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3 Challenges facing the European Union

13 There is no denying that the European Union faces serious policy chal- AQ3
14 lenges that threaten its strength and unity. After five decades of successful
15 deepening of regional integration and enlargement of membership, the mem-
16 ber states seem to have reached a critical point where further advances in
17 integration, such as fiscal and political union with an integrated common
18 foreign and security policy, look uncertain. In this chapter, we describe how
19 four particular items can have a high impact on the EU’s ability to gov-
20 ern and maintain its promise of an “ever closer union.” After our empirical
21 analysis (Chapter 4), we will revisit these challenges and forecast how the
22 EU and its member states are likely to address them.

23 The first major challenge emerged with the financial crisis of 2007. It
24 demonstrated the weakness in the Economic and Monetary Union (EMU)
25 that few expected to be so grave—monetary union without a fiscal union
26 is the EU’s Achilles heel. It is now crystal clear that monetary union cannot
27 be sustained without a serious fiscal restructuring that requires a stronger
28 political union. The second problem facing the EU is Brexit. The British
29 vote in favor of exiting the EU could open the floodgates for future exits
30 from the Union unless proper policies are adopted to counter this threat.
31 The third challenge pertains to the fragility of internal border security which
32 the refugee and immigrant crisis exposed. The lack of a common, or even a
33 European, migration policy threatens the very foundation of the EU’s Schen-
34 gen Agreement, which guarantees unrestricted mobility. And finally, poor
35 relations with Russia are likely to persist and have exposed the EU’s need
36 for deeper security and defense integration.

37 As we review the challenges, it will become apparent how each one affects
38 another. Brexit will cast a shadow on many of the issues given Britain’s
39 important past role in limiting the supranational advancement of the EU.
40 How it leaves the Union will also impact its own internal politics and loop
41 back to its exit strategy. Whether to move forward on fiscal union can have
42 implications for the development of a more integrated military profile since
43 the national autonomy of defense may be producing economic inefficiencies.
44 Lastly, how to deal with the refugee crises can have implications for security
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46 policies, specifically, how to control external borders. As we go through each
47 challenge, we will attempt also to outline the implications for others.

49 **Fiscal union**

50
51 The most recent financial crisis in the EU exposed the weaknesses in mon-
52 etary union. The reasons behind the crisis are complex but boil down to
53 the incomplete nature of integration that followed signing of the Maastricht
54 Treaty in 1991. The original intent of the Treaty of Rome to create a Single
55 Common Market was completed in 1992, but created complex internal and
56 external challenges that EU members failed to anticipate. Most were con-
57 vinced that taking the next logical step in economic integration—fiscal and
58 monetary union—was around the corner. However, European leaders did
59 not make the required bold move to establish the fiscal structure required
60 for a true federated political union. This shortcoming remains the Achilles
61 heel of the EU reflected in the recent financial crisis and the inability of the
62 EU to get itself out of the ensuing mess. As Kugler, Fisunoglu, and Yesi-
63 lada note, “reluctance and, in some cases, opposition among some members
64 to deepening political union resulted in a lopsided regional integration.”¹
65 EMU among 19 member states and an economic union of all members that
66 had a say in the intergovernmental political union resulted in a divided
67 opinion on the most important next step in completing integration—fiscal
68 (political) union.

69 Fiscal union would produce a single fiscal policy for the EU member
70 states. While the EU does have a budget and role in determining the level
71 of the value added tax on consumption, most important decisions regarding
72 taxing and spending still remain at the national level. The member states
73 are also tied together under the Stability and Growth Pact (SGP). How-
74 ever, the pact only controls the level of debt-to-budget ratio and has no
75 true accountability if members overspend. At best, the SGP is a means to
76 coordinate states’ fiscal policies in macroeconomic terms without a detailed
77 strategy for economic growth. The stricter Fiscal Stability Treaty entered
78 into force in 2014 among 24 member states with some provisions regard-
79 ing accountability along with mechanisms for member states to temporarily
80 opt out of the complex debt-to-budge ratio calculations should they face
81 a recession. A fiscal union would replace the complex coordination efforts
82 and the myriad state policies with an integrated policy that offers a single
83 vision for economic performance. A fiscal union would require that supra-
84 national institutions create a budget detailing expenditures and adopt a
85 common tax policy for citizens and business entities for all member states,
86 not only the EMU members. The resulting policy would regulate economic
87 activities like those one finds in national budgets and coordinate the Single
88 Common Market. It would also serve as a single decision point to resolve
89 economic crises without resulting in intergovernmental debates that focus
90 on member state interests instead of continental interests. Fiscal union goes

91 hand-in-hand with the creation of a political union, one that approximates
92 a federal arrangement, because strong supranational institutions are needed
93 to create and possibly enforce it.

94 There are two schools of thought regarding whether or not to have an
95 EU fiscal union. According to one school, monetary union cannot survive in
96 the long run unless it is accompanied by a strong political union. Supporters
97 cite numerous historical cases to support this position. This perspective is
98 formally proposed by William Riker in his powerful analysis of the rise of a
99 federated United States.² He argued that confederations could not succeed
100 unless they offer continuous positive gains for the members. He supported
101 this deduction by showing that the United States confederation (1781–1789)
102 collapsed when taxes were to be imposed on the US population without
103 visible immediate returns.

104 The alternative European-based school of thought maintains that the
105 present degree of political union in the EU is sufficient for long-run prosper-
106 ity and survival.³ Specifically, a partial monetary union can be sustained
107 when it is adopted in some and not all members. There is no urgency to
108 create a fiscal, federal structure similar to one found in the US. For this
109 view, an effective confederation does not require further political federation
110 to thrive.

111 Paul De Grauwe states that this debate between these two views about the
112 link between political and monetary union is somewhat difficult to resolve
113 because of the lack of clarity about the meaning of political union.⁴ There
114 is real asymmetry in the degree of integration between the two camps of
115 member states, which has already created a two-track EU. Of the 28 EU
116 members 9 have not yet adopted the euro. Interestingly, Brexit reduces sub-
117 stantively the economic and demographic impact of the less integrated set,
118 but the devolution slowdown reinforces previous failure to deepen political
119 integration and carries with it the danger of weakening collaboration on
120 the CFSP/CSDP front, which will be discussed at the end of this chapter.
121 [Figure 3.1](#) effectively shows how this two-track EU emerged. The two lines
122 show different levels of integration between two sets of member states—
123 those that are in EMU and others that are outside the Eurozone.⁵ This is
124 what a two-track EU represents.

