Statement submitted to the European Parliament Joint Hearing:
"Budgetary implications of the current refugee and migration crisis"

By: George Soros
Thursday, 30 June 2016

When I was invited to address this joint hearing, the refugee crisis was the greatest problem Europe faced. Since then it has played a crucial role in what could prove to be an even greater calamity — Brexit.

The vote for Brexit was a great shock to me and, I imagine, to most people in this room. Last Friday morning, the disintegration of the European Union seemed practically inevitable.

But as the initial disbelief wore off, something unexpected happened, and the tragedy no longer looks like a *fait accompli*.

Over the past week, buyer's remorse has begun to set in, as the hypothetical became very real: sterling plunged, Scotland threatened to break away, and some of the working people who supported the "leave" campaign started to realize the bleak future that both the country and they personally face. Even the champions of leave are retracting their dishonest pre-referendum claims about Brexit.

In a spontaneous response, over four million people petitioned Parliament to hold a second referendum. By the time the Parliamentary debate on this petition takes place, it is not inconceivable that more people will have signed the petition than voted for Brexit.

Just as Brexit was a negative surprise, the spontaneous response to it is a positive one. People on both sides of the referendum, and most importantly those who did not even vote—particularly young people under 35—have become mobilized. This is the kind of grass roots involvement that the EU has never been able to generate.

The referendum has highlighted for people in Britain just what they stand to lose by leaving the EU. If this sentiment spreads not only in Britain, but also in the rest of Europe, what seemed like the inevitable disintegration of the EU could instead create positive momentum for a stronger and better Europe.

The process could start in Britain. The popular vote cannot be reversed but a signature collecting campaign could transform the political landscape by revealing a newfound enthusiasm for EU membership. This approach could then be replicated in the rest of the European Union by forming a movement that would seek to save the EU by profoundly restructuring it. I am convinced that as the consequences of Brexit unfold in the months ahead, more and more people will be eager to join this movement.

What the EU should not do is penalize British voters while ignoring their legitimate concerns about its deficiencies.

European leaders should recognize their own mistakes and acknowledge the democratic deficit in the current institutional arrangements. Rather than seeing Brexit as the negotiation of a divorce, they should seize it as an opportunity to fundamentally reform the EU. Their goal should be the creation of a reinvented EU that the UK and other countries at risk of exit would want to join.

Will disaffected voters in France, Germany, Sweden, Italy, Poland and elsewhere see the EU benefitting their lives? If the answer is yes, the EU will emerge stronger. If the answer is no, it will eventually blow apart.

***

Unfortunately, Brexit has not only created an opening to reinvent the EU, it has also aggravated two looming dangers.

First, it unleashed a crisis in the financial markets comparable in severity only to that of 2007/8. This has been unfolding in slow motion, but Brexit has accelerated it. It is likely to reinforce the deflationary trends that were already prevalent.

The eurozone has been lagging in the global recovery because of restrictive fiscal policies; now it has to contend with an impending slowdown. The orthodoxy of the German policymakers stands in the way of the only effective response: having a eurozone budget that could adopt counter-cyclical policies.

Meanwhile, the banking system of continental Europe has not recovered from the earlier crisis; it will now be severely tested. We know what needs to be done. Unfortunately, political and ideological disagreements within the eurozone have stood in the way of using the European Stability Mechanism (ESM) as a backstop for banks as well as sovereigns.

Second, the EU faces growing military threats. Our external enemies have been emboldened. They pose new, as-yet unfathomable dangers in various parts of the wider region that are also liable to aggravate the refugee crisis.

It is against this background that I propose to discuss the refugee crisis, with special emphasis on the financial needs it presents.

***

The European response to the refugee crisis was riddled with flaws even before the present turn of events.

Chancellor Angela Merkel showed great moral leadership when she opened Germany's doors wide to refugees. Unfortunately, her initiative was not well thought through; it ignored the pull factor. When the sudden influx of migrants overwhelmed the capacity of the authorities, public opinion turned against her. That is when she struck her ill-fated deal with President Recep Erdogan.

I have identified the flaws of that deal in detail.

First, it was not truly European; it was imposed on Europe by Merkel.

