EU and NATO Enlargement in the Baltic Sea Region

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Introduction

ATIS LEJIŅŠ, Director, Latvian Institute of International Affairs

Excellencies,
Ladies and Gentlemen,

I am very pleased to welcome you today to the conference on EU and NATO enlargement in the Baltic Sea region.

This is a historic conference – it is the last dealing with EU and NATO enlargement before the Prague summit a little more than a month from now where the next NATO accession round will be announced. I allow myself to make the prediction that the Baltics will soon join Poland in NATO.

And, before the end of the year, the EU will embark on its first enlargement round which will bring Poland and the Baltics together into the European family.

This is also a historic conference, by the way, because tomorrow Latvians will go to the ballot boxes in their last national election before accession – the next election will be in October 2004.

I will not say more about the elections, except:
a) the President of Russia Mr. Vladimir Putin has demonstrated a very keen interest in its outcome, and
b) it seems that every country has had or will have elections that are more than just interesting this year.

It took quite a number of conferences to bring the Baltics to the EU and NATO – not least here in Riga! I counted the number LIIA has organized – they come to 33!

The second conference held in December 1993 particularly comes to mind. Some prominent speakers spoke on the subject, including Carl Bildt, Zbigniew Brzezinski, and Adam Daniel Rotfeld, who is with us again today after a lapse of nine years. This time, however, no longer as a director of a research institute, but as undersecretary of state in the Polish MFA. I congratulate you on your new posting, sir!

I re-read what Professor Brzezinski said in 1993. Enlargement took place almost exactly like he said it would in this very auditorium!

He said:
After the Visegrad countries would join NATO Baltic membership would have to be addressed around 2000 – and it was.

Russia would need to cooperate not oppose NATO enlargement, because it was in her interests to do so. This Russia has done even though it took some time. The so-called red lines have been taken off the map.

He also said that there would be a NATO-Russia treaty – he called ita global security treaty with the proviso that the independence and security of Ukraine would not be compromised. Today we have the NATO-Russia Council and also the NATO-Ukraine Council.

After noting that Finland and Sweden will soon join the EU, he observed that the expansion will certainly continue to include many other states.

We can now add – also Poland and the Baltic states.

May I make the prediction that Finland and Sweden will follow the Baltics and Poland into NATO?

The only argument speaking against this logical development is based on Cold War thinking – unless it is based on doubts about NATO's future and continued relevance, as claimed by not a few analysts.

You will not be surprised to hear from me that some Balts, Danes, and Russians working in a ad hoc group called the Baltic Task Force and made up of analysts and NATO enlargement activists are grappling with this question after first looking very closely whether the new NATO-Russia council would compromise Baltic entry into NATO.

It did not – there is no linkage between Baltic NATO membership and the Conventional Forces in Europe Limitation Treaty as confirmed last week in Warsaw at the NATO-Russia council meeting.

We are ready to look into depth today at the double impact of EU and NATO enlargement on the Baltic Sea region. It is almost the reality and we must see what such a great historical geopolitical shift means and how it will effect our lives.

We have a distinguished list of speakers to speak on the political and economic issues on hand and for this I am indebted to the Swedish Miistry of Foreign Affairs

for its generous grant without which this conference would not have been possible, and to the Riga City Council for hosting a fine dinner for the speakers yesterday at the splendid Melngalvju nams, House of Blackheads, recently raised from the ashes of World War Two.

Thanks are also due to the Stockholm School of Economics for making available this beautiful auditorium.

I am also very grateful to the United States Embassy for it financial support in bringing our key note speaker all the way from Washington – Mr. Stephen Rosenfeld, the former editor of the editorial page of the Washington Post.

Regular readers of the International Herald Tribune and the Washington Post will, of course, recognize him immediately – he has written numerous articles on topical issues for the past 40 years. I remember noting them in the library of the Swedish Institute of International Affairs in the 1980's where it was my habit to consult the IHT on what was going on in the world. But he has widely written also for other publications, including Foreign Affairs and Foreign Policy.

He continues to write as an independent writer associated with the Institute for the Study of Diplomacy, Georgetown University.

One of the strangest features in the past year has been the strain in transatlantic relations that have developed after the tragic events on September 11. After a short period of enormous solidarity with the USA, Europe and America seem to be pulling in separate directions on many issues.

The dictionary explains that "crisis" is derived from the Greek word for "decision" That could mean that if you make the **wrong** decision, you get a crisis. But if you make the **right** decision, you get out of a crisis.

In Prague and in Copenhagen some very important decisions will be taken: Mr. Rosenfeld will speak on these in his speech "New Duties, Opportunities and Burdens of NATO."

KEYNOTE SPEECH

NATO EXPANSION: THE VIEW FROM WASHINGTON

STEPHEN S. ROSENFELD, Former Editor, Editorial Page, Washington Post

I am delighted to be back in Latvia. My first trip came on a spring weekend in 1989.

My wife and I, speaking a mix of English and poor Russian, talked for hours on the street with dozens of Latvians. For them masses of flowers symbolized their aspirations for freedom. Latvia as a nation was blooming in front of our eyes. What a marvelous passage!

Today we are here to ponder a bureaucratic but vital part of that same passage: the further extension eastward of Western-sponsored security ties. At this moment, to this audience, I need not pursue the details.

The acceptance of Latvia and six others in an expanding NATO next month seems to be moving along well. This is happening, I observe, notwithstanding the grave warnings once issued by the noted diplomat George F. Kennan and his establishment band. He called enlargement "the most fateful error of American policy in the entire post-cold-war era." Kennan's prophecy of a wicked nationalistic backlash in Russia is so far simply not proven out.

Expansion has long since shifted from high and uncertain political drama, to the professional diplomatic exercise due to be played out soon in Prague. Since the end of the Cold War, in fact, NATO has become something of a victim of its own success. It is duly celebrated but increasingly taken for granted and quietly guided by the capable hands of bureaucrats on both sides of the Atlantic.

The capacity of the Atlantic Alliance to provide full-service shelter for Europe and the United States over five decades is a genuine triumph. It deserves to be regarded as one of the great diplomatic achievements of the modern age.

Other unlikely characters also have taken leading roles, Ronald Reagan and Mikhail Gorbachev among them.

There were some early alarms over Berlin and Cuba. The Soviets, for their own safety and confidence, had to become just as concerned as Westerners about maintaining stability across Europe's Cold War dividing line. For that, it is not only NATO that deserves to be hailed. It is the Cold War itself. Yes, during The Cold War millions lost dignity, freedom and millions lost life itself. The countries represented here need no reminder.

In another, nuclear context, the Cold War tensed the world. But it also saved the world. In past centuries, the surviving behemoths of large-scale war would likely have fallen upon each other to determine an ultimate winner. But in the new nuclear context, all players recognized their mutual peril and took steps to deter it. Widely criticized as a framework of tension and repression, the Cold War turned out also to constitute a set of explicit and implicit assurances that left the greater world beyond, balanced and peaceful in so far as nuclear war is concerned.

The key feature was established in the Cuban missile crisis of 1962. It taught both sides to leave the other, in a crisis, plenty of political space to maneuver and turn around. In time, the West's victory in the Cold War erased the old familiar galvanizing fear of Soviet threat and power.

The three most demanding items on the NATO-Cold War agenda of the '90s were satisfied:

First, Western institutions, including NATO, were extended to the East to provide stability for a Europe "whole and free."

Second, the multiple dangers to peace and security emanating from the former Yugoslavia were, if not removed, then at least addressed and treated, militarily as well as politically.

Third, Russia itself was shorn of the label of enemy of the West. It is being brought into a ragged but potentially effective strategic partnership with its own tie to NATO. As still a nuclear colossus, it is a necessary continuing partner in nuclear arms reductions. Politically it is the single country with a meaningful connection with all three states on George Bush's "axis of evil": Iraq, Iran and North Korea.

So much for the agenda of the 1990s. The new post-Communist American-European agenda of the current decade of the 2000s is hardly less demanding.

It poses four challenges:
One, to reintegrate the West for the new historical era. That means, first of all, urgently closing the expanding psycho-political rift between Europe and the United

States. Something with the rancid flavor of anti-Americanism is spreading. The alliance debate on Iraq, the recent German elections, and Frenchmen protesting McDonald's are cases in point. We Americans understand them poorly. We need to hear enlightened European views.

Two, in the decade of the 2000, it is imperative to reduce the frictions of international trade and development.
Three, to cope with the hydras of proliferation and weapons of mass destruction.

Four, to check international terrorism. Anti-terrorism has now replaced the Soviet threat as the main organizing principle of post-Cold War international policy.

Our conference will be tackling the substance of some of these issues. Here let me note some of the peculiarities of the American system that confuse people on both sides of the Atlantic and affect how American and alliance policy are made.

Foremost are the tensions among and within our three constitutional branches of government. The State Department favors expansion to serve the evolution of Europe as a peaceful stable post-Cold War partner. This was our brave secretary of state Madeleine Albright's rationale for initiating expansion.

The Pentagon also favors expansion – but conditionally, as leverage to compel current as well as prospective members to meet the heavy expenses of an alliance role. East Europe is readier to seize the benefits than to pay for them. "Burden-sharing," as it is called, is among the most venerable of alliance preoccupations.

Though expansion was conceived by his Democratic predecessors, President Bush also favors it – to assert American global leadership and to knit a new common NATO purpose to replace the unraveled Soviet threat.

Meanwhile, conservative voices, military and civilian, Bush appointees but not necessarily Bush loyalists, weave in and out of the strategic dialogue. Perceiving Europe as a "military pygmy" many conservatives see a growing gap in capabilities between Europe and America that weakens military potential and undercuts political solidarity.

Nearly two years into his presidency, Bush has shown a Reagan-like public touch but he can seem strangely detached from the business at hand.

He is deeply conservative in an evangelical religious fashion. His political leanings and personal loyalties run to the far right. He extols power, military power,

American power. Much more ideologue than intellectual, Bush is also a politician with an edge of vengeance. In international policy, he prefers working with allies chosen one by one rather than working within the discipline of an alliance. Congressional elections are due in the United States in November. In the now-narrowly Republican House as well as the now-narrowly Democratic Senate, the vote could go either way. The next presidential elections come in 2004, and preparations are already in high gear. The early signs are that foreign policy will be a key issue.

These currents could yet carry Bush further toward his curious personal sort of unilateralism with both isolationist and internationalist options. Intervention in Iraq is the anvil on which Bush's basic policy is being hammered out. Latvians and other aspiring allies will have their own chance to learn that joining NATO involves a good deal more than throwing Western European arms around Eastern European shoulders in cheerful camaraderie.

In fact, this is the latest version of a debate that has divided presidents and legislators, Americans and Europeans, for 50 years or more. Is the rationale for NATO more military or political? Who should pay, and for what? Who wields power?

