



BREXIT: THE DAY AFTER

July 2016

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AUTHORS



Prof. Mark Galeotti: Professor of Global Affairs, New York University



Erwin Pfuhler: Private Consultant



Dr. Akin Unver: Lecturer at the Department of Near Eastern Studies, Princeton University



Timothy Stafford: Research Fellow, CSIS Pacific Forum



Dr. Frank Umbach: Research Director at the European Centre for Energy and Resource Security, King's College London



Hugh Stephens: Executive Fellow, School of Public Policy, University of Calgary



Dr. Jelena Petrovic: Project Manager, Wikistrat



Nick Ottens: Project Manager, Wikistrat

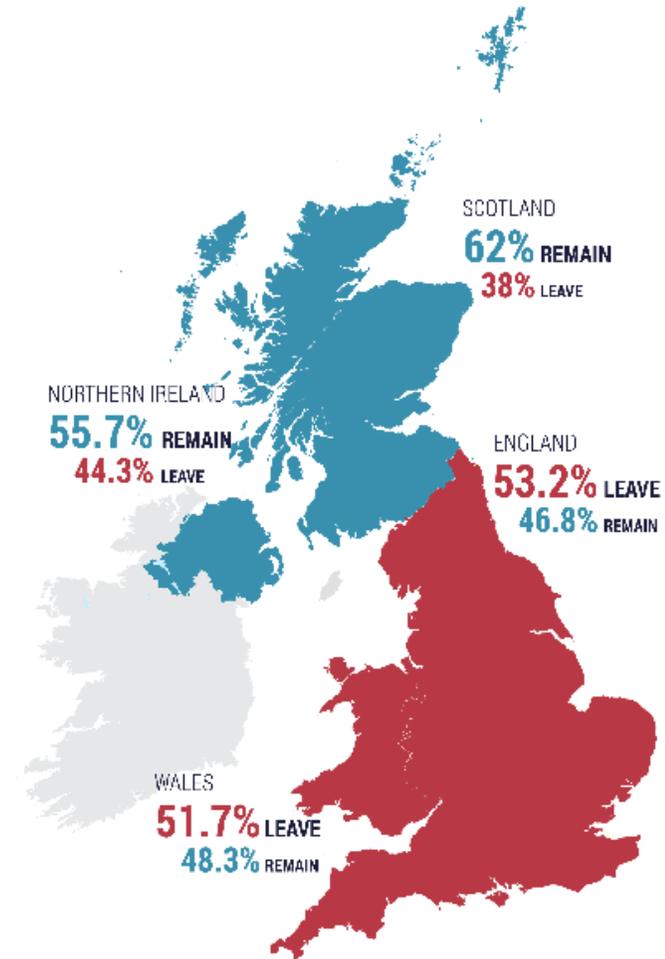
BREXIT: THE DAY AFTER

INTRODUCTION

With 52 percent of voters in the “Brexit” referendum in favor of leaving the EU, the world woke up last Friday to a new geopolitical reality which some have compared to the day after the fall of the Berlin Wall.

The vote rattled global stock markets, generating sharp declines in major indexes, with the price of gold and silver seeing dramatic increases.

At the same time, Eurosceptics and far-right parties across Europe welcomed the results, seeing a boon to their domestic political fortunes. Moscow seems to view the referendum as having a positive impact on its global position, anticipating a boon in relations with an EU now dominated by Germany.



OBJECTIVE



The objective of this report is to provide in-depth analysis regarding the consequences the Brexit referendum result may have on global and regional actors.

BREXIT: THE DAY AFTER GERMANY



Political Impact

- Far-right parties boosted by the Brexit result – including Alternative for Germany (AfD) – may gain influence in the upcoming 2017 elections. The AfD will no doubt continue to push discussion regarding the EU. The results of the French elections will also significantly influence the discourse.
- Chancellor Angela Merkel is unlikely to change political course and will therefore likely face a loss of seats. In such a scenario, a “grand coalition” between the CDU, the SPD and the Greens could be appealing – but may also paralyze the political system. This would negatively affect the EU.

