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Brexit and the Future of Europe

Ernst & Young: EU Account Roundtable

21th October 2016, Warsaw

Brexit has happened in unfortunate times. For European Union these are still difficult times. Though I do not believe it is justified to continue talking about Europe in crisis any more, nevertheless the list of things to do both at national and European level is long. It includes not only the completion of euro zone reforms and economic challenges in broader terms, it is also about internal and external security, and migration. European house is not in fire any more and the need to shift from a short term urgency approach toward long term solutions does not come as surprise.

What makes this shift undoable is lack of political unity caused by the domination of national agendas. Political leaders come to Brussels with a strong focus on their national priorities, oppose the European approach to problems requiring joint solutions and on their way home criticize Europe for lack of capacity to do what citizens expect. The short termism and euroscepticism are accompanied by populist arguments, far too often being taken over from populism narrative by mainstream politicians. The extreme form of this phenomenon has been the political path leading to Brexit referendum.

I said that Brexit happened because, indeed, it was provoked by an irresponsible action of a mainstream politician and handled through an irresponsible campaign based on “facts do not matter” approach to politics. It bears long term consequences for all actors involved. It is legitimate to ask whether Brexit process could be converted into a good crisis that, as Winston Churchill said, should not go to waste.

From the EU 27 point of view, one could see the time between the referendum and the entry into force of the withdrawal agreement as a window of opportunity to proceed urgently and swiftly with decisions, actions and concrete reforms consolidating the Union, and in particular completing the euro zone architecture and putting in place mechanisms for its effective and efficient functioning. There are reforms needed in any case, with or without the UK as a member of the Union. Many of those have taken place since 2008. Still, too much of what we call unfinished business remains.

My worry is that we have already reached this moment of Brexit fatigue when the fact that for the first time in the European integration history a member state will leave the Union is just an issue for which we have to organize ourselves, to ensure orderly procedure for the event. It is not just an issue. It is a long term process with very few certainties. It came as a surprise. Nobody

potentially to be affected was prepared. We are, also legally, on uncharted waters.

Both, the EU and UK will get smaller as a result of Brexit. We will get smaller politically and economically at a time when the global world, the one around the corner and the one more remote in terms of geographic distance, is becoming more and more messy, unpredictable, bigger on all accounts, and not necessarily sharing our values and principles, including the respect of international law.

In UK, political approach to Brexit seems to dominate. Those in charge and bearing responsibility seem to continue with assumption that EU will do whatever UK will be demanding. This is very unlikely. What also must not be forgotten is that the February deal negotiated between UK and the Union is not anymore on the table. It is also rather clear that it did not have any impact on the referendum. In reality, it was not even used by the British government as an argument during the campaign. More and more repercussions of the withdrawal are being identified which were not spelled out before the referendum and which are directed by representatives of different sectors of the economy (universities and research communities, farmers, services, in particular financial ones, etc) to the attention of government.

UK will negotiate with the Union two types of agreements, one related to the withdrawal and the second - to be negotiated and concluded once the first enters into force, making the UK a third country - related to the future relationship with the European Union. However, article 50 says clearly that the future arrangements will be taken into account while concluding the withdrawal agreement. This will lead to negotiating badly needed transitional arrangements, allowing to avoid the emergence of legal vacuum in the relationship between the two sides. Of course, transition to be orderly will require knowledge of the future arrangements. Transition toward what - one might ask. Often we can hear from the other side of the channel that none of the existing arrangements between the Union and third countries suits the Brits. They will need a UK specific deal. Nevertheless it seems smart to look at those relationships that are already in place. They diverge from the Norwegian and Icelandic one, through the Swiss one, then Turkish, as well as the Canadian and Korean FTAs, to the WTO model. What seems to fit best the requirements of the future EU - UK deal is the Ukrainian association agreement, embracing deep and comprehensive FTA and an institutional and political accord. It seems attractive only in case UK will not want to leave the custom union. Then, a deep and comprehensive FTA including tariffs, quotas, NTBs, freedom of establishment also in services, public procurement and sector by sector specific cases would be a good framework. In case of Ukrainian agreement, there is a framework for institutional cooperation and a political one, based on respect of values and principles.

One more issue deserves a comment. There have been recently observations made by some British populist politicians that contrary to the warnings there has been no dramatic impact of the Brexit on the British economy. Hard data which went down in the first two weeks after the referendum, then recovered.

Of course confusing market and system reactions to referendum with long term impact on living standards of shifts in trade, terms of trade, exchange rate, monetary policy, investment, employment and growth is a political error.

UK trade relations with the EU are very asymmetric. While 60% of UK trade goes to EU, it is only 8% of EU trade that goes the other way around. Trade deficit with the EU amounts to 2% of the UK GDP. In case of services it is the surplus which amounts to 5% of UK GDP. Can UK find attractive markets for services, including financial ones, outside EU?

It is, however, interesting to look at soft data and in particular expectations of businesses with regard to employment and investment. No investment plans are being made and falling employment expectations dominate. QE seems to be back on the agenda, and surplus target is being abandoned.

In short, the jury is still out. But uncertainties can be dangerous.