So far the alliance has been resilient enough to endure the strains of recurrent "disarray." It is not as though NATO is about to crack. Undeniably, however, the tests posed by Saddam and Osama have put the United States in one of its periodic aggrieved self-lacerating moods. Significant slices of American opinion feel the country is being exploited by freeloading Europeans, who seem unwilling to accept their fair share of the costs and risks of international comradeship and alliance solidarity.

There is always some excess in these recurrent American suspicions, but there is some truth as well. Things are at a sour stage now. They could get darker. I do not predict a full-blown political crisis in the alliance. But pressures are building. The issues are agonizing. The atmosphere is raw. It was always foolish to think that the United States and its European friends could make the uncharted passage, from Cold War to new age of global market democracy, without some turbulence.

In any event, official statements take you only so far in penetrating the post-Cold War fog. The hot ticket in Washington these days is a much-discussed article, "Power and Weakness," by Robert Kagan in Policy Review magazine. (http://www.policyreview.org/JUN02/kagan_print.html).

Kagan, a heavyweight on Washington's conservative circuit, attempts nothing less than to lay an intellectual foundation for a new post-Cold War American empire.

Let me offer you a taste of Kagan's ideas and analysis, as they bear on the current Washington policy debate. It's worth quoting him at some length.

America and Europe are divided in their "strategic culture," he writes approvingly. The United States "resorts to force more quickly and, compared with Europe, is less patient with diplomacy. Americans generally see the world divided between good and evil, between friends and enemies, while Europeans see a more complex picture.

Kagan continues: "When confronting real or potential adversaries, Americans generally favor policies of coercion rather than persuasion, emphasizing punitive sanctions over inducements to better behavior, the stick over the carrot. . .And, of course," Kagan goes on, "Americans increasingly tend toward unilateralism in international affairs. They are less inclined to act through international institutions such as the United Nations. Less inclined to work cooperatively with other nations to pursue common goals. More skeptical about international law, and more willing to operate outside its strictures when they deem it necessary, or even merely useful." All this Kagan supports.

He believes a country's strength dictates an entitlement to bring power to bear. The United States is now the strongest state by conventional measure. Hence its insistent claim to assert power. Kagan would establish a "double standard," as he calls it. It would permit the United States a one-of-a-kind, self-issued license to deal with rogues and play the part of world policeman.

By whatever means it takes.

Other states would be held to conventional rules and restraints. Particularly in Iraq, Kagan is ready for America to roll.

So, it seems, is George Bush.
For what it is worth, I am not ready; not yet anyway. The most rigorous consultations and exploration of alternatives must precede the momentous decision, conceivably a nuclear decision, that the president now faces. But it cannot be left to the president alone to choose the policy, or by himself to frame the terms of choice, or to set the timing for it. Leadership in a democracy compels a full measure of courage and initiative and of judgment and balance as well.

Good luck as you ponder these daunting issues.

Transatlantic Relations, the New EU and New NATO

ROBERT NURICK, Director, Carnegie Moscow Center

Not too long ago I happened to mention to an American friend of mine that I had been asked to speak about NATO's role in addressing the security challenges in the Baltic region. This friend is not a specialist in international relations, but he is an intelligent and well-informed person, and his reaction to this topic was frankly one of some astonishment. What security challenges in the Baltic Region?, he asked. What NATO role? After all, once the Baltic States are in, is there anything really left for NATO to do here other than, perhaps, worry about how to integrate Russia? And aren't our main security challenges elsewhere?

This reaction should not surprise us. Of course, we all know that important security issues remain in this region; we will be addressing them in our discussions today. Nor has NATO suddenly forgotten about this part of the world: whether we look at the upcoming agenda of the Prague Summit or at the planning in NATO headquarters, we can see that NATO activities and responsibilities in the Baltic region-to say nothing of elsewhere in Europe – are not going to be disappearing after the next round of enlargement decisions are taken. But nevertheless it seems to me the reaction of this friend of mine is not so strange or surprising or silly. After all, the fact is that this region is a stable region. It is certainly not the area where Americans see their main security problems as coming from; indeed Europe as a whole is not now an area most Americans worry much about. Moreover, those security issues that do remain – both in the Baltic region and in Europe more broadly-seem quite different from the kinds of defense problems that NATO was originally designed to address.

How, then, should we think about NATO and Baltic security? What I would like to do today is develop a couple of rather broad, perhaps simple-minded, observations or themes – one having to do with the region, one with Russia, and one with NATO.

The first broad observation is that it is increasingly difficult to think about the security agenda in this region in purely regional terms. There are of course some issues which are distinct to the Baltic area, but most of those that are on the minds of NATO planners or on the minds of political analysts are so increasingly because of the links that they have to issues which go well beyond the Baltic region itself.

Secondly, turning to Russia, it is increasingly difficult to think about NATO-Russia relations in isolation from our own internal debates about NATO's own future.

There seems to be very little argument now, including among much of the political class in Russia, about the importance of "integrating" Russia – that is, of giving it an appropriate stake and seat in broader security arrangements in Europe and beyond. But whether NATO as an institution can serve this integration function well is, I think, an open question: its ability to fulfill this role will depend not only on the state of NATO-Russia relations, but also on answers to some large questions about NATO's own future purposes and responsibilities.

Finally, it seems to me it is increasingly difficult to talk about NATO and its future in isolation from other institutions. As we will hear today, there is a great deal of discussion and debate now about NATO's evolving role, about its missions, about how and whether it can respond to new security threats and challenges. Whatever the results of those debates may turn out to be, I think it certain that they are going to point in directions that will not only take NATO beyond the alliance's traditional geographic area of responsibility, namely Europe, but – perhaps more importantly for our purposes today – also into functional areas of responsibility where NATO has not traditionally been very active. Moreover, these are areas that often fall within the competence of other institutions, in particular the European Union. What this means is that thinking about the evolving roles and responsibilities of NATO is not something that can easily be done any longer without thinking about the evolving roles and responsibilities of the EU and other institutions. These are no longer separable questions.

I would like to develop these rather simple themes by considering briefly the agenda for the Prague summit, which NATO officials have described this as having three basic parts: "new members," meaning of course enlargement; "new relationships," and here I'll focus on the NATO-Russia relationship; and "new capabilities," which is a prism for the larger debate about NATO's future.

NATO enlargement and Russia-NATO relations

First: NATO enlargement, and in particular, the Russian reaction to it. As an American living in Moscow, I am sometimes asked about Russian interests in enlargement – how those interests are viewed, and how they should be viewed. And one lesson I've learned is that this is a bad question for an American to try to answer. Russians will answer that question for themselves: they will decide what their interests are, and it is not generally constructive for outsiders to try to advise them about what their "real" interests are. What we do need to do, however, is think about how Russian perspectives on enlargement might affect our own interests, and about the policy initiatives we might therefore wish to take. Put simply: when we look at the list of Russian concerns and complaints, what is it that western policy needs to attend to?

Here I here I think there are basically two issues--one essentially a defense issue, and the other essentially a political and strategic issue. The defense issue can be stated rather simply: do no harm. That is, it is entirely fair for Russians to expect that whatever decisions NATO takes will not complicate Russia's defense problems or make Russia's internal debates about defense policy more difficult to manage. Now this notion–that enlargement could constitute a defense problem for Russia-is very difficult for most of us in the West to take seriously. We know that we're not threatening Russia. We know that the Baltic States don't threaten Russia. We don't believe enlargement threatens Russia. We know that the "NATO is a threat" argument has sometimes been highlighted in Moscow for purely political reasons, in the hope of dissuading NATO from taking the Baltic states in. And indeed many Russians understand all this, and will acknowledge that enlargement is not a defense problem for Russia of the traditional sort. But it is also the case that NATO remains a factor in Russian defense planning and in Russia's debates about defense policy. This is why the West had an interest in providing some defense assurances to Russia during the first round of enlargement, and why it has an interest in doing the same now.

What kinds of assurances? We know the tools that NATO employed for the last round of enlargement: unilateral policy statements concerning NATO deployments in territory of the new members and about NATO nuclear weapons policy, supplemented by more formal understandings through the Conventional Forces in Europe (CFE) treaty. These will be I think the basic tools that NATO will look to this time as well.

But whatever the specific mechanisms, it is important to get this defense aspect of the enlargement issue with Russia out of the way, because NATO does have some longer-term objectives with respect to Russia that it wants to try to serve. One of the main longer-term NATO objectives is to facilitate defense reform in Moscow, which in the Russian context is intrinsically linked to a second, even broader one: to encourage Russian planners to shift their focus away from worst case scenarios involving conflict with the West, to what even the most conservative Russian defense planner will in quieter moments agree are the more likely and difficult threats to Russian security. Those threats are mostly either internal, or arise to Russia's south, not from the West.

The problem is that at the moment the Russian debates about these issues seem stuck in a sort of a halfway house. On the one hand, most Russian analysts do understand perfectly well that their defense problems have changed, that the main challenges do not come from the West. But it is also the case that a large number of formal security documents continue to identify NATO as a potential military threat, and that much of the military's structure, doctrine and equipment needs as defined

by the General Staff still seem based upon a view of requirements inherited from the cold war and that have not been fundamentally re-defined. Requirements have been scaled down to reflect changing economic and political circumstances in Moscow, but their character has not changed as much as the world around Russia has changed. The durability of these strands in Russian defense thinking has been a constraint on defense reform as well as on Russia-NATO relations more generally. NATO has an interest in getting beyond this.

Russia's "seat at the table"

The second key issue is a political and strategic question, which, in my view, has always been the central issue, raised for Russia, and for western policy towards Russia, by NATO enlargement. This is the so-called "seat at the table" problem. That is, where does Russia "fit" in what used to be called the "European security architecture" – the arrangements we have created to deal with security issues in Europe and beyond? This is hardly a new problem. It was an element of the NATO enlargement debates going back to the mid-1990s, and it was an issue NATO tried to deal with during the first round of enlargement when it set up the so-called Permanent Joint Council with Russia. But by a year or two ago it was widely acknowledged in NATO that these arrangements were not working very well, that we did not get this problem right the first time, and we had to try something new. The result, as you know, was the new NATO-Russia Council. This council, which started operations this past spring, is I think a potentially important step forward. But whether or not this potential will in fact be realized I think depends on a number of factors, which are worth examining.

The first is simply how Russia approaches it. It is no secret that there was widespread concern in NATO most of last winter that Russia might approach this council as a means to frustrate, if not paralyze, NATO decision-making. A related concern was that Russian attitudes toward the new council would reflect the underlying suspicions, particularly from the military, that we had historically seen towards the alliance and its purposes. These concerns were behind many of the safeguards that were built into this council. Where do things stand now? So far the news from Brussels appears to be quite good. People in NATO have said they are pleased with the nature of Russia's engagement and, therefore, with how the new council is working to date. I hear similar expressions of at least cautious optimism in Moscow. So – so far, so good.

