

INSTITUT
MONTAIGNE



Bremain or Brexit:
Europe, build your future!

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INTRODUCTION

Since David Cameron's announcement of the date of the referendum made on February 20, the future of the European Union (EU) seems to be hanging on the British people's decision. The Institut Montaigne has no intention of taking part in the political debate inside the United Kingdom, but merely wishes to inform European citizens and their leaders of the political and economic consequences of the referendum. Our conviction is that, irrespective of the result, June 23, 2016, will be an important date in the history of Europe's construction.

After joining it in 1973, the British people voted in 1975 with a 67.2% majority in favour of the country remaining in the European Economic Community (EEC). The United Kingdom perceived its place in the construction of Europe first and foremost as an economic opportunity, with any political adhesion to a common destiny being subject to more reservations. Since 1975, political leaders have been divided as to the United Kingdom's place in Europe, as have intellectuals, the consequence of which has been a permanent renegotiation of the terms of their membership, which explains the large number of derogations and withdrawal rights from which the United Kingdom benefits within the European Union. This exceptional status has not prevented an increasingly significant faction of the British conservative party from calling for a referendum on their country's exit.

A large majority of the political class and British public opinion has always been ill at ease with the idea of an increasingly close rapprochement that could result in political integration. From this point of view, creating a single common currency represented an even more important step, inasmuch as the United Kingdom had to leave the European monetary system a number of years earlier.

More recently, the difficulties faced by economies in the Euro zone to recover from the economic downturn – whereas the British economy, which had been very severely hit, recovered more strongly – together with the EU's loss of credibility in its capacity to face up to the world's major challenges, have fuelled a feeling of alienation. The EU is no longer seen as an opportunity and is perceived today as a risk vector (immigration, economic instability of the Euro zone, over-regulation).

Over and above these circumstances, the British referendum also emphasizes a vicious circle: (i) the EU's inability to affront various elements that have been overlooked on the construction of Europe (what is the place of political integration in the nature of the European project? How to reconcile sources of legitimacy between governments and parliaments of member states on the one hand and European institutions, especially the Commission and the Parliament, on the other? What is the reality of the unique nature of the construction of Europe and the "*in fine*" coincidence of the different components of the European Economic and Monetary Union – EMU – between the common market and adopting a common currency? More fundamentally, what is Europe's objective?), (ii) the discomfort of the British political class in the face of the construction of Europe and (iii) an increasing distrust of the EU, are mutually adding fuel to each other. Through its not knowing how to define with precision what it promises to European peoples and what it wants to be, Europe has confirmed the fears expressed by certain countries that they will be drawn into a process that they do not control and that they paralyse in return.

In any case, even though it is the world's main economic power, holding the referendum emphasises the EU's lack of vision and its incapacity to implement policies that produce tangible results perceived as being beneficial by the nations that comprise it. A "Europe of producers", which had been materialised in the initial rapprochement project, has progressively become a "Europe of consumers". It has difficulty in offering the protection that European peoples and businesses hope for.

Irrespective of the result of the June 23 referendum and of whether the British decide to stay or leave, Europe must affront these overlooked aspects; it must give back meaning to its integration project and re-invent itself so that the European project, which has produced an unprecedented period of peace and prosperity in the history of our continent, can still be a reality tomorrow.

I - Context

1 – The United Kingdom and Europe

A – The historical and strategic context

The special relationship that the United Kingdom maintains with continental Europe is a mixture of contradictory feelings of belonging and remoteness. Even if the United Kingdom is deeply European in cultural terms, it continues to maintain an ambiguous political relationship with its neighbours. Its opposition to the emergence of continental Europe as a dominating power on political and military levels is undoubtedly one of the most constant bedrocks of British strategic conception and diplomatic culture.

Britain joined the European Economic Community at the beginning of the 1970s during a period when the United Kingdom was vulnerable. The European project opened up new perspectives to a country that was marked politically by Decolonisation and economically by a relatively significant decline. Since it was not immediately motivated by the trauma of two world wars, on the other side of the English Channel the United Kingdom's participation in the European Union was seen more as an essentially economic association and a strong right to examine the continent's political orientations, rather than as a project for peace. From this point of view, the motivations that led the United Kingdom to join the EEC and later the EU are clearly different from those of other member countries, with France and Germany at the forefront.

The special context of its European membership probably explains why, after the country's long period of economic recovery during the 1980s and 1990s, an increasing part of Britain's political class began to question the need to take part in the European project.

Paradoxically, even if it does not totally share the same motivations as those of other member states, the United Kingdom's participation has also been beneficial for continental Europe. It has, more specifically, provided the construction of Europe with a long tradition of economic openness and a demanding political culture in terms of democracy and principles.

The presence of the United Kingdom at the heart of the EU has determined the way in which the EU has been understood by member states from Central and Eastern Europe. As from 2004, they joined a project in which the United Kingdom played the role of "guarantor of economic liberalism". The United Kingdom also contributed to making their membership above all an economic project, whose priority and at least initial objective - from their point of view - was to enable them to catch up economically after their transition to a market-driven economy.

Sometimes, the presence of the United Kingdom also reconciled or contributed to creating an equilibrium between the two cultural worlds separated by the River Rhine, Germany and France, Northern Europe and Southern Europe, countries of Germanic tradition and countries of Latin tradition, countries with a Protestant majority and

countries with a Catholic majority. Conversely, the United Kingdom was also able to play a counter-weight role on which Germany relied to promote more liberalism and in which France found an ally for questions of defence.

In this way, London is both a “grain of sand” in European institutional mechanisms as well as a “grain of salt” that gives a particular flavour to the way business is conducted in Europe, a partner that has helped to develop a certain balance.

B – The economic dimension

Even if the United Kingdom’s political relationship with Europe has often been ambiguous and sometimes uncomfortable, the British economy has been fully engaged in specialisation dynamics within the common market, from which it has succeeded in obtaining every advantage.

