

## **Annette Bongardt and Francisco Torres** **The political economy of Brexit: why making it easier to leave the club could improve the EU**

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# The Political Economy of Brexit: Why making it easier to leave the club can allow for a better functioning EU<sup>1</sup>

by  
Annette Bongardt<sup>2</sup> and Francisco Torres<sup>3</sup>

**Abstract:** The UK exit from the EU represents a qualitative change in the nature of EU membership. On the one hand, membership needs to entail constant caretaking as far as individual members' contributions to the common good are concerned, with both rights and obligations. Countries with preferences that are too divergent for the Union to function properly should then not be discouraged to invoke Article 50 and to opt instead for membership in the EEA or for a free trade agreement. The Union has to deliver to be sustainable, but it cannot do so if there is a constant hold up of decisions that are in the common interest. On the other hand, with the Eurozone having established itself as the de facto core of European (political) integration, the UK's preference for a stand-alone (and incomplete) economic union became untenable, because the need to make the monetary union work calls for further integration and institution building in the economic union sphere.

## 1. The Choice for Brexit

As the 23rd of June UK referendum on EU membership was approaching a majority for a British exit from the EU (Brexit) seemed an increasingly likely possibility, yet the outcome appears to have taken almost everyone by surprise. The leave camp won with a rather good turnout (above 70%, which is significantly higher than the turnout for the United Kingdom's EC referendum back in 1975 or the British Parliamentary elections in 2015).

### Hardly a surprise

Looking back at the discussions during the campaign, it is probably fair to say that arguments seemed to carry little weight. As far as the unsuccessful 'remain side' is concerned, the issue was probably less one of a 'project fear' on the part of some but rather that on the whole the 'remain camp' was campaigning not on a positive message but on a negative one. It defended the option to stay in the EU on the alleged merits of a diluted, non-functioning EU/EMU project, and conditional upon many exceptions. Even some academics did just that in public debates. Not to mention the (by now former) Prime Minister and part of the conservative party who – having raged against EU membership for years, sometimes very much along the lines of

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<sup>1</sup> Pre-print version of Bongardt and Torres (2016), *Intereconomics - Review of European Economic Policy*, Vol. 51, No. 4, ZBW – Leibniz Information Centre for Economics, Springer.

<sup>2</sup> European Institute, London School of Economics and Political Science, National Institute for Public Administration, UFP, Porto, and CICIP (FCT).

<sup>3</sup> European Institute, London School of Economics and Political Science, PEFM, St. Antony's College, Oxford University, Universidade Católica, Lisbon, and CICIP (FCT).

UKIP, threatening the rest of the club with exit – had made a sudden turnaround (thereby not exactly enhancing the credibility of remain), pointing to the perils and costs associated with a Brexit. It should then have come hardly as a surprise that the remain camp's Eurosceptic-led campaign did not work: people tend to prefer going for the original instead of the copy, in this case, for 'leave' rather than for 'remain' with reservations in a very watered-down EU.<sup>4</sup>

### **No panic, just different UK preferences**

We do not see the magnitude of shock from UK exit to the EU that others<sup>5</sup> seem to perceive. Markets did not panic (but are obviously adjusting to new realities, as illustrated by movements in the external value of the British pound or UK asset prices) nor did the EU population and polity. After all, the UK was already not participating in many EU policy areas and common goods.

On the other hand, the scope of exemptions granted to the UK and the country's strong opposition to EU integration have been undermining the good functioning of the EU. Those exemptions – cherry picking in the club benefits – were set to increase further: Had the option to remain in the EU won the referendum, the pre-referendum settlement with the UK, an intergovernmental agreement which enshrined additional exemptions, would have to be enacted.<sup>6</sup> At the same time, opposition to EU integration would have probably also risen.<sup>7</sup> For instance, the Eurozone, which is the core of the EU, would have risked seeing its legitimate efforts to strengthen EMU, including where necessary by deepening the single market, to be vetoed by the UK.<sup>8</sup> Quite possibly then the EU project was not sustainable with the UK inside.

