Introduction: Cycling backwards

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For decades, Europe was about integration. Following the British referendum, the main issue now is disintegration. There was a time when the prevailing view of European integration was the 'bicycle principle': you must keep moving forwards; if you stop, you fall off. Cycling backwards is arguably much more difficult. This stunning change may be one reason why governments do not seem to have given much thought to what they would do in case the British people chose Brexit. They must now confront a highly complex and radically new negotiation. Hundreds of thousands of pieces of legislation, rules and regulations have become obsolete overnight. Pretty much like with an organ transplant, all these vessels must now be cut off and reconnected somehow because, one way or another, Britain – or what remains of it – will continue to be deeply integrated with its former EU partners.

Following highly emotional reactions, hopefully the time of rationality has come. The British and EU27 governments face two negotiations. First, the divorce proceedings will start when Britain invokes Article 50 (by the end of March 2017); the proceedings are required not to exceed two years, unless prolonged by a unanimous decision. Second, they will have to negotiate under Article 218 on all aspects of the future relationship between the UK and the EU as a whole. The EU27 currently does not intend to start the second negotiation before the first one is concluded.

From the EU27 side, the task is doubly complicated. Each government must decide what it wants and what it could be ready to concede. Then all 27 governments and the European Parliament must negotiate among themselves what their collective

1 I am grateful to Richard Baldwin for comments and to Roel Beetsma, Franc Klaassen and Rutger Teulings for permission to use tables that they initially prepared for their own contribution.

position will be for the second step, namely, negotiations with the UK. Importantly, any agreement must be approved unanimously by the 27 member countries and also by the European Parliament. This is an extremely tall order of requirement.[2]

This book is an effort to contribute to the extraordinary challenges that lie ahead. It focuses on economic issues and on the negotiating positions of the EU27 countries. I have asked leading economists from a large number of countries[3] what, in their view, their own country's strategy should be. The objective is not to dwell on the millions of thorny detailed issues that will come up, but instead to focus on the big picture. Each country has its own interests to protect, and possibly new ambitions, that are quite conceivably different from what other countries will want. Intentionally, there is no British contribution in the book. That requires another book, many other books in fact. Indeed, CEPR researchers have already contributed an eBook on the topic (Baldwin 2016).

Unsurprisingly, the responses are diverse. One reason is that the potential impact of Brexit varies from one country to another. Another reason is that the view of what the EU stands for, or *should* stand for, is not the same from one country to another. All sorts of historical and geopolitical issues pop up. A key ingredient of the Jean Monnet method was to avoid dealing with this set of issues, including the ultimate destination of the integration trip. What appeared then to be a brilliant strategy is now hitting back. Ambiguity can only take us so far…

The authors were asked what, in their views, the negotiation strategy of their own countries on economic matters could/should be. They were given free rein to structure their contributions and choose their topics. Most start by laying out the facts: the importance of trade, foreign direct investment and labour mobility for their countries.

2 To make matters even more complicated, the second negotiations are unlikely to be completed by the time the EU will have to decide on its Financial Framework for 2021-2028.

3 Contributions come from the 15 following EU countries: Austria, Belgium, Finland, France, Germany, Greece, Hungary, Ireland, Italy, the Netherlands, Poland, Portugal, Slovakia, Spain and Sweden. I also requested a contribution from Switzerland given this country's de facto integration into the EU and the current challenge posed by its own 2014 referendum that imposes restrictions to labour mobility. The chapters are presented in alphabetical order of the countries described by the authors.

Then come all sorts of important considerations ranging from domestic politics and history, to views on the EU and the role of principles. This chapter is an attempt to summarise the rich set of contributions.

