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What would happen if the EU broke up?

A paper by John Bruton, Taoiseach of Ireland (1994 to 1997),
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Introduction

The compromise that has allowed the European Union to develop over the last sixty years is today under unprecedented pressure. This is due to a combination of one general social trend, and two very specific pressures, all three of which feed off, and amplify, one another.

The general social trend is a lack of understanding among the general public, in all EU countries, of the full extent to which their livelihoods depend on economic decisions in other countries, and of how unrealistic, in modern conditions, is an "ourselves alone" policy. Politics is still local, while the issues it has to tackle have become global or regional. This is aggravated by the fact that public opinion has no democratic vehicle for expressing itself beyond national boundaries, and is forced to focus all its hopes on national governments, who are too small to manage globalisation on their own.

The two specific pressures currently putting stress on the EU are the euro crisis, and the growing desire of the UK to have a different type of relationship with the EU.

The euro crisis is forcing the EU to deal with a whole range of new issues that were postponed at the time the original design of the euro was being put together. The existing EU budget and the normal powers and procedures for EU decision-making are inadequate to the scale and scope of the new issues thrown up by the euro crisis. For this reason, the euro crisis has to be tackled outside the traditional procedures of EU governance, where the European Commission makes the proposals, which can be voted through by majority votes. Instead, the leadership on the euro crisis issues comes from the European Council, where decisions require unanimity, and there is a much more overt clash of national interests.

The euro crisis is made harder to manage by the fact that the UK is in the EU, is not in the euro, but must cooperate if EU institutions are to be used to solve a euro area problem. Meanwhile the UK is pursuing an entirely different agenda of its own. This difficulty is illustrated by the fact that the Fiscal Compact Treaty for the euro had to be brought into effect outside EU structures, because the UK was not satisfied with concessions for its particular interests. This type of conflict is liable to occur again in the future.

The risk is that these pressures will undermine the underlying spirit of compromise that enabled a much smaller EU to overcome various problems in the past.

In this paper, I will set out the existential threats facing the European Union. I will start by stating what we are at risk of losing, if the EU were to founder.

Why we need the European Union

The European Union is a historically unprecedented institution building project. It is the first ever voluntary coming together of sovereign states, pooling some of their sovereignty, so that they could do more together than they could separately, that has occurred in human history.

Almost every other political unification or state building in history has involved the use of force. The creation of most European states, including the UK, and the maintenance of the unity of the USA, involved the use of force. In contrast the EU came together peacefully and voluntarily, without coercion of any kind.

Some might argue that the EU was necessary only in order to cement a post war reconciliation of Germany and France and that, now that that is achieved, it has done its job, and it needs no further development.

This is wrong for two reasons.

1. The EU provides an assurance of mutual security

Firstly, the fact that there is a queue of states still lining up to join the EU shows that the EU still provides a necessary political and economic umbrella under which reconciliation and mutual security between states can be assured in the twenty-first century.

This was why the Baltic states, Poland and other central European states joined, and it is the reason several Balkan states, and even Georgia and Ukraine, might like to do so. It is also the reason why Greece, much to the surprise of many, has favoured Turkish membership. While the United States of America is remarkably successful in many ways, there is no queue of other American states lining up to join. Even Puerto Rico has not done so after more than 100 years of Washington rule.

2. The EU provides a way to manage globalisation democratically

Secondly, the EU is the most advanced effort in the world providing a measure of democratic supervision over globalisation. There are two key differences between the EU and other efforts to supervise globalisation, like the United Nations and the World Trade Organisation.

First, the EU has a directly elected Parliament which co-legislates for the EU alongside the 27 Governments, who often decide issues by majority.

Secondly, other international organisations operate on a purely intergovernmental basis, which means that there has to be unanimity to get a decision. Democratic involvement only arises after a deal already has been negotiated in private, when it is ratified in national parliaments without possibility of further negotiation or amendment.

As a result of these two differences, other organisations, like the WTO and the UN, can do much less, and have to do much more of what they do behind closed doors, than is the case with the EU. The EU provides a unique model for democratic rule-making, at supranational level, something which will become more, not less, necessary as we proceed into the 21st century.

Indeed the failure of the world to deal with climate change is a good example of the weaknesses of present intergovernmental models of global governance. If the different regions of the world had Unions, like the EU, which could negotiate seriously, and with genuine political legitimacy, as the EU can, the failures of Copenhagen and other climate change summits would not have happened.

