



Europe and Brexit



Global Counsel

Introduction

The UK referendum result is a landmark event in the history of the European Union and will have important implications for the politics, policy and economy of the EU. It has established that the EU has an exit door and this fact alone could transform the ambition, priorities and performance of Eurosceptic forces across the EU. The way EU states respond to this will shape policy for years to come - not least in the terms they grant the UK on its way to life outside the EU.

That exit process brings risks of its own for EU states. British exit of the EU is arguably the most significant economic demerger between major economies since the Second World War. As this implies, it carries the risk of disruption for the movement of goods, services and people between the UK and the rest of the EU. This is happening against a backdrop of economic vulnerability.

The EU is also potentially losing one of the major architects of its policy for almost four decades. In areas such as trade, competition and product market reform, the UK has left a serious mark on EU policy. How the EU makes policy in its absence is unlikely to be unchanged, and this has important implications for business. The impact of this is likely to be immediately felt in flagship policy projects like the Digital Single Market.

Much about the process of transitioning the UK out of the EU has no precedent and is unclear. But we know already that the UK will change the EU in deciding to leave and in the act of leaving; and it will leave behind a different EU.

Find out more about Global Counsel's work in this area at www.global-counsel.co.uk/brexit

A new political fact

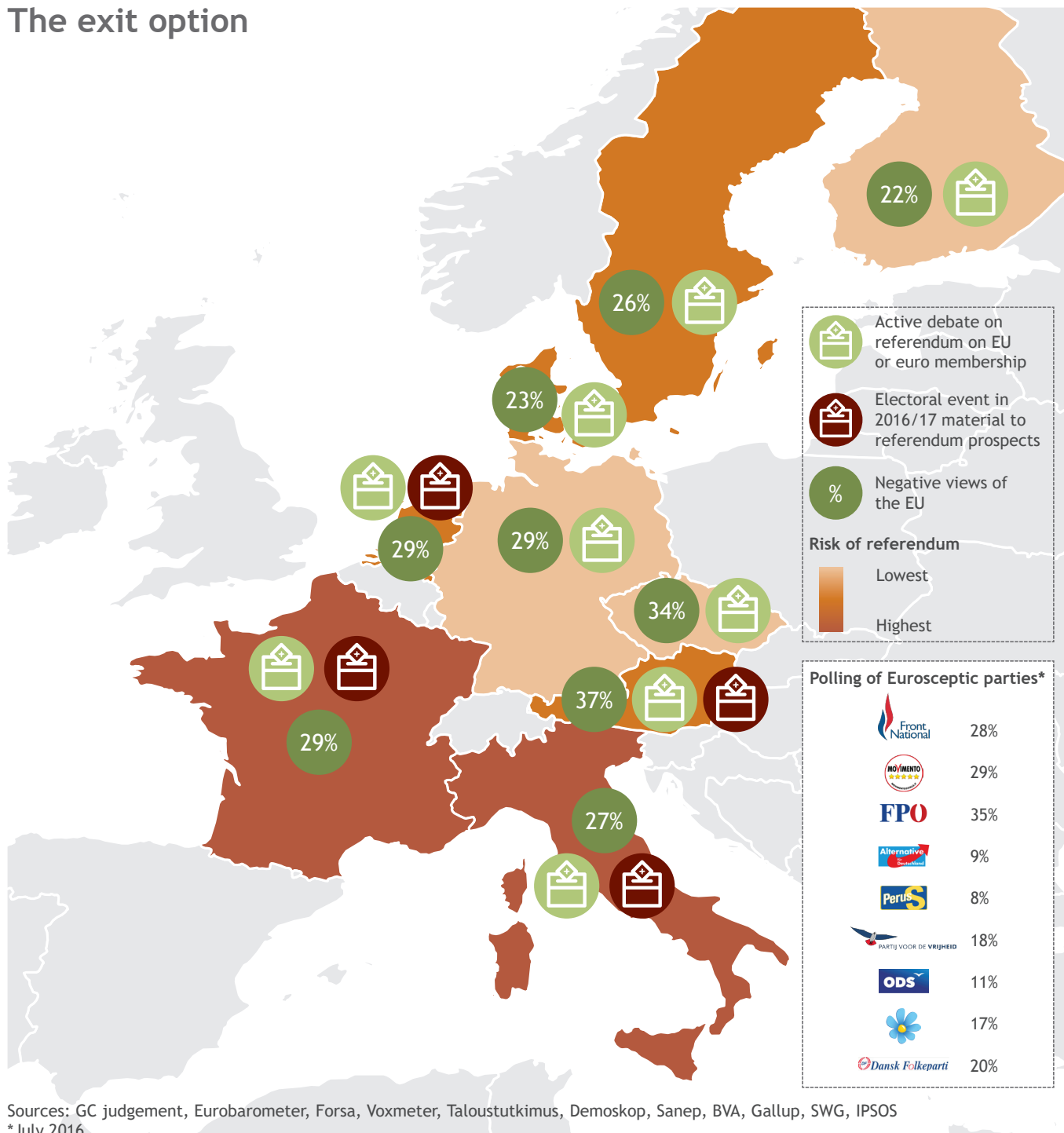
Grexit hinted at it but Brexit has established it: the European Union has an exit door. After six decades of integration and ever closer union, it is hard to overstate the importance of this new political fact. It has already reframed the aims of many European Eurosceptics and will create a unique test case for life after the EU.