125 Among the non-Eurozone EU countries, the United Kingdom, Sweden,
126 and Denmark prefer nothing more than what one might call a loose confed-
127 eral system that limits steps towards a political union. Brexit was probably
128 induced by increased migration, but was preceded by the UK's opposition
129 to further deepening of economic and monetary integration exemplified by
130 its rejection of the euro, resistance to fuller fiscal union, and its decision not
131 to join the banking union. At the same time, a larger number of member
132 states were willing to join the Eurozone as full participants. The monetary
133 and fiscal policies of the recently added Eastern European states—Bulgaria,
134 Czech Republic, Hungary, Poland, Romania, and Croatia—are becoming
135 consistent with choices already made by the 19 nations that have joined the

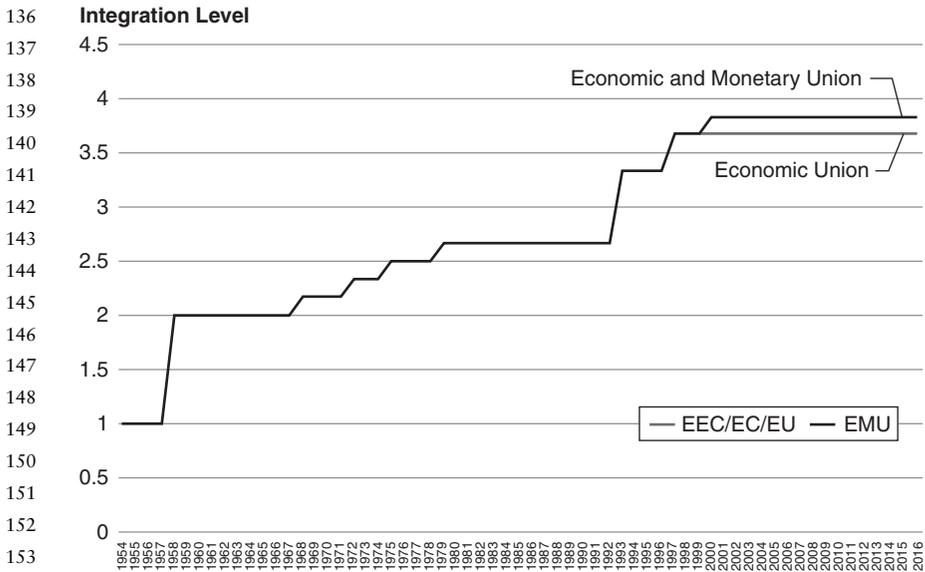


Figure 3.1 Two-Track Integration in the EU

Source: Updated and adapted from Jacek Kugler, Ali Fisunoglu, and Birol Yesilada, “Consequences of Reversing the European Union Integration,” *Foreign Policy Analysis* 11 (2015): 49.

euro and they are on a waiting list to join. A more robust fiscal union and negotiations on banking union have progressed, in part, as a response to inadequate treatment of the Greek financial crisis and continuing monetary concerns in the southern EU states.

Following the devastating economic and financial Eurozone crisis, we believe European member states have come to a decision point. Their recent attempts to strengthen financial resources to meet budget shortcomings and debt servicing problems of member states signal the recognition of needed fiscal union by leading member states’ governments. The EU responded to these crises by adopting measures to improve the economic governance framework of the EMU such as the strengthening of the Stability and Growth Pact or the adoption of new mechanisms to prevent economic imbalances and better coordinate economic policies already mentioned.

The Presidents of four European institutions—the European Commission, the European Parliament, the European Central Bank, and the European Council (as President of the euro summit)—together with the President of the Eurogroup, in the “Five Presidents Report”⁶ laid down a roadmap to deepen the Economic and Monetary Union in two stages as of July 2015 and complete it by 2025 at the latest. Accordingly, Stage 1 or “Deepening by Doing” (July 1, 2015–June 30, 2017) calls for the use of existing instruments and the current treaties to boost competitiveness and structural

181 convergence, achieve responsible fiscal policies at national and eurozone
182 level, and complete the financial union and enhance democratic accountabil-
183 ity. In Stage 2, or “Completing EMU” (by 2025), more far-reaching actions
184 will be launched to make the convergence process more binding. For exam-
185 ple, a set of commonly agreed benchmarks for convergence, which would
186 be of legal nature, as well as a euro area treasury, are needed.⁷

187 In October 2015, the Commission began implementing the “Five Pres-
188 idents’ Report” by adopting a package of measures, but the road ahead
189 is full of political uncertainties as member states’ governments display dif-
190 ferent levels of commitment to more political union. If another economic
191 and financial crisis appears, it will be because policy-makers are not willing
192 to face the conundrum at the heart of the single currency—the shackling
193 together of very different economies with very different needs. The nature
194 of the problem is quite monumental—it is a north–south divide which boils
195 down to German preferences against those of the southern member states.
196 Facing slow growth and high unemployment in the troubled economies,
197 Germany and its allies want austerity measures to be implemented without
198 exception in Portugal, Italy, Greece, and Spain. The governments’ prefer-
199 ences, and the general public opinion in these countries, are against tight
200 austerity policies, while Keynesians argue that austerity is exactly what these
201 economies do not need to resolve their economic problems.

202 Reality is quite bleak. The European Commission forecasts the following
203 in 2017:

- 204
- 205 ● UK: 5.2 percent unemployment and gross public debt at 88.9 percent of
206 GDP;
- 207 ● Germany: 4.3 percent unemployment and gross public debt at 66.7
208 percent of GDP;
- 209 ● France: 9.9 percent unemployment and gross public debt at 96.8 percent
210 of GDP;
- 211 ● Italy: 11.4 percent unemployment and gross public debt of 133.1
212 percent of GDP;
- 213 ● Spain: 18.0 percent unemployment and gross public debt of 99.9 percent
214 of GDP;
- 215 ● Portugal: 10.0 percent unemployment and gross public debt of 129.5
216 percent of GDP; and
- 217 ● Greece: 22.2 percent unemployment and gross public debt of 179.1
218 percent of GDP.⁸
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221 The Commission also expects GDP growth in the euro area to be 1.7
222 percent for 2016, 1.5 percent in 2017, and 1.7 percent in 2018, figures
223 which are hardly sufficient to significantly alter sovereign debt challenges of
224 the problem states.