In the future Anglo-Saxon and more continental European perspectives will probably tend to diverge ever more on issues such as financial regulation, CETA, TTIP, among others, for there has been mounting disagreement. Most EU countries favour a model of society more in line with social Europe. The UK's manifested preferences in regard to product and labour market

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<sup>4</sup> This is also the case in many other EU countries, where governments seem not to govern on the basis of their convictions but appear to shadow populist anti-EU parties on the right and on the left. The more they do so the more they risk losing votes to the originals that they imitate.

<sup>5</sup> See for instance George Soros in his statement submitted to the European Parliament on 30 June 2016.

<sup>6</sup> Prime Minister Cameron's unilateral demands for a 'new settlement for the UK in a reformed European Union' regarded the single market and UK sovereignty. Presented under four headings, they regarded completing the single market with regard to the free movement of goods, services and capital; imposing limits to social benefits with the aim to reduce the free movement of persons to the UK; guarantees as to the integrity of the single market in the face of Euro-area measures; and an end to the treaty commitment towards an 'ever closer union'. The wish list is by itself untimely and of a poor exercise in democracy. The correct forum for member states to ask for changes to the treaties and for proposing EU reform is at the time of treaty revisions where all member states can present their positions and negotiate, and where treaty revisions are then democratically ratified. This proceeding stands in stark contrast with the inter-governmental agreement struck among heads of EU state and government, who conceded exemptions to the UK, which affected other EU citizens and the EU's credibility.

<sup>7</sup> According to Paul De Grauwe, the Brexit camp would be working from within to undermine the union. See P. De Grauwe: <http://blog.oup.com/2016/05/eu-benefit-from-brexit/>.

<sup>8</sup> A. Sapir, G. Wolff: One Market, Two Monies: The European Union and the United Kingdom, Bruegel Policy Brief, 2016/01. See also A. Bongardt: Growth: The Possibility of a Truly Single Market, In: The Future of Britain in Europe, 2016, London: IPPR.

regulation tend to be closer to the US or Canada.<sup>9</sup> The above upcoming issues will test whether the UK's preferences are more in line with the US and Canada than with the rest of Europe. If so, it would constitute one more argument playing in favour of the UK's decision to leave the EU: the divide that already seemed insurmountable – it motivated the referendum on EU membership after all – was bound to increase even further given that those issues will soon have to be tackled in the EU. The EU's capacity to shape globalization in line with citizens' concerns (not merely growth-oriented but in a more inclusive and greener manner) will be critical for the support of the project.

### **Not such a big divide on the EU within the UK electorate as claimed**

Contrary to what is often alleged, and considering that also many in the remain camp do not like the EU and its political project, one can argue that in essence there is not that great a divide on the EU within the British electorate.<sup>10</sup> Of course, the UK has repeatedly signed up to the EU project, hereby including the political objective of an ever-closer union of peoples, at the time of accession and at each subsequent treaty revision. However, at the time of joining in 1973 – and one may add ever since – stress was put on economic advantages and not on political commitments, akin to the UK merely joining and operating in an enlarged free trade zone.<sup>11</sup> Yet, the realization of the benefits from deeper economic integration as is the case of the single European market requires sovereignty sharing.<sup>12</sup> Of course, sharing sovereignty in turn also presupposes (a certain degree of) convergence of preferences.<sup>13</sup> It is easier among more similar countries.

In a way, the leave camp (which won the referendum by a margin of almost 4 per cent or roughly 1.2 million votes) played it more straightforward whereas remain-camp eurosceptics, which in fact led the campaign of the remain camp, would like to stay but only in a very different EU. This is however not what most other EU members want. There is little doubt that most UK citizens seem not to support some of the most important European public goods and that the same applies to the European integration project. The UK government demanded additional exceptions in February of this year, one of which most notably on one of the EU's four fundamental freedoms, the free movement of persons, in order to support UK membership in the referendum. The remain camp campaigned for UK membership with those new concessions, which came in addition to continued non-participation in EMU, in the Schengen agreement and in various other EU common goods. In that sense, there was little point (as well to be made) for

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<sup>9</sup> OECD: Economic Policy Reforms 2015. Going for Growth, Paris 2015, OECD.

