

# Europe's Triple Crisis and the Uneven Role of Institutions: the Euro, Refugees and Brexit\*

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## Abstract

Europe is currently embroiled in three ongoing and interacting crises concerning the eurozone, refugees and Brexit. After briefly describing each crisis, I turn to the ways in which they intersect and the role of institutions in solving the crises. There are two central themes in the paper. The first is that the three crises intersect and feed on one another. The second is that, while institutions can often help, they are not panaceas. Existing scholarship on the EU often implies that the EU operates far from its institutional frontier and that substantial improvements in welfare are just around the corner if only we 'get our institutions right'. But institutional fixes do not exist for all problems. I argue that there is a large space for institutional improvement in the eurozone crisis, less regarding refugees, and still less for Brexit.

**Keywords:** eurozone crisis; refugee crisis; Brexit

## Introduction

The European Union (EU) is currently embroiled in three ongoing and interacting crises concerning the eurozone, refugees and Brexit. There are other crises facing Europe today but I choose these three because they are instructive for our purposes. The arrangement of preferences among the key actors in these crises, as well as the differential opportunities for improvement through institutional changes, provide us with opportunities for learning about the prospects and limits of institutions. There are two central themes in the paper. The first is that the three crises intersect and feed on one another. Each crisis is best understood as part of a larger complex of challenges to the EU rather than in isolation. The second is that, while institutions can often help, they are not panaceas. When preferences of Member States diverge, institutions may prove to be of little help. Existing scholarship on the EU often implies that the EU operates far from its institutional frontier and that substantial improvements in welfare are just around the corner if only we 'get our institutions right'. But institutional fixes do not exist for all problems. The basic political structure of the Economic and Monetary Union (EMU) was sub-optimal (Heipertz and Verdun, 2010; Sims, 2012). Institutional improvements provided the prospect of collective gains. Institutional improvements are less available for refugees and Brexit though they are far from absent. In what follows, I will first describe the three crises, then move to the intersections among them, followed by what institutions can and cannot do well, given the distribution of preferences among the Member States.

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## I. The Eurozone Crisis

The eurozone crisis had all the characteristic features of a financial crisis (Kindleberger and Aliber, 2005): cheap undifferentiated credit priced almost identically for all countries, excessive lending and borrowing, and a psychological mania in that money appeared 'free'. Consumption was very high especially in the south of Europe (Greece, Italy, Spain and Portugal) and Ireland. Kindleberger and Aliber would have seen this pattern as a bubble and of course bubbles always burst. A small event, one out of all proportion to the underlying economic fundamentals, can burst bubbles. There is no plateau, little warning. Once a bubble bursts, confidence plummets and credit dries up very quickly (Merler and Pisani-Ferry, 2012).

The natural question to ask is 'why?' The most popular explanation, not confined to the tabloids, is a cultural one. There are two Europes. First there is northern Europe which is fiscally responsible, works hard, invests wisely and lives within its means. Northern Europe includes Germany, Austria, the Netherlands, and Finland. Then there is southern Europe (Greece, Italy, Portugal and Spain) which is fiscally lax, doesn't work hard, engages in periodic consumption binges, and does not save, invest and grow. It's a story of virtue vs. indulgence, saints and sinners, Calvinists and Catholics (Matthijs and McNamara, 2015).

This version of the financial crisis finds expression in ordo-liberalism, an economic doctrine in which ideas shape and rationalize interests at the same time. The eurozone crisis occurred because of the clash of ideas between the north (largely Germany) and the south. Economics is not only about interest rates, money supply, credit and debts, and trade. It is of course about these 'things' but also about the ways they are conceptualized. German leaders, particularly economic leaders, are guided by the economic philosophy of ordo-liberalism. There may be few academic economists in Germany who identify as ordo-liberals, but in the making of economic policy, this viewpoint is important (Brunnermeier *et al.*, 2016; Matthijs and McNamara, 2015; Jacoby, 2017).

As described by Brunnermeier *et al.*, (2016), there is a clash of economic philosophies between the north and the south of the eurozone. The northern vision is about rules, rigour, and consistency while the southern view (of which France is the champion) is more about the need for flexibility, adaptability and innovation. Economic policy-makers attempt to capture these differences in the simple rules vs. discretion dichotomy. It is Walter Eucken and the Freiburg School against Keynes.

Conceptual frameworks shape policy preferences. In terms of policy-relevant beliefs, ordo-liberals worry about moral hazard while others worry about collapse of demand and political fragmentation. Why, for example, does Germany not pursue the goal of helping the periphery of Europe to recover, as a way of assuring that German loans are repaid, rather than imposing austerity reforms and in the process shrinking their economies? Pure self-interest does not adjudicate between the two interpretations. If repayment were the only goal, it is plausible that aiding the periphery would be the appropriate strategy. After all, healthy economies are more likely to be productive and capable of servicing their debts.

