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## **The Fight for a Better Europe**

**Fritz Breuss**

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Lecture given at the Conference "International Economic Integration: Firms, Workers, and Policies", in honour of Wilhelm Kohler's 65th birthday, Eberhard Karls University Tübingen, 23 May 2019

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### Abstract

In this laudation of Wilhelm Kohler's 65th birthday I firstly will do a retrospective on the fight for Europe by Willi and me at the same time with different methods. We both did research around Austria's accession to the EU. We made several ex-ante studies about the possible economic impact of EU membership. The expected effects on GDP and trade were positive. This was then verified in ex-post studies. At that time the EU only was in the stage of the Single Market. Later it continued its process of deepening (EMU with the introduction of the Euro) and enlarging. Lastly the EU increased to 28 members. These integration steps gave enough impetus for Willi and me to do respective research. Research has also been done on the reform of the SGP and the several tries to reform the EMU after the Euro crisis. The Brexit is a new challenge not only politically, but economically. After discussing the present multiplicity of problems of the EU (Brexit, Euro crisis, migration problem) and a reflexion of the already existing reform proposals I try to develop a vision for a new (institutional) future for Europe: a dissolution of the present EU and a new foundation as the United States of Europe.

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## **1. Common interests in Europe**

I am probably one of the few congratulates to Willis birthday who did not have the privilege to be his co–author. Nevertheless, I have the pleasure to be his friend. Both of us were born in Vorarlberg and studied economics: he 10 years later than me. Whereas I went to the University of Vienna to finish my studies, Willi finished his studies in Innsbruck. The first contact with him was during our stays in England. At the same time, when he was a Visiting Graduate Student at the Department of Economics, University of Birmingham I spent – as a then researcher at WIFO – a sabbatical at the University of Cambridge. He contacted me at that time via letter concerning his studies on Austrian import demand equations, which he later published in *Empirica*.

In the meantime, we got also in contact personally, spending time with skiing in Fieberbrunn, a little village near Kitzbühel. Although we both grew up with skis in the Alps, Willi was already a ski instructor and of course, drove me off easily.

Because Willi gave a talk on “Reflections on Trade Wars” (that was already a topic under US president Bush Jr.) at a little symposium “International Economics and Integration” on behalf of my 60<sup>th</sup> birthday at the WU Vienna, it is my privilege to speak on this 65<sup>th</sup> birthday.

Willi has done research in many areas of international economics: at the beginning with testing the Heckscher-Ohlin-Vanek theorem (his Habilitation treatise at the University of Innsbruck, 1986; see Kohler, 1988), then studies on outsourcing and recently on migration and labour market. Besides these theoretical excursions, he was all the time interested and committed in building up Europe, almost parallel to my interests. These were reflected in several studies on the economic impact of Austria's accession to the EU and on the consequences of EU enlargement.

So, in my laudatory speech, I would like to focus on Willi's work on European integration. Inspired by his thoughts I then will develop ways to overcome the present standstill in European integration due to the presence of a multiplicity of crises: the Euro crisis, migration crisis, Brexit, and newly the neo-protectionism tendencies in world trade. With the Brexit, for the first time, the EU integration process goes into the reverse direction. The Euro crisis led to a split of the EU/EMU between the core and the periphery and the migration shock since 2015 separated the old from the new EU member states in the East. With US president Trump we experience a rebirth of protectionism – now against China and Europe; under President Reagan in the eighties the enemy was Japan.

## 2. The race between integration politics and theory

In the past, integration theories preceded the integration policy. Remember only Jacob Viner's in 1950 published book "The Customs Union Issue". With this approach, one could easily analyse the Customs Union completed in 1968 by the then six EEC member states. Also, the trade implications of the EFTA free trade area in 1967 could be captured by Viner's theory. The more the integration in Europe made progress in deepening (from the customs union to the Single Market and the introduction of the Euro) and hence grew in complexity, the less theoretical underpinning was available to evaluate the economic implications of the deepening of the EU and its enlargement. The integration theories and methods to analyse this ever-increasing complexity lagged European integration.

### 2.1 *The complexity of EU Integration*

Over the last decades, European integration has systematically progressed from a customs union (completed in 1968) towards the Single Market, EMU, and the big EU enlargements since 2004. Most studies to evaluate this process were economic in nature. The EU, however, is more than an economic project. During my time as a member of the Europe Institute at the WU Vienna, we followed an interdisciplinary research approach: an economic, legal and political analysis of the European Integration. Asking my colleagues "What is the EU?", the expert for European Law insisted that the EU is a purely legal project; the political scientist, however, sees the EU as an exclusive political endeavour. Me as an economist specialized in European Integration, the EU is – from the beginning – a highly economic issue. So, what is the truth?

In any case, the former EEC progressed to the EC and later to a political cum economic entity, the European Union (EU). The recent three major integration steps, i.e., Single Market, EMU and enlargement, are overlapping. Neither did they happen at the same time, nor do all EU member states take part in all integration areas. Whereas all EU member states must enter the Single Market as the base of EU integration, only 19 countries are members of EMU.

Furthermore, the EU is split in other areas too. Sometimes, this is named euphemistically "flexible EU integration" (in a statement on 3 March 2017, Francois Hollande and Angela Merkel expressed themselves in favour of an EU with different speeds) or "Europe à la carte". Only the core EU, the six founding member states (BE, DE, FR, IT, LU, NL) are taking part in all aspects of European integration (Single Market, Euro area, Schengen, NATO). All 28 (after Brexit, 27) member states must enter the Single Market.

