The speed at which Britain has been written off in some of continental Europe’s capitals is quite remarkable. Yet even after the exit, Britain remains one of Europe’s major economic nations and the European Union must come to an arrangement with it. Taking steps to punish the British population, which is what some now dream of doing, will not pay off. Besides, Britain now has enough of its own domestic problems to deal with. Politicians who complain of Britain’s “cherry picking” in a bid to prevent it from trading freely with the European Union only reveal their own ignorance. Free trade is not a zero-sum game; and those who adopt such a reductionist approach will only end up hurting themselves.

It is time for the European Union to take a critical look at itself. The trick of identifying the political exploitation that occurs in Brussels with Europe in order to distribute advantages and power in the slipstream of people’s enthusiasm for integration no longer has the desired effect. Citizens don’t want soothing soundbites anymore, they want policies that they can understand and that offer them tangible advantages. Attempts to proceed along the path followed to date, perhaps at an even brisker pace, run the risk of destroying Europe.

Twenty-five years ago, Germany wanted to ensure that Europe remained close to its citizens by anchoring the subsidiarity principle in the Maastricht Treaty. However, there have been no visible efforts by the Brussels-based

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establishment to date to show that this principle has been taken seriously. On the contrary, Brussels grabbed as much power as national governments would tolerate and was presumptuous enough to implement excessive regulatory measures—extending to prohibiting light bulbs and high-performance vacuum cleaners—that increasingly met with disbelief.

The really important issues, however, like integrating the military powers of member states and creating a common European army, were ignored. What kind of a European Union is this if it is not even able to control its own borders?

**BRUSSELS AS A RISK FACTOR**

The topic that massively swayed the Brits’ decision to exit was migration. Britain previously experienced mass immigration from overseas territories back in the 1950s and 1960s. Although successive Prime Ministers Edward Heath and Margaret Thatcher put a stop to the inflow of even more immigrants back then, the striking consequences of that immigration wave included slums, dilapidated urban areas, an overburdened welfare state, and wage competition among poorly qualified workers. The fact that the European Union enabled poverty-driven migration from other EU states discredited it in the eyes of many Brits.

On top of this, refugees from non-EU states started arriving because the European Union was not in a position to secure its borders. And that was the last straw.

The economic chaos in some EU countries also helped to discredit the European Union. Due to an inflationary credit bubble, Southern Europe became too expensive and lost its competitiveness. Manufacturing output is still 20 percent below its pre-crisis level in some of the European Union’s key economies. Youth unemployment led to political turmoil. Some states and a large number of banks were pushed to the brink of insolvency. These problems could only be masked with generous bail-out packages and unrestricted promises of liability. The EU doctors gave drugs because they lacked the competence or the courage for surgery.

Although the British do not share the burden of rescuing southern Europe, they are frightened of being pulled down with it. If the Germans want to play that game, they are free to do so, but the British definitely do not want to get involved in a liability union.

That is probably also what distorted all of the forecasts. Undecided individuals tend to avoid risk and opt for the status quo. Most observers thought that the status quo was EU membership, but the Brits astonishingly saw “splendid isolation” as the secure way of life, while the European Union was perceived as an incalculable risk.

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**ECONOMIC ADVANTAGES AND DRAWBACKS**

Britain is facing economic and political highs and lows that will make even the most resolute Brexiteer falter. The separation of Northern Ireland and Scotland is now in the cards. There will be capital flight as the City loses its role as Europe’s financial hub. Companies like Vodafone, easyJet, Samsung, the Bank of America, Ford, and even Europe’s largest bank, HSBC, are considering moving their European headquarters away from London. The joint British-German stock exchange will hardly be able to set up its main headquarters in London now. London real-estate prices will fall, financial institutes will go bankrupt, and the City’s turbulent growth will grind to a halt, giving way to a long period of stagnation. Inversely, Paris, Luxembourg, and Frankfurt will blossom.

It is not all bad news for Britain, however, as the City’s turbulent growth also had a downside. Although capital imports invigorated the domestic sectors, the overvaluation of the pound caused by those imports led to deindustrialization. Regardless of whether a country sells financial services, natural resources, or merely bonds to the world, an influx of purchasing power always leads to a higher real exchange rate, which in turn undermines the competitiveness of its manufacturing sector. This mechanism was seen to have similar effects in Switzerland, Norway, Greece, and the Netherlands in the 1970s, despite their differences.