225

226 Following the anticipated Brexit, further integration is the realistic suit-
227 able option to prevent future monetary crisis and maintain the EU. Under
228 Germany's leadership many have taken concrete steps towards some degree
229 of fiscal union with a European treasury and EU-level income tax. Such
230 steps are move the community into a stronger position but still fall short of
231 full fiscal union that can handle serious crises similar to one experienced in
232 2009. Moreover, key countries that face serious fiscal challenges have come
233 out in opposition to austerity, namely Greece, Portugal, Spain, and most
234 recently, Italy, all of which present a direct challenge to German orthodoxy.

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Refugee crisis

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238 The refugee crisis in Europe is not only a humanitarian problem, it is a seri-
239 ous challenge to the EU's solidarity and exposed the need for a common
240 policy towards asylum seekers, immigrants, and the financial responsibility
241 between the EU and its member states. Security, political, and social con-
242 cerns further add to the problem. Disagreements over border security and
243 control of movement of individuals placed significant stress on the EU's
244 Schengen Agreement, which regulates Europe's passport-free travel area.
245 The common institutions created to support the management of Schengen,
246 Frontex, which works on border control, and the European Asylum Support
247 Office, were insufficient in meeting the large numbers of migrants and asy-
248 lum seekers because they were neither empowered nor sufficiently funded
249 to play more than auxiliary roles.⁹ Further complicating the problem is the
250 fact that the EU lacks harmonized immigration and asylum policies because
251 member states preferred autonomy in these areas.

252

253 There is no doubt that future stability of Schengen is vital for the EU's
254 future since dismantling this agreement could be followed by the disin-
255 tegration of the EU. Free mobility within the Single Common Market is
256 guaranteed by the Treaty on European Union and is one of the cornerstones
257 of integration. The right to seek out and take advantage of opportunities
258 within any EU member's economy, whether for labor or capital, is critical
259 for the mechanisms of price and wage convergence. Politically, it helps in
260 developing a uniform identity for Europeans by breaking down national
261 economic preferences. Such identity is necessary for citizen support and trust
262 in supranational institutions. In addition, closing off borders due to alleged
263 threats indicates that security is not a collaborative effort, but a national
264 one. Reneging on the Schengen Agreement therefore sends a psychological
265 and practical signal of returning to a zero-sum condition, which inherently
266 contracts the spirit of integration.

266

267 It is safe to state that EU leaders did not anticipate a crisis like the current
268 migrant problem when they signed the Schengen Agreement. While such a
269 problem is not new (e.g., the war in former Yugoslavia flooded EU states
270 with refugees in the 1990s), the scale of the present challenge is on par with
the volume of World War II asylum seekers as the refugees from the Middle

271 East and North Africa, and other war-torn countries, arrive at the gates of
272 the EU (see [Figure 3.2](#)).

273 According to the International Organization for Migration (IOM)
274 approximately 1,015,078 migrants arrived in EU countries in 2015—
275 1,011,700 arrived by sea and almost 34,900 by land. These numbers are
276 well over the 280,000 arrivals by land and sea in 2014. During this time, the
277 Aegean and Mediterranean seas turned into graveyards of migrants as many
278 perished trying to reach EU countries.¹⁰ Political pressures created by this
279 crisis led several EU member states' governments to adopt rather controver-
280 sial policies aimed in keeping these people from entry into their countries by
281 suspending their roles in the Schengen Agreement. Such moves contradict
282 the principles of the Schengen Agreement which guarantees free movement
283 of people within the EU. The problem pertained to the EU's Dublin regula-
284 tion which assigns the responsibility for registering and processing asylum
285 applications to the first Schengen country where they arrive in the EU.¹¹
286 With massive numbers of refugees entering Greece and Italy, these govern-
287 ments were no longer able or willing to fulfill their obligations and permitted
288 refugees to move on to other EU countries as they wished. Germany had
289 the most asylum applications in 2015 followed by Sweden, Austria, and
290 Finland, while Hungary and Sweden had the highest numbers in proportion
291 to their population.¹²

292 The crisis also exposed deep-rooted issues of discrimination among
293 European citizens across member states. A survey by Pew Research in spring
294 2016 found that:

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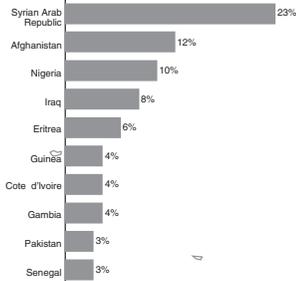
- 296 • Many in the EU countries feared that the influx of refugees would
297 increase the likelihood of terrorism in their countries and impose an
298 uninvited burden on them. The highest concerns were in Hungary
299 (76 percent) and Poland (71 percent) followed by Germany, the
300 Netherlands, and Italy at 60 percent.
- 301 • More than 65 percent of the people in Greece, Hungary, Italy, Poland,
302 and the UK viewed refugees from Iraq and Syria as a major threat.
303 The lowest percentages were in the Netherlands (36 percent), Germany
304 (31 percent), and Sweden (24 percent).
- 305 • Xenophobia also played a significant role in people's perceptions. Indi-
306 viduals with more negative views of Muslims, predominantly with
307 ideological views of the political right, also perceived a higher threat
308 from refugees than those who were more leftist in their political views.
309 In all EU countries surveyed, the anti-Muslim view also meant an
310 anti-migrant position, with the UK leading the pack with 80 percent.
- 311 • In countries surveyed, more people had a negative view of diversity, as
312 a result of migrants coming to their countries, than those who thought
313 migrants made their country a better place to live.
- 314 • Regardless of their political views, most Europeans believed that the EU
315 was doing a very poor job in handling the refugee crisis.¹³

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Increasing numbers of refugees and migrants take their chances aboard unseaworthy boats and dinghies in a desperate bid to reach Europe. The vast majority of those attempting this dangerous crossing are in need of international protection, fleeing war, violence and persecution in their country of origin. Every year these movements continue to exact a devastating toll on human life

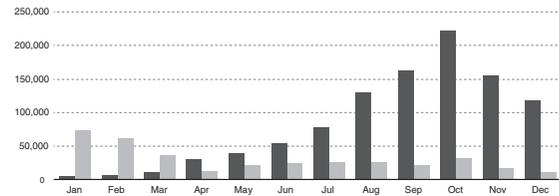
Top-10 nationalities of Mediterranean sea arrivals