Members of the Euro area are only 19; 22 take part in Schengen and 22 (others) are members of NATO.

## *2.2 The dream of a GUT of EU Integration*

Due to the complexity of EU's integration (from a customs union to Single Market and EMU and the several steps of enlargement) one dreams of finding a "Grand Unified Theory" (GUT) of European integration like the theoretical physicists are looking for. Even if it would be possible to include as many theoretical knowledge into an economic model, the political dimension of EU integration would still not be captured.

To evaluate the economic (welfare) effects Baldwin and Venables (1995) stylized such a GUT for the case of a (fictitious) country entering a regional integration agreement (RIA). Their approach encompassed the main elements connected with the formation of a customs union (trade effects) and some elements of the Single Market (Krugman's scale effects; dynamic investment effects). Factor movements (migration, FDI flows) were not included, as well as other aspects of EU membership (e.g. contributions to the EU budget). Kohler (2004) extended the Baldwin-Venables approach to include migration and budget aspects in case of EU enlargement.

Theoretical and methodological tools have recently caught up with the latest great integration steps<sup>1</sup>. Much progress has been made in the field of gravity equations. Starting with Bergstrand's attempts to encompass monopolistic competition and the Factor-Proportions Theory into a generalized gravity equation (Bergstrand, 1989; Bergstrand et al., 2013) to the innovative approach by Anderson and van Wincoop (2003). The latter was extensively used to estimate the recent regional free trade projects (CETA, NAFTA, TTIP; see Aichele and Felbermayr, 2014, Aichele et al, 2014; Anderson et al., 2015a, 2015b). Later approaches include new aspects of modern trade theory (Felbermayr and Kohler, 2015). Gravity approaches and other modern trade models, like the ifo trade model (Felbermayr and Kohler, 2015) are primarily used to estimate trade and welfare implications of regional trade agreements (CETA, TTIP) or the implications of the Brexit. The "New Quantitative Trade Model" (NQTM) of ifo (Felbermayr et al., 2018) is a milestone in encompassing modern trade theory. However, it again misses aspects of new-new trade theory (Melitz, 2003),

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<sup>1</sup> Arkolakis et al. (2012) however, demonstrate that also the new trade models did not bring more light in the old question in international trade: how large are welfare gains from trade? They derive a simple welfare formula (p. 94): Welfare depends on only two variables: (i) the share of expenditure on domestic goods,  $\lambda$ , which is equal to one minus the import penetration ratio; and (ii) an elasticity of imports with respect to variable trade costs,  $\varepsilon$ , the "trade elasticity. Then, the change in real income,  $\hat{W} = \hat{\lambda}^{1/\varepsilon}$ , where  $\hat{\lambda} = \lambda'/\lambda$  is the change in the share of domestic expenditure.

namely heterogeneity of sectors. In extending Anderson and Wincoop, Oberhofer and Pfaffermayr (2017) estimate trade and welfare effects of Brexit with a new panel data structural gravity approach.

Also, CGE modeling progressed from static to dynamic approaches. In the latter field, Keuschnigg and Kohler were pioneers. They applied this method to estimate the potential trade and welfare effects of Austria's EU accession. Recently, Balistreri and Rutherford (2013) and others implemented the modern trade theory features of the new (Krugman, 1980) and new-new trade theory (Melitz, 2003) in computable general equilibrium (CGE) models and compare them with the usually used Armington approach<sup>2</sup>.

An often-used method (lacking any theoretical underpinning) is the statistical "treatment" or "synthetic counterfactual method" (SCM), comparing a country e.g. acceding the EU with a set of countries which are not doing so. Boockmann et al. (2015) made this exercise in the case of ex-post evaluating 20 years of Austria's EU membership.

A novelty in trade analysis is also the impressive improvement of consistent international databases. GTAP offers a global database for many countries and sectors (inclusive SAMs). WIOD – the World Input-Output Database – is another helpful source for the interdependency of value-added chains in a global context. The institutions WTO and World Bank (World Integrated Trade Solutions: WITS-TRAINS) and the WTO's Integrated Database (IDB) as well as IMF and UNCTAD supply data on tariffs and FDI, only to mention a few. The disadvantage of GTAP and WIOD data that they lag considerably in time.

Even if one would be happy with an Integration GUT explaining the main aspects of the EU's Single Market, one would be unsatisfied with the possible effects of the participation in EMU and introducing the Euro. The introduction of the Euro was a much greater regime change than just to switch from a customs union of the Single Market. In case of EMU (and the euro), one must resort to other integration theories than exposed in Kohler's (2004) equation. The theory of Optimum Currency Areas (OCA) by Mundell (1961) is such a candidate. But even the one still would not be able to understand the political upheaval which started just after the global financial and economic (GFC) in 2008, followed by the Great Recession in 2009 and the "Euro crisis" in 2010.

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<sup>2</sup> Britz and van der Mensbrugge (2018) implemented these new features into the CGEBox, a flexible framework for CGE analysis in GAMS.

