Brexit: Challenges and Opportunities for Small Countries and Territories

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ABSTRACT: The article is based on a round table discussion that was held at the Centre for Small States, Queen Mary University, London, on 18 September 2017. The article uses the presentations from the event, together with answers to questions that were posed, to construct an analysis of how Brexit has affected, and will likely continue to affect small states and sub-national island jurisdictions in Europe and beyond. There is still no real clarity in relation to British Prime Minister Theresa May's declaration that 'Brexit means Brexit', but the effects of the United Kingdom's (UK) decision to leave the European Union (EU) are starting to be felt – whether that's redefining Euroscepticism across Europe, marginalising the diplomatic and economic profile of the UK's overseas territories, or creating anxieties in the Commonwealth Caribbean regarding future trading relations. Thus Brexit is creating a significant ripple effect and the article provides some reflections on how these are impacting on small countries and territories; many of which are already highly vulnerable.

KEY WORDS: Brexit, Euroscepticism, security, overseas territories, Commonwealth Caribbean, trade

Introduction

On 23 June 2016 the UK voted to 'Leave' the EU with 52% supporting that choice and 48% voting to 'Remain'. The UK is now less than a year away from departing the EU, although an agreement has been reached to have a 'transition' period to help facilitate a smooth exit from the EU. This will run until December 2020. Talks between the UK and EU have been halting at best and despite provisional agreements on how much the UK

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owes the EU, the status of the Irish border, and the position of UK citizens living elsewhere in the EU and EU citizens living in the UK, there is still much to discuss and decide. Perhaps because of this lack of clarity combined with the very strong likelihood that Brexit will happen, broadly-based effects are starting to be felt. Within this context the article considers the growing impacts of an impending Brexit on various small states and sub-national island jurisdictions. It winds its way through some of the key contours of Brexit and touches several parts of the world that have largely been ignored by politicians and the media, including the small states of Europe, the countries of the Commonwealth Caribbean, and the UK's own overseas territories. The article draws upon the contributions of Baldur Thorhallsson, Paul Hardy, Motselisi Matsela, Jessica Byron, Caroline Morris, and Jack Corbett¹ and is complemented by observations of the two authors.

The impact of Brexit on the small states of Europe

One might not instantly think how important Brexit could be for the small states of Europe, but there are several reasons why the impact may well be sizable. First, there is the historical connection between the UK and many small states in Europe. The UK's policy towards the European project has heavily influenced the approach of small states across the continent. In 1973, two small states (Ireland and Denmark) accompanied the UK into the then European Economic Community (EEC) and the remaining European Free Trade Area (EFTA) states - Austria, Norway, Portugal, Sweden, Switzerland, and Iceland – signed free trade agreements with the EEC. Further, the UK has always been a champion of widening the membership of the EU, in tandem with trade liberalisation. Nowhere was this more evident than in the EU's enlargement processes after the end of the Cold War. The UK helped to push several small states through the entrance gate of the Union. As UK Prime Minister Tony Blair said in 2004 during the enlargement celebrations: 'It's certainly a great day for Europe and a great opportunity for Britain ... The countries coming into Europe share our view of a Europe of independent nation states working together for the common good of all". In turn, small European states view London as the main advocate of free trade and neo-liberal industrial relations, giving them the market access needed for economic prosperity. Also, the UK has been one of the key

contributors to the EU budget, which has helped to underpin the success of enlargement. In 2015, the UK was the third largest net contributor to the EU budget. Further, small European states see the UK as a vital part of the security and defence mechanism of the EU. Thus, Brexit poses a serious challenge for small European states both inside and outside of the Union.

