

Europe's political risk is Britain's problem

Blog post by Chief Economist Gregor Irwin, 19 May 2016

Fitch Ratings this week concluded that Brexit would increase political risk across Europe by boosting populist political parties, including many who are Eurosceptic, and by changing the political centre of gravity in the EU. There is not much to disagree with in that. As the referendum debate grinds on, however, it is also worth considering some of the ways in which the political risks for the rest of Europe will feed back and impact on the UK following a vote for Brexit.

First, consider the balance of power in Brussels. It may seem paradoxical, but without the UK the EU's most powerful member, Germany, may find it has less influence. This is because Germany would become more exposed in policy debates in Brussels without having the UK - Europe's intransigent and thrifty liberal - to hide behind and balance against the French and their allies who are more sceptical of markets. This could have significant implications for new legislation from Brussels. Ironically, it won't only be damaging for Germany; it may hurt the British too, as EU legislation will still impact on the UK, even outside the EU, if Britain still wants to maintain access to all or part the single market.

Second, consider the impact Brexit might have on Europe's two big elections next year, in France and in Germany. Both incumbents face different threats from Eurosceptic insurgents who are taking votes from the mainstream parties. The most direct threat is in France where Front National's Marine Le Pen might find enough votes to get through to final round of voting, particularly if she is able to point to the UK supposedly negotiating a better relationship with Europe on the outside. In Germany the challenge comes from the Alternativ für Deutschland, which has exploited a Eurosceptic gap in the German political market, causing consternation among Chancellor Merkel's centre-right CDU party in particular. The AfD is not about to enter government, but it is a political force. What does this mean for the UK? Neither the French nor the Germans will want Brexit to complicate their elections. So we should expect Brexit negotiations to be on a slow track until these elections are out of the way.

Finally, consider who is likely to be most worried that a vote for Brexit could provoke calls for a similar referendum in their country. Top of the list are Sweden, Denmark and the Netherlands. That should be no surprise. These countries are all different but they share similar policy preferences to the UK and are firmly in the EU's liberal camp. But the UK would be wrong to expect much help from them in a Brexit negotiation. The last thing their governments will want is for it to be easy for the UK to leave, as it will embolden Eurosceptics at home. Britain's friends in Europe may turn out to among the toughest adversaries when it comes to negotiating the way out.