

# EUROPE IN THE BREXIT & TRUMP ERA: DIS-INTEGRATION AND RE-GROUPING

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## KEY TAKEAWAYS

### Global Geopolitical Trends Affecting Europe

- Europe borders with Chaosland, a part of the world overwhelmed by great instability factors; war, terrorism, widespread poverty, environmental turmoil caused by climate change, mass migration, failing States.
- From an environmental perspective, Chaosland is mostly set in the tropical crisis belt, where the impact of rising temperatures is more marked. According to some scenarios, climate change could lead millions of people (already affected by poverty and war) to abandon their homes. Many of them, will aim for Europe.
- Failing states surrounding Europe, and demographic decline compared to a widespread rise in the world's population, with the tendency to gather in megalopolises, make Europe unfit to fight in the coming decades. On the eastern front, Europe is up against two unstable, intrinsically revisionist powers: Russia and Turkey.

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## European Problems Are Intensifying – And a “Germanification” of Europe Makes Them Worse

- America's renewed isolationism does not help Europe. A possible outcome of the de-Westernization of Europe could be its Germanification. Germany, however, is economically and culturally unfit to become a hegemonic power. Actually, the German-led muddling-through is leading to the return of nation states.
- A well-functioning transfer union and a better policy mix (less monetary accommodation, more fiscal easing) could do a lot to cure Europe's malaise. But there is little political will to implement such a process.
- Divergence is increasing within the EZ and the EU; manufacturing production, unit labour costs and productivity, debt dynamics and sovereign yields are all diverging. The years of "great moderation" are over.

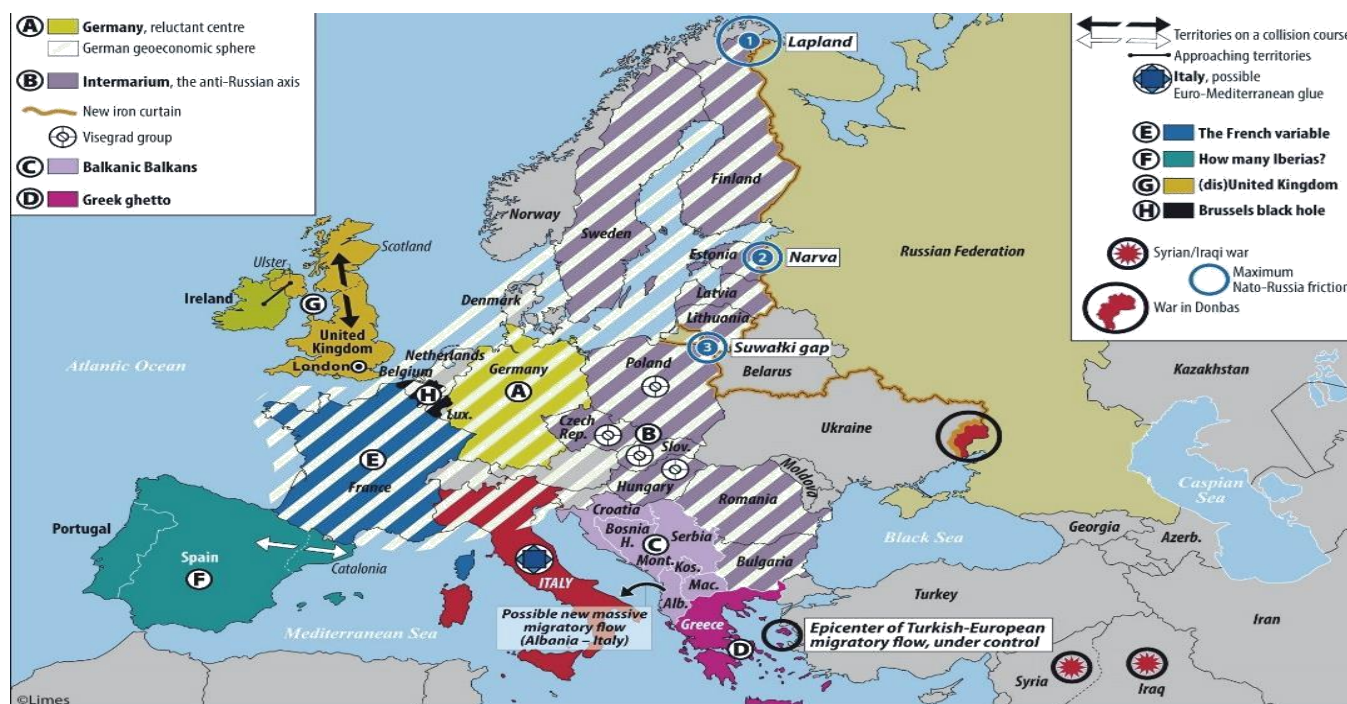
## Could Europe Survive Much Longer in Its Current Form? Hard to Believe

- Europe could survive if countries were reorganized in concentric circles and cross-border regions were created with common policies on immigration, defence (including a European army) and security agreed on.
- Positive surprises are possible, but unlikely. Therefore, should the EU survive the 2016-17 electoral cycle, by the 2021-22 cycle it might be entering its last years of existence.

## Dis-Integration and Re-Grouping

- This ongoing process of dis-integration would be followed by a process of re-grouping of European countries around those currently constituting the “core”, in particular Germany. This is likely to be only a short-term solution for a far bigger problem, as European countries, whether they like it or not, face a common destiny.

*Key Picture: Several Europes Could Emerge from the Ongoing Dis-Integration Process*