Second, what has been the role of Brexit in influencing national politics in small European states? Interestingly, according to research conducted by Paul Taggart and Aleks Szczerbiak Brexit has had a limited impact on national politics across EU member states, especially in comparison to the Eurozone crisis and the migration crisis. As the authors argue in regard to the Netherlands, 'although the [Freedom] party originally lauded the UK's 'independence day', Brexit barely featured as one of the themes in [its] March 2017 parliamentary election campaign when, although it slightly increased its share of the vote and remained the main opposition grouping, the party performed below expectations'.³ However, Brexit has certainly influenced the debate, for example in Austria, Denmark, and Greece, where Euroscepticism has been redefined to pose a more pressing challenge to the EU. Notwithstanding in other small member- states, chiefly Ireland, Brexit has dramatically reduced party-based Euro-scepticism. As Taggart and Szczerbiak argue, there were several factors relating to Brexit that tempered their Euroscepticism: 'the economic uncertainty that it was felt to generate; the new opportunities it presented for Irish "reunification" and for Ireland to act as a bridge between the UK and EU; and the fact that British Hard Euroscepticism came to be associated closely with English nationalism. Finally, the UK's withdrawal from the EU will make it much harder for pro-Europeans to sell membership to the already Eurosceptical publics in Norway, Switzerland and Iceland. So Brexit has firmly frozen Iceland's EU accession negotiations, which have been on hold since 2013.

Third, is the likelihood that Brexit will change the EU's balance of power in the long-term, to the detriment of smaller member-states. One can argue that Germany and France have used Brexit to reconfirm their strong alliance, particularly since Emmanuel Macron won the French presidency. Brexit leaves small states in Europe with an increasing risk of a Franco-German 'cooperative hegemony' with Germany as the main leader; although

in the near-term the relative weakness of the coalition government in Germany should temper this development. Despite the UK rarely being a constructive player in the European integration process, it has played an important role in counter-balancing the power of Germany and France. The ability of small EU member-states to have a say on the joint decision-making of the Franco-German axis will depend on the strength of EU institutions in continuing to balance the interests of all members, and the collaborative working of small states to influence decisions taken within them.

Fourth, there are several small-state clusters in Europe which will certainly be affected by Brexit:

- A. The small states in the Northern economically liberal cluster comprising Sweden, Denmark, Finland, the Netherlands, and the Baltic states have most to lose from Brexit. Germany and the UK have been the most powerful members of the 'economically liberal' cluster and with the UK's departure the sway of the cluster will certainly decline. In contrast, the Southern protectionist cluster including Greece, Portugal, and Cyprus along with France, Italy, and Spain is likely to be strengthened as a consequence of Brexit. At present, both clusters have a blocking minority in the Council of Ministers, but the UK's withdrawal from the EU will mean that the Northern liberal cluster will lose that power. Historically, Sweden, Denmark, and the Netherlands are the main allies of the UK when votes are cast.
- B. Brexit will possibly affect the Atlanticist cluster of small EU members such as Denmark, the Netherlands, and the Baltic states, which stand to lose their most important ally in the EU in regard to transatlantic relations and national security. On the other hand, small states in favour of strengthening the EU's security and defence policy, such as Finland and Sweden, may gain. Indeed, due to having an unreliable partner in the White House and increasing tensions with Russia, the UK even with Brexit on the horizon might work more effectively with the EU. The collective opposition to Russia in the aftermath of the poisoning of Sergei Skripal and his daughter in the UK is a recent example. Further, high profile voices have talked quite openly of the UK 'leaning to Europe', 5 and Malcolm Chalmers of the Royal United

Services Institute wrote recently that on most of the issues facing Europe, 'the UK is now closer to its main European allies than it is to the US'. So perhaps Brexit will have less of an impact on small European states than the broader geo-political climate.

C. The cluster involving the EFTA states - Norway, Switzerland, Iceland, and Liechtenstein – face the same general challenges from Brexit as the small EU member states. Thus, Brexit is the 'highest priority' in the Icelandic Ministry for Foreign Affairs, which has identified a number of issues of concern, such as the removal of landing rights for Icelandic airlines in the UK. Perhaps in part because of these concerns, Iceland has also suggested that the UK should apply for EFTA membership. Iceland's Foreign Minister, Guðlaugur Þór Þórðarson, has talked about the boost EFTA might receive if existing members could 'piggy-back' on the new global trade agreements the UK has talked about signing. In addition, trade relations between the UK and EFTA members would improve, as currently Iceland and Norway still pay tariffs on some of their marine exports to other European Economic Area (EEA) states. On the other hand, the governments in Norway and Switzerland have been cautious about the possibility of the UK joining EFTA. They fear that the UK might take over their leadership role in the organization and that the current tensions between the UK and the EU might damage the good relationship between EFTA and the EU.