Another factor is the council's agenda, and how it may evolve. In its early stages the agenda has reflected an understanding by both Russia and NATO that, in light of the history of the previous council and the difficulties of NATO-Russian relations,

this new council should work well and be seen to work well from the outset. This political consideration meant that the new council's agenda was limited, at least initially, to issues where the prospect for consensus between NATO members and Russia were thought to be high. This made perfectly good sense. And the resulting agenda has not been trivial: the Council has been able to find a good number of issues where useful work could be done, and where the prospects for a meeting of the minds between the existing NATO members and Russia are quite good. Again – so far, so good.

The big question for the longer-term, however, is whether or not this council, along with related processes established in NATO, will be sufficient to serve the broader political purpose that NATO wants to achieve – namely, to help solve the "seat at the table" problem. Again, the council's agenda will be very important in this respect. In my view, the council will only be able to serve this broader integrated role if it deals not only with the "easy" issues, where consensus seems likely, but also eventually with the harder issues, where consensus is not only unlikely but perhaps impossible-and maybe not even warranted, in the sense that neither Russia nor NATO desires joint decision and joint action. In short, there needs to be a venue where Russia and NATO members can seriously address serious issues, even where – perhaps especially where – there is little expectation that they will in the end be able to agree about what to do. To broaden the council's agenda over time so that NATO and Russia can constructively deal with the hard issues on the security agenda, will not necessarily be easy. In particular, will require some understandings not only about how items get put on that agenda, but how they get taken off.

Not long ago there was considerable press attention to a so-called "retrieval clause" adopted by the council which, it was reported, would allow any NATO member to remove any issue from the agenda. This was greeted with some resentment in Russia, out of fear that the clause would be abused. Fortunately there are no signs of this so far, and it would indeed be unfortunate if retrieval rights were used to emasculate the council's work. But some kind of retrieval procedure is going to be absolutely necessary if this council is going to serve its broader political functions. That is, over time it's going to be very important that NATO and Russia can agree on a procedure which, without too much fuss and without creating a political storm every time it is invoked, allows them to speak about difficult issues, to deal with them for as long as it's constructive to do so, and then take them off the agenda of the council. For if it is not possible to take issues off the agenda of the council, or possible only at great political cost, then NATO is going to be very conservative about the range of issues it agrees to put on the agenda of the council. Over time this is going to be a key issue to watch. It will be interesting to see whether after the Prague summit we have any indications about how it goes.

NATO's future

My third and final general observation concerns not so much the future of Russia-NATO relations but the future of NATO itself. I must say that I have never seen as much real uncertainty, as much serious disagreement and debate, about where NATO is going and what its real prospects are, as we are witnessing now. Stephen Rosenfield has just described these debates very well. The issues, the questions, are very fundamental. What is NATO now for? How should it adapt to what everyone agrees is a vastly different security environment, not only from the cold war days, but even from what we thought it was four or five years ago? How relevant indeed is NATO to the new security challenges we now face?

Now, all these questions existed before September 11, but they have clearly been dramatized and given new urgency. The list of complaints and concerns on both sides is, I think, pretty well understood. Again, Stephen Rosenfield has given a very good summary of how these issues look from Washington. As he has noted, there are many strands to the argument, and many models or visions have been put forward about what NATO's future might look like.

One vision simply is that NATO should do what it has always done, which is focus on Europe. The security agenda in Europe is of course smaller and less preoccupying than it used to be. But it is not a blank slate, as we all know from looking at the Balkans. In this vision, NATO's military functions would focus primarily on peacekeeping and peace-enforcement, including at the more demanding end of the spectrum the kinds of operations that the alliance undertook in Bosnia and Kosovo. This is one model; this is one prediction about NATO's future.

Another and more common vision for NATO seeks to reflect the new security challenges, including those arising outside of Europe proper, and asks how NATO can best deal with them. Here the model is essentially of NATO as of a kind of shopping mall, as a provider of defense services. That is, NATO would continue to field an array of military capabilities upon which NATO countries could draw to put together "coalitions of the willing," to deal with security issues and security challenges outside of Europe. This is a second model.

A third model is essentially of a "political NATO." This vision for the alliance is based on the belief that, with the end of the Cold War, the core military functions for which NATO was created have been fulfilled, while the new challenges to Western security are not of the sort that NATO is well-equipped to address. In this view, however, NATO does still serve a very important political function, as the institution that cements U.S. security engagement with Europe, and now also as the

place that can best integrate new countries, including Russia and Ukraine, into this broader security architecture.

These models in one form or another are being discussed inside and outside of NATO. I don't think we're going to have an entirely clear picture after Prague what the future will lie, but as we proceed there are a couple of fundamental points to keep in mind.

The first and most basic point, in my view, is that if NATO is not involved in what most concerns its members, what most worries its members, then its members over time will lose interest in it. As an American I begin with this prospective, and what that means in particular is that if NATO looks like it is essentially irrelevant to the problems of weapons of mass destruction and terrorism, then U.S is not going to be interested in NATO, and not going to use it. And we have to remind ourselves of what we all know – that these problems, these concerns, are not primarily about Europe. Here I think that those in the U.S. and elsewhere who have been pushing NATO to accept responsibility for issues outside of Europe have the better part of the argument. NATO will need to address these issues or else it will slowly become irrelevant and uninteresting, and not only to the United States.

But there is another side to this – one where those urging some caution about NATO's evolving role have the better of the argument. This cautionary note has to do with the fact that the new threats – the problems of terrorism and weapons of mass destruction – are multidimensional; they are not military problems alone. In many cases they are not primarily military problems at all. And certainly it is the case that military tools alone are not sufficient to deal with them. What this means of course is that there will inevitably be limitations to what NATO's role can and should be in addressing them. As many Europeans point out, an effective long-term strategy for dealing with terrorism and weapons of mass destruction will require addressing a host of social, economic, and border issues that historically have been within the competence of the European Union. Their basic point is that important aspects of this new security agenda are not defense issues of the sort that NATO has traditionally dealt with, and that the EU must be at the center of an institutional response to them. This line of argument implies a fairly simple, straightforward conclusion, but also raises some difficult problems.

The fairly simple and straightforward conclusion is that it is going to be important for NATO and the EU to work out a division-of-labor. The terms of this division-of-labor in dealing with issues like terrorism might be described fairly simply. NATO should deal with the military dimensions of these issues, the EU with much of the rest. In other words, it would be the EU's task, not NATO's, to address the

underlying political and social conditions which breed terrorism or allow terrorism, and to shoulder much of the responsibility for dealing with the consequences or the aftermath of military action should it occur.

However straightforward this may sound, in practice it is likely to be anything but. First of all, it is not at all clear that a division-of-labor of this kind is going to be sustainable politically either in the United States or in Europe. Americans may view such an arrangement as one in which the U.S. does most of the dirty work of defense. Europeans, on the other hand, may view it as one that invites the United States to bow out of the difficult political, diplomatic and economic reconstruction responsibilities that effective long-term strategies will require. So an institutional division-of-labor is going to be important, but how it works out in practice is not going to be easy.

There is also a second issue raised be the kind of division-of-labor outlined above, which has gotten much less attention than I think it deserves. One painful lesson that I think we have learned in the US about dealing with terrorism is that things that can go badly wrong is when the people responsible for military and defense are cut off – by function, tradition, and institutional cultures – from those responsible for domestic police work, counter-terrorism, and other aspects of what we now call "homeland security." For if there were systemic failures leading up to September 11, they derived in no small measure from the fact that the CIA was not in the habit of talking very often and very well to the FBI, or vice-versa, and neither were necessarily communicating regularly and systematically with local police and border agents. A lot of the work that has been done since has been to try and repair this problem. The point of this lesson for the NATO-EU relationship is that a division-of-labor that reflects an institutionalized separation between on the high-end defense on the one hand, and homeland security – that is, police operations, domestic intelligence, health services, border guards – on the other, is a recipe for trouble.

What that implies to me is that its going to be very, very important now for a serious NATO-EU dialogue not only about what there relative responsibilities will be, but how they will be able to continue to talk to each other and interact with each other institutionally once this division of labor is more or less understood and in place. This call for a serious NATO-EU dialogue is one that Europeans hate to hear from Americans. But I think it's something that has to be addressed. It is time for NATO officials and EU officials to sit down and talk about what they're going to do.

COMMENT

Prof. Dr. KARL KAISER, Otto-Wolf-Director, German Council on Foreign Relations, Berlin

I would like to focus on the question: what kind of NATO you are joining? And what its problems are.

As has been said before, the problems of NATO have been put into sharp focus, but have not been created by September 11th. If you look at the preceeding period you could see a number of trends that clearly indicated both a marginalization and a profound change at NATO. What were they? Already before September 11th it was clear that classical defense, for which NATO had been created, was no longer the main purpose, i.e. classical defense against a large-scale attack.

Second, enlargement, to include the democracies of Central and East-Central Europe was a decided matter, but also a new relationship with Russia, the very country that had been at the origin of the creation of the NATO. Therefore, this was going to be obviously a very different kind of alliance. That was clear before September 11th.

Third, the first time NATO ever used force in Kosovo, it did so for a case for which it was not created, by the way, without a mandate of the United Nations. NATO assumed since then a function for which it was not originally established, namely, to maintain peace and stability in the Balkans and to create the preconditions for the reemergence of a civil society and democracy there.

Fourth, in the meantime, since the end of the Cold War, a European defense policy and capacity has become a major target of the Europeans, something the Americans had always supported, although once it came into existence, it raised lots of problems in Washington. And it created problems inside the Europeans, who still have difficulties in agreeing on a common policy and on how to reconcile NATO and the European defense policy. This is primarily due to the disagreements between Greece and Turkey in the Alliance.

Finally, the question whether NATO could really maintain a transatlantic character is not new. It arose, for example when there was a threat of American withdrawal from the Balkans, and a debate started in Washington to what extent it was the interest of the US to intervene there.

All these questions have been there when September 11th struck. But since then, lots of things have changed. The initial reaction of the United States was innovative, creative and multilateral, contrary to the Europeans' expectation of the Bush administration, prior the September 11th when the Kyoto protocol and other disagreements between Europeans and Americans had come up and created the image of unilateralism. The Bush administration forged a new global alliance to deal with this new problem. It used the United Nations in an unprecedented way, creating in these few weeks more international law than had been done in years before.

The NATO alliance however, was not really used in the first military actions. NATO never prepared for this contingency. Surely AWACS planes were sent to the United States; that was helpful. Article V was activated, which was greatly appreciated an as act of solidarity. But Article V had not been created for this case. And when is Article V going to be deactivated? In a war one knows when it has to be deactivated: when the war ends. When the last terrorist has disappeared from the face of the earth, is that the end of Article V for NATO? This problem shows how unprepared NATO was for this kind of contingency.

As we contemplate the future of NATO, let us remember, first, that NATO maintains an extremely important function which is also one of the reasons why we pursue enlargement. NATO is an instrument against the re-nationalization of security policy. It is one of its great achievements, to have created a system of states among which the use of war as a means of policy is excluded in a definitive way. The NATO area is a peace area among the members.