If the financial sector is now rolled back and capital imports stop, the opposite effect will occur: namely, the pound will depreciate, the domestic sector will stagnate, and manufacturing will recover. Britain’s newly revived automotive industry will also be given a boost. All this does not mean that the country will benefit from Brexit.

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**What kind of a European Union is this if it is not even able to control its own borders? The topic that massively swayed the Brits’ decision to exit was migration.**
on balance. However, many living in the country’s economically underdeveloped former industrial regions will stand to benefit, typically those people who voted in favor of the exit.

In continental Europe, Germany is the big loser, as Britain is its third-biggest trade partner. On the one hand, Germany will start to feel competition from Britain in its export markets. On the other, Germany will lose one of its key allies in the ongoing defensive battle against

**It is not all bad news for Britain.**

French efforts to achieve greater state intervention and less free trade. Brexit means that the coalition of free trade and market-oriented countries in the Council of Ministers will lose their blocking minority (which is 35 percent of the population), and as a result the European Union threatens to turn into a trade fortress at the expense of Germany’s open economy. Germany must demand a renegotiation of the Maastricht Treaty based on the dramatically changed significance of the blocking minority clause alone. Otherwise it is sitting in a trap.

**HOW THE EUROPEAN UNION WILL REACT**

France and the Southern European countries would like to seize this opportunity to implement further mutualization initiatives as quickly as possible in the whirlwind of exit discussions. They imperatively want to implement mutualized deposit insurance for bank customers to socialize losses from writing off the bad loans of Southern European banks. To this end, the permanent ESM bailout fund is to be used in conflict with the banking directive on the direct recapitalization of bad banks. In addition, a mutualized unemployment benefit scheme is to be set up to offset the effects of chronic unemployment in Southern Europe with permanent transfers from the north. A credit-financed euro budget controlled by a common finance minister will then be set up so that further common tasks can be financed in this manner with as little fuss as possible and without having to overcome resistance from taxpayers, who will only find out the details later, once the money has gone. Under the pretext of the political union called for back in the days of German Chancellor Helmut Kohl, France is fiercely determined to drive Germany in this direction, despite the fact that the very first steps towards a true union would be to adopt a common foreign policy and form a joint army, ideas that France hates like the plague.

Such socialization initiatives will only compound the eurozone’s woes. Its plight arose due to excessive borrowing by southern European countries following the announcement of the euro at the Madrid Summit in 1995 because investors were happy to accept low interest rates based on their belief in the implicit joint liability of the Eurosystem. More joint liability will keep interest rates low, give rise to even more borrowing, and prevent the real devaluation through price moderation that is needed to improve competitiveness in southern Europe. The path into the debt mire accompanied by endless bickering is clearly marked out. The ugly disputes between Greece and Germany in 2015 were merely the forerunners. Assuming liability for a friend and helping him out with loans is the quickest way to lose him.

The example of the early decades of the United States should be a warning to everybody. The debt socialization that took place in the years after the United States was founded created an economic bubble due to excessive state borrowing that drove a third of all states to bankruptcy when it burst. Joint liability led to nothing other than hate and resentment. Historians such as Harold James of Princeton even see links between the joint liability disaster and the War of Secession a few years later.

**AND HOW THE EUROPEAN UNION SHOULD REACT**

To prevent all this from happening again and to stop other countries from following Britain, the European Union has to capitalize on the Brexit shock to implement far-reaching reforms. The EU treaties have to be revised accordingly.

A meaningful reform would ensure that the European Union only takes on tasks that reflect the so-called Pareto-optimal principle. According to this principle, only those measures are taken that benefit some or all, but do not harm anybody. Voluntariness, strong rights for minorities, and regulated exit options ensure that this principle is largely fulfilled.

One implication of the Pareto-optimal principle is that the European Union really only takes on community tasks with cross-border externalities, but refrains from redistribution activities, including those disguised as risk-sharing. Of course, redistribution can sometimes be justified by the Pareto-optimal principle in the sense of providing mutual insurance before the die are cast, but this calls for a treaty between the states of Europe that
is truly binding in the long term, which basically means founding a federal state. As long as no such federal state exists, there should be no redistribution activities, for such activities will constantly encourage the disadvantaged to leave. Moreover, the extremely different weighting of EU citizens’ votes in all decision-making bodies of the European Union and the European Central Bank prohibits all redistribution activities.