Source: MacroGeo

## 1. FROM A “GLORIOUS” PAST TO A CHALLENGING FUTURE

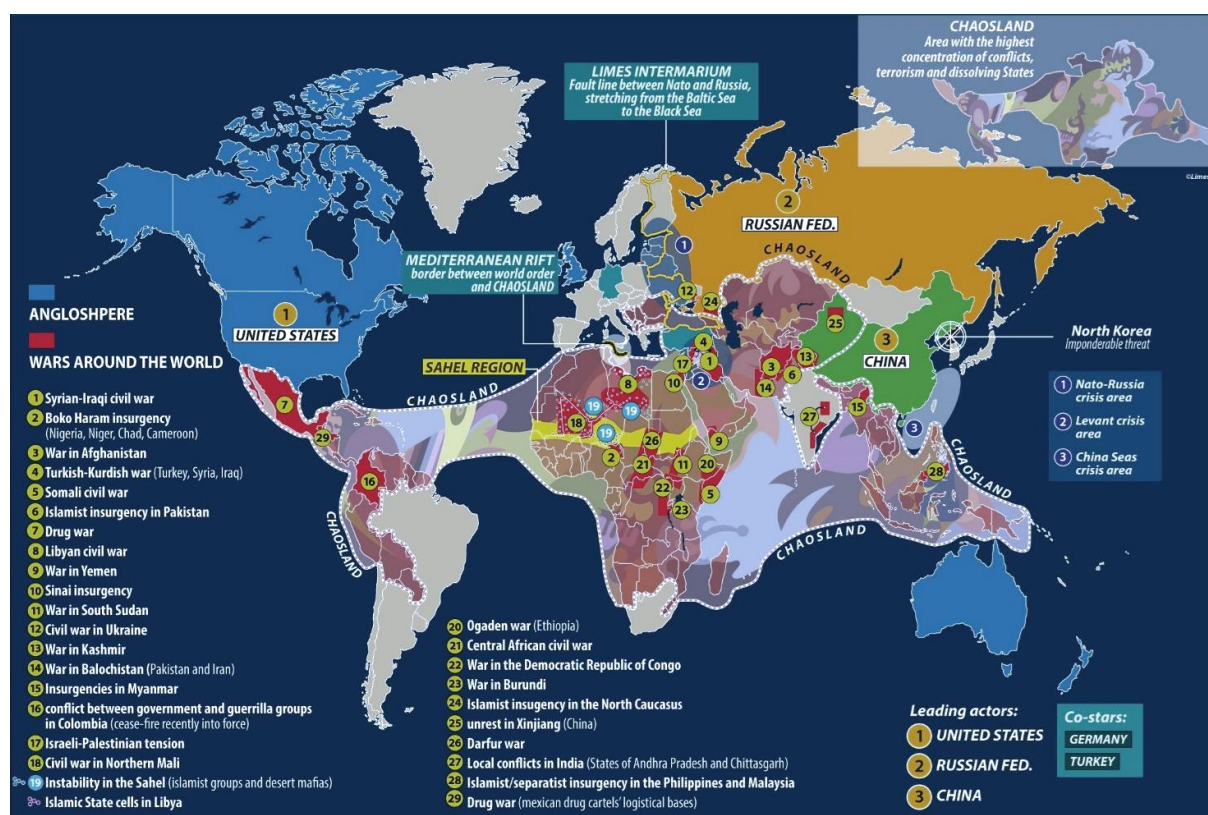
At the beginning of the last century Europe dominated the world. In other words, the world was European. Nowadays, Europe is dominated by global geopolitical dynamics it can no longer control nor manage. The European Union is not the global player it promised to become. On the contrary, it has embarked upon gradual dis-integration. None of its member states are powerful enough to compete as leading players on the global geopolitical stage. A number of those states are threatened by dis-integration.

This is a long-term geopolitical process that would be difficult to reverse for many reasons and for one in particular. Europeans do not feel they share the same interests and therefore tend to unload their problems on one another rather than address them together. This Europe is based on power relations far more than on shared rules. Common rules are interpreted on the basis of a balance of power. Europe's geopolitical dis-integration is the result of pressure coming from external and internal structural factors that are closely interconnected. Europe is not only faced with emergencies; Europe is in a historical cycle at the end of which, who knows when, the continent's geopolitical map will differ greatly from the current one.

## 2. CHAOSLAND AND ITS GLOBAL RAMIFICATIONS

In order to better understand the meaning and the extent of this transformation, Europe has to be set within the global context, to then analyse in greater depth a number of its internal dynamics. Europe borders with Chaosland (**Figure 1**), hence with the part of the world brimming with the greatest instability factors; war, terrorism, widespread poverty, environmental turmoil caused by climate change, mass migration, failing or failed states.

Figure 1: A Map of Chaosland

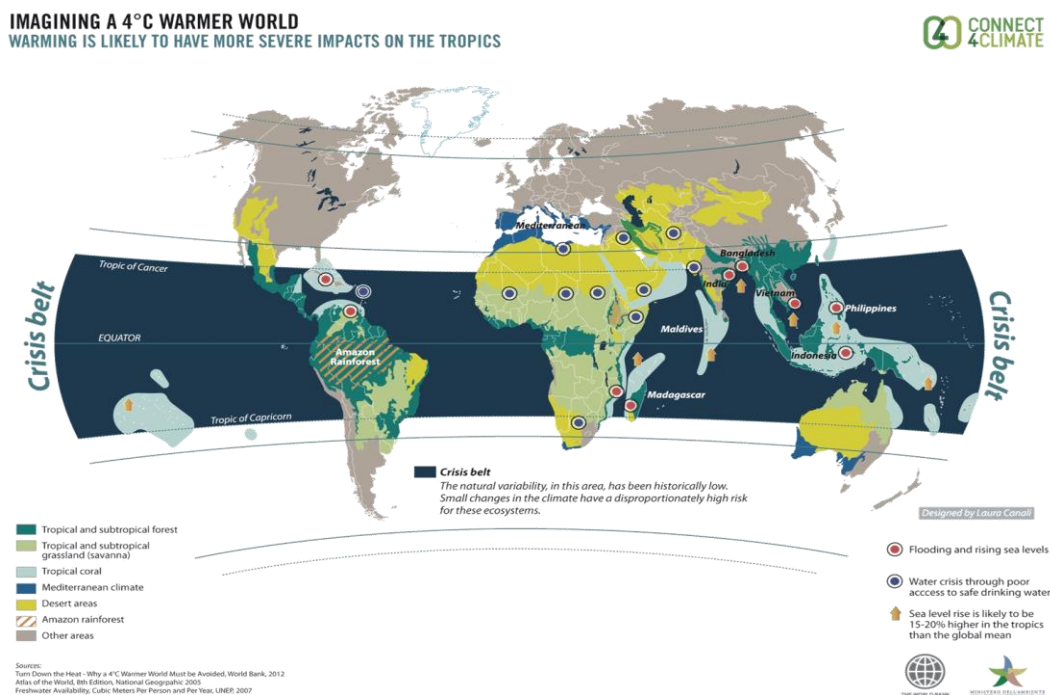


Source: MacroGeo



From an environmental perspective, Chaosland is mostly set in the tropical crisis belt, where the impact of rising temperatures is more marked. Here, even a minimum rise in temperature can cause significant consequences for the environment. According to extreme scenarios envisaged by the World Bank (**Figure 2**), climate change could lead millions of people to abandon their homes.

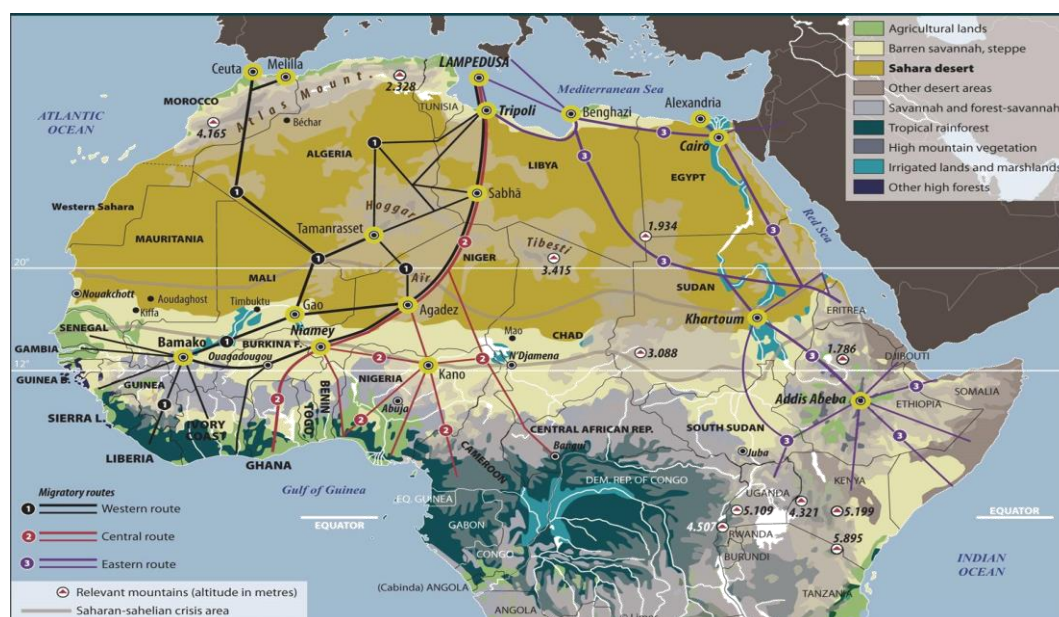
*Figure 2: Chaosland Largely Coincides With the Climatic Crisis Belt*



Source: World Bank and MacroGeo

Added to wars and widespread poverty, climate change (primarily desertification and rising sea levels) is one of the driving structural factors of migration from Africa towards Europe (**Figure 3**).