### 3. Which benefits of joining a changing EU?

As mentioned already, EU integration is based on two pillars: deepening (Customs Union, Single Market, and EMU/Euro) and enlarging. When Austria tried to join the EU, it had already 12 member states, all in Western Europe and it had just established the Single Market (SM) in 1993, based on the Maastricht Treaty (officially the Treaty on European Union, TEU) which entered into force on 1 November 1993. In three countries referenda were necessary for ratification (Denmark, France, and Ireland). The process of ratifying the treaty was fraught with difficulties in these states because it not only implemented the SM but planned to introduce the Euro later. Denmark only accepted the Treaty in a second referendum after granting an opt-out for introducing the Euro (similarly to the UK). The referendum in France only narrowly supported the TEU. The Maastricht TEU then was amended three times: Treaty of Amsterdam (1999), Treaty of Nice (2003) and Treaty of Lisbon (2009).

#### *3.1 Austria's approach towards the EU*

After the political decision that Austria should become a member of the EU, Willi and I, in a kind of friendly competition race, were occupied in evaluating the possible economic implications of this step for Austria (Breuss, 1996). Whereas me and my colleagues applied the WIFO macro-economic plus Input-Output model to evaluate the overall and sectorial economic impact (Breuss et al., 1994), Willi together with Christian Keuschnigg in a series of papers used the then-new type of CGE models, namely a dynamic CGE model for Austria (Keuschnigg and Kohler, 1996). Also, in the business of ex-post evaluation, we both were engaged. On the occasion of Austria 20 years EU membership, Kohler together with colleagues (Boockmann et al., 2015) made an ex-post evaluation concerning trade, welfare, and growth effects for Austria. With the "SCM" approach they estimated positive welfare (GDP per capita) effects for Austria: 10 to 14 percent higher GDP p.c. compared to a control group without EU connections. This coincides with my own ex-post macro-economic evaluation of Austria's EU membership. Overall, I find that EU membership (Single market plus EMU participation) contributed to an annual increase in real GDP between 0.5 and 1.0% (Breuss, 2016a, 2018).

There are only a few studies which evaluate comprehensively the implications of the Euro for a participating Eurozone member country. Many estimates with gravity models are done for the trade effects of the Euro (Rose, 2000, 2016; Badinger, 2012). McKinsey Germany (2012) estimated that the biggest winner of the Euro are Austria and Germany. I come to similar conclusions with my prototype model of European integration, constructed

for the evaluation of the several steps towards the EU (Opening up of Eastern Europe, EU membership, EMU/Euro membership; EU enlargement since 2004; see Breuss, 2016a, 2018). Accordingly, the Euro increase Austria's real GDP by 0.5 percentage points per year<sup>3</sup>.

### *3.2 The great EU enlargement*

The next challenge for us was the great EU enlargement, starting in 2004 with 10 new member states in Eastern Europe. What would be the effects for Austria and other incumbent EU member states? With the Global Economic Model of Oxford Economics, I tried to find out the possible benefits and dangers of EU enlargement (Breuss, 2002). Kohler, together with Keuschnigg in a series of estimates with their dynamic CGE model, which was first built for Austria, estimated the trade and welfare effects for Austria and Germany and other old EU member states (1999, 2000a, 2000b, 2000c, 2001; Keuschnigg et al., 2001).

As mentioned earlier, Willi Kohler (2004) derived – in the spirit of Baldwin and Venables (1995) - an equation explaining the various welfare effects of the Eastern EU enlargement, starting in 2004. The quantification is based on a numerical simulation model for Germany, which renders welfare elasticities for various parts of the enlargement scenario, including trade and migration as well as the budgetary costs. Based on calculations of country-specific “enlargement shocks”, the German elasticity values are applied to other EU-15 countries. Aggregating across countries gives an EU-15-wide overall (static) welfare benefits from enlargement equal to +0.3% of GDP with a range of +2% for Austria, +1.1% for Germany and -1.2% for Portugal.

According to my most recent evaluation with an integration macro model (Breuss, 2018), EU enlargement, starting in 2004 increased Austria's real GDP annually by 0.2 percentage points.

### *3.3 The Costs of Non-Europe after the Brexit*

Brexit is only the beginning of a possible collapse of the EU. Felbermayr et al. (2018) undertake such doomsday scenarios with the new quantitative trade model of ifo. They look at seven different counterfactual scenarios: (1) collapse of the European Customs Union (tariff-free trade replaced by MFN tariffs), (2) dismantling the European Single Market, (3) dissolution of the Eurozone, (4) breakup of the Schengen Agreement, (5) undoing all RTAs with third countries, (6) complete collapse of all European integration steps, (7) complete EU

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<sup>3</sup> For an overview of studies quantifying the effects of European Post-War economic integration, see: Badinger and Breuss (2011).

collapse including the termination of fiscal transfers. Brexit is also simulated within the existing EU-28 and after the breakdown of the EU. Biggest losers are the UK and Ireland.

The greatest welfare loss for EU member states would be the dismantling of the Single Market (income per capita loss in Germany -3.9%, in Austria -6.2%, in Luxembourg -19.7%)<sup>4</sup>. The second biggest loss would be the breakup of the Schengen Agreement (-0.8%, -1.2% and -1.0%). The dissolution of the Eurozone would be the third most damaging action (-0.4%, -0.7% and -2.2%).

