Wither Europe? — Crisis in the EU & Searching for an Identity

By Devin Horne and Constantine A. Pagedas

The concept of "Europe" and what it means to be European has always been open to interpretation. Over the years, this ambiguity has created something of a European identity crisis. In the aftermath of World War II, when some of the war-torn economies of Western Europe came together to pool their resources and to leverage their influence in the early stages of the Cold War, significant disagreements existed regarding how wide and how deep European integration could and should go. These disagreements continue to challenge the European Union today.

Beginning with the creation of the European Coal and Steel Community in 1951, Germany, France, Italy and the three Benelux countries took the first step of lowering trade barriers in specific industries. This move by the "original Six" proved so successful, at a time when Europe faced dire economic, political, and security challenges, that plans quickly moved ahead to develop the European Defense Community (EDC), the European Atomic Energy Community (Euratom), and ultimately the European Economic Community (EEC), with the signing of the Treaty of Rome on March 25, 1957.

The EEC's Common Market was based both on the free movement of goods, persons, services, and capital, and on the development of common policies, to include those affecting agriculture, energy, and transportation. By most accounts, the EEC was highly successful. Germany, France, and the other members experienced a prolonged period of sustained economic prosperity and relative political stability.

Author Devin Horne

Author Constantine A. Pagedas

Nevertheless, this early period of European integration also suffered setbacks. The proposed EDC was considered by some countries to be a non-starter and never got off the ground. An organization that pooled the security resources of Western Europe was seen as duplicative of, and even competitive with, the nascent North Atlantic Treaty Organization (NATO), which most importantly included the United States and its atomic arsenal to protect Europe against the Soviet Union.

Concomitantly, the United Kingdom, which had one of Europe's largest economies and had been invited to join the original Six in the creation of the EEC, remained aloof. The British government soon came to regret this decision, especially as British trade in the 1950s and 1960s was increasingly heading toward the Continent. Moreover, being outside the EEC meant that the British could do little to shape the organization's political and economic direction at an early stage. As the EEC developed, other European countries also took notice of the economic benefits afforded to its original Six members, and in varying ways made advances to develop stronger ties to the Common Market.

Photo: (c) Pinatel

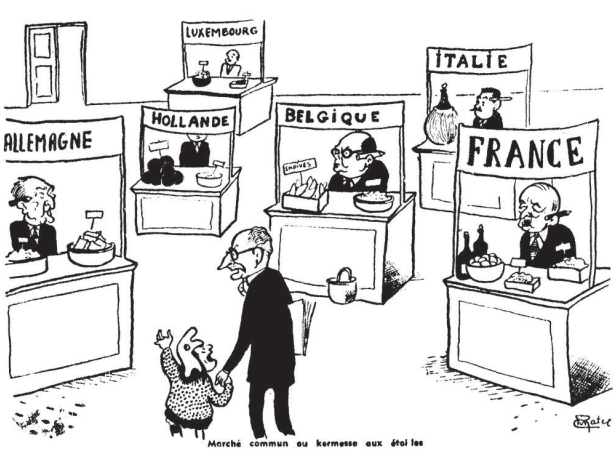


ILLUSTRATION: "Common Market or village fête"
On March 29, 1957, commenting in the French daily Combat *on the signing in Rome of the treaties establishing the EEC and the EAEC, the cartoonist Pinatel portrayed the French people's doubts about the implications of the Common Market.*

How Wide & How Deep?

The UK experienced two failed attempts to join the EEC before it finally joined on Jan. 1, 1973. Former US Secretary of State Henry Kissinger labeled 1973 as "The Year of Europe", which began a long period of EEC expansion. Indeed, the Common Market expanded relatively quickly, bringing the benefit of lower trade barriers to a growing group of countries. Several additional membership rounds brought many new countries into the European fold, including many Eastern European countries following the end of the Cold War. By 1992, the Maastricht Treaty created what is now officially known as the European Union, shifting more and more political power to Brussels and eventually leading to the 1999 creation of a single European currency, the euro, and the so-called Eurozone.

Today, the EU is one of the largest markets in the world comprising 28 member states and over 500 million people, or approximately 7.3% of the world's population. In 2014, the EU generated a nominal gross domestic product of approximately $18.5 trillion, about 24% of global nominal GDP. Meanwhile, 19 of the 28 EU member states are members of the Eurozone, and look to the European Central Bank in Frankfurt, Germany to set monetary policy.

Yet, again, the expansion of the EU over these many years was not without its tribulations. Even after it was admitted into the Common Market, the UK has been at best a lukewarm member. Prime Minister Margaret Thatcher in the 1980s and more recently David Cameron are two of the most vivid examples of British leaders who resisted further surrendering British sovereignty to Brussels and who renegotiated the terms of the UK's EU membership.