*Figure 3: Migrants Crossing Deserts in Search of a Way Out*



These factors contribute to the weakening or dis-integration of states surrounding Europe (such as for example Libya, Syria and the many other geopolitical black holes) or even within Europe. The dis-integration of the USSR and Yugoslavia are unfinished processes as shown by the war in Ukraine and permanent tension in the Balkans, where de facto non-existent states such as Bosnia-Herzegovina coexist alongside well-established, albeit not recognised, mafia states such as Russian Transnistria (**Figure 4**).

*Figure 4: A Number Of States Are Becoming Increasingly Fragile*



Source: Fragile State Index 2015, [Fund For Peace](#)

With its demographic decline and an average age of about 40, Europe will thus be increasingly exposed to the dynamics of Chaosland, where the population continues to increase and the average age is about 20. Nowadays, Europeans (including Russians and Ukrainians) are a little more than 700 million, sporting a downward trend, while Africans are already 1.2 billion and will double their numbers by mid-century and be four times as many by 2100. By the end of this century, on a planet with over 11 billion people, only 646 million will be European (**Figure 5**).

*Figure 5: Population developments*

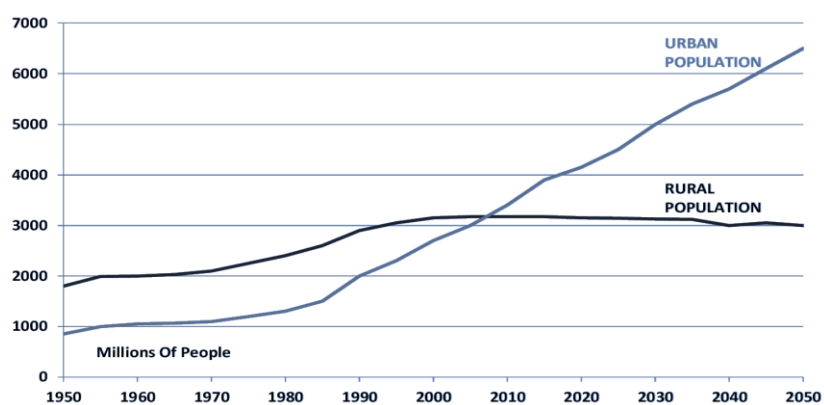
Population (millions)				
Year	2015	2030	2050	2100
<i>Major Area</i>				
World	7,349	8,501	9,725	11,213
Africa	1,186	1,679	2,478	4,387
Asia	4,393	4,923	5,267	4,889
Europe	738	734	707	646
Latin America and Caribbean	634	721	784	721
Northern America	358	396	433	500
Oceania	39	47	57	71

Source: United Nations, World Population Prospects, The 2015 Revision.



Furthermore, in a world in which, for the first time in history, more people live in cities than in rural areas and are destined to concentrate in megalopolises – which in some cases may be more important than the states they will nominally be part of – perhaps only two cities in the current European Union, London and Paris, will be part of this league (**Figure 6**). A continent with few and elderly inhabitants cannot easily coexist with a populated and young world pushing at its gates. This also for psychological reasons: old people do not run risks – nor do they grasp opportunities.

*Figure 6: Urbanization Is Increasing Throughout The World*



Source: United Nations (2015)

On the eastern front, Europe is up against two unstable and intrinsically revisionist powers; Russia and Turkey. These are actually two former empires determined to resume their previous standing. They are both declining, but precisely for that reason more unpredictable. They recently devised a somewhat fragile agreement on the Middle Eastern front as well as on supplying energy to Europe. Europeans are above all divided on how to approach Russia, with an eastern anti-Russian block led by Sweden, Poland and Romania, an ambiguous Germany, while western and southern Europe, including Italy, are far more open to Moscow. These internal dividing lines within NATO and the EU are all the more evident in the Ukrainian war (**Figure 7**).

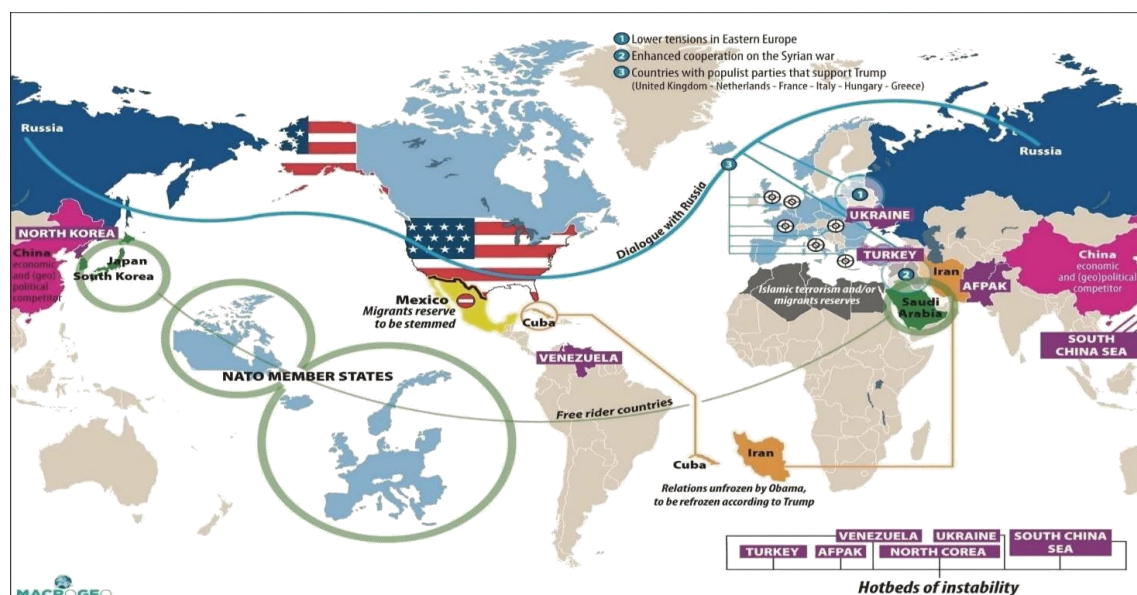
*Figure 7: The New Iron Curtain is Thousands of Kilometres Further To the East*



Source: MacroGeo

As far as Turkey is concerned, with its three million mainly Syrian refugees, it is able to constantly blackmail the European Union. If Trump, who is already sceptical about NATO, were to accentuate the United States' disengagement from our continent, this would reduce to a minimum European influence as far as Moscow and Ankara are concerned (**Figure 8**). We shall see whether a real reset with Russia, hoped for by Trump and Putin, will arise from this disengagement, or whether instead, opposition to such an approach from Congress, and from American military and intelligence agencies, will restrict or maybe reverse the effects of the new president's intentions.

