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Ageing Population: how to escape the cost trap?

Focusing on patients, measuring health outcomes



Recent data show that 16% of the European population is over the age of 65 years, which is a testament to innovations in medicines, access to and quality of treatment and overall lifestyle improvements. However, if fertility rates stay the same, the number of elderly people in the EU will double by 2050, which will put pressure on sectors of society – including healthcare. While some warn of an impending crisis as a result of an aging population, according to Vladimír Špidla, EU Commissioner for employment, social affairs and equal opportunities, “All the rhetoric of catastrophe often obscures the fact that demographic ageing is actually a success story.”

Yet, with this changing population, it is critical that governments, industry, health insurance providers and healthcare professionals work together to rethink the overall approach to healthcare delivery and devise comprehensive solutions to effectively and holistically manage costs. Focusing on increasing the efficiency of the healthcare system, measuring health outcomes, and understanding what truly works can help ensure ongoing access, meaningful patient care and value in the long-term.

In the current climate of economic recession, those supporting the elderly are concerned about cuts in health spending. Indeed, a 2006 report from the Economic Policy Committee, which advises the European Commission and the Member States, said public spending on healthcare was projected to rise by 1.5% of GDP by 2050. “We’re not saying that govern-

ments should necessarily spend more but that they should spend their limited resources more wisely,” said Anne-Sophie Parent, director of AGE, the European Older People’s Platform.

Elizabeth Teisberg, associate professor at Virginia University and co-author of the book: *Redefining Healthcare*, told a recent conference in Brussels: “The real question is how do we create healthcare systems that drive improvements in value and increase value for patients? Europe is ahead in terms of universal coverage, which is essential for equity and efficiency. But it is not enough.”

Focusing on the patient, rather than just on delivery or the cycle of care, and ensuring that clinical teams exchange information and not just results, are ways to overcome the organisational obstacles, she said.

Health outcomes are also a key issue. “We need to understand what works, when it works and how it works,” Teisberg said. “The required measurement of outcomes is one of the most effective things that governments can do.”

Measuring results rather than assessing standards based on current systems is a way of addressing rises in healthcare costs, Teisberg remarked. “If you measure results, you unmask disparities, which most people will find intolerable,” she said. “If we create standards about inputs to care based on current systems, we lock ourselves into the current cost escalation that we are facing.”

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INNOVATION IS AT THE HEART OF *EUROPE'S WORLD*

This is the twelfth edition of *Europe's World*, and we feel it's fair to say that few if any publications in the field of international relations and policy debate can have grown as fast or widened their scope so remarkably.

Europe's World was launched four years ago come October as the first Europe-wide policy journal with neither national nor party political bias. Its other claim to originality was that it put together as its base a network of think tanks and universities across Europe that ensures an international readership of over 100,000 policymakers and analysts, as well as a constant stream of suggestions for topics and authors. Combining the printed version of *Europe's World* with an electronic version proved highly fruitful, both in terms of the growing number of readers who log-on but also because it enables readers to compare the views of contributors who take differing views on an issue. And so it is that the initial aim of *Europe's World* – to create a genuinely pan-European policy debate – has taken shape.

Since those early days, *Europe's World* has taken the logical step of widening its electronic version into a website that offers visitors a portal to the world of European think tanks. Now, as well as being able to consult articles present and past in *Europe's World*, our readers can comment and dialogue on topics of their choice, while also accessing details of the activities and publications of think tanks across Europe.

But however imaginative our publishing methods may be, there can never be any substitute for

editorial excellence. *Europe's World* is in this issue adding a new section entitled "The Arab World" to complement existing sections that as well as covering international and European issues include "Security and defence", "The Developing World" and "Sustainable Europe".

The thinking behind the new section is that Europe's own future is so tightly linked to that of its Mediterranean and Middle Eastern neighbours that development of the Arab world is an increasingly crucial part of the EU policy discussion.

As well as introducing the new section, this edition of *Europe's World* features a special report on "Overcoming the Crisis" in which some 25 acknowledged experts from very different backgrounds offer their ideas on tackling the causes of the worldwide economic crisis and on ensuring that it will never be repeated. As Europe girds itself for the global negotiations that will shape the world's new political and financial architecture, we hope that the cross-section of views they offer will make a useful contribution.



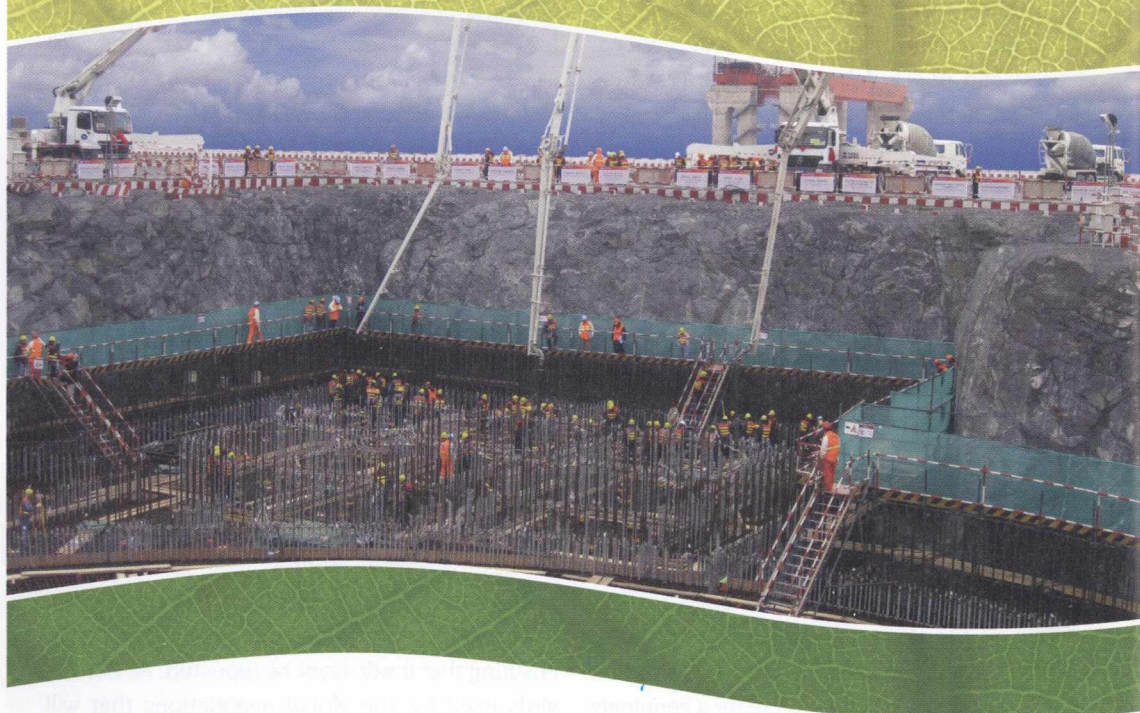
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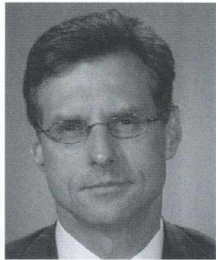
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The transatlantic economy really is "too big to fail"



With the transatlantic economy "in shambles", says Joseph Quinlan, what better time to push ahead and create a deeper more integrated EU-U.S. marketplace? But first, he warns, policymakers on both sides must call a halt to the transatlantic bickering over stimulus measures to combat the economic crisis

"Too big to fail" has become a common refrain in the global financial crisis. It's a phrase used to justify large bank bailouts on Wall Street and in defence of automobile giants. Invoking the phrase is akin to drawing a line in the sand – that a company like A.I.G., the massive U.S. insurance company, or General Motors, must be saved at all costs.

It is also rhetoric that rings hollow. Granted, the failure of either company just mentioned would have serious and far-reaching repercussions. But the impact on the global economy would be marginal. The same is not true, though, if the transatlantic economy – through benign neglect from

both sides of the Atlantic – were to flounder as a result of the financial crisis. As one of the largest and most important economic entities in the world, the transatlantic economy is indeed "too big to fail", a fact that policymakers have been slow to grasp. And, sadly, the economic crisis has pushed the U.S. and Europe further apart rather than pulling them closer together.

The overarching importance of the transatlantic economy is one of the best kept secrets in the world. Despite all the chatter about the rise of China and India, and the spectacular growth of sovereign wealth funds, the transatlantic economy accounts – on a Purchasing Power Parity basis – for

around 45% of world GDP. Over half of world exports and imports originate with the transatlantic economy, and in 2007, the transatlantic economy accounted for nearly three-fourths of global outward foreign direct investment stock and for a similar share of global mergers or takeover deals. In terms of wealth, or of personal consumption, there is no substitute for the transatlantic economy – the U.S. and Europe together accounted for 60% of global personal consumption spending in 2007, up slightly from a decade before.

All of this is another way of saying that there is no more important commercial artery in the world than the one that binds the United States and Europe. That's why when one half of the transatlantic partnership suffers or goes into recession, like the United States in 2008, the other half suffers as well. Thank to the U.S. sub-prime meltdown and the attendant credit crisis, the transatlantic economy has now fallen into one of the deepest recessions since the Great Depression of the 1930s.

The global weight of the transatlantic partnership means that disputes and disagreements between the United States and Europe invariably take on a global dimension too. Unless U.S.-EU cooperation comes to the rescue, the stalled Doha international trade liberalisation negotiations are bound to fail. Aid and assistance to the world's developing nations will also

flounder, and global issues like the war on terrorism, talks on climate change, energy security, peace in the Middle East and the proliferation of weapons of mass destruction won't progress. All of these critical issues hinge on collaboration and cooperation between the United States and Europe.

Against this backdrop, the world cannot afford a failure of the transatlantic economy, and that makes the transatlantic bickering since the crisis began all the more discouraging. Instead of cooperation and collaboration, conflict and competition have marred the transatlantic partnership in recent years. At the macro level, the transatlantic debate has pivoted around U.S. demands for more fiscal stimulus versus European demands for more industry regulation. Europe has in large part been more circumspect about priming the fiscal pump than the United States has, which is on its way to a

federal budget deficit in excess of 13% of GDP. Unfortunately, but not surprisingly, the financial crisis has done more to divide than unite the U.S. and the EU.

One of the key risks is that soaring unemployment on both sides of the Atlantic will trigger political populism and anti-trade and investment policies. The jobless rate in the United States and Europe too is poised to climb in the near term, and the higher it goes, the greater will be the pressure on policymakers to erect protectionist barriers

The world cannot afford a failure of the transatlantic economy, and that makes the transatlantic bickering since the crisis began all the more discouraging

and pursue policies that will be detrimental to the transatlantic economy. American efforts to encourage U.S. firms to invest more at home than overseas could quickly result in less foreign direct investment in Europe, and would probably be countered by European policies that aim to protect and shelter so-called "national champions". The result would be to damage and perhaps even halt transatlantic deal-making.

There is another risk, and it is that both the United States and Europe may squander the "Great Recession of 2008/2009" by failing to think big. The crisis is tough, but it also creates an opportunity to think outside the box in tackling some of the structural deficiencies and impediments to growth that have long burdened the transatlantic economy.

If the crisis is also an opportunity, that means the need for transatlantic leadership has never been greater. Cyclical forces (the current recession) and secular dynamics (the growing clout of the emerging markets) should be met with a renewed transatlantic effort to tackle and overcome many of the barriers that stand in the way of further US-Europe integration. Rather than muddling through – the most likely scenario – the transatlantic partnership should view the current crisis as a golden opportunity to fundamentally alter the political backdrop.

Rather than working in silos, independent of each other, the U.S. and Europe should consider the following transformational initiatives:

- Concentrate on further integration of the transatlantic capital markets, allowing for greater access to transatlantic capital and economic efficiencies that would help promote growth. Related to the ongoing financial crisis, leaders on both sides of the Atlantic should consider the creation of a transatlantic "bad bank", a move that would help improve the impaired balance sheets of banks on both sides of the Atlantic and pave the way for greater transatlantic financial integration and coordination.
- The establishment of a wider and deeper Transatlantic Market, notably with emphasis on reducing and eliminating barriers to transatlantic service activities. Such a process would not only promote growth in the near term but would also reinforce and strengthen the global competitiveness of both.
- Undertake joint efforts to strengthen the energy security of the transatlantic partnership. And by the same token, both parties should work closely in aligning goals and objectives related to the environment and global climate change.

All of these issues have been broached and debated at length in the past, even though little energy and coordination has been forthcoming on either sides. But with the transatlantic economy in need of a major "reset", the time for transformational policies is now.

Now is also the right time to push ahead in other areas that require joint US-EU cooperation. More transatlantic coordination and common goal-setting is needed on things

like biofuel standards, container cargo security, green product standards, reinsurance, health care, intellectual property rights, import product standards and accounting standards. Greater transatlantic standardisation and harmonisation would help promote growth on both sides.

Today's crisis presents a unique opportunity for leaders on both sides of the Atlantic to re-write and re-configure some of the fundamentals of the transatlantic economy. With the financial systems of both the U.S. and Europe impaired by the toxicity of non-performing loans, what better time to revamp and create transatlantic capital markets? With the transatlantic economy in shambles, what better time than to push ahead with the idea of a deeper and more integrated transatlantic marketplace? And with both the U.S. and Europe so energy-deficient while also struggling with global climate change, what better time for the two to more aggressively coordinate their responses to global challenges?

Rather than looking inward and retreating behind protectionist devices, American and European policymakers and legislators should adopt bold, far-reaching initiatives that set a new and sounder course for the transatlantic economy. Their more coordinated response to the crisis would underpin the transatlantic economy's global role. That the transatlantic economy is too big to fail should be top of mind to policymakers on both sides of the Atlantic. □

Joseph Quinlan is a Fellow at the German Marshall Fund in Brussels, and at the Center for Transatlantic Relations in Washington D.C. joseph.quinlan@bankofamerica.com



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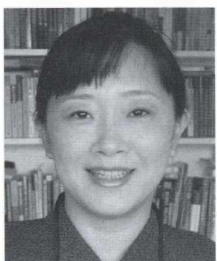


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East Asia: the acid test for Europe's common foreign policy



For all its economic clout, the European Union still doesn't count for much in political and security terms in Beijing or most other capitals in East Asia, says Jing Men. She sets out what an EU policy agenda for the region should look like

East Asia is becoming increasingly important to the EU's external relations. Trade with East Asia accounts for over a quarter of total EU trade, so the EU is keen to maintain regional stability there. The 2007 strategy paper by the Council of the European Union emphasised the EU's interests in the region and highlighted guidelines for EU foreign and security policy. Yet when compared to U.S. foreign policy in East Asia, the EU's is incoherent, much less active and more loosely defined. To turn the EU into an active actor in East Asia remains a challenge and serious efforts will be needed if it is to achieve substantial results.

when the success in creating a single market within the EU had encouraged it to tackle markets abroad. The economic achievements at that time of Japan, the four Asian tigers (Singapore, Malaysia, South Korea and Taiwan) and China's drive toward far-ranging economic reform prompted Europe to pursue ambitious ideas for economic cooperation with these countries. The inter-regional ASEM cooperation framework (Asia-Europe Meeting) established in 1996 created a platform of direct dialogue and communication between leaders from both continents. The members list of ASEM has since grown to 45.

Until it has an effective foreign and security policy, the EU will be an underdeveloped power, and will have problems when seeking to exert power and influence in East Asia

The first EU Asia policy paper "Towards a New Asia Strategy" came out in 1994,

Nobody today needs telling that East Asia is the most dynamic region in the world. And largely as a result of China's rise, geopolitical

relations in the region are being redefined. Japan used to be the leader of the multi-tier hierarchical "flying geese" model of regional development, but that was before it suffered its "lost decade" of economic depression. Between the U.S. and China the relationship has gradually changed from conflict over ideology and of differing political stances in international relations to one of competitors yet partners who have learned to defend each other's interests through cooperation instead of confrontation. The decision by the U.S. Secretary of State Hillary Clinton to make East Asia her first official visit sent a message to the world that she saw the region as crucial to U.S. foreign policy.

The EU is much less involved in East Asian regional affairs, with its cooperation on foreign and security policy to a large extent only on paper. France's withdrawal from Vietnam in the mid-1950s in the wake of British and Dutch decolonisations in the region saw European influence there dwindle rapidly. Then, in the Cold War era, the U.S. concluded treaties with most countries in East Asia as it sought to set out the terms of regional peace and stability.

The European Security Strategy of 2003, along with last December's review of its implementation marked the EU's present effort to develop towards becoming a world power. But despite its rising global ambitions, the EU's capacity to do so remains in serious doubt. Compared with U.S. influence worldwide and the rising economic and military power of China, the EU is widely seen as the epitome of soft power. Attaching, as it does, great importance to democracy, the rule of law and respect for human rights,

COMMENTARY

By James Moran

But it's far from the black-and-white picture painted here

Jing Men is certainly right when she says that East Asia is becoming increasingly important to the EU. Trade, or more precisely trade interdependence, is certainly a major driver, although Europeans also know that success in our efforts to face up to climate change, the financial crisis, weapons proliferation and a host of other global issues will critically depend on forging effective alliances with the region.

It is the case that given geography, history and its network of alliances and military presence, the U.S. has a particular role to play in the security of East Asia. Jing Men contrasts this with the EU's lower 'hard power' profile, and implies that as a result Europe lacks influence. But black and white pictures seldom do justice to reality.

Recent developments have shown that the EU can make a significant contribution to regional stability, even if its force projection remains limited. An obvious example is that of Aceh, where a dangerous conflict close to one of world's most important sea-lanes was largely resolved through a partnership of Indonesia, ASEAN and the EU. The EU played the role of an honest broker there, combining its strengths in security, democratisation and development in the Aceh Monitoring Mission. And we stay engaged in Aceh. This is neither hard nor soft; it is 'smart'.

the EU acts as a guardian of these values. These are important conditions for would-be EU members to espouse, but its lack of hard power means that the EU's capacity to influence other regions is rather limited. In other words, the EU has a weakness in terms of its international relations.

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Until it has an effective foreign and security policy, the EU will be an underdeveloped power, and will have problems when seeking to exert power and influence in East Asia. The United States, by contrast, remains a significant external power with strong military forces deployed in Japan and South Korea, two countries that have been close allies since the end of World War II. The U.S. is a major actor in the on-going North Korean nuclear crisis thanks to its 25,000 soldiers in South Korea. In China-Taiwan

relations, the U.S. plays an essential role because of its Taiwan Relations Act and the strong naval presence of its aircraft carriers in the Pacific. The U.S. influence in ASEAN countries is also undeniable.

If the EU is to enhance its influence in East Asia, it has to develop a more effective diplomatic and security policy. One problem is how to overcome internal differences and achieve consensus among its member states in the making of East Asia policy. Its 27 member states need to find a better balance between the overall EU interest and their individual national interests. The EU also needs to strengthen its relations with major actors in the region, not only in economic cooperation and trade relations but also in military exchanges. The dialogue between the EU and East Asian countries should include military cooperation.

As to North Korea's nuclear programme, the EU should strengthen communication with the other five members in the framework of six-party talks and try to strengthen direct contact with North Korea. North Korea is greatly in need of capital and technology, so the EU might become its ideal partner. EU economic cooperation with North Korea could help encourage the latter to be more cooperative in its relations with the outside world, and thus lead eventually to its complete nuclear disarmament. South Korea is an indispensable actor in the six-party talks, and an enhanced EU relationship with South Korea would help strengthen Europe's influence in this major security issue, too. Last year's EU-South Korea biennial summit meeting scheduled for October was cancelled due to the "busy

timetables" of French president Nicolas Sarkozy and his Korean counterpart Lee Myung-bak.

The EU has for a long time had a close economic cooperation with Japan, but EU-Japan political cooperation is much less developed and needs to be deepened. With both parties deeply concerned over security and stability issues the two should clearly strengthen their cooperation on global and regional conflict prevention, disarmament and non-proliferation.

The EU could also play a special role in relations across the Taiwan Strait. Despite the fact that the EU established a strategic partnership with China, it still maintains the arms embargo against Beijing that it introduced in 1989, although EU member states are themselves divided over whether the embargo should be lifted. The EU tried to give serious thought to the issue five years ago, but pressure from the United States and China's introduction of its Anti-Secession law against Taiwanese independence made the issue more complicated than ever. The EU obviously wouldn't want to see weapons made in Europe being used against American soldiers, but it nevertheless needs to ensure that its partnership with China is not jeopardised by differences over the arms embargo. While requesting that China should make noticeable improvements in its human rights record, the EU should also develop consensus among its member states on their policy towards China.

The scheduled EU-China summit at the end of last year was postponed due to President Sarkozy's planned meeting with

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James Moran

Yes, East Asia is one of the most dynamic regions of the world. But it is also one of the least integrated. Knowing the dangers inherent for their security and development, East Asian countries have been struggling for years to find ways of better managing their common space. ASEAN remains the best example of this and the EU, in addition to its longstanding financial and technical support, provided inspiration for their new charter, which should help to spur integration there.

And the EU is reaching out to the region in other ways: it has established strategic dialogues with China, the U.S. and Japan and has expressed its intention to accede to the Treaty on Amity and Cooperation which underpins the East Asia summit process, where the EU wishes to become an observer. Last October's Asia-Europe Meeting (ASEM) summit enabled us to make common cause in dealing with the financial crisis. Europe has been consistently and publicly supportive of the six-party talks on North Korea and the cross-strait dialogue between China and Taiwan. The EU remains a major aid donor to those countries fighting poverty, and it funds conflict resolution efforts in many countries of the region.

The EU is negotiating a number of new generation partnership agreements with China, South Korea and ASEAN countries, and FTA's with the latter two. The partnership accords include common commitments on security issues, like non-proliferation and counter-terrorism.

Last autumn's postponement by Beijing of the EU-China summit was certainly a setback, but both sides have moved to put this behind

Strategic Dialogue Report on

EUROPE AND CHINA

based on the debate held on 19 May 2009 in Brussels
by Friends of Europe and the Security & Defence Agenda

OUT IN JUNE 2009

On the eve of the EU-China Summit in Prague, the "Europe and China" conference addressed a wide range of topics, touching on geopolitics, the economy, security and defence, and environmental issues. Key speakers from the EU, China, and international organisations such as NATO provided the debate with valuable insight into what the future of relations with China will be. In spite of diverging interests in certain policy areas, the consensus was that cooperation was necessary to achieve the goals of both the EU and China.



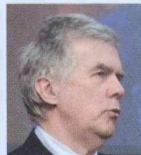
"We share the view that there can be no sustainable development without peace and security, and no sustainable peace without development and poverty eradication."

Benita Ferrero-Waldner, European Commissioner for External Relations



"We all hope that the economy will hit bottom and turn around quickly. We all fear that a prolonged recession might incur social contention, political strife and even international conflicts. But the crisis will not fade away if we sit idle. We ought to take decisive actions and effective measures."

Zhe Song Ambassador, Mission of the People's Republic of China to the EU



"We need to think in terms of an alliance between the West and China. This is a single world and we should think in terms of a single alliance to defend against disorder and chaos. I do not know what China is thinking - but it ought to think our interests are identical."

Robert Cooper, Director General of the Council of the European Union



"An outsider can always be confused by the EU. Bilateral relations with individual member states have a much longer history. We try to solve problems in a bilateral context."

Jian Yuan Vice President, China Institute of International Studies (CIIS)

the Dalai Lama. Although that was in his capacity as France's head of State, he was at that time also President of the Council of the European Union, so this incident affected EU-China relations negatively. This makes it more necessary than ever for the EU to develop a joint policy on China that all its member states would implement, thus ensuring that in the future overall EU-China relations would not be affected by the behaviour of individual member states. Doing so would also help increase EU influence by reducing China's ability to exploit any situation where EU member states do not speak with one voice.

Much has been written about this being the "Asian century". If it is genuinely to strengthen its role in East Asia, the EU must introduce changes that will guide it towards a new-style East Asia diplomatic and security policy. The EU must develop its actions from paper engagement to substantive engagement, from differences among the EU member states to consensus, from policy incoherence to policy coherence, and from individual action to joint action. □

COMMENTARY

James Moran

them. China's Prime Minister Wen Jiabao came to Brussels in January for talks with the Commission's President José Manuel Barroso, and the summit was rescheduled to take place under the Czech presidency. Then there will be a further encounter in Beijing before the end of the year. And that is as it should be; we may have our differences on such matters such as human rights, but the EU and China need each other as never before. The financial crisis has given both sides a sharp reminder of just how interdependent we have become.

None of this is to deny that the EU should speak more effectively and with one voice when dealing with the region. And while complementarity with the U.S. and other partners is clearly important, Europe needs to reflect more on its own security involvement there. It's very much on the agenda. □

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Time for Europe to take a long, hard look at its global decline



Global influence in international security is a zero-sum game, says **Frans-Paul van der Putten**, who warns that China is now pulling steadily ahead even though few Europeans yet understand what this means for them

Europe is ill-prepared, if prepared at all, for the way its influence in international security is declining, or for the consequences of that decline. China's rise is the forerunner of what *Newsweek's* Editor Fareed Zakaria has called 'the rise of the rest', meaning the non-Western China's emerging role as a major international security actor heralds an overall decline in the power of the West, but clearly it is one that will affect Europe more than the United States. The U.S. will retain its position as the most influential actor in international security, even though the gap between it and other powers may be narrowing. Europe is already being overtaken by China as the second most influential player, so the question is not whether Europe will be a less powerful actor in international security, because that process cannot be avoided, but whether Europe will still be capable of protecting its interests around the world.

Come the day when international security will no longer be so exclusively dominated by

the West, Europe's need to actively protect its economic interests will be all the greater. Developing the means to do so is bound to mean significant costs and sacrifices. Europeans may need to spend substantially more on military capacity, relying less on their military alliance with the U.S. They may also have to give up the permanent seats in the UN Security Council held by Britain and France in return for being able to shape the Council's post-reform structure. They will also probably have to accept a significantly less open economic model, and to impose fewer normative demands on non-Western countries.

Far-reaching changes of this calibre are for most Europeans impossible to accept at present, and probably not even to seriously contemplate. Yet as long as this mindset prevails, no major shift in Europe's security strategy will be possible. So in the meantime it is necessary to increase the flexibility with which Europe can respond to the fundamental geopolitical changes now taking place. This can be done by investing

in a robust knowledge infrastructure and by creating public debate on Europe's changing position in international security, and on the rise of new great powers.

Greater preparedness will begin with greater awareness of changing power relations outside Europe, in particular the rise of China. Europe needs to develop an independent knowledge infrastructure to supply policymakers with information on what is happening to China's international security role. European policymakers tend to depend on data and insights from American sources – universities, think tanks, defence consultancies and government agencies. But the bulk of these are from an American perspective, whereas Europe has its own distinct geopolitical position. This is particularly true of China's impact on international security. European policymakers should also initiate public debate on major new developments like the increased role of Chinese state-owned investors in the European economy, and China's growing impact on the international agenda for human rights and global governance. These debates are also needed for Europeans to decide what sort of price they are prepared to pay to stay in the global race for influence.

After the end of the Cold War, Europe once again moved to a more prominent position in global security because America's European allies automatically became the most important secondary security actors. But Europe's relative return to prominence is now being affected by the rapid rise of China. This is already visible in regional crisis management in the Middle East and Africa, regions where both Europe and China play a role in regional stability. Two

COMMENTARY

By Wei Pan

How we in China see the future of global governance

It is not too early to imagine ways in which China's rising economic power might reshape the global political map. Crisis or no crisis, China will by the end of this year overtake Japan to become the world's second largest economy. Some Americans have even started to talk about "Chimerica" co-governing the world. But predicting the future is a notoriously risky business, and in any case we know that Japan with its theoretically influential economy in fact has little political impact in world affairs, while the Soviet Union with its relatively small economy was able to turn the world upside down.

It is in any case wrong to fantasise that China is likely to follow the old logic of the Western powers by spreading religious belief, projecting military power, directing value orientation, and imposing a political system. China is more likely to seek "mutual respect" rather than "dominance", and three simple doctrines may well shape its behaviour.

First, the very ancient principle of "hua bu zhi yi" would be followed; it means the Chinese should not govern foreign peoples. Please don't immediately challenge me with Tibet, because the people there are Chinese citizens. "Non-interference" may be an overly legal expression but it nevertheless reflects the maxim with which the Chinese "empire" in East Asia survived all other empires. It seems amazing to us in China that after the imperial failures of Great Britain

recent examples of regional security crises in these parts of the world are the nuclear issue in Iran-U.S. relations and the Darfur crisis. In both instances, European influence is diminishing at the local level, while that of China's is growing. This is a result of the European strategy of applying economic sanctions and adopting a confrontational stance towards Tehran and Khartoum.

China, by contrast, has preferred to keep its local economic interests intact and to remain friendly with these countries' governments. Europe's actions limiting economic ties and criticising local governments have a progressively smaller impact each time they are applied, while strengthening China's position, so that Beijing emerges as indispensable to efforts to de-escalate these crises because it has influence both in the UN Security Council and at local level. This doesn't apply to all regional security crises, but it does reveal a significant advance of Chinese influence in parts of the world where Europe and the U.S. were formerly dominant.

Another sphere in which China's rise affects the European position is the setting of international norms for global governance and human rights. Many in Europe believe that the EU's "soft power" means their part of the world has a promising future as a norm-setter and as a model for multilateralism to shape international security mechanisms. But Western-originated norms for governance and human rights are increasingly on the defensive. If they are not to become obsolete, both international norms and the international organisations built on them will need to accommodate non-Western influence and interests.

In global security governance, a key issue is the relationship between human rights and state sovereignty. China, like many other non-Western countries, is reluctant to see the UN interfering in a domestic crisis against the wishes of the local government. Europe supports the idea that the international community's responsibility is to interfere in situations where human rights are seriously threatened. China doesn't disagree in principle, but disputes the Western definition of human rights. The underlying issue is that the approach favoured by the West leads to more Western influence, whereas China's approach is more beneficial for China. Both China and European countries are keener than the U.S. that the UN Security Council should keep on functioning, and so are forced to make certain compromises. The difference is that for Europe, with its preference for soft over hard power, norm-setting spearheads its global security strategy.

The balance of direct political influence of China and Europe in each other's regions is also set to change. That Europe plays no role in East Asian security is becoming more significant than ever now that the region plays such a major role in the global economy. Europe's political absence from the East Asian region is notable not just because of the region's global importance, but also because the region faces two acute security crises. The European Union is involved in the Taiwan issue – and the military stand-off between China and the US – through the arms embargo it maintains against China and through Europe's military alliance with the United States. The EU has no viable strategy to deal with the arms embargo, and no clear policy on the

Taiwan issue. Regarding the second crisis, the North Korean nuclear crisis, Europe is formally involved through British and French permanent membership of the Security Council, even though the other three permanent members together with Japan and the two Koreas have effectively sidelined the European actors through the Six-Party Talks. Europe is currently not contributing to regional security in East Asia even though formal mechanisms exist for exerting influence there.

Although Europe's economic clout is thus not coupled with political influence in East Asia, China is becoming increasingly influential in Europe. Major Chinese companies and funds are already investing in European businesses, and are likely to do so on a larger scale in the future. Most of China's major corporations and investment funds are state-owned, but this does not mean that Chinese state-owned investors are primarily motivated by political considerations, even if such considerations are never entirely absent from their agendas. Incidentally, the activities of Chinese state-owned companies are also enhancing China's influence in regional politics in Africa and the Middle East. Chinese investors have the capital that European companies at present lack. Although the Chinese government aims to keep a low profile in this context, in the long run it is bound to have not only greater interests in Europe but also the means to exert influence.

If Chinese state-owned investors are allowed to purchase a substantial number of financial, high-tech, and logistics firms in Europe, this would provide the Chinese government with the potential to exert political influence. European governments will face a

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Wei Pan

and the USSR, the U.S. is still trying to "govern" Afghanistan. Strategic importance, superior fire power and huge financial expenditures do not make military occupations or puppet regimes viable (unless, of course, the Afghans were to be given U.S. citizenship!). America's military budget is equivalent to those of all other countries combined, and although its military have pledged to "win two wars at the same time," they haven't won a single war since World War II. They may win battles, but they lose their wars.

My second point is that the most important value for China in international relations is "mutual respect." Our approach is that because no government is able to govern a "foreign" people, respecting foreign governments is the way to receive respect and maintain peace. If the French government, for instance, were to feel free to humiliate the Chinese government so as to win greater domestic support in France, the Chinese government would do the same. Keeping good relationships between people requires mutual respect, and so do inter-government relationships. If they were to stick to this principle, few countries would feel the need to possess weapons of mass destruction, not even Iran and North Korea.

A major departure from this principle of mutual respect is the self-imposed sense of moral superiority that we see as an amusing left-over from the era of colonialism. China respects human rights, but not when they are defined as a "superior" way of governance. China could never become a "stakeholder" in human rights of the kind that are used to justify bloody civil conflicts or even naked invasions.

Thirdly, China will strive in international economic relations for mutual benefits under



Benita Ferrero-Waldner, EU Commissioner for External Relations and European Neighbourhood Policy
Franny Armstrong, Director of the film "The Age of Stupid"
Jean-Pierre Jouyet, President of the Autorité des Marchés Financiers (AMF) and former French EU Minister
Recep Tayyip Erdoğan, Prime Minister of Turkey
Shaojun Zeng, Secretary General of the China New Energy of Commerce and Executive Director of R&D Center of Tsinghua University



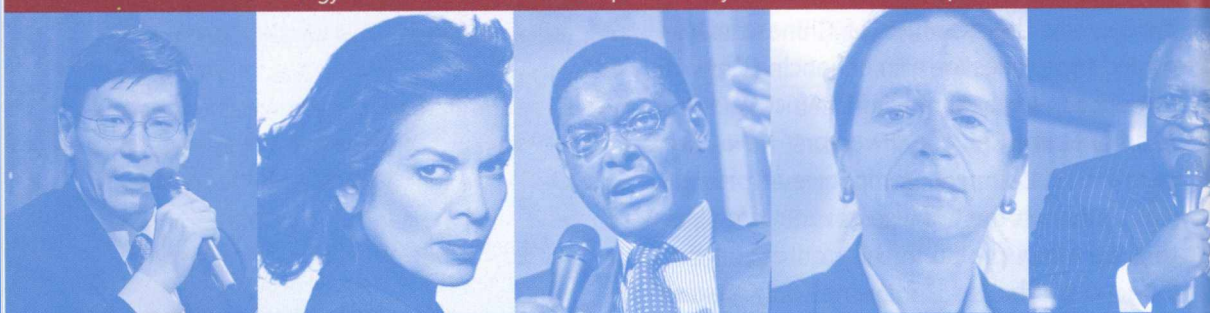
James Musoni, Rwanda's Minister for Finance and Economic Planning
Dana Hovig, Chief Executive Officer of Marie Stopes International
Aurélie Bouchez, Deputy Assistant Secretary General for Political Affairs and Security Policy, NATO
Georges Pauget, Chief Executive Officer of Credit Agricole SA & Member of the European Financial Services Round Table (EFR)
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difficult choice. Either they must allow state-owned Chinese investors to expand their presence in the EU economy, or they must introduce defensive measures to screen and sometimes prohibit foreign investments, even if that compromises the principles of a free market. Allowing state-backed companies to play a greater role in the international economy could benefit large countries such as China. The stakes are in any case getting higher because the global financial crisis is due to increase China's economic influence in Europe, while the concept of state interventionism – as practiced in China – is also on the rise internationally.

Many European countries have been working hard to further strengthen European integration while adapting to the post-colonial and post-Cold War world. But in the external security strategy sphere they are not doing enough to keep up with international developments. The focus on the EU's future potential and on what has been achieved so far, and on its internal processes, has apparently distracted attention from the geopolitical realities of Europe's shifting relative position. Just as the rise of Europe between 1500 and 1900 was a fundamentally new phenomenon, so is today's rise of the non-Western world. It is very difficult for Europeans to imagine a world in which we and the Americans are no longer the politically dominant minority. But China is already successfully challenging the old system, and Europe needs to look at what is happening and think hard about the implications. □

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COMMENTARY

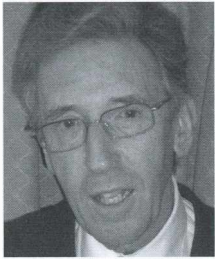
Wei Pan

fair terms. China still suffers from various discriminations imposed by the "international community," such as its "non-market economy" status in the WTO and the arms and high tech embargo by both the U.S. and the EU. More debatable, perhaps, is the status of China's state-owned financial and industrial enterprises. They are independently run and listed on the stock exchanges. With more than 99% of China's registered firms being mini-sized family businesses, the Chinese government has created state-owned enterprises to undertake expensive domestic infrastructure projects and to compete internationally. In the world markets for natural resources, a few Western oligarchs have been the dominant forces, relying on their own governments as back-up and to manipulate foreign politics. "Free" markets without any state intervention have never existed as either the state captures capital, or capital captures the state. In Africa, China's state-owned enterprises emphasise mutual benefits and try to win the local people's hearts by offering sustainable cooperation in the long run. By contrast, the western oligarchs' profit-making looks more like an outdated conquistadores' offer of "cheap weapons for pure gold," and of course that is the hidden core of the Sudan dispute.

As China's industrial capacity grows, these three principles may yet prevail and help make the "free world" freer than it is today. For my part, I can only wish that Europeans could see that this approach offers a chance to achieve real progress rather than presenting the West with a crisis of "global governance". □

Wei Pan is Director of the Center for Chinese and Global Affairs at Peking University's School of International Studies. panwei@pku.edu.cn

The microchip is changing the face of foreign policy



The communications revolution is robbing governments of their age-old monopoly of foreign policymaking, says David Howell, who believes it will also challenge the CFSP aspirations of the EU. He warns that Europe's common policies will need to be very flexible to adapt to the new conditions

Does the European Union have anything close to a world view? Because the architecture of international relations has changed almost beyond recognition since Rome Treaty days, it's incontestable that today's EU has to address a world pattern of influences, trends, challenges and priorities that are totally different from those that faced the founding fathers, or even the much-enlarged EU a year or two ago.

The most visible evidence of this is the emergence of the G20 as a forum for the world's hopes and fears, reflecting the rise of Asia and the decline of Western hegemony. But the trends have been there for well over a decade and go far deeper than the headlines or the tensions of worldwide economic turmoil.

From the mid-1970s onwards, a succession of events made the old international agenda obsolete. The Cold War is now a memory even if its traumatic scars linger, and a mosaic of ethnic and nationalistic quarrels has long

since replaced its old ideological divide. Power has shifted between capitals but has also been dispersed into internet linkages which have empowered almost half the human race, with still more communication innovations just ahead.

These developments have shaken the international institutions of the 20th century to their foundations. The United Nations, the Bretton Woods Institutions, the World Trade Organisation, NATO and the nuclear non-proliferation regime, to name only the most prominent, have all come under intense scrutiny as to their purpose, structure and relevance. Neither the EU nor the political structures within its member states, have escaped the waves of questioning now reaching into almost every corner of human affairs and governance.

This massive fluidity in international affairs confronts policymakers and those who would build more secure global structures with a set of entirely new complexities.

For the EU, searching for a more focussed global and better co-ordinated role while at the same time trying to settle its own future, the situation presents challenges that are particularly acute. In the first place, the transatlantic perspective has changed fundamentally. America has surrendered its unipolar moment and even its super-power status is now severely diluted. There used to be the view that a unified Europe could be a counterweight to U.S. dominance, but American influence is now at its nadir throughout the Middle East, Central Asia and beyond, as well as in its own backyard of Mexico and Latin America.

Obamamania may for the time being be obscuring all this, and there is no doubt that the U.S. presidency is now held by a highly personable and able individual. But *Pax Americana* is today as much history as *Pax Britannica*. The concept of a world shaped by the 'transformational diplomacy of American values', as President George W. Bush's Secretary of State Condoleezza Rice liked to put it, now has zero validity.

How can this be, it may be asked, when the U.S. military spend is vastly greater than the rest of the world's put together, when the country boasts 13 carrier fleets and 2,000 missiles and when the U.S. economy still accounts for 20% of global GNP?

The answer lies in one word – the microchip. Size no longer equates with power. On the contrary, size means vulnerability, slowness to adapt and inflexibility. The miniaturisation of weaponry, combined with the communications revolution, has given birth to an irreversible asymmetry of warfare and violence. The power to organise, to coerce and to strike has been placed in

the hands of a horde of non-state players and activists, both good and bad, as well as lobbies and pressure groups of every political hue. This power is in the reach of the smallest extremist groups and the most rogue-inclined rulers.

Afghanistan becomes a running sore; the Middle East a maelstrom of religious factions and terrorist networks instead of a democratic paradise – the 'drained swamp' which the last administration's neo-cons so naively dreamed of.

The counter-argument used to be that even if America could no longer get its way through military might it at least remained the master of the financial and economic universe. But that claim, too, has been vaporised in Wall Street's furnace of bankruptcies, debt and collapse.

Suddenly, it is no longer a question of Western dominance and who between Europe and America calls the shots. The answer is neither. The European powers now have to look elsewhere, and think in different terms if they are to make their mark and protect their own security and welfare.

The second major shift is even harder for EU member states and European strategists to comprehend. The fabric of relations and connections between states and societies has been radically altered. The international pattern is no longer primarily government-to-government. The information age has taken away the monopolies of data and international intercourse between state authorities and placed it in the hands of countless groups, professions and interests

which can and do coordinate activities and pressures across national boundaries regardless of official stances and policies. What this means is that the evolution of external policy and relationships, whether at member state or EU strategic level, is no longer predominantly in the hands of officialdom. The pattern is being crafted at sub-governmental and non-governmental levels between professional bodies, regulators, battered banking authorities, local government, scientists, judicial experts, medical authorities, media magnates, international designers, standard-setters in safety, health, sports – the list is endless.

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We are looking here at what has been called the privatisation of foreign policy, which could also be described as the emerging biochemistry of international relations in a networked world, a world in which no great centralisation of rules, laws and powers and no great role of 'world leadership' by a single nation or bloc is either required or relevant.

Europe's approach to the wider world, and consideration of its own future, has

to take account of all this. It is not merely a question of recognising that power has migrated significantly from the debt-sodden West to the high-saving and cash-rich nations, but of understanding that influence in the new networked world comes in entirely different packages. An interesting consequence of this is that organisations that had seemed redundant in Cold War times or before the Internet Age are now engaging a renewed usefulness. A good example is the Commonwealth network which emerged out of the old British Commonwealth and now embraces almost two billion people in a subtle lattice-work that provides major opportunities for influence and the promotion of its members' interests.

A third problem for European strategists, as they struggle to make sense of this kaleidoscopic world is that the resource patterns of the globe, particularly energy, are being radically transformed and will have a profound impact on how power is distributed internationally. Much is made of Europe's need to reduce its dependence on Russian gas through a common energy policy, and with a more evenly balanced EU-Russia relationship. But in practice this may be viewing the whole issue through the wrong lens.

Climate concerns and the goal of drastically reduced CO₂ emissions are the main drivers, and major technological advances in the efficiency, safety and economy of nuclear power mean there is a realistic opportunity for Europe to escape the Russian grip altogether. Even in the short term, Russian gas exports to Western Europe plunged by 22% between 2008 and the 2009 likely requirement, and prices dropped too.

Extensive new natural gas developments on European soil will further weaken the Russian bargaining position. Dependence on Middle East oil may also be on the same downward path. In both directions, the energy factor is now taking second place to the need for different sorts of relationship. What Europe needs from Russia and from heavyweight Asian players like India, China and Japan is greater cooperation in containing Iranian destabilisation and detoxifying the Middle Eastern quarrels that fertilise terrorism – neither America nor the EU having proved capable of mounting the necessary pressure on Israel to settle the Palestine issue.

In this international scene of extraordinary fluidity and uncertainty, the EU cannot afford the stilted rigidity of direction which treaty procedures and formalities of hierarchy impose. Its world view must be flexible, agile and above all realistically attuned to the inevitable constraints which a 'committee' of 27 countries, inevitably imposes.

Europe can come together and act effectively on specific and well-defined issues, but not on everything. It cannot substitute for the growing mesh of bilateral relations which the information age has created. Nor can it live within a legislative or treaty-determined straightjacket. That is why so many good and sincere Europeans nevertheless feel uncomfortable with the Lisbon treaty's aspirations, which claim not to touch foreign policy matters and yet clearly point in the direction of a single European voice and an EU Foreign Minister in all but name.

Behind this realism there lies what is perhaps the most difficult issue of all for

European strategists to accept. It is that there is neither a settled world nor a settled and 'complete' EU to be positioned within it. Euro-enthusiasts like to talk about an ultimate end-point for European integration, a 'solution' or goal, with movement towards which constitutes 'progress'. But this concept is both intellectually and philosophically flawed. European nations, in all their glorious diversity, have now been pitched into a state of permanent *mouvimenti*, or oscillation. Questions about the distribution of powers and competences between different levels will remain under constant and continuous challenge. It is in the nature of human affairs that they will never be settled. There will be no final treaty or constitution that can sign off and seal the task. Arguments will come and go for powers to be administered centrally or peripherally as circumstances alter.

