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## Spain and the prospect of Brexit

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# Elcano Policy Paper

## Spain and the prospect of Brexit

### Summary

The decision of the British people to leave the EU has consequences not only for the UK but also for the remaining 27 EU member states, and more particularly for Spain. The ultimate scope of these consequences will greatly depend on the form that the withdrawal finally takes and how the new relationship between the two sides crystallises. Spain, like the other actors involved, has specific stances and problems; some of these have already been addressed and others will need to be addressed over the course of the negotiations. In the pages that follow the various features of this complex process are scrutinised, constantly bearing in mind the EU context led by the European Commission's chief negotiator, Michel Barnier, in whom Spain, like the other member states, has invested full powers to negotiate on its behalf. After explaining the rationale behind the timetable of negotiations there is an account of the principles underlying the divorce settlement that has been reached and its implications from a Spanish perspective. Next, the type of future relationship that is most in Spain's interest and the principal risks of the process to Spain's interests are examined, covering both economic and interpersonal aspects. This is followed by an exploration of the Gibraltar issue, with a proposal for a conceivable way of recasting the status of the Rock, taking advantage of the circumstances around Brexit. Lastly, possible cooperation in the fields of defence, security and the promotion of European values is assessed, before closing with some brief conclusions aimed at underscoring the importance of the negotiations that are underway.

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## Introduction

On 23 June 2016 the UK held a referendum in which a slim majority of the electorate voted to leave the EU after more than 40 years of membership. Since then, the British side has shown a considerable uncertainty about how to manage its withdrawal; this has been exemplified by the resignation of the Prime Minister, David Cameron, and his replacement by Theresa May,<sup>1</sup> a lively debate about whether Brexit should be hard or soft,<sup>2</sup> doubts about when to formally trigger the process and the early general election held in May 2017. This saw May retain office at the head of the British government, but in a weaker position, with the Tories losing their parliamentary majority. On the other side, the EU has made a show of unity and self-confidence, certainly greater than the UK had been expecting. From the outset, the European Council adopted a clear and cohesive approach, which included ruling out the possibility of opening talks before receiving official notification of London's wish to leave the Union, a requirement to respect the indivisibility of the four fundamental freedoms, including the free movement of people, and a stalwart defence of the Commission as the sole negotiator. During the period that included Brexit and the election of Donald Trump as US President, the EU also launched an ambitious 'reflection process' regarding its future, something its 27 remaining members have treated with the utmost seriousness.<sup>3</sup>

On 29 March 2017 Brussels received the official letter triggering Article 50 of the Treaty. Three months later, on 19 June, talks got underway to establish the terms of the divorce, the first phase of which focused on the amount the UK will need to pay to settle its economic commitments to the Union, the rights of citizens post-Brexit and how to avoid there being a hard border between Northern Ireland and the Republic of Ireland, something that could jeopardise the 1998 peace agreement. On 8 December 2017, following six months of negotiations, an eleventh-hour deal was struck between May and Juncker whereby, as we shall see, the EU seems to have secured virtually all its goals. In 2018 a second phase of the talks gets underway; this should settle all outstanding questions relating to the withdrawal agreement, the framework of future relations –including the major issue of how trade relations will be structured– and details concerning the transitionary period.

Although there is still a remote possibility that the UK might choose to remain within the internal market and/or the customs union to fulfil its commitment to preventing a hard border in Ireland (something that could be interpreted as a soft Brexit by the back door),

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1 Despite the fact that Mrs May gave her half-hearted support to the remain camp in the referendum, a few days after it was held and even before she won the Tory leadership race, and with it the keys to 10 Downing Street, she chose to throw her full weight behind the result, coming up with the paradoxically uninformative statement that 'Brexit means Brexit'. See <http://www.independent.co.uk/news/uk/politics/theresamay-brexit-means-brexit-conservative-leadership-no-attempt-remain-inside-eu-leave-europe-a7130596.html>.

2 Hard Brexit involves a simultaneous departure from the internal market and the customs union. This is the option May embraced in the speech she delivered at Lancaster House on 17 January 2017, when she also adopted a hard-line negotiating stance with her claim that 'no deal for Britain is better than a bad deal'. See <http://www.telegraph.co.uk/news/2017/01/17/theresa-mays-brexit-speech-full/>.

3 On 29 June 2016, less than a week after the referendum, the first informal meeting of the remaining 27 member states took place to determine their response to the result of the UK's decision, which included the start of a political reflection on the future of the EU. See <http://www.consilium.europa.eu/es/press/press-releases/2016/06/29-tusk-remarks-informal-meeting-27/>.

everything at the moment seems to point to a hard Brexit after a transition period of approximately two years, ie, from 2021. A separate possibility that cannot be ruled out over the medium to long term is that of the process being reversed. The greater the economic impact of withdrawal proves (including before Brexit formally materialises), the greater the likelihood of the UK opting to return to the internal market and the customs union, even though this would involve having to accept the free movement of people. And eventually it could even request its readmittance to the Union as a means of having a say in the institutions once again. Accepting the body of EU laws and regulations on a permanent basis without having the ability to influence them would be an extremely tall order for the UK, but a highly convenient solution for the EU and for Spain.

This policy paper analyses Spain's stance regarding the process. The large numbers of British tourists visiting Spain and the abundance of British residents in the country are matters of common knowledge. Less well known, however, is the profound degree of interdependence in terms of trade and finance, rendering the UK Spain's largest or second largest overall economic partner (depending on the year), according to the Elcano Royal Institute's Risks and Opportunities Index.<sup>4</sup> For all these reasons, it is in Spain's interest that relations between the EU and the UK change as little as possible post-Brexit.<sup>5</sup> That said, the Spanish desire to achieve a wide-ranging and ambitious agreement with the UK will not under any circumstances jeopardise the unity of the EU's support for the chief negotiator for the Commission, the Frenchman Michel Barnier. A strong and ever-more integrated EU has always been Spain's main priority. And this takes precedence over relations with the UK, however important these may be in economic terms.

In the pages that follow the various features of this complex process will be scrutinised. After explaining the rationale behind the timetable of negotiations there is an account of the principles of the divorce settlement that has been reached and its implications from a Spanish perspective. Next, the type of future relationship that is most in Spain's interest and the principal risks of the process to Spain's interests are examined, covering economic, interpersonal and security aspects. This is followed by an exploration of the Gibraltar issue, with a proposal for a conceivable way of recasting the status of the Rock, taking advantage of the circumstances around Brexit.

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4 See Alfredo Arahuetes & Federico Steinberg (2016), 'La interdependencia de la economía británica: una contribución al debate sobre el Brexit', ARI nr 18/2016, Elcano Royal Institute, [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/economia+internacional/ari18-2016-arahuetes-steinberg-interdependencia-economia-britanica-contribucion-debate-sobre-brexit](http://www.realinstitutoelcano.org/wps/portal/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/economia+internacional/ari18-2016-arahuetes-steinberg-interdependencia-economia-britanica-contribucion-debate-sobre-brexit).

5 The official Spanish stance on this emphasises the need to minimise the fall-out from Brexit for Spain, which involves reaching an agreement that is as close as possible to the status quo. See the appearance by the Foreign Minister, Alfonso Dastis, on 29 March 2017 before the Cross-Party Committee on the EU in the Spanish Congress: [http://www.congreso.es/public\\_oficiales/L12/CORT/DS/CM/DSCG-12-CM-28.PDF](http://www.congreso.es/public_oficiales/L12/CORT/DS/CM/DSCG-12-CM-28.PDF). See also in this context the report titled 'Negociaciones sobre la retirada del Reino Unido de la UE', drawn up in April 2017 by the Secretary of State for the EU (SEUE), attached to the Ministry of Foreign Affairs.



# 1 The withdrawal agreement

## *1.1 Institutional issues and the timetable of negotiations*

Britain's Prime Minister, Theresa May, formally triggered the withdrawal process on 29 March 2017. In her letter of notification, May also mentioned her desire for a deep and special relationship with the EU, in terms of both economic and security aspects. It is evident from the European Council's guidelines issued on 29 April, however,<sup>6</sup> under Article 50, which regulates the departure process of a member state, that provision is made only for negotiating an agreement concerning the UK's withdrawal, and not the future relations between the two parties. It is true, nevertheless, that it also sets out a sequential timetable whereby in a second phase of talks (once the first phase has been concluded satisfactorily) the parties are given a deadline for embarking upon the design of a framework for future relations.

The European Council<sup>7</sup> meeting of 15 December 2017, following the Commission's recommendation in its communication<sup>8</sup> of barely a week earlier and the joint report<sup>9</sup> released by the UK and EU negotiators, approved the conclusion of the first phase of talks, deeming that 'sufficient progress' had been made in three areas: (a) the rights of British citizens in the EU and EU citizens in the UK; (b) the economic settlement (known as the Brexit bill), concerning the UK's outstanding financial commitments under the Multiannual Financial Framework 2014-20, as well as the UK's stakes in such institutions as the European Investment Bank, among other issues; and (c) a solution to the issue of the border between the Republic of Ireland and Northern Ireland. Of these three areas, the first two are of particular significance to Spain, above all the matter of citizens' rights. There were, however, other issues to be resolved in this first phase of negotiations, including decisions about the relocation of EU agencies hitherto located in London. Barcelona's bid to host the European Medicines Agency was passed over in favour of Amsterdam, partly because of the political crisis that unfolded in Catalonia.