The relationship is both strongly orientated towards an offer of financial services on a European scale and, as far as the rest of the economic fabric is concerned, often closely involved in regional value chains, whilst importing goods that it does not consider economically useful to produce itself. As a result, financial services have a net surplus of over 15 billion pounds sterling whereas, globally, the British economy, which is highly dependent on imports from the continent, had a commercial deficit towards the EU of almost 70 billion pounds sterling in 2015. Lastly, the United Kingdom is by far the leading European destination for direct foreign investment.

The single market is therefore the structuring horizon for the British economy, which, even if it continues to develop relations with the rest of the *Commonwealth* and other countries (United States, China, etc.), is still a profoundly European economy.

C – The United Kingdom within the European institutional framework

The United Kingdom’s place in the European institutional framework is a result of this dual political and economic context. Even if it fully assumes its role for setting up and strengthening the common market and is a driving force in commercial agreements, the United Kingdom is more reserved on other fundamental dimensions of the EU. It promotes the single market, but it obtained a permanent derogation on the perspective of adopting the Euro. Whilst accepting free movement of persons, it has wished to stay outside the Schengen area. Although it benefits from policies financed by the EU, it obtained a “discount” on its contribution to the budget. In many ways, the characteristics of a Brexit are already realities, as the United Kingdom possesses considerable latitude as far as European policies are concerned.

Nevertheless, despite this ambivalence, the United Kingdom cooperates with the European institutions. Even if it is very much attached to certain derogations and negotiates European texts energetically, European law is applied in the country rather more scrupulously than amongst its peers. Moreover, despite the recent erosion pointed out by certain commentators, the influence and quality of British civil servants in European institutions is unanimously recognised.

2 – Why hold a referendum now?

A – A critical point at European level

The choice of enlarging rather than strengthening, which has been applied since the second half of the 1990s, has been materialised by the increase in the number of members of the European Union from 15 to 25, then to 27 and lastly to 28. This has changed the dynamics of European decision making. With the increase in the number of partners in a highly egalitarian system of governance conceived for a smaller number of members, decision making by European bodies has become a longer and more risky process.

At the same time, the institutional framework set up when the Euro was created showed evident deficiencies, which the crisis has resoundingly underlined: an incapacity to coordinate the different member states' macroeconomic policies, to guarantee convergence and to prevent development of deep imbalances, the fragility of the financial integration supporting the monetary union and an absence of institutionalised political governance.

These problems have been very clearly highlighted by the crises that have succeeded each other since 2007. The solution to the 2008 crisis –recapitalising European banking sectors – was, in fact, more a solution coordinated by the main member states. The beginning of Greek crisis management in 2009-2010 publicly revealed the differences in views of Euro zone partners, with France and Germany at the forefront, at a time when convergent positions were more crucial than ever. At that time, the United Kingdom feared it would be brought in to contribute to the financing of the Euro zone, particularly when the European funds were mobilised in 2010. The Euro zone crisis in 2011-2012 developed as a result of the markets' fundamental questions regarding the nature of the solidarity within the Euro zone. When it comes to governance, progress has been partial, as its implementation has been slow and only rendered possible at the edge of the abyss.

These crises also marked the failure of the Lisbon agenda adopted by the European Council in March 2000. The agenda set itself the objective of making the EU “the most competitive knowledge-based economy in the world by 2010, capable of sustainable economic growth and accompanied by a quantitative and qualitative improvement in employment and greater social cohesion”.

Over the last ten years, not only has the EU not kept the promises it made for itself, but it has been progressively identified as being the source of economic policies (adjustments in public finances, austerity plans in certain countries), which, irrespective of their need or their relevance, have been rejected by a large part of European public opinion.

If distrust has most certainly been fuelled by Europe's failures, economically speaking, the level of uneasiness has recently acquired a new dimension, due to the absence of any coordinated solution or cooperation in the face of the refugee crisis.

Today, the peoples of Europe no longer understand where Europe is going. The lack of explanation at national and European level has left considerable room for disputing the European project and has tarnished the reputation of the EU, which, paradoxically, is criticised both for its powerlessness in the face of major issues and its hyperactivity

in very different fields. As a result, non-compliance with the founding principle of subsidiarity has taken a leading place amongst the main criticisms directed at Brussels by the United Kingdom.

B – The internal political context

If the economic dimension fuels people's frustration with the EU and puts the European project into question, British criticism is also, or even first and foremost, in another vein. Advocates of the referendum first promoted it for internal political purposes. The Brexit debate has in fact crystallised on questions of immigration and sovereignty and *in fine* it has brought us back to the motivations behind UK membership of the EU and questions on British identity. Economic arguments have been relatively more invoked by supporters for staying, who focus more on the negative consequences of a Brexit than on the benefits of the common market for the British economy.

Even if the surge of anti-European ideas amongst British politicians is not only to be found in the conservative party, the referendum has been strongly influenced by the internal situation of the conservative party, as it resulted from a promise made by David Cameron to the most euro-sceptic members of his political family. Inside the party, the division is such that half the government supports Brexit. Certain commentators believe that the Conservative party is entirely Euro-sceptic and that the only dividing line separates party members who believe that the United Kingdom should leave the EU from those who believe that it is possible to obtain new concessions from the EU. According to them, and irrespective of the results of the vote, the Conservative party will remain deeply divided between defenders of Brexit and partisans of Bremain.

C – The European Council held on February 18 and 19

David Cameron respected the commitment he had made to his party by addressing a letter to the President of the European Council, Donald Tusk, on November 10, 2015. In this letter, he described the reforms he would like to see in the European Union and set forth the framework for future negotiations with his partners.

These negotiations took place at two European summits, in December 2015 and then in February 2016. After almost thirty hours of negotiations on February 18 and 19, 2016, the Heads of State or Government came to an agreement on a text.

On request from Belgium, the agreement contained a "self-destruction" clause, which provided for the agreement to become null and void should Britain vote in favour of their country leaving the European Union.