The key for this restless Union to operate effectively on a treacherous world stage is an appreciation of the limitations of an EU common foreign policy, and an equal wariness of over-ambition as a potentially fatal disintegrating force.

A world view has nowadays to be formed in constantly shifting conditions, and formed by a Europe that is itself a constantly changing political process and not a settled and organised platform. Charting Europe's future is akin to navigating a storm-tossed vessel in the worst possible sea conditions, and will call for leaders with better piloting skills than now and better charts than our treaties so far if we're to avoid the ugly rocks ahead. □

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How to draw a line under the Cold War



Faced with the daunting new challenges of the global economic crisis, the time has come for the West to re-think its relations with Russia, says Sergei Karaganov. He sets out his plan for an ambitious new collective security agreement

This year offers a seemingly magical combination of anniversaries of events that shaped the world we live in. The main one, of course, is the twentieth anniversary of the fall of the Berlin Wall, whose consequence was the death of "real socialism", and the amazing historical phenomenon of complete reconciliation between Russians and Germans. Yet it may be that the end of confrontation in Europe will prove only temporary. The old divisions may be re-emerging, even though in a different form, even though the Cold War in Europe was declared to be over, the truth is that it actually never finished.

When the Soviet Union voluntarily withdrew from Central and Eastern Europe, and gave a green light to the reunification of Germany, we Russians believed that the NATO alliance would not be extended to

those countries and territories from which we had withdrawn. Our hope was for unification with Europe in a "common European home" and the creation of a "united and free Europe". And our hopes were not just based on starry-eyed self-deception; the leaders of the U.S. and of Germany had promised Gorbachev the non-enlargement of NATO.

After the first few euphoric years, the West's behaviour became more triumphant. It acted more and more like the Cold War's victor

Those Russians who had borne the brunt of the Communist dictatorship and who had also done more than any other nation to put an end to it came out of the Cold War without any feeling of defeat. On the contrary, they felt victorious because they had vanquished Communism; in geopolitical terms, they withdrew with their banners unfurled, expecting an honourable peace.

But after the first few euphoric years, the West's behaviour became more triumphant.

It acted more and more like the Cold War's victor. And the successive waves of NATO enlargement had neither military nor ideological logic, once the potential "military threat" posed by the Soviet Union to the West had vanished into thin air.

There remained only a geopolitical logic for the West, its desire to bring the former Soviet republics and the erstwhile socialist states of Central and Eastern Europe into the Western sphere of political and economic influence. At first, NATO's new members were declared to have met both democratic and military criteria, although later these were abandoned when NATO began to invite even the most backward and corrupt states to join.

Europe's division during the Cold War years was widely believed to have been based on an ideological and military confrontation, but it quickly turned out that once these threats were gone, the old geopolitics came to the fore, at least so far as the U.S. and "old" Europe were concerned. NATO not only enlarged its membership but also transformed itself from an anti-Communist defensive alliance into an offensive one. NATO committed aggression against Yugoslavia and annexed Kosovo away from it. The United States, with some of its NATO allies, attacked Iraq, and through NATO is now waging an offensive war in Afghanistan, far from the alliance's original area of responsibility. And, it must be admitted, it is doing so with Russia's consent. Nevertheless, NATO's expansion towards Russia's own borders and the membership of countries whose elites have historical complexes regarding

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By Slawomir Debski

Let's talk, but not about a war that ended long ago

Sergei Karaganov suggests that the Cold War is not over, it has merely lulled. He is entitled to his view, the view of a Russian with professional interests in politics, but it is not one that is much held in the West. The Cold War was between the Soviet regime and the democratic world. On one side were a group of nations that valued individual liberty and the rule of law. On the other was the Soviet regime, a dictatorship with a policy of enslavement – of individuals, societies and nations. When the Soviet Union finally collapsed in 1991 the Cold War was over. It was as simple as that.

Karaganov says that the West claimed victory. But there was little triumphalism in the West, more a feeling of relief, and expressions of magnanimity towards the old enemy, which had ended up broken and poor.

In support of Karaganov's contention that the Cold War is unfinished, he sees NATO as the prime cold warrior. It is true that the downfall of the Soviet empire has in no way affected the determination of NATO countries "to safeguard the freedom, common heritage and civilization of their peoples". While the Soviet threat led to the emergence of NATO, it had long been preceded by a western alliance held together by traditional democratic values combined with a common interest in security. New candidates, by their very desire to join NATO, reaffirm its relevance and that they are

Russia because of setbacks in centuries past, has inevitably increased anti-Russian sentiment inside the alliance.

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I do not myself believe that NATO threatens Russia or can do so in the future. It was not only its doctrine that made NATO a defensive alliance. I feel confident when saying that even in Soviet times NATO was not a serious military threat. Yet for all its efforts to improve its image, NATO is now viewed by many Russians as a much more hostile organisation than in the 1990s, or even before.

Politically, NATO enlargement has become the main threat to European security. Thanks to it, Europe has still not emerged from the Cold War, even though the ideological and military confrontation of those times is far behind us. It is being replaced with a new stand-off – between Russia on the one hand and the U.S. and some of the “New Europeans” on the other. Old Europe is keeping somewhat aloof, but the countries of Western Europe are hostages and cannot

easily distance themselves. It is a new confrontation that is taking shape against the backdrop of an increasingly unstable and dangerous world.

The Cold War thus remains unfinished in the minds of the political classes, including Russia’s, and nor has it been concluded institutionally and organisationally. This is perhaps the most important point of all; institutions like NATO and even the Organisation for Security and Cooperation in Europe (OSCE) that were initially established to serve the Cold War have again been used to recreate confrontation. No peace treaty ended the Cold War, so it remains unfinished, and now is pulling the world back into the past.

My hope is that, when historians look back at contemporary events, Tbilisi’s attack on South Ossetia will prove to have been a fruitful episode, and that the victims – the Ossetians, Russians and Georgians killed in that war – did not die in vain. Russian troops crushed the Georgian army on the ground, but politically they delivered a strong blow against the logic of further NATO expansion, which if not stopped would have inevitably brought about a major war in the heart of Europe.

For the time being the situation remains open. The U.S. and its client states failed to unleash some new form of Cold War after the South Ossetian episode, not least because “old” Europe would not permit it. Any attempts to start a new Cold War were also overshadowed by the global financial and economic crisis which has made old squabbles and attitudes more

than comical because it has emphasised the new challenges that confront us all.

It is very much to be hoped that the global economic crisis and the coming to power of Barack Obama will put the whole farcical idea of a new Cold War in its proper perspective. But its institutional roots will remain, and risk poisoning life and obstructing strategic cooperation between Russia and the West. Greater Europe, in which I would include not only Russia but also the U.S., needs a new peace treaty and a new architecture to draw a line under not just the Cold War but also under World War II. The Yalta and Potsdam treaties turned out to be only provisional agreements on the division of Europe. Russia recently proposed overcoming the present situation with a new treaty on pan-European security. This treaty, or rather system of accords, could finally draw a line under Europe’s truly horrible 20th century. For unless this page is definitively turned, history may once again catch up with us and bring about a relapse into our past. We therefore need a new round of creative diplomacy that completes the construction of a European security system and clears away all vestiges of the past.

There are various options for a “new European architecture”, but let me offer the one I find the most attractive. We need a new pan-European treaty on collective European security, signed on the one hand either by individual countries or by NATO and the EU, and on the other by Russia and the Organisation for Collective Security Treaty. Countries not included in any of the current security systems would be able to join in the

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willing to participate in the defence of the values it stands for.

Karaganov proposes a new “peace” treaty between Russia and Europe. The weakness of this proposal is that it presumes the existence of a latent “cold war” that could quickly become a warm war or even a hot one. Russians may believe this, others may dismiss it as nonsense.

The reality in Europe is that it is at peace, a condition that it has not enjoyed for centuries. The EU countries are no threat to one another or to any other country. I am surprised that Karaganov does not mention the European Union as a provider of security, where a policy of self-limitation for the sake of common benefits has created an environment that favours the formulation of political and legal arrangements rather than the gun. The security provided by the EU and NATO is the magnet that has attracted new members.

It is perfectly understandable that Russia does not feel comfortable on Europe’s periphery. No one likes to be an outsider. That’s the reasoning behind the idea of “new security architecture” in Europe. And it should be said that talks, under whatever fanciful heading they take place, are often productive and at least are unlikely to do harm.

Russia is no longer broken and poor and understandably aspires to be one of the leaders of today’s world. To gain that status and be respected for it the Kremlin needs to re-think its future. First, Russia should cease to view NATO and the EU as its rivals. Second, it should acknowledge that the overwhelming

treaty and receive multilateral guarantees, and any further NATO enlargement would de facto be frozen.

The OSCE would be transformed into the Organisation for Collective Security and Cooperation in Europe. It would be a good idea if the future treaty were to reiterate the Helsinki Final Act's provisions on the inviolability of borders. With the break up of the Soviet Union and Yugoslavia very much in mind, we must seek to prevent the further fragmentation of states, and also their reunification through the use of force. Kosovo, South Ossetia and Abkhazia must be the last of the states that broke away through force, which means that the "Pandora's box" of self-determination must be closed, in Europe at least.

Once the legacy of confrontation inherited from the 20th century has been

overcome, perhaps then one could speak about deep cuts in the nuclear arsenals of Russia and the United States, and even about the coordination of their policies in the military-strategic area. Their cooperation in crisis situations like Afghanistan, or in countering the proliferation of weapons of mass destruction, would thus become much more profound.

This is the Euro-Atlantic part of my proposed system, and one that must necessarily include the U.S. In Europe proper, a collective security treaty should eventually be supplemented with a treaty establishing a Union of Europe – a union between Russia and the EU on the basis of their common economic space, a common energy space with cross-ownership of companies producing, transporting and distributing energy, a common human space that would be visa-free and coordinated by

Russian and EU policies in the international arena.

Deepening and enlarging the Shanghai Cooperation Organisation, increasing its membership and involving in its work the U.S. and the EU as observers to fill the multiple security vacuums around the Persian Gulf, would supplement the proposed cooperation architecture. Special note should also be given to a new system for governing the global economy and finance, whose creation will be even more difficult if the confrontation problems of the Cold War and its successor are not solved.

My proposed system can of course be accused of starry-eyed idealism. But its main idea is to move forward by resolving the problems that are still a hangover from the Cold War and even from World War II. We have to finish the "unfinished war", and then, perhaps in the year 2019 that will mark the 100th anniversary of the Treaty of Versailles, we may finally bid farewell to the 20th century.

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majority of European states are attached to four fundamental principles: 1) that the United States' long contribution to the security of Europe must be maintained; 2) that NATO is indispensable and complementary to the EU; 3) that every European state is free to choose its alliances; and 4) that privileged spheres of influence are unacceptable.

Russia is more than welcome to subscribe to these core principles for security in Europe. Talks with Russia? Fine, but not against the background of a "war" that ended long ago.

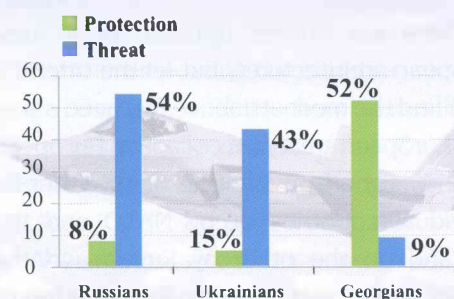
MATTERS OF OPINION

Most Russians see NATO as a threat

Over half of Russians polled think that NATO represents a threat to their country, compared to less than 1 in 10 who associate it with security and protection. In a Gallup poll conducted in mid-2008, 54% said NATO was a threat and only 8% thought it provided some form of protection. Ukrainians were similarly concerned, with 43% seeing NATO as a threat despite their country's NATO membership ambitions. Georgians, however, overwhelmingly saw NATO as offering protection.

In the same poll, less than half (47%) of Georgians said their leadership was heading in the right direction, vs. almost two-thirds of Russians when asked the same question.

DO YOU ASSOCIATE NATO WITH THE PROTECTION OF YOUR COUNTRY OR WITH A THREAT?



Excluding Don't Knows

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Why EU-Russia frictions look set to end



Russia's dwindling oil and gas earnings won't greatly change Europe's often fractious relationship with its great neighbour, says **Christopher Weafer**. But Russia is changing for a number of other reasons, making this a good time for the EU to improve its relations with the Kremlin

When oil peaked at \$147 a barrel in July 2008 Russia earned about \$1.3bn a day from its energy exports. Now that has dropped to around \$500m a day and Russia is in shock because its easy source of wealth seems in jeopardy. Could this be a catalyst for change, leading in particular to a review of its often difficult relationship with the European Union?

The EU-Russia relationship has over the past decade alternated between periods of cooperation and episodes of confrontation. It would be fair to say that both sides have felt justified in their frustration. The EU had hoped for better access to Russia's natural resources and its financial service markets, and had also wanted to see the development of a more open political system in which opposition parties played a significant role. Europe looked, too, for a greater alignment between Moscow and itself on many issues of international politics, and at the same time it voiced complaints about the inadequacy

of the rule of law in Russia, its obstructive bureaucracies, corruption and too much state control.

Russians, including former president and now Prime Minister Vladimir Putin, pointed out for their part that EU investment in Russia is significantly greater than that which Russia has been allowed to make in the other direction. Moscow sees the investment issue from a diametrically opposite viewpoint to that of Brussels, pointing to EU entry barriers as an important reason for the current strains in the relationship.

One way of smoothing this persistently tense relationship might be to accept that it should be limited to being no more than a commercial arrangement between Russia as a major commodity producer and the EU as a consumer. Such an arrangement works well, for example, in the otherwise fractious relationship between Venezuela and the United States. The security of

energy supplies from Russia to the EU from the Soviet era to the present day has never been an issue other than as a consequence of Russia's transit route rows with Ukraine. To accept that on the EU's part would certainly reduce the level of frustration.

But such a relationship would not be in either side's best long-term interests. It would clearly be much better to forge a closer economic, cultural and political relationship than to base it on a somewhat frosty commercial one. Many commentators hope that the current economic recession and Russia's much lower hydrocarbon revenues may force Moscow to adopt a more accommodating stance with the EU, and to lose some of the almost arrogant swagger that its critics observed when the oil price was rising to last year's record peak. Some on the Russian side hope that the EU's steadily growing need for imported energy

will break down the trade and investment barriers that they in part blame for holding back the development of some of Russia's strategic industries. The political row that ensued in 2007 after a Russian bank bought a 5% stake in EADS, the Airbus parent company, is cited regularly as an example.

Russia is broadly following a long-term development plan, despite being frequently side-tracked by issues such as the dispute with Shell over its Sakhalin-2 project, and the slow progress that Russians themselves acknowledge in advancing reforms. Episodes such as Sakhalin are not the result of random management decisions; when Vladimir Putin was president he set out goals for the country that can only realistically be achieved over a period of at least 20 years. They include creating a more diversified economy with less dependence on commodities, greater wealth distribution, improved social infrastructure

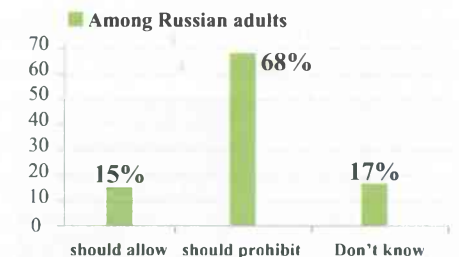
MATTERS OF OPINION

Russians want foreign investment, but not ownership

Many Russians think inward foreign investment is helping rather than harming their country's economy, but there is widespread opposition to allowing foreign ownership of Russian companies: over two-thirds – 68% – believed the government should prohibit this, supporting a law enacted by Vladimir Putin in 2008 that restricts foreign investment in 42 sectors, e.g. oil and gas, fishing and publishing.

This view was held even among those who would like Russia to become a Western-style democracy: Of these, fewer than a quarter thought the Russian government should allow foreign firms to purchase Russian ones.

IF FOREIGN COMPANIES WANT TO BUY BIG COMPANIES IN RUSSIA, DO YOU THINK THE RUSSIAN GOVERNMENT SHOULD ALLOW OR SHOULD PROHIBIT THAT TO HAPPEN?



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and greater political debate. But Putin also said that before making progress on reforms, and before spending money to create new industries, there were legacy issues from the Soviet period and the 1990s that needed to be fixed. He believed that the state was the best institution to control the evolution, because private enterprise had failed to do so in the 1990s. On a more pragmatic level, he has also regularly acknowledged that it is not possible to move too fast with reforms and other changes because Russia does not yet have the required management skills, either in the civil service or in the country's big corporations. It is a problem that will require a generation change rather than just money.

So for the eight years of Putin's presidency, the Kremlin's priorities included restoring the power of government, rebuilding the country's international standing and restructuring Russia's so-called strategic industries. During this time the government was not too interested in pushing ahead with new energy deals or major reforms. In any case, the Kremlin had not decided

on, or published, the "rules for investing" in strategic sectors such as energy. As to reforms, they were seen as liable to absorb a lot of senior government time that was simply unavailable.

The end of the Putin presidency brought an end to what can be described as the "preparation" phase of the long-term plan. The start of Dmitry Medvedev's presidency marks the start of a secondary phase of targeting reforms, of investment spending and of brokering energy deals with neighboring countries. Putin chose Medvedev as his successor, and on important issues they share a common view. But Medvedev's first year in office has been less than auspicious, and little progress has been made with his programme. Instead, we have had corporate problems with steel producer Mechel and fertilizer producer Uralkali both coming under attack. Then there was the conflict with Georgia and another dispute with Ukraine over gas. Now the main priority for the Russian government is to preserve domestic economic and social stability while riding out the global storm. To that extent, the 20-year plan has been extended by a year or two. But it remains in place and the crisis should provide a spur. Previous periods of oil weakness and economic decline have produced significant directional changes in Russia. Decline in the late 1980s was a major contributory factor to the demise of the Soviet Union, while the crisis of the late 1990s ended the transition phase between the Soviet era and modern Russia. The silver lining in this particular cloud may well be that it gets the Medvedev programme moving; it will be nothing dramatic, but for all that a positive driver.

The energy frustrations that have sometimes bedeviled Russia's relationship with the EU should now be coming to an end. In signing into law the strategic industries legislation in May last year, Russia finally established its new investment rules. Realistically, the Kremlin was never likely to allow any major new projects involving strategic industries to be created until these rules were in place. Now, Russia will be in a hurry to move ahead with such major projects as developing the Yamal gas province; a project that will eventually produce up to 250bn cubic metres (bcm) of gas annually. That is equal to almost half of the country's present output. Russia needs that project to replace the expected decline from maturing fields, and the EU needs it to provide a significant amount of the expected 200 bcm increase in its gas imports over the

coming 20 years. But with an estimated cost of \$200bn to develop the project over the coming 20 years, it is clear that Russia cannot do this alone.

Russia's problems and priorities are very deeply rooted, so real progress will take time. But any assumptions that having less daily cash flow as a result of the oil price plunge will change Russia into a more compliant and accommodating neighbour are simply unrealistic. For all that, now is the time for the EU to widen its interaction with Russia because for both sides patience will pay off in the end. □

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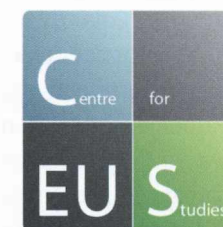
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SECURITY AND DEFENCE

The EU's "Eastern Partnership" is key to relations with Russia



The joint Polish-Swedish initiative for strengthening the EU's ties with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine is taking shape, says **Radosław Sikorski**, Poland's Foreign Minister. He explains why it will also be crucial to improving the European Union's relations with Russia

A fundamental tenet of Polish foreign policy is to support eastern European countries' democratisation and economic transformation. States based on liberal democratic political systems and on modern market economies are going to be more credible EU candidates and also become more attractive partners. That's why Poland has repeatedly tabled initiatives designed to strengthen the EU policies towards eastern Europe.

The European Council's December 2007 conclusions were the cue for Poland and Sweden to draft a concept paper for deepening cooperation with six eastern European and south Caucasus states (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine). It was presented to EU foreign ministers in May 2008 and endorsed a month later by the European Council. This Polish-Swedish Eastern Partnership (EaP) initiative was reflected in a

Communication of the European Commission last December. It laid down a new structure for tightening cooperation with these eastern partners, and added a missing dimension to the emerging architecture of the EU's relations with neighbouring regions and states, that until then had consisted of the Union for the Mediterranean, the Strategic Partnership with Russia, Black Sea Synergy and the EU's strategy on Central Asia.

The concept of active engagement in advancing the democratic transformation of eastern Europe and the south Caucasus is based on a conviction that stability and prosperity there in these post-Soviet times is fundamental to the security and economic future of the whole European continent. Five years ago, when the EU's 'Big Bang' enlargement brought in the central European and Baltic states, the Union's eastern border

shifted to new neighbouring countries with either short or shaky traditions of statehood, all of which were also struggling with serious economic and social problems.

The EU's new European neighbours to the east do not only belong in Europe in a geographic sense, as their citizens also consider themselves European by virtue of common experience and culture, not least because of their mainly Christian roots. But what distinguishes these states from EU countries is their democratic deficits, their weak and inefficient legal institutions, their under-developed civil societies and their low levels of economic development. We should not forget that these countries have been independent states for a mere 18 years, during which time – following the demise of communism – they had simultaneously to design a new economic system, confront all the problems created by the disintegration of cooperative ties within the former USSR, and at the same time build the foundations of their own statehoods.

It should be the common concern of EU countries and the whole of Europe to narrow the economic and social gaps between the Union and its eastern neighbours. Otherwise the risk is that they may generate negative political and social forces that inevitably would affect the West. The joint Polish and Swedish initiative is an open offer of closer cooperation, and has the aim of supporting transformation by stimulating their economic development and strengthening democracy, freedom and civil societies by enhancing legal and administrative capacities enough to approach EU standards.

Implementation of the EaP will bring benefits to these eastern European nations.

Although EU membership for EaP states is not yet on the agenda, we in Poland feel that the prospect of accession should be kept open. The alluring prospect of joining the European Union is one of the main sources of EU influence and 'soft power' and constitutes – as the example of central European states like Poland so clearly shows – a powerful incentive for deep reforms.

The EaP countries have great geographic, demographic and economic potential. The advantages of establishing a free-trade zone with this area of almost a million square kilometres with a consumer market of almost 80m people may seem fairly limited right now, but they are growing fast and promise future benefits once the introduction of EU-based rules has been achieved. The new free-trade zone would give the European economy a boost and the new eastern partners would gain access to the EU's single market.

The countries of eastern Europe and the south Caucasus are strategically situated between the EU and the rich natural resources region of the Caspian Sea, Central Asia and Russia. Important energy transit routes to the EU go through Ukraine, Belarus and Georgia, and Azerbaijan is itself a major oil producer. The gradual integration of these countries into the EU economy would strengthen Europe's energy security, and that would be further enhanced if we bought gas on the Russian border and invested in new transmission infrastructure in those states that lie between the EU and Russia.

The principles of differentiation and joint ownership are to get high priority in the EaP's development, so it will allow partner countries to approximate EU standards at whatever

It would be hard to imagine a Russia that is not in Europe and of Europe

SECURITY & DEFENCE AGENDA



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Jaap de Hoop Scheffer
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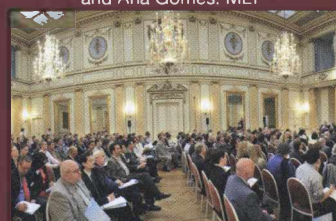
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pace they choose. Joint ownership will ensure that partner countries have a real influence on deciding EaP goals, and multilateral cooperation will create flexibility within the EaP framework. It is also being designed to strengthen bilateral links between the EU and partner countries. The EaP initiative is to be managed by the European Commission, which over the last 20 years has had vast experience of managing similar initiatives and projects.

That said, it would be worthwhile for the EU to think about setting up inside the Commission's structure an Eastern Partnership Special Coordinator who would be tasked with coordinating all actions covered by the initiative. The EaP's institutional structure spans meetings at the level of heads of state and government, foreign and other key ministers as well as lower-ranking senior officials, so a Coordinator could play a significant role in giving the whole initiative the political impulse needed to expand and launch ambitious new projects.

The EaP also has an important political aspect: it shows partner countries attractive development prospects and offers them the opportunity to make the strategic choice of adopting a pro-European orientation. The EaP highlights the empowerment of these countries by treating them as independent entities and not pawns that are organically linked to Russia.

Russia remains a strategic partner of the EU and one of the essential pillars of the European political architecture. Hopefully, we will in the foreseeable future manage to negotiate a new Partnership and Cooperation Agreement with Russia that will be a realistic foundation for a future European-Russian alliance. Changed and constantly changing Russia is still seeking its own partnership formula with Europe and

with other leading international actors, while at the same time trying to define its place in today's dynamically developing world. As part of that search, our Russian partners at times resort to instruments and formulas from the past, although doing so tends to reflect their helplessness and their problems with adapting to new realities. Although we in the EU may refuse to accept certain Russian actions, we should, nevertheless judge them in the context of Russia's ambitions and against the traumatic background of recent Russian history. Most important of all, we should look at them in the context of a not so distant future in which it would be hard to imagine a Russia that is not in Europe and of Europe.

If we see Russia's future as being in partnership with the European Union, we cannot deny the same prospect to the people of the countries that make up the joint neighbourhoods of both. It would be a poor solution for the EU and Russia to be separated by a region whose contacts with Europe are less substantial than those it has with Russia. That is why I am convinced that the faster we integrate the states of eastern Europe and the south Caucasus with the EU, the more likely it will be that Russia itself adopts a pro-European orientation. Russia has vast potential, but we learned during last August's conflict in South Ossetia and the gas crisis in January, it is a potential that can be used to the detriment of Europe's economic stability and its security. The Eastern Partnership, with Russia encouraged to participate in its multilateral projects on a case-by-case basis, would open the way to the gradual convergence of the western and eastern parts of Europe. □

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We've neglected arms control at our peril



With military conflict threatening in hotspots around the world, **Michael Brzoska** warns that years of complacency about arms control are now taking their toll. He argues that the EU should take the lead in heading off a new arms race

Arms control went out of fashion several years ago. We can already see negative consequences of this neglect, but still more serious problems loom ahead. If we stay on our current course, international agreements are likely to erode further, with tensions rising and military spending increasing.

So whatever happened to arms control? To start with, one of the major arms control agreements, the treaty banning certain types of anti-ballistic missiles, was cancelled by the U.S. Another, capping the arsenals of heavy weapons in Europe, has been suspended by Russia. Efforts to add teeth to the Biological Weapons Treaty through verification have been thwarted. A treaty banning all nuclear tests was concluded more than 10 years ago, but still has not been ratified by enough states

to be viable. The START Treaty, limiting the number of U.S. and Russian delivery systems for strategic nuclear missiles expires this year, and so far there has been little effort to replace it. These examples are far from an exhaustive list.

Iran is just the first of what's likely to be many future cases of nuclear capability – ostensibly for civilian purposes but easily transformable for military use

Worst of all is the crisis surrounding the Nuclear Non-Proliferation Treaty of 1967. Under this, states without nuclear weapons renounced their right to go nuclear. In turn, the existing nuclear powers promised to disarm in the longer term. The treaty certainly helped to slow the pace of nuclear proliferation, so instead of the 20-30 new nuclear weapon states that had been widely predicted in the early 1960s, there have been only four more – Israel, India, Pakistan and North Korea. Three states that have in the past possessed nuclear weapons have

since given them up, namely South Africa, Belarus and Ukraine.

Yet the threat of nuclear proliferation has of late again been growing. A major cause is the delay in disarmament by the original nuclear powers. Non-nuclear weapon states are particularly annoyed with Washington and Moscow, which each still have several thousand nuclear warheads in their arsenals, even though more than 40 years have passed since the conclusion of the NPT. Worse still, although they frequently repeat their pledges to get rid of nuclear weapons, in practice they seem bent on keeping them.

Another concern is renewed interest around the world in civilian nuclear energy. Iran is just the first of what's likely to be many future cases of nuclear capability – ostensibly for civilian purposes but easily transformable for military use.

But there is a positive side to the arms control picture. Some efforts at humanitarian arms control have succeeded, and now there are treaties banning anti-personnel mines, blinding lasers and cluster bombs. The trade in small arms and light weapons is better controlled now than it was ten years ago, with negotiations on an arms trade treaty likely to start soon. Even though a number of the leading arms producing countries have not given their support to humanitarian arms control, the drive to limit them seems to be working, with the use of anti-personnel mines having declined.

Another positive development has been the way arms control now involves other players than just nation states. Traditionally,

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By Jan Marinus Wiersma
and Hannes Swoboda

Yes, and that's why Europe should take the lead on nuclear non-proliferation

Michael Brzoska is right to deplore the lack of enthusiasm for arms control. We both share his concerns, particularly when it comes to the international community's inability to strengthen significantly the non-proliferation treaty. The spread of nuclear arms technology is still one of the greatest threats to global peace. And the risk may be growing, because of the nuclear ambitions of states such as Iran and North Korea, but also because of a general revival of interest in nuclear power generation.

Every additional nuclear installation widens the potential security gap. If nuclear energy is to be an acceptable option for meeting our energy needs, proliferation and security issues need to be addressed, too. The change of administration in the United States represents a window of opportunity. President Obama has not merely announced he will make non-proliferation a central theme of his foreign policy, his intention is solidly based on the dynamism of the American debate on nuclear threats. The now-famous *Wall Street Journal* article in January 2007 by four of the Grand Old Men of American foreign and security policy – George Shultz, Bill Perry, Henry Kissinger and Sam Nunn – was an unmistakable indication of the bi-partisan support that exists in the U.S. for a thorough review of America's nuclear

arms control was largely limited to state actions as the only ones that could legally sign international treaties. Today, arms control in the 21st century also addresses sub-state actors, including armed groups and terrorists. They have been involved in efforts to control the trade in small arms and light weapons, in the ban on anti-personnel mines and in United Nations Resolution 1540, which is aimed at strengthening national controls to prevent non-state actors from engaging in any activities that relate to nuclear, biological and chemical weapons. In all these cases, the idea is to institute international standards for the regulation of acceptable behaviour of non-state actors, as well as to improve states' abilities to implement them.

Yet despite these positive developments, and others like verification technology, the overall balance is still clearly negative. Humanitarian arms control and non-state arms control are important, but they are not enough to stop major states from armed confrontation, and nor do they address the security dilemma.

The idea of the security dilemma was first set out in the early 1950s by a German-American political scientist called John Herz to describe the simple phenomenon that when one state builds up its arms capability that will inevitably be seen by a rival state as a threat. That rival state will in turn then build up its own arsenal. Instead of

increasing security, the uncoordinated build-up of armaments decreases security.

Arms control was devised in the late 1950s and early 1960s to defuse the security dilemma. Its principle purpose was to introduce strategic stability and prevent arms races. Rivals were to agree which weapons they judged to be particularly threatening, and then to limit their deployment. Arms control was designed, too, to limit the degree of devastation in those cases where nations actually went to war, and also to restrict the cost burden of defence investment.

When the Cold War ended, arms control received a major push. A number of major agreements were concluded, but by the mid-1990s enthusiasm again began to wane. As the sole superpower, the United States increasingly saw arms control as a brake on its power. The Clinton Administration still pushed in the late 90s for new agreements, like the Comprehensive Nuclear Test Ban, but the Republican majority in the Congress rejected them. Things deteriorated further under President George W. Bush, with many American policymakers asking why regulate if there is no problem, and why control arms when there is no rivalry among the major powers?

Both arguments against arms control were short-sighted, as history is now beginning to show. Arms control is easiest to achieve

Arms control is easiest to achieve when it is least needed. With hindsight we can now see that it would have been a sensible precaution against future increases in international tension

when it is least needed, and becomes most necessary as soon as it is difficult to get. With hindsight we can now see that it would have been a sensible precaution against future increases in international tension to pursue arms control when it was easy to achieve.

Similarly, it is short-sighted for a sole superpower to trust in its own might and to refuse cooperation. Any world power should have an interest in limiting the military capabilities of potential and future rivals. Even for a superpower, it makes good sense to enter agreements that freeze armaments cooperatively, whatever the price to be paid in terms of reduced military options. But George W. Bush and his neo-conservative advisors thought differently, and destroyed rather than fostered arms control.

What has this neglect of arms control led to? One striking effect is that it has critically reduced the credibility of major western countries when arguing for armaments restraint. A case in point is the difficulty of convincing Iran to cooperate on nuclear policy; and more such cases are unfortunately likely in the future. The coming nuclear renaissance will aggravate the credibility gap created by arms control's neglect. The chief victim in all this will be the very promising proposal that expansion of civilian nuclear energy should be linked directly to non-proliferation, namely by pooling the production of fissile material in just a very few multilateral facilities. Non-nuclear states seem unlikely, though, to accept a second asymmetric deal on nuclear technology in light of what the nuclear weapons states have done to the first treaty.

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posture. Adoption of a 'nuclear zero logic' by the Obama Administration, as Ivo Daalder and Jan Lodal labelled it in *Foreign Affairs* magazine, no longer seems unrealistic.

Ambition will not do the trick on its own. We need concrete and creative proposals with solid political backing to address security issues and the fragility of the NPT. The multilateralisation of the nuclear fuel cycle is one of the missing pieces in the non-proliferation puzzle. As Joseph Cirincione noted in his book "Bomb Scare", a comprehensive non-proliferation solution must include the reform of the ownership and control of the means of producing fuel for nuclear reactors. In the wake of the EU's December 2008 decision to support an IAEA nuclear fuel bank, which itself represents a significant step forward, the EU, together with the United States and Russia, should now develop fresh initiatives to bring all nuclear material under international control. Progress in this area would greatly help to ensure that the 2010 NPT Review Conference is a success.

To solve the non-proliferation puzzle, we also need to find the other missing pieces. They include re-thinking the role of nuclear arms in our security policies and reaffirming the ultimate goal of total disarmament. An extraordinary degree of responsibility rests on the shoulders of the recognised nuclear weapons states. Symbolic measures may help, so a formal announcement of a 'no first use policy' by nuclear-capable states would be very welcome. And the removal of the remaining tactical nuclear weapons on European soil along with the ratification of the Comprehensive Test Ban Treaty would equally signal confidence in international agreements

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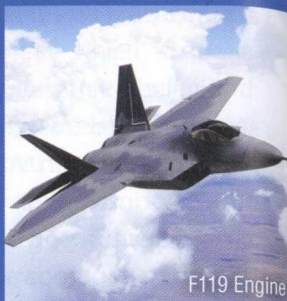
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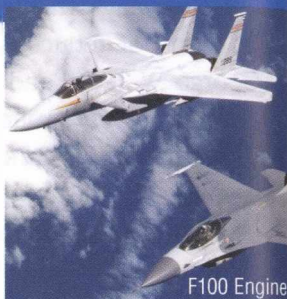
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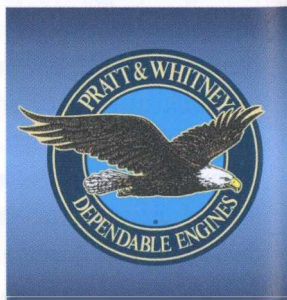
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The collapse of arms control will make itself felt increasingly in the relationship between Russia and the West. With Russia reasserting itself in security and defence terms, President Medvedev has threatened to deploy short-range missiles in the Kaliningrad area as a counter to U.S. missile defences being stationed in Poland. And if relations between Russia and the West worsen, we can probably expect more of the same. The sooner that arms control is back on the international agenda, the easier it will be to get new agreements limiting heavy conventional weapons, short-range missiles and nuclear warheads.

We must not forget the financial side of arms control. Military spending is already higher in real terms than during the Cold War, and it is using up resources that could be used to fund education, fight poverty and mitigate climate change.

The European Union along with most of its member states has watched the erosion of arms control uneasily, but without making much effort to save it. The advent of the Obama Administration in Washington has opened a window of opportunity for renewing arms control, and Europe has a strong interest in taking on a leadership role in a fresh drive to halt weapons, and especially nuclear weapons proliferation. Its shared goal with the U.S. should be the implementation of a new arms control strategy that will improve international security and stability. □

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as the most effective way to counter nuclear proliferation. A moratorium on the deployment of new weapons systems in Europe would build greater trust between those partners whose agreement is indispensable if we are to achieve progress: the EU, Russia and the United States.

Following a high-level conference on non-proliferation that was organised in the European Parliament by the Socialist Group last December, we were able to conclude that a strong political momentum is developing around the issue. The window of opportunity is there, but will not be realised on its own. The Obama Administration needs to know that the European Union is fully on board to take the non-proliferation agenda forward. This means that the EU needs to move its ambition up a level and aim for a new global consensus on nuclear management and disarmament. □

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Europe must wholeheartedly back Obama's initiative on Iran



The mutual mistrust between the West and Iran may seem overwhelming, but **Christoph Bertram** argues that President Obama's willingness to enter into a dialogue with Tehran offers the best chance of building a cooperative new relationship that could even prevent Iran from developing nuclear weaponry

For six years, the European Union has offered the only political negotiating framework for reducing the tensions over Iran's nuclear programme. That these European efforts failed was due not only to Iran's intransigence but also to America's refusal to engage with the Islamic Republic. No solution to the nuclear issue will ever be found in isolation from the overall political relationship between Iran and the West, and here the role of the U.S. is central. President Barack Obama's declaration that he wants to enter into direct and wide-ranging talks with the Iranian leadership therefore offers the first serious chance of finding an acceptable arrangement on the nuclear question and, at the same time, perhaps of entering into a constructive new relationship with Tehran.

The need to formulate an effective policy towards Iran and the surrounding region has in recent years become more and more urgent. Iran's ongoing efforts to develop the full nuclear fuel cycle along with its stubborn refusal to heed UN Security Council resolutions regarding uranium enrichment, as well as its failure to respond fully to the International Atomic Energy Agency's enquiries all represent a real threat to the international community's efforts to tackle nuclear proliferation. Iran has moreover gained enough power and influence to seriously undermine international stabilisation efforts in Afghanistan and Iraq, and its links to Hezbollah in Lebanon and to Hamas in Gaza mean that Tehran also has a role in any future resolution of the Israel-Palestine conflict.

Obama's new approach offers the last chance to curb nuclear proliferation. Europe's governments, who were the first to engage directly with Iran, should do everything in their power to support it

Much of Iran's increased regional influence and hostility to the West is of America's own making. The U.S.-led invasion of Iraq in 2003 resulted, after all, in the removal of Tehran's chief regional rival – in the shape of Saddam Hussein and his regime – and in the weakening of American power as a result of the long and difficult process of trying to restore stability in Iraq and in Afghanistan. In early 2003, when the Iranian leadership had indicated a willingness to enter into across-the-board negotiations with Washington, and had even hinted at potential concessions on disputed matters ranging from nuclear energy to the recognition of Israel, Washington dismissed the initiative out of hand. And when Tehran's negotiation with EU countries led to a temporarily suspension of its nuclear enrichment programme between 2003 and 2005, the U.S. offered nothing in return. Since then, Tehran has been given little or no incentive to yield to Western international pressures.

It is to President Obama's credit that far from shying away from the challenge he has made dealing with Iran a top priority. His opening moves were made remarkably quickly. Scarcely three weeks in office, on the occasion of his first press conference in early February, he announced that "in the coming months, we will be looking for openings that can be created where we can start sitting across the table, face-to-face diplomatic overtures, that will allow us to move our policy in a new direction... There are going to be a set of objectives that we have in these conversations, but I think that there's the possibility at least of a relationship of mutual respect and progress."

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By David Aaron

But it's also time for Iran's leaders to show their hand too

Christoph Bertram's urging of European support for President Obama's effort to open a dialogue with Iran wisely notes how difficult a process it will be and how problematic its success; the Arabs have a saying about Persians – "they will take you to the river, and you will come back thirsty."

For Europe, the issue will not merely be its support, but rather tenacity in resisting pressure for further unilateral concessions by the West and the United States – particularly on sanctions. This was foreshadowed by Bertram's observation that "America's new willingness to sit down with the Islamic Republic in direct talks, and to forgo military threats while dropping its demand that Iran should halt enrichment as a pre-condition for negotiations, is unlikely to unlock the relationship." If this means more unilateral concessions are needed, I would strongly disagree. So much animosity and suspicion will require unilateral displays of bona fides, but these must come from both sides.

Obama's unilateral, and some might say pre-emptive, concessions are not trivial. After all, virtually every Iran expert, whether hard-liner or soft-liner, believes that the chief concern of Iran's leadership is regime survival. President Obama's reference to the Islamic Republic of Iran's New Year message signals U.S. readiness to recognise the Tehran government

Since then, the President has lost no time in clarifying his approach further. In the most radical departure from the policies of his predecessor, he used the occasion of Iran's Nawrouz New Year, on March 20 to address the "leaders and people of the Islamic Republic of Iran" in a video message. In contrast to his own earlier statements during last year's election campaign, and those of some of his advisers since then, Obama now implies that military intervention is no longer a serious option for the US, explicitly repudiating threats as a means to advance diplomacy. Just as significantly, by implicitly accepting the legality of the Iranian system of government, Obama has abandoned the long-held U.S. objective of regime change in Tehran.

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Thus, with a few bold strokes, President Obama has turned U.S. policy towards Iran around before even completing his first hundred days in the White House. And more can be expected. The new approach suggests an end to programmes embraced by the Bush Administration such as planting nuclear detection devices inside Iran or engaging in secret cross-border operations; the President is also likely to take a clear distance from Congressional resolutions supporting Iranian opposition groups. Not

least, he departs from the stance repeatedly adopted by the UN Security Council that Iran must halt its nuclear enrichment activities as a pre-condition to negotiations. And the Administration has announced that it will henceforth formally join the EU in direct talks with Iran.

The success or failure of the new U.S. approach will, of course, be determined not only by Washington's new flexibility but by the willingness of the leadership in Tehran to engage in serious negotiations on both the nuclear problem and on the overall political relationship. Tehran's initial reaction wavered between caution, the issuing of declarations of principle and verbal flexibility. On February 10, the 30th anniversary of Iran's Islamic revolution, President Ahmadinejad declared: "The new U.S. administration has announced that they want to produce change and pursue the course of dialogue. It is quite clear that real change must be fundamental and not tactical. It is clear that the Iranian nation welcomes real changes and is ready for dialogue in a climate of equality and mutual respect." Ali Larijani, the influential Speaker of Iran's parliament – the Majlis – had been more specific when addressing the Munich Security Conference a few days earlier: "The dispute over the nuclear issue is not an unsolvable problem if we stop being entrenched in our positions."

So far, though, despite these positive signals the group that holds power in the Islamic Republic has shown scant signs of wanting to engage in the huge policy shift that a positive response to America's advances would imply. The men who run the

Islamic Republic remain deeply suspicious and distrustful of U.S. motives and objectives. The 'Supreme Leader' Ali Khamenei is reported to be convinced that even minor concessions on Iran's part will only intensify the pressure for major concessions, and must therefore be resisted. The leadership is also aware that there is growing disenchantment with the regime within Iran, and is concerned over the emotional appeal that Obama's personality and his initiative may have for many Iranians. Tehran may therefore prefer to pocket whatever concessions the new U.S. position offers, and pursue new negotiations as little more than a convenient screen behind which to complete its nuclear programme and possibly develop a military nuclear capability.

The one step, of course, that might convince the suspicious sceptics in Tehran and open the Islamic Republic to a deepening engagement with the U.S. would be an offer to lift all economic sanctions in exchange for full nuclear inspection rights for the International Atomic Energy Agency (IAEA). But this would demand making an even more dramatic farewell to past U.S. policies than the initiatives taken so far, and is politically much more difficult for Obama to contemplate.

Ever since the fall of the Shah in 1979, sanctions have been the weapon of choice for successive U.S. Administrations, resulting in a total blockage of economic interaction between the two countries. The resolutions passed by the UN Security Council to make Iran forego further nuclear enrichment also involve the imposition of sanctions, though relatively modest ones. And Iran is being

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as legitimate, and that's no small thing after all the efforts aimed at bringing about "regime change" there during more than a quarter of a century. To reinforce this message, the Obama Administration has stopped saying "all options are on the table", which means that Washington now eschews making military threats against Iran. This, too, is a profound concession.

Even the willingness of senior U.S. officials to meet with Iranian officials is not diplomatic small change. The United States could have waited for a favourable Iranian response to the President's message before initiating contact. But the U.S. did not do so, because the new Administration wanted to give further substance to its initial concession of accepting the Iranian government's legitimacy.