Spain has supported the sequential approach to negotiations put forward by the EU (now accepted by the UK after initial reluctance,<sup>10</sup> one of the instances of London giving in during

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6 The approval of the guidelines showed the unity of the 27. As the President of the European Commission, Jean-Claude Juncker, noted at the time, acceptance of the guidelines took scarcely 15 minutes, in contrast to other debates where more differences emerge in the European Council. See <http://www.consilium.europa.eu/en/press/press-releases/2017/04/29-euco-brexit-guidelines/>.

7 The European Council's guidelines of December 2017 paved the way to the second phase of negotiations on the separation agreement: <http://www.consilium.europa.eu/media/32236/15-euco-art50-guidelines-en.pdf>.

8 *Communication from the Commission to the European Council (article 50) on the state of progress of the negotiations with the United Kingdom under Article 50 of the Treaty on European Union*, [https://ec.europa.eu/commission/sites/beta-political/files/1\\_en\\_act\\_communication.pdf](https://ec.europa.eu/commission/sites/beta-political/files/1_en_act_communication.pdf).

9 Joint report from the negotiators of the European Union and the United Kingdom Government on progress during phase 1 of negotiations under Article 50 TEU on the United Kingdom's orderly withdrawal from the European Union, [https://ec.europa.eu/commission/sites/beta-political/files/joint\\_report.pdf](https://ec.europa.eu/commission/sites/beta-political/files/joint_report.pdf).

10 David Davis, the British negotiator, accepted the EU's position on the sequential approach on the first day of negotiations with his French counterpart, Michel Barnier. See <https://www.theguardian.com/politics/2017/jun/19/uk-caves-in-to-eu-demand-to-agree-divorce-bill-before-trade-talks>.

the first months of talks).<sup>11</sup> Spain was, however, the first country to declare itself in favour of interpreting Article 50 in a flexible way (as set out by the Spanish Foreign Minister, Alfonso Dastis).<sup>12</sup> The EU went some way to modifying its initially rigid stance, accepting the more pragmatic posture advocated by Spain, and including the possibility of starting to talk about the future framework for relations before Brexit had been concluded in its entirety. It is important, however, not to generate unrealistic expectations regarding what might be agreed over the months ahead in terms of the future relationship, given the complexity of what is at stake and the lack of time to play with. The most likely outcome is that a policy declaration will be agreed in the autumn of 2018, containing the outline of a deal for addressing the future relationship to accompany the divorce settlement that will be concluded by the Council following a recommendation by the Commission and after securing the consent of the European and British parliaments.

Another element of prime importance in the second phase of the withdrawal negotiations will be the part that deals with the transitional arrangements. In January 2018 the European Council approved a set of directives<sup>13</sup> aimed at addressing the British Prime Minister's request in her Florence speech.<sup>14</sup> The main goal of these directives is to pre-empt any 'cliff edge' situation, namely that the day after the UK leaves the EU there is no new framework of relations between the two sides. A scenario is therefore envisaged in which the UK, from the moment it leaves the Union until 31 December 2020 will continue to be subject to all the pertinent provisions (including payments to the EU budget and the free movement of people), although it will be absent from the EU's power structures and nor will it participate in decision-making processes from 29 March 2019. Spain is also fully cognisant of the difficulty of talks that are set to extend over the course of several years. It is therefore in its interest (and not only in Spain's but also the UK's and the rest of the EU's) to avoid the disaster of not having in place a transition deal.

At the same time as the divorce is being negotiated, it will be necessary to adjust the EU's institutional framework. At a minimum, a partial reform of the treaties will be needed in order to remove references to the UK. It will be possible to take advantage of what is essentially a technical exercise to carry out a twofold reform of the European Parliament. One idea is for some of the 73 British seats to be used to form a transnational list. This proposal, which was first put forward by Andrew Duff,<sup>15</sup> has its proponents in some countries, such as Italy, France and indeed Spain (and even in the European Commission),<sup>16</sup> but not in the

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11 As made evident by Salvador Llaudes (2017), 'Brexit: de renuncia en renuncia hasta el progreso suficiente... por ahora', Elcano Commentary nr 54/2017, Elcano Royal Institute, [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/comentario-llaudes-brexit-renuncia-hasta-progreso-suficiente-por-ahora](http://www.realinstitutoelcano.org/wps/portal/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/comentario-llaudes-brexit-renuncia-hasta-progreso-suficiente-por-ahora).

12 Dastis made his comments to the *Financial Times* in January 2017: <https://www.ft.com/content/40075c22-e314-11e6-9645-c9357a75844a?mhq5j=e3>.

13 Council directives of 29/IV/2018, supplementing (as an annex) the Council Decision of 22/IV/2017: <http://www.consilium.europa.eu/media/32577/negotiatingdirectives.pdf>.

14 The Prime Minister's speech delivered in Florence on 22/IX/2017: <https://www.gov.uk/government/speeches/pms-florence-speech-a-new-era-of-cooperation-and-partnership-between-the-uk-and-the-eu>.

15 Andrew Duff's proposal to create a transnational list dates back to 2011: <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0176&language=EN>.

16 The creation of transnational lists for European Parliament elections is supported by the President of the European Commission, Jean-Claude Juncker, as evident from his 2017 State of the Union speech: [http://europa.eu/rapid/press-release\\_SPEECH-17-3165\\_es.htm](http://europa.eu/rapid/press-release_SPEECH-17-3165_es.htm).

European Parliament itself, which has taken a negative position (here the opposition of the European People's Party proved decisive, although it should be noted that the Spanish contingent voted in favour). It seems unlikely, Therefore, that the idea will prosper or, if it does, it will be for the 2024 elections, not 2019's. Another section of the 73 seats formerly allotted to the UK will be used to rectify the current under-representation of some states, especially Spain, which looks certain to gain five.<sup>17</sup>

### *1.2 Citizens' rights*

This is undoubtedly the most critical issue for Spain. Officially there are 296,000 British nationals registered on Spanish soil, although the actual number could approach a million, given the large number of people who stay for limited periods, frequently in houses that they own. Spain is the most popular destination in the EU for British citizens living abroad. Contrary to popular belief, half of the British population in Spain is aged under 59, meaning that the number of those actively engaged in work (in all parts of the economy, from English-language teachers to business executives by way of the catering industry) is considerable. Meanwhile the official data suggest that there are 130,000 Spanish nationals living in the UK,<sup>18</sup> which is likewise the most popular destination in Europe for Spaniards. In this case too, the data almost certainly understate the reality, given the growing presence in recent years of young Spaniards, spurred on by the geographical proximity of the two countries and drawn both by employment opportunities that did not exist in Spain during the crisis and the importance of mastering English.

The fact that there is a greater number of EU citizens in Britain than vice versa has sometimes been cited as a comparative advantage for the UK. It is therefore worth pointing out that, unlike the other EU countries, there are more British citizens in Spain than Spaniards in the UK, but this does not necessarily mean that the Spanish position is stronger in this area. So while the UK has an interest in its citizens being able to continue enjoying the advantages of living in Spain, Spain has a similar interest by benefiting to a large extent both from the presence of Britons on Spanish soil and Spaniards in the UK. As far as the importance of guaranteeing citizens' rights in the divorce negotiations is concerned, there is complete consensus among the political parties and in Spanish diplomatic circles, as made evident at the appearance of Alfonso Dastis before the Cross-Party Group on the EU and the SEUE report.<sup>19</sup>

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17 See Victoriano Ramírez et al. (2017), 'La composición del Parlamento Europeo para el año 2019', ARI nr 105/2017, Elcano Royal Institute, [www.realinstitutoelcano.org/wps/portal/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/ari105-2017-ramirez-martinez-palomares-composicion-parlamento-europeo-2019](http://www.realinstitutoelcano.org/wps/portal/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/ari105-2017-ramirez-martinez-palomares-composicion-parlamento-europeo-2019).

18 For a summary of these figures and many others indicating the importance of bilateral relations, see William Chislett (2017), 'Why Spain would like a "soft" Brexit for the UK', ARI nr 27/2017, Elcano Royal Institute, [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_en/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_in/zonas\\_in/ari27-2017-chislett-why-spain-would-like-soft-brexit-uk](http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/ari27-2017-chislett-why-spain-would-like-soft-brexit-uk).

19 'The best solution would be to stick as closely as possible to the letter and spirit of the current legislation. The Commission notes that, legally-speaking, acquired rights do not exist. Spain will advocate that Spanish citizens continue enjoying the most favourable conditions in terms of residence and employment rights, as well as the recognition of the residence and employment rights of those Spaniards who wish to work in the United Kingdom in the future'. See SEUE (2017), 'Negociaciones sobre la retirada del Reino Unido de la UE', Ministry of Foreign Affairs and Cooperation, Madrid, April, p. 22.

