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## Counterfactual aid evaluation: when what you see may not be what you're getting

Prowse, Martin; Cabral, Lidia

*Published in:*  
Europe's World

2010

[Link to publication](#)

*Citation for published version (APA):*

Prowse, M., & Cabral, L. (2010). Counterfactual aid evaluation: when what you see may not be what you're getting. *Europe's World*, 140-143.

*Total number of authors:*

2

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# Europe's World

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## EUROPE'S WORLD GLOBAL GOVERNANCE SNAPSHOT

The search is on for 'global governance' solutions to the world's economic and political problems. The trouble is, of course, that there's not much agreement across Europe or around the world on what sort of policy instruments, institutions and rules would open the way to a fairer international system serving the needs of North and South, East and West while avoiding the pitfalls that led to the global crisis.

To take a snapshot of the main areas of agreement and disagreement, *Europe's World* has consulted some 50 leading figures as contributors to this issue's special section on global governance. The opinions they put forward – some in the form of full-length articles, others in shorter comments and others still in their replies to an array of questions – show that while there is consensus in some areas there are strong disagreements that stand in the way of a common European position on global governance, let alone a unified approach amongst the international community.

On the principle of global governance as a credible and effective mechanism, WTO chief Pascal Lamy opens our special section with a warning that coherence and credibility will be major challenges. But he agrees with British expert Iain Begg that Europe's half-century of progressive and enlightened integration gives the EU the experience and authority that could enable Europeans to shape much of the form and content of global governance.

But European consensus on where we go from here is far from certain. About half of the contributors to the special *Europe's World* section constituted a panel representing very different areas of expertise and nationalities who were asked their views on the degree and urgency of reform to existing international institutions –

predominantly the IMF, World Bank and the UN and its agencies – and their answers revealed some wide differences of approach.

More than four-fifths of the panellists want IMF reform, for example, with two-thirds wanting that immediately. But only a quarter or so think the nature of its reform should be 'radical'. The picture was broadly similar for the World Bank and the UN Security Council, and also for the G20 where 70% of our panellists wanted to see reform, but with only 17% envisaging sweeping changes of one sort or another.

The panel was also asked about some of the new global governance mechanisms that have been mooted. Almost four-fifths backed the creation of an international climate change agency, and there were small majorities of 58% and 62% respectively for a carbon tax global coordination authority and an international financial derivatives and hedge funds authority.

The section on global governance highlights different strands of thinking on what is perhaps the most important policy issue of today. But it's also a microcosm of the efforts of *Europe's World* to create healthy and constructive debate on the many policy challenges that face us in Europe and elsewhere.

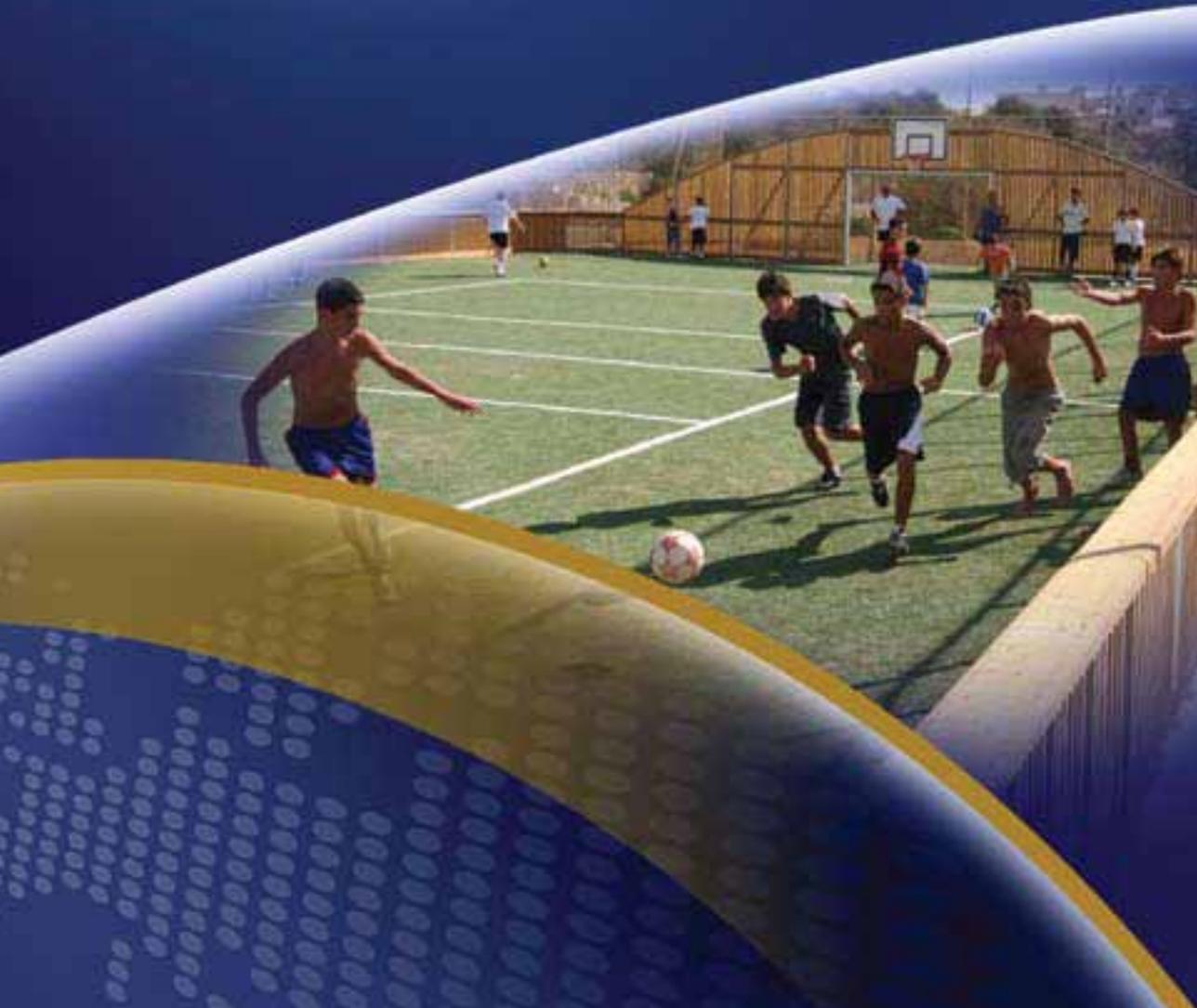


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\*International Energy Agency, "Worldwide Trends in Energy Efficiency," 2008.

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\*\*\*National Science and Technology Council, "Federal Research and Development Agenda for Net-Zero Energy, High-Performance Green Buildings," October 2008.

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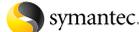
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## The 'Obama effect' has been to lay bare deep transatlantic tensions



Despite Europe's public enthusiasm, Barack Obama's first year in the White House has revealed official dissatisfaction in both the EU and the U.S. over transatlantic relations. **Kurt Volker**, former U.S. ambassador to NATO, sets out his agenda for repairing and strengthening them

President Barack Obama took office in late January 2009, and there can be little doubt that he remains highly popular in Europe a year on. But it is also hard to escape the conclusion that despite the best of intentions on both sides of the Atlantic, there is dissatisfaction with the state of transatlantic relations. One hears criticism from Europeans about a U.S. lack of attention, about engaging with Russia more than with America's own allies, especially in Central Europe, about under-valuing the European Union and about waiting for the Obama Administration to make up its mind on Afghanistan.

*The unrealistic euphoria has given way to a perhaps exaggerated sense of disappointment*

Equally, one hears American frustrations that despite President Obama's investment of time and energy, including several trips to Europe, there has yet to be any substantial increased European investment in joining with the United States to meet global challenges, starting with NATO's top priority, the war in Afghanistan. For many Americans, working with Europe is seen as process-oriented and time-consuming, without delivering real results.

These criticisms are all a bit unfair, but on both sides the unrealistic euphoria of a year ago has given way to a perhaps exaggerated sense of disappointment and bruised feelings.

The more realistic view is that both European and American complaints reflect long-term underlying challenges, and that these have come into sharper focus because it is no longer possible to blame them on the Bush Administration. For one of the major effects of the Obama presidency is that by taking the Bush Administration out of the equation, some uncomfortable truths have been exposed.

First, despite all the rhetoric of European unity and the new Lisbon treaty, there are major policy differences among European nations on some of the most important foreign and security policy issues: Russia, energy and Afghanistan spring to mind, although there are others too.

Second, because of these policy divisions, the advent of the Lisbon treaty, which mostly promises structural and process changes, appears unlikely to make a real difference to Europe's inability to act as a coherent player that is able to make full use of its substantial political, economic and security resources. Where its member states already agree, the new EU "foreign minister" appointed under the treaty will have solid ground on which to act. But on the most important and difficult challenges, EU governments will still hold strongly to their national prerogatives and positions.

The signals from the selection of the EU's new President of the European Council and its High Representative for Foreign and Security policy show that the major European states recognise this. Rather than select well-known, charismatic and strong leaders, EU heads of government instead chose lower key consensus-builders whose role is likely to be that of coordinating

# COMMENTARY

By Vessela Tcherneva

## The truth is that Europe and America have diverging interests

**K**urt Volker propounds two worrying ideas: the first is that for Washington Europe has ceased to be a priority, and the second that different expectations on each side of the Atlantic now make working together very difficult.

Paradoxically, Barack Obama enjoyed support from both Europeans and Americans because both hoped he could solve these two problems. Americans expected Obama to close the gap with their traditional European allies and bring them closer to the U.S. agenda. Europeans welcomed his election because they hoped that he would be more "European" in style and sensibility.

As a recent European Council on Foreign Relations report put it, Europeans tend to believe that if Americans don't share the same position on a global issue it is because they simply don't understand it. Thus bridging disagreements is just a matter of Europe articulating its arguments better. And as Europeans prefer to use soft power instead of military means of war, they genuinely expected Obama to share that preference. Any deviation from that expectation was seen in Europe as a misunderstanding that can still be corrected.

But this European illusion must have evaporated with the last words of President Obama's speech at the Nobel Peace Prize

member states. And rather than putting their best people forward for the foreign minister portfolio, many member states put a higher priority on securing key economic portfolios in the incoming European Commission.

Third, despite the efforts of committed Atlanticists in both the Bush and Obama Administrations, working together with Europe does not in itself seem to be a priority for a United States that must turn its attention to the economy, healthcare, Afghanistan, Iran, Russia and engaging such troublesome actors as North Korea and Burma.

The theory put forward by these Atlanticists, among whom I count myself, is that the U.S. and Europe form a single community that shares core democratic and human values; that we face the same global challenges and to deal with them effectively, the Atlantic partners must work together. But this theory only gains wider acceptance when the U.S.-European partnership actually produces results. It is hard to make the case when results are lacking and Europe is seen to be divided and inward-looking, making only grudging contributions to the common effort.

The "Obama effect" has thus lifted the veil on a host of deep-rooted problems; just because the United States has a different president, global and transatlantic challenges have not gotten any easier – only more visible. And while overcoming these problems should be the task that Europeans and Americans set for themselves, the natural tendency of both will likely be to

exacerbate them. The EU will be drawn toward an extended period of inward-looking institution-building now the Lisbon treaty is in force and a new EU leadership is settling in. The U.S. will be inclined to focus its energies elsewhere – regional crises and rising powers – rather than investing further effort in Europe. Atlanticists on both sides need to work to reverse these trends.

These tendencies can be overcome. Both sides should offer fresh leadership to re-define and re-invigorate an effective U.S.-European strategic partnership. As its first and defining

*Just because the United States has a different president, global and transatlantic challenges have not gotten any easier – only more visible*

leadership team under the Lisbon treaty, Europe's new leaders should surprise critics and assert a strong role, rooted in a values-based, outward-looking concept of the EU as a global actor and strategic partner with the United States. And the Obama Administration has an opportunity to reach out to this new European leadership

with a broader, bolder vision and a fresh commitment to a transatlantic community willing and able to tackle global challenges together.

The key to these efforts will be the setting of an ambitious transatlantic agenda to drive co-operation forward. It should include the following elements:

- **Revamp U.S.-EU structures:** The U.S.-EU relationship has become hidebound by process. The Lisbon treaty brings a chance to start over with new structures and approaches. The relationship should be made more flexible, and inclusive of the U.S. at early

stages, driven by a substantive agenda and focused on joint action. It needs to allow for co-ordination between the U.S. and individual EU member states, as well as the European Union's presidency and Commission. This co-ordination should be part of the whole process of U.S. and EU-decisionmaking, rather than the setting-up of a negotiation between two sides after decisions have already been made (see the new report by Daniel S. Hamilton and Frances G. Burwell, "Shoulder to Shoulder: Forging a Strategic U.S.-EU Partnership").

• **Revive the vision of a Europe whole, free and at peace:** The integration of Central and Eastern Europe into Euro-Atlantic institutions has been one of the great success stories in recent history. Over 100m people now live in freedom, growing prosperity and security. Yet there remain populations in Europe's south and east who do not, and the commitment to further growth of this democratic space in Europe has been flagging on both sides of the Atlantic. We therefore need a renewed commitment to building a democratic, prosperous and secure European continent for all its citizens – including those in Europe's South and East. And to create the incentive for much-needed reforms there, the EU and NATO should reiterate, credibly and strongly, that membership remains open to all European nations who seek it, and meet the rigorous standards of both.

• **Forge a new Transatlantic consensus on dealing with Russia:** As Russia has become more authoritarian at home and more assertive in promoting its "sphere of influence" abroad, Europe is divided between those who seek protection from Russia, and those who seek to entangle it through

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ceremony in December. Speaking of the necessity of Afghanistan as a 'just war', Obama noted: "I understand why war is not popular in many countries, but I also know this: The belief that peace is desirable is rarely enough to achieve it."

Obama badly needs his fellow Americans' support if he is to cope with the economic downturn and all its consequences. His Oslo speech of course addressed the broad international public, but it was mainly directed at mobilising domestic support for his approach to a number of complex crises at a time of America's declining role in an increasingly multi-polar world. Obama has to reassure his voters that he will act with America's partners to tackle a wide spectrum of challenges, and who these partners are is no longer as straightforward as Europe has grown used to thinking. On global finance it is China, on disarmament it is Russia and perhaps on climate the EU. On issues like North Korea, Iran and the Middle East only European countries are relevant.

Europe's inability to understand how America's interests have been diverging with its own is exacerbated by the lack of unity among EU member states, as Kurt Volker emphasises. EU disunity concerns not only transatlantic issues but also the very nature of the transatlantic relationship. A majority of European governments imagine they have a "special relationship" with Washington that affords them a particular advantage, and the trend in Europe towards the re-nationalisation of what had been EU policy areas is enhancing the natural inclination of the U.S. to engage with individual governments rather than communicating with the post-modern, inward-looking European Union.

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engagement. We need the transatlantic community – Western and Central Europe and North America – to make unity their top priority. They should commit to a broadly-based approach to dealing with a more assertive Russia that respects and balances all our different interests and anxieties. A lop-sided strategy – toughness without openness, or engagement without firm principles – would perpetuate a divided transatlantic community and give an incentive for Russia's assertive behaviour to continue.

• **Revitalise NATO:** Just as a strong European Union is a core American interest, a strong NATO must be seen as a core EU interest. Today there is talk of "three NATOs" – one focused on expeditionary roles, one focused on passive territorial defence against existential threats, and one focused on more actively engaging and defending Europe's east. As NATO prepares its new Strategic Concept, these need to merge into a single vision that unites the transatlantic community. To do so requires a true political deal in which the U.S. and Europe face security challenges equally, no matter where they emerge, with America remaining a committed European power and Europe becoming an equal partner with the United States in tackling global security threats.

• **Forge strategic U.S.-European energy co-operation:** The recent U.S.-EU summit decision to launch an Energy Council has the potential to be a major step forward as the shared interests of the U.S. and European economies in having diversified, reliable access to increasingly green sources of energy are overwhelming. Overcoming years of divided efforts, this joint Council should capitalise on our combined market strength, investment capacity and world leadership in technology and innovation. In doing so we can create the conditions where it becomes cost-effective to move away from high-carbon and high-dependency fuels. Increasing our low-carbon energy independence would in turn give weight to an independent, values-based transatlantic foreign policy.

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- **Get Afghanistan and Pakistan right:**

The above agenda can be derailed if we fail in Afghanistan. Failure would be catastrophic for the human rights of the population there, would destabilise Pakistan, increase regional instability and empower Islamist extremism. It would also probably cause the United States to reject the notion that Europe can be an effective global partner, settling instead into the view of Europe as a mere regional player and, in contrast to most other regions, one that requires little U.S. attention. We are already on a dangerous path with European contributions seen by Americans to have been only sparing. Partly as consequence and partly as cause, the United States is taking things more into its own hands. Because the future of transatlantic co-operation depends on it, Europe and the United States must give highest priority to a shared, transatlantic approach on Afghanistan and Pakistan.

President Obama's first year has highlighted the real, underlying challenges to the transatlantic partnership. His second year, and the first year of the new EU leadership armed with the Lisbon treaty, should now be a year of building: What's needed is the deep, architectural work of establishing a stronger U.S.-European strategic partnership with a compelling agenda that will carry us into the future. □

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# COMMENTARY

**Vessela Tcherneva**

This gloomy picture explains Kurt Volker's pessimism about the future of the EU-U.S. relationship. Yet his prescription for remedying matters is not entirely convincing because it presupposes that the issues he lists would have equal priority on both sides of the Atlantic.

America's biggest immediate test will be Afghanistan, and for Europe it will be Russia. And while the U.S. acknowledges the challenge, Europeans still prefer not to face up to the difficulties they have in engaging with Russia. Moscow prefers to build bi-lateral relationships with Berlin, Paris or Rome instead of talking to Brussels, and in Europe some EU member states have been cultivating Russia assiduously. Engaging credibly with Russia, the EU's biggest neighbour, a substantial trading partner and key supplier of energy and other resources will be the Union's greatest foreign policy challenge.

The transatlantic link cannot be a goal in itself when the two partners' agendas no longer overlap sufficiently. Americans will 'reset' their relationship with Russia in line with their broader agenda. Europeans don't really support the war in Afghanistan and will in the future be even less willing to participate in it. And overall, Europe will increasingly have difficulty with being the global partner of a U.S. whose "unipolar moment" as the sole superpower is gone for good. But the marginalisation of the traditional western alliance is still to come. □

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# How the rich OECD nations should handle the emerging giants



A new world is dawning, warns **Patrick Messerlin**, in which the comfortable certainties enjoyed for so long by the world's industrialised countries are to be challenged by the emerging economies. The answer should be for OECD members to improve their own governance and lead by example

There are now stark differences between OECD countries burdened by negative growth along with skyrocketing debt and key emerging economies that are already back to their pre-2008 growth levels. Europeans in particular have to recognise their shrinking weight in relative terms at the IMF, a forum much closer to their finance ministers' heart than the WTO where over the last two decades the Europeans have already suffered from "diminishing giant" syndrome.

In the aftermath of the G20 Pittsburgh Summit last year bruised European and American officials insisted heavily on the fact that G20 membership was imposing "new responsibilities," and they invited policymakers from the emerging giants to be more fully involved in designing a new global economic framework – implicitly suggesting that it has not been the case so far.

Yet the evidence does not support this European and American view. Rather, it suggests that the "core" emerging economies

– Brazil, China, India, Korea and Mexico – have already played a decisive role in two major international economic issues – the world trade regime and the management of the worldwide economic crisis – while the jury is still out on the third one – the global environment.

Few people appear to realise the fundamental contribution of the emerging economies to the success of the current world trade regime, something that has been of great benefit to OECD countries as well as to themselves. During the last three decades, the amazing success of China's trade liberalisation has done much more to convince the other developing countries of the gains from trade than all the OECD countries' exhortations. China has undertaken over the last 20 years a liberalisation process that it took 40 years for the U.S. and Europe to do. And China is the WTO member that has made the deepest liberalisation commitment on services, while Brazil has been decisive in cracking U.S. and EU agricultural protection

and India in raising high the issue of services liberalisation. During key WTO ministerial negotiations in July 2008, Brazil was the most pro-active negotiator. The immediate reasons for the failure of those negotiations are generally attributed to India and the U.S., yet most observers seem to agree that the responsibility of the U.S. was the greater.

On crisis management in the wake of the financial meltdown of autumn 2008, the emerging economies have certainly been as diligent and active as the U.S. and the EU, judging by IMF indicators. The deterioration of the overall fiscal balances of South Korea, China and India has been just as severe as in the larger EU member states. Crisis-related discriminatory measures taken in 2009 by all the main emerging economies other than India and Brazil are comparable to those in the U.S. and throughout the EU. The general levels of government debt forecast for 2014 are better controlled in the core emerging economies than in either the U.S. or the EU. Last but not least, these core emerging economies have abstained from increasing tariffs, and their stimulus packages grant much more limited subsidies to the banking and car sectors than do comparable packages in OECD countries. The exception to this, of course, has been China's dramatic stimulation measures in a dozen or so sectors. But these have been industrial policies, and hence will be a source of severe trouble in the future.

As to the environmental issues and the overall problem of climate change, the positions of the emerging economies were until mid-2009 negative or defensive. But India did much to change the mood when it became pro-active in the climate change

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By Deisy Ventura

## Yes the OECD must get its act together, but these emerging countries don't really need it

Patrick Messerlin thinks that the failure of OECD countries to address pressing issues like trade, the economic crisis and the environment, will have dramatic consequences for the main emerging economies – Brazil, China, India, Korea and Mexico. He even goes so far as to argue that deficiencies among the OECD's members threaten world peace.

These points must surely raise questions about the OECD itself. Is it really the right institutional arena for the world's emerging economic powers? Mexico has been in the OECD since 1994 and Korea since 1995, and the future membership of Brazil, China and India has become an OECD priority, even though their accession still seems like a distant goal. Of the South American countries, small and highly-liberalised Chile was the first to join the organisation, an event that coincided with the coming to power of Chile's first conservative government.

This raises the question; does the prospect of OECD membership exert a positive influence on the governments of would-be member countries? And do these countries really want to become members? By and large, these emerging economic powers are

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debate in the run-up to last December's Copenhagen summit, and then just before the meeting opened China announced a substantial cut in the increase, although not the level, of its emissions. The initial hesitation of most emerging economies on climate change was no great surprise, given that attitudes to these issues depend heavily on income levels; the higher incomes are the more attention environmental issues receive and the stronger public support for solutions. This has been illustrated within Europe itself where the poorer EU member states have opposed the measures being proposed by the richer ones. Where the emerging economies have been more sensitive than OECD countries is on environmental issues like fisheries. At the same time, Brazil has improved its forest and agricultural land management while the U.S. and the EU have been massively subsidising production of environmentally-unfriendly (particularly detrimental to forests) first generation bio-fuels.

So much for the core group of emerging economies. The credentials of other G20 countries like Argentina, Indonesia, South Africa, Russia, Saudi Arabia, South Africa and Turkey has been less convincing. These are countries that have been more hesitant in trade matters, more ambiguous in the instruments they have chosen for managing the crisis, and that are still more reluctant to deal with environmental issues. These attitudes also largely echo their less than convincing economic performances.

The fact that the core emerging economies have already contributed substantially to the shaping of the new global economic framework doesn't mean that they do not

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already introducing the reforms that are needed to join the OECD because that's how to secure their own economic future, not because of any wish to enter the so-called rich man's club. OECD membership could even be considered a prize these countries may receive for making sensible economic adjustments.

Another question raised by Messerlin's article is whether OECD countries can contribute to world peace and to the health of emerging economies. The economic crisis has shown the limitations of the economic models adopted by OECD members. Developing countries and emerging countries are clamouring for markets to be opened because exports to developed states are critical to their economic future. But the crisis has led once-staunch defenders of liberalism – the United States, for instance – to opt for a measure of protectionism.

Because the developed world is finding it so difficult to live up to its own principles, the future of the World Trade Organisation has been put at risk and relations between richer and emerging countries have been further complicated.

Among the coming economic giants, Brazil has emerged the strongest from the crisis. But neither Brazil nor other developing countries have presented an alternative to OECD's development model. All emerging countries are distinguished by deep inequalities in income distribution, which has disastrous consequences for the quality of their institutions. Human rights abuses are common, especially when it comes to economic and social rights, and environmental

still face serious challenges, with the huge income discrepancies between themselves and the rich countries endangering their own long-term growth and political stability. This could yet impair their future involvement in the G20 process. Those of the emerging economies that have democratic political systems are too often confronted, just like OECD countries, by the "iron law of tiny majorities" – when governments have to rely on very small majorities which greatly complicate the taking of hard decisions. Non-democratic emerging economies are in no better shape, as is illustrated by the factionalism among China's policymakers, where there are those who support rural versus coastal provinces, and market-based reforms versus state-control. This factionalism has so far prevented China from making progress on subjecting the yuan to market forces, has fragmented China's overall stimulus package into sectoral industrial policies and is forcing Chinese people to keep high saving rates for covering health and retirement expenses. All of this is making more difficult the much-needed "rebalancing" of the Chinese economy towards more domestically-based growth.

In this context, what actions should the OECD countries envisage? It is fashionable these days to look to stricter international rules as "the solution", but that's not a strategy well-suited to times like ours that are dominated by an on-going shift of the tectonic plates in international economic relations. The combined emergence of new world powers with the diminishing influence of the current powers is not propitious for stricter disciplines. The world's rising powers will increasingly be

dis-inclined to accept disciplines that they see as American or European tutelage. At the same time, they themselves are still far from being able either to exert leadership or introduce more discipline.

This means that the OECD countries will have to lead by example. When reforming their own domestic regulatory frameworks, they should avoid any dramatic swings away from allegedly "rational markets" to allegedly rational governments. Rather they should improve the quality of regulation along with enforcement and monitoring. These are things that were largely taken for granted throughout the last decade, but as the crisis revealed were far from adequate. As regulating is a form of competition between governments, focusing on improved regulation looks increasingly like the best channel of influence available to OECD countries.

What, in concrete terms, would such an approach mean? In trade matters, OECD countries should keep their markets open, and open those that are still closed – in agriculture (crucial to the sustained growth of emerging economies like Argentina, Brazil or Indonesia) or in services (crucial for countries like India or Korea). Above all, these areas hold the key to generating more domestically-based growth in all the emerging economies. All of this implies the much stronger support of OECD countries, and especially the U.S., for a successful conclusion of the Doha Round.

The OECD countries' crisis management has demonstrated a number of macroeconomic flaws, lax debt policies for instance, that have been amply underlined by the IMF. But there

are equally severe microeconomic flaws that so far have been barely noticed, including over generous and largely uncontrolled subsidies to the banking and car sectors. Stern action in these areas needs to be taken by OECD countries as a matter of emergency.

Climate change also requires the strong involvement of OECD countries. Once the dust of the Copenhagen conference has begun to settle they should make concrete trend commitments to substantial financial transfers to the poorest of the emerging economies. They should also be very careful when choosing the instruments they will use; carbon taxes for instance are much more friendly to world trade, being similar to value added taxes, than cap-and-trade policies which are prone to discrimination of all kinds and so are potentially protectionist.

This year, Korea – one of the best performers during the global crisis – will hold the G20 chair, so giving strong support to Korea's initiatives offers a splendid opportunity for the OECD countries to show that while they can still be proud of today's slowly disappearing post-WWII world, because it has been the source of remarkable progress, they also do not fear the new world that is emerging. □

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**Deisy Ventura**

issues don't receive the attention they deserve. Although projects like biofuel development in Brazil have been broadly welcomed, they are a drop in the ocean when set against the environmental devastation that takes place in these countries. The northern hemisphere's timidity at Copenhagen has done little to settle this matter. But the greatest common weakness of both emerging and developed countries is their failure to make sustainable development a reality. □

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# What Europe can do to secure a deal with Iran



Economic sanctions against Iran have so far had little impact on the Iranian government's nuclear enrichment strategy, admits former U.S. official **Matt Levitt** who helped design them. But he argues that greater EU efforts to put pressure on Tehran could bring real results

Against the backdrop of the Iranian government's continuing crackdown on its critics, Western powers are preparing for a fourth round of multilateral sanctions and other measures in the hopes of persuading Tehran to alter course on its controversial uranium enrichment policy. But even with Russia now apparently on board, will more sanctions work? And is there a specifically European role to be played in such a strategy?

There is convincing new evidence that the Islamic Republic has continued pursuing a secret nuclear weapons programme in defiance of the International Atomic Energy Agency (IAEA) and UN Security Council resolutions. Last September, the United States and some European allies exposed a new secret enrichment facility near Qom which, according to a recent IAEA report, suggested Iran may have additional secret sites. Iran acknowledged building "contingency centres" like the Qom facility in response to "the augmentation of the threats of military attacks

against Iran." In December, *The Times* of London reported that Tehran had been working on a triggering device for a nuclear bomb. Iran responded by test firing the Sajjil-2, the latest version of its 1,200 mile range missile that brings south eastern Europe within range.

Targeted financial measures have, of course, so far not stopped Iran from pursuing its nuclear programme. But sanctions were never intended to do so. As a former U.S. Treasury official who was involved in crafting the campaign of targeted financial measures aimed at Iran, I know that sanctions are no silver bullet. On their own they can only do so much, but coupled with such other tools as robust diplomacy and a credible military presence in the region, financial measures can create diplomatic leverage that should also focus on Russia, China, the Gulf States and America's European and Asian allies.

Sanctions can help to accomplish three goals; to disrupt Iran's illicit activities; to deter third parties from either knowingly

or unintentionally facilitating Iran's illicit activities; and to make Iran re-consider these activities. This last involves convincing the revolutionary and unelected leadership that the nuclear programme is a threat to regime survival, not a guarantee of that.

But negotiation and diplomacy alone will not convince Iran to abandon its nuclear programme. The EU could therefore become a critically important player. In the first place, the EU can continue to actively seek international consensus on multilateral sanctions through the UN to be implemented in 2010 now the unofficial 2009 deadline for diplomatic progress with Iran has expired. As important as the entities to be listed will be the unanimity of the decision to impose sanctions, so it is vital that the EU should engage in robust diplomatic discussions with China and Russia to develop consensus over sanctions with teeth. These should focus on entities engaged in illicit conduct in support of Iran's proliferation programme, in particular those, such as Bank Mellat and Bank Melli, already designated by the U.S. These would follow up on the warnings in UN Security Council Resolution 1803 calling on member states to exercise vigilance over the activities of financial institutions in their territories with all banks domiciled in Iran (Bank Melli and Bank Saderat were singled out specifically), and their branches and subsidiaries abroad.

Together with the US, the EU could press the international community to follow up

on the U.S. and EU designations of the Khatam al-Anbya construction company, which is one of the most significant of the entities owned or operated by Iran's Islamic Revolutionary Guards Corps (IRGC) so far targeted. With the increased militarisation of the Iranian regime, and the abuses of the IRGC-affiliated Basij militia, now is the time to target IRGC affiliates. Many of the IRGC entities involved in the regime's nuclear and missile programmes and that give their support to international terrorism are also involved in the violent suppression of political protests at home. This makes the IRGC a possible target of Iranian public resentment and increases the likelihood that the Iranian public will blame the regime rather than the West for tightened sanctions.

*Sanctions can help to accomplish three goals; to disrupt Iran's illicit activities; to deter third parties from facilitating Iran's illicit activities; and to make Iran re-consider these activities*

The EU could both add to its own list and press for inclusion on the UN list Iran's national maritime carrier, the Islamic Republic of Iran Shipping Lines (IRISL), which the U.S. accused back in September 2008 of being involved in illicit commerce. The State Department noted at that time that the IRISL had already been identified by the UN Security Council as being engaged in "proliferation shipments." The IRISL has also been implicated in shipping arms to terrorist groups, as in the January 2008 seizure of the Monchegorsk, an IRISL-chartered ship bound for Syria with components for mortars together with powder, propellant, and shell casings for 125mm and 130mm guns. Dutch customs automatically label merchandise shipped by IRISL or Iran Air

at the highest risk category and inspect the cargo, and the UK government has banned British companies from doing business with the Iranian shipping line.

But multilateral action is difficult to achieve and can often lead to lowest common denominator decisionmaking. In parallel to demands for robust action at the United Nations, the EU and U.S. should pursue financial sanctions focused on IRGC-affiliates and all other individuals and institutions involved in Iran's illicit activities.

Another promising area where the EU could take the lead would be to actively support the efforts of multilateral bodies like the Paris-based Financial Action Task Force (FATF), which has issued a series of

increasingly blunt warnings about doing business with Iran. The FATF is a 34-member organisation seeking global standards against money laundering and terrorism financing. The FATF has repeatedly warned about Iran and has instructed member countries to develop "counter-measures" to deal with its illicit financial activities.

There is an EU role, too, in the area of informal sanctions. This would amount to little more than leveraging market forces. EU governments' engagement with the private sector by drawing attention to the risks of doing business with Iranian entities engaged in illicit conduct would have a significant impact. Already denied access to U.S. dollar accounts, an EU ban on Iranian banks doing business in euros would have

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serious consequences for Iran, especially coming hard on the heels of the latest U.S. government fine of a European bank, a record \$536m penalty imposed on Credit Suisse for engaging in the illicit facilitation of Iranian banking transactions.

This sort of outreach should be expanded beyond the banking sector to insurance, shipping, and other industries. Even in today's economy, and to a certain extent because of it, the private sector is very sensitive to reputational risk and is acutely aware of its due diligence and fiduciary obligations to its shareholders. As one European diplomat put it, "what the EU needs to look at is measures that restrict the Iranian banking sector from accessing the European financial sector, transferring money out and holding back accounts." This would have a severe impact on Iran, but would first have to overcome countries' competing trade interests.

Iran is desperate for Western technology, and Europe is a key market. The EU could play a critical role in denying Iran access to key technologies like the know-how to liquefy natural gas, and in developing a more systematic approach to dealing with Tehran's efforts to transfer technology and arms to radical allies in the Middle East. The EU could expand its current policy banning the sale or transfer to Iran of "all arms and related material, as well as the provision of related assistance, investment and services" to include a ban

on the purchase or transfer from Iran of the same. The EU and US could also encourage countries to require ports and/or authorities to collect detailed, accurate, and complete data regarding all cargo being shipped to or through their countries (especially from risk-prone jurisdictions like Iran), to conduct rigorous risk assessments, and to proceed with actual inspections as necessary.

*There is an EU role, too, in the area of informal sanctions. This would amount to little more than leveraging market forces. An EU ban on Iranian banks doing business in euros would have serious consequences for Iran*

Given the rapid progress Iran is making on its nuclear programme, it may be time to consider more drastic and less targeted measures. Secretary of State Hillary Clinton has spoken about the possibility of inflicting "crippling sanctions" on Iran. One promising avenue is Iran's reliance on foreign-refined petroleum. Insufficient refining capacity means Iran re-imports 25-40% of its needs from refineries abroad. Targeting this could be a powerful tool, with the precedent being the dramatic failure of the regime's

gas ration card programme in June 2007. The cards were loaded with a six month ration, but many Iranians reportedly used up their entire ration within weeks. Actions like targeting Iran's access to refined petroleum are more likely than confrontation to eventually convince the regime that the bomb is more of a liability than an asset. □

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# SECURITY AND DEFENCE

## It's high time the EU and NATO worked shoulder to shoulder



Afghanistan and Kosovo are worrying examples of the inefficiencies created by the impasse in relations between the EU and NATO. **Soren Gade Jensen**, Denmark's Defence Minister, makes the case for improved co-operation between the two, leading to a more effective and comprehensive approach

The security threats of today's globalised world are too complex to be handled by any one nation, or even by a single international organisation. International terrorism, the proliferation of weapons of mass destruction, failed states and fragile ones, the consequences of climate change, and cyber attacks all require closer co-operation and an armoury of civil and military responses. Effective multilateral co-operation is going to be in great demand.

Almost 116,000 people at present serve in 17 peacekeeping operations led by the UN, which is an eightfold increase in UN peacekeepers since 1999. The UN is tightly stretched, and increasingly is turning towards other organisations for co-operation, just as was intended in the UN Charter.

The EU and NATO are among the important actors, but unfortunately the relationship between the two has too often been seen as a zero-sum game – what's good for one is bad for the other – and to some extent that's still the case. Yet rational analysis shows that this is nonsense. The EU and NATO relationship should instead be seen as a win-win endeavour, in which co-operation benefits both organisations.

Although both the EU and NATO have achieved important steps forward in recent years, there is still a surprising need to explain why a close relationship between them is so necessary. It seems obvious to me that closer EU and NATO co-operation is vital if we are to more effectively address today's security threats and conduct effective crisis management operations.

The consequence of the current impasse in the relations between EU and NATO is that resources are not used in the best possible way. Yet 21 nations are members of both organisations and all their members have common objectives and share the same values.

The sensitivities the relationship suffers from are well-known. But the strong support given by the U.S. to making the EU's Common Security and Defence Policy (CSDP) more capable, combined with France's reintegration into NATO, and now the Lisbon treaty, add more ingredients to a political recipe that could lead to improved EU-NATO co-operation. Now is the time for a fresh start.

In many of the peace support operations being conducted around the world, we have seen a shift towards more robust military engagements in unstable environments, and also an increasing number of multi-faceted and hybrid operations where military and civilian capabilities are being deployed at the same time. It has become very clear that military capability is far from offering the only solution to many of the crises we now face. You may win a war with military means, but you cannot win the peace.

To obtain positive results in the shortest possible time, military efforts need to be embedded in an overall strategy which also spans political, diplomatic, civilian, humanitarian, and development efforts. This comprehensive approach is what is needed, and will continue to be a Danish priority.

Working together, the EU and NATO could – along with UN, the African Union and others – contribute efficiently to the application of a genuine comprehensive approach. So far, the

practical implementation of the comprehensive approach has primarily focused on the interaction on the ground between military units, civilian experts and humanitarian organisations. Experience has shown that there is a need for a more integrated approach on a political level as well as on an operational planning level. Military and civilian engagements should be planned and carried out in a much more synchronised and dynamic manner, rather than in a coordinated, but sequential and separate way.

Enhancing the EU-NATO relationship would be a very important element in taking the whole concept of the comprehensive approach much further than has been the case so far. But the unfortunate reality is that a lack of clarity surrounds both organisations' co-operation mechanisms. This is especially true of situations where the EU is engaged with a civilian mission in an area where NATO is conducting military operations, at present Afghanistan and Kosovo. This lack of clarity limits possibilities for efficient co-operation, and thus the prospect of a more comprehensive approach.

We face many challenges in Afghanistan. Most EU and NATO countries are contributing military forces to the ISAF mission. It is a tough job being carried out under strenuous conditions. A crucial part of the comprehensive approach in Afghanistan is to build up and strengthen the capacity of the Afghan security forces and institutions. Without law and order Afghanistan will not be stable and without stability there can be no development.

The potential for EU and NATO co-operation in Afghanistan is obvious. Afghanistan is in many ways a test case for EU-NATO co-operation on the ground. That means we have to cooperate wherever and whenever conditions necessitate it

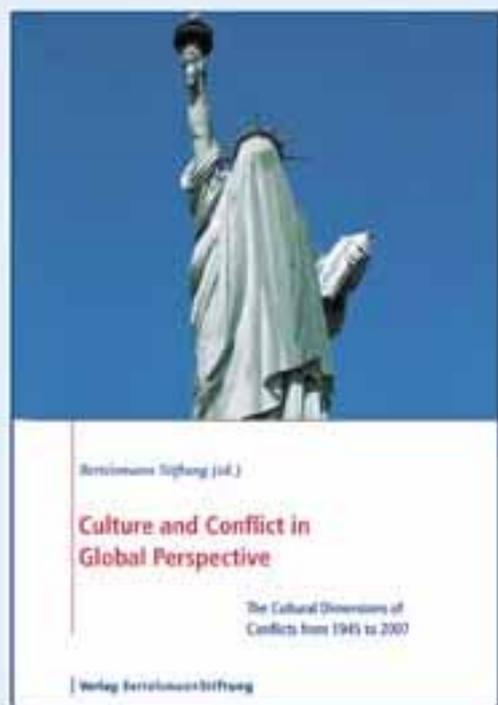
# Culture and Conflict in Global Perspective

Has Samuel Huntington's prophecy of a "clash of civilizations" in the post-Cold War era become true? Events such as 9/11 2001 or the crisis due to caricatures of Mohammed might suggest it has. The topic of culture and conflict has been the subject of fierce debate among scholars and the public alike over the last two decades.

The Bertelsmann Stiftung, which has been committed to promoting international cultural dialogue for many years now, is publishing "Culture and Conflict in Global Perspective", a theoretically-informed definition of cultural conflicts and a worldwide mapping of such conflicts between 1945 and 2007.

The publication is based on an empirical study that explores in what conflicts cultural factors played a role and to what extent they influenced the intensity of violence in the respective conflicts.

With contributions by renowned experts such as Aurel Croissant, Uwe Wagschal, Nicolas Schwank and Christoph Trinn.



*Bertelsmann Stiftung (ed.)*  
**Culture and Conflict in  
Global Perspective**  
The Cultural Dimensions of  
Conflicts from 1945 to 2007

2010, 98 pages, paperback  
€ 18,00 [D]  
ISBN 978-3-86793-058-1

and when it makes sense – not just where we find it convenient. The EU and NATO urgently need to improve their co-operation in Afghanistan because results on the ground will improve the chances of long-term success, and will at the same time strengthen the transatlantic dialogue.

The political choices open to European nations should never be reduced to being between the EU and NATO. We need both organisations. NATO is the cornerstone of our collective defence, and is also a forum for transatlantic dialogue, a framework for international operations and a driver for Europe's defence transformation. At the same time, the EU has emerged as a serious security actor, not just regionally but also globally. The EU has proven its value in a number of civilian and military operations, and I expect it to further develop its military and civilian crisis management capabilities in the years ahead. With the UN's increased "outsourcing" of peacekeeping missions to regional organisations, the demand for EU crisis management tools will surely increase. The bottom line is that the EU as well as NATO will continue to be an essential framework for international crisis management operations. Combining the tools at the disposal of the EU and NATO would open the way to truly efficient multilateral co-operation in these operations.

We cannot disregard the well-known sensitivities that exist in the EU-NATO relationship. We have to do much more to move ahead and break the current stalemate. We owe it to the men and woman who already contribute so much effort to existing EU and NATO operations. They risk their lives to help alleviate critical situations in hotspots and crisis zones around the world, and their tasks

could be made a little easier if we were to take a number of practical initiatives.

We should promote and pursue initiatives in the area of synchronised defence planning. A synchronised and parallel planning process in the two organisations would be an advantage for member states in their national planning processes. It would also bring greater clarity as to what resources are actually available for either EU or NATO operations. We cannot disregard the fact that we only have one set of forces.

We should also pursue initiatives for the common acquisition of equipment where there are critical shortfalls. The financial and economic crisis has seen cuts in the defence budgets of many European countries, so resources are increasingly scarce, and capacities like transport helicopters are very expensive. Multinational solutions are an important tool for overcoming these critical shortfalls in both current and future operations. Why do the same job at the same time in two different organisations, when 21 nations are members of both? The EU-NATO Capability Group offers a very good platform for enhancing this.