While support for the EU has risen in many EU states, the real test of Brexit on public opinion in the rest of the EU will come later. It will reflect the perception of the success of the British experiment, but also the self-confidence and coherence with which the EU sets out for electorates a programme for the future of the EU that addresses the same political concerns that produced a vote to leave in the UK.

Electoral events conducted in the full glare of current European tensions make the Italian referendum this autumn and the French elections in spring 2017 key moments of potential volatility. Both could intensify the prospects of destabilising debates on EU cooperation. Euroscepticism in the Netherlands, Scandinavia and Finland is sufficiently embedded to exert a material influence on both politics and policy over the next eighteen months, not least on exit terms for the UK. Outside the euro and instinctively sceptical, Sweden and Denmark merit particular attention.

Other European governments are acutely aware of the way that the British experiment will be watched by their own domestic Eurosceptics. This will shape their domestic politics and their demands of Brussels, especially in areas such as migration and demands for policy flexibility. It will shape the way they manage the UK's transition out of the EU and the terms of its future relationship with the EU.

The exit option



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

The biggest economic demerger since WWII

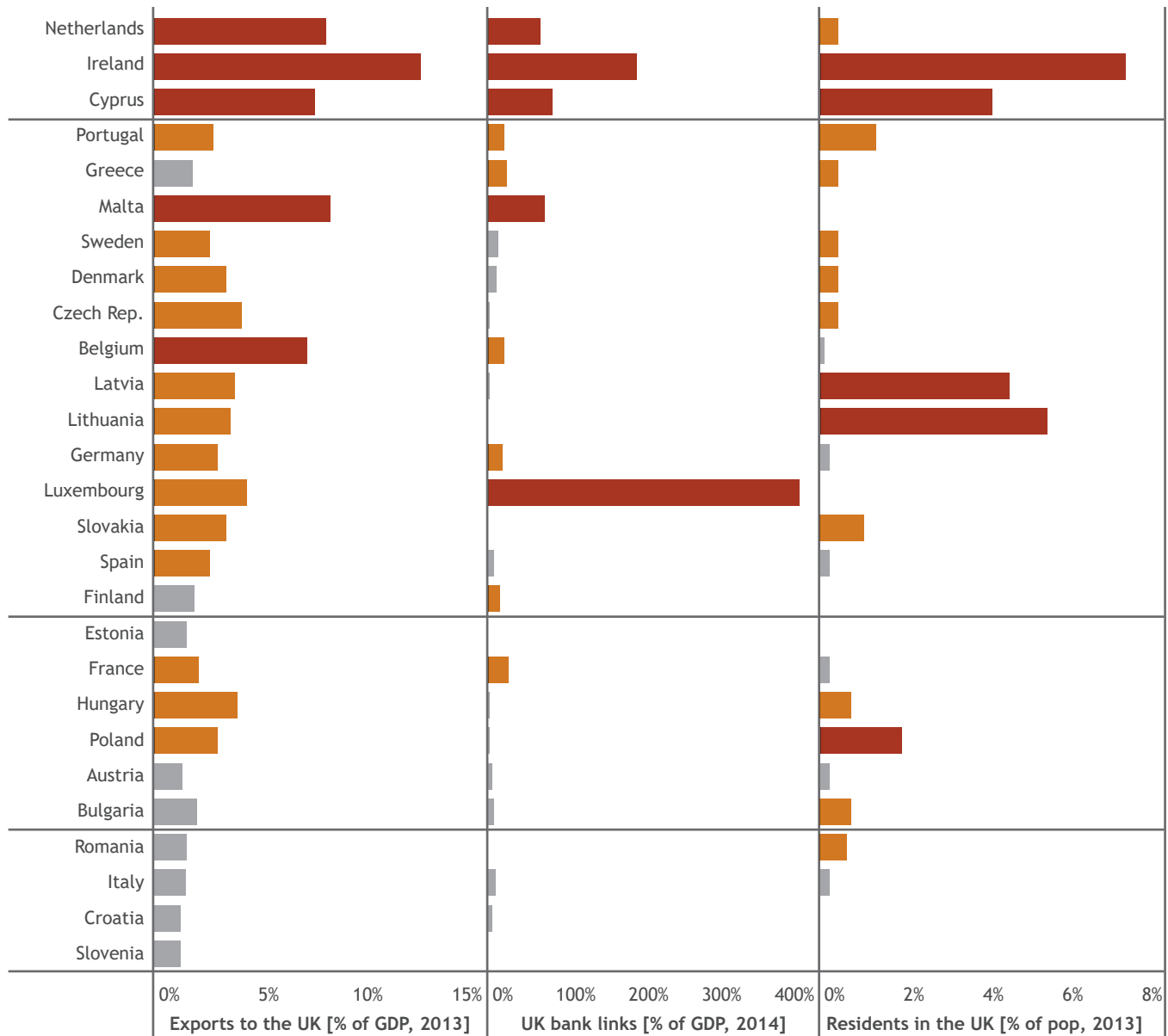
Transitioning the UK out of the EU is a policy exercise unlike anything that has occurred since the Second World War. Demerging economies as integrated as those of the EU27 and the UK has no modern precedent outside of wartime. Established supply chains and distribution networks in almost all sectors are obviously exposed. But so are dense social and cultural networks: from the migrants that have settled in both directions to the ecosystems of scientific and academic cooperation that have developed under the auspices of European cooperation.