*Figure 8: The World According To Trump*

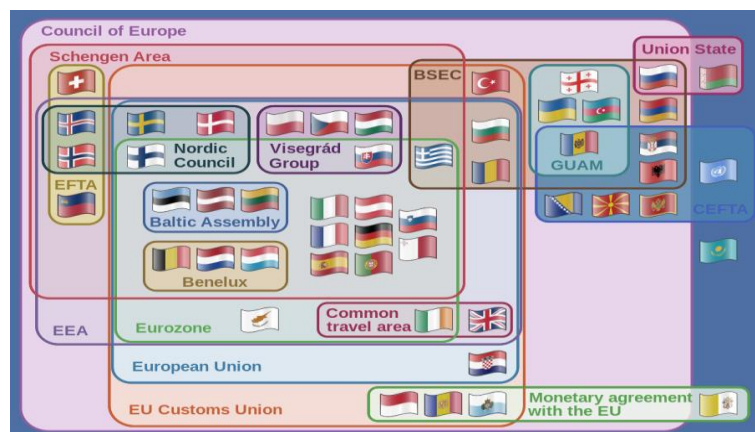


Source: MacroGeo

### 3. IN THIS CONTEXT, EUROPEAN PROBLEMS ARE GETTING WORSE

As far as Europe's internal dynamics are concerned, over the last sixty years European countries have built a number of institutions and "clubs" (**Figure 9**). However, one should never forget that the European integration process after World War II was a quintessentially American project. Its strategic aim was to contain both Soviet expansion and Communist influence in Europe by drawing a firm line between East and West – and committing America to its defence. From 1945 to 1991, the outcome was an American Western Europe.

*Figure 9: Euler Diagram of European Communities*



Source: [Euler Diagram of European Communities](#)

The founding pillars of European Communities, and later those of the EU, were those of NATO. This meant keeping America in, Russia out and Germany down. A sober assessment of current geopolitical trends indicates that the Americans are in a nationalist mood (“America First”), refocusing their strategy towards the Asia-Pacific, to better compete with China (see Figure 8). The Russians are (relatively) back, being very much part of the European balance of power, if only because they are still our most relevant energy suppliers. Germany is by far Europe’s number one player, overshadowing France’s project aimed at using the European Union as a means to contain Germany’s power. So, our continent is structurally affected by a major geopolitical macro-trend that started at the end of the Cold War: its de-Westernization.

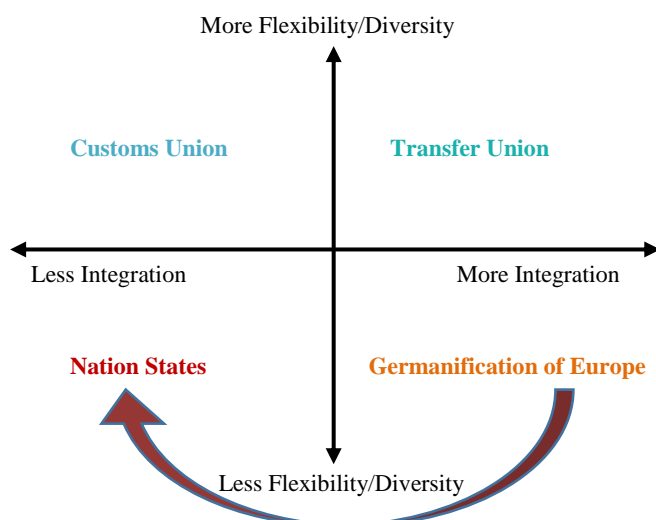
The coming Brexit is another relevant and very symbolic step towards the de-Atlanticization of Europe, which is, of course, not only a geopolitical trend but also – mainly – a cultural one. Western values and institutions that Europe managed to establish after two catastrophic world wars, which both started from the very centre of this continent, are at stake here. As the brilliant historian Mark Mazower wrote almost twenty years ago, “Europeans accept democracy because they no longer believe in politics. [...] The real victor in 1989 was not democracy but capitalism, and Europe as a whole now faces the task which Western Europe has confronted since the 1930s, of establishing a workable relationship between the two”. A long and winding road.

A possible outcome of the de-Westernization of Europe could be its “Germanification.” That is precisely what Western Europe was supposed to prevent. In fact, one has only to remember the frenzied reactions of France, Britain and Italy (Mitterrand, Thatcher and Andreotti) immediately after the fall of the Berlin Wall, thinking the unthinkable – namely an alliance with the Soviet Union for the sake of avoiding German reunification. There are still many people in continental Europe who fear some kind of German dominance, well beyond its economic dimension. Even though it is most unlikely we will ever experience a German Europe.

#### **4. A “GERMANIFICATION OF EUROPE” IS NOT A LIKELY OUTCOME**

In spite of what seems to be the ongoing trend, we argue that a Germanification of Europe would not result in a stable equilibrium, and therefore is not a possible ultimate outcome. In order to explain this point, one needs to use a diagram (**Figure 10**), which introduces another dimension to the debate on European integration. Traditionally, we tend to look at the process of European development only across the horizontal axis of “more integration” or “less integration.” Even the discussion around so-called “enhanced co-operations” or a “two-speed” Europe, takes place along these lines. We believe, however, that this characterization is seriously misleading, since it assumes that all EU countries will eventually reach the same end-point of “full integration,” while in reality (as Brexit has shown), the end point might be different for each country.



**Figure 10: Further European Integration Can Only Occur With Increased Flexibility<sup>1</sup>**

Source: MacroGeo

There is, therefore, the need to introduce another dimension, that of “flexibility” or “diversity”, thereby identifying four quadrants. Should the EU become more integrated, but also more flexible/diverse (see below what this involves in our opinion), it would evolve into a Transfer Union. Conversely, a less integrated and more rigid EU would favour a return of nation states. The former can be considered a “positive” scenario in which the financial, economic and political capital invested to create European institutions as we know them would not be lost, and might even increase. We consider the latter a “negative” scenario since that huge amount of capital would be wasted. The diagrams on the high/left-low/right diagonal are those associated with “muddling through”; less integration but more flexibility would bring the EU back to a sort of “Customs Union” (something the UK was trying to achieve, before Brexit) while more integration and less flexibility would lead exactly to what is currently known as the “Germanification of Europe.”

In this scenario, Germany would require all countries to strictly follow EU/EZ rules (which clearly do not suit all countries) AND – at the same time – imitate Germany’s recent policies; pursue budget and current account surpluses, adopt structural reforms (for the pension system, the job market, etc.), clearly inspired by an unappetising combination of neo-liberism and Ordo-liberalism. However, that scenario, which appears to be a stable “muddle through” balance to gradually achieve more integration, would prove to be an unstable path leading to a return of nation states, given the political backlash that German-imposed policies cause (epitomised by the rise of populist parties).