Second, NATO provides a stability framework for Europe with great success and continued relevance. If one removes this framework the situation is likely to change for the worse. And let us not underestimate the problems of the Balkans. If NATO, although most of the work is done by the Europeans, withdraws there is going to be a lot of trouble.

But if one looks ahead to this century with its looming uncertainties and instabilities, where is the US going to find allies in the troubles of the world? Of course among like-minded countries and democracies with which it has cooperated for decades in an alliance system. For that reason NATO and the NATO members will not cease to be relevant.

The fight against terrorism is the defining element of the future, particularly in its combination with weapons of mass destruction. This is a task one country cannot really fulfill alone, not even the US. In this struggle one needs allies. The global anti-terror alliance that has been created will remain a necessity. As we look at

failing states, this cannot be dealt with by one country alone. We are living in an interdependent and open world in which countries are vulnerable. If terrorism is to be defeated with a medium and long-term strategy, democracy is necessary, moreover, development and the removal of other major sources of tension, such as the conflict between Israelis and Palestinians.

What are the consequences for NATO? In an open and interdependent system we need a very different kind of cooperation to preserve the openness on which our prosperity is based. Five million containers enter the US every year. How do you control that traffic? One needs a very different approach to security to deal with it. We need a different way of looking at development, the third world, and at culture. How do we penetrate autocratic Islamic societies to support those forms of Islam that are peaceful, and oppose the abuse of religion for the purposes of extremism?

We need a new NATO which will by definition have to go outside the geographic area of the past, "out of areas" as we used to say. That is where the new dangers originate. While maintaining a very important function in Europe, NATO will also act outside. It will do so through "coalitions of the willing", since not everybody can take part in everything. This raises difficult problems for a number of states, but it has to be done to avoid becoming irrelevant, NATO has to act with Russia on many issues, not necessarily on all, but on many. NATO sometimes has to intervene in conflicts in order to prevent them from escalating to unacceptably dangerous proportions. It is, therefore, a very different kind of NATO compared to 1990 that the new members will joint after the Prague summit.

We need, third, a much better equipped Europe, in a double sense: First in the literal sense that the military equipment corresponds to the needs of security challenges of the present and not of the past. Such an adaptation requires enormous changes and reform, for example, in Germany which had been given the task by NATO to defend the center of Europe against a Soviet assault with heavy armour. It takes time and a lot of money to change that structure. Britain and France with their colonial past, of course, have a much different structure of military forces which is more suited to the present purposes. But reform is necessary which means that the budgetary consequences have to be faced. But it also means that Europeans have to act as Europeans and agree on common policies.

Finally, priority must be given to prevent the proliferation of weapons of mass destruction because nothing will change history as much as one nuclear weapon, or one other weapon of mass destruction in the wrong hands.

We have to look at the problems of the present in a much larger context than American-European or NATO-EU relations. George W. Bush is in a very similar

position as Harry S. Truman was when the world was reshaped after the end of World War II. We are, to use Dean Acheson's expression, present at the creation. The character of some of the disagreements between Europeans and Americans are partially due to the fact that at their bottom is a disagreement about the principles of world order. To what extent can we simply change them and how should we change them? This can be seen in the controversies about Iraq.

Should preemption become a generally accepted principle of international politics? If that were to happen it would herald the end of international law and order as we have developed it after World War II as a system based on the prohibition of the use of force according to Article 2 of the UN Charta. On the other hand, and there the American President has a point, the nature of the modern security problems is such that one may have to intervene before the classical case of an aggression takes place that activates Article 51 of the UN. But preemption as a principle and doctrine does not solve the issue.

Should war be a means to change a regime? What would be the end result if we were to adopt that as a principle, given the fact that the majority of all regimes in the world are not democratic. Non-interference in internal affairs has been a central element of the international order since the peace of Westphalia of 1648.

My concluding point would be that these are issues that the democracies of the world must review together, not by unilateral statements that come from here or there. They are too important to be left, so to speak, to the disagreements of the moment. They should be jointly reviewed in order to adapt rules and institutions where adaptation is really necessary. In that context, I do believe that NATO, while having to adapt and to change as the alliance of democracies, will continue to be fundamentally necessary to deal with the instabilities that we have face.

General MARIO ARPINO, Consultant, Italian Institute of International Affairs, Rome

Thank you Mr. Chairman for giving voice to the lonely representative of the southern border of Europe and NATO, in such a distinguished, specifically northern environment. I have a few notes on some issues already mentioned by the previous speakers. I speak from a military perspective, since I come from the military.

The war on terror is said to change much of our military planning – maybe true, maybe not. We will see. This must be very interesting for the Baltic region countries because they all are keen to join both EU and NATO organizations with adequate tools and procurement plans in accordance with the new requirements.

Everybody knows that after the Amsterdam and Helsinki summits the European states decided to achieve an autonomous military intervention capability sufficient to accomplish the Petersburg peace-keeping missions, which span an area from disaster relief, which is the minimum, to peace-making, which is war. The span is very complete. How to do that? We have two tools both in Europe and in NATO. We have the Defense Capability Initiative (DCI) which we are pursuing in order to allow NATO as a whole to get closer to the American standards in terms of war fighting capability, etc. On the European side, we have the European Security Defense Initiative (ESDI) in order to accomplish the Petersburg tasks. We were proceeding along both these paths with the blessing of the Washington Summit in April 1999. I was at the summit and remember the enthusiastic acceptance of both the ESDI and DCI initiatives. We were very slowly progressing toward attaining ESDI and DCI goals when 9/11 occurred, and brought the call for some changes.

War on terrorism was declared by the United States, was unanimously approved in principle by the NATO nations through the application of Article 5 and by the European parliament.

We noted many, many offers from the European states, even non-NATO states to participate in the war. However many states were reluctant to offer ground troops, mostly required and appreciated by the Americans. Europe was still not mature to do that. Nevertheless, some of our European states did it. Many offered navies. This is disengaging. (Laughter) We can appreciate navies, but I am an airman. The air force engages, the ground troops are engaged in combat, the navy is floating there giving security. Still it's a good contribution, namely when they have aircraft aboard. As a matter of fact, we Europeans were reluctant to adjust our badges to meet not only the ESDI requirements, but also to meet the additional challenges.

By contrast we note an impressive increase in the United States military budget, which is widening the gap, already quite wide, between the United States and Europe in terms of power, technological advances, and war-fighting capability.

Now I have some provoking questions about this point. Is the future scenario that of the US as war-fighters and Europeans as peace-keepers? I don't know. We have been speaking about decoupling. Is this decoupling or not? Maybe yes, maybe not. How does European enlargement affect these scenarios? This is a good question. I don't ask for, and I'm not fishing for answers. But I believe that it sets the terms for a good debate.

Now, on transatlantic relations, as Mr. Rosenfeld said, the relations have been very good I could say even seraphic, for at least fifty years. That's why we have Europe. To put it bluntly, Europe was a security consumer. The US were a security producer. That's the reality. Nevertheless, we have now shared values such as freedom, democracy, free trade, good mutual understanding, etc. And the fee for the security consumers was a good deal of political support to U.S. foreign policy, a good availability to US of our national airbases, logistic ground support, free of charge host nation support and so on. And this was all. And this continued even after the Berlin Wall collapsed. The Americans proved to be very collaborative even in absence of substantial European combat support, taking advantage of what we were able to offer.

For instance, during the Balkan wars we could not have done all we did without the Americans. They did perhaps sixty or seventy percent of the job, and they are still doing a lot there. In the meantime, Europe is modernizating but without any hurry and corresponding to the individual national resources of the individual EU states. When we had a differing viewpoint than the United States, these differences were resolved with good agreements, with excellent understanding, and good mutual respect.

That was before 9/11. Now we have a paradox in transatlantic relationships. At the beginning everybody declared to be enthusiastically supportive, as Professor Kaiser said, involving ourselves in a collective defense against terrorism. But the paradox arises from the fact that this also provoked a kind of splitting between the two shores of the Atlantic sea. This is bad. The Americans were able to establish a friendly relationship with Russia; this is a good goal, with Pakistan, even with China. But relations between America and her traditional allies worsened. The feeling is not very good, as Professor Kaiser said, as it was previously. Something is happening. Among the Allies, the United States shows some confidence only to the United Kingdom, the British are trusted allies. And in the mean time, Europe seems to be totally fragmented in different voices and arguments.

Also, for a range of different reasons, today there are very few matters, very few issues that we seem to share, unfortunately, with the Americans. Europe is not in full agreement with the USA on the Middle East, on the way to approach Pakistan, not on the International Court of Justice, not on the Security Council resolutions, not on the war against Saddam, etc. This is not a gruff confrontation, but rather disagreement. This is not good.

The recent statements by Henry Kissinger and the essay produced by Robert Kagen are significant illustrations of the gap between the USA and Europe.

I have other provoking questions now. Do we actually want a Europe like the one which is now emerging? I don't think so. Do we really feel our whole European order, so recently reestablished, to be jeopardized by terrorism? As a matter of fact, do we feel as Europeans, to be really in war against terrorism? This is the question. Are we so confident that the Americans will come and save us again in the future for the third time, for the fourth time? Maybe. Should Europe have this necessity? This is only a provoking question. I don't request any answer now.

With regard to the European domestic debate, Europe must choose whether to favor individual states' interests or collective national interests. I prefer common interests. This uncertainty is at the root of the ambiguous behavior of Europe and generates a serious skepsis in America about the actual willingness to reach an effective political identity as far as common European defence identity is concerned. This is poisoning our domestic European debate and it is not good.

This decisive debate is much more important than the problems Greece and Turkey have between them, as mentioned by Mr. Kaiser earlier. In the new European Union, it is Europe which must help to create a new NATO for the simple reason that we need NATO much more than the Americans do. We need Europe and NATO much more than the Americans need Europe and NATO. The on-going convention for a future European constitution is a unique opportunity which must not be missed to move ahead in this matter.

For instance, we will perhaps be obliged to give up a small piece of our sovereignty. I understand that it could be hard to be accepted by some candidate states. They only very recently reached their full sovereignty. Giving up immediately a bit of it could be a problem. But they must be prepared to make this sacrifice.

Most of the unilateralism on the part of the United States is due to the fact that the EU does not have a single effective point of response. In the convention, in my opinion, we could overcome this situation if the convention endorses at least three things.

First, majority decision-making in the European Council, including decisions on foreign policy, allowing perhaps non-participation in military expeditions for individual states. This is possible.

Second, establishing a European consulting mechanism in order to give a single voice to the European representative in the United Nations Security Council.

Third, introducing in the frame-work of the European security and defense policy the Berlin-Plus concept to enforce a corporative approach. This is a must. This concept was unfortunately disregarded at the Nice summit, but needed, at least in the beginning of the process, because in a large Europe only few members may reasonably have the capability and the will to participate in peace-keeping or combat missions. The question is, are the candidate nations prepared to share these views? The answer could be yes. My doubts are whether the present fifteen nations' community is well prepared to take a position on this. Thank You.