The major redistribution activities between Europe’s peoples that should be stopped according to Pareto optimization relate to migration and the euro, both of which are key issues that prompted the British to leave Europe.

The British were particularly angry that they were obliged to accept internal immigration by those fleeing poverty in other EU countries. This migration was largely caused by the so-called inclusion principle that made the northern European welfare states, including Britain, magnets for poorly qualified segments of the population. According to this principle, immigrants were integrated into their host country’s social welfare systems after very short waiting times and received social benefits financed by tax contributions just like the domestic population.

**THE HOME COUNTRY PRINCIPLE**

The home country principle is a better alternative. According to this principle, only the home country is responsible for tax-financed social benefits, but their recipients can take the entitlement to such benefits with them if they choose to emigrate. In the host country, they cannot ask for support, but only receive the contribution-based benefits that they themselves have earned. Individuals can also take contribution-based benefits with them if they decide to move on.

The home country principle is the only principle that is compatible with the continued existence of the welfare state, and only this principle ensures that immigration leads to benefits for all countries involved, thus satisfying the Pareto principle.

**NO SELF-HELP WITH THE PRINTING PRESS**

Reforms of the Eurosystem are now urgently required to reduce the liability risk for participating countries and prevent them from sinking into the mire of mutualized borrowing. Unfortunately, Germany’s Constitutional Court is largely leaving the European Central Bank a free hand in its fiscal bail-out initiatives masquerading as monetary policy. If politicians do not set any new limits, there is a danger that the ECB Council, in which the Bundesbank is constantly out-voted, will gamble away all of the EU countries’ seignorage wealth resulting from the power to print legal tender worth several trillion euros on bail-out initiatives.

At some point, voters may make it clear to politicians that the single currency isn’t worth that gamble. The critical time will come about one-and-a-half decades from now at the latest, when the baby boomers who are now around fifty try to collect a pension from the children they didn’t have. The German federal government’s foreseeable financial problems could concur with the realization of liability risks from the fiscal bail-out institutions and the European Central Bank’s excessive bail-out measures, creating a conflict situation that is no longer possible to control. The political clarification process may be delayed, but when it finally happens it could be explosive and not very conciliatory.

The euro is basically useful for Europe, but the policy of excessive money printing and lending must be stopped. The European Central Bank should not be allowed to buy any more government bonds from member states, as that leads to over-indebtedness. Instead, it should follow the example of the U.S. Federal Reserve, which never buys bonds from member states. It is also unacceptable that individual countries in the eurozone are printing the money that they are no longer able to borrow, and can crowd out refinancing credit issued by other central banks as a result. It was, and remains, a scandal that almost unlimited sums of money can be taken from the joint teller machine called the European Central Bank via the ELA emergency credit, the secret ANFA credit, and the lowering of standards for collateral for refinancing loans, without any need to ever settle the resulting balance-of-payment deficits (Target liabilities). The Bundesbank’s Target claims, which reflect electronic extraordinary money and credit creation by crisis-afflicted countries at the expense of the Bundesbank, are once again heading towards the €700 billion mark, largely unnoticed by the public. Settlement of the inter-district (Target-like) debts with marketable assets, as practiced by district central banks in the United States (ideally with gold, as was the case up until 1975) would put a stop to self-service with the electronic printing press.

Countries that are serious about the euro would remain in the Eurosystem after such a reform, but countries

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Taking steps to punish the British population will not pay off.

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that are only participating so that they can print the money they need to finance their running costs, to redeem their private debt, and to buy foreign assets would leave and that would be a good thing. The Eurosystem has to be restructured into a more flexible monetary union that can be exited in an orderly manner, otherwise it will progressively degenerate into a self-service store.

**THE BREATHING EURO**

The breathing currency union is a construct somewhere between the U.S. dollar and the Bretton Woods fixed rate exchange system that reigned after World War II. It avoids the ongoing exchange rate uncertainty linked to different currencies. However, it does not push member countries of a currency union that has become too expensive into enduring crises while permanent austerity policies wear thin their populations’ nerves, create conflicts among different social groups, and corrode society. Inversely, it stops countries that are no longer competitive from being financed by the budgets of other countries; and it does not inflict inestimable liability risks upon the latter.

