leadership of the party take a fairly considered view about Germany's relationship to the EU their members have a broader range of views. Should they continue to make progress in the run-up to the Federal Elections in September 2017 they will weaken Mrs Merkel's room to manoeuvre on Brexit. Here as ever Mrs Merkel will have to balance the interest of his country with her continent, a challenge she has become very familiar with over the last decade. In supporting her more hardline European colleagues to impose a tough deal on Britain's exit she may well irritate AfD supporters who sympathise with British antipathy to the European super-state. Equally, she may favour a deal that is more sympathetic to the British (and therefore

German industry) which may encourage mainstream views to consider a more distant relationship with the EU.

These pressures will be front of mind when Mrs Merkel joins her fellow heads of government in Brussels at a series of meetings of the European Council to decide how best to handle the greatest de-merger of economies since the second world war. She will carry on her shoulders the concerns not only of her principal continental allies but will have to bear in mind the anxieties of views ranging from the Netherlands, Austria and Finland all of whom have their own Brexit contagion concerns as the table on page 7 shows.

The heads of government discussing the terms of which Britain should leave the EU once Article 50 has been invoked will talk about preserving European Unity but know that stemming any risk of domestic Brexit contagion will be their principal objective. They will know that only 6% of British votes said after the poll that their main reason for voting to leave was because when it came to trade and the economy the UK would benefit more from being outsider of the EU. Yet that is just what they will be negotiating. They will also know that more than a third of British voters cited immigration at the reason to quit the EU. This conundrum, recognising the voters were concerned about the implications of one policy and so favoured a more radical alternative will be front of mind. In trying to avoid the trap that David Cameron fell into, and paid with his job, they are likely to favour a package which makes the terms that Britain leave the EU as unappetising as possible to encourage voters never to consider the radical option that led to the announcement in Manchester on the morning of 24th June.



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