The UK, however, was not the only member to forgo adoption of the euro or limit its involvement in the Eurozone. Denmark, for example, also opted out of adopting the euro as its currency. In addition, other countries such as Norway and Switzerland have noticeably chosen to remain outside of the European project altogether.

Europe's Fragile Footing

The creation of the Eurozone on Jan. 1, 1999 and the convergence of the 10-year government bond yields of its members gave rise to global perceptions of a homogenous and harmonious Europe. For the first 10 years of its existence, the economies of the Eurozone thrived. Much of this was due to the expectation that the fiscally liberal Eurozone countries located predominantly in southern Europe would naturally adopt the fiscally conservative ways of the "model economies" of northern Europe, such as Germany.

Indeed, the introduction of the Eurozone meant that the buying power of the fiscally conservative northern European countries grew. Germany, for example, benefitted from a slightly weaker currency in the euro compared to the former deutschmark. Overnight, German exports became much cheaper. German businesses experienced record profits and were in turn able to expand their reach into then-untapped markets of the EU, destroying local competition along the way.

On the other hand, more fiscally liberal southern European countries such as Greece, Italy, and Spain immediately saw their costs of living significantly increase as a result of switching from much weaker currencies such as the drachma, the lira, and the peso to the euro. This was offset somewhat by the ability of these countries to enjoy lower interest rates previously only found in the fiscally conservative north. As a result, southern European countries racked up significant levels of debt in order to sustain themselves and their increasingly expensive government programs.

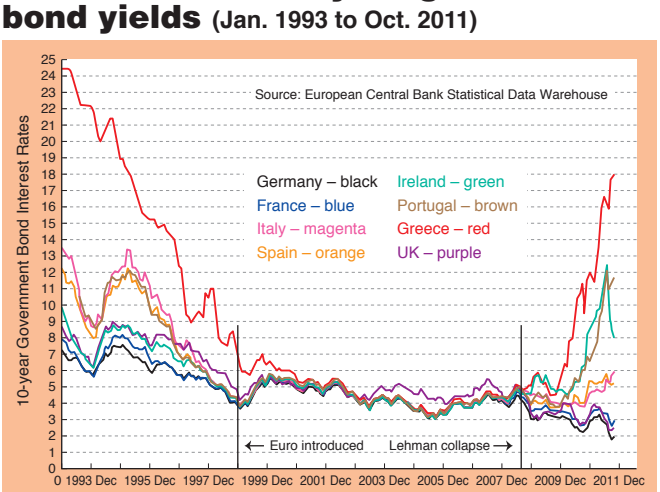
The issue of the Eurozone and overall European integration was brought to a head with the Lehman Brothers collapse in 2008 and subsequent financial turmoil, as the EU was suddenly faced with a sovereign debt crisis. Several members of the Eurozone, including Portugal, Italy, Ireland, Greece and Spain, the so-called PIIGS, were unable to pay back or refinance their growing government debt, or bail out their over-indebted banks. Having adopted the euro, thus losing the ability to manage their own monetary policy, these highly leveraged countries were forced to take on more debt or risk default and/or expulsion from the Eurozone. The PIIGS sought financial assistance from other Eurozone countries, as well as the European Central Bank (ECB) and the International Monetary Fund. There were, however, conditions attached to the bailouts as the PIIGS were forced to impose severe cuts in government spending and crippling austerity measures on their populations.

Thus, the fiscally conservative policies that had not been adopted by the financially liberal southern Eurozone countries in the first 10 years of the euro's existence would now be *imposed* by the financially conservative north, namely Germany, in order to make the south more like the model economies of the north. The very real threat of bankruptcy and potentially crashing out of the common currency loomed in the background for the heavily indebted Eurozone countries. Some, such as Ireland and Portugal, have made a modest return to economic growth. Others, however, most notably Greece, have been less successful as several politically weak Greek governments have struggled with the economic reforms demanded by their creditors.

As *Chart 1* demonstrates, the Eurozone and the adoption of the euro masked the cultural and fiscal variations that existed among its member states from 1999 until 2008. It also shows the reality that investment in different Eurozone countries carried with it significantly varied risks after 2008 *because* of these differences. EU member states in turn blamed one another for the Eurozone sovereign debt crisis and as a result increasingly disagree over the roles and responsibilities of Brussels, the ECB, and the individual

CHART 1

Eurozone & UK 10-year government bond yields (Jan. 1993 to Oct. 2011)



Source: Vox Media, "Greece's debt crisis, explained in charts and maps", July 6, 2015

national governments. Although the Eurozone reached last-minute deals to bail out several troubled governments primarily in Europe's southern region, the relationships between certain member states remain difficult.