Regional Security Consequences

Prof. ADAM DANIEL ROTFELD, Under Secretary of State, Polish MFA

1. Introduction

A lot has been written and even more has been said about changes within the international security environment brought about last year. The terrorist attack on the United States set in motion or accelerated profound changes in the process of international security. These changes go beyond the business as usual category. We are not fully aware of all consequences of what has already happened or will take place in the foreseeable future. Let's consider for a while what it meant for Europe, and especially for our part of Europe?

It is much easier to describe the new security environment for what it is not than for what it is. Definitely, it is not a clash of civilisations, neither a war on globalization. The terrorist attacks of 11 September were also not a war of the poor against the rich. For many reasons the decisions that have so far been taken in 2002 or will be taken in the coming months may be of a decisive significance for the shaping of a new security system both regionally, especially in Europe, and globally.

2. Shaping a new security system

By the very nature of things, such a development of the situation poses a serious challenge to security analysts and students.

On the one hand, it provides a unique opportunity for influencing the shaping of the security system. I mean here not so much the need to launch new grand designs or blueprints but rather bringing home to statesmen that their *ad hoc* decision-making may help resolve current problems by taking tactical steps, but could make it difficult to shape and form a desirable security system both in the transatlantic relationship and on the regional and subregional scale.

On the other hand, I have an impression that nowadays politicians lack the guiding idea which would facilitate taking optimal decisions. There are four premises of key importance in shaping a new security system. The first is that the development and spread of the technologies of 'the network age' particularly information technology, are part of the process of globalization. The second is that a growing number of states are too weak to control developments on their territory; consequently, they have become a base and an asylum for international crime and terrorist networks. The third is the blurring of the distinction between domestic and external security.

The fourth is the growing importance of non-military aspects of state security. These remarks – however general they can seem – relate to very concrete situations. These arguments paved the way for the decision to quickly enlarge NATO further to the East and to establish a qualitatively new relationship between NATO and Russia. Let's state it clearly: the main actors (the United States, Russia and NATO) are still the same, so are the Baltic states and their neighborhood. However, after September 11, the position of both the United States and Russia on NATO enlargement changed dramatically. The main reason is a shift in perception. Today, all main actors perceive each other differently then a year ago. September 11 changed a perspective through which Central and North Europe were considered both in Moscow and in Washington.

3. The new agenda

What does it mean in practice? A year ago, at the Conference organized by SIPRI and the Swedish National Defence College (Frösunda, 20 – 21 April 2001) I made the following comment "One common element of the EU and NATO enlargement is the principle of inclusiveness. The intention is to adapt the alliance to deal with new threats on Europe's periphery and beyond its borders. The formulations which NATO has used with regard to further enlargement express the general philosophy of inclusiveness but are cautious and balanced, and make no specific commitments." Half a year after the terrorist attacks against the United States, the approach to the NATO extention was changed dramatically. In his speech addressed to the Stockholm Conference on the Baltic Sea Region (April 24, 2002) President Aleksander Kwaśniewski of Poland stated: "The discussion on the new aspects of the Alliance's operations stems from the necessity to better adjust these to the changing international environment. For the first time in history the members of the Alliance took the decision to apply Article V of the Washington Treaty and involved themselves, to a lesser or greater degree, in the campaign against global terrorism. Following upon the events, an attempt will be made, during the November Prague Summit, to define anew the role of the Alliance attuning it to the changed security environment. The planned changes cannot, however, impair that which is of the greatest value in the Alliance: the resolve to fulfill the primary functions enshrined in the Washington Treaty, including collective defense of all member states. "

I is topical for us all to redefine our security agenda and prepare some new specific recommendations and conclusions which could provide a starting point and a competent basis for political decision-making both in the field of new threats, new tasks and new capabilities on one hand, and, on the other hand, reductions and elimination of concrete categories of weapons of mass destruction and arms export controls as well as the efficacy of non-proliferation.

4. US policy & leadership

In this context, of key importance is the understanding of US policy. A great deal has recently been said and written about the US Republican Administration's return to unilateralism. I will not dwell on the arguments and counterarguments in the ongoing dispute. Let me state that the question whether the United States will decisively influence regional security in Europe and the global security system is a rhetorical one. An open question, however, is how it will exert leadership in the world: whether it will be, as Zbigniew Brzeziński said the other day in Warsaw, a world of domination, and even hegemony, of one superpower, or a security system whose participants will recognize American leadership based on a community of interests and the respect for common values. In other words, whether the US leading role should be based on consensus and willingness of democratic states or on imposed hegemony. Brzeziński said: „American hegemony is now the only viable alternative to potential world anarchy". It constitutes the sole effective bulwark against dangerous proliferation of weapons of mass destruction. American direct military presence in the West, in the East and in southern Eurasia is the basis for stability of the existing international system. Furthermore, the geostrategic scope of US direct hegemony is expanding dynamically. According to Brzeziński, NATO enlargement in the military field stands for expanding the US protectorate over Europe.

No need to say that I, personally, prefer a different understanding of the US's unique position in Europe and in the world. As Henry Kissinger concluded in his recent monograph *Does American need a Foreign Policy? Toward a Diplomacy for the 21st Century.* (Simon&Schuster, New York, 2001, p.288) "While traditional patterns are in transition and the very basis of experience and knowledge is being revolutionized, America's ultimate challenge is to transform its power into moral consensus, promoting its values not by imposition but by their willing acceptance in a world that, for all its seeming resistance, desperately needs enlightened leadership."

5. Divergence in perceptions

The recently most debated essay „Power and Weakness" (Policy Review, No. 113) by Robert Kagan offers a reasoning to the effect that it is high time „to stop pretending that Europeans and Americans share a common view of the world, or even that they occupy the same world (...)". He goes on: „Europe is turning away from power (...), it is moving beyond power into a self-contained world of laws and rules and transnational negotiation and cooperation. It is entering a post-historical paradise of peace and relative prosperity, the realization of Kant's „Perpetual Peace". The United States, meanwhile, remains mired in history, exercising power in the Hobbesian world where international laws and rules are unreliable and where true security and the defense and promotion of a liberal order still depend on the possession and use of military might. That is why on major strategic and

international questions today, Americans are from Mars and Europeans are from Venus: They agree on little and understand one another less and less. In short, the reasons for the transatlantic divide are deep, long in development, and likely to endure. Europeans and Americans no longer share a common "strategic culture". In the same line of reasoning Fareed Zakaria addressed this summer to Europe a simple message: 'If it wants to be global power and player in the Atlantic Alliance, Europe has to get back into the business of making war'. ('Europe: Make Peace With War, *Newsweek*, 3 June 2002).

The recent position taken by the United States towards the United Nations in the context of Iraq and search for international support prove that Joseph Nye was right when he noted, 'the paradox of American power in the 21st century is that the largest power since Rome cannot achieve its objectives unilaterally in a global information age'. The world needs the United States as never before, but the United States needs the rest of the world, too. Neither domination and hegemony nor neo-isolationism offer an adequate response to the new challenges.

6. What has to be done?

The common feature among these and other American security analysts is the search for an answer to the question how to maintain the status quo and ensure stability and security in the changing world.

The questions which we put to ourselves are today much more modest and are limited basically to two issues. The first one amounts to the fact that one of the main causes of instability and anarchy in the modern world is the increasing number of weak and failed states; they are hardly able to fulfil the basic function of maintaining control over their territory and ensure security to their citizens. One of the upshots is the growing significance of non-state actors. Therefore the first question reads:

- What are the security implications (both positive and adverse) of non-state actors' activities?

The second question is:

- What has to be done by the Baltic states, by Poland and other countries of the region in cooperation with the United States to prevent in the new security environment the proliferation of WMD and small (light) weapons in the areas of conflicts? In other words, how one may strengthen the system of arms export controls?
- How our countries can contribute to the new policy oriented against terrorists and hostile states with CBW and nuclear weapons?

These and other questions were raised by Aleksander Kwaśniewski in his speech delivered here, in Riga (5 July 2002) in a broader context. As you may know, at the

summit meeting of the Vilnius Group states in Riga, 5-6 July 2002, President of Poland Alexander Kwaśniewski presented the idea of creating a joint platform of co-operation between the 13 states of the Vilnius and Visegrad groups in order to unite these two streams of integration of the states from Central, Eastern and Southern Europe with the European Union and with NATO. The main motive of the Riga I initiative is an attempt to diminish the risk of marginalisation of those states that will not become a part of either Eeuroatlantic or Eeuropean structures in the near future. In this sense, the Initiative should be considered as a counter-measure against negative phenomenon and tendencies that can appear in this situation. I am thinking about populism, aggressive nationalism, tensions and conflicts with neighbors. In other words, this Initiative aims at:

- Creating a new platform for a broad co-operation;
- Supporting the transformation of countries involved towards a democratic state of law;
- Strengthening different forms of co-operation between countries, that are beyond the main security structures, on the one hand and NATO and EU on the other;
- Establishing a closer co-operation in combating organized crime and illegal migration;
- Last but not least, creating a new platform for a military co-operation, especially in crisis situations.

The Initiative will enforce the sense of common identity and solidarity among the countries of the region, it will eliminate the possibility of new lines of division in Europe to arise. The Riga Initiative is not a closed formula, it is not aimed to substitute or duplicate institutions or mechanisms of cooperation existing in this part of Europe. Neither is it the intention of Poland to create a new, closed club of states and to exclude countries that are interested in cooperation.

A few words about the transformation of the Atlantic Alliance in the nearest future. NATO command structure has been, and will remain, the key element of the Alliance's military assets and, thus, the core of its ability to respond collectively to arising threats and challenges. For many years this structure has provided a guarantee of NATO's being able to take effective action against any potential danger, within the frame work of both Article 5 and crisis-response operations. Therefore, our efforts to review NATO C2 structure must acknowledge, as a primary goal, the indispensability to retain these features, especially the capacity of the Alliance to carry out effectively the full spectrum of its missions.

I would like to conclude my presentation with three remarks:

1. The current situation can be characterized not only by the diversity of threats, but also by the diversity of opportunities. A new NATO and a new European Union have to and will play a key role in addressing the central security challenge.

2. The very notion of *cooperative* or *inclusive security* is more about political philosophy than a concrete programme of action. Depending on specific needs, cooperative security has different contents and includes different forms of operational collaboration.
3. There is nothing deterministic about the shaping of a new security system. Nothing is prejudged; institutions and procedures should be transformed. Nothing is shaped forever, and even joint decisions are often interpreted differently.

COMMENT

PER CARLSEN, Director, Danish Institute of International Affairs, Copenhagen

I'm pleased to be here in the largest of the Baltic capitals, I thank the Latvian Institute of International Affairs for the invitation. We all await the outcome of the coming month's negotiations with a certain impatience and expectancy. I personally believe that the outcome will be what we all are hoping for, namely the accession of the three Baltic States into the European Union and NATO.

