

Despite tensions stoked by the position of Gibraltar, the UK and Spain have long enjoyed a close and mutually beneficial relationship. According to **Luis Garicano**, Brexit puts much of this at risk: with Spain unlikely to budge on freedom of movement and Gibraltar as a negotiating card, the UK is likely to find itself with a very bad deal.

Spain's response to Brexit

Brexit was a bombshell in Spain, its impact surpassing that of the country's general election, which was held three days after the UK referendum on membership of the European Union (EU). Spaniards were stunned and worried about both the political and economic implications. Indeed, according to a Bertelsmann study of public opinion in large European countries (De Vries and Hoffman, 2016), Spain was the country most opposed to the idea of Brexit: nearly two thirds of Spaniards said they were against it.

Unlike in some other EU countries, concerns in Spain do not extend to a potential contagion into national politics. Among the mainstream political parties, only Podemos has flirted with 'Euro-scepticism': it once advocated leaving the euro, as the Communist Party, one of its allies, still does.

In fact, Spaniards have historically been among the strongest supporters of the European integration project (as well as being among its main beneficiaries). As of 2016, three quarters of Spaniards would

vote 'Remain' if a similar referendum were held in Spain (De Vries and Hoffman, 2016). But Spain is worried about the future, and there is general concern about what Brexit may mean for Spain and for Europe. There are several reasons for this.

First, the relationship between Spain and the UK is a picture perfect illustration of the economic and political benefits that the EU, and the Single Market, can bring about: large flows of people in both directions, as retired Britons seek out Spain's quality of life and Spanish youth seek jobs and education in the UK; a peaceful and workable non-solution to the Gibraltar question, one of the most intractable territorial disputes left in Europe; large flows of goods and services trade in both directions; and very large foreign direct investment (FDI) by companies from each country to the other.

Untangling this web, as a 'hard Brexit' would require, would be very costly to companies and workers all over Spain (and, of course, in the UK). This economic cost is a particular concern given that Spain is just

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coming out of a brutal economic crisis and levels of unemployment are over 20%.

More broadly, Spain wants a strong Europe. All political parties in the Spanish parliament are in favour of strengthening the Union, including deepening the Eurozone towards a fiscal union, common border and security policy, immigration policy and so on. Spaniards worry that Brexit may begin the unravelling of a European project that has been a crucial pillar of Spain's return to democracy and prosperity.

Finally, Spaniards' worry also has a more local angle, as the referendum has potential – albeit unclear – implications for the regional dispute in Catalonia. A growing minority of Catalans have been agitating for independence. The way Europe deals with a potentially independent

Scotland's likely accession request in the aftermath of Brexit is being closely followed in Spain, even though all parties acknowledge the crucial differences between the constitutional and legal status of Scotland and Catalonia.

In spite of these worries, some in Spain see opportunities in Brexit. Most notably, the Spanish government sees Gibraltar as a UK colony on Spanish soil. There is unconcealed glee in the Spanish conservative government about the broad support that remaining in the EU has commanded in Gibraltar. Many in government see a unique opportunity to solve an issue that has enormous symbolic value for many Spaniards. Spain will also fight to attract the financial services industry and manufacturing jobs that may abandon the UK post-Brexit.