Policy implications flow from different visions of the eurozone. The first concerns economic governance. The Germans favour a stability culture to control inflation. Growth is best dealt with by supply-side measures. For France and the South of Europe,

'gouvernance économique' implies a certain way of thinking about the role of government intervention in the economy, stimulating demand when the economy is in recession and slowing down the economy when it is overheated (Brunnermeier *et al.*, 2016, p. 3). This implies a strong counter-cyclical role for the fiscal authorities, a role accepted in German domestic politics but rejected at the European level.

A second policy implication involves liquidity and solvency. The southern discretionary approach tends to see many economic problems as 'temporary liquidity problems that can be easily solved by an injection of new lending' (Brunnermeier *et al.*, 2016, p. 4). If the problem is liquidity, loans can be paid back. However, if there is lack of trust that central institutions will correct temporary deficits, liquidity problems can easily become solvency problems. DeGrauwe (2011) has discussed this situation as one where multiple equilibria are possible and where outcomes (good and bad) depend on institutional factors.

Finally, the policy responses on the German side are austerity, fiscal tightening and domestic reform. Reform of the tax system in Greece, cutbacks in government employees, and spending controls were put in place. Among debtors, there was support for bailouts and debt write-downs. Both approaches were presented as 'saving EMU', the Germans through fiscal discipline and countering moral hazard and the southern view by assuring that liquidity problems do not become insolvency problems.

Political institutions to ensure stability in the eurozone, particularly in the event of asymmetric shocks, were weak. Out of numerous gaps, the lack of a lender of last resort was most crucial. Design of the eurozone '... seemed to require elimination of national lender of last resort functions for central banks, without creating as strong a replacement at the European level' (Sims, 2012, p. 1). This gap created incentives to alter the institutional framework but provided no overall direction for institutional change, such as whether the central bank should be more or less autonomous or whether fiscal transfers should be part of the eurozone's governance system.

## II. Refugee Crisis

The European refugee crisis erupted in the summer of 2015 with hundreds of thousands of people from the Middle East and Africa attempting to cross the Mediterranean. Pressures for the dramatic movement of refugees were building with the civil war in Syria and the Arab Spring dating from December 2010. State failure and civil unrest in sub-Saharan Africa and central Asia also contributed to the refugee crisis (Hollifield, 2016).

The refugee crisis has opened up new cleavages among countries in the EU. One such cleavage is between frontline southern states (Italy and Greece) vs. rearguard states in northern Europe (France, Austria, Finland). A bigger and more politically charged divide has opened up between Member States in the north and west of Europe, and some refugee-rejecting states from eastern Europe chief of which are Hungary, the Czech Republic, Poland and Slovakia. Victor Orban of Hungary calls Juncker's refugee plan 'mad' and Angela Merkel's acceptance of refugees 'moral imperialism'. Reactions of governments in Poland and Hungary to acceptance of refugees have been strongly negative. In September of 2015, EU Member States agreed to accept 160,000 refugees, but as of May 2017 fewer than 30,000 had been accepted and resettled. The intervening event was the election of the Law and Justice Party in Poland in October 2015. Before that, Poland had agreed to accept 10,000 refugees but after the elections, this decision was

reversed. This prompted the EU to open sanction procedures – infringement procedures – against Hungary, Poland and the Czech Republic on 13 June 2017. The outcomes of these legal actions are not yet known but the divisions between central and eastern Europe and many other older members of the EU, are now a reality.

One of the ironies of the triple crisis concerns the alliance of Germany and Greece regarding refugees. As representatives of their respective northern and southern coalitions regarding the financial crisis, they are antagonists locked in a bitter and prolonged creditor-debtor struggle. The refugee crisis brings Germany and Greece together with a new configuration of interests. As Offe puts it (2015, p. 140), Germany and Greece are now ‘playing major roles in the refugee crisis, with the important difference being that they antagonized each other in the debt crisis while they now are both severely and commonly affected victims of their fellow Europeans’ refusal to share the burdens of the wave of refugee migration for which the EU was entirely unprepared’ (2015, p. 140). Possibilities for a bargain focus on Germany and Greece with Germany holding the card of debt forgiveness and Greece capable of offering even greater acceptance of refugees and control of its northern borders.

### III. Brexit

On 23 June 2016 a referendum was held in the United Kingdom in which approximately 52 per cent of the voters cast their ballots for leaving the EU. The vote to leave was in many ways a surprise, though not a big one. The pollsters got it wrong, but not by much (2–3 per cent). While the polls were off in their predictions, the broad trends were captured by social media and patterns of tweeting. Of course, tweets are not held to the same standards as scientific polls. Tweets are seldom randomly sampled, their ‘predictions’ are not stated with confidence intervals, and we do not have good models of ‘eligible tweeters’ as with ‘eligible voters’. We do not know if there is selection bias as to who tweets and who does not. The relevance of social media to macro political events such as referenda and elections is not well known and study of these relationships is in its infancy (Howard and Kollanyi, 2016; Llewellyn and Cram, 2016). Nevertheless, the patterns of tweeting dramatically increased in the summer of 2015, just as the refugees crossing the Mediterranean increased (Porcaro and Mueller, 2016, Figure 1). It was impossible not to notice the correlation between refugee flows and pro-Brexit sentiment.