There is an obvious room for improving EU-NATO relations and co-operation. The steps needed to do so can be pragmatic, informal or *ad hoc*. It is not so much a question of launching yet another initiative, it is about political will. We Europeans need to generate the political will needed to ensure the relationship between EU and NATO better matches the security realities of the 21<sup>st</sup> century. □

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# How governments should compensate for defence spending cuts



Most European governments cut their defence budgets last year, intensifying fears that the EU's military outreach, and thus the goals of the European Security and Defence policy (ESDP), will be seriously weakened. The European Defence Agency's **Dick Zandee** puts his case for a revolutionary approach to defence co-operation

At first it was called a "peace dividend", but now it's seen as a very real problem. In the years following the end of the cold war, European defence budgets shrunk alarmingly. Only in recent years have they begun to stabilise, with some national defence budgets even showing small increases as the result of political support for military campaigns in the Balkans, Africa and the Middle East. The EU's member states together spent €193bn on defence in 2005, €201bn in 2006, €204bn in 2007 and €200bn in 2008.

But in the fall-out from the global financial crisis, many European defence ministers are once again having to slash spending. The impact of these cuts will be felt over the next few years when European governments are forced to delay

equipment procurement and reduce the numbers of military personnel they send on foreign missions.

*European governments that have already scaled-back on military spending have so far failed to co-ordinate these measures on an international basis*

Defence ministers are going to have to contend with some uncomfortable facts. Defence inflation goes up faster than normal inflation, and one factor that contributes to this is the price of military equipment, which each year will cost 5-10% more than the previous year. Military deployments are in any case very expensive, with the average expenditure for, say, a Finnish soldier deployed in KFOR in Kosovo running at about €95,000 for a six month deployment period, and for the EUFOR operation in Chad the comparable bill goes up to €250,000 per soldier. The 1,800 Dutch troops in NATO's International Security Assistance

Force (ISAF) operation in Afghanistan cost twice what they did four years ago. All in all, modern missions cost far more than peacekeeping missions of the past. Last year France had to spend an extra €260m in its missions to address urgent operational requirements. This was double what it spent the year before, and five times more than in 2007, meaning that most probably it will have either to cancel or postpone military spending in the future.

In the face of defence spending cuts, how can European countries best maintain their military capabilities? Those European governments that have already scaled-back on military spending have so far failed to co-ordinate these measures on an international basis. Their cuts have also been very uneven, so that some governments greatly reduced certain services, but left others intact. The Danes, for instance, gave up their submarines while the Dutch sacrificed their maritime patrol aircraft. But the bottom line is that with less money available, the only way European countries can maintain if not improve their military capabilities is by setting priorities together.

Last year EU member states set 12 priorities aimed at addressing shortfalls in aircraft equipment and at assuring supplies of the devices needed to deal with roadside bombs and shoulder-fired missiles. But these priorities can only be achieved if European governments put an end to nationally-focused policies that are wasting

money through unnecessary duplication. More standardisation is needed and we must encourage Europe's very different national military systems to work together.

The figures speak for themselves; there are still four main battle tanks in the EU, seven different attack helicopters and 23 types of armoured fighting vehicle. Sixteen naval shipyards produce an assortment of frigates, submarines and other equipment, whereas only three shipyards supply the United States Navy. In Europe, 80% of defence investment is spent with national suppliers.

*Co-operation  
between EU  
countries should  
not be limited just  
to procurement as  
countries also need  
to pool and share  
their resources*

To address the fragmentation of defence spending in Europe, co-operation between EU countries should become the rule rather than the exception. And this co-operation should not be limited just to procurement as countries also need to pool and share their resources. The European Defence Agency's project for a European Air Transport Fleet is now looking at how to pool training and logistics as well as procurement, how to exchange flight hours and how to make aircraft available to others. Role-specialisation and task-sharing have long been taboo, but are now increasingly necessary for more and more countries. Multinational co-operation between clusters of European countries is now addressing this problem. Nordic countries have shown the way, with Norway and Sweden having already aligned their military education, training, procurement and other investments and

with Finland and Denmark now joining the effort. The establishment of the 'European Air Transport Command' by Belgium, Germany, France, Luxembourg and the Netherlands is another example of European defence collaboration. From 2010 onwards the Education Agent Training Course will replace five separate national commands – saving costs and improving air transport aircraft.

We should also encourage further collaboration between military bodies and civilian bodies. Terrorism now poses Europe's greatest security threat and the traditional separation between

external and internal security is no longer relevant. Illegal immigration, drug trafficking, environmental challenges and the disruption of energy flows are at the top of Europe's homeland security agenda. The three pillar EU structure created by the Maastricht treaty in the aftermath of the Cold War was out of touch with these issues. But now of course all that is at an end with the introduction of the Lisbon treaty and Catherine Ashton's new role as High Representative for the Common Foreign and Security Policy, as well as Vice-President of the Commission and head of the European Defence Agency.

## EUROPE'S WORLD BACKGROUND BRIEFING

### The cuts are deep, and going deeper

The defence budgets of EU member states were cut sharply in 2009 and analysts predict that the cuts will go deeper still. The U.S., the UK and France were the only NATO countries that met their minimum of 2% defence spending pledges as they respectively spent 4.7%, 2.9% and 2.3% of their GDPs on defence last year. That meant a one percent drop in spending for the U.S. but a 4.7% increase in spending for the UK and a 5.4% increase for France.

Most European countries slashed their defence budgets last year. Italy and Spain made cuts of 6.9% and 3.9% respectively, which was more or less the norm among European countries. These widespread defence spending cuts threaten dire consequences as European defence capabilities lag far behind those of the U.S., with complaints about sub-standard weapons, communications and transport equipment already becoming more and more commonplace. Countries new to NATO like Latvia, Lithuania, Bulgaria, Romania and Poland are left most vulnerable by recent cuts because they

are ill-equipped for a global security environment that requires investment in modern body armour, night vision equipment and mine resistant armoured vehicles. The heavy weaponry of the Cold War era is no longer of much use. Yet these countries are either unable or unwilling make the spending commitments needed. Last year, Lithuania's defence budget was 1.16% of GDP, down 6.7% on the previous year, and Poland's defence budget was trimmed by 5%.

European countries last year spent \$280bn on defence, compared to the \$738bn spent by the U.S. On paper, Europe boasts more personnel in active duty (1,536,274) than the U.S. (1,445,000), but in reality only a small number of European troops can be used effectively and few can be deployed to combat zones. The EU's Nordic Battlegroup, for instance, couldn't take part as planned in the EUFOR mission to Chad in 2007, and the mission itself was so under-resourced that EU forces had to fall back on using Russian helicopters. □

Thanks to the Lisbon treaty the Commission will find it easier to synchronise research investment projects like Software Defined Radio and Unmanned Aerial Vehicles; this is because under the European Co-operation Framework for Security and Defence this can be done on a more systematic basis. Each project can now be monitored by the EDA, the Commission and the European Space Agency, and this will ensure that taxpayer's money isn't spent twice. Another advantage will be that civilian and military communities collaborate more, and as their interaction increases they won't be needed as much in conflict zones and across Europe.

But cross-pillar co-operation should not be limited to investment in technology. A variety of national and international initiatives have been taken in the area of maritime surveillance, but most lack co-ordination. Last November, the Council decided to aim for an integrated approach to maritime surveillance that would involve both civil and defence actors. This directive should work more effectively across pillars, agencies and national borders than previous efforts. For too long civil-military co-ordination has been a buzz-word in Europe but no more than that, so now is the time to turn it into a practical reality.

In today's world of multiplying security threats, the coming decades will be critical to Europe's defence capabilities. Even when we emerge from the economic crisis our resources will be constrained, so European nations will have no choice but to co-operate more

fully. While a "European Army" is an unattainable goal, European defence co-operation should aim at pooling, sharing and even integrating military means. EU member states need to join together in small groups to invest in military equipment, and we should avoid creating any core groups that exclude others. The EU's member states can perform a lot better on defence if they spend their scant resources wisely, but this means collaborating. □

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# Only a European re-think can tackle home-grown terrorism



There's no conflict between the freedom of the individual and the demands of public security says **Thomas de Maizière**, Germany's Interior Minister. What's needed is new thinking on how to prevent the radicalisation of young people in Europe's Muslim communities

Islamist terrorism has in recent years become central to security policy in Germany and many other Western countries. The terrorists' intention is to sow mistrust and stoke fears; their aim is to weaken the democratic rule of law and to shatter citizens' trust in our society. On our side, we are determined not to let this happen, but the reality is that frequent terror alerts do not help because they tend to increase rather than reduce insecurity among the population.

The debates across Europe on new security laws to fight terrorism have sometimes created the false image that states threaten rather than protect the freedom of their citizens. Frequently, it is assumed that there is a conflict between freedom and public security; even though in fact but there is none.

Freedom and public security are not irreconcilable opposites. They complement and even depend on one another. Public security is a pre-requisite for the unfolding of freedom; and protecting freedom is at the core of a state's responsibility for public security.

*New security laws to fight terrorism have sometimes created the false image that states threaten rather than protect the freedom of their citizens*

A state's monopoly on the use of power is justified if citizens can rely on the state to provide for their security. But this does not imply that we need ever newer security laws. The prevention of threats, along with law enforcement that involves the prosecution of offenders, are crucial responsibilities, but they do not demand as a

pre-requisite the adoption of new laws.

Of course security authorities need suitable instruments to fight terrorism. First as terrorists take advantage of new

technologies, the legal and technical means of security authorities must also be adapted. State intervention is right and important, but terrorism cannot be fought by the security authorities alone.

Prevention is better than repression. We should do everything in our power to avoid radicalisation, to interrupt radicalisation processes at an early stage and to guide radicalised persons back to our society and values. An important task in the years ahead will be to erode the foundations of terrorism, and this requires a commitment by everyone.

Western countries face a worsening problem of home-grown terrorism. Despite some of the more visible signs that may exist, society at large is often unaware of this radicalisation process. This is where we need to step in, and that means we need to find answers to three questions. First: Where and how do people become radicalised? Second: Why are they attracted to radical ideas? Third: What can we do against it?

In Germany, radicalisation takes place to a large extent through radical mosque communities or private prayer rooms, and also through the internet. State surveillance is one possible counter-measure, and is used, but it is just as important to work closely with the Muslim population.

The signs of radicalisation can be spotted much earlier at local level than by the security authorities. Parents, friends or even the Imam must be persuaded that they will be acting responsibly if they decide to contact the relevant state agencies in such cases. Doing so is not about denunciation

# COMMENTARY

By Hugo MacPherson

## Nothing wrong with strategies, but it's local-level work that pays off

Thomas de Maizière outlines three factors he thinks essential to a re-think of the home-grown terrorism threat in Europe.

He emphasises preventative and community-based approaches because by looking at the root causes of how and why some people are radicalised we can perhaps intervene earlier. He also calls for Muslim communities to accept special responsibility for fighting Islamist extremism, and lastly he says closer East-West and intra-European co-operation is key.

But this looks more like a wish list than a game plan. Reams of research have already explored why people are radicalised, and they've found that no "profile" of potential terrorists exists. That makes identifying people who are vulnerable to radicalisation very difficult.

The community-based approach that de Maizière suggests is a good start. Work is now underway in the UK to raise awareness of the myriad factors that can lead to radicalisation with local political leaders, police, teachers and youth workers all increasingly aware they have a part to play in recognising the early signs of radicalisation.

These are delicate relationships that can only be built up over time, so a vital ingredient for any counter-terrorism effort is gaining the support of Muslim communities.

but rather it is about helping these (usually) young people find their way back into society.

The state can nevertheless do much to provide support. The security authorities are responsible for monitoring the more visible signs of radicalisation, and other state agencies can help potential terrorism recruits to leave the extremist environment and become reintegrated in society. Nothing, though, can replace the support and help of these young peoples' immediate environments.

The second question – why are some people attracted to radical ideas? – has been thoroughly explored both by researchers and security practitioners, who generally agree that people are more inclined to

accept radical ideologies if they do not feel part of society. This is especially true of young people who feel excluded, and who have experienced real or even just imagined discrimination. When they lack attractive social or professional prospects, they often think they could find a new and more welcoming home within a radical group.

Society's task is therefore to give them a feeling of belonging, and to offer them a more enticing perspective on life. And that means a new sense of commitment by civil society as a whole. Social cohesion must become more than a mere catchword. Our society needs to engender a greater respect and acknowledgement of others. It needs to acquire more knowledge about different cultures and religions. And it needs to create

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a tightly-knit network of personal relations between the members of different social and religious groups. These are the essential ingredients of a new effort to overcome and eventually prevent prejudice.

It is equally important that our citizens should consider it their duty to commit themselves to the principles of liberal democracy. It is everyone's task to actively counter extremism and speak out on radical statements, whether in the public or private sphere.

Muslims have a particular responsibility as regards the fight against Islamist extremism. Within their own communities, or in social frameworks such as youth work, they have the opportunities that others do not. Non-Muslims rarely have much contact with Muslims who are in the process of becoming radicalised, and in any case their arguments would not be so well received.

The UK and the Netherlands in particular have notched up a number of very positive civic engagement projects involving Muslims, and we in Germany intend to make use of the experience that has been gained by facilitating and supporting similar contacts with Muslim groups.

Another element of preventive counter-terrorism that is essential is that Europe and the Western world as a whole should cooperate much more closely with key Muslim countries. We need Turkey, Saudi Arabia, Afghanistan, Pakistan and the Maghreb countries as partners in the fight against Islamist terrorism, and that in turn means improved operational co-operation between security authorities. These countries

# COMMENTARY

By Hugo MacPherson

Any suspicions of "government spying" on young Muslims or perceptions of a culture of Islamophobia are likely to see Muslim community leaders rejecting the idea of joining forces to tackle the threat. Even a soft approach is better than nothing, because no counter-radicalisation effort can survive without support from the Muslim communities.

Governments have to shoulder some of the blame for the phenomenon of home-grown terrorism. Research suggests that perceptions of neo-colonialist foreign policies of some EU countries have helped the radicalisers' recruitment of young people. But it's forging partnerships outside Europe that is going to be equally important, even if fraught with complications.

Working alongside countries like Saudi Arabia and Pakistan doesn't automatically yield high-quality intelligence and a greater understanding of the terrorist threat. These countries are often slow to identify extremist groups operating within their borders, and they also tend to be powerless to stop them. But it's also true that radical groups from these countries do sometimes influence Europe's young people, especially through the internet, so we should be investing more in technological methods to combat these on-line threats.

The bulk of radicalisation nevertheless still takes place among young people through personal relationships based on face-to-face contacts. If home-grown terrorism is to be an important focus of our security efforts, then home is where we must start. Al-Qaeda-inspired terrorists thrive on the way we

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have a clear interest in maintaining their own stability, and that means they should be anxious to allow terrorist groups as little room for development as possible in their territory. At the same time, it is in our interest to obtain from them as much important information about terrorist structures and activities as we can.

Improved co-operation shouldn't stop there. We need to establish an extended dialogue with Muslims and with Muslim countries, especially those countries from which many of the Muslims living in Germany originate, and which have a great influence on their religious practices. That makes it doubly important that we should convince these countries to accept that their own Islamic authorities have a special responsibility in the fight against radicalisation.

But protecting our citizens against the threat of Islamist terrorism is a responsibility shared by all of us – the Federal government, lawmakers, civil society, our EU partners and Muslims both in Germany and abroad. We need one another, and in many areas we can only make a difference if we act together. □

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*Thomas de Maizière is Germany's Interior Minister.  
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# COMMENTARY

By **Hugo MacPherson**

continue to underestimate them. They are not, as Thomas de Maizière apparently hopes, operating to "sow distrust in our societies", but rather they are motivated by a desire to see their vivid revolutionary fantasies – based though they may be on a warped version of Islam – made reality in Europe and around the world.

So is a Europe-wide re-think what's needed to combat the home-grown terrorism threat? Yes, Europe can do better on sharing information on the activities of radical groups, on creating profiles of recent radicalisation cases and by promoting counter-terrorism best practice. Above all European governments should be looking again at policies that have contributed to the radicalisation of young people.

And because Europe's Muslim communities are not all the same we should be cautious about any calls for a Europe-wide counter-terrorism strategy. It might look neat on paper, but it is the slow-burning local community-focused approaches that are beginning to show dividends. Building a European framework for sharing information comes later. □

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# Europe is ready for a common borders policy



Control of the EU's external borders is improving, says **Ilkka Laitinen**, who heads the Frontex agency. But he warns that without a coherent Europe-wide approach to illegal immigration and cross-border criminality it will be of little use

Europe's borders are both permeable and impermeable; the EU's philosophy is that its external borders should be as permeable as possible to legitimate flows of passengers and goods, and impermeable to illicit activity. So, to better understand the challenges of border control we need to answer the question "permeable to what"? Border management mainly revolves around combating illegal immigration and the closely-linked problem of human trafficking. On top of that there is cross-border crime such as the smuggling of weapons, drugs and dangerous substances and the wider problem of terrorist activity.

These are, of course, challenges common to most countries around the world, but especially so in Europe because we are part of a novel experiment called Schengen.

Some 29 countries, EU member states and associates, are either in Schengen or in the process of joining. Its main feature is the mandated absence of internal border controls, and this creates an obvious need for strong external controls. Any challenge not met effectively at the zone's external borders becomes a common, European one for all the countries in Schengen.

*EU governments are doing a lot to tighten up co-operation at Europe's borders, but much more is still needed*

The Schengen zone's border security is therefore only as strong as its weakest link, and that's why Schengen has dictated a shift of resources away from

internal borders and a strengthening of external ones. It also led to the creation of Frontex, the EU border security agency responsible for coordinating member states' operational co-operation.

Frontex is at the forefront in responding to all these European-level border challenges.

Intelligence information of course comes from national authorities, enabling us at Frontex to do risk analysis and develop European-level situational pictures. We have uncovered smuggling and trafficking routes as well as new *modi operandi* being used by criminal networks. Frontex also guides and coordinates joint operations by EU member states' border services, focusing them on border areas where they are needed most. EU governments are doing a lot to tighten up co-operation at Europe's borders, but much more is still needed.

Inevitably, joint maritime operations are Frontex's most visible ones because of the dramatic nature of search and rescue on the high seas. But while these naval operations are important, and take up the lion's share of our budget, this is just one aspect of the challenge. At least half of arrests take place at land borders; air travel is by far the most popular route for irregular immigration to EU countries, and the vast majority of that is initially legitimate, involving people who have short-stay visas. Overstayers represent by far the biggest slice of all illegal immigrants in the EU.

Trends in illegal migration and cross-border crime are also far from stable. Of late there has been a distinct shift in the routes used by irregular migrants coming to the EU via the Mediterranean – with interceptions of boats moving steadily eastwards since 2006, from the Canary Islands (down 89% between the first and second quarters of 2009), via Malta and Lampedusa, to Greece (up 68% during that period). Poland, for instance, saw a sudden rise in asylum claims by thousands of Georgians in a matter of

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By Jean-Pierre Maulny

## Land borders are important, but maritime security demands the most attention

Ilkka Laitinen is right that Frontex must do more to deal with cross-border criminals, but he seems to overlook the role of maritime operations. The EU needs to co-ordinate security on its land borders, but its maritime security needs are even more pressing. Because the sea is an open space, unco-ordinated national efforts to secure sea borders will founder. Harmonising maritime security among member states should become Frontex's top priority. The EU's recent Operation Atalanta highlights the potential for success, Frontex should take note and encourage more co-ordination among the member states and the EU agencies.

A record 11 ships and 20 member states have been taking part in Atalanta, the first major naval operation under the European Security and Defence Policy. The mission's popularity also explains its success, because unlike military forays in Afghanistan, its protection of fishing boats and container ships against piracy look to Europeans like tangible results.

There's going to be a growing need for naval missions in the future as 90% of the EU's international trade goes by sea, and that huge percentage is likely to increase. With pirates upping the ante and attacking more

months last year, and air routes used by traffickers and facilitators can change in a matter of weeks.

Common to all crime – cross-border or otherwise – is what we might call the “hidden crime dilemma”; the hard statistics we have generally result only from what we detect. It is very difficult to estimate the extent of a problem you cannot see. We know how many suspected illegal migrants we detect at borders, but our estimates of the numbers who cross illegally and are not detected can, at best, be only approximate. The number of persons currently staying illegally in all the EU’s member states is often estimated at eight million, but no one really knows. Recent revisions of the methodology used to arrive at this figure suggest that it should be revised downwards to around three million, but then again future methods of estimation may once more raise the figure.

What happens at the EU’s external and internal borders is not the whole story. Awareness of what is happening beyond the border, what happens inland, and co-operation between the myriad services and agencies involved in border control-related activities – particularly on gathering information and intelligence – is fundamental to improving border security.

The complexity and inter-connection of these various aspects of border control is illustrated by return operations. In one sense, this is the end of the process

of border control, when migrants have exhausted all legal avenues allowing them to stay in Europe and national authorities return them to their countries of origin. Frontex’s contribution is to coordinate joint return operations by a number of member states working together. Apart from the obvious logistical and financial complexities of return operations, there are legal, political and diplomatic questions that are beyond Frontex’s control. Returns can only be made via bi-lateral agreements with receiving countries, are made on the basis of national legislation, cost a great deal of money and are potentially very sensitive to political developments. The outcome of these return operations also has considerable and immediate impact on immigration routes and the *modi operandi* of people traffickers.

*Intercepting illegal migrants or cross-border criminals is all very well, but if there is no coherent and uniform method of dealing with them, then border control is of little use*

However effective it may be, border control is only part of the puzzle. How individual member states deal with illegal immigration can differ very widely. Detention periods for undocumented immigrants can range from 18 months in one EU country to just a few days in another. The demand for work, asylum or refugee status also varies from country to country, for a variety of reasons, some which we are only now beginning to understand. The lack of a common EU immigration policy together with the different practices of national authorities have an immediate feedback effect for border services, because not surprisingly traffickers and other criminals

adapt their own methods to the policies and practices of individual member states.

At a European level then, it is fair to say that the challenges are considerable, to some extent unknown and change constantly in nature and form. The policy response must therefore be as informed, flexible and forward-looking as possible. The European Commission and Council have recognised this and have, besides the creation of Frontex, put in place a number of legal and financial measures, and new technologies to enhance the EU's collective response.

We also now stand at an important policy cross-roads. The Lisbon treaty has entered into force, allowing for much better inter-agency co-operation on all matters affecting border security. The Stockholm programme together with the EU internal security strategy will determine EU Justice and Home Affairs policy for the next few years, including border security. And, thirdly, a change to Frontex's mandate is being considered that would allow the agency to become more efficient and intelligence-driven.

Then there are new technological solutions either in place or very soon to be so. These include the mandatory use of biometrics to promote security of documentation (ePassports), biometric visas (under the Visa Information System) that will become a reality during the course of this year, and the Automated Border Crossing systems that are already in use in many EU countries. A key innovation will be the European Commission's forthcoming proposal for a much-needed European

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and more ships in the Straits of Malacca, the China Sea and the Gulf of Aden, EU governments will find they have to monitor the situation more closely than ever and must be prepared to use force when necessary.

So it was reassuring when the European Council decided to continue the Atalanta mission in 2010, and when two more states asked to join it. A recent list of European maritime initiatives shows that the EU is now taking maritime security very seriously indeed. In December 2008, the EU decided to link-up all maritime surveillance systems, and in the second half of last year during the Swedish presidency there was a major effort to create closer ties between the European Security Maritime Agency, Frontex and the European Defence Agency. Two other projects now in the pipeline are the surveillance of the Mediterranean by six countries led by France, and the surveillance of the North Sea by 10 countries led by Sweden.

What are the implications of all this for Frontex? Ilkka Laitinen emphasises that maritime security operations are already Frontex's most visible activity, and in the future it could further contribute to maritime security in important but less high-profile ways. It could, for instance, oversee the distribution of assets to EU member states to address maritime security, and it could share its maritime security expertise with non-EU countries like Libya, Morocco and Tunisia.

Laitinen might also have mentioned a number of other ways that Frontex could secure Europe's borders through maritime initiatives. Many member states still lack



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**Anne-Marie Slaughter**, Director of Policy Planning, US State Dept



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**Radika Coomaraswamy**, UN Undersecretary General for Children and Armed Conflict



**Pieter De Crem**, Belgian Minister of Defence



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**Admiral Giampaolo Di Paola**, Chairman of the NATO Military Committee



**Carl Bildt**, Swedish Minister of Foreign Affairs

- Mohamad Gilao**, Political Advisor, Transitional Federal Government of Somalia
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- Jacqueline McGlade**, Director of the European Environment Agency
- Miroslav Lajčák**, Minister of Foreign Affairs of the Slovak Republic

- Ambassador John E. Herbst**, Coordinator for Reconstruction and Stabilization, United States Department of State
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- Marc Perrin de Brichambaut**, OSCE Secretary General
- Mark Pyman**, Transparency International's Director for International Defence and Security

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Entry/Exit and Registered Traveller system. EUROSUR will also soon become the focal surveillance and intelligence instrument for all national authorities and agencies.

Although all this is encouraging, all the signs are that mobility will increase in the future, with even more business and leisure travel, and quite possibly more refugees and more irregular immigration. The problem also risks being further aggravated by political and social unrest in neighbouring societies as well as longer-term problems like climate change.

The EU's borders are by definition permeable, and we need to make them more permeable still to legitimate border crossers because our economic development depends on it. But we must also make them less permeable to illicit users. Integrated border management is just one part of a much larger problem that requires an overall strategy if we are to meet it. Intercepting illegal migrants or cross-border criminals is all very well, but if there is no coherent and uniform method of dealing with them afterwards in an efficient, effective and humane way, then effective border control is of little use. □

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**Jean-Pierre Maulny**

the means to scan sea-borne containers thoroughly, so Frontex should take charge of container scanning in Europe and bring it up to U.S. standards. Frontex also needs to develop capabilities to monitor a wider geographical area so that it can better track piracy, migration and the illegal trafficking of drugs and small arms.

Frontex's efforts will, of course, only be one plank in a wider European maritime defence and security strategy, and it's a strategy that still has a long way to go. It needs to build closer links between civilian and military bodies, and should also aim to create a single European naval industrial base, as opposed to the various national industrial bases that currently supply EU forces. An EU maritime defence strategy should also set out security headline goals similar to the ESDP's defence headline goals. □

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## CATALONIA, COMMITTED TO INTEGRATION, SOCIAL HARMONY AND COHESION



*Oriol Amorós i March, secretary  
for immigration at the Catalan  
government ministry of social  
action and citizenship*

In recent years over a million foreign migrants have come to Catalonia and made their home here. Immigration over this short period has risen from 2% to 16%. Catalonia has the largest number of immigrants in the Spanish state (21%), followed by the Autonomous Community of Madrid (19%) and the Autonomous Community of Valencia (16%). These unprecedented demographic changes mean that Catalonia now boasts a population of over seven million people with a large number arriving over a very short period of time. It's a positive situation, our society has accepted the reality and irreversibility of change and has committed itself to integration, in similar terms to those expressed in many EU documents.

The national agreement on immigration, signed on 19 December 2008, expressed this commitment. It was widely supported by the Catalanian government with 90% of parliamentary representatives, municipal associations, economic and social agents, as well as the main non-governmental organisations signing up. The document defines public policies and actions that must be put in place between now and 2020 to manage immigration. It contains more than a hundred measures and addresses key citizen concerns. These were raised during a

wide-ranging consultation process involving more than 1,500 people and taking in more than 2,300 contributions. The process aimed to understand the changes that have taken place in Catalonia, identify the demands and social concerns that these changes generated, and to respond to these concerns in a way that encourages social cohesion in Catalonia.

If we are to set political priorities, we must identify the causes and effects of Catalonia's recent demographic shifts. In the last ten years, Catalonia has been transformed, but it is the third time this has happened in the last hundred years. The steady economic growth in Catalonia over the last ten years accounts for much of this change. Catalonia has enjoyed an average growth rate of 3.5% of GDP over a twelve-year period, and between the years 1977 and 1997 the birth rate of the native population declined considerably. The incorporation of women into the labour market has also contributed to this change. In the 1990s, the rate of female employment was very close to the European average, and was almost ten points above the Spanish average. Since we can't change these facts and in any case don't want to change them, it is clear that the majority of the million plus new Catalans are here to stay. This moves us beyond the concept of guest workers and places integration at the heart of our political agenda.

In harmony with EU policy, we clearly need policies that manage Catalonia's demographic changes. There must be policies to deal with worker mobility for both qualified and unqualified workers, as well as policies on return (both voluntary and compulsory), policies on circular migration, and policies on the

## VIEW FROM CATALONIA

problem of unaccompanied minors. And there must be maximum co-ordination with the other European countries on all these issues. But the first priority is the integration process for the large majority of foreigners who have come to stay. This fact must be clearly and unequivocally accepted.

To encourage social cohesion we have to listen to our population and address their concerns. These concerns include the administration of migratory flows, minimising competition for public resources, and facing up to the challenge of living in a diverse society, as opposed to a society with a diversity of parallel societies. The challenge is to strike a balance between plurality and social cohesion, while respecting both. The agreement formulated clear responses to these issues. Catalonia must manage migratory flows in accordance with the labour market, prioritise internal human resources, give legal status to migrants and raise awareness about the reality of new influxes. And to avoid human decapitalisation Catalonia must work in conjunction with the countries of origin and the common EU policy on skill management. We also need to adapt the public services and create a universal reception service that gives equal access to all. On this issue, the European Union would do well to raise common standards with regard to the recognition of social rights.

Our response is cross-sectional and involves much co-ordination between institutions. Education has been greatly adapted. Catalonia is a pioneer in reception classes and community education. The reception classes are located within ordinary schools and are co-ordinated by the teaching staff of the school itself. The staff specialises in integration, social cohesion and the promotion of multilingualism. The aim is to integrate newly arrived pupils – who are often mid-way through their school curriculum – into ordinary classes. This involves linguistic immersion and a huge effort on teaching ordinary subjects. The time pupils spend in these classes depends on their ability to adapt to their surroundings and goes hand in hand with participation in regular classes. New students spend time with other students in common areas

and enjoy common activities together. This doesn't interfere with the school's academic agenda. Now there are 1,238 of these classes. Community education aims to help students succeed at school, foster civic responsibility, and to build relations between adult education centres, local institutions, leisure activities and remedial classes.

We are acting with greater urgency to integrate the new arrivals into a common public culture. Within this culture, different people can share the same values, the same language, the same legal framework and some basic rules for getting on with each other. Above all, this culture should encourage respect for elementary rights and duties.

Public participation – a field where the EU could achieve greater co-ordination between the member states – and the fact that Catalan is the public language in a multi-lingual society, have also helped this effort.

Catalonia has seen its demographic base renewed on many occasions over the last hundred years. It will gain in significance and cohesiveness if it asserts itself as a country of immigration. Through forward thinking it can allow people to set down roots and discover opportunities. Catalonia should unite through what people do together and not by what their descendants did. We need to recognise ourselves as a country of immigration not only in order to maximise opportunities, but also so that we know how to respond to risks. These thoughts are brought together, and expressed in, our agreement.

*This section is sponsored  
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*For further information,  
- National Agreement on Immigration (in English):  
[http://www.gencat.cat/benestar/immi/pdf/PNI\\_Angles.pdf](http://www.gencat.cat/benestar/immi/pdf/PNI_Angles.pdf)  
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# Global Governance is a challenge for democracy (but an EU opportunity)



Creating global governance mechanisms that are efficient but also responsive to national concerns will not be easy, says **Pascal Lamy**. But the WTO's Director General and former EU Commissioner sees useful lessons to be drawn from Europe

This new decade is marked by the worst-ever economic crisis that's also the first to have a global reach. The crisis has poured a good deal of cold water on the hopes and expectations created 20 years ago when the fall of the Berlin Wall ushered in an unprecedented era of economic openness and poverty reduction and a marked expansion of freedom, ideas, culture and technology.

The world today is in serious distress. Millions of jobs have been lost as a result of the economic crisis; we've also seen pandemics along with environmental problems, and this is impacting on millions of people in rich and poor nations alike. Nuclear proliferation, too, is on the rise, creating yet another of these global challenges that need global solutions. Our growing inter-dependence requires that the laws, social norms and values – all the

mechanisms for framing human behaviour – need to be examined, debated, understood and operated together as coherently as possible. In sum, we need stronger and more effective global governance.

As with any system of power based on nation states, what is needed is "good" global governance; a system that offers a balance between leadership, efficiency and legitimacy, and which can ensure coherence.

Global governance poses a number of challenges. The first is the difficulty of identifying leadership at a global level. The second is legitimacy, and particularly what is often perceived as decisionmaking at an international level that is too distant, non-accountable and not directly challengeable. The third relates to coherence. In theory there should be no problem here because coherent action by a nation state in the

various aspects of international governance should be translated into coherent global action. But we all know that nation states also have a monopoly on incoherence because in practice they often act incoherently. This is where the third challenge to global governance lies; how to deal with efficiency that is at times only partial and is also incoherent. And the fourth and final challenge is the remoteness of power and the multiple levels of government that also call efficiency into question.

Managing global problems by using traditional models of national democracy has important limitations. And yet the very credibility of our national democracies is at risk if global governance fails to establish its own democratic credentials because citizens around the world feel that the issues that affect them daily aren't being adequately dealt with.

In these troubled times for the European Union, it is no easy matter for it to present itself as a new paradigm of global governance. Yet the European construction is one of the most ambitious experiments to date in supranational governance, and the way Europe has coped with the sort of challenges I've just outlined is a useful reminder that defined and organised inter-dependency among nation states is perfectly possible.

The building of Europe is a work in progress, and the European paradigm is itself very specific to the conditions and pressures that prevail in Europe. Our continent was ravaged by two world wars

and by the holocaust, leaving millions of men and women dead and many more millions in search of peace, stability and prosperity. One should therefore be cautious about ascribing universal values to what so far has only been a part of our European world. Other paradigms emerging elsewhere in the world reflect different conditions elsewhere.

At the heart of the European project has been the creation of a space of pooled sovereignty, a space in which the EU's members agree to govern among themselves without having permanent recourse to international treaties. The essence of the European governance paradigm is the

coming together of national political wills to act together in the framework of a common project and an institutional set-up that can make it work. It's the combination of these three elements rather than just the governance methods used.

There is also the fact that Community law takes precedence over national law,

and then there's a supranational body like the European Commission that has been given the monopoly of initiating legislation. There is also the EU's Court of Justice whose decisions are binding on national judges, and a parliament composed of a "senate" of member states, the council of ministers, and a "house of representatives" elected by the European demos, the European Parliament.

Taken together, these are the things that make the European Union a radically new economic and political entity when it comes to international governance. But today's EU could

*Global governance poses a number of challenges. The first is leadership, the second legitimacy and the third coherence*

never be the product of these innovations alone. Indispensable and indisputable though they are, those institutional innovations are still inseparable from the conditions from which they emerged. It is agreement on the substance that permits agreement on the form.

I believe that the construction of the EU internal market, the European Monetary Union and trade policy are all areas where European integration has scored above average. The fact that the European Union numbers 27 member states and around 500m citizens, represents over a quarter of world trade and accounts for the world's largest GDP – and on trade speaks with one voice – gives Europe the capacity to defend its vision of trade opening accompanied by rules.

On the environment, Europe has played a global leadership role that reflects the large consensus existing within the EU on the need to protect and preserve the environment. Yet the institutional set-up within which Europe acts, the mixed competences and different voices, prevent Europe from being as effective in this area as it might, with the recent climate change summit in Copenhagen a warning. But it's an area where Europe still has a chance to break even.

In my view there are two other areas where Europe is not punching its weight in the world. On development aid, the EU is the world's largest donor and its flag can be seen at almost every major humanitarian crisis. Europe's aid effort is backed by strong public support, with some 72% of Europeans polled recently in favour of honouring or going

beyond aid commitments to the developing world. And yet for all that Europe has so far had only a limited influence on setting world development policies.

The second problem area is the Common Foreign and Security Policy. The good news is that European citizens demand more and better foreign policies from Europe. But this also touches on one of the areas where symbolic barriers – those of dreams and nightmares, of collective identities and myths – remain powerful. It's why I think that building a European foreign and security policy requires a permanent compromise between interests and values. The EU's new High Representative for Foreign and Security

Policy, a Vice-President of the European Commission who now chairs the General Affairs Council is a step in the right direction. But it will also take a common will to act together and a common concept, a sort of shared project, to get there.

There are a number of lessons that we can draw from more than 60 years of European integration.

The first is that institutions alone cannot do the trick. Neither can political will without a clearly defined common project. Nor can a well thought through common project deliver results if there is no institutional machinery. The reality is that we need the three elements together to create an integration dynamic.

Even if these three elements are present there is a risk that a real or perceived

*There are a number of lessons that we can draw from more than 60 years of European integration*

legitimacy problem remains, creating a glass ceiling for further integration. The reality is that supranational institutions like the European Union require a long-term investment that is often incompatible with the short-term attention span of many of its leaders, who are often elected on thin majorities or with fragile coalitions. Global legitimacy requires long-term care and attention.

Governance systems can be likened to the three states of mass. The national level represents the solid state, the international system is more like gaseous mass and in-between these lies the European integration process as a kind of liquid state. But whatever the state of the mass, to make a governance system work demands a combination of political will, capacity to decide and accountability. In this respect, European integration offers some useful lessons for global governance.

Lesson one is the importance of the rule of law and of enforceable commitments. Global governance has to be anchored in stakeholders' commitments and in rules and regulations with mechanisms that deserve respect. This is at the heart of the post-war multilateral trading system, which has developed over 60 years of trade regulation among nations and has a binding dispute settlement system to ensure compliance with its rules.

It's also at the heart of what the international community is trying to do on climate change – achieve a multilateral

deal where nations commit to emissions reduction accompanied by measures to facilitate adaptation and mitigation. And it is what the international community is striving to achieve on nuclear non-proliferation. It is true, too, for the regulation of finance, as the financial crisis so clearly demonstrated.

Commitments that are anchored in a multilateral context, and that can be monitored accordingly, allow for greater efficiency and coherence.

*Supranational institutions like the European Union require a long-term investment that is often incompatible with the short-term attention span of many of its leaders*

The second lesson for global governance is respect for the principle of subsidiarity; the international system should not be overburdened with issues better dealt with at local, regional or national level.

The third lesson is that "coherence starts at home" because it lies first and foremost with the members of international organisations. Take the United Nations; we can and must have the "UN Delivering as One", but we also have to see "UN members behaving as One" in the different organisations that make up the United Nations family.

The last of these lessons is that since the political demos remains essentially national, the legitimacy of global governance would be greatly enhanced if international issues become part of domestic political debates. National governments need to be held accountable by their voters for their international level behaviour. Democracy at the national level has to have more

of an international dimension to foster legitimacy at the global level. The fact that the governments which represent states in international organisations are the result of citizens' choices through domestic elections is not in itself enough to ensure those international organisations' legitimacy. More is needed, so national actors – whether political parties, civil society, parliaments or citizens – must ensure that global level issues are discussed.

The good news is that many of these issues are already works in progress, so we need not expect a big bang. The global economic crisis has accelerated the move towards a new architecture of global governance in what I think of as the "triangle of coherence". On one side of the triangle lies the G20, replacing the former G8 to provide political leadership and policy direction. On another side lie the member-driven international organisations that provide expertise and specialised inputs such as rules, policies and programmes. The third side of the triangle is the G192, the United Nations that is the global forum for accountability.

In the longer term, we should have both the G20 and the international agencies reporting to the "parliament" of the United Nations. A revamping of the UN's Economic and Social Council could lend support to the recent resolution adopted by the UN General Assembly on a UN-wide coherence system. This would constitute a potent mix of leadership, inclusiveness and action to ensure

coherent and effective global governance. With time, the G20 could even be an answer to reforming the UN Security Council.

A structure of this type needs to be underpinned by core principles and values, and this is precisely what Germany's Chancellor Angela Merkel proposed with the creation of a Charter for Sustainable Economic Activity. It is a commendable effort to provide a "new global economic contract"

that would anchor economic globalisation on a bedrock of ethical principles and values, and so renew citizens' trust that globalisation can work for them.

Globalisation poses a serious challenge for our democracies, and our governance systems must respond to that. If our citizens feel that global problems are insoluble, that will risk emasculating our democracies. The same will hold true if our citizens see that global problems can be addressed, but that they themselves have no influence on the result.

Our governance systems must more than ever offer citizens avenues for shaping the world they want their children to inherit. And the European Union remains the laboratory of international governance, a place where the new technological frontiers of international governance are being tested. □

*The global economic crisis has accelerated the move towards a new architecture of global governance ... We should have both the G20 and the international agencies reporting to the "parliament" of the United Nations*

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# Global governance could take a leaf from the EU's book



Everyone knows that international policy co-ordination would be of benefit to all, but what structures, what mechanisms? **Iain Begg** looks at some of the EU devices that could help shape global governance thinking

In an increasingly inter-connected global economy, the actions of one government have repercussions for others. Co-ordination among them matters a great deal, yet it is hard to achieve because what is in the common interest, especially in the short-term, does not always make sense for any single country, especially in times of crisis when governments are under intense political pressure to 'do something'.

Around the world, governments have, on the whole, accepted that overt protectionist policies are ultimately counter-productive, despite the temptations that arise in a severe downturn. But they are less willing to see other policies in the same light and the current crisis has revealed shortcomings in mechanisms for assuring co-ordinated policy action at the global level. After the collapse of Lehman Brothers, it rapidly became clear that governments lacked an effective international toolkit for this, and as a result anarchy could well have broken out.

Governance arrangements that facilitate co-ordination offer a number of clear-cut advantages. Burdens can be shared, inconsistencies and incoherence in policy stances can be avoided, and participating governments' collective response can be far greater than the sum of the parts. Co-ordinated policy also makes it less likely that any single country will be picked-on by financial markets, or that a domino effect is engendered that might lead to a vicious circle of defensive policy reactions.

Why then is co-ordination so difficult to achieve? One obstacle is that countries have different priorities that can affect their willingness to commit to specific policy orientations; another is that the incentives to be a free-rider are often sizeable – why risk your own public finances if someone else is willing to risk theirs? But often the problem is simply that the institutional mechanisms that could enable better co-ordination are not in place, a problem that can be exacerbated

when the crisis for which co-ordination might be the answer is unanticipated and unfamiliar.

The financial and economic turmoil of the last two years has obliged governments when constructing policy responses to learn by doing. This has inevitably given rise to mistakes and misunderstandings, such as some of the immediate actions taken to protect national banking systems from the shockwaves of the Icelandic bank meltdown in 2008. This had the effect of passing the hot potato to the next in line, rather than providing a sound solution. Despite the difficulties in orchestrating rescues of financial intermediaries, especially those with significant levels of cross-border activity, there are some examples of successful co-ordination that nevertheless stand out. The world's leading central banks engineered a 50 basis point cut in interest rates in October 2008 and, albeit somewhat haphazardly, the major economies put together national stimulus packages that de facto became a co-ordinated fiscal stimulus strategy.

What these examples reveal is that although a co-ordinated outcome was eventually achieved, it was cobbled together rather than created by design. The main institutional forum for the key decisions is now the G20, but before that it was the G8, the G7 and other configurations, meeting infrequently and

with no effective executive or administrative back-up. As a highly integrated region, the EU has had to confront the challenges of co-ordination and has developed a number of over-lapping mechanisms. These include the Stability and Growth Pact (SGP) for the 16 eurozone members that is intended to curb irresponsible fiscal policies, the Lisbon strategy aimed at promoting economic reform and other mechanisms for achieving specific goals like social cohesion or shared energy policy objectives.