A highly integrated market: the four freedoms in action

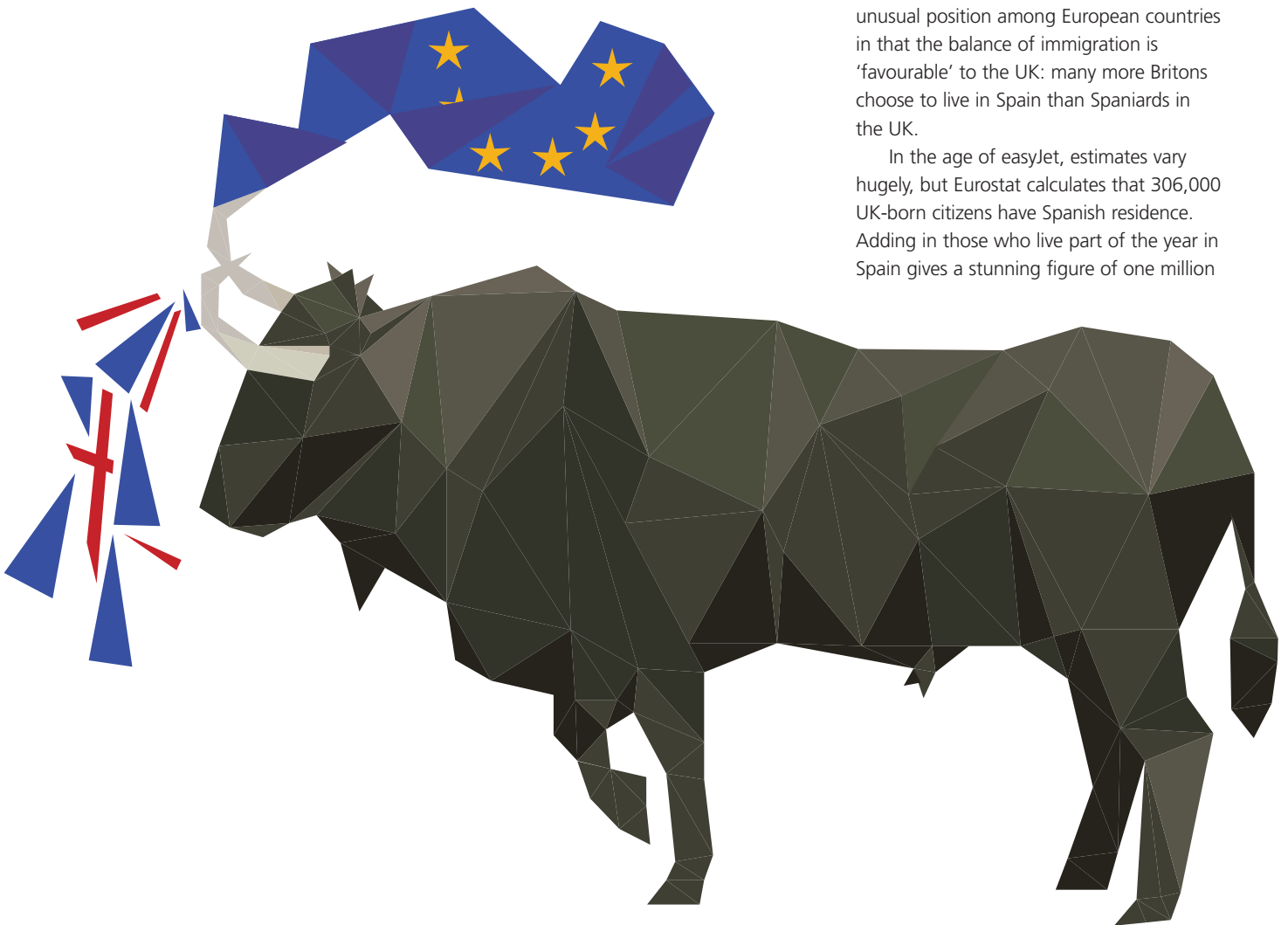
Spain is one of the clear success stories of the European integration project. The Spain-UK relationship in particular features a highly integrated market, with benefits from trade widely spread among the entire population. Spanish and UK citizens have taken advantage of the four freedoms that are basic to the Single Market: free movement of goods, services, people and capital.

Free movement of people has resulted in huge bilateral migration flows

Migration will be the crux of the negotiations, as it was a key driver of the Brexit vote and limiting freedom of movement within the EU is likely to be the one UK request that is most difficult for the EU to accept.

Yet the picture of bilateral flows between Spain and the UK could not be further from that painted by pro-Brexit politicians Nigel Farage, Michael Gove and Boris Johnson. In fact, Spain has quite an unusual position among European countries in that the balance of immigration is 'favourable' to the UK: many more Britons choose to live in Spain than Spaniards in the UK.

In the age of easyJet, estimates vary hugely, but Eurostat calculates that 306,000 UK-born citizens have Spanish residence. Adding in those who live part of the year in Spain gives a stunning figure of one million



full- and part-time residents, according to a study by the Institute for Public Policy Research (Finch, 2010).

On the other side, 79,814 Spanish-born residents were recorded in England and Wales in the last census in 2011. Official estimates by the Spanish Statistical Institute suggest that 102,498 Spaniards live throughout the UK, although again the true number is likely to be much larger.

The potential issues at stake that must be sorted out in negotiations for all of these citizens are many. From access to healthcare to housing and work permits to visa-free travel, Brexit may change it all. According to multiple press reports, it appears to be a source of anxiety and even anguish, particularly for less mobile UK pensioners resident in Spain.