Predictions about the results of Brexit range from economic catastrophe to little effect to actual improvement in performance of the UK economy. In addition, there were several non-economic reasons for Brexit, including restoring sovereignty and regaining control of one’s borders. Many in the UK saw themselves as liberal with regard to trade in goods and services and capital flows, but much more interventionist on immigration. The desire to control borders holds for immigration from outside the EU as well as eastern Europe. As Matthijs points out, between 2004 and 2014 about 2 million people moved from Poland to Germany and the UK (2017, p. 93). These movements no doubt sensitized UK citizens to the subsequent waves of migrants from the Middle East and North Africa.

The stakes for Brexit, both for the UK and the EU, are high but asymmetric. British trade with the EU is over 46 per cent on the export side while EU exports to the UK are around 8 per cent. Gravity models of trade tell us that the UK’s trade partners are not likely to dramatically shift, since trade patterns are dominated by geographic location and trade

volumes of importing and exporting countries. It is not likely that there will be a large re-direction of trade toward New Zealand, Australia or Canada. Commonwealth effects are likely to be already 'baked into' existing trade levels. When trade negotiations enter the hard bargaining stage, asymmetric interdependence implies that bargaining leverage should lie with the EU.

#### IV. Intersections

Do the three crises interrelate or do they move on parallel tracks? The causal sources of the crises appear separate at first: a credit-induced boom and structural imbalances in trade and capital flows for the financial crisis, wars and instability in the Middle East and Africa for the surge in refugees, and a mixture of economic, demographic and identity factors for Brexit. Even if the sources are different, they come together in distinct historical conjunctures. I see at least three intersections.

The first intersection is between the financial crisis and the refugee crisis. The financial crisis worsened the refugee situation and vice-versa. Refugees arrived in 2015 and 2016 when growth was sluggish and unemployment was high on Europe's periphery. While recovery had started, the GDP of the eurozone in the final quarter of 2015 was still below its pre-crisis peak in 2008 (*Economist*, 2016). Italy and Greece, the two primary first destinations, were ill-equipped to respond since they both had sluggish economies as well as high levels of unemployment. One sad fact about the geography of the financial and refugee crises is that it presented the worst possible constellation of locations, interests and actors. From the standpoint of geography what was needed was a southern Europe experiencing an economic boom with high employment close to refugees emigrating from adjacent areas. Though far from a uniform pattern, the most accepting countries were/are in the north and the least enthusiastic in the south and east.

The second intersection relates to the effect of the refugee crisis and intra-EU migration on Brexit. In the UK, there was a small bias for 'remain' in the first half of 2015 but this margin dissipated quickly in the summer of 2015 with dramatic increases in the flows of refugees across the Mediterranean. Anti-refugee sentiment continued throughout the year, punctuated by significant moments in the campaign itself, for example, the announcement of the date for the vote (Porcaro and Mueller, 2016). Internal EU migrations to the UK also added fuel to the Brexit fires. (McBride, 2017) The enlargements of 2004 and 2007 added 12 new members to the EU. Both of these expansions caused spikes in migrations from the new members to the UK. The number of Polish immigrants in the UK surpassed 800,000 by 2011. There were also considerable numbers of immigrants from Lithuania, Latvia and Slovakia. By 2015 net migration to the UK surpassed 300,000 a year, a number which David Cameron called 'unsustainable' (McBride, 2017).

The third intersection took place between Brexit and the eurozone financial crisis. The way in which these two events interacted is more subtle than the others. The UK was never part of the eurozone and tried to stay as aloof as possible from developments inside the monetary union. Nevertheless, the interactions between Brexit and the financial crisis are multiple and important. First, at the purely economic level, the eurozone crisis created uncertainty and depressed economic growth. Shrinking markets within the eurozone countries were bound to adversely affect British trade and finance.

Second, the economic recession in the eurozone meant greater migration from eurozone and non-eurozone countries to the UK. Migrations increased from Poland, Czech Republic, Slovakia, Latvia and Lithuania. While these were not refugee movements – they all came from within the EU and were economic migrants – they no doubt gave rise to resentment and primed the UK to be negatively disposed to the 2015 surge of refugees.

Thirdly, with few exceptions (see Fabbrini, 2015; Henning, 2017) very little attention has been paid to the ways in which the governance system of the eurozone alienated the UK from political and institutional developments inside the EU. Fabbrini (2015) has brought to our attention the emergence within the EU of two distinct systems of governance, one centered on the traditional ‘community method’ involving the making of laws on the basis of Commission proposals and co-decision by the Council of Ministers and the European Parliament and the other centering on the intergovernmental method employed in the European Council. The second governance system regulates issues traditionally close to core state powers (security and foreign policies, large parts of justice and home affairs) and particularly the economic policy of the eurozone. The UK is not a member of the eurozone and is therefore not represented in the distinctive institutions of the eurozone, such as the Eurogroup and the Euro-Summit. This is appropriate on the grounds that only members of the eurozone should participate in its governance. However, there are policy externalities. The UK is correct when it sees itself as excluded from having a voice in the overall democratic nature of the eurozone. The new intergovernmental treaties – Fiscal Compact, European Stability Mechanism, Single Resolution Fund – were taken outside the Lisbon Treaty so as to isolate those states who might want to veto actions relating to monetary policy (Fabbrini, 2015, p. 263). Intergovernmental governance has deepened integration in the eurozone, giving rise in the UK to fears of exclusion and (in the eurozone’s Member State publics) to a perception of a general loss of legitimacy of the EU’s institutions.