Top-10 nationalities represent 75% of the sea arrivals based on arrivals since 1 Jan 2016



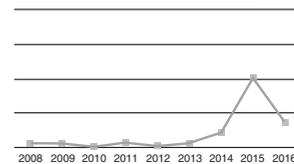
Other countries represent 25% of the total

Comparison of monthly Mediterranean sea arrivals



Evolution - Mediterranean Sea

Sea arrivals | Dead/missing persons



Demographics based on arrivals since 1 Jan 2016



*Serbia (AND KOSOVO): S/RES/1244 (1999)
The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations

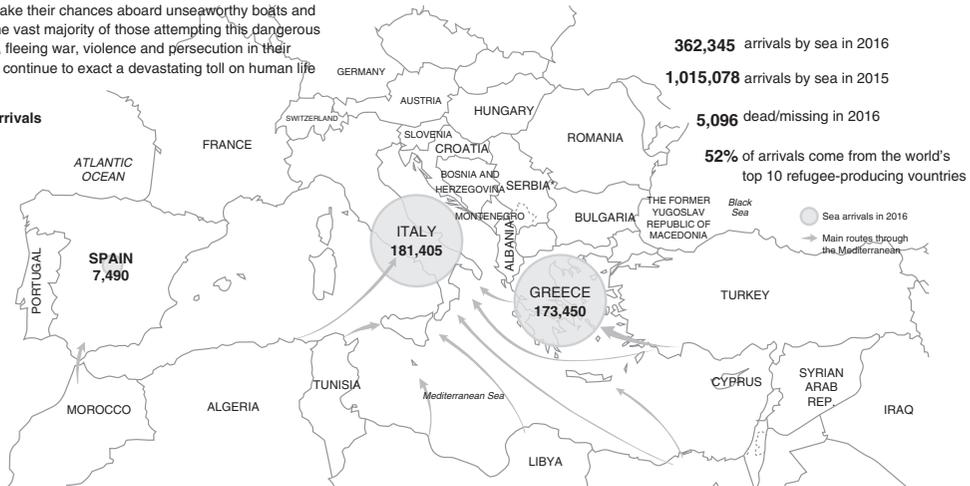


Figure 3.2 Flow of Migrants to the EU
Source: UNHCR, <http://data.unhcr.org/medportalviz/dist/index.html?year=2016&cache=020117>.

361 The failure of the EU to find an appropriate solution to the problem only
362 means that the crisis is likely to get worse. As the war in Syria intensifies and
363 problems between the EU and Turkey show no signs of improvement, the
364 Turkish government could easily allow refugees to mass exit into Greece.
365 Earlier, the two sides reached a tentative agreement whereby Turkey would
366 prevent refugees from going to Greece in exchange for 5 billion euros assist-
367 ance and visa-free travel for Turkish citizens in the EU. However, for
368 various reasons, the EU has been reluctant to follow through on visa-free
369 travel for Turks. In return, President Erdogan of Turkey has hinted at tearing
370 up the agreement.

371 The irony of the immigration dilemma in the EU is that the influx of
372 migrants answers one other key challenge facing European countries—
373 low birthrates in the majority of member states. As will be discussed in
374 [Chapter 5](#), this is a serious problem for the EU in meeting challenges from
375 its global competitors. As China and India increase their share of global
376 economic output, the EU faces a decline in economic size relative to these
377 countries and the US.¹⁴ Yet, anti-migrant sentiment among Europeans and
378 the increased financial burden these people present to member states' gov-
379 ernments stand in the way of finding a common European policy for asylum
380 and immigration.

381

382

Brexit

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384 On June 23, 2016, the British, in a historic decision, voted by a slim margin
385 of 52 to 48 percent to leave the EU, also known as Brexit. Although Con-
386 servative Party member Theresa May did not vote to leave the EU in the
387 referendum, as prime minister she has the task of formulating answers on
388 how the UK will exit the EU. Her comments about the future suggest that
389 control of immigration is her top priority even if it means giving up mem-
390 bership of the single market.¹⁵ “Hard Brexit” supporters would like that,
391 yet it is not certain that the general public or business leaders would support
392 a total withdrawal from the European market. According to the BBC, one
393 recent poll found that most people would rather have the single market than
394 controls on immigration.¹⁶ So, the road ahead looks anything but clear.

395 The Treaty on European Union, as amended by the Treaty of Lisbon,
396 outlines how a member state can withdraw its EU membership (Article
397 50). According to Article 50, the process begins when “A Member State
398 which decides to withdraw shall notify the European Council of its inten-
399 tion” using “its own constitutional requirements.” The UK’s “constitutional
400 requirements” led to Parliament passing an act asking the government
401 to start the negotiations, although only after prior legal processes.¹⁷
402 Prime Minister May announced that she intended to begin the two-year
403 countdown to Brexit on March 29, 2017 when she triggers Article 50.¹⁸
404 The timing of the official declaration is highly important since negotiations
405 for withdrawal must end in two years. Unless the European Council decides

406 to extend this timeframe, the withdrawing member state is then out on its
407 own because all “The Treaties shall cease to apply to the State in question”
408 after the two-year deadline. The start date is in the hands of the British
409 government; however, given the fixed time line and other factors explained
410 below, the terms of the withdrawal are in the European Council’s hands and
411 with that, in the hands of the more powerful member states.

412 The British exit could be “soft,” “hard,” or somewhere in between.
413 Hard Brexit would include the UK’s complete withdrawal from all treaties
414 tying it with the remaining EU member states and their economies. The
415 result would have the UK treated like a World Trade Organization (WTO)
416 member, which would give it some preferential trading access under WTO
417 agreements. Having preferential trading access will limit the amount of
418 goods and services it can export. Investment flows will also be limited. This
419 can lower production and thereby harm growth. Depending on domestic
420 politics, imports from Europe can also face high tariffs leading to inflation.
421 However, since the UK joined the WTO not as an independent entity but
422 as part of the EU, it will need to request separate admission to the WTO.
423 Therefore, there would be a gap in time before it would even have such
424 limited access to the European market. Given its new status outside the
425 European Customs Union, it would be able to negotiate free trade agree-
426 ments with any other country/regional entity of its choice. Hard Brexit will
427 also mean that the UK will no longer need to pay into the EU budget
428 and will not be required to accept EU labor migrants. However, this will
429 also mean that British citizens will not have free access to the EU labor
430 market.