Challenges Now Facing Europe

Although the Eurozone crisis of the past few years revealed the magnitude of differences among the EU member states, Europe also faces several new interlinking challenges. Prolonged weak economic growth as a result of the Eurozone crisis, a wave of migrants seeking a better life in Europe, and a renewed security threat from Russia all cast doubt on the political and economic cohesiveness of the EU.

Economic Challenges: High unemployment and low economic growth have dogged the EU since 2008 *(Chart 2)*. According to Eurostat, EU unemployment spiked in 2008 and has hovered between 10% and 11% since 2010. At the same time, annual EU-wide economic growth last surpassed 2% in 2010. The EU went into full recession in 2012 and barely reached 1.4% growth in 2014. In February 2016, the European Commission downgraded its Eurozone growth projection for 2016 to 1.7% from the 1.8% that was estimated in late 2015, and cautioned that risks to the economy were becoming more pronounced. The Commission maintained its projection for 2017 at 1.9%.

Furthermore, although 10-11% unemployment is high, the story is much worse when examining individual countries. As *Chart 3* demonstrates, countries such as Greece and Spain are experiencing significantly higher unemployment rates than many of their EU counterparts.

Migration Crisis: Alongside the challenge of weak economic growth, Europe is also struggling with a burgeoning migration crisis. Refugees from Syria and Iraq, and from as far away as Afghanistan and Central Africa, are trying to enter the EU from Turkey and North Africa into Greece and Italy, creating a wave of migration not seen since the end of World War II.

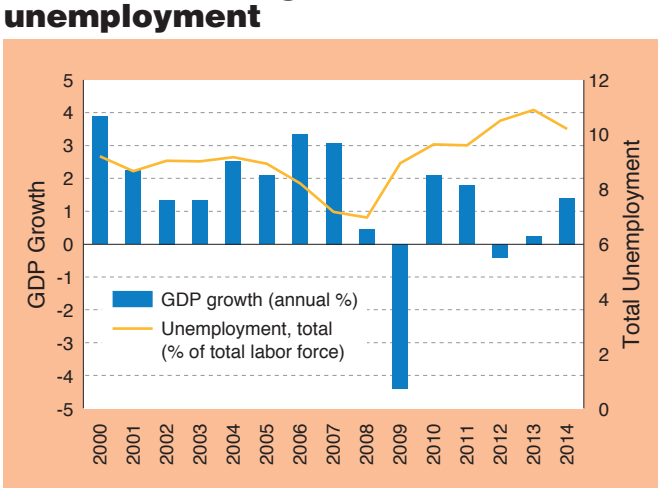
As of the third quarter of 2015, Europe had received just over 900,000 applications for asylum. That level was almost twice the number of applications received in 2013. Furthermore, those numbers only represented *legal* attempts to enter Europe and did not account for the hundreds of thousands of migrants attempting to enter without proper documentation. Indeed, by some estimates, between 1 and 1.5 million refugees illegally entered Europe in 2015. In Germany alone, the government expects up to 800,000 illegal immigrants to cross its borders and seek asylum in 2016. *Chart 4* shows the countries of origin of these asylum seekers as well as the most targeted destinations in Europe.

The massive flow of migrants into Europe at a time of stagnant economic growth and high unemployment has further divided the EU. Although German Chancellor Angela Merkel has advocated for increased tolerance and acceptance of refugees, a *Wilkommenskultur*, nationalist tendencies that emerged with the Eurozone crisis have also been highlighted with newly arrived migrants. For example, numerous countries across Europe are taking steps to limit the flow of refugees across their borders, establishing fences and stronger border controls.

Yet Europe's countries on the very front lines of the refugee crisis, the economically strapped countries such as Greece and Italy, see no alternative to allowing these migrants passage to northern Europe. As such, the concurrent issues of migration and a struggling EU-wide economy are now pushing the various member states in opposite directions. It remains to be seen whether the EU deal with Turkey that went into effect on March 20, 2016 to return illegal migrants currently in the EU back to Turkey in exchange for resettling legitimate asylum seekers now in Turkey offers a permanent solution