## V. Lessons for Institutionalists

Institutions can be defined in general terms as ‘... the rules of the game in a society or ... humanly devised constraints that shape human interaction’ (North, 1990, p. 3). Similarly, Keohane defines institutions as ‘persistent and connected sets of rules ... that prescribe behavioral roles, constrain activity, and shape expectations’ (1989, p. 3). Institutions defined as rules are related to, but distinct from, formal institutions which are also called organizations. They are similar in that organizations embody rules as defined above. Indeed, an organization may have been created precisely to carry out a set of rules. But ‘persistent and connected sets of rules’ do not require an organizational vehicle. The institution of multilateralism (Ruggie, 1993), a core set of rules about how to structure international economic relations, exists apart from any particular organization (such as the IMF or NATO) which adopts multilateral principles. One reason to distinguish between rules and organizations is that the latter have agency. Organizations such as the EU can ‘act’ in the standard sense (sign treaties, consider applications for membership) while a rule (such as the Dublin Regulation) cannot.

Institutions are pervasive but their existence may signify different things. They may reflect the interests of the powerful (Knight, 1992), may provide solutions to problems of co-operation (Keohane, 1984), be purely ceremonial (Meyer and Rowan, 1977), or be utterly pathological (Barnett and Finnemore, 1999). The dominant approach within

political science and economics sees institutions as solutions to problems of market failure. Institutions may solve problems of deficient equilibria if these problems are associated with low levels of trust, weak or asymmetric information, or the inability to monitor and enforce bargains. Thus, transparency, reporting, monitoring and third party adjudication are often part and parcel of the institutional toolkit.

This template carries over into regional integration studies. Many scholars see chronic institutional underperformance in the EU, implying that there are 'big bills left on the sidewalk' (Olson, 1996) in terms of unexploited co-operative gains. Some expect that all problems can be solved with the right mix of information and institutional engineering. Like the economist who is expected to create a market for every externality or failed exchange, the political scientist is to create the right set of rules to respond to any and all challenges. This view is flawed. We should be wary of institutional hubris every bit as much as market hubris. We can appreciate this point better if we see institutions in context next to their kindred analytic tools: preferences, resources and ideas (Moravcsik, 2003, 2010). Preferences are what people want, their goals, how they trade off different goals. Resources are the means people have at their disposal to pursue these goals. Ideas, including causal beliefs, link resources to actor goals. Institutions refer to the framework of rules within which actors pursue their goals.

Failure to achieve goals can be due to different causes. Sometimes actors aren't successful because of scarce (inadequate) resources; sometimes, they lack the basic knowledge to achieve goals; sometimes they fail due to inefficient institutions; and sometimes they fail due to the arrangement of preferences among the actors.

In short, if the quartet of terms – preferences, resources, ideas and institutions – is to have integrity, we must allow all four to vary independently. We must allow for failures due to scarce resources, divergent preferences or inadequate information (ideas) and inadequate rules. Which brings us to the cases at hand: the eurozone crisis, the refugee crisis, and Brexit. My view is that the latter two crises, especially Brexit, are less about institutional failures, or inadequate resources, and more about the distribution of preferences.

It is often difficult to distinguish between an institutional failure and a failure due to the constellation of preferences. However, collapsing these two categories creates a muddle and intractable analytic difficulties. A necessary step to clarity is to distinguish between fundamental (basic) and situational preferences. Basic preferences refer to what individuals want in settings that are pre-strategic while the latter refers to preferences that depend on particular circumstances. Perhaps a better term for basic preferences is interests. As Moravcsik puts it, 'State preferences ... comprise a set of fundamental interests defined across 'states of the world'' (2003, p. 164). A country's basic preference may be survival and security from physical harm while its strategic preferences may be for alliances, divide and rule, or neutrality. The introduction of a new institution (as a rule) can change a preference for a strategy from defect to co-operate, by making the defect strategy more costly. This definition of preference accords with usage in economics. A firm in a duopoly may act on the basis of market share while one in a competitive setting pursues absolute gains. Basic preferences do not change. Rather, variation in economic structure accounts for differences in situational preferences.