Second, it was severely underfunded.

Third, it was not voluntary: it imposed quotas that many member states opposed and required refugees to take up residence in countries where they were not welcome, while forcing others who reached Europe by irregular means to be returned to Turkey.

Finally, it transformed Greece into a *de facto* holding pen with inadequate facilities.

Since then, the situation has only deteriorated. Member states have become increasingly unwilling to cooperate with one another, and are pursuing discordant policies. While migrant flows to Greece have eased considerably, they have surged in the Central Mediterranean.

In these circumstances, a comprehensive and coherent European asylum policy is not possible. The trust needed for cooperation is lacking. It will have to be rebuilt through a long and laborious process.

***

This process should start by addressing the dire lack of financial resources.

Without sufficient funding, the EU cannot perform the functions it was designed for nor meet the expectations of the European people. And because it fails to achieve the objectives it has set for itself, the Union loses its legitimacy and the support of its citizens.

The refugee crisis illustrates the problem. At least €30 billion a year will be needed both inside the Union—to build effective border and asylum agencies, to ensure dignified reception conditions, fair asylum procedures and opportunities for integration—as well as outside its borders—to support refugee-hosting countries and to spur job creation throughout Africa and the Middle East. This does not include the costs borne by member states, which are on track to spend upwards of €200 billion between 2015 and 2020 on refugee reception and integration.

The refugee crisis should not pervert the EU's relationships with neighboring countries as it has with Turkey. I am concerned that in its latest communication on migration and external relations, the Commission calls for making development funds contingent on the implementation of migration controls by African partners. This violates decades of practice in development funding and risks a race to the bottom in the treatment of migrants and refugees. The grand bargain with African and other countries cannot simply be that, if you stop migrants from coming to Europe, you will receive financial aid. A meaningful grand bargain would focus on real development in Africa that over a generation would actually address the root causes of the crisis. This means free trade, massive investment, and a commitment to rooting out corruption. Leaders in Europe have called for a Marshall Plan for Africa. This is an admirable ambition. But when it comes to the details, Europe is a far away from such a vision. The United States invested 1.4% of its GDP to help rebuild Europe—every year for four years. An investment on the scale of the original Marshall Plan would require around €271 billion a year for the next four years.

The political and economic costs of inaction would be even greater. Brexit is the starkest example of these consequences. But we also have compromised the Schengen system, driving up the economic costs.

Given that its very survival is at stake, the EU should be putting all of its available resources to use. And yet the triple-A credit of the Union has barely been deployed. This is the height of irresponsibility.

The current approach is based on reallocating minimal resources from the EU budget and then asking member states to contribute to various dedicated vehicles, such as the Turkish

Facility and the Trust Fund for Syria. This can only be a temporary solution, as it is neither sustainable and nor large enough to finance efforts that must grow in size and scope (such as a European border force). These trust funds are powerful instruments in the short term to redeploy resources and allow member states to commit more resources to a particular endeavor, but they also illustrate the fundamental deficiency of the EU budget, i.e. that it remains dependent on the good will of the member states at each step.

In order to raise the necessary funds in the short term, the EU will need to engage in what I call "surge funding." This entails raising debt by leveraging the EU's relatively small budget, rather than scraping together insufficient funds year after year. During the financial crisis, the EU has repeatedly put its borrowing capacity on display, establishing financial instruments capable of quickly borrowing tens of billions of euros on attractive terms. Once Europe's leaders make a political decision to act, they can move quickly.

There is a strong case to be made for using the EU's balance sheet. Tapping into the triple-A credit of the EU has the additional advantage of providing a much-needed economic stimulus for Europe. With global interest rates at historic lows, now is a particularly favorable moment to take on such debt.

In the short term, reforms of the EU's existing instruments would allow a far more effective mobilization of resources than the creation of new ones. Two sources of money in particular—the European Financial Stability Mechanism (EFSM) and the Balance of Payments assistance facility (BoP)—should be put to the task. These sources complement each other: the EFSM was designed for loans to eurozone members, whereas the BoP is for EU members that do not belong to the eurozone. Both kinds of loans will be necessary for a comprehensive approach to the crisis. They have similar institutional structures and both are backed entirely by the EU budget—and therefore do not require national guarantees or national parliamentary approval.