Crisis Management

- While Germany will push for a fast U.K. exit to avoid even more economic, financial and political uncertainty and turmoil, it will also seek to avoid any harsh or hasty reactions on its own part – or that of Brussels.
- The Brexit will ultimately be a long process. The shock and negative reaction to the move by large portions of the British public and a majority of the political elite will make Germany’s preferred faster exit harder to achieve. In addition, the U.K. government and David Cameron’s successor will seek to draw the process out.



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The overall public opinion in Germany and its political class on the EU and its member integration policy is still positive.

Dr. Frank Umbach
Senior Analyst, Wikistrat

BREXIT: THE DAY AFTER GERMANY



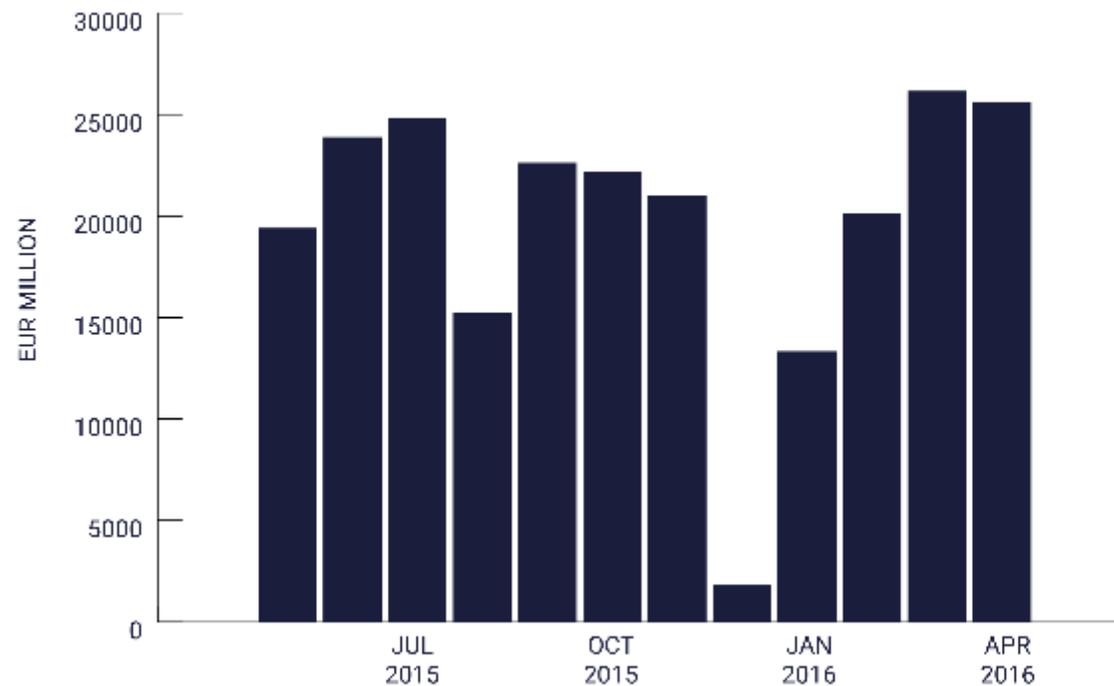
Expats

- The overall assumption is that Germany will suffer some economic and financial costs – including reduced GDP growth, as both economies are closely interconnected. Approximately 370,000 are employed by subsidiaries of German companies in Britain. More than 100,000 British people live and work in Germany, and 262,000 Germans live and work in Britain.

Free Trade

- Germany relies on free trade with the United Kingdom to maintain its positive balance of trade (€89 billion), exporting €38 billion of goods to Britain.
- Free trade goes hand in hand with free movement of labor – and Poland would benefit the most from such an agreement with Britain. Thus, if Germany pushed hard for free movement of labor, it would benefit its relations with Warsaw.

