depending on the choices made by the United Kingdom.

Overall, a no-deal Brexit would be disruptive in the short-term:

- ere would be immediate very signi cant administrative and logistical challen trade. Preparations to reduce those disruptions are underway but are unlikely to cient. But while Most-Favoured Nation tari s will a ect some sectors signi can macroeconomic e ect on the German economy might not be huge.
- If the UK fails to honour its nancial commitments to the EU, about €16.5 billior be missing for the remainder of the current EU budgetary period. e gap could thanks to the existing 'own resources' ceiling. e overall missing 'Brexit bill' wo amount to about €45-50 billion.
- Not honouring nancial commitments would be considered by the EU as akin to and would likely lead to an uncooperative no-deal Brexit. It would be more disruthan a cooperative no-deal Brexit, in which the EU and the UK cooperate on a mpressing emergency les.
- e European Commission has issued a number of draft regulations to mitigate of a no-deal Brexumber of u(d19(g i.9 (e mor)15 a no-deBT0.2 1 0.69 0.13 k/GS0

in some sectors.

The a no-deal Brexit in the medium to long term are di cult to assess deal Brexit would lead to deterioration in long-term political relationships, which we make a new trade arrangement and other cooperation in the future less likely.

is the situation in Ireland, which is also the most contentiou

Guntram Wolff (guntram.wol @bruegel. org) is Director of Bruegel

This Policy Contribution is a version of a note prepared for a hearing on Brexit of the Bundestag EU Committee, 14 January 2019. Without implicating, I would like to thank Zsolt Darvas, Maria Demertzis, Francesco Papadia, Jean Pisani-Ferry, André Sapir, Nicolas Véron and omas Wieser for ideas and comments. Antoine Mathieu Collin provided excellent research assistance. e United Kingdom submitted on 29 March 2017 the noti cation of its intention to withdraw from the European Union based on Article 50 of the EU Treaty. As a default, the United Kingdom will therefore become a third country on 30 March 2019 and cease to be a member of the EU.

I see four possible scenarios:

- 1. e UK exits based on the negotiated withdrawal agreement. is scenario is not further discussed in this Policy Contribution.
- 2. e UK leaves the EU without any agreement. is so-called no-deal Brexit is the core of this Policy Contribution (as per the Bundestag EU Committee's request).
- 3. e UK asks for an extension of the two-year Article 50 period, thus remaining a member of the EU until the end of the extension period. Such an extension would require the consent of the EU. Moreover, if the extension exceeds a few months, the UK would have to participate in the 2019 European Parliament elections.
- 4. e UK could decide to unilaterally revoke its Article 50 noti cation. e Court of Justice of the EU¹ has con rmed that this can be done without requiring the consent of the EU. It would mean that the UK would remain a full member of the EU under the current terms.

It is impossible to say at the time of writing which of these four scenarios is the most likely. But it is important to highlight that the current UK political situation is very volatile. I would therefore attach A no-deal Brexit could take various forms. In one scenario, there will be a complete breakdown of all EU-UK cooperation. At some level, the EU has an interest in playing it very tough in a scenario in which the UK parliament decides not to ratify the agreement that was negotiated by its elected government with the EU. Such an act would certainly be seen as very unfriendly by the EU. e EU would therefore be reluctant to agree with the UK on 'emergency' measures. So a non-cooperative no-deal Brexit is quite possible. In another, perhaps more reasonable, scenario, the EU and the UK would still cooperate on some minimal issues. is is my baseline assumption for this section, but I stress that it would require the UK to honour its nancial commitments to the EU.

One of the politically immediately important questions will be the EU budget. If the UK leaves without honouring its nancial commitments to the EU, the EU would politically be tempted to treat the UK as a defaulting counterparty. is has major political implications and could mean that the EU will not be ready to negotiate a meaningful relationship with the UK for some time.