### *Role of Institutions in the Eurozone Crisis*

Of the three crises, the one most amenable to an institutional solution is the eurozone crisis. From the very beginning, the institutional architecture of the eurozone was radically

incomplete. Gaps were evident in banking regulations, the monitoring and control of structural imbalances, and fiscal deficits. The biggest institutional gaps were in the areas of fiscal imbalances and lender of last resort functions (LLR). As Sims (2012) points out, the EMU eliminated the LLR function at the national level without providing an equivalent mechanism at the European level. The Stability and Growth Pact set out criteria for debts and deficits, but there was a virtual absence of institutions at the centre of EMU to deal with deficits should they occur. EMU lacked centralized fiscal resources to deal with country indebtedness and in any case, the EU was legally prohibited from bailouts and monetary financing. The problem was both inadequate resources and lack of centralized institutions, with resource scarcity largely endogenous to institutions.

The lack of a central LLR function leads to a situation where a manageable budget deficit might generate anxiety out of proportion to the underlying problem. Localized deficits might spread beyond their point of origin. Liquidity problems could easily become solvency problems. This has elements of a classic social dilemma in the sense that the structure of the situation could easily lead to a bad equilibrium (a situation that is stable even though it is no one's first preference): high interest rates, difficulty paying off debt, shrinkage of affected economies aggravating debt and ability to repay. A 'good' equilibrium is available with different institutions (DeGrauwe and Ji, 2013, p. 17). DeGrauwe and Ji (2013) conducted an empirical test in which they compared bond markets in eurozone countries with bond markets outside the eurozone with respect to sensitivity of these markets to national debt. Eurozone bond markets were notably more fragile in the sense that they registered higher interest rate spreads with German ten-year bonds than bond markets in 'stand-alone' countries.

We can model the incentives facing Germany and Greece in the eurozone crisis as an approximation to a prisoner's dilemma game as illustrated in Figure 1. Germany's incentives are in favour of austerity and no bailout with accompanying reforms in Greece. Greece's incentives are to resist reforms and to advocate for bailouts. Each prefers to not co-operate and push for the other to give in. Both would be better off with co-operation and certainly both countries want to avoid a eurozone collapse. On the other hand, Germany mostly wants to avoid moral hazard by setting an example that the costs of domestic spending cannot be externalized. Greece wants to avoid domestic collapse on the part of the government in power. Institutions which clarify expectations about what happens in case of crisis could play a positive role.

### *The Role of Institutions in Refugee Crisis*

The refugee crisis will not be easily solved by institutions. The interactions among the crises and the distribution of preferences among Member States, along with demanding voting rules, works against easy resolution.

Instabilities in North Africa, the Middle East, and sub-Saharan Africa paint a bleak picture. As Miliband (2016) points out in a sobering article, modern warfare, particularly civil wars, are protracted affairs, often lasting over three decades (2016). Correlated with the length of wars we observe that refugees are displaced for an average of 17 years and for internally displaced people the figures are even higher. Many lament the dire situation posed by the refugee crisis. While institutional solutions are difficult, they are not impossible. EU institutions are strained but not overwhelmed. To be overwhelmed is to find

Figure 1: Greece and Germany

		Greece	
		C	D
Germany & Creditors	C	<b>Cell 1</b> <b>Supports fiscal union</b>  <b>Greece restraint</b>  Greater stability Less tendency for small disturbances to become large	<b>Cell 2</b> <b>Supports fiscal union</b>  <b>Greece overspends</b>  Moral hazard realized
	D	<b>Cell 3</b> <b>No bailout funds; Germany insists on costly reforms</b>  <b>Greece tries to control spending, but</b>  Shrinking Greek GDP Greece unlikely to be able to pay off debt	<b>Cell 4</b> <b>No fiscal union</b>  <b>Greece chronic overspending</b>  Fiscal deficits Growing gap between Germany and Greece

Note: C = Co-operate; D = Defect

**Germany's preferences would be:** D/C > C/C > D/D > C/D

**Greece's preferences would be:** C/D > C/C > D/D > D/C

Row payoff represented first, so D/C for Germany = Germany defect/Greece co-operate while for Greece, C/D = Germany co-operate/Greece defect

I do not think the eurozone crisis perfectly fits the prisoners' dilemma game but it is a useful approximation. While Germany would like Greece to undertake reforms, Germany may also think that it is unlikely for Greece to be able to carry out these reforms without wrecking their economy. Some politicians in Greece may also welcome the idea of externally imposed reforms.

oneself in the situation where one is seriously committed to helping but lacking in the wit or resources to do so. This is not the situation with regard to the EU in the refugee crisis. There is little in the EU's political constitution (the treaties and the institutions they have created) that prevents measured responses. Yet, talk of 'institutional failure', 'institutional weakness' or 'the crisis of EU institutions' is widespread.

Similarly, resource limitations do not provide a compelling argument for inaction on refugees. As EU scholars know, budgetary restrictions are very tight, but budgets are endogenous to preferences. We know from the financial crisis that there are many ways these restrictions can be circumvented. Member States can contribute from their own budgets rather than requiring the EU to violate its budgetary ceiling. Special purpose

institutions, along the lines of those created for the eurozone crisis, can be created which raise their own funds and operate outside the formal legal structure of the EU and the eurozone. There is much room for creativity when the will of Member States is present but little when there is disagreement on objectives.