The nature of the threats we face

If the EU were to break up, either because of the collapse of the euro or because a major country like the UK feels it has to exercise its right to leave the EU, and either event were to set off a breakdown of the trust that keeps the EU itself together, we would have lost a unique instrument for security building in Europe, and for problem solving in the wider world. Of these, a breakup of the euro is undoubtedly by far the more serious existential threat to the EU, because the scale of the economic losses is potentially much greater, and the means of controlling those losses are much less.

The euro crisis is not solved

The euro crisis has become slightly less acute in recent weeks. The announcement of a new bond-buying policy by the European Central Bank has calmed the markets. But there is no doubt that the markets will test the ECB's will-power at some stage. Meanwhile the link between the solvency of European banks and the solvency of European states has not been removed. A default by any EU state would wreck the banks of that state, because each state's banks tend to be big purchasers of the bonds of that state.

Similarly a potential collapse of a bank in a state would force that state to inject capital into banks, if it did not want a run on banks generally to take place, spreading contagion to other countries. The loss of confidence caused by a major bank's getting into difficulty could lead to a dramatic collapse in state revenues, leaving it with a much increased budget deficit, at the very time it was also having to find the money to recapitalize the bank.

Four things that must be done to solve the crisis of the euro

If these problems are to be resolved, four things will have to happen, more or less at the same time.

1. Greek Government debt will have to be forgiven.

2. The European Stability Mechanism (ESM) will have to be seen to be big enough to stand behind Spain and other countries that might get into difficulty, on a contingency basis.

3. The new mechanisms to supervise, and if necessary rationalise, Europe's banks will have to be put in place.

4. The already agreed reforms to reduce deficits, and to promote growth by opening up the job and service markets to competition will have to be demonstrated to be being fully implemented, in letter and spirit, to show creditors that, if one forgives debt or creates an enlarged ESM, one is not throwing good money after bad.

At the moment, it is uncertain whether the Greek debt issue is being tackled adequately. There remains a risk that dealing with the full problem will be postponed until after the German election in September 2013. Greece needs immediate help to finance itself to the end of 2013, and that bridging finance cannot await elections in Germany or anywhere else. Delay may add to the overall cost of the solution, even if it does allow time for Greek reforms to begin to establish credibility. It is vital to educate public opinion in creditor countries, like Germany, and in countries sitting complacently on the sidelines, of the true consequences for themselves of a euro break up.

The EU has already enacted a raft of legislation, including the Fiscal Compact Treaty, to ensure that countries both reduce their deficits, and liberalise their labour and service markets. One of the most important reasons why growth potential has been low in Greece, Italy, and Spain is lack of competition or flexibility in key sectors. This also masks deep unfairness in society, with some groups able to overcharge or be overpaid for the services they provide, while others are driven into marginal, badly paid, and precarious jobs.

Germany however is not yet satisfied with these arrangements. It wants to have an EU Commissioner with the power to veto state budgets, and enforceable contracts on reforms between states and the EU. But not enough attention is being paid to the fact that Germany itself, France and other core countries could also be doing a lot more to open up their own digital, financial, energy, retail and professional service markets. While Germany has set a good example in labour market and pension reform, there are other reforms it could initiate, that would help other EU countries to sell more goods and services into the German market, and thereby trade their way out of their problems.

There is understandable political resistance to any further debt forgiveness for Greece. But debt forgiveness within the euro is one thing. Greek exit from the euro is an entirely different matter. It would be far more dangerous, and that needs to be explained to public opinion in all EU countries, including Germany.

What would happen if the Eurozone broke up?

Even a disorderly default by a country within the euro, no matter how severe its consequences for its own people and for its creditors, would have far less severe consequences for the euro, and for the EU itself, than an exit of a country from the euro would have.

I have heard a view from some Northern Europeans that an orderly exit of Greece from the euro could be contemplated, if it was accompanied by building up a huge fund, much bigger than the existing ESM, to stand behind all the other euro area states. Their hope was that this would be enough to prevent a Greek exit leading to a loss of confidence in the financial position of the rest of the Eurozone. I believe this view, that Greek exit from the euro can be managed, is profoundly mistaken.

The whole edifice of the EU rests on law. The EU has no police force to enforce its will. It relies on member states freely respecting the interpretation of EU law by the European Court of Justice, and implementing the Court's decision, however unpleasant that may be. The exit of a country from the euro is, quite simply, a breach of their treaty obligations, and treaty obligations have the force of law.