Member states are exposed to this disruption in different ways. Heavy exporters and importers to and from the UK will obviously be concerned at the prospect of the erection of new barriers to trade. EU companies using London to connect to the global financial economy and EU banks that ultimately rely on the deep capital markets of London for onward lending to businesses will be concerned at the prospect of reduced access to what is ultimately the region's financial capital.

How disruptive these impacts are will ultimately depend on the model agreed for the UK's future relationship with the EU. This will be a delicate balance of politics and pragmatism. Ensuring that trade between the EU and the UK remains tariff-free in general is among the easier problems to solve. Integration based on a greater degree of regulatory convergence such as financial services, or commitments in areas such as free movement of people, are likely to be more politically contested.

Exposure by member state

Exposure ■ High ■ Medium ■ Low



Sources: ONS, Bank of England, IMF, European Commission, CEIC, GC calculations

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The EU without the UK

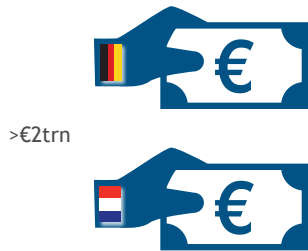
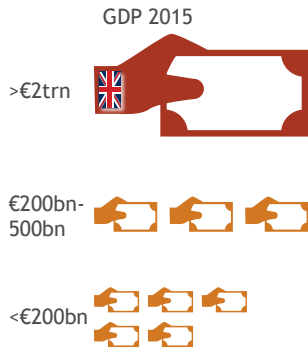
Britain is a large state and economy that has become an integral part of the EU single market since its establishment. Among the many implications of detaching that state from the single market, one of the most potentially disruptive is the changing terms of access for EU businesses to the global capital markets for which the UK is an established hub. 60% of EU capital markets business is conducted through the UK, including hundreds of billions of inter-bank lending that ultimately finances credit to EU corporates and households.

The UK has strong policy biases that have played a marked role in shaping the overall policy direction of the EU. One area where this has been important is trade policy, where the UK has been the core of a small but influential group of states that have taken a consistently liberal approach to the EU's external common commercial policy. With Germany on side, this group has always exercised a blocking minority in policy - without the UK, that will no longer be the case. The UK is also a major net contributor to the EU budget and shaper of how it is spent. The €11 billion net contributed by the UK to the EU budget will need to be replaced, with politically sensitive implications for other net contributors - or cut, with important ramifications for recipients.