Fifth, the UK's exit from the EU is likely to change the geopolitics and geo-economics of the North Atlantic, the UK's immediate regional setting. Brexit will add to the list of states (Norway, Iceland, Canada, and the United States) and territories (Greenland and the Faroe Islands) in the region that are not part of the EU. This creates uncertainty as to the role the UK will want for itself, for example in relation to the opening of the Arctic Ocean. Further, in the wake of the initial Brexit negotiations, the UK has decided to withdraw from the London Fisheries Convention of 1964, which allows countries to fish near each other's coasts. The Icelandic government has raised concerns over having yet another state/actor taking part in negotiations over common fish stocks in the North Atlantic, making the negotiations even more complex than they presently are. Moreover Norway and Denmark have raised concerns about the future of their fishing rights. Also,

Brexit means that the UK will get a seat at the negotiating table concerning policy sectors such as environmental protection and sailing and shipping in the North Atlantic.

So it is clear that Brexit is, and will continue to be, a major challenge for small European states, both inside and outside of the EU. The balance of power and balance of interests in the EU may alter in areas such as economic policy-making, trade and fisheries, but in others — such as security and defence — the broader geo-political context may well mitigate some of the expected changes. For those small European states and territories outside of the EU the presence of a more independent actor offers both risks and opportunities.

Brexit and the small states of the Commonwealth

In the build up to the referendum on whether the UK should remain in or leave the EU, much was made by the 'Brexiters', including Boris Johnson, David Davis, and Daniel Hannan, of the strong links to the Commonwealth and the potential future development of relations. As Peg Murray-Evans has argued, the Commonwealth 'was cited as the basis for an ambitious agenda for a series of new British trade agreements following a vote to leave the EU', and that by joining the EEC the UK 'betrayed our relationships with the Commonwealth'. So what potential is there for the UK to deepen its links with the Commonwealth, of which 30 of its members are considered to be small states?

Trade is a potentially significant aspect of any deepening of relations. However, overall trade between the UK and the small states of the Commonwealth is limited. In 2015 it was only 6.5% of total UK–Commonwealth trade, and the trade balance continues to favour the UK. Botswana (54.4% of its total exports) is the largest exporter to the UK selling mainly beef and diamonds. Other major exporters are Belize (22.0%), Seychelles (21.0%), Mauritius (13.4%) and St Lucia (10.8%). It has to be noted that there are other small countries whose trade share is insignificant, but for whom the UK is an important market. So despite the relatively limited trade the UK has with the small countries of the Commonwealth – and indeed the Commonwealth more generally⁸ – the UK remains an important trading partner. However, it is unlikely that the UK will become a much more significant trading partner in the future. Indeed, as the UK prioritises comprehensive trade

deals with the EU, US, and larger Commonwealth countries such as Canada and Australia, negotiations might crowd out the interests and concerns of the smaller Commonwealth states. And this would be particularly damaging as the UK's present trading relations with the African, Caribbean and Pacific (ACP) countries are tied in with the EU. Indeed, once Brexit happens the UK will not have any formally agreed trade relations with these countries. Further, from the perspective of the small states of the Commonwealth, they will lose a useful intermediary with the EU, in the form of the UK. The EU will then have a much stronger francophone and Lusophone edge, which may well impact negatively on broader EU-ACP relations.

Remittances is a further issue of interest. The UK is a significant source of remittances globally, including to a number of Commonwealth countries and remittances therefore represent one of the most significant economic linkages between the UK and the Commonwealth. Among the top ten Commonwealth remittance recipients are four small states (Cyprus, Mauritius, Malta, and Barbados) and two Least Developed Countries (LDCs) (Uganda and Zambia). Notwithstanding, the literature and historical flows suggest that remittances are resilient and remittances are not that sensitive to economic cycles. This then suggests that remittances are driven by altruistic rather than economic motives. However, in the worst-case scenario, Brexit could result in tighter immigration controls which could then cause a reduction in remittances and possibly a permanently lower £/US\$ exchange rate, further exacerbating the reduction.