<sup>10</sup> For a poll taken on the day of the referendum see M. Ashcroft: "How the United Kingdom voted on Thursday... and why", 24 June 2016.

<sup>11</sup> According to N. Davies: Not forever England: A European History of Britain, In: Europe East and West, 2007, London: Pimlico, pp. 83-105, the UK's attitude towards Europe has not only been driven by government and party policies but can be attributed to more fundamental misconceptions about its history, Anglo-centric and diminishing the many interactions with Europe. The UK's first in-out referendum (on EC membership in 1975) already showed a divide also within the two main parties.

<sup>12</sup> L. Tsoukalis: The New European Economy Revisited, 3<sup>rd</sup> edition, Oxford 1997, Oxford University Press.

<sup>13</sup> A. Bongardt; F. Torres: Forging sustainable growth: the issue of convergence of preferences and institutions, In: Intereconomics, Forum – Convergence in the Eurozone, 2013, Springer Verlag, 48, 2. See also A. Bongardt, op. cit.; I. Begg, A. Bongardt, K. Nicolaïdis, F. Torres: EMU and Sustainable Integration, In: Journal of European Integration, 37, 7, 2015; and E. Jones, F. Torres: An 'Economics' Window on an Interdisciplinary Crisis, In: Journal of European Integration, 37, 7 (Nov.), 713-722.

the UK in staying in the EU. And possibly even those demonstrating against Brexit in the streets of London in the aftermath of the referendum (some of whom woke up late to the costs associated with not caring much about the EU, alias similarly to many others across Europe) would again be more on the ‘Leave’ side as far as contributing to European public goods and participating in the political integration project is concerned.<sup>14</sup> This continued unhappiness of the UK with its EU membership is in our opinion based on a misunderstanding of the essence and objectives – above all, political – of the EU club and the European integration project.<sup>15</sup>

### **Club benefits**

The UK was torn right from the outset between the economic benefits that come with membership of a more deeply integrated club, and the perceived political costs in terms of sovereignty sharing or loss.<sup>16</sup> The fact that it did join in 1973 testifies to the fact that the prospect of higher economic advantages – brought about by large market scale and the customs union – prevailed over its reservations about the supranational EC integration model and the political aim of an ‘ever closer union’, which was (and still is) part and parcel of it.

Over time, the UK has opted to limit its participation in European common goods: it does not participate in the Schengen agreement and in police and justice matters, it secured a protocol to the treaty relating to the application of the Charter of Fundamental Rights, and it has an opt-out from EMU. For the UK the benefits to be had from the EU are hence narrowed down very much to the (incomplete) economic union sphere and more precisely to the single market whereas other member states can take a more encompassing and compensatory view across wider issue areas.<sup>17</sup> The UK justified its renegotiation attempt with the objective to make the single market work better for it (higher benefits) and with the allegedly high (sovereignty) costs of membership. Yet, in-depth reports carried out by the UK government did not yield any need for repatriation of competences and concluded that proposals for advanced improvement could be

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<sup>14</sup> See S. Hix: <http://blogs.lse.ac.uk/government/2016/06/30/hotseat-simon-hix-on-the-eu-referendum-result-the-implications-of-brexite/>, argues that even if those people who may belatedly have second thoughts could vote again that would not really change the outcome.

<sup>15</sup> According to M. Emerson: Brexit – a last testament, CEPS Commentary, 23 May 2016, the first factor for strong British support for Brexit was “*a decided political and cultural preference from the very start in the 1950s for free trade over greater political integration*”.

<sup>16</sup> The UK left the Spaak committee in 1955 in disagreement with the supranational model of integration and took the decision not to join what was to become the European Economic Community (EEC). It then promoted the creation of a rival, intergovernmental club, the European Free Trade Association (EFTA), in 1960. However, already in 1961 it applied for EEC membership in recognition of the higher economic benefits associated with the higher level of economic integration. The UK only entered the EEC in 1973 though, having been kept out until then by General de Gaulle’s two famous ‘non’. R. Baldwin, C. Wyplosz: *The Economics of European Integration*, 5<sup>th</sup> edition, New York and London 2015: McGraw-Hill, trace the stances towards European integration, manifested by the EEC/EFTA divide, back to the different lessons that countries drew from the economic dislocation and human loss caused by WWII, that is, the notion of shared destiny in the EEC (the case of Germany, France, Italy and the Benelux countries) and the wish to preserve sovereignty (notably the case of the UK).