*The real advantage would come in times of economic crisis where a co-ordinated response should help to mitigate the burden on any single country and assure a credible collective solution*

These various EU mechanisms reflect different motivations. First there is that of imposing discipline on what should be avoided, what should be encouraged and the role of co-ordination commitments in reinforcing governments' implementation of unpopular measures, especially where there are vested interests. Another, less well-recognised motivation is stimulating policy learning to facilitate the adoption of improved policy. This can be achieved by exploiting ideas and practices from other countries, and is most likely to work well when there is a supportive governance framework.

All the EU co-ordination processes have their detractors and could undoubtedly work much better, but they provide a possible basis for the development of co-ordination as part of global governance reform. That makes the distinctive principles behind these EU approaches worth exploring. The

rationale for the SGP is to deter and penalise fiscal policy behaviour that has potentially adverse ramifications for other eurozone countries. The SGP solution was to impose rules backed by sanctions which, though widely regarded as rather toothless, arguably had a moderating effect on national excesses – at least until the onset of the present crisis.

Could such a commitment device be envisaged at global level, and how might it be organised? The essence of the SGP is the rule that public finances should be kept within the prescribed limit of a 3% deficit, and should aim for balance over the medium-term, but with more flexibility in times of recession. When the original SGP was adopted in 1997, its critics objected to the simplistic nature and inflexibility of the policy rule and its dubious economic rationale, while non-compliance by Germany and France in 2002 raised doubts about its effectiveness. The pact was then reformed in 2005 to make it more flexible. Although the European Commission is responsible for surveillance of member states, a decision on whether to instigate disciplinary measures is taken by Ecofin, the body bringing together all the national finance ministers. The disciplinary measures theoretically include the eventual imposition of a fine on countries that fail to rein in deficits, but in practice the principal weapon is naming and shaming.

In principle, the IMF, too, has a duty to engage in surveillance of economies

and could be assigned a similar role in implementing agreed fiscal rules alongside the more robust Financial Stability Board agreed by the G20 last April. The latter's mandate, though, is mainly to police the financial sector, so it might be better to consider a new, multilateral Fiscal Stability Board. Although, the notion of sanctions in the form of fines at a global level is even more far-fetched than in the EU, the scope

*In a severe downturn, speed of action and appropriate sequencing are essential and, although the actions taken by the G20 did eventually stabilise the world economy, vital time was lost and the recession was aggravated*

for naming and shaming is still considerable. And the IMF can also exercise some influence through the conditions it attaches to loans. In good times, the incentive for governments to comply will come principally from financial markets, which can be expected to penalise those that depart too much from agreed targets.

But the real advantage would come in times of economic crisis where a co-ordinated response, embodied in transparent targets that are mutually consistent, should help to mitigate the burden on any single country and assure a credible collective solution. In a severe downturn, speed of action and appropriate sequencing are essential and, although the actions taken by the G20 did eventually stabilise the world economy, vital time was lost and the recession was aggravated. However, the gradual reversion to business as usual will pose a sterner test, because the recession's depth differs from country to country. The central bank money sloshing around the system will eventually have to

be mopped-up and fiscal policy tightened. But if done in an unco-ordinated or, worse, incoherent manner, the effect could be to trigger precisely the sort of W-shaped double-dip recession that many fear.

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The Lisbon strategy's approach is more distinctive and promising, yet harder to relate to conventional thinking on co-ordination. It consists of the articulation of common goals and guidelines, the development of national reform programmes aimed at advancing economic reform, and an iterative process of scrutiny and evolution in these reform programmes. It has been criticised for its unrealistic ambitions and rhetorical flourishes that are belied by timid policy action, for its lack of incentives or enforcement mechanisms, and for being tangential to real policymaking. But its bad press has been exaggerated. Almost subliminally, the strategy has had an impact that is visible in the many shifts in national priorities and the adoption of new directions in policymaking.

In contrast to the SGP's focus on what countries should or should not do, the Lisbon approach is to stress what they could do by being sufficiently receptive to different influences. It seeks to achieve this by creating templates for

good policy, providing a pool of ideas, fostering exchange of experience and establishing mechanisms like peer review and benchmarking that can help to identify better solutions to policy problems.

Could something similar be constructed at global level? The OECD already provides some co-ordination through its Going for Growth initiative, which tries to influence structural policies, but this is confined to its richer country members and has limited provision for policy learning. The expertise of policy advisers in the global institutions could also play a part, but what is missing are suitable international fora or specific mechanisms to promote policy learning. Nevertheless, by drawing on these sources it would be possible to develop guidelines similar to the Lisbon ones. To overcome the inevitable resistance of governments to being told what to do, an incremental approach probably makes good sense. A first answer could be to experiment with some of the low key approaches employed in the EU, such as setting targets, mutual surveillance and thematic seminars. More elaborate structures might subsequently be envisaged, including a role for constructive scrutiny by international agencies and some sort of global policy learning agency.

Effective co-ordination is never going to be easy, but that should not deter us because the benefits are simply too great to ignore. □

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## The *Europe's World* panel on global governance

For our global governance scorecard, a panel of 26 top political and economic analysts gave their opinions on the need for reform in global institutions. This mini-survey threw up some surprising results, and above all emphasised that top analysts can be thoroughly divided on these issues.

Most agreed that leading global institutions like the International Monetary Fund, the World Trade Organisation and the UN Security Council need reform. Of 26 analysts, 17 stated that the WTO needs to change, and 19 said the same of the UN Security Council. An overwhelming majority of 21 out of 26 believe that the IMF needs reform and seven of them think that reform should be "radical".

When it came to other institutions, particularly the UN agencies, opinion diverged widely. Half said that the

United Nations Development Programme should be reformed, but only 16% thought that the reform should be radical, while 50% said no reform at all was needed. The panel also disagreed on other UN agencies like the Food and Agricultural Organisation, the World Health Organisation, UNESCO and the World Intellectual Property Organisation," 45% said that UNESCO needs reforming, but only 17% thought its reform should be radical. On whether new global Institutions are needed, opinion was again divided. Over three-quarters of the panellists thought that an international climate change agency is needed, but only slightly over half see a need for a carbon tax global co-ordination authority. A minority of 11 out of 26 thought there is a need for an international derivatives and hedge funds authority. □



**JOAQUÍN ALMUNIA**  
European Commissioner for Competition Policy



**JAN KRZYSZTOF BIELECKI**  
President & CEO, Bank Polska Kasa Opie and former Polish Prime Minister



**DANIEL DAIANU**  
former Romanian Finance Minister



**JOVAN DONEV**  
Executive Director, EuroBalkan



**FRANZ FISCHLER**  
former European Commissioner for Agriculture and Fisheries



**HEINZ GÄRTNER**  
Research Fellow, Austrian Institute for International Affairs (AIIA)



**DOBRIŠA GOVEDARICA**  
Executive Director, Open Society Fund Bosnia-Herzegovina



**ULRIKE GUÉROT**  
Head of the Berlin Office, European Council on Foreign Relations (ECFR)



**MARIO HIRSCH**  
Director, Luxembourg Institute for European and International Studies



**ANDRÁS INOTAI**  
Director General, Institute for World Economics of the Hungarian Academy of Sciences (IWE)



**HENRIK ISAKSON**  
Senior advisor, National Board of Trade (Kommerskollegium)



**WOLFGANG ISCHINGER**  
Chairman, Munich Security Conference



**MICHAEL JENNINGS**  
Senior Lecturer, School of Oriental and African Studies (SOAS)



**JEAN-PIERRE JOUYET**  
Chairman, Autorité des Marchés Financiers (AMF)



**JENI KLUGMAN**  
Director of the UNDP's Human Development Report Office



**ENEKO LANDABURU**  
Head of the European Commission's Delegation to Morocco



**JEAN-PIERRE LEHMANN**  
Founding Director, Evian Group



**CLARE LOCKHART**  
Director, Institute for State Effectiveness



**JING MEN**  
InBev-Baillet Latour Chair of European Union-China Relations, College of Europe



**JOSEPH QUINLAN**  
Fellow, Johns Hopkins University



**ADAM DANIEL ROTFELD**  
Chairman of the International Advisory Committee, Polish Institute of International Affairs



**DINGLI SHEN**  
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**FRANS-PAUL VAN DER PUTTEN**  
Research Fellow, Netherlands Institute of International Relations (Clingendael)



**MANFRED WEBER**  
General Manager and Member of the Board of Directors, Association of German Banks



**NICK WITNEY**  
Senior Policy Fellow, European Council on Foreign Relations (ECFR) and former CEO of the European Defence Agency



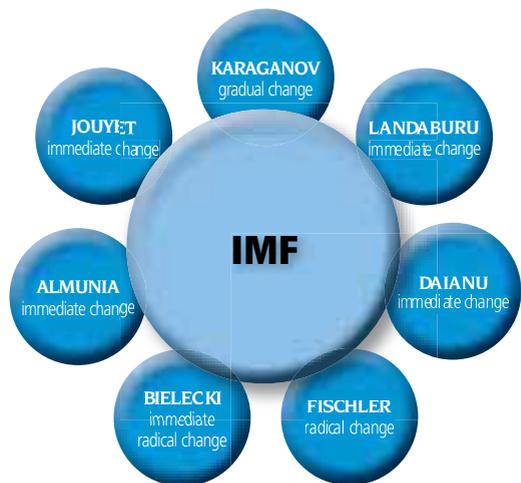
**SERGEI KARAGANOV**  
Dean of the School of International Economics and Foreign Affairs of the Research University – Higher School of Economics, Russia

## RIPE FOR REFORM?

|                                                            | Degree of Change    |                      | Timing of Change |           |
|------------------------------------------------------------|---------------------|----------------------|------------------|-----------|
|                                                            | Reform <sup>1</sup> | Radical <sup>2</sup> | Gradual          | Immediate |
| <b>UN Security Council</b>                                 | 73%                 | 37%                  | 42%              | 33%       |
| <b>World Bank</b>                                          | 83%                 | 21%                  | 37%              | 37%       |
| <b>IMF</b>                                                 | 80%                 | 26%                  | 16%              | 66%       |
| <b>UN agencies</b>                                         |                     |                      |                  |           |
| Development Programme (UNDP)                               | 50%                 | 16%                  | 29%              | 16%       |
| Food and Agriculture Organisation (FAO)                    | 58%                 | 21%                  | 29%              | 21%       |
| High Commissioner for Refugees (UNHCR)                     | 37%                 | 17%                  | 21%              | 8%        |
| World Intellectual Property Organisation (WIPO)            | 37%                 | 12%                  | 17%              | 12%       |
| Industrial Development Organisation (UNIDO)                | 45%                 | 17%                  | 17%              | 17%       |
| Educational, Scientific and Cultural Organisation (UNESCO) | 45%                 | 17%                  | 29%              | 12%       |
| International Labour Organisation (ILO)                    | 50%                 | 8%                   | 33%              | 8%        |
| World Health Organisation (WHO)                            | 45%                 | 8%                   | 33%              | 17%       |
| <b>G20</b>                                                 | 70%                 | 17%                  | 50%              | 17%       |
| <b>Financial Stability Forum</b>                           | 45%                 | 17%                  | 17%              | 33%       |
| <b>BIS</b>                                                 | 33%                 | 8%                   | 17%              | 12%       |
| <b>WTO</b>                                                 | 63%                 | 12%                  | 45%              | 17%       |
| <b>OECD</b>                                                | 62%                 | 4%                   | 45%              | 8%        |

<sup>1</sup> % of all panellists favouring some degree of reform

<sup>2</sup> % of all panellists urging radical reform



## NEWCOMERS WE NEED?

|                                                               | YES | NO  |
|---------------------------------------------------------------|-----|-----|
| International Climate Change Agency                           | 79% | 21% |
| Carbon Tax Global Co-ordination Authority                     | 58% | 42% |
| International Financial Derivatives and Hedge Funds Authority | 62% | 38% |





## C. Fred Bergsten

Director of the Peterson Institute for International Economics

### “The global crisis has accelerated governance reform”

The current global economic system was constructed in the middle of the 20<sup>th</sup> century, and could not be expected to fit the realities of the 21<sup>st</sup> century. The most fundamental change is in the composition of economic capability, and thus systemic responsibility, among the major countries.

Emerging and developing countries now account for 50% of the world economy when national output levels are converted at purchasing power parity (PPP) exchange rates. They are growing two to three times as rapidly as the rich countries, so every year their share of the global market rises by one or two percentage points. Soon they will constitute a substantial majority of global output, even with their GDPs converted at

market exchange rather than PPP rates.

The global governance structure can only achieve political legitimacy, and thus substantive effectiveness, if it accurately reflects these realities. An historic step forward is the replacement of the G7/8 as the steering committee for the world economy by the G20, half of whose members are emerging markets.

More informal but functionally equivalent reforms have taken place in the governance of the World Trade Organisation. Its *de facto* co-ordinating committee now includes Brazil, India and sometimes China as well as the traditional “trade G2” of the European Union and United States along with Japan.

Similar changes now need to be made at the International Monetary Fund. At least 10% of the quotas and voting rights, and at least five of the 20-24 seats on the Executive Board need to shift primarily from over-represented Europe primarily to under-represented Asia. Even more important, both substantively and symbolically, is that the next Managing Director should be selected from an emerging market economy.

The global crisis has accelerated governance reform in all these institutions. That momentum must now be sustained and completed if the new economic order is to both prevent future crises and provide ongoing prosperity and stability for all. □



## Daniel Daianu

Former Romanian Finance Minister

### “G20 could turn into a global economic security body”

The G20 is the right instrument for our times, as it fits the extraordinary redistribution of economic power we are seeing in the world. And G20 could also turn into a global economic security body as that

would enable it to hook up with the UN, where India and Brazil should become permanent members of the Security Council.

A re-suscitated IMF should usher in a re-working of

principles and decisionmaking, as they affect international financial institutions (IFIs), and that would certainly be in tune with today’s increasingly multi-polar world and the “wake up call” that is the current

economic crisis. The IFIs should for their part return to John Maynard Keynes' vision of the Bretton Woods rules he helped create in 1944 that the inherent instabilities of financial markets must be reined in if we are to foster economic

growth and international trade.

The policy mismanagement that helped create global imbalances, along with market failures of global significance, have to be tackled by a common global

governance structure. As to the EU it needs to be much more cohesive internationally if it is to be an equal partner of the U.S. and China in the daunting challenge of dealing with climate change and other global threats. □



### **Kemal Derviş**

Director of the Brookings Institution's Global Economy and Development Programme and former Administrator of the United Nations Development Programme

#### **"G20 should increase the legitimacy of the international institutions"**

The great crisis of 2008-2009 has led to one major change – and thus to progress – in global governance; the G20 replacing the G7 as the premier international forum for discussing global co-operation. The London and Pittsburgh G20 meetings built confidence, proposed an increase in the war-chest of the IMF at a critical time and contributed to rebuilding the confidence shattered by the worldwide financial collapse.

The proposals made were broadly adopted at meetings in Istanbul of the World

Bank and IMF, with the specifics awaiting more work, particularly when it comes to the significant shift towards emerging countries needed in voting weights and to the mechanisms of multilateral macroeconomic policy co-ordination.

The recent sequence of events should remind us that an informal meeting of leaders, even when they represent the most important countries, cannot replace the governing bodies of the international institutions of the UN system, including the IMF

and the World Bank. Global co-operation requires burden sharing and co-ordinated action within the framework of these institutions.

Progress on issues such as long term financial stability, climate protection, effective control of infectious disease and the peaceful management of nuclear energy depends on how the G20 will be able to provide leadership, while recognising that all nations and peoples must have a say and must be part of a legitimate international system. □



### **Jiří Dienstbier**

Chairman of the Czech Senate's Foreign Affairs Committee and former Foreign Minister

#### **"Nation states cannot meet the challenges of deregulated globalisation"**

The legal, economic, financial and taxation instruments that have long been developed by nation states are in no

way sufficient to meet the challenges of deregulated globalisation.

Some problems – notably terrorism, development and environmental issues – can be resolved only at a global level.

Others must be addressed by regional groupings like the EU, or within the nation states at regional or municipal levels. This sort of model will in any case be permanently tested by the changing global environment as well as by the ambitions of the players both on the world scene and

at home as they struggle for political influence and power. The important thing is that we should aim to better understand the hierarchy of the problems we face, and that we should define and respect the levels at which they need to be tackled. An example of this could be the

longstanding proposal by Jacques Delors to create a UN Economic Security Council. The message we need to draw from the phenomenon of globalisation is that we need more effective global tools and institutions. □



### **William Drozdiak**

President of the American Council on Germany

#### **“An alternative is regional institutions to act in the service of global governance”**

The quest for effective global governance needs to focus on pragmatic models, not on utopian visions. The United Nations has made some very real contributions in peacekeeping, health and development over the last 65 years, but will never live up to the grandiose dreams that some have had of world government. The more salutary ambition would be to re-shape existing multilateral institutions in ways that harness the forces of globalisation while respecting the reality of nationalism as the dominant force in terms of power and order around the world.

The most successful reform so far has been the dramatic shift in global economic power from the G8 group of industrialised democracies

to the G20 and its amalgam of both wealthy and emerging powers. The G20 encompasses 80% of the world's population and a similar proportion of global economic output, and in the eyes of the world it has greater political legitimacy than the G8 which barely accounts for 12% of the world's population. When thinking about global governance, the important measurement is the balance between the widest possible representation of global interests and the most effective way to implement policies. Too often, consensus means the lowest denominator and thus the least effective kind of action.

Rather than look to global institutions, an alternative is to employ regional institutions to act in the service of global

governance. NATO and the European Union, perhaps the two most important multilateral institutions in the West, have proven value in preventing war and building prosperity. The test of their future worth will be how they adapt to the post-American world of the 21<sup>st</sup> century. Can NATO forge a new strategic concept that broadens the definition of security to include nation-building through effective police training and economic development? And can the European Union extend its mandate to help other regions of the world achieve peace and prosperity? Both institutions must adapt to the changing security demands of our time, and find new ways to work together on solutions that have proved so elusive in the past. □



## Monica Frassoni

Co-President of the European Green Party

### **“The only global governance model that would work is federal”**

The only model of global governance that would work in a world as complicated as this is federal; a system with a clear definition of (very) limited competences, a common charter of human and civil rights, an executive branch and a widely representative institution that we might compare to a global parliament. In this way, the few decisions taken would be recognised by all concerned and a genuinely global “public opinion” would be able to form and express itself, using all

the new instruments of global communication.

Is this just a dream? Certainly, but it’s also a political programme. Let’s face facts; in the UN, the WTO and even in the EU, “governance” is still mostly done through intergovernmental negotiations that are tragically slow, obscure, disappointing, expensive, time consuming and all too often unfair in their results.

What we have to go for is a real global democracy. And we must

do so by acting at different levels; the EU must resume its discussions on its future shape, the UN must reform itself and those wanting to go further on climate change or disarmament should create an ambitious “coalition of the willing” whose members would agree to give up part of their national sovereignty to find common solutions. Failing these steps, there will be no chance of global governance, but only the present global confusion. □



## Angel Gurría

Secretary General of the Organisation for Economic Co-operation and Development (OECD)

### **“G20 could give the momentum needed to usher in unprecedented international co-operation”**

When Canada’s Paul Martin and fellow finance ministers – including myself, as Mexico’s then Minister of Finance – set up the G20 many years ago, we had the right vision. The rapid and far-reaching globalisation of markets has to find its counterpart in closer and more effective policy co-ordination.

Today’s financial, economic and social crisis is confirming the truth of this, while the upgrading of the G20 to the level of heads of state and government testifies to the scale of the common challenge

we face, and the need to build a stronger, cleaner and fairer world economy. International organisations like the OECD are ready to play a role in offering analysis and policy options, and in monitoring and ensuring follow-ups to G20 leaders’ policy decisions.

The G20 accounts for 85% of global GDP, and 90% of global population, and has already given a convincing demonstration of its capacities for effective crisis management. Going forward, the world needs to be put on

to a new growth path, and this requires leadership as well as competence, accountability and transparency.

The G20 framework for strong, sustainable and balanced growth could give the momentum needed to usher in a period of unprecedented international co-operation. Improved co-ordination on the economic, social and environmental fronts could do much to avoid future crises and underpin a more prosperous world economy. □



## Danuta Hübner MEP

Chair of the European Parliament's Committee on Regional Development and former EU Commissioner for regional policy

### **"The dynamics of crisis have fundamentally altered the global financial system"**

The dynamics of crisis have fundamentally altered the architecture of the global financial system, and have also changed our understanding of it. The facts have changed, and now our minds must follow. The upshot is that we are presently undergoing a fresh learning process as to the interaction of market participants and policymakers.

This "new normalcy" requires the development of a collective capacity to steer the global economy. Until the crisis broke, unbalanced patterns of demand in the global economy could have been resolved by co-ordinated efforts, but as we all know, these were sadly lacking.

The growing importance of the world's emerging economies is already shifting responsibilities for overseeing the global economy from the level of the G7/8 to G20 and perhaps G20-plus. But however many communities are eventually represented, groups such as today's G20 will have to stay committed to maintaining an open trading system.

The major challenge facing governments across the world will be the international harmonisation of rules and regulations. If national governments seek to resist the creation of a global rulebook for, say, financial services, banks and other financial institutions will shop across borders for the friendliest system.

On the fiscal side, however crucial co-ordination may be, it will be practically impossible to achieve. Tax benefits leak easily across frontiers, and the free-riding that results is difficult to police. Here we will have to cope with second-best responses.

We have already seen that the fastest channel to spreading the crisis around the world was the financial marketplace. And although we knew how to stabilise volatile capital flows, the available funding was nowhere near enough. The lesson we have still to learn is that no matter how stringent the new reforms are, they will not be effective unless we also back them up with adequate financial resources. □



## Wolfgang Ischinger

Chairman of the Munich Security Conference

### **"We need fundamental reform of the international institutions"**

With the change from G8 to G20, global governance has been given a new face. At long last, the forum of the world's biggest economies more fully represents all parts of the globe. But global governance is more than that.

In the first place, G20 decisions must be implemented coherently by all participating states. Second, global governance refers to all realms of international politics – economics, welfare and security – so international co-operation is even more

essential where these policy areas overlap. Third, to be successful global governance requires a fundamental reform of the present international institutions, with the International Monetary Fund's voting rights an example of reform that is long overdue.

We will also have to discuss how to re-design the United Nations if we want to meet the most pressing challenges of the 21<sup>st</sup> century. And finally, global governance will always

have an informal element; without private consultations beforehand, official decisions by institutionalised bodies will be difficult to reach. Fora like the Munich Security

Conference can help to find common ground on how to meet these challenges, and contribute to enhancing conflict prevention and conflict management. □



### **Sandra Kalniete MEP**

Former Latvian EU Commissioner for agriculture

#### **"Global governance requires predictable and fair funding"**

Because the major problems we all face are global, they can only be tackled by action at a global level. And this in turn requires a fundamental reform of the architecture of global governance. It's an enormous political challenge.

But change is already beginning to happen. Frameworks like the G20 and last December's Climate Change summit in Copenhagen underline the inadequacy of most of our present international institutions.

Among the ideas now being floated there is that of an "Age of Continents", in which it is

sheer size that matters, so the world will in future either be run by a G2 made up of China and the U.S., or perhaps by a G3 that includes the EU.

The world's smaller states – and even bigger ones – are becoming increasingly irrelevant if they try to act alone without being active participants in regional integration and co-operative frameworks. Each EU member state – whether large or small – has to realise that its ability to be a global player depends on Europe's collective ability to govern the EU effectively and to make timely decisions. Pooling

sovereignty is the only available alternative to global irrelevance.

Global governance also requires predictable and fair funding for tackling the most urgent global problems. The most obvious source of such funding is global taxation of carbon emissions and also of financial transactions. These taxes would not only help to fund development programmes but would also play a vital role in steering such policies as those needed to curb global warming and reduce harmful currency speculation. □



### **Sergei A. Karaganov**

Dean of the School of International Economics and Foreign Affairs of the Research University – Higher School of Economics, Russia

#### **"Despite its decline, Europe will be a shining example of how the world should be governed"**

Several major trends will dominate the next two decades. There will be the continuous shift of economic and political power from Europe and to some extent

from the U.S. to East and South Asia. But although Europe's geopolitical decline will continue, it will remain a beacon of stability and a shining example of how the

world could and should be governed.

Russia, after reaching a peak of its new influence in 2007-2009, will also face geopolitical

decline, moving in the direction of becoming a resource and food subsidiary of Great China, Inc., with a risk, too, of cultural decline. Key factors will be:

- The U.S. continues to drift away from Europe towards the Pacific.
- The greater Middle East region remains dangerously unstable.
- Nuclear weapons proliferation persists.

The combination of climate change, scarcity of pure water increase of demand for food, energy and mineral resources is set to create a new global agenda, including competition for territory. So what model of governance for this kind of a

world would be feasible, even if hard to envisage today? In the field of economics and finance – a G2 of the U.S. and China leading the G20, or possibly a G3 that included the EU that would also lead the fight against climate change.

In the field of hard and nuclear security – an alliance-type relationship between the U.S. and Russia, moving towards a triangular relationship with China. And for "semi-hard" security – stability – a new euro-atlantic security alliance, or Russia in NATO, thus finishing the "unfinished Cold war".

And a "Union of Europe" between Russia and the EU, with common human, economic and energy spaces – the only hope to prevent the further marginalisation of both while providing a third stabilising pillar for the future international order.

There should also be a new collective security arrangement for the larger Persian Gulf area, with nuclear guarantees provided to all countries of the region by the great outside nuclear powers. And the UN should stay, of course, with an enlarged Security Council and be a provider of common rules and a universal panel for debate. □



### **Kishore Mahbubani**

Dean of Lee Kuan Yew School of Public Policy, National University of Singapore

## **“Europe provides both the problem and the solution to reforming global governance”**

We are entering a new era marked by the end of western domination of world history and by the return of Asia. All global institutions and processes will have to be reformed to accommodate this new era, but this will not be easy.

The West, especially Europe, is heavily over-represented globally. Europe makes up 12% of the world's population, yet it has 40% of the permanent seats in the UN Security Council. The

EU is also over-represented in IMF voting shares. The Benelux countries have a greater voting share (4.57%) than China (3.66%). Not surprisingly, European interest in preserving over-representation has become a key obstacle to reforming global institutions.

Paradoxically, though, the EU's success in promoting genuine regional harmony and co-operation within Europe provides the best possible role model for

reforming global governance.

Such EU principles as avoiding military conflict, greater trade and economic integration, fair and equitable representation in key decisionmaking bodies and accountability for governance decisions are the same principles that will be needed to reform global governance. Europe provides both the problem and the solution to reforming global governance. □



## Reza Moghadam

Director of the International Monetary Fund's Strategy, Policy and Review department

### "We at the IMF have already begun the process of reconciling effectiveness and legitimacy"

As we begin to emerge from the current crisis, the great unknown is whether the spirit of global co-operation and co-ordination that staved-off collapse will survive to lay the foundations of a sustainable recovery.

Fortunately there are encouraging signs, the most important being the emergence of the G20 as a very successful forum for economic and financial dialogue and co-ordination. To their credit, the G20

countries are looking ahead and committing to drawing periodically on IMF analysis to assess the consistency of their policies. Whether the G20 members will be able to achieve sufficient policy collaboration and action remains to be seen, but the act of committing to a process is a crucial step forward.

The G20 is nevertheless still an exclusive group in which some 165 countries are not represented. This means that at some point effectiveness

and legitimacy will need to be reconciled. At the IMF – which is itself struggling with these issues – this process has already begun, with major quota realignments and more transparent management selection procedures now at the top of the governance agenda.

If these efforts succeed, we will face the interesting prospect of thinking about completing the transition in global governance from the G7 to the G20 to the G186. □



## Jean Pisani-Ferry

Director of BRUEGEL, the Brussels-based economic think tank

### "After a brilliant start, global co-operation and governance may disappoint in the years ahead"

The G20 summits of 2008-2009 helped resist the temptations of protectionism and delivered a global agenda on new financial regulation, concerted stimulus efforts, a major increase in the IMF's resources and an unprecedented commitment to macroeconomic co-ordination.

It wasn't a negligible harvest, so now the question must be whether this co-operative spirit can last long enough to survive the acute phase of the crisis? For the aftermath may

be less easy to deal with than the apex, with two issues of particular relevance. The first is the future of the co-ordination process launched last year at Pittsburgh, whose goal is a rebalancing of global growth. How can a heterogeneous group of countries succeed, when some – not least the U.S. and China – have no tradition of allowing foreign oversight of their domestic policy choices?

External surpluses and deficits and corresponding exchange

rate policies will be key, as any re-balancing of global economic growth requires the U.S. and China to engage in major overhauls of their own growth models. Domestic adjustment has started on the U.S. side, but it's by no means certain that the U.S. political process will take external dimensions into account when confronted by the hard choices that lie ahead. And welcome as it was, China's stimulus shouldn't be seen as a first step towards more consumer-oriented growth.

The task ahead for Chinese policymakers is daunting, and China's refusal to bow to U.S. and European pressures on revaluing the renminbi doesn't bode well for future macroeconomic and monetary co-operation in the G20.

The second issue is the redefining of global governance responsibilities. Europe's huge over-representation in international organisations like the IMF and World Bank has

long irritated the rest of the world, and so far, the G20 has achieved no progress on this. An even more difficult question is whether the emerging world is ready to take part fully in the fashioning of new global rules. Again, China's answer will be key; for all the talk of G2, Beijing still seems very reluctant to take on its full share of global responsibilities. It will still be a poor country when it overtakes the U.S. as the world's leading economic power, and right now

it lacks the human resources to play a full role in international financial diplomacy. China is also afraid of being made co-responsible for decisions it will have little ability to influence.

The upshot of all this is that after a brilliant start, global co-operation and governance may disappoint in the years ahead, even though it is to be hoped that the acquis of 2008-2009 will provide the basis for its further development. □



### **Hans-Gert Pöttering MEP**

Former President of the European Parliament and Chairman of the Konrad-Adenauer-Stiftung

#### **"The European Parliament must play a central role if we want a democratic model of global governance"**

In the context of ongoing globalisation, global governance is surely needed to provide solutions for key political problems that are more and more exceeding their longstanding geographical limits. The focus of political decisionmakers cannot stop at a border when our problems are so international.

The best example of these new challenges is, of course, the

fight against climate change. Saving our environment is by its very nature a global question, and there is no doubt that only global agreements can counter the ecological dangers we have ourselves created.

This makes it a prime example for the problems of modern global governance. Interest groups and multinational corporations are competing for

the attention of policymakers, and at the same time new ways are needed to ensure that citizens' voices are heard loud and clear.

The European Parliament as a directly elected body that is the only supranational parliament in the world, must play a central role if we want a democratic model of global governance. □



### **Jiang Shixue**

Deputy Director of the Chinese Academy of Social Sciences' Institute of European Studies

#### **"China would never accept the idea of a G2"**

With the emergence of so many global issues, strengthening global governance has become not just important but very necessary. To make it effective,

we need to keep a number of principles in mind: First, global governance should be implemented in the framework of a multi-polar world order.

This means that the idea of a so-called G2 alliance between the United States and China is totally nonsense. China would never accept such a notion.

Second, global governance should never be used as a pretext to intervene in any nation's internal affairs and sovereignty. In other words, it needs to be accompanied by co-operation, participation and mutual respect between nations.

And third, as part of the process of strengthening global governance, the interests of the developing countries must be protected. In particular, the emerging economies, such as the BRICs (Brazil, Russia, India and China), must be given a

major say in designing the rules that will relate to global governance.

And last but not the least, the United Nations must be given an important role in any future global governance arrangements. □



### **Danilo Türk**

President of the Republic of Slovenia

#### **“We need global institutions capable of making international co-operation inclusive”**

There is scarcely any more pressing a question than that of seeking a new model of global governance. The world needs an alignment of its major economic and military powers to ensure global order and peace.

co-operation inclusive, participatory and sustainable. Today's polycentric world offers us a real chance of achieving the former, but reform of our existing global institutions is going to be needed if we're to get the latter.

whether that group can move the world in the right direction, but there will be an early test; reform of the International Monetary Fund. Let us press for global financial reform that would include as an early measure IMF reform and real changes to its quota system, its decisionmaking process and its lending policies. □

At the same time, the world needs global institutions capable of making international

The lynchpin of the two is the emerging G20. It is hard to say



### **Guy Verhofstadt MEP**

Leader of the Liberal Group in the European Parliament and former Belgian Prime Minister

#### **“Integration that transcends borders is the logical response to 21<sup>st</sup> century realities”**

There is in this day and age no single state big or rich enough to meet the global challenges. The internationalisation of our economies and financial systems along with climate change and terrorism have increasingly made policy measures by nation states inappropriate and irrelevant.

structures to tackle common problems. Unlike the great empires of the past, these regional blocs are meant to create a functioning politico-economic equilibrium based on consensus and common purpose.

Only in this way will we build a global system that is prepared to take decisive action on the political, economic, financial, commercial and environmental challenges facing our planet.

National governments are choosing more and more to join together in regional co-operation

If we are to adjust global governance accordingly, these regional powerhouses need to be represented in the UN Security Council and at the IMF, the World Bank and the WTO.

Integration that transcends the borders of the old nation states is the logical response to 21<sup>st</sup> century realities. This will lead us to a safer, more democratic and more prosperous world in the 21<sup>st</sup> century. □

# Worldwide reform means engaging public opinion first



There are real fears that the deep-seated reforms demanded by the global financial and economic crisis will not get the public support that is needed, warns former Polish finance minister **Leszek Balcerowicz**. He sets out a six-point approach to long-term recovery

Crisis such as the present one seriously disrupt our economic growth, but the question we should also be asking is in what ways do they affect longer-term development? It's an important question, yet it has attracted surprisingly little research.

Traditional growth theories focus on systematic growth forces which by definition operate all the time, although with varying degrees of intensity. These forces consist, among others, of capital accumulation, employment and technical change. And going deeper, there are underlying institutional factors like property rights, market competition, tax and regulatory burdens and the effectiveness of the rule of law.

Another strand of economic research focuses on the causes of the financial and

economic crises, but without looking at them in a longer-term growth perspective. And yet another one deals with crisis management, meaning what governments should do once a crisis erupts. In the case of a financial crisis this usually includes fiscal and monetary easing as well as rescue operations for larger financial institutions. The prevailing approach to crisis management has been short-term, and as was amply demonstrated during this latest crisis, was based on what I would call, perhaps rather pointedly, the self-justifying doctrine of intervention.

*Integrating different streams of analysis into a new and coherent approach to economic growth is a huge challenge to policymakers*

This holds that whatever crisis management measures are adopted, they are invariably justified by the argument that the alternatives would have been worse and might well have provoked catastrophe or even a meltdown of financial markets. Metaphors like 'if there is a fire, you don't worry about pouring on too much

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By Adam S. Posen

## We can argue about the causes of the crisis, but agree on its lessons

water' have been deployed to support this approach, even though they remove from the analysis such elementary questions as how to measure what are optimal doses of anti-crisis medicine that won't weaken the forces of market recovery, while also assessing the longer-term legacies of their crisis management measures.

This latter problem has only recently begun to surface in the debate under the heading of governments' "exit" strategies from sharply increased levels of public debt, from sharp increases in central banks' money supply levels and from the increasingly widespread belief that large financial institutions will go on being "too big to fail". Integrating these different streams of analysis into a new and coherent approach to economic growth is a huge challenge to policymakers and academics alike. But a number of points strike me as relevant to the current situation.

First, because financial crises as deep as the present one are socially so costly, it is only natural to try to prevent them. But just as with medicine, this demands an accurate diagnosis of a problem's causes. The proximate reason for all financial crises is the excessive growth of credit – a credit boom which goes bust. But the underlying reasons for the boom differ from crisis to crisis. In the present case, as the De Larosière report emphasised, a major contributory factor was the serious failure of public policies; the U.S. Federal Reserve's excessively loose monetary policy was followed by many other central banks, while other factors included defective financial regulations, expansionary fiscal policies in countries like the U.S., Britain and Ireland which suffered serious

Leszek Balcerowicz is absolutely right that we must seize on the current crisis as an opportunity for reform. He is also right that the policy response to the crisis, though necessary, must not be allowed to lastingly set back growth and progress in Europe. Finally, I fully support that the reform efforts must be linked to a public understanding of the causes of the crisis. Unfortunately, the specific causes and measures he advocates falsely interpret those causes, and the situation in Europe that has come out of the crisis.

First, on causes Balcerowicz's emphasis on monetary and fiscal laxity is misplaced. The crisis was largely due to the excessive laxity of bank supervision and regulatory enforcement in the financial sector. The idea that it was macroeconomic policy that caused the crisis doesn't fit the facts – many countries that had bubbles, including the UK, had much higher interest rates and much tighter public budgets than the U.S., and many countries that didn't have bubbles were exposed to large capital flows and global low interest rates (if the latter is what matters). The timing is also wrong, with the Federal Reserve's supposed excessive ease coming into play well after the bubble was underway. Those countries that did a better job of regulating and supervising their financial systems suffered less damage.

housing bubbles, a lack of appropriate macro-prudential regulations, and so on. Preventive measures should therefore focus on these policy failures rather than degenerating into hostility towards hedge funds and other private equity devices.

My second point is that there are a number of obvious economic channels through which booms that turn into busts will affect growth. These include increased unemployment, the reduction of excessive debt burdens and therefore of credit-driven spending, the restructuring of those sectors that had expanded in response to excessive spending, and the curtailment of lending by previously over-extended financial institutions.

There exist no policies that could suspend the operation of all these linkages without damaging longer-term growth. Continued fiscal expansion is certainly not the answer, as after a while it damages both private spending and business investment. But there are reforms that can facilitate the adjustment of the economy, and thus ease social pain by countering the growth in long-term unemployment. These reforms include measures to remove the labour market rigidities while also speeding-up the repair of banks' balance sheets. The speed with which economic recovery can be achieved would largely reflect the extent to which these steps are taken.

Third, and on a closely related note, most if not all EU countries were already in

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need of substantial structural reforms long before the crisis broke. This was due to a combination of their fiscal problems, their lack of competitiveness and the aging of their societies. Today's crisis makes these reforms more imperative than ever.

My fourth point, other than for those who still believe in a free lunch, is that the employment and growth implications of the EU's commitments in the area of climate change policy need to be carefully analysed. Multiplying the number of burdens being placed on the European economy is not the best policy to be implementing in the aftermath of a crisis of the scale we now face.

Fifth, it is difficult to overestimate the importance of fiscal discipline on longer-term growth. It is all too easy to find examples of countries that subsequently suffered badly because of sustained expansionary fiscal policies. By the same token, I cannot think of a single case when the long-term growth prospects were damaged by excessive fiscal stinginess. Given the fiscal legacy of the current crisis, no efforts should be spared in anchoring fiscal discipline firmly in the EU countries. Institutional measures such as a fiscal frameworks and public debt thresholds can do much to help. Ultimately, though, it is public opinion that will determine governments' fiscal stances, so fiscally conservative public opinion would be a great economic asset as it would constrain policymakers' profligacy. It is therefore up to opinion leaders to strengthen this sort of attitude.

My last point is that crises are of course unpleasant, but they are also widely thought

Second, and reflecting this reality, the real challenge is to unwind the emergency guarantees and state interventions into the financial system, while restoring the necessary degree of regulatory discipline. This will take a true buy-in from the public now that the moral hazard of governments bailing-out both too-big-to-fail institutions and too-widespread-to-lose forms of savings has become the expectation. Fiscal and monetary discipline, on the other hand, will for the most part be restored shortly, although with some pain and protest. But the recognition of bond market requirements, even if not of strict adherence to the Maastricht fiscal criteria, is binding throughout Europe – and with one notable exception, was problematic before the crisis, long-term interest rates and inflation expectations in European economies reflect this reality.

Third, the vast majority of economies in the eurozone and in eastern Europe are right to treat the crisis as an exogenous demand shock – something that is coming from outside their control, and is temporary. Whether in the form of Finnish and German programmes to support work-sharing or the Czech Republic and Poland's tolerance of one-time currency depreciations without changing monetary policy frameworks, those economies that are without structural imbalances are right to ease temporarily in response to a demand shock. The minority of European countries that need more fundamental rebalancing, such as Ireland, Hungary, and Spain, obviously face a different set of challenges.

We would be wrong on the politics as well as the economics, however, if we did not publicly recognise that the majority of European

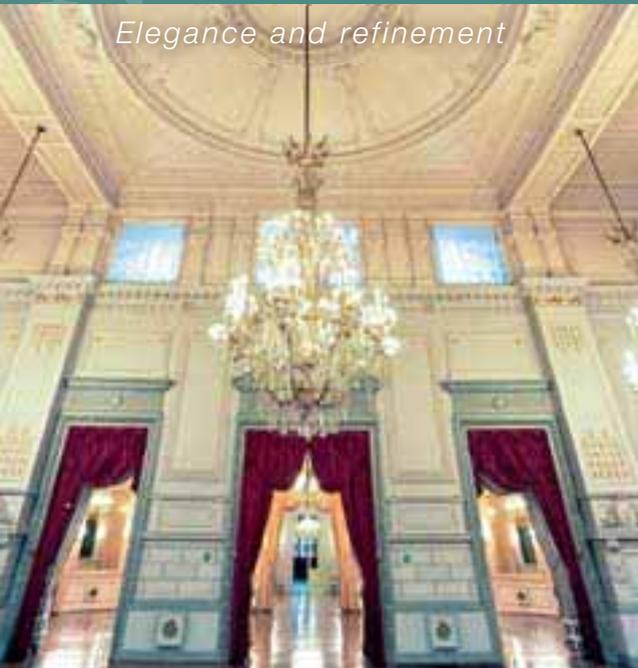
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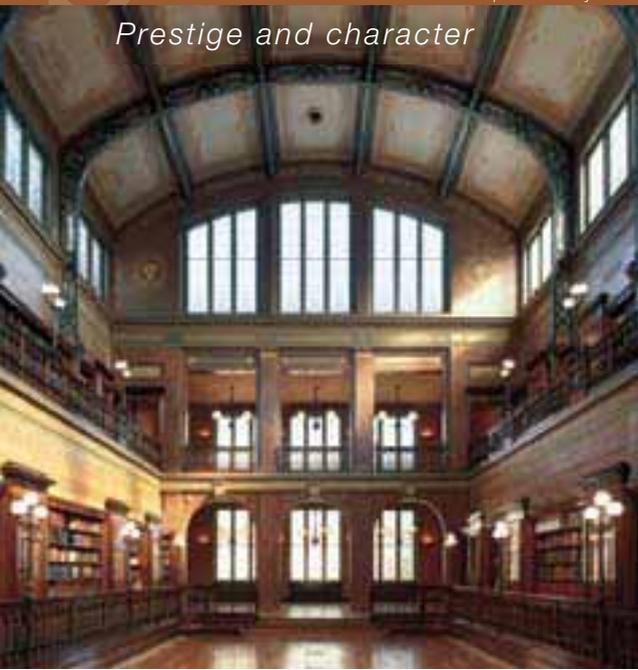
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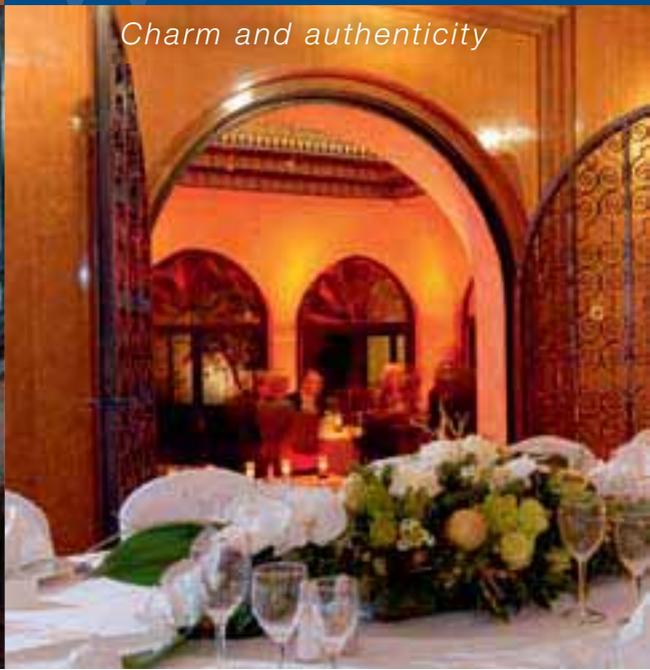
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to facilitate growth-enhancing reforms. This isn't always the case, though, as the policy conclusions that will be drawn from the present crisis will largely depend on what the public perceives as the reasons that caused the trouble. If European public opinion were to put the blame on previous market reforms, the policy lessons to be drawn from the crisis may go off in the wrong direction. This was precisely the case in Russia in 1998 and in Argentina in 2000, as in both cases the dominant stream of public opinion blamed previous reforms for the crisis even though the truth was that both crises had been caused by fiscal irresponsibility and insufficient reform.