A third issue is Official Development Assistance (ODA). Small states receive a small amount of ODA directly from the UK, amounting to US\$24 million in 2014. Although this still made the UK the fourth largest bilateral donor following the US, Japan and Germany. But, ODA to these countries through the UK's contribution to the EU, and other multilateral institutions, is substantial. For instance, it is estimated that £1.4 billion is allocated each year to small developing states bilaterally and multilaterally, including via the EU. The question then arises after Brexit, will the UK continue to contribute this significant amount of aid? The UK, along with the majority of advanced countries, has committed to contributing 0.7% of its gross national income (GNI) as ODA. The UK is one of six countries to have met this target; in 2015 this commitment was enshrined into

UK law, and the Conservative government and Labour opposition remain obligated to the 0.7% figure. However, there are downside risks reflected in the UK's relatively poor growth forecasts that raise questions about its ability to meet such commitments. These concerns are worsened by the future loss of UK contributions to the EU and uncertainty around the economic impact of Brexit.

A final issue is debt. Small states are the most highly indebted in the Commonwealth, led by those in the Caribbean. The debt situation in the Caribbean is acute, with some debt to GDP ratios close to, or above, 100%. It also coincides with a trajectory of relatively low growth, and these countries cannot afford large and unexpected shocks. The appreciation of indebted countries' currencies against the UK pound is not likely to bring material gains because the majority of Caribbean countries have pegged their currencies to the US dollar. Further, World Bank Development Indicators show that in the Commonwealth, only 0.15% of external long-term public and publicly guaranteed debt is contracted in UK pounds. Thus, the prospects for exchange rate-induced debt relief are minimal.

So for the small states of the Commonwealth the link with the UK, within the context of the EU, is important both in relation to trade and aid. Therefore, it is unlikely that they will gain significant benefit from Brexit, but there are clear risks if the UK moves too far away from its current approach and does not put in place a new trade agreement with ACP countries and fails to maintain its overall level of development assistance.

Brexit and the Caribbean

In order to illustrate further the possible impact of Brexit on small states, let us consider the countries of the Caribbean in a little more detail. The most obvious changes, as intimated above, will be in relation to trade in goods and services. For the countries of the Commonwealth Caribbean plus the Dominican Republic (CARIFORUM), their relationship with the EU via the Cotonou Agreement, will be maintained, but their association with the UK will change, and this is important because the UK is at present the largest market for these countries. Even for the Dominican Republic, which has had

more distant relations, the UK is the largest market for its organic bananas. The only Caribbean country that will be unaffected by Brexit is Cuba.

The EU is CARIFORUM's second largest trading partner, after the US. In 2015, CARIFORUM countries exported about US\$3.1 billion of goods to the EU, including goods worth US\$718 million that went to the UK (about 23%). Once the UK leaves the EU, unless other arrangements are made, it will impose most favoured nation (MFN) rates, leading to significant tariff increases on Caribbean goods. The countries most affected would be Guyana, Belize, Dominican Republic, Barbados, and St Lucia. For example, without Economic Partnership Agreement (EPA)-equivalent preferential treatment, banana producers in the Dominican Republic, Belize, and the Windward Islands, would face greater competition in the UK market from cheaper Latin America suppliers. For services, and most Caribbean countries have services exports, the picture is less clear, as there are many question marks over the measuring of trade in services. But estimates suggest that Barbados and Jamaica are most vulnerable to changes in the UK market. One area of concern is tourism. As Razzaque and Vickers note: 10

The Brexit shock will, in the short to medium-term, have an impact on Caribbean tourism. The weaker pound, potentially lower UK economic performance and greater caution around consumer spending will make the Caribbean's tourism sector less competitive. Given that UK travellers are reported to spend seven times more than the average tourist in the Caribbean, the magnitude of this shock may be significant for certain countries.

Future development cooperation is another important concern. A key consideration is whether, when the UK leaves the EU, it will honour its commitments to 2020 when the current European Development Fund (EDF) expires? Under Cotonou, and within the EU, the UK is generally viewed as a useful intermediary on trade and development questions, and many Caribbean countries view having the UK outside of the EU as detrimental to their broader interests. They also wonder whether the UK's voice on global development questions will be as influential once it is outside the EU.