Although Theresa May's initial offer in this regard<sup>20</sup> was disappointing, what was finally agreed is reasonably similar to the safeguards preferred by the European Commission.<sup>21</sup> Thus the basic idea is to honour the rights of all European and British citizens who reached British and European soil respectively prior to a 'specific date' that remains to be established. According to the joint report, this date will be the departure of the UK from the EU, although in its directives of January 2018 the European Council argues that it should be extended until the end of the transition period. After resisting such a suggestion for some weeks, the UK has recently signalled a preparedness to move on in this area too.<sup>22</sup>

For Spain it is important that the agreed principle comes into force. If it remains simply as it is, however, it would be insufficient. The outcome that most closely adheres to Spanish interests is one that enables a situation as close as possible to what currently exists, with completely free movement of people (although this would only occur if the UK stayed in the internal market). The priority should therefore be to try to avoid, or at least restrict as far as possible, the bureaucracy that Spaniards (and other EU citizens) will be subjected to in the UK, and possibly vice versa. This will, of course, apply to those already there, but also to those who go in the future, including students and workers who wish to obtain permanent residence or to apply for British citizenship. Clearly, this would work in both directions, so the British would benefit from it too. The idea would be to avoid recourse to visas or any other formality that would hamper a relationship that is fully satisfactory as things stand (witness the almost 19 million UK citizens who visited Spain in 2017).

It is, however, unlikely that the final agreement reached by the EU and the UK on this matter will be entirely satisfactory. If this does indeed prove to be the case, it can by no means be ruled out that a bilateral solution will be sought between Madrid and London, without in any way undermining the European Commission's negotiating position. Rather, it would be a case of supplementing after-the-fact, if this should prove necessary, the agreement on the future framework of relations between the EU and the UK with an agreement between the two parties involved, whereby it would be possible to address any particularly controversial or costly matters, such as the healthcare entitlements of UK citizens resident in Spain.

### *1.3 Budgetary and financial issues*

The most toxic question in the divorce negotiations is the one relating to the financial settlement between the UK and the EU, popularly known as the Brexit bill. This is not, despite the narrative current in Britain, either a bill for leaving the EU or penalisation for deciding to quit it, but rather an agreement to settle all the economic commitments that the UK has entered into. Spain, as the SEUE report points out, 'believes that all the liabilities to which the UK has committed itself should be included in calculating the balance to be paid: the

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20 'Safeguarding the Position of EU Citizens Living in the UK and UK Nationals Living in the EU', 26/VI/2017, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/621848/60093\\_Cm9464\\_NSS\\_SDR\\_Web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621848/60093_Cm9464_NSS_SDR_Web.pdf).

21 'Position paper on 'Essential Principles on Citizens' Rights'', 12/VI/2017, [https://ec.europa.eu/commission/sites/beta-political/files/essential-principles-citizens-rights\\_en\\_2.pdf](https://ec.europa.eu/commission/sites/beta-political/files/essential-principles-citizens-rights_en_2.pdf).

22 In the document 'EU citizens arriving in the UK during the implementation period' (28/II/2018), the British government explicitly stated: 'There will be no new constraints on working or studying in the UK in the implementation period. This will also be the case for UK nationals moving to the EU during this period'. See <https://www.gov.uk/government/publications/eu-citizens-arriving-in-the-uk-during-the-implementation-period/eu-citizens-arriving-in-the-uk-during-the-implementation-period>.

debts to be settled; the structural funds of the current financial cycles; the pensions of EU civil servants; the contingent liabilities (arising from loans and aid programmes)'.<sup>23</sup> The value of this financial agreement has been estimated at €60-100 billion, amounts consistently rejected by the British, who at first were even talking about not having to make any kind of contribution, although they finally accepted that they would have to fulfil the pertinent obligations in order to avoid falling off the 'cliff edge'.<sup>24</sup>

The UK has been obliged to accept the logic of the negotiations in this area, as in so many others. The Commission has thus shown the strength of its position, which is relatively inflexible since it represents the interests of 27 member states, who in turn had already had to negotiate considerably to reach a common position. It has managed to agree the principles (without mentioning the amounts) for calculating the financial settlement,<sup>25</sup> including the UK's commitment to contribute to the EU's annual budgets up to the end of the current Multiannual Financial Framework (in other words to the end of 2020) and the agreement to pay what it owes with regard to the European Investment Bank, the European Central Bank and the European Development Fund, among others. Spain has shared the EU perspective and has not deviated from the line taken by Brussels, although unlike other countries it has not taken a particularly obdurate approach with London on the financial terms. As already noted, its foremost priority in the first phase of negotiations was the agreement on citizens' rights.

There is, at any event, a major by-product of Brexit in the economic field. As the UK is a net contributor to the EU budget, it is necessary to rethink<sup>26</sup> the new Multiannual Financial Framework (which starts in 2021). In a context in which there is no great enthusiasm for increasing public spending in the wake of the economic crisis, the prospect of the remaining 27 members deciding to increase their contributions to maintain the same level of spending that currently exists seems unlikely (although it is true that Germany and France have announced their willingness to increase spending). The most likely outcome, therefore, is that the next budget to be approved will be smaller than the current one, since the British contribution will have to be discounted.

This will entail that Spain, a traditional recipient of funds, will in all likelihood join the group of net contributors, something that can be read in two ways. On the one hand there is the

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23 SEUE (2017), *op cit.*, p. 17.

24 'Britain concedes it will have to pay EU exit bill', Financial Times, 14/VII/2017, <https://www.ft.com/content/be2b22ce-67fc-11e7-8526-7b38dcaef614>. Later the Prime Minister herself accepted that the UK would have to end up making payments: 'The UK will honour commitments we have made during the period of our membership', Florence Speech, 22/IX/2017.

25 On p. 3 of the Annexe of the Recommendation of the Commission for the Council Decision regarding negotiations on Brexit, dated 3/V/2017, it says: 'The methodology for the financial settlement based on the principles laid down in section III.2 has to be established in the first phase of the negotiations', [http://ec.europa.eu/info/sites/info/files/recommendation-uk-eu-negotiations\\_3-may-2017\\_en.pdf](http://ec.europa.eu/info/sites/info/files/recommendation-uk-eu-negotiations_3-may-2017_en.pdf). This position is also found on p. 1 of the Working Paper of Barnier's Task Force, dated 24/V/2017: 'The United Kingdom's obligations should be fixed as a percentage of the EU obligations calculated at the date of withdrawal in accordance with a methodology to be agreed in the first phase of the negotiations', [https://ec.europa.eu/commission/sites/beta-political/files/financial-settlement-essential-principles-draft-position-paper\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/financial-settlement-essential-principles-draft-position-paper_en.pdf).

26 A recent analysis scrutinises the fallout that Brexit could have for the EU budget. See Mario Kölling (2017), 'El impacto del Brexit para el presupuesto de la UE', ARI nr 53/2017, Elcano Royal Institute, [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/ari53-2017-kolling-impacto-brexit-presupuesto-ue](http://www.realinstitutoelcano.org/wps/portal/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/ari53-2017-kolling-impacto-brexit-presupuesto-ue).

negative implication of paying more. But by taking its place in the group of net contributors alongside Germany, France, Italy and the Netherlands –countries with which in the future it will have to coordinate more– Spain may end up increasing its influence in the EU, because the countries that contribute most are also those that wield most decision-making power.

### 1.4 Territorial issues

The territorial complexity of the UK and the controversies –both internal and international– surrounding this situation entail that one of the most sensitive aspects of Brexit relates to its application to the four ‘constituent nations’ (England, Wales, Scotland and Northern Ireland) and to British dependencies both in Europe and further afield. The initial proposal of the UK and the EU –which Spain fully endorses– is that the departure of the member state must be complete and talks aimed at implementing it must be a single negotiation between London and Brussels. In other words, none of the territories or dependencies ‘may apply the law of the Treaties to themselves’ nor may they ‘negotiate separately’.<sup>27</sup> It seems clear, however, that this general principle is not going to be easy to implement in its entirety, and nor will it satisfy the many actors involved in the various disputes.

Although there are other sensitive territorial issues to be resolved,<sup>28</sup> the three most important questions relate to Northern Ireland, Scotland and Gibraltar. Spain has a major interest in all of them. In the first two –territories where there is a majority in favour of remaining in the EU– this is because the possible adoption of special solutions is connected in one way or another to the independence aspirations of a large part of their populations (and in the current circumstances surrounding the Catalan independence dispute, this means that Madrid follows any development with special interest). Spanish interest in Gibraltar – whose population voted overwhelmingly for the remain option in 2016– therefore requires even less explanation: Madrid aspires to gaining sovereignty in the future over a territory it officially considers a colony, and, in the short term, of establishing a balanced *modus vivendi*.