Ifo's "New Quantitative Trade Model" (NQTM) features 43 countries and 50 goods and services sectors. For the estimation, they use yearly data for 200-2014 from the World Input-Output Database (WIOD). Paying attention to the role of non-tariff trade barriers and of intra- and international value-added networks, they simulate lower bounds to the trade, output, and welfare effects of different disintegration scenarios. Although this new ifo model is a "universal weapon" insofar as it allows to analyse a whole range of integration (EU), regional trade agreements (RTA) or specific disintegration cases (Brexit), it nevertheless is not able to capture the whole bunch of ingredients of the Single Market (all aspects of the four freedom – not only free trade of goods and services – but also factor movements: migration and FDI) and the non-trade aspects of introducing the Euro.

The disadvantage of the new ifo trade model is that – due to data limitations - it must assume perfect competition and homogeneous producers. Melitz (2003) type models allow heterogeneity of producers.

So impressive, the ifo simulations are, one should treat them with great care. Already the impressive welfare and income effect (+4 ½% more GDP after six years) forecast by EU Commission studies at the begin of the Single Market in the so-called "Cecchini Report" (European Commission, 1988) could not be realized. As a consequence, one invented the "Lisbon strategy" in order to foster the performance of the Single Market. The "Lisbon strategy" was initiated in 2000 to make the EU within 10 years "the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion", by 2010. Unfortunately, the Great Recession in 2009 made it impossible to reach the ambitious Lisbon goals. Therefore, in 2010 a new attempt was made with the growth strategy "Europe 2020".

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<sup>4</sup> According to the estimation of the Single Market effects by Mion and Ponattu (2019), Germany and France are the greatest winners in absolute welfare terms (Germany +86.139 Mio. EUR, France +69.360 Mio. EUR). In per capita terms smaller countries, like Austria (1.583 EUR) profited more from the EU's Single Market than Germany (1.046 EUR) and France (1.074 EUR). Difficult to understand is why a non-EU country, Switzerland is the biggest winner of welfare per capita (2.914 EUR)-

The new ifo model, however complex it may be, is only a trade model which allows simulating correctly trade cost changes (tariffs and NTBs). EU's Single Market (SM) and even the EMU/Euro project is, however, much too complex for the ifo model. In the scenario where the SM is undone, the authors introduce only (estimated) intra-EU NTBs. There are no scale or productivity effects<sup>5</sup> captured, not to mention the effects of the several common policies: GAP, CCP, competition policy (implication for inflation), regional policy etc. Out of the four freedoms the ifo model only deals with two (trade of goods and services). The free movement of capital and labour is simply left out (not considered). Even less appropriate is the ifo model to quantify correctly the Euro project. Here they assume that the costs of transactions (between Eurozone members) related to currency-exchange rates are additional NTBs, estimated from sectoral gravity equations. In such a case, Friedrich August von Hayek would have argued that the ifo EU scenarios are pure "pretention of knowledge". Furthermore, having a model like the ifo trade model with 50 sectors and 43 countries easily supports to pure "number crunching".

Furthermore, the new ifo model – and similar exercises by other authors – suffer from a lack of actual data. WIOD and GTAP10 are based on a database going back to the year 2014. What would physicists say, when they had to test their theories with outdated data?

#### **4. More Europe or more Europes**

As described repeatedly before, the EU, on the one hand, consists of overlapping integration areas (Customs Union, Single Market, Eurozone, Schengen). On the other hand, the EU-28 is split insofar, as not all 28 member states take part in all areas of integration. Therefore, one could speak of an EU with several Europes. Should we continue with this process of fragmentation? This might herald the end of the EU. UK is a good example as it is a prototype EU member state which is absent in almost all new integration steps (Euro, Schengen, non-participation in the Charter of Fundamental Rights of the European Union). For the UK, former Prime Minister Margaret Thatcher always said, that "for us, a free trade arrangement with the EU is enough".

Looking at the complexity of the EU as a political construct "Sui generis", one cannot deny that the progressing EU is more and more built on ideas which are justified for a nation-state but not for a union of states ("Staatenverbund"; see Maastricht judgement by the German Federal Constitutional Court - Bundesverfassungsgericht 12 October 1993). The first

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<sup>5</sup> The modern quantitative trade model used by Mion and Panattu (2019) to evaluate the welfare effects of EU's Single Market apply productivity and mark-up effects. It is based on the work of Behrens et al. (2014, 2017).

integration step like the Customs Union established in 1968 was a realistic target. Already the Single Market, coming into effect in 1993 was partially an illusionary project. Why? A real single market like that of the United States consists not only on four freedoms but also on a common currency, not to mention a common language. The even greater illusionary project is the EMU project with the Euro.

#### *4.1 The great illusion of EMU and the Euro*

The Economic and Monetary Union (EMU) of the EU with the introduction of the Euro is the most ambitious project of European (economic and political) integration. It is unique in so far as it breaks with the traditional practice in monetary affairs, that only “one country, one money” is a natural combination and is sustainable. In contrast, the architects of the Euro wanted to try out whether “one market, one money” is feasible in the EU (see European Commission, 1990). This project borders on hubris. First, only 19 EU member states out of EU-28 are part of the Eurozone. The non-Euro countries can disrupt the Single Market of the EU-28 by devaluing against the Euro countries. This is then no longer a Single Market with equal opportunities and fair competition. Being no (federal) state – like the US – the Eurozone (a subset of the EU) has got a fictional (asymmetric) policy design. The ECB is responsible for executing monetary policy for the average of the Eurozone member states but having (not yet) a Eurozone finance minister. Fiscal policy – still in the competence of the EU member states – must be coordinated. At the beginning, only the Stability and Growth Pact (SGP) was the main coordinating instrument. Since the outbreak of the Euro crisis in 2010 a new frame for policy coordination was introduced with the “European Semester”. Within this frame, the other coordination instruments were reformed and supplemented. The SGP has been reformed (SGP III) and tightened and accompanying instruments (Six-Pack, Two-Pack, Euro Plus Pact, TSCG = Treaty on Stability, Coordination and Governance (Fiscal Compact)). This new or adapted instruments of economic policy coordination should lead to a “Fiscal Union”.