As far as the Caribbean is concerned, the UK increased its grant funding in 2015, including a £300 million infrastructure programme, ¹¹ and there is a considerable amount of cooperation on issues such as criminal justice reform, strengthening healthcare, disaster safety, and constitutional improvements, and this is likely to continue. Initial discussions have also begun over future trade relations, and whether the present EPA that CARIFORUM has with the EU, can be replicated for the UK once Brexit has happened. There is also a hope that the significant Caribbean diaspora in the UK (between 800,000 and one million people) can be more effectively used to help deepen ties and influence the UK's agenda towards the Caribbean in the future. Certain countries, such as Jamaica, have begun to take a greater and more strategic interest in its diaspora within the UK. However, the recent scandal over the Windrush generation and the threats against them, even though they are British citizens, have strained relations, but ultimately it may have the effect of further empowering the Caribbean diaspora in the UK.

One final point in this section is the extent to which Brexit might impact on the Caribbean's own regional integration movement, which has been moribund for some time. Brexit might be catalytic for Caribbean regionalism in three ways. First, it has provided an additional stimulus for thinking about CARICOM integration, and Jamaica commissioned a new review on this in response, led by former Prime Minister Bruce Golding. The report, made public in February 2018, talks about the region's historic failure to modernise, to act on its decisions, and the steps that are needed to create a CARICOM that is fit for purpose. It also criticises CARICOM's lack of accountability, poor engagement with the private sector and civil society, and its cost. Golding suggests that if key changes are not made then Jamaica 'should withdraw from the CSME [Caribbean Single Market and Economy], but seek to remain a member of Caricom'. 12 Second, it has given Caribbean countries a new imperative to include the non-independent territories and give them a greater voice in regional bodies; something that the territories themselves welcome as they wrestle with the uncertainties of Brexit. Third, Brexit has mobilised the Caribbean to have greater diplomatic engagement within organisations like the Community of Latin American and Caribbean States (CELAC) and other structures of Latin American integration, as the EU is propelling its own engagement in the hemisphere through intra-regionalism.

Brexit and the UK's overseas territories

The final section considers Brexit's likely impact on the UK's own overseas territories (UKOTs) and how the ongoing negotiations between the territories and the UK are proceeding. During the campaign leading up to the referendum on Brexit, the territories, perhaps unsurprisingly, did not receive much attention. Nevertheless, they have serious concerns that Brexit will damage their interests in several ways.

- 1. Access to the single market: The trading relationship that several UKOTs have with the EU is very important. For the Falkland Islands, sales of fish, meat and other agricultural products are valued at £180 million per year, making the EU, and more particularly Spain and Italy the largest market for Falklands' products. In addition, the ability of several OTs (e.g. Gibraltar and Bermuda) to 'passport' their financial services to the rest of the EU is beneficial.¹³
- 2. Free movement: The freedom to travel, work, and reside in the EU is an important benefit for the UKOTs, most of whose residents are UK citizens. The opportunity for students to travel to the EU to study is also noteworthy. Also, 40% of Gibraltar's entire workforce cross daily from Spain, while the vast majority of tourists arrive through the frontier. A 'harder' border would thus have a damaging impact on Gibraltar's economy. Similar concerns are shared by Anguilla, whose economy is heavily dependent on neighbouring French and Dutch islands.¹⁴
- 3. EU funding: Total EU bilateral funding for the UKOTs (excluding Gibraltar) via the 11th EDF, 2014–20, is €76.8 million. Regional funding is worth another €100 million. Funds are focused on economic diversification, Small and Medium Enterprises, climate change mitigation, and sustainable energy. These funds provide important support for the UKOTs, and particularly for some that are not in receipt of UK development assistance, for instance British Virgin Islands and Cayman Islands. Also, EU financial aid is helping to secure the economic viability of Anguilla (36% of its budget comes from the EDF) and Pitcairn, which also struggles to cover its budgetary expenditure, and to mitigate the impacts of remoteness for territories such as Tristan

da Cunha. Gibraltar also receives funding from the EU. It is estimated that almost €60 million has been disbursed since 1990.

4. Political dialogue: UKOTs gain from institutional links with the EU. The main link is with the European Commission, and from this link there are various associated groupings to facilitate cooperation, such as the Overseas Countries and Territories (OCT)—EU Forum and the Overseas Countries and Territories Association (OCTA). Since 2004 Gibraltar has taken part in elections to the European Parliament. These political links have been important in allowing the territories' opinions to be aired. For example, important discussions are held about financial services and tax issues and initiatives before they are implemented. The UKOTs fear that without such a platform after Brexit, they will become much more vulnerable to EU action against 'tax havens', including possible 'blacklisting'.

