

Leave the euro?

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Evaluating the impact of France leaving the euro zone (“Frexit”) is tricky, as many channels for doing this exist and the effects are uncertain. However, given that this proposal is being advanced in the more general debate over the costs and benefits of membership in the European Union and the euro, it is useful to discuss and estimate what is involved.

There is little consensus about the many points involved in an analysis of the issue of membership in the euro. On the one hand, the benefits linked to the single currency 18 years after its creation are not viewed as completely obvious; on the other, it is not evident that the monetary zone has become less heterogeneous, and, possibly linked to that, the current account imbalances built up in the first decade of the euro zone’s existence, which have grown since then due to the consequences of the 2008 global financial crisis, are putting constraints on economic policy.

The dissolution of Europe’s monetary union would be an unprecedented event, not only for the member states but also from the point of view of the history of monetary unions. Not that there have been no experiences of dissolution – [Rose](#) (2007) counted 69 cases of withdrawal from a monetary union since the end of the Second World War – but in many respects these experiences offer little if any basis for comparison ([Blot & Saraceno, 2014](#)). Nor do they reveal any empirical patterns that could inform us about the possible misfortunes or chances of success that a break-up of the euro zone might have.

However, the reference to past episodes is not the only tool

with which the economist can carry out an analysis of a break-up of the euro zone. It is indeed possible to highlight the mechanisms that would be at work if the monetary union project in Europe were to be wound up. There are numerous possible pathways to a break-up of the euro zone, and any analysis of the costs and benefits must be interpreted with the utmost caution, since in addition to uncertainty about any quantitative assessment of what is involved, there is also the issue of what scenario an exit would create. In these circumstances, a departure from the euro zone cannot necessarily be understood solely from the point of view of its impact on exchange rates or its financial effects. It is very likely that an exit would be accompanied by the implementation of alternative economic policies. The analysis carried out here does not enter this territory, but merely explains the macroeconomic mechanisms at work in the event of a break-up of the euro zone, without detailing the reaction of economic policy or second-round effects.

The central hypothesis adopted here is that involving a complete break-up of the monetary union, and not the simple departure of France alone. Indeed, if France, the second-largest euro zone economy, were to exit, the very existence of the monetary zone would be called into question. The devaluation of the French franc against the southern Europe countries remaining in the euro zone would destabilize their economies and push them out of the scaled-down euro zone. We do not deal here with all the technical elements related to how a break-up would be organized [\[1\]](#) – launching the circulation of new currencies, liquidation of the ECB and termination of the TARGET system, etc. – but rather on an analysis of the macroeconomic effects [\[2\]](#). Two types of effects would then be at work. First, the dissolution of the European monetary union would de facto lead to a return to national currencies, and therefore to a devaluation or revaluation of the currencies of the euro zone countries vis-à-vis not only their euro zone partners but also non-euro zone

countries. Second, the redenomination of assets and liabilities now denominated in euros and the prospect of exchange movements would have financial effects that we analyze in the light of past financial crises. Our scenario is therefore for a contained crisis.

A unilateral exit from the euro zone by France and the ensuing break-up of the euro zone exclude a scenario for a common currency where strong cooperation between the old member states would help to maintain a high level of exchange stability and effectively continue the economic status quo. There is little likelihood of a scenario like this, since it would lead to not using the margins of maneuver opened up by the exit and to maintaining the much-denounced and presumed straitjacket. The crisis would be contained in that the most violent effects would be reduced by coordinated policies. This would mean exchange movements that are rapid and substantial, but which stabilize over a time horizon of a few quarters [\[3\]](#). We assume, furthermore, that each country pursues its own interest without special co-operation.

I – A summary of the economic mechanisms at work

The gains expected from leaving the euro zone

In the first place, leaving the euro zone would mean that the exchange rates between the currencies of the countries that compose it could once again vary against each other. Given this, the question arises of the value at which the exchange rates of these currencies will tend to converge. The expected gains would be, on the one hand, an improvement in competitiveness due to the devaluation of the franc. A devaluation would lead to imported inflation in the short term, before increasing purchasing power and spurring growth. The second gain involves the possibility of defining a monetary and fiscal policy that is differentiated by country, and therefore more appropriate to France's situation.

An exit from the euro zone would also make it possible to set tariffs less favorable to imports from other countries, and thus more favorable to producers on the national territory, but which would also affect consumer prices and thus consumer purchasing power[\[4\]](#).

The costs of leaving the euro zone

France's exit from the euro zone would lead to the departure of other countries, which would see their currencies depreciate against the franc, especially the southern European countries. The net effect on competitiveness may prove ambiguous.

A Frexit would lead to currency movements, which would translate into a return of transaction costs on currency exchanges between euro zone countries. Moreover, the break-up of the euro zone would also lead to a redenomination of assets and debts in the national currency. Beyond the legal aspects, these balance sheet effects would impoverish agents who hold assets denominated in a depreciating currency or debts redenominated in an appreciating currency (and enrich those in the reverse situation). Uncertainties about balance sheet effects, particularly for financial intermediaries and banks, could be expected to lead to a period experiencing a sharp downturn in lending.

How much additional autonomy would be acquired for monetary policy is uncertain at present. Indeed, it is difficult to conceive of a monetary policy that is much more expansionary than the ECB's policy of negative rates and security redemptions [\[5\]](#). The Banque de France could, of course, buy back the national public debt by creating money, but, in light of the low current interest rates on French sovereign debt, it is not clear that this would lead to significant gains [\[6\]](#). It should be noted that a persistent current account deficit would need to be financed by external savings and that this external constraint could affect monetary policy, for example

by requiring an increase in short-term and long-term interest rates that could impose capital controls by the government.

Finally, the introduction of trade protectionism would obviously lead to retaliation by the aggrieved partners, which would hurt French exports. The overall net effect on world trade would be negative, with no gain at the national level.

II – The impact on exchange rates and competitiveness

A Frexit would not lead to strong gains in competitiveness. We simulated the effect of a Frexit in the following way:

1. We assume that a Frexit would lead to a rapid disintegration of the euro zone;
1. We then use our estimates of long-run equilibrium exchange rates presented in Chapter 4 of the *2017 iAGS Report*. It appears that the equilibrium parity for the new franc would correspond to an actual effective devaluation of 3.6% compared to the current level of the euro. This is a real change, once it has been corrected for the effects of inflation and is effective, that is, taking into account exchange rate fluctuations in relation to different trading partners, possibly in the opposite direction. The new franc would be devalued relative to the German currency, but would appreciate relative to the Spanish currency;
2. Using the empirical estimates of exchange rate adjustments (Cavallo et al., 2005), we determine a short-term exchange rate trajectory. Our estimate is for a 13.7% depreciation of France's effective exchange rate with respect to the other euro zone countries, and an appreciation of 8.6% with respect to the countries that do not belong to the euro zone.

Using simulations with the emod.fr model, we estimate a modest increase in competitiveness. The effect on GDP would be close to 0 in the first year and 0.4% after three years. These

figures are low and refer to a scenario without any readjustment within the euro zone. If we consider the possibility of a gradual adjustment within the euro zone (based on the mechanisms, for example, referred to in *iAGS 2016*), the potential gain would be even lower. Once again it is possible to envisage that the monetary policy conducted by the Banque de France would seek to devalue the French currency more strongly than that of its competitors. But in such a scheme, it is very likely that the latter will in turn wish to preserve their competitiveness and engage in a policy of competitive devaluations.

III – The financial impact: The effects of the banking crises

The dissolution of the euro zone and the return to national currencies would have significant repercussions for the national banking and financial systems through their international business, and it would bring about a return of exchange rate risk within the euro zone. We first assess the risks that the collapse of the euro zone would have for the banking system. The mechanisms at work are likely to provoke a banking crisis, which could have a high cost for economic activity.

The return to national currencies in a financially integrated space would necessarily entail a major upheaval for the financial system. These effects would not be comparable to those observed at the time the euro was adopted. Indeed, as [Villemot et Durand \(2017\)](#) have shown, potentially the balance sheet effects would be significant for a low coordination scenario.

The balance sheet effects could be reduced if there were international coordination when leaving the euro. Such co-ordination would make it possible to distribute the ECB's assets and liabilities in a coherent way, notably within the framework of TARGET 2. However, it's difficult to assume a significant level of coordination when leaving the eurozone,

and it is illusory to believe that the difficulties in achieving coordination will lessen. On the contrary, they are likely to increase in a climate of instability instead of one with a shared destiny. As a result, the scenario we use for leaving the euro zone excludes the establishment of a new financial or monetary architecture.

The risk of a banking or financial crisis is central to understanding the impact of the break-up of the euro zone. The impacts would pass through three main channels. The first involves a flight of deposits and savings and the distress liquidation of financial assets. The second is related to the effects of currency misalignments on banks' balance sheets and insurers. The third concerns the sovereign risk that would affect either the public debt and its financing, or if this debt were subject to uncontrolled monetization, the return of intense external pressure. The economic literature includes recent efforts (notably Rogoff and Reinhart, Borio, Schularik, the IMF) to try to evaluate banking or financial crises. It should be clarified at the outset that this literature does not deal with the dissolutions of monetary unions. In the various banking crises recorded since the 1970s by Laeven and Valencia (2010 and 2012), there is no mention of a crisis linked to the dissolution of a monetary union. Nevertheless, the financial dynamics in play in the event of the break-up of the euro zone would be, as mentioned above, risk factors for a banking or financial crisis.