<sup>17</sup> The UK did not want to participate in the completion of economic union through the various intergovernmental arrangements aimed at strengthening economic governance, most notably the European Banking Union. The UK besides having opted out of EMU like Denmark, does not participate in the Euro-plus Pact, the Fiscal Compact (having obliged all the other MS to resort to an intergovernmental arrangement in the first place) and in the European Banking Union. See A. Sapir, G. Wolff, op. cit., for a nice graphical representation.

dealt with within the existing EU governance architecture.<sup>18</sup> On the other hand, from the point of view of the EU club, the UK's non-participation in many European common goods means that benefits from UK membership are also more limited while the UK's blocking of decisions at the EU level raises costs associated with its membership.

The Brexit vote has already diminished the UK's influence in the internal market, more precisely in the financial sector in which it takes a particular interest due to the sector's large weight in the national economy and where British influence on EU regulation used to be strong in the past. The British commissioner who was in charge of financial services regulation (the Commissioner for Financial Stability, Financial Services and Capital Markets Union) in the European Commission stepped down after the vote; his entire portfolio came under the responsibility of the Commission Vice-President for the Euro and Social Dialogue, a choice that was swiftly approved by the European Parliament.<sup>19</sup> It opens up the perspective that financial regulation in the single market can be better geared towards the financial stability public good of the Euro area, thereby reinforcing the economic union in a crucial area for the monetary union. In the past the regulatory area under the control of the ECB has been smaller than the single market in financial services (which has been to the benefit of the UK).

### **Not so likely that other countries will follow the UK on EU exit**

One may say that it was irresponsible to call a referendum on the UK's EU membership and to the extent that it was called to solve internal and leadership problems within the Tory party that claim may well be right.<sup>20</sup> It did have the side effect though of providing an occasion (largely wasted in terms of a meaningful debate) to clarify lingering issues in the relationship between the UK and the EU.

The idea that the UK's departure would trigger a domino effect, prompting other EU member states to follow suit, has been somehow widespread. However, other member states have a much higher participation in the EU common goods and a stronger notion of shared destiny and/or higher dependence on the EU. One may hence reasonably doubt whether other member states will be more likely to ask for an exit from the EU now than before. Some anti-EU parties will of course go on demanding just that, as it is part of their agendas and their *raison d'être*. Yet, most member states' governments and parliaments will think twice – they will reflect on the UK's case and will ponder the wider benefits to be had from their EU membership. In addition, without the UK at least part of the anti-EU parties across Europe, such as the National Front in France, the Alternative for Germany and similar parties in the Netherlands, Denmark, Austria, Italy, Poland and Hungary, could well have fewer reasons for protesting against the EU, taking

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<sup>18</sup> The in-depth reports carried out by the UK Government's Foreign and Commonwealth Office Review of the EU Balance of Competences over the years 2012-2014 (available under <https://www.gov.uk/government/news/final-reports-in-review-of-eu-balance-of-competences-published>) suggest that the UK has little fundamental cause for grief with the status quo and indeed much to lose from leaving the EU..

<sup>19</sup> Any possible new (temporary) UK commissioner, when appointed, will most probably be put in charge of a less important area, if any, given the uncertainties surrounding Brexit.

