

3 Challenges facing the European Union

There is no denying that the European Union faces serious policy challenges that threaten its strength and unity. After five decades of successful deepening of regional integration and enlargement of membership, the member states seem to have reached a critical point where further advances in integration, such as fiscal and political union with an integrated common foreign and security policy, look uncertain. In this chapter, we describe how four particular items can have a high impact on the EU's ability to govern and maintain its promise of an "ever closer union." After our empirical analysis (Chapter 4), we will revisit these challenges and forecast how the EU and its member states are likely to address them.

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

As we review the challenges, it will become apparent how each one affects another. Brexit will cast a shadow on many of the issues given Britain's important past role in limiting the supranational advancement of the EU. How it leaves the Union will also impact its own internal politics and loop back to its exit strategy. Whether to move forward on fiscal union can have implications for the development of a more integrated military profile since the national autonomy of defense may be producing economic inefficiencies. Lastly, how to deal with the refugee crises can have implications for security

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.

48 49 **Fiscal union**

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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

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

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

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

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

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

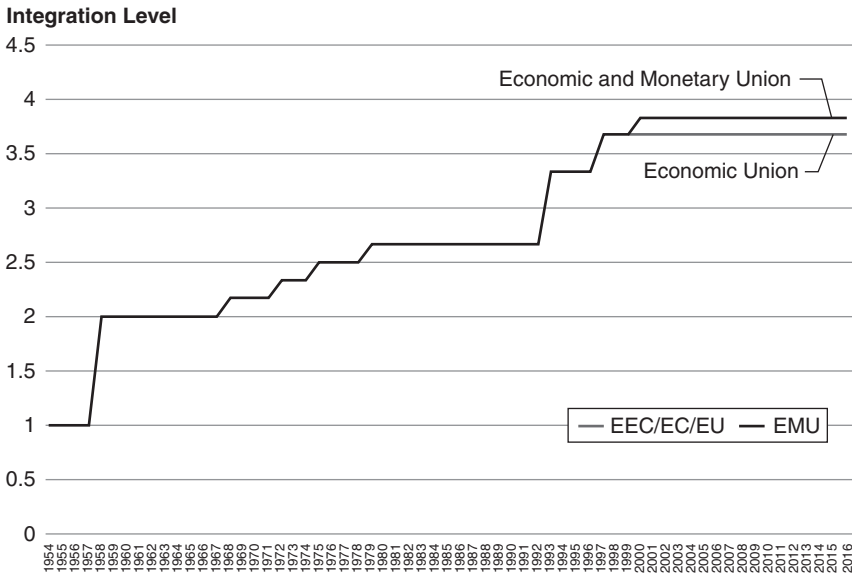


Figure 3.1 Two-Track Integration in the EU

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

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

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

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

- UK: 5.2 percent unemployment and gross public debt at 88.9 percent of GDP;
- Germany: 4.3 percent unemployment and gross public debt at 66.7 percent of GDP;
- France: 9.9 percent unemployment and gross public debt at 96.8 percent of GDP;
- Italy: 11.4 percent unemployment and gross public debt of 133.1 percent of GDP;
- Spain: 18.0 percent unemployment and gross public debt of 99.9 percent of GDP;
- Portugal: 10.0 percent unemployment and gross public debt of 129.5 percent of GDP; and
- Greece: 22.2 percent unemployment and gross public debt of 179.1 percent of GDP.⁸

The Commission also expects GDP growth in the euro area to be 1.7 percent for 2016, 1.5 percent in 2017, and 1.7 percent in 2018, figures which are hardly sufficient to significantly alter sovereign debt challenges of the problem states.

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

Refugee crisis

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

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

It is safe to state that EU leaders did not anticipate a crisis like the current migrant problem when they signed the Schengen Agreement. While such a problem is not new (e.g., the war in former Yugoslavia flooded EU states 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

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

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

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

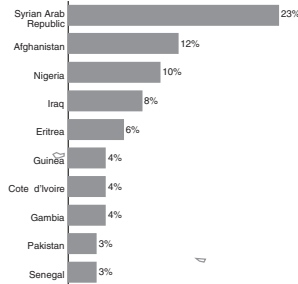
- Many in the EU countries feared that the influx of refugees would increase the likelihood of terrorism in their countries and impose an uninvited burden on them. The highest concerns were in Hungary (76 percent) and Poland (71 percent) followed by Germany, the Netherlands, and Italy at 60 percent.
- More than 65 percent of the people in Greece, Hungary, Italy, Poland, and the UK viewed refugees from Iraq and Syria as a major threat. The lowest percentages were in the Netherlands (36 percent), Germany (31 percent), and Sweden (24 percent).
- Xenophobia also played a significant role in people's perceptions. Individuals with more negative views of Muslims, predominantly with ideological views of the political right, also perceived a higher threat from refugees than those who were more leftist in their political views. In all EU countries surveyed, the anti-Muslim view also meant an anti-migrant position, with the UK leading the pack with 80 percent.
- In countries surveyed, more people had a negative view of diversity, as a result of migrants coming to their countries, than those who thought migrants made their country a better place to live.
- Regardless of their political views, most Europeans believed that the EU 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