Many see a chronic institutional underperformance of the EU in addressing the crisis. My view is that the crisis is less about the EU falling short of its institutional potential and more about divergent preferences among key Member States, domestic political processes that reward anti-immigrant behaviour, and demanding EU voting rules. In short, this is not institutional failure. It is a 'failure' of preferences to align in such a way as to allow for co-operative solutions. Unless one argues that institutions can change fundamental (not just strategic) preferences, then one is brought to the inevitable conclusion that the preferences of the leaders of Hungary, Slovakia, the Czech Republic and Poland cannot be brought into line with those of other more pro-refugee countries such as Germany and Sweden. One can't argue that the problem is the undemocratic nature of the Visegrad countries. Unlike in Western Europe where anti-immigrant attitudes come from anti-system parties of the right and left, in the Visegrad countries 'anti-immigrant rhetoric comes from the very center of the political space' (Hunyadi and Molnar, 2016, p. 1) which makes it difficult to delegitimize the mainstream political parties.

To illustrate the array of preferences, see Figure 2 below. If both Germany and Hungary prefer acceptance of refugees but prefer to free ride while others shoulder the burdens, one could think of this as a prisoners' dilemma game. The familiar preference orderings would conform to a prisoner's dilemma game:  $DC > CC > DD > CD$  and  $CD > CC > DD > DC$  (players 1 and 2, respectively). The problem is that preferences do not follow the standard prisoners' dilemma structure. Hungary prefers mutual non-co-operation (both Hungary and Germany do not accept refugees) to an outcome where Germany accepts and Hungary free-rides on German generosity. This claim is supported by the strenuous reactions of Orban to Merkel's generous 'willkommenskultur', calling it 'moral imperialism'.<sup>1</sup>

As stated previously, we must theoretically allow for failures due to scarce resources, divergent preferences, scarce or faulty information, and weak or inefficient institutions. Voting rules are endogenous to institutions, which in turn are endogenous to preferences. Provided those rules are democratically created, it would be odd to blame the rules themselves. A different response to the refugee crisis, a better one according to many, was not forthcoming because of the preferences of the Member States and their adopted rules. The old-time religion of integration theory would have called this 'a failure of will' but whatever one calls it, it is not an institutional failure.

If institutions cannot fix a serious problem, maybe moral suasion can change hearts and minds. A good case can be made that the refugee crisis is a humanitarian crisis. As Betts (2015, p. 364) argues, moral philosophy starts with the idea of obligation and the notion that we have a special duty toward those in need. One can invoke Rawls and the veil of ignorance. What kind of world would we choose if we did not know which position we would occupy in it? Most of us would choose a world where others would be obligated to take us in. By forcing us to assume a disinterested position, Rawls's ethical experiment clarifies our values. Communitarians might be less likely to open the borders fully to

<sup>1</sup> Admittedly, other interpretations are plausible, including one in which Orban sees German generosity as relieving pressure on Hungary to accept more refugees.

Figure 2: Refugee Crisis

		Hungary/Visegrad Countries	
		C	D
Germany	C	Cell 1 <b>Germany co-operates</b> <b>Hungary co-operates</b> (Not Likely)	Cell 2 <b>Germany co-operates</b> <b>Hungary does not co-operate</b>
		Cell 3 <b>German does not co-operate</b> <b>Hungary co-operates</b> (No)	Cell 4 <b>Germany does not co-operate</b> <b>Hungary does not co-operate</b> (Not Likely)
	D		

Notes: C = Co-operate; D = Defect.

**In PD, Hungary's preferences would be:** D/C > C/C > D/D > C/D

But in reality, Hungary prefers mutual non-co-operation to unilateral defection, such that Hungary prefers cell 4 (mutual defection) to cell 2 (unilateral defection).

**Hungary's preferred outcomes:** Cell 4 > Cell 2 > Cells 1 & 3.

There are no positive externalities from Germany unilaterally accepting refugees.

**Germany's preferred outcomes:** Cell 1 > Cell 2 > Cell 3 > Cell 4.

refugees but would nevertheless be likely to accept some level of responsibility. True, the communitarian state takes care of its own first, but even if we see the state as a lifeboat with limited capacity, we have to be honest about how much room we have. Lebanon has 1.2 million refugees and a total population of 4 million. Germany, the most generous country in the EU, made commitments to accept 800,000 and has a population of over 80 million. The EU has a population of over 500 million. Yet, the 120,000–160,000 that Merkel suggested be taken in by the rest of the EU appear to be too much for some countries.

An obstacle to finding an institutional solution involves the current decision-making rules. These rules set a high bar for agreeing on what constitutes a breach to a Member State's obligations insofar as refugees are concerned. Article 7 of the Lisbon Treaty allows for the use of material sanctions and suspension of voting rights for serious breaches. If a breach is decided, the vote on sanctions is by qualified majority in the European Council (Sedelmeier, 2017, p. 239) but the existence of a breach presents a higher barrier, unanimity minus one in the European Council. Given that there are several members opposed to the mandatory refugee quotas, it appears impossible to garner the necessary votes.

