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European Disintegration: Too Much to Lose

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For decades the search for deeper integration characterised the European Union. Today the discussion revolves around disintegration. It began with the Greek debt crisis, but only came into its own with summer 2015's major influx of refugees and the reimposition of controls at certain borders. In June the United Kingdom will vote on whether to remain in the EU. In April, Dutch voters expressed their criticism of the EU through their referendum on the Association Agreement with the Ukraine, which may hinder its ratification. These developments are generating uncertainty over the Union's future. Closer examination of the common trade policy and the single market, as one of the central pillars of European integration, reveals that all member-states would have a great deal to lose if the Union were to break apart.

A theoretical break-up of the European Union would involve a series of escalating steps, successively reversing existing integration measures. Following a partial or eventually even complete dissolution of the Schengen area, individual countries such as the United Kingdom might leave the single European market. Within the Union, too, the four fundamental freedoms (freedom of movement for goods, services, persons and capital) could be abolished. Ultimately, European free trade and the common trade policy could be completely called into question.

Dissolution of Schengen

The Schengen agreement came into force in 1995 to realise free movement of persons within the single European market (although the United Kingdom and Ireland did not join, and Bulgaria, Croatia, Cyprus and Romania are not yet full members). It is flanked by police and judicial cooperation and harmonised asylum arrangements, designed to create a common area of security and justice. The agreement provides for temporary suspension, as presently practised in certain places in connection with the refugee question. A permanent suspension could ensue if the EU failed to find a shared response to the refugee problem.

The reintroduction of border controls is already proving costly. A study by the Bertelsmann Stiftung estimates the additional total financial burden in Germany alone at up to €235 billion in the ten years from

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2016 to 2025. The Ifo-Institut reaches similar conclusions, putting the cost at between €17 and €132 per citizen and year, depending on the scale of controls. Citizens and businesses would suffer financial losses as cross-border tourism and shopping would decline if long waits were expected at border crossings. This would also inhibit the social and cultural exchange that is presently flourishing especially in Europe's border regions, and exacerbate divergences in the Union's labour markets. For businesses, border delays act like a tariff and make it harder for foreign purchasers and investors to visit. According to sources cited in the aforementioned Bertelsmann study, the associated costs amount to 1.4 to 3 percent of the value of the goods. Assuming a 3 percent increase in the cost of imports, €1.43 billion in GDP would be lost EU-wide over the ten years between 2016 and 2025. That corresponds to the annual GDP of Italy. All these consequences of border controls would also be felt by companies from third countries like China and the United States trading or investing in Europe.

Individual Exits from Trade Policy and Single Market

Non-ratification of free trade agreements by individual member-states has now become a possibility. The Dutch rejection of the EU–Ukraine agreement in April 2016 raises question marks over the common trade policy. In view of the increasingly heated debate over the Transatlantic Trade and Investment Partnership (TTIP), such a development is not entirely unexpected.

Member-states are naturally also able to withdraw from the internal market. The European Union possesses a wide range of options for regulating external protections and internal trade vis-à-vis third states. Of these, the most relevant for the single market are production and marketing standards. Even between EU member-states, differences in standards have persisted over time and the outcome of the single European market is by no means a complete levelling of these differences across the entire Union. It is rather a situation of extensive mutual recognition, also with respect to third states. The principle of mutual recognition originates in a groundbreaking ruling by the European Court of Justice in 1979. From today's perspective the case was a curious one involving cassis de Dijon, a liqueur containing less than 25 percent alcohol. The Court ruled that if it was legal in France it was also legal throughout the European Union, and its sale must therefore also be permitted in Germany. In addition to such internal market aspects, there are also various shared arrangements for external tariffs.

If individual members were to leave the Union, negotiations could be held on the shape of the new relationship. The following existing models could serve as orientation:

"Norwegian model": free trade area with internal market. Under the European Economic Area (EEA), trade between the EU and EFTA members Norway, Liechtenstein and Iceland is largely free of tariffs, while each side sets its own tariffs for trade with third countries. Such a free trade area requires complex and expensive controls of origin designations, in order to avoid imports from third states being routed through the country with the weakest external protections to also benefit from duty free-trade within the EEA. Agricultural and fishery products are regarded by both sides as sensitive, and excluded from free trade in the EEA. The states of the European Free Trade Area (EFTA) must satisfy all relevant production standards for their exports to the EU, but have to observe fewer EU regulations than EU member-states do. Each year Norway adopts about three hundred new EU regulations, out of an average total of roughly one thousand. Although EFTA states enjoy observer status in important organisations like the European Food Safety Authority (EFSA), they have no vote in standard-setting decisions.

"Swiss model": narrowly defined free trade area with internal market. Switzerland is a member of EFTA, but not of the EEA. It forms a free trade area with the EU, where each side retains its own tariffs. Switzerland accepts large parts of the single market for products listed in detail in sectoral agreements. Here again, the agricultural sector is excluded, as is influence over rule-making. Freedom of movement of persons has frequently given rise to conflict, but the 2002 agreement remains in force for the present, even after the successful Swiss referendum against "mass immigration" in 2014.