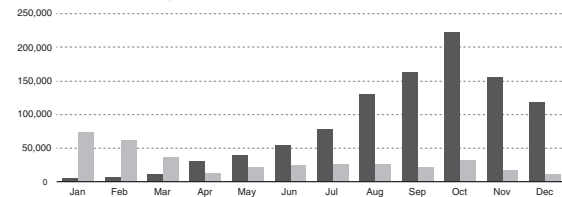
Top-10 nationalities of Mediterranean sea arrivals

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



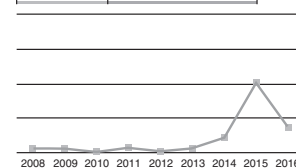
Other countries represent 25% of the total

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>.

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

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

Brexit

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

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

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

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

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

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

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

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

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

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

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

Finally, Brexit will also alter the power hierarchy within the EU. The British departure will result in a larger German power ratio. In 2015, Germany's GDP was 25 percent that of the remaining member states. Without the UK, this figure increases to 30 percent, slightly increasing this country's power in the hierarchy. Given the fact that Germany and the UK often sit at the opposite sides of important policy issues that would deepen integration, Brexit would raise the following question of policy importance. Would Germany be able to push for further deepening of integration, including a fiscal (political) union, with the UK out of the picture? We will address this question in the subsequent empirical chapters.

Common foreign and security policy

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

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

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

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

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

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

Merkel also said that the UK's decision to leave the EU ought to galvanize military cooperation among the remaining member states more than ever before and especially during the Trump presidency.²⁵ Deeper integration in military matters is also important for projection of EU power that is not economic in nature. If the EU wants to be influential abroad as a global power, it will need an integrated military force with heavy lift capability. The current emphasis on "soft power" is a limited and insufficient tool in meeting serious foreign and security policy challenges of the EU. In December 1998, Britain and France signed the St. Malo Declaration calling for an autonomous European defense capability which, at the time, was viewed as a necessary step towards establishing the EU's CFSP with a joint European army. However, the plan did not lead to a significant EU defense force and capability since most member states' governments did not show interest and were planning to reduce defense spending. Yet, it signaled the desire of the EU to establish its own integrated defense that would act independently of the US when needed. For the EU defense force to be effective, Germany's participation was essential, yet German law at the time prohibited deployment of German troops abroad. The major armed forces with overseas deployment capability, though significantly lower than that of the US, remained British and French.

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

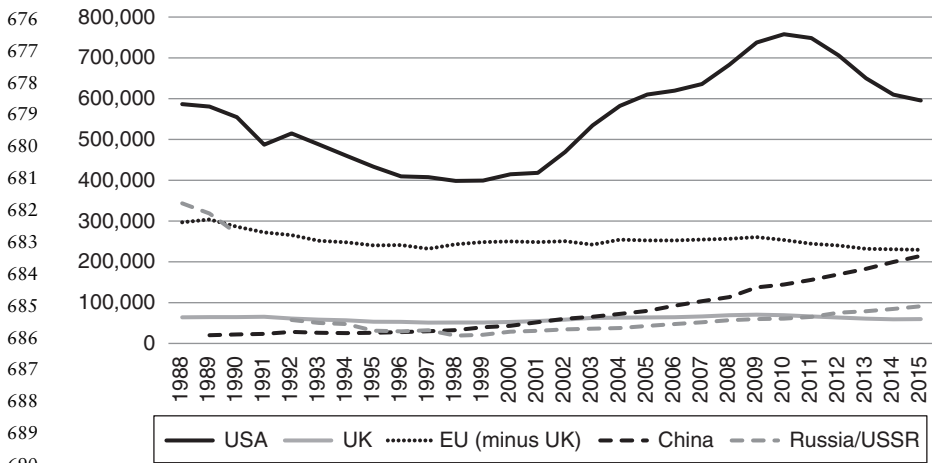


Figure 3.3 Military Expenditures, 1988–2015 (US million in 2014 dollars)

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.

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

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

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

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

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

Conclusion

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

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

Notes

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- 3 See Hugo Dixon, *Euro Zone Doesn't Need Political Union*, blog.reuters.com, August 3, 2015 (accessed January 2, 2017); Otmar Issing, *The Case for Political Union Isn't Convincing*, Europesworld.org, June 1, 2013 (accessed January 2, 2017).
- 4 One can look at a monetary union as a union between countries that use the same currency and have a single monetary authority. However, a political union is much more difficult to define because it involves several key policy issue areas and institutions of governance that could cover foreign and security policies, taxation, judiciary, and similar policy areas. Political union affects monetary union in several ways. First, it makes it possible to centralize a large part of national budgets at the supranational level and enables significant fiscal transfers between states as insurance against asymmetric shocks. Second, it reduces the risk of asymmetric shocks that are political in nature. When member states are independent in pursuing their respective fiscal policies, the unilateral decision of any member to increase or lower taxes creates an asymmetric shock. As is apparent from the recent crisis a simple Stability and Growth Pact that followed EMU was simply insufficient to correct these imbalances.
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