Starting with Northern Ireland, the possible future border on the island proved to be the most difficult question in the first phase of talks, without there even being a clear agreement about how the dispute is to be resolved (beyond the UK’s commitment to remaining fully aligned with the rules of the internal market and the customs union in the event of not arriving at another solution).<sup>29</sup> Both London and Dublin asked from the outset that the talks try to preserve the Common Travel Area throughout the British Isles (an area exempt from border controls, which is fundamental for the continued viability of the Good Friday peace agreement). The EU not only accepted the request, it also now advocates it –taking Irish

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<sup>27</sup> See pp. 14-15 of SEUE (2017), *op. cit.*

<sup>28</sup> For example, the European Council Guidelines of 29 April also refer to the parts of Cyprus under British sovereignty, to stipulate that bilateral agreements between Nicosia and London should be compatible with EU law, specifically with regard to the protection of the European citizens who live or work there.

<sup>29</sup> On 28/II/2018 the Commission submitted its proposed legal text outlining the December agreement, including the part related to full alignment. Despite the fact that the February text is a logical consequence of what had already been agreed, it met forthright rejection in London, which soured the atmosphere surrounding what were already very difficult negotiations. See [https://ec.europa.eu/commission/sites/beta-political/files/draft\\_withdrawal\\_agreement.pdf](https://ec.europa.eu/commission/sites/beta-political/files/draft_withdrawal_agreement.pdf).



concerns to heart— with considerable vigour, much more so than the British side, as a fundamental element of successful talks.<sup>30</sup>

The great challenge that persists to this day is how to square the circle: how the desire that the border between Northern Ireland and the Republic of Ireland should remain invisible to people and goods can be made compatible with the fact that it soon has to become an external border of the EU, and possibly of a customs union that the UK wants to leave. In any event, Madrid has been right to express its understanding on this issue and to close ranks with Dublin. Indeed, considering Spain's sometimes excessive sensitivity on the matter, it is almost surprising that it has accepted the European Commission's declaration, at the request of the Irish Prime Minister, that the territory of Northern Ireland would automatically return to the EU in the event of separation from the UK and unification with the rest of the island. As much as this may be the logical consequence of international law, which additionally has the precedent of what happened with Germany in 1990, it is also true that it was not necessary to say it explicitly (provoking complaints from conservative British media, who interpreted it as an attack on the territorial integrity of their country).<sup>31</sup> As will emerge in the case of Gibraltar, it is clear that solidarity between member states overrides other considerations in the current European climate (and rightly so, it might be added).

In contrast to the former case, neither London nor Brussels nor any other capital has suggested applying a flexible solution for Scotland in the talks (which, according to Edinburgh, should serve to keep Scotland inside the internal market, even if the rest of the UK leaves it).<sup>32</sup> This is an aspiration that is virtually impossible to satisfy, both for technical and political reasons, given that neither the British government nor the EU itself will have any appetite for opening what they see as a Pandora's Box. It is thus unnecessary for Spain to take a particularly high-profile stance here. The current nationalist government in Scotland has two strategies regarding its place in the EU: the first is the more pragmatic, but nevertheless highly difficult, approach that has just been mentioned, while the other is the more ambitious aspiration to full independence and being fast-tracked to becoming a new member state. It is legitimate for Madrid to take a dim view of both. For domestic political reasons, it does not want regions to be able to link themselves to European integration separately from the states to which they belong, and nor does it want to encourage the precedent of a territory being able almost simultaneously to achieve statehood and readmittance to the EU. But Spain needs to develop this position intelligently, without unnecessary obduracy.

Factors of various kinds render the case of Scotland quite different from the unilateral Catalan challenge (starting with the greater popularity the former enjoys in Europe) and

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30 The agreement to support Theresa May that was struck between the Conservative Party and Ulster's DUP in the wake of the general election of June 2017 may prove a source of instability and obduracy in talks on the border issue. The DUP rules out a special status for Northern Ireland that would separate it from the British market in order to maintain it in the internal market (something that is, however, advocated by Sinn Féin). The DUP does, however, in principle support a soft border and other arrangements connected with the Good Friday agreement.

31 In any case, this declaration does not form part of the European Council's formal guidelines adopted on 29/IV/2017 (which on this point only refer to 'flexible and imaginative solutions... with the aim of avoiding a hard border'). The text of this addendum to the minutes of the meeting was not even officially published, although the former Irish Prime Minister Enda Kenny described it as a 'significant legal statement from the European Council'.

32 As expressed in *Scotland's place in Europe*, published in December 2016, which contains Scottish proposals to mitigate the impact of Brexit. See [www.gov.scot/Publications/2016/12/9234](http://www.gov.scot/Publications/2016/12/9234).

mean that overreacting could prove counterproductive. The Spanish government seems to have taken this on board with its denial that it had ever said –contrary to a widespread misconception– it would veto the hypothetical candidacy of Scotland, providing it attained independence legally. This is a positive clarification that could have been accompanied by less emphasis on the idea that such a candidacy would go to the back of the queue to join the EU (since no such queue exists) and, because of what it does to the somewhat delusional ambition of being able to retain a special and direct relationship with the EU even if Scotland remains in the UK, leaves London to assume the political cost of denying it. Spain needs to avoid coming across as a centralised wielder of vetoes. It would be much better to be perceived as a country that understands plural territorial realities on condition that constitutional frameworks and European values are respected. The attitude of the Scottish government (and particularly the SNP) at the most fraught point of the Catalan crisis was extremely disappointing from the Spanish perspective, however, with the consequence that any flexibility on the Spanish side in terms of taking a significantly more positive line on Scotland's independence aspirations can be ruled out.

As far as Gibraltar is concerned it is clear that Brexit requires resolving the future framework of Spain's relations with the territory, and even improving the possibilities of a solution to the dispute. In the short term it is advisable to defuse the negotiations and ignore the bombast emanating from certain nationalist British quarters. The Spanish government has stated that it does not seek to settle the sovereignty dispute by exploiting the Brexit negotiations or involving the EU. But Madrid does have what it considers a legitimate aspiration to rebalance the conditions imposed in the 1970s and 80s by the UK, which was then a member state, and that Spain had to accept in order to join what was then the European Community. The conditions were highly favourable to Gibraltar (it forms part of the internal market but not the customs union or the VAT area) and have been taken advantage of to turn the territory into a form of tax haven.

The Spanish line of argument<sup>33</sup> is that Gibraltar, in accordance with British legislation and the relevant treaties, is not part of the UK, but rather a territory whose foreign relations are the responsibility of the UK. For this reason, the UK's future relations with the EU do not necessarily have to apply to Gibraltar, and extending such agreements to the territory would require an explicit acceptance by the EU, which Spain predicates on a bilateral agreement between London and Madrid. The goal of securing this veto was fulfilled with the inclusion of guideline number 24 in the document approved by the European Council on 29 April 2017 (as well as in the Council's directives of 29 January 2018, relating to the transition agreement). The path is thus clear for bilateral talks on: (a) eliminating tax, customs and commercial privileges; (b) respecting the interests of the people living in the Campo de Gibraltar district; and (c) exploring imaginative solutions to the underlying sovereignty dispute. These issues are scrutinised in more detail below.

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<sup>33</sup> See p. 15-16 SEUE (2017), *op. cit.*



## 2 The future agreement

### *2.1 The future agreement: economic risks for Spain*

The future economic and political relationship between Spain and the UK will be essentially determined by the agreement the British strike with the EU. While it is true that Madrid and London can reach bilateral agreements on specific aspects, the bulk of the trade, financial and security relationship will depend on the new general framework of relations between the EU and the UK, which remains unknown. The British side has stated its desire to maintain the closest possible relations with the EU, while the remaining 27 states are willing to seek a good agreement on condition that the British are not able to cherry-pick whatever parts of European integration they want.

Both parties have emphasised the need for constructive dialogue that prevents talks from breaking down. If they were to end in failure, at the end of March 2019 the UK would simply become another member of the World Trade Organisation (WTO), whereby the EU and therefore Spain would relate to it like any other third-party country (for example, Uruguay or Thailand), which would involve the erection of tariff and non-tariff barriers; these in turn would create a significant obstacle to trade, both in goods and services, and would do great harm to British hubs in global supply chains. The effects would be highly damaging. Whatever happens, as a senior EU official quoted in the *Financial Times* said: 'In many ways this is an absurd exercise. It is a tragedy where we have to play our role... reinventing things that we already have because [the British] cannot live with them'.<sup>34</sup>

Despite that all those involved will play their part to reach an agreement aimed at minimising damage, the dynamic of the talks and the red lines that both sides have set suggest that we are heading, unless the process is somehow reversed, towards a hard Brexit (at least in the first instance and once the transition period has elapsed), in other words a situation in which the UK would be outside the internal market and the customs union, outside the jurisdiction of the Court of Justice of the EU (CJEU) and making no (or very limited) contributions to the EU budget. And this is due to the explicit desire of the British, for the time being, despite it having a highly negative impact on their future prosperity, to control their borders to reduce immigration from Europe; this rules out agreements such as the one between the EU and Norway, which enables the latter to be part of the internal market and thereby have access to consumers in the 28 current members of the Union (although this requires it to contribute to the EU budget and to be subject to the jurisdiction of the CJEU). Meanwhile, the British Conservative government's policy of withdrawing from the customs union, which is rejected by the Labour opposition, is based on a desire to have the ability to strike trade deals with other countries.