So it is clear that the UKOTs have potentially much to lose, and thus great importance has been given to staying closely engaged with the UK government as the Brexit talks unfold. Greatest focus has been placed on Gibraltar, with a report produced by the House of Commons Foreign Affairs Committee; ¹⁵ a suggestion from the EU that any final deal with the UK will only include Gibraltar if both the UK and Spain agrees, and a subsequent demand that the UK must come to a bilateral agreement with Spain over the future of Gibraltar if the disputed territory is to stay in the single market and customs union until 31 December 2020. For the remaining UKOTs, which unlike Gibraltar are not part of the EU, talks with the UK have focused on three crucial areas: development funding, trade, and freedom of movement.

First, development funding. The UK has agreed to meet all commitments under the 11th EDF provided the projects had been approved by November 2017. Beyond 2020 there is no decision about funding. The preferred options for the OTs are for the UK to remain in the EDF or a new funding mechanism to be established that is not tied to Department for International Development funding, thus allowing all OTs to benefit. The OTs are also asking for a similar level of assistance that is provided presently by the EU. Second, trade. It is clear that little progress is possible until the UK's future trading relationship with the EU is better defined, but the OTs are pushing to be given the opportunity of being part of

any new and/or transitional trade arrangements, and that the terms contained within the existing Overseas Association Decision (OAD) should be replicated as far as possible. ¹⁶ This would also help to maintain trade that takes place between the UK, French and Dutch territories in the Caribbean and Pacific. The OTs have also asked the UK to offer them the chance to join free trade agreements with third countries once Brexit is completed. Third, freedom of movement. Again, there has been little headway on the issue; the position of British passport holders in the OTs and British Overseas Territory Citizens will be known only after substantive talks have taken place between the UK and EU.

So in short, almost two years after the Brexit vote, the UK has still little to offer their territories, and significant uncertainty remains. Apart from the commitment by the UK to cover the funding of projects to 2020 little else is known. And it is clear that as the negotiations between the UK and the EU enter their final stages, the interests of the OTs will be a marginal concern. Already the UK is saying that the territories should not be a liability for them during the negotiations, particularly in relation to their financial services industries, while the EU is ratcheting up the pressure on those same industries. Even if the final outcome of the Brexit deal for the territories is detrimental, it is unlikely the issue of independence will be considered, possibly with the exception of Bermuda. Nevertheless, the territories realise they must be more pro-active in mitigating potential new vulnerabilities. So those in the Caribbean, for example, are exploring how their links with groups such as CARICOM; Organisation of Eastern Caribbean States (OECS), and CARIFORUM can be enhanced, which in turn could strengthen their own ties with the EU. Observer status of the ACP group is also being examined.

Conclusion

What has certainly been true in the aftermath of the UK's vote to leave the EU, is that the full complexity and magnitude of the decision is only now being recognised. For many this a bitter irony as the vote was taken in a context of simple platitudes and scare stories (often on both sides of the debate). But now the full consequences are starting to become clear, and this article highlights just a few of them. From the insights of several key academic and policy-makers it is apparent that small countries and territories will need to

recalibrate their relations with the UK, but also with the EU. There are some opportunities, but the risks and uncertainties certainly seem to predominate. Therefore it is incumbent on them, including the UK's own territories, to plan as quickly as possible for the changes that will result. Of course, if a 'deep and special relationship' between the UK and the EU is agreed, then the broader impacts will be reduced, but for now long-standing partners of the UK cannot depend on that outcome being achieved.

Notes

- Baldur Thorhallsson, Professor of Political Science, Centre for Small State Studies, University of Iceland, and Leverhulme Visiting Professor at QMUL; Paul Hardy, Brexit Director, DLA Piper; Motselisi Matsela, Economic Adviser, Small States, Economic Policy Division, Commonwealth Secretariat; Jessica Byron, Professor of Political Science and Director of the Institute of International Relations, University of the West Indies, Trinidad; Caroline Morris, Senior Lecturer in Public Law, Queen Mary University of London; Jack Corbett, Associate Professor in Politics, University of Southampton.
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