In terms of the budget impact, the Brexit bill is estimated to be about €45-50 billion. For the currently ongoing Multiannual Financial Framework (MFF), the April 2019-December 2020 gap in EU budget is estimated to be €16.5 billion in total, or 0.064 percent of EU27 GNI under a set of assumptions². is amount will have to be transferred by member states to the EU budget, while an o setting factor is the nationally-retained 20 percent of extra custom duty revenues from imports from the UK. No new legislation is needed to cover this gap, because in the current MFF's overall own resources ceiling is 1.22 percent of GNI (ie the maximum amount of own resources which the EU may raise during a year), while the payment ceiling is 0.96 percent of GNI. e di erence between the overall own resources ceiling and payment/commitment ceilings "provide room for manoeuvre in case of unforeseen needs and emergencies"³. To our knowledge, this relatively large (about 0.26 percent of GNI) margin has never been used. e €16.5 billion April 2019-December 2020 gap would have to be distributed among the member states according to their GNIs. Germany's contribution for this period could increase by about €4.2 billion, while the extra customs duty revenue would offset about €0.2 billion, making the net cost €4.1 billion (after rounding).

Given that the size of the Brexit bill is small compared to the UK budget (for example, in 2020 it is 1 percent), but large compared to the EU budget (6.5 percent in 2020), the EU would justi ably consider the non-honouring of the UK's nancial commitments as a hostile act. I would recommend to the EU and the Bundestag to refuse making concessions on emergency measures in the absence of a substantial financial contribution from the UK.

(т (t, et al (http://ec.europa.eu/budget/m /ceilings/index_en.cfm.

Policy Contribution |

.1

· · · · ·

A no-deal Brexit has major implications for the trading relationship. Figure 1 summarises the current trading relationship between the UK and Germany and the rest of the EU (excluding Germany)⁴. e EU exports a total £341 billion to the UK of which £259 billion is goods and £81 billion is services. e German share of that is signi cant: exports of £69 billion of goods and £9 billion of services. is trade will be a ected by Brexit in any case. But in a no-deal scenario, there is no transition, which means that customs and regulatory controls will need to be applied immediately. Moreover, in a no-deal scenario, there is no agreement in how the trading relationship could potentially evolve – much in contrast to the deal scenario, where a political declaration sets out ambitious goals for a trading relationship. e EU27 remains the most important trading partner for the UK.



1

ſ

Source: Bruegel based on 0 ce for National Statistics, Pink Book 2018 (2017 data).



Source: Bruegel based on Eurostat, ComExt statistics. Note: data is end-2015.

The top five sectors exporting from Germany to the UK are road vehicles, medical and pharmaceutical products, petrochemicals, electrical machinery and other transport equipment (Figure 2).

In a no-deal Brexit, the United Kingdom will become a third country and the applicable tariffs will be WIO most-favoured nation (MFN) tariffs. e UK has already notied the WTO that it will apply the EU's MFN taries once it leaves the EU and there is no disagreement on that at the WTO. Table 1 gives an overview of the taries that would be applied to British exports, for the top ve trade sectors that concern Germany. This data suggests a rather modest effect on overall German exports, but the effects would be relevant in specific sectors such as the car industry.

~	1		.	-	a an	* *	⊷ , ,	<u>~</u>
	t			4	t 1 (t ton a second	e e e e e t	Ι ⊠(, ,
								-

it is worthwhile noting that the EU has not been able to implement the same rule relative to the United States, which requires visas from some EU citizens but not from others. Rights of residence and the right of non-EU nationals to work are currently decided by EU member states. In our view, EU member states would be well advised to cooperate and de ne a uni ed position relative to the UK to help ensure a similar status for all EU citizens wanting to work and live in the UK. It would also be important, in our view, to distinguish between citizens already resident and those wanting to migrate. e status quo of residents should not be altered on either side in case of a no-deal Brexit. An important interest for Germany and the EU more generally is therefore that the accumulated rights of their citizens in the UK should continue to be honoured, and that the EU and the UK should agree in a nodeal Brexit scenario to ensure cooperation in areas including social security rights and pension transferability.