Finally, the U.S. has also dropped the precondition, endorsed by the United Nations Security Council, that Iran should stop enriching uranium before it can enter into substantive negotiations. Getting Security Council members, and especially Russia and China, to back this demand was a singular Bush Administration success and provided a basis for UN sanctions. This precondition now is gone, thus removing a major road block to progress. Christoph Bertram may be correct that economic sanctions will not coerce Iran into making fundamental compromises, but they have succeeded in preventing the modernisation of Iran's oil sector and the development of its giant gas reserves. These are crucial economic incentives for Iran to reach some sort of accommodation with the United States and ease the pressure on its faltering economy.

warned of more tougher ones should new negotiations lead to nought.

But sanctions are almost certainly not the answer. They are likely to be as ineffective as before in producing Iranian concessions, and they will stand out as a contradiction to Washington's professions of wanting to establish, in the words of Obama's Nowruz appeal, "a future with renewed exchanges among our people, and greater opportunities for partnership and commerce."

It is true that economic sanctions against Iran have been biting in the context of a difficult economic situation that has been further strained by mismanagement and corruption, and in recent months by

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the collapse of energy prices. Tougher sanctions can only hurt Iran further. But the effectiveness of sanctions cannot be measured by the misery they create for ordinary Iranians but by the willingness they engender amongst Iran's leadership to give in to Western political demands. After 30 years of being subjected to international sanctions, Iran's Islamic regime has become hardened to such pressure and has grown more determined than ever to resist them. Economic sanctions have so far made no impact on Tehran's nuclear programme, or on its political behaviour, other than to make it more intransigent on both fronts.

However desirable, therefore, America's new willingness is to sit down with the Islamic Republic in direct talks, and to forego military threats while dropping its demand that Iran should halt enrichment as a pre-condition for negotiations, this alone is unlikely to unlock the relationship.

Many who are sceptical over Obama's initiative predict that at worst the direct talks will play into Tehran's hands, at best will serve to demonstrate Iran's intransigence to the world, and thus help generate a much tougher international response.

But the sceptics may be underestimating the determination that lies behind Obama's strategy. The new U.S. President's objectives are far more ambitious and wide-ranging than scoring a few tactical points before returning to his predecessor's failed strategy. When Obama initiates a regional approach to the Afghan conflict, he makes clear that he also seeks common ground with Iran, one of Afghanistan's most important neighbours.

When he calls for drastic reductions in nuclear weapons arsenals, he seeks to preempt the predictable Iranian complaint about Western double standards. When he speaks of "the possibility at least of a relationship [with Iran] of mutual respect", he is demonstrating his understanding of Iran's deeply felt desire for equality with the rest of the world. And by making Iran a top priority in his presidency so early on he is signaling how serious he is about getting results.

President Obama's opening moves suggest that he is not going to be easily discouraged, and that his refusal so far to contemplate more daring concessions – like the lifting of all sanctions – is not cast in concrete. Of course, progress will be slow, negotiations difficult, early results modest, and the prospect of failure can never be remote.

Yet there is no realistic alternative. Obama's new approach offers what will for long be the last chance to place the West's relationship with the Islamic Republic on a more cooperative footing, and at the same time curb nuclear proliferation. Europe's governments, who were the first to engage directly with Iran, should do everything in their power to support it. □

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David Aaron

Rather than going down the path of unilaterally making more concessions, such as lifting sanctions, the U.S. and the other members of the Five plus One Group now need to see some real movement from the Iranian side. As President Ahmadinejad has said, and Bertram noted, "real change must be fundamental and not tactical."

A few tid-bits have been forthcoming from Tehran, most notably a change in tone. Ahmadinejad also said recently that Iran will accept a two-state solution if that is what the Palestinians want, and Hamas, their client among the Palestinians, is saying the same thing. Tehran has meanwhile pledged several hundred million dollars to help Afghanistan, and charges of espionage against a U.S. citizen have been dropped.

But the proof of Iran's intentions will lie in the "new proposals" on the nuclear issue being widely touted by Iranian officials. Rather than the UN and the U.S. lifting sanctions, the United States and Europe must stick together and insist that Iran go down to the river and put some water in the bucket. □

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Blueprint for an EU role in Obama's "AfPak" strategy



Europe has a lot of ground to make up if it is to make a real contribution to the new U.S. drive in Afghanistan and Pakistan, warns **Shada Islam**. But she says that doing so is vital to transatlantic relations and to Europe's global ambitions

Barack Obama's ambitious new game plan for fighting the Al Qaeda-led insurgency in Afghanistan and Pakistan, and his demands for a stronger European role in the effort, present EU governments with a make-or-break opportunity to upgrade their less-than-impressive engagement so far. The stakes are higher than many in Europe would like to believe, for the destruction of Al Qaeda and Taliban safe havens in Afghanistan and Pakistan is crucial to the survival of both quasi-failing states. It is also needed to stop further terror attacks on both the West and the Muslim world.

Afghanistan and Pakistan – AfPak – present a critical test for transatlantic relations and Europe's hopes of crafting a strong new strategic partnership with Washington. EU countries' actions in both countries will also do much to determine Europe's credibility as a global security actor and its ability to leverage non-military "soft power" tools of aid, trade and diplomacy to stabilise troubled nations.

The EU has so far had a distinctly different approach to Afghanistan and to Pakistan. A large majority of EU states have sent troops to Afghanistan and are pumping in millions of euros to bolster that country's fragile economy, even though this has not translated into political influence. By contrast, Europe's relations with Pakistan, a country which is seen as even more pivotal than Afghanistan in the combat against terrorism, remain exceptionally low-key and uninspiring.

The time is now over for reflection, consultation and for sitting on the fence. European governments had been vocal in their criticism of U.S. policy towards Afghanistan during the Bush Administration, and their advice was ignored. With President Obama, Europeans have an opportunity to partner the U.S. in seeking solutions to the challenges of AfPak.

To do so, they must pay more attention to both Afghanistan and Pakistan. President

Obama is right in describing the AfPak border, with its numerous Al Qaeda training camps, as "the most dangerous place in the world." Sadly, European leaders have been unwilling or unable to make a forceful case for curbing Al Qaeda-led insurgencies in Afghanistan and Pakistan as a way to ensure Europe's security.

The EU has mainly left discussion on Afghanistan to NATO, and European policy towards Pakistan has been focused on aid with little emphasis on meeting the country's insurgency and governance challenges. Europe must now act urgently to forge a pro-active new strategy which responds to both the development and security challenges facing Afghanistan and Pakistan. Most important of all, it must put its relations with Pakistan much higher on its foreign and security policy agenda.

The Americans are using increased military power to back up their AfPak strategy. They now recognise that Europeans will not send substantially more combat troops to Afghanistan, but believing that the insurgency cannot be defeated by military action alone, the U.S. wants Europeans to participate in a so-called "civilian surge" that would go hand-in-hand with an increase in U.S. and NATO boots on the ground. The EU has the tools and the expertise to implement such a "comprehensive approach" by stepping up efforts to improve Afghanistan's governance and address its rule of law deficit. As well as improved law and order, it can also spearhead moves to strengthen the counter-narcotics drive by switching from a focus on eradication to implementing integrated rural development schemes which include the construction of local roads for the marketing of alternative crops.

COMMENTARY

By Raffaello Pantucci

Europe's real AfPak problem is that our politicians have not convinced public opinion

Shada Islam presents a sensible, if perhaps overly optimistic, view of European objectives on "AfPak". It is hard to disagree with many of her fundamental points, in particular that greater coordination on Central-South Asia would be a boon to European and American interests in the region.

Unfortunately, the reality is that such coordination is still lacking and we are unlikely to see a greater push under an EU banner. More European involvement in any sort of "civilian surge" would be welcome, but will be unrealistic until the security situation is stabilised.

European perspectives on AfPak are at a very different stage to those of the United States, and there are two reasons for this. The EU is currently not yet adept at dealing with hard security matters, and the security concerns that emerge in this region are seen in starkly different lights by politicians and public opinion across the European Union. And the former situation is unlikely to improve until the latter is tackled through greater coordination between EU member states, and it is on this that European leaders should now focus their efforts.

Its experience in regional cooperation and integration gives the EU exceptional credibility as an "honest broker" to ease strained relations between Afghanistan and its neighbours, and also contribute to better relations between Pakistan and India. Although it will be more difficult, Europeans could lead the way in opening negotiations with "reconcilable" Taliban insurgents and militants who either have no links to Al Qaeda or are willing to sever them.

European countries are regarded by many in Afghanistan and Pakistan with less hostility than the U.S. This is especially so in Pakistan, where U.S. drone attacks on insurgents in the tribal areas continue to cause public outrage. Washington's standing in Pakistan has also been tarnished by the Bush Administration's support for former President Musharraf, whereas the EU has built up credit among Pakistan's political elite – including lawyers, human rights activists and pro-democracy groups – by focusing on the need to hold free and fair elections, insisting on the independence of the judiciary and concentrating on the building of stronger civilian institutions.

Europe's performance in Afghanistan has not been uniformly grim. The EU is a leading aid donor there, providing a total of €3.7bn over 2002-2006. A stronger European military effort was promised at both the NATO and EU-U.S. summits in April this year, but we should make no mistake that the European effort in Afghanistan will be judged by the success or failure of its EUPOL police mission. This EU flagship operation is unfortunately overshadowed by the much larger U.S. police programme, and is also dwarfed by similar schemes run by EU member states. It is

also trammled by serious staff shortages, although EU governments have pledged to double the mission staff to 400 members, recruiting the additional police officers is proving difficult. To make the Afghan posting more attractive, governments should be ready to raise salaries, hire so-called "contract agents" or to turn to the private sector to supply police officers.

To be effective in Afghanistan, EU states must reinforce their coordination and cooperation on the ground and at headquarters. "AfPak" envoys appointed by EU member states, including Britain, France, Germany and Sweden, should make a point of working closely with Ettore Sequi, the EU's pointman for Afghanistan and Pakistan. On top of that, there must be a consolidation of the three separate EU representations in Kabul, namely the European Commission delegation, EUPOL and Sequi's office.

Bringing Pakistan back from the brink is going to be even more difficult, especially since the EU has so far failed to recognise Pakistan's strategic importance. Now, Pakistan is slowly climbing up the European agenda, with the organisation of a first-ever EU-Pakistan summit and plans to provide new trade concessions along with increased aid to the country. To be effective, EU assistance will have to focus on the two sides of the AfPak border to include both countries' Pashtun areas.

The EU's priority must be to help Pakistan tackle its twin challenges of building a functioning democracy and defeating religious extremism. This requires that despite Pakistan's chaotic politics, the European Commission and individual governments

keep channels of communication open with its democratically-elected leaders, however weak they may be. Democracy in Pakistan is above all conditional on the army's retreat from political life. No encouragement should be given to suggestions that the army meddle in politics as another military coup would not only undermine civilian institutions but also undercut efforts to curb insurgency and fight terrorism.

There is much room for improvement in the EU's trade and aid ties with Pakistan. EU aid to Pakistan, stuck at €500m since 1976, is a fraction of the \$10bn in U.S. aid that Pakistan has received since 2001, and which has been easily overshadowed by the new commitments being made by the Obama Administration. Europe's trade relations are also uneasy.

The EU is Pakistan's largest trading partner, with EU imports mainly of textiles and clothing currently valued at about €3.5bn a year. But a spate of EU anti-dumping investigations, and the removal of Pakistan from the EU's special duty-free scheme for developing countries, coupled with Brussels' reluctance to start negotiations on a free trade agreement with Islamabad, have strained the trading relationship.

An overhaul of EU aid priorities in Pakistan would be welcome, away from the present near-exclusive focus on health, education and rural development to a broader reform agenda, including police and judicial training, the modernisation of political parties and a strengthening of parliamentary procedures. This would mean setting aside more funds for Pakistan, not an easy move given the many other demands on the EU's external budget.

COMMENTARY

Raffaello Pantucci

Developments in AfPak are presented in a variety of different ways across Europe. For the UK, there is the palpable sense of an immediate terrorist threat posed by plots directed from the region, and that is generally accepted by the general public as the reason why British troops are fighting in Afghanistan. That's not to say there isn't heated discussion in the UK, but rather that it is focused on tactics and on whether following America's lead is the right way to deal with things. In Germany and Spain by contrast, both of which have faced plots directed from groups based in the region, the war in Afghanistan is instead sold as a distant peacekeeping operation. A large proportion of the German public thinks their troops should not be there at all, believing that it is their presence that is attracting trouble to Germany and choosing to ignore the fact that the threat emanating from the region was present before German forces went in. In between, Europeans hold a wide range of views and opinions, of which most tend towards the view that whatever is going on in AfPak is not directly relevant to their own security.

European leaders, meanwhile, appear for the most part to line up behind the U.S., having reached the conclusion that ongoing instability in the region poses a threat to both regional and international security. Unlike their own public opinions, they tend to appreciate the nature of the AfPak threat and therefore understand why European troops need to be there.

The gulf of understanding between Europe's political leaders and European voters is at the root of the problem of getting EU countries to take on a bigger role in AfPak, and is also

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The step beyond

The EU has a role to play in helping Pakistan's increasingly dynamic civil society groups. The focus should be on ensuring media independence and providing support for groups that advocate human rights, including the protection of women, children and support for marginalised communities. EU encouragement for promoting Pakistan's long-standing Sufi traditions would also help counter the spread of the cruel Taliban interpretation of Islam. The Pakistani government needs advice on crafting a new counter-terrorism strategy which strives to combat extremism through development, not just military deployment.

A more targeted approach that is centered on winning hearts and minds should focus on bringing development to the arid and mountainous northern regions. Building schools and hospitals is a priority, but Pakistan must also invest in developing better job training programmes for the region's young men who often migrate to the Gulf states in search of employment. More generally, Pakistan's friends must shift from backing the country's political personalities to helping build strong institutions.

European governments must lose no time in doing their AfPak homework. This doesn't just mean putting both Afghanistan and Pakistan higher on the agenda; EU countries should coordinate and where possible, consolidate their programmes, policies and representations. It's not what national policymakers like to hear, but Europe's failure to do so will sour transatlantic relations and also put the brake on crucial steps towards expanding the EU's global outreach. □

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COMMENTARY

Raffaello Pantucci

responsible for NATO's inability to get more European boots on the ground there. The decision to hold an EU-Pakistan summit with a particular focus on security is a welcome move, as is the Commission's decision to focus more of its aid spending in Pakistan on security and combating extremism. But none of this will help with the public relations deficit at home. European leaders have for the most part made little or no effort to sell their reasons for being involved in the region to their domestic audiences, being clearly fearful of negative political consequences.

A number of European capitals need to reach serious decisions about what they see as their own motives for being involved in AfPak, assuming that they conclude that stability there is vital. And that means making a much greater public outreach effort to ensure that public opinion in their country is also on board. The UK government has already made precisely this sort of outreach effort to explain its foreign policy to a domestic audience, and it is the sort of effort that should be paralleled across Europe. Doing so may lead to some awkward conversations for some of the EU's national leaders, but until it is done European efforts in the region will remain stymied, leading not just to possible security threats at home but as Shada Islam rightly points out, the possible souring of transatlantic relations. □

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Now we must apply the lessons of the European elections



As the political groupings in the European Parliament try to gauge the implications of this summer's European elections, **Wilfried Martens**, President of the centre-right European People's Party, puts forward his ideas on tackling the twin problems of falling voter turnouts and rising euroscepticism

The tsunami that has swept across our financial markets and is now wreaking havoc in the entire world economy is a catastrophe, and it is the task of politicians, business leaders and policymakers to make it as short-lived as possible. If handled correctly, though, the crisis may yet help the European Union and its institutions to raise themselves in the public's esteem.

The EU's legitimacy problem has two different aspects: apathy, leading to a low turnout in the European Parliament elections, and outright euroscepticism. The voter turnout problem partly reflects

frustration about the present state of the EU, and also the impression people have that they can exert little influence by voting one way or the other. Euroscepticism, on the other hand, and the looming threat of anti-European populism is directly linked to the idea that the EU is not only incapable of offering a solution to the crisis, but in fact is part of the problem. So although the EU represents our best hope of ensuring Europe is internationally competitive in today's increasingly difficult environment, it is actually being blamed for globalisation even though that is happening regardless.

Many people confuse the two problems of low voter turnout and anti-Europeanism, and believe that somehow turnout in future European elections can be increased by simply pointing out to people how good and important the EU is. The unpalatable truth is that in most cases this is not an approach that will work.

At first sight, the easiest answer to the problem of low voter turnout is to give more power for the European Parliament. But if this was the solution, then we would not have had steadily declining turnouts since the high point of 63%, at the first elections to the European Parliament in 1979, since when it has constantly grown in influence and powers of joint decision-making thanks to successive treaties ranging from Maastricht to Amsterdam to Nice. The Lisbon treaty further strengthened the parliament's powers, and although that's a good thing, it is clearly not the solution to the turnout problem.

The trouble with EP elections is that for voters to be interested, elections must be "about" something, which means they must involve a real choice between options. For that to be the case, real Europe-wide election campaigns by all parties at a European level are needed. This would also involve making the choice of the European Commission's President dependent on the outcome of the EP elections. In fact, both of these conditions have already been met; in 2004, Portuguese Prime Minister José Manuel Barroso was appointed President of the Commission because he came from the political organisation with the strongest election result, the European People's

COMMENTARY

By **Brendan Donnelly**

But how much better if the voters could decide the EU's future

Thoughtful politicians will always seek to strike a balance between their long-term vision and the need to operate within current political reality. In many ways Wilfried Martens' article is wholly persuasive. In the longer term, it may well foreshadow the likely and desirable political evolution of the European Union. But the political and institutional realities of 2009 remind us that the Union still has a long way to go before it corresponds entirely to the template set out so attractively by the EPP's leader.

Mr. Martens is certainly right to point out that the lack of clear political consequences following from the results of the European elections are an important reason why so few voters participate in these elections. One does not need to be an advocate of the Manichean political choices favoured by the British electoral system to acknowledge the difficulty of convincing the European electorate that the votes they cast in the European elections make a difference to their lives. The close linking of the election of the European Commission's president to the results of the European elections has for some years been a much-discussed answer to this conundrum. If the European elections of 2009 were "about" extending or terminating Mr. Barroso's period in office, then that political choice would give an entirely new quality to the elections.

Party. And this year's elections saw a more intensive presence of party organisations at European level than ever before. All this experience needs to be built upon, and I believe the most important way to reawaken voters' interest in European elections will be to open up the election of the Commission's President to them, and create a genuinely Europe-wide political debate during the next election campaign.

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The euroscepticism problem, however, can only be tackled if the Union itself starts to perform better, and is seen to be doing so by EU citizens. Which is why in the aftermath of the failed referenda four years ago in France and the Netherlands on the Constitutional treaty, the Commission tried to emphasise the idea of a "Europe of Results" that would seek to convince citizens of its worth through concrete and tangible achievements. Looking back at these, it is perhaps the case that one has sometimes focused a little too much on isolated examples like the introduction

of international roaming fees for mobile phones, but for all that it has seemed a worthwhile approach. I am convinced that in the light of the economic crisis the time has come for the Union to demonstrate its strengths whenever possible. The aim must be not only to win back the hearts of Europeans who have become sceptical, but also to convince them that the Union is indispensable if we in Europe are to meet the challenges we now face.

Europe's citizens increasingly understand that the relatively small nation states that make up the EU are no longer able to face these enormous challenges on their own. In Ireland, last autumn's financial crisis provoked a turnaround in public opinion about the EU, and even in Iceland, although it lies on the periphery of our continent, membership of the EU and the euro have become a priority. European countries have become so interconnected that isolated national measures on issues like the regulation of financial markets, recovery plans for our economies or the fight against climate change would be hopeless.

In short, most of us know that the EU must be united and able to speak with one voice on the world stage. A changing world in which new powers like China and India play an increasingly important role will not wait for Europe to make up its mind. The EU must instead show leadership through its efforts to solve the world's current problems.

As to the European People's Party, for us the economy is not an end in itself but should serve the people. We believe

in a society based on the individual, on freedom, solidarity and social cohesion. In other words, the social market economy. There can be no social cohesion or political stability without sustainable economic development. The economic crisis was caused by short-sightedness and a lack of control in the global financial system, so now we must redefine the roles of the regulators in financial markets and in the wider economy. And certainly we cannot let the financial sector walk off with the profits and leave the taxpaying public to bear the losses.

That doesn't mean we are advocating a move to socialism; we want better and smarter regulation, but not regulation for its own sake. Our position also clearly differs from the ideas of these market fundamentalists who believe that markets alone should rule the world. Today's situation requires additional public spending, but this must not go on for an infinite time period. We cannot live now at the expense of future generations. Therefore, we see five keys to recovery:

- New Job creation is our core priority. We in Europe need to continue to reform and invest in education and life-long learning to create opportunities for everyone.
- A prolonged global economic slump must be averted, and European governments must continue to improve their co-ordination on fiscal and monetary policies.
- The international financial architecture must be rebuilt. European regulations alone are not sufficient for a healthy global financial system – we need to increase overall transparency and surveillance. Banks must re-focus on their vital function

COMMENTARY

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Sadly, this year's European elections bear only very marginally on the political future of Mr. Barroso. It seems overwhelmingly likely that he will anyway remain at the head of the Commission with the support of a number of non-EPP national governments, notably the British government. It will not be until 2014 at the earliest that the "demos" of the European Union will have a chance to do in European elections that which defines "demoi," namely to take in common important political decisions, of which the Commission presidency is certainly one.

A similar clash between aspiration and contemporary political reality is evident in the discussion by Wilfried Martens of the financial crisis. If EU citizens could be persuaded that the Union is playing a decisive role in resolving this crisis, and in protecting them from its worst consequences, then that would be politically a much more significant development than the liberalisation of roaming charges. Martens is right to hint that such episodic initiatives by the Commission, however welcome in themselves, should not be overestimated in their long-term political impact.

On balance, it is probably true that the global credit crisis has reinforced Europeans' sense that the EU is a factor for economic and political stability. The single currency is widely recognised as a bulwark against the competitive devaluations which might otherwise have been national governments' responses to the crisis. It is wholly possible that in the coming months the EU can develop a specifically European agenda for international financial regulation which sets welcome limits on the "market fundamentalism" against which Martens warns.

of securing people's savings and providing liquidity for our financial systems.

- The economic recession is an opportunity to increase investment in green

technologies. We want Europe to be a world leader in this sector, as this will boost economic growth and create more jobs while at the same time

MATTERS OF OPINION

European elections: Insufficient information the most cited reason for not planning to vote

Voters who said they would be unlikely to vote in this year's European Parliament (EP) elections mainly said this was due to a lack of information or a sense that their vote would have no impact on future actions. The results of a Eurobarometer survey earlier in the year showed that the main reason they did not plan to vote, chosen from five suggested responses, was because they did not know enough about the EP's role. This was the answer given most often in all EU member states, with roughly two-thirds of EU citizens (64%) having this view; in Sweden, Estonia, the UK and Portugal, however, 70% felt that way.

Almost as many (62%) said that if they didn't vote it would be because they felt their vote would

not change anything – although this position had decreased by six percentage points in 12 months. For the third and fourth most popular answers, 59% said it would be because they did not feel sufficiently informed to vote and 55% because the EP deals with issues that do not concern them.

Far fewer people – one in five of those surveyed – agreed with the fifth potential reason for not voting, namely, that they were 'against Europe, the EU and the European construction'. This view was expressed by the highest proportion of people surveyed in Austria (35%), Greece and Sweden (both 28%), and by the lowest in Luxembourg, Bulgaria and Romania (from 5% to 8%).

MAIN REASON WHY PEOPLE SAID THEY WOULD NOT VOTE IN THE EUROPEAN ELECTIONS OF JUNE 2009



Source: Eurobarometer 2009

GALLUP

making Europe less dependent on fossil fuels.

- A resurgence of protectionism needs to be prevented. We have to avoid the mistakes of the 1930s both within the EU itself and also globally. Europe's internal market is a success story that has indisputably created growth and jobs in decades past, and must be allowed to continue doing so.

A "Europe of Results" can only strengthen the EU's legitimacy, though, if these policy recommendations and their successes are communicated clearly and effectively to the general public. This means that all of the European institutions and their leaders must raise their media profiles, and that's easier said than done. Newspaper and television editors still place EU news items low on their agendas, reflecting the paradox that readers and viewers find the EU of little interest, yet at the same time complain they are not adequately informed about it and its functions. It's a dilemma that will only be solved with much innovative and creative thinking by Europe's leaders, but it can nevertheless be done.

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COMMENTARY

Brendan Donnelly

But no objective observer could doubt that the primary actors in the European response to the global economic crisis have been the national governments. The architecture of the single European currency allocates to national governments the vital macroeconomic tool of fiscal policy. We have witnessed over the past year legitimate and sometimes vigorous differences of opinion between national governments on how this tool should best be employed. Unless and until the eurozone has something much more nearly akin to an "economic government," it will be difficult indeed to say in the macroeconomic field *Hoc fecit Europa*. Public perceptions in our continent will inevitably reflect this reality.

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We want pan-European politics, not a bureaucratic and undemocratic EU



"Unlike many in Brussels, we respect the judgement of European voters," says **Declan Ganley**, the founder of Libertas, a pan-European party that contested European Parliament seats in all 27 EU countries and was widely credited with Ireland's 'No' vote on the Lisbon treaty last year

The announcement that Libertas candidates would be running for election right across the EU's 27 member states in the European Parliament elections generated great attention among fellow pro-Europeans. For years, the many who support European integration but resent the bureaucratic and undemocratic behemoth of the EU have been faced with frustrating choices at the ballot box. There has, of course, been a plethora of parties that oppose the EU, but most have run on a nationalist and eurosceptic banner. It's a standpoint that appals me and the many volunteers who have supported Libertas before, during and since last year's Irish 'No' vote. Books have been written on the many positives European integration brings, but simply reiterating the four main freedoms – of movement, goods, services and capital – which have flourished during 50 years of peace and prosperity serve to neatly summarise its attributes.

Yet it's hard to remember these incredible freedoms when faced with the ugly response of Europe's political elites to the Irish electorate's rejection of the Lisbon treaty. The utter contempt shown to voters has been staggering and time and time again we saw the Irish people insulted. From Germany's Dublin ambassador Christian Pauls and his sly insinuations about how many voters came from rural communities to the unnamed official who referred to the Irish as 'bastards', we saw that these unelected officials did not just view elections as a problem to be negotiated; they were quite simply bewildered as to why you would ask European voters for anything other than their taxes. The people 'do not understand' the Lisbon treaty, just as they did not understand the Nice treaty, and just as the French and the Dutch did not understand the Constitution. The workings of European government are apparently too complex to be understood by mere citizens: They can only be interpreted by the experts.

But who are these experts? Maybe Ireland's EU Commissioner, Charlie McCreevy, who said, 'no sane person would bother to read [the treaty] because of the technocratic, near incomprehensible language of every sentence, clause, paragraph and page'? Caroline Flint, the UK Minister for Europe, who claimed the 'No' voters had 'misunderstood' the treaty and who then admitted she hadn't read it herself, but was 'briefed by experts'? Perhaps the experts include those who couldn't understand why the 'ungrateful' Irish weren't successfully bribed 'after all the money you got'? And perhaps they also number Martin Territt, head of the European commission's Dublin representation, who announced not long ago that another €1.8m of EU funds is to be pumped into encouraging the Irish to vote the 'right' way.

There's an analogy to be drawn here with the economic crisis. There was a similar culture of secrecy in the banks and on the trading floors as there is in the EU; the same insistence that the experts know best, and exactly the same disparity between a superficial obsession with regulation, red-tape and targets and a reality in which individuals were benefitting hugely and immorally from a lack of scrutiny. We should remember it took over 14 years for the auditors to sign off the EU accounts and that in 2007 €6bn went astray. We still don't know how much EU money was lost in the Madoff scam, for example. All we know is that the European taxpayers will foot the bill, even though they cannot be trusted to

vote on something as 'technical' as their own sovereignty or as 'complicated' as their own Constitution (which, if we're honest is what the Lisbon treaty is). The bankers must envy the Commissioners – the latter not only get to hold on to their pensions, but their jobs too.

And this is why, far from being swept aside by the financial crisis, Libertas' messages are more important than ever. The EU was born – first from the European Coal and Steel Community and then consolidated in the Treaty of Rome – out of harrowing circumstances. Europe was shattered not just economically but also in terms of its identity after the horrors of war. From that crisis emerged what we have

today: over 50 years of peace and prosperity. I'm proud that my children are part of a generation of young people who see Europe as an opportunity for travel and work, as an extension of their own world rather than as something to fear. Democracy and economic dynamism made that possible, and historically neither functions properly without the other.

So it was interesting to see that the EU spent €28m on promoting the European parliamentary elections, in an attempt to reverse the 20 year slide in turn-out and close the 'democratic deficit'. Libertas supported this as we too wanted to see this trend reversed. Our own success in the elections hinged on mobilising more of the voters who had retreated in apathy and frustration.

There was a similar culture of secrecy in the banks and on the trading floors as there is in the EU; the same insistence that the experts know best

But our analysis and proposals to redress this clearly differ from the EP's marketing advisors at the Berlin communications agency Scholz & Friends.

In keeping with the attitudes of the Parliament, they clearly see the problems with voter turn-out as a lack of education in the ways of Brussels. The theme of their campaign is 'It's your choice', with billboards asking voters their choices on food labelling, and offering an opportunity to leave video messages saying what they think. Yet as we have seen, there is a culture of opposition to real choice in the EU. It is resentfully offered and then ignored when it does not suit.

People don't vote because they know that their vote doesn't count; 80% of the laws that will affect voters' lives are passed by unelected Commissioners behind closed doors. The Parliament has little real impact on these decisions. There are 190 different parties represented, forced into watering down their views in coalitions that lead to petty squabbles and political in-fighting. Many of the parties are represented at national level, of course, and the parties tend to use their MEPs for such domestic gains as David Cameron's decision in the UK to withdraw the Conservative Party from the EPP primarily to appease its eurosceptic wing.

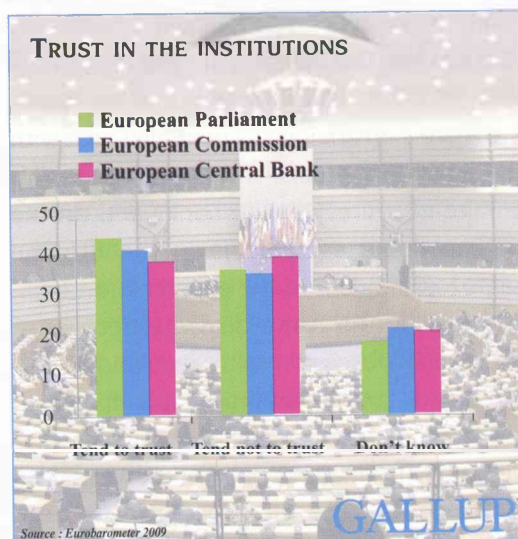
MATTERS OF OPINION

Waning trust in the EU institutions

Fewer than half of EU citizens have confidence in the EU's institutions – the European Parliament, the European Commission and the European Central Bank (ECB) – according to a Eurobarometer survey in the 27 EU member states at the start of 2009.

The survey of 1,000 people per country found that the ECB is the least trusted of the three institutions, with only 39% saying that they tend to trust it and a slightly larger number, 40%, saying that they tend not to trust the bank. This lack of trust in the ECB has decreased by 10 percentage points in six months.

As for the European Parliament and the Commission, more people – but still below 50% – said they trust each institution than those offering an opposite view. The European Parliament is trusted by 45% of those questioned, compared to 42% who say they tend to trust the European Commission. The drop in support for the two institutions in six months was, respectively, six and five percentage points.



Confidence in the European Parliament is lowest by far in the UK, where 59% tend not to show any trust, followed by Greece and Austria (both 42%). The greatest levels of trust in the European Parliament were to be found in Belgium and Slovakia (64%), followed by Cyprus (63%).

Just as the EU Commissioners view the MEPs as little more than a symbolic nod towards genuine democracy, so do national politicians use the European elections for their own ends. I believe that MEPs have a vital function to play in maintaining the democratic accountability of the EU, and that they can make a difference. But first they need to be shaken out of the culture of complacency that has been fed by their generous benefit packages, and the knowledge that the details of their meetings and votes will be kept secret. Their unaccountability keeps them safe. European elected politicians, like their voters, need to be taken seriously: they need to know that their votes count.

Unlike many in Brussels, we respect the judgement of European voters. We know that we have to win their votes through convincing arguments rather than bribes or political chicanery

Libertas is a pan-European party that has run candidates in all 27 member states. Our candidates are of the highest calibre who have sought to be elected with a clear mandate for reform without being governed by the agendas of national parties. They believe they will thus be in a stronger position to engage in the sort of cut-and-thrust debates with fellow MEPs which the Lisbon treaty is trying to silence.

All will represent Libertas' core principles in creating a new, democratic and open EU. Central to this is accountability: if there is to be a Constitution – and I'm not absolutely against one in principle – there must be a referendum in all member states. If Europe's laws are to have primacy over national sovereignty then those laws must be decided

on by elected officials. Similarly, we should have fewer meetings, and those we do have should be held in the open and not behind closed doors, and we should all be allowed to know how MEPs are spending our money. Savings amounting to nearly €10bn could be made by trimming the typically bloated excesses of bureaucratic institutions.

Ours is a project unprecedented in scale. We know there are tough times ahead for Europe and the world, and we need strong leadership and solid policies to inspire people. That's why we at Libertas have been taking our time to produce well-considered policies, ones that will channel our passion and enthusiasm for the European Union into

workable strategies that can unlock the huge potential of European creativity. Like Barack Obama, we are building a grassroots campaign which makes use of the internet; we have some of the best minds in the business working on our website at www.libertas.eu where we will be unveiling our policies for the Europe ahead. Unlike many in Brussels, we respect the judgement of European voters. We know that we have to win their votes through convincing arguments rather than bribes or political chicanery. Pan-European politics is what Europe needs, and Libertas is leading the way. □

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The economic crisis is also an opportunity for the EU's science strategy



If Europe is to breathe new life into its largely discredited Lisbon strategy, a comprehensive new strategy for science, research and technology is needed, says **Janez Potočnik**. He surveys the steps already taken and those that still lie ahead

Like arts and culture, science used to be considered a luxury – albeit a useful one – that societies could afford only in prosperous times. Today is hardly a time of prosperity, but no one would contest our need to maintain the EU's scientific effort. Obviously, pure science will not help us to overcome the economic crisis, nor mitigate its consequences. But most people would agree that technology and innovation are at the root of economic power, and that research has become deeply embedded in the fabric of our society. And we in Europe are not the only ones to be concerned about its future: "We will restore science to its rightful place," said Barack Obama in his inauguration speech, the rest of which was largely devoted to the economic crisis. He followed up on his commitment when at the end of April he announced the U.S. ambition to spend at least 3% of its GDP on R&D and international scientific collaboration.

I hope that the same thinking will predominate in Europe; science and research are vitally important in preparing our economy for the post-crisis world. Europe remains the second largest scientific power in the world, and by far the top destination for R&D investment by American and European multinational companies. That's a sound basis to build on, because we in Europe could multiply the benefits of our research and make ourselves the world leaders in innovation if only we would develop a more comprehensive science and technology strategy.

But we Europeans are still far from providing the support which scientific research and technological development need. Despite some progress, the overall European research effort has stagnated for years at around 1.84% of EU GDP. Our latest data show that this average figure hides great differences. Despite a general effort

from the less performing countries – mostly the new member states – the variations between member states remain significant, and overall, the EU is still far away from its 3% target. At the same time, U.S. investment in the field stands at 2.61%, even though it too is stagnating, and Japan's investment is at 3% significantly above that. More striking still is the situation in emerging countries like China, which are swiftly catching up with the most advanced regions of the world.

It would be an error to put the blame exclusively on European governments who contribute to the public part of the investment. A closer look at the figures reveals that Europe's underperformance in research funding compared to the U.S. lies in the weakness of private investment. The level of R&D

investment in Europe reflects our industrial structures, in which the high-tech sector has a smaller role compared to other economies. The intensity of R&D investment within industrial sectors is also generally lower in Europe than in the U.S. But now the situation requires a sustained effort from European governments, which have to keep investing in research to create the counter-cyclical effect needed in times of economic breakdown, and also need to orient this investment in strategic areas to ensure tomorrow's competitiveness. They need to actively create the framework conditions for research and innovation, the roadmap for which was laid out in the EU's Lisbon strategy that member states adopted in 2000 and agreed to reinvigorate in 2005. It is

The level of R&D investment in Europe reflects our industrial structures, in which the high-tech sector has a smaller role compared to other economies

often said that this strategy has not been as effective as expected, particularly because of flaws in its implementation. There is some truth in this, and the real test now is to find the right way to induce action by national governments. A permanent effort is needed to reinforce the impetus gained nine years ago, because the core of the Lisbon strategy is as relevant as ever because of its aim to make of the EU the most competitive and knowledge-based economy, notably through

the implementation of the European Research Area (ERA). As to the European Commission, within the limits of its legal competence, it supports the member states by proposing and promoting the measures needed to create the ERA.

It's worth looking at the ERA in more detail. For obvious reasons, starting with the growing costs of research and the scale of some of the problems research and technology are supposed to help to solve (in fields like health, energy, climate change and environment), science policy issues are increasingly addressed at European level. A genuine EU research policy is being implemented, based on EU funding, to create a European market for research and technology and to coordinate research across Europe. The ERA strives for the free movement of researchers, technology and knowledge, and we call this the "Fifth Freedom" in recognition of its power to boost the European economy in much the same way as the free movement of people, capital, goods and services.

But EU research policy is approaching a crossroads. The coming months will see the mid-term evaluation of Framework Programme 7, much discussion on the future of Framework Programmes, in general, the EU's future budgetary arrangements (the new financial perspectives), a new Commission and hopefully the implementation of the Lisbon treaty. All of these offer a new opportunity for defining the EU's next steps towards a new science strategy.

Which direction could we and should we move towards? One can credit the past 40 years of EU research funding and policy with having significantly raised the average level of research. Europe could progress further by creating the conditions for acting in a much more integrated manner on research and technology. We need to act on three fronts: larger-scale collaboration between member states, better methods for distributing EU funding and by combining our technology and industrial policies.

EU research policy has since its earliest beginnings supported cross-frontier collaboration as a way of maximising the added value of European funding. Up to and including FP6, these collaborative partnerships were between research teams; but from FP6 (2003-6) to the current FP7 (2007-13), they have been extended to national research programmes. This will continue under the label "Joint Programming" following a July 2007 proposal by the

We need to act on three fronts: larger-scale collaboration between member states, better methods for distributing EU funding and by combining our technology and industrial policies

Commission. The joint programming of national research agendas will focus on "Grand Challenges" in such areas as energy, health and aging that are beyond the scope of anyone. Another example of this joint approach is the planning of research infrastructures. The European Strategy Forum for Research Infrastructures (ESFRI) brings together EU Member States and associate countries to plan the pan-European Research Infrastructures needed for the coming 10-20 years. The Commission has proposed a "European Research Infrastructure" regulation to provide a European status for large-scale EU research infrastructures, and it would also enable them to be recognised as international organisations. I hope that this regulation will be adopted by the Member States as soon as possible so that future European research infrastructures can be put together faster and more efficiently.

We are still far from having fully realised the potential for transnational partnerships. There's still a gap between simple projects and large programmes, so there is both a clear need and a latent demand for some form of collaboration at the level of full research institutions. This would imply joint initiatives involving a small number of partners like research centres and universities that would pool significant parts of their activities. This is already starting to happen. Ten leading European Research Institutes have banded together as the

European Energy Research Alliance (EERA) to conceive and implement joint research programmes on clean technologies as part of the Strategic Energy Technology (SET) Plan, adopted by the Council last October. Ways of supporting this sort of joint venture could be developed in a more formal framework along the lines of two recent initiatives: the "Networks of Excellence" and the "Knowledge and Innovation Communities" of the European Institute of Innovation and Technology (EIT), which could become a kind of "distributed European MIT" bringing together academic research teams and units from different countries in a context of industrial applications and technological innovation. Some say that the EIT is a risky experiment, but isn't it precisely what the EU needs if we are serious about encouraging innovation and entrepreneurship?

Another step towards a comprehensive science and technology strategy would be to re-examine the EU rulebook for funding research. The present framework is the product of history; it has been developed by adapting legal and regulatory structures that were conceived for other purposes than research funding.

We have already taken a step in this direction with the creation of the European Research Council (ERC), which funds individual scientists and their projects without any partnership obligation. Another recent addition to the European research family is the Research Executive Agency (REA) to which we have outsourced the management of research funding. The idea is that by delegating to these bodies the management of funding, the European

Commission's Directorate General for Science and Research will be free to focus on shaping European research policy.

Scientific research as such is only part of the picture. Much more challenging is the question of how to create a genuinely European industrial and technology policy. Alongside the creation of the European Research Council, the major novelty of the 7th Framework Programme has been the launch of a number of Joint Technology Initiatives (JTIs) that associate public institutions and large private companies in fields like aeronautics, electronics and pharmaceuticals. These initiatives could add-up eventually to a modern industrial policy that is being implemented at European level. In the U.S., industrial and technology policy is implemented with support going to private enterprise, not through research funding in the main, but through public procurement, in particularly although not exclusively in the defence sector. Isn't it time for Europeans to explore public procurement in such fields as clean transport, health infrastructures and energy?

But to do so would demand a clear vision and strong commitments from all the EU's Member States and institutions. These troubled times in fact offer us a narrow window of opportunity that should not be missed. What is at stake is an integrated European Research Area that will determine Europe's attractiveness as a destination for R&D investment. □

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RESPONSIBLE DEVELOPMENT: MORE THAN JUST A CHOICE, A DRIVING FORCE AT LA POSTE

By Jean-Paul Bailly, CEO of La Poste Group



Over the past 20 years, finance has taken hold of the economy. Stock market prices have become the measuring stick for corporate solidity. Companies have concentrated all their efforts on maximising return on investment and value for shareholders. Financial players began imagining that they could create wealth from finance itself, and the world started living off this unbelievable virtual economy. This all-finance phenomenon was adversely exacerbated by a narrow focus on short term results. IFRS (International Financial Reporting Standards), for example, evaluate business according to daily market prices. The system works well when growth is rising, but is dangerous when things turn around. All the technical instruments contribute to a short-term dimension of financial results, and instantaneous transmission of information accelerates the consequences. Shareholders monitor corporate profits on a quarterly basis, and they react accordingly. All of this has made the system unstable and volatile. What if we refocused on a strategic vision, on broader issues, taking a long-term view? What if we considered sustainable development?

In reaction to the system's shortcomings, today's crisis is leading to far-reaching, but unpredictable, changes. The crisis is opening our eyes and widening our horizons. It is showing that a company's true pulse is its long-term viability. It is showing that true performance is shaped as much by how a company achieves success as by the success itself. It is giving rise to true corporate responsibility, in the environmental, social and societal realms. What we at La Poste call responsible development.

Today, nearly 75% of all companies are talking about sustainable development. It is a concept that has produced vast changes over the past five years. Companies have often – it has to be admitted – adopted it as part of their communication policy, using the vocabulary of experts that made the policy much less accessible. Gradually, companies forged progress plans focused on a few key points that could be measured and quantified. I will admit that La Poste Group did follow the same path. Our first strategic plan, "Performance and Convergence", put our Business Sectors on the front line against the competition. The 2008-2012 plan, "Performance and Trust", helped us to move to the next level: putting responsible development at the heart of our project. This completely open approach is based on one conviction: our success must respect all those involved and benefit everyone.

Let's start with our customers. By viewing customers with respect in our dealings with them, by giving them advice that fits their interests before thinking of our own, and by upholding a certain number of tangible commitments such as "cutting waiting time in the 1,000 largest post offices," we work to build their trust and confidence and earn their lasting loyalty. Which is essential as we await total market deregulation! Inspiring our 290,000 postal

employees to support the company's transformation by sharing in its success is fair and crucial. La Poste has used temporary and part-time employment contracts for too long. We will now give priority to job quality, skills development and professional growth. At the end of 2008, employees on fixed-term contracts made up only 3.3% of staff; 87.6% of workers were full-time and 10% of postal employees were promoted during the year! We are working to make La Poste Group an employer committed to developing its employees' abilities, and we are on track to meeting that goal. One of the things that sets La Poste apart from other companies is that it is a fully-fledged member of French society, sharing in the issues that face people on a daily basis. One of our priorities is to give hope to those who live in underprivileged suburban areas. In 2008, we hired over 1,400 young people from these districts, and we believe we can go further still. The future of La Poste Group is also closely intertwined with the future of the regions where it operates. We have appointed 21 regional sustainable development officers who can focus on local issues and work in close cooperation with local stakeholders, supporting them in their approach to sustainable development.