Having said that, if public opinion across Europe holds policy errors or the lack of reform as responsible for the crisis, then there is a chance that the right policy lessons will be learned and that sound growth policies will result. The key to overcoming the crisis and its difficult legacy is the way that Europe's citizens perceive the origins of the financial crisis that erupted in the autumn of 2008. □

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*Leszek Balcerowicz is a former Deputy Prime Minister and Finance Minister of Poland (1989-1991; 1997-2000) and a former President of the National Bank of Poland (2001-2007). lbalce@sgh.waw.pl*

states in terms both of population and economic weight responded rightly to the crisis, and did not cause it. The one-size-fits-all re-statement of the same old list of neo-liberal critiques of pre-crisis Europe, which the Balcerowicz article appears to support, is misguided in the current context. Yes, the Kurzarbeit-type measures could, if allowed to persist, impede labor re-allocation in normal times, and a reliance on devaluations is a long-run loser. And yes, there certainly still are structural concerns about Europe's low trend productivity growth, made the more pressing by the demographic burden. Yet most of Europe had made great strides on labour market liberalisations before the crisis, and dogmatic financial liberalisation has proven to be excessive. There certainly is room to re-think the recommendations. □

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# Why U.S.-EU economic co-operation holds the key to global governance



The globalised economy and the rise of new economic giants demand a radically reformed international system, says **Robert Hutchings**. But it will nevertheless fall to Europe and America to fashion these new structures for global governance

Despite the many calls for a “new Atlanticism” or a “new transatlantic bargain,” the U.S.-European relationship is still imprisoned by old habits and ways of doing business. Yet, it is an inescapable reality that almost all the new challenges lie outside the traditional NATO relationship, and many of them are in areas where U.S. and European views have long diverged.

It would be too much to ask that there be a U.S.-European meeting of the minds on every global issue, but on many of these issues U.S.-European strategic convergence seems both possible and necessary. These include management of the global financial and trading system, addressing energy security and climate change, and re-fashioning existing international institutions to address all these problems.

Perhaps it has taken the global economic crisis to compel Americans and Europeans to revitalise their co-operation and exercise

co-leadership. It was noteworthy that the International Monetary Fund found itself totally sidelined, making it the first time since its creation at the 1944 Bretton Woods conference that it has played no role in a major financial crisis. It was for this reason that the Europeans, led by UK Prime Minister Gordon Brown, called for a summit meeting of the G20 world economic powers to consider a “Bretton Woods II” world financial architecture, bypassing not only the IMF but the G7 as well.

This initiative and the three G20 summits which have since taken place – Washington in November 2008; London in April of last year; and Pittsburgh in October – have been a promising start. With European and U.S. leadership, several measures were undertaken to strengthen financial oversight and monitoring via the IMF and a Financial Stability Board that replaces the old Financial Stability Forum. The G20 leaders also agreed to recapitalise the IMF

and multilateral development banks via an impressive \$1.1 trillion package of measures to assist the poorest countries. The G20 was formally designated at Pittsburg as the premier forum for international economic co-operation, but although it is far more inclusive and representative than the G7, the G20 is itself far from ideal because Europe is so greatly over-represented, with France, Germany, Italy, the UK and the EU all having seats at the G20 table.

The essential next step is to bring the new economic powers more fully into the global system and to have their growing power and influence reflected in the IMF, World Bank and other institutions. The emerging market economies account for 30% of global GDP, 45% of total exports, and 75% of foreign exchange reserves, yet the traditional Western powers of the OECD continue to hold 63.8% of the total voting shares in the IMF, with the G7 alone constituting 43.7% of the total.

Symbolically, a good place to start would be for the United States and Europe to give up their conventional claims to the top World Bank and IMF jobs and open those leadership positions to candidates from other countries. Procedurally, emerging economic giants like China and India should be accorded substantially greater voting power. One possible formula would be for the U.S. to relinquish its position as the sole country with veto power in return for the EU's agreement to reduce its combined voting share at the IMF from 30% down to

the same level as the U.S. The size of the IMF's executive board should be reduced from 24 to 20 by consolidating European representation. Although the United States and its European partners have pledged to reform IMF governance, so far they have been loath to relinquish their privileged positions.

The global financial crisis also has contributed to a growing crisis of the world trading system, with governments responding to anti-globalisation pressures by pursuing mercantilist policies. Bi-lateral and regional trade agreements

have been proliferating, most of them the kinds of discriminatory trade deals that the U.S.-led international order was designed to prevent. Meanwhile, the Doha Development Round, launched in the aftermath of 9/11, risks becoming the first post-war multilateral trade negotiation to fail. Doha's failure would aggravate protectionist pressures and could cause irreparable damage to the World Trade Organisation's own credibility.

*One possible formula would be for the U.S. to relinquish its sole veto in return for the EU to reduce its voting share at the IMF from 30% to the same as the U.S.*

Yet despite their rhetorical commitments to completing the Doha round, neither the U.S. nor any other economic power has done much to move it forward, and the reasons for this inaction are not hard to find. In the U.S. and elsewhere, it has sparked widespread opposition from workers and trade unions, and only tepid support from the wider public. It is, in short, the familiar story of gains being widely distributed while losses are sharply focused, usually by sector, often by region. Reviving Doha will only be possible if the American public and the Congress see

large, headline-grabbing benefits that could offset opposition from those who would be adversely affected. The abstract appeal of free trade would need to be accompanied by a widely shared conviction that it is fair as well as free.

A bold international move would be needed to overcome entrenched positions, and that means a deal involving substantial concessions by the U.S. and the EU on agriculture in return for commensurate commitments by India, Brazil, China and others to open their own markets for services and agriculture. With the Europeans, simultaneous pursuit of an “enhanced transatlantic market” would make a new U.S.-EU Doha initiative on agriculture more attractive to both sides, as it would aim at reducing additional barriers

to transatlantic trade that are not covered in the multilateral round.

On energy and environmental co-operation, the G20 has increasingly taken on a key role that reflects the fact that its members account for more than 85% of global economic activity, energy consumption and greenhouse gas emissions. As in global finance and trade, solutions to the world’s growing energy and environmental challenges call for new mechanisms and the greater involvement of China, India and other rising powers.

Another legacy of the outmoded international system is that the International Energy Agency includes none of the major energy supply countries. The U.S. and Europe should take the lead in expanding

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its membership to include China, India, Russia and other non-OECD countries, and in elevating the IEA, along with an expanded Energy Charter Treaty, as a forum for energy security through negotiation among suppliers, consumers, and transit countries.

The EU and U.S. should also exercise leadership in fashioning a new global environmental regime that includes the world's rising economic powers. As Copenhagen's outcome has made clear, a global mega-deal is probably not feasible under current economic conditions, so the most realistic outcome would seem to be flexible national plans with political, rather than legally binding, commitments to cap carbon emissions by 2050, reviewed and monitored by an international body analogous to the WTO trade policy review mechanism. To induce China and India to join such a consensus, the U.S., EU and Japan would need to take the lead in assembling a clean energy fund with significant private sector participation – a more ambitious version of the International Partnership for Energy Efficiency Co-operation (IPEEC) established at the G8 summit in L'Aquila, Italy, last July.

In sum, the world is on the cusp of the most profound shift in global power and influence in a century. Managing this quiet revolution calls for nothing short of a new international system, with a radical revision of existing institutions and patterns of doing business. The existing international system, fashioned for the world of the mid-20<sup>th</sup> century, is not very relevant to the new global agenda, and the emerging re-distribution of power roughly from west to east is unlikely to permit any new global order to be managed by a U.S.-European condominium.

Having said that, the United States and Europe nonetheless have an indispensable role to play in fashioning a new global order that can integrate the rising powers and accommodate their interests, while at the same time preserving the basic liberal values that have underpinned the western-led post WWII system. But an attempt to deal with new problems within the framework of existing institutions cannot provide the solutions required. This is where the international community has been stuck for nearly two decades since the end of the Cold war; trying to adapt those institutions to new challenges and open them to new members, while invoking a sense of common interests that were more relevant to the last half of the 20<sup>th</sup> century than they are to the early 21<sup>st</sup>. That effort at incremental adaptation has almost run its course; now a new burst of creativity and leadership is needed.

It has been a popular rallying cry since the end of the Cold war that on almost every issue of the day Americans and Europeans would be better off working together than working separately. It is an inspiring message, and may even be true, but the years since the collapse of the old order have shown that just because Americans and Europeans should act together in this new era did not necessarily mean they would do so. □

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# Ending boom and bust: The case for macroprudential instruments



What can be done to make the world's financial markets more resilient and the 'real economy' more stable? **Paul Tucker**, Deputy Governor of the Bank of England, sets out his thinking on why new macroprudential policies are needed

There is a widespread agreement that we must all do our utmost to avoid a financial crisis like this again. And to do so we need a more resilient financial system that will be less prone to boom and bust. Part of the solution lies in the regimes that restrain the behaviour of banks and dealers so that they can withstand adversity. But another part lies in whether the authorities can lean against the boom phase of the credit cycle.

That's why in late November the Bank of England published a discussion paper on the possible role of macroprudential policy in helping to restrain the future build-up of risks within the financial system, and the threat these can pose to the economy generally. The aim would be to make the financial system more resilient and the real economy therefore more stable. With its focus on systemic risk, macroprudential policy sits between pure macroeconomic

policy and the micro regulation of individual financial institutions. Along with regulators, central banks have a clear interest in helping to develop ideas in this area, not least to avoid an unrealistic burden being placed on monetary policy. The recent crisis has reminded everyone that the business cycle and the credit cycle are not always the same.

The key elements of this debate can be put under the following headings: policy aims and objectives; policy instruments; whether to deploy those instruments on the basis of rules or by using discretionary judgment; and international co-operation. Behind its technical detail, there lies the straightforward question of whether our economies can create regimes in which the authorities are ready and able, as the Federal Reserve's Chairman William McChesney Martin put it some 50 years ago, "to take away the punchbowl when the party

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By Lars Nyberg

threatens to get out of control." Having a body that meets regularly to consider precisely that issue might serve us well because it would mean that during the good times at least one body remains focused on how the good times might go sour. But that sort of body is feasible only if we can design the instruments and mechanisms needed to hold to account the relevant authorities.

To begin with the aims and objectives, in big picture terms these include quelling asset price booms, targeting credit growth and strengthening the resilience and performance of the banking system during credit booms and busts. The Bank of England discussion paper aired the possibility of focusing on the resilience of the banking system over the credit cycle because that would indirectly affect credit supply conditions and so help to lean against credit-fuelled booms.

So why not target asset prices? Essentially because we at the Bank of England feel that the threat to financial stability is greatest when exuberance in asset markets is accompanied by excess credit growth and indebtedness. It is the impact of falling asset prices on an over-leveraged and liquidity stretched financial system that imperils the provision of essential financial services to both businesses and households. But, in that case, why not cast the objective solely in terms of targets for credit growth? We doubt it would be feasible. Macroprudential instruments could be deployed to influence the terms on which credit is supplied by the banking sector, but the resulting growth of credit will also depend on demand conditions which lie beyond the direct reach of macroprudential instruments. Also, residents of industrialised countries are free to borrow abroad, so total credit growth

## Cross-border banking is the problem, and also the solution

The most striking feature of the crisis is its international dimension. Earlier financial crises have mainly been national, and so were of national concern. But globalisation and the development of large cross-border financial institutions have changed all that, so problems arising in one corner of the world spread rapidly to others.

The heart of the matter is the mismatch between responsibilities and powers. The responsibility to clean up the mess in a national financial system that was caused by the failure of a cross-border institution may well lie in one country, while the main powers to regulate and supervise it rest with another. Needless to say, the incentive structure for the banks and other financial players is unsettling because so many mixed signals are likely to be sent.

This could lead a government to one of two conclusions. One would be essentially to close its borders to financial services and take a protectionist stance on regulation, supervision and crisis management. Protagonists of this view have a fully justified fear of having to pay for problems caused by some institution or market over which they have no control. But this would nevertheless be a costly and reactionary road to follow, as well as a tremendous blow to European integration that carries

cannot be controlled by constraining domestic lenders. But there is no good reason to turn our backs on the free flow of capital across borders, so we need a macroprudential regime that caters for that.

Focusing on the dynamic resilience of the domestic banking sector' would be likely to act to some degree as a circuit-breaker on domestic credit supply. So there would be an effect on credit conditions, and so plausibly some indirect taming of the credit cycle during the upswing. And, crucially, during the subsequent downswing, the macroprudential dial could be relaxed where necessary to lean against the risks of a perverse downward spiral in the supply of credit, the economy and the strength of the banking system.

Turning to policy instruments, the obvious ones are capital and liquidity requirements for banks, and how much collateral they must take when lending to borrowers on a secured basis (often known as 'haircuts'). Let's take by way of illustration just one approach; that of applying a top-up or 'surcharge' over and above the usual regulatory minimum capital requirement. Those surcharges could be applied to headline capital requirements or at a more disaggregated level, through 'risk weights' on different classes of lending and exposure. To lean against accumulating risks to stability, they would need to vary counter-cyclically, increasing in a credit boom and perhaps falling during a cyclical contraction in the supply of credit.

The case for focusing on particular classes of lending is as follows; imagine that the authorities judge that a boom in lending to a particular sector of the economy had become overly exuberant and so threatens stability. Assume that this lending was to the shadow banking system (say conduits, special investment vehicles and so on). If the authorities were to raise the headline minimum capital ratio, banks could respond in a number of ways, including the perverse reaction of cutting lending to parts of the real economy that were showing no signs of exuberance, while continuing to lend on overly relaxed terms to the exuberant shadow banking system. In the real world this might well happen if lending of this sort seemed to offer terrific returns. A regime like that would not command support for long. Of course, the focus should sometimes be aggregate credit conditions, but if the relevant authority were always to delay its intervention until everything was booming, it might be harder to restore calm to the party.

To turn to the key question of whether clear-cut rules or the discretionary judgement of the authorities should determine the use of policy instruments, it's worth saying that many commentators would ideally like policymakers to use simple rules. This helps people to understand what is going on, and makes it easier to hold policymakers to account. But accountability for a flawed rule helps nobody very much, and we at the Bank of England are doubtful that such a thing as a simple rule

*To make the financial system more resilient and the real economy therefore more stable, macroprudential policy sits between pure macroeconomic policy and the micro regulation of individual financial institutions*

## COMMENTARY

Lars Nyberg

either exists or could be developed. If that view is correct, then judgment would always be needed to make reasonable policy choices. That in turn would call for an assessment of the resilience of the system, credit conditions, sectoral indebtedness and systemic spillovers. In short, all the available evidence would need to be weighed.

In very broad terms, this would be akin to applying Basel-Capital-Accord Pillar II-type judgments to banks in general. Doing so would share with the Pillar II element of micro prudential regulation a focus on the circumstances that warranted a capital charge different from the Pillar I minimum. But it would also differ in a number of important respects; first, any changes would have to be applied to all banks in the authorities' jurisdiction, with individual banks being affected differently depending on their exposure to risk. Second, raising of capital requirements would depend on the problems facing the whole system, including how badly banks were exposed to each others' risks. Third, although in the micro prudential setting Pillar II always adds to the Pillar I minimum, a macroprudential authority might actually reduce risk weights and therefore capital requirements during a credit cycle's downswing. Fourth, application of a capital charge would need macroeconomic as well as financial system inputs, so to the extent that top-down stress tests were employed as one of these inputs, there could not be a standard battery of mechanical scenarios. They would need to be tailored to the risks confronting the financial system and the economy as a whole.

It would be important to constrain such a macroprudential regime so as to ensure

with it the loss of future welfare gains for the EU as a whole.

A different and more promising avenue from a European perspective would be to move in the opposite direction by further enhancing cross-border co-operation. This will admittedly be challenging as one would need to find new ways of managing national interest conflicts that arise in cross-border crises, meaning better burden-sharing mechanisms. It's never going to be easy, but discussing these matters ahead of a crisis rather than during it would greatly improve the chances of success.

Inevitably, globalisation and cross-border integration will also increase the role for supranational solutions. The development of European supervisory agencies and of a European Systemic Risk Board are important steps towards creating the sort of framework that can effectively oversee an integrated EU financial services sector.

The failure of financial regulation and supervision has been a painful feature of the crisis, for the existing frameworks were demonstrably ill-equipped to curb exaggerated risk taking in upturns and, conversely, destructive herd behaviour in downturns, or to contain the rapid spread of problems throughout the financial system. Extensive efforts are now being made to design a regulatory and supervisory framework that will reduce the risks of a major new financial crisis. As Paul Tucker puts it: "...putting in place a workable framework for macroprudential policy is now one of the great challenges facing our generation". I couldn't agree more.

transparency, accountability and a degree of predictability. That in turn would call for a very clear timetable for taking decisions, and for public explanations of those policy decisions. Even if the relevant authority had not actually used its policy instruments, a public explanation of the areas of banking it had examined might help to focus the minds of banks' managements and the boards of directors.

What of the international dimension? There are big questions about whether a country could do any of this on its own, and whether tight co-ordination would be both needed and would be effective enough.

A useful illustration might be a case where the financial stability authorities in one country

increased the risk weight on, say, domestic mortgage lending. The measure would apply only to banks headquartered domestically or operating out of a subsidiary, but could not apply to branches of foreign headquartered banks, still less to purely cross-border activity. It is easy to imagine that, rather than borrowing from domestically-domiciled banks, mortgage brokers would arrange for households to borrow from a lender based abroad, or at least with the loan booked abroad. In terms of the accumulation of debt in the sector concerned – in this hypothetical case, households – there might be little or no effect. That would obviously not be great for the risk of default by the borrowing sector concerned, but domestically based banks would have been required to build their defences. If so, the

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# COMMENTARY

**Lars Nyberg**

damage to those domestic-based banks of any financial strain would be reduced, and the eventual economic costs might be lower, especially if they were able to take up some of the slack created by withdrawal of credit supply by foreign banks to sound borrowers.

One might even go further than that. In the first place, a domestic authority increasing capital or liquidity requirements on lending by its banks to a particular sector could act as a signal to international counterparts like to the home authorities of overseas banks. It would clearly be important to share this sort of analysis with peer organisations elsewhere, even if things went no further than that.

More market transparency would of course strengthen that international dialogue and might usefully form part of a wider discussion on the use of macroprudential instruments. For putting in place a workable framework for macroprudential policy is now one of the great challenges facing our generation, and an active exchange of ideas is needed. The thoughts set out here draw on existing work by other regulators and central banks, but a lot more work is needed before policies of this sort could be put into practice. There are plenty of other elements to such a regime, but at least a debate is now under way. □

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At the same time, we all realise that it would be futile to think that we can rule out future crises in the financial system. One of the most important lessons of this crisis is the importance of effective crisis management.

When a crisis breaks out, it is important that the rules of the game should be as clear as possible, so if we are to minimise the risk of future crises we need a system in which banks' shareholders and creditors know they must not expect any government bail-outs. □

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## Why the euro is not on course to dislodge the dollar



America's use of the dollar as a formidable instrument for its own economic management has long excited international criticism and resentment.

But **Charles Wyplosz** explains why the euro is still far from poised to take over from the enfeebled U.S. currency

China's central bank governor Zhou Xiaochuan has expressed his displeasure with the U.S. dollar; he is not the first one to do so and certainly won't be the last, but as he sits on top of a cash pile of some \$2.3bn, people noticed. Many others around the world have also been displeased with the dollar, and they have seized on Governor Zhou's outburst to try feverishly to usher in a world where no one currency will rule the world. And it's only fair to say that Mr. Zhou's remarks led the G20 to promise a new issue of SDRs, the Special Drawing Rights that are the currency unit created by the International Monetary Fund (IMF).

Outrage at the dollar's supremacy is understandable. Being able to print a currency that everyone instantly recognises

and that most want to hold, as the irritation of the People's Bank of China so clearly illustrates, is a privilege that some consider 'exorbitant'. It allows the U.S. to raise seigniorage, a tax-like levy that central banks obtain by selling bank notes that cost them virtually nothing to print (nowadays central banks often don't even print bank notes, they just grant loans, but this is a minor technicality that detracts from the powerful and accurate image of seigniorage). Even better, it allows U.S. residents to borrow worldwide in their own currency and on better terms than others, thus financing huge public and private deficits that many see as the root cause of the global financial crisis and the probable cause of the next meltdown. It allows U.S. financial institutions to act as bankers to the world, a privilege that they have so far severely misused in

this century, while Governor Zhou – or his predecessor – was busily stocking up China’s reserves with more dollars every day. More profoundly, perhaps, there is a sense of unfairness. The dollar’s role was enshrined in 1944 at the Bretton Woods conference, three generations ago, so how far should the shadows of the past extend and is it not time to move on?

Dumping the dollar may be a fine idea, but we nevertheless need an international currency-like instrument for settling international payments. Governor Zhou is well aware of that, and quickly followed up on his outburst with a more sedate statement that the People’s Bank of China was definitely not about to sell its dollar mountain, but from now on would be acquiring other reserve assets than U.S. dollars, euros for instance. That of course raises the question of whether the euro could displace the dollar in the vaults of central banks around the world? Unlikely though it is, let’s assume that it could happen and ask ourselves what would change?

The first thing to change would be the seigniorage business. World international reserves amount to some €4,000bn and are likely to keep on rising fast if China and other emerging-market countries insist on accumulating ever greater foreign currency holdings. Would that mean the instant enrichment of the European Central Bank (ECB)? Hardly, as reserves are mostly held in the form of government bonds which pay interest. Governor Zhou and his

colleagues would have to fish for bonds from governments they perceive to be as safe as that of the U.S., and which are also able to issue enough bonds to meet the needs of central banks. The total debt of the eurozone governments currently amounts to about €9,000bn, but not all of that is considered to be top quality. The supply of euro-denominated instruments that are adequate to be held elsewhere as reserves is not that large. The German government, which issues the Bund futures contracts, could of course oblige by running large budget deficits for as long as the euro were to remain the world’s reserve currency, but it is far from sure that this would be a very welcome development.

Still, some seigniorage would be earned as people around the world store banknotes, whether for good reasons as a safe-haven for cash, or for bad (illegal trade) reasons. The euro has in fact already won a significant share of this market, with some €100bn worth of banknotes shipped abroad by the ECB, which compares to about \$400bn in U.S. banknotes circulating outside the United States. Some additional benefit would accrue to eurozone governments because their borrowing costs in what would have become the leading world currency would decline, but the overall effect is unlikely to be massive.

Over the last decade, European interest rates have not been systematically higher than American ones. Where the U.S. really made a profit was by borrowing

*The only way the euro area could wield more power has nothing to do with the role of the euro itself but relates to the “balkanisation” of Executive Directors in the IMF’s Board*

from the likes of Governor Zhou at short maturities and low interest, and then lending elsewhere at long maturities and higher rates. Lending is the business – and profit – of banks, and that’s a reflection of the towering role of Wall Street. If the euro were to gain a truly international status that could help challenge Wall Street, but that would also require serious changes in the way European governments deal with their financial markets and financiers. My own bet would be on London, already the leading market for euro assets, to reap the profits rather than Frankfurt or Paris.

Why, then, do so many people in the world want to see the end of the dollar’s supremacy, and why do some in Europe get excited at the prospect of seeing the euro become currency suprema? If the economic advantages are limited and financial domination unlikely, what’s left is political power. The dollar is often seen as America’s wonder weapon and the source of its dominance in international economic and financial negotiations, so the question is would Europe capture that role if the euro were to become the main reserve currency?

A first answer concerns the IMF. Power within the Fund is formally determined by quotas and, for the time being at least, the quotas do not directly acknowledge a currency’s reserve role. Indirectly, however, if countries wanting to borrow from the IMF were to insist on borrowing in euros,

that could have some effect, albeit a tiny one, on the complicated formula. The only way the euro area could wield more power has nothing to do with the role of the euro itself but relates to the “balkanisation” of Executive Directors in the IMF’s Board. Eight of the 24 board members are European, each with a smallish voting power. The case has long been made for all eurozone countries to merge into a single constituency with a single Executive Director, who would then have more voting power than his U.S. counterpart. It has yet to happen, though, because no EU country is willing to give up its own seat for the common good.

*The euro’s accession to international currency status could open a window of opportunity for European financial markets*

It is also far from clear what the dollar’s role as the world’s reserve currency confers in practical terms on the U.S. in international economic and financial terms. America’s GDP is in any case by far the highest in the world, and will be for many years to come. The euro area’s overall GDP is close to that of the U.S., but there is nothing like a single eurozone voice, no more than there is a single eurozone Executive Director at the IMF. And Wall Street is by far the single largest financial centre in the world, with the City of London only a distant second. And if U.S. banks do not necessarily top the world league in terms of size (it used to be Japanese banks, then Swiss and British banks), the truth is that nowadays big banks may be more a curse than a blessing. In financial as in economic matters, therefore, America’s domination

is towering and this may much more explain U.S. influence in world affairs than does the special status of the dollar.

As noted earlier, the euro's accession to international currency status could open a window of opportunity for European financial markets. To reap this advantage, however, continental Europeans would need to start developing a love affair with their financiers, even though this is certainly not the direction in which they have been moving of late. Germany's Chancellor Angela Merkel has even expressed the opinion that the U.S. model has been shown to be deeply flawed. It is of course, and although the solution she proposes might perhaps make it safer, it would certainly not make it better-performing. Nor does French President Nicolas Sarkozy's berating of "financial capitalism" suggest that Paris is about to mount a convincing challenge to New York, not least because the Paris Bourse now belongs to the New York Stock Exchange, just as do those of Amsterdam and Brussels. For the foreseeable future, continental Europe is unlikely to provide fertile ground in which finance can flourish.

Finally, could the ECB one day challenge the U.S. Federal Reserve? In a way it already does. Financial markets around the world pay nearly as much attention to ECB president Jean-Claude Trichet's utterances as to those of Fed chairman Ben Bernanke.

The reason is that ECB policies determine developments in an economic area about as big as the U.S. economy. And it is less and less the case that the dollar's depreciation is seen as an appreciation of all the other currencies. Nowadays, public comments and perceptions recognise that for one currency to go up another must go down and the euro is often the other one. Nor is it that commodity prices blindly follow the fate of the dollar. Sure, oil prices are still formally set in dollars but that does not mean that they are fixed. In fact, commodity prices now tend to rise when the dollar depreciates, and OPEC even uses a formula that automatically adjusts oil prices to track the average performances of the dollar and the euro.

*Could the ECB one day challenge the U.S. Federal Reserve? In a way it already does. ECB policies determine developments in an economic area about as big as the U.S. economy*

So what should we make of all this? First, that U.S. power in international economic and financial matters is only tenuously linked to the dollar's supremacy, contrary to appearances and to the beliefs of many. Second, that the euro is a long way from over taking the dollar. Europeans could nevertheless wield considerably more financial and economic power if they were to speak with one voice, but that seems at least as difficult for them as dislodging the dollar. □

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# A jobs plan for Spain (and Europe too)



Spain's troubled labour market highlights the unemployment problems across the EU, says **Mariano Rajoy Brey**, opposition leader of the Partido Popular. He puts forward a reform agenda for Spain that has EU-wide relevance

Whether or not Europe is in for a "double-dip" recession with a second downturn yet to come, the crisis we currently face is jobs. That means that most EU governments will be judged on how well they tackle unemployment, and this holds particularly true for Spain.

The Spanish labour market is in need of reform, and it's not a new problem. For decades, Spanish society has been resigned to low rates of employment. The country's highly acclaimed transition to democracy after Franco's era was not accompanied by comparable economic improvements. Back in 1975 there were 12.5m people employed in Spain, and 20 years later despite an increase in public sector employment that figure hadn't changed. Private sector jobs had actually shrunk during this period.

*Whether or not Europe is in for a "double-dip" recession with a second downturn yet to come, the crisis we currently face is jobs*

An improvement in Spain's labour market had to wait until new policies were brought in by the government of José Maria Aznar. I was proud to contribute to those developments at a time when job numbers increased substantially. From 1996 to 2004, the year we lost the general election to José Luis Rodríguez Zapatero's PSOE socialist

party, 5.5m new jobs were created, a figure which had grown to 20.5m by mid-2007. Nowadays, Spanish people are proud of two main accomplishments; the political transition of the 1970s and the economic upturn of the 1990s, both of which were made possible by centre-right governments.

But now things are moving in the other direction. The rate of job losses in Spain is the highest in Europe, and probably the highest in the western World. Nearly 80% of job losses in the eurozone were at

one point concentrated in Spain. Although Spain's Labour Market is so defective that basic reforms are called for, Mr. Zapatero is so concerned with short-term political advantage that he has rejected the need for reform. This approach may enhance the government's relationship with the trade unions, but it clearly damages the country's medium-term welfare, especially with regard to those people who currently are unemployed.

A comprehensive labour reform strategy for Spain means we should pay attention to four main areas: First, education. We in Spain spend billions of euros trying to improve the skills of both our working and unemployed populations. The results are far from satisfactory. Because of the shortage of people with adequate qualifications, many vacant jobs go unfilled. Yet we still have the highest unemployment rate in Europe.

The current system needs to be replaced, and at the same time accompanied by strict public spending controls and better performance monitoring. New evaluation procedures and official certification should be introduced in areas like foreign language skills and computer literacy skills.

Labour market mediation also needs to be reformed. The public employment agency is quite efficient at managing unemployment benefits, but performs poorly in terms of labour market matching. Few Spanish people can say that they found a job thanks to the national or a regional employment agency. New forms of partnership between the public and private sector, such as outplacement firms, produce better results.

# COMMENTARY

By Gilles Saint-Paul

## Of course we need reform, but there's no magic wand

The nice thing about Mariano Rajoy's proposals is that they don't reflect the whims of a politician but instead are firmly grounded in the debates on unemployment that economists have had among themselves for decades. There are certainly gains to be made from reducing mismatches between vacant jobs and job-seekers, and the structure of bargaining clearly has an important impact on unemployment levels. So his proposed reforms square well with the conclusions drawn from theoretical and empirical research in our discipline. It is comforting for an economist to hear such views from a political leader.

On the other hand, I was somewhat surprised by Mariano Rajoy's optimism both on the feasibility of the proposed reforms and the likelihood that they might trigger a process with adverse unintended consequences. We only need to look at recent history for lessons on why the rigidities we complain about are so resilient, and how reforms can go wrong.

Most economists complain about the dual nature of the Spanish labour market – a feature that economies like France, Portugal and Italy share, though to a lesser extent. But we should remember that this structure was introduced in the late 1980s by a government desperate to create jobs after a decade of unemployment rates of about 20%. At that time, a comprehensive reform wasn't politically feasible because it would have provoked strong opposition from the unions, even though it was those unions which were largely responsible for the rigidities that had led to high unemployment in the first place. The compromise was continued protection for permanent jobs, while making it easier to hire people on temporary contracts.

Collective bargaining for wage and general working agreements are overdue for reform. It is well known that labour bargaining gives better results when carried out on a national or even company basis, yet regional or collective bargaining tends to be the norm in Spain, even though it often ignores the problems of unemployment and absenteeism.

But the most important and most difficult area of reform concerns inequality. The Spanish labour market works on a two-tier basis, split between first-class workers, who if dismissed

*The reforms I am proposing concern the Spanish labour market, but have relevance elsewhere in the EU*

enjoy very high severance compensation, and temporary workers who have very little social protection. This is a difficult issue that urgently needs attention. Job protection is unfairly divided between these two classes of workers. The system is inefficient, and lay-offs depend almost exclusively on the kind of contract a worker has, as opposed to the skills or the performance of an individual worker.

The reforms I am proposing of course concern the Spanish labour market, but probably have some relevance elsewhere

## EUROPE'S WORLD BACKGROUND BRIEFING

### On jobs, the worse may well be yet to come

European Central Bank president Jean-Claude Trichet last year drew an ominous W in the air to describe how he thought Europe's economies would fare in 2010. Many indicators suggest that his 'double dip' prediction looks likely to be borne out.

Although many EU countries were badly hit by unemployment last year – Latvia's rate went from 9.1% to 20.9% and Lithuania's from 4.8% to 13.8% – year-end figures suggested Europe was hauling its way out of the first dip of the recession.

The GDP of the EU-27 grew by 0.4% in the last quarter of 2009. For some, this was a vindication of state employment subsidy schemes which protected many EU jobs from a 14.1% fall in industrial orders. In Germany, subsidy schemes helped unemployment to drop from 8.2% to 8.1% by November. And unemployment in the EU was rising at an average of only 0.1% per month by the end of 2009, a marked improvement on 2008 when it was rising from between 0.2% to 0.3% per month.

But these gains risk being short-lived. With state subsidy schemes running short of money, job-shedding could be widespread in 2010, so many EU member states are bracing themselves for the second dip of Trichet's W. The International Monetary Fund (IMF) predicts that eurozone unemployment will rise by almost 2% this year, and in Germany it could peak at 10.6% because many of the schemes that gave temporary shelter to the German economy will expire.

Spain is likely to be the worst hit this year, with its overall rate jumping from 17.9% to 20.1%. Other countries badly affected will include Ireland, with joblessness going from 12% to 15.5%, and Lithuania, 13.8% to 17.6%. Italy's rate is due to rise from 9.1% to 10.5% and in the Netherlands it will almost double to 6.6%.

And the double dip is set to continue into 2011, when the IMF predicts that EU unemployment will hit 12%.

in the EU. For although other European countries may have done better with their own labour markets, overall the results are dissatisfying, particularly when it comes to the relationship between labour markets and the welfare state.

For the most part, welfare systems and labour market reforms should be brought in at national level. However, reforms like those proposed above are easier to implement if there is a co-ordinated European strategy. The Lisbon Agenda agreed back in 2000 was a missed opportunity because although it was intended to be the first economic package that combined European and national competences, it signally failed to propose significant reforms even though the European Commission had been warning that the Welfare State was no longer sustainable for many EU members.

After a lost decade, we need to re-launch a new strategy for economic reform in Europe. This strategy should genuinely seek to ensure that our economies are the most competitive in the world, and that our social systems become genuinely sustainable. And to repeat my introductory remarks, political success should be measured in terms of jobs and welfare. If we don't act now it will be the EU that is deemed a political failure. □

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# COMMENTARY

Gilles Saint-Paul

In the short run, the dual structure was successful because it created jobs. But when in the early 1990s the next recession set in, an important drawback soon appeared – jobs were being destroyed at a faster pace than usual. This wasn't really surprising as it is easy to get rid of temporary workers by simply not renewing their contract. For this and other reasons, economists have grown wary of the dual contract structure of the Spanish, Portuguese, French and Italian labour markets. In the current recession, temporary contracts surely explain why unemployment has been growing so fast in Spain. But I believe it is only part of the story; the other part being that the structure of economic activity in Spain was heavily biased towards construction, and a painful structural adjustment must now take place with labour being re-allocated to other sectors. It is even possible that temporary contracts may actually prove helpful in speeding that re-allocation process.

Many, however, now advocate eliminating the dual structure and moving towards a single labour contract. I think they forget that this dual structure is the result of a political *modus vivendi*, and certainly there appears to be no viable political process able to change it. That's why the dual model has spread over the years from Spain to Portugal, then to France and more recently to Italy. It is hard to see how a single labor contract could reconcile the interests of permanent workers, temporary workers, and employers. If it were more rigid than temporary ones, but more flexible than current permanent ones, temporary workers might benefit but permanent ones would be more exposed. And employers would lose a margin of flexibility in managing their workforces. Everybody may want a single employment contract, but not one that's the same as everybody else's. □

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# Taking stock of EU enlargement's successes and failures



There's no doubt that the EU's ambitious enlargement strategy has been at a huge financial cost, says former Estonian prime minister **Mart Laar**. But it has been a great success economically, and not just for the newcomer states

It's not easy to weigh the successes and failures of the EU's "Big Bang" enlargement. Five years is still a comparatively short time in which to draw conclusions, and today's apparent successes can still turn into failures almost overnight. Yet the enlargement that took EU membership from 15 to 25 countries and later 27 was among the most important events in the European Union's 50 year history, and changed Europe beyond recognition.

We can all remember the grim past, in which central and eastern Europe was at first divided during World War II between Stalin and Hitler, and then at the Yalta conference in early 1945 was delivered into Stalin's hands, who promptly cut it off from the rest of Europe with his Iron Curtain. And then, after more than

four decades of straining against their communist dictatorships, the Soviet bloc's captive nations regained their freedom and started on their homeward trek – to Europe.

*The EU's enlargement strategy has yielded impressive results. The central and eastern European countries have created mature and effective systems of democratic government. On the economic front, they have also made astonishing progress*

The division of Europe was at an end and the re-unification of Europe in fact began to yield results long before the EU took a hand.

The situation in central and eastern Europe following the collapse of communism was far from easy. The chaos that ensued served to underscore the many problems that had previously been hidden behind the façade of communism's Potemkin village. The tragic events that soon followed in former Yugoslavia and parts of the former Soviet Union were

the bitter fruits of freedom. So for central and eastern Europe the prospect of eventually being able to join the European Union was of

enormous importance. Of course applicant countries would have to embrace certain rules and values – democracy, the rule of law and an open market economy – and looking back it would have been hard, if not impossible, for them to do so without the magnet of EU membership.

The truth is that the EU's enlargement strategy has yielded impressive results. In the area of democracy, despite all the pessimistic forecasts at the beginning of the transition process, the central and eastern European countries have created mature and effective systems of democratic government.

On the economic front, they have also made astonishing progress. One has only to look to Eurostat, whose data compares the newcomer countries' per capita GDPs calculated in PPP (purchasing power parity) with the EU. Overall growth has been impressive, especially over the last 10 years; Slovenia leads with 89.8% of the European average, the Czech Republic came second with 80.4% and Slovakia and Estonia were third and fourth respectively. The fastest progress was recorded in Estonia, which moved 25.4 percentage points closer to the EU average.

The World Bank calculates that GNI (gross national income) per capita in PPP has at least doubled in the transition countries. In 2008, for central and eastern Europe as a whole, GDP per capita in PPP stood at 63.26% of the European average, whereas 20 years ago in 1989 even the most optimistic communist statistics put it at only 40%.

But these growth figures also raise questions about the social costs involved. Economic growth of this sort won't be

# COMMENTARY

By **Katinka Barysch**

## Sure there are problems, but an on-going EU enlargement strategy is a no-brainer

**E**astward enlargement has been one of the EU's greatest successes. By opening its doors and stretching out a helping hand, the EU has contributed to transforming 10 central and eastern European countries from post-communist confusion into open market, well-functioning democracies. Of course the EU's new members aren't perfect; the 2008-09 global financial crisis has laid bare their economic weaknesses. The fight against corruption, cronyism and crime has slowed in some places, and massive investments in skills, technology and infrastructure are still needed to bring the eastern Europeans up to western European living standards.

But as Mart Laar argues, there is no doubt that people in the new EU countries live longer, healthier, happier and more secure lives than they would otherwise enjoy. The clear conclusion is that the EU must continue enlargement to help stabilise the regions that lie beyond its expanded eastern border. Yet the accession process is widely perceived to be in trouble, with would-be members queuing for decades while the EU is busy gazing at its own navel.

This picture is not quite accurate because enlargement is still progressing. At the end of last year Slovenia finally lifted its veto on Croatian membership talks (the result of a spat over a



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sustainable if it is achieved at the cost of massive poverty and skyrocketing inequality, the collapse of health systems, lower levels of education, falling birth rates and high infant mortality. Of course the closing years of the communist era also brought serious problems in all these areas. Poverty and inequality jumped to new heights, while people's health and levels of social protection fell. Then, after the early first shocks of transition, the situation in all these areas had by the late 1990s begun to improve, and continued to do so for ten years.

Poverty – meaning the at-risk-of-poverty rate after social transfers – has during that time fallen throughout central and eastern Europe, although it is still at 19.1% when the European average is 16%. The Czech Republic nevertheless shares with the Netherlands Europe's lowest poverty rate of 10%, followed by that other radical reformer, Slovakia. And when it comes to income inequalities central and eastern Europe is now below the European average.

Health has also improved in central and eastern Europe. Life expectancy at birth is three years longer in several of the newcomer countries, and has risen by 4.59 years in Romania. Infant mortality also decreased significantly, and is due soon to reach the same levels as in the EU-15 countries.

This rosy picture does not mean that the social situation in the EU's new member states is without its problems. Many regions of central and eastern Europe still lag well behind the older member states; life expectancy may have improved but it is still lower than in older EU states. On the other hand, fertility which declined rapidly

small stretch of coastal access). Croatia is likely to be a member within a couple of years and Iceland could soon follow. Serbia has just handed in its official application for membership, following applications from Albania and Montenegro over the previous 12 months. Serbs, together with Macedonians and Montenegrins, now travel to the EU visa-free – a hugely important change for the people of the western Balkans. Turkey has beefed up its machinery for managing the accession process and has started negotiations in the tricky area of EU environmental rules; some observers still hope that movement towards a Cyprus settlement could unblock other negotiating chapters.

But it is also true that enlargement is progressing more slowly than in the run up to the 2004 / 2007 "big bang" enlargement. There are several reasons for this. The current group of candidates is less well prepared and in many ways much harder to absorb than the 2004 intake. The countries of the western Balkans suffer from dodgy business environments, structurally high unemployment, weak and corrupt state administrations and, in some places, organised crime.

Some people in the western Balkans say that the EU should not be too tough: after all Bulgaria and Romania didn't match EU standards in many areas when they joined. That is true, but many EU politicians and officials have since regretted allowing those two countries to join in 2007 because once in they further relaxed their reform efforts. So the argument is now that for the EU to have made a mistake once is not a good enough reason to repeat it.

Turkey – although better prepared than most western Balkan applicants – poses a different set of challenges. Turkey is a proud country with a dynamic

in the transition countries during the 1990s, partly as a result of negative demographic trends begun under communism, is picking up again, and in countries like Estonia, is now among the highest in Europe.

Much less positively, criminality is higher in the new EU member states, and diseases like tuberculosis and AIDS are not only too prevalent but are also linked to heavy drinking and smoking. Despite the many positive developments in central and eastern Europe, these countries are still poor when compared to the European average.