• • • •

On financial services, we consider that the most important contingency plans have been made. From conversations with major nancial institutions across Europe, I can con-

A no-deal Brexit would be bad news for the EU as well as for the UK in the short term, compared to signing the withdrawal agreement. In this Policy Contribution, I have not quanti ed how much worse a no-deal scenario would be compared to signing the current deal. However, I have highlighted that a no-deal would be particularly bad for Ireland, because it would lead to customs controls on the island in order to protect the integrity of the single market. Moreover, I have highlighted a number of immediate quite disruptive challenges for trade, for speci c sectors such as airlines and pharmaceuticals, and for people. withdrawal agreement is a rather complex text, documenting the extent to which economic, societal and political relationships are a ected by Brexit. Leaving all these relationships with-

out any agreement is likely to cause signi cant short-term turbulence.

e

The longer-term trade and more general implications are difficult to assess as they require making assumptions about the future EU-UK relationship. As such, that longerterm relationship is less certain than it would be under the draft agreement with its annexed political declaration on the future relationship.

It is important to be prepared to reduce and mitigate the impact of a no deal Brexit, also taking into account the highly uncertain political situation in the UK. e EU institutions, EU member states, business and citizens all have a role to play. But no preparation can satisfactorily solve the problem that Ireland would be confronted with.

One important question for the EU is whether it would be ready to modify the terms of the political declaration or even the withdrawal agreement to make its ratification more likely. So far, the EU has stated strongly it will be impossible to alter the deal that was agreed between the UK government and the European Commission negotiators (Juncker, 2018). From a strategic point of view, this is the communication that one would expect. In fact, one can think of the strategic situation in terms of a game-theory setting, a so-called chicken game. In a chicken game (Maynard-Smith and Price, 1973; Rapaport and Chammah,

UK's readiness to honour its financial commitments. Some les do not require cooperation under a no-deal Brexit. But it would be naïve to assume that non-cooperation would be cost free. Non-cooperation would signi cantly aggravate the costs of no-Brexit for both sides, but the costs would be particularly high in the UK. I have argued that the EU is right to take a strong stance on money. Under a more reasonable scenario, I would expect cooperation on a number of key files such as visa rights, frictions on the Irish border and customs cooperation. Member states, parliamentarians and EU institutions should be ready for no-deal emergency agreements, especially when it comes to areas in which human lives might be at stake, such as health cooperation or nuclear cooperation. Also in nancial services, cooperation is highly advisable as a no-cooperation no-deal Brexit could increase nancial stability risks. No matter what the UK's position is, the EU should aim to prevent the worst outcomes when it comes to human lives and nancial stability.

The overall strategic direction I would advise the EU to take is to increase the cost of a no-deal Brexit as much as possible (while respecting ethical limits), while showing more flexibility on the political declaration and possibly the withdrawal deal itself. e EU and the UK have a long-term interest in being close partners. Departure of the UK without any deal would be a very bad signal to the world about the ability of the UK in particular and also of the EU to cooperate with strategic partners. It would be highly damaging in terms of the UK-EU (political) relationship. Highlighting this political cost of a no-deal Brexit should help convince the UK parliament to sign a deal. Nevertheless, all players should quietly make preparations at a technical level to prepare for no-deal.

The next six months could very well prove politically turbulent, with significant brinkmanship. It is of the upmost importance that the EU remains united. It is also important that the EU does not lose sight of its long termstrategic interests.

Darvas, Z. (2019) 'EU budget implications of a no-deal Brexit',	10.	, <i>i</i> , forthcoming
---	-----	--------------------------

- Darvas, Z., K. Efstathiou and I. Goncalves Raposo (2017) 'Divorce settlement or leaving the club? A breakdown of the Brexit bill', and the set of the Brexit bill', and the set of the set
- European Commission (2018) 'Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan', Communication COM(2018) 880 nal

German Council of Economic Experts (2018)	1	 ,
Sachverständigenrat	, •	

Juncker, J.C. (2018) 'Discours par le Président Juncker en plénière du Parlement européen à l'occasion du débat sur les préparations du Conseil européen des 13-14 décembre 2018,' speech to the European Parliament, 11 December

Maynard-Smith, J. and G.R. Price (1973) '	e Logic of Animal Con ict,	<i>t</i> ■ 246 (5427): 15-18

Ward, M. (2018) 'Statistics on UK-EU trade', CBP-7851, House of Commons Library, available at <u>https://researchbrie_ngs.parliament.uk/ResearchBrie_ng/Summary/CBP-7851</u>