I have kept our work on the biggest challenge for the end: our commitment to combat climate change. As a world-class group, we must make a contribution to the French and European objectives to cut greenhouse gas emissions. This drive will influence our industrial, commercial and real estate decisions. It will change the way we are organised and our operating methods, designed to bring everything into line with this challenge.

To do this, we are taking action alongside postal operators from across Europe and around the world. La Poste is one of the founding members of the European Postal Services' GHG (Greenhouse Gas) Reduction Programme launched by PostEurop in 2007. We take part in the Carbon Management Programme set up by IPC (International Post Corporation), which brings together 25 of the world's leading postal operators. Finally, we are at

the head of the Universal Postal Union's sustainable development working group.

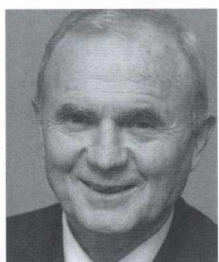
We are making bold commitments at group level. La Poste Group has France's largest vehicle fleet, with more than 60,000 cars, trucks and bicycles on the roads every day. We also have France's largest property base, with around 15,000 sites. Transport and buildings make up the two largest sources of CO2 emissions, so we have to feel responsible for their control. We aim to reduce our greenhouse gas emissions by 12% between now and 2012. By the end of 2009, 60,000 mail carriers will be provided with ecodriving training, and we are making investments in electric vehicles: the government has given us the task of significantly increasing demand for electric vehicles, which will help develop this industry in France and in Europe.

The Group is also committed to a more responsible use of paper resources. The Mail sector represents 50% of our turnover for tonnes and tonnes of paper consumption. Paper is an integral part of La Poste's business, and we have a large responsibility to manage this resource wisely. The Group has set the goal of using exclusively recycled paper or paper from sustainably-managed forests for internal consumption by 2012, and we are developing a range of more responsible products and services while raising customers' awareness of the values of written media and mail-related issues.

All these commitments are building trust and confidence in La Poste Group while stimulating its performance. This is the Group's choice, and its driving force. Our objective is not to make short-term profits, it is to generate added value for society over the long term. The financial crisis is going to be difficult, but it will provide the chance to change our companies' role and to visualise a system that is more responsible and more socially-aware. Let's take the chance!

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Why a common eurozone bond isn't such a good idea



A new breed of EU bonds to demonstrate "solidarity" would, say its proponents, prevent strong and weak eurozone members from being pulled apart by market forces. But Otmar Issing says the idea is deeply flawed and could even backfire

As the crisis in financial markets has deepened, spreads between the government bonds of different countries in the European Monetary Union (EMU) have widened dramatically. In February, the spreads of secondary market yields of government bonds with maturities of close to ten years with respect to Germany were 141 basis points for Italy, 257 for Greece and 252 for Ireland, although back in 2000 these spreads had only amounted to 32, 84, and 25 basis points, respectively.

With the start of EMU, long-term interest rates in participating countries had more or less converged to the lowest level existing before the introduction of the euro in countries like France, Germany or the Netherlands. Italy and Greece, meanwhile, had enjoyed a decline in the cost of servicing their public debt in comparison to pre-EMU days which showed that

they were drawing enormous benefit from their participation in the European Monetary Union. It was the judgement of market participants that the introduction of the euro as a common currency meant that not only the currency risk had disappeared i.e. the risk of devaluation; all eurozone members were seen as belonging to a zone of stability that clearly spanned not only monetary stability, but also through observance of the disciplines of the Stability and Growth Pact, fiscal stability too.

Spreads, meaning the difference in eurozone countries' long-term interest rates, normally moved around a low level of around 25 basis points, a difference that mainly reflected such technical factors as liquidity in the markets. And this was the situation that basically prevailed for many years, despite less favourable developments in fiscal policy in some eurozone countries.

Spreads over German government bond yields, 10 years maturity, in basis points.

	1992	2000	2009 (February)
Italy	542	32	141
Greece	1616	84	257
Ireland	122	25	252

Source: ECB (Secondary market yields of government bonds with maturity of close to ten years, monthly data) and Eurostat (Government bond yields, 10 years maturity, annual data).

But with the advent of the present crisis, all this changed rapidly. Countries with dramatically rising budget deficits like Ireland, along with high levels of public debt like Greece and Italy now have to pay substantially higher interest rates on government bonds. Investors who are becoming much more risk averse in these times of crisis demanded higher credit risk premia for buying bonds from those countries that were seen as weak debtors. By contrast, long-term interest rates in those countries that were seen as in a better fiscal position, like France, Germany or Finland, enjoyed very low rates as a consequence of investors' "flight to quality".

The increase in long-term interest rates hit those countries hardest that had already experienced a strong deterioration in their current or expected fiscal position. Concerns about the sustainability of public finances came to the fore, and the argument was even raised that a country might have to consider leaving the monetary union if this process were to continue – it's a threat, incidentally, that totally lacks substance because it would be the surest way to commit economic suicide. But it therefore came as no surprise that the idea of a common European bond should be proposed as a means of mitigating the impact of the crisis and of countering the problem of rising interest rate spreads in eurozone countries that are the most vulnerable to these developments. In fact, the notion of a common bond had been put forward some years before, although at that time the main argument was that a common bond would result in higher liquidity than that created by the issuing of different national bonds.

In the context of today, the liquidity argument is generally seen as being much less important. The main argument now is reducing the risk premia to be paid by creditors with lower fiscal credibility in the markets. Obviously, though, this could only be achieved by implicit or explicit guarantees from eurozone countries with sound public finances. A "true" multi-country European

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bond would have to comprise a full joint guarantee in which every participating country guarantees the full bond issued.

Supporters of the European bond idea argue that this would mean that the "strongest" guarantee for the "weakest", and ask whether this isn't exactly what Europeans mean when they talk of solidarity?

A common bond, by virtue of its construction, would delete the interest rate spread between bonds issued by different eurozone countries, so the question that has to be addressed is what effect the common issuance would have on the level of the interest rate, and more importantly on future fiscal policy and the euro itself.

A common eurozone bond would certainly imply that countries like France and Germany would have to pay higher interest rates, and that would in the end mean higher tax burdens for

their citizens. It's also important to point out that once the markets expect substantial amounts of the common bond to be issued, interest rates on the huge stock of existing – purely national – bonds of solid countries would in the course of time be very likely to increase substantially. No one can possibly know in advance exactly how big this "bill" would be, and in any case arguing about billions of euros – important as that is – misses the crucial point: issuing a common bond would be a first step on the slippery road to "bail-outs", and thus the end of the euro area as a zone of stability.

The immediate trigger and the root cause of rising spreads were financial markets' growing concerns about the solidity of some eurozone countries. This loss of credibility has been a consequence of dramatic deteriorations in their current and expected fiscal positions. But, a common bond is no cure for a lack of fiscal discipline; on the contrary, it would tend to encourage countries to continue on their wrong fiscal course.

The global financial crisis was created not least by the excessive risk-taking of institutions that were being supported in their

irresponsibility by the implicit "too big to fail" guarantees of their governments. Should the present crisis lead governments in Europe to create similar guarantees that "sovereign debtors are impossible-to-default", the consequences would be probably even more damaging. So-called solidarity via common European bonds would perhaps in the short-term increase the re-election chances of those governments that created the fiscal mess – a situation that would be ironically similar to the large short-term bonuses paid to bankers who took excessive risks – as the costs of this "support" would have to be borne by the citizens of other countries. It would be hard to find a clearer case of free riding. And the argument that some countries are in such a terrible situation that they will be unable to get out without substantial help from their neighbours is also unconvincing; in the end, that would turn against a common bond.

The only workable cure for the eurozone's ills is a credible commitment by all its members to reform and fiscal solidity. That's what would overcome investors' doubts and lead to the shrinking of the bond spreads.

A common bond would be no more than a placebo for a "weak" country, but it would also be harmful because it would foster the illusion that it is possible for a country to get out of difficulty without having undertaken fundamental reforms. And in fact the opposite holds true; times of crises give governments the best argument to take tough measures needed to get the country back on a sustainable path.

A common bond would be very costly for the more solid countries, but most dangerously of all, it would undermine the credibility of the eurozone as an area of stability and fiscal soundness. The major success achieved at the start of monetary union, when long-term interest rates in all countries converged to the level of the most stable members, would be spoiled. And the sanctions of negative financial market's reactions would mean that a high price had to be paid by all of the eurozone's countries.

In short, the "medicine" of a common eurozone bond would not cure the problems of its weakest members, but would instead prolong their reliance on budget deficits while

encouraging them to hope for the de facto "bail-out" that is waiting just around the corner.

The biggest threat of all would come from the political repercussions of such a move. Any policy that involves a price to be paid by those countries that have opted for fiscal solidity in favour of those with high deficits and continuing high debt levels would strongly undermine the stability status of the eurozone, and thus the confidence of its citizens. "Solidarity" in the true sense means that all of the countries concerned should comply with the fundamental rules of EMU by observing the disciplines of the Stability and Growth Pact and the "no bail-outs" principle. Fulfilling commitments that have been so solemnly undertaken is a core part of this, and those countries that may be tempted to undermine these principles would be demonstrating their own lack of solidarity. □

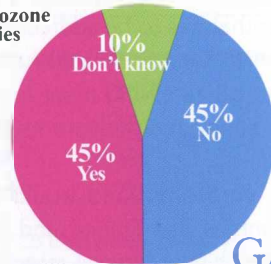
Otmar Issing is President of the Center for Financial Studies at Frankfurt University and from 1998-2006 was a Member of the Executive Board of the European Central Bank. He is the author of "The Birth of the Euro" (Cambridge University Press, 2008).

MATTERS OF OPINION

Eurozone citizens divided on crisis benefits of the single currency

OPINION IS EQUALLY DIVIDED ON WHETHER OR NOT THE EUROZONE COUNTRIES WOULD HAVE BEEN BETTER PROTECTED IF KEEPING THE FORMER NATIONAL CURRENCY

16 Eurozone countries



Source: Eurobarometer 2009

GALLUP

When citizens of the 16 eurozone countries were asked in early 2009 whether they thought their own country would have been better protected from the global economic crisis by keeping their former national currency, opinion was equally divided – with 45% saying yes, 45% no and 10% 'don't knows'.

But there were wide national variations: Slovaks, Finns and Slovenes were most strongly in favour of the eurozone's advantages with roughly 7 in 10 respondents saying they disagreed that their

former national currency would have offered greater protection. A strong majority of Dutch, Luxembourgers and Belgians – over 6 out of 10 people surveyed – also backed the euro's protective role.

However, most Portuguese, Italians, Spaniards and Cypriots (52% – 62%) felt they would have been better protected against the crisis had they not joined the euro, although these were the only eurozone countries where over 50% of people questioned expressed this view.

WE WOULD HAVE BEEN BETTER PROTECTED IF WE HAD KEPT OUR NATIONAL CURRENCY



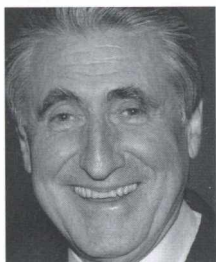
WE ARE BETTER OFF WITH THE EURO



Source: Eurobarometer 2009

GALLUP

A crisis-busting plan from Europe's boardrooms



We need to take practical steps right across Europe if we are to streamline our labour markets and create new jobs to replace the millions lost so far, says Ernest-Antoine Seillière, who sets out a four-point recovery plan

In those balmy days before the financial crisis struck, Europe's labour markets were in a healthy state. Private sector companies had created 10m jobs between 2006 and 2008, and with employment rates on the increase unemployment had by the beginning of last year sunk to its lowest level in over 20 years.

But that was then, for the crisis has had a savage impact on the EU's labour markets. Now that we are in the deepest recession in decades, unemployment rates for both skilled and unskilled workers are climbing fast.

Job losses in the EU, warns BUSINESSEUROPE's Spring 2009 Economic Outlook, are expected to reach 4.5m this year, with Spain and the UK each accounting for almost 1m unemployed people. By 2010 Europe's unemployment rate could reach 10%. Unemployment will not strike every EU country equally, but it is clear that the majority of them will be faced with

unemployment rates of over 10% by the end of this year. Forecasted unemployment in countries like Spain could rise to 16-19% by December.

All this is inevitably going to have a really severe impact on our social protection systems. They are already struggling with long-term financial sustainability problems because of shrinking working-age populations and higher dependency rates, and they will now be coming under even greater pressure as the proportion of unemployed people rises.

Any chances Europe has of a speedy economic recovery will depend on our agreement on a concerted response. We at BUSINESSEUROPE have therefore set out a four-pronged strategy for dealing with the crisis.

The first priority must be to restore companies' access to finance. This is indispensable if we want to ensure the survival and future development of companies both

large and small. Unless they have access to credit there will be no economic recovery, and without economic recovery there will be no job creation.

Second, EU member states must adopt and implement effective recovery programmes. Bold, well-designed and targeted economic stimulus packages are needed, and should look to the future with new infrastructure, by investing in research, development and innovation, and by improving the functioning of our labour markets.

But these recovery programmes are just building blocks. The third measure needed is to speed up structural reform. The present crisis should not be allowed to cloud our view of the long-term challenges facing Europe. Instead, the crisis should act as a catalyst for reforms to structurally improve Europe's competitiveness in a rapidly changing international environment where major new trading partners have already emerged. In other words, our short-term emergency measures must be consistent with the ambitions goals that were set nearly a decade ago in the EU's Lisbon strategy.

Back in 2000, the Lisbon strategy was launched with the aim of transforming Europe into "the world's most competitive knowledge-based economy" by 2010, and in 2005 was revised to focus on the creation of more growth and jobs. Despite the good results in terms of jobs created since 2005, there is widespread agreement that the Lisbon strategy has not fully lived up to the ambition of boosting both employment and productivity. BUSINESSEUROPE's Spring 2009 Reform Barometer found that although

COMMENTARY

By Philippe Herzog

And a heartfelt plea from the factory floor for real reform

It is welcome news that Ernest Seillière is seeking to lessen the impact on working people of the financial crisis. He is using his influence among employers to avoid redundancies and to praise companies that have instead adopted a shorter working week. And he reminds business leaders that they need to invest more in education and in apprenticeships.

So far so good, but we need to look more deeply into the real changes that need to be made to secure a prosperous future for all Europeans. Seillière speaks of continuity, but capitalism as practised in the West has failed, as it keeps massive human potential unemployed and has broken the link between productivity and wages. We are not succeeding in building a knowledge society. And now unemployment is soaring despite all the efforts to contain it.

He favours what we might call "continuity", and as part of that, he wishes to speed up the use of flexicurity. I wouldn't say that the whole idea of flexicurity is dead, but it's certainly not in excellent health. It is all about bargaining with staff so that companies will be well placed to innovate and take advantage of globalisation, but the strength of management in many large companies far outweighs that of the employees in most countries, so the reality is that flexicurity isn't creating much excitement among workers as a key to their futures. The European Commission has argued,

Austria, Finland, the Netherlands, Norway and Cyprus had made good progress in improving their employment rates, Hungary was Europe's worst performer. Weak progress was also registered in Latvia, Denmark, Slovenia, Bulgaria, Germany, Portugal and Belgium. Now that it's experiencing its worst rise in unemployment in decades, it is abundantly clear that the EU has no chance of reaching its own employment target by next year.

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This doesn't mean we should give up on the Lisbon strategy. It's obvious that its reforms and its disciplines are as crucial as ever to unlocking Europe's growth potential. That means we must actually step-up the rate of investment in R&D and innovation, and make improving the EU's regulatory environment a higher priority than at present, while above all achieving a true single market.

The fourth and last part of BUSINESSEUROPE's proposed response to the crisis is resisting all forms of protectionism, whether inside or outside the EU. A well-functioning EU single market

is the key to growth and the creation of more jobs. For every job apparently saved by protectionism, many more are lost in the longer-term. The message must be that we should all stand up against any actions that restrict the free movement of services, goods, capital and workers.

We have witnessed recently how tensions on the labour market have led to actions against foreign workers. While workers are understandably concerned about their jobs in the current difficult circumstances, we cannot tolerate obstacles to the free movement of workers. The posting of workers directive prevents social dumping. Although this was recognised by a Forum organised by the European Commission in October 2008 a lot could still be done to improve its practical implementation. This is the duty of national governments.

We're going to need extraordinary measures because we face unprecedented challenges in our labour markets. That means timely, targeted yet temporary measures to cushion the impact of the economic crisis on employment. Three specific types of practical intervention are called for: First, working hours flexibility will be an important measure for companies to take if they are to keep their workforce in the downturn, but still have them readily available when the upturn comes. Companies across Europe are already avoiding laying off employees by using temporary measures, and by March 700,000 workers in Germany were on shorter a week and France expects 330,000 workers to be doing the same by the end of this year. Second, although it won't be at all easy during the recession, greater investment in education and training is going

to be essential if European workers are to be better equipped to move into new jobs. For without a pool of sufficiently-qualified people, the next economic upswing won't be sustainable. Third, it will be essential to keep the cost of labour under control if we are to foster job creation and avoid even higher unemployment.

Of course, emergency measures have to be taken to improve the situation, but we must also be aware that this is a crisis that will have a long-lasting impact. Whole business sectors and industries are likely to be profoundly changed by it. Workers will be forced to leave shrinking industries and move into jobs in sectors with greater growth potential. So the crisis is set to reinforce the need to rapidly implement the so-called flexicurity approach. A year and a half ago, in December 2007, EU leaders adopted some common flexicurity principles to improve both job flexibility and security. Now the time has come to act on these, because the conclusions of the European social partners' joint labour market analysis in October 2007 are today more relevant than ever. Flexicurity offers a way of facilitating transitions in the labour market.

The past few years were marked by a resistance to change that considerably slowed much-needed labour market reform. So the current crisis should be seen as an opportunity to demonstrate how effective flexicurity can be.

Job-friendly social protection systems and investment in lifelong learning are key ingredients in enhancing flexibility and making our labour markets function better. It's going to be the EU countries that

COMMENTARY

Philippe Herzog

in vain so far, for "quality jobs", and it's an idea that needs to be persisted with.

Ernest Seillière is right to say that investing in the retraining of Europe's workforces is an essential first step towards economic recovery. I couldn't agree more but national and community political commitments at either national or EU level are still lacking. It was especially shocking that member states cancelled a special European Council meeting on employment that had been due to take place in May. The last time the Council considered the idea of a jobs pact was back in 1997.

The key question is the EU's future economic performance and how it will affect working people. Although Seillière is rightly critical of the results of the Lisbon strategy, he accepts its principles and method. I disagree with him, and have told him so. The Union's strategy needs more than an update expressed in a flight of rhetoric. If we are to achieve worthwhile reform we first need to have a wide-ranging pan-European public debate.

Like Ernest Seillière, we at Confrontations Europe are putting forward proposals to use this downturn in economic activity to train staff for tomorrow's jobs, and we believe they are more ambitious and face realities better than Seillière's. We're calling on employers to commit to a far-reaching review of their social responsibilities. They need to anticipate the re-structurings that lie ahead and discuss their strategies with their social partners to create more and better jobs, while also co-operating with institutions to manage transitional arrangements for their employees. Most small and medium enterprises (SMEs) should be included in these arrangements.



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implement these policies that will emerge stronger from the crisis. Just as companies can help speed the way to Europe's economic recovery by retaining their human capital and further developing skills, public authorities and trade unions also share responsibility for addressing the crisis. Social partners have an important role to play in designing and implementing effective responses, and we all know from experience that constructive social dialogue can ensure that both companies and workers will suffer less in a crisis. That's why the European social partners – BUSINESSEUROPE with the European Association of Craft, Small and Medium-sized Enterprises (UEAPME), the European Centre of Employers and Enterprises providing Public services (CEEP) and the European Trade Union Confederation (ETUC) – have agreed on a new Social Dialogue Work Programme for 2009-2010. By negotiating an agreement on inclusive labour markets, monitoring the implementation of the common principles of flexicurity, drafting a joint opinion on the post-2010 Lisbon strategy, we hope to make a real contribution to overhauling Europe's labour markets and making them more efficient.

We Europeans have to view the crisis as an opportunity to move ahead with structural reforms, and improve our competitiveness in the global market place. If we can do this, the EU will come out of the crisis stronger and better prepared to seize the opportunities the global economy offers. □

Ernest-Antoine Seillière is President of BUSINESSEUROPE, the Brussels-based European association of industries and employers.

Summer 2009

COMMENTARY

Philippe Herzog

The EU will have to take special responsibility for cross-border re-structurings, and must also encourage companies to play their part in stimulating the economic recovery of regions hit by plant closures. EU industries are badly hit and competition will grow, but we need to devise industrial policies that prepare a sustainable recovery and promote long term investment.

The EU's member states must engage in a massive training programme; The Lisbon strategy's call for "excellence" overlooked the fact that there is now an army of industrial workers who need to be retrained in such skills as new digital technologies. Instead, it sentenced unqualified workers, chiefly in the services sector, to remain as unskilled as ever. At a political level, we have to put education and training on top of the agenda, put an end to corporatism and bureaucratic barriers and accept that there is an understandable reluctance among some employees to sign up for training courses when they know that in the past they have frequently heralded job losses.

The EU is going to have to devise attractive incentives for companies to undertake lasting social investments, and that in turn means reforming the structural funds. The Commission currently makes its recommendations to member states, but doesn't follow up on how the money is used. Brussels needs to get much more involved on the ground, even if that means a member government may object to being closely monitored. □

Philippe Herzog is the Director of Paris-based Confrontations Europe. phertzog@confrontations.org.

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Edmond Alphandéry

President of the Supervisory Board of CNP Assurances and a former French Minister of the Economy

"It's up to Europe to set a global example of concertation"

What is most needed is concertation, cohesion and decision-taking at a global level. The European Union must set an example on the four topics that are high on the G20 agenda.

The banking sector's toxic assets. This issue will only be solved by isolating them from the banks' balance sheets. Massive loans are needed to buy these assets and public funds are also required for recapitalisation. The EU must be associated with national clean-ups because cross-border banking has created a transnational dimension and to apply the competition rules. I therefore strongly support the idea of a bond issuing EU stability fund (Gros and Micossi, *Europe's World*, Spring 2009).

Eastern and Central Europe: An even deeper crisis in the new member states could have major consequences for all the EU. The proposal by Franz Nauschnigg of the Austrian National Bank for the eurozone to create a counter-cyclical facility and for the launch of an EU facility for balance of payments and macro-financial assistance, deserves serious examination.

Macro-economic coordination: A failure of global coordination is at the heart of global imbalances, so what is now needed is a reallocation of demand from countries with current account deficits (mainly the U.S.) to those with structural surplus like China, Japan and

Germany. And as the EU has a similar problem with France, Italy and Spain in deficit and Ireland or Greece at risk of insolvency. The EU therefore needs a political framework to enforce macro-economic discipline and tackle intra-European imbalances.

Regulatory reform: The de Larosière group's proposals for allocating tasks and responsibilities in regulation and supervision between national and European levels should be fully adopted so as to become operative as soon as possible.

This crisis offers the EU a major opportunity to reinforce its institutions and to emerge all the stronger. □

Jerzy Buzek

Member of the European Parliament's Committee on Industry, Research and Energy and a former Polish Prime Minister

"Let's return to the grassroots and base growth on savings and productivity"

Europe needs to get back to the grassroots of its market economy and base its economic growth on savings and productivity. EU governments should be careful about the future effects of their actions. By lowering interest rates and injecting money into the economy, governments can, to some extent, tackle current problems, yet in the long term these actions can have the negative effect of risking high

inflation, heavy debt servicing cost and therefore substantially increased taxes.

What we need is to recreate the sort of institutional framework that will ensure confidence in the system. Markets have to be based on principles of transparency and have a regulatory framework that is understood by all. Instead of being at the heart of the economy, the financial sector

ought to be ancillary to the real economy.

This crisis may yet turn out to have a beneficial side, in that it makes us understand that a business may be worth more than the price of its stock. We have to encourage a new philosophy of financial rewards that is not based on short-term gain but on sustained growth and long-term contributions to the economy. □

Mark Eyskens

Former Prime Minister of Belgium

"My 10-point rulebook for the globalised economy"

- There is no need for a return to state collectivism, but collective decisionmaking should be as international as possible with a maximum level of transnational cooperation.
- Governments and political parties should advocate and organise a new complementarity of market and public authorities. Modern societies are in search of "co-opetition", an intelligent mix of cooperation and innovative competition
- More legislation is needed to monitor and control the financial sector, but it should avoid cross border regulatory arbitration.
- Protectionism in all its forms must be resisted worldwide.
- More Europe is needed, i.e. by the approval of the Lisbon treaty and strengthening of EMU. The United Kingdom should be allowed to join the

EU's monetary union while keeping the pound through the creation of a Euro-Sterling zone.

- Closer cooperation between multilateral agencies is highly desirable: IMF, World Bank, WTO, G20, Eurogroup, leading towards a Bretton Woods II.
- In the short run the banking system should be stabilised by means of: government loans, state guarantee, the creation of a "bad bank" and temporary nationalisations. Savings banks should be separated from risky investment funds and central banks should apply negative interest rates on the incoming liquidities of commercial banks to encourage them to maintain inter-banking credit flows.
- Keynesian recovery measures are called for, but governments should watch out for possible strong

inflation, increases of public debt and huge budget deficits, all of which are incompatible with financing Europe's ageing population.

- Considerable promotion and encouragement are needed for research and development, clean energy, environment, infrastructure, education and healthcare.
- More ethical behaviour has to be promoted in business and financial decisionmaking. Let us fear our own fear. Apprehension with respect to apprehension is now required. We must believe in hope. Please neither pessimism nor naive optimism, knowing moreover that an optimist often happens to be a wrongly informed pessimist. I am advocating meliorism, based on the firm conviction that people and things can be ameliorated. □

Franz Fischler

Chairman of Ecosocial Forum Europe and a former EU Farm Commissioner

"What we need first and foremost is a change in public consciousness"

Sustainability and global justice must form the central pillars of a new approach to global governance. Financial markets and the international economy need considerably more transparency and clearer rules, but a noticeable "change" in our collective social consciousness will also be needed to make the economy sustainable. In

a globalised world, common problems like climate change, hunger and unequal allocation of goods can only be solved by common actions. The market economy, social justice and a workable interaction between the environment and scarce natural resources are equally essential. But first a change in the public consciousness is essential.

The G20 must manage to regulate financial markets, close down tax havens and make short-term speculative transactions less profitable by introducing a transaction levy. We also need an agreement in Copenhagen at the end of this year on a just climate policy with a worldwide CO₂ market. Trade rules need to be

strengthened and made fairer to developing countries if they are to catch up with the developed world. They

therefore deserve temporary social and differential treatment in trade, and much greater financial support to

combat hunger and make their economies grow in a more sustainable way than industrial countries. □

Nicole Gnesotto

Senior research fellow at the Institut français des Relations Internationales (IFRI) and former Director of the EU's Paris-based Institute for Security Studies (2002-2007)

"We need a new global political deal now the West is no longer master of the world"

A new architecture for a globalised economy cannot be built without a political dimension. Globalisation is not a phenomenon restricted to the economic sphere because it affects all aspects of international relations, including the trends,

factors and actors of the post-Cold War order. The same principles seem unavoidable in both the economic and the political spheres; the world needs more solidarity, more justice, a greater sharing of power and more legitimacy. China and India,

along with other emerging powers need a greater say in the decision-making of international institutions, be it the UN or the IMF. They have to be actively involved in the writing of any new rulebook, as the West is no longer the master of the world. □

Bela Kádár

Former Hungarian Minister for Foreign Economic Affairs

"To save the market economy and democracy, governance has to step in where corporations ruled and markets failed"

The nature of this crisis is that it includes not only financial and cyclical roots but that it also reflects institutional and value differences. A sound international system that aspires to run and strengthen a market economy as well as a political democracy has to be based on institutional checks and balances.

During the past three decades, increasing imbalances and asymmetries have emerged

in our international power structures. The global economy has become dominated by large transnational corporations, and in the absence of global political governance and control mechanisms, unfair and irresponsible business practices have gained ground and led to the crisis we all face.

The inadequacy of our capacity to respond to global challenges, and even to correctly diagnose

the crisis, suggests the therapy. If we wish to save both the market economy and democracy, governance has to step in where corporations ruled but markets failed. Regulation, supervision and auditing at global, regional and national levels all have to be strengthened and given teeth; international co-operation has to be intensified, particularly when determining financial, trade and cyclical policies. □

Noëlle Lenoir

President of HEC's European Institute and the "Cercle des Européens" and a former French Minister of European Affairs

"My five courses of action"

Three words encapsulate my view of the way forward: transparency, supervision and

ethics. They mean that we need to take five clear-cut courses of action:

- We must ensure global oversight of financial markets and their functioning so

that their virtual nature can no longer lead to systemic crisis. Whatever institution is responsible for this, it must be a public entity set up by the international community.

- We have to make sure that banks' balance sheets reflect the reality of their financial

commitments, instead of allowing the externalisation of their liabilities.

- We must set up a global supervisory system based on a network of national bodies.
- Tax havens have to be eliminated so that states have the resources and financial

strengths needed to play their role at national and international levels.

- We need to seek to increase the profits for all stakeholders in a business, whether they be owners, managers or employees, because ultimately they are all consumers. □

John Monks

General Secretary of the European Trade Union Confederation

"The financial markets are where the re-building must start"

This crisis originated in the behaviour of financial markets and that is where the rebuilding must start. I would favour banks having to keep a higher ratio of assets, an end to off-balance sheet transactions like

hedge fund operations, and a return to distinctions between retail and investment banking and insurance.

The whole scam of derivatives and the selling on of debts also

needs urgent attention. If you have taken out a loan with a bank, you do not want to have it sold on to "A Spiv & Son, Vulture Fund Specialist", who will steal your asset and close you down. □

Poul Nyrup Rasmussen

President of the Party of European Socialists and a former Primer Minister of Denmark

"The EU must pull its weight and demonstrate real leadership"

The key is to make globalisation fairer and more sustainable. We in the Party of European Socialists argue that this requires us to work together at a global level to coordinate simultaneous investments in smart green growth and jobs, to complete the Doha Development Round, and to achieve the UN's Millennium Development Goals and the ILO's Decent Work Agenda.

Global financial institutions need to be subject to greater democratic scrutiny, and just as the IMF's resources are being strengthened so should new financing instruments be developed to keep developing countries' inward investment, aid and trade levels.

New instruments are also needed to regulate all financial

players and to put an end to tax havens, and these measures should include new obligations to disclose assets, remuneration, regulation and risk, limits on excess debt financing and new capital requirements. To make these bold goals a reality, the European Union must pull its weight and demonstrate real leadership. □

Klaus Regling

Fellow at the Lee Kuan Yew School of Public Policy and a former Director General for Economic and Monetary Affairs at the European Commission

"Better regulation and supervision, and the greater legitimacy of international financial institutions"

The key objectives must be to avoid the excessive build-up of leverage and risk, and to reduce

the system's pro-cyclical. In the first place, this requires the following changes in regulation,

supervision and policies

- All financial markets, products

and participants must be subject to regulation or oversight.

- Financial market transparency must be enhanced through comprehensive disclosure requirements for systemic, cross-border financial institutions, and for complex financial products.
- Regulatory capital requirements for activities not previously covered, for liquidity risks, and during economic upswings must be increased.

- International cooperation among supervisors in crisis prevention, management and resolution has to be improved.
- Incentive structures that encourage excessive short-term risk taking have to be changed.
- Macro financial stability should become an additional, complementary focus for banking supervision with a stronger involvement of central banks.
- Fiscal and monetary policies

need to play a larger role in reducing the pro-cyclicality of the system.

As for institutional changes, the legitimacy of international financial institutions must be strengthened by giving major emerging market economies a larger weight in decision-making. These countries should also become full members in global fora and standard-setting bodies. European representation in them should be streamlined. □

Onno Ruding

Chairman of the CEPS Board of Directors and a former Dutch finance minister

"Implement de Larosière and then consider further reform"

We are in the midst of a very serious financial crisis and must act now. No new architecture or rulebook can beat this crisis, and each country should actively contribute to managing and resolving it, domestically and through close international cooperation, in Europe and at a global level. Any measure to fight the crisis must resist protectionism, which would be particularly harmful in Europe as this would endanger the

Single Market. International action should be coordinated within the framework of existing multilateral institutions.

We must all work at developing new or amended architecture to prevent a next crisis. This would not necessarily require new rules; frequently the improvement of existing regulations, coupled with closer supervision of their implementation, is called for.

For financial institutions and markets, the de Larosière-Committee report offers a wealth of analysis and recommendations to improve this regulation and supervision. I hope EU member countries realise that these ambitious yet realistic recommendations are appropriate and needed and that they deserve support. Once implemented, we should consider whether further steps towards reform are required. □

André Sapir

Senior Fellow at the Bruegel think tank in Brussels and author of the Sapir Report on the economy of the European Union (2003)

"Restoring the health of banking is no longer a financial problem but a political one"

Beating the financial crisis means first and foremost restoring the health of the banking sector by sorting bad

assets and recapitalising it. This is no longer an economic or financial problem but rather a political one because it

demand decisions affecting the opposing interests of bank shareholders, bondholders and managers, to say nothing of

taxpayers. In some instances the decision will be temporary bank nationalisations so as to protect the interest of taxpayers.

Preventing another crisis means strengthening macro-prudential supervision and regulation along the lines that had been suggested for many years by the

Basle-based Bank for International Settlement (BIS), and more recently by the de Larosière Group's report to the European Commission. □

Tøger Seidenfaden

Editor in Chief of the Danish daily newspaper *Politiken*

"We urgently need much stronger international institutions"

What will beat this crisis and what will prevent another are two very different questions, both intellectually and politically.

In terms of crisis-prevention, the answer to the first question seems much more urgent than the second. There are many things in the financial rule-book that ought to be fixed – including extreme short-termism

in rewards, off-balance-sheet vehicles that make a mockery of solvency requirements, lack of transparency in bizarre derivative markets and so on. As the next crisis will be different, these steps will not in themselves prevent future, unpredictable follies.

What is urgently required to alleviate the present crisis, and strengthen our defences

against prolonged and future storms, is the creation of much stronger international institutions with the capacity to act globally and collectively. Unfortunately, those who want to act now are not interested in strong institutions, and those who are interested in strong institutions don't want to act now. The result being that the crisis will most likely be long and deep. □

Constantine Simitis

Prime Minister of Greece from 1996-2004

"Fiscal stimuli, yes. But social goals are also crucial"

Capital markets and the financial sector must come under uniform regulatory control, both within countries and internationally. A common set of regulatory standards must be imposed so that a global market is subjected to global requirements. Global standards favour the creation of world enforcement authorities, a much needed form of international governance. The IMF has been such an authority but only for weak countries and not strong countries like the U.S. that over-borrow.

Existing world organisations must be politically realigned: their charters must empower developing countries and their mandates should focus on recovery under a regime that encourages development with a reduction of inequality. Why not tax international capital gains in favour of a world stability fund? Why not agree internationally that interest on corporate debt not be "tax-expensed" after a certain limit? Taxing financial profits to build stability reserves could be the road to a stable new global order.

The crisis imposes fiscal expansion, as only states are able to create demand. Fiscal expansion will increase world public debt but this could lead to inflation as recovery takes off, thus crippling it. Fiscal expansion must therefore be geared towards investment that fuels growth. National investment is not enough, so international public goods should become a priority. International infrastructures have a network aspect: environmental protection, global health care, global education, energy management

and distribution, security of transport and data transfers are examples.

Recovery and stability are not just economic goals but underlie an urgent social

agenda. Regulation should be oriented towards maintaining stability and decreasing inequality. If states, along with the private sector, are again to become important managers of social surplus, they must

reform themselves, with transparency, democratic accountability and codes of conduct for public management of social goods making up the elements of a "reform for recovery". □

Loukas Tsoukalis

President of the Hellenic Foundation for European & Foreign Policy (ELIAMEP)

"To be a major player on the new global architecture, Europe must end its IMF over-representation"

Europe wants to be a major player in the negotiations for a new global financial architecture. This will have to involve a stronger and reformed IMF with a substantial redistribution of power in its governance structure. We know that European countries are grossly over-represented at the IMF executive board, while intra-EU

coordination leaves much to be desired.

The gains from a single representation of EU countries, or more realistically of the eurozone, are obvious: a clear message of European unity to the rest of the world, stronger collective influence of Europeans in international finance compatible with

a re-weighting of votes in favour of the large emerging economies.

Apart from a few well-paid jobs and remaining illusions of national sovereignty and prestige, the losses are more difficult to identify for countries with a common currency. Are we Europeans ready to put our votes where our mouth is? □

Alvaro de Vasconcelos

Director of the European Union Institute for Security Studies (EU-ISS)

"Now it's the West that needs the Rest"

The G20 London meeting in April symbolised the end of an era. Now the West needs the Rest. But the emerging powers won't be able to participate effectively in the new order until they get fair representation. As a forum, the G20 isn't up to the job of providing guidance and orientation when the world is in the tails of global turmoil. It doesn't have the institutions to ensure continuity, and most

important of all, it lacks the capacity to implement and enforce decisions.

G20 is just the first step in a process that will demand of the Western powers much more painful ones. They will need to share with the new global powers control of international organisations like the IMF. New multilateral organisations based on the WTO model will be needed

to regulate international finance.

All of which means an opportunity now exists to rebuild the foundations of the multilateral system. But if this opportunity isn't seized, there is a real danger that the trend towards bilateralism and *ad hoc* groups such as a G2 tandem of the U.S. and China and nationalist fragmentations arising from power politics, will prevail. □

George Vassiliou

Former President of the Republic of Cyprus

"How to beat this crisis and head-off another"

The first task to address immediately is that of 'toxic assets'. Even if this requires the nationalisation of a substantial number of banks governments shouldn't hesitate to do so. Nationalisation is the only fair policy. Instead of lending or giving money to banks, by selling them bank shares once

recovery begins, governments can recoup their taxpayers' money.

Looking to the future, if the financial system is to function well we need our markets to have a social dimension. To avoid repetition of this crisis we must:

- Introduce an effective system of global supervision of the financial sector in its widest definition.
- Put an end to banking secrecy and tax paradises.
- Conclude and implement the Doha Round of world trade liberalisations, and thus defend globalisation. □

Nicolas Véron

Research Fellow at the Bruegel think tank in Brussels

"Institutional innovation, not streamlining, is today's priority"

No perfect global institutional architecture can exist in our imperfect and largely undemocratic world. "All politics is local" while "all economics is global". There is a fundamental trade-off between legitimacy, conferred by long-established national political systems, and efficiency, which transcends borders. "Creating new institutions that will better

balance the requirements of legitimacy and effectiveness will be the prime task for the coming generation", as Francis Fukuyama put it back in 2006.

The idea of having the IMF or FSB or any other three-letter-acronym as the coordinator of all global action is a pipedream. The G20, or a similar group of heads of government, is way too large

and diverse to run everything itself. All it can and should do is endorse specialised institutions, fill the gaps between them, arbitrate turf conflicts, and when necessary push for reforms of their governance. Let's hope the next decade is remembered as a time of exceptional institutional innovation, like the late 1940s. Streamlining is not today's priority. □

Sir Stephen Wall

EU Adviser to Prime Minister Tony Blair and former UK Permanent Representative to the EU

"We need a eurozone regulatory structure, and if Britain wants a role it must manage its eurozone entry"

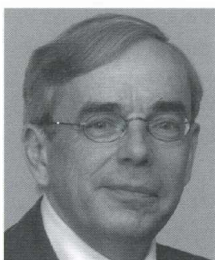
The credit crunch is global in its reach, but its cause lies in the United States and Europe, especially Britain, and its cure has been found in Europe and the U.S. A global understanding of the issues and an agreement on a framework to handle them better will help and the G20 will

play its part. But it will probably be a modest part.

For years, Britain touted its model of financial governance as the example for the rest of Europe and the world, and in the face of the UK's apparent success, the rest of the EU had

no answer that could not be dismissed as bureaucratic regulation. Now, we need EU wide rules and a single regulatory structure within a single currency. If Britain wants to play a leading role in this new management, then it needs to manage its own entry into the eurozone. □

Support for EU's newcomers will be crucial to recovery



Europe's 'big bang' enlargement to 27 countries was a win-win deal for all, says EBRD chief Thomas Mirow. But with the recession biting deeper, he calls for renewed solidarity with the countries of central and eastern Europe

This could have been a year of joy for Europe. We'll be commemorating the twentieth anniversary of the fall of the Berlin Wall in November, and it's five years since the 'Big Bang' enlargement of the European Union. The post-World War II division of Europe is well and truly over, and that's reason for real celebration.

But instead of letting off fireworks, the European Union is itself under fire. The global economic crisis is confronting us with the greatest challenge we've seen since those historic days of 1989. After years of strong growth and remarkable resilience, the new member states in the east, where the EBRD works, are now being hit hard by the economic turmoil which started in the west.

Integration into the global economy, which had been a crucial source of capital, stability and innovation, has now become a threat to many of the countries in eastern and south eastern Europe. This is true both of the financial sectors and the region's real economies

The EBRD has responded to this challenge by increasing investments and designing tailor-made packages for the financial and enterprise

sectors. But the tough question that has to be asked is whether the current crisis could lead to the unravelling of European integration? There are four key issues that need to be tackled if we are to ensure that Europe emerges strengthened from the present turbulence:

The first of these concerns the continuation of enlargement. The EU's enlargement has indisputably been a success. The EU is today the largest integrated economic area in the world, accounting for more than 30% of the world's GDP and more than 17% of world trade.

Even with this year's marked contraction of the economies of some central and eastern European countries, their accession to the EU has given a significant boost to growth; the European Commission estimates that at an extra 1.75% for the new member states in the period 2004-2009. For the pre-Big Bang EU-15 enlargement significantly contributed to their growth too through investment opportunities and increased demand for their products: 7.5% of the exports of the older member states went to the newcomers in 2007, compared with only 4.7% in 1999. By 2007, central and eastern Europe had become the second most important export destination for the eurozone countries.

But EU membership has always been about more than economic integration and trade flows. The prospect of "returning to Europe" as the former Czech President Václav Havel once put it has provided the backing for essential if sometimes painful economic, social and political reforms. In the present circumstances, this is a more powerful incentive than ever.

Right now the EU has – in its own terminology – three "candidate countries" (Croatia, FYR Macedonia and Turkey) and five "potential candidate countries" (Albania, Bosnia and Herzegovina, Kosovo under UN Security Council Resolution 1244, Montenegro and Serbia). These countries are increasing their efforts to get ready for EU admission, and the European Union must not shut its doors on them but must remain open to finalise this historic enlargement process. The economic crisis has clearly demonstrated that the EU cannot afford black holes on the map of Europe.

The second key issue concerns the EU's own internal structure. The Lisbon treaty offers a fundamental redesign of how it works, but despite the pressing need to enhance the mobility and flexibility of EU institutions it is still awaiting ratification. The economic crisis

makes it more important than ever to introduce these reforms, as does the growing role of the EU as a global player. The multitude of voices and opinions coming out of Europe tend to hide this, but beneath the surface it is possible to detect growing convergence on such questions as the future system of financial regulation. And the European model of social market economies is now more respected and accepted than ever.

Third, there is the euro. The 12 new member states that joined the EU in 2004 and 2007 committed themselves to adoption of the single European currency, with no set date. Expansion of the eurozone has therefore been slow, especially in central and eastern Europe, where to date only Slovenia (2008) and the Slovak Republic (2009) have implemented the steps that allowed them to become members of the single currency.

The financial and economic crisis has, however, clearly demonstrated the benefits of being part of this currency union. Ten years after the euro's introduction, the 16-member eurozone has the world's second most important currency, accounting worldwide for more than a quarter of all central banks' foreign exchange reserves and

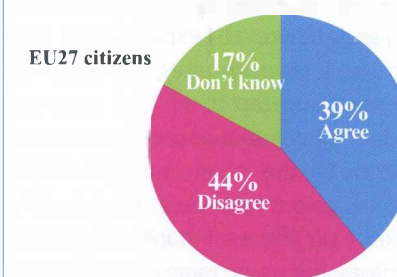
MATTERS OF OPINION

Joint action, yes – the euro, no

Only a minority of EU citizens believe that the euro has mitigated the crisis: 39% across the 27 EU member states, compared to 44% who believe it has not.

Not surprisingly, there was more appreciation for the benefits of the single currency in those countries that have adopted it. In all but two eurozone countries, most people said that the single currency had mitigated the negative effects of the crisis. Only France and Germany among eurozone countries bucked this trend, with more citizens taking an opposite view. In Spain the views were equally divided. One in six EU citizens (17%) did not answer the question.

HAS THE EURO MITIGATED THE NEGATIVE EFFECTS OF THE CRISIS?