In this context, Spain is placed in an awkward position. Given the sheer scale of bilateral economic flows, it would be in Spain's interest to have the softest Brexit possible (the same is true of Ireland, and to a lesser extent Germany, the Netherlands and Cyprus, which also

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<sup>34</sup> The news was reported in the *Financial Times* on 31/III/2017 thus: <https://www.ft.com/content/cce58e8e-158c-11e7-80f4-13e067d5072c?mhq5j=e5>.

have strong links with the British economy). However, to the extent that the main interest of Spanish foreign and economic policy is the success of the European project, Spain will align itself with the position of the European Commission which, as things stand, is emphasising that the four freedoms are indivisible and the EU cannot operate *à la carte*. Indeed, since the countries that decide to join the EU do so because it brings improvements, both economic and political, that exceed the costs of entering an area of shared sovereignty, withdrawal from the Union necessarily brings an economic cost for everyone, the size of which depends on how the future relationship is structured. Given the relatively small size of the British economy compared to the other 27, it is likely that the damage will be greater for the UK than for the EU, but also greater for Spain than other countries in the EU. Moreover, for EU members it must be evident that the UK will be in a patently worse position from an economic standpoint outside the EU than in it. Ultimately no-one has forced the British to leave and it is important not to set a precedent inviting other member states, and indeed non-members, to request *à la carte* relations with the EU.

If these positions are maintained and a hard Brexit comes to pass (which might be along the lines of an ambitious Canadian-style free-trade treaty, as to be discussed below, but at all events outside the internal market and the customs union), what Spanish citizens and businesses should be clear about is that the impact of Brexit will be considerable<sup>35</sup> and that, moreover, unless things change drastically they will start to make themselves felt in just a few years' time (probably in 2021, at the end of the transitional period). Many Spaniards find it hard to understand that a country should choose to leave the EU, and therefore they tend to think that in the end there will be some form of going back on the process.<sup>36</sup> In the short term, however, the probability of this happening is slight (should it occur it would be in the medium to long term, if the economic impact were to force the UK to reconsider).

Therefore, while hoping that rationality and common sense prevail in terms of an agreement that minimises the economic damage to both sides, which could conceivably translate into the most ambitious free-trade deal the EU has ever signed with a third-party country, it is advisable to prepare for more adverse scenarios that generate a greater degree of economic damage (the absence of an agreement or a bare-bones agreement restricted to the elimination of tariffs).

As already mentioned, the economic relationship between Spain and the UK is extremely fruitful. The UK is the fourth-largest export market for Spanish goods and the sixth-largest source of goods imported into Spain. It is also the main destination for Spanish investment abroad and the UK ranks second in the list of countries investing in Spain. Lastly, it is well known that Spain receives millions of British tourists every year, accounting for almost a quarter of visitors to the country. In 2016 Spain recorded a surplus on goods traded with the UK of almost €8 billion, a figure that rises to €11 billion if services, predominantly tourism,

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35 Various Autonomous Communities (regional governments) have already started calculating the possible damage. See Lucía Abellán (2018), 'Las comunidades españolas temen el impacto de un Brexit duro', *El País*, 11/I/2018, [https://politica.elpais.com/politica/2018/01/10/actualidad/1515597406\\_651975.html](https://politica.elpais.com/politica/2018/01/10/actualidad/1515597406_651975.html).

36 This is still the position of one of the authors of this paper, although he is in a clear minority. See Miguel Otero Iglesias (2016), 'Londres se enfrenta a la oclocracia del Brexit', 29/VII/2016, [ahorasemanal.es](https://www.ahorasemanal.es/londres-contra-la-muchedumbre-del-brexit), <https://www.ahorasemanal.es/londres-contra-la-muchedumbre-del-brexit>; and 'Una separación sin Brexit', *Agenda Pública*, 11/VII/2017, <http://agendapublica.elperiodico.com/una-separacion-sin-brexit/>.

are included. What is at stake is a considerable (and growing) volume of business that could well be affected if the British economy were to fall into recession as a consequence of Brexit, something that cannot be ruled out if there is no deal.

That is why it is important for Spanish companies to design contingency plans for coping with a reduction in business, whether in terms of preparing for changes in the regulatory framework or seeking alternative customers and suppliers in other markets, both within and beyond the EU. This applies especially to the goods-exporting industries most exposed to the British market such as transport (including vehicle manufacturing), machinery, chemical products, food and metals (see Figure 1), but also to such service industries as tourism, finance, infrastructure and telecommunications. It is in Spain's interest that the transitional period lasts for as long as possible and that once Brexit comes into force the situation changes as little as possible, and to ensure moreover that Spanish exports to the UK are not displaced by others from third-party countries with which the UK may eventually sign free-trade agreements.

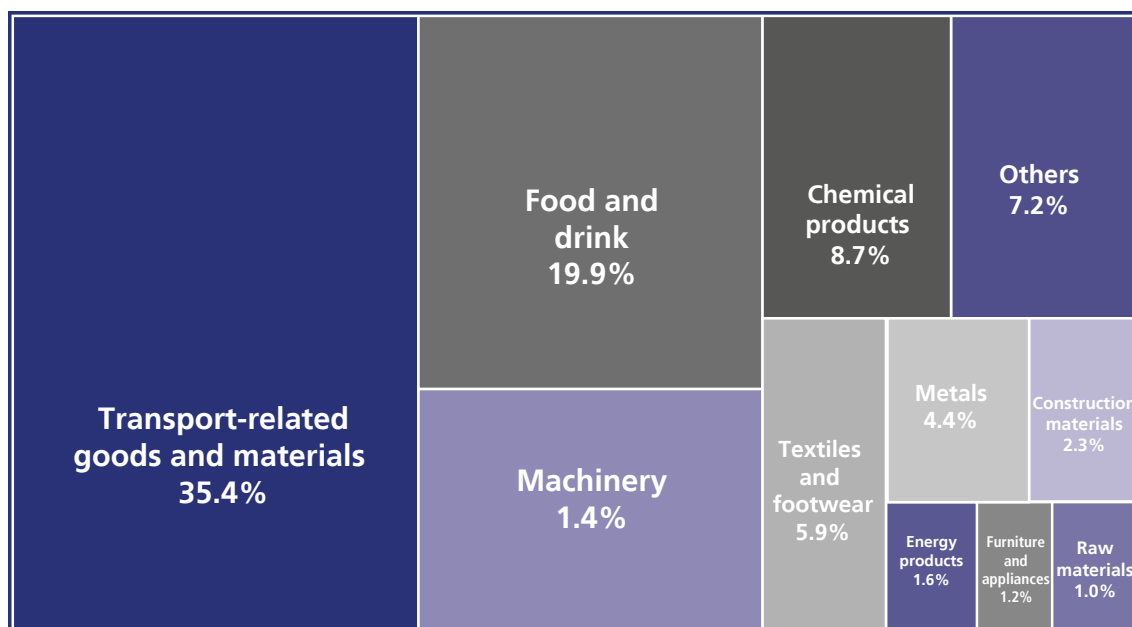
The financial services industry merits special comment owing to the presence of Banco Santander and Banco Sabadell in the British market. More than 20% of Santander's profits and more than 10% of Sabadell's originate in the UK and at the close of 2016 it is estimated that British debtors had liabilities to Spanish banks to the tune of €320 billion (which is the equivalent of around 30% of Spain's GDP).<sup>37</sup> As a report drawn up by Spain's Permanent Representative to the EU points out, if Brexit causes economic growth in the UK to decline (something that is already happening) it is likely that bankruptcies will increase, which would have a negative impact on Spanish banks. Other Spanish multinationals, such as Telefónica (in the telecoms industry) and Iberdrola (in the energy sector), which currently derive nearly 30% and 15% of their income from the UK respectively, are unlikely to be immune to such effects.<sup>38</sup>

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37 See Analistas Financieros Internacionales (AFI) (2017), 'Brexit: comienza la cuenta atrás', May.

38 See a summary of the report in Claudi Pérez (2017), 'Un informe del Gobierno alerta del efecto negativo del "Brexit" en España', El País, 9/III/2017, [https://politica.elpais.com/politica/2017/03/09/actualidad/1489089409\\_306320.html](https://politica.elpais.com/politica/2017/03/09/actualidad/1489089409_306320.html).

Figure 1. Spanish exports to the UK classified by product type



Source: the authors based on 2017 data.

As far as air travel is concerned, both the alliance between Iberia and British Airways and the vast number of British tourists who travel to Spain with low-cost airlines mean that an agreement on European airspace is very much in Spain's interest. It is also of the utmost importance that an agreement on the European Higher Education (and research) Area is reached that enables Spanish students to continue studying under the Erasmus programme and taking undergraduate and postgraduate degrees at British universities under favourable conditions. Scientific cooperation also needs to be maintained.