GERMAN BALANCE OF TRADE



SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL STATISTICS OFFICE

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Market Liberalization

- With the loss of Britain, the EU will lose a defender of market liberalization, shifting Europe's political balance (and likely resultant policies) towards the left – e.g., state-centered economic policy, more public financing, and lax attitudes toward debt and GDP growth.
- Germany must contribute strongly to a stabilization of the EU. There are tendencies in some Western European countries to follow Britain. Eastern European countries are not likely to leave the Union, but they will try to gain more influence. Germany will have to assume the role of an integrator. It may not play the dominator.

Russia

- Merkel's policy of sanctions towards Russia (which are against Italy's interest, and are also increasingly opposed by the CDU's coalition partners in the SPD) in exchange for fulfillment of Moscow's Minsk II obligations might be weakened over time.

France

- Berlin may try to reinvent the old Germany-France relationship. But given the political and socioeconomic crisis in France and various existing economic and foreign policy disagreements, it will also have to rely more on Italy and Poland. By losing Britain, Merkel will lack an overall important ally for her economic and foreign policies.



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Britain historically used its influence in the EU to fight against tight financial regulations. Without it, there will be more strict regulations on banking to guard against the next financial crisis.

Erwin Pfuhrer
Senior Analyst, Wikistrat

BREXIT: THE DAY AFTER RUSSIA



Wider Fractures

- President Putin has held back from expressing pleasure at the outcome of the vote, but many Kremlin-connected commentators are openly jubilant. It is not so much Brexit itself that they welcome so much as the belief that this will open wider fractures within the West, and leave the EU too divided and inward-looking to be meaningfully able to resist Russian adventurism in Ukraine and elsewhere in its self-defined sphere of influence.
- The Brexit vote is already encouraging populists across Europe to seek their own referendums, from France's Front National and the Dutch Party for Freedom on the right, to the Five Stars movement in Italy on the left. Regardless of the outcome, such calls – which can be magnified by Russia's propaganda machine – will distract Europe and minimize its capacity to be an effective geopolitical agent.

Western Unity

- While all parties claim to be committed to ensuring that a Brexit and subsequent realignments within the EU will not affect defense cooperation or the transatlantic relationship, this cannot be guaranteed. Moscow's hope is that Western unity will suffer and that governments seeking to shore up their domestic support will be less committed to maintaining or increasing their defense expenditure and tough line on their eastern front.
- A post-Brexit U.K. is likely to suffer prolonged economic dislocation, and as a consequence further liberalize its economic regime. The result will be a still-powerful financial hub that bucks the trend of greater transparency and accountability, making it all the more amenable to Russian legal and (questionable) financial activity.

BREXIT: THE DAY AFTER RUSSIA



Russian Economy

- Even as the pound tumbled on global markets, the ruble also fell. Brexit is likely to have negative economic implications for the EU as a whole – which remains Russia’s main trading partner, accounting for about half its total imports and exports. Any long-term slowdown in European economic growth will also affect Russia’s hopes of economic recovery.

Russian Concerns

- While Moscow is often contemptuous of the EU – especially its values, bureaucratism and sluggishness – it also recognizes that it acts as a moderating influence on both the U.S. and also some of its more aggressive and ambitious members.
- If the EU fractures or even declines in significance, countries such as Poland – with a growing economy, desire to assert its regional role, and longstanding animosity with Russia – may prove rather more problematic than Brussels. Likewise, if Washington feels Europe is not a viable partner, it may look more assiduously at cultivating regional relationships with Ukraine and countries in Central Asia, which would be a more direct challenge to Moscow's authority.



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Some more thoughtful Russian strategists are also aware that the Brexit is not an a qualified boon for Russia, and may have unexpected and problematic implications. The overall ideal, after all, is an EU that is distracted, divided and weakened – but not mortally so.

Prof. Mark Galeotti
Expert, Wikistrat

BREXIT: THE DAY AFTER NATO



The Trident
Debate

- A “Disunited Kingdom” puts the Scotland/Trident debate back on the table. If Scottish First Minister Nicola Sturgeon’s supporters get their way, the rest of Britain will have to determine what to do with its nuclear submarine fleet. NATO’s nuclear deterrence planning may take a hit and (in a worst-case scenario) fall entirely upon the United States.