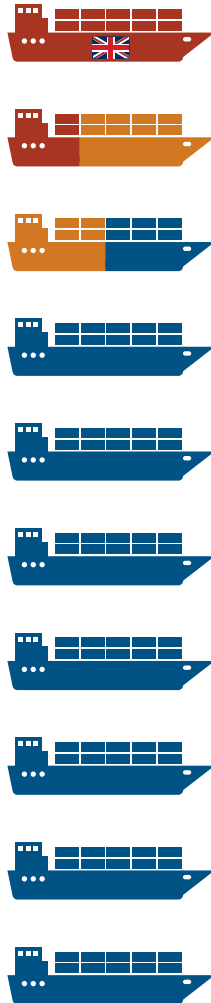
As by far the largest EU member state outside the Eurozone, the UK has always been a check on Eurozone caucusing. This was an explicit part of the pre-referendum deal negotiated by the UK. Without the UK's counterweight to the Eurogroup, other non-euro states can expect a serious shift in the political and policy dynamic. Poland in particular may reconsider its current ambivalence to fulfilling commitments to join the bloc.

The impact of the UK's departure

Euro ins and outs

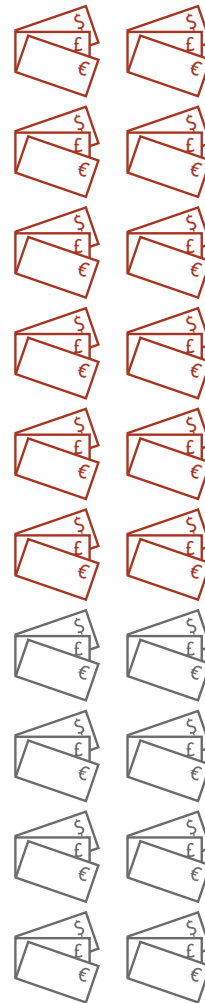


Trade liberals



The UK accounts for half of the consistently liberal votes in Council on trade issues

Capital markets



Around 60% of EU capital markets business is conducted in the UK*

The EU budget



The UK contributes €11bn net to the EU budget- which may have to be found elsewhere

*European Commission

The UK's exit and the Digital Single Market

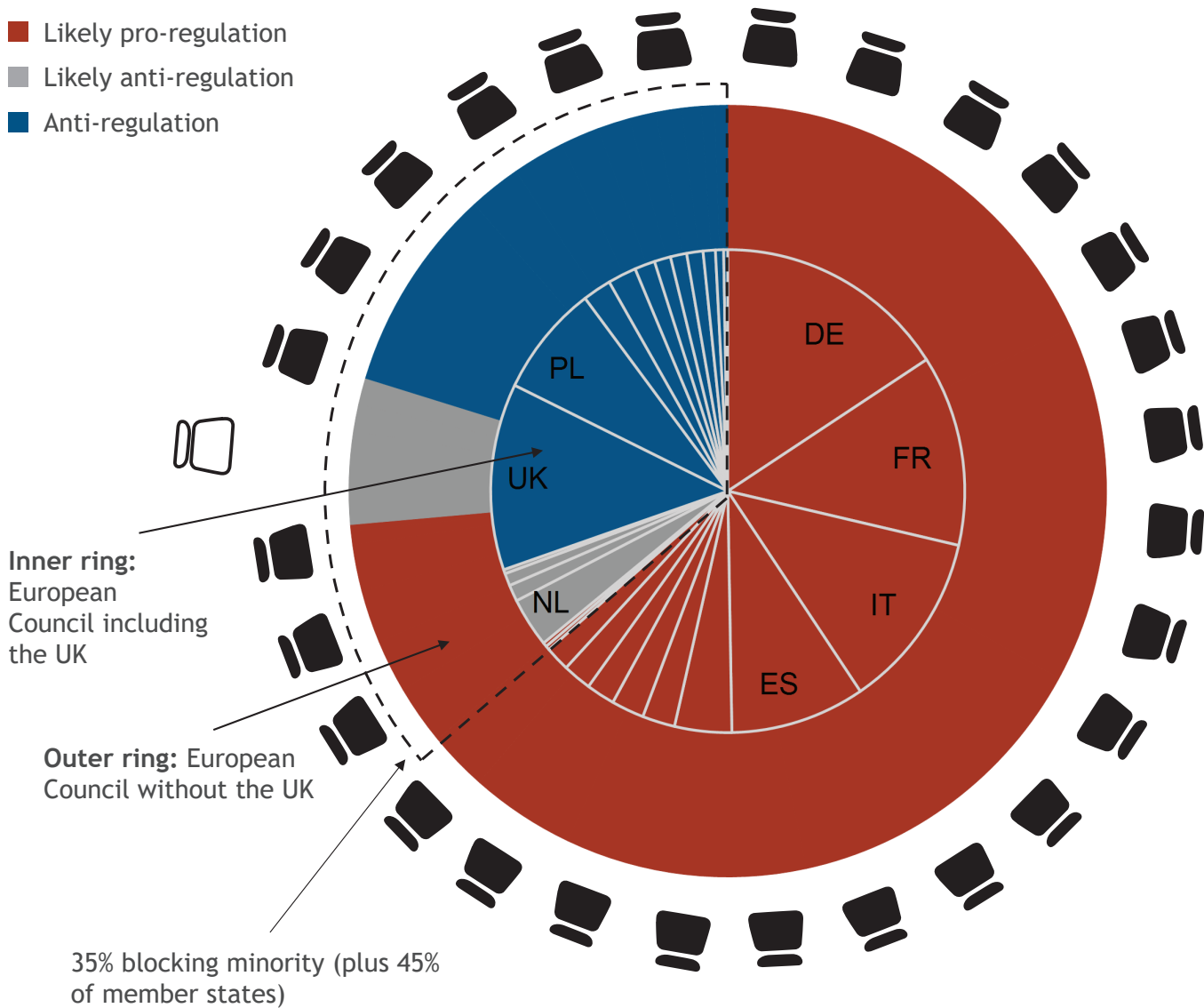
The UK is already shedding influence over the direction and detail of EU policymaking. The most prominent examples have been the resignation of Commissioner Jonathan Hill from the financial services portfolio and the cancellation of the UK's Presidency of the Council in 2017. British MEPs still operate with full decision making rights, at least until Article 50 is triggered, but their ability to guide policy and draw on British experience and interests is diminishing daily.