The euro was established on the basis that it was irreversible. A Greek exit, particularly if it was condoned or encouraged by other members, would say loudly that the euro is not irreversible. That would lead to constant speculation in the markets as to who would be next. And as speculation increased, so too would the size of the funds or guarantees necessary to check it, increase. That in turn would lead to heightened risk that some of the creditor countries, who would have to provide these funds and guarantees, might decide that they themselves should exit the euro, and re-establish their own currencies. That would be the end of the euro.

Breakups of currency unions have happened before, in Austro- Hungary after the First World War, and in Eastern Europe in the 1990s when the rouble zone broke up. In both cases, the consequences were disastrous.

The end of the EU itself?

The disappearance of the euro would mean that new currencies would have to be established. The relative value of these currencies would be unknown and unknowable. Some would lose value very quickly and others would shoot up in value.

Exports would become dramatically uncompetitive in some cases, and in others they would become so cheap that there would be accusations of dumping, currency manipulation and calls for immediate reintroduction of import duties to level the playing field. Such duties, if imposed, would end the Single Market. And that would be tantamount to the breakup of the European Union itself. Open markets, the assumption on which Ireland built its entire economy over the last 50 years, would be gone.

In some countries the banking system would break down, and people would have no access to credit for even the most basic transactions. In others, people would cease to trust the value of their own money, and money, after all, is based on a promise and if people can no longer trust the states standing behind the promise that underlies their money, the basis for money itself is gone.

None of the above is fiction. It is what happened when the rouble zone broke up in the 1990s and explains why incomes fell by 50% in the former rouble zone countries. And the exporter nations within the rouble zone, like the Russian Federation, suffered just as much hardship as the importer nations, like Latvia and Estonia.

The political stresses that this scenario would create for the 500 million people of the EU, and their governments, would be such that trust between European nations would easily break down completely. We see signs of that happening already, but it is being held in check by the hope that problems can still be resolved on a collective basis. A breakup of the euro would show that that was impossible to resolve matters on a collective basis, and it would then be a case of every nation for itself, with particularly severe consequences for smaller countries, like Ireland.

Meawhile in the United Kingdom

As if Europe did not have enough problems, one important EU country, the United Kingdom of Great Britain and Northern Ireland, is preparing to renegotiate the terms of its own membership of the EU, and hold a referendum on the outcome, which would potentially decide whether the UK would stay in the EU or leave.

The first thing to say is that the UK is entirely free to do this. Unlike other Unions, such as the United States or the United Kingdom itself, the European Union is a Union which states are free to leave, so long as they fulfil their normal obligations under international law, which arise when any country withdraws from any international treaty.

The UK has been an uneasy member of the EU from the outset. While Churchill envisaged a United States of Europe, he did not envisage the UK, which still had a global Empire at the time, being part of it. The UK did not attend the 1955 conference in Messina which led to the Treaty of Rome. When it eventually joined the Common Market, a decision endorsed by a referendum, the idea was sold to the electorate as that of an economic arrangement, whereas even the most cursory reading of the Treaty of Rome would have shown it to be much more than that.

A threat to veto the EU budget

The United Kingdom is now threatening to veto the entire EU budget, something it is legally entitled to do, unless there is an absolute freeze on the size of the budget. The difficulty with this stance is not legal, it is political.

The EU Single Market, which guarantees free movement of people, goods and services, was created as a political deal. Weaker economies opened up their markets to stronger ones, and removed protection from local businesses, on the basis of a promise that they would qualify for structural funds to modernise their economies. These funds are what the EU budget provides. (Some of the EU budget also goes on agriculture, but that has fallen from almost 80% of the total originally, to only 30% today.)

The political difficulty with the UK stance is that of fairness. In the past, when countries like Ireland, Spain, Greece, Portugal, and even the UK itself, joined the EU, they all qualified for very substantial EU structural funds, in the form of aid for agricultural modernisation, general infrastructure, training and communications.

Over the past decade, the EU has taken in 12 Central European countries, which are almost all poor by comparison with the rest of the EU. If the freeze on the European budget comes into effect, these countries will be told that they are not to get even a fraction of the help Ireland, Spain, regions of the UK and others qualified for as of right after joining. This is causing resentment.

I heard an Estonian Minister complain recently that, under the existing EU budget which is already an unfair compromise, his farmers have to compete in the same EU market with West European farmers who are getting three times the subsidies they do. Unless there are to be drastic cuts, this sort of anomaly can only be put right by an increase in the EU budget.