There is a large downside for both Spain and the UK from any disruption to trade and investment flows between the two countries

The freedom to trade goods and services has resulted in large bilateral flows and a substantial trade surplus for Spain

The most recent data (released by the UK's Office for National Statistics in March 2016) show that Spain exported goods and services to the UK worth a total of £24 billion in 2014 and imported £14.8 billion worth. Thus, Spain had a bilateral trade surplus of £9.2 billion, well over 1% of Spanish GDP (depending on the volatile exchange rate). After Germany (which had a £25 billion surplus), this is in absolute terms the largest positive imbalance with the UK of any country in the EU, and the fourth largest worldwide after Germany, China and Norway.

This overall surplus is composed of a surplus in the trade of both goods and services. The UK is the fourth largest market for Spain's goods and services, accounting for 7% of the total. In goods trade, the UK is particularly important for exports of transport equipment (20%), machine tools, chemicals, metals, mining and vegetables.

The large services surplus is due mostly to tourism. The UK is the main buyer of Spain's tourism, with 15.8 million British tourists visiting Spain in 2015 and the UK accounting for more than a fifth of total tourism income (Greenwood, 2016).

Thus, it is difficult to overstate the risk that a hard Brexit would pose, through trade, for Spain's economy. No country is more vulnerable than Spain to the trade disruption, given the trade surplus (in GDP terms); and no country has a larger interest in the 'softest' of Brexits. There is a large downside for both countries from any disruption to all of these flows – and no conceivable upside – from the negotiations. All that remains to ask is how bad the damage will be.

Freedom of capital movement has resulted in enormous FDI flows

According to a recent report (Greenwood, 2016), the UK is the main destination for Spain's FDI, accounting for 14% of the total outflow. This outflow has been directed particularly towards finance, telecommunications and electricity.

Spain has the largest investment in the UK's financial services of all EU countries. It is second worldwide after the United States through two of the largest Spanish banks (Santander and Sabadell). Almost one out of every five pounds of foreign investment in the UK's banking sector is represented by these two Spanish banks (17%, according to Greenwood, 2016). Both banks have huge exposure to the UK through their affiliates, which accounted for around a quarter of the banks' assets and profits in the first quarter of 2015.

The flow in the opposite direction is also large. The UK is the fifth largest investor in Spain, focusing on telecoms and tobacco (Greenwood, 2016).

In sum, the relationship is a clear success for the UK-led project of a Single Market, and one that will be expensive for both parties to unravel. For the UK, the highest human and economic cost will be from unravelling freedom of movement (with significant potential losses to large contingents of British residents in Spain). For Spain, the main potential vulnerabilities are in trade and FDI flows.

For both, there is the possibility of enormous vulnerabilities deriving from potential financial and macroeconomic turbulence as the new steady state is reached. This has the potential to be a really nasty transition.

For the UK, the highest human and economic cost will be from unravelling freedom of movement

Spain's priorities

Spain has three priorities, which are not necessarily compatible.

1: **The politics: preserving the Union**

As one of the most pro-European countries, Spain is committed to preserving and deepening the Union. This indicates that Spain will support the European Parliament's involvement and the European Commission's leadership in the negotiations. It will avoid obvious bilateral discussions (quiet discussions, one imagines, must always be taking place), and push for an arrangement that falls neatly into existing categories – that is, the European Economic Area (EEA) or Switzerland – or if not, Canada.

Political considerations make it likely that Spain will militate strongly against intermediate soft solutions, such as that proposed by Pisani-Ferry et al (2016).

2: **The economics: preserving the tangled web of the four freedoms**

The economics point in quite a different direction. The relationship between Spain and the UK is a very tangled web indeed with large benefits for both parties, and, in trade of goods and services, particularly for Spain. To disentangle it would involve massive costs. A hard Brexit is emphatically not in the interests of either the UK or Spain.

The economics (unlike the politics) suggest that Spain would be likely to militate against any disruptive Brexit and look for middle-of-the-road solutions. But this pragmatism is unlikely to extend to all UK aspirations. In particular, Spain has a very recent memory of large outward migration flows (throughout the period of the dictatorship) that have recently been revived again with the crisis, and so it will be extremely difficult for the government to accept limitations on freedom of movement.

3: **Gibraltar: a potential make-or-break issue**

Gibraltar, a small peninsula with large strategic value, was lost by the Spanish after its capture in 1704, during the War of Spanish Succession, by an Anglo-Dutch fleet; it was ceded to Britain by the Treaty of Utrecht in 1713. After multiple wars and sieges, it has become a highly successful enclave within the EU with a high degree of self-government. The status of Gibraltar, officially a colony, is nevertheless contentious, as is the status of its airport, which was built on land that the Treaty of Utrecht set as neutral territory.

Management of this dispute has been greatly facilitated in the context of the EU. The border between Spain and Gibraltar was only reopened in 1985 – and since then, trade and people have flowed freely between the two territories. Gibraltar has become the second richest territory in the Union.