Source: Eurobarometer 2009

GALLUP

having overtaken the dollar as the currency of choice for international bond issues.

The euro's increasingly important role brings stability, something that is never more important than in times of upheaval. The EBRD therefore encourages all new EU member states that have not yet started doing so to draft credible and convincing plans to be admitted to the eurozone. But there must be no softening of the criteria for joining the euro.

My fourth key question concerns European solidarity. EU enlargement unquestionably brought greater prosperity, with living standards improving throughout the EU, and most significantly of course in the new member states themselves. But many of the older member states also benefitted, and not only in ways that are measureable in economic terms. The growing together of people, regions and countries is underpinning the foundations on which Europe rests.

The EU's newcomers have adopted growth models that rely to varying degrees on foreign capital to finance domestic investment, and on banking systems that are largely owned by western European banks. It is a model that served new and old member states well: Investors from the EU-15 committed €37.2bn in central and eastern Europe in 2006, just about double the €19.1bn spent there in 2004. Over the past five years, foreign direct investment in the new member states has topped the €100bn mark.

This process enabled western European companies and banks to expand into new markets with higher growth rates and so satisfy pent-up demand and tap unrealised potential. This created jobs in central and eastern Europe and prosperity in the older member states. So it would be at our own peril if we were to turn our backs on the east during this crisis; this would have serious economic ramifications which could lead to highly unwelcome further developments.

The EU drew the right conclusions when it stressed that national bank rescue packages must not be designed in ways that starve subsidiaries, and also by doubling to €50bn the crisis funds available to EU countries outside the eurozone. These are the right signals. 20 years after the "Solidarity" movement played a crucial role in bringing down communism in Poland, and then in the rest of eastern Europe, the EU must not stand aside when solidarity is again needed.

The European Union has been on the receiving end of some heavy criticism for its reactions to the crisis. Rebuking Brussels has become something of a national pastime right across Europe. Whenever there is a problem, the EU's central institutions in Brussels, with the European Council and the European Commission in the front line, get the blame. That way the EU ends up in a no-win-situation: If it takes a pro-active stance it is pilloried for interference, over-regulation and for plotting the creation of a European superstate; but when it takes a more cautious approach, critics lambast Brussels for its alleged passivity or its failure to act decisively.

We must take this very seriously, and I say "we" advisedly. For it is we as European citizens who shape and represent the European Union. That's why I can detect something positive in the fact that a Hungarian peasant, a Portuguese fisherman and a German taxi driver may be united in moaning about the EU. It means that a European identity is emerging.

The challenge is to make this identity a positive one. It is possible because the EU has so much to say for itself. The crisis offers an opportunity to show that the EU can provide stability, support, and solidarity. By taking the right steps now, the Union is laying the foundations that will enable it to emerge from today's difficulties strengthened and more united. □

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Sweden's lessons for managing the crisis



The financial crisis that started in the United States and is now global may be unprecedented, but in some ways it follows familiar lines, writes **Urban Bäckström**, who draws on his experience of Sweden's financial crisis in the 1990s to offer possible scenarios for the economic future

Although Sweden is a small country, that experienced its own financial crisis in a relatively stable international environment, it gained lessons that may be of value to those seeking solutions to the current global crisis. While the dynamics of financial crises can seem random and unpredictable, recent research suggests that crises similar to the one that Sweden went through in the early 1990s have a relatively predictable course.

While the dynamics of financial crises can seem random and unpredictable, recent research suggests that crises similar to the one that Sweden went through in the early 1990s have a relatively predictable course

The Swedish crisis began in 1991 with the first major insolvency in the financial market. Subsequently there were a number of critical developments:

- The banks. Most of the Swedish banking system ended up in deep crisis. One bank went into liquidation, while the rest of the system was aided by extensive governmental emergency efforts.
- Asset values. Property values in Sweden fell by approximately 35% over a period of four years. Equities fell by some 55% over a three-year period.
- Currency. The Swedish krona was pegged to euro's forerunner, the Ecu in European Currency Unit, before the crisis. The crisis created a large capital outflow, where, despite a 500% (!) central bank interest rate, it was impossible to defend the parity of the krona, which subsequently depreciated by around 25%. This took place in

The IMF's former chief economist, Kenneth Rogoff, who is one of the leading researchers in this area, has found that in the prelude to the current crisis the development of the American economy followed the average trend relatively well, not only in Sweden but in Norway, Finland, Spain and Japan, which have also experienced serious financial problems. So it

autumn 1992, a year after the start of the crisis. Sweden then changed to a floating exchange rate with an explicit inflation target as the anchor for its monetary policy.

- **Real downturn.** The crisis triggered a sharp downturn in the economy; GDP fell by 7% over three years and unemployment rose by 7% over five years.
- **Government debt.** During a three-year period, Swedish government debt increased by about 50% and the public deficit reached 12% of GDP. Most of the increase could be explained by the crisis and the heavily indebted private sector paying off its loans. Falling GDP led to declining tax revenues and increased unemployment led to an automatic increase in public expenditure.

With the exception of its currency depreciation, the Swedish crisis followed the pattern of other countries' international financial crises relatively closely. Significantly, the process always takes time. Crises also come in sequences; those in the financial markets are first, and eventually there will be a decline in the real economy with high unemployment as the last part of the crisis.

Although the crisis that began in the United States has since spread worldwide, the outlook for the U.S. economy is clearly crucial to eventual global recovery. And if we assume that the United States is experiencing a typical financial crisis, as seen internationally, it faces declining GDP both this year and next. Unemployment in about three years is likely to be at 12% and gross public debt will have increased by 50%, which corresponds to around 90% of GDP. But if the United States follows the Swedish or international pattern, it will now have the worst of the crisis behind it in terms of the financial sector's problems. The U.S. will, however, still have almost every feature of the crisis ahead of it, in terms of government fiscal problems and in the decline of the real economy.

What, then, will be the impact on the world economy if these developments in the United

States turn out to be correct? Many other countries have problems of their own, and obviously there is a risk that their problems and those of the Americans could reinforce each other in a downward spiral. In that case we may get an outcome that is far worse than the one I just have sketched out.

In Sweden, the decline in GDP lasted for three years and the economy was then lifted by a very sharp increase in Swedish exports. The export boom was itself driven by a sharp depreciation of the krona. The increase in industrial output over two years was on average around 10% a year.

An equivalent development for the United States is hardly on the cards. Financial crises and currency crises are often linked, and we have not seen any of this in terms of the dollar. Instead, paradoxically, it has been somewhat strengthened by the crisis. Although the United States is the epicentre of the crisis, its government debt instruments are still regarded as the safest investment in the world. Will the Americans' financial problems alter this? One can imagine two scenarios for the dollar over the next five years. In the first scenario the dollar retains its position or perhaps even rises slightly. In the second the decline in the U.S. economy and growing fiscal problems lead to a sharp fall in the dollar. Some estimates show that it would take a 40% depreciation of the dollar to bring the United States' foreign payments into balance.

Neither scenario seems particularly favourable for Europe, or for the economies of the rest of the world. One of the imbalances that have built up in the world economy in recent decades is that the fast-growing Asian economies, as well as EU economies like those of Germany and the Nordic countries, have had export-led growth as their overall economic strategy. This had led to those countries becoming dependent for their own growth on increased American domestic demand. This has also led to the industrial sectors of those countries becoming larger than is compatible with long-term balance.

Both these scenarios exclude export growth as a continued success strategy for countries outside the United States. In any case, rich European countries are going to suffer a permanent structural decline in manufacturing. Much of the decline that we now see in European manufacturing industries is not the result of temporary economic movements but part of a long-term adjustment of the industrial sector's

size. Although the bigger EU countries have signalled that they intend to protect their industries against the worst ravages of the crisis, they will doubtless be unsuccessful because no country can ultimately call a halt to structural adjustment through the use of subsidies. Protectionist actions will increase governments' fiscal problems in any countries where such measures are taken, deepen the international downturn and delay recovery.

MATTERS OF OPINION

Yes, EU member states *should* collaborate on dealing with the crisis

Are national authorities the best placed to address the economic crisis, or would they do better to join forces and coordinate their efforts?

and applying them in a coordinated manner rather than individually (26%).

When citizens of the 27 EU member states were asked, more than twice as many picked the joint approach over the go-it-alone option: 61% felt they would be better protected against the crisis if their government worked with other EU countries, adopting measures

The chart shows that a substantial majority thought that each one of several measures, being discussed by the European institutions, would be effective in combating the crisis. For example, 71% of respondents wanted stronger coordination of economic and financial policies between all EU member states.

WHAT MEASURES WOULD BE EFFECTIVE IN COMBATING THE CRISIS?



Source: Eurobarometer 2009

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It is easy enough to sketch out negative scenarios that show the crisis persisting, and it is also easy to talk about what should not be done. But it is much more difficult to talk about what to do other than the monetary policy actions that have already made. And while it is difficult to argue against increased fiscal incentives, it is important to recognise how limited are the available opportunities for lifting the crisis through such measures. For those countries that already have fiscal problems, they can even aggravate them and thus have a negative effect on the real economy.

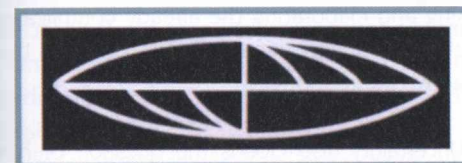
Short of any quick "miracle" cure, in the medium term the aim should be to renew and strengthen the framework for international economic and trade cooperation. A significant part of the origins of the present crisis lies in the imbalances in international trade and capital flows that built up over the years

without anybody taking responsibility for the consequences.

Remedial action in Europe should include completing the internal market. It is only when Europe has a dynamic internal market for goods and services that balanced European growth can occur. Furthermore, the whole world does not need to lend money to the American consumer for it to lead the economic recovery. In any case, it will be a good while before the United States can once again take on the role of locomotive for the world economy. □

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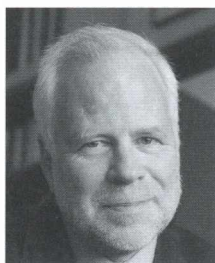
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Financial re-regulation, yes. But Europe's cacophony of ideas is counter-productive



EU countries' different ideas on how to respond to the financial crisis are not strengthening Europe's hand in rewriting global rules, warns **Barry Eichengreen**. And while there are some signs of a new European consensus, the challenge of implementing an EU-wide system remains daunting

The process of drawing lessons from the great global credit crisis of 2008-9 is still underway, not least because the crisis is far from over.

But one incontrovertible lesson is the need for more vigorous regulation of financial institutions and markets. Light-touch Anglo-Saxon style regulation failed its crucial test, and everyone is now agreed on the need for a more heavy-handed approach.

Alas, the details still remain to be worked out. How far should we go in the direction of re-regulation? At what point do restrictive regulations become an impediment to innovation, and how much should we really worry about stifling financial progress?

Then there is the "bloodhounds and greyhounds" problem of the regulated being always one step ahead of the regulators. As clever operators have often shown themselves able to evade sophisticated regulations, should regulators opt for simplicity? They could, for instance, adopt rules limiting the lines of business in which banks can engage and the kind of assets in which they

can invest. Like the Swiss National Bank, they could apply a simple rule that the ratio of banks' assets to their own capital could not exceed a single number, for instance eight. Alternatively they could opt for even greater complexity, further refining and elaborating the already complicated Basel II capital adequacy standard for banks that are active internationally.

Uncertainty also clouds the question of how to bring hedge funds and other non-bank financial entities into the regulatory net. Is it enough to force them to provide more information to the regulators, or should they also be required to disclose more information to the public? But perhaps this emphasis on greater transparency is useless since, given the speed with which these funds can churn their portfolios, the information they provide can be out of date as soon as it becomes available. Would a better approach be to require banks that lend money to hedge funds to hold more capital when doing so, both insulating the core of the financial system from hedge-fund failures and limiting the ability of those funds to lever up their bets?

Europe has its views on these questions, but it lacks one voice. There is a cacophony

of voices – the European Commission and the Parliament, the European Central Bank (ECB) and the individual member states – all shouting out conflicting advice and instructions. Now the fear is that Europe will not pull its weight in the international arenas where these issues are decided because its various representatives will pull in opposing directions. And that would mean that the United States will be able to play the Europeans off against one another.

There are some grounds for this fear. France, Germany, Italy, the Netherlands and the UK all have their own representatives in the Financial Stability Forum, the body launched 10 years ago by the G7 governments that now includes China and is tasked with agreeing the broad outlines of a new international regulatory architecture. The EU has as many as eight Executive Directors on the board of the IMF, which it is supposed will be responsible for overseeing implementation of those regulations and monitoring compliance. The much more broadly based Group of 20, which brings together industrial and emerging market economies, includes a wide range of European Union representatives, such as France, Germany, Italy and the UK but also the current holder of the EU's revolving presidency and the president of the ECB.

Having so many representatives should be a good thing for Europe, so long as they sing the same song. But the worry is that they will not sing in harmony. Where Britain pushes for light-touch regulation, France favours a more heavy-handed approach. Within the European Commission, Charlie McCreevy, who is responsible for the single market, remains opposed to significant re-regulation, while Joaquin Almunia, the commissioner for financial affairs, favours more ambitious regulation. The result, it is argued, is that neither the Commission nor the member states are able to shape the global debate.

In reality, this worry is increasingly anachronistic. There is in fact a growing consensus in Europe about what needs to be done and how to do it.

COMMENTARY

By **Marek Belka and Wim Fonteyne**

The bullet Europeans aren't biting is pooling their fiscal resources

Barry Eichengreen rightly identifies two major challenges that Europe faces in the era of re-regulation triggered by the global financial crisis. The first is to ensure that its views are reflected in international regulatory standards, and the second is to enforce these regulations in its own, largely integrated, market.

His proposed remedy is to make the European Central Bank (ECB) the single consolidated supervisor for the European market. Eichengreen is thus advocating a very different approach to the de Larosière Group ("The Group"), whose recommendations were endorsed as a basis for action by the European Council in March. The Group proposes a new body – the European Systemic Risk Council (ESRC) – that would be separate but closely linked to the ECB, and whose macro-prudential oversight mandate would mean overseeing risks related to general economic and financial developments. Microprudential oversight of individual institutions would continue to be exercised by national supervisors, brought together in colleges for cross-border groups. These supervisors and colleges would, however, operate under the oversight of three sectoral supranational Authorities, with which they would form a European System of Financial Supervisors (ESFS).

Is Eichengreen's proposal preferable? Having the ECB function as its representative would

France and Germany agree on the need for stricter oversight of the hedge fund industry. They agree that this should be done through both enhanced disclosure and increased capital requirements for banks providing credit to hedge funds.

An important factor is that the British, having experienced one of the most searing financial crises in all of Europe, have lost faith in light-touch regulation. The public and parliamentary backlash against the bankers is evidence that the ability of financial market participants to shape British policy in their own favour is not what it once was. The same is true in Ireland, where Commissioner McCreevy hails from, so he may find his de-regulatory legs cut out from under him.

To be sure, there remains less than full agreement in the EU on the form that re-regulation

should take. But neither is there complete agreement within the United States, where Barney Frank, chairman of the House of Representatives' Financial Services Committee, Treasury Secretary Tim Geithner, Federal Reserve Board Chairman Ben Bernanke, and the new heads of the Securities and Exchange Commission (SEC) and Federal Deposit Insurance Corporation are not always on the same page. The U.S. is represented in the Financial Stability Forum by the Treasury, the SEC and the Federal Reserve Board, who don't always speak with one voice. While more harmonisation among EU representatives in the venues where the new global financial architecture is being designed is clearly desirable, the same is also true of the representatives of the United States.

Where Europe is at a clear disadvantage, though, is in effectively implementing those

regulations. The lesson of the crisis is not merely the importance of having appropriate regulations; it is the importance of enforcing them. This means preventing banks from moving their operations to the most lenient jurisdictions so as to avoid the intent of the law, something that in turn requires the close harmonisation of national regulations. It means that financial conglomerates and banks operating in multiple countries should be subject to consolidated supervision. They should not just have those bits and pieces of their operations in a particular country overseen by the regulators of that jurisdiction. Finally it means that the provision of emergency liquidity – the lender-of-last-resort function – must be closely coordinated with the sort of supervision and regulation that should be designed to head off problems before they occur.

This is where Europe faces especially difficult challenges. Because many of the EU's members are small, and because the single market is an established fact, cross-border banking is especially extensive. Some 70% of bank assets in the EU are in the hands of banks operating in a number of countries. No single national regulator, including that of the country in which they are incorporated, can adequately handle their affairs. A "college" of national supervisors working together to oversee each cross-border bank would still be woefully inadequate. The academics among us will be reminded of faculty meetings in their own colleges, where each member gets a say but in the end nothing is decided. We have had colleges of supervisors in the past, and they glaringly failed to head off problems in cross-border financial institutions.

The need is for a single consolidated supervisor for the single European market. But if the EU vests this responsibility with a new institution, then it would be setting itself up for the kinds of problems that the UK experienced with Northern Rock, where the supervisor and the lender of last resort proceeded under different

COMMENTARY

Marek Belka and Wim Fonteyne

give Europe a single voice that is lacking in the Group's proposals. There are also many reasons to believe that the ECB would be a more effective consolidated supervisor than the standardised colleges the Group proposes, not least because it would centralise information and decision-making, and would more naturally bridge macro- and micro-oversight. The Group's proposals win on feasibility, however, as they are designed to work around the many existing obstacles and avoid the need for EU treaty changes.

Accountability concerns also argue against taking the ECB route that Barry Eichengreen advocates. Consolidating monetary policy and financial supervision in the ECB not only risks conflicts between both mandates, it might also make the ECB too powerful for its own good. Politicians are unlikely to allow such a powerful institution full independence, especially if it represents the EU on the world stage and when, inevitably, cases of perceived supervisory failure occur. Separate accountability channels for both mandates would be needed.

A more fundamental problem is that – to paraphrase the Bank of England's Governor Mervyn King – pan-European banks are European in life but national in illness and in death. Lender of last resort support remains the responsibility of national central banks, with the fiscal backing of their Treasuries. Dealing with bank insolvencies also remains a national responsibility. The current crisis has shown how high the resulting fiscal costs can be. As long as national Treasuries are directly liable for these costs, they will want control over supervision. This stands in the way of any move toward genuine supra-national supervision and may also impede the functioning of the ESFS, as the

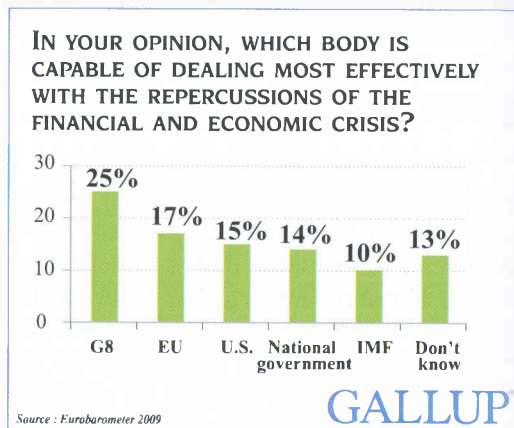
MATTERS OF OPINION

Europeans say G8 is best qualified to deal with the crisis, IMF the least so

EU citizens believe that the body most capable of dealing with repercussions of the financial and economic crisis is the G8 group of industrialised nations, ahead of other international bodies and nations states.

A Eurobarometer survey in January-February 2009, found that one in four of the 27,000 people questioned believe the G8 could deal most effectively with the crisis, putting it well ahead of the EU (17%), the U.S. (15%), or the individual's own national government (14%). The IMF received the least support with 10%. Romanians, British and Irish people expressed the greatest confidence in their national government's ability to deal with the crises and its repercussions. A third of Romanians (32%) thought their government better equipped than any of the other bodies cited.

Member states with a quarter of citizens or more putting the EU top of the list were Greece, Cyprus,



Poland, Luxembourg, Estonia and Hungary. People in the UK and the Nordic countries (Sweden, Denmark and Finland) were the least enthusiastic about the EU's crisis management abilities, with just 6% of Britons selecting this option.

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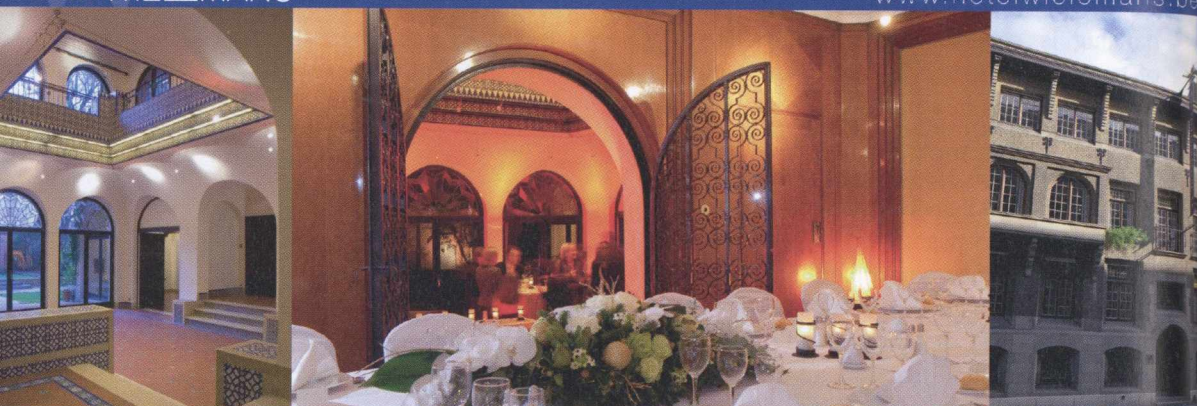
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assumptions. But if, on the other hand, this responsibility is vested with the ECB, then it will be exercised by an entity in which important EU members, notably the UK, have little say.

Two clear if unrealistic solutions suggest themselves. One is for the members of the single market that have not yet adopted the euro to do so. The ECB could then act as the single consolidated supervisor for the entire EU, delegating various information-gathering and enforcement functions to the national members of the European System of Central Banks. The second is for EU members reluctant to adopt the euro to get out of the single market. Countries like the UK could then have their own national currency, national supervision and national financial market. They could cooperate with the U.S., the EU and others as they saw fit.

Ultimately, one of these solutions, most likely the first, will come to pass. But neither will come about anytime soon. In the short run the best outcome would be to make the ECB the consolidated supervisor for the euro area and to build mechanisms enabling it to more closely coordinate with other European supervisors. College-of-supervisor problems there still will be, but they will be mitigated by smaller numbers.

Among other things that need to be created, a single eurozone supervisor would help to cultivate a single eurozone position on global financial reform, and a single eurozone voice on how to do it. France, Germany, Italy and the Netherlands can then give up their separate seats in the Financial Stability Forum, the IMF, and the other global venues where these deliberations are carried out. When that happens, the eurozone will no longer be condemned to punch below its weight. □

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Summer 2009

COMMENTARY

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constituent national supervisors will continue to face incentives to minimise the costs to their own Treasury.

To ensure the success of the Group's proposals and to give Europe the option of more fundamental reforms over time, this reality should be changed.

What is needed is a cross-border safety net for pan-European banks. Such a safety net must combine a special insolvency regime that ensures the cost-efficient resolution of a failing bank and allocates losses as much as possible to shareholders and creditors, with a privately-funded insurance scheme to fund resolution efforts with a view toward protecting depositors. The safety net should minimise the need for fiscal resources, while having access to them as a back-up option.

Such fiscal backing can be provided either through some binding distribution mechanism or through increased availability of fiscal resources at the EU level. Technically this can be done, and the crisis should be motivating European politicians to bite the bullet. □

Marek Belka is Director and Wim Fonteyne a Senior Economist in the International Monetary Fund's European Department. wfonteyne@imf.org

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HOW A SMALL COUNTRY IS FACING UP TO THE GLOBAL CRISIS

By José Montilla i Aguilera, President of Catalonia

At first glance, it might seem surprising how much a small country such as Catalonia is doing to fight against the global economic crisis. Much larger countries, and indeed the European Union, are having to use all their considerable resources to come up with suitable responses.

The government of Catalonia is keenly aware of the magnitude of this crisis and the need to provide a coordinated response at a global level. It is also aware of its limits and the potential scope of its political actions. However, it has taken the view that these limitations cannot be an excuse for inaction. Nor can Catalonia – the main economic engine of Spain – let its important resources deteriorate, or fail to respond to the needs, uncertainties and aspirations of the 7.5m Catalans.

For these reasons, the government of Catalonia swiftly accepted its responsibilities, first of all by talking clearly with its citizens, being honest about economic prospects, many of which take a negative view, and presenting a diagnosis – no matter how severe it might seem – of the extent and depth of the financial and economic crisis, always distinguishing between global and local aspects. In fact, long before the current economic crisis was glimpsed on the horizon, the government of Catalonia was aware of the need to transform the country's economic growth model. It was already spearheading sweeping economic and social changes to meet the needs of internationalisation, aiming for quality jobs and competitiveness in the Catalan economy.

As well as telling its citizens the truth about the seriousness of the crisis, the government

of Catalonia has aimed to reassure the country that help is at hand: that even the most weakened business sectors and the more vulnerable segments of society can hold on in this time of adversity. The government is executing this palliative action in accordance with its competences and in conjunction with the actions taken by the government of Spain. We are helping companies to cope with difficulties, stimulating new entrepreneurs to develop their projects, reinforcing the automotive sector and reactivating the construction sector. We are also helping families with difficulties to pay their mortgages and stepping up training for workers who have lost their jobs.

All told, €7,750m has been spent on these palliative actions, which is equivalent to 3.5% of Catalonia's GDP. Our efforts compare favourably to those countries with the most active role in fighting the crisis, according to figures from the International Monetary Fund.

The Catalan government is aware of the exceptional nature of some of this aid, which must be limited in duration and be in accordance with the European Union's guidance. That is, public aid can be neither permanent nor gratuitous, and it especially cannot prolong situations without a viable future. The temptation of protectionism has to be resisted. At the very least, protectionism would have the pernicious effect of reducing our economy's degree of openness.

While taking urgent action to soften the immediate effects of the crisis on the most vulnerable sectors, the government is, importantly, taking strategic, long-term actions so that the country will emerge from this

episode stronger than ever. Our aim is to revamp the foundations of economic and social progress in Catalonia. Obviously, here again, the government of Catalonia has a limited scope of action, but within these limits it is taking the initiative.

First, by making an extraordinary investment effort in infrastructures. The total amount of construction underway in Catalonia by the Catalan and Spanish governments accounts for more than €12.5bn.

Second, by enforcing the national pacts reached on research and innovation, housing and immigration.

Third, by undertaking an in-depth reform of our educational system. The Catalan Parliament is due to approve an innovative Law on Education in the near future.

All of these initiatives stem from a vision of the future of the country that goes beyond partisan politics. They have been designed and are being implemented through a far-reaching political and social agreement.

And looking beyond its own borders, the government of Catalonia seeks to contribute to and influence Spanish and European politics, specifically designing and deciding on major structural reforms. They include reforming the system of labour relations to encourage worker mobility, the revision of collective bargaining processes and the alignment of salary rises with business productivity. Our concerns also include the reform of the rental housing market and the adoption of suitable measures to step up the transformation of certain regulated sectors, especially trade, services, energy and transport, by properly transposing European directives. On these pages I want to particularly stress the importance of Europe-wide reforms, and particularly the need to make headway towards a common energy policy.

We here in Catalonia have always stressed, and continue to do so, that the solution to many of the ills and problems plaguing the peoples of Europe in the global setting leads us inexorably to a stronger and more united European Union. In short, the solution to the crisis is more Europe. We must turn our backs on the trends and temptations that emerge at difficult times; if we do not, the cost will be high, even though it will only come into sharp focus in later years.

So this is a compendium of the active policies that a sub-state government, that of Catalonia, is courageously undertaking, wielding the instruments of self-government it has at its disposal. Its effectiveness relies largely on the capacity to coordinate these initiatives with those at local, Spanish and European level.

However, as important as government activism, there is the need to achieve a positive impact on the collective mood of society in order to encourage a can-do fighting spirit that will wipe away pessimism and resignation.

Catalonia is a small European country that has surmounted many difficult moments throughout its history. For this reason, we Catalans know that, to emerge from the crisis, we must be realistic, hold steady in the face of adversity and make sacrifices to overcome it. We know that we have to work harder, and not necessarily to earn more. But this is the price that we must pay to ensure a future of economic prosperity, social cohesion and cultural progress.

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SUSTAINABLE EUROPE

Why Europe's lead will be crucial to Copenhagen's success



Europe has for almost two decades been the key player in the fight against climate change. Denmark's Climate and Energy Minister **Connie Hedegaard** says that European leadership remains vital because several of the world's leading economies are only now starting to address climate issues, and are very far from taking action

When ministers from all over the world meet in Copenhagen in December, they will all be united in a wish to fulfil the ambitions set out two years earlier in Bali. But agreeing on the need for a successor to the Kyoto regime is one thing, finalising a comprehensive framework for action on climate change is quite another.

The need for sweeping action is indisputable, for the science is very clear; we need to curb emissions now, and each year of delay will mean yet more radical action later on. And a delay may even push us beyond a critical tipping point.

The problems of climate change are also becoming clear. They range from water

scarcities to conflicts over natural resources and rising sea levels that threaten some countries in Africa and southern parts of Asia. Heavy storms, floods and droughts have affected Europe too.

With international scientists becoming increasingly pessimistic about the impact of climate change, their recommendations for new measures are multiplying. The Intergovernmental Panel on Climate Change (IPCC) says that our CO₂ emissions must peak within the next decade or so and then reduce, and that we must attain a 50% reduction of global emissions by 2050 if the most severe consequences of climate change are to be contained. These are tough targets that will require fundamental changes in energy supply systems, transport

and most other aspects of everyday life. The bottom line is that we will have to speed up the transformation of our economies to a low-carbon future, and now is the time to change gear.

There is very little time left for preparing a new global agreement, even if in Bali in late 2007 as many as 192 countries agreed to this tight schedule. But we also know that tackling climate change will be made no easier by being postponed, and that on the contrary the longer we procrastinate, the more drastic will be the measures required. The economic cost of inaction is far greater than the price of taking action now, several international studies have documented.

The task of uniting the European Union's 27 member

states to take concerted action to combat climate change is also demanding a great effort. The road to Copenhagen is bumpy, the curves treacherous and unpredictable. The financial crisis has taken many Europeans by surprise, and now constitutes a fresh obstacle to idealistic international cooperation. In times like these, politicians feel the need to show that they're giving top priority to their citizens' economic security, so the daily debate echoes with such key words as employment, housing, food and energy prices and financial stimulus packages. The answer is not giving up on climate change, but rather the opposite. Creating a green economy and developing the technological solutions of tomorrow will spur job creation and create new business opportunities.

Europe's vulnerability to energy supplies from Russia and the Middle East may in some member states increase the feeling that they should rely to a greater extent on domestic energy sources, like coal and lignite. But these are outdated energy sources, and where a link is being sought between combating climate change and increasing energy security, it should be the development and use of renewable energies that they turn to, as well as to greater energy efficiency.

We need to send a clear message to the developing world on our commitment to help finance the post-2012 agreement

Today's Europe of 27 means that the EU now consists of very different member states. We have to keep it very much in mind that at the time the Kyoto Protocol was adopted in 1997, the EU of 15 was unquestionably the motor driving the negotiating process. The situation now is completely different. And

that means Europeans need to be more determined than ever that despite the financial and economic crisis, despite energy supply concerns and despite our different interests and circumstances, the EU will remain at the forefront in the negotiations leading up to Copenhagen. The EU has already done a great deal by setting extremely ambitious reduction targets, but with much still to be done, we need above all to send a clear message to the developing world on our commitment to help finance the post-2012 agreement.

Political leaders around the world have begun to emphasise that the solutions to the global financial crisis include renewable energy and energy saving. It is clearly important that President Obama is clear on that point and has made energy

efficiency one of his priorities. Now, the new administration is moving quickly with legislation and economic incentives that underpin green jobs, clean technology and energy efficiency. A good example is the recent "Recovery and Reinvestment Act" that includes a solid allocation to green investments, and targets such as doubling renewables' share of electricity production in three years.

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As the financial crisis takes its toll, with banks crashing and businesses collapsing, it also demonstrates the need for long-term investment. Vestas, the Danish company that is the world's biggest manufacturer of wind turbines, was able to report continued growth in 2008 with an impressive increase in its total revenues. In the EU, national leaders have linked economic recovery with energy investment, including "green" investments. Seen from a Danish standpoint, this financial crisis could yet become a turning point that will see a much greater commitment to investing in energy efficiency.

In those EU countries that still depend on high-emission fossil fuels, the revised emissions trading scheme in the EU will establish a cap for total emissions, and will

enable their governments to generate funds by auctioning allowances for public investments in, say, renewable energy sources.

It was partly due to France's very efficient EU Presidency in the latter half of 2008 that the member states reached agreement on a comprehensive "20-20-20" climate and energy package just before Christmas. By pledging themselves to a 20% reduction in greenhouse gas emissions by 2020, to reaching a 20% share of renewable energy and to increasing energy efficiency by 20% in 2020 was a compelling expression of EU leadership and an example to other countries worldwide.

The conclusions of the European Council in March of this year also sent a clear signal that the EU is committed to providing its fair share of the financial assistance to the mitigation and adaptation processes in developing countries.

This is an important statement. If we are going to engage the rest of the world in serious negotiations, much more tangible messages from the EU are needed. The European Council conclusions in March make it plain that the EU has yet to clarify its position on main approaches for financing, the specifics of our contributions and on the principles for burden-sharing among EU member states.

In other words, the months ahead will be a challenge for traditional cooperation and coordination efforts in the EU. Besides developing our own position on these difficult issues, the EU needs to improve its flexibility in the negotiating process. The EU needs to be able to manoeuvre more

smoothly in the very complicated game of interests. In several cases where the EU has been taken by surprise by its negotiating partners our reaction time is too long – The EU must be able to react promptly and in a more concerted way.

Three important messages from the EU will be crucial to our ongoing negotiations with developing countries:

- Full acknowledgement of the Bali Action Plan's call for "new and additional funding"
- Clear and strong support for structures that deal with the impact of climate change that mainly affect developing countries
- Acknowledgement of the need for a coherent financial architecture that builds

on existing institutions as well as creating new mechanisms

As chair of the COP-15 Summit in Copenhagen, it will be Denmark's task to gather all the pieces in the big jigsaw puzzle of global negotiations. Our role will be to listen, to learn, to mediate and to foresee where a final agreement can be made. We intend to be everybody's COP president. But without a strong player taking the lead, it will be impossible to place the many pieces in this puzzle, so the EU must once again play its part as the leading partner. This time it will be a more demanding role than ever. □

Connie Hedegaard is Denmark's Climate and Energy Minister. tokel@kemin.dk

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What Europe needs to know about Obama's climate change options



An era of closer cooperation seems to be opening between the U.S. and Europe, says **Stuart Eizenstat**, who was Washington's lead negotiator on the Kyoto Protocol. But he warns that the realities of U.S. politics may limit how far Barack Obama can deliver new policies for December's earth summit in Copenhagen

One of George W. Bush's first actions as president was to withdraw the U.S. from the Kyoto Protocol on global warming. For much of his Administration, Bush and his senior climate officials denigrated the science behind climate change. They criticised United Nations' studies which showed the dire and unmistakable consequences of climate change. They denied that human activity was a major cause of climate change, opposed mandatory action to limit greenhouse gas emissions in the U.S. and virtually withdrew from UN climate negotiations. By 2007 President Bush was taking climate change more seriously, and launched a plan for major economies to consider new approaches to CO₂ reductions, but even then he opposed any mandatory action, and it was outside the UN negotiating process.

As the U.S. dallied, the European Union moved towards an ambitious target to reduce member states' CO₂ emissions by 20% from 1990 levels by 2020 – the

so-called 20/20/20 initiative. The EU also created the European Trading System (ETS), the world's first platform for mandatory trading of carbon credits.

The election of Barack Obama has dramatically changed the dynamics of climate negotiations for the better. President Obama has called climate change one of the most important challenges of our time, and placed it high up on his domestic and foreign policy agendas. The president is pressing forward with domestic cap-and-trade legislation and has the U.S. fully re-engaged in UN negotiations, despite the deep financial crisis and economic recession. He also called for a "major economies" meeting in Washington with UN participation.

This commitment is tangible. The president appointed Carol Browner as his special assistant at the White House for energy and climate change, with responsibility for

coordinating the Administration's position. Browner was head of the Environmental Protection Agency under President Bill Clinton, who signed the Kyoto Protocol before Bush was elected.

Secretary of State Hillary Rodham Clinton has appointed Todd Stern as her special climate change coordinator. Stern was an important member of the Clinton Administration's team at Kyoto that I led, and has both the knowledge and talent to be a successful lead U.S. negotiator as the world approaches December's Copenhagen Conference of the Parties to develop a global post-Kyoto agreement. On her first foreign trip as Secretary of State, Hillary Clinton put climate change near the top of her agenda with China which, together with the U.S. and the EU, holds the keys to the success or failure of Copenhagen.

The Obama Administration has taken the lead in developing domestic legislation with Congress to impose mandatory caps on U.S. greenhouse gas emissions. The recent economic stimulus package includes \$15bn for alternative energy development, more fuel efficient cars and a "smart grid" to bring them together. In a speech to a joint session of Congress, President Obama pledged to double the percentage of alternative energy used in the U.S. within three years. Currently, alternative energy meets just 7% of U.S. demand. He has also made clear that cap-and-trade revenues are central to his goals and deeply imbedded in his budget plans. Under cap-and-trade, the federal government would set annual limits on total emissions of gases such as CO₂ and allocate emission credits which could then be traded. With stronger Democratic

COMMENTARY

By Mikael Román

But Obama has also shown politics to be "the art of the possible"

These are fascinating times for anyone following climate change policies. Who would have imagined only a year ago that an Afro-American U.S. President would confront the worst global economic crisis since WWII with an agenda based on proactive climate-related policies? Yet this is what is happening under the Obama Administration. And the changes are coming so fast that it is almost impossible to follow developments, let alone grasp the implications for the UNFCCC negotiations.

Stuart Eizenstat's article is a timely and important contribution that not only summarises current developments but also pinpoints some important factors for the EU to consider in the run up to Copenhagen. So let me say at once that I largely support Eizenstat's analysis and, instead, would indeed take his argument a bit further.

I think there are three important observations that follow on from Stuart Eizenstat's article. One concerns the re-framing of the climate change issue that is currently being pursued by the Obama Administration. Climate policies are no longer seen as just a 'goal' but as a 'means' for achieving other policy objectives. Accordingly, U.S. climate change policy is best understood as part of a broader set of strategies and goals that include national

majorities in the House of Representatives and the Senate since last year's elections, the political scene in Washington is now set for more progress on such climate measures.

There is also a sea change in public and corporate attitudes towards climate change in the U.S. Groups like the Chicago Climate Exchange and Climate Action Partnership (USCAP) include major corporations which have pledged to make binding reductions in emissions. This year, California will implement the nation's first broadly-based climate change requirements from industry, and a dozen mid-Atlantic and north-eastern states will apply mandatory emissions reductions on utilities.

Does all this U.S. activity mean there is likely to be complete harmony with the EU on climate change? No it does not. There will certainly be closer cooperation than in the Bush era and there is a convergence of goals on climate change in the long term – around an 80% reduction by 2050. But there will still be substantial hurdles along the way and real leadership will be required on both sides of the Atlantic to avoid the kind of breakdown at Copenhagen that was only narrowly averted at Kyoto in 1997. So what are the main potential sticking points?

First off, it must be understood that the EU and the U.S. start from very different points in the race to reduce emissions. When the then 15-nation EU ratified the Kyoto Protocol, it pledged to cut CO₂ emissions by 8% from 1990 levels by 2012. With the U.S. outside the Kyoto process, U.S. emissions of greenhouse gases increased by 19% from 1990 to 2005. The EU-15's emissions rose

by 8% during that period, above the Kyoto targets but apparently well below the U.S. total. However, a closer look at the figures shows that much of the EU's performance was not due to deliberate planning. Since Kyoto adopted a 1990 baseline, shortly after German reunification, East German emissions could be included in the EU's initial data. UK energy policy also shifted from using coal to natural gas from the North Sea around that time. If you exclude the UK and Germany from the 1990-2005 data, the EU-13 emissions increased by 24%, above the equivalent U.S. figure of 19%. So the primary difference between the U.S. and EU performance was not the Kyoto Protocol or the EU's climate policies; it was down to outside factors. The European Environment Agency still maintains that the EU will meet its 2012 target. But in order to succeed, the EU will have to use forests and other Kyoto mechanisms, including emissions trading which the EU had originally opposed at Kyoto.

Second, Europe needs to understand where the U.S. is coming from. The Obama Administration's proposed emission reduction targets will be the high water mark for Congress, but will fall short of the EU's 20/20/20 pledge. The recent U.S. Obama budget established a target of 14% reductions from 2005 levels by 2020, with an 83% cut by 2050 (The Administration has properly chosen 2005 as a baseline, rather than 1990.) The bill that finally emerges from Congress is likely to have less ambitious targets. Therefore, the U.S. will go to Copenhagen in December with a very different set of targets from Europe and a different baseline. Todd Stern has already sent a very clear signal to the EU to recognise the different realities under which the U.S. is operating.

The EU must also accept that, in terms of domestic U.S. politics, it would be a Herculean task for Congress to pass mandatory emissions reduction legislation before the Copenhagen meeting. There are various reasons for this. For a start, a solid phalanx of senators is determined to kill any mandatory climate legislation. Also, the global economic crisis has created the worst possible environment to add more financial burdens on companies and households. Last year's debate on the Boxer-Lieberman-Warner climate bill highlights the domestic political challenge. This bill was pulled prematurely from the floor after several Republican Senators miscast it as a cap-and-tax bill and many Democratic senators from industrial states also opposed it.

The chairman of the House Energy and Commerce Committee, Henry Waxman of California, has promised to have a bill out of his Committee by the end of May, and the Speaker of the House, fellow Californian Nancy Pelosi, expects to have the bill on the House floor this summer. There is a real chance the legislation will pass the House by the August recess. Getting it through the Senate will be tougher as compromises will be necessary to achieve the 60 votes necessary to break a certain filibuster attempt. I believe Congress will pass some kind of mandatory cap-and-trade bill, but it is more likely to be next year than this year. And it will probably fall even further below EU targets than the Administration's proposals.

Despite the Obama Administration's commitment to dealing aggressively with climate change, it is unlikely to accept any binding international agreement at Copenhagen that goes beyond the targets that

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Mikael Román

economic recovery and long-term economic development, energy security, and even America's international leadership role. This has critical practical implications; it means that climate change mitigation occasionally may occur as a side-effect of other policies. It also implies multiple drivers for action in addition to established climate concerns.

My second observation concerns the domestic challenges facing President Obama. I agree with Eizenstat's analysis and recommendations to the EU as Obama has very diverse domestic pressures to cope with if he is to steer his policies through Washington's complex democratic process. Interestingly, the situation is largely analogous to Europe, where member countries also struggle to agree on joint climate policies despite their different energy profiles, industry configurations, greenhouse gas emissions and general socio-economic situations. What makes the Obama Administration's effort so compelling, though, is the way it has the potential to break the worldwide political deadlock on global warming. By framing climate change as a strategic issue that will serve a variety of purposes, the U.S. may be able to link various interests that have hitherto operated independently or even have been in conflict. There may yet be a lot to learn from Obama's endeavours.

This brings me to the EU and its preparedness for COP-15. The global scene has changed dramatically in the last couple of months, so now the question is whether the EU can adapt to the new situation. I myself have some serious concerns. The first challenge for the EU is to redefine its notion of itself as a leader in the Copenhagen process, because

Congress will set. Nor is the Administration likely to muster two-thirds support in the Senate to support a post-Kyoto Treaty unless there are binding commitments from China and India too. China already has binding domestic efficiency standards, but will certainly not agree to binding economy-wide or growth targets. There is a real risk that a price for passing a domestic cap-and-trade bill will be some potential trade sanctions on big emerging country emitters,

like China, who refuse to take mandatory obligations of some kind.