Trade is not always the big issue

Table 1 shows how important direct trade is for the individual EU27 countries. Several facts stand out. First, the UK market is very important for some (usually small) countries, but much less so for others. The stakes, therefore, are not the same. Second, as shown by László Halpern in the chapter on Hungary, indirect trade may be more important than direct trade in some cases. This is one aspect of the new 'value chain' form of trade. Third, British exports to many countries are negligible or small for the UK. This would seem to suggest that the UK will not be very concerned by a trade agreement. This would be misleading. As a large country, the UK is relatively closed but, as a whole, the EU27 absorbs about half of its exports. Conversely, the UK is a relatively small market for the EU27 as a whole, though not for all individual countries. Of course, this is a narrow consideration, but one that may weigh in the mind of negotiators. Finally, as noted in some chapters, Britain tends to import industrial goods and to export services. If the final agreement were to treat the UK as just another third-party country, WTO rules would apply by default. These rules imply heavy tariffs for traditional industries, including agro-industrial products, which could hit some countries hard. In addition, this specialisation means that trade disruption would have redistributive effects along the lines of traditional trade models.

Table 1 Direct trade links with the UK

Country	Exports to the UK		Exports from the UK	
	€ billions	% of exporter's GDP	€ billions	% of UK GDP
Austria	4.36	1.7	2.20	0.1
Belgium	31.74	7.3	15.99	1.1
Bulgaria	0.59	1.7	0.48	0.0
Croatia	0.21	0.9	0.19	0.0
Cyprus	0.12	4.3	0.51	0.0
Czech Republic	7.53	4.5	2.67	0.2
Denmark	5.37	3.3	3.15	0.2
Estonia	0.33	2.2	0.30	0.0
Finland	2.78	1.9	1.85	0.1
France	32.13	2.1	24.49	1.6
Germany	89.25	3.5	41.81	2.8
Greece	1.08	1.3	1.21	0.1
Hungary	3.58	3.7	1.76	0.1
Ireland	15.28	14.1	22.97	1.5
Italy	22.46	1.6	11.59	0.8
Latvia	0.54	2.9	0.30	0.0
Lithuania	1.03	3.4	0.37	0.0
Luxembourg	0.74	10.1	0.30	0.0
Malta	0.15	9.1	0.52	0.0
Netherlands	47.48	7.6	23.98	1.6
Poland	12.08	3.3	4.98	0.3
Portugal	3.35	2.7	1.72	0.1
Romania	2.38	1.8	1.36	0.1
Slovak Rep.	3.76	5.2	0.61	0.0
Slovenia	0.54	1.5	0.28	0.0
Spain	18.72	2.4	12.17	0.8
Sweden	9.07	3.2	6.08	0.4

Note: This table was prepared by Roel Beetsma, Franc Klaassen and Rutger Teulings as part of their contribution to this book. It has been moved here to avoid repetitions in other chapters.

Sources: Exports in billions are obtained from the IMF (2016a). They are presented in current (i.e. 2015) euros by converting local currency into euros against the average exchange rate of 2015. Exports as a share of GDP are calculated by multiplying total exports as a share of GDP, both numbers obtained from the IMF (2016b), by exports to the UK as a share of total exports, both numbers obtained from IMF (2016a).

Foreign direct investment matters in some cases

For many smaller countries, foreign direct investment (FDI) in either direction is negligible, as shown in Table 2. In others, though, it is very important and usually flows both ways. Luxembourg, Ireland and the Netherlands receive from and send to the UK considerable amounts of FDI. Part of these flows may relate to tax optimisation, which stands to divide EU27 countries. Another part, though, reflects value chain trade. It is noteworthy that for some of the largest countries (France, Germany, Spain) FDI *from* Britain largely exceeds FDI *to* Britain, suggesting that British firms subcontract production to these countries. Keeping these flows open may well be an important objective for the EU27.