<sup>20</sup> For bystanders, it was interesting to witness but puzzling that in the UK (not on the Continent) most criticism was initially directed not at the government that called the referendum but at two main scapegoats: Boris Johnson (who was then recalled by the new prime minister to be part of the government), on the right, and Jeremy Corbyn, on the left, although both had little to do with calling the referendum in the first place. An exception to that view was put forward by M. Wolf: How Europe should respond to Brexit, Financial Times 5 July 2016.

into account that their fears root in the EU's stance (attributed to UK influence) on liberalisation and trade. Other anti-EU / anti-EMU parties such as the likes of Podemos and Syriza, which already seem to have lost momentum, may have also other motivations but are part of the anti-globalization movement and strongly oppose the more liberalisation and trade-oriented traditional British stance. To the extent that right and left collude against the EU (even forming government coalitions as in the case of Greece) they do so especially against an open and liberal EU. In fact, globalization has been a key factor in motivating discontentment at the national level, which has been directed against the EU. While it is true that the EU's modernization agendas in the face of globalization (the Lisbon and Europe 2020 strategies) have so far produced mixed results at best (held back by weak governance, where competences for reform remained at the member state level and coordination is soft), it is also true that member states can only hope to influence and shape globalization if they work together. A sufficient convergence of preferences among member states is a precondition for more effective governance.

### **A divorce rather than an unhappy marriage**

What seems best at this point is a civilised and amicable divorce between the UK and the EU, implemented as fast as possible to avoid uncertainty.<sup>21</sup> It does not mean that the two could not be very good neighbours, rather the contrary. And quite possibly they may cooperate better on areas of common interest (without other matters, such as Eurozone integration, being perceived as standing in the way) after having separated; Norway and Switzerland provide good examples. Until now the relationship was not good and in part could also not function because of constant UK opposition from within. That situation lasted “perhaps for too long”, to paraphrase Sir Geoffrey Howe (in his famous speech in the House of Commons that ended the Thatcher era).

The UK-EU relationship ended up as something of a mismatch. Not only that the two were already not sharing many interests and the UK was not prepared to contribute to many European public goods (Economic and Monetary Union, including the Fiscal Compact and the European Banking Union; the Schengen agreement; freedom, security and justice, police and judicial cooperation; the application of the Charter of Fundamental Rights; etc.), but the UK was also unwilling to participate in the European integration process after obtaining the pre-referendum inter-governmental agreement in February 2016. Activating the exit clause of Article 50 however is just about withdrawal negotiations.<sup>22</sup> It is not about negotiating a new relationship.

### **Rebuilding the relationship after the divorce**

There are various ways in which the UK may want to negotiate its new relationship with the EU.<sup>23</sup> We believe that the Norwegian model – the UK as member of the European Economic Area (EEA), which grants it unrestricted access to the single European market – is the one that

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<sup>21</sup> See S. Koehler: <http://blogs.lse.ac.uk/europpblog/2016/06/27/uk-trigger-article-50-immediately/#Author>.

<sup>22</sup> One can infer from some declarations of some brexiteers and even government circles or commentators that this is not clear. Example of details of withdrawal negotiations are: what is going to happen to British-national Commission staff, given that the Commission is staffed by nationals from its member states? Or what will be the situation of British pensioners currently living in the EU, for instance in terms of residence permits and access to health care?

<sup>23</sup> For a detailed analysis see M. Emerson (ed.): Britain's Future in Europe – The known Plan A to remain or the unknown Plan B to leave, Bruxelles e Londres, 2016, CEPS e Rowman & Littlefield.

would better suit the interests of both the EU and the UK. The EU cooperates well with Norway, without political integration needs getting in the way.

A Norway-style deal is however only one of the options that the UK can contemplate after invoking Article 50. The conditions for acceding to the EEA are fairly straightforward but feature a sensitive issue for the UK, namely the free movement of persons. The UK will have to define its preferences, which in turn will condition the options that are available to it: EEA (with full access to the single market); free trade agreement (with a more limited privileged access to the single market, and where size matters for relative bargaining power in setting conditions); or WTO rules (the fall-back option, providing no privileged access to the single European market).<sup>24</sup> While the question of free movement of labour will certainly be an important factor for the UK in the negotiation, other factors like the impact on financial services (notably the issues of EU passporting rights and access to Euro clearing and settlements)<sup>25</sup> or the possible disruption of intra-community value chains (given the possibility of tariffs to be applied under WTO rules) are also bound to be relevant. In general terms it is in the interest of the UK to limit uncertainty with regard to future arrangements with the EU. Article 50 stipulates a two-year timeframe for withdrawal after notification. Negotiating a new relationship with the EU (and third countries) can take rather long, which is especially true for complex trade agreements (even more given that there is no more national expertise, as it is the European Commission that negotiates EU trade agreements).