This means that the Digital Single Market (DSM) liberalisation agenda will lose its most vocal proponent. Successive UK governments identified digital policy as one of the few areas where they were comfortable advocating greater EU integration as part of a liberalisation agenda to promote competition and rationalise overlapping national regulatory systems. A central plank of this agenda was the acceptance and encouragement of new technologies and companies, often from the US, and the promotion of a technology neutral approach. The UK-led 'antiplatform regulation' camp, which wrote to Vice-President Ansip urging him to resist introducing new legislation, loses not only its most high profile supporter, but also the voting weight of the UK in the Council, meaning that they no longer have a blocking minority to oppose a legislative initiative (see chart opposite).

Moving forward, the DSM is likely to draw more on industrial policy goals and data sovereignty. Such an agenda could see EU policymaking more explicitly prioritise the growth of indigenous EU digital champions above inward investment from non-European companies. This could find its expression in data protection policy, where the UK has been a major voice in favour of openness to other countries such as the US and in opposition to those who have advocated "data sovereignty" and localisation.

Online platforms policy post-Brexit

- Likely pro-regulation
- Likely anti-regulation
- Anti-regulation



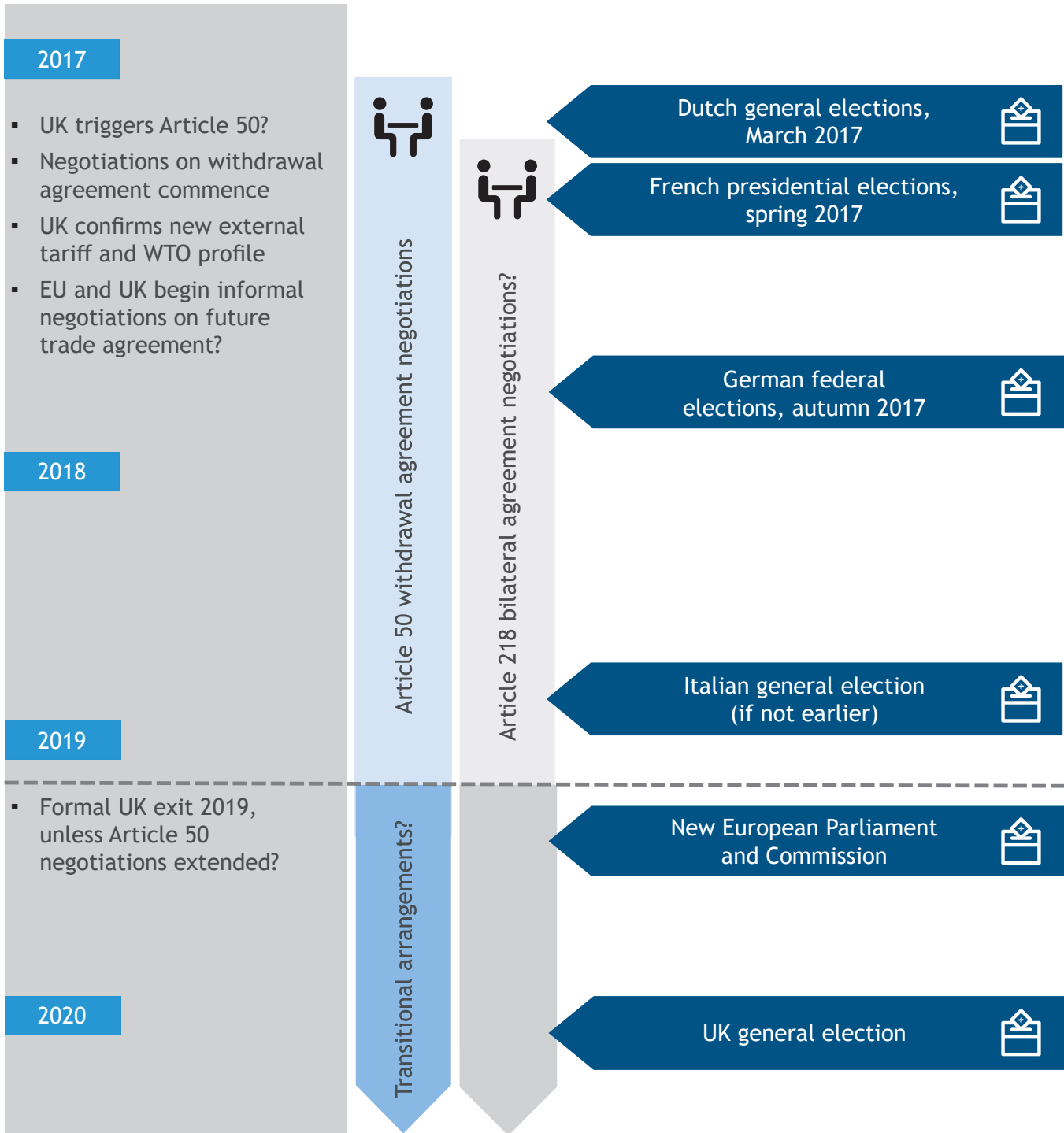
Source: GC judgement; anti-regulation: countries which co-signed anti-regulation letter on online platforms to Vice-President Ansip on 4 April 2016

The exit process

There is no precedent for the British exit negotiation and no authoritative interpretation of the process set down in Article 50. What the withdrawal negotiations should cover, how they will be sequenced and integrated - if at all - with the equally important agreement of future trading relations and what transitional arrangements will be available to smooth the exit process are all crucial issues that are as yet unclear. The type of relationship the UK seeks with the EU27 - and what the EU27 are willing to grant - will play a major part in determining what the exit process will need to cover and how.