The wounds inflicted during almost half a century of communism cannot all be healed in 20 years. And when this fairly obvious truth is not fully understood, a kind of Soviet nostalgia now exists; people sometimes forget the conditions in which they actually lived under communism, and how bad it was. Ironically, feelings of this sort are at times accentuated by a new consumerism that ignores the value systems that brought freedom to the captive nations of central and eastern Europe. Pope John Paul II was absolutely right when he warned in his encyclical 'Centesimus Annus' against both the left-wing welfare society and ultra liberal consumerism.

To understand the achievements of enlargement, we should compare developments in the newcomer states to those achieved in other parts of the former communist empire, notably those that make up the Commonwealth of Independent States (CIS). In the countries that made up the former Soviet Union,

the impact of communist rule has been so strong and the wounds so deep that even now they have not attained the same developmental levels as those of the developed world in 1989. Poverty and inequality remain high and their demographic situations are catastrophic.

In many successor states to the Soviet Union, the fundamental organisation of society has not changed despite reforms like as privatisation. It is misleading to speak of the failure of the reforms as in many of these countries the reforms have not yet begun. Democracy isn't working and the basic rules of a market-based economy don't exist. This may suit the Nomenklatura, but it undermines the interests of these countries' populations.

One reason for these negative developments is that with all its rules the European Union did not strike these countries as a reliable option. And the further away from the EU a country is, the greater the problems it has with transition. This partly explains the improving situation in Balkan countries, which are gradually coming into the EU. The prospect of membership for western Balkan countries has begun to have a positive influence on developments there, moving them towards the rule of law and functioning democracies. This has in turn brought peace and greater stability to the EU's own borders. This makes it important to keep EU enlargement on track and to further develop European neighbourhood policies. This widens the EU's own ring of stability, and while enlargement is undoubtedly a costly process, when compared to the possible

dire consequences of acting otherwise, it costs next to nothing.

The worth of the 2004 “Big Bang” enlargement can most of all be seen in light of the current economic crisis. Back in the 1930s, the Great Depression led in one way or another to the collapse of democracy not only across central and eastern Europe, but also in large parts of western Europe too. It is clear, that without the EU, central eastern Europe would have collapsed economically just as in the 1930s. The European Union’s rejection of protectionism, combined with the support given by its structural funds has helped to stabilise the economic situation there. Eurostat’s figures even suggest that overall the new member states are managing the economic crisis better than much of so-called old Europe. Cyprus and Malta fared best in economic growth terms in 2009, followed by Poland, Bulgaria, Slovakia and the Czech Republic – all of which were above average in Europe.

The Europe that has been built up as a result of the “Big Bang” enlargement is more diverse, but diversity has always been among Europe’s chief assets. Nowhere else in the world do so many cultures and languages co-exist, not only without conflicting with each other but also forging greater unity from diversity. This may still be a dream, but it is certainly a dream worth fighting for. □

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**Katinka Barysch**

economy and growing expectations of regional leadership. It does not fit so easily into the EU’s accession paradigm, whereby the EU sets the rules and each candidate must demurely apply them to prove its suitability as a member of the club.

These impediments on the part of the candidate countries are met by a sense of enlargement fatigue on the part of the EU. There are now more EU citizens against any further enlargement (46%) than are in favour (43%), according to a Eurobarometer survey last year. Rising unemployment within the EU will reinforce this scepticism as many Europeans associate enlargement with influxes of cheap labour. The kind of political leadership needed to defuse such fears is lacking. Berlin and Paris have toned down their calls for a ‘privileged partnership’ with Turkey, but they are still openly dubious about admitting so populous and predominantly Muslim a country. France continues to hold up various chapters in Turkey’s accession negotiations.

The EU cannot afford, though, to be ringed to the east by countries that are poor, disgruntled and unstable. It is not only the current candidates that need the EU as an anchor, so too do the EU’s other eastern neighbours: Ukraine, Belarus, Moldova and, across the Black Sea, Georgia, Armenia and Azerbaijan. The EU’s ‘Eastern Partnership’ is designed to draw these countries closer, but its attractiveness will be much reduced if the EU cannot offer a membership perspective, however faint. The relative prosperity and democratic stability of its new members should serve as a constant reminder of what the EU can – and must – achieve in its neighbourhood. □

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# We've got to get the EU's Balkans enlargement back on track



For a variety of reasons, says **Heather Grabbe**, the EU's strategy for bringing in the countries of the Western Balkans is losing momentum and credibility. She sets out the policy shifts that are now needed

The EU has to succeed in the Balkans. If it can't keep the peace in its own backyard its foreign policy won't be taken seriously anywhere else. But Štefan Füle, the EU's new Enlargement Commissioner has an impossible balancing act. He has to keep the accession process moving steadily forward enough to motivate the south east European countries, but not so fast that EU leaders complain and threaten to block it. It's a Catch-22; the Enlargement Commissioner has to promise membership is just around the corner to motivate the would-be members, but cannot offer a date or promise short-cuts because conditionality would then lose its credibility.

Yet if these countries consistently fail to meet the conditions, Brussels cannot just walk away from the Balkans. The region is in many respects already part of the EU; it is an enclave within the EU, sharing borders with member states like Greece, Bulgaria and Italy that have been the source of much inward investment. The European single market is the Balkan region's most important trade partner, and problems in the region spill over into the EU very quickly – quite literally, in the case of

environmental accidents on the Danube, and metaphorically with organised crime using the Balkans as a major route for the trafficking of weapons, drugs and people. EU interior ministers see lax border controls, failings in the rule of law and persecution of minorities causing migration as a threat to the security of their own countries.

So Balkan and EU leaders alike are stuck with an increasingly unpopular policy. Enlargement has consistently lost support in public opinion surveys around the EU as it is seen as expensive and as the potential source of more migration and crime. But when EU foreign ministers meet in Brussels to discuss the Balkans they know there is no alternative to the accession process. What other policy could the EU possibly offer that could resolve the region's problems? Eventual EU membership, with conditions to encourage reforms along the way, is the strongest political incentive and most substantive support the EU can offer to any country.

But enlargement policy has steadily lost credibility and public support in the Balkans too. The process is slow and bureaucratic by

nature, and the EU has had to add conditions to deal with the legacies of war. Many Serbs blame the EU for giving independence to Kosovo (even though not all member states recognised it) and for demanding the delivery of indicted war criminals to the Hague Tribunal. Some Bosnians and Macedonians feel that the EU has failed to deliver on promises made around the peace deals at Dayton and Ohrid. Across the region, reform fatigue and the sense that living conditions are not getting better have made people jaded about promises of a brighter European future.

In the popular imagination, the accession process occupies a familiar paradigm for the region: the distant imperial capital which imposes its rule and demands tributes has over the centuries shifted from Constantinople to Vienna and now to Brussels. Power resides in the Berlaymont, and fealty must be sworn to the blue flag with gold stars, yet people still feel little improvement in their daily lives.

How can the new Commissioner overcome this psychological trap of broken promises and half-hearted reforms? An important way will be to offer interim rewards that motivate countries to keep going, and raise public support. Robert Cooper, a senior EU diplomat, has described EU foreign policy as "Speak softly and carry a big carrot"; the EU is offering the Balkans the biggest carrot it has, yet it still looks rather small because membership is so far away. The answer is to chop the carrot up and offer pieces along the way to keep the would-be members interested by giving them financial benefits and inclusion in EU policies and programmes, as well as strong political engagement.

The EU is now proffering a huge chunk of carrot in the shape of visa liberalisation, which is the benefit most prized by citizens of Balkan countries. This is an example of successful

# COMMENTARY

By **Hido Bišćević**

## It's as much a challenge for Balkan governments as for Brussels

**H**eather Grabbe points rightly to the complexity of relations between the EU and south eastern Europe, in particular with candidate and potential candidate countries. Last year saw both a winning over and a slipping away from these objectives; the EU was very much in the process of redefining its priorities and its future strategic course against the backdrop of the Lisbon treaty and its promised new institutional landscape. With the EU's inward-looking preoccupations, and with the accession negotiations with Croatia having been blocked for most of the year, stagnation and slowdown inevitably affected national agendas right across the region. There were signs, too, of a re-nationalisation of policies that are meant to be increasingly shared, and that's because so many unresolved issues in the Balkans are either bi-lateral in nature or relate to status issues in different countries.

Yet in the comparatively short time since the EU's last enlargement round, it has become clearer than ever that it is vitally important to ensure that candidate countries have a dual commitment to the EU agenda as well as to their national or regional concerns.

Despite all the setbacks, Balkan countries have continued with their reform programmes, albeit to different degrees. This was generally recognised in the latest Communication of the European Commission on enlargement, with

conditionality at work. The EU set very specific conditions for these countries to meet, and a concrete and certain reward within a few years. Some Balkan countries have worked hard to tighten border controls, improve document security and introduce biometric passports, and in return the EU is marking the new year by lifting visa requirements for Macedonia, Montenegro and Serbia, with a review for Albania and Bosnia-Herzegovina due mid-year.

A few lessons from history would also help Commissioner Füle. Between 1989 and 2004, the same formula of a membership promise plus tough conditions helped post-communist central and eastern Europe – such as his native Czech Republic – to achieve a massive transformation. In the countries that were emerging from central planning and authoritarian rule, the EU's conditions for 15 years provided both an anchor and a catalyst. The anchor of EU-focused reforms gave a sense of stability and direction to the public administration even when governments changed every year, while the promise of accession was a catalyst that made reforms go faster because the rewards of membership were only a few years away.

So why isn't this formula working in the Balkans? The growing academic literature on enlargement suggests that conditionality needs favourable circumstances on both the supply and demand sides if the accession bargain is to work effectively. On the supply side, the EU has to be consistent, coherent and credible in the demands that it makes. It needs to be consistent in asking for the same reforms year after year, regardless of changes of government. This is a critical factor when party coalitions in Balkan countries are unstable and governments fall so often.

The EU needs to be more coherent in the demands it makes, so that politicians and

civil servants are pushed in the same direction instead of being given different messages from different parts of the EU. It is all too easy for the EU's present member states to undermine conditionality by whispering in a Balkan prime minister's ear that their own country's special relationship with his means that these conditions matter little so there is no need to change the system. As to credibility, the EU needs to show it is capable of delivering on its commitments, with its political leaders genuinely offering membership at the end of the process.

For conditionality to work, the EU has to be strong in both its promises and its threats, with no special pleading from any of the member states. Unfortunately, the EU has in both cases frequently failed in the Balkans. Self-styled "friends of the Balkans" have too often argued that one country or another is so important and so European that the Commission should not demand such difficult tasks as reform of the judiciary or delivery of indictees to The Hague. Other EU leaders have questioned the enlargement process, arguing for a "digestion period" after Croatia's accession, during which no more new members should join. Both proposals would undermine the conditionality that helps would-be member countries to transform themselves.

On the demand side, conditionality transforms countries most effectively when would-be members have strong states, a cross-party consensus giving priority to accession and substantial inflows of foreign direct investment (FDI). The central European countries that had the most capable national administrations made the fastest progress towards EU membership. But in the Balkans, states are weak.

After the fall of Berlin Wall in 1989, there was a strong push towards the reunification

of Europe through the EU accession process. This united all the mainstream parties in favour of undertaking any reforms that the EU demanded, with euroscepticism generally setting in only after these countries had achieved membership. But in the Balkans some nationalist leaders are already questioning whether it is worth meeting the EU's demands.

Inward investment keeps hope alive even when economic restructuring is causing job losses and social pain by bringing in new capital, job opportunities and hope that better times are ahead. But FDI into the Balkans is a trickle in comparison with the amounts that flooded into Poland, Hungary and Estonia in the 1990s.

The situation in the Balkans is far from hopeless, but the EU needs to maintain its credibility by taking much more care in the future. It also needs to keep working on state capacity-building in the region and work on bringing in more foreign investment.

Enlargement has been the EU's one really successful external policy. The EU is providing much of the support that the Balkans needs to become fully part of the European mainstream, escaping its ghetto of economic stagnation and organised crime. There is every reason for Štefan Füle to forge alliances with the many European leaders who support enlargement to make conditionality credible, consistent and coherent, and at the same time to strengthen the EU's promise to the Balkans that they really will join when they really meet the conditions. □

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**Hido Bišćević**

visa liberalisations for some of the western Balkans countries further strengthening their membership prospects.

But no one would deny that major issues concerning western Balkan countries' accession are still on the table, and that they even exert a geopolitical influence of sorts. This makes it all the more important to see stability and regional co-operation there as strategically vital. An all-out effort must now be made to complete the enlargement process and ensure there is no strategic vacuum.

But political leaders in the region also need to recognise their share of responsibility for dealing with and resolving the remaining issues. They need to uphold the present pace of reform and to enhance the rule of law. Above all, perhaps, they must genuinely embrace regional co-operation because it holds the key to economic integration and thus to their EU accession. Last but not least, they should pool resources in a new regional platform and in multilateral large-scale projects that can accelerate their economic development.

Now that the Lisbon treaty is in force, the EU's efforts to play a more assertive global role will certainly hinge on its success or failure in creating a durable stability architecture in south east Europe. The western Balkans also has a clear historical responsibility for ensuring that it becomes an integral part of the European political economy, in other words part of the solution and not the problem. □

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# Why Germany looks set to go on punching below its weight



Last autumn's elections freed Angela Merkel from the constraint of her 'grand coalition' with Germany's Social Democrats. But **Constanze Stelzenmüller** forecasts little change to Berlin's traditionally cautious foreign policy stance

Now that Angela Merkel is back in the Chancellery in Berlin with a much more comfortable coalition partner in the Liberals rather than the Social Democrats, the question uppermost in many minds is: what does this mean for German foreign and security policy? Will Germany stop punching below its weight in Europe and the world?

It's worth remembering that those hopes first flourished in 2005, when Chancellor Merkel began her first term. Her predecessor, Gerhard Schröder, at the helm of a centre left government, had taken a reluctant Germany into a military intervention to stop genocide in the Balkans, and had joined other Western nations in the attempt to stabilise Afghanistan after the ouster of the Taliban. But his relationship with the Bush administration soured irredeemably after his refusal to join in the war against Iraq. A Paris-Berlin axis to lead the EU created resentment and mistrust all over Europe, and ended in mutual recrimination. Schröder's "red-green" government often appeared to be motivated

more by egoistic national motives than any of its predecessors, most egregiously when courting Russia for the sake of Germany's energy security and at the expense of Eastern Europe.

In contrast, Merkel set out with a series of calculated gestures that seemed designed to reassure the world about Germany's reliability, predictability and loyalty to its allies. She paid deferential visits to France, NATO, the EU and Poland immediately on taking office, and assiduously cultivated a good working relationship with President George W. Bush, and also made a point of meeting with Russian NGOs during her first state visit to Moscow.

Nonetheless, her foreign and security policy proved during her first term to be both cautious and selective. She was a front-runner on climate change, but after the financial crisis broke in late 2008 she unabashedly championed protectionist measures like the cash-for-clunkers scheme which seduced Germans into exchanging their old cars for new ones with the help of a juicy tax rebate.

Deaf to pleas from NATO, German troops, still fettered by caveats, remained in Afghanistan's less-dangerous north. After last September's incident in which German troops called in an air strike on two fuel trucks hijacked by the Taliban in Kunduz, killing dozens of civilians, the opposition forced a Bundestag debate – and Angela Merkel's first government policy statement on Afghanistan in four years. Many, including Germany's military, wished that she had defended the mission as forcefully earlier on in her tenure.

Merkel for quite a while remained aloof from her fellow Germans' near-unanimous adoration of Barack Obama. And while, unlike her predecessor, she did not cultivate Moscow, she left the running of Russia and energy policy mostly to her SPD coalition partner, and to the powerful "Eastern Committee" (Ostausschuss) of the German industry federation – thereby effectively preventing the formulation of EU-wide policies in Russia and energy. Merkel has left no doubts about the depth and sincerity of her commitment to the safety of Israel; but on Iran, an important trading partner for German industry, her government has preferred to avoid confrontation. On NATO enlargement and reform, German policy seemed to consist mostly of resisting whatever it was the Americans wanted. Finally, the deal to salvage veteran German carmaker Opel just before the election with the help of Russian financing (it has since fallen apart) was made despite the fact that it jeopardised thousands of jobs in other Opel plants elsewhere in Europe – a blatantly protectionist move which might have been invented by Gerhard Schröder.

*Merkel set out with gestures to reassure the world about Germany's reliability, predictability and loyalty to allies*

Those who had been hoping for forceful and responsible German leadership on foreign policy issues have tended to blame Merkel's cautious and tactical approach on the fact that she was hampered by the grand coalition with the SPD forced on her by voters in 2005. And her own actions, together with those of her new Free Democrat (FDP) Foreign Minister Guido Westerwelle after the new coalition government took office in early November, appeared to prove them right.

Coalition agreements and policy declarations are usually the first to be shredded by what Harold MacMillan famously called "events, dear boy, events". They nonetheless remain instructive as declarations of intent, and useful as benchmarks to compare with later developments. Particularly when those markers are laid down with as much deliberation as by Chancellor Merkel and her new team.

Yet the messages they contained are oddly mixed. Germany's European neighbours received unambiguous declarations of commitment. The Sarkozy-Merkel relationship has been mostly cordial on the surface, but fraught with policy disagreements; so the fact that Merkel went to France not just once, but twice – on the day after taking office again and then on Armistice Day (a first for a German Chancellor) – went down well in Paris. Similarly, when Guido Westerwelle chose Poland as his first stop (another first for a German foreign minister), he was received with real warmth.

On the EU, the message is rather more ambiguous. The October 24 coalition agreement promised a return to Germany's traditional

role as balancer between large and small EU countries, between western and eastern Europe, and between the older and newer members. Westerwelle described the integration of eastern Europe into the EU as the mission of his generation. On key issues like ESDP, enlargement and the neighbourhood policy, however, the agreement's language ranges from politically measured to barely lukewarm.

But it was the new German government's response to the opening up of the new EU top jobs after the ratification of the Lisbon treaty that disclosed its real priorities: no German was nominated for President or High Representative, although rumour has it that Berlin covets the top job at the European Central Bank. Meanwhile, Merkel's nominee for the German Commissioner, is the prime minister of Baden-Württemberg, Günther Oettinger, a man who by many is not considered to have distinguished himself in that job.

As for transatlantic relations, the Chancellor, her foreign minister and her new defence minister, Karl-Theodor zu Guttenberg, hotly pursued each other to Washington. Invited to speak before both houses of Congress in joint session (only the second German Chancellor to have been accorded this honour since Konrad Adenauer in 1957), Merkel gave a ringing speech in which she offered America "partnership in leadership" – thereby finally responding to an invitation issued in 1990 by George Bush Sr., which had never been answered. But the offer of partnership was strangely lacking in substance: Merkel threatened Iran with "harsh sanctions", and reiterated Germany's security commitment to Israel, but offered no policy initiative of any kind. Indeed, Merkel's subliminal

message might be summarised thus: In my second term, I do not need to come to America bearing gifts.

As for Afghanistan, zu Guttenberg was the first German defence minister courageous enough to admit that conditions in northern Afghanistan are "war-like" – but he is now embroiled in a brouhaha over responsibility for the Kunduz bombing. When the Bundestag mandate for the German contingent in Afghanistan came up for renewal in mid-December, fear of opposition and public disapproval kept the government from asking for more troops; both the Chancellor and zu Guttenberg made it clear that no more troops would be forthcoming until the January 28th strategy conference in London. Foreign Minister Westerwelle, meanwhile, threatened not to attend the conference if it became a "mere troop contributor's meeting", and instead demanded a "comprehensive political approach". Given the scarcity of ideas in the German capital on precisely that topic, and the fact that the state of the economy remains fraught, it is hard to imagine that Berlin could contribute anything else than troops – but any such attempt will have to overcome massive public disapproval.

On Russia, too, the messages have been confusing, to say the least. In the aftermath of the Russo-Georgian war of August 2008, Merkel's first government had discreetly dropped the label "strategic partnership" for Berlin's bi-lateral relationship with Moscow; it was replaced by the term "modernisation partnership", a none-too-subtle down-grading. The new coalition agreement also clearly describes a relationship that is selective and conditional, avoids "one-sided dependencies" and takes into account neighbours' sensibilities. Yet on a recent visit

to Moscow, Westerwelle referred once more to Germany's "strategic partnership" with Russia. The rhetorical swingback was dutifully noted by the journalists accompanying the minister – but was there a meaning attached to the gesture?

Both conservative and liberal politicians in Germany have said repeatedly that they see disarmament and arms control as a key strategic priority, and enthusiastically endorsed the Global Zero initiative. Yet the only specific German initiative on offer is a demand that the U.S. should remove its remaining two dozen or so tactical nuclear weapons from German soil. The huge popularity of this idea is inversely related to the military value of these weapons – not least because so many Germans see the issue as one of morality.

The first steps taken by Angela Merkel's new centre-right coalition show much that is interesting, but no real shift in strategic priorities. In her first policy address to the Bundestag, Merkel emphasised that dealing with the economic crisis – which she warns is far from over – will be her main preoccupation. Other priorities, distractions, a reluctant public and a pre-disposition towards the incremental and the tactical rather than the innovative and strategic may well come to mean that the foreign and security policy of Angela Merkel's second term is to be much like that of her first. □

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# The EU is making a big mistake on banking supervision



If there's no repeat of the financial crisis, says Czech central banker **Mojmír Hampl**, then the planned new pan-EU agencies to supervise banking, securities and insurance may work. But that's a very big 'if'

At the close of last year, EU finance ministers gave their green light to a new supervisory architecture for the Union's financial markets. Now it is up to the European Parliament to address this hypersensitive issue, the most controversial part which is, of course, the powers and responsibilities of the three new pan-European supervisory agencies for banking, securities and insurance. It will be a far-reaching decision that will affect European finance for many years to come, and although some complain that the finance ministers' December compromise doesn't go far enough, there's actually a case for saying the opposite is true.

The springboard for this fundamental policy shift was the report by former

French central banker and IMF chief Jacques de Larosière. His spring 2009 report in the wake of the previous autumn's financial meltdown surprisingly ignored many vital issues that in the main had also been largely overlooked in the whole financial overhaul debate, both before and after the release of de Larosière's findings.

*We have a single financial market, but it is configured for good times only. In bad times national taxpayers pay for trouble because there is no pan-European taxpayer*

As the crisis has shown, the important thing is that there are too many rather than too few supervisory and regulatory institutions overseeing European financial markets – in the whole EU there are almost 70 of them. Jacques de Larosière and the political debate he has fostered completely gave up on simplifying and consolidating institutions at the national level first, and only then

perhaps building something supranational on that foundation. Instead of that, we are starting directly with what will be entirely new Europe-wide institutions. This is a classic bureaucratic response: faced with a problem, create a new institution. What a mistake. If we merely add new institutions to EU countries' already Byzantine arrangements, we will fail to address the effectiveness, flexibility and smoothness of information transfer through the EU-level supervisory system. Let's recall the beginnings of the crisis: the case of Northern Rock, for instance, is now seen as a notorious example of how difficult communication and the sharing of information among just three national authorities can easily make things rather worse and not better. We need to start with national supervisors first (as Germany now wisely does) and then if necessary go higher to the European level, not the other way round.

The new regulatory model also fails to address a persistent weakness of the single European financial market – how to pay the costs (or “share the burden”) when a multinational bank fails. A systemic solution must precede, not follow, any setting-up of new European institutions.

We Europeans may proudly say that we have a single financial market, but it is configured for good times only. In bad times it is national taxpayers who pay for any financial sector trouble because there is no pan-European taxpayer. In the EU we have so far failed to agree on any plausible burden-sharing models, yet it will be difficult to move

forward without one. Last June it was agreed at EU level that the decisions of the European institutions should not impinge on member states' control of fiscal policy, but how this fits with pan-European regulation is hard to say. Many of the decisions to be taken by the new European institutions may bring about costs that will only emerge much later.

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There is an interesting paradox here. Many day-to-day cross-border services ranging from freight transport to hairdressing face major barriers and restrictions. Yet if the provider of these services goes bankrupt or runs into difficulties, there is little likelihood that any national government would be called on to bail it out. How many “systemically important” hauliers are there? By contrast, banks and others can use European “passports” to provide financial services throughout the EU, which may have significant public finance implications. A nice idea, but half-baked: it fails to specify which taxpayers should

cough up if something goes wrong and savers want their money back, as with the Icelandic banks in the UK, the Netherlands or even Switzerland.

With these crucial issues unresolved, we are creating a Europe-wide decisionmaking system that breaks the golden rule of any institutional set-up: Decisions should be made by those who bear responsibility and who ultimately would pay. With too many decisionmaking powers at European level, national authorities will be answerable to their citizens and foot the bill, yet will not make the decisions.

Conversely, the European institutions will bear neither the costs nor the responsibility, but will have the power. This may ultimately create perverse incentives for both of them – all the more so if, as seems likely, there is a step-by-step increase in the power of the European institutions.

How disturbing then that the powers for these institutions that have been proposed by the European Commission and endorsed by EU finance ministers are far from negligible and may yet be increased. The three new agencies will not only enforce common technical standards that may eventually become binding throughout the EU if endorsed by the Commission (and

“technical” should not be translated as “inessential”). They will also be allowed to settle disputes between national supervisors, and more important still, should the Council declare a state of financial emergency – such as, perhaps, the one we are living through right now – the EU agencies might exceptionally be given a pre-dominant position over national supervisory authorities. Needless to say, “disputes” and “emergencies” are exactly the future situations likely to matter most to national policymakers and their taxpayers.

All in all, an outcome where in good times decisions about systemically important national financial institutions are made at European level, while in bad times national taxpayers pick up the tab would be a loss for the whole

EU. And it is hardly likely to prevent another crisis. In good times, we probably won't be able to tell the difference, but the grim reality is that we should be preparing the system for bad times. Why is it that we in the EU are once again building the house from the roof down? □

*If we merely add new institutions to EU countries' already Byzantine arrangements, we will fail to address the effectiveness, flexibility and smoothness of information transfer through the EU-level supervisory system*

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# WHAT THE CHIEFS SAY

## *What the Chiefs Say*

is a public affairs platform designed for senior executives from leading organisations to voice their expectations and concerns.

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European Salt Producers' Association

# REINVIGORATING THE GROWTH ENGINE STARTS WITH SMEs

by Jan Hommen



**ING** 

**Jan Hommen**  
**Chairman Executive**  
**Board**  
**ING Group**

The European economy is trying to recover from the deepest recession since the nineteen thirties. As the financial crisis started within the financial services industry, financial institutions have an important responsibility to go back to the basics of finance and have a clear eye for what lies at the heart of our business: collecting customer balances and redeploying these in the economy, by means of mortgages and corporate, private and other types of loans. With the Back to Basics programme ING initiated last year, we are taking important steps to reinforce our traditional role to create the conditions for social and economic progress by taking and spreading the financial risks of households and companies.

Since the abolition of EU internal frontiers, the Internal Market has boosted economic growth and prosperity, and helped creating millions of extra jobs. We could not have achieved that success without the entrepreneurial spirit and innovative behaviour that characterises so many SMEs. During the financial upheaval and economic instability of the past two years entrepreneurs have shown a remarkable ability to be agile and flexible, driven by a firm belief in their ideas and business in order to succeed. Financial institutions have a responsibility to support these entrepreneurs by fuelling their ideas and business spirit with capital.

However, reinvigorating the traditional European growth engine requires more than an injection of

capital. The business climate for SMEs and start-up companies in the European Union still leaves room for improvement. In particular in comparison with the United States, entrepreneurial initiative and risk-taking in Europe are still hampered by a complex regulatory environment and administrative barriers. This is a worrying reality, especially if one realises that SMEs are the backbone of the European economy.

Moreover, it is of great importance that SMEs themselves are encouraged to develop partnerships with banks at earlier stages than is the case today. Strong relationships between banks and SMEs will facilitate timely discussions on business plans and thus a smoother credit process.

The European Commission recognises the importance of entrepreneurship. It rightfully defines it as the mindset and process to create and develop economic activity by blending risk-taking, creativity and/or innovation with sound management, within a new or an existing organisation. It is thus to be hoped that, especially with the strong economic headwind of today, the European Commission will step up its efforts to strengthen this economic backbone.

To support the business climate, the administrative burden on businesses needs to be lessened and incentives to think across borders increased. Initiatives to develop increased social security for entrepreneurs can do a lot to support small entrepreneurs in Europe. Removing tax obstacles will improve the functioning of the Internal Market and avoid unnecessary compliance costs for business being passed on to consumers.

Reinvigorating the growth engine of the European economy through sufficient provision of capital is a responsibility taken seriously by ING. We will continue to support the European Union and other key players in its efforts to improve the business climate for Europe's entrepreneurs.

# SOFTWARE AND CLOUD SERVICES – ENABLING THE EUROPEAN ECONOMY

*by Jean-Philippe Courtois*



Photo by Paul O'Driscoll

**Microsoft**

**Jean-Philippe  
Courtois  
President, Microsoft  
International  
Senior Vice President,  
Microsoft Corporation**

Technological innovations can dramatically change the way we live our day to day lives, the way we work, and in fact, it can change entire industries. In the next 5-10 years, 'cloud computing' promises to be the next significant turning point in the way we use technology.

When we talk about cloud computing, we refer to the delivery of computing capability over the Internet. This concept is familiar to anyone who has a personal Hotmail account; however, its application in the business world is less understood. Historically, businesses have run their IT in house, with applications and data on servers at their physical location. As businesses increasingly look to drive down costs and focus on their core competencies, there is a move towards the cloud – taking advantage of the economies of scale that can be achieved by consuming services across the Internet and paying only for what you use. There are obvious benefits such as shifting capital expenditures on hardware to operational expenditure. Other benefits include an ability to have a more agile IT capability that can respond to spikes in demand as needed and a reduced carbon foot print. Microsoft's vision is one that embraces all of these benefits while providing customers with the flexibility to place some data in the cloud and to keep some on-premise.

With this flexibility created through the software plus services model, we are seeing a great deal

of innovation and entrepreneurship. The cloud computing approach lowers the barriers to entry for all, including the 8,000 start-ups participating in our BizSpark program in Europe, many of which are already providing some very innovative cloud-based services, creating great opportunities for the European ICT industry.

Both policymakers and the technology industry have an important role to play in preparing Europe for this next generation of computing in order to drive a competitive economy.

As cloud computing introduces a wide range of game changing technologies, the rules of the game must be adapted accordingly. Policy must be enabling: Creating incentives for innovation, encouraging broadband access and expansion, and ensuring choice and interoperability. Policy must also protect citizens and businesses: safeguarding privacy and security of data, upholding Internet safety, and protecting intellectual property rights. We at Microsoft are committed to developing our cloud computing services with these key issues at the heart of our approach.

Besides the positive economic opportunities cloud computing will create, improved access to efficient and flexible computing power has the potential to enable breakthrough innovation across many critical societal issues such as education, healthcare, sustainability, and research. We support the EU's various initiatives and programs helping to lay the ground for cloud computing and a new Digital Agenda. In particular, policies should focus on SME adoption and skills, a digital internal market, and improved broadband. It is only through partnership between governments and industry that we can progress towards an open, green and competitive knowledge-based society.

[www.microsoft.eu](http://www.microsoft.eu)

# LPG - AN ANSWER TO EUROPE'S RURAL ENERGY CHALLENGES

by *Loïc Driebeek*



 **SHV Gas**

**Loïc Driebeek**  
*Chief Executive Officer*  
**SHV Gas**

As the new European Commission comes into office, Europe has to define its future energy policy and secure a sustainable energy supply for all EU citizens and businesses - especially those in rural areas, located beyond the natural gas grid. The challenges are diverse and LPG can help to answer them.

Today, there is a constant debate among policymakers about the best way to fulfill the increasingly diversified demand for energy in Europe. Within all this discussion, the needs of homes and businesses in far flung rural areas are seldom mentioned. The fact is that around 30 million homes and businesses are located beyond the natural gas grid. These consumers often use appliances fuelled by high polluting fuels such as solid fuel or heating oil.

Many commentators seem to consider the countryside to be a great place to site nuclear power stations, wind farms and solar panels without considering the needs of the people who live there. SHV Gas believes that the relatively high carbon footprint of rural areas needs to be addressed without penalising their way of life. It is in this area that we believe LPG – used either in high efficiency applications or in conjunction with renewable technology – has a vital role to play.

One example of an energy efficient technology powered by LPG is Micro-CHP. Combined Heat

and Power (CHP) is a well-established technology that allows heat and electricity to be produced simultaneously from the same fuel source – LPG. The potential of Micro-CHP is enormous as it could turn energy production into a two-way process using smart grids for electricity. We need the framework and the conditions for Micro-CHP put in place to make its potential reality.

The new European Commission has to set priorities for its energy policy and the first signs from the incoming Energy Commissioner Guenther Oettinger are promising. Indeed, the EU's energy policy needs to focus on energy efficiency to reach its targets. The Second Energy Efficiency Action Plan will play an imperative role – if binding efficiency targets are included. In addition, the EEAP should also provide incentives for new technologies and the take up of cleaner fuels in the short term.

We also call for a level playing field of incentives and disincentives for energy use. The revision of the Energy Taxation Directive can be a step in the right direction, however any legislation has to take into account benefits of each fuel when it comes to lower CO<sub>2</sub> and air quality. LPG is exceptionally clean burning with just CO<sub>2</sub>, water and trace elements being produced. It is the lowest carbon conventional fuel available and therefore should play a bigger part in the EU's energy policy.

Finally, energy policy makers need to understand the different energy challenges of rural and urban communities. The future of rural energy has to be sustainable – not only environmentally friendly, but also secure, affordable and deliverable. This can only be managed through decentralised, efficient and modern energy solutions, for which EU support is vital.

# LISBON AND NORTHWEST #253: ALIGNED RISK ASSESSMENT IS KEY TO US-EU COUNTER-TERROR COOPERATION

by Adam Isles



**Raytheon**

Adam Isles  
Director Strategy  
and Policy Consulting  
Raytheon

In the wake of the December 25<sup>th</sup> bombing attempt on an Amsterdam to Detroit airliner, authorities in the European Union and the United States have signaled high-level commitment to an aligned aviation security approach. Disruption of cells long before operatives ever reach an airport is, of course, an underlying shared goal. That said, notwithstanding the change in U.S. Administration, tensions across the Atlantic remain over which tools to employ. The European Parliament is on the verge of utilizing its newfound post-Lisbon power to reject, as too privacy impinging, an agreement that would give U.S. authorities access to European-stored financial data for use in detecting and tracking terrorist activity, and it will also soon review a 2007 agreement on air passenger data. Members of the U.S. Congress may, in turn, question the Visa Waiver Program's continued viability, particularly given that, in addition to the Christmas Day attack, a number of other recent attempts – the failed 2006 U.K. aviation plot, the 2001 Richard Reid attempt to name a few – not to mention the September 11<sup>th</sup> attacks, used Europe as a launching point.

However, both sides of the Atlantic want al-Qa'ida defeated and yet cherish privacy too. Let's thus focus our energies instead on a new joint risk assessment that looks at how the threat has evolved since 2006, when groups of Westerners first headed to Pakistan's FATA in significant numbers, plus more recent developments in Yemen and Somalia. Terrorist tradecraft trends –

e.g., operatives with clean records and explosives concealment – should be examined, with a particular focus on transit passengers, who pose a greater risk assessment problem because of their lack of connections to the transit airport jurisdiction.

Current screening capabilities should then be evaluated for their ability to distinguish potential operatives from the great mass of travelers on legitimate journeys, and gaps between terrorist tradecraft and current capabilities must be identified. Police, border, and transport security officials should all participate in this assessment, and legislators on both sides of the Atlantic with appropriate clearances should then be briefed. The oldest and hence most trusted relationships across the Atlantic are bilateral; hence guidance is needed from key EU member states on how to reflect these relationships in a post-Lisbon Union.

If America and Europe fail to align on risk, al Qa'ida will exploit the seams to launch attacks on planes over the Atlantic in hopes the ensuing reactions will drive a wedge between allies. We need instead a joint, unflinching, unwearied effort to consider the new capabilities that may be required including a more complete approach to information analysis. Aligned technology acquisitions and airport standard operating procedures would ideally result. So would greater information sharing with appropriate privacy protections, based on agreed common principles. More important, our alliance would be anchored in a joint, current understanding of the threat we both face, and must face together.

*Adam Isles was Deputy Chief of Staff to U.S. Homeland Security Secretary Michael Chertoff from 2007 to 2009. Earlier in his career, he was Director for G-8 Affairs at the National Security Council staff and a lawyer in the U.S. Department of Justice's Criminal Division. Today, he is Director for Strategy & Policy Consulting on homeland security for Raytheon Company. He can be reached at [adam.isles@raytheon.com](mailto:adam.isles@raytheon.com)*

# CYBERDEFENCE AND SECURITY POLICY PROTECTING SENSITIVE SYSTEMS AND INFORMATION FROM CYBERATTACKS

by Ilias Chantzos



**Ilias Chantzos**  
**Director Government**  
**Relations, EMEA**  
**and APJ,**  
**Symantec**

Orchestrating a "defence in depth" approach delivers multiple, agile layers of protection in order to detect, stop and ultimately prevent cyber attacks. It is essential to have a proactive approach on threats in order to anticipate, counter, and attribute them. We also understand that security cannot be limited to the boundaries of a perimeter or of a country – networks know no borders.

Clearly cyberdefence goes beyond deploying firewalls, antivirus software and intrusion detection. But what else can be done to ensure vital intelligence is delivered and protected, thus giving a decisive advantage against adversaries?

NATO is describing cyber threats as an area that requires consideration by strategists and policy makers. European policy needs to further develop so as to adopt a security posture that links the work done in defence with the protection of the civilian critical infrastructure.

When talking about cyberdefence we refer to defence against activity that originates primarily from hostile actors who have political or quasi-political intentions that can impact national security. The attack can target critical infrastructure such as communication centres, energy grids, water distribution systems or military command posts. We have seen large, well-known 'denial of service' attacks on government systems, such as Estonia, Lithuania and Georgia, using sophisticated botnet

networks remotely managed through command and control centres. It is distressing to know that these well-organised botnets, distributed around the globe, are available for hire with little ability to know the originator and intermediaries involved.

Targeted and tailored attacks, while different in their characteristics, often have the same objective: to render their prey vulnerable while either extracting confidential information or crippling services altogether. Again, Ghostnet and Google are recent examples of stealing confidential information. We feel that information is the prize at the heart of all attacks, perhaps for financial gain as we have seen in our Underground Economy report<sup>1</sup> or to collect data for modern information-centric warfare strategies. No matter what the circumstance, access to or denial of access to information has become the aggressor's objective.

If we look at historical examples of intelligence in warfare we can refer to WW2, where the breaking of the Imperial Japanese Navy codes led to the removal of Admiral Yamamoto, and yet it was the failure to deliver this intelligence in a timely manner that allowed the surprise attack on Pearl Harbour. Therefore, safeguarding information and making it available becomes a critical component of any national security strategy because, either accidentally or due to a malicious outsider or insider, a major security incident can affect a country's strategic assets.

A cyberattack would usually follow four stages: Incursion, Discovery, Capture, and Exfiltration. Solutions to shield information for defence and intelligence purposes are available; the key to success is continued co-ordination among governments and involvement from industry experts, through public private partnership, information exchange and co-ordination. Cyberdefence should become more of a European priority, and as information is an exceptional resource it is what needs to be defended the most.

<sup>1</sup> Symantec Underground Economy Report

# CREDO FOR SOCIAL AND "SYNCHRONIZED ARMED FORCES EUROPE"

by Col. (ret.) Bernhard Gertz



**Col. (ret.)  
Bernhard Gertz**  
*Vice-President*  
*(European Organisation  
of Military Associations)*  
**EUROMIL**

I believe in the need for a common European foreign policy and in particular a Common Security and Defence Policy!

While the continued existence of national armed forces will ensure a certain element of "diversity" in available military structures and capabilities, it inevitably also entails duplication – and thus a waste of scarce resources. In the present economic climate, this is not acceptable. Only a united Europe, with common security and defence policy tools, will have sufficient clout to influence and stabilise the international balance of power.

The "big leap" to a European army will not happen in the foreseeable future, however. It will not be achieved by good intentions alone. Political statements must be followed up with practical measures to overcome national and institutional obstacles.

### **The European citizen in uniform**

Significant impediments to achieving shared objectives are profound differences in the so-called "military culture" and, more precisely, in the often differing views about the status of soldiers in state and society. The "European citizen in uniform" does not exist as long as public statements by elected representatives of military staff associations are answered with military arrest. And as long as some European countries, contrary to the European Human Rights Convention, continue to deny and implement the right of freedom of association in the armed forces.

The challenge for us is to optimise "unity in diversity", and the goal of frictionless co-operation of national armed forces based on a division of labour in joint European operations. We owe it to our soldiers, who we expect to put life and limb at risk for our political goals.

EUROMIL, therefore, supports the initiative of the European Parliament to call for "Synchronized Armed Forces Europe" as adopted in the report of the implementation of the European Security and Defence Policy.

"Unity in diversity" requires harmonisation and synchronisation of defence policies. This does not assume abandoning national military identities or settling on the lowest common denominator.

If, for example, Austria, Belgium, Denmark, the Netherlands, Finland, Germany, Ireland, Hungary and Sweden were to request the French government that it grants the right of association to its soldiers, it would probably be unsuccessful. Similarly, even if petitioned, the German parliament is unlikely to abandon its decision-making authority over overseas military deployments.

### **Security has a social dimension**

European best practice – e.g. in issues related to rights and duties, to governing training standards, the level of equipment, medical care and social security arrangements for the protection of soldiers and their families in case of injury or death, can provide the framework for a gradual development of increased and durable co-operation.

Particularly, in those areas of professional armed forces, where the social dimension of security and defence has not yet been fully recognized: Deciding over operational mandates and doctrine, tasks, structures, training, equipment and weapons entails the duty to transform and adjust the social framework conditions of soldiers to the highest standards!

# TO TACKLE FOOD SECURITY, START LOOKING TO SCIENCE

*by Friedhelm Schmider*



**Friedhelm Schmider**  
**Director General**  
**European Crop**  
**Protection Association**

The FAO estimates that, even with more equitable distribution, food production will need to increase 70% by 2050 to cope with a 40% increase in world population. This translates into an additional one billion tonnes of cereals alone to be produced annually.

Agriculture's task is to produce more food to feed a growing population on the existing farmland base, while adapting to the impact of climate change, preserving biodiversity, reducing greenhouse gases, safeguarding the environment and staying within the narrowing limits of the public purse. That's an enormous challenge, and not just for farmers, but for legislators because failure will pose a real threat to people's lives. We can take some comfort in the fact that we have much of the science, technology and know-how to meet the demand: we will have to deploy it wisely and keep on innovating.

Europe is simultaneously the world's largest producer of food, the biggest exporter of food and the biggest importer; and our imports exceed our exports by a substantial margin. Europe will either be a big problem or part of the global solution to the food productivity challenge and this challenge must be reckoned with right here in Europe for very Eurocentric reasons: the linked imperatives of affordable nutrition and social stability being chief amongst them. We can't solve the problem

by putting more land under the plough. The supply of agricultural land is severely limited and gone are the days when we would wish to cut down forests to grow food, whether here in Europe or anywhere else. Deforestation for food is the single largest contributing factor to the rise in greenhouse gases. Forests and wild lands preserve biodiversity and help maintain ecological balance. Forests, parklands and wilderness areas are both rightfully treasured and severely threatened in most of the world. To protect them we will have to grow more food on the existing land base.