A transformation period

During the last decade the Baltic States have undergone an epoch-making transformation from Soviet-style republics to forward striving western-style societies.

The transformation process has been tough for the people of the Baltic States, but the political leaders have stayed focused even so and the reward should be granted this autumn with invitation for the Baltic States to join the EU and NATO. The establishment of western style democratic institutions together with the liberalisation of the economic sector in accordance with EU and NATO guidelines is difficult. In some cases the standard of living has deteriorated to a lower level then before the fall of the Soviet Union.

It has sometimes been difficult to convince the general population that the transition period was the first difficult step towards a better society and it will be even more so if the accession should fail, which it will not!

However, even with membership of the EU and NATO the harsh times aren't over yet. There is still substantial work to be done, not least when it comes to the relationship to the outside world, especially Russia. The Baltic States must continue to improve their relations with Russia so that the enlargement doesn't push the East – West divide further to the East. Rather it should wipe it out all together.

It would likewise be a terrible mistake if Europe and America would cease paying attention to the Baltic region after the accession since the reformation is an on-going process. It's not just a moral obligation to continue the support but also a precondition for a stable development in the region, a development that can be transferred to other regions with similar conditions.

Such a region could be the Caucasus where instability and chaos has all too long reigned. The Baltic transformation can be seen as a role model for the way to develop a western style democratic society with a free marked economy and the experience gained should be used elsewhere if possible. In this aspect the Baltic States have an important role to play within as well as outside the EU.

An organisation similar to the Council of Baltic Sea States (CBSS) could in the Caucasus region facilitating enhanced co-operation and progress for the benefit of the region as a whole. EU should also focus its attention on this region since the development of recent years has been troubling. Nobody wants a second Yugoslavia with all that it implies.

Again Russia is the major player when it comes to the Caucasus which underlines the importance of keeping Russia close to Europe.

Russian minorities are present in all the three Baltic States, a fact that has contributed to the less than perfect relationship with Russia in the past. But instead of making a problem out of this, the Baltic States and Russia ought to utilise this obvious resource in a positive way by employing Russian speaking citizens in jobs with relations to Russia. The Baltic States will gain nothing from keeping a substantial part of the population out of jobs and influence, since everybody is needed to get the job done.

Baltic organisations

Another way to facilitate improvement between Russia and the Baltic States could be through the existing Baltic organisations. Russia is already a full-fledged member of the "Council of the Baltic Sea States" (CBSS) but participation in the other Baltic networks and organisations should also be considered.

Keeping Russia out of the defence dimension the Baltic States risks reproducing or even intensifying the old East – West divide as we know it from the Cold War period. I can therefore only emphasise the importance of keeping Russia close to Europe and the EU, and as the Baltic States will define the outer frontier of the EU the task lies first and foremost with them. By using the experience gained from CBSS in a future defence co-operation the Baltic States would not only enhance regional stability but also place themselves in the forefront position of EU security and defence policy.

The EU also holds responsibility for keeping the Baltic States on the right track. Future financial, military and practical assistance will still be needed in the time to come and the EU must recognise its share of the burden and do what's necessary to keep the process going.

Russia

Russia is an important neighbour to the Baltic States and to the future enlarged EU. In order to strengthen stability and prosperity in the region, the EU sees co-operation with Russia as a primary concern and so should the Baltic States.

The EU's Northern Dimension will hopefully experience a revitalisation during the Danish Presidency and the Baltic States will take up a position as important members of the dimension programs. Again relations with Russia are of great importance since Russia will be the only country in the Northern Dimension which doesn't hold EU membership.

The outer borders of the EU will be next to Russia and commerce and trans-border relationships will hopefully flourish and benefit from the uniformity and transparency that comes with EU law standardisation.

The EU is not trying to keep Russia out of Europe after enlargement and neither is NATO. The enlargement is a unique opportunity to bury the disputes and hostilities that were dominating the Cold War era in favour of a new and more co-operative East – West policy.

With the accession of the Baltic States to the EU and NATO, the border disputes with Russia, should come to an end followed by a ratification of the already signed treaties by the Russian Duma. Obsolete Cold War rhetoric is not the road to a more positive and rewarding working climate and I believe that this is a fact recognised in Moscow as well.

One of the few positive outcomes of 9/11 seems to be the fact that the Russian leadership has realised the necessity for a common security and defence strategy in Europe and that co-operation with NATO is the most efficient way to achieve such a strategy. The time has come to focus on new threats and security issues such as those presented by international terrorism, environmental problems and international crime and let the disputes of the Cold War take their place in history as a closed chapter.

Belarus

A reminiscence of the past unfortunately remains in the heartland of Europe. Belarus has yet to emerge from the dark ages of totalitarianism where notions such as democracy, respect for human rights, freedom of speech and press etc. are largely unheard of.

Again the Baltic States play an important role since Lithuania together with Poland will define the future EU borders towards Belarus. It is a difficult situation since the EU has decided not to maintain any official contacts with Belarus's authorities but at the same time a strategy of strengthening the democratic elements in the country is pursued by enhancing co-operation with NGOs.

Even though it seems an impossible job, Europe and Russia must help Belarus out of its backward past and into the European society of free and democratic states.

Kaliningrad

Let me briefly mention Kaliningrad that also demands attention in relation to the enlargement process. Kaliningrad will be completely encircled by the EU and NATO after the enlargement and viable solutions to an array of problems must be found including transit visas, trade relations etc. A special obligation lies within the Baltic States to continue the positive co-operation with Russia concerning the Kaliningrad area.

EU likewise carries a large degree of responsibility for the future development of Kaliningrad. Through the various aid and development programmes carried out by the EU a great deal has been achieved in the Kaliningrad area but better co-ordination and determination from both sides can lift co-operation to a new level

Russia herself has made some suggestions on how to enhance the co-operation for instance by pooling the resources of some of the existing programs (Common Strategy on Russia, Partnership and Co-operation Agreement, Northern Dimension and Technical Assistance to the Commonwealth of Independent States) into a more efficient combined program with an overall responsibility for Kaliningrad. Russia has got to make it's own preparations to facilitate a more efficient implementation of the programme objectives.

Concluding remarks

I have in my speech addressed an array of questions concerning the Baltic region. The overall picture is positive and I am fully convinced that the hardships endured by the Baltic populations through so many years will be rewarded in the near future. However as already mentioned, there is still a lot to be done, both within the Baltic States themselves as well as in the relations with neighbours. Existing problems will not disappear with entry into the European Union or NATO, only a continuing work effort from all sides involved will make it so.

Dr. ARKADY MOSHES, Head, Russia and EU Programme, Finnish Institute of International Affairs, Helsinki/ Senior Researcher, Institute of Europe, Moscow

I heard with great interest what we were discussing this morning. It was really interesting. It was intellectually challenging. It was forward and future looking. It was not, though, too much provocative, frankly speaking. I mean provocative in the direct policy related sense.

Before I get to the details of my comments, I think the most important statement here is that with regard to the region and with regard to such an imperative as engaging Russia, we are facing a very serious challenge. Which is: How do we manage the double enlargement? Because for many years the question was, whether, then when, then who, and now it's finally, how? The "how" came last, but it's definitely not "the least". Because how we do it may really create problems, but it also may help us to implement the opportunities. The most specific things which I have to say are the following.

First of all, lets not forget the harsh reality that Russia still doesn't like NATO enlargement. It acquiesces to that, but it certainly doesn't see NATO enlargement, particularly in this part of the world, as the process that will serve its interests, and that it is in its interests. This is more serious than people can think just looking into the diplomatic niceties which can be found in the relevant documents.

Why it is particularly bad, from my point of view, is that NATO enlargement does create here, with regard to Russia, I emphasize, a wrong focus. Which in fact, Per Carlsen already emphasized. Which is that instead of eliminating dividing lines you have a risk of moving the dividing lines further east. This won't help in the long term.

Why is the task of managing NATO enlargement in the region so difficult? Because the two most likely outcomes in the practical terms are the following. Basically it emphasizes the old things. It emphasizes Russia and the others, rather than all together. So the two things are the following.

If the negotiations on specific issues, like the CFE treaty for example, become the priority number one, then you immediately invoke, or return to the Cold War paradigm.

What to do to compensate Russia for the enlargement? This means that we would assume that Russian security interests will be damaged. There is no good way out of

this logic of thinking. And this will be true if we bring back the document of 1997 and basically say, there will be no Allied troop bases, there will be no nuclear weapons, so you Russians shouldn't be worried. But it means again, that in the back of our minds, there is this assumption that there are reasons why Russians should be worried.

An alternative to this would be not to do anything. And to basically say, well, it's a new world, we all face new types of security challenges, so lets go ahead. There is no reason to hurry up with CFE Baltic accession. Nobody is going to attack us. Which might be true. But then you will hear the argument that enlargement goes on without the Russian security concerns being taken into account at all. And then you have the debate starting all over again.

Particularly troublesome I would say, would be the thing which is nearly inevitable, which is the continuing upgrading of defenses of the Baltic states. Of course, a lot still remains to be done on this score, before their contribution to the Allied efforts might be found sufficient by all actors involved. But how will this be interpreted in Russia? You can guess. It's not hard. Particularly if it's all accompanied with the debate on Finnish and Swedish NATO membership that may start next year. The paradigm of rolling encirclement. I don't want to go through this all over again. But these are the two most likely options. And how we actually sail between these two extremes remains to be seen. I don't have an answer. And I don't think that there is enough work, academic work, being done to really avoid either of those bad situations.

The next point which I would like to touch upon is the Russian concern, still present and visible, where there is nothing particularly new. That is that the Balts are going to the old NATO. And that by getting to the old NATO they will try to strengthen the old NATO. Designed, able, and willing to do one thing, namely, to contain the Soviet Union and Russia.

Parallel to that, there are concerns that Baltic EU membership might be counter - productive for the Russia-EU dialogue. I want to be very well understood; I don't want to dramatize the situation. I don't want to say that this is a universal view of one hundred percent of the Russian analysts. But it's there.

On the other hand, when I talk to my Baltic colleagues and friends, I quite often encounter this not universal, but rather discernable, sense of euphoria: "Once we're there, it's Brussels that will have to take care of our bilateral problems with Russia, like the border issues, like the minority issues." And when you put together Russia's concerns, and this kind of euphoria, which you meet here, it becomes very hard for you to find an answer.

If you think that I am too theoretical, I will give you one particular example. The Russian Strategy, or Russian long-term concept of relations with the EU, has one paragraph, which says that Russia reserves the right not to extend the Partnership and Cooperation Agreement (PCA) to those states where human rights are not guaranteed. I'm not saying it's likely, but the line is there. If we take the ratification of the PCA extension for granted by the Russian Duma - and 2004 would be a good year because Duma elections will be already in the past - that might help. But I wouldn't take it for granted as it is.