Neighbourhood model: (seeking) customs union. A customs union goes further than a free trade area, with jointly set external tariffs. Here the non-member state loses the freedom to define its own customs policies. A customs union with Turkey was agreed in 1995, to be implemented in stages. Agricultural products were excluded. Under the agreement many tariffs between the EU and Turkey have been abolished, and it is intended for both sides to apply identical external tariffs – the EU's ones. A customs union with nine further Mediterranean countries is also proposed, but has been obstructed primarily by large differences between the tariffs of the Mediterranean countries themselves. Although a common market with shared standard-setting is not proposed, EU import requirements must be observed.

Third state model: "internal market à la carte" with national customs policies. States that left the EU could keep their own tariffs, or negotiate their future relations with one another and/or with the remaining smaller EU. Even in the case of a completely re- nationalised external trade policy, aspects of the single market such as harmonisation or mutual recognition of third-state technical standards could continue to be defined jointly. Even before the negotiations over the Transatlantic Trade and Investment Partnership (TTIP) this was already practised with the United States in certain sectors and individual standards, for example with respect to telecommunications and civil aviation safety.

Dissolution of Single Market and Free Trade Area

The logical next step would be for all the EU member-states to nationalise their trade policy and abolish the four fundamental freedoms. That would have serious consequences for trade, investment and prosperity in all member-states. It is estimated that the single market has permanently increased GDP by about 2 to 3 percent. And it is thought that exports from EU member-states are today 8 percent higher than they would have been without European integration. Most importantly, the cross-border value chains that have emerged would erode if the single market was dissolved. While existing jointly set standards would continue to apply, the member-states would create new ones moving forward on their own account. And if tariffs were to be reintroduced between European countries, the EU would no longer even be a free trade area.

Extreme Case: Dissolution of Customs Union and Common Trade Policy

The complete dissolution of the customs union and the common trade policy would be the final step of disintegration. In that event, every EU member-state would set its own external tariffs and negotiate its own trade agreements with third states. The European Commission's Directorate General for Trade would be obsolete. The countries of the Union would not only control their own national borders, but also expand their national customs services and trade administration. Individual member-states would probably have to renegotiate existing trade agreements like the one with South Korea.

Disintegration would create endless questions needing clarification. The known examples in other regions of the world are few and generally negative.

Repercussions and Conclusions

The temporary suspension of Schengen and the ensuing inconveniences for EU citizens and businesses affect precisely the area of integration that many experience as the most positive and tangible European achievement. Externally too, for politicians, tourists and potential investors outside the Union, the current suspension creates the disagreeable impression that Europe is unable to cope with its problems and now faces political and economic collapse.

The dissolution of the European Union would cause relatively little harm in the short term. But in the medium and long term the dismantling of European value chains would certainly erode the competitiveness of European products on the global market. The further markets drifted apart through national actions such as setting separate technical or health standards, the stronger this effect would be. Here it is especially pertinent that new integration areas are emerging in other regions of the world such as Asia. Although it is today a very significant economic space – and globally the most highly integrated – the EU would become dramatically less attractive. The single market currently attracts 14 percent more foreign investment than comparable non-EU countries. The interest of European and overseas investors in what would then be smaller markets would shrink: even Germany accounts for only just over one-fifth of the EU's total GDP. Exacerbating the problems, a drop in investments would occur even if investors only perceive the risk of further European disintegration steps, as can presently be observed in the United Kingdom.

A growing reticence among member states to ratify free trade agreements limits the Union's possibilities to conclude important trade and investment agreements, makes it a less attractive negotiating partner, and could lead to its increasing marginalisation in the global economy. It might become necessary to explore whether the parts of such agreements relating to trade in goods could still come into force on the basis of ratification by the European Parliament. Such legal niceties aside, the fundamental political question is how to respond to the erosion of confidence in Europe's democracy and institutions exposed by the discussion over TTIP and the emerging possibility of member-states declining to ratify free trade agreements – despite the full and proper involvement of the European Council, European Parliament and national parliaments in the negotiating process. This democratic deficit needs to be resolved politically.

The EU today possesses considerable influence, both in bilateral negotiations such as on TTIP and in international bodies like the World Trade Organisation. Although smaller member-states might be able to profile their own positions more clearly after leaving the EU, their influence on outcomes would be marginal. And that economic weakness would also rub off on the political arena, when one considers that trade is the flagship of European integration. If this founders, strength and credibility in other areas will suffer too. Given that the political Union is irrevocably tied to trade integration, it would also be threatened.

Any European disintegration going further than a temporary suspension of Schengen would therefore be highly irrational. The expected losses would far exceed any possible gains. That applies for different reasons to all member-states. In the current atmosphere of growing anti-European sentiment and nationalisation of politics, unequivocal attention of each citizen must be drawn to the potential consequences. The citizens of the EU should be made aware of how much is at stake.

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