431 In contrast, a soft Brexit would include continued membership in the
432 European Economic Area (EEA). Britain would not have the same access to
433 the EU market as an EU member state, but would have substantial access.
434 How much access will need to be negotiated in an association agreement.
435 However, like other EEA members that are not EU members, the UK will
436 have obligations. One such requirement would be to pay into the EU budget,
437 but without participation in decision-making. Another would be accepting
438 EU labor migrants—a major issue that influenced the leave vote. How-
439 ever, British citizens will also have free access to the EU labor market. EEA
440 membership would still free it from the Customs Union, thereby allowing
441 the UK to negotiate FTAs with all other countries/regional entities of its
442 choice.

443 If the final outcome is something different than a hard Brexit, the UK’s
444 EU membership withdrawal is not the same as the UK’s complete separa-
445 tion from the EU. The projected profile of this relationship is one of degree
446 that depends on the negotiating leverage of the UK vis-à-vis the EU. Given
447 the asymmetric power relations, it is unlikely that the UK will have much
448 leverage in determining the final outcome. One indicator of this is the UK’s
449 trade dependency with the EU over the years 2011–2015. The UK’s average
450 total trade (imports + exports) with the EU during these years amounted to

451 23.1 percent of total UK economic output. Of the UK's total trade with the
452 EU, 44 percent of it is with Germany, France, and Italy. The share of trade
453 with Germany alone is 24.5 percent. We see less dependence on the UK if
454 we look at the trade of Germany, France, and Italy relative to their GDPs.
455 German trade with the UK represents only 3.9 percent of German GDP.
456 Dependency for France and Italy is 2.9 percent and 1.8 percent, respectively.
457 Given the strong preference convergence of the top three EU powers, their
458 small economic stakes in British trade, and the strong need for Britain to
459 maintain trade with the EU, it will be the EU (especially the top three pow-
460 ers) that will have more influence over the final outcome. When the EU
461 makes regulatory policy in the future, it will mean that the UK will need to
462 adopt new policies, otherwise it will be faced with non-tariff trade barriers.
463 In other words, the UK will lose its voice in decision-making because it will
464 no longer have membership in the Commission, Council, or the European
465 Parliament, while needing to accept their decisions if it wishes to remain
466 part of the free trade area—which it will need in order to maintain and grow
467 its economy.

468 What would all this mean for the UK's economic future? The UK's vote
469 will affect both the EU and British economies through several channels:
470 uncertainty, investment, trade, and migration. In the short term, the most
471 significant factor will be economic and political uncertainty which is likely
472 to slow investment and trade. Based on recent experience, estimates of the
473 future effects of Brexit are clearly uncertain, but according to the *Financial*
474 *Times*, its long-term effect on Britain's national income ranges from -7.8
475 percent to -3.0 percent.¹⁹ This will have a significant impact on Britain's
476 unemployment and inflation, and could result in potential economic stag-
477 nation. From the EU side, Brexit will contribute to the EU's budget deficit.
478 Britain's contribution to the EU budget has been set at 19.4 billion euros
479 which includes its rebate and customs duties. In return, Britain receives 7
480 billion euros in agricultural and regional subsidies. The difference of 12.4
481 billion euros makes up roughly 5 percent of the EU's annual budget, which
482 will need to be picked up by other member states.²⁰ Such deficits place addi-
483 tional pressure on the EU to deepen integration and put its fiscal house
484 in order.

485 The Brexit issue is also intertwined with the migration/refugee crisis dis-
486 cussed in the previous section, but also in a more general sense, in terms
487 of migrants to and from other EU countries. While UK citizens are wary of
488 migrants from the Middle East and North African countries, they are also
489 concerned about how Brexit will affect British citizens employed in other
490 EU countries and vice versa. Certainly, the influx of EU citizens into the UK
491 was one of the major issues highlighted by the campaigners for Brexit. It is
492 estimated that 3 million non-British EU citizens lived in the UK in 2015, or
493 approximately 5 percent of the UK population.²¹ Most of them are there
494 for work and they account for roughly 7 percent of the total workforce.
495 In contrast, the number of British citizens living in the rest of the EU was

496 approximately 1.2 million in 2015. Given these figures, it is quite proba-
497 ble that the EU will want the UK to maintain free labor mobility which
498 benefits both parties. Should the UK require EU immigrants to follow the
499 same migration criteria as non-EU immigrants, most would need to leave
500 the UK and the number of new EU immigrants would drop significantly. It
501 is unlikely that the EU would negotiate a new relationship with the UK that
502 would leave current and future workers out. The EU top powers, especially
503 Germany, would likely require mobility to continue and the UK will likely
504 accept this given its EU economic dependence.

505 Another potential problem created by Brexit is how this decision is going
506 to affect Scotland's relations with the UK. During the EU referendum, 62
507 percent of Scots voted to remain in the EU. In fact, every Scottish voting dis-
508 trict chose to stay. This is in sharp contrast to England, which voted to leave
509 by 53.4 percent. Such difference of preferences creates a serious divergence
510 between England and Scotland where the latter is not going to be happy
511 with the consequences of the referendum. In fact, Scottish independence
512 leaders have made it quite clear that they would consider splitting from
513 the UK unless Scotland could maintain EU membership, but such member-
514 ship would not be automatic as it would require a whole new process of
515 accession for an independent Scotland. The election results display a clear
516 divergence of preferences between the two. To give a constituent part of
517 the UK that much autonomy is unlikely given the traditional supremacy of
518 Parliament. There is a good possibility that a referendum for Scottish inde-
519 pendence shortly before the full UK exit from the EU so that Scotland can
520 join the EU while England, Wales, and Northern Ireland leaves. The loss of
521 such a large portion of the UK will further diminish its power and influence
522 in Europe and the world.

523 Finally, Brexit will also alter the power hierarchy within the EU. The
524 British departure will result in a larger German power ratio. In 2015,
525 Germany's GDP was 25 percent that of the remaining member states. With-
526 out the UK, this figure increases to 30 percent, slightly increasing this
527 country's power in the hierarchy. Given the fact that Germany and the UK
528 often sit at the opposite sides of important policy issues that would deepen
529 integration, Brexit would raise the following question of policy importance.
530 Would Germany be able to push for further deepening of integration, includ-
531 ing a fiscal (political) union, with the UK out of the picture? We will address
532 this question in the subsequent empirical chapters.