For now, the initiative is with London; once the UK triggers Article 50, the process will be driven by EU member states. The UK will ultimately choose the moment to formally initiate the exit process, but once it does so the time constraints of the Article 50 process and the need for clarity on the future terms of trade with the EU will ultimately strengthen the hand of the EU27. However, both sides ultimately have a strong economic rationale for an orderly transition that minimises disruption - even if politics pulls national capitals in other directions.

Domestic political events and elections across Europe will shape the course of negotiations. Elections in the Netherlands, Germany and France in 2017 will inevitably impact negotiations and distract national capitals. Potential changes in governments and the persistent concern with managing domestic Eurosceptics are both likely to complicate negotiations.



About Global Counsel

Global Counsel is an advisory firm that works with clients navigating the critical area between business, politics and policymaking in the European Union. We help companies and investors across a wide range of sectors to anticipate the ways in which politics, regulation and public policymaking in Brussels and member states create both risk and opportunity - and to develop and implement strategies to meet these challenges.

Over the past two years, Global Counsel has worked with clients to help them understand and prepare for the impact of a possible UK exit from the EU. We have also supported clients on the Juncker Commission's work programme including flagship initiatives such as the Digital Single Market, the Energy Union and the Capital Markets Union.

Global Counsel draws on the expertise of a team of former public policymakers and political advisors with experience at the highest level of policymaking in national governments, the European Commission, the Council and the European Parliament. Our expertise and experience cover business sectors including financial services, energy, technology, media, manufacturing and telecoms. Global Counsel has offices in London, Brussels and Singapore.

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