Moreover, the economic literature on currency crises has pointed to the link with banking crises (Kaminsky and Reinhart, 1999). The collapse of a monetary union in reality reflects a crisis situation for the exchange rate system, which leads to revaluations and devaluations with the over-adjustment of exchange rates, as highlighted in the previous section. The reference to the cost of banking crises thus illustrates the potentially negative effects of exiting the euro zone. However, it should be remembered that these costs

correspond to an overall assessment of banking crises that does not make it possible to identify precisely the mechanisms through which the financial shock is propagated into the real economy – an assessment that would involve identifying the impact of rising risk premiums and the effect of credit rationing, where it is much more difficult to determine the uncertainty. An analysis by Bricongne et al. (2010) of the various channels through which the 2007-2008 financial crisis was transmitted suggests that a significant amount remains unexplained. Also, in the absence of a more detailed analysis, we make the assumption that the historical experiences of banking crisis are the main quantitative element that can be used to get close to the eventual negative impact – via the financial effects – of a break-up of the euro zone.

Laeven and Valencia (2012) analysed 147 banking crises in developed and emerging countries over the last few decades (1970-2011). They calculated the losses in production as the three-year cumulative loss of actual GDP relative to trend GDP [\[7\]](#). For the developed countries, the cumulative loss of growth was on average 33 GDP points. During these three crisis years, the public debt increased on average by 21 GDP points (partly due to bank recapitalizations), the central bank's balance sheet increased by 8 GDP points, and the level of non-performing loans increased by 4 percentage points. It should be noted that there was a high degree of heterogeneity in the cost of the crises, depending on the crisis and country in question. For example, the authors' assessment of the cost of the 2008 banking crisis in terms of growth following the bankruptcy of Lehman Brothers was 31 GDP points for the United States and 23 GDP points for the euro zone as a whole. Hoggarth, Reis and Saporta (2002) conducted a similar study and sought to provide robust assessments of trend GDP. They noted cumulative production losses during crisis periods ranging from 13 to 20 GDP points, depending on the indicator chosen. However, these estimates of the cost of banking crises are to be taken with caution, since they are based on numerous

assumptions, in particular on the trajectories that countries would have followed in the absence of a crisis.

IV – The gains from monetary autonomy

The gains from an alternative monetary policy would depend on the new direction taken by a monetary policy that remains to be defined and that will determine the conditions for financing the economy. Such a policy would probably be ultra-accommodative due to the financial and banking instability generated by the balance sheet effects.

Evaluations of the contribution of financial conditions in France from 2014 to 2018, however, suggest that these are not the most important factor explaining the sluggishness of economic activity. Over this period, the contribution of financial and monetary conditions to GDP growth is between -0.1 and 0.2 points [\[8\]](#). There is thus little gain to be expected from a new ultra-accommodative monetary policy (independently of the effects on exchange rates discussed in the first section or the impact of external pressure).

Conclusion

This text has attempted to outline the possible consequences of a Frexit, without going into too detailed and therefore perilous quantification.

1. Contrary to what is sometimes advanced, there is little to be expected in terms of competitiveness or manoeuvring room for short-term monetary policy;
2. The main cost would come from the banking or financial crisis arising from balance sheet effects, particularly given the context of a disorderly exit.

At this stage of the analysis, it is difficult to identify the potential positive economic effects of a Frexit, while the risks of a negative impact due to financial effects seem to be very significant.

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[\[1\]](#) These points are to a large extent discussed in *Capital Economics* (2012).

[\[2\]](#) It is difficult to develop a long-term counterfactual scenario in the case of exiting the euro. We therefore focus on the short- and medium-term effects of possible transitions.

[3] We implicitly eliminate the scenario of a currency war where each country would try to gain competitiveness by devaluations that would permanently lead us away from convergence towards a real equilibrium exchange rate.

[4] The introduction of tariffs like this calls for leaving the European Union. Without developing this analysis here, it is very likely that leaving the euro zone would lead to leaving the European Union. There have been assessments of the EU's contribution to intra-European trade and growth that we are not using here in our short-term approach.

[5] Through its quantitative easing program, the ECB essentially purchases sovereign debt bonds, including French debt securities. In February 2017, the outstanding securities held by the ECB under this programme ([PSPP](#)) amounted to € 1,457.6 billion. Breaking down the purchases based on the share of the ECB's capital subscribed by the central banks of the member states, the fraction of French debt securities exceeds 200 billion euros.

[6] Getting free from the constraints of the Stability and Growth Pact could be a gain in itself. This assumes that the constraints of the SGP go beyond simply the sustainability of the public debt demand.

[7] These evaluations show, however, that there is a high degree of heterogeneity in the assessed costs depending on the country in question.

[8] <https://www.ofce.sciences-po.fr/pdf/documents/prev/prev1016/france.pdf>

Inequality in Europe

By [Guillaume Allègre](#)

In the preamble to the Treaty establishing the European Economic Community, the Heads of State and Government declare that they are “[r]esolved to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe”. Article 117 adds that “Member States agree upon the need to promote improved working conditions and an improved standard of living for workers, so as to make possible their harmonisation while the improvement is being maintained”. Sixty years after the Treaty of Rome, what is the state of economic and social inequality in Europe? How did this change during the crisis?

Every year Eurostat measures inequality in the different EU Member States. The Great Recession has led to widening inequality within the countries of Europe. The Gini index of equivalent disposable income rose from 30.6 in 2007 to 31 in 2015 on average in the 28 EU Member States. However, part of the increase is due to large breaks in the series in France and Spain in 2008. Inequality is thus clearly lower in Europe than in the United States: for 2014, the Gini index of disposable income is estimated at 39.4 in the United States, while in the European Union it ranges from 25 (Czech Republic) to 37 (Bulgaria). The United States is therefore more unequal than any country in the EU and much more unequal than most countries.

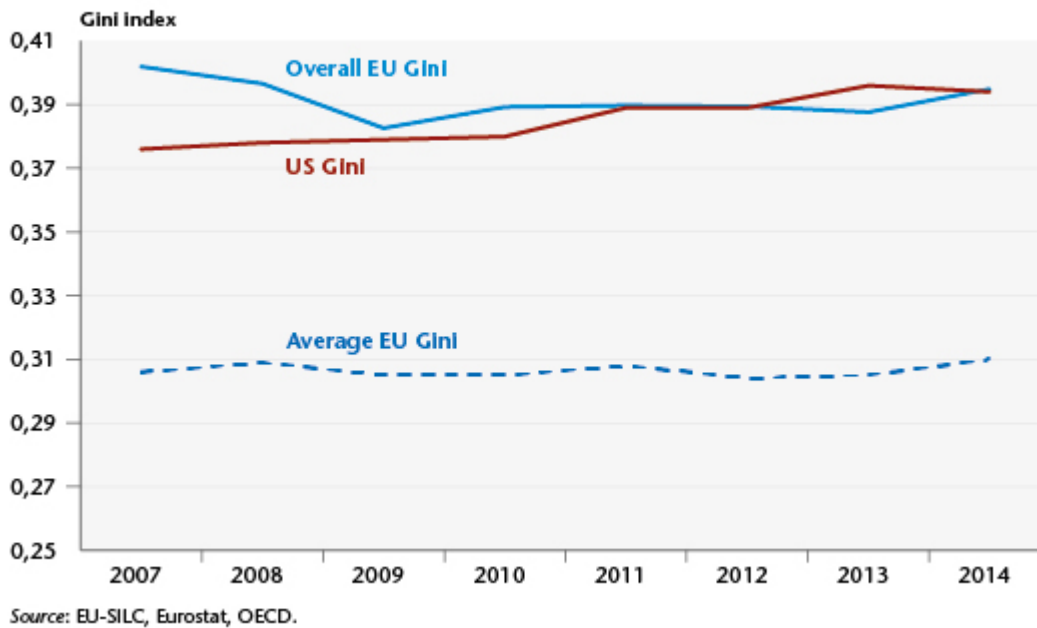
However, the presentation of an average Gini index in the European Union may be misleading. Indeed, it takes into account only inequalities within the European countries and not inequalities between countries. However, there are significant inequalities between European countries. In the national accounts, household income based on EU consumer purchasing power in 2013 ranged from 37% of the European

average (Bulgaria) to 138% (Germany), i.e. a ratio of 1 to 4.

At the European level, Eurostat calculates an average of national inequalities, as well as the international inequalities. On the other hand, Eurostat does not calculate inequalities between European citizens: what would inequality be if national barriers were eliminated and European inequality was calculated at the European level in the same way that one calculates inequality within each nation? It might seem legitimate to calculate inequality between European citizens like this insofar as the European Union constitutes a political community with its own institutions (Parliament, executive, etc.).