The City of London

It is well understood that a key objective for the UK will be to maintain the supremacy of the City of London. Passporting rights, which allow financial institutions registered in one country to operate in all other EU countries, are the key element here. Some large countries (France, Germany, Italy) consider that scale matters and that they stand to gain some of the business that the City would lose if its passporting rights are revoked. These considerations matter. With well-established links to the City and a tradition of providing international financial services, some smaller countries (Ireland, Luxembourg, the Netherlands) also expect to benefit from an end to passporting rights for the UK. These views are incompatible. If scale matters, we should expect much of the City's business to migrate to just one place, not to be scattered among many countries. This realisation could work against a united front. Besides, financial firms may develop strategies that allow them to keep most of their activities, especially the most lucrative ones, in London.

Table 2 Accumulated foreign direct investment in and from the UK, 2014

	Accumulated investment in the UK		Accumulated investment by the UK	
Country	€ billion	% of investor's GDP	€ billion	% of UK GDP
Austria	2.87	0.87	1.22	0.05
Belgium	31.8	7.93	13.6	0.60
Bulgaria	0.01	0.02	0.17	0.01
Croatia	--	--	0.28	0.01
Cyprus	4.61	26.5	0.65	0.03
Czech Republic	0.01	0.01	2.08	0.09
Denmark	8.37	3.21	8.71	0.39
Estonia	--	--	0.15	0.01
Finland	1.85	0.90	1.30	0.06
France	94.3	4.41	47.4	2.10
Germany	62.1	2.13	29.5	1.30
Greece	0.24	0.14	1.93	0.09
Hungary	-0.01	-0.01	1.11	0.05
Ireland	17.0	8.82	41.9	1.85
Italy	5.51	0.34	12.3	0.55
Latvia	--	--	0.13	0.01
Lithuania	--	--	0.08	0.00
Luxembourg	97.8	200	134	5.93
Malta	0.79	9.70	--	--
Netherlands	218	32.9	147	6.52
Poland	0.14	0.03	6.19	0.27
Portugal	0.58	0.34	3.14	0.14
Romania	0.01	0.01	1.05	0.05
Slovakia	0.00	0.01	0.29	0.01
Slovenia	0.01	0.03	--	--
Spain	56.7	5.44	20.2	0.89
Sweden	12.0	2.77	22.4	0.99

Note: This table was prepared by Beetsma et al. as part of their contribution to this book. It has been moved here to avoid repetitions in other chapters.

Sources: Foreign direct investment data are from the Office for National Statistics (2015a,b), all in 2014 pounds and converted into euros using Eurostat (2016b) data. GDP data are from Eurostat (2016a).

Labour mobility is the big issue

Free labour mobility and the ban on discrimination against foreign nationals hailing from the EU constitute one of the four freedoms that – along with the mobility of goods, services and capital – are considered a fundamental pillar of the EU. Prior to the referendum, the British government asked for some exemptions concerning both the right to settle in the UK and the treatment of EU citizens regarding welfare services. By and large, this request has been rejected. Prime Minister Theresa May considers that popular opposition to this freedom played a critical role in the Brexit referendum. The UK government is now duty-bound to reject this obligation, one way or another.

This is likely to be the most complicated part of the negotiations. It involves a matter of principle: can one of the four freedoms be jettisoned, or even simply made relative? For a number of the contributors, the answer is a straightforward "no". Others note that migration is a hot political issue in most countries and argue that the answer might not be so black and white. In fact, the issue is quite complicated. To start with, some countries are net receivers of EU migrants, while others are net issuers (see Table 3). Furthermore, immigrants can come from the EU or from the rest of the world, and the mix is very different from one country to another. It might seem that Brexit only concerns intra-EU migration, but then comes the Schengen agreement. Once they are registered in any EU country, people are free to move to any other EU country, except Ireland and the UK since these two countries have an opt-out from the Schengen agreement. The national debates about migration are shaped by these distinctions, which naturally leads to diverging views. This matters a lot for the negotiations.

Furthermore, a significant number of British citizens live in EU27 countries, where they contribute to economic activity as workers or retirees. Tourists from the UK are conspicuous in many Southern European countries, but also elsewhere. A few contributors also mention the importance to their countries of student mobility, noting that British universities attract many foreign nationals (this is noted in the cases of Austria, Finland, France and Slovakia).