What has this to do with pests and plant disease? Without advanced pest and disease control about 50% of Europe's present food crop production would be lost. Even with the most effective techniques, about 30% is destroyed by pests and disease, so there is plenty of room for innovation. The crop science industry therefore has an essential contribution to make to food productivity. Without advanced crop science we most certainly will not measure up to the food supply challenge. The crop science industry is also committed to making its contribution in a sustainable way that protects the environment and promotes biodiversity, and not just in words but in our actions. We prescribe and support the safe, environmentally sound use of our products, which include the full range of chemical and biological agents necessary for an integrated approach.

Actively reducing the productivity of European farms will have the inevitable consequence of expanding the farmland base; and somewhere more forests will be turned into food. It will also drive up food prices and thereby reduce the availability of good nutrition. Isn't that a pretty good description of a food crisis? I don't think it's the way we want to go.

# THE EUROPEAN CHALLENGE OF PUBLIC HEALTH

by *Wouter Lox*



The EU salt industry believes in the importance of a healthy lifestyle, and questions the effectiveness of nutrient reduction programs.

Public health is one of the major challenges of the 21st Century. In today's society specific attention is given to the improvement of public health by a.o. putting policy programs in place to fight obesity or to reduce cardio-vascular mortality. National and international policymakers set out strategies aimed at improving the consumers' health. One of the recent examples, are the nutrient reduction programs, and especially salt reduction programs.

Governments are in the process of imposing salt reduction programs. Various recent scientific studies question however the scientific logic and feasibility of the long term effort to limit salt intake in healthy humans.

Although no one denies the fact that salt has an impact on blood pressure and that high blood pressure is a risk factor for cardiovascular diseases, there are however many factors influencing this risk. Changing our lifestyle may help reduce blood pressure more than simply reducing salt. Eating more fruit and vegetables, reducing the intake of calories, lowering stress, increasing physical activity and losing weight have proven to be more effective in lowering blood pressure than just reducing salt.

The fact that more and more research is skeptical about the beneficial effect of generic salt reduction programs for the overall population leads to a more outspoken non-consensus in the scientific world with regard to the relationship between salt reduction and improved public health. In view of this non-consensus, EuSalt calls for a regular assessment of salt reduction programs and their impact on public health improvement and decreased mortality. There is clearly no conclusive evidence illustrating the overall positive effects of salt reduction programs for the overall population.

Moreover, founding entire policies on just one nutrient is misleading towards the European citizens in EuSalt's view, as it does not incite consumers to change dietary patterns or lifestyles.

Instead of focusing on single nutrients, EuSalt believes the Commission should be promoting weight control and well-balanced, healthy lifestyles. Salt plays an undeniable, vital role in daily life; adopting a salt reduction program implicates risks for nutrient imbalance for specific population groups with specific nutrient requirements.

EuSalt therefore proposes to focus the health policy on lifestyle changes and dietary patterns and not on sole nutrient reductions. EuSalt calls for thorough and regular assessment of the impact of the programs that have been or will be put in place.

With regards to the public health domain, EuSalt – as a responsible stakeholder – invites the concerned policymakers to look at a broad and transparent consultation of stakeholders to tackle this particular challenge. EuSalt has signed the EU Commission Register and is keen to be involved in the upcoming consultations on health.

# SUSTAINABLE EUROPE

## A low carbon strategy for Europe



Many of Europe's outdated and inefficient power stations have to be replaced in the coming two decades. **Nick Mabey** sets out the strategic steps that EU governments need to take together to create a low carbon economy at the least cost

Copenhagen notwithstanding, the world's transition to a low carbon economy is now well under way; global revenues of companies whose goods and services relate to climate change already exceed those of the aerospace and defence sectors, and are on course to reach nearly €1.35 trillion by 2020. And because Europe has long recognised the benefits of the low carbon transformation, it has played an international leadership role by adopting commitments to reduce its emissions ahead of any other major economy.

And now it is time to accelerate the pace of the European low carbon transformation. With massive investments to be made in the coming years to upgrade and create infrastructure that will operate for several decades, a critical question is how these

investments can move Europe toward a low carbon pathway in the long-term. If Europe delays the pace of its decarbonisation agenda, it will miss the most cost-effective opportunity in a generation to clean up its infrastructure.

The present economic recession adds new impetus for accelerating low carbon transformation in Europe; lower emissions due to the downturn are creating an historic opportunity to step-up the pace of decarbonisation. Recent analysis shows that the fall in emissions caused by the recession has reduced the cost of achieving the 30% target well below the estimates for reaching 20% when that target was agreed as EU policy in December 2008. And science, too, is calling for faster action; mankind has about five years to begin the low carbon industrial

transformation needed to move to a 2°C world. The International Energy Agency (IEA) estimates that every year of delay in climate action will add an extra €336bn to the clean investment needed in the energy sector globally between 2010 and 2030.

The low carbon economy will, on balance, increase employment and economic activity in Europe as imports of fossil fuels are replaced by domestic investment in new technology and in highly efficient infrastructures. But as with any transition, it will also create winners and losers. To maintain public support, a just transition must ensure that jobs are protected and industry losses minimised. The best way to manage this transition is to put the right policies in place quickly to capture the full benefits of the transformation.

The main pillar of the EU's present policy for combating climate change and accelerating the transition to a clean energy economy is the Climate Package that was adopted in December 2008. The EU's member governments agreed to reduce their collective greenhouse gas (GHG) emissions by 2020 by 20% from 1990 levels, and to derive 20% of Europe's final energy consumption from renewable sources. The intention is that this emissions reduction target will rise to 30% in the context of a global agreement where other developed countries take on comparable targets and major developing countries contribute "adequately".

The EU has already committed to reducing emissions by 80-90% by 2050, and assuming a linear trajectory this would mean at least a 40% reduction by 2020. But right

# COMMENTARY

By **Knut H. Alfsen**

## These are the right measures, but it's wrong to say they'll cost little

**N**ick Mabey argues that Europe should move ahead and implement policies such as those that made up the EU Climate Package adopted in December 2008. He also argues that we need to focus much more on infrastructure ranging from buildings and utilities to roads, railways, airports and harbours because whether we can meet emission targets will in the long-term depend on the quality of that infrastructure. Investment in new low carbon infrastructure and green infrastructure banks (GIBs), he argues, will make it easier to lower greenhouse gas emissions.

Mabey's arguments are only valid in some respects. The climate would benefit if European nations were to adhere to the blueprint he outlines, but it is far from clear that Mabey is right when he states: "the low carbon economy will on balance increase employment and economic activity."

Analyses of "green growth" and transition paths towards low carbon economies have only recently been initiated, and many people still resist the low carbon economy because they think it will lead to job losses. Reducing emissions will carry a cost, but the cost will be minimal compared to the cost of possible climate change damage. Business as usual is not an option. The 2003 heatwave in Europe was a reminder that extreme weather reduces productivity as well as causing fatalities.

now the EU has no real roadmap for moving beyond its current 2020 target apart from hazy statements that an additional 5% could come from international offsets generated in developing countries and a further 3% from land-use changes.

A credible policy strategy is needed for speeding up Europe's low carbon transformation. The EU's Emissions Trading Scheme (ETS) remains the main tool for achieving emission reductions, but unfortunately the current debate has centred solely on reducing the short-term cost of compliance with the ETS, with a heavy focus on the use of international offsets. Although offsets reduce immediate compliance costs, they lower the incentives for transformational change in Europe. The UK's Climate Change Committee has built its assessment of Britain's long-term carbon budget on the assumption that net flows of offsets will cease in large quantities by 2030, by when all major economies will have binding reduction caps. Yet relying on a future stream of low-cost offsets to reach the EU's increasingly stringent targets carries the risk of high costs in the future.

Transformational change requires innovative policies that scale-up investments in energy efficiency, low carbon infrastructure and transport. In the short-term, a strong focus must be placed on achieving domestic energy efficiency targets. Adopting more rigorous efficiency standards for buildings and appliances will help both companies and consumers achieve immediate cost-efficiency gains. In the medium and longer-term, a fundamental challenge is to ramp up investment in smart grids, low carbon infrastructures, buildings and transport.

Because the geography of Europe has placed its major renewable energy resources on the periphery – North Sea wind, Mediterranean solar power and Eastern European biomass – a pan-European electricity grid will be needed if it is to efficiently decarbonise its power sector and meet the increased demand for clean power from electric cars.

Emissions from transport are growing rapidly and contributing a steadily greater share of the total. Tougher standards and more government support are going to be needed to boost R&D programmes on greener vehicles, advanced engine technologies, hybridisation and electric cars, high-speed rail networks and other public transport systems. Policies for promoting innovation will play a pivotal role in consolidating the first-mover advantage of Europe's low carbon industries, and in maintaining a market share lead in clean technology.

These policies in support of low carbon industries can catalyse a new generation of low carbon jobs and stimulate the re-tooling of Europe's more traditional industries. Estimates vary, but most analysts agree that strong public policy support for low carbon industries can have a noticeable employment effect. EU estimates suggest that improving current policies so that the 20% target for renewables in final energy consumption can be achieved by 2020 will provide a net effect of about 410,000 additional jobs. And a 30% reduction target for Europe could potentially yield an increase of 1.1m jobs in 10 years' time.

As well as putting in place much stronger decarbonisation policies, Europe's

governments are going to have to support the introduction of new skills into the European workforce. Without the right incentives for training and re-tooling, Europe risks a serious shortage in low carbon jobs. A recent UK study by the Aldersgate Group of companies has emphasised the need for rapid and accelerated investment in skills.

Most of the public discussion across Europe about the job creation potential of environmental policies has concentrated on clean energy jobs, but as the low carbon transformation deepens, more attention should be placed on investing in new skills in areas that span resource efficiency, energy efficiency, clean transportation, the de-materialisation of products and green buildings.

But public policy alone is not enough to catalyse change. Without an adequate finance strategy, low carbon industries will not flourish on the scale required. More aggressive investment is needed to lay the foundations for new global European industries. This in turn means more creative ways of mobilising funds from risk-averse investors and channelling them towards energy efficiency, low carbon infrastructures and transport.

In the UK, Germany and even the U.S., the idea is now growing of developing green infrastructure banks to help support the low carbon transition. A green infrastructure bank (GIB) could leverage private capital and scale-up the volume of low carbon investment in Europe. GIBs could put in place multiple public-private financing mechanisms to shift capital towards low carbon infrastructures. Green banks would

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**Knut H. Alfsen**

When Mabey says "a just transition must be ensured where jobs are protected and industry losses are minimised", we must remember that a large and rapid transition is likely to distort current industrial structures. While job numbers and industry production volume might be maintained in a transition to a low carbon economy, the types of jobs and the nature of the industry will certainly change.

Much will depend on how the other main international players respond to climate change. If the U.S., China and India move slowly toward low carbon societies, it is hard to see Europe moving quickly without large transitional costs.

Where I certainly agree with Nick Mabey is that if we are to be sure of continuing public support we must explain very clearly the sort of transitional economy that is needed. We must engage the public in discussion of the measures that can meet the challenge of climate change. That's the only way we'll be able to put in place the right policies with the necessary urgency. □

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probably become self-financing in the medium term, and would certainly deliver greater confidence and faster growth in low carbon markets.

Sector-specific banks are not new. The European Investment Bank (EIB) was launched in 1958 to facilitate the fledgling European economic integration process. The Luxembourg-based bank is policy-driven, based on the priorities of its member state shareholders and raises its funds in the international capital markets and then uses these for loans to projects in Europe and elsewhere that further EU policy objectives. The EIB already directs large amounts of its portfolio towards low carbon activities, and is in effect already becoming a pan-European GIB. But national GIBs are also needed to undertake more complex and specifically national tasks, especially those concerned with energy efficiency and low carbon infrastructure. In many countries, a GIB could be based on an existing national development bank, although there is also a strong argument for creating new and dedicated institutions that would have strongly focused expertise.

GIBs could provide opportunities for governments to boost low carbon investment by ensuring that guaranteed funds are earmarked for green infrastructures. They could act as loan guarantors on behalf of the government, while at the same time reporting on levels of success and syndicating low carbon investment programmes such as national energy efficiency schemes.

Advocates of the GIB approach are in little doubt that a specialised infrastructure bank is preferable to ad hoc financial

mechanisms. In the first place, it would provide public sector expertise to deliver public good outcomes within a commercial environment, eliminating some of the conflicts of interest that can otherwise arise. It would also provide an on-going innovative capacity to respond to the many, usually unexpected, demands that the low carbon transition will generate. And in the second place, a GIB could increase market confidence because national governments would be backing their own policies through direct investment, thus signalling private sector investors that low carbon investment is a solid proposition.

There is no low cost, high carbon future for Europe. Failure to lead the global transformation to a low carbon economy would leave the EU exposed to massive climate change damage and soaring fossil fuel prices as peak oil hits in the next few decades.

With a low carbon economy the only viable alternative, the question now is how quickly will Europe drive its transition? Delay often seems attractive as a least cost option, but not in this case. Europe in any case needs to replace much more of its ageing energy infrastructure in the coming two decades, and failure to make its new generation of power plants, buildings and factories low carbon will lock high costs into the future. The Chinese have a saying that you cannot cross a ravine by taking small steps, and now is the time for Europe to jump into its low carbon future. □

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# The climate challenge now offers the EU a global role



With so much of the climate change agenda linked to development aid priorities, **Steen Gade**, chair of the Danish Folketing's environment committee, sets out his vision of an EU action plan

Last December's COP 15 climate change summit in Copenhagen fell far short of being the "Hopenhagen" conference so many had wished for. It didn't agree on much more than continuing the discussions until Mexico this December. The meeting took note, and no more than that, of the "accord" in which almost all the 115 countries present recognised the need to limit temperature rises to 2°C.

In that sense, Copenhagen was a failure, yet it also clarified three challenges to be met by the end of this year. The first, and most promising, is to fulfil the promises on financing. The second is to try in Mexico to develop the accord into a binding global UN-agreement. The third is to continue the negotiations until Mexico on all the more specific areas – above all reduction targets,

commitments and actions – without creating any doubts about the EU's own willingness to continue along the Kyoto track.

*Copenhagen fell far short of being the "Hopenhagen" conference so many had wished for. In that sense it was a failure, yet it also clarified three challenges to be met by the end of this year*

It is very much to be hoped that the EU will take the lead in all three of these processes. That would mean that making new money available to developing countries has to begin right now; the short-term finance offer from the EU of €2.4bn a year from now until 2012 will have to be delivered extremely quickly. One of the most effective ways would be through forest conservation schemes like the Amazonas fund. If the EU is to be trusted

in the developing world, it has to commit additional spending to that already earmarked for the 2015 millennium development goals (MDGs), not least because we already know that the mid-term goal of 0.56 % of GNP by

2010 has not yet been reached. It will be a major challenge for EU countries as a whole to reach the MDG target of 0.7% of their GNP by 2015 while at the same time giving additional climate change funding. But that is what we in the EU have promised, and the short-term delivery of climate change help must begin before the summer of this year. At the same time, the EU has to reach a decision on long-term financing, following the European Commission's estimate that the world's developing countries will need €100bn a year by 2020. It's going to be up to the EU to give clear guarantees that it will contribute its fair share.

If the Copenhagen accord is to be transformed into a binding UN decision, the EU will have to work hard to dispel all the mistrust among developing countries about its own willingness to sign up to steep reductions like reducing CO<sub>2</sub> emissions by 30% by 2020 rather than by 20%. This level of EU commitment is going to be needed before the mid-year meeting in Bonn, if the EU wants to take the lead on the global scene. Copenhagen's legacy at present is a lot of mistrust.

This is what is needed if the EU is to be in a position to play a leading role in the years ahead. But these initiatives are no more than a pre-condition for the even more concentrated, clever and effective EU climate change initiatives that will be needed in relation to developing countries. The key word here is going to be equality, in line with

both the spirit and the wording of the 2007 Lisbon strategic partnership between Africa and the EU. It is also going to be important to recognise that developing countries are often in very different situations, so the concrete policies to be thrashed out need to take into account the differences that exist between the LDCs and BRIC countries like China, India and Brazil. But of course what unites these different groups is that real partnerships with the EU are in all these cases the way forward.

*If the Copenhagen accord is to be transformed into a binding UN decision, the EU will have to work hard to dispel all the mistrust among developing countries about its own willingness to sign up to reducing CO<sub>2</sub> emissions by 30% by 2020*

Helping developing countries adapt to a low carbon economy is closely linked to the same agenda as better development aid. This means partnerships for creating national plans that have clear climate goals, greater co-ordination between aid donors, more transparency and the involvement of civil society, businesses and national parliaments. On top of all this, the climate agenda demands much more regional co-operation on development aid than we have seen in the

past. The climate agenda offers us a chance to breathe new life into the relationship between donor and developing countries.

This whole process of adaptation is crucial for developing countries, and it is up to the EU member states to emphasise the consequences of climate change. This includes detailed physical information about climate change and about the vulnerability both of nature and of human kind. It includes

imparting knowledge about infrastructures like water systems, crops and health. Many of the problems that these countries are already dealing with will worsen, with new problems being added to them. Adaptation therefore has to be integrated into all existing development plans and initiatives. This is where the EU can really make a difference by making climate change an integral part of its development aid and its donor co-ordination efforts.

The second major challenge to be met is finding ways the EU can create low carbon development projects, especially those that focus on energy. We know that more than a billion and a half people are still without power, and therefore have no real prospect of development. The EU already has a very good platform on linking energy to its development aid thanks to the Lisbon partnership with Africa. This needs to be further developed instead of inventing any new instruments. Renewable energy must also be strengthened, with a strong focus on solar and wind. The European Development Bank needs to make more long-term financing available to the energy facility, as well as to infrastructure.

Traditional thinking has limited infrastructure projects on energy to hydro-projects and coal or oil based plants, but wind farms and solar plants should not only be for rich countries. There are considerable technology transfer and long-term employment gains to be made in solar and wind. Co-operation between the EU and the African Union can, if designed the right

way, be the most effective way to stimulate technology transfers. In Mali I have seen for myself the way a solar-driven water pump has transformed the lives of the women and how solar power has extended school hours into the evenings and given villages a refrigerator to store medicine for the sick.

The new climate-related development agenda must aim at renewable energy both in de-centralised rural environments and in integrated regional and centralised versions. What we in Europe need to do is to use our own experience of renewables and of energy efficiency to shape a new partnership with developing countries.

That means scientific and educational co-operation, the creation of networks between, for example, electricity companies and the broad involvement of private sector companies to enable them to develop new business opportunities, especially in energy efficiency and renewables.

*The EU can really make a difference by making climate change an integral part of its development aid and its donor co-ordination efforts*

Climate change has been called the biggest challenge that will face the next generation and for Europe it is a chance to play a major role on the global scene in this fast-changing world. We Europeans will not get too many such chances in the coming years, and my earnest hope is that we will understand all its possibilities and dare to take the lead. □

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## Why we need a radical re-think of official aid



It's not the volume of development aid that really matters, says **Roger Riddell**, but its effectiveness. He charts the rumbling debate of recent years on reforming aid-giving and highlights the major problems to be resolved

In the 60 years since its early beginnings, official development aid (ODA) by the world's richest countries has expanded into an intricate web of donors and recipients. Practically every country is either a donor or recipient, and some like India and China are both. When the Cold war ended there were some doubts about ODA's future, but the last decade has in fact seen aid by the main donor governments growing in volume.

Yet, for all that, there's a lot wrong with aid. The gap between what it does and what it could do is widening fast.

International discussions about aid have long been dominated by the issue of how much aid is being given, and in what form.

*G8 donors pledged to increase aid by \$50bn a year by this year.*

*The latest estimates suggest they will manage only \$13bn*

This is important because the more aid that is given, the greater the likelihood of more people being lifted out of poverty. The main problem has not been so much the failure of governments to pledge to increase aid, but the failure of so many to honour those pledges. This has happened before and is happening now. At the G8 meeting at Gleneagles in 2005, donors pledged to increase aid by \$50bn a year by this year, yet the latest estimates suggest they will manage only \$13bn. And only five of the 27

EU member states are on course to meet their self-imposed target of giving 0.56% of national income in official aid.

Besides the amount of aid, attention has also been focused on its effectiveness. This is important because improving aid effectiveness contributes to narrowing the gap between what aid actually does and what potentially it could achieve.

Until recently, donors' efforts were focused exclusively on trying to improve the quality of their own aid. This changed, though, when in March 2005 the Paris Declaration on Aid Effectiveness was signed by all the major donors as well as a significant number of recipient governments. This marked the first formal acknowledgement by donors that wider systemic issues matter greatly in aid-giving. In other words, that what one donor does, or does not do, has an impact on the overall effectiveness and impact of aid. Donors and recipients agreed on the need to work more closely together.

In September 2008, a major stock-taking exercise of the Paris Declaration was held in Accra, Ghana, and it produced the Accra Agenda for Action. The meeting's main conclusion was that implementation of the Paris Declaration had been too slow and needed to be speeded up.

But the main problems with the Paris Declaration are more fundamental. First, it is not a binding agreement. Like the pledges donors have made to increase aid, under the Paris agreement no donor is required to change its prevailing practices. Second, the declaration fails to mention some of aid's

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By Eckhard Deutscher

## We've already re-thought aid; It's action we need now

Roger Riddell puts his finger on a number of problems that for years have plagued development co-operation; insufficient focus on results, a patchy record on living up to aid commitments and, especially, the absence of a properly designed international system for development co-operation.

He also refers to the Paris Declaration on aid effectiveness and the Accra Agenda for Action, the two key pillars for enhancing aid effectiveness. Together, they go much further in addressing these problems and rethinking development co-operation than his article acknowledges.

By being very results orientated, the aid effectiveness effort aims to change behaviour and recalibrate the system to make it work where and for whom it matters – on the ground with co-operation driven by their needs and priorities of poor countries and poor people.

The broad alliance of development stakeholders taking the aid effectiveness agendas forward has addressed such issues as the predictability and volatility of aid flows, the fragmentation and proliferation of aid, untying aid and the use of recipient countries' systems

major systemic problems or to identify the key underlying reasons for their persistence.

The central problem of the aid system is that there is no system. The way aid is given and received suffers from two fundamental problems. In the first place, no attempt is made to determine accurately which countries need development aid or to assess each recipient's specific requirements, even though we know that the gap between what is needed and what is provided is very large. And in the second place there is no system for raising aid funds or for ensuring that aid goes to those who need it most. Aid-giving is voluntary, and no sanctions or penalties are applied either to those who choose not to provide aid, or who pledge to provide aid and then renege on their promises. The aid channelled to different countries is the sum of the separate decisions made by individual donors of how much aid they will give to their chosen recipients. If one donor decides not to provide aid to a particular country, no other donors feel the need to make up the shortfall.

The reason why these systemic problems matter so greatly is that directly or indirectly they are the cause of a number of major distortions and practices which together severely undermine the effectiveness and impact of aid. Aid-giving decisions are made by rich country governments. While all acknowledge that the prime purpose of aid is to contribute to sustainable development and poverty reduction, their decisions continue to be influenced by short-term political considerations and their own national and commercial interests. The following illustrates some of the consequences.

- Most aid does not go to those who need it most. Less than half of all official aid is channelled to the poorest 65 countries of the world.

- Aid is given on a short-term basis, often switched to different recipients and is volatile and unpredictable. Afghanistan, Iraq and Pakistan together received less than 2% of all official aid in 1999. Five years later, they accounted for 26% of all official aid (including debt relief), nearly a 30-fold increase. Aid volatility has risen over the past two decades, reducing the effectiveness of aid by a loss equivalent to \$16bn.

- The number of donor recipient countries have to deal with has increased dramatically, from an average of 12 in the 1960s to 33 by 2005; currently at least 30 countries have to deal with more than 40 separate donors each. In 1996, 17,000 separate donor-led aid activities were recorded and 10 years later this had risen to 81,000. It is estimated that over 30,000 donor missions to recipient countries take place each year, averaging over 100 a year. In some countries, a new donor mission arrives every day.

- Less than half of all aid that poor countries receive passes through the recipient governments' financial systems. Most aid is packaged up into different projects, overseen and often managed by the donors. Less than half of all aid is completely untied with the recipient free to choose where to purchase the goods and services it needs. The tying of aid from donor countries raises the costs of aid to recipients by between 20% and 30%, equivalent, in aggregate, to a loss of about \$8bn a year.

- Donors have in recent years been creating a succession of new mechanisms and funds to channel aid to recipient countries to address such specific needs as increasing food production, expanding primary school enrolments, extending immunisation programmes to address HIV/AIDS, TB and malaria problems, or addressing environmental and climate change problems. These run in parallel with, but are usually not linked to mainstream aid programmes. The allocation of money from these funds is predominantly controlled by the donors, although that's the reverse of what was agreed in the Paris Declaration and often skews the budgets and sectoral priorities of recipient countries.

Almost since official aid was first given, politicians have both warned of aid's systemic problems and proposed alternatives. These include raising aid funds through an automatic compulsory mechanism based on the ability to pay; pooling aid resources and allocating them on the basis of need; and, if there are grounds for believing that the recipient government is unable or unwilling to use the aid funds transparently, "ring-fencing" the aid in a fund to be administered independently.

Most of these good ideas have been eclipsed by the focus on increasing aid levels. A common response to anyone advocating these solutions to aid's systemic problems is the counter-argument that they are part of the very nature of the aid system, and that it is naive to suggest that it can be changed. They warn that if governments are unable to decide for themselves how to give aid and then check on its use, then they simply won't provide it.

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for delivering aid. It also focuses on aligning issue-specific funds with the development efforts of particular countries. Yes, we're still a long way from having solved all these problems, and especially those connected with the fragmentation and proliferation of aid donors, but there is a real effort to make progress.

This is being made possible because the aid effectiveness agenda has given us a roadmap and a unity of vision that is unprecedented. It has generated strong political will for reform, and political will is likely to prove more relevant than any legal resolutions. But political will is also fragile, and can only be sustained if we can point to concrete results. Enhanced development results are the most relevant yardstick, and the one we should apply.

The main reason is the link between aid levels and impact. Roger Riddell laments the disproportionate fixation on inputs, meaning aid volumes in relation to positive outcomes. The truth is that the focus on results has increased dramatically. In years past, donors made aid commitments on the expectation of sound development returns. While we at the OECD's Development Assistance Committee (DAC) are watching closely to see how donors live up to their commitments, the most decisive impact on long-term aid levels is going to be the donor countries' ability to deliver and demonstrate results.

Riddell's article suggests that a solution to systemic problems would be the creation of a global fund that all donors would contribute

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There are two ways to respond to these arguments. One is to point out that that aid's systemic problems are getting worse and fast and frustrating progress on the core objective of ending extreme poverty. Resolving key systemic problems would probably have a greater effect on extreme poverty than expanding the amount of aid given. The other is to draw attention to high-level discussions where the sorts of changes needed to fix aid are being presented as politically viable. At the 2006 Spring meetings of the IMF and World Bank, UK Prime Minister Gordon Brown made a plea for the operational work of the IMF to be made "independent of political influence and wholly transparent". Why stop there? The argument about short-term political distortions and independence applies with equal force to the aid system. And at last September's meeting of G20 finance ministers a background paper tabled a proposal for all except the very poorest countries to pay into a global climate fund and for the money to be disbursed to the countries needing it most. Once again, why stop there? The same argument should be extended to the aid system as a whole.

The aid system needs a radical overhaul. The catalyst for change lies in political leadership, and EU governments provide almost 60% of all official aid and are also among the world's most forward-thinking donors. Now, the Lisbon treaty offers Europe a new opportunity to speak out about the need for fundamental change in the aid system and to lead the discussion about how to bring this about. □

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to on the basis of their assessed ability to pay, with the proceeds then distributed according to need. But in practice channeling all development assistance through a single entity strikes me as neither feasible nor desirable, for it would invariably stifle innovation and the competition of ideas. It could even be argued that this approach might well accentuate some of the problems that are highlighted in his article – attention would shift away from results and towards the distribution of this global aid pot, and a centralisation of needs assessment would remove control over development strategies further from poor countries.

What is needed much more is decisive action on the aid effectiveness agenda's ambitious roadmap for change. This will in itself amount to a radical overhaul of development co-operation.

But I would go further. Roger Riddell's article rightly states that aid is a core component of international relations. Yet aid alone will not be the solution to the development challenge. Global factors beyond aid have a huge impact on development, and the donor world needs to become less insular and more involved in the development dimension of policy areas like climate change, trade, investment and finance, security and migration. Aid agencies need to work with the many other actors who shape poor countries' development. □

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# The global slump makes a fair trade revolution more urgent than ever



A radical change in the handicaps to export-led growth by the world's poorest countries is now urgently needed, says **Peter Lilley**, a veteran Tory politician who is co-founder of an all-party British pressure group

The worldwide recession has had an enormous impact on financial security, national budgets, and economic confidence from London and New York or Tokyo to the poorest nations, where for the bottom billion poorest people, economic contraction can be a matter of life or death. Yet an attainable solution is close to hand, and that's why I and my colleagues at Westminster – Clare Short, John Battle, Ming Campbell, Lord Hastings – have launched an All-Party UK-based campaign called "Trade Out of Poverty".

It is always tempting at times of economic uncertainty to turn inwards and raise the draw bridge in the belief that one is doing the right thing by tending to one's own and putting the rest on hold to be dealt with in better times. But this risks compounding the negative effects of

the recession, not least for the countries that most need our help. We should know better than to give in to this sort of protectionism. In the 1930s protectionism turned a recession

*The developed world's trade policies not only limit access to developed markets, but also impose complex and costly trade regulations and support unfair subsidies which render products from developing countries uncompetitive*

into a prolonged slump that was counter-productive for the rich and catastrophic for the poor.

Fortunately for today's rich but cash-strapped countries, the less developed countries, unlike our banks, don't need a bail-out package, nor do most of them want one. As Mo Ibrahim wrote recently in *Europe's World*, Africa doesn't need rescuing, it needs a square deal. This sentiment was echoed by Rwanda's President Paul Kagame in the British newspaper

*The Guardian* when he called for solutions in which Africa would be an active participant and not just a recipient.

African countries, and the Third World as a whole, need to be given the opportunity to create their own wealth. Historically, the single most important driver out of poverty for countries from Japan to South Korea and Brazil to Mauritius has been trade with other countries. Increased opportunities for trade could ensure that the recession does not set back the poorest countries and, better yet, trade will ensure it lifts itself out of poverty.

Although the developed world pays lip service to the need to open its markets to the poorest countries, it maintains a number of barriers that impede their efforts to trade their way out of poverty. The developed world's trade policies not only limit access to developed markets, but also impose complex and costly trade regulations and support unfair subsidies which render products from developing countries uncompetitive. "Trade Out of Poverty" is now actively working towards making the necessary changes to these unfair trade policies. We advocate five clear steps that the developed and developing world must take together to make it possible for the poorest countries to beat the recession and earn their way out of poverty.

Rich nations like those of the EU, the United States and other OECD members must open their markets unconditionally to all those defined by the World Bank as Low Income Countries. The tariffs levied by developed countries have come down substantially during successive trade rounds, but the highest remaining tariffs tend to be those levied on agricultural products and labour intensive manufactured goods – precisely the goods that the poorest

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By Moses M. Ikiara

## Right diagnosis but the prescription falls short

Peter Lilley is right about the problems faced by low-income countries, but he doesn't put his finger on the entire solution. He argues correctly that without a fair deal on trade, low-income countries will never be able to create their own wealth. They need help to expand their export capacity, and the measures Lilley proposes for cushioning these countries against the recession are appropriate enough. But although they match the growing consensus on what needs to be done, the key question is how do we make sure that commitments made by richer countries to poorer countries are honoured? Lilley doesn't address that at all.

When the G8 met in Italy last July at L'Aquila it pledged \$20bn to improve food security, confirmed its members' aid commitments, moved to re-launch the World Trade Organisation's Doha round of trade talks and approved an initiative to halve the average transaction costs for migrants' remittances. All of these pledges are commendable, but will the G8 leaders stick to them? What we need now are the instruments to make sure that these commitments are honoured.

Lilley also fails to set out all of the conditions that would lessen the dependence of poorer countries on development assistance. Market access is fine, but will have little real impact

countries can most readily produce. The U.S., for example, levies more duty on imports from Bangladesh and Cambodia than on French and British imports that are six times greater in value; American duties on imports from Bangladesh and Cambodia in fact exceed by far the development aid each receives from the U.S.

The normal procedure under the rules of the World Trade Organisation is for tariff reductions to be reciprocal. But the important step to be taken now is for rich countries to open-up their markets to the

poorest unconditionally, without requiring them to open up their markets to exports from the industrialised world.

The world's poorest countries represent a fifth of the global population, but account for less than a fiftieth of world trade. The export industries of the poorest countries are small in scale, unsophisticated and usually specialised in products which cannot easily be produced in the developed world. By no stretch of the imagination are they a 'threat' to the industries of the developed world.



## EUROPE'S WORLD BACKGROUND BRIEFING

### EU heads for 70% of aid to Third World

The economic downturn has so far done little to dampen Europeans' enthusiasm for development aid. In a recent Eurobarometer survey, 90% said they think development is important, with 50% saying that poverty is the greatest challenge faced by developing countries. Dishearteningly, though, only 25% of those questioned had heard of the Millennium Development Goals, the UN's blueprint for tackling extreme poverty by 2015.

Almost three-quarters (72%) of the people surveyed think that European countries should honour, or even go beyond, their commitments to the developing world, but only 26% said the EU is the best suited to assist developing countries. The United Nations is widely seen as the key player.

EU governments appear to be taking note of the general public desire to give more aid. In 2003, the European Commission pledged that EU aid commitments should be at least 0.39% of Gross National Income, and in 2008 and last year the member states honoured this promise.

Aid contributions by EU member states have grown steadily in the last decade. In 2000 they donated less

than €29bn to poorer countries, but by 2008 that had doubled to almost €60bn.

Sweden is the most generous EU country, having given 1.3% of its GNI in aid in 2008, with the Netherlands next at 0.83%. Greece and Italy are the least generous, spending 0.21% and 0.22% of GNI on aid respectively.

The OECD's aid simulation for this year suggests that the economic crisis will have done little to reduce EU spending. It forecasts the EU again topping the global list of aid donors with a total €70bn in development assistance, a handsome 70% of all official development assistance worldwide.

The EU puts other large aid donors to shame. The U.S. aid total of €10bn in 2001 had doubled to €20bn in 2008, but still only represented 0.19% of GNI. In that year, EU member states spent 0.4% of GNI on aid, that totalled almost €40bn more than the U.S. Japan's development aid stood at €7bn, or 0.19% of GNI, and Canada gave €5bn, or 0.32% of GNI. □

Since the poorest countries take less than 2% of the rest of the world's exports it is of minimal significance to rich countries whether those markets are opened wider or not. By contrast, the rich countries represent the market for over 90% of the exports of the poorest countries, so the barriers we impose are absolutely crucial to them.

A number of trade arrangements such as the EU's 'Everything But Arms' already claim to give unconditional access to least developed countries. Unfortunately, the devil is in the detail, and those details comprise rules of origin and other non-tariff regulations that undo much of the good intended by this kind of agreement. In short, trade rules must be simplified.

Complex rules of origin mean that countries entitled in theory to tariff-free access to developed markets actually end up paying tariffs. Rules of origin also impede developing countries' ability to take part in the complex supply chains that characterise modern manufacturing. The importance of Rules of Origin was demonstrated by the relative performance of exports under the African Growth and Opportunities Act (AGOA) introduced by the U.S. in 2000 and the EU's Everything But Arms initiative of 2001. Exports from sub-Saharan Africa to the U.S. and Europe were fairly similar during the 1990s but since then exports to the U.S. have quadrupled whereas exports to the EU have stagnated. The main reason was the AGOA's simple rule of origin, allowing African garment makers to use textiles from elsewhere.

Other non-tariff trade barriers that limit poor countries' ability to trade include differing

unless poorer countries are given favourable terms of trade. Wealthy and more powerful countries should remove their own export subsidies, abolish tariffs and help poorer countries' exporters to switch to value added goods that get better trading terms.

Strict immigration rules also need to be softened so that people from low-income countries can travel abroad to learn the secrets of economic success. Barriers should be lifted so that companies from poorer countries can establish a presence in major commercial centres and gain access to global supply chains. Remittances from migrant workers already make a major contribution to the GDPs of low-income countries, and if foreign transaction costs were lowered their impact could be greater still.

Multinational corporations can also be encouraged to do their bit; they should be given incentives to transfer technology to firms in the low-income countries they operate in. Sourcing a greater share of their raw materials from those countries, and reinvesting their profits there would also help.

This brings us to development assistance. Aid should be targeted so that poorer countries can harness it to improve their own economies. Assistance should pay for regional training centres of excellence, schools and universities, and it should aim to strengthen democratic institutions, encourage good governance and combat corruption. It should also support viable regional trade blocs, small and medium-sized enterprises and farmers.

sanitary and phyto-sanitary regulations set by developed countries that impose prohibitively high compliance costs on developing countries. Harmonising regulations across developed markets would facilitate trade and lower the cost of compliance.

In addition to these changes in external trade policies, rich countries should remove their export and domestic subsidies, particularly on products that the poorest countries are best placed to grow and manufacture. This change, though apparently daunting, is not that far from the expected evolution of trade policy. In

*Poor countries need more investment in physical infrastructure like roads, ports and electricity. Yet over the last 20 years the proportion of aid budgets devoted to infrastructure has fallen by two-thirds*

the Doha Development Round, the EU tentatively agreed to abolish export subsidies by 2013, although the offer was withdrawn when the Doha negotiations stalled. As far as domestic subsidies are concerned, fears that their removal will harm EU agriculture are grossly exaggerated, since only a few agricultural products from low income countries are in direct competition with those grown in Europe, and in any case EU farmers have alternative crops to turn to.

Ironically, the highest tariffs in the world are between neighbouring poor countries,

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which partly reflects the fact that tariffs are the easiest source of government revenue to collect. The high tariffs that poor countries impose on each other are one reason why less than a tenth of African exports go to other African countries, while nearly three-quarters of European trade is within Europe. To beat the present recession, the poorest countries need to remove the barriers between each other even if they retain tariffs against exports from the developed world. Rich countries can facilitate this move by providing the advice and expertise to re-design tax systems, while at the same time providing aid to top up lost revenues during the period that tariffs are being replaced by revenue from domestic taxes.

These are policy changes that could do much to help the poorest countries weather the recession. This does not mean, however, that there is no place for development assistance in the form of aid. Poor countries will only be able to take advantage of the opportunities provided by preferential market access if they develop their own export capacity. This requires as high priority more investment in physical infrastructure like roads, ports and electricity and also in administrative infrastructure to meet international trading standards of quality, traceability and so on. Yet over the last 20 years the proportion of aid budgets devoted to infrastructure has fallen by two-thirds. Donor countries in the EU and elsewhere must put renewed emphasis on aid-for-trade to help developing countries build up capacity for trade. □

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# COMMENTARY

**Moses M. Ikiara**

Aid will only work well if appropriate conditions are attached; it has little purpose unless it contributes to structural growth in low-income economies. To achieve this, paternalism and the pursuit of political interests must be avoided and the donor-receiver relationship between rich countries and low-income countries also needs to be revised. Instead of talking down to low-income countries, developed countries should treat them as their political equals. One only has to look at the way China and newly industrialised countries like Malaysia, Singapore and Korea are relating with Africa to see that this is possible. □

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# “Counterfactual” aid evaluation: When what you see may not be what you’re getting



Development aid specialists have long argued about how development assistance should be evaluated so that both host governments and aid donors can have a clearer picture of what works and what doesn't. **Martin Prowse and Lídia Cabral** debate two contrasting visions of how to make aid more effective

How effective is development assistance? It's a question that has come under close scrutiny in recent years, and in 2005 the Paris Declaration set five key "aid effectiveness" principles. Point one is that local "ownership" should be strengthened by ensuring that the government of a country receiving aid sets the agenda. Second, that aid donors should align their thinking and programmes with the host government's policies and management systems. Third, improved harmonisation of different aid donors' development programmes through closer co-operation and agreed divisions of labour. Fourth, better evaluation of development results and, fifth, mutual accountability so that both aid recipients and donors are equally accountable.

Progress on implementing these important principles was assessed in September 2008 in Accra, Ghana, at the third High Level

Forum on Aid Effectiveness. The Paris/Accra agenda suggests that aid effectiveness can be improved by changing the processes that make up an aid management system, not least by introducing better donor co-ordination mechanisms and harmonising strategies and policies. It also suggests that progress in improving aid effectiveness can be judged mainly by measuring the degree of compliance with these changes in processes and systems.

A very different approach to measuring the effectiveness of aid has been taken by advocates of "counterfactual evaluation", who don't focus on process issues but on the degree to which aid improves the well-being of the poor. These evaluations set out to answer what they call the counterfactual question of whether beneficiaries' well-being would have changed even if the intervention had not taken place?

This sort of evaluation is often done by randomly selecting participants from a wider population, and then randomly assigning participants to a "treatment" group (which receives an aid intervention) and a "control" group (which does not). As participants in the control group are similar to those in the treatment group, any significant difference between the two groups is said to be attributable to the aid intervention.

Advocates of this approach, the so-called "randomistas", argue that weak aid evaluations have contributed to a lack of consensus around the simplest of questions, which is "what works"? Believing their approach to aid evaluation is a superior model, they have gone so far as to suggest that all aid should be based on randomised experiments. Not surprisingly, this trend has sparked a variety of reactions, six of which are outlined below.

The first concerns policy horizons. Randomised experiments often need time to ensure that aid interventions have become fully embedded before the final survey is conducted. This may conflict with the shorter time horizons of governments and donors who often want evidence produced quickly to fit in with budgetary, legislative or political windows.

A second response focuses on moral and ethical concerns about using a control group. In other words, should we intentionally withhold an intervention from potential

beneficiaries as part of an experiment? Advocates of randomised experiments suggest that it is easy to avoid unethical evaluations. For example, it is common that the entire eligible population is not reached by a project immediately, either because of budget constraints, or because the intervention is being rolled out over a period of time. In the latter case, those to receive the intervention later can be the comparison group for the first participants. Moreover, randomistas argue that what is really unethical is to go on spending billions of dollars on ineffective interventions.

*The so-called "randomistas" argue that weak aid evaluations have contributed to a lack of consensus around the simplest of questions, which is "what works?". They suggest that all aid should be based on randomised experiments*

The third criticism of randomised experiments concerns context. Will successful interventions in one region or country have the same effect in a different region or country, or through a different institutional structure? A fourth critique focuses on experiments' design; for example, do intervention and control groups stay separate, or is there some direct and indirect leakage between the two groups?

The fifth point looks at wider political dimensions of aid relationships. The case for randomised experiments on efficiency grounds may ignore political currents that are a critical element of development assistance. Aid donors and recipients often have (undeclared) strategic interests that need to be factored in when assessing the impact of aid. The sixth and last critique highlighted here concerns the scale and

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reach of evaluations. The argument here is that while RCTs may be well-suited to small-scale development projects, they are not appropriate for evaluating larger aid-funded operations and broad policy changes. Investments in large-scale infrastructure, and also major policy shifts like public sector reforms, are not at all suitable because of the difficulties of establishing counterfactual data. This is important because, as the Paris agenda shows, the grain of aid flows has been moving towards direct budget support and other forms of programmatic aid which focus on broad governance and institutional issues which may not be amenable to a counterfactual design.