There are ways to avoid a showdown between the EU and U.S. at Copenhagen. Early and constant communications by the EU with Obama's top climate officials will help the Europeans understand the likely U.S. position. Coordinated efforts to get key developing countries like China and India to make meaningful contributions to

MATTERS OF OPINION

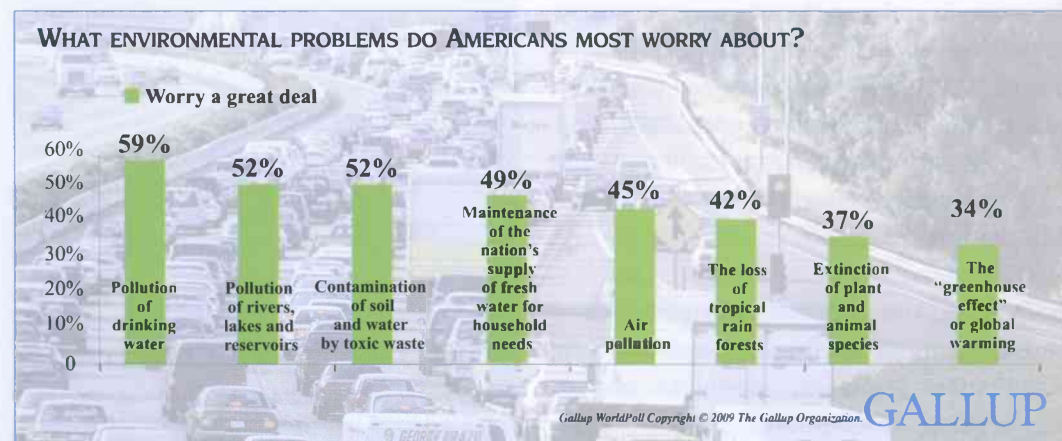
Climate change is the least of Americans' green concerns

Policymakers in the Obama Administration are, in the run-up to Copenhagen, having to take into account recent findings that Americans worry less about global warming than about many other environmental issues.

Despite widespread media reporting of climate change, the U.S. public puts concern over global warming bottom of the list of their worries about the planet: the only issue on which more people are either 'not at all' or 'just a little' worried (40%) than worried "a great deal" (34%), according to a Gallup poll, conducted in March 2009.

The survey presented a list of eight environmental problems and asked Americans to say how much they worried about each one. Top of the list came pollution of drinking water (59% worried 'a great deal'), followed by pollution of rivers, lakes and reservoirs and contamination of soil and water by toxic waste (both 52%), maintenance of the freshwater supply for household needs (49%) and air pollution (45%).

Global environmental problems were bottom of the list: the loss of tropical rainforests, the extinction of plant and animal species and, finally, global warming (all with less than 43% of Americans being worried a "great deal").



Copenhagen would also help, unlike the obstructionist tactics they employed at Kyoto. After all, China last year overtook the U.S. as the world's biggest emitter of greenhouse gases.

Most importantly, we need to develop a different framework than the Kyoto Treaty. I would suggest that at Copenhagen, each country (or in the EU's case group of countries) commit to meeting its own targets, with every effort made to ensure they add up to the overall level of reductions that scientists believe are necessary to stabilize global temperatures. A new international monitoring mechanism is needed to ensure compliance. This would contrast with Kyoto, where the so-called Annex I developed countries took essentially identical targets. This change will prove difficult for the EU, since its companies will face a tighter set of targets than competitors in the U.S. or elsewhere. But it may be the best we can hope for under the circumstances.

U.S. attitudes toward climate change have been transformed under the Obama Administration. But political realities will limit how far the U.S. can go by Copenhagen and beyond. The sooner the EU appreciates these limitations the better able it will be to achieve a meaningful post-Kyoto agreement. □

Stuart E. Eizenstat is a former U.S. Ambassador to the EU and was President Bill Clinton's Deputy Secretary of the Treasury as well as Under Secretary of State for economic, business, and agricultural affairs. seizenstat@cov.com

COMMENTARY

Mikael Román

it is not. The EU is only one of several players. Another question is the extent to which the EU, with its elaborate apparatus of negotiations around a pre-defined agenda, has alienated itself from political reality. The discussions in Copenhagen are not going to unfold the way people expected only a year ago. This does not necessarily mean, though, that nothing will come out of the process. As the current U.S. experience shows, crises also provide opportunities for new political directions. But it will take political agility and entrepreneurship, and it's not clear whether the EU is up to the challenge.

Current developments in the U.S. are crucially important because they illustrate 'the opportunities for politics' that still exist in the climate change debate. This is a discussion that has been lacking throughout the last decade, when politics were instead seen as a major obstacle to progress. This was particularly unfortunate because politics is 'the art of the possible' and we need that more than ever. □

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The time has come for a world energy revolution



Our energy supply and consumption patterns are unsustainable environmentally, economically and socially, says **Fatih Birol**, the International Energy Agency's chief economist. What we now need is nothing short of an energy revolution

Humanity's future, to say nothing of its prosperity, will depend on how we tackle the two central energy challenges that face us: securing the reliable supply of affordable energy, and switching rapidly to efficient low-carbon energy. European governments have led the way with their plans to reduce greenhouse gas emissions, and at the UNFCCC negotiations in Copenhagen at the end of this year it will be imperative that despite the economic slowdown this momentum should continue.

The IEA's latest World Energy Outlook has a Reference Scenario calculated on policies that governments had enacted by the middle of last year. It offers a baseline against which we can assess how much we need to change course. It sees annual world primary energy demand growing 1.6% on average up to 2030, from 11,730

million tonnes of oil equivalent (Mtoe) to just over 17,010 Mtoe – an increase of 45% in just over 20 years.

China and India account for just over half of this increase, with Middle East countries contributing a further 11% to demand. Non-OECD countries account for 87% of the increase, so their share of world primary energy demand rises from 51% to 62%.

Most oil production increases are expected to come from just a few countries – mainly in the Middle East, and also Canada with its vast oil-sand reserves, the Caspian region and Brazil. Gas production in the Middle East triples, and more than doubles in Africa, where there are large low-cost reserves.

The trend in which consuming countries grow steadily more and more reliant on

Increasing import dependence does not necessarily mean less secure energy, any more than self-sufficiency guarantees uninterrupted supply

energy from a small number of producing countries threatens to exacerbate short-term energy-security worries, and although the EU is less affected by this than some regions, it sees in the Reference Scenario a slight rise in its oil import dependence from 11m barrels a day in 2007 to 11.5 mb/d in 2030. Of greater concern, given the recent supply stand-off between Russia and Ukraine, is the EU's increasing dependence on gas imports, which rise to 86% of demand by 2030 from 57% in 2006.

Increasing import dependence does not necessarily mean less secure energy, any more than self-sufficiency guarantees uninterrupted supply. Yet greater short-term insecurity seems inevitable as geographic diversity of supply is reduced and reliance on vulnerable supply routes grows.

Longer-term energy security risks are also set to grow. With more and more of the world's remaining oil reserves in a small group of countries, their market dominance may threaten the pace of investment. The greater the demand for oil and gas from these regions, the more likely those regions are to seek higher prices, and to maintain them by deferring investment and limiting production.

Unfettered growth in energy demand is clearly going to have serious consequences for the climate. The IEA's Reference Scenario points to continuing growth in CO₂ and other greenhouse gas emissions; CO₂ emissions are projected to be up 45% by 2030, with other greenhouse gases contributing to an eventual average temperature increase of up to 6°C.

COMMENTARY

By David Buchan

Yes, but it'll be hard to shake off the oil and gas shackles

Implausible Trotskyist though he is, Fatih Birol is of course right to urge world revolution in energy. But getting us to arise and shake off the shackles of fossil fuels will be quite another matter.

To many people, fossil fuels feel less like shackles than a warm comfort blanket to which we have grown pleasantly accustomed. "The good news", says Mr Birol, "is that we already know many of the policies and technologies that can deliver substantial savings in energy consumption and CO₂ emissions". Yes, we do know them, and unfortunately these policies and technologies, at least at the present stage of their development, often produce more expensive and less reliable or continuous energy than our old hydrocarbon standbys.

We can only grasp the magnitude of the challenge of Mr Birol's world revolution by reminding ourselves of the fantastic convenience of the established fossil fuel order that we tend to take for granted. Though to slightly varying degrees, oil, gas and coal are excellent stores of energy, flexible to use and relatively easy to transport when compared to wind and solar power (intermittent) and nuclear (expensive and inflexible) which must be converted into electricity that, for all its wonderful versatility, loses power in long-distant transmission and is hard to store.

Three-quarters of the extra CO₂ will come from China, India and the Middle East, and as much as 97% from non-OECD countries as a whole – although on average non-OECD per-capita emissions will still be far lower than in the OECD. Bucking the global trend, only the EU and Japan see lower emissions in 2030 than today, in the Reference Scenario.

A new course of action, taking strong and co-ordinated action to curb greenhouse gas emissions, is an imperative. December's Copenhagen conference must provide an international framework for a post-2012 global climate-change policy. The target that Copenhagen sets for the long-term stabilisation of greenhouse-gases

will determine how stringent our policy responses need to be. The energy sector has a relatively slow rate of capital replacement because of the long lifetimes of much of its infrastructure. More efficient technologies normally take many years to spread through the energy sector, so now both public and private sectors must accept the need for additional investments, as well as potentially the costs of early capital retirement, to speed up this process and deliver deep cuts in emissions.

Two IEA climate-policy scenarios show how we could stabilise the concentration of greenhouse gases at 550 and 450 parts per million of CO₂ equivalent; the 550 scenario equates to an increase in global temperature of approximately 3°C and the

450 scenario to one of around 2°C. In the 550 scenario, energy demand up to 2030 rises by about 32%, with the share of fossil fuels falling markedly, and average demand up 1.2% yearly, compared to 1.6% in the Reference Scenario. Energy-related CO₂ emissions would peak in 2025 and have declined slightly by 2030.

The 450 scenario presents an immense challenge. The 2030 emissions level for the entire world would be less than the emissions projected for non-OECD countries alone in the Reference Scenario. In other words, even if OECD countries were to reduce their emissions to zero, they alone could not put the world onto the 450-ppm trajectory. And it would mean a technology shift that in both scale and speed of deployment would be unprecedented.

The good news is that we already know many of the policies and technologies that can deliver substantial savings in energy consumption and CO₂ emissions. But decisions and their implementation have to begin now.

We're talking about significant changes in the pattern of investment across the supply and demand chains, as well as huge additional spending on new capital stock, especially in power plants and in more energy-efficient equipment and appliances. And although the sheer scale of the transformation means placing a substantial burden on both private and public sectors, the current financial crisis should be used as an opportunity rather than a barrier for launching it.

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Yet escape from fossil fuels we must. This is not only because hydrocarbons are fouling the atmosphere, and at a rate that may now have destroyed any plausibility of the IEA's scenario of keeping CO₂ in the air to 450 parts per million and the rise in temperature to 2°C. As one would expect from the IEA, an organisation founded to provide its members with energy security, Mr Birol reminds us that reliance on oil and gas carries increasing short-term risks of supply interruption, and long-term risks of scarcity leading to higher prices.

But Fatih Birol's most important point is his call for the economic crisis to be "used as an opportunity rather than a barrier for launching" the necessary replacement of polluting and inefficient energy equipment. He says the energy sector has "a relatively slow rate of capital replacement". Studies by his own agency show "relatively slow" to be an understatement.

According to the IEA, housing stock lasts anywhere between 40 to 400 years, industrial buildings 10-150 years, large hydropower plants 60-120 years, coal-fired plants 40-60 years, nuclear reactors over 40 years, power grids and gas pipelines around 40 years, and so on. Apart from children's lost iPods, the only electrical item we replace very frequently is Thomas Edison's incandescent (and energy inefficient) light bulb.

The "opportunity" Mr Birol speaks of is to respond to the current need for fiscal stimulus by replacing now some of the energy or energy-using plants that we know we will anyway have to replace in the future.

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² See more information at www.beveragecarton.eu

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Renewable energy will have a major role. Even in the Reference Scenario, global renewables-based electricity generation (mainly hydro and wind but also solar and biomass) is set to double between 2006 and 2030. In the EU, wind's share in total power generation is set to rise to 14% by 2030 from 2% today, and would account for well over half the total increase in the EU's power generation. In the 450 scenario, with its goal of limiting to around 2°C the increase in global temperature, renewables make up 30% of the EU's power generation mix in 2030, a sharp increase from 10% today.

It's up to governments to galvanise the transformation. Clear price signals, including carbon pricing, are crucial, and many of the non-OECD countries, in addition to needing some financial support to help reduce their greenhouse gas emissions, can benefit from the removal of their fuel price subsidies. But clear price signals are not enough as a low-carbon future requires major breakthroughs in technology development and deployment. Governments can create incentives to innovate, encourage research and break down international barriers. Much of the additional spending will have to be made by households, with a step-change in social attitudes to energy efficiency. Through information campaigns, regulation and targeted fiscal incentives, governments have a key role to play.

Accelerated replacement investment would not be anticipating the future by very much in some sectors. In the power sector, a major emitter of carbon greenhouse gases, 40% of the generating plants – and 50% of coal-burning plants – in OECD countries are already over 30 years old. Most iron, steel and cement plants are of a younger vintage, and according to the IEA, plants less than 10 years old will by next year account for 59% of capacity in iron and steel, and 68 % in cement. But so far the only "scrappage" subsidy for energy-using capital equipment that governments have come up with is for cars. We need to be bolder in embracing the inevitable; that's what world revolution is about.

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Here's how we can live with a global population of 9bn



The weather and bad luck tend to get the blame for famine and poverty, but the real culprit is bad governance, argues **Anna K. Tibaijuka**. Better urban planning and improved food distribution and farming inputs would go a long way towards tackling the problems of population growth and urbanisation

Economists, demographers and social scientists often argue that the earth will be unable to meet the needs of a population set to grow from 6.7bn now to 9.19bn in 2050. Historically, the basis of this argument is Thomas Malthus's 1798 essay on the Principle of Population in which he argued that population would grow faster than food supply, leading to global disaster.

This prediction has been applied in particular to the world's urban areas, which currently host half the world's population and which are collectively growing at the rate of five million residents every month. United

Nations estimates indicate that the world's urban population will double in the next 40 years, rising from 3.3bn in 2007 to 6.4bn in 2050. The pessimists see these "exploding urban populations" as the main cause of poverty, hunger and underdevelopment in the cities of the developing world, where the majority of the world's people live, and which are responsible for virtually all of the world's urban population growth.

Cities are associated with environmental degradation, squalor, poverty and crime. It is only in recent years that policymakers have begun to understand that well-planned

and well-governed cities can prevent the negative consequences of urbanisation, and can actually provide an opportunity to address and mitigate urban poverty and environmental degradation.

Today's global food and energy crisis may appear to validate Malthus's prediction, but a deeper analysis of the underlying causes of the crisis point a finger at governance rather than at scarcity. Nobel laureate Amartya Sen has noted that the Bengal famine in 1943 did not result from a lack of food for everyone, but from poor governance that resulted in inequitable or inefficient food distribution systems. The current food crisis has its roots in a range of inappropriate policy decisions, the lack of investment in infrastructure, corruption and financial greed. Some analysts believe that if these things are tackled, the world would have enough food to feed twice its current population. Malawi is a good example of how investments in agriculture can avert famine; once reliant on food aid, it introduced a farm input subsidy programme in 2007 which improved maize harvests by more than 70%.

Today's food and energy crisis points a finger at governance rather than at scarcity

Hunger is nevertheless increasing around the world. The most recent estimates by the UN Food and Agricultural Organisation (FAO) put the number of hungry people in 2007 at 923m, a figure that has no doubt risen in the past year with the rising cost of food and fuel. The situation is likely to worsen in urban areas, where continuing inflation has hit food prices and other basic commodities and the cost of survival has

risen dramatically, even when input costs such as those associated with fuel have gone down.

Often it is not scarcity that drives up prices, but poor distribution mechanisms and inequitable access. Famines are also more frequent in countries that are poorly governed and where corruption is rife. Recent news reports indicate that food scarcity in some African countries has been the result of corrupt practices that distort food supply chains, making food unaffordable for the majority of the people.

In Africa, poor governance is exacerbated by lack of investment in infrastructure. Only 7% of arable land in Africa benefits from irrigation, which means that the vast majority of farmers rely entirely on rain to produce crops. Less than 14% of the roads in Africa are paved, and the vast majority of the continent's rural populations lack electricity. Poor or non-existent infrastructure makes it harder to transport food to areas where it is needed most, and makes crop production less competitive.

In countries facing famine or starvation, it is the poorest who die, not the rich. The data and analysis we have at UN-HABITAT shows that the urban poor are particularly vulnerable in times of food scarcity or inflation, not just because they are forced to spend up to 80% of their incomes on food but also because they are often left out when food aid allocations are made. This is not just a reflection of their poverty but of their

exclusion and the inequality that intensifies it. Most food aid ends up in remote rural areas; urban poor populations are hardly ever targeted.

Similarly, if we look at the world's urban areas, it is clear that it is not the number of people residing in a city that determines its livability and prosperity, but whether the city is planned and managed to deal with these populations. Beijing, one of the world's largest cities, exhibits among the lowest levels of inequality in the world, while Nairobi, with one-third the population of Beijing, is one of the world's most unequal cities.

In the case of Nairobi, low levels of GDP per capita, poor planning and lack of political will to address urban poverty are to blame for the large numbers of slums and excluded city dwellers. These factors, rather than the growing numbers of people in the city, have sustained inequality in access to services, which have further compounded the problem of urban poverty.

I use the Nairobi example to reaffirm Sen's thesis – that unequal access to resources and opportunities are more important determinants of famine and underdevelopment than scarcity. Many African governments believe that if only they could keep out rural migrants from their cities, urban poverty could be stemmed. In countries such as Zimbabwe, the policy of stopping rural migrants from setting up home in urban areas has led to an increase in urban poverty levels, as those who live "illegally" in the city are denied access to services that could make them less vulnerable to poverty. In many sub-Saharan African countries, apartheid

and colonial policies ensured that some benefitted from services at the expense of others. These policies continue to this day, and have exacerbated urban poverty and inequality.

High levels of inequality present a double hazard: they have a damping effect on economic growth and contribute to a less favourable environment for investment. Just as importantly, urban inequality has a direct impact on all aspects of human development, including health, nutrition, gender equality and education. UN-HABITAT data shows, for example, that women and children living in slums are more likely to die sooner or suffer poor health than those living in non-slum areas of the same city. Unequal access to opportunity and services, rather than poverty *per se*, have thus shown to play a critical role in determining who will survive urban life and who will not.

Many cities and countries are addressing the challenges and opportunities provided by cities by adopting innovative approaches to urban planning and management that are inclusive, pro-poor and responsive to new challenges such as climate change. From China to Colombia, and everywhere in between, national and local governments are making critical choices that promote equity and sustainability in cities. These governments recognise that cities are not just part of the problem; they are, and must be, part of the solution. □

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Global recovery means development policy must top the international agenda



It was no accident that development issues ranging from aid to trade featured prominently at the G20 summit in London, writes Douglas Alexander. But he warns that the EU still has much to do if the world's poorest countries are to be sheltered from the worst effects of the crisis

Many of the poorest and most vulnerable people in the world are being badly hit by the global economic crisis and the long term effects are likely to be severe.

Considerable progress has been made against world poverty during the last ten years. If this is not to be lost – with the cost counted in human lives – the needs of the world's poorest countries must be made a central part of the strategy to kick start the global economy.

At April's G20 summit in London, leaders agreed collective action to stabilise the world economy and secure recovery. That collective approach is vital not just for the developed world, where the financial crisis began, but also for the world's poorest countries that have, if anything, proven more vulnerable to the subsequent economic downturn. For the least developed countries, this is a crisis upon crisis. Last year's spike in oil prices pushed around 25m people into poverty, and higher food prices ensured that as many as 130m people remained trapped in poverty, and up to 40m children suffered lasting effects from malnutrition.

Now, the impact of the global recession means that the people in these poorest countries are finding every source of financing being hit. Private capital flows to developing countries are expected to shrink by a catastrophic four-fifths; they are thought likely to fall from \$1 trillion two years ago to less than \$200bn this year. And the remittances that emigrants from many developing countries send home – globally worth some \$280bn or more every year – are starting to fall. Workers who migrated to the West are among the first to suffer from the recession, and are finding it much tougher to send money home.

World trade is forecast to shrink this year for the first time in more than 25 years. That means job losses in rich and poor countries alike; an example of how devastating this may be is that in countries that depend on exporting raw materials like the Democratic Republic of Congo as many as 200,000 miners have already lost their jobs.

The human cost of this global recession will be that by the end of next year we could see 90m more people living in extreme poverty. Economists in the Department for

International Development suggest that is equivalent to losing up to three years of the progress we have made towards meeting the UN's Millennium Development Goals (MDGs) – the eight ambitious targets due to be met by 2015 that include halving the billion or so people who live on \$1.25 a day as well as dramatic improvements in education and healthcare.

To this enormous challenge there now has to be added the daunting task of restoring global growth in the short term, and reshaping the financial system, preserving the world trading system and laying the foundations for a sustainable recovery in industrialised and developing countries alike. The outcome of the London G20 summit – shared actions along with the measures that each nation has taken nationally – represent a global recovery plan on an unprecedented scale, amounting to as much as \$5 trillion by the end of 2010.

It's worth reminding ourselves of the plan's five main thrusts. First, to restore credit, growth and jobs, a \$1.1 trillion programme of support for the world economy was announced, mostly to be provided through the international financial institutions. Second, the financial system is to be strengthened by a better and more credible system of surveillance and regulation that will include hedge funds and credit rating agencies. Third, means to fund and reform international financial institutions to overcome this crisis and avoid future crises from happening have been identified. This includes additional resources through the IMF, World Bank and other multilateral development banks to support growth in emerging markets and developing countries. Fourth, a transparent monitoring mechanism is being created to combat both direct and indirect protectionism, and \$250bn will be available to halt the slowdown in the trade financing that facilitates up to 90% of world trade. And fifth, as part of this plan for an inclusive, green and sustainable recovery, the G20 leaders reaffirmed

their commitment to the MDGs and to their development aid pledges. Some \$50bn is being made available to low-income countries, thanks in part to agreed IMF gold sales, and the UN is to monitor the impact of the crisis on the poorest and most vulnerable.

The challenge now is to make real not only the G20 commitments in London but also to live up to the summit's declarations that 'prosperity is indivisible' and that 'growth, to be sustained, has to be shared'. And the European Union is going to have a key role to play in this. But to do so it must start by reforming its approach to development assistance.

Europe's importance in the effort to tackle global poverty is unquestioned: it is by far the world's largest aid donor. In 2006, EU member countries provided £36bn in aid – more than half of total global development assistance. The crisis means it is more vital than ever that EU countries should stand by their commitments to increase aid so that the MDGs can be met.

It is not just the amount of money spent by Europe on aid that matters. The international influence that Europe exerts through its collective effort is crucial too. I saw this influence at first hand last year when I worked alongside EU Development Commissioner Louis Michel at the Accra conference on aid effectiveness. There, the strong and coordinated EU position on aid effectiveness enabled a global agreement to be reached that will dramatically improve the way that donors deliver aid, and that partner countries receive it.

As well as the EU's leadership in terms of both quantity and quality of aid, it is in policies beyond aid that Europe has a clear comparative advantage as a global development actor. Because the EU is itself the world's largest single market, and is also the main trading partner

of so many developing countries, it has the potential to develop new trading relationships with developing countries that will do much to stimulate their economies. And on climate change, the EU has led through example in its commitments to reducing emissions, while also being the largest provider of finance for tackling climate change. Also, because peace is so essential to prosperity, Europe is also very conscious of its security responsibilities. It is well placed to help prevent conflict and build peace, particularly in many of the fragile states where the EU works.

But these European actions, and therefore the EU's influence, are not always well coordinated. Much should be improved if the Lisbon treaty comes into force. It will enable the EU to overhaul and streamline the relationships between its foreign, security and development policies, and that would give a major boost to European efforts to help the developing world.

The innovations that Lisbon would bring are well known, but worth recalling; a High Representative to implement external policies agreed by the Council of Ministers while also being Vice-President of the Commission should make decision-making more effective. And the EU's own External Action Service should mean greater coherence in all countries, including the poorest.

These new arrangements should mark a considerable step forward in the fight against global poverty. But to capitalise on them, the European Commission must have a stronger development voice. The current fragmentation across regions, and between policy making and policy implementation, prevents Europe from having as powerful voice as it could. It also means that the programmes it undertakes with partner countries do not always benefit from the full range of expertise that would otherwise be possible.

When the new Commission takes office in the autumn, this should be addressed if responsibility for programmes in Latin America and Asia is brought together with that for programmes in Africa, Caribbean and Pacific under the auspices of the EU Development Commissioner. The incoming Commissioner who holds that portfolio will also need to play a strong role in ensuring the policies of the Commission as a whole are in future made more coherent with Europe's development objectives.

The EU's new Development Commissioner should accelerate the decentralisation of decision-making to European Commission offices in developing countries. This will ensure that decisions on development programmes are based on the needs of those countries, and are well-coordinated with other actors on the ground.

The London summit in April helped to create the momentum to get the MDGs back on track. At a recent meeting that DFID hosted with the UK's Overseas Development Institute, colleagues from across Europe and beyond agreed there was a real sense of urgency to take the opportunities offered for institutional change in 2009 to put in place real improvements in EU development for the long term.

In these times of turmoil, the European Union can help to create the necessary momentum to get the MDGs back on track before it is too late. These are global problems that require global solutions. That is why the United Kingdom is committed with working with the European Union for the benefit of all our futures. □

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Five reasons why Africa really matters to the world



For all its size and diversity, Africa has been marginalised as if the continent were of little consequence to the rest of the world, says Ernst Stetter. But he warns that neglecting Africa could turn out to be a disastrous mistake

Africa's economic weakness when compared to most other developing regions may partly be why it is regarded with apathy by a world struggling with so many other massive problems. It may even be argued, or offered as an excuse, that Africa's very weakness may now be its advantage. The line is that, at least initially. Many African countries will not be greatly affected by the crisis. Its impact will probably not be as cruel as elsewhere, it is claimed, because Africa accounts for such a small share of global markets, with only 1.3% of world stock market capitalisation, 0.2% of debt securities and 0.8% of bank assets. And such foreign direct investment as there is – representing just 4% of the world's total – is concentrated in Africa's handful of resource-rich countries.

This is a mistaken view, of course. One way or another, the African continent will suffer from the effects of the crisis. The economic recession in developed countries

will weaken demand for African exports. Wealthier African countries like South Africa, Nigeria and Algeria that have a degree of exposure to the rest of the world may face more problems than just the loss of their export markets. And in the medium and long-term foreign investment in Africa is likely to shrink, thus so too will foreign aid to its poorest countries.

Only four years ago the then UK Prime Minister Tony Blair spoke of the "Year of Africa" and of the willingness of richer countries to bring Africa into the world economy, his stirring call was the culmination of a process that had seen the African continent climb close to the top of the international agenda after years of relative neglect. Once the Cold War was over, Africa became a victim of the general apathy of a West at peace with the countries of the former Soviet Union. Blair's message was a reminder that Africa is important; its abundance of natural resources providing

an alternative to the volatile Middle East as a source of energy and raw materials. Productive cooperation in Africa by Europe and the United States was made all the more urgent, by the rise of China as a major investor in the continent.

All this is just as valid now as it was then, despite the world's preoccupation with the deepening financial crisis. Also, with the crisis as yet showing no sign of abating, it is important for Africa to make its voice heard above the hubbub, and to set out a convincing case for why it still matters.

What should be discussed in this reinvigorated dialogue? Factors that have increasingly contributed to the continent's marginalisation range from its political weaknesses to the destabilising effects of AIDS. Globalisation should have been as valuable to Africa as it has been elsewhere, but because many African countries have not been in a position to open up their economies and attract investment and trade, they missed out.

It's important to point out here that some parts of Africa have witnessed, since 2004 in particular, upturns in economic growth that are far more than a passing phenomenon, even if this is mostly fuelled by high prices for raw materials. This demonstrates that Africa has it in its power to move forward and achieve sustainable development, provided that Africa and the industrial world can work together.

On a positive note, it is very significant that many African countries have become more politically stable over the past decade,

COMMENTARY

By Louis Kasekende

Africa matters, of course, but not for those reasons

Whether or not Africa "really matters to the world" is a fundamentally flawed question because the underlying assumption is that Africa should explain why it is important enough to justify development assistance, or aid, from donor countries.

From an African point of view, it is evident that the continent is at the receiving end of the many decisions that are reached in a global governance architecture that is dominated by OECD countries and by the emerging BRIC partners, Brazil, Russia, India and China. This was evident in early April at the G20 summit in London when world leaders discussed possible reforms of the financial architecture. Although the crisis was created by flawed accounting practices and the lack of supervision in America and Europe, it is in Africa that the economic downturn translates into chronic poverty. This is particularly the case as most African countries lack the fiscal space and foreign exchange reserves to launch a stimulus package as developing countries in the rest of the World.

Reforms in the financial sector have a direct impact on Africa's development prospects. Some of the G20 workgroup proposals seem to suggest a new Basel III accord, which would include requirements that banks only partner with other banks that have an AAA rating. This, though, overlooks the fact that many banks on Wall Street had that rating a week before

yet with the tragedy of AIDS, the public image of the continent is so often associated with hunger, poverty, disease and conflict, fails to capture Africa's diverse reality. Take a look at the "other" Africa with its strong market performance in recent years, driven by better regulatory regimes, structural reforms, higher growth rates, rising foreign direct investment and foreign exchange reserves, robust export performance, and lower debt levels. This is the Africa of the future that has been attracting a lot of support from the European Union, China, Japan and the U.S. Encouraged by these positive developments, donor countries have become less reticent about attaching conditions to aid and trade with Africa as a means of encouraging good governance and democracy.

Africa now has to develop a strategy that will allow itself to convert its gains into long-term economic stability and sustainable growth. My suggestions for such a strategy are as follows:

Many resource-rich African countries are in a position of power, but they are also at the mercy of the ups and downs of commodity prices. These countries need to learn from the diversification strategies and growth trajectories of other resource-rich countries, for instance Malaysia, Norway, Australia and New Zealand.

Reforming Africa's political and economic governance is clearly a priority, but it is first and foremost an internal problem in Africa. For more than 30 years, outsiders have tried to support and contribute to more democracy, greater economic growth and

good governance. However, Africa's political and economic elites still seem unwilling or incapable of developing their full potential so that the continent can take its fair place in the international system.

These are opportunities that need to be grasped if a revitalised Africa is to play a greater role in tackling the international challenges that directly affect the continent but are at present dealt with by institutions where African influence is marginal. Multilateralism does not mean the yielding of sovereignty, yet global governance structures have held Africa hostage for many years and made it impossible for it to take its rightful place in the international system.

China's interest in the continent and Chinese investment there have raised concerns in Europe and in the U.S, yet these concerns supply us with the answer to the question "does Africa matter?" I would offer five key reasons why Africa matters, and particularly why it matters to Europe:

- Africa's post-colonial history has been a history of integration into the European economy and its markets. If Africa matters to Europe, it matters to the globalised world.
- Environmentally, Africa matters to the world because it has the greatest capacity for maintaining equilibrium in the biosphere and avoiding further depletion of the ozone layer.
- Africa offers easy market access to Europe as well as to the U.S. and China, and can in some cases extend extraordinary investment opportunities with high rates of return. Africa's historical links and its

geography provide European investors with a comparative advantage over North America and Asia, including China. The political climate in the continent is gradually changing towards democracy, respect for the rule-of-law and the protection of human rights.

- Africa has an abundance of natural resources. The continent ranks as the world's No 1 in its reserves of bauxite, chromites, cobalt, diamonds and gold. It is rich in palladium, phosphates, platinum group metals, titanium minerals, vanadium and zircon. African production accounts for 80% of the world's platinum group metals, 55% of chromites, 49% of palladium, 45% of vanadium and up to 55% of gold and diamonds.
- Cooperation with China. The Chinese have signalled their readiness for a dialogue with the African Union on matters of mutual interest. Europe in particular should get involved in such a dialogue, putting forward proposals for Chinese participation in European initiatives.

Despite its relative isolation in world trade in terms of the amount of goods involved, the African continent should be considered as having a great future, economically and politically. What the countries of Africa now have to do is to work to become a strategic international force, pioneering coherent and inclusive development plans for the world. □

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COMMENTARY

Louis Kasekende

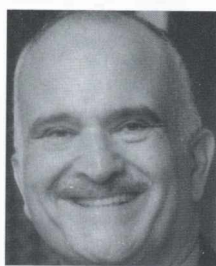
they collapsed. More importantly for Africa, this banking requirement would have serious consequences for development because private capital flows to Africa would be severely restricted.

The argument that urges much greater African participation in global governance structures can also be applied to climate change. The Western industrialised and emerging countries are the main greenhouse gas emitters, while Africa suffers the consequences of related natural disasters like droughts, hurricanes and flooding. Africa's "right" to participation in global decisionmaking therefore stems from the impact all this will have on its development prospects, even though the continent is in terms of trade and capital flows a relatively small player on the global stage.

Africa matters because global decisions have a direct impact on the continent's development prospects, especially when it comes to regulation and climate change. African countries have demonstrated that they can fulfill their responsibilities by tackling some of the most contentious and entrenched problems facing the world. These should be the reasons why Africa matters to the world, rather than it being a continent that is richly endowed in resources or because it is the final destination of so much aid. □

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Policy options for modernising the Middle East's industrial base



The countries of West Asia and North Africa – WANA as Jordan's Prince El Hassan bin Talal likes to term them – have an opportunity to emerge from the global economic crisis and shape a regional industrial base, and he suggests a policy agenda

Rather than write of the Middle East or the Arab world, I increasingly prefer to use the term WANA, meaning West Asia-North Africa. But whatever we choose to call it, the danger is that the global economic crisis provides an almost perfect alibi for governments and others within WANA to continue with "business as usual", when what really is needed is a loud wake-up call. Such a wake-up call needs leadership from within WANA, working in close partnership with Europe and the new Administration in America.

With an almost daily flourish of trumpets, the headlines in the WANA region are

about reform, democratisation, and the eradication of poverty. Yet as a recent study by the Stockholm-based International Institute for Democracy and Electoral Assistance (IDEA) has clearly shown, the approach to democracy-building of the Bush Administration did more harm than good. It made the democracy goal adopted by many leaders in WANA an empty shell.

So what, then, for the French-inspired and EU-backed Union for the Mediterranean, and its role in democracy building? How the EU will be perceived within WANA both as a partner and an actor will be crucial. History tells us that Europe's industrialisation in the

19th and 20th centuries not only provided more jobs and better welfare, but created the conditions for greater social and political mobility throughout society. This is the stuff of democracy-building in the real world, and it is what is missing in WANA. It should form the basis of an effective policy agenda for the Union for the Mediterranean.

A brief word about the concept of WANA. The definition of West Asia originates from the UN Economic and Social Commission for West Asia, an entity which has been ineffective in promoting development within the region. The WANA region presents a paradox: on the one hand there is tremendous wealth;

on the other there is continuing conflict and the distribution of wealth is diminishing. WANA is home to some of the earliest and most advanced civilisations, yet today WANA seldom makes news headlines except in the context of destruction and violent conflict and the suffering and destitution of millions. There are no effective region-wide cooperation frameworks in WANA, no systemic representation and no civil society cooperation. There is an overwhelming concentration on security politics that should be replaced by focusing on the human dignity deficit. There can, after all, be no national security if there is no human security.

Relations between WANA states are primarily driven by national rather than regional agendas. The area's continued inability to discuss, let alone create, a regional process for security and cooperation must be seen as one of the major destabilising forces

in WANA today. Yet only such a multilateral process can provide real security for future generations.

There is an urgent need for a non-threatening framework for dialogue in the region. The people of WANA have for many years been deprived of effective solutions to their problems, with the result being that

Over-dependence on aid and oil revenues affect almost all the economies of the region, and they represent a form of life-support system

a wide range of pressing political, social, economic and environmental issues have been ignored because of the lack of multilateral mechanisms for dealing with them.

The upshot is that WANA governments' policies are confined to their own

national interests. The problems, though, are regional and the challenges that stem from security and developmental deficits are shared. State policies and bilateral relations must therefore be augmented by multilateral dialogue. The lack of regional coherence in responding to shared challenges has led to inaction, making these challenges seem insurmountable. On the other hand, external parties who have attempted to address these problems lack the know-how and presence to bring about real change.

A more accurate analysis of WANA's problems and the development of practical mechanisms to address them must come with a sense of common ownership by neighbouring populations that share the same future.

The multilateral track of the Madrid Middle East Peace Process that was launched back

in 1991 floundered precisely because it was Arab-Israeli centric. A number of dividing lines exist within the region and with the outside world, but the major fault line is within WANA and between the different states. This, too, has been the sad story of the Barcelona Process, because it ignored this reality. It is to be hoped that the Union for the Mediterranean will take this into consideration.

A multilateral process involving the Arab states as well as Iran, Turkey, Afghanistan and Pakistan can later on include Israel once the appropriate threshold is achieved with the Palestinians. The core idea is to create a platform for a truly regional approach to developing solutions and to promote supra-nationalism, with a continuing respect for states' sovereignty.

The Obama Administration's new foreign policy team has publicly stated that interconnections exist between the different trouble spots in the Middle East, ranging from Afghanistan to Iraq, Palestine and South Lebanon. In the wake of the recent Gaza crisis, I myself called for both the Organisation of the Islamic Conference and the League of Arab States to present clear statements of their positions if the apparently growing disconnect in the region is to be halted. And this represents a challenge at the political level. Two other socio-economic challenges also need urgent attention.

The global economic crisis conceals chronic structural imbalances within the region. Over-dependence on aid and oil revenues affect almost all the economies of the WANA region, and it is no exaggeration to say that they represent a form of life-

support system. The problem of how to wean them off this addiction and deal with the fallout of the global economic crisis seems to be insurmountable.

Japan's "lost decade" in the 1990s has shown that once artificial life support is introduced to shore up ailing sectors in a post-bubble economy, it becomes particularly difficult to withdraw them successfully. The world economy is now facing a similar challenge.

In the advanced industrial economies, the coordination of economic rescue packages is a top priority for decisionmakers. Many leaders recognise that national stimulus plans will not be effective without synchronisation across national boundaries. Otherwise, nations can easily slide into beggar-thy-neighbour policies. This need for multilateral economic cooperation applies just as much to WANA.

For the "Dutch disease" and a rentier spirit prevail in WANA, and have affected both oil and non-oil producing countries. Quite apart from oil revenues, they span remittances from migrant labour, financial investment flows from the oil countries mainly into real estate, stock exchange bubbles and, lastly, foreign aid. A side-effect of this has been the widening of income gaps, both within countries and between the different WANA states.

Without a modern industrial base, profitable investment opportunities are limited, so the gains from trade liberalisation are extremely small. This means that an effective regional industrial policy to develop a modern industrial base in the

next generation is a top priority for WANA. The virtual absence of these sectors has some advantages though; it means that the region can leapfrog into the future without the burden of ailing industries that at present has to be shouldered by industrial countries.

Political scientists often tell us that rentier economies, or economies that depend on oil and foreign aid, stimulate greed and grievances. These scholars also tell us that oil rents eventually weaken state institutions, and this hollowing out of the state often gives rise to growing discontent.

In a non-oil economy, labour is the main engine of wealth. But in a rentier economy, huge revenues from oil or external financial transfers actually create a disincentive to work. A de-linking occurs between wealth and work, and this de-linking applies to most industrial and agricultural activities. Social and political mobility become extremely limited, and societies turn from production to consumption. This helps to explain the high level of unemployment in the Arab world.

According to World Bank figures, the Middle East North Africa (MENA) region suffered a 25% fall in per capita incomes during the last 25 years of the 20th century, when oil prices were low. In this decade, thanks to record oil prices, GDP growth rates shot up. A recent study by India's Strategic Foresight Group entitled "The cost of conflict in the Middle East" suggested

that the past 20 years of conflict have cost WANA countries some \$12 trillion.

Rent-seeking tends to lead to policy failure in the form of an intense political competition aimed at gaining short-term access to revenues and benefits, as opposed to political competition over what policies might be in the long-term public interest. The politics of greed and grievance replace more far-sighted policymakers.

So what, then, are the possible policy options for the region? The absence of a modern industrial base diminishes the absorptive capacity of regional economies for the surplus generated by oil revenues. Many countries have as a result set up sovereign wealth funds to invest their surpluses in international markets. The managers of these funds quite rightly complain that insufficient investment opportunities exist in the region in agriculture and manufacturing. The question is how to increase the absorptive capacity of the region and build a modern industrial base.

It is possible to devise effective policies to counter these economic and political problems, but this is particularly difficult. It requires, in the first place, a much greater awareness of the causes of the challenges, and in the second place it means genuine regional cooperation.

A precondition is a change of policy orientation from the national to the regional. To foster new thinking, new instruments are

The absence of a modern industrial base diminishes the absorptive capacity of regional economies for the surplus generated by oil revenues

needed like a Regional Stabilisation Fund, a Water and Energy Community, regional social cohesion and a regional industrial policy. Without this sort of regional focus, WANA countries risk sleepwalking into a new phase of conflict and economic decline.

A number of examples for cooperative initiatives exist: social entrepreneurship that is beyond microcredit and sustained vulnerability; cultural affinity with economic systems such as istikhlaaf, meaning human stewardship and improvement of the world, and the zakat, principle of charitable giving; moving guardianship and zakat; moving from patronage to partnership and the responsible division of ECOSOC into an economic council and a social council and regional human and social policy structures to close the human dignity divide.

Funds for 'needy countries' may never reach the neediest of individuals, such as internally displaced or stateless persons, because no one takes responsibility for them. Yet social unrest can be avoided by a more dynamic approach to the carrying capacity of WANA countries that would enhance their absorptive capacity. How can this be done?

The lessons learnt, or rather not learnt, are many in our region. Three years ago, with such distinguished members as Gordon Brown, just before he became the UK's Prime Minister, the Commission on Legal Empowerment of the Poor (CLEP) considered ways of empowering the "bottom billion" by expanding and deepening the tools for pulling themselves out of poverty. Our 2008 report "Making the law work for everyone" says that legal empowerment is not about

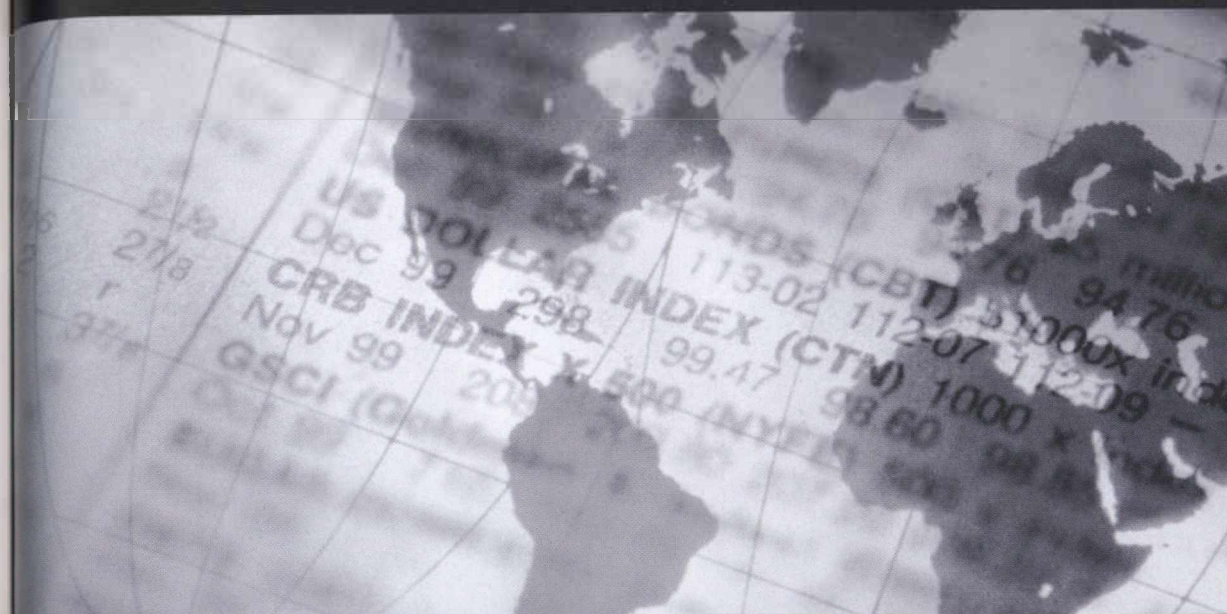
aid but about policy and institutional reforms that expand the legal opportunities and protection of the poor. It is an example of the methodology urgently needed to initiate a paradigm shift in our region.

When the Union for the Mediterranean unveils its action plan, this should include the often impressive projects that were discussed within their preparatory consultations, such as water, renewable energy, environment, cleaning the Mediterranean Sea, maritime routes, education, scientific research and industrial parks. But more cohesion with Europe will not be achieved without cohesion within WANA. If Europe and the industrial world are facing a once-in-a-century economic crisis, WANA has been enduring a two-century crisis caused by the inability of the Arab and Muslim renaissance movements of the 19th and 20th centuries to modernise sufficiently to catch up with their former colonial masters.

