

UK in Focus | The geopolitics of Brexit and the implications for the future of European security

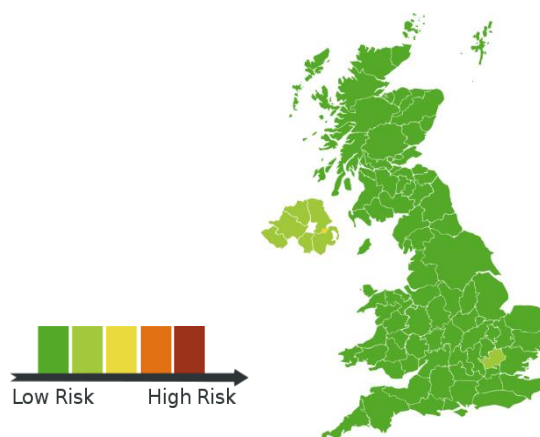
On 23rd June 2016, the UK will hold a referendum on continued membership of the European Union (EU). For many in the UK, this situation will be familiar; in 1975, two years after signing the Treaty of Rome, a public vote was called on membership of the European Economic Community. This latest development exposes the growing scepticism over the EU's efficacy. No state has held a referendum on withdrawal from the EU in its current form and a potential "Brexit" will have implications not just for the future policy orientation of the UK, but also for the future of the European project.

This is particularly relevant as Europe faces arguably its biggest security challenge for decades; a resurgent Russia and the ever increasing and imminent threat of IS. Russia still sees Europe in Cold War terms and has made the return to Great Power status a national priority. It has unsettled its western neighbours by annexing the Crimea and carrying out mock bombing raids at a level not seen since the Cold War. Mounting disunity in Europe plays directly into the hands of Russia. Co-operation and collaboration on foreign and security matters will therefore be as important as they have ever been, particularly in the context of a possible "Brexit".

With this in mind, this Focus piece addresses the following concerns: will the UK be more secure in or out of the EU? What are the implications for future multilateral arrangements? And what will be the policy implications for the EU in the event of a "Brexit"? This will be addressed by assessing three key member states: the UK, Germany and France.

United Kingdom

Key Risks
Referendum on EU membership on 23 rd June
Uncertainty over future in EU and the implications
Moderate risk of terrorism



Source: Equant Analytics, 2016

The threats faced by the UK will not be greatly influenced by the outcome of the referendum. The EU was formed on the basis of shared norms and values and while threat perceptions do differ slightly at the national level, there is enough consensus to ensure that the UK will remain a willing partner on security issues. For example, the UK, along with many other EU member states, will remain a target for Islamist extremists. Responding to these threats still falls principally within the remit of national intelligence agencies with the EU striving to add

value by 'strengthening national capabilities' and 'facilitating European cooperation'. The UK would still work closely with key intelligence allies (the US, France and Germany) while "Brexit" would also provide the UK with greater scope to control its own borders, opt out of the European Convention on Human

Rights and implement a "British Bill of Rights", giving it greater control over the deportation of terror suspects. As such, if the UK were to leave the EU, its ability to deal with the threats it faces would not be substantially hindered.

However, neither would it be improved. It could make access to EU security and intelligence initiatives problematic in the future. For example, access to Eurodac (a fingerprint identification system), the European Arrest Warrant, or the Schengen Information System (which allows criminals to be tracked across borders) may not be straight-forward. Under Article 50 of the Lisbon Treaty, it states that negotiations on terms of exit can take up to two years with paragraph three stating 'the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.' In other words, it is conceivable that the UK would not have complete influence over the final terms of the withdrawal. Furthermore, it is uncertain when the UK government will choose to invoke Article 50.

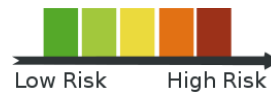
The UK government's official position favours continued membership of the EU where it can still play a key role in defining its foreign and security policy orientation, this is particularly important in terms of containing the threat of a resurgent Russia or the ever increasing and imminent threat of IS. The UK holds considerable influence in the EU's foreign policy arena as a result of its ability to rapidly devise and implement initiatives. This usually ensures the UK is one of the first states to outline its position and gives it an advantage when negotiating policy.