Table 3 Citizens from EU27 in the UK and vice versa, 2015

Country	EU27 citizens in the UK		UK citizens abroad	
	Number	% of population of emigration country	Number	% of UK population
Austria	21,698	0.3	11,013	0.02
Belgium	29,142	0.3	27,335	0.04
Bulgaria	51,875	0.7	5,329	0.01
Croatia	9,029	0.2	670	0.00
Cyprus	84,815	9.7	40,547	0.06
Czech Republic	41,605	0.4	4,795	0.01
Denmark	24,972	0.4	18,556	0.03
Estonia	9,361	0.7	487	0.00
Finland	14,325	0.3	6,898	0.01
France	149,872	0.2	185,344	0.29
Germany	322,220	0.4	103,352	0.16
Greece	39,700	0.4	17,679	0.03
Hungary	56,166	0.6	6,980	0.01
Ireland	503,288	10.7	254,761	0.39
Italy	151,790	0.3	64,986	0.10
Latvia	66,046	3.4	1,148	0.00
Lithuania	116,861	4.1	3,301	0.01
Luxembourg	2,092	0.4	6,559	0.01
Malta	31,758	7.6	12,046	0.02
Netherlands	68,489	0.4	49,549	0.08
Poland	703,050	1.8	34,545	0.05
Portugal	98,967	1.0	17,798	0.03
Romania	89,402	0.5	3,124	0.00
Slovak Republic	67,781	1.2	4,890	0.01
Slovenia	2,298	0.1	578	0.00
Spain	91,179	0.2	308,821	0.48
Sweden	35,055	0.4	24,950	0.04

Note: This table was prepared by Beetsma et al. as part of their contribution to this book. It has been moved here to avoid repetitions in other chapters.

Sources: Population data re from UNCTAD (2016) and migration data are from the United Nations (2016).

The positions taken by the contributors reflect these contradictory aspects. They all recognise that labour mobility is a make-or-break issue. Most consider that it is simply non-negotiable as a matter of principle. The countries from Central and Eastern Europe are also extremely keen to preserve the rights of the large numbers of their citizens who live in the UK. However, a few contributors call for a more pragmatic approach and suggest various temporary opt-out clauses (Austria, Greece, Sweden) or some more permanent arrangement (France). Migration, it is sometimes noted, is a live issue in many countries, and domestic political considerations may well interfere with the negotiations.[4]

The European Court of Justice

In his contribution on Belgium, Paul de Grauwe focuses on the vocal British rejection of the legal supremacy of the European Court of Justice, including in matters concerning the four freedoms. It is argued that this issue cannot be separated from the Single Market since it ultimately settles relevant disputes. Experience with the European Economic Association and EFTA confirms that the issue is real and serious. This may well be another make-or-break issue.

Third countries

The EU comes with some baggage in the form of countries with special arrangements. Along with the EU countries, Iceland, Lichtenstein and Norway are part of the European Economic Association (EEA). In practice, these three countries have nearly the same arrangements as the EU countries, including full access to the Single Market and contributions to the EU budget, albeit without decision power. Switzerland rejected EEA membership through a referendum and reached its own parallel agreements with

4 The Schengen agreements are rarely discussed, which is logical since the UK has opted out. Some contributors note that the agreements are in trouble anyway and may have to be rethought. The Polish contribution fears that Brexit will weaken the opposition to a common asylum policy.

the EU. The most important difference is that Swiss financial institutions do not have passporting rights. Norway and Switzerland are sometimes mentioned as possible templates for the UK.

Of interest is that, in 2014, Switzerland decided by referendum to break away from the labour mobility agreement. Since then, it has been involved in difficult negotiations with the EU regarding the transposition into law of this decision. Given the prominence of the labour mobility issue for the UK, a chapter is devoted to the case of Switzerland in which Simon Evenett examines the linkages between the now parallel negotiations between the EU and Switzerland and the UK.