So what will we have in the end? Will we have really this stabilizing effect of Baltic EU membership on the whole triangle, if I may put it so? This is possible. I'm not trying to exclude it. But it may also work under some particular circumstances the other way around. Why? Because Brussels is totally unprepared to deal with these issues. It's totally unwilling to deal with these issues. It has enjoyed its position of an observer through all these years. It was so nice to say that it's for the Balts and for the Russians to settle their scores on this. We will be there, watching the things, maybe intervening when the things really can become hot, like it was in 1998 in Latvian-Russian relations, but no more than that.

Kaliningrad has already demonstrated that this position of lack of policy and of lack of vision how to prevent the worst things from happening, can blow up. Everybody knew what was going to happen with Kaliningrad three or four years ago. Everybody knew that in Moscow. Everybody knew that in Brussels. Lithuanians were active, trying to bring attention to the issue. But with very few results. So now when we have the problem, we say that we basically have four months to sort everything out. Which is simply technically not feasible and not doable. And regardless of whatever we agree upon in November and December, to have whatever system is agreed upon in place will take years, because the facilities are not there on either side. These negotiations should have been conducted three years ago. I'm not trying, as I say, to make the things look more complicated than they are. Because they are rather complicated already. But we tend to overlook that.

I have one more minute for my last comment. If Russians were allowed to travel to Kaliningrad the way Americans travel to Alaska through Canada, Moscow would be happy. But I'm not sure Lithuania would. And this is why I disagree with Per Carlsen. This is not a technical issue.

Another story is that all this political noise about sovereignty issues should be put aside. But a kind of a political understanding should be there because only if you have a treaty on the status of Kaliningrad as a pilot region of cooperation, a ratified treaty, thereby becoming part of *the aquis*, then you have solid legal ground to

stand on for working in the visa and economic spheres. If you don't have this, you can't do the work.

And the final thing is the NATO-Russia Council. I completely agree with Robert Nurick that here everything is about the agenda. So one venue to really keep it alive, and keep it effective, would be to think of the new agenda. And I would go as far as proposing to gradually bring some of the issues that are now discussed and decided upon in the North Atlantic Council to the NATO-Russia Council. Because one of the reasons that the Permanent Joint Council (PJC) died, was exactly this, that whenever we came up with practical suggestions, the answer was; this is none of Russia's business, because this is the internal affair of the alliance. We basically ended up discussing Bosnia for which PJC was completely redundant, because cooperation in Bosnia started before PJC was founded. We are still not free from this risk.

I know that a very cautious approach is needed, but the vision should be that. Otherwise you end up in the old Russian formula nineteen minus one, the way we were discussing the nineteen plus one formula.

Another thing would be of course, to really put the NATO-Russia Council on the new ideology, on the ideology of joint action action against common threats. As opposed to reciprocal actions vis-à-vis each other, which has been in force until now. I think that would help.

DEBATES

Question: I remember early in my life the military conflict between Greece and Turkey. One postulate you have not touched very much is the ability of NATO to stop military conflicts between NATO countries. If NATO has a strong ability to stop military conflicts between member countries, I think it would be a very good idea to expand NATO to Russia, for example.

Stephen S. Rosenfeld: I think the idea of using Greece and Turkey as a positive model for bringing peace to others is a non-starter. Who is going to take instruction from our friends the Greeks and Turks in peacemaking?

Atis Lejins: Does that means that NATO is a peacekeeper between certain NATO members?

Robert Nurick: Just a quick comment. I think it is certainly true that putting the difficulties of Greece and Turkey aside, NATO certainly has served the function of dampening conflicts among its members. And indeed, this is one of the explicit purposes of it when it was established after World War Two. I don't think though that in itself this is going to an argument for bringing in Russia. First of all Russia has not indicated it wants to join.

Secondly, the kinds of conflicts now that could arise between Russia and the West are of a very different sort, not only from the past, but also of the kinds that have arisen among NATO members. There is, as several people have already emphasized, a very, very important need to cement that relationship. And to give, as I tried to indicate this morning, Russia a serious voice and stake in the existing security arrangements. But this is going to be done, I think for the foreseeable future, in a situation where Russia is not a member of NATO. The question is can NATO both preserve the integrity of its own internal processes, while at the same time engaging Russia in the way it needs to be? That is the balancing act that's going to be on the agenda.

Question: I should like to ask the question that was raised by Vaclav Havel some time ago last year. Must Russia be treated and pampered like an overgrown child? We are free, independent Baltic States, who lost their independence thanks to the Molotov-Ribbentrop pact, in other words, we were stolen by Russia. This is the right point of departure in order to evaluate what to do and how to do it. And if something is needed, than instead of a contribution or compensation for Russia, maybe Russia needs some pills on how to get over this emotional problem.

Arkady Moshes: Well, this is debate we've been through ten years, I think, or more. I agree with you that Russia's attitude towards the NATO enlargement as such. This is a psychological problem first of all. But, it has very little to do with the history now. It has very much to do with very specific aspects of enlargement of the alliance, which was set up with the idea to contain the Soviet Union, and later Russia. And if someone goes through the patterns of contingency planning in NATO, he will immediately recognize how much was actually preserved. And that gives Russia legitimate grounds for concerns. I repeat, it has now much less to do with who is entering the alliance, rather than what the alliance will be doing, what its mission will be in the future.

Atis Lejins: Yes, but Arkady, you know I grew up in Australia, and I remember what happened to the British Empire. Not only in Australia, but also in India, Africa and elsewhere. I think you cannot say it's all history, because history - it's there. We can see what difficulties the British and the French empires had with their former parts of the empire. And I think that certain parallels can be drawn with Russia, with the Baltic States and the other parts of Central-East Europe. We must be sensitive about history.

But now, I have two speakers who would like to continue this debate, Professor Kaiser and Professor Rotfeld.

Professor Karl Kaiser: On the issue of Russia and NATO, I'm struck by the fact that Arkady Moshes arguments are very much looking at the past, not sufficiently taking into account what has changed.
Take the example of Poland. When Poland tried to get into NATO, it tried to get into NATO with the arguments to be protected against Russia. And look where Poland is today. Today Poland is one of the active forces of integrating Russia into the West. It has a new policy of opening, of reconciliation, of ausepolitik; what the Germans used to do in the old days. It's very different. And your skepticism, it seems to me, totally overlooks that the group of twenty is fundamentally different from what the old institution was. It expresses what is definitely a consensus where the US, Germany and other countries are totally agreed on integrating Russia in the West and Putin gives the chance to do it. A better chance than we had before. And I cannot imagine, and that is where I think your argument that the Balts now joining, is basically still thinking in terms of aggression or war between Russia and the Baltic countries or the West. Why that argument, I think, overlooks the new situation. The Group of Twenty will have to deal with the security issues of today and tomorrow. And they are the issues outside of the classical area of NATO. What we have referred to is terrorism and I cannot imagine that on anything serious, that we will have to face as NATO, that we will do it not as the old club and not with Russia. I just don't see it.

Arkady Moshes: In a way I was slightly misunderstood in one particular respect. The things that I was saying, are not necessarily those I agree to myself one hundred

percent, but that was the summary of the arguments that are very often presented in my country. But the one thing, which I in fact am skeptical about is exactly this; whether the new NATO-Russia Council will be able to really deal with the agenda of the future effectively?

Adam Daniel Rotfeld: Well, I would like to say that for me it is difficult to be very brief, but I will try to say that I share professor Kaiser's view totally.

First of all, as you probably remember, the relations between Poland and Russia were extremely difficult, and in fact, I noticed while working in Stockholm for many years, the Russian press had negative information about Poland most of the time. And suddenly after 1999 there was for some period a kind of silence, and then for the first time some positive comments began to be heard. At the moment the relations between Poland and Russia were never so good as they are now. And they are improving. However there are still a lot of problems, and these problems will be solved.

Having said that I would like to say that what Mr. Moshes said was very common in the Soviet Union and in Soviet block in general. People very often privately said one thing but meant another. By chance I have with me a document, some of us will remember that document, it was exactly more or less ten years ago, on the fourteenth of December, in Stockholm when at the meeting of the OSCE Ministerial Council behind closed doors at the very beginning of the meeting Foreign Minister Kozyrev made a statement. I have the statement before me. I will not offer you the whole text, but I will cite one sentence. He said that the space of the former Soviet Union cannot be regarded as a zone of an application of the OSCE norms. In essence this is a post imperial space in which Russia has to defend its interests using all available means including military and economic means. All those who think they can disregard these particularities and interests, that Russia will undergo the fate of the Soviet Union, should not forget that we are talking of a state that is capable of standing up for itself and its friends.

You can imagine what kind of reaction was in the room when Kozyrev, who was known as very liberal, democratic, pro-western personality made such a statement. Then after a break he said that it was a rhetorical device, and continued to say that neither President Yeltsin, who remains the leader and maker of Russian domestic and foreign policy, nor I myself as the Minister of Foreign Affairs, would ever agree with what I read out in my previous statement. And I would like to say that it was really a rhetorical comment and he explained later that the text which he read out previously was a fairly accurate compilation of the demands of the opposition and not just the most radical position in Russia.

And it seems to me that it was exactly the intention Arkady Moshes to offer us that in Russia we have a kind of schizophrenic approach that on the highest level very often

people are much more open minded than in the medium and lets say the lowest level of bureaucracy. And I should say that I recently experienced that twice. Once in Reykjavik also behind the closed doors. It was a totally different statement made by Igor Ivanov. Very cooperative, very open minded, and people were impressed. And then we had an informal luncheon with Secretary General of NATO, I was sitting next to a Russian representative who has a very high position, I will not mention the position, or the name, who proceeded during lunch, to make a statement which was more or less what we heard today from Arkady Moshes. I asked him privately, what is the Russian policy? That which was presented half an hour ago by Igor Ivanov, or what you are saying? And he said to me; it is up to you to make the choice!

And I would like to say that this approach was repeated again one month later when Mr. Putin in Rome made a very positive comment. We have, as Arkady Moshes rightly said, a kind of psychology, that people did not digest properly their own situation. Russia is a new state. It is a state with a long history, but Russia did not exist as it exists now. Never. It is really something new. And for the Russians, it will take a lot of time to accept their position. If I were the Russian adviser of the Russian president, I would say that one should first define what are the threats to Russia. In other words, whether the threats are from the west, or from the south.

Atis Lejins: From the east also?

Adam Daniel Rotfeld: No, from the south. I would like to say the threats are, lets say, from that region which is known as Central Asia and China, or whether the threats are from Estonia, Latvia, and Lithuania and the rest of the Western countries. There can be no doubt about the answer. And I would like to tell you here very seriously, all of us, we have had a lot of contacts, and responsible people know, that Russia should be reoriented. But that process of reorientation will take time. And our co-task should be to help, to facilitate that process. And we should do our best to promote all these new ideas. I should say that in many countries the intellectual communities are much more open-minded than politicians. And in Russia it seems to me very often quite the opposite.