CHART 2

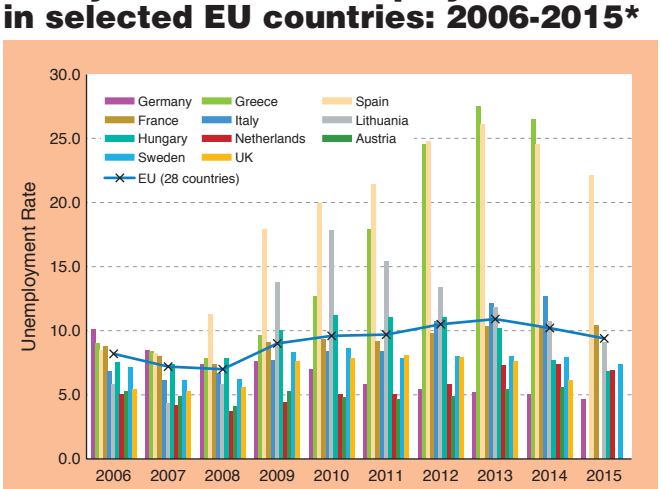
EU annual GDP growth & total unemployment



Source: World Bank, World Development Indicators (WDI).

CHART 3

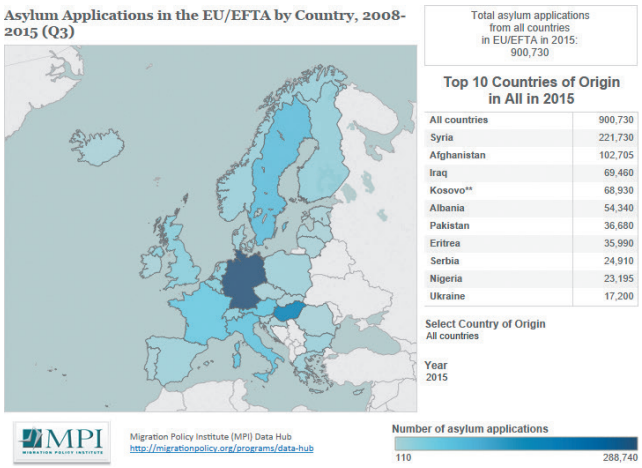
Unadjusted total unemployment rates in selected EU countries: 2006-2015*



Source: Eurostat Database
**2015 data not available for Greece, Italy, Austria, or UK.*

CHART 4

Asylum applications in EU/EFTA by country (2008-2015, Q3)



Source: Migration Policy Institute

or only temporary relief to this complicated problem.

Resurgent Russia: A third challenge to the EU involves the security threat posed by Russia. Following Russia's annexation of the Crimea and incursion into Ukraine in 2014, the EU faces a Russia increasingly flexing its military might in Europe's backyard. So far, the EU has only taken limited measures in addressing the Russian violation of Ukrainian territory. In 2014, the EU began imposing economic sanctions on Russia in coordination with the US. Although the US has limited economic engagement with Russia (making sanctions relatively painless), Russia is an important trading partner for Europe. In 2013 alone, EU countries exported 150.2 billion euros worth of goods and services to Russia, an amount that had held steady in the years just prior to the imposition of economic sanctions.

Indeed, cracks in Europe's resolve to confront Russia's aggression in Ukraine have begun to show as EU economic growth remains slow. Some countries have disproportionately felt the economic costs of the sanctions on Russia. In 2013, Germany, for example, had the highest value of exports to Russia of all EU member states, totaling approximately 38 billion euros, and members of the German government have already publicly expressed doubts about continuing sanctions when they are due for renewal in July 2016. Moreover, Italy and Hungary announced on March 14, 2016 that EU sanctions against Russia would not be automatically renewed, while economically-challenged Greece has frequently emphasized Russia's importance as a trading partner, as a supplier of its energy, and as a positive influence in trying to end the war in Syria.

It remains to be seen whether Europe's struggling economies will be able to sustain economic pressure on Russia, which too has felt the dual bite of restrictions on its exports to the EU and historically low oil and gas prices. Yet, as the EU tries to grapple with uneven economic growth, a refugee crisis of historic proportions, and an assertive Russia not seen since the end of the Cold War, many have again begun to question the value and future of the European experiment.

Photo: United Nations High Commissioner for Refugees

A volunteer life-guard helps a young girl after the boat she and her family used to cross from Turkey to Lesbos in Greece crashed on a rock off the island's coast.

Evolving Perceptions

Europeans generally remain optimistic about the EU. This optimism, however, has been declining, while Euroscepticism has been on the rise over the past few years. The most recent *Eurobarometer* report of November 2015 indicated that 53% of EU citizens remain optimistic about the future of the EU despite all of the political and economic challenges Europe now faces. Nevertheless, this is a decline from the 58% who indicated optimism in May 2015.

In the same November report, 32% of respondents indicated that they trusted the EU while only 28% stated that they trusted their respective national governments. In terms of democratic engagement, only about 40% of *Eurobarometer* respondents believed that their voices counted in the EU, while nearly 54% disagreed that their voices count.