History and politics

Brexit is a major political event. It challenges the idea of bringing all of Europe into a 'common house', which could now unravel. Maybe to a surprising degree, many contributions refer to Britain's own history and role not just in Europe, but also in individual country experiences over the centuries.

Historical links with Britain loom large. George Alogoskoufis notes that the UK has been a key contributor to Greek independence and security for over two centuries. Rui Peres Jorge and José Tavares argue that Portugal and the UK form "the oldest strategic alliance in the European continent", with an emphasis on trade that will not escape readers of David Ricardo. Several Northern countries only joined the EU after Britain did, and this was not a coincidence. Miroslav Beblavý and Vladimír Bilčík remind us that most Eastern and Central European countries remember Britain championing their membership to the EU. Dariusz Rosati adds that Poland shares with Britain a strong attachment to NATO and welcomes its support against threats from Russia, a view likely to be shared strongly by the Baltic States and other Eastern European countries. Alan Barrett and Edgar Morgenroth observe that Ireland fears the resurgence of its long-troublesome border with Ulster and is attached to shared cultural roots, the result of secular population movements, common language and education. Luis Garicano considers that the case of Gibraltar will matter greatly for Spain. On the other side, de Grauwe considers that historically, Britain always has endeavoured to limit the power of the continent and will want to use the negotiations to further this goal. All these considerations obviously matter, even though Britain's opt-out from Eurozone and Schengen membership has already led to some estrangement from its former *protégés*.

The fear that other countries may be tempted to follow Britain and leave the EU is another important issue. This is currently shaped as the choice between a 'hard Brexit' and a 'soft Brexit', that is, between the deep severance of economic and political links on the one hand, and a quasi-membership associated with mutual concessions on the other. Countries with deeper economic ties, as shown above, are less willing to support a hard Brexit, as are countries that share some historical or worldview kinship with the UK.

Other contributions (Finland, Slovakia and Sweden) note the role played by the UK in promoting a liberal economic order in Europe. They express concern that Brexit will leave their countries in a weaker position as the largest countries could challenge this order. The Visegrad countries, which feel dominated by the core members of the EU, voice a similar concern. They have regarded the UK as a natural ally and worry that its withdrawal will make their position more difficult. Indeed, the often-mentioned suggestion that Britain should not be offered an easy arrangement for fear of triggering more withdrawals, or a 'Europe *à la carte*', is particularly relevant for the Visegrad concerns. Several contributors believe that a Brexit will lead the Visegrad countries to forge common positions, which would isolate them.

Contributions to the EU budget

Unsurprisingly, the countries that are net recipient of EU funds (Greece, Poland, Slovakia) worry about the implications of Brexit, as does Austria (a net donor). Indeed, the UK has been a net contributor, which means that its withdrawal will reduce net transfers to a number of countries. At the same time, most contributions from the largest countries do not even consider payments to the EU to be an important issue.

Conclusions: What kind of Brexit?

Much of the current public debate contrasts a ‘and a ‘soft’ Brexit . The British government has stated that it is seeking a hard Brexit, meaning a complete withdrawal from the web of links that bind it to the EU. Many EU27 governments have also publicly signalled a preference for a hard Brexit. This means that the negotiations would start from a clean slate, in contrast to the negotiations for a soft Brexit, which would start from the existing arrangements and seek to change those that the UK sees as incompatible with the referendum. This way of presenting the negotiations can be seen in many ways.

It can be a negotiation strategy. Starting from a clean slate instantly frees the UK from all its previous commitments and puts the focus on what it wants (“Brexit means Brexit”). From the EU27 standpoint, a hard Brexit establishes that the UK cannot expect any preferential treatment relative to any other non-EU country (“out is out”). Thus each side of the negotiating table starts from far out, presumably hoping to force the other side to walk more than half of the way.