We should not exaggerate the obstacles flowing from the current rules (Art. 7). Rules can be very flexible. They can be stubbornly or flexibly applied, they can be bent,

amended, and made subject to extensive exception-seeking. They can be circumvented, which is what the European Council did when it created the European Financial Stability Facility (EFSF) and Fiscal Compact outside of the legal architecture of the EU. They can be made more complex for special reasons, which is what the heads of state and governments did when they made the International Monetary Fund (IMF) part of the Troika (Henning, 2017). The EU has employed coalitions of the willing, opportunistic opt-outs and opt-ins regarding Schengen and EMU, treaty rewrites, and heroic treaty interpretations related to monetary financing. Much could be done within the overall institutional structure of the EMU and EU to creatively use what is now available.

### *The Role of Institutions in Brexit*

At first, the Brexit negotiations appear to offer little room for institutional improvement. The UK wants to leave, the EU prefers that they remain, and neither side plans to make it easy for the other. If this is the understanding of the situation, we have something close to a game of redistribution where tradeoffs and compromises are grudgingly made. However, a more careful look reveals a number of areas where there are common as well as divergent interests. There is ample room to think about the efficient as well as distributive role of institutions.

In an interesting document prepared for the European Parliament, with the title ‘The United Kingdom’s Exit from and New Partnership with the European Union’ (2017) the authors identify a number of key interests motivating the UK. Among them are ensuring free trade of goods, services, and free movement of capital. These objectives are three out of four of the fundamental freedoms central to the EU. These are followed by ‘securing the rights of EU and UK nationals’, a matter of mutual concern to EU and UK nationals.

Admittedly, there are also divergent interests. An important one has to do with control over borders, both to regulate movements within the EU and outside the EU. Migration and control over borders were important issues in the election. Many members of the EU would like to see free movement of peoples within the EU and for the UK to accept more refugees from outside the EU borders. This is an issue where disagreements run deep and are hard to resolve.

A second divergent interest has to do with bringing an end to the jurisdiction of the Court of Justice of the European Union (CJEU). The direct effect and supremacy doctrines run counter to the British concept of parliamentary sovereignty since supremacy implies that the EU treaties are themselves higher normative orders than national laws.<sup>2</sup> With exit from the EU it follows that the CJEU no longer has jurisdiction over the UK legal order. However, the CJEU is not only guardian of the Treaty, but is also the vehicle for resolving disputes within the single market. Since the UK and the EU seem to have convergent interests regarding the benefits of the single market (minus the free movement of labour), the future role of the CJEU is not so clear-cut. Also, getting rid of the CJEU’s jurisdiction for new cases may be relatively easy, but what does one do about the ways that complex judicial reasoning and case law are already baked into ‘domestic law’ (Jupille and Caporaso, 2009).

A third divergence is symbolic. The EU does not want to establish a precedent that it is easy to leave because each country may feel free to strike its own bargain. The EU wants

<sup>2</sup>This is hotly contested in several countries not least of which is Germany.

to make clear that ‘Europe cafeteria style’ is not acceptable. The strategy that flows from this premise is anything but straightforward. It may involve situations in which the EU threatens to pursue actions which are welfare-decreasing to the Member States simply for reputational reasons, such as to discourage others from using the UK as a precedent. The opportunity cost to membership should be high and the way to do this is to threaten to use the structural power of the EU (27 members, large market, asymmetric reliance of the UK on the EU) to extract concessions.

With such a mix of interests, it is hard to represent Brexit–EU relations as a simple game, but we can approximate their respective situations if we simplify and focus only on the four fundamental freedoms. Looking at Figure 3 (EU and UK–Brexit) below we see that Cell 1 is not really a possibility since the UK will not accept labour mobility

Figure 3: EU and UK (Brexit)

		EU	
		C	DC
UK	C	Cell 1 <b>UK accepts</b> <b>EU accepts</b> (Not Realistic)	Cell 2 <b>EU maintains position</b> <b>Soft Brexit, accepts EU</b> <b>conditions</b>
	DC	Cell 3 <b>UK opposes</b> <b>EU accepts</b> (UK wins)	Cell 4 <b>Both hold firm</b> <b>Implies Brexit</b>

Notes:

**United Kingdom:**

(C) Concede = Accept four freedoms, including labour mobility.

(DC) Don't Concede = Do not accept four freedoms.

**Preferred outcomes:** DC/C (cell 3) > DC/DC (cell 4) > C/DC (cell 2).

CC is not relevant. There are no co-operative gains.

**European Union:**

(C) Concede = Drop demand of four freedoms or package.

(DC) Don't Concede = Insist on four freedoms or package.

**Preferred outcomes:** DC/C (cell 2) > DC/DC (cell 4) > C/DC (cell 3).

Institutions can do little here. There is no market failure. Outcome cannot be Pareto sub-optimal. EU prefers cell 2 to 4, but UK prefers cell 4 to 2. This is a distributive game rather than an efficiency game.

and the EU will not unpack the four freedoms. Similarly, Cells 2 and 3 are not really attainable because both actors are not going to cave in on such a basic goal. It follows that the EU prefers Cell 2 to Cell 4 and the UK prefers Cell 4 to Cell 2. There is little room for institutions to co-ordinate expectations and preferences in this stark situation. Preferences are arranged in such a way that co-operation will not improve outcomes for either actor.