The unprecedented presence of three representatives of the European Parliament and its President, Martin Schulz, at the European Council meeting is also to be noted. By acting in this way, perhaps the European Council was trying to give parliamentary legitimacy to negotiations. However, the MEPs did not possess any precise mandate from their Parliament and their presence could in no way have the same value as discussions in the European Parliament.

Lastly, even if it is normal that, on leaving the European Council, Heads of State or Government have a different interpretation of the agreement they have reached, the successive declarations made by François Hollande and David Cameron give an

impressive overview of the highly diverging interpretations of the agreement from the very moment it was reached. The French President declared: “There has been no derogation to common market regulations, there are no plans for modifying treaties and the United Kingdom has no right of veto on the Euro zone, which was a very important point for France”, whilst his British counterpart explained that it “was clear for the 28 member states that treaties will be modified to include the protections that the United Kingdom has negotiated as a country outside the Euro zone; and that we will definitively leave an ever-closer Union.”

II - The consequences of a Bremain

In compliance with the demands addressed by the British government to its European partners, the agreement provides for developments in four areas: economic governance, competitiveness, questions of sovereignty and migration issues. Over and above the British demands, these questions bring us back *de facto* to more fundamental issues arising in the construction of Europe today. On the other hand, the agreement provides no substantive reply.

By negotiating the February 19 agreement and openly raising the question of the United Kingdom remaining in the EU, European governments, especially the British government, have set off a process that will irreversibly and profoundly change the nature of the EU. From this point of view, the implications of a choice made by British voters to leave the EU have been largely analysed and feared (see Chapter III), but any choice made to stay in the EU will also have far-reaching consequences, which have probably not been fully assessed or, at least, which have not have been explained sufficiently clearly.

1. An agreement whose implementation is by no means obvious

A. The nature of the agreement

As indicated by the document uploaded by the European Council, the authentic text is not, strictly speaking, an “agreement”, but the “conclusions reached by the European Council at the meeting”. In reality, the document is comprised of a series of separate acts: a decision taken by the heads of state and government of the member states of the Union, a declaration on a draft decision by the Council of the Union, a declaration by the European Council and four declarations by the Commission announcing the proposals for legislation adopted by the Union. Each of these acts form different parts of European law, which explains why certain subjects are treated in several different acts.

B. Ambiguities to be raised

The first act on conclusions, the decision taken by Heads of State or Government, is not an act under European law. It is a simplified version of an international treaty, which explains why Britain has registered it with the United Nations. In principle, a treaty of this type cannot have any effect on European law. Under these conditions, what would happen if the treaty conflicts with European law?

In any case, the question of the precise nature of the text does not seem to be central to the debate. To be sure that it really is an international treaty would necessitate a clarification from the signatory States. We must also raise the question of the relevance of such treaties for member states, to settle the EU’s internal affairs.

Similarly, it is not certain that these conclusions will automatically lead to a change in European treaties. This does not seem to be necessary for a large part of the text. If

the Court of Justice had to pronounce itself on the potential incompatibility of certain dispositions implementing the agreement, in the absence of the revision of treaties, it would constitute an element of judgment but the interpretation of the European judge would *in fine* stay within the framework of treaties. Nevertheless, Section C of the decision by Heads of State or Government provides for a new subsidiarity protection mechanism, which modifies the rules contained in the treaty on the decision-making procedure executed by member states in the Council. Lawyers' opinions differ as to knowing whether this new procedure will require for treaties to be modified for taking its place in European law.

2. A triple break

A. Questioning the prospect of an "ever closer Union"

If interpretations vary as to the meaning and the scope of the "ever-closer union" notion, already present amongst the recitals for the Treaty of Rome, the reference has been progressively incorporated into the European "*corpus*" as the objective of the construction of Europe.

The agreement mentions that the "United Kingdom shall not be required to participate in more extensive political integration within the EU" and that this notion will be incorporated into treaties "the next time they are reviewed". At this point, it will be recognised that the reference to an "ever-closer union" will no longer apply to the United Kingdom. Further on, the text of the agreement recognises the existence of different means of integration between member states.

Even though this has been admitted "de facto" for several years, officially recording a difference of ambition in the political integration project borne by the EU and legally recognising the existence of these different routes goes further than the existing opt-out clauses and means that one of the principles on which the construction of Europe has been based until now will be put into question. Fundamentally, because it is a renegotiation of what exists at present, the agreement does not mean putting the United Kingdom's commitment to the EU on hold, but represents a step backwards.

Moreover, the agreement specifies and reinforces the role of national parliaments in EU governance. Without being unprecedented in law and in practice, this evolution, which modifies the present balance of the legislative process in favour of member states, may be seen as contributing to reinforcing the democratic legitimacy of European decisions or as making present governance, which is already complicated, even more complex.

The balances modified in this way open the door to a more graduated differentiation between member states with regard to their commitments within the Union, despite the fact that the institutions forming this new Europe and enabling it to live do not completely exist.

B. The separation of the common market and the Euro zone

Up till the present time, European texts have been based on the correspondence or the long-term perspective of correspondence between the common market and the monetary union. Despite British and Danish opt-outs, adoption of the Euro was nominally a perspective for all member states and, in the long term, the single market was to possess a common single currency.

The February 19 agreement acknowledges the fictitious nature of the correspondence between the single market and a single currency and organises the coexistence within the EU of the Euro zone and countries where the Euro is not the national currency.

Even if a reminder is given on the principle of strengthening the Economic and Monetary Union (EMU), the principle is counterbalanced by the fact that measures taken in this context will be optional for countries outside the Euro zone. However, the EMU includes all the members of the EU and not just the States that have adopted the Euro as their sole currency. By acting in this way, the European Council splits up the EMU between members of the Euro zone and those who are not members. Even if the agreement contains the seeds of a possible different form of integration between the two zones, the conditions for coexistence of the different levels of economic integration have not been clearly explained. Nevertheless, this coexistence raises fundamental questions, because the areas of integration overlap.