After France and Germany broke the rules of the SGP in 2002 and 2003 without being punished, its rules were reformed in 2006, including more flexibility in case of national specific effects (“SGP, mark II”; see Breuss, 2007). Willi Kohler (2007) philosophized on the “Theoretical underpinning of the SGP”. After a tour d’horizon over possible theoretical justifications for the pact (from the OCA theory over aspects of policy coordination and long-run sustainability), he concludes that the specific rules of the SGP and its “numerology” are not well founded theoretically. Breuss and Roeger (2007) try to find out with simulations with the QUEST model, which SGP rules (“Mark I” or “Mark II”) were more adequate to stabilize

the economy. The answer depends on the question which kind of slow growth a country faces: demand shocks or long-run supply shocks. In case of a demand-shock recession, SGP rules are harmful in the short-run. In case of supply shocks, SGP rules are advantageous in the long-run. The application of the SGP, mark II in the GFC in 2009 exactly confirmed our simulation results, done before.

The Great Recession in 2009 and the following Euro crisis in 2010 revealed several lies in the Euro policy design. Starting with the ad hoc rescue of Greece with bilateral credits, the governments of the Eurozone installed new rescue instruments: EFSF+EFSM, ESFS and lastly the ESM. Remarkable in this rescue operations is that it was done only intergovernmental without the usual community method. In the whole process of rescuing the peripheral Eurozone countries (after Greece, Cyprus, Ireland, Portugal, and Spain) the European Parliament was at no time involved! Only a “Troika”, consisting of the European Commission, the ECB and the IMF operated and supervised the Euro rescue operation. In some countries, e.g. in Germany the Court of Justice (Bundesverfassungsgericht) obliged the government to as the German Bundestag to accept the rescue operations.

The last 20 years of the introduction of the Euro (first in 1999, the Euro could be used only in its scriptural form; in 2002 it became legal tender in the 11 founding member states) can – considering its performance – be divided into two periods. The first ten years, I call it the “nice weather period” the Euro performed well, it kept inflation down and the overall growth performance of the Eurozone were comparable to those of the USA. The financial markets believed the “No bail-out” lie which led to a convergence of the yields of government yields irrespective of their different risks. The second decade (the “crisis years of the Euro”), starting with the Great Recession in 2009 and the Euro crisis revealed the many weaknesses and failure in the policy design of the Euro. In 2010, starting with the Greek debt crisis, financial markets realized the differences in political risks in the Eurozone countries which lead to a dramatic increase in the spreads of government bond yields. The Eurozone was not crisis-proven and had no rescue instruments (Breuss, 2016c). Due to the rescue operations in the overindebted periphery members of the Eurozone, as well as due to the late intervention by the ECB and the restrictions for fiscal policy stimuli because of the SGP, the Eurozone since 2009 performed dramatically worse than the USA with an increasing growth gap (see Breuss, 2017)<sup>6</sup>.

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<sup>6</sup> Breuss (2019) in his evaluation of 20 years of the Euro came to the conclusion that Austria profited by 20 years EU membership (Single Market participation) and the introduction of the Euro by one percentage points more real GDP per capita, of which 0.7 percentage points are due to the Single Market and 0.3 percentage points due to the Euro.

#### 4.2 Reform after another to crisis-proof EMU

The outbreak of the Euro crisis in 2010 revealed it clearly that the policy design of EMU is flawed. After the rescue operations, starting with Greece in 2010 the representatives of the EU in rapid succession published proposals to reform the EU. It started with a blueprint for a deep and genuine economic and monetary union by Barroso (“Barroso plan”) on 30 November 2012 (Barroso, 2012), followed by the “Van Rompuy plan” “Towards a Genuine Economic and Monetary Union” on 5 December 2012 (Van Rompuy, 2012). Then came “The Five Presidents” Report on 22 June 2015 “Completing Europe’s Economic and Monetary Union” by Juncker, Tusk, Dijsselbloem, Draghi, and Schulz (2015). In a series of statements in 2017 the European Commission complemented these earlier reform suggestions:

- White paper on the “Future of Europe” (European Commission, 2017a)
- Reflection paper on the deepening of the Economic and Monetary Union (European Commission, 2017b).
- Roadmap for Deepening the EMU (European Commission, 2017c).