The EU-SILC database, which provides the equivalent disposable income (in purchasing power parity) of a representative sample of households in each European country makes such a calculation possible. The result is that the overall level of inequality in 2014 in the European Union is the same as that in the United States (graph). What conclusion should be drawn? If we look at the glass as half-empty, we could emphasize that European inequality is at the same level as in the world's most unequal developed country. If we look at the glass as half-full, we could emphasize that the European Union does not constitute a nation with social and fiscal transfers, that it has recently expanded to include much poorer countries and that, nevertheless, inequality is no greater than in the United States.

Figure: Inequality in disposable income in Europe and the United States, 2007-2014



Overall inequality in the European Union can be seen to decline slightly between 2007 and 2014. The Theil index, another indicator of inequality, can be used to break down the change in European inequalities between what comes from changes in inequality between countries and what comes from changes within countries. Between 2007 and 2014, the Theil index fell from 0.228 to 0.214 (-0.014). Inequality within countries was generally stable (+0.001) whereas inequality between countries declined (-0.015). These developments are similar to what has been observed by Lakner and Milanovic at the global level ([“Global Income Distribution: From the Fall of the Wall to the Great Recession”](#)): rising national inequalities and declining inequalities between countries (in particular due to China and India catching up).

So far, the main instrument used by the European Union to reduce inequality in Europe has been the opening of borders. But while opening up borders can help the EU's less affluent countries (notably Bulgaria and Poland) to catch up, it can also have an impact on inequality within countries. However, Europe does not as yet have a social policy. This sphere falls above all within the competence of the States. But opening up

the borders is exacerbating social and fiscal competition. For instance, the higher marginal rates of personal income tax (IRPP) and corporate income tax (IS) have dropped significantly since the mid-1990s, while the VAT rate has increased (A.Bénassy-Quéré et al., “[Reinforcing tax harmonization in Europe](#)” [in French]).

In France, the government has committed to lower the corporate income tax rate from 33.3% to 28% by 2020. This follows a trend towards [lowering taxation on business but raising it on households](#). The impact on inequality has so far been counterbalanced by the fact that [the rise in taxation has focused on the wealthiest households](#). However, the French Presidential candidates Fillon and Macron advocate a substantial reduction in the taxation of capital income (withholding tax and the reduction of the ISF wealth tax on real estate for Macron; elimination of the wealth tax for Fillon) in the name of competitiveness. The [dangers of fiscal and social competition](#) are thus beginning to make themselves felt.

The Treaty of Rome and equality

By [Hélène Périvier](#)

The Treaty of Rome: Article 119, Title VIII, “Social Policy, Education, Vocational Training, and Youth”, Chapter 1: Social Provisions: *Each Member State shall during the first stage ensure and subsequently maintain the application of the principle that men and women should receive equal pay for*

equal work.



Europe's institutions take pride in the fact that one of their founding values is the principle of equality between women and men^[1]. Indeed, as early as the Treaty of Rome, the question of equal pay was the subject of negotiations that resulted in the adoption of Article 119, guaranteeing "the application of the principle that men and women should receive equal pay for equal work".

On closer inspection, the motives that led the signatory countries to adopt this article are not linked, at least not directly, to considerations of justice or to egalitarian values that the Member States might have upheld right at the outset, thereby making equality a founding "value" of Europe's institutions. No, the motives are above all economic in nature.

The Treaty of Rome is aimed at economic integration and not at a political or social union. Re-examining the genealogy of Article 119 sheds light on the tension between economic issues related to the organization of trade and production and social issues, particularly those related to justice and equality.

Guaranteeing fair competition

Article 119 seeks to organize fair competition within the new space for the free movement of goods, services and people. Of the six countries signing the Treaty, it was France that demanded an article on equal pay. Indeed, unlike some of its partners, including Germany, France had already adopted

legislation on women's wages and equal pay. In the framework of restructuring industrial relations after the Second World War, the French State had developed occupational classifications and a wage hierarchy that led in some branches to affirming the principle of equal pay, even if there was still substantial potential for discrimination (Saglio, 2007). In July 1946, the Croizat decision abolished the 10% reduction on women's wages. Finally, the Law of 11 February 1950 generalized collective bargaining agreements and introduced the principle of "equal pay for equal work" (Silvera, 2014).

France therefore feared that an opening up to competition in the market for goods and services would disadvantage productive sectors in which the proportion of women was high, especially in textiles (Rossilli, 1997). In 1956, the International Labour Organization (ILO), conscious of these issues, commissioned a report by a committee chaired by the economist Ohlin on the social consequences of European economic integration. The question of equal pay was raised explicitly (point 162, p. 64), and data at hand, the report denounced the risk of unfair competition in highly feminized industries (Ohlin, 1956) [\[2\]](#). The differences in social rights between Member States called for labour market regulation in order to avoid distorting competition within the common market. The discussions, which led to Article 119, did not include discussion of women's rights or fair pay for women's work (Hoskyns, 1996).

Principles of supranational justice and economic pragmatism

The inclusion in the Treaty of Rome of the principle of equal pay was thus motivated by economic and not ethical considerations, and it is for economic reasons that, even though the principle was announced, it was not applied immediately, as it would have led to a massive increase in wage costs (unless men's wages were cut). Despite all this, principles of justice were not completely alien to this process. Indeed, they were part of the international approach

to the affirmation of human rights in the post-war years: the United Nations Universal Declaration of Human Rights of 1946 [\[3\]](#) affirms equal rights in its preamble, and the 1944 Declaration of Philadelphia, which underpinned the mandate of the ILO, states that, “all human beings, irrespective of race, creed or sex, have the right to pursue both their material well-being and their spiritual development in conditions of freedom and dignity, of economic security and equal opportunity” [\[4\]](#). The ILO Equal Remuneration Convention (No. 100), adopted in 1951, states that, “Each Member shall, by means appropriate to the methods in operation for determining rates of remuneration, promote and, in so far as is consistent with such methods, ensure the application to all workers of the principle of equal remuneration for men and women workers for work of equal value” [\[5\]](#). Some European countries adhered to the stated principles faster than others, including Belgium and France, which ratified Convention 100 respectively in 1952 and 1953. These countries pulled along their partner signatories to the Treaty of Rome in their path, in order to limit the distortion of competition that would result from a lack of uniform adherence to this principle of justice in an integrated economic area.

In looking further back at the genesis of texts pertaining to equal pay, economic motivations can also be found: the founding text of the ILO in 1919 does include the principle of equal pay, regardless of gender, for work of equal value (Section II., Article 427, 7) [\[6\]](#). This particular attention to equality is explained partly by the trade unions’ fear that men’s wages might fall. Indeed, during the war, women had worked for lower wages doing jobs reserved for men in peacetime. Demanding equal pay made it possible to contain this unfair competition represented by women (Ellina, 2003; Hoskyns 1996).

The metamorphosis of Article 119

It is fruitless to seek the historical roots of the

affirmation of the principle of equal pay, as the economic argument is articulated around considerations of justice. This dialectic led the actors of the moment to draw on one or to reaffirm the other. During the Treaty of Rome negotiations, differences between countries concerning entitlement to paid leave, the regulation of working time and the payment of overtime were also identified as sources of the distortion of competition. It is thus not so much the place of gender equality in the negotiations between the signatory countries that is to be questioned as the very nature of a Treaty that aims at economic integration and not the harmonization of the social policies of the signatory countries. At the time, economic integration was probably the least confrontational perspective from which to negotiate and bring about a rapprochement between European countries.

Article 119 of the Treaty of Rome, although intended to regulate competition, has become a pillar of the construction of European law on equality and the fight against discrimination. In the late 1970s, under the impetus of feminist movements, this principle was used more and more and became a founding principle of Europe's institutions (Booth and Bennett, 2002). In 1971, the Court of Justice of the European Communities referred to it in declaring that the elimination of discrimination on the grounds of sex is one of the general principles of Community law (see the Defrenne judgment^[7]). In 1976, the scope of equal pay was extended by the 1976 Directive (76/207) to cover all the terms of hiring and training as well as working conditions (Milewski and Sénac, 2014). As a tool for regulating the common market, it has become a principle of law.

Finding the spirit of Philadelphia once again

The principle of equality as set out in the Declaration of Philadelphia does not rely on the economic interest of promoting gender equality but affirms this principle as a value in itself. During the negotiations preceding the signing

of the Treaty of Rome, the harmonization of social provisions was achieved by generalizing the principle of equal pay to countries that had not yet taken it on board, not by asking countries that had already adopted it to abandon it. In this approach, the principle of justice takes precedence over the economic perspective: the evaluation of the economic consequences of having a principle of equal pay that had not been generalized in an integrated economic space led to its adoption by all the member countries in this space, and ultimately to strengthening it.