This because Germany is essentially not a hegemonic power, one that would be able to unite and lead Europe, by establishing a well-functioning Transfer Union, for the following reasons:

- 1) *A self-centred economic structure.* You cannot “have your cake and eat it.” In the German case, one cannot build a geopolitical sphere of influence around a core country that structurally absorbs liquidity, exports deflation and thus weakens its favourite export markets – its European partners. By insisting on running a persistent surplus with everybody else, Germany is stimulating conflicts in the Eurozone and

<sup>1</sup> This diagram was presented in a July 2016 [Limes article](#), based on a previous article issued in [www.roubini.com](http://www.roubini.com) in June 2015.

exacerbating Germanophobia, especially, but not only, in southern European public opinion. This is not the way leading countries usually achieve hegemony. On the other hand, one should consider that the central tenet of anti-Keynesian German economic policies is so-called Ordo-liberalism. This is more an ideology based on strictly ethical assumptions, than a policy. Fear of an emerging Transfer Union, that is debt mutualisation in the Eurozone, is based on a rock-solid cultural concept that is very much part of the German national identity.

- 2) *An inward-looking, "post-heroic" approach.* Consequently, its tendency to reject the use of force, bearing in mind the risks of strategic overstretch, may be (wrongly) interpreted as a complete rejection of power. The fact is that Germany is a trading power and perceives itself as such. Therefore, in Germany's eyes peace is not an option, it is a vital necessity. So far there is no German grand strategy. At the same time, growing economic power inevitably brings greater geopolitical responsibilities (and temptations). This is why Berlin is set to strengthen its military power by investing up to 35 billion euros in the modernization of its army, navy and air force, as well as its cyberwar capabilities. The perceived American disengagement from Europe raises some doubt about the reliability of the US/NATO nuclear umbrella. This has sparked a not-so-secret debate in the German establishment and among the European diplomatic and military élite concerning the timeliness of a European atomic bomb, which in practical terms would mean a German nuclear arsenal, more or less like France's and Britain's.
- 3) *The lasting burden of history*, meaning a lingering lack of acceptance of open German hegemony by the European partners. The Washington Consensus may perhaps be over, but it will not be superseded in Europe by a non-existent Berlin Consensus. In four words: Germany is not America.

Let us now analyse in greater detail what makes Germany's economic paradigm structurally unfit to become the centre of a well-functioning *Transfer Union*.

## **5. TRANSFER UNION: A MIRAGE FOR MOST EUROPEAN COUNTRIES, A NIGHTMARE FOR GERMANY**

One should not consider the European integration process as a historical *unicum*. Many countries today, such as Germany, Italy or China, are the result of *unification* processes, and some of them still recall this in their names (e.g. United States and United Kingdom). Making those "unions" work does not require magic, but rather more simply a well-functioning transfer union. In unification processes, a poorer area joins a richer area previously separated by a barrier (fiscal, administrative, linguistic, etc.). When the barrier/border falls as a result of the unification process, what happens naturally is that resources (in particular, capital and workforce) move from the poorer area to the richer area. But if a well-functioning transfer union is established, those resources are returned to where they came from, mostly via fiscal transfers, as has happened consistently in Italy, the UK, the US, etc.

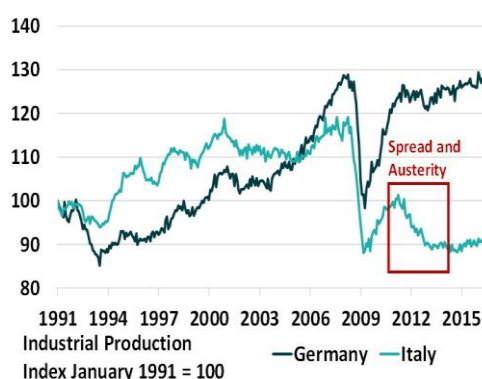
The recent German re-unification process followed exactly this same script. West and East Germany (previously separated by a fictitious border) were reunited; the West imposed on the East a 1:1 exchange rate between their respective currencies, which was unbearable for the East, whose economy started to collapse as people (and capital) moved to the West. West Germany spent a fortune (with fiscal transfer) on re-building East Germany and stopping the exodus. Those transfers are still ongoing, almost thirty years after the fall of the Berlin Wall.

So, is the Eurozone (and – on a larger scale – EU) following in the same footsteps? Of course it is.

Since the euro inception, Germany (as well as the UK, at EU level) has attracted millions of workers and capital from all over Europe (**Figure 11**). Industrial production has soared in Germany, while collapsing in competing countries (such as Italy), which have experienced progressive de-industrialization process. This has ultimately led to the ongoing political backlash and the rise of right and left-wing populist parties.

*Figure 11: Germany has Attracted Resources from all over Europe since Euro Inception*

Germany		
Citizens of (thousands)		%
Turkey	1372	18.2
Poland	640	8.5
Italy	537	7.1
Romania	345	4.6
Greece	304	4
Other	4339	57.6

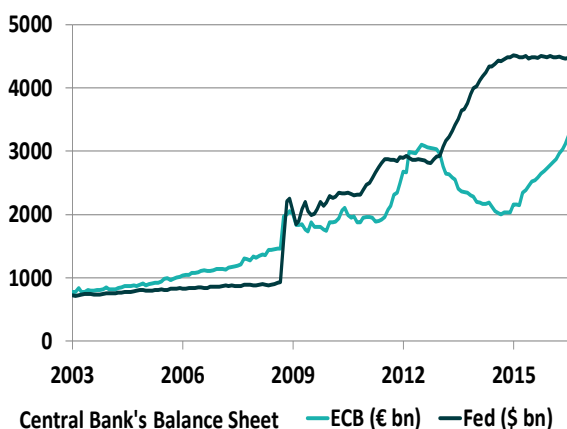
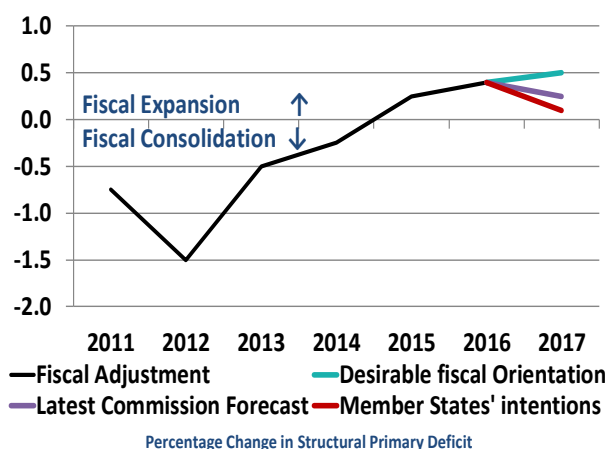


Source: [Eurostat](#) and Thomson Datastream. The left table shows the main countries of citizenship of the foreign/foreign-born population, as of January 1<sup>st</sup>, 2015, in absolute numbers and as a percentage of the total foreign/foreign-born population.

These flows have not been compensated by equally powerful fiscal transfers, apart from some EU structural/social cohesion funds, and some limited form of risk-sharing at a EZ level introduced via the Target 2 balances, ECB's OMT, QE and a series of ad hoc funds such as the EFSM, EFSF and eventually the ESM perceived by some to be the kernel of a future EU/EZ Treasury.