Since an exit would not prevent a country from rejoining the currency union at a later date, it would be like a stay in hospital, giving countries the opportunity to withdraw and heal themselves with the option of returning to the union at a later date. The eurozone urgently needs clear rules to facilitate orderly exits.

In relation to this, there is also a need for bankruptcy rules for states that clarify the procedure to be followed in the case of over-indebtedness and distribute the foreseeable costs of the insolvency among investors. Such rules help investors to anticipate the threat of insolvency and prevent them from granting too much credit in the first place. Thus, inflationary credit bubbles that destroy an individual country’s competitiveness can no longer materialize so easily. Paradoxically, it is rules on insolvency that
will block the path to debt mires and prevent states from going bankrupt. It is once again constructive to take a look at how things are done on the other side of the Atlantic here, too. The United States was only able to develop into a stable federation after rules were drafted on the insolvency of member states after the U.S. Civil War and debt mutualization had ended.

Perhaps the milk has already been spilt in the European Union today, because the debts of individual states are already too high. If that is the case, the initial conditions for a better regime have to be created via a debt moratorium in which investors relinquish a share of their claims. To ensure that the whole thing doesn’t start all over again, the crisis-afflicted country has to be prepared to leave the euro temporarily in order to regain its competitiveness.

**REAL COMMUNITY TASKS**

It is now time for the European Union to focus on real community tasks that bring visible added value for all EU citizens. This primarily involves a common foreign and security policy, since a matter like security cannot be divided up among countries. The attempt to set up such a policy reached an advanced stage back in 1954 with the Western European Defence Union, but foundered due to the vote of the French parliament. It is high time to make up for this lost opportunity: it is an anachronism that twenty-eight EU countries have twenty-five separate armies with twenty-five high commands, even if most of them are loosely linked via NATO. The EU states should follow the example of the U.S. states, which have a common army within NATO.

If that seems over-ambitious, Europe should now at least have a really effective Frontex force with sovereign powers that can protect its borders from economic migrants, before the avalanche of mass immigration from third countries gains so much impetus that it can no longer be halted. EU membership represents a right to use common club goods. Whoever believes that humans have the right to choose the country that they would like to live in has not understood that property rights form the basic conditions for peaceful coexistence and that they alone enable Pareto-improving immigration with mutual benefits. Whoever makes the property rights to the Community’s public goods that are related to EU citizenship freely available by demonizing measures to secure its borders, for instance, is shaking the very foundations of the European Union, as that would give rise to eruptions that are harmless compared to the Brexit.

It is unacceptable that criminal bands should currently decide who can immigrate to Europe. Persons entering the European Union illegally must be expelled immediately before traces of them are lost and they can no longer be returned to their home countries. Such individuals can apply for asylum in the eurozone from abroad or gain entry via a points system. Spain, Canada, Switzerland, the United States, and Australia all show how this can be done. Hot spots in Africa should be part of the solution.

Additional community tasks obviously include cross-border transport routes for people, goods, energy, and data. The European Union is already active in these areas and that is a good thing. The single European energy market featuring the same prices for different forms of energy in all countries is the precondition for an efficient, low-cost coordination of energy-saving efforts. This is a better use of the EU budget than subsidies for the agricultural market, which should now finally be exposed to international competition. Moreover, the European Union also has uncontested competence in terms of the environment, insofar as environmental damages are of a cross-border nature, as is the case with greenhouse gases. The definition of norms, minimum standards and quality categories to provide improved orientation for consumers is also the uncontested domain of the European Union in tradable mass products, because their uniformity improves international competitiveness.

As far as the European Union’s decision-making structures are concerned, it is worth recalling the plan put forward by Germany’s former Foreign Minister Joschka Fischer. He proposed a two-chamber system with proportional representation of Europe’s population in parliament and national representation in a senate. If the decisions of these chambers were to be restricted to non-redistributive areas, the Council of Ministers and EU Summits could be dispensed with.

The topics covered in this article are serious. Indeed, they are so serious that the hollow words uttered by Brussels to date can no longer be tolerated. A new generation of politicians with real integrity is now needed, politicians who can credibly project the visions of figures like Konrad Adenauer, Alcide de Gaspari, and Robert Schuman into the present, because Europe has no other choice.