C. Reconsideration of freedom of movement for persons and workers

Heads of State or Government have reaffirmed the founding principle of free movement for persons and workers inside the Union, whilst confirming the legality of “measures, which, without creating any non-justified direct or indirect discrimination, enable limits to be put on any flows of workers that are so important that they have negative effects on both their Member States of origin and of destination”. The agreement itself provides for a “safeguard mechanism” which every member state may use, and which will notably enable the state to limit family allowances granted to a European worker when his children have remained in their member state of origin. In its judgment of June 14, the Court of Justice of the European Union proves the United Kingdom right in a controversy that opposes it to the European Commission, concerning the British procedure of granting family benefits to citizens of the European Union. The solution that was retained corresponds widely to the British conception of freedom of movement of persons within the union.

The dramatic circumstances of the migration crisis have probably contributed to this evolution, but the “alert and safeguard” mechanism that must allow member states to “face up to situations characterised by an inflow of exceptional size and for a prolonged period of workers from other member states” applies to European citizens and not to non-European refugees. Although the agreement explicitly confirms that “any discrimination based on nationality” will continue to be banned, the newly created mechanism, which probably will not only be applied by the United Kingdom, may result in movements of workers being limited within the European Union. Considering the importance granted to the principle of free movement throughout the construction of Europe, this limitation appears to be unprecedented.

3. What does the future hold for the EU?

The agreement gives substantial guarantees to the United Kingdom's demands. However, materialising and incorporating the measures it plans into European law will require interpretation and will undoubtedly entail a real reform of European institutions and practice.

A. Implementation will require confronting certain aspects overlooked until now

Should the United Kingdom remain in the EU, the February 19 agreement will force member states to draw up an exact redefinition of the new European model in which they wish to continue taking part. It will oblige Europeans to stop avoiding certain fundamental questions and open a new chapter in the history of the EU. Perhaps it will mark the end of European integration through law and could be the first step towards a EU in which "concentric circles" exist and develop, or integration "*à la carte*".

However, no European government seems to be prepared for the effective implementation of a new model, even though the current system is unlikely to endure. A new model still needs to be entirely defined and the schedule for the coming months will most certainly complicate any initiative for substantiating this evolution. Under these conditions, there will be great temptations for governments to maintain a *status quo* or only to allow minimum evolutions. However, even though the cost of non-action is already high, not thinking about, nor choosing evolutions whose implementation will be imposed by the agreement, will put Europe in a dangerous situation, for which it will lack the power to resist.

B. Can the EU be kept as it stands?

European institutions and the main member states have not prepared any legal or institutional follow-up to the February 19 agreement. Now, the construction of Europe has been a dynamic process from the very beginning. Maintaining the United Kingdom in the EU on the basis of the agreement signed on February 19 would give rise to a period of major political uncertainty. Numerous member states would be liable to invoke such or such a point of the agreement before the European Union Court of Justice, which could then develop new jurisprudence on this basis.

Furthermore, the agreement provides for a State that is not a member of the Euro zone to ask the President of the European Council to present a question to the Council on integration of the domestic market and especially the banking union. In this way, the United Kingdom would keep a right to examine future affairs in the Euro zone.

Lastly, whilst progress in the Euro zone's integration is still subject to the United Kingdom's reinforced control, a step backwards at the entire European level becomes more probable. Indeed, the United Kingdom staying in the EU could tempt certain other states to begin similar renegotiation processes on the terms of their membership to the European Union, even to the point of gambling their belonging to the EU.

C. What does the future hold for the Euro zone?

By opening the door to a larger differentiation between the member countries of the Euro zone and the countries that are not a part of it, the February 19 agreement puts the project of a “multi-speed” Europe back on the table. In this type of model, the Euro zone would pursue its economic, financial and, *in fine*, political integration, consolidating what would become the EMU’s core. As things stand today, the difficulties it is confronted with at present do not seem to be solvable in the short term.

No established project for strengthening the Euro zone is under preparation at present, neither in Paris or Berlin. However, several proposals are under consideration: setting up a dedicated minister, a Parliament and a Treasury for the Euro zone. All these possible changes to the institutional framework have a point in common in that they compensate for the lack of coordination in Euro zone countries’ economic and budgetary policies.

But the present state of the balance of power between the main member states of the Euro zone make implementation of any of these innovations highly improbable in the near future. Germany appears relatively unfavourable to this idea, seeing it as a first step towards a Europe of budgetary transfers when it considers that the application of the rules of the shared currency remains unsatisfying. Indeed, if budgetary discipline appears to be one of Germany’s main public administration virtues, numerous countries in Southern Europe – mainly France, Italy and Spain – have very high levels of public deficit. Under these conditions, Germany would be opposed to any reform of governance for the Euro zone that is liable to result in the long term in government borrowing by some of these states being collectively financed. In the absence of any new proposals acceptable to the German government, the Euro zone is likely to remain in its present state of deadlock. It drastically illustrates the difficulties of attaining the necessary equilibrium between the restoration of sustainable public finances and a macroeconomic policy able to support recovery. Germany has, in the past, proposed contracts of reform to Southern countries, in order to pave the way for the Euro zone’s necessary reforms, but these have been unsuccessful. Nevertheless, the current situation makes it absolutely necessary for States to resume the dialogue and reach compromise.

III - The consequences of Brexit

Since no member state has ever left the EU, the areas of uncertainty surrounding the legal exit procedure for the United Kingdom are numerous. In addition, alongside discussions on the exit of the United Kingdom, there would be negotiations on the new agreement linking it to the European Union. A vote in favour of Brexit would *de facto* open up a very uncertain period in the short and medium term, both for the United Kingdom and its economy, and for the European project.

1 - The short and medium-term consequences

The short-term consequences would result from the uncertainty that would surround both the exit procedure (under Article 50 of the Treaty), the future of links between the UK and Europe and domestic political consequences in the UK.