Since the 2000s, there has been a shift in the promotion of policy on equality: it is no longer a question of analyzing the economic consequences of the principles of justice or conversely of denouncing the infringement of the principles of justice of certain economic policies, but rather of overturning the hierarchy between the two perspectives. Equality is promoted in the name of the real or phantom economic benefits that it would produce. Supranational organizations, European institutions and national forces all tout the virtues of equality in terms of economic prosperity. The assertion of the principle of justice in itself is no longer sufficient to establish the merits of equality policies, which are a priori considered costly. Equality, which is often reduced to increasing women's participation in the labour market and their access to positions of responsibility, is a source of growth and wealth. It is no longer a question of a complex articulation between economic forces and founding principles, but rather the justification of these principles based on the profitability or efficiency of the market economy (Périvier and Sénac, 2017, Sénac, 2015). This approach, far from anecdotal, is endangering equality as a principle of justice, and distances us from the humanist approach of the supranational institutions during the first half of the 20th century. Have we lost the spirit of Philadelphia (Supiot, 2010)?

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[3] www.un.org/en/universal-declaration-human-rights/

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Europe's competition policy – or extending the domain of integration

By [Sarah Guillou](#)

The principle of “fair competition” was set out in the general principles of the Preamble to the Treaty of the European Communities (TEC) in 1957, as was the commitment that the Member States will enact policies to ensure this fairness. Competition policy – overseen by the Competition Directorate – is the benchmark policy for market regulation, but also for industrial strategy and, more recently, for fiscal regulation.

The need for a competition policy flows directly out of Europe's project to establish a common market, and numerous attempts at industrial policy have come to grief on the altar of Articles 81 to 89 of the TEC (and now Articles 101 to 109 of the Treaty on the Functioning of the European Union), which establish the framework for competition. In practice, the two policies are clearly complementary in the European Union, and the space granted to the former develops thanks to the set of exceptions to the latter.

Competition as a general framework in the European Union

As a foundation of the common market, respect for and controls on market competition is a general principle underlying all European policy. More fundamentally, competition can be considered a *constitutional* principle of the European Union. It makes it possible to define the European space, the common space whose existence depends on controls on competition between States. Europe's competition law is therefore developed first of all to control economic competition between the States. The aim is to prevent the States from adopting policies that create benefits for companies in their own

territory and discriminate against companies from other States.

Within the European Commission, the Competition Directorate therefore has a significant role and responsibility. Supervision of competition is exercised through the control of mergers and cartels on the one hand, and the control of State aid on the other. To monitor cartels or any other abuse of a dominant position, competition law is exercised *ex post* to protect consumers and competitors from predatory behavior and abusive pricing. Control over concentration developed generally from the second half of the 1980s, in synch with the increase in the size of mergers and the opportunities for European rapprochements, which resulted from the success of the single market. Moreover, mergers and acquisitions are increasingly the subject of negotiations between the companies involved and the European Commission and conclude with a transfer of activity. For example, the acquisition of Alstom's energy division by General Electric in 2015 was accompanied by the sale of part of the gas turbine business to the Italian company Ansaldo Energia. This control has given the Commission an active role in the structuring of the market, which amounts to a super power, but since the 1990s, fewer than 1% of notifications concerning concentrations have led to a veto by the Commission.

European supervision of aid has been relatively continuous since it presupposes a permanent exercise of supervision of "undistorted competition" in the European area. It is a tool both to control any distortions of competition created by a Member State granting advantages to its companies and to fight against a race to "who grants most" in terms of subsidies. Thus, Article 87 (1) of the Treaty establishing the European Community states that State aid is considered to be incompatible with the common market, and Article 88 gives the Commission a mandate to monitor such aid. But Article 87 also specifies the criteria the Commission uses to investigate aid.

Business subsidies are subject to the Commission's authorization if they exceed 200,000 euros over three years and they are not included in the set of exemptions decided by the EU. The majority of aid investigated is authorized (almost 95%). As for France, the percentage of aid disallowed out of the amount granted is in line with the European average. There have of course been some noteworthy decisions, such as when EDF was required to repay 1.4 billion euros in 2015 following tax assistance dating back to 1997. But the Commission also recently allowed the French State to acquire an interest in the capital of PSA Peugeot Citroën (2015). Similarly, the Commission authorized the public-private partnership underpinning the construction of the Hinkley Point nuclear power plant in Great Britain.

Some recent developments in the exercise of this control should be noted. The regulation of State aid has been used to examine the provisions of tax agreements negotiated by companies with certain governments such as Ireland, Luxembourg and the Netherlands. By favouring some companies to the detriment of their competitors, these tax agreements create not only distortions in competition but also competition between States to attract the profits and jobs of the large multinationals. For example, in October 2016, the Commissioner for Competition, Margarethe Vestager, described the tax agreement that Apple had received in Ireland as unauthorized State aid, and accordingly required the Irish government to recover 13 billion euros from Apple. This use of the regulatory power over State aid constitutes a turning point in competition policy, in that it recalls that the object of competition policy is to ensure that competition between States does not go against the notion of "a common market."

Industrial policy is expressed in the exceptions to competition policy

Note that while competition policy is well defined at European level, there are many meanings of industrial policy in Europe,

almost as many as there are members. This makes it more difficult to find policy compromises prior to the definition of such a policy. Moreover, the institutional logic and the economic logic are not the same. As already noted, competition policy has a strong institutional anchorage, which is not the case with industrial policy. Even though the European Coal and Steel Community was at the origin of the European Community, industrial policy is not at the heart of the European project. Moreover, the economic logic is different: competition policy is defined with reference to space (the relevant market), whereas industrial policy can be understood only by integrating the life cycle of companies and industries, and therefore in reference to each country's industrial history. In a shared sense, industrial policy can be defined as policy that is aimed at orienting an economy's sectoral and / or technological specialization. It is therefore easy to grasp the dependence of industrial policy on national preferences. The tool favoured by the States to express this policy is aid to companies, whether directly or indirectly.

State aid is classified according to 15 objectives, ranging from "preservation of the heritage" to aid for "research and development and innovation". For the EU as a whole, the three categories that are largest as a percentage of total aid are: environmental protection (including aid for energy savings), regional aid, and aid for R&D and innovation. The amounts involved are far from negligible: in 2014, for example, 15 billion euros for France and 39 billion for Germany. A higher amount of aid in 2014 was due largely to an increase in aid for renewable energy as a result of the adoption in 2014 of revisions on the rules on this type of aid. Germany is the country that contributed the most to this increase. Support for renewable energies is indeed at the heart of its industrial policy.

European industrial policy develops as exemptions to the application of control on aid and hence to competition policy.

These exemptions are set out in the general regulations on exemptions by category. There are many Block Exemptions, which revolve around the following five themes: innovation and R&D, sustainable development, the competitiveness of EU industry, job creation, and social and regional cohesion. It can be seen in this set of exemptions that supervision is also the expression of Europe's policy choices on orienting public aid, and thence directing public resources towards uses that are in line with these choices. These choices are the result of a relative consensus on the future of the European economy which shapes industrial policy. The largest categories of aid are research and development and environmental protection. In a word, the European economy will be technological and sustainable. This is a policy of orientation and not a policy of resources, and it takes shape within the overarching framework of the policy on competition.

What future for Europe's competition policy?

It seems that, given the primacy of competition policy and its foundational role for Europe's union, competition policy is the conductor of microeconomic policy. It has, up to now, proved capable of adapting. Thus, in compliance with the European project, economic constraints and societal orientations have led to changes in the definition of exemptions on the control of aid, which have allowed for the expression of industrial policy. Similarly, it has seized upon the fiscal hyper-differentiation between certain States, which sharply contravened European integration and the common market.

Competition policy must not be weakened in authority or scale, but it must retain its capacity to adapt both to industrial orientations and to the deployments of Member States' strategies on competition with each other. It is also an essential counter-power to the growing strength of the multinationals, and governments must support it in this sense rather than becoming the mouthpieces of their national

champions.

The Preamble of the Treaty of Rome: 60 years later, what conclusions can be drawn?

By [Éloi Laurent](#)

The Treaty establishing the European Economic Community (the more emblematic of the two Treaties of Rome) gave life and body to the ideal of European integration that had been sketched in particular by Victor Hugo. Sixty years after its signature, here is a brief commentary, necessarily subjective, on the Preamble of this founding text (the past and present participles that open each paragraph of the text refer to the six heads of state and government who were signatories to the Treaty on 25 March 1957).

Determined to lay the foundations of an ever closer union among the peoples of Europe,

There are at least two possible readings of the objective referred to in the first paragraph of the EEC Treaty. The first sees in the “union” of “peoples” the union of their governments, and from this perspective it seems very difficult to dispute that since 1957 the European executive authorities have come together and now collaborate closely, with new elements of their sovereignty pooled. But the injunction of Jean Monnet, one of the principal architects of the Treaty, should not be forgotten: “our mission is not to unite states, but to unite people”. What, then, is to be said of the union of nations? A number of more or less anecdotal surveys seem to

indicate that [stereotypes die hard in Europe](#) and that Europeans still do not know each other very well.