As for the EU, it faces a credibility issue with regard to the exact terms that it grants the UK: it cannot simply accept whatever member states or third countries want to do in their national interest, at the expense of the union and of the European project. The UK's reported wish of a 'Norway-plus' agreement, which amounts to cherry picking in the internal market, is a case in point. Another is the UK's enhanced special status that EU leaders (without any backing from their citizens) granted Prime Minister Cameron for him to support the remain option rather than fighting for leave as he said he was prepared to do; the EU concessions turned out to be of no avail other than setting a dangerous precedent and damaging the EU's project and credibility. That is why access to the single market, which is at the centre of what the EU does, needs to come with clear conditions and rules, safeguarding all of the four freedoms. This is valid for Norway and should be for the UK. Switzerland may well be about to lose its access to the single market in the near future.<sup>26</sup>

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<sup>24</sup> As put by D. Gros: Britain's Moment of Truth, Project-Syndicate, 7 July 2016, "... real-world examples show, no country that wants to benefit from the European project has been able to have its cake and eat it. Open borders and economic integration require common rules".

<sup>25</sup> Thanks to privileged access UK banks benefited from the ECB's liquidity operations during the global financial crisis. The regulation and oversight of central counterparties (CCPs) – presently done jointly by the ECB and the Bank of England – means that there is a high proportion of euro-denominated financial activities, from which the City of London benefits. See W. den Haan, M. Ellison, E. Ilzetzki, M. McMahon, R. Reis: Brexit: The potential for a financial catastrophe and long-term consequences for the UK financial sector, CFM survey, June 2016: Brexit and the City, VoxEU.

<sup>26</sup> Due to the 'guillotine clause', whereby the violation of only one bilateral agreement – and there are more than 120 between the EU and Switzerland – means that all the others are discontinued. The present issue is free movement. It is also noteworthy that those agreements grant Switzerland access to the single market but not for financial services. More generally, the EU is loath to continue 'static' free trade agreements that do not allow for automatically updating legislation, unlike what happens in the EEA (EU plus Norway, Iceland and Liechtenstein).



## 2. The post-Brexit EU – Where to from now?

### **A qualitative change in the nature of EU membership**

What comes out of this announced divorce is that EU exit will become easier (without necessarily causing a domino effect on other member states). Countries with preferences that are too divergent to accommodate may consider not to be part of the core of European integration and to opt out, preferring instead membership of the EEA that allows them to fully participate in the single market, or to negotiate a free trade agreement. Denmark, also a former EFTA member with the UK, is a case in point with various opt-outs, most notably to the euro. What the UK case has clearly shown in our view is that for the Union to be sustainable and to deliver, membership needs to entail a constant care taking as far as individual members' contributions to the common good are concerned, with rights and obligations.

The nature of EU membership has changed due to Article 50 plus the precedent set by the Brexit vote, which have made it politically easier for a member state that is not happy in the EU to leave the club. Countries will now have to make a constant effort – both with respect to their electorates and to their partners in the Union – to stay members. It is a development, which is in itself quite positive. It is in the interest of both the EU and discontent member states that do not wish to contribute to the club's public goods (apparently also the case of some other EU members). It leads us back to the idea of variable geometry or various concentric circles in European integration.<sup>27</sup>

The challenge that the EU faces is that the club has become not only much larger over the years but by many accounts also a lot more heterogeneous, implying the risk that its decision-making and problem-solving capacity is compromised if governance is inadequate and does not evolve to enable institutions to function properly. On the one hand, the EU has to come to grips with different preferences on issues such as regulation or institutions. Substantial differences between states may undermine trust (on which for instance the principle of mutual recognition relies) among them. Still, countries could of course trade off benefits across issue areas and various common goods. The fact that Brexit opened the door for any discontent member state to exit the club ought to reduce any member state's capacity to hold up decisions that are in the common interest, and to that extent can be expected to facilitate decision-making and problem solving.