WANA missed the first industrial revolution based on coal and the steam engine, and then the second industrial revolution based on oil and the internal combustion engine. The silver lining now is that the absence of a modern industrial base means that WANA has no ailing industries to rescue. Can the Union for the Mediterranean provide a vision for WANA to leapfrog into the third industrial revolution of the post-carbon economy of renewable energy and the electric and fuel-cell plug-in car? □

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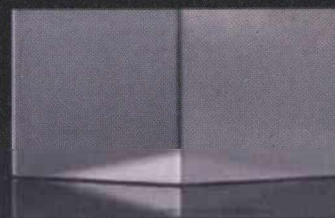
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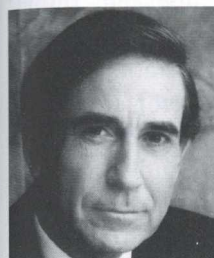
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Why democracy in the Arab World is a two-edged sword



Calls for Arab rulers to embrace democracy have been central to U.S. and even European policy, says Shlomo Ben Ami. But the former Israeli Foreign Minister warns that the unintended consequences could be the rapid rise of radical Islamist parties

The last U.S. Administration's drive to promote democracy in the Arab world, and Europe's admittedly lukewarm support of the concept, was widely seen by Arab leaders as naïve and self-defeating, a policy that suffered from an astonishing ignorance of the political choices they have to contend with. Unlike those in the West who urge the virtues of Arab democracy, Arab rulers themselves have a much clearer idea of the conflicting socio-political pressures that divide their societies, and throughout the eight years of the George W. Bush's Administration had no intention of succumbing to the popular forces clamouring for democracy.

These Arab leaders know all too well that there is no liberal democratic alternative to their rule, for they have done all that was in their power to stifle it. The reality is that the Arab world is going through a momentous struggle between the incumbent conservative regimes and the powerful new forces of Islam. Secular nationalism failed to accomplish the historic task of recovering past Arab glories, of improving the state of the masses and reforming the state, the latter having never been an especially legitimate entity in the eyes

of the masses. And it is the incompetence of the conservative elites, their corruption and their humiliating failure to save Palestine from the grip of the Zionists that have all combined as the platform upon which the Islamist response has emerged. Lacking true democratic legitimacy, the governing regimes throughout the Arab world are generally seen as puppets of the West, and that, of course, is why the masses tend to harbour strong anti-Western sentiments.

This is a state of affairs in which any abrupt move away from the secular autocracies that rule most Arab countries to democracy would be bound to result in the rise of the Islamists to power. That is what happened in Algeria in 1991 with the electoral victory of the FIS, which was immediately followed by a military takeover. And it happened again in Palestine in 2006 with the victory of Hamas, and in Iraq with the emergence of a Shiite ruling class from the debris of Saddam Hussein's dictatorship. And in Lebanon too, where Hezbollah has been constantly gaining ground. So it should come as no surprise that the staunchest supporters of free elections throughout the Arab world are now the Iranians as they know that each

truly free election in the region would result in an Islamist victory. The message must be then that contrary to what many in the West believe, the real choice throughout the Arab world is not between dictatorship and democracy but between secular dictatorship and Islamic democracy.

The West called for Arab democracy, but neither Arab leaders nor Israel wanted it. The major concern showed by both are that the real beneficiaries of greater political freedom would be Hamas, Hezbollah and the Muslim Brotherhood, all of which would have a great deal of trouble in endorsing the pro-Western policies of the Arab autocrats, not least their commitment to peace with Israel. For if these same Arab rulers have not always been eager to back America's policies in the region, that has been because public opinion in their countries – the famous 'Arab street' – was strongly opposed to them. The United States had to suffer some very serious setbacks to its 'grand strategy' in the Middle East to understand that the calls for democracy now to be heard in Arab Societies are not aimed at all at serving America's interest or the cause of peace with Israel, but rather at repudiating both of these.

Not even in Jordan, a key country for the stability of the region, is the alliance with America popular. The impact of the Israeli-Palestinian conflict and America's destabilising policies in the broader Middle East have rightly increased concerns about the vulnerability of the Hashemite Kingdom at a time where the king goes into great trouble to maintain the precarious internal balance between the Bedouin component of his state and the Palestinian majority. And, if this is not enough, the Palestinians in Jordan tend to increasingly identify with the Islamic Action Front that is an affiliate of the Muslim Brotherhood. Any assumption that Arab democracy would as a matter of course be friendly to America's

policies, or to peace with Israel, is a self-serving fantasy.

Never over-eager to engage in democratic experiments, Arab rulers are now more than happy to put the brakes on. And it's worth saying that their resilience is impressive. China and Russia have taught them that autocracy can survive a freer press and the 'threat' represented by freedom of information. Despite the stirrings of Arab democratic thought thanks to factors like the proliferation of satellite dishes, freer presidential elections in Egypt, municipal elections in Saudi Arabia and Kuwait, street demonstrations in Damascus, and the popular mobilisation in Lebanon against Syrian occupation, no irreversible institutional changes have so far been put in place. Put another way, there have been no guarantees that freedoms granted cannot ever be denied. The djinn of democratisation may have been released from the bottle, but traditional Arab rulers have not abandoned the fight to put it back.

Egypt's President Hosni Mubarak did not lose time, once relieved of American pressure, in postponing municipal elections for two years. So as to cut short the political momentum of the Muslim Brotherhood. He has also gone back on his promise to further amend the constitution and allow more political parties to emerge. Yemen, which for a short while had allowed a brief springtime of media freedoms to bloom, has also fallen back on all-too-familiar practices with a harsh crackdown on the free press ahead of presidential elections. Nor is Saudi Arabia's King Abdullah, America's most important friend in the region still greatly impressed by the West's discourse on democracy. He continues to be adamant in turning down calls for elections to the country's Consultative Council. And Syria, a country practically on parole, has moved from the rhetoric of reform to a harsh

crackdown on the opposition. Its position behind the Lebanese Hezbollah's war against Israel was probably the best reflection of Syria's diminished respect for President Bush's America and for its broad Middle East agenda. In the wake of Hamas' victory and the impressive performance of the Muslim Brotherhood in the Egyptian elections, even Syrian President Bashar Assad's despotic regime must have looked to the architects of the Bush doctrine preferable to an Islamic republic in Damascus.

But it is not calls for democracy that are wrongheaded; it is the idea of an abrupt shift to free elections that could be fatally destabilising. The West instead needs to push for democratic reforms that would bring about a gradual transition to democracy while empowering the forces of change and modernisation.

Despite the general sense that the West's drive for Arab democracy has been derailed by fears that once elected Islamic parties would sweep away traditionally pro-Western regimes, it would be wrong to despair of Arab democracy or fall back on the conventional wisdom that democracy is not for the Arabs. The stability of Arab regimes not sustained by democratic consensus is bound to be fragile and misleading. In this post-modern world, where the freedom of information is unstoppable, it is dangerously wrong to think that peoples' natural yearning for liberty can be stifled without major consequences. It's certainly true, too, that the West should not want to be perceived by the Arab world as hypocritically applying double standards. Nor can Arab leaders realistically expect their political opponents to abandon the call for democracy.

The West tends to make two requests of the major Arab regimes; one is reform and democracy, the other is peace with Israel.

If given the choice, most Arab rulers would prefer to reduce these pressures from the West by advancing the cause of peace with Israel while relegating democracy to the fullness of time. Peace with Israel is after all a vital interest, for a solution of the Israeli-Palestinian problem has become an urgent necessity if Arab regimes are to focus on the genuinely existential threats posed by the emergence of the Shiite Iranian empire, and by the fundamentalist challenge at home. This is particularly true of Egypt, whose jealous rejection of Turkey's attempt to step into its traditional role as the regional peace broker reflects its hopes that in the eyes of the West peacemaking is an acceptable substitute for democracy, particularly for the U.S. Congress where the large annual aid payments for Egypt have to be approved.

A solution of the Palestinian problem would not herald an era of celestial peace for the Middle East, for the ills of the region stretch far beyond the boundaries of the Arab-Israeli dispute. The entire Muslim world is by any standard dysfunctional and would probably have been so even if the State of Israel did not exist. But an Israeli-Palestinian peace settlement, besides being a response to an authentic clamour of generations of Arabs and Israelis and a profound moral imperative, would be of great consequence to regional stability. It would eliminate one of the most sensitive triggers for mass hysteria throughout the region, a frequent pretext for the Bin-Ladens of the Muslim world in their global war of terror, and the ultimate alibi of Arab rulers when stifling social and political liberties. □

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The Mediterranean Union risks being stillborn



The high hopes that accompanied last year's launch in Paris of the "Union for the Mediterranean" are already becoming muted, writes **Roderick Pace**. He argues that the political cultures that so beset the Barcelona Process during its 10-year life are now condemning its successor to a similar fate

The infant Union for the Mediterranean (UfM) seems to be suffering from growing pains or perhaps worse. It is already becoming infected by the same maladies that it had set out to heal. Steadily but surely, interactions in the UfM have relapsed back into the same old patterns of behaviour that the invention of the UfM was meant to end. Unless remedial action is taken quickly, it may not be long before the UfM joins the roll call of dead, unsung and unlamented Mediterranean policies.

The main cause of this sad state of affairs is that the UfM has departed from the pragmatism originally proposed by France's President Nicolas Sarkozy when he launched the idea in 2007. Instead, a strain of typical Mediterranean politics has been allowed to flourish and suffocate the fragile politics of dialogue and good sense.

The UfM's other problem is the hubris of linkage politics. The term linkage politics

is used to describe the vexed approach to world politics that many countries in the Euro-Mediterranean partnership favour, and which already threatens the health of the UfM. The process is reminiscent of the way that as part of the Barcelona Process, progress towards a Mediterranean Security Charter was yoked to progress on the Middle East problem. The result was, of course, that no progress was registered on either.

Last year's early beginnings of the UfM saw as the main north-south issue whether the League of Arab States was to be involved. Israel and a number of EU countries feared that its membership would eventually lead to the ousting of Israel from the process. Last October, Jordan postponed an important Euro-Med conference on water security so as to put pressure on the other UfM member states to accept the League's participation.

In another bout of linkage politics, Egypt suspended a few months later all UfM

The sad conclusion to be drawn is that no matter how the institutions of the UfM may be strengthened, little will really change in the UfM unless attitudes and working methods change

activities when the Gaza conflict erupted, although it could instead have put them at the top of the agenda as a way of tackling the crisis. More positively, Egypt then led the diplomatic effort to end the hostilities but the UfM's suspension had highlighted the way that worthwhile initiatives can become hostage to other issues. It was a form of bravado politics that undermined the credibility of the UfM and further eroded mutual trust in the region.

The second major problem being faced by the UfM is its lack of financial means. In the very early stages of the initiative, Algeria's President Abdelaziz Bouteflika drew attention to this problem by asking how UfM projects were going to be financed, given that most of the appropriate EU funds are already committed until 2013. The prospects that the EU will increase these funds from its own resources, or that sufficient private capital can be found to make up the shortfall, look increasingly dim because of the global economic recession.

A third problem emerges from inside the EU itself. Until the fog of the global recession begins to lift, and so long as Europe is stuck in the limbo of its failure to ratify the Lisbon treaty, the EU will go on being inward-looking and disinclined to address other regions' problems before it has settled its own. It is a stance that others may call short-sighted, but it is nevertheless a fact of life.

Caught as it is in the midst of a worldwide crisis, the infant UfM can least afford to pursue any objectives that risk undermining its own effectiveness, and its credibility. So it is essential that it should return to the first principles set out in President Sarkozy's original proposal. Although at that stage it was still somewhat nebulous as a project, he intuitively laid down some common sense principles that are worth recalling. He proposed that the Mediterranean Union should begin by breaking with the past and with old attitudes and ways of thinking. In other words by breaking with the tendency of those involved in the

COMMENTARY

By Khalifa Chater

What this baby needs is intensive care

Roderick Pace's diagnosis seems somewhat harsh. He sees the Union for the Mediterranean (UfM) as an institution in terminal decline with no prospect of progress or development, and little or no vision. This is too much. One of the UfM's virtues is that it has the autonomy to take key decisions about its future, something unimaginable during the wearisome decade of the Barcelona Process, the UfM's predecessor as a hoped-for champion of Mediterranean interests. Whatever faults the UfM may have acquired during its short life, at least it has the means to adapt to changing circumstances, and to review and develop its objectives.

Let us take a candid look at the UfM's problems and see what can realistically be done about them. Nicolas Sarkozy's original plan for a Mediterranean Union had the goal of breaking the geopolitical logjam that was the ruin of Barcelona. But the French President had to take account of the demands of his EU partners. As a result of horse-trading Sarkozy's plan was revised and disfigured, and I'd go as far as to say it was largely eviscerated. It has been reduced rather to a communications and public relations operation, but lacks even a mutual commitment between its northern and southern constituents.

So should we shut down the Union for the Mediterranean here and now, as Roderick Pace seems to suggest, or rather should we make do with it, notwithstanding the intrinsic defects that limit its ambitions? Or, more usefully, should we go for constructive engagement between the partners, hoping to put its founding institutional kernel to work as a force leading towards the creation of a cohesive community that will take everyone's interests into account? I do not believe its fate is to be stillborn. Using the same metaphor, the UfM may be a sick baby but it is one that will survive and thrive under intensive care.

Barcelona Process to play safe. In what can be seen as having a deeper significance than pure rhetoric, Sarkozy appealed for boldness and risk-taking, looking back to age-old capitalist maxim that the greatest dividends are often realised from the most risky investments. The French President let it be understood that he had calculated risks in mind, those that supply our societies with the sort of dynamism they need but not ruinous or thoughtless gambles.

Any objective assessment of the UfM's development since then is unlikely to find much evidence that its major problems stem from the initial difficulties on either the European or the Arab side. These were, one way or another, all satisfactorily resolved. It was the UfM's inability to break with past ways of doing things that has been devastating, and has led to the present sense of disorientation.

As the haggling over the shape of the UfM unfolded, various solutions were found quite quickly, with all the EU member states being eventually included in the formative process. Turkey was reassured that the UfM was not to be a parking place for her outside the EU, and Spain's misgivings about the abandonment of the Barcelona Process were placated, and even generously rewarded, when Barcelona was chosen as the seat of the UfM's secretariat.

Divisions on the Arab side had looked more life-threatening although in the end they too petered out. The mini-Arab summit held in Tripoli in mid-June last year bringing together Algeria, Libya, Mauritania, Morocco, Tunisia and Syria was able to avoid the complete rejection of the UfM, even though Libya decided to stay out on the grounds that the

new grouping could endanger both African and Arab unity.

When UfM countries foreign ministers met in Marseille last October, a patchy solution was found to the question of including the League of Arab States. The compromise was that the League would be involved at all levels, albeit as an Observer, while Israel was given a seat on the UfM's secretariat for the next three years, with the possibility of a further extension.

But what the 43 participating states overlooked was that age-old Mediterranean malaise – grown more conspicuous than ever with the advent of the Israel-Palestine issue – of the lack, and apparent impossibility, of a proper dialogue between the region's many organisations and multilateral initiatives. If there were one single thing the UfM needed to break with it was this.

The Barcelona Process that was replaced by the UfM illustrates the problem. Although it was often described as the only initiative in which Arabs and Israelis met under the same roof, what routinely happened under that roof was both bewildering yet rarely visible to the public. In numerous meetings that ranged from scholarly encounters to sessions of the Euro-Mediterranean Parliamentary Assembly, discussion quickly turned into confrontation and often ended in stalemate.

No matter whether the subject was economic, social or political, at committee, working group or plenary level, exchanges were all too easily transformed into a "continuation of war by other means". Words replaced bullets, denunciations and walk-outs became the strategic ploys, and intransigence became the bravery of a battlefield whose heroes were those who obstinately

refused to concede a point to their opponent, even when evidently wrong.

The sad conclusion to be drawn from all this is that no matter how the institutions of the UfM may be strengthened, and no matter how much the concept of its co-ownership catches on, little will really change in the UfM unless attitudes and working methods change first. In other words, Nicolas Sarkozy's passionate appeal for a break with the past and the old ways of doing things still holds the key to the future. The first step for the Mediterranean Union is to start a proper dialogue with the sole aim of moving away from these longstanding patterns of behaviour.

The auguries are not encouraging; Mediterranean countries are strongly resistant to making a fresh start. When the UfM was launched in Paris in July 2008, Syria's President Bashan Assad reportedly walked out of the room when Israel's Prime Minister Ehud Olmert took the floor.

So how likely is it that the political elites of these countries will muster the acumen needed to set the UfM on a fresh course? Back in 2002, a group of Arab intellectuals and scholars wrote the first in a series of Human Development Reports published by the United Nations Development Programme (UNDP), and in it they charted a course that marked out the many reefs the Arab world needs to navigate successfully. Yet today there seem to be few movers and shakers in the Mediterranean region, including Israel, who will be bold enough to respond to Sarkozy's appeal for change. What is missing is boldness, a break with the past, simplicity and let's not overlook it capital. □

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COMMENTARY

Khalifa Chater

The UfM needs to examine and deal with the issues raised by relationships in the organisation that are out-of-kilter, namely inequality in trade and impediments to the free movement of people. Co-development programmes need to be undertaken as a priority in building the UfM, and the study of mutual interests would give its decision makers an opportunity to listen to the expectations of the public

To succeed, the UfM needs to operate in an environment of peace, with normalised relations among its partners. The Gaza war showed clearly that hiding the political dimension of a conflict – in this case between Israel and the Arab nations – renders it impossible to create the conditions needed to implement any programmes, even purely technical ones. This fact ought to have been taken into account when the Mediterranean project was at the design stage, and the Paris Summit of July 2007 that launched the UfM in fact presented a review of the geopolitics needed. As long as the peace process between all of its partners remains incomplete, any meeting of the UfM conference will be constrained. Seeking such a peaceful environment in the Mediterranean region is never going to be easy, but the UfM enthusiasts should have been aware of this obstacle, and might have perhaps postponed the project until they saw a clearer way forward.

That said, the reality is that UfM is here, and many of us hope that it is here to stay. The encouraging thing is that, as a necessary consequence of globalisation, the adjoining areas of Europe and the Mediterranean countries are going through an integration process that is likely to go well beyond a mere market entity implemented by the European Union. Sooner or later, the creation of a true community of values will be on the agenda. Would it not be sensible for the supporters of UfM to go for a strategy of "rational pragmatism" so as to support, speed up and maybe anticipate this trend? □

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Europe has a central role to play in the Middle East



There is a risk, says **Marc Otte**, the EU's Special Representative for the Middle East peace process, that the region may yet become "a black hole of globalisation and a general threat to world peace". He argues that Europe must project the EU model of integration and cooperation to help tackle the problems of the Middle East

When General de Gaulle said that he was setting off with "simple ideas" to the "complicated East", he encapsulated the predicament of Westerners trying to make sense of the problems and the deep-rooted motivations of all the players in the Middle East.

De Gaulle's comment can also help to shed light on the reasons why the West and its allies have of late seemed unable to articulate anything other than purely reactive strategies, leaving the initiative to their adversaries. In Iraq, in Palestine, in Lebanon and in Afghanistan, not to mention Sudan, failure looms as the military and civilian resources of both NATO and the EU come under very real stress.

Consider the Israeli-Arab conflict. The standard view is that the parameters for

a solution are well known and that all it would take to implement them is leadership and political courage. Yet even as both Israelis and Palestinians keep on telling the pollsters that a two-state solution is their preferred option, Israeli voters recently ushered in a government that has still to explicitly endorse the two-state solution. And opinion polls among Palestinians show that the popularity of those who advocate military "resistance" is again on the rise.

In Iraq, Palestine, Lebanon and Afghanistan, not to mention the Sudan, failure looms as the military and civilian resources of NATO and the EU come under stress

What is it that the rest of the world seems to be missing? Is there really a lack of leadership and political courage all around? Are the people simply losing hope in the feasibility of the more or less obvious solutions to their problems? Do they find the costs too high? Are outsiders, as is too often the case, only listening to what they want to hear? Or

maybe only to whom they want to listen to? Are the local parties happy to oblige, so as not to damage relations with their patrons and protectors?

Deeper interconnections between issues of increasing complexity now dominate the changing strategic landscape in the Middle East, especially as its boundaries now extend in the mindsets and strategies of those concerned all the way from the Mediterranean to Afghanistan and Pakistan. And by that definition, the region is now acutely symptomatic of the unpredictable way the international system has changed faster and more radically than anyone could have expected.

First there is the emergence of new players, who are challenging the assumption that Western values are necessarily the model for the future shape of international relations. In some new and future system of agreed universal values, democracy, human rights, rule of law, focus on fulfilment and responsibility of the individual may have to live side by side with other principles.

The new players include a host of non-state actors who have become strategic threats and act in concert with states that reject the traditional rules of conduct in international relations. By supporting the worst forms of terrorism and actively seeking to acquire weapons of mass destruction, their aim is to increase their own disruptive potential.

At the same time, considerable governance deficits are leading to the creation of failed states or failed societies at the local level, and at the global level

COMMENTARY

By **Abdel Monem Said Aly**

This approach risks aggravating the Middle East's daunting complexity

Although Marc Otte quotes General de Gaulle as saying that he is going to the "complicated East" with "simple ideas", Otte's own article confronts the already complex Middle East with even more complex ideas. In the present situation of the region, these ideas are likely to further complicate matters, creating yet more disappointments, and providing greater opportunities for sabotage to those who oppose peaceful solutions, economic development and improved institution-building in the region.

Most of these ideas have been tried before in both bilateral and multilateral frameworks, or in God knows what kinds of first and second track negotiations over the last three decades or so. All have been inclusive and comprehensive, or partial and parallel, and sequential and consequential and sometimes all of these at the same time. They all aimed to restore peace to the Middle East, to work for regional integration and all aspired to the democratisation and modernisation of all the countries in the region. And all were much too complex in that they advanced ideas that overburdened a region that already suffers from too much history, ideology and under-development. The end result of all these initiatives has been more "failed" states, more wars and a more rather than less fragmented region.

preventing solutions for such problems as the international financial system, global warming, international migrations, competition for resources and so on. This becomes fertile ground for the radicalisation of large segments of societies across the globe, fuelled by social disruptions and preyed upon by reinvigorated religious fundamentalists, extreme nationalists and those who preach messianic ideologies.

The Middle East has evolved into one of the main battlegrounds in the confrontation between the Western model and "the other". Iran is obviously the elephant in the room, but the rising power of Iran is not enough to explain the prospect of the Middle East becoming a black hole of globalisation and a central threat to world peace.

For centuries, change in the region has for better or for worse always included a fair degree of intervention from outside. Any reflection on the future role of outsiders should apply the principle of "first, do no harm", as Aaron David Miller reminded us in his recent book "The Too Much Promised Land". Regional players have often proved apt at bringing disaster on themselves without there being any need for the outside world to aggravate matters with yet more misguided policies.

Now, a new wind is blowing from Washington, capturing the attention of friend and foe alike. Barack Obama's

message is that talking to one's enemies does not necessarily mean appeasement. Comprehensive peace, including the two-state solution is the objective, and this is increasingly understood to be in the U.S. national interest. Failure to solve the Arab-Israeli conflict would further destabilise the region. The Obama Administration's determination to achieve results and not to engage in further lengthy processes is a call for everybody to contribute positively.

This new U.S. commitment is improving the odds on a genuinely sustained and comprehensive conflict resolution effort that could change realities in the region. This new approach should be parallel rather than sequential, thus creating mutually reinforcing processes. This means there will be no room for picking and choosing, no possibility of "freezing" one issue in order to tackle another that could be perceived as more important. It should also be inclusive, involving all the players like Turkey and, ultimately, Iran.

Without changing the essentially bilateral character of peace negotiations, the creation of an overall international umbrella should be envisaged so as to shepherd negotiations, agree on goals, calendars and benchmarks to assess progress, tie parties to conflicts into binding commitments regardless of developments in domestic politics, establish monitoring by outside referees, articulate contributions

by the international community to the implementation of final settlements and discuss the creation of a regional system in the post conflict situation. That would serve to mobilise all players more effectively and send a powerful message of legitimacy and unity of the international community for those who would choose to remain outside. The regional dimension provides guarantees that bilateral and partial deals will last because they are consolidated by regional economic integration and security arrangements.

An internationally agreed forum should mandate the establishment of the mechanisms to set all this in motion. The international economic crisis should be a powerful motivation to set the Middle East on the track of modernisation. The Arab world was represented at the G20 and now needs to find the financial and human resources to become an active participant in negotiating global reform. The financial packages and policy measures agreed at the G20 in London must be used to consolidate peace in the region, and therefore need to be developed by the regional players in conjunction with the international community. The new roles being assigned to the IMF and the World Bank should also be used to create a new template for the region, just as the Marshall Plan paved the way for Europe's economic and political integration. The trade dimension has to be addressed, too, with regional trade arrangements and WTO membership for all the countries in the region placed on the drawing board. European models like CSCE and OSCE could perhaps be replicated and adapted to regional conditions.

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I would argue that what is instead needed is to go back to the drawing board and concentrate on two elements that are of fundamental importance: the first being the state and the second political power. The only two successful examples of peace in the Middle East have been the Egyptian-Israeli peace deal and that between Jordan and Israel. Both have stood the test of time even though wars and crises have been in abundance because they were in the hands of states, and reflected their leaders' needs and interests. A Syrian-Israeli peace pact came close to fruition, but then was paralleled by the Oslo talks and other forms of peace process in which no state actors were involved but where 'sub-state' institutions had become engaged. Bringing a European model of peace building and regional development to the Middle East has done little more than to take geo-political problems that should be in the hands of strategic decisionmakers and place them in the hands of bureaucrats who know more about how to complicate matters than to resolve them.

The realities of the Middle East are basically that the region is divided between those who want peace, itself a prerequisite for economic development, and those who oppose peace on the grounds of history or religion, and sometimes both. The priority of peace negotiations in the Middle East should be to encourage states to conclude peace agreements on their own, and also to deprive radical forces, whether they be state or non-state actors, of ways of spoiling the process. These constitute acts of power when we define power in more comprehensive terms than just the use of force.

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In short, the institutionalisation of relations between countries in the Middle East, along European, Asian or even Latin American lines, has to be pursued as a long term goal and as a political backdrop for peacemaking.

What happens in the Middle East fundamentally affects European interests, and the European Security Strategy emphasises that point. Europe has been involved for a long time and has no choice but to remain so because the future of the Middle East is not some distant strategic concern but is a neighbourhood issue. The spill-over of conflict and instability there is an immediate problem for European societies. Europe is not just a payer but a full player in diplomatic, security and economic affairs, whether we all of us like it or not.

The EU has been a pioneer in developing multilateral instruments like the Barcelona Process a decade ago, and today the Union for the Mediterranean and the European Neighbourhood Policy. History has taught us Europeans that projecting the EU's model of integration and cooperation is still one of our best assets in stabilising our neighbourhood and widening the areas of rule of law and prosperity. Europe can and must play a central role in the coming transformation of the Middle East. □

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COMMENTARY

Abdel Monem Said Aly

A concert of regional powers like Egypt, Saudi Arabia, Morocco, the new Iraq and Turkey, working in coalition with the United States and the EU, should work towards peace agreements in the region. The Obama Administration's approach of "more peace than processes" is to be recommended because it is much simpler than the multi-layered and multi-purpose processes of the past. This concert of powers should work to encourage, persuade and put pressure on states – basically Syria and Israel – to finish what they once started and create the formula for a Palestinian-Israeli two state solution that will be "imposed" – yes imposed ! – on the two parties. The beauty of the Arab peace initiative in fact is that it came from states and it looks at region-building and the normalisation of relations in the Middle-East in simple terms that states can comprehend and implement. What is needed is for this concert of powers not to let itself be side-tracked by lofty and complicated ideas, and to understand the reality that a failed and even more disintegrated Middle East will present problems that are even more complex than those that face us today. □

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THE HAGUE Recession is tempering Dutch enthusiasm for Europe

By Alfred Pijpers of the
Clingendael Institute

It's hardly surprising that the Netherlands is being swept by the chill winds of global recession. The country has a comparatively large financial sector and exports account for more than 70% of gross domestic product. The Dutch government had to rescue ABN Amro Bank from the rubble of Fortis, and the large financial group ING needed huge credit facilities. The Dutch used to think of their country as a cradle of European budget discipline, but today they are dismayed by the rising tide of national debt as billions of euros are injected into the economy.

Planners in The Hague predict that economic output will fall by more than 3% this year; imports and exports have already dropped by an unprecedented 14%. Many small and medium-

sized companies are facing serious difficulties, particularly those in the transport, construction and tourism sectors. Pension funds are being forced to raise premiums or reduce payments. The ABP Fund for retired civil servants and teachers – one of the largest pension funds in the world – lost more than €44bn in book value on last year's plunging stock markets.

Yet for all the gloom and doom, the outlook for the Netherlands is less bleak than elsewhere in

Although popular support for the EU in general is still strong, the national autopilot is no longer on course for "ever closer union." Instead, the Netherlands is steering towards a more flexible pattern of cooperation inside and outside Europe

Europe. As the old saying goes, "When the world goes down, one can still flee to Holland." Very low inflation and the country's solid social security system together guarantee that most people will be able to maintain their purchasing

power. Unemployment is rising but remains the lowest in the EU-27. And the relatively modest size of Dutch industry means the national economy is less vulnerable to shocks in certain key sectors. Just 22,000 Dutch people work in the car industry, for instance, well below Germany's 833,000, France's 258,000 or even Belgium's 45,000 auto workers.

Nor is the current crisis affecting the stability of the country or government. The ruling centre-left coalition has presented a balanced package of emergency measures and enjoys support from broad sections of Dutch society. Cohesion within the coalition has even been bolstered by the rising star of Geert Wilders and his populist Freedom Party. After the turbulent period when the party of assassinated right-winger Pim Fortuyn briefly entered a ruling coalition – and later when the Dutch voted No to the European constitution – the Dutch political establishment quietly agreed never again to share power with any populist party and never again to organise a referendum on Europe or any other serious subject.

Since the populists hardly ever win more than 25%-30% of the national vote, the traditional Dutch parties nearly always have a comfortable majority in the broad political centre ground. And unlike Belgium, where a cordon sanitaire is maintained around Flemish right-winger Flip de Winter, the Freedom Party is neither boycotted nor isolated. Wilders and his people have open access to the media and participate fully in public debates. The ruling party elites even cherry-pick their ideas when they suit the mainstream political agenda.

For the Dutch, Europe has never been far from the action during the economic crisis. Jean-Claude Trichet, the president of the European Central Bank, and the EU competition commissioner, Neelie Kroes, almost personally supervised the demise of Fortis Bank, while Prime Minister Jan Peter Balkenende and Finance Minister Wouter Bos have eagerly participated in the various EU and G20 emergency summits. European monetary union and the anti-protectionist stance of the Commission are much appreciated in the Netherlands. As Bos famously said, "If we had no eurozone, we would all have ended up as Iceland." The Dutch support European coordination of (restrictive) fiscal stimulus and a strong role for the EU in promoting global regulation.

But events have once again proved that in times of trouble Europeans turn first to their governments rather than to Brussels. The EU may be indispensable for developing regulations in the long run, but it lacks the necessary resources to act in the short term. The EU's main job is to coordinate the efforts of member states, leaving much of the decision-making – and the political legitimacy – to the capitals. The Dutch Labour Party, in particular, thinks the current crisis is a golden opportunity to revisit the future role of the nation state, both in Europe and in the world economy.

It's an approach that fits well with the changing Dutch mood about Europe. Although popular support for the EU in general is still strong, the national autopilot is no longer on course for "ever closer union." Instead, the Netherlands is steering towards a more flexible pattern of cooperation inside and outside Europe, with a substantial role for The Hague. The junior minister for European affairs, Frans Timmermans, recently summarized this new attitude when he said: "I believe that Europe cannot be built without strong nation states. And that we cannot have strong nation states without strong European ties." □

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SARAJEVO It's becoming urgent for the EU to get back on track in Bosnia and Herzegovina

By Dobrila Govedarica
of the Open Society Fund
in Bosnia and Herzegovina

Economic recession is fuelling fears that Bosnia and Herzegovina may be heading for serious trouble. More than 15,000 people lost their jobs over the winter and spring months as the global downturn hit home, and the country's pensions and social welfare funds face collapse. The economy is the latest problem to be added to Bosnia's long list of woes. Fourteen years after the Dayton peace agreement, ethnic tensions are still there and political rifts are widening. Support for Europe is also on the decline. According to a recent Gallup poll, 16% of Bosnians believe their country will never join the European Union, double the figure for the rest of the western Balkans. The people of Bosnia simply don't see EU membership as a realistic option in the near future. They are also disappointed that so far Europe has neither galvanised expected reforms nor resolved ethnic conflicts. Unless genuine

reforms start soon, a return to civil war seems more likely than EU accession.

There is today no consensus on national unity in Bosnia and Herzegovina. Attempts to build a viable state on the basis of the Dayton accord have failed. Serbs and Croats want more autonomy and

As Bosnia and Herzegovina slides back towards conflict and disintegration, the EU clings to an inadequate and outdated framework for bilateral relations

some Serbs are even calling for secession. In contrast, Bosnians are demanding a stronger and more centralised state. Bosnian leaders pay lip service to EU membership, but in reality they thwart reform and reconciliation. The political elites continue to exploit ethnic differences to turn the people against each other and to distract attention from the lack of democratic accountability. Ethnic oligarchs use indoctrination, religious propaganda and commercial censorship of the media to take control of public life. Corruption is flourishing and undermining progress towards democracy. Citizens who call for change are bullied into silence.

As Bosnia and Herzegovina slides back towards conflict and disintegration, the EU clings to

an inadequate and outdated framework for bilateral relations. Rather than grappling with the country's complex situation, the 2008 Stabilisation and Association Agreement offered standard templates for reform and integration. But political deadlock has frozen domestic legislation in Bosnia. And even if there were sufficient political will to meet EU criteria, the country's institutions generally lack the capacity to comply. They suffer from overlapping jurisdictions, poor funding and inadequate education among staff. According to the European Commission's report last year, many Bosnian target areas show no progress at all. This situation cannot be reversed without major changes in the overall political climate.

If the EU is truly committed to regional integration in the western Balkans, Bosnia and Herzegovina must be brought back on track. It will take a robust and united strategy to break the chain of failed reforms. The EU will have to establish clear, detailed and non-negotiable requirements for politicians and institutions. And it will have to work with people outside the political elites. It is time Europe recognised that all Bosnians need tangible incentives to re-start the democratic process, not just another helping of advice from Brussels' standard menu. □

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ROME

Italy is ducking its chance to use crisis for sweeping reforms

By Serena Giusti of the Istituto per gli Studi di Politica Internazionale (ISPI)

Italy is experiencing the sharpest economic contraction for 28 years and unemployment is next year expected to jump to 9% from the 6.9% forecast for 2009. But economy minister Giulio Tremonti is determined to keep public finances under control, in line with advice from the European Central Bank and the European Commission. The major tax cuts promised in last year's election campaign have been put on hold, and measures announced so far to stimulate the economy appear to be limited.

Silvio Berlusconi's centre-right government says it will invest €44bn in infrastructure over three years in an effort to lessen the impact of recession. Among the more controversial projects, the spending programme revives Berlusconi's ambition to bridge the Messina Straits between Sicily and the mainland. The previous centre-left government cancelled the plan in 2006, saying the bridge was too expensive, unnecessary and liable to

become a windfall for organised crime – the Sicilian Mafia and the 'Ndrangheta of Calabria.

Another construction sector proposal is also creating a stir. The government wants to relax planning laws and give property owners tax breaks to extend their houses. But some people are warning that over

The Italian government is accused of overstating the European and global dimensions of the crisis to hide the structural weaknesses of the Italian economy. It has downplayed the fact that Italy is the only leading country forecast by the International Monetary Fund to face three consecutive years of contraction

development will damage the country's distinctive regional landscapes. Elsewhere in the economy, the government's €2bn support package for the car industry is similar to the French initiative to help Renault and Peugeot-Citroën. The Italian measures apply to foreign-made vehicles as well as cars manufactured by Fiat, Italy's largest private-sector employer, in line with the government's anti-protectionist policy. Rome says the impact on international competition from such national schemes must be kept to an "absolute minimum".

Not everyone in Italy is impressed with the government's EU-orientated economic strategy. Confindustria's president Emma Marcegaglia is calling on Europe to follow the U.S. lead and launch bigger stimulus programmes. The Italian government is also being accused of overstating the European and global dimensions of the crisis to hide the structural weaknesses of the Italian economy. It has downplayed the fact that Italy went into recession earlier than any other big European economy, and that Italy is the only leading country forecast by the International Monetary Fund to face three consecutive years of contraction.

The government is said to have over-emphasised how 'exceptional' the country's banking system has been. Italian banks proved less vulnerable to the financial meltdown than those of other major European countries with their resilience put down to cautious lending and borrowing strategies, the low levels of household debt in Italy and high levels of savings. But the government still allocated a maximum of €12bn for recapitalisation of the banks through a government-backed bond offer, and Tremonti has even floated the idea of EU bonds. Some major banks may yet ask for state aid, especially institutions exposed to the unfolding crisis in eastern Europe.

In terms of party politics, Italy's European approach to the current crisis is meeting little resistance. Euro-scepticism has evaporated in some members of

The time could have been right for Italy to rethink its whole economic system, to slash bureaucracy and to modernise business practices. Instead, the government is doing a lot of talking

the ruling coalition, notably the Northern League. (It was one of the greatest achievements of Berlusconi's EU policy to make sure the Northern League voted for the ratification of the Lisbon treaty.) So far opposition parties have offered no alternative plans to deal with the economic crisis, apart from demanding that welfare benefits are maintained.

Potentially, the time could have been right for Italy to rethink its whole economic system, to slash bureaucracy and to modernise business practices. Instead, the government is doing a lot of talking about its commitment to address the country's problems effectively, even if it means more meddling in sectors such as banking and some industries. □

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NICOSIA

How Greek Cypriots see the stalled talks on a Cyprus settlement

By **Andreas Theophanous**, Director of the Cyprus Center for European and International Affairs

The climate of optimism last year that a Cyprus settlement might be achieved has, once again, been mitigated by events. Demetris Christofias' election to the presidency of the Republic of Cyprus and the resumption of negotiations with Turkish Cypriot leader Mehmet Ali Talat last September had raised hopes of "a Cypriot solution by the Cypriots".

The underlying assumption had been that the major obstacle to a solution was former President Papadopoulos. But this somewhat simplistic view has, so far at least, proved misleading. Although the bi-communal dimension of the Cyprus question is important, the problem extends to other aspects, and in essence these are far more important. It is the 1974 occupation of the northern part of Cyprus by Turkey, the introduction of more Turkish settlers there, property rights and Ankara's insistence

on retaining guarantor rights over what is now a full EU member state that are the major issues constituting stumbling blocs to a settlement. The situation has an impact on Euro-Turkish relations, not to mention its influence on internal Turkish politics.

Yet for all the setbacks a real breakthrough may still be possible if a series of different objectives can be met. So far, Turkey does not seem to have had a strong enough incentive to make serious concessions over Cyprus, because in essence there has been no penalty to pay. The result is that Ankara would be prepared to accept any Cyprus solution provided it more or less legitimises what happened in 1974. If this is indeed the case, we may be moving towards a new deadlock, unless the settlement dialogue can be sustained by a determined effort both to reach a better understanding in Cyprus itself and also to facilitate Turkey's EU ambitions.

Developments within Turkey are as crucial as those in the broader region. The U.S., Russia and Turkey have between them been taking different and inconsistent approaches to various issues of ethnic conflict. The U.S. supports the territorial integrity of Georgia, but also an independent Kosovo. Russia stresses the importance of the territorial integrity of states,

but in the case of Abkhazia and South Ossetia its position is compromised. Ankara insists on a confederal solution in Cyprus based on two states (leaving the issue of Turkish guarantees aside), but is strongly opposed to a similar scenario in Iraq. And, of course, any talk of such

It is difficult to achieve a breakthrough when Turkey continues to deploy 40,000 troops in the northern part of the island and when there are more Anatolian settlers there than indigenous Turkish Cypriots

a stance in relation to its own Kurdish question is considered a casus belli. Not surprisingly, the only constant in all this is that these powers' own perceived geopolitical and national interests are to each of them the determining factor in their policymaking.

It is, in any case, difficult to achieve a breakthrough in Cyprus when Turkey continues to deploy 40,000 troops in the northern part of the island and when there are more Anatolian settlers there than indigenous Turkish Cypriots. As recently as mid-April, settler voters in the occupied northern part of Cyprus outnumbered Turkish-Cypriot voters, and contributed to the victory of Dervis

Eroglu's nationalist party. This development may well create additional complications for the Cyprus negotiations.

Curiously enough, though, when Ankara faces major turning points with respect to its relations with the EU there are always "new initiatives" and expectations for a fruitful outcome. But unfortunately there has been no major change in substance to Ankara's policy on Cyprus. On the contrary, the pressure seems directed towards the weaker Greek-Cypriot side rather than to the Turkish-Cypriot side and to Ankara. In other words, a re-run of what happened to previous UN settlement efforts, including the one that culminated in the rejection by the Greek Cypriots of the Annan Plan.

The bottom line now is that if there is to be any momentum capable of delivering substantial progress towards a solution to the Cyprus problem, Ankara must first recognise and respect the Republic of Cyprus as an independent member state of the United Nations and the European Union. Once Turkey is able to take this step, the rest will follow. □

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VIENNA

Recession's silver lining for Austria's embattled centrist government

By **Heinz Gärtner** of the Austrian Institute for International Affairs

The deteriorating economic situation in eastern Europe has hit Austria badly. Forecasts for the Austrian economy are dire as unemployment is expected to reach 7.5% this year and growth to fall by 2.7%. Austrian banks are having a particularly bad time. As far back as 2006, BAWAG bank was among the first victims of the failing financial system, and Hypo Alpe Adria almost crashed. Many Austrian banks still have outstanding loans in eastern Europe at a time when investors are pulling out. Vienna also reluctantly accepted that its banks must become more transparent as part of the G20 leaders' agreed crackdown on banking secrecy and tax evasion. Austria avoided being named on the OECD's black list of tax havens, but it nevertheless ended up on a grey list of nations yet to comply fully with international disclosure standards.

The recession's political repercussions are also

widespread in Austria. Far right-wing parties have benefited from people's fears that during the downturn foreigners will take away their jobs. Many voters believed these parties' promises to secure their social benefits despite the slump, so Austria's right-wing did well at national elections last year, and made surprise advances too at this year's provincial elections. The main right-wing FPÖ gained about 10% of the vote in Salzburg province, while in Kärnten (Carinthia) the BZÖ – which broke away from the FPÖ seven years ago – won almost half the votes. The results shocked the two centrist parties in government – the Social Democrats (SPÖ) and the conservative People's Party (ÖVP) – as opinion polls had underestimated the political impact of recession and failed to predict the swing.

But recent results don't necessarily mean that the whole of Austria is shifting to the right. In fact, the country's economic problems are tending to push the SPÖ and ÖVP together and strengthen their coalition's cohesion. The government is now much more stable than the same coalition was before the last election – although no doubt it helps that both parties have new leaders. The ÖVP says it wants to protect Austrians from "Wall Street capitalism" and even finds higher state expenditure acceptable in

an economic crisis. The SPÖ blames neo-liberals for the recession and is returning to its social democratic roots. Both parties agreed a stimulus package to help revive the ailing economy. The last time state intervention helped to overcome a recession was in the 1970s when Chancellor Bruno Kreisky adopted the concept of "Austro-Keynesianism". He claimed that a higher budget deficit cost him less sleep than higher unemployment. Austrians think there is good reason to believe this formula might work again if all members of the European Union pull together.

So has the recession made the EU more popular in Austria? Not really. Despite a very pro-European government, Austrians have generally low expectations of Europe. Today only one third of the people see the EU in a positive light, compared with the two thirds who supported Austrian membership in 1994. Public opinion has changed very little during the recession. On the other hand, 60% of Austrians support greater EU powers in certain areas, mainly economic policies such as trade, investment, jobs and common measures to fight the current crisis. And only 18% of Austrians want to leave the EU, against 76% who want to stay. □

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VILNIUS Lithuania's "austerity crusade" threatened by deepening recession

By Klaudijus Maniakas
of the Institute of
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and Political Science

Lithuania is responding to a dramatic reversal in its economic fortunes with a relentless austerity campaign.

The conservative-led government has cut public spending repeatedly since taking office last year. It has hiked taxes and reduced wages. The problem for Prime Minister Andrius Kubilius is that his economic policy pretty much begins and ends with these budget cuts. Economic reforms and promised initiatives are increasingly judged by one criterion alone – whether they reduce public expenditure or not. But the recession is biting harder than expected and revenue targets are not being met. People are wondering if Lithuania might have to follow Latvia's lead and ask the International Monetary Fund or the European Union for help.