In the meantime, Commission president Jean-Claude Juncker made important proposals to reform EMU in his “State of the Union Address” (Juncker, 2017). In brief, he calls for the following new ingredients for a deepening EMU:

- “The Euro for all”. He sticks to the Treaty which obliges each EU Member State to introduce the Euro, given she fulfils the Maastricht criteria. To do so, he proposes a convergence instrument to give pre-accession assistance to non-euro area MS. In my suggestion (Breuss, 2013a) I have pledged for the same, namely the “Euro for all” but for economic reasons. A Single Market is only complete if all member states also introduce the Euro. Otherwise is the SM an illusion and can be distorted by currency devaluations against the Euro. Furthermore, since the introduction of the ESM, we have enough capacity to bail-out weak Euro member states.
- European Monetary Fund (EMF): Transformation of the EMS into an EMF.
- Creation of a double-hatted European (EU) Minister of Economy and Finance: He/she is responsible not only for the Euro area (Macron suggestion). It should not be a new position (Euro finance minister – Macron suggestion) but should be a Commissioner for economic and financial affairs plus the chief of the Euro Group.
- Creation of a dedicate “Euro area budget line”: There should be no separate Euro area budget (Macron suggestion) but this line should be within the EU budget providing four functions:

- (1) Structural reform assistance (since 2015 “EU Structural Reform Support Service” – SRSS)
  - (2) A stabilisation function
  - (3) A backstop for the Banking Union
  - (4) A convergence instrument to give pre-accession assistance to non-euro area MS
- European Banking Union (EBU): it should encourage all Member States to join the EBU. Currently, only Euro area MS must take part in the EBU.

After the global financial crisis (GFC) in 2008, followed by the Great Recession in 2009 and the Euro area (debt) crisis after 2010 the proposed changes in EMU Economic Governance aim at the re-building the EU on three pillars: (1) a Fiscal Union with Economic Policy Coordination; (2) an Economic Union consisting of the Single Market, ensuring convergence and competitiveness; and (3) a Financial Union consisting of Rescue/Bailout measures (ESM, European Banking Union, Capital Market Union). The targets (1) and (2) are bridged by the process of the “European Semester” since 2011. Many of the necessary institutional changes have already been implemented.

For the implementation of the newly suggested reform packages, on 6 December 2017 the EU Commission sets out a “Roadmap for deepening Europe's Economic and Monetary Union” (European Commission, 2017c) with the following four main targets, which would not need Treaty change and implementation during 2019:

- Transformation of the ESM into the EMF
- TSCG (The Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union) is an intergovernmental Treaty signed by 25 Member States (all except the Czech Republic, Croatia and the United Kingdom) in 2012. It complements the EU fiscal framework, such as the SGP-III. Its substance should be integrated into EU law.
- Stable Euro area with four initiatives:
  - (1) An instrument for structural reform support.
  - (2) Dedicated convergence facility for non-euro Member States to introduce the Euro.
  - (3) EBU and CMU: Fully functional backstop to the Single Resolution Fund (EBU); Implementation of the European Deposit Insurance Scheme (EBU); Finalising all pending legislative initiatives for Capital Markets Union.
  - (4) Stabilisation function in case of asymmetric business cycle shocks in the Euro area (several specific funds).
- EU minister of economics and finance (Vice president of the Commission and head of the Euro Group). Creation of a dedicated “Euro area budget line” (within the EU budget)

without a separate Euro area budget. No Eurobonds. No transfer union with a Redemption Fund.

In addition to the “official” suggestions by the Commission suggestions there were others, prominently by French president Emmanuel Macron (2017) in his famous “Initiative for Europe” speech at the University Sorbonne on 26 September 2017. The major points he requests are: He pledges for “more Europe”, a sovereign, united democratic Europe as a plan for the next 10 years. The Eurozone is at the heart of Europe’s global economic power. Concretely, he wishes for the Eurozone an economic government consisting of three pillars: (1) a Eurozone parliament, (2) a Euro finance minister, and (3) a separate Euro budget (no transfer union, only for the fight against unemployment).

Besides these proposals by politicians and EU institutions to reform the EMU, many academics have also made a big variety of suggestions to reform the EMU (see Baldwin and Giavazzi, 2016). Besides the need for a stabilisation function at national or Euro area level in case of asymmetric shocks (Allard and Bluedorn, 2016; Bénassy-Quéré et al, 2016), some propose the introduction of an US-type system of “fiscal federalism” (Henning and Kessler, 2012; Italianer and Vanheukelen, 1993). The former Commissioner Andor (2014) pledges for the introduction of a European Unemployment (re-)insurance (see also Bénassy-Quéré et al, 2016).

Many researchers request the introduction of a kind of Eurobonds (e.g., Bénassy-Quéré et al., 2018). The Eurobonds have a long history. Already in 2008/09 EPDA (2008) suggested the introduction of a common European Government Bond or a Common European T-Bill. The European Commission (2011) spoke of Stability Bonds (not “Eurobonds”) which, however, would need a Treaty change (Art. 125 TFEU – “No bail-out clause). Brunnermeier et al. (2016), member of an expert group at the ECB Stability Board are designing ESBies. In 2014 an Expert group on a debt redemption fund and euro bills (Tumpel-Gugerell, 2014) understood “Eurobills” as government fixed-income securities up to a predefined, rather a short-term maturity (up to one or two years), jointly issued by the euro area Member States. Merits: Safe asset; the reverse trend towards fragmentation of euro area financial markets; Risks: Moral hazard risks; exclusion of MS (if not all countries participate or leave the club). The EU reflection paper on the deepening the EMU (European Commission, 2017b) proposes Sovereign-bond-backed securities (SBBS). These are securitised financial products, issued by a commercial entity (bank) or an institute. It excludes debt mutualisation between Member States (No Redemption Fund). The idea is currently discussed in the European Systemic Risk

Board (ESRB). Dolls et al. (2016) suggest a risk-sharing alternative: insurance with market discipline as a blueprint for a European Fiscal Union.