More fundamentally, it is the confidence placed by Europeans in their union that seems to be a relevant indicator of how solid it is [\[1\]](#). The Eurobarometer of autumn 2016 (published in December 2016) indicates that confidence in the EU has fallen to 36%, almost fifteen points below its 2004 level (according to Eurostat data, confidence in European institutions fell from 53% in 2000 to 42% in 2014). It is from 2011 that a majority of citizens began to turn away from the European Union, at a time, one might think, when the EU Member States were proving resolutely incapable of proposing a coordinated and effective strategy to get out of the crisis and when the bloc was once again plunging into recession. Confidence in the EU is lower in the euro area than in the non-euro countries, and it is particularly low in the major signatories of the EEC Treaty – Germany, France and Italy – where it fails to rise above 30%.

Resolved to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe,

The central tenet of Europe's strategy over the post-World War 2 years is set out here: by creating and consolidating the "four freedoms" of circulation (of goods, services, capital and persons) and steadily forming a European internal market, called a single market in the 1990s), the drafters intended to promote the prosperity of nations and to break down the mental barriers that have so deeply divided Europeans. The result, sixty years later, is an asymmetric integration: mobility, while high for goods and especially capital, remains low for people and services. Article 117 of the Treaty, which aims at "equalization in the progress" of living conditions, envisages that this will be achieved by the "functioning of the common market, which will promote the harmonization of social systems". Europe's asymmetric integration has instead

generated fierce tax and social competition. However, Europeans are strongly attached to their respective social models: according to the Eurobarometer, 82% of them believe that “the market economy should go hand in hand with a high level of social protection”. Sixty years after the signing of the Treaty of Rome, if a European identity does indeed exist, it is centred on this belief.

But while for decades the free movement of people, structurally weak in the EU, has had only a marginal presence in European debates, it played a central role in the decision of the United Kingdom to leave the EU: whereas the British intended to propose a trade-off between the free movement of goods, capital and services, which they intended to keep, and the free movement of people, which they no longer want, the EU’s institutions and Member States reaffirmed that the four freedoms form a bloc, to be taken or left together.

Affirming as the essential objective of their efforts the constant improvement of the living and working conditions of their peoples,

There is little doubt that Europeans’ living conditions have improved since 1957, but their “constant improvement”, affirmed as an “essential goal” by the Treaty of Rome, has come into question empirically in the recent period. According to the United Nations Human Development Index (HDI) [\[2\]](#), an imperfect measure that partly reflects people’s living conditions, the situation in European countries, which can be assessed only since 1990 (the date when homogeneous data became available for the EU-28), indicates almost constant progress in the member countries up to 2000, the turning point after which the rate of HDI growth slows, falling to almost zero in 2014. “Employment conditions”, which are approximated by the unemployment rate, have also deteriorated since 2000, with the unemployment rate recovering to its 2000 level only in 2016.

But the essential point is undoubtedly the way that Europeans today perceive the possibility of their living conditions improving. The Eurobarometer says that 56% of Europeans now believe that their children will lead harder lives than they did. According to data from the Pew Research Center, [Europeans are now the most pessimistic in the world in terms of their economic future](#).

Recognising that the removal of existing obstacles calls for concerted action in order to guarantee steady expansion, balanced trade and fair competition,

Anxious to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions,

These two paragraphs are aimed at averting two imbalances in Europe, which have in fact been reinforced in recent times: current account imbalances (going against “balanced trade”) and geographical imbalances (undermining the “harmonious development” of the territories of the European Union). On the first point, trade imbalances between EU Member States and in the euro area in particular are now well known and documented, as is the major destabilizing role being played by Germany. On the second point, the success of the single market inherited from the Treaty of Rome has been paradoxical: it brought countries closer together but led to divergence between the regions (and more generally the territories). It can for instance be shown that in the European Union [the gap in economic development between regions is stronger than the gap between countries](#) [3]. This spatial fracture within Europe’s countries, which is found in other countries outside Europe but which the single market has undoubtedly accentuated by the powerful agglomeration effects it generates, is not without consequence for the geographical polarization observed in recent polls, in the United Kingdom, [Austria](#) and France.

Desiring to contribute, by means of a common commercial policy, to the progressive abolition of restrictions on international trade,

The drafters of the Treaty of Rome were right: the EEC and then the EU have contributed greatly to the liberalization of trade around the planet and therefore to contemporary globalization. While in 1960 the six EEC Treaty countries represented about a quarter of world trade, by 2015 the 28 EU countries accounted for about 34% of world trade. One-third of globalization has involved Europeanization.

Intending to confirm the solidarity which binds Europe and the overseas countries and desiring to ensure the development of their prosperity, in accordance with the principles of the Charter of the United Nations,

Resolved by thus pooling their resources to preserve and strengthen peace and liberty, and calling upon the other peoples of Europe who share their ideal to join in their efforts,

Have decided to create a European Economic Community...

This last section sets out the heart of the European promise: peace based on a market that relies on the law and calls forth enlargement. There is no denying that civil liberties and political rights have progressed on the continent, guaranteeing the Member States the longest period unbroken by war since the sixteenth century. In 1957, only 12 of the current 28 Member States were democracies – all are today. And democracies are far less prone to war than other political regimes. It is no exaggeration to say that Europe is today the most democratic continent in the world, with almost 90% of its countries considered free, compared with only 70% in the Americas, 40% in Asia, 20% in sub-Saharan Africa and only 1% in the Middle East and North Africa (according to data from Freedom House). But the threat has changed in nature: it is no

longer primarily international conflict that endangers Europe (although the new Russian imperialism cannot be taken lightly), but internal conflict.

Political instability, already evident in Greece, is rising in many countries, in Austria, the Netherlands, Finland, Italy and of course France. The European Union has contributed to the deep social resentment that is feeding the very secessionist parties that intend to dismantle it. The response to this risk of disintegration must be on a par with the Treaty of Rome, whose preamble affirms values [\[1\]](#)and sets out horizons. In this respect, the European Commission's tribute is contradictory: the [White Paper on the future of Europe](#), released on 1 March, considers the question of what Europeans want to do together and how they could do it, together or separately. But for the first time in sixty years, the Union is not expanding but shrinking. For the first time in sixty years, Europeans believe their children will have harder lives than they did. For the first time in sixty years, democracy is being threatened on the continent and, aggravating this situation, from within. The greatest danger for European construction is not the crisis: it is complacency about the crisis.

[\[1\]](#) The Eurobarometer, created in the spring of 1974, measures confidence in European institutions and the European Union, and is intended to reveal Europeans to one another through the expression of their respective public opinions.

[\[2\]](#) The HDI aggregates indicators on health, education and income on a parity basis.

[\[3\]](#) If the special case of Luxembourg is left out.

The European economy in 2017 – or, the post-Brexit EU

By [Jérôme Creel](#)

The just released [L'économie européenne 2017](#) provides a broad overview of the issues being posed today by the European Union project. Brexit, migration, imbalances, inequality, economic rules that are at once rigid and flexible... the EU remains an enigma. Today it gives the impression of having lost the thread of its own history or to even to be going against History, such as the recent international financial crisis or in earlier times the Great Depression.

A few months after the bankruptcy of Lehman Brothers, the G-20 Summit of the heads of State and Government held in London in April 2009 drew up a list of recommendations to revive the global economy. These included implementing active fiscal and monetary policies, supporting the banks and improving banking regulation, rejecting the temptation of protectionism, fighting against inequality and poverty, and promoting sustainable development.

These recommendations were in contrast to the policies implemented shortly after the Great Depression back in the 1930s. At that time, economic policies started with restrictive measures, thereby fueling the crisis and rising inequality. Protectionism in that epoch became not just a temptation but a reality: tariff and non-tariff barriers were erected in an effort to protect local business from international competition. We know what happened later: the rise of populism and extremism that plunged Europe, and then the world, into a terrible war. The economic lessons learned

from the catastrophic management of the 1930s crisis thus contributed to the recommendations of the London G-20 Summit.

What now remains of these lessons in Europe? Little, ultimately, other than a resolutely expansionary monetary policy and the establishment of a banking union. The first is meant to alleviate the current crisis, while the second is intended to prevent a banking crisis in Europe. While this is of course not nothing, it is based on a single institution, the European Central Bank, and is far from sufficient to answer all the difficulties hitting Europe.

Brexit is one of these: as the first case of European disintegration, the departure of the United Kingdom poses the issue of the terms of its future partnership with the European Union (EU) and re-raises the question of protectionism between European states. The temptation to turn inwards is also evident in the way that the refugee crisis has been managed, which calls for the values of solidarity that have long characterized the EU. Differences between EU Member States in terms of inequality, competitiveness and the functioning of labour markets require differentiated and coordinated policies between the Member States rather than the all-too homogeneous policies adopted up to now, which fail to take an overall view.

This is particularly true of the policies aimed at reducing trade imbalances and those aimed at cutting public debts. By applying fiscal rules to manage the managing public finances, even if these are not perfectly respected, and by imposing quantitative criteria to deal with economic and social imbalances, we lose sight of the interdependencies between the Member States: fiscal austerity is also affecting our partners, as is the search for better price competitiveness. Is this useful and reasonable in a European Union that is soon to be the EU-27, which is seeing rising inequalities and struggling to find a way to promote long-term growth?