If that was not a great enough challenge for the creation of fiscal union, the policy mix chosen to fight the Great Recession following the Global Financial Crisis of 2008-2009, was – at the very least – sub-optimal, i.e. skewed towards monetary accommodation as opposed to fiscal expansion to support aggregate demand (**Figure 12**).

*Figure 12: Germany Has Imposed the Wrong Policy Mix on Europe*

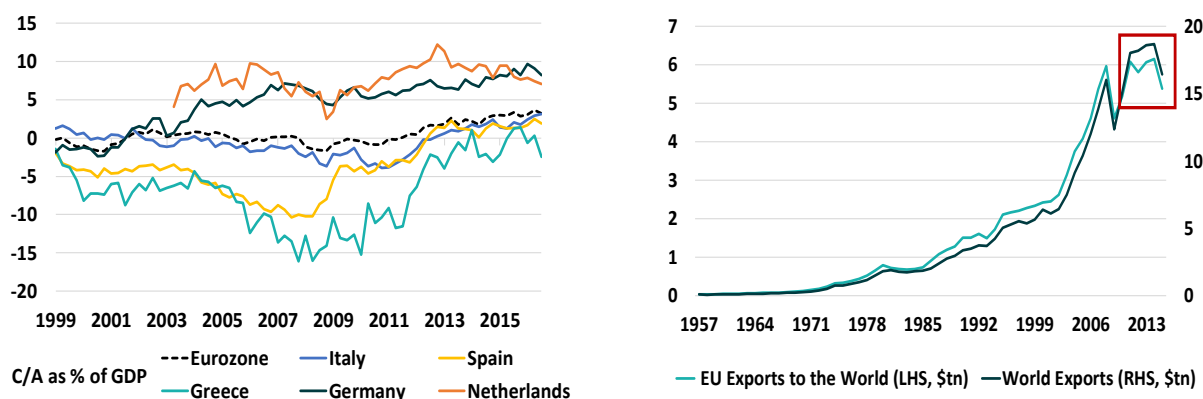


Source: European Commission, ECB, Fed



The result of those austerity-based policy choices is that all EZ countries have had to move towards a current account surplus, while Germany also holds [a current account surplus vis à vis them](#), effectively forcing those countries to achieve positive net exports to extra-European countries. In itself, this is already the starkest negation of what a hegemonic country is supposed to do, having a large current account deficit towards the countries it intends to “lead,” in order to make them dependent on its domestic demand (at global level, this is what the US does, for example). This surplus towards the “rest of the world” leaves EZ countries extremely vulnerable in a period in which globalisation is in retreat, protectionism is increasing and global trade is falling (**Figure 13**).

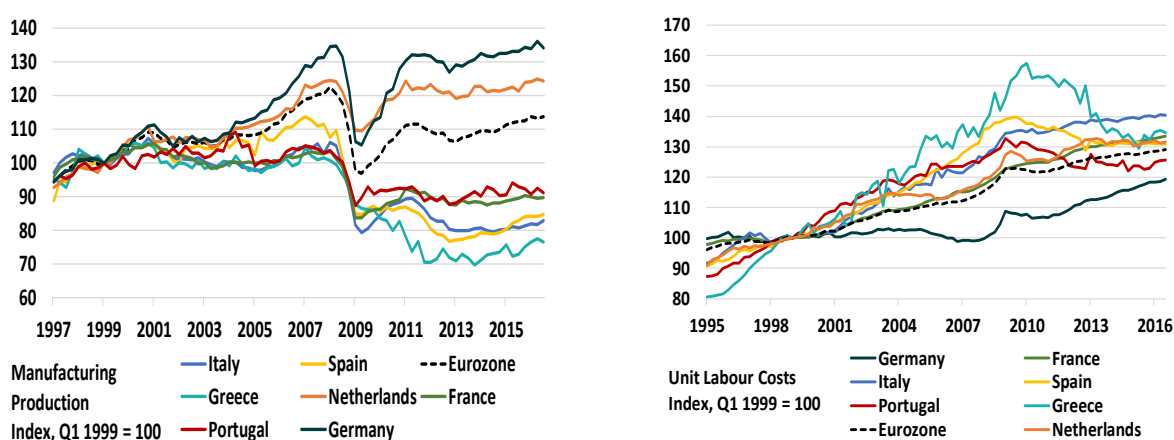
*Figure 13: Having a Current Account Surplus Versus Extra-European Countries Makes EZ Countries Vulnerable*



Source: Thomson Reuters Datastream

But even if globalisation were to remain a powerful engine for growth, economic activity would still remain unevenly distributed across the Eurozone. The trajectory of manufacturing production in key EZ countries is diverging massively, even as austerity-driven policies have managed to reduce somewhat the massive divergence existing in unit labour costs (**Figure 14**). Only a massive and well-coordinated effort at EZ/EU level would be able to reduce the differences existing in what is clearly not an “optimal currency area.” The Juncker Plan for European investment is a good start, but far inferior to what would be needed to implement the functions of a transfer union.

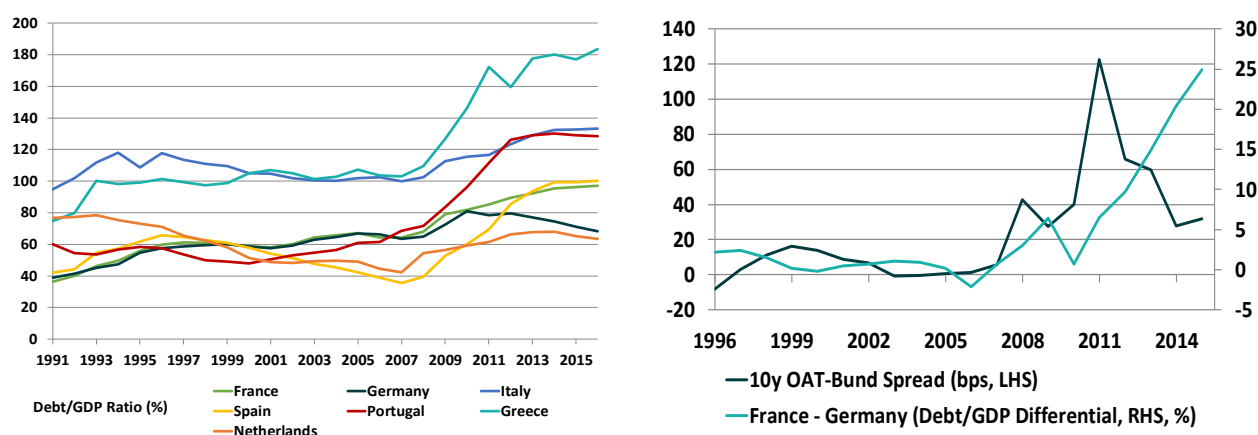
*Figure 14: Manufacturing Production's Trajectories Are Diverging, Even If Unit Labour Costs Have Converged*



Source: Thomson Reuters Datastream

These divergences eventually appear in the typical summary indicator of a country's economic sustainability: debt/GDP ratio dynamics (which are instead a poor indicator of debt sustainability, compared to others such as interest/GDP). In the Eurozone, only Germany has seen debt/GDP ratio fall recently (thanks to balanced fiscal budgets and growing GDP), while all other major countries have seen that crucial ratio increase. In particular, France's debt dynamic is now clearly diverging from Germany's, which explains the rise in the 10y OAT-bund spread as much as the rise of Marine Le Pen in polls (which is, in any case, the result of the same political backlash against German-induced austerity policies (**Figure 15**).