As things stand we can only speculate about what the future relationship between the UK and the EU will be like, but everything suggests that there will be a major effort to secure an ambitious free trade deal that sets tariffs at zero, keeps non-tariff barriers to a minimum, has flexible rules of origin, gives access to public procurement markets and includes cooperation on direct investment; additionally, there may be industry-specific agreements covering financial services, car manufacturing, the pharmaceutical industry, air travel and farming (although the latter will be complicated by the fact that it raises the prospect of an à la carte menu for the UK). This would undoubtedly be the best scenario for Spain. Since the UK will incorporate into its domestic law all the EU regulations in force at the time of leaving the Union, if it is possible to reach an agreement of this sort (it has already been dubbed CETA +, in reference to the deal struck with Canada), the trade in goods and some services should not be drastically affected at the outset.

However, as soon as the EU starts adopting new regulations (especially in the services sector), the UK will need to replicate them to continue having access to the European market. This would mean that its much-coveted regulatory sovereignty would be a chimera. Here it is important to point out that a possible free-trade or comprehensive association agreement between the UK and the EU would be the first-ever marked by a process of divergence rather than convergence the day after it is signed. This is a measure of how ironic, not to say Kafkaesque, the negotiation process is.

If no specific agreement is reached covering the financial services industry, and banks with London headquarters lose their 'passport' enabling them to operate in the other 27 EU member states (which is the most probable scenario, since even CETA did not cover financial services), Spanish banks should not be overly affected by the new regulatory framework: they already possess passports by virtue of having their headquarters in Spain. There are some banks, such as Santander and Sabadell, that have subsidiaries in the UK, but their internal business there should not be affected by the change in regulations (apart from the wider effects that Brexit may have for the British economy in general, as pointed out above).

On a somewhat different point, there has been considerable speculation about the prospect of Spain (and especially Madrid) attracting banks and other institutions from the City of London seeking to relocate to another country within the internal market. A recent report from PwC, for example, estimates that if the authorities made the regulatory, employment and fiscal playing field more attractive to foreign investment, companies coming to Spain could add as much as €3.6 billion (about 0.3%) to the country's GDP and generate up to 50,000 new jobs.<sup>39</sup> It would be wise not to be over-optimistic on this score, however.<sup>40</sup> Although Madrid's advantages in terms of quality of life are reasonable, it is more likely that Dublin, Amsterdam, Paris and especially Frankfurt will attract the majority of banks currently operating in London and wanting to open offices in the EU, or to clear settlements denominated in euros, something they can currently do in London (in November 2017, it was also decided that Paris would be the future home of the European Banking Authority). And as far as fintech is concerned, it seems reasonable to assume that Berlin and other capital cities in the north of Europe enjoy something of a head start.

Turning next to Brexit's impact on the tourism industry (one of the greatest Spanish concerns), it is difficult to make very firm estimates as things stand. For now, the worst fears have not been realised, rather the opposite. Despite the uncertainty surrounding Brexit, the numbers of UK tourists have continued rising, and the same is true of their spending.<sup>41</sup> Ultimately everything will depend on the agreement that is struck between the EU and the UK on the

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39 See the PwC report titled 'La Oportunidad Brexit: Impacto económico en España de la atracción de empresas afectadas por el Brexit', drawn up for the Junta de Compensación de Valdebebas, which is constructing a 1,000,000 m2 business park, <http://valdebebas.es/wp-content/uploads/2017/06/Informe-PwC-Impacto-Brexit.pdf>.

40 Although as yet there is no confirmation, there are rumours that both Citibank and UBS (two large global banks) could transfer a large part of their business to Madrid. See 'Ofensiva del Gobierno para atar el traslado de Citibank y UBS a Madrid', *El Confidencial Digital*, [https://www.elconfidencialdigital.com/dinero/Ofensiva-Gobierno-Citibank-UBS-Madrid\\_0\\_3044095577.html](https://www.elconfidencialdigital.com/dinero/Ofensiva-Gobierno-Citibank-UBS-Madrid_0_3044095577.html). If this were the case it would be extremely good news.

41 See the article in *Expansión* with the headline 'Los turistas británicos incrementan su liderazgo en llegadas y gasto en España un año después del Brexit', <http://www.expansion.com/empresas/transporte/2017/06/18/594660a0268e3e580b8b45d1.html>.

movement of people. Even in the worst-case scenario, however, (involving entry visas in order to visit, study or work), the impact should not be excessively great. If, for example, an online visa system were to be introduced involving the payment of a moderate amount in advance, such as the US has for EU visitors, the number of British visitors to Spain should not fall drastically.

Such a decline would be reduced even further if, as seems likely, the UK and Spain were to sign a bilateral agreement covering the mutual use of their public health systems. This would help Spain prolong its status as the Britons' favourite destination for retirement abroad, meaning they would continue to purchase housing (UK citizens currently account for almost 20% of property purchases by foreigners)<sup>42</sup> and contribute to indirect taxation thanks to their high rates of consumption. This would even happen if Sterling were to depreciate significantly, something that remains to be seen.

In short, Spain will continue to be a highly attractive country to British tourists for reasons of proximity, price, landscapes, culture and quality of life. That said, it is important that the Spanish tourism industry prepares for a possible reduction in British visits and draws up contingency plans both with the Spanish authorities and with British tour operators, who are equally dependent on tourism to Spain. It would also be advisable from the Spanish perspective to reduce such a dependency, cultivating new markets, especially in Asia, and specifically in China, which is set to undergo strong tourism growth in the decades ahead.

### *2.2 Gibraltar: an opportunity to change the status quo*

The question of Gibraltar is not at the top of the Spanish agenda in the negotiations over Article 50 but it is the most prominent and fraught side-issue. Together with a series of specific problems to be resolved in the regulatory and freedom-of-movement areas, Brexit is also an opportunity to reconfigure the status of the territory administered by the UK, enabling one of Spain's longstanding irredentist claims to be addressed.

As pointed out, in April 2017 Spain succeeded in persuading the institutions and members of the EU to grant what amounts to a veto over any aspect of the negotiations that affect Gibraltar, to the immense chagrin of the Gibraltar government. The greatest short-term concerns in Madrid relate to cross-border movement and taxation, in terms of their impact both on the economy of the Campo de Gibraltar district and on the illegal activities and trafficking resulting from the area's unique situation. Whatever happens, the British withdrawal from the EU will entail a modification to the legal and political position of the UK-administered territory, which has hitherto enjoyed a special customs and tax status that was established prior to Spain's accession to the European Community in 1986.<sup>43</sup>

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42 According to the research department of BBVA, the British buy more property in Spain than any other group of foreigners (with a market share of almost 20%) followed at some distance by the French (almost 10%) and the Germans (close to 8%). The regions of Valencia, Andalusia, the Canary Islands, Murcia and the Balearic Islands attract British buyers the most and are in principle most affected by their purchasing power.

43 See Araceli Mangas (2016), '*¿Brexit? Escenarios internacionales y Gibraltar*', DT nr 9/2016, Elcano Royal Institute, [www.realinstitutoelcano.org/wps/wcm/connect/a3a98f06-b347-49f1-bc99-67ce69060283/DT9-2016-Mangas-Brexit-Escenarios-internacionales-Gibraltar.pdf?MOD=AJPERES&CACHEID=a3a98f06-b347-49f1-bc99-67ce69060283](http://www.realinstitutoelcano.org/wps/wcm/connect/a3a98f06-b347-49f1-bc99-67ce69060283/DT9-2016-Mangas-Brexit-Escenarios-internacionales-Gibraltar.pdf?MOD=AJPERES&CACHEID=a3a98f06-b347-49f1-bc99-67ce69060283).

In the absence of an agreement such as the one that will be set out below, there can be no doubt that Gibraltar will leave the EU along with the UK and the border crossing between Spain and the Rock will become an external border of the internal market. Madrid accepts the need for special talks on this issue, which will be held separately from those conducted by the Commission (or in parallel, but with the Spanish veto). However Brexit unfolds, it should under no circumstances lead to closing the border, for all manner of reasons, particularly human considerations, even if control of the crossing now falls more under Spain's domain. Conditions may also be established concerning the registered ownership of properties and businesses on Spanish soil by Gibraltar natural and legal persons and regarding access to residence permits and the exercise of professional and occupational activities in Spain, although in the latter case the talks will obviously have a reciprocal dimension to facilitate the daily entry of 8,000 Spaniards (and thousands of foreigners) who work on the Rock but live in the Campo de Gibraltar district. Within the framework of the overall negotiations with the UK, or dealt with as a special matter, it will also be necessary to address the new customs arrangements and the fact that Gibraltar will no longer have to comply with the environmental, corporate or fiscal regulations of the EU (something that, in any event, it had applied in a somewhat relaxed and exceptional way). The Spanish government is also seeking the joint management of the airport in exchange for preventing its removal from the Single European Sky initiative.