L'économie européenne 2017 takes stock of the European Union in a period of severe tensions and great uncertainty, following a year of average growth and before the process of separation between the EU and the UK really begins. During this period, several key elections in Europe will also serve as stress tests for the EU: less, more or better Europe – it will be necessary to choose.

Britain's referendum of 23 June 2016: The leap into the unknown

By Catherine Mathieu

On 23 June 2016, the British people decided (by 52% to 48%) to leave the European Union. After having long criticized the functioning of the EU and the constraints that it placed on the United Kingdom, on 19 February 2016 David Cameron obtained an agreement intended to allow the UK to remain in the EU – but it was not enough to convince the voters. In an [OFCE Policy Brief](#) (No. 1 of 13 July), we analyze how the British people's concerns went beyond economic issues and that what counted was their desire to maintain (or regain) their political sovereignty.

The departure from the EU is, in the words of David Cameron, “a leap into the unknown”, and all that is possible now is to develop scenarios based on hypotheses about the outcome of the

negotiations to be undertaken with the EU: from a rosy scenario in which both sides want to maintain as much as possible of the existing relations, to a dark scenario where the EU wants to set an example and the UK becomes a tax and regulatory haven.

As of early July, the UK clearly had not yet decided to formally leave the EU (by triggering Article 50), and will probably not do so before September. The resignations of the Brexit camp's leaders and continuing changes in the political situation are leaving a fog over the establishment of negotiations: the pound has lost more than 10% against the euro and 12% against the dollar, and may not stabilize until the UK's situation is clarified. It seems that we are entering into a grey scenario where the various shades are still unknown.

In the short term, depending on the hypotheses adopted, the impact of a Brexit could be slightly negative for the British economy, on the order of 0.2 point of GDP in 2016 according to the National Institute of Economic and Social Research (NIESR), but this could reach several percentage points of GDP after two years depending on the scenario, with the UK Treasury entertaining the gloomiest prospects (-3.6% to -6%).

In the long term, again depending on the hypotheses adopted, the economic impact of the UK's exit would be decidedly negative, especially according to the British Treasury, but the assumptions of a sharp decline in British trade are undoubtedly exaggerated.

Europe is dead – Long live Europe!

By [Maxime Parodi](#) and [Xavier Timbeau](#)

The British people's vote for Brexit merely reinforces the political logic that has become an imperative. On the one hand, people want to be consulted, while on the other, Europe is summoned to change. François Hollande believes that, "the vote of the United Kingdom is putting Europe to the test"; Alain Juppé holds that, "we must write a new page, a new chapter, in the history of Europe"; the leaders of France's National Front, but not they alone, are calling for a referendum on France's membership in the EU and in the euro. Throughout Europe, debate along these same lines is underway.

A few days ago, we wrote on the [Terranova Foundation site](#): "The referendum on the UK's membership in the European Union will lead to a shock that is more political than economic. It will be difficult to contain demands for similar consultations. Meeting these demands by 'more Europe' will only heighten the distance between the peoples and European construction. To think that referendums could on the other hand legitimize the status quo would also be a mistake. We propose responding to the democratic need not by a 'all or nothing' approach but by a process of democratic ownership that helps to legitimize European integration and to imagine future possibilities."

This method of democratic ownership of Europe and the euro has to be taught. Referendums "for or against" won't cut it. The federal leap now acts as a foil for probably a large majority of Europeans. But a public domain does nevertheless exist in Europe. Articulating what today are the sites of democracy, the EU Member States, with the need, for some subjects, of a supranational legitimacy is the alternative to the invention

of the European citizen. But it is the method that counts. And all the levers of participatory democracy, of broad national and transnational debates, including through citizen juries, must be mobilized to take stock of the current state of Europe and propose reforms that will render it more democratic. **This could lead to concrete advances such as a parliament of the euro zone or an extension of the European Parliament's powers.** It is also the way to reverse the trend towards the breakdown of Europe.

Brexit: What are the lessons for Europe?

By [Catherine Mathieu](#) and [Henri Sterdyniak](#)

The British vote to leave the European Union is aggravating the political crisis in Europe and in many European countries. Leaving the EU has become a possible alternative for the peoples of Europe, which may encourage parties advocating national sovereignty. The United Kingdom's departure automatically increases the weight of the Franco-German couple, which could destabilize Europe. If Scotland leaves the UK to join the EU, independence movements in other regions (Catalonia, Corsica, etc.) could seek a similar outcome. But the fragility of Europe also stems from the failure of the strategy of "fiscal discipline / structural reforms".

The departure of the United Kingdom, a fierce advocate of economic liberalism and opponent of any increase in the European budget and in the powers of Europe's institutions, as well as of a social Europe, could change the dynamics of the

debate in Europe, but some East European countries, the Netherlands and Germany have always had the same position as the UK. The departure will not, by itself, cause a shift in European policy. On the other hand, the liberalization of services and the financial sector, which the UK has been pushing for, could be slowed. The British Commissioner, Jonathan Hill, head of financial services and capital markets, should be promptly replaced. This will raise the sensitive issue of British EU officials, who in any case can no longer occupy positions of responsibility.

This will also open up a period of economic and financial uncertainty. The reaction of the financial markets, which do not like uncertainty and are in any case volatile, should not be accorded an excessive importance. The pound sterling has of course rapidly depreciated by 10% against the euro, but it was probably overvalued, as evidenced by the British current account deficit of around 6.5% of GDP in 2015.

According to Article 50 of the European Constitution, any country that decides to leave the EU should negotiate a withdrawal agreement, which sets the exit date^[1]. Otherwise, after two years the country is automatically outside the Union. The negotiations will be delicate, and must of necessity deal with all the issues. During this period, the UK will remain in the EU. European countries will have to choose between two attitudes. An understanding attitude would be to sign a free trade agreement quickly, with the goal of maintaining trade and financial relations with the UK as a privileged partner of Europe. This would minimize the economic consequences of Brexit for both the EU and the UK. However, it seems difficult to see how the UK could simultaneously enjoy both complete freedom for its own economic organization and full access to Europe's markets. The UK should not enjoy more favourable conditions than those of the current members of the European Free Trade Association (EFTA – Norway, Iceland and Liechtenstein) and Switzerland; like them, it should

undoubtedly integrate the single market legislation (in particular the free movement of persons) and contribute to the EU budget. The issue of standards, such as the European passport for financial institutions (this is now granted to the EFTA countries, but not to Switzerland), etc., would be posed very quickly. The UK may have to choose whether to comply with European standards on which it will not have a say or to be subject to regulatory barriers. The negotiations will of course be open-ended. The UK could argue for a Europe that is more open to countries outside the EU. But how much weight will it have once it's out?

A tough attitude intended to punish London so as to set an example and deter future candidates from leaving would instead require the UK to renegotiate all trade treaties from scratch (i.e. from WTO rules) so as to encourage multinational companies to relocate their factories and headquarters to mainland Europe and close British banks' access to the European market in order to push them to repatriate euro zone banking and financial activity to Paris or Frankfurt. But it would be difficult for Europe, a supporter of the free movement of goods, services, people and business, to start erecting barriers against the UK. The euro zone has a current account surplus of 130 billion euros with the UK: does it want to call this into question? European companies that export to the UK would oppose this. Industrial cooperation agreements (Airbus, arms, energy, etc.) could only be challenged with difficulty. A priori it would seem unlikely that London would erect tariff barriers against European products, unless in retaliation. Conversely, London could play the card of setting up tax and regulatory havens, particularly in financial matters. It could not, however, avoid international constraints (agreements such as at COP21, on the fight against tax avoidance, on the international exchange of tax and banking information, etc.). The risk would be to start a costly game of mutual reprisals (one that it would be difficult for Europe, divided between countries with different

interests, to lead).

Upon leaving the European Union, the United Kingdom, a net contributor to the EU, would a priori save about 9 billion euros per year, or 0.35% of its GDP. However, the EFTA countries and Switzerland contribute to the EU budget as part of the single market. Again, everything depends on the negotiations. It would seem that the savings for the UK will be only about 4.5 billion euros, which the other Member countries will have to make up (at a cost of around 0.5 billion euros for France).

Given the uncertainty of the negotiations (and of exchange rate trends), all assessments of Brexit's impact on other EU countries can only be very tentative. Moreover, this will necessarily have only a second-order impact on the EU countries: if tariff or non-tariff barriers reduce French exports of cars to the UK and of British cars to France, French manufacturers can supply their national markets while facing less competition and can also turn to third countries. It is nevertheless useful to have an order of magnitude: in 2015, exports from France (from the EU) to the UK represented 1.45% of GDP (respectively 2.2%); exports from the UK to the EU represented 7.1% of British GDP. A priori, an equivalent impact on UK / EU trade will have 3.2 times less impact on the EU than on the UK.