The recession in Lithuania is particularly severe. Growth had

been robust until the global slowdown choked both credit and export markets. The country topped the EU table of the worst economic performers in the first quarter, when the year-on-year fall in output was measured at more than 12%. The official forecast for a 10% contraction this year is looking more and more optimistic. However, the government has so far refused to borrow from the IMF and to use the EU's balance of payments facility. With the downward spiral apparently unavoidable, the arguments against such action are becoming difficult to understand.

There is one EU financial door open to Lithuania that is giving some leeway for stimulating the economy. Vilnius is re-channelling EU structural funds to help small businesses

Politics is one possible explanation for the government's determination to stick to its austerity drive. There is a consensus in the country that certain budget cuts are necessary, and Prime Minister Kubilius has a track record for financial prudence after he steered Lithuania through the last economic downturn in 1999. The previous social democrat-dominated government lost power after it consistently ignored warnings

about the approaching crisis and failed to shore up the nation's reserves. Thus the latest four-party coalition feared any increased borrowing would damage their standing during the presidential and European Parliamentary election campaigns this spring. In addition, the front runner for president, EU Budget Commissioner, Dalia Grybauskaitė has described recourse to the IMF as a sign of impotence. She has argued that the only economic policy choice for Lithuania is between more budget cuts and devaluation of the currency.

Like other Baltic currencies, the Lithuanian litas is pegged to the euro. But there seems little chance that Lithuania will be able to join the eurozone in the near future. The European Central Bank and eurozone member states quickly quashed an IMF suggestion that beleaguered EU countries might be let into the monetary union to help stabilise their economies. At best, therefore, membership of the eurozone is only a medium-term option for Vilnius.

There is, though, one EU financial door open to Lithuania that is giving the government some leeway for stimulating the economy. Vilnius is re-channelling EU structural funds to help small businesses and the construction sector.

Under this, the European Investment Fund will manage a new fund to provide guarantees and micro-credits to small and medium-sized enterprises. A separate energy fund, managed by the European Investment Bank, will help to finance energy efficiency projects in Soviet-era apartment blocs. This will help to reduce the country's energy consumption and, indirectly, its dependence on Russian gas. This fund will also inject liquidity into the banking system as the renovation micro-loans will be distributed via the banks.

The government is keeping a careful eye on Lithuania's banking system. So far it has ridden out the worst of the global financial turmoil, with the government only having to raise and extend deposit guarantees. The country's two biggest banks have benefited from the backing of their Swedish parent banks. However, a deepening recession will certainly expose more problems in the financial sector. And if the situation gets noticeably worse, it might be enough to overcome the government's reluctance to ask the EU for direct economic assistance. If so, it will be interesting to see if this makes the Union more popular among Lithuanians. It could even improve the current government's own popularity rating. □

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PODGORICA Recession and the EU rain on Montenegro's parade

By Sanja Elezovic of the
Foundation Open Society
Institute, Montenegro

The people of Montenegro are asking whether the European Union is gradually closing the door to new member states. Their anxiety was reinforced this spring when the EU hesitated before allowing Montenegro to take the next step toward becoming a candidate country. There have also been repeated signals from the EU that internal consolidation is the priority, rather than enlargement. If the door is shutting on the western Balkans, it will be a particular blow to Montenegro where people have pinned so many of their hopes on the European Union.

Montenegro's multi-ethnic population lives in relative harmony. Since independence in 2006, the country developed good relations with its former Yugoslav neighbours and it began a period of rapid economic expansion, fuelled by foreign investment and increased domestic consumption. Democracy and social cohesion remain

weak, though, and corruption and poverty are endemic. Authoritarian political elites maintain their hold on power, while progressive civil society groups have been unable to attract enough support to force genuine democratic change.

Under these circumstances, EU membership is widely seen as a magic solution to most of the country's problems. It unites otherwise fractious political parties, and promises proper democratic accountability and a transparent market economy. Well before independence, Montenegro had unilaterally adopted the euro as its official currency. A political consensus was reached in 2005 on the importance of EU

The pre-accession adoption of EU standards has been an effective catalyst for change. Under pressure both from Brussels and from local civil society, the political elites have supported institutional, legal and market reforms

membership, backed by 75% of the people. Montenegro agreed a Stabilisation and Association Agreement with the EU in 2007 and submitted its formal application to become a member state last December.

So far, the pre-accession adoption of EU standards has

been an effective catalyst for change. Under pressure both from Brussels and from local civil society, the political elites have supported institutional, legal and market reforms. But there are concerns that words are not being matched by deeds. Renewed attempts to describe integration as purely an administrative exercise are ringing alarm bells. People fear that talk about "law approximation" is bound to divert attention from the more important task of law enforcement.

Global recession is threatening to put another obstacle in the way of EU membership. Montenegro had been supremely confident that economic success was part of a winning formula that would speed the country towards the EU. Intensive investment in construction and tourism helped to boost growth to 8% in 2007 and 10% last year. But the worldwide slowdown has burst the economic bubble. The import-dependent country is suffering from heavy losses in both the banking sector and its vital aluminium industry, and the market for real estate is stagnating. Montenegro may well be heading for recession.

This year therefore looks like a turning point for Montenegro. Last year, membership seemed merely to be a matter of making good the promises of reform.

But if political leaders think that EU member states are blocking the way for newcomers, they are likely to put their energy

If political leaders think that EU member states are blocking the way for newcomers, they are likely to put their energy into strengthening their own positions, rather than building on institutional reform or enforcing the rule of law

into strengthening their own positions, rather than building on institutional reform or enforcing the rule of law.

Democracy is fragile in the western Balkans, and integration into the EU offers a sound structure for strengthening political systems in the region. And because democracy is so essential to economic and social development, if the current momentum is lost it will certainly cause irreversible damage to Montenegro. □

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Letters to the Editor

Europe's World's aim of stimulating debate on key issues draws many thoughtful reactions from leading policymakers. We feature here a selection of letters commenting on articles in our Spring 2009 issue

Renewable energy is much more than a flight of fancy by Andris Piebalgs



**ABDALLA
SALEM
EL-BADRI,**
Secretary
General of
the Organization of the
Petroleum Exporting
Countries (OPEC)

Sir,
The Organization of the Petroleum Exporting Countries agrees with many of the points which Andris Piebalgs makes about the nature of today's energy mix. OPEC has long welcomed diversity in supplies and it is clear that the use of renewable energy is set to grow, albeit from a very low base. Other sources of energy – such as nuclear power – are also expected to play their part, though as history demonstrates, we should be ever alert to their associated safety risks and their intensive capital requirements. Realistically, though, fossil fuels will continue to satisfy most of the world's energy needs for the foreseeable future.

That being the case, OPEC shares Piebalgs' view that technology has the potential to help meet the demands of a more carbon-constrained world. Some of our member countries are currently pushing the boundaries in this respect. Algeria, in tandem with international oil companies, is at the forefront of research and development into carbon capture and storage, a pioneering technology that could significantly reduce greenhouse gas emissions from conventional fossil fuels. It is OPEC's view that more must be done on this front, and our member countries will continue to make progress in this field.

We must also look to developed countries to take the lead in global efforts to mitigate greenhouse gas emissions, given their historical responsibility. They have comparative technological and financial advantages over other nations

in this area. More action by developed countries would therefore both be equitable and in accord with the United Nations' principles of common but differentiated responsibilities and respective capabilities, recognised at the Rio Summit and under the UN Framework Convention on Climate Change.

Excessively low oil prices are a problem. They inhibit much-needed investment in long-term oil production

Piebalgs says that a case can be made for setting targets for renewable energy and providing these industries with financial support. OPEC has long been calling for clearly stated, non-discriminatory energy policy objectives from consuming nations, since these will contribute to oil market stability. However, since such policy objectives will be factored into the investment decisions of oil producing countries, we

must be sure that they are transparent and realistic. We must also remain fully aware of the impact of bio fuels with regard to efficient land use, food prices and water.

Commissioner Piebalgs recognises the advantages of diverse energy supplies. Given that oil is such an important element in this mix, excessively low oil prices are a problem. They inhibit much-needed investment

in long-term oil production capacity and curtail investment in other sources of energy, including renewables. Every technology, every energy source and every project has its price. Therefore, a stable and realistic price for oil is important – one that takes into account the broader questions of long-term energy supply, demand and investment.

If we are to achieve a sustainable solution to global

energy needs, one which supports continued world economic growth, it is vital to maintain transparent, open dialogue and cooperation. This will help everyone – including energy producers and consumers alike – to reach a greater level of understanding of the issues we all face. □

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Charting Europe's changing shape by Olli Rehn



BJARNI BENEDIKTSSON,
Independence
Party member
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Sir,
Iceland was hit early and hard by the global financial crisis, and the nation's financial system very nearly collapsed. So Icelanders aren't about to argue with Olli Rehn when he says that long-term economic and financial stability requires stronger global governance. I also agree that the European Union can lead the way, but that will require more unity, direction and purpose than sometimes seen in the past. The EU may also be well placed to protect its citizens' welfare

in times of crisis, as Rehn says. The Union will, however, have to play to its strengths if it hopes to capitalise on this unique position to tackle the transnational problems facing Europe's people and member states.

I welcome Commissioner Rehn's warm words about Iceland. It's good to know he thinks accession negotiations could make quick progress if Icelanders decide they want to belong to the Union. Iceland has been part of the Single Market since 1994 and the Schengen Area since 2001. But it should be recognised that Iceland's advanced state of economic integration with the EU is actually a source of weakness when times get tough.

Iceland is integrated into EU capital and financial markets, but lacks adequate tools to deal with major crises. Above all, our currency is vulnerable and we have no credible lender of last resort. Iceland is like an open trailer hooked onto the EU car. It's a comfortable ride in good conditions, but dangerous in a storm on rough terrain.

It is interesting that Olli Rehn underlines the importance of continued enlargement irrespective of the present economic difficulties. However, it is also important that the EU continues to respect the individual circumstances of candidate countries. This means that policies tailored to meet the demands of the EEC in the early 1970s may need to be

adapted in light of the EU's changed composition and other developments. As Rehn suggests, fisheries would be a considerable challenge were Iceland to seek EU membership, partly because the fishing industry is the foundation of Iceland's prosperity and partly

due to the nature of the Common Fisheries Policy. Agriculture, too, presents different problems in the far north-west of Europe than in other parts of the EU. As the Commissioner says, only the Icelandic people can decide whether they wish to apply for

EU membership. I believe that political leaders in Iceland must actively involve the people and other interested parties in a constructive and conclusive debate on the issue. □

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The recession's storm holds a silver lining for development cooperation by Jean-Michel Debrat and Simon Maxwell



ANDERS NORDSTRÖM,
Director
General of
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International
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Sir,
Jean-Michel Debrat and Simon Maxwell make a good case for Europe to respond constructively to the severe impacts that the global recession is having on developing countries. But their five priorities for redesigning EU development cooperation are long on general aspirations and rather short on specifics. That is partly because they focus on where the impact will be (exports, remittances, foreign direct investment, trade credits etc) rather than on the underlying causes. It

is therefore worth looking in more detail at the channels through which the global recession is affecting the developing world.

The origin of the recession was a global financial crisis triggered by a banking crisis in the U.S. and Europe. This resulted in a severe contraction of global capital markets and a corresponding threat of financial mercantilism. So, just as the global recession hit hard, developing countries found they could no longer raise the capital required to finance necessary adjustments. Developing economies are therefore being thrown back onto their domestic financial sectors for both capital and financial services. This, then, is one specific area where the EU should direct its efforts.

There are many ways the EU can help to develop the domestic financial sectors of partner countries, including the imaginative use of the financial resources mentioned by Debrat and Maxwell. The EU could help to develop forms of financial risk sharing, such as guarantees or subordinated debt instruments, which do not remove the incentives from banks to assess risks and cut costs.

The EU can also ensure that the impacts on middle- and low-income countries are taken properly into account when the whole international architecture of financial regulation is being redesigned. These effects were neglected after the crisis in 1997-98; such mistakes must not be repeated. We must listen to the developing world and consult the institutions

that were created to promote financial sector development in partner countries, such as the Financial Sector Reform and Strengthening Initiative (FIRST) and Making Financial Markets Work for Africa.

The EU can also provide appropriate technical assistance. The follies of the last few years may have damaged Europe's financial sector, but the EU still has a wealth of knowledge of, say, retail and commercial banking, capital markets, microfinance and the development of savings and co-operative banks. FIRST and programmes like ESMID and the Toronto Centre are building on the opportunities for knowledge sharing. The Toronto Centre, for instance, combines high-level regulatory capacity-building and change management, guided by top-level financial system players. ESMID promotes a holistic development of local and regional debt markets, which in turn creates mutually beneficial links between public and private finance.

Emerging market economies and poorer nations are experiencing different types of impact from the global recession. But the overall message of this crisis is clear: globalisation means all countries share the pain as well as the gain. Global recession also underscores the link between the health of the

financial sector and economic growth. Robust financial sectors are an engine of growth, but growth is destroyed when financial sectors collapse. □

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**BRIGITTE
ÖPPINGER-
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Sir,
The economic crisis seems to have come as an unprecedented shock for many top business managers, as well as for opinion leaders, politicians and a large part of the general population. The worldwide repercussions of the U.S. sub-prime crisis were hard to understand, especially for people who played no part in the credit bubble but who were severely affected when it burst. As an extended period of unsustainable financial profit-making ended in chaos, even the staunchest economic liberals began calling for state intervention. And discussions at the last World Economic Forum included the case for changing the paradigm behind the global economic system.

While it seems the full effects of the crisis are still emerging, and forecasts of the economic

downturn can still shock, certain consequences are now clear. The crisis will no doubt have a crucial (and deserved) impact on future trade and financial regulations, and help to redefine the economic role of the state. Hindsight also proves that "free" markets do not lead to socially desirable results in the long run. This is not just true for the poor but also (less expectedly) for the rich.

Analysts also agree that poor and middle-income countries will bear a considerable share of the economic burden. I therefore agree absolutely with Jean-Michel Debrat and Simon Maxwell that it is essential to maintain and even to increase development activities. I also agree that the European Union should gain the international influence it deserves as the world's biggest donor, and I fully support their arguments about the advantages of greater development cooperation.

To achieve the Millennium Development Goals (MDG) we will need a strong public sector plus close collaboration between developed and developing nations and between donor and recipient countries. We must also harness the power of the people to move on; it is astonishing to see the sort of strategies that innovative people come up with, especially in times of crisis. The private sector is another

key partner, as recognised by international conventions such as the Cotonou Agreement and the Paris Declaration. Since global recession will now make public money even more difficult to mobilise for development, I believe donors should not ignore the potential contribution of entrepreneurs to achieving the MDGs.

Western economies may be in recession, but other countries are still growing. So EU

companies should be encouraged to build on the opportunities offered by developing economies and supported in their efforts to secure jobs and reduce poverty. Austria is already working with the European private sector, fostering better practice especially in the important sectors of alternative energy, rural development and sustainable agriculture. A lot of this work qualifies as "green investments" which are in great

demand right now. One of Austria's top priorities is our Public-Private Partnership Programme which builds on the entrepreneurial spirit in both developed and developing countries. Such an approach can create win-win situations in a world which is re-thinking all the old ways of doing business. □

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How NATO could improve its relations with Russia by Dmitri Rogozin



**ALEXANDER
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Sir,
Many western experts believe that the current financial crisis has halted Russian attempts to challenge the preeminence of the West by promoting the idea of a multi-polar world. They say if oil prices continue to fall, Russia will be forced to spend all of its accumulated financial reserves in order to save the country's socio-economic system. In that case, Moscow

will have to forget its ambitious plans indefinitely. So I would advise Russian politicians to stop trying to argue their case from a position of strength. Instead, they should point out that the West is hurting itself by denying Russia its legitimate place in a common security structure for the 21st century.

It would help if people everywhere remembered that Russia is definitely not the enemy of the West; the Cold War ended 20 years ago. Hence Dmitri Rogozin is right to remind us about the U.S.-Russian alliance against the Taliban and al-Qaeda in Afghanistan after the 9/11 terrorist attacks. The Islamic terrorist threat is far from

over. If Obama were prepared to enter a "holy alliance" with Russia against resurgent Islamic extremism in the Greater Middle East, then talk about a new Cold War in Europe would stop

The West is hurting itself by denying Russia its legitimate place in a common security structure

immediately. Russia and the West would unite in the face of a common foe. It is a workable framework which former U.S. President George W. Bush and his "neo-con" supporters conspicuously failed to deliver.

In addition, since American and British forces are

withdrawing from Iraq and other EU member states are reluctant to give NATO more support in Afghanistan, U.S. President Barack Obama has little choice about bringing Russia into the stabilization process for the region. If the new Administration were also prepared to admit Russia into a joint missile defence project, then the U.S. could also gain Moscow's commitment to a much-needed containment policy against the Mullah regime in Iran.

Energy is the second global challenge where the West really needs to work in partnership with Russia. I believe the current conflict over gas is artificial and senseless. Russia is the only country in Europe that can guarantee the energy supplies needed by western economies. And Russia has no other viable option than to open up its production sites to western companies. So I see no alternative to a strong energy alliance between the EU and Russia, based – of course – on the principles of reciprocity.

If cooperation in these two fields can be achieved, then the West should be prepared to make Moscow an offer that it is unlikely to ignore – membership of NATO. This may seem a radical idea today, but NATO has changed profoundly in the last 20 years and its present-day structure will

doubtless be unrecognisable within another couple of years. For example, Israel may apply for membership sooner or later. If countries like Ukraine and Georgia have sovereign rights to join NATO, then why not Russia and Israel? □

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ANA MARIA GOMES
MEP, Vice-Chairwoman of the European Parliament's Subcommittee on Security and Defence

Sir,
Dmitry Rogozin makes a bold proposal for "a new legally-binding treaty on a system of mutual security guarantees in Europe." Russia's ambassador to NATO also challenges people to imagine a world where Cold War tensions finally disappear and "Russia's foremost foreign policy goal – a strategic partnership with the West" becomes a reality.

Russian participation is clearly indispensable for the world to confront the greatest challenges to regional and global security. There can be no effective response to international terrorism, organised crime or nuclear proliferation and disarmament without Russia. We

also need Russia in Afghanistan and the Middle East.

However, the past eight years have been quite sobering for anyone looking for signs that Russia is ready to take on some of the responsibilities of global leadership which the U.S. had been unable or unwilling to perform. Take the example of Russia's decision to suspend participation in the Conventional Forces in Europe Treaty in July 2007. There certainly were tensions with NATO over amendments to the treaty made in 1999, but how did abandoning the CFE Treaty altogether solve this problem? Why did the then President Vladimir Putin announce the very next month that Russia would restart the Soviet-era practice of sending strategic bombers on long-range flights beyond its borders? And was it coincidence that Kyrgyzstan announced it was cancelling the lease on the Manas air base with the U.S. shortly after Russia offered Bishkek \$2.15bn in aid and loans? Would Russia prefer NATO and the U.S. out of Afghanistan? Of course not.

I entirely agree with Ambassador Rogozin when he complains that "it is time for Europe to stop acting like an occupied continent and start displaying its own political will." Unfortunately, Russia is contributing to the political divisions in Europe just as much as the U.S. In the

strategic field of energy, Russia's self-interested and state-led policy is designed to control Europe's gas supplies and infrastructure for the foreseeable future. That may fit into a 19th century pattern of power politics, but it certainly does not match Rogozin's vision of a future where Russia acts like an ordinary European power working within a harmonious security architecture.

Perhaps of greatest importance to Europeans is Russia's

record on democracy and human rights. The Bush years represented a low point in post-war U.S. leadership; they also provided a lot of cover for Russia's occasionally aggressive posture. With President Barack Obama in office, Bush's policies are over. But the fragility of the rule of law, civil liberties and human rights in Russia are still here. Independent journalists and human rights activists are not safe in Russia and the political system lacks real democratic diversity.

Europe may be far from perfect. But it is hard to imagine that Rogozin's dream of a strategic partnership with the West will come true as long as Russia evades the rule of law and shirks its commitments to democracy and human rights which it has made as a member of the United Nations, the Organisation for Security and Cooperation in Europe and the Council of Europe. □

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Europe must swallow its bitter economic medicine by Leif Pagrotsky



MIROSLAV BEBLAVÝ,
Chairman of the Slovak Governance Institute and former State Secretary at the Slovak Ministry of Labour, Social Affairs and Family

Sir,
Leif Pagrotsky's diagnosis of Europe's economic ills, and his prescriptions for their cure, contain valuable if uncomfortable nuggets of truth. But I would dispute some of his assertions, including the all-too-familiar alarmism over competition from non-EU countries. The problem for the

European Union is not that other countries are catching up with our high living standards. Good for them, I say. What is truly troubling is that on average European economies are not keeping pace with people's expectations. The EU's performance is too weak to allow people to maintain their customary way of life.

Pagrotsky is spot on when he says that the solution to our economic problems is to be found within Europe. Our economic and social problems are largely home grown, so there's no point blaming the rest of the world. Yet there is very little reason to think that either the root causes – or

the right solutions – will be found at European level. All available research suggests these problems are still largely internal to member states. Even the supposedly neoliberal interventions from Brussels usually cut both ways. For each "liberal" decision at the European Court of Justice, such as the Laval case, there is a countervailing decision, like the Simap and Jaeger rulings.

Pagrotsky's own policy prescriptions look suspiciously like a Swedish export, combining liberal product markets plus private innovation with rigid labour markets and extensive welfare systems. While this certainly is preferable to the

protectionist and interventionist recipes of the French variety, I doubt the Swedish model applies either to the new EU member states or the Anglo-Saxon countries. I think we should spend less time figuring out how to homogenise Europe and more time creating national reform strategies. Slovakia is not Sweden. Our combined success in the EU depends on finding policies that fit our individual strengths, not an abstract European ideal. □

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LAURENT COHEN-TANUGI, international lawyer and Head of the French "Europe in the Global Economy" Task Force

Sir,
Leif Pagrotsky mentions, almost in passing, that the Lisbon agenda is not delivering the promised economic results. European Union policymakers also seem to have forgotten the all-important debate about pursuing the Lisbon strategy ever since the international financial crisis and its dire economic repercussions struck Europe. Yet the Lisbon strategy is highly relevant in the current economic climate. At heart,

it's all about finding ways to strengthen Europe in the globalised economy.

For some critics, the present Lisbon strategy reflects a free market philosophy that is now doomed by the global credit crisis. Others say the strategy and its associated structural reforms must continue more or less unchanged after 2010. In reality, the present economic turmoil validates the spirit of the original agenda agreed in March 2000 which encompassed economic, social and environmental concerns. But the current crisis also underlines the basic weaknesses of the Lisbon strategy, which were spelt out in a report commissioned by the French government last year. This report, which can be found at www.euroworld2015.eu and www.euromonde2015.eu, identified a double flaw: Lisbon is underperforming as an internal EU policy, and it lacks the pan-European external dimension needed if the EU is to act effectively at a global level.

Today, it is clear that economic recovery in Europe and the U.S. will come from a combination of fresh investment in the knowledge economy, innovation, clean and energy efficient technologies and advanced social policies. Meanwhile, the present crisis brutally demonstrates the vulnerability of even successful national reform strategies to

the shockwaves of a globalised economy. It also underlines the inability of the EU to confront problems at the European level. The best performers in terms of the Lisbon strategy were not spared by the crisis. And the EU apparently lacks the political, financial or technical means to respond when national economies are hard hit by the unfolding global crisis.

The current crisis also shows how the European economic and political systems are still fragmented along national lines, despite the Single Market and the euro. Such a contradiction appears unsustainable in the long run. Unless we integrate further, we are bound to regress.

The debate on the future of the Lisbon strategy post-2010, launched by the European Council last spring, has so far failed to rise to the occasion. To succeed, the post-Lisbon agenda must evolve into a true European strategy for globalisation. It must be more efficient, improve internal solidarity and acquire enough external Community competences, policies and instruments to shape globalisation. This should be the focus of the European Parliamentary elections in June and the roadmap for the new Commission. □

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A bond-issuing EU stability fund could rescue Europe by Daniel Gros and Stefano Micossi



PAVEL PELIKAN, Professor at the Department of Institutional Economics, Prague University of Economics

Sir,
Daniel Gros and Stefano Micossi are undoubtedly right to say that Europe's banks need more money to provide "good" loans to support economic recovery. It is also true that non-European investors would readily provide the necessary finance if they were offered a "good" government paper in return. But since European governments have earned very varied reputations concerning their ability to manage public finances soundly, not all countries can attract enough international investment to re-capitalise their banking sectors through the sale of national bonds and the like.

Unfortunately, Gros and Micossi's proposal for dealing with this dilemma – a massive European Financial Stability Fund (EFSF) – is seriously flawed. As usual, the devil is in the detail. Put simply the basic problem is this: How do you allocate the new capital to individual banks? The U.S.

has yet to solve this problem properly for the TARP, which the EFSF is intended to emulate. A European fund would face additional complexities over the role of national governments in the allocation process. For example, should EFSF managers be allowed to bypass member states altogether and select recipient banks directly? Or should there be some politically-determined rationing scheme, with each government choosing how to allocate its share of the capital to banks within its jurisdiction?

Since Gros and Micossi complain that European governments do too little to support their banks, I guess they would prefer EFSF managers to make the decisions. Yet this would exclude what I see as the main advantage of their proposal; the principle of distributing eventual losses according to the country where they arose. If fund managers allocated the capital unwisely, then governments might still be forced to pay for their mistakes. Such a system would be neither efficient economically nor acceptable politically. If on the other hand governments made the decisions, the principle of loss-distribution could operate but

the EFSF would be superfluous. It would be cheaper to let each EU member state issue as much paper as it wanted, with the European Investment Bank guaranteeing an agreed amount per country.

The EFSF would also have to face a number of other questions that are now troubling the TARP. Two are particularly

Gros and Micossi's proposal for a massive European Financial Stability Fund is seriously flawed

important and controversial. First, how easy should it be for a bank to obtain capital? Gros and Micossi favour easy capital, but here they face many opponents in both Europe and the U.S. Easy capital is only the right choice if we can be sure it will be transformed into good loans. Clearly there can be doubts on this score, since the entire financial crisis was caused by bankers who transformed too much easily-created capital into bad loans! This makes it reasonable to require bankers to meet more or less difficult conditions, and thus try to stop them making the same mistakes again – even if it is not entirely clear what these conditions should be.

Second, should most of the capital go to the worst banks with the largest losses, or to those which behaved more wisely? While Gros and Micossi leave this question aside, many policymakers now appear to favour the worst banks option. I see a strong "evolutionary" argument against this choice. Propping up the worst banks interferes with the invaluable working of markets as selection devices that demote insufficiently competent people from top economic positions. By contrast,

channelling the capital to good banks would facilitate their taking over bad ones, which would allow their (probably) superior competence to benefit larger parts of the banking sector.

I don't claim to know all the answers to the current crisis, but nor does anyone else. This point is important for proposals such as the EFSF because contrary to what many well-meaning EU politicians appear to believe, unity is not automatically better than

diversity. Not only do some questions require different answers under different conditions, but diverse answers are also better in situations where the optimal common solution is not yet known. It is better to test a range of alternatives first, rather than reaching a premature consensus around a mediocre answer just because some powerful policymakers strongly, but wrongly, believe it to be right. □

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consumers, religious leaders and many others play their part in the process. Many diplomatic services are moving fast to adapt their organisations, skills and resources to this new reality.

Classic diplomacy still has its role. States continue to exercise power and experienced, emphatic diplomatic negotiators (and ambassadors and embassies) will be needed to conclude important intergovernmental agreements in future. But they will work in parallel with new activities called Public Diplomacy. (Maybe it is ill-named, as Ross says, but it's still a necessary function whatever we choose to call it.) So from now on:

- Diplomats will be working with more non-state players to gain influence
- Public Diplomacy will be an

integral part of decision-making in diplomatic systems

- Diplomats will be recruited from a wider spectrum of people to include experts in communications, information technology, rhetoric, international culture etc.

- Diplomatic efforts will be tailor-made to the job in hand. For instance, the people and skills required to reach an ambitious climate agreement in Copenhagen in December are very different to those needed to handle the consequences of Geert Wilders' controversial film on Muslims
- Diplomacy will become more decentralised, with embassies and diplomats acting more independently from head quarters; these days, there is often no time for old-style coordination and hierarchical decision-making

• Diplomats will be more open to the public and the press. We have already seen a tendency for ambassadors to participate in electronic media. Some even act like reporters in the field.

So Carne Ross need not worry that modern diplomats are out of touch. His stereotyped description of diplomacy may be entertaining but it is also unrealistic. Public Diplomacy departments are being established in more and more foreign ministries; it is sometimes surprising which governments accept non-state players as legitimate counterparts. Tomorrow's diplomacy will be different and much more difficult. □

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It's time to scrap ambassadors and their embassies by Carne Ross



KLAVS A. HOLM, Under-Secretary for public diplomacy in the Danish Ministry of Foreign Affairs

British diplomat, Ross should know better than to portray diplomats as old-fashioned stereotypes, swilling champagne while dressed in tuxedos or moustachioed ambassadors attending lavish dinner parties.

Carne Ross need not worry that modern diplomats are out of touch. His stereotyped description of diplomacy may be entertaining but it is also unrealistic

Sir, Carne Ross' attack on old-style diplomats characterises them as obsolete and ill-suited to tackle tomorrow's challenges. He says ambassadors and embassies are out of touch with reality and only in contact with others of their own ilk. Where does he get his information from? Movies like Walt Disney's "The Princess Diaries" or adverts for Ferrero Rocher chocolates? As a former

In fact, modern diplomacy is undergoing dramatic changes to adapt to new working conditions. Diplomats have always tried to maximise the influence of their home countries through contacts with international players who wield real power. Historically, this meant working in the principalities of Europe and the royal courts. For most of the last 150 years, their activities

centred on parliamentary and ministerial power houses. Globalisation and the communications revolution have changed all that. The Internet and emails etc. give non-state players influence over the classic political and diplomatic decision-makers. Today, the international media, non-governmental organisations, multinational businesses, individuals, political

The EU needs to shift gears on greening the transport sector by Peder Jensen



MATTHEW JORDAN-TANK, principal urban transport specialist, European Bank for Reconstruction and Development

Sir, Peder Jensen highlights the growth in carbon emissions from transport in Europe and the inability of policymakers to halt the trend. One problem is the difficulty of calculating carbon reductions from 'green' transport projects, which has meant that only two urban transport

projects have been approved so far (out of over 1,200 registered ones) under the Kyoto Protocol's Clean Development Mechanism. Clearly, both the method of making such calculations and the project approval system need simplifying in the post-Kyoto era. As an alternative, the Green Investment Scheme,

which the EBRD supports under the Multilateral Carbon Credit Fund alongside EIB, offers greater flexibility by allowing host countries a means of channeling excess carbon credits into other climate change projects, such as clean urban transport.

Road pricing proposals should emphasise the broader benefits, rather than focus exclusively on the costs. Pricing projects designed to reduce demand for car travel are only palatable to voters if they also offer people better public transport.

Jensen recommends three main policies to help reduce carbon emissions from transport; demand management measures, more coordinated controls over land use to reduce the need for travel, plus full pricing to use transport networks. These suggestions are well-intentioned, but we must be careful about the way we view such problems as traffic congestion and pollution from cars. There is a real risk that people across Europe will be alienated by a blunt approach in which 'the ends justify the means.' As British policymakers are discovering to their dismay, both the precise transport package and the way it is presented are important to achieve broad public support. In Manchester,

for example, 80% of voters rejected a proposed cordon-based congestion charge in late 2008.

I would offer a few guiding principles to make green urban transport policies more attractive. First, road pricing proposals should emphasise the broader benefits, rather than focus exclusively on the costs. Pricing projects designed to reduce demand for car travel are only palatable to voters if they also offer people better public transport. Treating the two issues in tandem also makes good policy sense, since CO₂ emissions per passenger/km for urban rail transport are just 10% of the equivalent emissions from cars.

Targeted road pricing is vital to achieving 'smart' urban transportation. But over-emphasising these schemes' potential to generate revenue can turn users against the idea. Policymakers should consider making road pricing "revenue neutral" by off-setting other car-related fees and taxes. One third of new revenue can go to roads, one third to public transport and one third to the general public coffers.

As road pricing can be counter-intuitive to users, a successful pilot is likely to help sell the idea, as it did in Stockholm. Drivers are also more likely to accept proposals to charge for using new lanes on a road and

less likely to accept 'free' lanes being converted into 'priced' lanes. The U.S. example of tolls paid on SR-91 in California is instructive.

Active Traffic Management can reduce congestion and emissions significantly. Studies show that more efficient accident response capabilities, using CCTV bundled with other communications systems, the police or specialised emergency response units, can cut traffic delays by 20-40%.

New technologies are also making new solutions more viable. For instance, the fall in the cost of equipment such as Global Positioning Systems opens up a range of options. Pay-As-You-Drive (PAYD) insurance is one very promising method of reducing total travel demand, as is a shift from traditional fuel taxes paid at the pump to mileage-based taxation. PAYD pilots in Europe and the U.S. already show promise. Finally, Active Traffic Management can reduce congestion and emissions significantly. Studies show that more efficient accident response capabilities, using CCTV bundled with other communications systems, the police or specialised emergency response units, can cut traffic delays by 20-40%. □

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Assessing EU membership hopes in the western Balkans

by Erhard Busek



BASTIAAN BELDER MEP,
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Committee
on Foreign Affairs

Sir,
Relations between the European Union and the western Balkans have reached a decisive phase, I was glad to read that Erhard Busek thinks the region is still of great importance to the EU and that the international community did a good job in bringing more stability to these countries. In other respects, though, Busek's message is confusing. He claims the EU gave the western Balkans a clear European perspective and it is now up to these countries to make the next move. I don't deny the importance of local initiatives. But I am afraid that Busek is over-optimistic about the part being played both by Europe and the international community.

The region's enthusiasm for becoming EU members is, in my opinion, paper thin. There is growing scepticism towards further enlargement among the EU's people and political

elites. And the figures in Busek's article show that great swathes of the population in the western Balkans fear the European Commission will not let them in. Personally, I wonder whether the EU really is willing to accept these countries as member states at all. If the door to Europe is genuinely open, then the EU needs to back its official words of welcome with more enthusiastic actions. If entry negotiations are on hold, then I would strongly recommend that the EU institutions say so clearly.

The region's enthusiasm for becoming EU members is, in my opinion, paper thin. There is growing scepticism towards further enlargement among the EU's people and political elites. And the figures in Busek's article show that great swathes of the population in the western Balkans fear the European Commission will not let them in.

I also reject the idea that Europe shares a common vision on the western Balkans. There was no such unity in the past decade and member states' various reactions to Kosovo's declaration of independence

show that divisions continue today. Splits over Bosnia's political future have been plain for years. Thus it is unfair of Busek to say that it's up to the people of Bosnia to decide whether they want to build a new future for their country. It's not that simple.

So what is the best way forward? In the first place, there must be a fresh EU commitment to this forgotten region. Second, European leaders should tell their own people that these countries will become EU members in the short or medium term. For too long, politicians have said one thing at home and another in Brussels. Third, Europe must help the western Balkans in concrete, direct and concentrated ways. I support EU membership for the western Balkans, but only when each country meets the Copenhagen criteria in full. They therefore each need a master plan to prepare them for membership within the framework of the Stabilisation and Association Process. □

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Climate change is now fast outstripping climate policy by Anders Wijkman



EVA BULLING-SCHRÖTER,
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Safety

mean temperature risk causing very large impacts, such as melting the Greenland ice sheet. Second, global greenhouse gas emissions in recent years have been close to the upper limits of projections from the Intergovernmental Panel on Climate Change. Therefore, it is clear that the EU's target of limiting global warming to 20 Celsius is an absolute minimum needed to prevent dangerous climate change.

There is one important facet of climate policies that Wijkman neglects: the social dimension. It is well known that international solidarity will be required to stop certain regions suffering excessively from the uneven pattern of predicted climate changes. However, the social impact is much wider than that. For example, ambitious mitigation measures will only be acceptable if they do not increase the gap between rich and poor people within societies. Everyone needs decent access to power and transport, so low-income households will need protection from the cost of necessary restructuring in the energy and transport sectors. Climate measures must therefore be accompanied by expanded social security

systems. In many ways, combating climate change and seeking social justice are two sides of the same coin. Social justice can no longer be de-coupled from the fight against the ecological crisis. As the anti-globalisation slogan says: "There will be no green peace without social peace, and no social peace without green peace."

Since research in this field is still relatively new, I am very cautious about the prospects of developing successful CCS technologies. I will remain highly sceptical so long as there are doubts about the security of carbon deposits

I support the climate policies and measures proposed by Wijkman with one exception: carbon capture and storage (CCS) in the ground. Since research in this field is still relatively new, and given recent problems with the storage of nuclear waste in Germany, I am very cautious about the prospects of developing successful CCS technologies. I will remain highly sceptical so long as there are doubts about the security of carbon deposits. Unfortunately, energy corporations already

use the promises of CCS to legitimise the construction of new "conventional" coal power plants. Currently, more than 20 such coal and lignite power stations are planned in Germany. Once operational, these plants would stop the country from achieving any

ambitious climate targets for decades to come.

I also think Wijkman might be short-sighted with regard to the relationship between "market failures" and the ecosystem crises. Surely the question is not about market failures, but

whether the forces inherent within the market system - which drive corporations to maximise profits and economies to expand endlessly - can be sustainable at all. □

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How EU policies could address Africa's food security by Gilles Saint-Martin



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Organisation for
Economic Cooperation
and Development

Sir,

As Gilles Saint-Martin rightly says, contrary to popular opinion African agriculture is not universally disaster stricken. That insight is supported by our recent analysis of food production in Cameroon, Ghana and Mali. Since the mid-1980s, a combination of increased yields and more land under cultivation has spurred rises in food production in these countries at rates significantly

faster than population growth. There are other agricultural success stories in Africa too. However, as Saint-Martin also notes, demographic growth outstrips food production in many African countries, worsening the economic and nutritional plight of millions of vulnerable people. And of course, food security is often threatened less by agricultural failure than by political unrest, economic instability and government crises.

Saint-Martin cautions European Union policymakers against rebuilding food stockpiles and selling off surpluses at a discount. We agree that a return to the interventionist agricultural policies of the past would be detrimental both to the long-term interests of poor food-importing countries and EU consumers and taxpayers. The OECD's Producer Support Estimates for 2008 show the

EU has made steady progress for 25 years, reducing both the overall level of farm support and also the proportion of the most market-distorting practices.

We also approve Saint-Martin's backing for additional EU funds to finance food security in developing countries and to promote cooperative agricultural research. However, we are less enthusiastic about his view that Africa needs its own version of the Common Agricultural Policy to "regulate markets and imports." Public investment in agricultural research, education, rural infrastructure etc. is more effective at improving food security than government interventions in the market place. The benefits of free trade must not be sacrificed in the name of enhanced local food production, especially in African countries which are highly dependent on food imports.

We are likewise sceptical about the need for a new global body to "facilitate the management of resources on a global scale [and] regulate arbitrage by speculators." The root of the problem is not market instability and speculative bubbles. Last year's food price spike dramatically increased public awareness of the greater pre-existing problem: that millions of poor and undernourished

people are vulnerable to high food prices.

The search for a sustainable solution to this problem must focus on policies that foster rapid and inclusive economic growth in poor countries. So Saint-Martin is on the right track again when he emphasises the need for EU policies to encourage economic cooperation and trade

integration within Africa. Such cooperation would allow African countries to share experiences on best policy practice and avoid *ad hoc* beggar-thy-neighbour isolationist responses. □

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Turkey's route may be via the Middle East by Sinan Ülgen



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publics of countries located in those regions.

Turkey has been lately doing something that for decades was undermined by the traditional political establishment, namely to develop good relations with Syria, Iran, Northern Iraq, Lebanon and Armenia. Probably for the first time, Turkey has made herself a regional power with a great capacity to transform the Middle East and the Caucasus. Prime Minister Erdogan's visit to Syria in April 2007 to watch a soccer game between the Fenerbahce and Ittihad teams was the kick-off for what we can now call football diplomacy. Similarly, President Gül went to Armenia to pay a visit to his counterpart there. In other words, the ruling Justice and Development Party (AKP) appears to be changing Turkish

foreign policy by challenging a number of deep-rooted taboos. Perhaps what we're seeing is neo-Ottomanism and a relatively more tolerant approach to religion.

Turkey's friendly relations with Middle Eastern countries should never jeopardise those with the EU. Turkey must always ensure that she is politically in tune with the European Union

But Sinan Ülgen has missed two fundamentally important issues that need to be taken into account by the AKP government. The first is that Turkey's friendly relations with Middle Eastern countries should never jeopardise those with the EU. Turkey must always ensure that she is politically in tune with the European Union. And she should

never forget that Middle Eastern countries as well as those of the Caucasus and southwestern Mediterranean countries are likely to opt for developing good relations with a Europeanised Turkey. But neither Prime Minister nor the AKP itself has of late displayed much of a pro-European stance, and the Prime Minister's visit to Brussels in January of this year was marked more by his pro-Hamas and anti-Israeli stance.

This leads me to the second issue. Turkey has recently given its support to the claims of

Hamas vis-à-vis the international community, and has openly condemned Israel for occupying Gaza and killing innocent civilians. The problem here is not its condemnation of Israel, but its explicit defence of Hamas' position. It has become very evident that the pro-Hamas stance of the AKP carries with it the risk of alienating the European public and harming Turkey's EU membership bid. Turkey will do much better with her neighbours if she clearly shows her pro-European stance, and if she is more diplomatic in her dealings with Israel. For my

own part, I am convinced that the main rationale for AKP's Euroscepticism and its pro-Hamas stance is that both were seen by the party elite as electorally attractive, even though the local elections in late March of this year may now have suggested otherwise because they registered a decline in the AKP's support. Turkey's leaders must hand vis-à-vis the European Union by developing friendly relations with her neighbours but without neglecting the EU or alienating Israel. □

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How hubris is leading the EU to its nemesis By Pierre Moscovici



JOHN REDWOOD
MP, member
of the UK
House of
Commons

Sir,
Pierre Moscovici points to the growing gap between the wishes of the people of the European Union and the actions of their governments. The Lisbon treaty was billed as the means to reconnect the EU to the people. But, as widely expected, it turned out to be just another menu of increased powers for the Brussels institutions and even more rules and regulations

for the rest of us. It was an exercise by the political elite for the political elite.

So, unlike Mr. Moscovici, I am not surprised by all the antics over the Lisbon treaty. Voters have repeatedly refused to endorse constitutional change for the Union. Yet the EU's architects – who claim to be democrats – refuse to admit their errors even when the people say No. They continue to drive "their" Union in a direction that voters reject.

I also disagree with Mr. Moscovici's view that Lisbon has created a new instability

in the Union. So long as the architects of the EU can keep member governments on board, they can continue to trundle the great EU locomotive towards ever greater bureaucracy and integration. This is their favoured course because it blurs the lines of accountability and undermines the more brutal aspects of democratic accountability in ways that they find comforting.

I think the EU project will continue because it has so much political will behind it. It will only stop or go into reverse when governments themselves no longer find it convenient – or

if enough people get so angry that they find natural leaders who can challenge this mighty European edifice. I suspect the EU's architects will be clever enough to compromise with their critics and offer enough of them well paid and comfortable jobs so that they can carry on regardless. In which case, they should not expect the people to like them or their institutions. As far as the rest of us are concerned, the EU is like a party to which we're not invited. We never get offered a drink but we still have to foot the bill. We obey the rules, pay the money and curse the way "they" ignore our votes and our values. □

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Sir,
Articles such as Pierre
Moscovici's suggest the time
has come to offer a bold way
out of the European Union's
current impasse. So why not go
for a fully-fledged democratic
United States of Europe as a first
step towards global democracy?
Offering such an easy solution
to a complex problem might

be unpopular in many quarters,
but the authors of the U.S.
Constitution of 1787 had already
resolved the essence of the crisis
presently afflicting the EU. How?
By realising that you need two
parliaments – not one – to bring
together the smaller and larger
components of a federation.

The perennial *quid pro quo* of
European decision-making
since the 1980s would have
been entirely unnecessary
if the EU had been bold
enough to consider creating
a real democratic federation.
The present European
Parliament could become the
future European House of
Representatives, and the present
Council an elected European
Senate. Voting for the House of
Representatives would be based
on population weight, while the
Senate would be composed of
two elected representatives from
each member state. Senators
could hold office for six years,
with one third of them being
elected every two years. With a
clear separation of powers and
an elected European President
at the helm, such a Europe
would gain the democratic
quality of the U.S.

Such political medicine would
be hard to swallow, especially
in countries like France. But
please tell me – why not try it,
after so many debacles since
the 1980s? □

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