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Common foreign and security policy

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No serious and full integration would be complete without integrated
defense and foreign policies. The Treaty on European Union (Maastricht
Treaty) established an integration structure based on three pillars, one of
which would be the realization of a Common Foreign and Security Policy
(CFSP). The idea of such a uniform policy for all EU member states moved

541 forward under the amended Treaty on European Union (Lisbon) when it
542 created the office of the High Representative of the Union for Foreign Affairs
543 and Security Policy, who heads the European Defence Agency as well as a
544 diplomatic corps referred to as the European External Action Service.²² The
545 EU is challenged by not having a clear, united CFSP. Currently, the High
546 Representative and the President of the European Council can speak for the
547 EU. This creates a condition where contradictory statements can be made,
548 unless all parties read from the same script. Which begs a question: Who
549 writes the script? In addition, the CFSP is currently under the unanimity-
550 voting rule which means any one member state can veto a policy position.
551 One high-profile case was the US-led invasion of Iraq. Given no consensus,
552 each member state went its own way. It is beyond the scope of this chapter
553 to discuss evolution of the CFSP, but it should suffice to say that as a result
554 of the Lisbon Treaty, the CFSP became embedded in a whole range of other
555 EU policies that have implications for external action by member states. The
556 Lisbon Treaty elevated the European Security and Defense Policy (ESDP) to
557 a Common Security and Defense Policy (CSDP, while still being within the
558 CFSP) and made it clear that this change indicates a greater willingness by
559 member states to develop a military arm of the EU—yet without a greater
560 push for a more supranational approach. The reference to partnership with
561 NATO as the foundation of member states’ security policy (for those that
562 are members of NATO) is proof of an intergovernmentalist approach to the
563 CSDP. This is apparent in the upholding of Article 17 of the Treaty of the
564 European Union by the Lisbon Treaty (ToL, Art. 28A, par. 2) reasserting
565 “progressive framing of a common Union defense policy will lead to a com-
566 mon defense, when the European Council, acting unanimously, so decides.”
567 It is clear from recent developments that the CFSP needs NATO for ter-
568 ritorial defense of the EU. In most, if not all, of its overseas operations,
569 the EU has relied on the assistance of NATO in one way or another. Thus,
570 the phrase “separable, but not separate” describes the current partnership
571 between the CSDP and NATO. This is illustrated in [Table 3.1](#), which lists
572 the membership of EU and NATO countries. Of the 27 NATO members, 22
573 are also EU members.

574 Why have a CFSP? A simple answer would be to further European inte-
575 gration and place the EU as a global power in every respect of that term. As
576 Wolfgang Wessels and Franziska Bopp explain:

577

578 The provisions for CFSP and, increasingly also the Common Security
579 and Defence Policy (CSDP), can be regarded as the cornerstone of the
580 Lisbon Treaty. Furthermore, the challenges the Union faces within the
581 international system are ever growing and requiring an ever-increasing
582 scope of action across different policy fields, geographical regions and
583 arenas of policy-making. This makes the policy field a very relevant,
584 although sometimes diffusing research area as three types of foreign
585 interactions intertwine: traditional national foreign policy, the foreign

Table 3.1 Overlapping EU and NATO Memberships

<i>Country</i>	<i>EU</i>	<i>NATO</i>	<i>Country</i>	<i>EU</i>	<i>NATO</i>
Austria	Yes	No	Luxembourg	Yes	Yes
Belgium	Yes	Yes	Malta	Yes	No
Bulgaria	Yes	Yes	Netherlands	Yes	Yes
Croatia	Yes	Yes	Poland	Yes	Yes
Cyprus	Yes	No	Portugal	Yes	Yes
Czech R.	Yes	Yes	Romania	Yes	Yes
Denmark	Yes	Yes	Slovakia	Yes	Yes
Estonia	Yes	Yes	Slovenia	Yes	Yes
Finland	Yes	No	Spain	Yes	Yes
France	Yes	Yes	Sweden	Yes	No
Germany	Yes	Yes	UK	Yes	Yes
Greece	Yes	Yes	Norway	No	Yes
Hungary	Yes	Yes	Iceland	No	Yes
Ireland	Yes	No	Turkey	No	Yes
Italy	Yes	Yes	USA	No	Yes
Latvia	Yes	Yes	Canada	No	Yes
Lithuania	Yes	Yes			

policy of the EU as prescribed in the treaty articles on CFSP and CSDP, and the EC external relations, which concentrate on long-standing and mostly economic foreign relations and development policy.²³

However, to have a CFSP for its own sake is not enough. Like many other integration efforts, the rationale for the CFSP is tied to the single market. An integrated economy, like that of the EU, can be vulnerable to external shocks manifested by individual states. For example, monetary coordination was once needed so that if one currency's exchange rate dramatically changed vis-à-vis the US dollar or Japanese yen, it would not send an uncontrolled shock to the other currencies. Monetary coordination was eventually replaced by a stronger control mechanism, the single currency, among a subset of member states. Unilateral foreign and security policy actions could also send shocks to other member states. A single or small group of member states could decide on actions that could affect prices, currency values, foreign investment, or the ability to borrow from international markets. One extreme example would be the case of armed conflict. Should one or more member states be involved in a major war with a third party, it could impact economic relations among the remaining member states. Should one or more member states be physically invaded by a third party, this too could harm the other member states' economies.