A more fundamental issue is posed by the fact that the EU is faced with a situation in which successive enlargements brought countries with divergent views on supranational governance and European economic integration as a political project into the same club, whereas in the beginning they had been confined to different clubs, notably the EEC founding six versus EFTA, but then widened to include former COMECON and other countries. Those issues ultimately

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<sup>27</sup> At present only six countries participate in all main EU institutions and reinforced cooperation sub-clubs, namely Austria, Belgium, France, Germany, Portugal and Slovenia. The UK stands out as the least integrated of all member states, followed by the Czech Republic, Sweden, Denmark, Poland and Hungary. See N. Koenig: A Differentiated View of Differentiated Integration, Policy paper 140, Berlin 2015, Jacques Delors Institut. On differentiated integration see W. Schäuble, K. Lamers: Überlegungen zur europäischen Politik, CDU/CSU, 1 September 1994, and F. Torres: A Geometria Variável da União Monetária, cap. 5, In: A. Vasconcelos et al., Portugal no Centro da Europa, Lisbon 1995, Edições Quetzal, 129-148.

raise the question as to the optimum size of the club.<sup>28</sup> The Eurozone has de facto established itself as the core of European integration in the EU (since the Maastricht treaty, the EU aims at Economic and Monetary Union). Arguably, with the need to consolidate EMU the UK's preference for a stand-alone economic union became untenable given the need to make the monetary union work, which called for further integration and institution building in the economic union sphere.

### **The Eurozone as the core EU**

The fundamental lesson from Brexit is that the EU will need to focus and deliver on EU common goods in order to be sustainable. With divergent preferences across member states, that may have to happen through variable geometry. However, too much differentiation, through opt-outs and reinforced cooperation, for which there are already many examples of sub-clubs, offers a way out but only in the short term, as it puts the cohesiveness of the EU project at risk. Enrico Spolaore hints at this tension:

“if further integration is going to take place, Europeans may have to accept a multi-speed Europe, with only a subset of countries within the EU voluntarily moving towards a much closer fiscal and political union, while others keeping looser ties, or even leaving the Eurozone and/or the EU. Rather than resisting this reality, European institutions should be built with much more flexibility, and should include explicit provisions not only for entry but also for exit”.<sup>29</sup>

EMU is a political project that has triggered and still requires further integration. Making monetary union work requires completing the economic union so that it can sustain the single currency and deliver on the EU's wider objectives. The single market can therefore not be seen as static. It is in the legitimate interest of present and future Eurozone members – all EU members except the UK and Denmark, which have an opt-out, although Denmark shadows the Eurozone – that it be deepened with regard to Eurozone requirements, as to make the monetary union function well and indeed make it sustainable in light of the increased interdependencies between members. This requires advances on institutional modernization and structural reform in the face of globalization.<sup>30</sup> The issue is obviously important for the sustainability of the monetary union, but goes beyond and right to the heart of the EU project. To be sustainable, the EU needs to complete Economic and Monetary Union and make it deliver economic and social results. Member states should be prepared either to contribute to those aims or to seek alternative ways to follow different and non-compatible preferences, be it in the EEA or in free trade agreements with the EU.

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<sup>28</sup> I.e., whether at the margin benefits are still larger or just equal to heterogeneity costs.

<sup>29</sup> E. Spolaore: Monnet's chain reaction and the future of Europe VoxEU.org. See also E. Spolaore: What is European Integration Really About? A Political Guide for Economists, In: *Journal of Economic Perspectives*, 27(3), 2013, 125-44, and E. Spolaore: The Political Economy of European Integration, ch 26 In: H. Badinger and V. Nitsch (eds), *Handbook of the Economics of European Integration*, London and New York, 2015, Routledge.

<sup>30</sup> Thus far it was one of the issues where preferences on institutions have been evolving slowly, if at all. See A. Bongardt, F. Torres: EMU as a Sustainable Currency Area, In: N. Costa Cabral, J. R. Gonçalves and N. C. Rodrigues (eds), *The Euro and the Crisis: Future Perspectives for the Eurozone as a Monetary and Budgetary Union*, 2016, Springer Verlag.