A – The Economic impact

In the short term, the impact on financial markets will be the most visible. There is particular concern about fairly strong financial turmoil and a further drop of the pound, though it is always difficult to anticipate developments on the foreign exchange market, in essence extremely sensitive to central bank policy. Alongside this, reassessment of the economic outlook of the United Kingdom's businesses could mean that falling stock markets and rising risk premiums in the bond market are quite likely. Beyond the United Kingdom, European markets could be affected in varying ways: (i) a mass move, that has already begun, towards "quality" in favour of the government bonds of economies in the heart of the Euro zone, with a risk of divergence of rates for the peripheral economies; (ii) a negative impact on securities that are the most affected by the United Kingdom's economy.

On the currently fairly competitive markets where liquidity can be unequal and even evanescent, this reassessment of a number of prices and premiums would potentially add fuel to a period of high volatility, likely to create difficulties for certain financial institutions. The authorities have the means to deal with such situations. Coordinated intervention between the Bank of England and the Central Banks of its main partners would make it possible to manage this type of episode.

The consequences would be more significant if, in the short term, the prospect of Brexit stirred up new questions about European solidarity, especially within the euro zone. In this case, the financial turmoil could turn into a financial crisis resulting in a political crisis, along the lines of the 2011-2012 crisis in the euro zone. Such a scenario is, however, quite unlikely, inasmuch as non-European investors are well aware of the special nature of the United Kingdom's membership of the European Union and the lack of institutional consequences for the Euro zone should Brexit occur. Moreover, the institutional reinforcement put in place to prevent and cope with tensions within the Euro zone should enable the European Central Bank to effectively deal with problems to do with liquidity on the market of sovereign debt. However, the monetary authorities would be less ready to respond to a destabilisation caused by the financial markets of banks of certain Southern countries. A key risk, already described by numerous commentators, exists in this area.

In the medium term, the following questions arise in an attempt to anticipate economic developments after a Brexit:

- Would an exit lead to a recession, partly because of a *de facto* tightening of financing conditions? If this happened, what would the recovery trajectory of the British economy be, knowing it would be partly determined by the new form of relationship with the EU?
- Would funding of the United Kingdom's current account deficit be made more complicated by these developments? In particular, to what extent would foreign direct investment in the United Kingdom be affected?

There may also be the concern that the United Kingdom's economy may experience a period of financial turbulence in the short term and economic slowdown in the medium term, with the uncertainty surrounding the exit procedure and long-term form of the relationship of the United Kingdom's economy with the rest of the EU contributing to amplifying these effects. In the longer term, a recovery would be likely and would be even more pronounced if the exit did not significantly change the current functioning of the single market or allowed the British economy to gain competitiveness. These conditions are of course very difficult to predict.

Finally, looking beyond the British economy, the impact on other European economies would be both financial – in the short-term, what would be the implications of financial tensions over Brexit on the financing conditions of the European economies? - and commercial - in the medium term, what would the consequences of a slow-down of the United Kingdom's economy be for European economies with which its trade flows are particularly significant?

B - Political and institutional impact

Although Greenland chose to leave the European Economic Community in the 1980s, this withdrawal does not constitute a precedent, as Greenland was not, strictly speaking, a member state and the union is a more integrated structure than the Community was.

Article 50 of the Treaty on European Union (TEU) is the one stipulating the exit procedure of a member state of the European Union. Once the notification by the member state concerned of its intention to leave the EU has taken place, a deadline of two years is set, after which the European Treaties cease to apply to the State concerned, unless the European Council unanimously decides to extend this period. However, Article 50 has never been applied and some supporters of a UK exit are calling for other routes. Thus, according to Michael Gove, the current UK Secretary of State for Justice and a leading advocate of Brexit, Article 50 of the TEU is only one of the tools available for the United Kingdom to leave the European Union. Moreover, although some have suggested that the arrival of David Cameron at the next European

Council on June 28, which would follow a vote in favour of Brexit, be considered, in itself, the notification described in Article 50, he rejects this interpretation and advises the government in charge of negotiations with the EU not to immediately notify its intention to leave the EU to give time for better preparation of the negotiations.

Moreover, even if notification does take place, Article 50 leaves major issues unanswered. Would British Members of the European Parliament continue to sit during this period of two years, and therefore to vote on draft legislation that would affect the EU after the departure of their country? Would the British Commissioner or European officials of British nationality, including those that would be required to work on the United Kingdom's exit conditions, stay in their positions during these two years? In such a scenario, a withdrawal of British representatives from the main European institutions seems logical to avoid potential conflicts of interest.

However, it is not legally provided for. Similarly, throughout the duration of the negotiations, the United Kingdom would still be a member of the European Union and occupy, as such, the EU presidency from July to December 2017...

The uncertainties surrounding the exit procedure inherently contain a real risk of paralysis for the European institutions.

Moreover, the negotiations will focus on the terms of separation between the United Kingdom and the European Union, but will also help define, in parallel or subsequently, the United Kingdom's new commercial status in its access to the single market.

In addition to these institutional challenges, Brexit would open up a period of high political uncertainty in the United Kingdom and Europe.

In the United Kingdom, besides the questioning of David Cameron's leadership of the Conservative Party and a likely change of government, the prospect of an exit would affect the internal balance with Scotland (Nicola Sturgeon, current Prime Minister, has said that if Brexit takes place, a new referendum would be held on the independence of Scotland). As for Northern Ireland (where public opinion is very much in favour of maintaining the United Kingdom within the EU, which played an important role in the peace process during the 1990s), in case of Brexit, the fate of the Irish border would be an important issue.