At first glance, then, it appears that two major trends in improving the effectiveness of aid are moving in opposite directions. Yet, there may be more synergies between these two trends than initially meets the eye. Three areas merit greater attention. The Paris/Accra agenda promotes programmatic forms of support, such as general and sectoral budget support. And although establishing a broad “with versus without” counterfactual approach is difficult, it may be possible to do so within an over-arching evaluation made-up of different elements.

Second, it may also be possible to use a before and after counterfactual design (so-called interrupted time series designs) when there is enough available longitudinal data using quarterly or monthly figures. This sort of analysis needs the analysts to be aware of any other important policy shifts that may have been implemented at the same time, or changes in administrative procedures and even how data was captured.

Counterfactual evaluations could also help governments decide which interventions are most effective within a sector that

receives substantial financial support. Reconstructing a control group through matching intervention and control units according to their recorded characteristics, for instance, offers plenty of potential. Other statistical impact evaluation approaches which don't use a counterfactual design can also serve this purpose.

The debate on measuring the effectiveness of aid is far from over. Counterfactual evaluations have certainly raised interest in better evidence and more formalised and rigorous evaluation techniques. But so far there has been limited progress in assessing the new aid orthodoxy, with its main focus on processes and systems. And although counterfactual designs are good at telling us what works, most are not very good at telling us why they work. In other words, counterfactual evaluations that rely solely on quantitative methods may be unable to tell us very much about how or why success occurs – they often can't tell us about key transmission mechanisms such as cultural values, or local norms or practices associated with the intervention in question. So complementing counterfactual evaluations with qualitative forms of research like focus groups, semi-structured interviews or just participant observation may give evaluators a clearer idea of whether success in one intervention can be replicated elsewhere. In fact, both quantitative and qualitative research within counterfactual evaluations looks like a good way of giving governments and donors a clearer picture of what works and what doesn't. □

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## What an effective Arab strategy for the EU should look like



Europe's attempts to forge a strategic partnership with the Arab world have been mismanaged and under-resourced, says **Abdullah Baabood**. He suggests that the 65-year old, 22-nation League of Arab States offers a viable framework for future co-operation

The European Union has yet to develop a coherent strategy toward the Arab world. Ever since the suspension of the Euro-Arab Dialogue (EAD) as a consequence of the Iraqi invasion of Kuwait, which split the Arab world and weakened the League of Arab States, Europe has followed a differentiated approach in conducting its relations with Arab states.

So for almost two decades, the EU's relations with the Arab region have been conducted through various initiatives and policies that lack both overall design and coherence. There has been a proliferation of unrelated policies like the Euro-Mediterranean Partnership, the EU-Africa Partnership, the

Cotonou Agreement with African, Caribbean and Pacific countries and the EU's stalled agreement with the Gulf Co-operation Council, the GCC. These have not only left Arab countries like Iraq and Yemen out of any institutional arrangements but have added to fragmentation of the Arab region, deepened intra-Arab divisions and indirectly contributed to the weakening of the Arab regional order.

*EU's relations with the Arab region have been conducted through initiatives and policies that lack overall design and coherence*

Europe initiated the Euro-Arab Dialogue (EAD) in the mid-1970s following the first oil shock, but with limited experience in inter-regional co-operation, the EAD got off to a false start with the two sides

having different expectations. The EU, at that time the European Community (EC), wanted energy security in exchange for economic and technical co-operation, while the Arab side hoped to exchange its new found oil power for political support in the Arab-Israeli conflict. These divergent motivations forestalled meaningful Euro-Arab co-operation, so the EAD endured a quiet death when in the 1990s the Arab world became more divided still following the Iraqi invasion of Kuwait.

Europe subsequently tried to kindle closer relations with sub-regional Arab groupings like the Arab Maghreb Union (AMU) and the Gulf Co-operation Council so as to keep some sort of a dialogue alive with these strategically important parts of the world. But the AMU relationship did not develop as envisaged and was eventually subsumed into the EU's wider Mediterranean policies, which were to culminate in the Barcelona Process and its Euro-Mediterranean Partnership (EMP), and lately its successor, the Union for the Mediterranean which has somewhat confusingly been combined with the European Neighbourhood Policy (ENP) to create "a ring of friends" from which the GCC is deliberately excluded.

These EU policies were developed with largely strategic considerations in mind in the wake of the Union's eastern enlargement and the security and migration challenges that were expected from the south. But the European idea of developing a zone of shared prosperity that would ensure stability and security in the Mediterranean has yet to bear fruit. The income gap between the Mediterranean's northern and

# COMMENTARY

By Claire Spencer

## It takes two to dialogue, so where's the Arab League?

The 'Arab world' is an elusive construct, as Abdullah Baabood readily admits. But the absence of a clearly delineated European 'Arab strategy' hardly prevents Arabs from integrating towards a common cause. The Arab League, as he says, comprises 22 different states and entities and some 350m people across an area straddling the Mediterranean basin, the Levant, Asia's borders, the Horn of Africa and the Gulf. The first two are in Europe's immediate backyard and the rest are on the edges of other geopolitical sub-systems.

The demise of the Euro-Arab Dialogue some 20 years ago was entirely a consequence of these geopolitical complexities. It takes two to dialogue and there has to be both a purpose and substantive outcomes for either to see the point. This is where the Euro-Mediterranean Partnership stepped into the breach from 1995. The logic of engaging some, if not all, of the Arab world in the Barcelona process was clearly influenced by the promise of the parallel Oslo process to deliver peace between Palestinians and Israelis. The EU's Barcelona partners, whether on the Mediterranean littoral or not, were chosen because of their proximity to Israel and Europe, and for the possibilities that an all-encompassing free trade zone would offer them. The hope was that these possibilities could support the political solutions anticipated through Oslo.

southern Mediterranean regions is still widening and it would be hard to claim that Euro-Mediterranean policy has helped resolve the region's lingering conflicts.

The EU's relationship with the GCC states also bears stark witness to the reluctance of Europeans to engage constructively with the Gulf. Europe has for long subjected this important, strategic and sensitive sub-region to what might at best be termed benign neglect. In the 20 years since the signing of the 1989 Co-operation Agreement, EU-GCC negotiations for a free trade agreement (FTA) have failed to reach a conclusion and in 2008 were suspended. Co-operation in other areas that include the energy sector has been very limited, while the stagnant

political dialogue consists of little more than the two sides reiterating their positions. This political dialogue has therefore done little to unlock trade disputes or even enhance Europe's security of oil supplies from the Gulf. In 2008, the GCC states unilaterally suspended the FTA negotiations, a move that amply reflected their disappointment with Europe's apparent refusal to acknowledge the region's strategic significance.

It is increasingly obvious that the EU now needs to rethink its strategies with regard to both the Mediterranean and the Gulf regions if it is to ensure that the Mediterranean Union is not just a continuation of old policies under a new name. For the Mediterranean Union to make a real impact it needs to be

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equipped with the levels of financial and political capital that its Barcelona Process forerunner was denied. In the case of the GCC, the EU needs to move beyond the free trade negotiations and get down to genuinely substantive co-operation issues, even if that means that the EU has to sign bi-lateral FTAs with each of the GCC's member states.

The EU also needs to create appropriate connections between the different strands of its policies in the Arab world, for example by creating linkages between its Mediterranean and the Gulf strategies. The European Commission's 2004 strategic partnership document for the Mediterranean and the Middle East did very little to advance the EU's political footprint in the region or give it greater coherence. Dividing the Arab world into Mediterranean and Gulf sub-regions and leaving other Arab countries out is not helpful to Arab governments' own regional integration efforts, and today a number of Arab countries that include Iraq, Yemen and Somalia are clearly feeling the effects of a weakened Arab regional order.

At sub-regional level a pragmatic case may exist for continuing separate dialogues with the Mediterranean and GCC countries, but in reality there is much to gain by linking the EU's various policy threads with different Arab countries, and most especially those of the Gulf and Mediterranean. For the vulnerable Gulf states, the Mediterranean and Levant is their security hinterland as well as being the backbone of their cultural identity. The Gulf, meanwhile, offers a source of investment and employment, for the Mediterranean region; it is second only to Europe in terms of foreign direct investment

When Oslo failed, Barcelona's supporting mission also failed. The substance of the EU's Barcelona offer to the Mediterranean Arabs, above all those without oil revenues, was economic development through trade, with pressures towards liberalisation and political reform as a counterpart. Looking towards the Gulf, however, none of this made sense: What the EU could offer, the GCC in large part already had. What the GCC wanted from EU states was above all military hardware, high-end imports and expatriate technical, educational and managerial assistance. Most GCC governments could, and still can, pay for these, so with them there's little or no room for the EU's Mediterranean-style aid-and-trade leverage.

What unites the remaining countries identified by Abdullah Baabood – Iraq until recently, Yemen, Sudan and the Horn of Africa – is their aid dependence. The EU and other international actors have struggled to create, rather than reform, viable governance structures in these weakened states, even where the U.S. (in Somalia and Iraq) holds a critical responsibility for their fragility. No room here, either, for more than attempted leverage. Dialogue with several rather than a single set of stable state leaders is the norm.

Missing from all these equations is any imperative from within the membership of the Arab League to address these different needs and circumstances themselves. Why look to the EU to provide, persuade, cajole or impose what a functioning Arab region should be looking to do for itself? A more deeply committed and integrated set of Arab League leaderships could set their own terms for dialogue with the EU, and condition where and how the

(FDI) in the Arab Mediterranean countries, so combining Gulf financial muscle with European know-how and technology could go a long way towards improving the prosperity and stability of the whole region.

The non-Mediterranean and non GCC Arab countries – Iraq, Yemen, Sudan, Somalia, Eritrea, Djibouti and the Comoros – could be incorporated into the EU’s Mediterranean policy as the GCC is a sub-regional organisation while the Mediterranean is not. Mauritania and Jordan are both members of the EMP but they are hardly Mediterranean countries. Alternatively, these countries could come under a more encompassing new overall EU policy towards the Arab region that would build on and reinforce existing inter-regional relations while linking the Gulf to the Mediterranean.

The seemingly neat term “the Arab world” is an amorphous description and can be misleading. Being “an Arab” is as slippery a notion as being “a European”. Heterogeneity and diversity are key features of the Arab world, and after all the term is used to describe the 22 countries that belong to the League of Arab States (LAS), whose combined population is some 350m from different ethnic and religious backgrounds who inhabit lands extending from the Atlantic to the Gulf and from the Saharan desert to the Anatolian foothills.

In stark contrast to Europe, the Arab world has seen little formal integration.

Some regional arrangements like the United Arab Republic (UAR) between Egypt and Syria in 1958 lasted only three years. Other regional acronyms have come and gone, sometimes acrimoniously. The ACC – the Arab Co-operation Council grouping Egypt, Iraq, Jordan and North Yemen – survived only a year after its birth in 1989. The Arab Maghreb Union (AMU) has been a flop, and although the Gulf Co-operation Council, consisting of Saudi Arabia, Kuwait, Oman, Bahrain, Qatar and the UAE has fared better, it has nevertheless been held back by rivalries.

The LAS is altogether more durable and resilient. It was set up in 1945 with the main aim being to “draw closer relations between member states and co-ordinate collaboration between them, to safeguard their independence and sovereignty and to consider in a general way the affairs and interests of the Arab countries”. It has served as a forum for member governments to co-ordinate their positions, to deliberate on matters of common concern, and where possible to settle some disputes and limit conflicts. The LAS has had a long history as a platform for fostering trade and economic co-operation, including the creation of a Pan-Arab Common Market through the Greater Arab Free Trade Area (GAFTA).

Despite its many shortcomings, not to say many premature obituaries reporting its demise, the Arab League has not only survived but also has helped resolve many

*The EU needs to rethink its strategies with regard to the Mediterranean and the Gulf if the Mediterranean Union is not just a continuation of old policies under a new name*

regional conflicts while playing an important role in intra-Arab co-operation and economic integration. Any weakening of it has had a negative impact resulting in wars and even the failing of member states like Somalia and to some extent Yemen. It is therefore surprising and odd given the European passion for promoting regional integration that the EU has no formal dialogue with the League. Europe has thus under-achieved in its sub-regional policies towards the GCC and the Mediterranean while neglecting the only regional organisation grouping all 22 Arab countries.

In short, the EU needs to re-think its whole strategy towards the Arab world and play a much more constructive role to promote the integration of the region. It should recognise the League of Arab States as the most suitable partner with whom differentiated policies like those with the GCC and EMP/ENP along with any others relating to Arab countries could be filled into an overall framework. A more encompassing and coherent EU-Arab policy should include such common issues as economic co-operation and integration, scientific and education co-operation, cultural dialogues, energy security and climate change, conflict resolution, stability and regional security as well as good governance, democratisation and civil society relations. It is a sad comment on the present situation that these elements are not seen by EU policymakers as the components of a strategic approach. □

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# COMMENTARY

Claire Spencer

European development assistance and political frameworks are directed.

The real answer, perhaps, lies less with the much commented on deficiencies of EU policy, than with the prevailing divisions within the Arab world. One shared wound is the debilitating lack of a Palestinian state, despite endless attempts to counter Israel's resistance to the clear demand formulated in recent years by the Arab League; namely, to withdraw from the occupied territories in return for full diplomatic normalisation with all 22 of its members. The other shared wound is the highly unequal division of resources, not only across the region but within individual Arab states and societies.

If the Arab League cannot devise its own approaches to dealing collectively with these issues, no amount of EU strategising from outside will do it for it. This is not to say that the EU's own exploitation of the gaps between its external relations and foreign policy objectives is entirely blameless. The history of individual EU member states breaking ranks across the Arab world also has much to answer for. Unavoidably, any Arab regional integration strategy worthy of the name has to begin at home. □

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# The West's hollow talk of Arab democracy



Political leaders in America and Europe are vociferous in their calls for the Middle East to embrace democracy. But **Khaled Hroub** says that the reality is the West connives in keeping Arab autocrats in power

The non-democratisation of the Arab region results from an unholy alliance between Western interests, local autocrats and what is claimed to be its 'cultural specificity'. Within this alliance, there have been various trade-offs. Western interests are served by puppet rulers who in return enjoy support and recognition. As to the justification of cultural specificity as it pertains to governance in Arab countries, all this is window-dressing for the revolting reality that in effect says: 'Let's be honest, it's better for both the West and we the local dictators not to have democracy here'.

In a nutshell, it was much easier in the post-colonial Middle East for the West to do business with un-democratic regimes where deals could be made without accountability or transparency. The result of this decades-long trade-off has been the transformation of

cultural specificity pretext into a (somehow racist) alienation of local democratic and liberal forces and a paving of the way for the rise of Islamist radicalisation.

*We have wasted decades and missed our chances to establish democracies that could have empowered liberal forces*

This trade-off has not always led to mutual prize giving. Sticks as well as carrots have been used and not only by the powerful West against weak Arab regimes, but more surprisingly in the opposite direction too. The Western agenda for reform and democracy has been used more often than not as a threat, a typical message being: "help out in the war against Iraq or we press for democracy and human rights in your own country. An Arab message in return would be: "stop pressing on the reform issue or we won't co-operate in the 'war on terror'!"

Two other major issues have sustained the trade-off; Israel and the rise of the

Islamist movements. Israel has been seen by the vast Arab public majorities as an alien and illegitimate entity imposed by force on Palestinian land with Western support. To have this perception channelled through democratic means and shaping policies towards Israel would further complicate any hopes of a peace deal between Arab countries and Israel. It is far easier to launch negotiations and eventually sign peace agreements between Israel and authoritarian regimes like Egypt and Jordan, and in the future with Syria, where there is no need for any parliamentary agreement. In Morocco, Tunisia, Mauritania, Qatar, Oman and Bahrain, where various low-level contacts and Israeli representations exist, these countries' undemocratic nature has allowed the ruling elites to impose whatever relationship with Israel they choose.

The rise of radical Islamism has been no less obstructive when it comes to the democracy debate in the Arab world. The decades of unholy alliance between Arab autocrats and the West have seen radical Islam emerge as a 'salvation' force. If free and fair elections were to be held in any Arab country, the Islamists would come to power. That was the case in Algeria in 1991/2, in Iraq in 2005 and in the Palestinian West Bank and Gaza in 2006. In most other cases where a 'limited space for democracy' was allowed, such as in Jordan, Morocco, Kuwait, Yemen and Bahrain, the Islamists immediately filled that space. For the southern shores of the Mediterranean to be controlled by Islamist parties is seen as worse than a nightmare for the West in general and Europe in particular.

The reality is that we have wasted decades and missed our chances to establish

# COMMENTARY

By Nathan J. Brown

## Yes, but that's no reason to give up on Arab democratisation

Khaled Hroub tells us that Western governments have cast aside their values by working with despotic Arab regimes. The Islamist spectre and the excuse of "cultural specificity" have been used to justify this cynicism, and in those cases where democratisation has been pursued it has only been used against selected adversaries. These claims are all too accurate. Democracy and human rights have been trumpeted as the centrepiece of Western policy, but from Saddam Hussein to Yasser Arafat they have been used primarily as a club to beat those leaders the West doesn't like for reasons unrelated to their despotism. Democracy has been soft-pedaled for cooperative regimes like Egypt, Jordan and Saudi Arabia, and tossed out the window when the would-be beneficiaries have beards.

But I nevertheless have grounds for contesting Khaled Hroub's conclusion. He writes that the "non-democratisation of the Arab region results from an unholy alliance between Western interests, local autocrats and claims of 'cultural specificity'." This consists of one mistake, one exaggeration and an erroneous policy lesson.

The mistake is that Hroub tries to explain the absence of democracy, yet for all its current popularity, democracy is in historical terms a rare form of government. It is democracy's emergence, not its absence, that needs to be explained.

## Democracy's mixed fortunes in the Arab world

All but three Arab states – Iraq, Lebanon and the Palestinian Authority – are authoritarian regimes and even they, according to the Democracy Index of *The Economist*, qualify only as 'hybrid regimes', well below the categories of 'full democracies' or 'flawed democracies'.

That the only Arab countries to scrape into this lowest category are unstable states emerging with highly fragile institutions from years of occupation and war doesn't say a lot for the state of democracy in the Arab world. Although most countries in the region now hold elections, in some cases including all-women lists, their legislative assemblies have very limited powers compared to the executive.

Most Arab countries remain a one-man – or one-family – show, according to Jordanian academic Mustafa Hamarneh, with bureaucracies that work for the leader, not the state.

The seven emirs of the United Arab Emirates appoint the prime minister and cabinet, while the legislative

assembly, half of whose members are elected, has only consultative powers. Morocco holds multi-party elections, has a national list for women and is led by a coalition government, but the king appoints the prime minister and cabinet, and is able to dissolve parliament.

In Egypt, the principal opposition to the government is the Muslim Brotherhood, and it is forbidden from organising as a party so its members must stand as independents. But presidential candidates are now allowed to challenge Hosni Mubarak, who won 88.6% of the vote in the last election. Mubarak has been in power since 1981 and rules under a state of emergency.

Elsewhere in the Arab world, gerrymandering is reportedly widespread. Elections in Bahrain are described by observers as free and fair, but electoral districts are skewed against the Shia Muslim opposition: The size of constituencies varies from 500 in Sunni districts – favourable to the ruling al Khalifah family – to 12,000 in Shia-dominated areas. □

democracies that could have empowered Arab liberal and democratic forces. The West's blind support for autocratic Arab regimes has eliminated all hope of peaceful change. The democratic process has lost its aura and its thrust, not least because democratisation seems to lead to the rise of political movements the West finds unacceptable. Palestinian democracy that led to the victory of Hamas is only the most recent example, for over the decades the illiberal and undemocratic policies of the West in Arab countries have weakened liberal forces, and led instead to the rise of Islamist fundamentalism.

The whole notion of democracy has been eroded and discredited, with the radicalisation that engulfs many Muslim societies now spilling over into their emigrant communities in the West. It is a phenomenon that has wider causes and deeper historical roots than current affairs because it results from the closing down of all avenues of change thanks to the active involvement of the West.

When in 2002 the Bush Administration launched its Middle East Partnership Initiative for democratisation in the Middle

East, it turned out to be too little, too late – and it died too soon. The allocated budget was just \$29m, but its rapid death can also be ascribed of its short-sighted design. Yet the official burial of the idea of democratising the Middle East in fact took place at the hands of Barack Obama, who has shown little interest in the issue right from the start of his presidency. Obama’s praise of Egypt’s Hosni Mubarak as a man who one could do business with demoralised opposition groups in Egypt who have been struggling against the long-serving autocrat and his designs to pass power on to his son, Gamal Mubarak.

Not only the United States has furthered the non-democratisation of the Arabs,

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# COMMENTARY

**Nathan J. Brown**

Democracy triumphs when entrenched social forces and mobilisable constituencies find that they cannot defeat each other, so they allow strong political institutions to mediate their differences. For the Arab world to democratise, political opposition will have to link to organised constituencies, and that is something that to date only Islamists have done. Existing regimes will have to conclude, like 19th-century Europe’s ruling groups, that they have no alternative but to negotiate the inclusion of those they have been trying to keep out.

Hroub’s exaggeration is his over-emphasis on Western policy when explaining the absence of democracy. Western policy has, to be sure, been ineffectual, hypocritical and damaging. But it is only part of the problem—and therefore changing it is only part of the solution. At best it can aid long-term trends toward democratisation. The real challenge for Western policymakers is to find a way to integrate long-term support for democratisation into policies that are all too often reactive and based on a need to respond to last week’s headlines.

As to the erroneous policy lesson, although Hroub does not prescribe any specific policy, he implies that the best policy might be a revolutionary break with current regimes and an insistence that democratisation be placed at the centre of Western policy. Even if such a path was theoretically wise, and Hroub does not claim that it would be, the story of the Bush Administration’s freedom agenda should caution us against such a path. Bush simply wished away the tension between democracy promotion and other Western interests – with the result that eventually everyone become disillusioned. We need a steadier, long-term policy, not a messianic new vision.

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for Europe has been no less active. Two recent examples are Libya and Saudi Arabia, with Europe playing a major role in 'rehabilitating' Libya and 'bringing it back to the international community'. Internationally ostracised, Tripoli has become the new Mecca for European leaders trying to win multi-billion dollar oil and investment deals. The rehabilitation of the Qaddafi regime has never included any push to ease political oppression in Libya, but an even more telling case is Saudi Arabia. No European leader risks antagonising the Saudis by raising the issue of democracy and human rights there. Saudi women are prohibited from driving cars, travelling on their own, working or studying without the permission of a male member of the family. Saudi societies and those of some other Gulf States lack minimum levels of political freedom and participation. The *status quo* is excused by Arab regimes in the name of cultural specificity; the same pretext used by Western governments to justify their 'value-free' policies towards these regimes.

Lump together all the trade-offs between the West and a number of Arab regimes, along with the Israel factor and the Islamist factor, and the alarming conclusion is that the West cannot afford democracy in the region. Western talk about the necessity of democracy in the Middle East rings all too hollow. □

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# COMMENTARY

**Nathan J. Brown**

For democracy to emerge in the Arab world, two things must happen: Those with alternative political visions must be free to mobilise their constituencies, and Arab leaders must learn to see their challengers as legitimate political actors. Western powers can contribute to such developments, but low-level assistance to organisations with pleasant but safe agendas will do little to help. The usual types of democracy promotion generally do no harm, and might even do some good, but they need the support of diplomatic muscle. And that can only be delivered by a clear policy that makes it clear that Arab regimes' relations with the West will be affected by their treatment of opposition groups.

This discussion usually leads directly to the familiar question of whether the West should "engage" with Islamists? The answer is that this is the wrong question. The right ones are: "What can the West do to encourage Arab regimes to engage with Islamists?" and "How can the West encourage Arab regimes to allow reformers to convert armchair theorising into effective – but non-revolutionary – mobilisation?" Engagement must be among competing political visions in the Arab world. Western policymakers can help in modest ways, and if they fail to do so they risk continued political cynicism and radicalism in the region. And even if they opt to do so they must be aware that the pay-off may be a generation away. □

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# How Europe could alter the Arab-Israeli 'political calculus'



If the EU wants to make a real contribution to resolving the Arab-Israeli conflict, says **Ezzedine Choukri Fishere**, it should consider imposing an 'occupation tax' on all dealings by Europeans with the Israeli settlements in East Jerusalem and the West Bank

Arab intellectuals and policymakers have often accused Europe of using financial generosity to cover up its political impotence over the Arab-Israeli conflict. If Europe is to be taken seriously as a global player, they argue, it must also flex some muscle when it delivers the banknotes. And in Arab eyes European officials implicitly plead guilty when their excuse is to point to Europe's complex multilateral politics and bureaucratic EU decisionmaking. But Europe's Arab interlocutors, are unimpressed by these explanations: they want Europe to stop just talking like a Great Power and start acting like one.

And that's not likely to change. We Arabs will continue to play on Europe's guilt feelings, just as EU officials will continue to seek ways to make Europe look like a coherent global actor.

But more realistically we should stop asking the European Union to emulate a nation state. Europe cannot sponsor or lead a negotiation process between Arabs and Israelis, let alone impose a solution on them.

What Europe can do is to focus on what it is more suited for, which is to influence the core dynamics of the Arab-Israeli conflict.

Over the last two decades, the EU's desire to look more and more like a nation state has guided its position on the Arab-Israeli conflict in the wrong direction. Europe's inability to play a political role in the Middle East peace process was wrongly diagnosed as resulting from a European bias towards Israel. Policy advisors argued that gaining Israel's trust was necessary if it was to recognise that Europe should play a role in the peace process. Almost nothing became too dear to win this elusive trust; technology transfers, European quotas in the United Nations, association agreements, upgraded relations and even, reportedly, the prospect of joining the EU.

Driven by this irresistible desire to appear relevant, European policy revolved around seducing Israel while at the same time bribing the Palestinian Authority. Financing Israel's occupation of Gaza and the West Bank served both objectives at the same

time, at a cost to European taxpayers of several billion euros. Yet this policy earned Europe neither recognition nor relevance. Palestinians continued to trivialise Europe's contribution, and Israelis to loathe it for 'financing Palestinian terror'. So in the end Europe paid out a lot of money just to expose its own weakness. How much worse can things get before this counter-productive EU policy is abandoned?

The idea that Europe can seduce the occupier into giving it a role in ending occupation seems wrong-headed, while trying to convince Israel that Europe is even-handed is also a waste of time. Israel doesn't want an even-handed mediator but an unconditional supporter. This is partly why Israel prefers the United States as sole mediator, and it is also why its acceptance of a monopoly role for the U.S. evaporates as soon as any American president starts developing views different from those of Israel. When this happens, America's inability to project power makes all the difference. In other words, no matter what blandishments are showered on Israel, when push comes to shove it is the ability to use power – not charm – that determines whether or not an outside power has a say in Arab-Israeli peacemaking. Europe's failure to play a role in resolving this conflict does not result from imagined anti-Israeli views but from the fact that the EU is not a state. States are not given roles; they acquire them by the power assets they can deploy in the service of their foreign policy. And Europe cannot deploy the type of power needed to tilt the balance in Arab-Israeli peacemaking.

But it can do other things. The EU can enhance its influence if it abandons the fantasy of acting like a state and instead trades visibility for effectiveness. Instead of being obsessed with participating at conferences (with three representatives speaking in 'one voice'), Europe can if it chooses affect the dynamics at the core of Arab-Israeli peacemaking, help the parties face their existential challenges and still be faithful to its own principles and broader interests in the region.

The core dynamic of Arab-Israeli conflict is and has long been the inability of the parties to overcome their short-term political constraints and take decisions that are strategically sound but utterly unpopular.

*Europe's Arab interlocutors want Europe to stop talking like a Great Power and start acting like one*

The return to power in Israel of Likud, and the failure of the Obama Administration to get it to freeze West Bank settlements illustrate this dynamic. Strengthening Israel's grip on East Jerusalem and the West Bank, as well as the Golan Heights, simply brings Israeli politicians more votes. Advocating withdrawal from these territories, which is a sine qua non condition for peace, drives away Israel's voters. Palestinian rejectionist factions thrive on this just as much as their Israeli counterparts; so advocating concessions to Israel doesn't win more moderate Palestinian politicians greater popularity either. On both sides, politicians agonise in private over the strategic concerns that are being undermined by short-term political realities. But there is little they can do about it; some call this leadership deficit and others a sane political calculation.

To change this dynamic, external players now need to influence the political calculus inside Israel and Palestine by lowering the political cost of peace and raising the cost of occupation and thus enabling politicians to choose peace. Israel's preparedness to return Palestinian territories, with certain conditions, is the trigger for any meaningful Arab-Israeli conflict resolution process, but no Israeli government will be willing or even able to do that unless the political calculus inside Israel changes. Making withdrawal a tolerable political option (or making

occupation a more costly one) is needed to start a meaningful peace process.

Europe has already tried incentives for withdrawal, but those incentives alone clearly will not do; the cost of occupation must also be raised. In plain English, an 'occupation tax' is needed. This would be different to applying sanctions, which in any case risk triggering a "Masada Complex" that would push Israel to further extremes. But a sanction targeting the tools of occupation – not Israel as a whole but the whole

## EUROPE'S WORLD BACKGROUND BRIEFING

### What the EU spends on aid to the Palestinians

The EU has been the largest aid donor to the Palestinians since the Oslo accords of 1993, when of the \$2.4bn pledged to support the peace process 38% was from the EU. The deal at that time was that the U.S. would work on a political settlement while Europe focused on aid and state-building.

The European Commission's 2000-2009 aid commitments to the Palestinian Territories amounted to €3.41bn, not including donations by individual EU member states. For 2008, €497m was committed, and the programmes co-ordinated by the Commission total about a quarter of all assistance to the West Bank and Gaza Strip.

Most EU aid is now channelled through PEGASE, a European Neighbourhood Policy instrument set up in early 2008 to support the Palestinian Authority's reform programme. Of €440m pledged by the Commission for 2008, €325m was through PEGASE to fund direct assistance for public services and infrastructure investment.

Whether this money will reach its targets remains to be seen. In recent years, the failure of the peace process has meant EU funds have been diverted away from capacity-

building to repair war-damaged infrastructure and meet basic humanitarian needs.

Relief payments already form a large part of the budget: the EU provided over half the 2008 budget of the United Nations Relief and Works Agency (UNRWA), set-up in 1949 to help Palestinian refugees in Lebanon, Syria and Jordan, as well as those in the West Bank and Gaza.

Corruption within the Palestinian Authority and the recent split between the PA and Hamas have compounded the problem, especially for the people of Gaza. Here, the EU pays the salaries of doctors, nurses and teachers, but also those of Palestinian Authority officials who have been unable to work since Hamas seized power. Money is being wasted as long as the political situation is unresolved.

An international donor conference to fund the rebuilding of Gaza held in Sharm el-Sheikh in March of last year raised \$4.4bn, including €436m from the Commission. The EU says it has fulfilled its pledge but that other countries, including many Arab states, have yet to fulfil theirs. □

settlement's enterprise and the violation of Palestinians' human rights.

An 'occupation tax' should start with turning the current exclusion from EU preferential customs treatment of settlement's products into a full-scale ban on imports from settlements – and any transactions with them. Companies and banks should be barred from doing business in or with settlements, and especially with construction companies and their suppliers. At the same time, pressure should be exerted on the government of Israel to end its financial assistance to settlements.

The 'occupation tax' should also include action aimed at ending the impunity that to all practical purposes is enjoyed by the Israel Defense Force (IDF). IDF officials argue that some level of human rights violation is inevitable during occupation and that the IDF record is not much worse than any other occupation army. They are right; an occupation cannot be sustained without the systematic violation of human rights. And this is precisely why these violations must be made costly: to signal to Israeli voters that the cost of occupation is bound to rise. This can be done if Europe supports 'first' the investigation of suspected war crimes and other violations by the IDF of international humanitarian law and, second, the establishment of international tribunals when those crimes occur.

Despite its apparent difficulties, this sort of occupation tax would be a wise policy

option for Europe, and a blessing for Israelis and Arabs alike. It would send a clear message to Israel's voters that Europe; while committed to the security of Israel, will not compromise its own standards by accommodating Israel's imagined need to occupy Palestinian lands. At the same time, it would restore credibility to European claims that human rights standards are universally applicable, and would also help those people in Israel who are fighting for its soul and democratic ideals. An occupation tax alone is obviously not going to bring peace, but neither is negotiation. Both are needed and neither suffices alone.

*External players now need to influence the political calculus inside Israel and Palestine by lowering the political cost of peace and raising the cost of occupation*

Bringing the two sides to a new negotiation process, or even drafting a blueprint for a political solution, is something only the United States can do, with support – at best –

from Europe and others. Yet affecting the internal political calculus in Israel is a task that Europe is more fit to lead. It is a role that Europe can afford, given its unique situation between being a constellation of states, who have shared interests and similar constraints, and a group of nations bound by principles and values. Such a role would better protect its broader interests in the Middle East and allow it to remain faithful to its values. □

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# European resolve (and cash) could end the Palestinian refugee crisis



Until the plight of the 4.5m Palestinian refugees is eased, argues **Alon Ben-Meir**, there will be no solution to the Arab-Israeli conflict. He sets out a plan for EU action on re-settling the refugees

President Barack Obama's meeting with Israel's Prime Minister Benjamin Netanyahu and the Palestinians' President Mahmoud Abbas last September fuelled speculation that there would be palpable progress in the Middle East peace process. Yet so far all attempts at reconciliation have yet to be translated into action. Continuing Israeli settlement activity on the West Bank and in Jerusalem has kept George Mitchell and his colleagues in the American negotiating team shuttling back and forth to the region, but the historically contentious issue of the Palestinian refugee crisis remains. This has already disrupted numerous efforts toward a final agreement, and is likely to present the biggest hurdle for negotiators in the future.

Instead of waiting for final status talks to resume, the international community led by the European Union should now take steps to improve the political atmosphere surrounding the Palestinian refugee issue. There is only one realistic solution that could be envisaged as part of a two-state solution, and that means compensation,

resettlement and rehabilitation in the West Bank and Gaza. The EU must therefore take the lead and use its formidable economic and political clout to help bring the tragedy of the Palestinian refugees to an end. By doing so, it would establish itself as an indispensable interlocutor in the Arab-Israeli peace process, thus enhancing its own strategic and economic interests in the Middle East.

Of all the issues that divide the Israelis and Palestinians, spanning as they do territorial claims, secure borders and the future of East Jerusalem, the Palestinian refugee problem continues to stymie all pragmatic solutions. The majority of Palestinians believe that the creation of Israel in 1948 precipitated the problem, so the solution lies in the Right of Return to the state of Israel as a matter of principle. Israel has hotly refuted this argument, and in every encounter with the Palestinians since 1988 has made it clear that to sustain its Jewish majority, which the Israelis consider a sine qua non for any agreement, the solution must be found through resettlement and rehabilitation in

the West Bank and Gaza. This will fulfill the call for Palestinians to return to their homeland, albeit not to their original homes. Other refugees may opt to resettle in their present country of residence as long as these countries are prepared to accept the refugees as their own citizens.

Many Palestinian and Arab leaders have since 2000 conceded in private as well as in negotiations with Israel that apart from a symbolic 20-30,000 refugees returning to Israel proper as part of family reunification, the solution lies largely in resettlement and compensation in the new state of Palestine. Such a solution is based on the 1967 Resolution 242, of the UN Security Council, which calls for "achieving a just settlement to the refugee problem." This is opposed to the 1948 Resolution 194 of the UN General Assembly, where article 11 states that "the refugees wishing to return to their homes and live at peace with their neighbours should be permitted to do so at the earliest practicable date." It should be noted that in every final status negotiation between the two parties, a solution to the Palestinian refugees was discussed only in the context of resettlement and compensation. The understanding between the two parties was based on the premise of UN Resolution 242, which superseded the non-binding Resolution 194.

Considering the historical magnitude and the politicisation of the Palestinian refugee issue, it is necessary at this point to change

the political formula. Waiting for an Israeli-Palestinian peace deal to be signed could take years, and as matters stand the refugee issue could collapse any final status agreement, as happened in Camp David. To change the political dynamics, the EU should take direct action to alleviate the crisis as a precursor to a future peace deal. Instead of seeking to change the political narrative about the need to resettle the Palestinians in their homeland, the EU should first create the means to make that possible.

*The historically contentious issue of the Palestinian refugee crisis has already disrupted numerous efforts toward a final agreement, and is likely to present the biggest hurdle for negotiators in the future*

The EU has championed the cause of Palestinian refugees since Israel's inception, and has been the largest donor to the United Nations Relief and Works Agency (UNRWA) for Palestine refugees. Considering, too, the natural alliance the Palestinians have with the EU as a possible balance to the close U.S.-Israeli relationship, the EU is in an ideal position to dramatically change the status of the 4.5m refugees registered by the UN. This is also an opportunity for Europe to solidify its role as an

international mediator, with a vested interest in the success of the Middle East.

To have a substantial impact on the way this conflict has been framed, the EU will need to take a number of steps to change the entire structure in which the refugees exist. This would require capital of perhaps up to \$10bn, far more than the €264m allotted for UNRWA – , as well as a close relationship with the Palestinian Authority and neighbouring Syria, Lebanon and Jordan, where many of the

refugee camps are located. Raising the funds to support the resettlement of refugees into the West Bank and Gaza would help to lay the foundation for the state of Palestine, but needs to be accompanied by a support system.

This would be in line with the plans of the Palestinian Authority's Prime Minister Salam Fayyad to establish a de facto state in the West Bank and Gaza. Fayyad's state-building vision has engendered Western enthusiasm along with financial and political support from the Obama Administration and the EU. Although Mr. Fayyad invokes Resolution 194 on the Palestinian refugee question, he also emphasises that "the government will do all within its power and authority to bolster the legal right and the living conditions of the refugees in the occupied territory, particularly in refugee camps, including the provision of all the resources it can afford to support and alleviate the suffering of the refugees in all aspects of their lives."

Every country that speaks of the need to find a solution to the Palestinian refugees must contribute to this effort, including the U.S., Russia, China, the oil-rich Arab states and Israel itself. Re-settlement of the refugees means large-scale investment in jobs, contracts for housing and schools and measures to ensure that existing Palestinian communities can absorb the influx. The EU needs to partner with the PA to create a ministry for resettling refugees. Improving the economic situation in the West Bank and Gaza will be key if Palestinians are to be motivated to leave the refugee camps.

This approach is fundamentally different to previous attempts, because it is based on finding a solution to the refugee crisis

before any final status negotiations. The EU should not only adopt this idea but promote it publicly as an official position. Guaranteeing money for resettlement will lure many Palestinians into thinking practically about this issue, rather than using it as a political tool. Billions of dollars for resettlement will have the effect of changing the debate and forcing people to think about how to use the money constructively. The EU must also emphasise that this is not a controversial idea, as past negotiations have been based on the premise of UNSC 242 and the concept of re-settlement into the West Bank and Gaza.

There are those who argue that while the solution to the refugee problem is financial, with the right of return exercised inside the new Palestinian state, it is a solution that will be difficult to attain unless linked to a viable Palestinian state. If that is not achieved as part of a package, Palestinians and Arabs will feel they were "bought". This is why it is absolutely critical that the resettlement of refugees should facilitate rather than obstruct the creation of a Palestinian state.

Moving Palestinians out of refugee camps and into viable communities in their future state will also have a huge impact on the whole Arab community. Not only should the Arab world help the EU to fund this project, but they should give logistical and organisational support for a significant transfer of people. Arab states that have used the plight of the refugees to cover up for their own shortcomings can finally do something beneficial for the people who have been living in squalid conditions for decades. And Israel should welcome this development as it would help to mitigate

the call for a return to Israel proper and ease some of the human rights claims against them. By taking the lead and raising money, the EU can assure the Israelis that all the money raised and the needed permits for construction will be for the sole purpose of moving Palestinians into their homeland in the West Bank and Gaza.

The goal must be to change the current situation of the refugees, not by giving them aid – which is a major role for the UN – but by establishing the funding and grounds where refugees can start returning to their homeland by the thousands and investing in their new communities. For the 60% of refugees already living in camps in the West Bank and Gaza, this will mean working with

the PA to pull their families out of refugee status and into proper housing.

Resolving the Palestinian refugee problem requires not only money from the EU, but above all political and organisational know-how to overcome the many detractors whose political fortunes depend on the continued plight of the refugees. What is now needed is a bold and visionary solution that is totally consistent with the right of return to the future Palestinian state. □

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**ATHENS**

**Greece is not just Europe's black sheep – it's truculent too**

By **Nikos Frangakis**,  
President of the Greek Centre  
of European Studies & Research  
(EKEME)

Not for the first time, Greece is being labeled a black sheep of the EU. The fiscal derailment of the Greek economy, with a public sector deficit that may reach 12.7% for 2009, has coincided with the election of a new PASOK government. To win their landslide, George Papandreou and his socialist colleagues vowed to give precedence to growth over stabilisation, as Greece's growth slumped to minus 1.5% in 2009, down from an expected – 0.5%. Meanwhile, the national debt is set to pass 125% of GDP by 2011.

The sheer size of the budget deficit along with suspicions that statistical data had been intentionally fudged by Athens' made for some extremely negative comments on the part of various EU authorities.

But the new Papandreou government at first insisted that its plan to restore growth through assistance to lower-income groups should be stuck to, with the cutting back of public expenditure and higher taxes coming a distant second. Greek public opinion has been

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*The sheer size of the budget deficit along with suspicions that statistical data had been fudged made for some extremely negative comments on the part of various EU authorities*

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largely supportive of the new government's stance, while "Brussels' pressures" along with the downgrading of Greek paper by the markets were viewed by many as unwarranted intrusions into national policymaking. Papandreou is the son of the firebrand socialist Andreas Papandreou, who was prime minister at the time of Greece's notoriously troubled relations with the EU in the 1980s, made his own views very clear when he said: "We will implement our programme notwithstanding the pressures in the EU... It is well known that we live in a Europe and a global system

where neo-liberal forces still have the upper hand, these very forces that brought the crisis to a head... We know that this establishment likes to shift the burden of the crisis to the middle-and lower-level strata of society".

The rough ride that Greece has had in the financial markets – with the spreads for Greek paper reaching 250 basis point over bonds, and with the Greek banks at risk of being shut out of ECB financing – has now brought about a belated change of attitude. The government has found itself in urgent need of Brussels' and Frankfurt's support, so a new stability programme has been put together with the European Commission that consists of a three-year effort to bring the deficit down to 3%.

Implementing its austerity measures will probably create extensive public unrest, so now the question is whether a new age of "Euro-resentment" will lead to Greece's eventual departure from the eurozone.

The Greek economy has long been problematic for Brussels, and when in the mid-90s Athens

decided to hitch its economy to the eurozone it did so to try and rein in its deficit-prone finances. With the help of the EU's structural funds, the Greek economy deflected double-digit inflation and was able to meet the Maastricht criteria just in time for the euro's introduction in 2001. Even then there seemed to be some creative accounting so that the Maastricht criteria could be met. And in the years up to 2004, the Greek economy failed – some say didn't even try – to adapt to the disciplines of the Stability and Growth Pact.