If these extreme examples are not convincing, all we need to do is see the fallout from the current refugee crisis already mentioned in this chapter. The large populations attempting to escape North Africa, the Levant, and

631 Afghanistan have stretched the resources of the member states that are
632 geographically the closest to the source conflicts. Securing the EU external
633 border and housing and feeding refugees puts pressure on member states'
634 budgets which makes it more difficult to fulfil EU obligations. The move-
635 ment of refugees further west and north causes similar problems for these
636 other receiving countries. As previously stated, a few member states have
637 dealt with the problem by resurrecting border controls not seen since the
638 late 1980s. The link between the CFSP and the refugee/migrant crisis is
639 highlighted by a recent observation by Chancellor Merkel. During a visit to
640 Belgium and Luxembourg, Merkel said:

641

642 Let's not fool ourselves. From the point of view of some of our
643 traditional partners—and I am thinking here about transatlantic
644 relations—there is no eternal guarantee of close cooperation with us
645 Europeans . . . [Europe] is facing one of its biggest challenges for decades
646 due to conflicts on its borders, such as Russia's aggression in Ukraine
647 . . . and it would be naive always to rely on others who would solve the
648 problems in our neighbourhood.²⁴

649

650 Merkel also said that the UK's decision to leave the EU ought to galva-
651 nize military cooperation among the remaining member states more than
652 ever before and especially during the Trump presidency.²⁵ Deeper integra-
653 tion in military matters is also important for projection of EU power that
654 is not economic in nature. If the EU wants to be influential abroad as a
655 global power, it will need an integrated military force with heavy lift capa-
656 bility. The current emphasis on "soft power" is a limited and insufficient
657 tool in meeting serious foreign and security policy challenges of the EU. In
658 December 1998, Britain and France signed the St. Malo Declaration call-
659 ing for an autonomous European defense capability which, at the time, was
660 viewed as a necessary step towards establishing the EU's CFSP with a joint
661 European army. However, the plan did not lead to a significant EU defense
662 force and capability since most member states' governments did not show
663 interest and were planning to reduce defense spending. Yet, it signaled the
664 desire of the EU to establish its own integrated defense that would act inde-
665 pendently of the US when needed. For the EU defense force to be effective,
666 Germany's participation was essential, yet German law at the time prohib-
667 ited deployment of German troops abroad. The major armed forces with
668 overseas deployment capability, though significantly lower than that of the
669 US, remained British and French.

670

671 The removal of the British armed forces through Brexit will have a seri-
672 ous impact on Europe's military capabilities and would make the EU even
673 more dependent on NATO and the US for its security at least in the near
674 future. Data in [Figure 3.3](#) and [Table 3.2](#) demonstrate the UK's military capa-
675 bilities and defense spending relative to other countries. Inevitably, if not

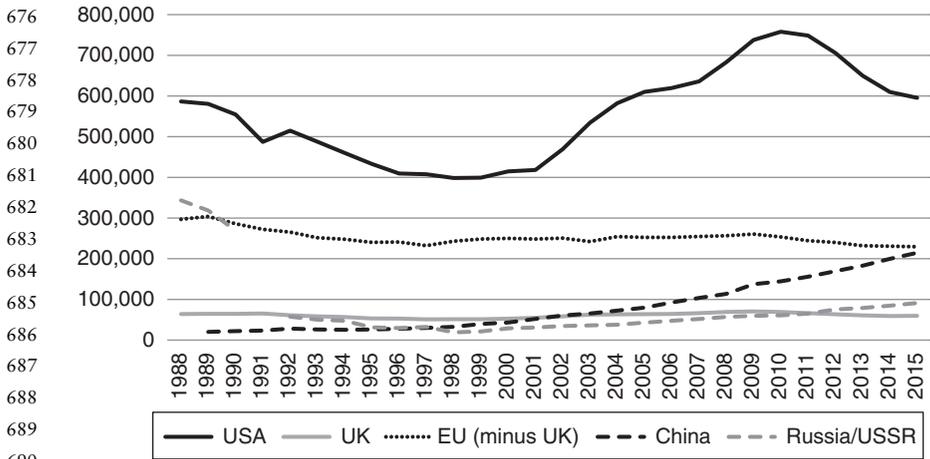


Figure 3.3 Military Expenditures, 1988–2015 (US million in 2014 dollars)

immediately then soon enough, implementing a fully functioning CFSP will require the creation of distinct EU capabilities, separate from NATO.

The overall military budget for EU nations that fall in the top 35 listed in Table 3.2 (excluding Britain) is \$168 billion compared with the US budget of \$612 billion with an equivalent economy; China spends \$126 billion, again with an equivalent economy, and Russia, despite a very small economy, spends \$76 billion. Numbers of active personnel tell a very similar story. The same group of nations in the EU can field a little over a million troops, compared with the US with 1.4 million, China's 2.3 million, and Russia's 766,000. A coordinated Europe is large; a divided one is not. Germany has a budget of \$45 billion with active personnel at 229,000 troops; France spends \$43 billion with a personnel of 183,000; and Spain has a budget of \$34 billion, fielding 320,000 active personnel. Other EU nations fall far behind. Compared with the US or direct competitors like Russia or potentially China, these are insufficient number for effective competition. Finally, France will be the only remaining nuclear power in the EU after the United Kingdom exits, with a capability far inferior to that of the United States or Russia; it still matches that of China and is realistically capable in the future of sustaining parity with Israel's nuclear capacity. For such a large aggregation of advanced societies, the military profile is unexpectedly weak.

The observed trend is likely to get worse when one considers planned defense budget cuts among NATO's leading EU members for reasons related to fiscal austerity following the financial crisis. Since 2008, NATO members have been reducing their defense budgets while Russia has been steadily increasing its defense spending, from 3.4 percent of its GDP in 2015 to 4.2 percent in 2016 (\$81 billion or £52.2 billion).²⁶ Russia is also stepping up its military activities and is actively seeking to draw Turkey away from NATO

Table 3.2 Comparative Military Power

Country	Overall ranking	Active personnel	Aircraft	Tanks	Aircraft carriers	Nuclear warheads	Submarines	Budget (million US)
United States	1	1,430,000	13,683	8,325	10	7,506	72	612,500
Russia	2	766,000	3,082	15,000	1	8,484	63	76,600
China	3	2,285,000	2,788	9,150	1	250	69	126,000
India	4	1,325,000	1,785	3,569	2	80–100	17	46,000
United Kingdom	5	205,330	908	407	1	225	11	53,600
France	6	228,656	1,203	423	1	300	10	43,000
Germany	7	183,000	710	408	0	0	4	45,000
Turkey	8	410,500	989	3,657	0	0	14	18,185
South Korea	9	640,000	1,393	2,346	0	0	14	33,700
Japan	10	247,746	1,595	767	1	0	16	49,100
Israel	11	176,500	680	3,870	0	80–200	14	15,000
Italy	12	320,000	795	600	2	0	6	34,000
Egypt	13	468,500	1,100	4,767	0	0	4	4,400
Brazil	14	328,000	748	489	1	0	5	33,142
Pakistan	15	617,000	847	3,124	0	90–110	8	7,000
Canada	16	68,250	404	201	0	0	4	18,000
Poland	18	120,000	475	1,063	0	0	5	9,360
Australia	20	58,000	395	59	0	0	6	26,100
Ukraine	21	160,000	400	4,112	0	0	1	4,880
Iran	22	545,000	481	2,409	0	0	31	6,300
Syria	26	178,000	473	4,950	0	0	0	1,872
Switzerland	27	135,000	175	200	0	0	0	4,830
Spain	28	123,300	531	415	1	0	3	11,600
Sweden	29	14,000	216	280	0	0	5	6215
Czech Republic	30	21,060	109	123	0	0	0	2,220
Netherlands	32	47,660	160	0	0	0	4	9,840
Belgium	34	33,000	166	52	0	0	0	5,085
North Korea	35	690,000	943	6,600	0	< 10	78	7,500

Shading indicates world leader in that category.