For the rest of Europe, the consequences of Brexit contain a double risk. Firstly, from a practical point of view, the magnitude of the negotiations to be engaged may distract governments and European institutions from consideration of the issues raised, and rightly so, by the British referendum, and secondly, from an existential point of view, the exit of the United Kingdom may also set a precedent and mark the beginning of a process of dislocation. European governments are likely to be divided regarding this. Some will argue for a tough response, reaffirming the principle that it is not possible to be outside the EU and enjoy the same rights as member states.

Such a line would have the advantage of limiting the risk of contagion. Other countries may instead want to adopt a more flexible stance so as not to move away from the United Kingdom, which would remain an economic, diplomatic and military power.

2 - The longer-term implications and the various aspects of the negotiations

The long-term consequences of an exit by the United Kingdom will be both economic and political. Economically, the main problem will be that of the terms of the relationship with or access by the United Kingdom to the single market. Other issues raised by a step backwards from the current degree of integration cannot be ignored: this is particularly true of issues related to the presence of three million nationals of other Member States in the United Kingdom and the one million British citizens who have settled in other EU countries, as well as the wider issues of migration within and outside Europe. Finally, looking beyond the challenges of the exit negotiations and the implications of the possible restructuring of the British political landscape, these are obviously outweighed by the political consequences for the other EU Member States and European construction as a whole.

A - Access to the single market

Access to the single market will be the main British demand after EU exit. From a practical point of view, it will be necessary to organise the time scale of both negotiations between the United Kingdom and its other European partners on the exit process and also the definition of the future framework of their economic and commercial relations.

If no clear plan emerges on the terms of the relationship with or access of the United Kingdom to the single market - the supporters of Brexit have made little reference to this aspect, although it is an essential one, and no consensual doctrine seems to exist in their camp - three forms of relationship may be considered:

- Association within the European Economic Area (EEA);
- Bilateral agreement similar to those concluded by the EU with Switzerland, Turkey and recently Canada;
- Absence of bilateral agreement and registration of trade relations between the United Kingdom and the EU under WTO rules.

Without going into institutional considerations, although these are important (how to exit the EU only to re-enter the EEA on an individual basis), the United Kingdom's relationship with the EEA seems unlikely to address the concerns of supporters of Brexit: participation in the EEA provides full access to the single market, but although it does allow for consultation on single market regulations, it does not give a full right to vote on the drawing up of regulations. Finally, there are fiscal consequences, since non-EU members of the EEA also contribute to the EU budget.

The search for an *ad hoc* bilateral agreement is certainly the most likely prospect. The current homogeneity of the regulations also provides a powerful argument for the British side to seek access that is the broadest and most unconditional as possible. The conclusion of an agreement, however, would first require answers to crucial questions. From a practical point of view, as the single market and regulation go hand in hand and the United Kingdom's inclination towards Brexit is motivated by the desire to regain control of regulation and to reduce it, compared with European practice, how would it be possible to maintain homogeneous regulations that ensure proper functioning of the single market? With regard to the principle, it is difficult *a priori* to give a third party access to the market under the same conditions as those reserved for member states – who are linked by other obligations - without altering the spirit of the European project and creating a precedent, which other states – Switzerland, for example – would certainly not miss the opportunity to use to renegotiate a better deal.

Finally, although some supporters of Brexit consider that the WTO multilateral framework would suffice for trade relations between the UK and the rest of the EU, this hypothesis appears implausible in view of the current integration between these economies, built up in a richer, deeper and more complex context than the WTO.

The challenge of the framework of economic and trade relations between the United Kingdom and Europe schematically covers three distinct cases: the case of financial services, the highly integrated industries between Britain and continental Europe and the sectors that export a structurally significant part of their production to the United Kingdom.

Access to the single financial market for British financial institutions and their ability to develop an offer or the free provision of services - in each of the financial sector sub-sectors - across the single market will no doubt be a strong and visible issue when negotiations start. The "European passport" allows a financial institution with a permanent establishment in a member state of the European Union to provide financial services in another member state, to the extent that all players are subject to the same rules (European regulations and directives transposed into national legislation). Only member countries of the EU or the European Economic Area, which apply all European regulations, benefit from the "European passport". Exit from the EU would therefore automatically lead to the loss of this passport. Under these circumstances, the international financial institutions offering their services in the EU from a legal entity based in London would be forced to relocate the entity within a member state.

To avoid significant transfers of businesses, it is likely that the United Kingdom would argue that, in the current state of the law, applicable regulations are compatible with European legislation and that it would try to negotiate a status *sui generis*. The wish that some parties might express to minimise economic disruptions related to the Brexit and the interest of economic actors in having a supply of quality financial

services such as that proposed by the City, would also push developments in this direction.

Financial services will not be the only issue in these negotiations. Indeed, the value chain of many industries closely links the territories of continental Europe and the United Kingdom. Since the latter is one of the top trading partners of the European economies, the discussion on the conditions for its relationship with the EU's single market will also be fuelled by considerations in favour of maintaining this trade, leading to the invention of pragmatic solutions whose impact on the single market appear only in the medium term.

Nevertheless, the desire to conciliate will not make it possible to ignore questions of principle on the conditions of access to the single market and the maintenance over time of completely homogeneous regulations. To date, these questions remain completely unanswered. Solutions sought on the basis of pragmatism alone might deeply weaken the reality of the single market, which remains one of the most successful achievements of European construction.

Nevertheless, the will to accommodate would not address questions of principle such as (i) the conditions of access to the single market, (ii) the maintain over time of homogeneous regulation and (iii) the control of the European Central Bank over the location and the prudential regime of essential infrastructures of the financial markets, such as clearing houses on public debt fostered by treasuries of member states of the Euro zone. To this day, these questions are unanswered. The solutions looked for in the light of mere pragmatism might profoundly weaken the reality of the single market, which remains today one of the most accomplished results of the European construction.

B - Other aspects of the negotiations

Trading relations between the United Kingdom and the European Union will not be the only issue in these negotiations. Other issues, also much more discussed in the British debate, should be addressed.