However, the nature of the EU's consensus-based strategy, its lack of a unified military force, and predisposition for "soft power" has resulted in slow or ineffective responses to emerging crises. For example, the recent migrant crisis exposed the propensity of member states to respond according to national agendas rather than as a collective. At the same time it has avoided the Iraq debacle which was driven by unilateral decisions and actions.

Worryingly for the EU, regardless of the outcome of the referendum, this is the first formal declaration of discontent and the first time in the EU's recent history that a referendum on continued membership has been called. This will have serious implications for the future of the EU and has sparked fears of a "domino effect" should the UK opt to leave. This will have particular significance for two other major European powers and partners: Germany and France.

Germany

Key Risks
Moderate risk of terrorism
Emerging social and political divisions over controversial issues such as immigration
Political tensions over current government's interaction with the EU



Source: Equant Analytics, 2016

Germany, widely regarded as the de facto leader of the EU, is undergoing a period of political and social tension. Domestic tensions have been rising steadily as the EU has been confronted with problem after problem since 2008. Germany, using its considerable economic strength and political influence was able to help provide leadership and support throughout the economic downturn. While economic tensions remain with Greece, the wider economic issue has subsided in recent time to be replaced by the combination of a rise in the threat of terrorism and an influx of refugees. Germany has again led the EU by example, accepting the lion's share of migrants into its borders, albeit also addressing some of the core longer term demographic issues which it faces.

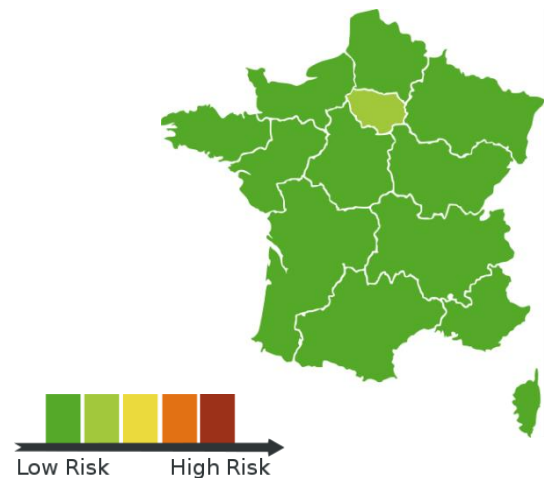
This has, however, come at a social and political cost. Angela Merkel's approval rating, especially amongst the right wing, is dropping with anti-immigration parties such as AfD (Alternativ für Deutschland) having made substantial gains in recent local elections. They are riding on a wave of frustration at both the EU and the government's response to the refugee crisis. In fact it is the first time since the Second World War that Germany's two major parties (CDU and SPD) have fallen below 50% in opinion polls. Many Germans resent that they had to bear the economic cost of the slowdown as well as the majority of the refugees. Tensions have risen as a result of stories linking the attacks in Brussels and Paris to terror cells based in Germany as well as the Cologne events last new year's eve. These issues have led to the rise of protest movements like Pegida and the increase in votes for far right parties like AfD. This is represented by the slightly heightened risk in the Saxony region, the home of Pegida. Some Germans feel that their current government should be taking a tougher stance towards immigration, citing the UK as an example; a successful "leave" vote could severely damage Merkel's position domestically.

On the other side of the political spectrum, those among the German population who have supported Merkel's actions throughout the economic crisis, and especially with the influx of refugees, feel let down by the idea that the UK would shirk its European responsibilities further by voting to leave the EU. Indeed, it has exacerbated fears created by the rise of the new right in Germany and is escalating domestic social tension. Politically, a withdrawal from the EU may undermine bilateral relations. Britain is seen as a key regional ally for

Germany and Merkel recently warned the UK against exit; however, if the UK did vote to leave, it is highly likely that they would seek to replace Britain as the US' main partner in Europe while also attempting to further integrate with France.