Many Euro area members, first and foremost Germany resists the idea of Eurobonds and Redemption Funds because this would involve a permanent transfer flow from the core to the periphery. The EU would become a transfer union. The idea of a Debt Redemption Fund was brought up at the begin of the Euro crisis in the “Barroso plan” (Barroso, 2012) with reference to such a suggestion by the German Council of Economic Experts (2011). In 2014 the Expert group on a debt redemption fund and euro bills (Tumpel-Gugerell, 2014) concluded that such a fund would have the merits that it could stabilise government debt markets, supporting monetary policy transmission, promoting financial stability and integration. However, the risks would be the danger of economic, financial and moral hazard, and the trade-offs. The chances to introduce a redemption fund, like Eurobonds are low because both instruments would need Treaty change (Art. 125 TFEU – “No bail-out clause). Without EU Treaty amendments, the EU/EMU could introduce such instruments only through a purely intergovernmental construction. This is a further EU illusion: without the EU being a federal state and having an own budget like the USA with a Treasury issuing such bonds (“Treasuries”) it is not credible to issue Eurobonds.

#### *4.3 EU's Single Market with only three freedoms?*

Brexit was a turning point for Europe. The Brexit has demonstrated that not all EU member states are happy with the idea of “... creating an ever closer union ...” (TEU, Art. 1(2)). But the wish of the British people to leave the EU is not only based on the unloved third of the three Single Market freedoms, the free movement of people<sup>7</sup>. Nevertheless, some economists call into question the need for the four freedoms in the Single Market. Pisani-Ferry et al. (2016) – in anticipatory obedience - proposed a continental partnership with the EU, neglecting the free movement of labour. Kohler and Müller (2017) state that EU's position in the Brexit negotiations is based on the premise that the four freedoms of the single market – goods, capital, services, and labour – are indivisible. They argue that this indivisibility claim has no economic foundations and that negotiating on this premise risks unnecessary harm. However, one cannot emulate a common market with one currency like that of the USA

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<sup>7</sup> In Article 50 of the “Political declaration setting out the framework for the future relationship between the European Union and the United Kingdom”, the EU offers the UK that the principle of the “free movement of people” no longer apply during the transition period up to the end of 2020. This Political Declaration comes together with “Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and European Atomic Energy Community”, published in the Official Journal of the European Union, 2019/C 66 I/01 and 02, Vol. 62, 19 February 2019.

without allowing goods, services and production factors to move freely. Therefore, the four freedoms are economically and politically the least one can expect from a common market in the EU.

## **5. A United States of Europe as the ultimate solution?**

In view of the multiplicity of crises and challenges the EU is confronted with, it is no longer possible to continue with the present institutional set-up of the EU.

After the Euro crisis in 2010, the EU/Eurozone was split between the successful core and the overindebted periphery. A problem which is solved only superficially. The migration shock in 2015 led to a further split, now between the West and the East of the EU. Still, there is no solution to distribute asylum seeker within the EU. No solution is in place to secure the EU borders and to reform the Dublin III rules. This reveals other EU illusions: the “Schengen” and “Dublin” illusions!

Apart from these problems, the Brexit and the migration shocks have awakened nationalism in Europe. Some countries are not obeying EU law (Hungary and Poland), others are – for internal nationalist reasons – provoking quarrels between founding members of the EU (Italy versus France). The basic axis France-Germany weakened recently because Berlin did not adequately react to Macrons EMU reform proposals.

### *5.1 Juncker’s future of Europe in five scenarios*

Midst of this melange of problems EU Commission president Jean-Claude Juncker offered his view on the Future of Europe in a White Paper (European Commission, 2017a). Considering the multiplicity of ideas about the EU’s future by the Heads of State or Government of EU’s MS, he offered not one vision about the future of the EU but five scenarios.

1. *Carrying on*: This means, no changes to the status quo. This would be accepted by the Visegrád group.
2. *Nothing but the single market*: This was the wish of the UK government before the Brexit. Here on must ask, whether this scenario excludes the Euro?
3. *Those who want more do more* (Flexible integration): This would be the favourite of Macron and Merkel (“EU running at different speeds”) but is opposed by the new EU member states in the East.
4. *Doing less more efficiently* (“Subsidiary principle”): Behind this scenario stands the idea of “subsidiarity”, although this word is not mentioned in the text. This is favoured by Austrian Chancellor Sebastian Kurz.

5. *Doing much more together*: This sounds as if the Commission would prefer the idea of the United States of Europe (USE).

In his “State of the Union” address, Jean-Claude Juncker (2017) offered – as a life-long fighter for the European project – his own “*sixth scenario*”. For him, “Europe is more than just a single market. More than money, more than a currency, more than the euro. It was always about values.” His sixth scenario includes three fundamentals, three unshakeable principles: freedom, equality and the rule of law<sup>8</sup>.

### 5.2 *Only a radical newly founded EU is able to survive*

In view of all EU illusions (SM, Euro, Schengen, Dublin), a complete reboot of the EU is necessary. All reform proposals primarily targeting EMU/Eurozone (which again excludes the non-euro member states!) are just tinkering with symptoms but do not offer a basic solution to the multiplicity of EU problems.