According to the OECD[\[2\]](#), the fall in EU GDP will come to 0.8% by 2023 (against 2.5% for the UK), whereas remaining in the EU, participating in the deepening of the single market and signing free trade agreements with the rest of the world would lead to a rise in GDP for all EU countries. But how credible is this last assertion, given the euro zone's current poor performance and the cost for the economic and social cohesion of European countries of opening the borders? But if Europe is functioning poorly, then leaving should improve market prospects. The UK's foreign trade would suffer a contraction, which would hurt its long-term productivity, but despite its

openness the British economy's productivity is already weak. The OECD does not raise the question of principle: should a country give up its political sovereignty to benefit from the potential positive effects of trade liberalization?

According to the Bertelsmann Foundation[\[3\]](#), the reduction in EU GDP (excluding the UK) in 2030 would range from 0.10% in the case of a soft exit (the UK having a status similar to that of Norway) to 0.36% in the worst case (the UK having to renegotiate all its trade treaties); France would be little affected (-0.06% to -0.27%), but Ireland, Belgium and Luxembourg more so. The study multiplied these figures by five to incorporate medium-term dynamics, with the reduction in foreign trade expected to have adverse effects on productivity.

Euler-Hermes also reported very weak figures for the EU countries: a fall of 0.4% in GDP with a free trade agreement and of 0.6% without an agreement. The impact would be greater for the Netherlands, Ireland and Belgium.

Europe needs to rebound, with or without the United Kingdom...

Europe must learn the lessons from the British crisis, which follows on the debt crisis of the southern European countries, the Greek crisis, and austerity, as well as from the migrant crisis. It will not be easy. There is a need to rethink both the content of EU policies and their institutional framework. Is the EU up to the challenge?

The imbalances between EU Member countries grew from 1999 to 2007. Since 2010, the euro zone has not been able to develop a coordinated strategy enabling it to restore a satisfactory level of employment and reduce the imbalances between Member states. The economic performance of many euro zone countries has been poor, and downright catastrophic in southern Europe. The strategy implemented in the euro zone since 1999, and strengthened since 2010 – “fiscal discipline / structural

reforms" – has hardly produced satisfactory results socially or economically. On the contrary, it gives people the feeling of being dispossessed of any democratic power. This is especially true for countries that benefited from assistance from the Troika (Greece, Portugal, Ireland) or the European Central Bank (Italy, Spain). The Juncker plan that was intended to boost investment in Europe marked a turning point in 2015, but it remains timid and poorly taken up: it was not accompanied by a review of macroeconomic and structural policy. There are important disagreements in Europe both between nations and between political and social forces. In the current situation, Europe needs a strong economic strategy, but it has not been possible to agree on one collectively in today's Europe.

There are two fundamental reasons for this morass. The first concerns all the developed countries. Globalization is creating a deeper and deeper divide between those who benefit from it and those who lose^[4]. Inequalities in income and status are widening. Stable, well-paid jobs are disappearing. The working classes are the direct victims of competition from low-wage countries (Asian countries and former Soviet bloc countries). They are being asked to accept cuts in wages, social benefits, and employment rights. In this situation, the elite and the ruling classes can be open-spirited, globalist and pro-European, while the people are protectionist and nationalist. This same phenomenon underlies the rise of France's National Front, Germany's AFD, UKIP, and in the US the Republican Donald Trump.

Europe is currently operated according to a liberal, technocratic federalism, which seeks to impose on people policies and reforms that they are refusing, sometimes for reasons that are legitimate, sometimes questionable, and sometimes contradictory. The fact is that Europe in its current state is undermining solidarity and national cohesion and preventing countries from choosing a specific strategy.

The return to national sovereignty is a general temptation.

Furthermore, Europe is not a country. There are significant differences in interests, situations, institutions and ideologies between peoples, which render progress difficult. Because of the differences in national situations, many arrangements (the single monetary policy, the free movement of capital and people) pose problems. Rules that had no real economic foundation were introduced in the Stability Pact and the Budgetary Treaty: these did not come into question after the financial crisis. In many countries, the ruling classes, political leaders and senior civil servants have chosen to minimize these problems, so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social welfare, wages and regulations have been deliberately forgotten. How can convergence towards a social Europe and a fiscal Europe be achieved between countries whose peoples are attached to structurally different systems? Given the difficulties of monetary Europe, who would wish for a budgetary Europe, which would take Europe further from democracy?

In the UK-EU Agreement of 19 February, the UK has recalled the principles of subsidiarity. It is understandable that countries concerned about national sovereignty are annoyed (if not more) by the EU's relentless intrusions into areas that fall under national jurisdiction, where European intervention does not bring added value. It is also understandable that these countries refuse to constantly justify their economic policies and their economic, social or legal rules to Brussels when these have no impact on the other Member states. The UK noted that the issues of justice, security and individual liberties are still subject to national competence. Europe needs to take this feeling of exasperation into account. After the British departure, it needs to decide between two strategies: to strengthen Europe at the risk of further fuelling people's sense of being powerless, or to scale down

the ambition of European construction.

The departure of the United Kingdom, the de facto distancing of some Central European countries (Poland, Hungary) and the reticence of Denmark and Sweden could lead to an explicit switch to a two-tiered EU. Many national or European intellectuals and politicians think that this crisis could provide just such an opportunity. Europe would be explicitly divided into three groupings. The first would bring together the countries of the euro zone, which would all agree to new transfers of sovereignty and to build a stronger budgetary, fiscal, social and political union. A second grouping would bring together the European countries that do not wish to participate in such a union. The last grouping would include countries linked to Europe through a free trade agreement (currently Norway, Iceland, Liechtenstein and Switzerland, and later the UK and other countries).

Such a project would, however, pose many problems. Europe's institutions would have to be split between euro zone institutions operating on a federal basis (which need to be made more democratic) and EU institutions continuing to operate in the Union manner of the Member states. Many countries currently outside the euro zone are opposed to this kind of change, which they feel would marginalize them as "second-class" members. The functioning of Europe would become even more complicated if there were both a European Parliament and a euro zone Parliament, euro zone commissioners, euro zone and EU financial transfers, and so on. This is already the case for instance with the European Banking Agency and the European Central Bank. Many questions would have to be decided two or three times (once in the euro zone, again at the EU level, and again for the free trade area).

Depending on the issue, the Member country could choose its grouping, and things would quickly head towards an à la carte union. This is hardly compatible with the democratization of Europe, as soon there would be a Parliament for every

question.

The members of the third grouping would then be in an even more difficult situation, with the obligation to comply with regulations over which they had no power. Should our partner countries be placed in the dilemma of either accepting heavy losses of sovereignty (in political and social matters) or being denied the benefits of free trade?

There is clearly no agreement between the peoples of Europe, even within the euro zone, on moving towards a federal Europe, with all the convergences that this would imply. In the recent period, the five Council Presidents and the Commission proposed new steps towards European federalism: creating a European Budget Committee, establishing independent Competitiveness Councils, conditioning the granting of Structural Funds on respect for budgetary discipline and the implementation of structural reforms, establishing a European Treasury and a euro zone minister of finance, moving towards a financial union, and partially unifying the unemployment insurance systems. These developments would reinforce the technocratic bodies to the detriment of democratically elected governments. It would be unpleasant if these were implemented, as is already partially the case, without the people being consulted.

Furthermore, no one knows how to proceed with convergence on tax and social matters. Upwards or downwards? Some proposals call for a political union in which decisions are taken democratically by a euro zone government and parliament. But can anyone imagine a federal authority, even a democratic one, that is able to take into account national specificities in a Europe composed of heterogeneous countries? What about decisions concerning the French pension system taken by a European Parliament? Or a finance minister for the zone imposing spending cuts on Member countries (as the Troika did in Greece)? Or automatic standards on public deficits? In our opinion, given the current disparity in Europe, economic

policies must be coordinated between countries, not decided by a central authority.

Europe needs to reflect on its future. Using the current crisis to move forward towards an “ever closer union” without more thought would be dangerous. Europe must live with a contradiction: the national sovereignties that peoples are attached to have to be respected as much as possible, while Europe must implement a strong and consistent macroeconomic and social strategy. Europe has no meaning in itself, but only in so far as it implements the project of defending a specific model of society, developing it to integrate the ecological transition, eradicating mass unemployment, and solving the imbalances within Europe in a concerted and united manner. But there is no agreement within Europe on the strategy needed to achieve these goals. Europe, which has been unable to generally lead the Member countries out of recession or to implement a coherent strategy to deal with globalization, has become unpopular. Only after a successful change of policies will it regain the support of the peoples and be able to make institutional progress.

[\[1\]](#) See in particular the report of the French Senate by Albéric de Montgolfier: *Les conséquences économiques et budgétaires d’une éventuelle sortie du Royaume-Uni de l’Union Européenne* [The economic and budgetary consequences of a future withdrawal of the United Kingdom from the European Union], June 2016.

[\[2\]](#) OECD, 2016, *The Economic Consequences of Brexit: A Taxing Decision*, April. Note that to treat leaving the euro as a tax increase does not make economic sense and represents a communication that is unworthy of the OECD.