France

Key Risks
High terror threat in run up to Euro 2016 tournament
Social discontent over immigration
Right-wing parties enjoying greater support – Presidential elections in 2017
UK's vote on continued membership of EU could increase support for "Frexit"



Source: Equant Analytics, 2016

According to a number of polls, most of the current EU member states support the UK's continued membership of the EU. However, there are many within France who favour Brexit. Michel Rocard, the former French prime minister, said 'leave, before you destroy everything'. Some believe the UK is increasingly unaligned to the EU's norms and values and is actually holding the European project back. France's financial sector even senses an opportunity; Brexit may allow Paris to become Europe's new financial hub ahead of London. However, the Brexit vote has also exposed underlying issues in France's domestic political scene.

In December 2015, France held its first regional election under the revised 18-region format. Sarkozy's centre-right *Les Républicains* party gained seven regions (eight when including the Union) with Cambadélis' *Parti Socialiste* gaining five (seven when including *Divers gauche*). However, the main story was that the Marine Le Pen's far-right party, *Front National*, failed to take any in spite of gaining record support in the first round of voting (28%). Le Pen argued that widespread tactical voting was to blame for the lack of regions won. *Front National* may have suffered a setback, but it is certainly not out of the running for the Presidential elections scheduled in 2017; a potential Brexit could boost the Eurosceptic party's popularity by showing it's possible to exist outside of the EU. This is particularly worrying for France given that "Frexit" is currently firmly on the political radar screen with many unhappy with the EU's current political and economic landscape.

Furthermore, the free movement of people under the Schengen Agreement has come under intense scrutiny in the wake of the Paris attacks in November 2015 which killed 137¹. Revelations that the attacks may have been co-ordinated in Germany have given rise to arguments for greater control of national borders. French security services are on particularly high alert in the run up to the UEFA Euro 2016 competition, which starts on 10th June.

But what implications could a Brexit, or even a Frexit, have for bilateral security arrangements between the EU's two most "active" states in terms of foreign policy? In 2010 David Cameron and Nicolas Sarkozy signed the Lancaster House treaties with the purpose of fostering greater co-operation on foreign and security matters. Among others, the treaties included arrangements for a Combined Joint Expeditionary Force (CJEF), the Nuclear Stockpile Stewardship, and closer counter-terrorism co-operation. Importantly, the Lancaster House treaties are unaffiliated with European Defence Agency (EDA) and separate to any clauses in the Lisbon Treaty. Brexit, or Frexit, would therefore not significantly affect military or security capabilities of either state.

The other interesting aspect of a potential Brexit (assuming France remains in the EU) is the impact this may have on political arrangements between France and Germany. As Europe's two most populous states, the bilateral partnership is arguably the EU's most important and there are a number of long-standing defence and security initiatives which aim to foster greater co-operation in this area; for example, the DFVSR (Franco-German Defence and Security Council). However, relations have been strained lately; Hollande and Merkel have found themselves wide apart on a number of issues, particularly disagreement over how to handle the migrant and the eurozone crises. Given that domestic support for Merkel and Hollande is also declining, their re-election in elections next year is far from assured and this will have implications for the future political landscape of the EU.

¹ Including seven perpetrators

Legal Disclaimer

Equant Analytics is a FinTech and Advisory business combining macroeconomic, geopolitical and market data with tailored analytical, risk and trading interfaces. Equant Analytics provides the world's macroeconomic data, which is interpreted to market intelligence and integrated into investment decisions through a proprietary analytical and trading interface.

Whilst big data makes information readily available, there is a market gap for businesses, which can offer information, intelligence and a trading interface to their clients in one affordable packaged solution.

Equant Analytics Ltd is a private limited company registered in the UK at Companies House, No 0955476.

Any data or information provided in this report is for illustrative purposes only and does not represent investment advice or recommendation. All efforts are made to ensure that data and information are accurate and reliable at the time of delivery. Any divergence of the data from other publicly available sources or from material available on Equant Analytics data platforms is due to rounding or use of alternative methodologies. These are made explicit in the text.

3rd June 2016

Dr. Rebecca Harding
Co-founder & CEO
rh@equant-analytics.com
+44 (0)7803-710711

Thanos Papasavvas, CFA
Co-founder & CIO
tp@equant-analytics.com
+44 (0)7500-335953