The only solution seems to be to dissolve the present EU and re-design it as the United States of Europe (USE). This is not a new idea but has many prominent predecessors in history. In the course of history, many famous people have spoken or dreamt of a United States of Europe, ranging from George Washington<sup>9</sup>, Napoleon Bonaparte, or Giuseppe Mazzini to Richard Coudenhove-Kalergi. But probably the clearest, most concrete vision was articulated by the French writer Victor Hugo. On the Paris Peace Congress in 1849 he uttered his vision by saying: “...*A day will come when we shall see those two immense groups, the United States of America and the United States of Europe, stretching out their hands across the sea, exchanging their products, their arts, their works of genius[...]*”.

In the 20<sup>th</sup> century, even the SPD Heidelberg Program demanded the United States of Europe. After World War II, Winston Churchill (1946) in his speech at the University of Zurich pledged for the United States of Europe – but without the United Kingdom! Many EU representatives (e.g. Reding, 2012) speak now and then about the need of the USE. On 3 April 1992, Helmut Kohl spoke of the Maastricht Treaty as follows: On 3 April 1992 Helmut Kohl even spoke of the Maastricht (quote by Reding, 2012): “*In Maastricht, we have laid the foundation for the completion of the European Union. The Treaty on European Union marks*

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<sup>8</sup> “The Sibiu Declaration” of the European Council at its informal meeting in Sibiu, as of 9 May 2019 did not reach a concrete result on the “Future of Europe” but agreed on 10 commitments (see European Council, 2019).

<sup>9</sup> The first president of the USA, George Washington allegedly voiced support for a “United States of Europe” in a letter to Marquis de La Fayette: “*We have sown a grain of freedom and unity that will gradually germinate around the world. One day, the United States of Europe will be established, following the pattern of the United States. They will be legislators of all nationalities.*” (see also Fulbright, 1948).

*a new, decisive step in the process of European integration that in a few years will lead to the creation of what the founding fathers of modern Europe dreamt of after the last war: a United States of Europe.*” Later Kohl never again mentioned the name USE.

An attempt to renew the idea of the USE was tried with The Treaty establishing a Constitution for Europe (TCE). It would have replaced the existing EU Treaties with a single text. However, even for the founding member states France and the Netherlands, this was “too much Europe”. In referenda, in May and June 2005 their voters rejected the TCE. In a little bit diluted version, the content was implemented into the Treaty of Lisbon, replacing the Constitutional Treaty and came into force on 1 December 2009.

The GFC in 2008, the Great Recession in 2009 and the Euro crisis again ignited the vision of the USE. Breuss (2013b) made this suggestion during the Euro crisis and again right after the Brexit vote in the UK (Breuss, 2016b). My suggestion was to design a new Constitutional Treaty for the USE. It could be a copy of that of the USA, but it can also be a unique European Constitutional Treaty. Then the old EU is dissolved, and the voters of the European countries are asked in a referendum whether they accept membership in the USE. Maybe only a few “true European” countries are ready to go this step. Maybe only 10 countries. If this project will become successful other European countries could join the USE. In my vision, the USE would be a Federation State like the USA, where the present nation states become federal states represented in an institution like the US Congress.

Others would firstly destroy the actual EU national member states. In April 2013, Ulrike Guérot and Austrian novelist Robert Menasse (2012) published a "Manifesto for the founding of a European Republic“ in which they draw attention to the current tensions and developments of the European Union . Consequently, in their paper, they call for the foundation of a European Republic. The Manifesto has been tied to an appeal for a new Europe which so far has been signed by a variety of European academics, intellectuals, artists and policymakers, such as French star economist Thomas Piketty, Club-of-Rome member Ernst Ulrich von Weizsäcker or professor Gesine Schwan. Simultaneously, Guérot (2016) lays down her dreams in the book „Why Europe needs to become a Republic! A political utopia“. Their visions are proclaimed in “The European Balcony Project”<sup>10</sup>. It is, however, not clear whether the present nation states of the EU are ready and willing to give up their actual political power and sovereignty to their regions and later to a European Republic!

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<sup>10</sup> See: <https://europeanbalconyproject.eu/en/>

## 6. Conclusions

Brexit was a turning point for Europe. To continue as before is no longer possible. In this laudation to Wilhelm Kohler's 65<sup>th</sup> birthday, I firstly have done a retrospective on the fight for a better Europe by Willi and me at the same time with different methods. We both did research around Austria's accession to the EU. We made several ex-ante studies about the possible economic impact of EU membership. The expected effects on GDP and trade were positive. These results were then verified in ex-post studies. At that time the EU only was in the stage of the Single Market. Later it continued its process of deepening (EMU with the introduction of the Euro) and enlarging. Lastly, the EU increased to 28 members. These integration steps gave enough impetus for Willi and me to do respective research. On the reforms of the SGP and the several tries to reform the EMU after the Euro crisis. The Brexit is a new challenge not only politically, but economically. After the reflexion on these common research interests in Europe and a discussion of the already existing reform proposals to overcome the multiplicity of present problems (Brexit, Euro crisis, migration problem) I tried to develop a vision for a new (institutional) future for Europe: a dissolution of the present EU and a new foundation as the United States of Europe.

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