The Macro Financial Assistance facility (MFA) is yet another source of borrowing specifically designed for actions outside of the EU. It has proven an important instrument in countries like Ukraine but it needs a new framework agreement. (This is urgent because a framework agreement takes a long time to enact and the current Ukrainian government deserves more support than the EU is currently able to offer.)

The combined gross borrowing capacity of the EFSM and the BoP assistance facility is €110 billion. The borrowing power of the latter is almost completely unused. The EFSM has made some €46.8 billion worth of loans to Portugal and Ireland and its spare capacity grows each year as those loans are repaid.

All the instruments mentioned add up to a substantial unused borrowing capacity.

Spending a large amount at the outset would make it much easier to manage immigration and will allow the EU to respond more effectively to some of the most dangerous consequences of the crisis.

These include the kind of anti-immigrant sentiment that fueled Brexit and is poisoning other states; support for extremist political parties; and despondency among those seeking refuge in Europe who now find themselves marginalized in Middle East host countries or stuck in transit in Greece.

Making large initial investments will help tip the economic, political and social dynamics away from xenophobia towards constructive outcomes that benefit refugees and host countries alike.

***

Of course, raising more debt with the current budget will eventually pose deeper questions in light of the limited revenues of the EU budget. The situation has gotten worse over the years as the real own resources of the EU budget (such as customs duties) have shrunk. It is now time to drastically reshape how the EU's own resources are raised.

The reduction of the EU's resources in 2014 to 1.23% of GDP was a tragic mistake and we are paying the price for it now. The EU cannot survive with a budget of this size. I was greatly encouraged last year when Minister Schauble raised the idea of a pan-European gasoline tax. The European Parliament should seriously consider this idea.

The proper route for such a tax increase would be for the European Commission to propose new legislation to be adopted with the unanimous support of all members. This would likely fail, given unanimity rules in budgetary matters. But if a "coalition of the willing" of at least nine countries could be assembled, the Commission could act without unanimity. The proposed European financial transaction tax (FTT) sets an important precedent even if it is still a work in progress. A stable source of revenues would greatly increase the amount that the EU can borrow and would allow it to finance new initiatives.

In any case, the EU and its member states must find new sources of tax revenue. Another approach would be to levy special EU-wide taxes. The new tax revenue could come from a variety of sources, including the existing EU-wide VAT; or a new tax on travel into the EU and on visa applications, which would shift some of the burden onto non-EU citizens wishing to travel to the EU.

I accept the difficulty of raising additional tax revenue but there are encouraging precedents for instance, the Single Resolution Board that raises a levy on the banks could in principle borrow money against that levy. There are many instances where, despite institutional obstacles, the creativity of lawmakers and the Commission has allowed new instruments to emerge.

The eurozone also needs a budget of its own, as a subset of the European budget. The ESM created during the crisis can be seen as the embryo of such a budget but it is an intergovernmental construct subject to the vetoes of national parliaments. Member states should be encouraged to bring the ESM under the control of the European Commission and the European Parliament. In practical terms, this would amount to a transfer by the member states of the €80bn of paid-in capital they have invested in the ESM. This would also allow extending its use to other purposes like the creation of a European unemployment scheme.

Finally, I come to the legacy expenditures that have crippled the EU budget. Two items stand out: cohesion policy, with 32% of expenditures, and agriculture with 38%. These will need to be sharply reduced in the next budget cycle starting in 2021.

With these changes related to its finances, the EU would be much stronger. It would be in a position to respond to a destructive economic slowdown, it would have the means to address the corrosive consequences of the refugee crisis both in Europe and abroad and finally it would recognize the institutional existence of the eurozone and its specific fiscal and financial needs.

To sum up, the refugee crisis poses an existential threat to Europe. As I said before, it is the height of irresponsibility to allow the EU to disintegrate without utilizing all its resources. Throughout history, governments have issued bonds in response to national emergencies. When should the triple-A credit of the EU be put to use if not at a moment when it’s in mortal danger?