Under these circumstances, does it also make sense to take advantage of Brexit to press for the possibility of a solution to the existing territorial dispute and the issue of a definitive status? The stance taken by Madrid over the past year and a half has been constructive, emphasising the interest in preserving the future bilateral relationship with London and simultaneously taking the opportunity to update the shared sovereignty offer that has already been on the table for rather more than 15 years.<sup>44</sup> Spanish diplomacy has sought to underline the idea that it does not wish to cash in on the current circumstances to exert what it considers its historical claim, but the circumstances do exist.<sup>45</sup> And their existence is due not so much to the weakness of the other side (something from which Spain would be ill-advised to try to benefit, since to do so would not only be underhand but also counterproductive, since it would almost certainly cause a backlash) as to the perception that Gibraltar will soon have to leave the EU against its wishes and against its interests. Indeed, so far this year Spain and the UK have already held no fewer than three technical meetings on very specific issues involving officials from their respective Foreign Ministries.

In other words, the issue continues to have a fairly significant importance for Spain, but its resolution is not particularly urgent at the moment. By contrast, the importance and urgency for Gibraltar of resolving its status vis-à-vis Europe seems overwhelmingly clear. This means that prior to March 2019 it is worth exploring the possibilities of a formula that would enable Gibraltar to maintain its link to the EU, via Spain. It would be idle to point

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44 See Martín Ortega Carcelén (2017), 'La propuesta de cosoberanía para Gibraltar: beneficios para todos', ARI nr 33/2017, Elcano Royal Institute, [www.realinstitutoelcano.org/wps/portal/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/ari33-2017-ortegacarcelen-propuesta-cosoberania-gibraltar-beneficios-todos](http://www.realinstitutoelcano.org/wps/portal/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/ari33-2017-ortegacarcelen-propuesta-cosoberania-gibraltar-beneficios-todos).

45 The Spanish Ministry of Foreign Affairs and Cooperation has recently published a study that, while not reflecting the official position, does contain a detailed reflection on the subject. See Magdalena M. Martín Martínez & José Martín y Pérez de Nanclares (Coord.) (2017), *El Brexit y Gibraltar: un reto con oportunidades conjuntas*, Escuela Diplomática, Madrid, [www.exteriores.gob.es/Portal/es/Ministerio/EscuelaDiplomatica/Documents/coleccion%20ED%2023\\_para%20web.pdf](http://www.exteriores.gob.es/Portal/es/Ministerio/EscuelaDiplomatica/Documents/coleccion%20ED%2023_para%20web.pdf).



out the difficulty of this goal but it is worth noting that for the first time in recent years there is an incentive that might induce the Gibraltarians to consider possibilities they might find acceptable (while obviously also being acceptable to Madrid and London) such that all the interests at stake end up being satisfied. It would be an extraordinary dividend of Brexit –a process otherwise condemned to yielding negative results– that would also help resolve a longstanding dispute in a way that there are no winners or losers, thus helping to ease tensions in the eminently necessary bilateral relationship between Spain and the UK that is now in need of reconfiguration, to the benefit of the prosperity of Gibraltar and the neighbouring Andalusian districts.

How can it be achieved? The toning-down in recent years of Spain's demands –by renouncing the territory's absolute take-over– helps to glimpse the possibility of a solution. It is a generous proposal relative to the traditional position of claiming full sovereignty. Immediately after the 2016 referendum, Spain set out its joint-sovereignty proposal to London in terms of four key elements: (a) dual-citizenship for Gibraltarians; (b) maintenance of self-government within the framework of a broad regime of autonomy that matches the Spanish constitutional system; (c) a fiscal regime specific to the territory, subject to its compatibility with European regulations; and (d) dismantling border controls.

The Gibraltarians, who voted overwhelmingly in favour of staying in the EU and have so much to lose by leaving it, can take advantage of the opportunity offered by this potential solution if they find it palatable. Its advocates in Spain (and for that matter in the UK, of which there are also some) emphasise what could be the offer's better points: (a) it could underpin all the advantages Gibraltar currently enjoys due to its British links, such as citizenship, the military presence and the very special connection with the UK in all respects; (b) it would enable continued membership of the EU and a special tax regime that has done so much to contribute to corporate success and current prosperity; and (c) it would entail the resolution of various disputes with Spain (the general claim for decolonisation submitted to the United Nations, territorial waters, the isthmus and airport, border controls and illegal trafficking). In exchange this would require the apparently modest price of flying a Spanish flag side by side with the Union Jack and countenancing the notion of belonging to two states as regards powers not fully devolved to self-government.

Although it may be a modest price, it is one that the Gibraltarians are reluctant to pay due to the twofold symbolic cost of having to revoke a decision already made in the 2002 referendum that pre-emptively rejected such a solution, and particularly of having to accept a sovereignty that, while shared, they do not want (especially if the offer is presented by Spain as a long-term but transitional formula and not as a definitive solution). In this context, shared sovereignty could be condemned to failure at the outset, although it is also clear that the dispute will persist so long as Spain's irredentism remains unsatisfied and, especially, it will be impossible to retain any access to the EU internal market, which Spain views as minimising the damage. Some observers have therefore put forward somewhat



imaginative suggestions on a substantive basis of shared sovereignty, aimed at lessening the symbolic impact of what it all entails.<sup>46</sup>

There are already various examples in the EU (or rather specific cases in adjacent regions) that show the potential for flexible solutions when the application of an orthodox conception of state sovereignty is not appropriate to a small territory. None alone provide a solution acceptable to all sides in the Gibraltar case, but a suitable combination of them could nevertheless provide some inspiration.

The first example is the two enclaves in Switzerland (the German Büsingen and the Italian Campione d'Italia, both with surface areas similar to Gibraltar's), because they illustrate what shared sovereignty, albeit *de facto* rather than *de jure*, can achieve in a peaceful and viable way. Berne does not in fact exercise legal sovereignty over either of these two portions of EU states, but their unusual geographical features have led to their belonging to the Swiss customs area (goods and vehicles, which have special number plates, are subject to checks at the border, but not people); they are also integrated into Switzerland for the purposes of healthcare and sporting competitions. On a day-to-day basis they share the majority of state services and facilities between Switzerland and Germany or Italy (for example: currency, police forces, education, telephone network, postal services and public transport).

A second case in point is the Isle of Man and the islands of Jersey and Guernsey (with their neighbouring islets and outcrops), which as small territories enjoy a high degree of autonomy but are not independent, in the sense that they do not formally belong to the UK but are bound to it by being dependencies of the English Crown. This allows them to be connected to London, which is moreover the authority responsible for specific powers: mainly security and foreign affairs, including a special link to European integration that will be maintained until the moment Brexit materialises. There is therefore a precedent whereby a territory can form part of the EU without belonging to or being formally integrated into a member state, by virtue of a connection to a royal head of state in a country that is a member state, and that moreover discharges certain functions on the international stage on behalf of that territory.

Andorra and its two co-Princes (one French and one episcopal) could provide the third and final ingredient of this possible imaginative solution. Whereas the islands mentioned above are examples of territories connected to a member state not by belonging to it but by sharing the same monarch, the case of Andorra suggests the possibility of the territory's link to the monarchy having a dual character: in Gibraltar's case to the British and Spanish Crowns. In short, it would be a highly autonomous special territory linked to two crowns, one of them held by the King of a member state that will not be leaving the EU in 2019.

Rather than hoisting the Spanish flag and emphasising the idea of shared sovereignty, what this proposed solution would do is blur the perception of where sovereignty resides by flying

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46 See Alejandro del Valle (2016), 'Gibraltar, "año cero": Brexit, cosoberanía y nuevas oportunidades de España', ARI nr 75/2016, Elcano Royal Institute, [www.realinstitutoelcano.org/wps/portal/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/politicaexterior/espanola/ari75-2016-delvallegalvez-gibraltar-ano-cero-brexit-cosoberania-oportunidades-espana](http://www.realinstitutoelcano.org/wps/portal/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/politicaexterior/espanola/ari75-2016-delvallegalvez-gibraltar-ano-cero-brexit-cosoberania-oportunidades-espana).

the Union Jack (as in the Isle of Man and the Channel Islands). The EU flag would of course remain next to Gibraltar's own since the territory would not be leaving the EU by virtue of its special relationship with Spain, and Gibraltarians would vote in a Spanish constituency in elections for the European Parliament.

In the event of such a solution being adopted, the extent of Spanish control over the territory would not be limited to providing a purely formal cloak enabling Gibraltar to remain in the internal market or hanging a portrait of Felipe VI next to Elizabeth II in Gibraltar's government offices. Rather than being a matter of mere appearances it would need to involve the effective wielding of powers albeit shared with the UK, in the areas of foreign relations, control of borders, immigration and asylum and defence (with the stipulation that the naval base, which could continue being predominantly for British use, would not be exclusively British, in the manner of the base at Rota). There would also be dual citizenship, enabling the advantages of EU citizenship to be enjoyed, while for all other matters in which the Gibraltar authorities lacked sufficient powers of self-governance, practical solutions would be applied as in the Swiss enclaves referred to above. There would be no type of control at the border and the special fiscal regime could be extended to the whole of the Campo de Gibraltar district.