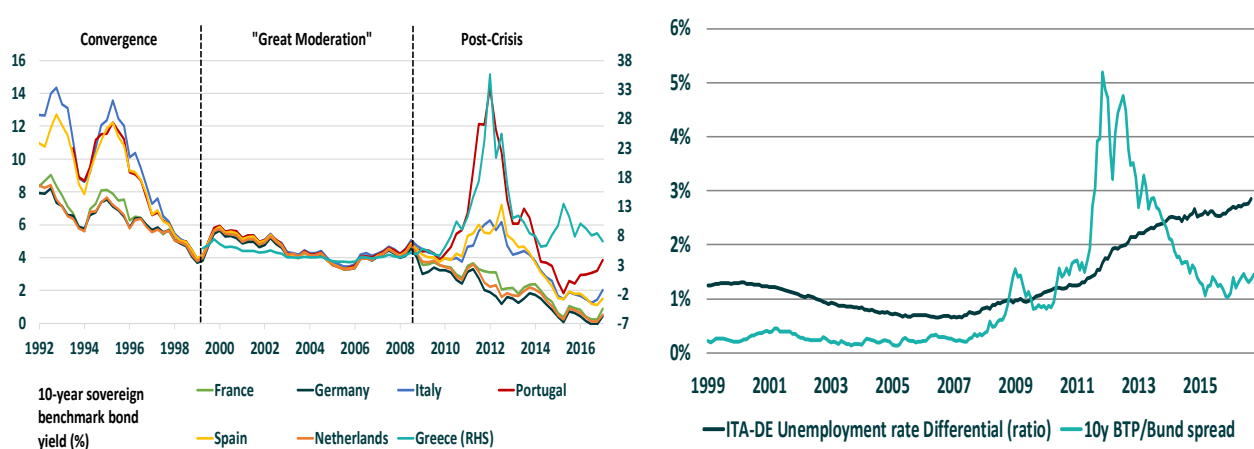
*Figure 15: Public Debt Dynamics Are Diverging, Including Inside the Eurozone's "Core"*



Source: Thomson Reuters Datastream

Hence, even if French OATs cannot be considered perfect substitutes for German Bunds, it is no surprise that intra-EMU spreads are rising and have a hard time converging toward zero, as they did during the years of "great moderation." (**Figure 16, left**). Nor are they supposed to. If the unemployment rate differential between Italy and Germany (as the proxy of medium-term growth prospects) is large, there is no fundamental reason why the spread between BTP and bunds yields should be zero. A figure of around 250 bps, as estimated by Banca d'Italia at the time of the "spread crisis" in November 2011, seems much more realistic (**Figure 16, right**). Only decisive action by the ECB and its QE purchases could induce and justify a lower yield differential.

*Figure 16: Sovereign Yields Are Diverging. And Rightly So ...*



Source: Thomson Reuters Datastream

On the basis of the aforementioned considerations, it is clear that EZ divergence (and *a-fortiori* at EU level) is increasing and will be hard to reduce in coming years, unless a number of decisive steps towards the adoption of a transfer union are made. In the next section, we discuss how likely this is.

## 6. CAN EUROPE SURVIVE MUCH LONGER IN ITS CURRENT FORM? HARD TO BELIEVE

As discussed above, the recipe for a united Europe is “America in, Russia out and Germany down.” Instead, what we are currently experiencing, is “America on its way out, Russia on its way in, and Germany up”, all of which seems to suggest Europe will be unlikely to integrate further in the next few years. The algebraic sum of the two major geopolitical trends – de-Westernization and non-Germanization of Europe – at the very best may bring about a balance of power in Europe, at worst an almost anarchic continent. One can safely say that history has returned to Europe, which is exactly what the EU was meant to avoid. As former German Foreign Minister Joschka Fischer said on May 12<sup>th</sup>, 2000, in his bold but unfortunate speech at Humboldt University in Berlin on the ultimate objective of European integration, “The core of the concept of Europe after 1945 was, and still is, a rejection of the European balance-of-power principle and the hegemonic ambitions of individual states that had emerged following the Peace of Westphalia in 1648.” Welcome back to a quite unbalanced balance-of-power in Europe.

So, the question is: can Europe survive for much longer in its current form? The answer comes under four headings: theory, practice, surprises, and conclusions.

### 1. *In theory, Yes!*

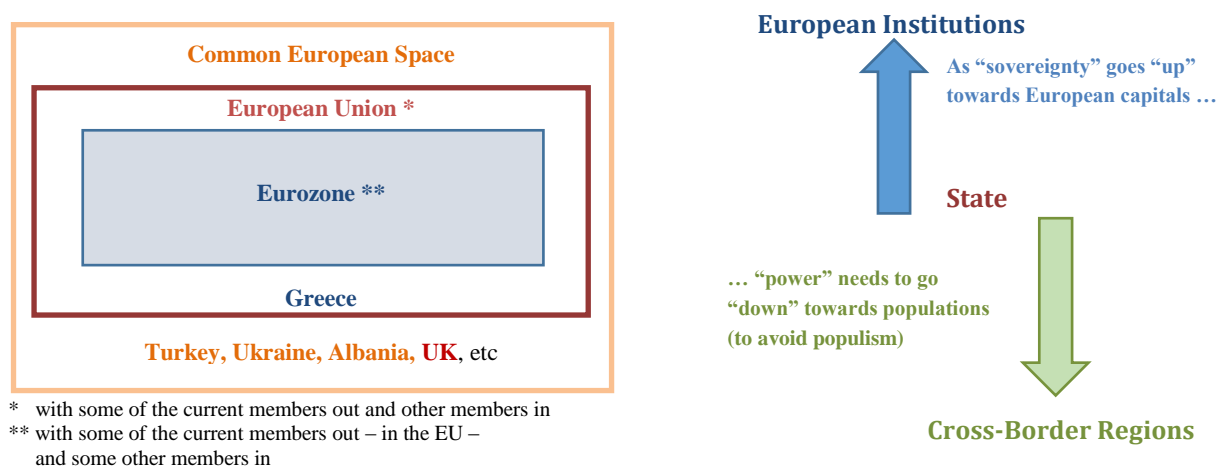
There are two levels of intervention needed in order to make further European integration possible.

At a *supra-national* level, European countries should organise themselves in “concentric circles” (**Figure 17**). The core of this system of circles would be constituted by a “reformed” Eurozone, at that point with complete fiscal union. Some current EZ members, such as Greece, should be allowed to leave, while remaining part of the EU (something that is not possible, at the moment). Other EU/European countries might instead join the EZ (e.g. Romania, or Serbia).

A wider circle would be the European Union, which comprises the inner EZ circle. Part of this circle would consist of those countries who want to remain part of the EU without *ever* adopting the EUR as their currency, such as Poland, Sweden, or Denmark. This would mark a radical change compared to the current situation, in which all countries (apart from the UK and Denmark) are expected to *eventually* adopt the euro, at different moments in time (i.e. at a different speed). Some of the current EU members would leave (e.g. the UK), while other European countries might want to join (e.g. Norway).