The problem is that the UK Government has made the size of the budget a red line issue without getting into any informed debate about what the money is actually spent on, or about what sort of EU budget is necessary to ensure that the EU Single Market, to which the UK itself is very much attached, works fairly and is preserved.

The UK wants access to the Single Market, but is not prepared to pay any entry fee.

And a demand to renegotiate.....

The same problem arises in the renegotiation of the terms of UK membership of the Union which the current UK Government wants. In preparation for this renegotiation, the UK Government is now doing a comprehensive audit of all EU laws, to identify areas of activity that could be taken back from the EU to be administered exclusively under UK law instead. There may be some good ideas for handing back powers to member states, which will emerge from this audit, on which all other members could agree. If so, this will be good. But there may also be a lot of problems, if the UK comes up with proposals that suit its own interests, but do not suit other countries.

The difficulty may be that the UK will want to take back many, yet to be specified, powers, but will also want to retain full and unfettered access for all its goods and service exports to the EU Single Market. 50% of UK exports go to the Eurozone, whereas only 15% of Eurozone exports go to the UK, so this is important to the UK.

The difficulty is that all markets are political constructs. The EU Single Market, like any market, is a product of common rules, regulations and conventions. Without common rules or understandings nobody could rely on what they were buying.

That is why, for example, there have to be common EU quality standards to construct a common EU market. Otherwise one country could impose peculiar quality standards, designed to exclude competitors from its market and to enable its own producers to make monopoly profits at the expense of its consumers. Any rulemaking power that could be abused in this way, cannot be handed back to national level without endangering the Single Market. That is the problem that the proposed UK renegotiation of its EU membership terms will encounter.

And the competition in any market also has to be fair, and someone has to regulate it. If competitors have different environmental, or product liability standards, or if some firms are operating monopolies or cartels, the competition will not be fair. These matters cannot be handed back to be decided by national authorities without also endangering the Single Market.

If the UK were to draw up a list of EU rules it would like to make in Westminster rather than Brussels, the other 26 could also do the same, but they might come up with a very different list. The process could become bogged down in serial reopening of compromises, made years ago, on issues that have little relevance to the urgent existential threat the EU faces today. If the UK makes proposals that require treaty change, that change will have to be approved in all 27 countries. And if the UK announces that it is going to have a referendum on the outcome of the renegotiation, other countries might do the same.

One gets the impression that many in the UK do not really care about that.

The EU is still regarded by many in the UK as a foreign country, not a Union of which the UK itself has been an integral part for the past 40 years. Membership of the EU is seen as a convenience rather than as a commitment. If the price of satisfying UK voters is to cause more problems for the "foreigners", in "Europe", that is not seen by some UK political leaders as such a bad thing.

The difficulty is that the "foreigners" in Europe may not see it like that.

With so many genuinely urgent things to do, such as safeguarding the very existence of the EU itself, the other 26 member states may just not be inclined to devote time to a painstaking case by case analysis of a series of requests for new UK opt-outs from some bits of some rulemaking authority, with UK opt ins to others, and to a judicious analysis of whether each one of these decisions might affect the integrity of the Single Market, either now or at some time in the future.

The European Court of Justice would certainly have difficulty ensuring the consistency of a special EU menu for one country with the basic freedoms for all on which the EU is based.

There is also the old question of whether UK Ministers and MEPs should continue to have voting rights on things they are opting out of. As it is, one has to say that it is distinctly odd that the present Chairman of the Committee of the European Parliament that deals with euro currency matters, represents a constituency in the UK, which has no intention of joining the euro.

If, as is likely at the end of its proposed renegotiation, the UK is dissatisfied with the result, because not enough powers are being handed back to Westminster, it will have little option but to recommend that the UK withdraws from the EU.

It is setting itself up now, to find itself in exactly that position, in 2016.

The UK's options outside the EU

This will require careful handling because 50% of UK exports go to the EU, and London is Europe's main financial centre, for the time being anyway.

How is the UK to protect these interests if it is outside the EU?

One possibility is to join Norway, Iceland and Liechtenstein in the European Economic Area, which would guarantee full access for UK goods and services to the EU market. But the price for that would be having to implement all EU legislation that was relevant to the Single Market, and contribute to the EU budget, but without having any say in EU decisions. That would be worse from a Eurosceptic point of view than the UK's present position, even though it would guarantee continued access for the UK to the EU market for both goods and services.