## Conclusion

This paper advanced two themes: the interrelatedness of the euro, refugee and Brexit crises and the variable effectiveness of institutions. The relations among the crises are for the most part self-aggravating, each one making the other one worse. Refugees from Africa and the Middle East put additional administrative and financial stress on Greece and Italy, two countries least equipped to handle displaced people. Migrations from Greece, Italy and central and eastern European countries to the UK sensitized the UK to refugees from the Middle East and Africa. Austerity policies hit not only citizens of the EU's periphery but also the migrants and refugees who fled to Greece and Italy. Austerity increased the chances of unemployment for refugees as well as citizens, unemployment increased the prospects for losing one's residency papers, and this in turn decreased the prospects of remaining inside a host country.

Solutions to Europe's triple crisis will take place partly outside the EU. The refugee crisis was sudden and involved the movement of millions of people in 2015 from poorer, war-torn, and dysfunctional states to richer democratic ones (Betts and Collier, 2017). Ending the wars in Iraq, Afghanistan and Syria, while not an immediate prospect, would certainly help to relieve the refugee situation but by itself this is not enough to solve the problem. Dysfunctional regimes in South Sudan, Nigeria and Somalia, where there are chronic food shortages, will continue to fuel the refugee situation. Over 90 per cent of the world's displaced peoples are living in the less developed world. Poor countries such as Iran, Lebanon, Jordan and Ethiopia have provided a haven of sorts to refugees. The EU may see itself at the center of the refugee question but most of the help, on the ground, comes from poorer countries outside the EU.

Waiting for wars to end is not a policy but pinning hopes on the generosity of EU countries does not seem a realistic alternative. Merkel has not been successful in convincing other EU members to accept even the small (120,000–160,000) numbers of refugees she has proposed. Macron in France has vowed not to allow the 'jungle' in Calais to continue. Central and Eastern European countries are firm in their determination to keep their borders closed. Italy and Greece are not equipped to deal with the problem on a long-term basis, even if their rescue efforts have been valuable. The EU has shown itself to be limited in the face of a crisis that revolves around identity concerns more than economic issues (Boerzel and Risse, 2018).

The EU has made a lot of reforms to alleviate the financial crisis. The banking system has been reformed. Regulations regarding finance have been harmonized. The Commission has been given added powers with regard to monitoring macro-economic imbalances, competitiveness and budget deficits. The eurozone crisis has been stabilized. There will be long, drawn-out negotiations between Greece and the Troika, but Greece's problems are not likely to become problems for the whole eurozone. In addition, perhaps there is a hidden exchange lying in wait between Greece, geographically well-situated

with respect to accepting refugees but badly in need of debt relief, and Germany which supports acceptance of more refugees by the EU, and also has the power to grant debt relief to Greece. So, a swap – a political bargain – is within reach whereby Greece continues to accept refugees, regulates its northern border, in return for a write-down of debt and increased funds to manage the refugees (*Financial Times*, 2016). A temporary solution to be sure but it does buy time for more durable solutions to be devised and implemented.

This takes us to the second theme, the limits of institutional solutions. I have found liberal institutionalism helpful in addressing the three crises. Some variants of liberalism treat institutionalism as separate (Moravcsik, 2003, 2010) with liberalism focusing on preferences and institutionalism on information. I prefer to join the two concerns and see the success of institutions as linked to both changes in incentives and changes in information. Many market failures are due to scarcities or asymmetries of information, as the 'market for lemons' instructs us. Yet the supply of sanctions, as in punishment for not pursuing a co-operative strategy (such as overfishing, exploiting the commons), is also part and parcel of institutional solutions.

Liberal institutionalism provides a better explanatory account of the triple crisis than realism (relying on coercive abilities) and constructivism, relying on communication, socialization and malleability of preferences. The Brexit and refugee crises are not due to market failures, information shortages or asymmetries in the distribution of information. Knowing more about what Orban and Merkel want (both basic and strategic preferences) will not help. The environment of the eurozone is information-rich and symmetric rather than information-poor and asymmetric. Institutional changes will not make these preferences align. Basic differences cannot be made compatible as they can in instances of market failures. Of course, this does not mean there is no room for improvement (see Bordignon and Moriconi, 2017). I am struck by the ingenuity of the Member States concerning the eurozone crisis (Fiscal Compact, Troika) compared to the inertia and paralysis concerning the refugee crisis. Perhaps the EU still has some cards to play regarding both refugees and impending UK exit. However, the UK will soon be outside the EU and many refugees will have suffered years of needless hardship (Bully, 2017). The Brexit outcome can feature either a soft or hard landing and there is still time to make a difference regarding refugees, with or without the help of the least co-operative EU members.

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