Pivot to
France

- The U.K.’s likely financial turmoil will reflect upon its defense spending for a significant period of time, making overseas operations less likely. This will be compounded by a fractured political system, making France the NATO partner of choice for power projection operations.

Intra-EU
Intelligence
Sharing

- The prospect of reduced intelligence sharing between the U.K. and EU threatens to weaken the intelligence capabilities of states on the front line of NATO challenges (Russia and terrorism).

Enter
Russia

- The pro-sanctions coalition will weaken as France and Germany move to restore commercial ties with Russia. EU “doves” will undermine NATO’s hard stance on the Ukraine issue without Britain to advocate the “hawk” position.



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The Brexit will inspire a focus shift from international to domestic issues – thus decreasing the likelihood of support to any out-of-area operations or major NATO initiatives. In addition, it threatens to undermine support for Article V operations in the Baltic and Eastern Europe.

Dr. Jelena Petrovic
Project Manager, Wikistrat

THE NETHERLANDS



Economic Impact

- The Netherlands may be among the EU countries suffering the most from Britain's exit. Dutch companies invest more in Britain than in any other country, while the United Kingdom is the second-largest investor in the Netherlands after the United States.
- The Netherlands sold €38 billion worth of goods and services to the United Kingdom in 2015 and imported €21 billion. If Britain leaves the single market, those numbers will probably go down as well.
- Some 44,000 Britons live in the Netherlands. A similar number of Dutch people live and work in the United Kingdom. A Brexit will make it harder for them to stay.

Changing Balance of Power

- The Netherlands has always wanted Britain in the EU to balance against the Franco-German axis as well as the protectionist instincts of the southern member states.
- A Brexit means less weight for liberal trading policies and emphasis on the single market (as opposed to political union) – policies which are favored by the Dutch.

Imitation Unlikely

- The nationalist Freedom Party, which wants to take the Netherlands out of the EU, got a boost – but it is unlikely to enter the next coalition government (elections are due in 2017). None of the other parties wants an in-out referendum.
- Polls on EU membership are wildly inconsistent (from a low of 22 to a high of 48 percent wanting to leave) but none has a majority of Dutch voters supporting an exit.

BREXIT: THE DAY AFTER TURKEY



Collapsing EU

- Ankara believes that Britain is the first brick to fall in a collapsing EU. This reasoning suggests that Turkey too should abandon the EU negotiation process now that it is becoming a dysfunctional entity. More extreme views close to President Erdoğan suggest that Ankara should initiate an alternative, Turkey-centric union with the Balkan countries.

Visa Negotiations

- Brexit uncertainties may lead to Turkey's withdrawal from the visa waiver/migrant negotiations with the EU, which might have led to Turkey accepting the return of refugees which had crossed into Europe through its borders.

Negative Portrayal

- Within the EU, Britain was Turkey's main ally, usually championing Ankara's cause against a more reluctant France and Germany. Turkey is thus surprised at the anti-Turkish tenor of the "Leave" campaign.

Anti-Islamic Sentiments

- If the next British government takes on a more nationalist turn, Turkey will be worried about the implications on anti-Islamic and other racist sentiments within the United Kingdom.



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The leave campaign demonized Turkey immensely, portraying Turks as dangerous migrants that would 'flood Britain' if it remained in the EU. This negative portrayal happened much to Turks' bafflement, given the almost complete lack of tension in bilateral relations and near-ideal convergence of interests in regional affairs.

Dr. Akin Unver
Senior Analyst, Wikistrat

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THE BALKANS



Fading
Attraction of
EU

- States will become less willing to comply with EU accession criteria, as Britain’s withdrawal undermines the notion that European integration is inevitable and desirable. With conditionality becoming less effective, systemic issues in the candidate states (Serbia, Macedonia, Albania, Montenegro) and potential candidate states (Kosovo and Bosnia) will remain unaddressed – thus leaving the region in a limbo of poor governance.

Consolidation,
Not
Enlargement

- European voters will increasingly prefer a focus on domestic over international issues – and may decide that it is time for the EU to consolidate rather than to enlarge. The Balkan states may indefinitely be put on the backburner.