Immigration – intra and extra EU – will in this respect be a major topic. Alongside the rejection of a social regulation introduced by the EU, a Brexit would open up the question of the status of the three million Europeans living in the UK and the million Britons living in the European Union. Currently, under the principle of the free movement of workers, any national of a European member state may settle and work in another EU country. Although it is in the interests of both parties that their nationals retain their acquired rights, it would nevertheless be appropriate to reach an agreement that will be more consistent with policies implemented on immigration. From this point of view, this debate is similar to that on the management of extra-

European migration, which has been of strong symbolic importance in the British campaign, as it also has elsewhere in Europe.

Maintaining cooperation in the key areas of security and defence – both in terms of response capability and the defence industry – or energy, will also constitute a major challenge for the negotiations, despite the still incomplete integration of these policies.

3 - What does the future hold for the European Union?

Finally, a Brexit would clearly have profound political consequences. Beyond its implications on the British political landscape, the EU and the European construction process would be strongly affected. The United Kingdom's exit could be seen by many political and economic actors as the first step backwards in the history of European construction even if, in some ways, a Brexit would not necessarily undermine the current institutional construction of the EU.

Challenging the European project can fuel all sorts of populism and profit those who see the development of the European project as too big a competition with their own interests. The influence on European public opinion, already affected by Euro-scepticism, of the questioning of the European project and the risk of contagion of other member states – leading to a possible breakup of the Union – would be significant. It is also likely that the European political balance would be profoundly changed, once the UK's own particular liberal and parliamentary tradition is removed from Europe.

Meanwhile, the wish that some parties could express to maintain as strong as possible a link with the UK would encourage the search for compromise solutions, with the risk that the European project would lose even more clarity. Other actors could, conversely, take a firmer stance that, although it might stand firm in the face of the facts, would not enhance the positive image of Europe. In any case, there is a considerable risk that, given the magnitude of the discussions to be engaged, all European stakeholders do not find the political energy to confront the fundamental questions that the British referendum raises on European construction.

Finally, the budget of the European Union should be modified in a balanced manner but considerably to compensate for the net fiscal contribution of the United Kingdom (around ten billion euros per year). The European Union will have to make a difficult choice: increasing the contribution of member states or cutting the budget, in a way that the sole reduction of operating costs of European institutions would be sufficient and that it would be necessary to review certain public policies.

The impact of the exit of the United Kingdom on the perception that our non-European interlocutors have of the EU is more difficult to assess, but would be rather

unfavourable, cutting off a leading partner on the world stage from Europe and marking a setback in a project that is often misunderstood.

A - The risk of contagion

The main opinion surveys conducted in the member states of the European Union demonstrate a strong increase in the populations' distrust towards European institutions and the European project. No country is now spared from the rise of Eurosceptic parties. A Brexit would immediately strengthen these political movements and could lead to new referendums or the coming to power of governments openly opposed to the construction of Europe. The Netherlands, Hungary, the Czech Republic and Poland are certainly the countries with the highest risks, but it also exists in France, where disenchantment with Europe has increased very rapidly since the beginning of the crisis.

The temptation of other referendums, confirming the conclusion of an agreement granting special status to the country concerned or simply on EU membership, would be even stronger, in that the exit of the United Kingdom from the EU would appear to be a favourable opportunity and a way to benefit from EU advantages without their burdens and constraints and, ultimately, enjoy economic success coupled with what eurosceptics describes a restoration of sovereignty.

In addition, the United Kingdom, which was one of the mainstays of the European policy of extending the Union to the East, seems to have exported its concept of Europe to many central and Eastern European countries that joined the EU in 2004. It is, as such, significant that the MEPs of the Law and Justice party currently in power in Poland sit in the same group as the British Conservative MEPs in the European Parliament. A certain British concept of the EU, whose main ideological principles would be support for the development of the single market, opposition to the transfer of sovereignty and Atlanticist geopolitical positioning seems predominant in many countries of Eastern Europe. Thus, for the former members of the Warsaw Pact, commitment to NATO often means political proximity to the UK. If Brexit occurs, these countries could defend a political line that is tolerant towards the UK and continue political opposition to strengthening political Union, from within the EU.

B - What does the future hold for the Eurozone?

To some extent, a United Kingdom exit from the European Union could help to clarify the consistency of the Euro zone with the perimeter of the single market by ending the British exemption and should lead to taking another look at current balances. For example, the question of the location of certain key financial infrastructures that are essential for the operation of the Euro zone and currently outside it would certainly arise, given the existence of the single market and its uniform regulation. Similarly, the planned union of capital markets would necessarily take a different turn if it were

to be considered in the absence of an ultra-dominant financial centre within the single market.

More fundamentally, the Brexit would also be the opportunity to reflect on how to successfully carry out economic integration within the euro area and to revisit its economic governance, without these debates being paralysed by fear of arousing strong opposition between the in and out groups. However, this opportunity cannot be exploited without a shared vision and strong political will.

C - Franco-German relations

Despite the undeniable loss of French influence on European institutions, the future of the Euro zone and the EU remains dependent on a Franco-German commitment to promoting the European project. Both partners need to ensure an inclusive approach to the implementation of their initiatives, to avoid running the risk of making them counter-productive. Crisis management in Europe for the last decade is the best illustration of this fact.

The German ruling class is now very concerned about the mixed economic performance of France. For a German nation that does not wish to assume its role of political and economic leader in Europe alone, but needs to maintain a balance, the recovery of the French situation is essential and almost a prerequisite for giving new life to the European project.

Under these conditions, a Brexit would make France and Germany face up to their disagreements and lack of progress in France could lead some of the German leaders to seek the preservation of a strong link with the United Kingdom, at the expense of France; which would severely impede the renewal of the European construction.

D - Franco-British relations

The UK and France are the two major players in European defence. Their respective military power is equivalent and comparable to any other in Europe. They have developed important and fruitful ties in this area. Without a real European defence policy, an exit of the UK from the EU would probably not have a major impact on the bilateral relationship, although it would alter certain balances in Europe in that France would be the only EU member with permanent status on the UN Security Council and a nuclear deterrent.