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*Austerity measures will probably create public unrest, so the question is whether "Euro-resentment" will lead to Greece's eventual departure from the eurozone*

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When the conservative New Democracy party came to power in 2004, revised statistical data showed a deficit almost double the Stability Pact's ceiling of 3% of GDP. Although a measure of structural reform was attempted the new budgetary discipline didn't last long. The question now is how convincing, and durable, will be the steps that its PASOK successor must introduce. □

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## MOSCOW Russia-EU relations getting warmer, but still not cordial

By **Dmitry Polikanov**,  
from the Russian Center for  
Policy Studies (PIR Center)

The question of the EU's visa requirements for Russians still provokes fierce controversy in Moscow's political circles. The Russian Federation has for some time been lobbying old friends like Italy to persuade the EU to lift visa restrictions, for Russians have long wanted to know why they don't have the same rights as people from countries like Ecuador who can spend 30 days in the Schengen zone without a visa. As Moscow has also completed the bulk of the necessary formalities, Russians think the EU should grant them visa-free status without delay.

It's an issue that highlights the change now taking place in EU-Russian relations. Last year, these were off the agenda. Unlike in previous years, when both Moscow and Brussels did their best by signing either a political declaration or a roadmap, in 2009 Russia and the EU both seemed so tired with each other that each summit ended in disappointment.

This year, though, EU-Russian relations are set to warm up again. Moscow has waited patiently for the future of the Lisbon treaty to be resolved, focusing instead on bi-lateral relations with the key EU members states and citing the chaos of EU structures as the reason for not engaging directly with Brussels. But now that Catherine Ashton is in place as the EU's new Foreign Minister, this should change.

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*In 2009 Russia and the EU both seemed so tired with each other that each summit ended in disappointment. This year, though, EU-Russian relations are set to warm up*

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A number of items on Catherine Ashton's agenda are of interest to Moscow, not least the new Partnership and Co-operation Agreement (PCA). Russia and the EU signed a previous PCA in Corfu as long ago as 1994, at a time when the EU believed that Russia would accept EU standards, and Moscow expected the Union to provide stimulus packages for the Russian economy. Both expectations proved to be hopelessly unrealistic, and over time each party became disillusioned with the agreement. But it wasn't until 2007 that they decided to open talks on a new PCA.

This time a round there is little hope 'though' of a swift conclusion as neither party has a clear long-term strategy with respect to the other. The Kremlin positions itself as a European power, but seizes every chance to stress its sovereignty, independence and samobytnost (indigenous values). Relations with Europe in any case take

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*The EU has been so pre-occupied with its own internal issues, and regional problems such as the Middle East, that it has invested little effort in its relationship with its most important neighbour*

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second place to those with the U.S., which remain Russia's top priority. For its part, Brussels would like Moscow to be more reliable on energy issues, and also more democratic.

But the EU has been so pre-occupied with its own internal issues, and regional problems such as the Middle East, that it has invested little effort in its relationship with its most important neighbour.

The two sides have different values and long-term strategies, and so far that has meant that neither can sign up to a general framework document. A detailed agreement like the previous PCA would require too much diplomatic ground work, so the chances of a new ACA look slim.

In the absence of a comprehensive agreement, Moscow and Brussels both know they could build confidence in one another by ironing out a number of practical issues. In the coming months, the Kremlin will promote a new treaty on European Security (TES). This is one of President Dmitry Medvedev's pet policy initiatives and is very important for the Kremlin. Russia will use any platform – the OSCE, NATO, bi-lateral talks, the UN, the EU – to promote the document, a draft of which was eventually published last December, nearly 18 months after the idea was first mooted.

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*In the coming months, the Kremlin will promote a new treaty on European Security (TES). This is one of President Dmitry Medvedev's pet policy initiatives*

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The Lisbon treaty's changes to the EU's structures are expected to make it more consistent on foreign policy and defence, and that's likely to encourage a much more active discussion of Moscow's proposal, which it must be said is worded in the sort of general and non-committal style that would also make an EU bureaucrat proud. □

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## TALLINN Bloodied but unbowed, Estonia is again to knock on the eurozone's door

By **Aksel Kirch**, of the Tallinn University for Technology

It is almost five years since the Estonian Government approved the first version of the national changeover plan for adopting the euro. But in the event Estonia was told it didn't meet the inflation criterion. Now, despite the country's serious economic woes, a new version of the changeover plan was agreed in mid-2009, and although no target date has been set, both the Estonian government and the central bank are agreed that their objective is to join the eurozone as soon as possible. Once again, though, Estonia complies with all the criteria other than the inflation rate.

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*Although no target date has been set, both the Estonian government and the central bank are agreed that their objective is to join the eurozone as soon as possible*

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Estonia expects, however, to meet all of the Maastricht criteria this Spring. The central bank's autumn 2009 forecast showed

Estonia's external balance to be improving, with companies having rapidly cut labour costs, while a moderate decline in prices contributed to improved competitiveness. Risks to the liquidity of the Estonian financial sector have also diminished, so many Estonians now argue that their country's steady course towards joining the euro area is now further diminishing its future financing risks.

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Yet of course Estonia's economic crisis has been real enough. An excessively high social price has now been paid for the some of the country's stabilisation achievements. The rate of registered unemployment in the labour force is growing rapidly, with joblessness reaching 15% last autumn. Unemployment is therefore at its highest since the restoration of Estonia's independence nearly 20 years ago, and is particularly worrying amongst 15–24 year olds.

In contrast to some of the newer EU member states, in Central Europe especially, popular support in Estonia

for EU membership is still significantly high. The last Eurobarometer survey (in November 2009) shows that about 62% of Estonians believe EU membership is "a good thing", whereas in neighbouring Latvia only about 23% of people support EU membership. And Estonia's political leadership seems in no doubt that it should make use of this situation. When people are generally positive concerning the EU's economic future and believe that advantageous economic change will be all the quicker through joining the eurozone, then the necessary restructuring reforms should go ahead. Estonia in any case needs a determined restructuring of its economy to ensure the growth and competitiveness of private enterprise. This means attracting new investment capital and also developing the country's human capital. Last year, the Economy Ministry initiated a "Made in Estonia" action plan whose first priority is the promotion of the country for foreign investment.

Estonians also see the economic crisis as an opportunity to strengthen its knowledge-based economy, and also to push for greater cross-border co-operation, especially in the Baltic Sea region as its 106m people make up 23% of the EU's population. □

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## BRUSSELS

### The Belgian paradox: High EU profile, low EU interest

By **Hendrik Vos**,  
Head of the Centre for  
EU Studies, Gent University

Belgian Prime Minister Herman Van Rompuy's appointment as the first president of the European Council, coupled with Belgium's forthcoming turn in the second half of 2010 in the rotating EU Presidency might suggest that Belgium and the EU are closely intertwined. Yet in truth Europe is hardly an issue in the Belgian political debate. Belgian politics are very inward-looking and chiefly characterised by a permanent search for balance between the country's divergent ideological groups and language communities. Following the last federal elections in June 2007, the political battle between the two language communities has intensified. In Flanders, the Christian Democrats led by the current Belgian premier Yves Leterme delivered a convincing electoral victory, for Leterme promised far-reaching institutional reforms that included devolving more power to the regions and dividing the electoral district around Brussels to reduce the influence of Francophone politicians.

During negotiations on a new federal government, the differences between the Flemish and the francophone Walloons were such that it took nine months before a coalition of Dutch-speaking and French-speaking Christian Democrats and Liberals, supplemented with francophone Socialists could be formed. Headed by Leterme, the government stumbled from one deadlock to another and after only a few months Leterme submitted his resignation to King Albert II, but it was not accepted. The autumn 2008 financial crisis moved institutional issues more into the background, not least because Belgium's largest banks got into such

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*Europe is hardly an issue in the Belgian political debate. Belgian politics are very inward-looking*

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serious financial trouble. The sale of Fortis to France's giant BNP Paribas, following which dissatisfied shareholders took Fortis to court, saw allegations of illegal contacts between some judges and politicians and led to Leterme's resignation at the end of 2008 when he was succeeded by Herman Van Rompuy.

Van Rompuy calmed tempers by putting less emphasis on institutional issues, and in any case the deepening

economic crisis, especially the future of Antwerp's large Opel plant, deflected attention from such contentious issues as the federal budget and diverging positions over Belgian asylum and migration policies. Van Rompuy's surprise

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*That one of the most pro-European countries shows only scant interest in the EU is a remarkable paradox. It is a lack of interest that exists not only among the general public but also among politicians*

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appointment as "European President" saw Leterme return to office as Prime Minister, and in the coming months Belgian politics are once again likely to centre around institutional issues, with the attention given to European politics triggered by Van Rompuy's more likely to be short-lived. The fact that one of the most pro-European countries shows only scant interest in the EU is a remarkable paradox. It is a lack of interest that exists not only among the general public but also among politicians. Last year the European Court of Justice ruled that Belgium had failed on 16 different occasions to transpose European directives. Seldom has a country been reprimanded

so often in the course of a single year. The Commission's latest overview shows Belgium to be currently facing 88 infringement procedures at the court on the grounds of non- or poor transposition of European directives, with only Spain and Italy the objects of a greater number of cases. In the last three years, the number of cases against Belgium has risen by 50%.

What of the Belgian Presidency? In years past the politicians used the country's

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*It looks as if the presidency programme will chiefly be organised by senior officials and diplomats, as neither government ministries nor parliamentarians appear particularly interested*

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turn in the EU Presidency to speed-up clearing the transposition backlog. But today there are few indications that this will happen and it looks as if the presidency programme will chiefly be organised by senior officials and diplomats, as neither government ministries nor parliamentarians appear particularly interested. It's a strange contrast with Belgium's higher profile in the ranks of EU leaders. □

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## MADRID

# Spain's EU presidency looks like a tricky balancing act

By **Deniz Devrim**,  
of the Barcelona Centre for  
International Studies (CIDOB)

Spain has taken up the rotating EU presidency at a crucial moment in the European project, and the presidency also presents a unique opportunity for Spain to redefine its role within today's enlarged EU of 27 member states.

This follows last year's lively debate among Spanish opinion leaders on Spain's status within the enlarged EU. Some hold Prime Minister José Luis Zapatero responsible for what they say is Spain's vanishing influence within the Union, and claim that Spain has been absent in global economic and foreign policy debates during his tenure. They say in comparison to his predecessors Zapatero has not made adequate efforts to create alliances with other EU leaders.

Critics include José Maria de Areilza who was foreign policy adviser to José María Aznar, Zapatero's predecessor, and José Ignacio Torreblanca, head of the Madrid office of the European Council on Foreign Relations. They say that

Spanish foreign policy lacks vision and consistency and that contradictory statements by the Prime Minister make his foreign policy appear to be more the sum of its parts than a coherent concept of Europe or Spain's place in the world. These accusations quickly drew a rebuttal from Foreign Minister Miguel Ángel Moratinos, who has pointed to what he calls the committed multilateral and constructive approach of the Spanish government.

Spain is widely seen as one of the EU's success stories, yet it has consistently failed to wield much strategic influence. It is counted among the larger EU member states and has broad global interests, notably in South America, but it has been increasingly difficult to define Spain's position.

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*How can Spain reinforce its voice on the EU stage? One way to boost its image as a heavyweight would be to abandon its label as a recipient of EU financial assistance*

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So how can Spain reinforce its voice on the EU stage? One way to boost its image as a heavyweight would be to abandon its label as a recipient of EU financial assistance. Doing so could completely transform Spain's image, strengthen its weight in the negotiation of

individual items and allow it to play a much more important part in shaping the EU's future. Another step that Spain could take to engage more closely with the political heart of the EU would be to combine traditional Spanish interests like Latin America and the Mediterranean with new areas. Raising such issues as enlargement and relations with EU's eastern neighbours on the agenda, and defending a stronger EU foreign policy, would give Spain a louder voice. And to reverse the prevailing negative discourse in Spain, Madrid could seek allies in other member states that come in favour of further enlargement.

Spain's six-month EU presidency also gives it an opportunity to lay the foundations for a new approach to the rotating presidencies. For the first time in EU history, its presidency runs in parallel with the permanent Presidency held by former Belgian prime minister Herman Van Rompuy. The delicate balance of co-operation between the two will be closely observed. Spain's balancing act means that it must assert a strong and competent presidency so as to raise Spain's profile on the EU stage, but as well as putting European interests above its national ones it must also cede powers to the EU institutions in line with the Lisbon treaty. □

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## ANKARA

# Turks are now puzzling over the EU's back-handed compliment

By **Mensur Akgün**  
of the Istanbul Kultur University

When EU foreign ministers last December praised Turkey's achievements in the areas of the judiciary, civil-military relations and cultural rights, they went on to express their satisfaction with Turkish democratisation efforts and to note the positive regional role it plays. They also demanded that Ankara should step up its efforts to comply fully with the Copenhagen criteria for EU membership – human rights and so on – but puzzlingly they neglected to mention Turkey's offer on normalising its relations with the Republic of Cyprus.

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*EU foreign ministers praised Turkey's achievements but puzzlingly neglected to mention Turkey's offer on normalising its relations with the Republic of Cyprus*

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In effect, the EU was saying that the eight suspended chapters of Turkey's accession negotiations would remain suspended, and that a recent offer by Turkey's chief negotiator, Egemen

Bağis, aimed at normalising Ankara's relations with the Greek Cypriots was going to be ignored.

The intensified negotiations on the Cyprus problem in the coming months have once again raised hopes of a settlement. But the outcome of last December's General Affairs Council already looks like yet another missed opportunity. The EU foreign ministers, who of course included Marcos Kyprianou of Cyprus, could have responded to Turkey's call much more positively and welcomed it as a confidence-building tool for the ongoing negotiations.

EU member governments, many Turks now believe, are not yet willing to back such an ingenious solution, preferring instead to defer a potentially confrontational decision and rely once again on the UN to find a solution. That's thought to be why they back-tracked on the EU's March 2004 promises and decided not to decide. They put the ball firmly back in the Commission's court and asked it to monitor the situation closely and report back to them.

But the assembled foreign ministers were of course well aware of the offer made by Mr. Bağis, not least because it had been publicly announced in Istanbul in the presence of the EU's then enlargement commissioner Olli Rehn as well

as several EU ambassadors. Bağis' offer had marked a significant retreat from the previous Turkish position of January 2006, which linked Turkey's meeting of its Customs Union responsibilities to issues like direct flights into Ercan airport on the Turkish side of the island.

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*Bağis' new offer was a face-saving formula, but also one that is seen by many Turks as an historic opportunity for normalising relations with the Greek part of Cyprus*

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Bağis' new offer was a face-saving formula, but also one that is seen by many Turks as an historic opportunity for normalising relations with the Greek part of the island. For Turkey is now linking the normalisation of relations with the Republic of Cyprus solely to the acceptance of the Direct Trade Regulation drafted by the European Commission back in 2004. That promise was made only two days after the simultaneous referenda on adoption of the UN's Annan Plan, which on the Greek Cypriot side had been rejected by 75.8% of the voters. □

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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 Autumn 2009 issue

## Energy security: The steps Europe now needs to take by William Martin and Jonathan Gillman

From **HERBERT REUL**,  
Chairman of the European  
Parliament's Committee  
on Energy.

Sir,  
William Martin and Jonathan Gillman were right to point to last winter's gas supply crisis as a reminder that energy security must be tackled effectively and urgently. Unlike them, however, I believe that the institutional structures already established in Europe worked remarkably well. Regional co-operation and the concerted action of companies in all EU member states, as well as the diplomatic efforts of the European Commission, all contributed to solving the crisis, and very few gas customers suffered disruptions in supplies. Gas companies also made concerted efforts to redirect gas flows to affected regions. Most of these actions were successful, including measures to reconfigure

pipelines and install reverse flows.

The 2008-09 crisis certainly did demonstrate where additional action is needed. Diversification of transport routes – and, possibly, suppliers – is clearly required in some regions of Europe, mainly the countries of former

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*Another key element of a sound energy strategy will be to limit growth in demand. Energy efficiency in the building sector, for example, offers huge potential savings*

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Yugoslavia where pipeline interconnections are lacking. Building pipelines, developing storage sites and constructing LNG terminals is a job for energy companies, however, not the EU. The EU's role is to concentrate on helping companies to overcome administrative and political burdens and barriers to trade.

The completion of the internal energy market, for example, will greatly enhance security of supply by guaranteeing third-party access to storage sites and pipelines. This is a much more practical way forward than for the EU to stockpile gas. Financially viable projects will come from the private sector. Public contributions such as those granted under the economic recovery programme should remain exceptions.

Martin and Gillman correctly highlight the importance of maintaining a broad energy mix. The latest generation of efficient nuclear power plants will contribute to EU energy security by decreasing our dependence on imports, and several member states are already planning or constructing new facilities. Others, however, face particular constraints. Nuclear power is not an option for Austria for legal and historic reasons, while the new German

government will prolong the lifetime of at least some nuclear power stations but so far rules out constructing new plants.

I fully agree with Martin and Gillman over the necessity to be careful with subsidies for renewable sources of energy. They should not distort markets for decades. Germany is a good case in point: we have installed ten times more wind power generators than the UK, even though Britain has a much longer coastline, and many

more solar panels than all southern European countries. This is not an effective allocation of funds at the pan-European level.

Another key element of a sound energy strategy will be to limit growth in demand. Energy efficiency in the building sector, for example, offers huge potential savings.

Martin and Gillman criticise the shortcoming of the EU's approach to energy. Yet our energy policy has come a long

way in recent years and further legislation is in the pipeline. These measures have largely been advanced in the name of limiting climate change and completing the internal market. It is evident, however, that Europe's energy security will benefit too. Perhaps it's time we shifted the focus of debate away from the environment and the internal market, and emphasise the energy security aspects of our policy rather more. □

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From **SEAN BARRETT**,  
Chairman, Oireachtas  
Joint Committee on  
Climate Change and  
Energy Security.

Sir,  
Martin and Gillman argue that the EU's competence in the energy area can be used to protect its most vulnerable members. But the bold action they advocate risks eroding trust with Russia. Europe needs a more measured approach which prioritises the expansion and diversification of supply routes to and from Russia.

The liberalised markets created in Europe in gas and electricity do not yet include the whole of Europe's territory. Developing markets in Europe are adjusting to the political realities of

climate change and evolving to greater levels of sustainability. This is all taking place in accordance with Directives on emissions trading and renewable energy sources. A foreign policy that emphasises the early exercise of overt power cannot take priority over the EU internal market project. Institution building towards market development is the most effective way of exporting the conditions for social and representative democracy. The prize of peaceful co-existence goes way beyond, but ultimately ensures, energy security.

As Chairman of the Irish Legislature's Joint Committee on Climate Change and Energy Security I advocate an approach which places first things first. Yes, we need more internal

and external infrastructure, some of which will depend on Russia. However, we need to promote flexibility within our internal market and above all we need to dramatically improve the efficiency with which we use energy and the rate of deployment of renewable energy. Ireland is at the end of a long pipeline and has a vital interest in any action designed to secure the future reliability and affordability of gas in Europe.

I want to see the day when relations with Russia are based on mutual respect, are grounded in self-interest and above all are sustained by our interdependence and common future. □

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# Africa doesn't need rescuing, just a square deal

## by Mo Ibrahim

From **DAVID FROST**,  
Director of the  
Directorate for Strategy,  
Policy Planning, and  
Analysis, Foreign and  
Commonwealth Office.

Sir,

The UK government would agree with much of what Mo Ibrahim has written. It is true that conflict dominates the majority of media stories on Africa. Unfortunately this presents a one-dimensional picture of Africa which fails to do justice to an immensely complex and culturally rich continent.

Enormous strides have taken place in Africa over the last twenty years. Advances have been made in the development of democratic governance, in the opening up of civil society and the ability of citizens to hold their governments to account, in human rights and in the ending of the most protracted and debilitating conflicts. Peaceful transition has largely, although not entirely, replaced violent military change. There have been more than 60 multi-party elections in the last six years. News which highlights recent reversals in governance or bad elections in countries as wide-ranging

as Mauritania, Zimbabwe, Kenya, Niger or Guinea clouds what is a generally positive picture. Mo Ibrahim's Index of African Governance provides an invaluable reminder to us all of the overall picture and trajectory of African politics while at the same time holding African leaders up to scrutiny.

Acknowledging the positive developments is not, however, to downplay the daunting

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*News which highlights recent reversals in governance or bad elections in countries as wide-ranging as Mauritania, Zimbabwe, Kenya, Niger or Guinea clouds what is a generally positive picture*

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problems faced by Africa. Again the UK government would agree that while the sustainable solutions to Africa's problems lie within the continent itself, the international community must also play its part. In 2004, then Prime Minister Tony Blair brought together seventeen independent people, mainly from Africa, to form a Commission for Africa. The aim was to examine development issues and stimulate development in the

continent. Their starting point was that Africans must drive their own development with rich nations supporting their efforts.

The Commission's Report, endorsed by the African Union and the 2005 G8 Summit at Gleneagles, identified many of the issues which Mo Ibrahim refers to. These include trade access and infrastructure development, improvements health and education, essential if the Millennium Development Goals are to be met in 2015; the integration of African countries into the world economy; and the accountability of African Countries to their people.

The UK is working to support development in these areas and is on target to meet the 0.7% of GDP spending commitment on international development. We encourage others, both within Africa and outside, to respond similarly, and we welcome the work by Mo Ibrahim and other influential opinion-makers to ensure that the commitments, made at Gleneagles and subsequently, are met. □

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From **RENIER NIJSKENS**,  
Director, Africa  
Department of  
the Belgian Federal Public  
Service of Foreign Affairs.

Sir,

Quick fixes are all too familiar in the field of international development. But if Mo Ibrahim's 'square deal' for Africa is to last, all partners must be guided by a common, genuine and long-term 'win-win' objective. Achieving this will demand change both in Europe and in Africa.

From an EU perspective, there is an avowed willingness to foster development, which is backed by substantial funds. Yet the European Union needs to look again at how best to take on board genuine African concerns about much-needed regional integration. The controversy surrounding the proposed Economic Partnership Agreements should not be allowed to put a strain on Africa in this regard.

EU efforts to help Africa to create a more investment-friendly business environment could be strengthened hugely were the EU to streamline its development assistance, including simplified access and better coordinated delivery. Progress on this front

also requires much larger financial incentives, with fewer ties to EU conditions and more links to the sort of progress that is measured by home-grown (and truly effective) tools such as the African Peer Review Mechanism and the Ibrahim Index of African Governance.

On the African side, Ibrahim's 'square deal' would benefit from a number of improvements which go beyond the greatly improved technical and

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*EU efforts to help Africa to create a more investment-friendly business environment could be strengthened hugely were the EU to streamline its development assistance, including simplified access and better co-ordinated delivery*

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regulatory aspects of dealing with foreign investments. One major unwritten constraint still present in most African countries is the shadow of unwanted political interference in successful businesses. Too often foreign investors face aggressive pressure from ruling elites to let them manage or deal with new capital and investments. A refusal is often the start of a severe and destructive backlash. Such practices

substantially limit the flow of essential "A" Class investment into Africa. A clearer separation of the political sphere and the private economic environment – and an end to 'pleasing' and 'greasing' – could work wonders.

Public opinion within Africa could also become an extraordinary tool to help strengthen the continent and improve its stature. The African people deserve a greater say in the management of their public affairs and, thanks to the boom in communication technology and greater access to education, ordinary citizens now have a better chance than ever to make their voices heard.

There is today unprecedented potential for Africans to understand and challenge the "no questions asked" approach to investment which, while it might bring short-term advantages to some, cannot encourage good governance in the longer-term. And, as Ibrahim says, good governance is the cornerstone of solid and lasting development for all. □

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# Nice location, shame about the neighbours

by Nick Witney

From **JOSEP A. DURAN I LLEIDA**, Chairman of the Congress of Deputies' Foreign Affairs Committee, Spain.

Sir,  
Nick Witney is right to warn that if Europe is not careful it may find itself caught up in an awkward crisis in the Middle East. This scenario can only be avoided if Europe makes use of the tools provided by the Lisbon treaty.

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*In his first year in office, Barack Obama has started to engage with the Middle East conflict. Like many of the president's initiatives, his actions have not yet translated into tangible achievements*

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As Witney points out, Europe is vulnerable both to Russia and to the Middle East. For the most part Witney is right about Russia. Despite being a great power, Russia's might pales in comparison to that of the former Soviet Union. Europe can aspire to a reasonable relationship with Russia, in a conception of external relations summed up by Lord Palmerston's motto: "England has no

eternal allies or enemies, but perpetual interests."

According to Witney, the Middle East poses Europe's second greatest challenge. Europe's relationship with the Middle East runs deep. It extends far back in history with wounds that have yet to heal.

European involvement in the Middle East is largely dependent on U.S. involvement. In his first year in office, Barack Obama has started to engage with the Middle East conflict. Like many of the president's initiatives, his actions in the Middle East, have not yet translated into tangible achievements. This is because the situation in the Middle East is complex, and because the hopes vested in Obama are leading to frustration. However, the U.S.'s path towards energy independence may lessen their need for involvement in the Middle East.

This possibility means that Europe may have to rethink its approach. It cannot afford to simply observe U.S. action from the sidelines. This approach could land Europe in the midst of a conflict

without being able to rely on a U.S. lead resolution.

In my view, Witney's diagnosis is correct. But it should not be a reason for despair. From this year on, Europe can avoid being sidelined, particularly when

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*Europe cannot afford to simply observe U.S. action from the sidelines. This approach could land Europe in the midst of a conflict without being able to rely on a U.S. lead resolution*

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it comes to events in the Middle East. Much will depend on the reaction of member states. Their diverging votes on the Goldstone report do not bode well for the future. But, from January 1st, new tools will be available and there are many examples in European's history which show that when the right tools are available, they are used wisely.

As Europeans, the Middle East is one of our most important challenges. But it also gives reason for hope. □

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## In spite of Europe's Obamania, the transatlantic relationship remains tricky by Werner Weidenfeld

From **DANIEL HAMILTON**, Richard von Weizsäcker Professor and Director of the Center for Transatlantic Relations at the Paul H. Nitze School of Advanced International Studies, Johns Hopkins University.

Sir,  
Werner Weidenfeld correctly points to the high hopes Europeans have for U.S. President Obama, and also question whether Obama's popularity will translate into more effective transatlantic co-operation. Obama and his team have made it clear that they consider a revitalised transatlantic partnership essential when it comes

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*As the geopolitical framework for transatlantic partnership shifts, the relationship is challenged to adjust accordingly*

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to tackling the world's most pressing challenges. Nonetheless, their approach will be less Eurocentric than many Europeans expect. For one Obama's popularity has not persuaded key European governments to fully align

themselves with U.S. priorities on a number of issues. Moreover, a number of headaches in U.S.-EU relations, including spats over trade protection and issues such as 100% cargo screening provisions and potential taxes on European tourists, stem from the U.S. Congress, not the Obama administration.

Congress is key to effective climate change legislation, ratification of treaties, and a host of major issues important to Europeans. Europeans should not view Congress as a European parliamentary body. On most key issues, the administration must work to cobble together legislative coalitions to advance its agenda – and success is never preordained. Finally, regardless of the President's personal popularity, the issues themselves – from Afghanistan, Pakistan and Iran to global economic governance and climate change – offer tough tradeoffs and few easy choices.

In short, while tone and style have changed for the better, differences in national

interest and outlook, both across the Atlantic and within Europe, could mark the limits of charisma. And as the geopolitical framework for transatlantic partnership shifts, the relationship is challenged to adjust accordingly. Nonetheless, the transatlantic partners

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*For one Obama's popularity has not persuaded key European governments to fully align themselves with U.S. priorities on a number of issues*

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approach each other today with a new tone and spirit. The Obama administration presents Europe with the rarest of opportunities: an open moment to forge an Atlantic partnership that is more capable of responding to the opportunities and challenges of the new world of rising powers. Whether Europeans have the will for such partnership, and whether Americans have the patience, is an open question. □

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# Europe's reform of financial supervision is headed in the right direction

## by Hans Hoogervorst

From **THOMAS HUERTAS**, Banking Sector Director at the UK's Financial Services Authority (FSA) and Vice-Chair of the Committee of European Banking Supervisors (CEBS).

Sir,  
As Hans Hoogervorst observes, a public safety net of central bank lending and government intervention in the European financial sector is necessary. But the moral hazard it creates must be counter-balanced by strong regulation and adequate supervision.

With respect to regulation, the consensus within Europe and globally is that banks need more capital, especially for trading book risks, and better quality capital. Banks need to limit their asset-liability mismatch and hold a buffer of truly liquid assets to mitigate the liquidity risks that remain. The Basel Committee for Banking Supervision is already taking steps in this direction, and the European Union is looking to make appropriate changes in EU legislation. These efforts are being supplemented by measures at national and Community level to strengthen deposit

guarantee schemes and to improve early intervention and resolution procedures for banks.

These measures should be welcomed. As should the Commission's proposal to introduce a European Systemic Risk Board along with European Supervisory Agencies (ESAs) for banking, securities and insurance. But we must be realistic about what the former can achieve,

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*Banks need to limit their asset-liability mismatch and hold a buffer of truly liquid assets to mitigate the liquidity risks that remain*

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and be guarded about some of the Commission's proposals for the latter. Although the Systemic Risk Board is tasked with identifying systemic risks and recommending mitigation strategies to handle those risks, there is no guarantee that the Board will be successful. But it should be established.

With respect to the ESAs, the Commission's proposal has much to recommend it – the supervisory agencies

would establish a single rule book for the entire EU. This would reinforce the oversight of cross-border groups, whilst day-to-day supervision would remain within the purview of national authorities.

The initial Commission proposal would do two things. It would grant the Commission the right to unilaterally amend the technical standards that the ESAs had approved and it would grant the Commission the unilateral right to declare a crisis. In this event, some supervisory responsibilities would be shifted from national supervisors to the ESA, including the right to propose, if not impose, resolution measures.

All of this risks allowing the Commission to set supervisory standards and initiate crisis intervention measures, actions which should be carried out by technical authorities. The new ESAs should build upon the current structures of the three Level 3 Committees. All possible care should be taken to ensure their independence. □

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## Why global rules to prevent another crisis are so elusive by Lorenzo Bini Smaghi

From **OTHMAR KARAS**,  
member of the European  
Parliament's Committee  
on Economic and  
Monetary Affairs.

Sir,

While I support Lorenzo Bini Smaghi's central argument that the International Monetary Fund and the World Bank both need to be strengthened as part of the global response to the worldwide financial crisis, I do not believe the IMF could have prevented the current crisis even if it had been stronger. The Fund is especially important for emerging countries which are in need of money, but the primary causes of our present troubles lie elsewhere. I believe that we have to concentrate on these root causes if we want to avoid further financial crises in future.

In my opinion, the current crisis was triggered by a combination of factors, ranging from new financial products and loopholes within existing regulations to the widespread desire within financial markets to earn as much money as possible and to buy unaffordable products. It is therefore essential that the European Union (in co-operation with the G20) addresses the twin issues of

inadequate regulation and international co-operation, as well as strengthening the role of the Bretton Woods institutions.

In terms of tighter regulation, the EU has been at the forefront of the global response. It is launching a number of regulations covering credit rating agencies, capital requirements and new structures for financial supervision. This is in line with its ambitious goal of dealing with systemic risk, as well as

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*The problem of the 'soft power' of international financial regulation can only be addressed through the creation of a new global supervision entity along the lines of the World Trade Organisation*

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improving supervision of the three main financial sectors – banks, insurance and securities. The Directive for Alternative Investment Funds, for example, will be an important step forward for the securities industry.

In terms of international co-operation, it is now abundantly clear that no country can solve the problems of our times on its own. Only by acting together can we transform our common

political will into legal reality and implement agreed standards such as Basel II in a coherent and effective manner. Governments therefore have to take their responsibilities more seriously and implement the changes already agreed within the G20. In the long-term, the problem of the 'soft power' of international financial regulation can only be addressed through the creation of a new global supervision entity along the lines of the World Trade Organisation. This is an ambitious goal, one that will demand co-operation among all countries in the world.

Thus, while Bini Smaghi is right to say that savings and trade imbalances are serious problems, and that reforms in the IMF and the World Bank are necessary and desirable, I believe that an under-regulated and highly innovative financial services sector presents a greater danger to the world economic system. Without additional regulation and coherent supervision, especially of products and markets with a high degree of systemic risk, the global system will not be strong enough to avoid the build-up of dangerous bubbles in future. □

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# Let's use this crisis to re-think global governance

## by Anna Diamantopoulou

From **ANGELA KNIGHT**,  
Chief Executive of  
the British Bankers'  
Association.

Sir,

Anna Diamantopoulou presents a vision for using today's economic crisis to reform the 'governance' structure and to sow the seeds for a more equitable period of global growth. The vision is laudable though I cannot agree with all of her proposals for achieving it.

Indeed, unsustainable economic imbalances – between developing and developed economies and between the world's savers and spenders – played a major role in bringing about the crisis.

Britain's financial services industry has long highlighted the need for fundamental reform of global regulation under the remit of the global standard setters. We also argued that emerging economies should play a greater role in shaping the future. Many positive changes are now in train, with the emergence of the G20 as the major global body promoting and implementing these changes being strongly welcomed.

The EU has a part to play and is reforming its regulatory structures through establishing a Europe-wide forum for financial stability and a series of agencies

to take over the existing pan-European regulatory committees. As far as the banking industry is concerned, a European Banking Agency will shortly replace the current Committee of European Banking Supervisors and will have more authority. All this will help the co-ordinated future we need, but in other areas, Europe must not act alone. For changes in the UK to work, Europe must recognise that the only true, sustainable regulatory changes in an international industry are those which are decided internationally and are co-ordinated internationally. One solution for future stability is the so called "Tobin tax" but this is unlikely to work. This idea is impractical and utopian, which is why, three decades after it was first proposed; it has never actually been implemented. It is necessary to solve the problems and set out the future together with our international partners. But it is just as necessary to ensure that the steps decided upon are coherent, well thought out, practical and well grounded.

The task is to balance growth with social justice and environmental concern. The financial services already play an important role in supporting these objectives. In the UK, for example, the industry provides employment either directly or indirectly for around

a million people. It is the largest contributor of corporation tax plus other employment taxes – all essential for building schools, for hospitals and other vital public services.

Furthermore, the banking industry is also committed to financial inclusion and has dramatically reduced the number of households with no access to a bank account. In furthering our desire to reach into the poorer ends of society, the banks are Britain's biggest corporate charitable donors.

And with regard to the environment, our banks are key players in lending and financing green projects in the UK and abroad as well as looking to their own use of natural resources. Some are now either carbon neutral or committed to achieving this.

Business and social justice go hand in hand. Profitable businesses mean greater employment and larger contributions to the public purse. If we are to enjoy a long-term stable outlook again we must consider these issues and future changes. As well governments must focus on how to address the global economic imbalances which were the foundation of the crisis in the financial system. □

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From **WILLIAM R WHITE**, former Head of the Monetary and Economic Department of the Bank for International Settlements.

Sir,

There are good reasons to accept Anna Diamantopoulou's thesis that, in an increasingly complex and interdependent world, more power needs to be ceded to higher levels of government. She rightly argues that this should apply both at a global level and at the level of the level of European institutions and that membership by sovereigns in supranational bodies must be accompanied by "binding standards and material consequences for countries failing to fulfill them".

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*The most important institutional development has been the increased moral authority given to the G20. This recognises that many emerging market economies are now of significant importance in the global economy and deserve more influence over how it is managed*

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Unfortunately, the article makes no reference to a number of important institutional developments

which have occurred in response to the crisis. Perhaps the most important has been the increased moral authority given to the G20. This recognises that many emerging market economies are now of significant importance in the global economy and deserve more influence over how it is managed. This is all the more so since many emerging market countries have significant trade surpluses and must have a forum for ongoing discussions with debtor countries on global trade imbalances. Further, a similar extension of both the authority and membership of the Financial Stability Board (FSB) deserves to be noted. Consistent with the thrust of Ms. Diamantopoulou's suggestions, the FSB is now more strongly focused on ensuring that countries do actually implement the international financial and regulatory standards to which they have committed.

If this is the good news, there is some bad news to go along with it. Of greatest importance has been an increasing reluctance to address the exchange rate issues at the heart of the global imbalances problem. Another practical problem has been the disquieting tendency for many national

financial regulators to try to lead by example. Evidently, convergence based on "follow me" is not likely to work over time. We must hope that, with time, the promises offered by the existence of the G20 forum and the FSB will actually materialise.

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*Internal success in dealing with cross-border financial issues would enhance Europe's already formidable reputation with respect to international co-operation*

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Anna Diamantopoulou's call for a more united and forceful Europe on the world stage is also welcome. Internal success in dealing with cross-border financial issues would enhance Europe's already formidable reputation with respect to international co-operation. A willingness on the part of Europeans to merge their seats in international bodies, and to speak with a united voice, would not only make that voice better heard but also make room for emerging market participants. Everyone would gain by such a courageous move. □

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# If the EU reneges on Balkan enlargement, it's at its own peril

## by Otto Schily

From **EDUARD KUKAN**, former Minister of Foreign Affairs of Slovakia and Chairman of the European Parliament's Delegation for relations with Albania, Bosnia and Herzegovina, Serbia, Montenegro and Kosovo.

Sir,  
Otto Schily says the European Union is "stumbling" on the road to enlargement in the western Balkans. I think the term "wobbling" is more accurate, given that the EU is not hesitating over the principle of whether to proceed; it is simply trying to work out how to go about it. This type of hesitation is only natural in the circumstances.

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*The Union should maintain the momentum for enlargement without making false promises, which would damage its credibility in the region*

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Despite all the recent talk about enlargement fatigue, there is broad agreement about the strategic importance of the western Balkans; past experience amply confirms it. Within the region, the mere prospect of integration has a positive impact, offering as it does the potential solution to

various ethnic and national conflicts. It represents one of the major issues which all countries in the region can agree upon; it mobilises internal reforms and, more importantly, ultimately it gets the people's support.

Whether we like it or not, however, there are no short-cuts on the path to EU membership. It is right that the western Balkans, like any other region, should fulfil all the EU's conditions, starting with the Copenhagen criteria and including the lengthy process of adjustment to common EU standards. Both the region's political leaders and its citizens share the responsibility for meeting these obligations.

Yet the EU also has responsibilities towards the western Balkans. The Union should maintain the momentum for enlargement without making false promises, which would damage its credibility in the region. The EU should also address the mixed messages being sent out to the people of the region due to the lack of popular support within the Union for more western Balkan members. Schily recommends that current member states reaffirm their Thessaloniki commitment

to accept all western Balkan countries which meet the membership criteria in full. But will hostile public opinion be changed by yet another EU statement of intent? I doubt it. In my opinion, the problem lies elsewhere. For EU leaders, I think it is a matter of promoting the whole process more actively in front of their sceptical electorates. For the western Balkans, it is a matter of delivering sound results.

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*There are no short-cuts on the path to EU membership. It is right that the western Balkans should fulfil all the EU's conditions, starting with the Copenhagen criteria and including the lengthy process of adjustment to common EU standards*

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I believe that the EU is a credible player with an important mission to perform in the western Balkans. I am glad that the principle of enlargement is not in doubt. With more regional applications for membership coming up, it is time to stop wobbling and get on with the job. □

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## Getting the regions' Brussels role right is the key to EU credibility

by Anna Terrón and Javier Sánchez

From **HARM EVERT WAALKENS**, Chair of the House of Representatives' European Affairs Committee, the Netherlands.

Sir,

As a parliamentarian with strong political roots in the Dutch province of Groningen, I heartily support the case made by Anna Terrón and Javier Sánchez to give local governments a greater say in EU policymaking. I know from my own observations that European legislation is most often implemented by regional and municipal authorities; their experience is indispensable when identifying bottlenecks in the system. I believe a great deal more can be done to improve regional participation in EU law-making, both at the European and the national level.

Some positive developments are already underway, including a stronger role for the Committee of the Regions under the treaty of Lisbon. This Committee must be consulted in all matters affecting regional or local interests. It must make sure, for instance, that the administrative burden of implementing new legislation is in line with the resources

available to local governments. The quality of the opinions expressed and resolutions passed by the Committee of the Regions has improved, with the local dimension taken into account more and more in its impact assessments of EU legislation.

These measures are welcome, but not sufficient. A shift in thinking is also necessary to recognise that regional governments play a key role in shaping public opinion about the European Union. When the regions are taken seriously in the decisionmaking process, local people and politicians are less inclined to blame the EU for imposing unwelcome rules, thereby feeding so-called euro-pessimism, which, as Terrón and Sánchez note, is increasingly pervasive in most parts of Europe, the Netherlands included. European institutions must, therefore, embrace regional governments as genuine partners.

National parliaments can do a lot more too. In the Netherlands, for example, the House of Representatives keeps a close eye on 'gold plating' – the tendency of governments to slip in extra measures when adopting EU

directives. These additions often make implementation more complex for local authorities. If regions were more involved in national decisionmaking, they could simplify things.

There is also room for improvement within cross-border cooperative ventures which involve regions from more than one member state. These so-called 'Euregios' often run into practical problems due to different national laws, which they seldom manage to resolve through harmonising the relevant legislation.

A higher profile for local and regional authorities in the EU does not mean they should have a formal role in making the final decision. This must be left to the Council and the European Parliament in order to maintain proper accountability and transparency. However, the Council and Parliament – reinforced by national legislatures – do have a responsibility to make sure that the regions and municipalities are involved to an optimal degree. We are on the right track. □

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# Aid for education is our best weapon against militant Islam

## by Paul Salem

From **MICHAL RUTKOWSKI**,  
The World Bank's Director  
for Human Development  
of the South Asia Region.

Sir,

I support Paul Salem's view that investing in education is extremely important to reduce poverty and foster economic development, but I challenge his argument that governments should use educational aid as a weapon to fight militant Islam. Some of Salem's data, and his reasoning, must be re-examined.

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*The evidence shows that Arab countries have made significant progress in human development in terms of the level of participation in education, gender parity and related social benefits such as life expectancy and infant mortality*

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Salem says the Arab world suffers from 'educational poverty,' yet he fails to mention that for the past three decades Arab countries have invested a large slice of their gross domestic product in education. Salem also claims that economic development in the Arab world has left the people under-educated and economically marginalised. The evidence, however, shows that

Arab countries (with or without significant oil revenues) have made significant progress in human development in terms of the level of participation in education, gender parity and related social benefits such as life expectancy and infant mortality.

Salem's assertions that educational poverty "creates an environment where radical and violent movements can find traction" and that education is the best protection against militant Islam both need to be examined in the light of history. Militant Islam is a relatively new phenomenon: it appeared in the 1950s and spread during the following decades, despite this being a period when investment in education and educational progress were very strong in the Arab world.

Another important issue which Salem only touches upon is the role that quality may play when looking at the links between education and extremism. As Salem notes, the Arab education system is supply driven, reliant on outdated technology and geared towards rote learning rather than problem solving. This is where the real challenge lies. More support for liberal education, or

modernising religious schools to encourage critical thinking, certainly would help to make education more relevant to the evolving needs of the labor market. Recent evidence from South Asia suggested that when religious madrasas changed their curriculum to include modern subjects, like those taught at non-religious schools, students achieved similar test results to their counterparts in secular education.

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*The core problem is not religious versus secular education. It is the poor quality of education across the board*

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The core problem, however, is not religious versus secular education. It is the poor quality of education across the board. Governments should attempt to find more innovative ways to link the substantial levels of public investment in education with improvements in numeracy and literacy. Hence I believe that it is critical for policymakers and countries to focus on improving the quality of education as they prepare children for the modern world. □

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