[\[3\]](#) *Brexit – potential economic consequences if the UK exits the EU*, Policy Brief, 2015/05.

[\[4\]](#) See, for example, Joseph E. Stiglitz, 2014, “Le prix de

l'inégalité", Les Liens qui libèrent, Paris.

A new EU arrangement for the United Kingdom: European lessons from the February 19th agreement

By [Catherine Mathieu](#) and [Henri Sterdyniak](#)

Following the demand made by David Cameron on 10 November 2015 for a new arrangement for the United Kingdom in the European Union, the European Council came to an agreement at its meeting of 18 and 19 February. On the basis of this text, the British people will be called to the polls on 23 June to decide whether to stay in the EU. This episode raises a number of questions about the functioning of the EU.

– The United Kingdom has challenged European policy on matters that it deems crucial for itself and largely got what it wanted. Its firmness paid off. This has given rise to regrets on this side of the Channel. Why didn't France (and Italy) adopt a similar attitude in 2012, for instance, when Europe imposed the signing of the fiscal treaty and the implementation of austerity policies? This is a cause for concern: will what has been accepted for a big country be tolerated for a smaller one? The UK's threat to leave is credible because the EU has become very unpopular among the population (especially in England), and because the UK is independent financially (it borrows easily on the capital

markets) and economically (it is a net contributor to the EU budget). A country that is more dependent on Europe would have little choice. This raises worries: won't we see other countries follow suit in the future? Will Europe be able to avoid becoming a Europe à la carte (each country taking part in the activities that interest it)? But is a model based on forced participation preferable? Europe must allow a country to abstain from policies that it deems harmful.

– The United Kingdom will therefore organize a referendum, which is satisfactory from a democratic perspective. The most recent referendums have hardly yielded favourable results for European construction (France and the Netherlands in 2005, Greece in July 2015, Denmark in December 2015). The British will be limited to choosing between leaving the EU (the February agreement clearly rejects the possibility of new renegotiations if the referendum results in a majority in favour of an EU exit) or staying with a reduced status; the possibility of the UK remaining in the EU and seeking to strengthen its social dimensions, as advocated by some of the Labour Party and the Scottish Nationalists, will not be offered. Too bad.

– The United Kingdom is explicitly exempted from the need to deepen the EMU or from an “ever closer union” or “deeper integration”, all formulas contained in the treaties. The proposed arrangement clarifies that these notions are not a legal basis to extend the competences of the EU. States that are not members of the euro zone retain the right to take part or not in further integration. This clarification is, in our opinion, welcome. It would not be legitimate for the Union's powers to be extended continuously without the consent of the people. In the recent period, the five presidents and the EU Commission have proposed new steps towards European federalism: creating a European Fiscal Committee; establishing independent Competitiveness Councils; conditioning the granting of Structural Funds on fiscal discipline;

implementing structural reforms; creating a European Treasury department; moving towards a financial union; and partially unifying the unemployment insurance systems. These moves would strengthen the technocratic bodies to the detriment of democratically elected governments. Wouldn't it be necessary to explicitly request and obtain the agreement of the peoples before embarking on such a path?

- The exit of the United Kingdom, a certain distancing by some Central and Eastern Europe countries (Poland, Hungary), plus the reluctance of Denmark and Sweden could push towards an explicit move to a two-tier Union, or even, to take David Cameron's formulation, to an EU in which countries are heading to different destinations. The countries of the euro zone would for their part accept new transfers of sovereignty and would build a stronger fiscal and political union. In our opinion this proposal should be submitted to the people.

- At the same time, the draft agreement provides that the Eurogroup has no legislative power, which remains in the hands of the Council as a whole. The UK has had it clarified that a non-member state of the euro zone could ask the European Council to take up a decision on the euro zone or the banking union that it believes harms its interests. The principle of the euro zone's autonomy has thus not been proclaimed.

- The United Kingdom has had it clarified that it is not required to contribute financially to bail out the euro zone or the financial institutions of the banking union. This may be considered discomfoting vis-à-vis the European principle of solidarity, but it is understandable. This is because the establishment of the euro zone has abolished the principle: "Every sovereign country is fully backed by a central bank, a lender of last resort", which is posed by the bailout problem. The UK (and its banks) are backed by the Bank of England.

- The United Kingdom has had the principles of subsidiarity reviewed. A new provision states that parliaments representing

55% of the Member States may challenge a law that does not respect this principle. The UK has had it noted that the issues of justice, security, and liberty remain under national competence. It is a pity that countries devoted to their specific social systems and their wage bargaining systems have not done the same.

– It is understandable that countries concerned about national sovereignty are annoyed (if not more) by the EU's relentless intrusions into areas under national jurisdiction, where Europe's intervention does not bring added value. It is understandable that these countries are refusing to have to incessantly justify to Brussels their economic policies or their economic, social or legal regulations when these have no impact on other Member States. Europe must undoubtedly take these feelings of exasperation into account.

– As regards the banking union, the draft text is deliberately confusing. It is recalled that the "single rule book" managed by the European Banking Agency (EBA) applies to all banks in the EU, and that financial stability and equal competitive conditions must be guaranteed. But at the same time, it says that Member States that do not participate in the banking union retain responsibility for their banking systems and can apply special provisions. Moreover, countries that are not members of the euro zone have a right of veto on the EBA. This raises the question of the very content of the banking union. Will it make it possible to take the measures needed to reduce the scale of speculative financial activity in Europe and steer the banks towards financing the real economy? Or is the objective to liberalize the markets for the development of financial activity in Europe so as to compete with London and non-European financial centres? In the first case, what was needed was to clearly take in hand the market in London, telling it that membership in the EU requires close monitoring of financial activities. And that its departure would allow the EU to take capital control measures to limit speculative

activities and encourage banks in the euro zone to repatriate their activities.

- Likewise, Belgium, Luxembourg, the Netherlands and Ireland would have needed to be told that EU membership means the end of tax avoidance schemes for the multinationals.

- The United Kingdom has had a declaration passed affirming the need both to improve regulations and repeal unnecessary provisions to improve competitiveness while at the same time maintaining high standards of protection for consumers, labour, health and the environment. This compatibility undoubtedly amounts to wishful thinking.

- The text recognizes that the disparity in wage levels and social protection in European countries is hardly compatible with the principle of the free movement of persons in Europe. This has long been an unspoken part of European construction. The United Kingdom, which was one of the only countries not to take interim measures to restrict the entry of foreign workers at the time of the accession of central and eastern European countries in 2004, is now demanding that such measures be provided for in any future accessions. The draft agreement states that a European person's stay in a country other than his or her own is not the responsibility of the host country, meaning that the person either must have sufficient resources or must work.

- The question of the right to family benefits when children are not living in the same country as their parents is a tangled web. In most countries, family benefits are universal (not dependent on parental contributions). Both principles cannot be met at the same time: that all children living in a country are entitled to the same benefit; and that everyone working in a given country is entitled to the same benefits. The United Kingdom has won the right to be able to reduce these allowances based on the standard of living and family benefits in the child's country of residence. But fortunately

this right cannot be extended to pension benefits.

– Most European countries currently have mechanisms to promote the employment of unskilled workers. Thanks to exemptions on social contribution, to tax credits and to specific benefits (like in-work credits or housing benefits in France), the income that they receive is largely disconnected from their wage costs. The British example shows that these programmes can become problematic in case of the free movement of workers. How does a country encourage its own citizens to work without attracting too many foreign workers? Here is another of the unspoken issues of open borders. It is paradoxical that it is the United Kingdom that is raising the question, while it is near full employment and is claiming that the flexibility of its labour market allows it to easily take in foreign workers. In any case, the UK was granted that a country facing an exceptional influx of workers from other EU Member States can obtain the right from the Council, for seven years, to grant non-contributory aid to new workers from other member countries in a graduated process over a period of up to four years from the start of their employment. The UK has also had it clarified that it can use this right immediately. This is a challenge to European citizenship, but this concept had already been chipped away for the inactive and unemployed.

The European Union, as currently constructed, poses many problems. The Member States have divergent interests and views. Because of differences in their national situations (the single monetary policy, freedom of movement of capital and people), many arrangements are problematic. Rules without an economic foundation have been introduced into fiscal policy. In many countries, the ruling classes, the political leaders, and the top officials have chosen to minimize these problems so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social conditions, wages and regulations have been deliberately forgotten.

The UK has always chosen to keep its distance from European integration, safeguarding its sovereignty. Today it is putting its finger on sensitive points. To rejoice at its departure would be irrelevant. To use this to move mindlessly towards an “ever closer union” would be dangerous. Europe should seize this crisis to acknowledge that it has to live with a contradiction: national sovereignty must be respected as much as possible; Europe has no meaning in and of itself, but only if it implements a project that supports a specific model of society, adapting it to integrate the ecological transition, to eradicate poverty and mass unemployment, and to solve European imbalances in a concerted and united manner. If the agreement negotiated by the British could contribute to this, it would be a good thing – but will Europe’s countries have the courage to do so?