The other possibility is to follow Switzerland and negotiate a series of bilateral trade deals with the EU. The UK would not be entering such negotiations from a position of strength, because it relies more on the EU market than the EU relies on the UK market. Switzerland has negotiated full access to the EU market for goods, but not for services. Services are the UK's key export sector, so a Swiss-style deal would not be attractive.

If Britain negotiated a Customs Union with the EU, like that of Turkey, it would find its trade policies with the rest of the world were still being determined in Brussels, but with less input from London than at present. Again it would also only have a guarantee of access for goods exports but not for services.

Finally, the UK might simply leave the EU, without negotiating any special deal. That would leave it paying tariffs on its exports to EU member states, including Ireland, and would necessitate the reintroduction of customs posts on the border in Ireland. It would undermine years of peace-making by successive Irish and UK Governments, and would cost thousands of jobs in export firms in both the UK and Ireland.

At the moment people are free to cross the border between the Irish Republic and Northern Ireland without being stopped. There has never been passport control within the island of Ireland, even at the worst times in the Troubles.

If the UK were to leave the EU, however, it would then be free to reintroduce immigration controls on immigration from a chosen EU member state or states. Indeed one UK political party has already said it would like to do that. In this scenario, Ireland, as a continuing member of the EU could not, and would not, impose any such immigration restriction to Ireland from the states whose immigrants the UK had banned. If a UK Government, outside the EU, wanted to restrict immigration from any EU state, it would have to introduce passport controls on the Irish border, a really unthinkable step.

Enhancing the EU's democratic legitimacy

As I said at the outset, I believe that the pressures that are causing fractures within the EU derive in some measure from a lack of understanding among the general public of the extent to which their livelihoods depend on economic developments in other countries.

Political leaders make little effort to explain this, because to do so would undermine the nationalist myths which brought most states into being in the first place, and also because it is often convenient to blame the EU for the effects of decisions that were necessary but are unpalatable. For these reasons, too little effort is made to forge any form of patriotic pride in the EU or its achievements. No venue has been created in which an EU wide public opinion might be formed.

In a sentence, the EU needs more democratic cement to hold itself together.

European Parliament elections are not truly European. They are 27 different elections, in 27 different countries, in which national issues predominate.

The European Parliament itself has refused to contemplate the election of some of its members from EU-wide party lists, which would have begun the process of creating an EU-wide debate, because it would have necessitated an EU wide political campaign on behalf of the rival EU-wide lists of candidates.

Under present procedures, the President of the European Commission and the President of the European Council are selected in private meetings of heads of government. They do not have to win the votes of EU citizens, and consequently EU citizens do not have the feeling that they can vote the government of the EU out of office, in the same way that they can vote their national government in or out of office.

Thus the EU does not enjoy the same democratic legitimacy as do national governments. Given that the response to the euro crisis requires that more and more issues, involving redistributing resources, now be considered at EU level, it is vital that the EU is made visibly more democratic, and Europeans come to feel that they can have the same sort of direct say in who governs the EU that they have in who governs their own country.

As a member of the Convention that drafted what eventually became the Lisbon Treaty, I suggested that the President of the European Commission should be chosen by the people of the EU in a multi- candidate election in which every EU citizen would vote, rather than be selected, as at present, by 27 heads of Government meeting in private.

This proposal received almost no support at the time, although it has since been adopted as policy by the German CDU, and by the European People's Party, the largest party in the European Parliament.

If my proposal had been accepted when it was originally proposed, the EU would now be in a much stronger democratic position to devise a more coherent response to the euro crisis. The UK press would not be able to argue that EU leaders were "unelected". A European Commission, headed by a President with a full EU-wide democratic mandate, would have more authority to propose solutions. The Council of 27 heads of government would still play a vital role, but the EU would be less constrained by the electoral timetables of individual countries, as is the case now with the German election of 2013.

Some might argue that an EU Presidential election would not work because we all speak different languages, or because the candidates would not initially be well known throughout Europe. But that does not stop Europeans forming knowledgeable opinions about the candidates in US Presidential elections, some of whom have never even visited Europe!

Others might argue that the people might choose an unsuitable or unrepresentative candidate. That could be catered for by requiring that a candidate only be allowed to stand if he or she has first been nominated by a minimum number of European MEPs and national MPs drawn from a sufficiently large number of different EU states.

It is not enough to find better technocratic solutions to the EU's problems. These solutions must have better democratic legitimacy too.