The outer circle would constitute the Common European Space which is where countries willing to have some form of association with the EU, but are unable or unwilling to join the EU, belong (e.g. Ukraine, Turkey, Albania, etc.). The recent migration crisis has shown how important it is to engage on a structural/systematic basis with those countries, even if they do not formally belong to the EU.



**Figure 17: What Europe Needs to Survive – Concentric Circles and Cross-Border Regions**

Source: MacroGeo

At a *national level*, as sovereignty moves “up” towards European capitals (Brussels, Frankfurt, etc.), power would need to move “down”, from the state level to the regional level, so that citizens would not feel left out and left behind. New cross-border regions would need to be formed as new centres for the political decision-making process, to better address the needs of the population residing in those regions, irrespective of the state they formally belong to. In fact, regions such as Piedmont in Italy and Provence/Alpes/Côte d'Azur in France have much more in common than Piedmont does with Calabria, or the Côte d'Azur with Centre Val de la Loire, for example. Clearly, the role of the nation state as the centre of the political decision-making process would be severely reduced, in this context.

To connect these two levels, a well-functioning Transfer Union would need to be created, to compensate for the fact that, in unification processes (even among cross-border regions), the “core” always gains at the expense of the “periphery”; structural development and cohesion funds would be key in such an organisation. Agreements on pan-European migration policies would be equally important, to ensure that Europe could deal with the phenomenon that is re-shaping the continent. Finally, the EU should strengthen its external borders by creating a European coast-guard as well as a European army. The strengthening of the external circle is instrumental to the internal re-shaping discussed above.

## 2. In Practice, It would be very difficult!

What we have described above is a multi-decade long project requiring plenty of economic, financial and political capital to be invested by European countries, and at the moment we cannot see any country willing to invest more on greater European integration. Even this idea of establishing a degree of enhanced, inter-governmental co-operation between *some* European countries (without formally involving the EU), on themes such as defence, immigration and security seems more like a short-term solution for a far larger problem.

Additionally, the current “champion of Europe,” Angela Merkel, leads a country that imposed the aforementioned austerity policies that have caused the ongoing political backlash and the rise of populist parties across Europe, and it is fair to assume (in the light of the recent increases in its military expenditure), that Germany is at the very least re-evaluating the “relative convenience” of keeping the EU together in its current form, including the need for fiscal transfers towards the periphery. All this, in light of ECB President Draghi’s mandate

ending in November 2019, when it is fair to assume that monetary policy will not be as accommodating as it has been under his watch, acting as a substitute for much-needed fiscal support to aggregate demand.

Finally, Europe does not live in a vacuum. It is instead very much at the centre of global trends that tend to have an impact on it. First, in a world characterised by increased protectionism, Europe will struggle, given its structural trade surplus with the rest of the world as discussed above. Secondly, even if the EU were to “survive” this 2016-17 electoral cycle (i.e. with mainstream leaders emerging from elections in Germany, France and possibly Italy), we expect that more of the same “mistakes” will likely be made by those leaders (including not ending austerity), in a period in which, (a) Brexit will most certainly occur, (b) Trump will be in power, (c) Russia will increase its pressure on Europe, and (d) the MENA will continue to be in flames, with implications for migration.

### *3. Positive Surprises: Possible, but How Likely?*

In this seemingly hopeless scenario, something may certainly work in favour of Europe. For example, after the 2016 -17 electoral cycles, and the possible emergence of mainstream leaders, more political capital could be invested in the European integration process, with celebrations of the 60<sup>th</sup> Anniversary of the Treaty of Rome (on March 25<sup>th</sup>, 2017) providing an occasion to re-launch the project. Perhaps this idea suggested by Merkel (before backtracking) of a “two-speed” Europe might be the first step towards the creation of the concentric circles discussed above.

A new generation of pro-European leaders (e.g. Macron in France and Schulz in Germany) may emerge from this political cycle and be willing to invest in more European integration. Perhaps, as a result of this, a better policy mix would be adopted over the next five years; monetary policy could be less accommodative, while fiscal policy could become much looser, perhaps as a result of fiscal transfers (and therefore the EC’s policy actions suggested in its recent paper “Towards a Positive Fiscal Stance For the Euro Area” would be implemented). Finally, the European Commission’s White Paper to be presented in March (an evolution of the 2015 Five Presidents’ Report) might be enthusiastically signed by all EU member states. All these could be positive surprises for the future of the European integration process; however, in our opinion, they are quite unlikely, and only a small fraction will eventually become reality.

### *4. Conclusions: The EU Might Soon be in its Final Years of Existence*

As a result of the considerations above, we conclude that, by the 2021-22 electoral cycle, the EU might be entering the last five years of its “real” existence. We are less interested in discussing whether a formal simulacrum of the EU will still be in place, as of course it will take a number of years to dismantle the legal structures created around Brussels. However, when the political will to proceed further with the integration process will be over, so will the project. However, this would only be the end of a chapter in European history and the beginning of a new one, that of re-grouping, which has actually already begun.

## 7. RE-GROUPING AFTER DIS-INTEGRATION?

Even if the European integration process were to come to a halt, we are unlikely to experience an absolute return to the past of nation states. As Mark Twain put it, history never repeats itself but it rhymes. At best (or worst, depending on your point of view) we will see the emergence of a German geo-economic core with some geopolitical features around the so-called Neuro – that is a Euro of the North, led by Germany and embraced by some states belonging to its industrial value chain and sharing its monetary and fiscal culture (e.g. Holland, Poland, the Czech Republic, Slovakia, and some Scandinavian countries, plus perhaps northern Italy – if Italy were to fall apart).

In fact, a reconfiguration of the distribution of power along new/old lines is already ongoing (see **Key Picture**), due to a degree of commonality among different players at a national, regional or even local level (the “German core”), or to a shared perception of a common threat (the “anti-Russian core”, which looks with disgust at any sign of German-Russian rapprochement, the West’s historical geopolitical nightmare). France will need to decide whether to remain with Germany (more likely under mainstream leadership, largely for geopolitical reasons) or going it alone (more likely in case of a Le Pen victory). Spain will try to remain part of the German-led core (as it has done since the EUR inception) for as long as possible. Italy will try to form (as often in the past, albeit unsuccessfully) an alliance of the South with France and Spain, but if these two countries were unavailable, it could only regroup with Greece and Portugal – leading to the decision of standing alone.

Finally, the UK will try to use as leverage its supposed “special relationships” with the U.S., China, the Middle East, the German-led core as well as the Commonwealth. And, if that option were to fail, it could try to become a sort of massive off-shore financial centre; a choice that would lead to the re-configuration of the country (a large democracy, made of four nations, kept together by the fiscal transfers of the South East).

Will this re-grouping help European countries come to terms with the structural trends (desertification, migrations, climate change, geopolitical shifts, etc.) discussed above? We very much doubt it, which is why we expect a bumpy ride for a geopolitical Non-Europe. As hard as it might be to admit, Europe may not belong to just one club, but history and geography bind Europeans together and compel them to face a common destiny.