The previous Spanish minister of foreign affairs, José García-Maragallo, has stated clearly – and his position has been echoed by the Spanish permanent representative to the United Nations at a recent meeting on decolonisation – that after Brexit, a new understanding must be found, and that it must involve co-sovereignty of the UK and Spain over Gibraltar. In his words, 'they will have to choose between British outside the Union or Hispano-British inside the EU'. Only co-sovereignty will allow Gibraltar to have the treaties apply to it.

In the solution that the Spanish government is advocating, Gibraltar citizens would preserve access to the Single Market, obtain both nationalities and conserve a large degree of autonomy. Spain and the UK would be jointly in charge of defence, foreign affairs, border control and immigration. Crucially, the Spanish flag would fly on Gibraltar. (For a good description of the positions of Spain and Gibraltar on these issues, see Machado, 2016).

How much of an obstacle this issue – tiny in terms of welfare for the two countries, but with huge symbolic value – may pose in the negotiations remains to be seen, but it is sure to have considerable weight.

Spain is likely to demand that Single Market access continues to require commitment to the four freedoms

Gibraltar highlights the likely result of Brexit negotiations: the UK's 'death by a thousand cuts'



What can we expect Spain's negotiating position to be?

From the perspective of its commercial, investment and migratory interests, Spain could be willing to accept a soft Brexit – that is, a modified EEA with some governance mechanism for the participation of the UK in joint decision-making.

But Spain has been adopting a low profile in the international arena for many years now. The country's 'Europeanism' suggests that it is highly unlikely to deviate from the position taken by France and Germany. Thus, once Article 50 is invoked, it will demand that the Commission leads and the Parliament has a say in the negotiations. Spain is likely to be a disciplined soldier on the European side, and demand that access to the Single Market continues to require a commitment to all four freedoms, most notably to freedom of movement of people within the Union.

A potential stumbling block is Gibraltar. Everything we have heard from the Spanish government up till now suggests that it is

unlikely that any deal in which Gibraltar retains access in any form to the EU will be reached that does not involve joint (Spanish and British) sovereignty over the peninsula.

The Gibraltar issue highlights the likely result of the negotiation between the EU27 and the UK: the latter's 'death by a thousand cuts'. Every country involved in the bargaining has veto power and every one of them is likely to have a shopping list – some issue that is important enough to block progress. For the Poles, it may be freedom of movement; for the Irish, it may have to do with Northern Ireland. The ability of the UK government to resist these demands, with the clock ticking, simply does not seem to be there.

As a result, the UK is likely to find itself, at the end of these two years, with a very bad deal. By the time that each of 27 countries has finished putting together their own version of 'Yes, but what about Gibraltar?' objections, the pro-Brexit politicians will either have to start explaining to voters the distance between the fantasy they invented and the reality – or be prepared to back off from Brexit.

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This analysis was first published in the VoxEU ebook *What to do with the UK: EU Perspectives on Brexit* edited by Charles Wyplosz (<http://voxeu.org/content/what-do-uk-eu-perspectives-brexit>).

While Professor Garicano is in charge of economic, industrial and innovation policy for the Ciudadanos Party in Spain, the analysis presented here is undertaken in a personal capacity as an academic observer and LSE professor. He says: 'None of what is written here should be taken to be the position of the party or a recommendation of what it should do; it most emphatically is not.'

In the interest of full disclosure, Professor Garicano adds: 'I am a Spanish citizen, my kids live in Holland and my job is in London. Thus, my life will be directly affected by the negotiations that are the subject of this analysis, as will the lives of many other UK and European residents.'

Further reading

Catherine De Vries and Isabell Hoffman (2016) 'Keep Calm and Carry on: What Europeans Think about a Possible Brexit', *EUpinions*, BertelsmannStiftung.

Tim Finch (2010) *Global Brit: Making the Most of the British Diaspora*, Institute for Public Policy Research.

Nick Greenwood (2016) 'Referéndum de Reino Unido sobre la permanencia en la UE: consecuencias para las economías británica, de la UE y española', *Cuadernos de Información Económica*, Confederación Española de Cajas de Ahorro.

Andrés Machado (2016) 'Picardo repica a Maragallo: Ni en cuatro años ni en 4000 ondeara la bandera Española en Gibraltar', *El Mundo*, 6 October.

Jean Pisani-Ferry, Norbert Röttgen, André Sapir, Paul Tucker and Guntram Wolff (2016) *Europe after Brexit: A Proposal for Continental Partnership*, Bruegel.