Note: The authors of the original source for this table state the following as regards ranking: “For better or worse, the strength of a country’s military is directly linked to its influence on the world stage. To make sense of a country’s actual strength, we have compiled key elements that comprise the 35 strongest militaries around the world according to a ranking published by *Global Firepower*. Quality of equipment, training, and professionalism of each military is not taken into account.”

Source: adapted from Amanda Macias, Jeremy Bender, and Skye Gould, “The 35 Most Powerful Militaries in the World,” *Business Insider*, July 10, 2014.

766 by signing a lucrative gas agreement with that country's government. At the
767 same time, Russia signaled that it is a potential source of credit to Greece
768 if that country's government does not secure a favorable deal from Euro-
769 zone finance ministers. One additional example of how Russia is actively
770 undermining the EU's CSDP is the new agreement it signed with Cyprus that
771 grants the Russian navy access to Cypriot ports.²⁷ The Cyprus government
772 also acknowledged that the two countries were discussing the possibility
773 of Russia using an air base on the island for humanitarian relief missions.
774 All this is happening while Cyprus maintains that it wants to be a full
775 participant in an EU-NATO partnership and desires to join NATO itself!

776 As if these developments did not create enough challenges for the EU's
777 CSDP, members continue to duplicate their defense industries to such an
778 extent that collective efficiency is nonexistent. A strong intergovernmental
779 approach to the CFSP and CSDP assures that each member state continues
780 to maintain national defense industries rather than determine which country
781 should specialize in manufacturing of which weapons systems. This further
782 complicates integrated defense systems and fails to achieve economies of
783 scale. Currently the EU has 21 naval shipyards compared with 3 in the US,
784 89 different European weapons programs as opposed to 27 American sys-
785 tems, and 11 different tank productions while the US has 2.²⁸ Moreover, the
786 technological advantage of the American defense industries continues to put
787 the US ahead of its European allies. Additionally, the new members of the
788 EU that also joined NATO (former Warsaw Pact states) continue to present
789 a costly modernization program for these countries' militaries. Without a
790 fully integrated EU-NATO partnership, and a deeper political union among
791 EU member states, the European side of the alliance will continue to feel
792 the pressure of falling behind the US and will remain a junior partner. The
793 bottom line is that until EU members formulate integrated and optimized
794 defense industries, their expenditures in this area will continue to be inef-
795 ficient and present an obstacle in developing costly systems, e.g., heavy lift
796 capability aircraft, which would reduce Europe's dependence on the US.

797 In view of these developments one wonders how Brexit will affect the
798 EU's future steps for a more integrated CFSP. A related major concern is
799 added by indications from the United States that the permanence of NATO
800 is not assured. A serious review of the usefulness of NATO is underway, with
801 the Trump administration hinting that the EU can defend itself alone. We
802 previously reviewed the arguments by Mearsheimer and Walt that press for
803 isolationism and reliance on an offshore balancing.²⁹ This strategy would
804 detach the US from the EU while potentially retaining a newly detached
805 United Kingdom in the fold. Such changes would dramatically affect the
806 future of security in Europe, altering attitudes towards the CFSP.

807 On the one hand, challenges facing the EU suggest that a more integrated
808 defense structure and foreign policy are essential for members' collective
809 security. On the other hand, security challenges cannot be detached from
810 financial challenges that would undoubtedly stand in the way of moving full

811 speed ahead with attaining such goals. In the subsequent chapters we will
812 employ empirical analysis to shed some light on what the future holds for
813 the EU with regard to these challenges.

814

815

Conclusion

816

817 The issues examined in this chapter present formidable challenges for the
818 deepening of integration in the EU. These challenges affect each other
819 and also affect other issue areas such as the future enlargement of the
820 Union. Until EU leaders sort out these problems, there is unlikely to be
821 another significant enlargement of membership that would add challenging
822 economies like that of Ukraine or Turkey. Fiscal union is the logical step
823 forward if the EU wants to stabilize and strengthen its Eurozone. However,
824 members cannot agree on stabilization policies and the large federal budget
825 necessary for meeting the challenges of another financial crisis. Currently,
826 the EU could not realistically address another such crisis at the current level
827 of political integration. The same can be said about an EU Federal Tax and a
828 Treasury Department. Under these circumstances, fiscal stability will remain
829 mainly in the hands of national governments and we have already seen how
830 difficult it is, if not impossible, to reach a stable agreement on austerity
831 versus growth policies.

832 The refugee crisis and disagreement over immigration policy also affect
833 the future of integration and threaten the very fiber of the EU's Schengen
834 Agreement. Suspension of the Schengen Agreement by some member states
835 threatens one of the key pillars of economic union. It is also true that the
836 current union between member states cannot remain simply an economic
837 and monetary union. Fiscal challenges have already demonstrated the dangers
838 of EMU without a political union. Yet, political union cannot be just a
839 fiscal endeavor. EU security and foreign policies need to proceed further to
840 the establishment of a reputable CFSP that is more than just "soft power."
841 Otherwise, the EU will be at a serious disadvantage in its competition with
842 other regional and global powers like China, India, Russia, and the US. As
843 for relations with the US, revamping the transatlantic alliance (EU-NATO
844 partnership) is the most viable option given the financial limitations of EU
845 member states and the UK's decision to leave the Union. In that regard,
846 Brexit will negatively affect all of the policy challenges facing the EU. In the
847 following chapters, we examine the impact of Brexit on EU integration, take
848 an indepth look at factors that affect integration, and identify policy options
849 for reversing the stagnation of integration and how EU leaders might move
850 forward to save their union.

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Notes

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