Another interpretation is that EU27 countries want a hard Brexit as a matter of principle. They are unwilling to provide bespoke treatment because it would contravene international agreements built up over decades. They are also concerned that soft treatment of the UK would encourage other countries to seek special arrangements, a process that could unravel the EU as we know it.

Yet another possibility relates to domestic politics. In virtually every EU country, Eurosceptic political parties are on the rise, sometimes even forming part of a governing coalition (in Finland and the Netherlands, for example). These parties consider Brexit as vindication and hope to capitalise on the event to grow further. Pro-European governments, on the other hand, are keen to make Brexit very painful for the UK if only to demonstrate to their electorates that Euroscepticism is a dead end.

Finally, a variety of vested interests may influence governments. Some fear being on the losing end and call for mutual concessions. Others believe that they stand to benefit from a hard Brexit. A key example is the hope that the City of London will lose a significant part of its lucrative business, which will migrate to create a new global financial centre elsewhere.

Whatever the motivation, a large number of contributors support a hard Brexit. The list includes those writing about Belgium, Finland, Germany, Italy, Hungary and, possibly, the Netherlands. Other contributors, who resent a strategy that they see as a sort of Nash equilibrium that hurts everyone, favour a soft Brexit. This list includes contributors from Greece, Portugal, Spain and Sweden. The remaining contributors do not take a firm stand, adopting a more nuanced, case-by-case view. France could even be ready to trade some of its positions on Brexit against concessions by other countries (Germany is mentioned) on intra-EU arrangements.

Table 4 Positions on key issues

	Willingness to be flexible on:			Kinship on liberal views	Concern about budget contribution
	Trade	FDI and financial services	Labour mobility		
Austria	Yes	Yes	Some		Yes
Belgium	No	No	No		
Finland	No	No	No	Yes	
France	No	No	Yes		Yes
Germany	No	No	No		
Greece	Yes	Yes	Yes		Yes
Hungary	No	No	No		
Ireland	No	Yes	No		
Italy	No	Some	No	Some	
Netherlands	No	Some	Yes	Yes	
Poland	Yes	Yes	No	Yes	Yes
Portugal	No	Yes	No		Yes
Slovakia	No	Yes	No	Yes	Yes
Spain	Yes	Yes	No		
Sweden	No	No	Yes	Yes	

Source: Author's own interpretation of contributions to this book.

Table 4 summarises this diversity of opinions. At the risk of oversimplification, the first three columns present my own interpretation of the contributor's views on how flexible their countries are willing to be on the three core issues of trade, FDI and labour mobility. The fourth column indicates whether the contribution mentions kinship with the UK in promoting a liberal economic order, and the last column does the same for concerns about the loss of the British contribution to the EU budget. Beyond the lack of unanimity, the table shows that the countries that share a liberal economic order orientation with the UK are typically more prone to displaying some flexibility on the Single Market rule, especially when they are also concerned about the British contribution to the EU budget.

Clearly, the EU27 countries have a lot of work to do among themselves before negotiations start (which may delay the negotiations). Another way of looking at this is that the British negotiators may have some scope for exploiting disagreements. Of course, it matters a great deal that the largest countries (France and Germany, and maybe Italy too) are set to be inflexible. Experience shows that these countries often carry the day, but will it happen again this time? The Brexit vote is unsettling the EU. The art of cycling backwards may shake old habits and trigger resistance from the smaller countries. In addition, domestic politics – as reported in the cases of Austria and Belgium – or idiosyncratic national considerations – such as Spain's preoccupation with Gibraltar and the Visegrad countries' tendency to rebel – could upset the old tradition. It may prove hard to reconcile Germany's determination to reject the ultimate British request for *extra-wurst* ('special sausage') treatment and Sweden's hope of 'Brentry' (bringing Britain back to the EU). The fact that any agreement requires unanimity and approval by the European Parliament heavily favours the status quo.

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