Notably, the number of respondents identifying immigration as the largest problem facing the EU jumped by 20% to 58% between the May and November 2015 reports. At the national level, immigration overtook the categories of "unemployment" and "the economic situation" as the top issue. Indeed, this also represented the first time since the survey began in 2003 that a non-economic issue topped the list of challenges for national governments.

The rise of immigration as an issue relates directly to the increase of refugees from Syria, the Middle East, and beyond. However, it also reflects concern about the state of the European economy and broader concerns regarding terrorism. For example, Spain has found it difficult to support the plight of refugees when over 20% of its population is currently unemployed. Economics places the country directly at odds with EU members such as Germany, whose leadership has been trying to develop a coherent European-wide immigration policy response.

Photo: Sean Gallup/Getty

The Alternative für Deutschland (AfD) ran on an anti-euro, anti-immigration platform in regional elections on March 13, 2016 and had a surprisingly strong showing.

Terrorism ranked just below immigration as the second most important issue at the EU-level. Following the January and November 2015 attacks in Paris and the March 2016 bombings in Brussels, migration has become ever more closely tied to concerns over terrorism. In turn, such public anxieties feed into the political ideologies of extremist, nationalist parties across Europe, further dividing EU citizens and its member states.

Indeed, the growth of anti-immigrant, populist political parties across Europe reflects a growing disapproval of both national and EU governments. On March 13, 2016, for example, German voters gave the populist Eurosceptic party Alternative für Deutschland (AfD) a surprising victory in regional elections. Founded only in 2013, the AfD has been a strong opponent of the euro and Germany's providing bailouts to the troubled Eurozone countries of the south, as well as a driving force against Merkel's more open-door policy allowing migrants to enter the country.

A similar trend of populist nationalism has increased across much of Europe, marked by the rise of the National Front in France, the Northern League in Italy, the UK Independence Party, and the Sweden Democrats, as well as the Fidesz and Jobbik parties in Hungary. At the same time, left-wing nationalistic parties such as Syriza in Greece have also taken a combative tone towards the EU to defend Greece's sovereignty, as evidenced by Prime Minister Alexis Tsipras' political brinkmanship with its Eurozone partners in July 2015 for the renegotiation of Greece's debt. So while overall satisfaction with the EU may remain slightly above 50%, it has been in steady decline for some time. There is increasing pressure from both the right and left questioning the whole European experiment that will form the basis for debate among EU members for the foreseeable future.

Wither Europe?

Europe has experienced an unparalleled period of peace and prosperity since the end of World War II, and the EU has been a significant factor in this trend. Despite occasional setbacks, the EU has facilitated an unprecedented level of trade, free flow of people, and exchange of ideas across Europe that has never been seen or experienced in that continent's long and often troubled history. At the same time, the EU's confidence as a major trading bloc in the global economy and a positive political force in the world has taken a serious hit from the Eurozone crisis, compounded by the ongoing economic weakness in much of Europe, the intensifying refugee crisis, and an uncertain relationship with Russia.

On June 23, 2016, the UK will hold a referendum on whether it should leave or remain in the EU. If a majority of voters decide that the UK's interests lie outside of the EU, the so-called "Brexit" would be yet another serious blow to the European project. Even though the UK is not a member of the Eurozone, many of the fundamental economic and financial underpinnings of the European market will be greatly compromised. Indeed, the EU may find itself again in a serious political crisis with other similarly inclined countries searching for an exit. The growing popularity of nationalist parties on both the right and the left across all of Europe is a troubling development that should give European leaders some pause.

Today, the EU sits Janus-like between its prosperous past and an uncertain future. In many ways, the debates from 75 years ago regarding the width and depth of European integration are still being waged today. At one extreme, some argue that Europe should revert to a simple trading bloc of countries with lowered trade barriers among its members and national currencies controlled by national governments. At the other, some posit that the EU continues to be the next step toward a post-nationalistic Europe whose institutions would eventually supplant completely the government functions of individual member states, creating what some have even termed a "United States of Europe". In any event, such wide and varied perceptions about the EU's role among the 28 members significantly impede Europe's ability to respond to the economic, political, and security challenges it currently faces. Nevertheless, few can argue that in the aftermath of two world wars the Europeans have not earnestly tried to find an identity that peacefully accommodates their diverse and evolving member states. JS

Devin Horne is an energy analyst at International Technology and Trade Associates, Inc. (ITTA), a consulting company in Washington, DC.

Constantine A. Pagedas is executive vice president at ITTA. He is also the editor of the Mediterranean Quarterly: A Journal of Global Issues.