Similarly, other bilateral co-operations would probably be little impacted over the long term even if, in the shorter term, relations could be complicated by tensions that would necessarily arise during such important and complex negotiations.

CONCLUSION

Whether the British decide to stay or leave the European Union, there will be a before and an after June 23, 2016. The very holding of this referendum is a symptom of the Union's inability to raise strong support for this joint project from the peoples of Europe. Whether the British decide to stay (Bremain) or leave (Brexit) the European Union, the period after the referendum will be decisive for the direction to be given to the European project.

If the decision is Bremain, the 19 February agreement of the European Council will have to be implemented. It necessarily implies that Member States redefine together the European architecture in which they wish to move ahead. Although it touches on fundamental issues for the future of the European Union, - the implementation of the principle of subsidiarity, migration issues or the competitiveness of its economy –it provides no clearly reasoned answers. Its ambiguous legal status and inherent uncertainty even weaken the leading role played by the law in the history of European construction.

European leaders must realize that this agreement could be the first step towards an "à la carte" or "multi-speed" Europe. Now, a Bremain will probably be seen as a positive development and the temptation would then be great to stick to the *status quo*, whereas they should be actively preparing a new European project. Worse, a degree of complacency with regard to the UK could lead the continental States to grant the British government new concessions. This type of reaction would once again enact the impotence of Europe and open the door to gradual disintegration.

Should the United Kingdom exit the Union, political uncertainty could be such that it would paralyze the latter for several years and other exit procedures could be initiated. To get out of this zone of turbulence and restore confidence in the European Union, Member States and their leaders must, imperatively, show strong political will and clarify as soon as possible the reason for the Union's existence and its ambition. To do this, a new European discourse will necessarily have to be expressed by the various European governments, and primarily by those of France and Germany. The elections to be held in 2017 in these two countries should enable the next two heads of state or government to ostensibly leave behind the current situation, in which there is too little political investment in the construction of Europe.

In either case, the European Union can no longer be used as the scapegoat for our domestic renunciations. The political leaders of the Member States must invest fully in the mission to lead and promote the European project. The current impasse is partly artificial. To get out of it, the main European leaders should recognize the mistakes that led to the British referendum and explain why the European Union is beneficial for the countries that comprise it.

To regain the trust of the peoples, the European Union must produce tangible results and cease focusing its energy on institutional debates. In the current situation, the temptation to maintain the *status quo* and do nothing would be political suicide.

The exit of the UK or its remaining after a victory “by a short head” for the Bremain camp must not paralyze the main European leaders. If that were the case, the various crises in Europe would become worse by the day and with them the rise of euro scepticism and the populist movements that fuel it.

Recommendation 1

In the days following the referendum and by the European Council meeting of 28 June at the latest, EU leaders must immediately make a joint declaration of their willingness to continue European construction. They will need to define a clear roadmap for the coming months extremely quickly, in order to dispel the uncertainties that today hang over the future of the European Union.

Recommendation 2

If Bremain wins, Member States must demand a *strictu sensu* interpretation of the 19 February agreement and totally refuse any extensive implementation thereof in order to prevent the contagion of other countries.

Recommendation 3

If Bremain wins, European leaders must, without delay, respond to the to key issues raised by the agreement of 19 February by:

- Reaffirming that the abandonment of the goal of "ever closer Union" cannot be extended to other Member States;
- Reaffirming that the principle of free movement of people and workers will not be subjected to new exemptions;
- Explaining in the clearest terms the future organisation of economic and monetary union and the internal market.

Recommendation 4

If Brexit wins, a joint public declaration by the French president and the German chancellor in the aftermath of the election would be of value, along with those European leaders who wish to intervene. This joint statement would first take note of the exit of the United Kingdom and would ask the British leaders to act appropriately, immediately. Indeed, Europe should in no way allow its agenda to be controlled by a country choosing to leave.

This statement would strongly call for more integration within the euro zone - fiscal integration and enhanced budgetary integration - which would commit France to finally carrying out the necessary economic reforms - increased sharing of common responsibilities - and oblige Germany to consider the issue of European debt. Finally, it would emphasize its will to complete banking union as soon as possible. This call would clearly also be subjected to the choice of French and German citizens during the elections scheduled in both countries for 2017.

Recommendation 5

If Brexit wins, the British government must take note of the will of British citizens and decide to set aside British MEPs, officials of European institutions and the British European Commissioner.

It would also be unthinkable for the United Kingdom to take on the presidency of the European Union, which it is due to take over during the second half of 2017.

Recommendation 6

If Brexit wins, European leaders will have to define, without delay, the duration, the content and the different stages of negotiations with the United Kingdom. Clear definition of the framework is a prerequisite in order to avoid divisions among Member States preventing the European Union from fully defending its interests.

Recommendation 7

If Brexit wins, the European Union and its Member States must not give the United Kingdom a more favourable position than that of European Economic Area countries that are not members of the European Union. This would serve as a reminder that there is no more profitable status for a State than that of member of the European Union.

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THERE IS NO DESIRE MORE NATURAL THAN THE DESIRE FOR KNOWLEDGE

Bremain or Brexit: Europe, build your future!

The EU referendum is the symptom of the union's current inability to foster a strong adherence in peoples of Europe to this common project. The aftermath of the vote, regardless of the outcome, will be determinant for Europe's future orientation.

Britain leaving would be understood as a significant retreat of the European construction and would reinforce the calls for disintegration. The process of leaving and the negotiations with the British people might severely paralyse Europe.

The agreement of February 19, implemented in the case Britain stays, leads the EU towards a less homogeneous integration, for which member states are significantly unprepared.

In the immediate post-referendum period, member states will have to cope with its shock and reinvigorate in order to press ahead with the European project. This is the object of the recommendations addressed by the Institut Montaigne.

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