What this possible solution therefore offers is virtually the same substantive effects of shared sovereignty but without the symbolic elements that the Gibraltarians find so difficult to swallow. None of this necessarily has to be the Spanish proposal of course; rather it is a case of speculating about a possible negotiating position that could prove acceptable all round. And while not being, or seeking to be, a formal proposal for a departure point but rather a hypothesis about a point of arrival, it is also obvious that its possible course will depend on the unique set of circumstances to transpire this year. If the British and Gibraltar authorities fail to take advantage of Brexit to address the issue, the scope for success of an imaginative proposal such as that outlined above will also fade away and Spain will continue pursuing its claim for a full assumption of sovereignty over the territory, even if shared on a temporary or indefinite basis.

### *2.3 Cooperation on defence, security and the promotion of European values*

Future relations between the EU and the UK should not be restricted to economic aspects, however important they may be. The British government has released two documents in which it seeks to lay down the foundations of a close relationship in foreign policy and defence<sup>47</sup> and cooperation on security and the fight against organised crime.<sup>48</sup> For its part, the EU has also expressed its intention of maintaining cooperation in these and other fields. Spain has a particular interest in such cooperation being as fruitful as possible, both in order to promote European values (that the UK continues to uphold) with greater force and to maintain strategic alliances on the EU's Atlantic flank, which runs the risk of being side-lined both by Brexit and the crisis that transatlantic relations are currently undergoing.

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47 Published by the Department for Exiting the EU and available at <https://www.gov.uk/government/publications/foreign-policy-defence-and-development-a-future-partnership-paper>.

48 Also published by the Department for Exiting the EU and available at <https://www.gov.uk/government/publications/security-law-enforcement-and-criminal-justice-a-future-partnership-paper>.

Matters related to security and defence –including those related to the fight against terrorism– will be key to determining the future of the relationship between the UK and the EU. Geography and history are what they are, and both sides of the English Channel will therefore continue sharing common interests and views. Both the EU and the UK have an interest in preserving and promoting their values to the rest of the world, especially in a complex and shifting geopolitical context in which Europe will continue to lose ground to emerging powers. So apart from the reasonable and desirable cooperation under the framework of NATO, in the fight against terrorism, in the United Nations and in the G-20, it would also be advisable to increase coordination in such areas as research, innovation and diplomatic cooperation.

Once Brexit materialises the EU may experience some waning of its international influence as a normative power that promotes liberal, democratic values and as an advocate of human rights; hence the importance of establishing an explicit strategic alliance with the UK, such that both parties can continue promoting these values on the international stage. This is especially important against a background of democratic withdrawal around the world and the rise of authoritarianism and illiberal democracies in various quarters. The EU and the UK should therefore propose a 'Partnership for Democracy', with the goal of promoting democracy and human rights worldwide.<sup>49</sup>

Apart from this proposal, which is in the interest of both Spain and the other EU members states, Spain should be clear that its relationship with the UK on matters of security should not be exclusively limited to the framework of future EU-UK relations. While it would be absurd to aspire to a special strategic relationship (which in any event should not be pursued until the Brexit negotiations have come to an end), the Atlantic character of the two countries opens the way to deeper cooperation in specific geostrategic spheres. As Luis Simón has argued,<sup>50</sup> Spain (and Portugal too) should explore cooperation with the UK in light of their shared Atlantic character. This involves generating mutual understanding at the highest political level and willingness on the part of Spain to align its capabilities and alliances in accordance with a maritime and global vision.

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49 Pablo José Castillo Ortiz (2017), 'Towards a post-Brexit "partnership for democracy" between the EU and the UK', Commentary nr 6/2017, Elcano Royal Institute, [http://www.realinstitutoelcano.org/wps/portal/rielcano\\_en/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_in/zonas\\_in/commentary-castilloortiz-towards-post-brexit-partnership-for-democracy-between-eu-uk](http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/commentary-castilloortiz-towards-post-brexit-partnership-for-democracy-between-eu-uk).

50 Luis Simón (2016), '*Beyond Brexit*: hacia una mayor cooperación estratégica entre España y el Reino Unido', ARI nr 58/2016, Elcano Royal Institute, [http://www.realinstitutoelcano.org/wps/portal/web/rielcano\\_es/contenido?WCM\\_GLOBAL\\_CONTEXT=/elcano/elcano\\_es/zonas\\_es/ari58-2016-simon-beyond-brexit-hacia-mayor-cooperacion-estrategica-espana-reino-unido](http://www.realinstitutoelcano.org/wps/portal/web/rielcano_es/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_es/zonas_es/ari58-2016-simon-beyond-brexit-hacia-mayor-cooperacion-estrategica-espana-reino-unido).



## Conclusions

Brexit is bad news for Spain. The economic and human bonds as well as the Atlantic character shared by Spain and the UK suggest that Spain is one of the countries that has most to lose from Britain's departure from the EU. Brexit will deprive Spain of a strategic partner on some of the key issues within the Union. It will also lose out economically due to the very considerable volumes of trade, inward investment and tourism that flow between the two countries (these will continue to be significant, but they will face obstacles that are currently non-existent). Lastly, it will lose out to the extent that a weaker EU, deprived of Britain's foreign and security policy, will wield less influence in the world and be less capable of promoting its values and interests, precisely when the EU most needs to put its imprint on globalisation amid the rise of the emerging powers and the increasing isolationism of the US. The specific negative effects are therefore manifold, whereas the potential for positive generic impacts (the drive towards European integration and a certain increase in Spanish influence among the EU 27) cannot with any certainty be viewed as adequate compensation. It is true, however, that developments might yet unfold that change current perceptions.

The very considerable degree to which Spanish policy mirrors EU policy entails that the future relationship between Spain and the UK will be essentially determined by the agreement London strikes with Brussels, the details of which remain unknown; it should come into force in 2021 once the transitional period, due to commence at the end of March 2019, has expired (when Brexit will finally materialise). Although Spain can strike bilateral deals with the UK, this will only happen once Brexit has been consummated: the Spanish authorities have wisely made it clear that they will not negotiate any aspect in parallel in order not to undermine the EU's negotiating position.

Spain, like the other members of the EU, has an interest in the post-Brexit relationship with the UK changing as little as possible. This would require the UK staying within the European Economic Area, in what has been dubbed the Norway solution. This is not a decision that rests with Spain or the EU, however, but with the British government, which is as much divided on the question as British society and the Labour Party, although since February 2018 the latter has been advocating membership of the internal market and/or the customs union. At the time of writing (March 2018), and although it is not as yet definitive, it seems the May government (as aired in her three Brexit speeches: Lancaster House, Florence and Mansion House) is seeking to leave both structures of economic integration in order to control its borders, aims not to be fully subject to the decisions of the European Court of Justice, is not prepared to contribute to the EU budget and wants to have the freedom to negotiate free-trade agreements outside the Union. In the rosier of scenarios this leads to an ambitious free-trade deal (not unlike the Canadian one), which from an economic perspective is a bad solution for Spain because, even in the absence of tariffs, both trade in services and the movement of people will face greater difficulties than those that currently exist. It is therefore essential that Spanish companies prepare contingency plans for such a possibility.

Aware that some European countries, including Spain, will suffer economic loss from Brexit, the British government has made separate approaches to the 27 remaining members for the red lines of the Commission's negotiating position to be relaxed. Specifically, it hopes to achieve either a Canada-type deal, but with access to the common market for its financial services industry (hence the name 'Canada +') or a European Economic Area-type deal, but including control over immigration (hence the name 'Norway -'). In Spain's case it has been made abundantly clear that there is no intention of undermining the Union's common negotiating position, which revolves around the idea that the four freedoms are indivisible, and which was firmly adhered to during the first phase of the divorce negotiations, now concluded. As Michel Barnier has pointed out, if the UK sticks to its red lines the most it can hope for is 'Canada Dry', namely a modern but unappetising trade deal, especially for the financial services industry.

Spain should maintain this position, because its main foreign policy objective is the EU's consolidation, entrenchment and solidity, in the form of an internal market and the rule of law under the jurisdiction of the European Court of Justice. Jeopardising this strategic objective in order to obtain an economic advantage in relation to the UK would be a scant favour to Spain's long-term interests, because other member states, and indeed non-member countries, such as the US and China, would be encouraged to follow the British example and seek an EU à la carte. This does not mean, however, that it is not in Spain's interest that Brexit should be as least damaging as possible. But as things stand this is in the hands of the British government.

In fact, even though over the short to medium term London may accept the arrangements arising from the current Brexit negotiations, in the long term it may resubmit an application to join the EU, because a country of the UK's size and historical and strategic weight is unlikely to tolerate for long a situation in which the rules of the game are decided by others.

Lastly, Brexit opens up the possibility of renegotiating the current position of Gibraltar. Although this is not the most important matter for Spain, it may be possible to take advantage of the circumstances –adopting imaginative solutions such as the one proposed in this paper– to pave the way for a new status for Gibraltar that is favourable to all the parties involved and is in accordance with what Spain considers its legitimate interests and aspirations.

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