Alternative
Arrangements

- In the absence of the EU’s normative power (and willingness to invest time and money in the Balkans), candidate and potential candidate states may turn to Moscow, Ankara, Riyadh and Beijing for geopolitical, economic and financial support.

Germany or
Nothing

- Britain may come to be seen as “closed” to immigration, thus elevating Germany to an unrivaled position as a “migration Mecca”; the Balkan migration route may revive and formalize as the primary pathway to Europe from the Middle East and Africa.

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CHINA



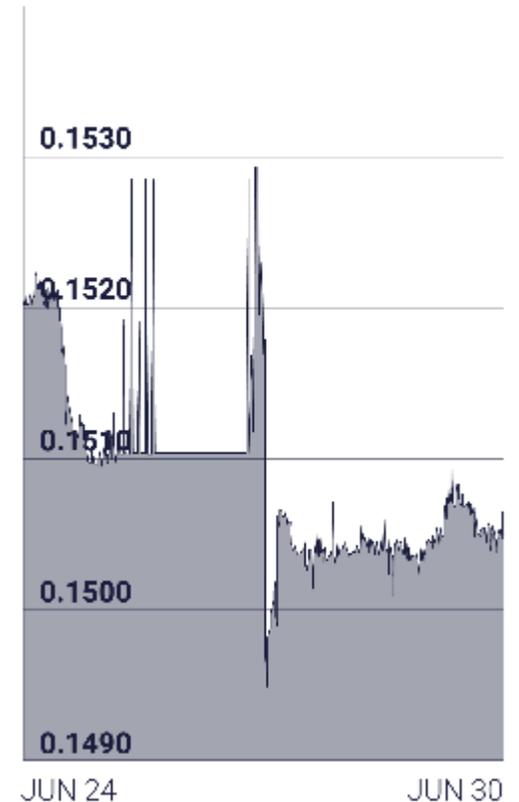
Economic Impact on China

- The dollar is likely to gain strength versus the yuan, enabling a major increase in exports due to favorable rates of exchange.
- Falling oil prices may result in major manufacturing expansion, undermining Beijing's efforts to rebalance growth by reorienting the domestic economy away from exports and towards the service sector.
- Concerns will grow regarding financial turmoil and the effect of a weakening pound on overseas investments. In addition, there will be severe concern about the prospect for financial contagion, as global financial disruption threatens the domestic shadow banking system.

China-U.K. Relations

- China will focus on cementing its privileged relationship with the U.K. despite London's diminished role within Europe. Indeed, agreements will be much easier to negotiate on a bilateral basis than with a complex multinational organization like the EU.
- Depending on the arrangements Britain makes with the EU, China could lose the advantage of Britain being the entry point to the organization – especially in terms of financial services.
- The negative economic impact of an EU withdrawal on the British economy will harm the volume of Chinese exports to Britain, though this will have a relatively marginal impact on China's overall volume of trade.

YUAN VS. DOLLAR



BREXIT: THE DAY AFTER CHINA



China-EU Relations

- China will benefit long-term from the newly exposed weakness within the EU, and will focus on strengthening relations with individual member states rather than devoting resources to the European Commission – a process which it will find to be significantly easier.
- China will be circumspect but will urge the EU to cut a deal with Britain that will minimize negative global economic impacts.

China-U.K. Relations

- The U.K. will be less able to take a stand on issues such as human rights, cyberwarfare and Tibet due to constrained global freedom of action and an increasingly perilous hold over its own financial services industry. The U.S. will as a result be increasingly isolated in its calls for democracy and human rights.
- An EU lacking British participation will prove less willing to prohibit arms sales to China, as France and Germany will drive the common defense policy towards a more commercial, trade-oriented agenda.
- Outside of Europe, Britain will find itself less able to afford export controls on advanced equipment due to reduced European purchases, thus increasing its own government's willingness to allow for sales to countries like China.



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China is concerned that a Scottish exit from the U.K. in response to a Brexit will encourage sub-state nationalist groups in Tibet, Taiwan and Xinjiang.

Timothy Stafford

Contributing Analyst, Wikistrat



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