Robert Nurick: I completely endorse what Professor Rotfeld just said. This is a process. It is proceeding. It's proceeding very unevenly and its one, curiously enough, where it is being led not by the intellectual class, certainly not by the *institutski*, but rather by Putin, who's setting the tone and direction of this debate. I mean it's quite interesting.

Arkady is absolutely right, there still are these old neuralgias there. It was not long ago, I can tell you, when the issue would come up in Moscow many people in the Russian political class would come up with the most dire scenarios about what Russian responses were going to be. Many of them were completely incredible. And I think designed mostly to frighten people. But, they reflected this underlying political

neuralgia. Most of those are now muted. You hear these very little. Indeed there is very little discussion about NATO enlargement at the moment as a whole in Moscow.

But the reason I think is that people are taking their cues from, in the first instance, from Putin, who I think has made a clear decision that he does not want NATO enlargement to complicate his relationship with the US, and more generally with Europe. That is where Russia's priorities lie in reforging that relationship. And that is why that I and others, I think, pay so much attention and place so much emphasis to things like the NATO-Russia Council. Not because of the council itself, that's just an institution. But it's a symbol of a process which is either going to make these issues, the issues of Russian-Baltic relations and NATO enlargement either easier or harder. Because if we get the larger question right, mainly Russia-NATO relations, than the question of the particular Baltic issues I think will continue to be muted and very easily manageable. If we don't get it right, if the Russian-NATO relations collapse, in acrimony of the sort before, than the Baltic issues will be only one of a whole line of problems that we'll have to deal with which will be very hard.

The key I think to all this is the broader relationship. And that's why we need to pay so much attention to it.

Question: Karlis Neretnieks, Swedish Ministry of Defense. I wonder if I made a correct observation or not. But during the presentation by Mr. Arkady Moshes you raised the question of defense contributions to the Baltic States. And in the same sentence, more or less, you mentioned Sweden and Finland as possible NATO members. Please correct me if I'm wrong, but I did get the impression, somehow, that we were seen as NATO proxies more or less, helping the Baltic States with quite substantial defense contributions. And that we were doing it instead of NATO doing it, because that would be not acceptable. If we did it, than okay, it might be acceptable. But at the same time, we were acting on behalf of NATO. Was that a misunderstanding?

Arkady Moshes: No, actually my point was slightly different. There was actually two things that I wanted to say. That if now NATO works more on raising the defense capabilities of the Baltic States, that might be interpreted in Moscow as a worrying trend.

Second, if, as a completely separate issue, Finnish and Swedish NATO membership gets on to the real agenda, sometime next year, or maybe in 2004, that will add to, by that time an already heated debate. I emphasize twice that I didn't want to dramatize anything. If you have something here, something there, then in the end you get the whole porridge boiling.

Atis Lejins: But you know Arkady, we have downstairs from the Latvian Ministry of Defense our annual review on the armed forces 2002. There you can read it all. Russia knows what kind of forces we will have when our defense reform is finished in 2008. It's all disciplined by NATO already. It will not be more than 26,000 men, with the reserves. We will have no battle tanks, no attack helicopters, nothing like that. Are you afraid that NATO might come in with big bases and lots of tank armies?

Arkady Moshes: No, the military district has a little bit more than 30,000. So it depends on how you calculate. That's again the old story. The other story is if the council succeeds, and if we no longer consider each other through the good old glasses we've been doing for twenty years now, and you're doing it too. Contingency plans.

Atis Lejins: Yes, we will have armed forces. That's true.

Arkady Moshes: Contingency plans. They haven't changed.

Atis Lejins: (Laughter from Atis Lejins) Okay. Good.

Question: Dmitry Polikanov from Moscow: I have some comments. First getting back to our morning debate about the future tasks for NATO. Actually, I agree entirely that the future tasks for NATO will be to protect values. Because if the world develops like it develops now, then in fifteen years probably, or in twenty years, there will be a huge problem with the South, with China which tries to reassert itself as a military superpower, and so on. There will be a need for military, for physical protection against the golden billion, whatever you call it.

And from this point of view, the incident between Spain and Morocco this summer may now be a funny joke, but it may also become some kind of trend for the future. From this point of view, Russia's role may become crucial because Russia may help to form this kind of northern ring to serve as a buffer between Europe and China for instance.

The major problem is that Americans are not ready to protect Europe, or to protect anybody except themselves. And Europe is not ready to pay for it's own security. If both sides manage to come to some kind of compromise, and to some kind of division of labor this will be good for Western values.

Second point. I appreciated the comments this morning about the crisis of the non-proliferation regime. Actually, to a certain extent, this is the task for police, for customs controls, for border controls and so on. But we cannot disregard the fact that there is a serious crisis. You cannot stop North Korea from selling missiles to Syria, for instance,

only with preemptive strikes. Because all other sanctions won't work against North Korea, for which missile export is the only source of income.

Then thirdly about Russia and about Russian foreign policy. Answering to the rhetorical question of Dr. Rotfeld; who controls foreign policy in Russia? Actually we should note bureaucracy in Russia, or some kind of bureaucratic inertia which exists in Russia.

On the one hand before September 11th there were many people in Russia, hardliners, who were questioning the usefulness of NATO. Now after September 11th even the liberals like Vladimir Lukin question the usefulness of NATO. And from this point of view nobody really sees the threat coming from NATO, and looks at it as a harmless organization. I can remember the phrase by Defense Minister Sergey Ivanov saying that Georgia can join NATO, or whatever organization, even the sexual rights league if I'm not mistaken.

Everybody questions the usefulness of the organization, on the other hand, it has some kind of corporate identity. Many people who work in the Ministries, in the Ministry of Foreign Affairs, in the Ministry of Defense, etc. and politicians need to promote the NATO threat. They should always remind the public, and the leadership that such and such a threat exists. Otherwise they also become useless. And they know this and they know that if military reform goes on generals will be fired. So there is no choice left for them than to somehow exaggerate the threat all the time.

Finally a very small comment about Kaliningrad: I would prefer to have it as a technical issue. But for Russia first again if we look at the long term prospective, from ten to fifteen years, Russia does not want to lose Kaliningrad. There is a realistic threat that Russia may loose Kaliningrad if there is a visa regime.

We cannot accuse Russia of an imperialistic approach here because even the states which are aspiring to joint the EU, like the Czech Republic, are also not very willing to revise the results of World War Two.

In addition for Russia it is somehow humiliating that countries like Ecuador have a no visa arrangement with the EU, from the point of social economic development Ecuador is probably at the same level as Russia or even a little bit lower. Perhaps it is less important for the EU than Russia, and perhaps it is also more dangerous for the EU than Russia.

Atis Lejins: I thank you Dimitri, for taking up fears about losing Kaliningrad. You remember, of course, the history. We Balts lost Prussia to the Germans a few hundred years ago. Then the Germans lost East Prussia to the Russians just fifty years ago. I wonder who will lose Kaliningrad and who will gain in the next hundred years?

Per Carlsen: The issue is that nobody wants Kaliningrad.

Atis Lejins: (Laughter) That's the big change!

Per Carlsen: The problem is that we are trying to get people to go there, to invest and to get Kaliningrad working. So that's the real issue. And we should work on that.

Why I asked for the floor was when the discussion came up about the old and the new NATO, at the morning's panel I wanted to raise the issue because having listened to Mr. Rosenfeld talking about burden sharing, I was thinking about burden sharing for what? And when Bob Nurick talked about capabilities I was thinking about capabilities to do what? And Karl Kaiser on the other hand was raising the very big issues in the debate across the Atlantic on the new world order and how we are going to deal with that. In the middle of these issues the small technical ones and the overall ones, I think there is one called the strategic concept of NATO. Ten years ago when the Warsaw Pact broke up and Russia came down, we had a review on the strategic concept of NATO to find out what should NATO be doing? And that is probably one of the problems that Arkady Moshes is talking about. Because the defense planners of course, still have to relate to their strategic concept. And that's why we have all these tanks still roaming around in Germany. We don't have so many in Denmark, but we definitely have too many. And we're using too much money on those strange tanks, which we cannot use for anything. So there is something there. I think we should look at this important issue at NATO. What is our strategy? What do we want to use our organization for?

Troels Froling: Danish Transatlantic Association, a member of the Baltic Taskforce. Just a comment on the historical dimension of NATO, coming from a small country in Europe, and this is especially directed to Arkady and to other Russian friends.

One should remember the success of NATO and the European Union lies in the whole integration processes, meaning taking away the nationalist dimension of the old European big powers, and medium and small states. This is a historical perspective, a quite unique development. This is a success story. Going back into European history three hundred years, that's the history of wars and breaks between them where young people grew up to become soldiers and then went to fight the wars. Now in the last fifty years, at least in the western part of Europe, was actually a long break, a parenthesis in this not so glorious history of Europe. In discussing what's the new NATO about, what's the new EU going to be about, I think it's most important to remember this dimension of taking away the hard edge of nationalism, of so to say, taking away the possibility of renationalization in the military dimension and in other fields.

Question: My question is about the new Bush doctrine, with the accent on preemptive strikes. Should we in Europe be worried about this new doctrine because if you are talking so much about it, I suppose there is some new danger.

Stephen S. Rosenfeld: I'm not a military person, but I'll attempt to answer. The word preemptive lets loose a ghost, an apparition which Americans are saying; today is Tuesday, I'll fling a bomb over there, and now it's Thursday. It sounds strange to my ears as an American when I hear the possibility discussed. In fact as I understand it, the preemption comes into play as an idea not because Americans are mad and crazy, but because some very disagreeable things have happened in certain parts of the world. Countries which are thought to be limited by their technology turn out not to be. As a result you have substantial change in the security regions. And I speak particularly of Iraq and of that region right now.

I remember when the Israelis bombed the Iraqi nuclear reactor at Osiraq. The response to that by our government was mumbled, and very little was said about it. It turned out our government was supporting Iraq in Iraq's war with Iran. We'd gotten into that. The threat, nonetheless, as considered by the Israelis, was a nuclear reactor in the hands of an errant power. Bombing was considered by many people from the peace camp as an atrocious thing to do, a preemptive strike that could not be justified. Later France was also involved and spent much effort enticing buyers for dual use nuclear technology, etc. When people who have not committed themselves to the international system's peaceful ways, when they acquire with an intent to use weapons of that sort, what is the proper response? In the United States we're having a debate about that. And perhaps in other parts of the world too. Some people feel as you do, that something objectionable and wrong is happening, but others wonder whether the new threat justifies it.

In my remarks I observe that this Iraqi situation, under certain conditions and under certain scenarios has a nuclear aspect to it. I meant, somebody could use a nuclear weapon, or perhaps more likely in some cases a biological weapon. We're not talking about theoretical things. Our President, who is not my favorite president, is responding to what the intelligence information brings him to his breakfast table, which is some very bad news.

Robert Nurick: Very quickly, first as the other American here I think I should just add a few words on the preemption question.

I can't tell you whether you should be worried about it. I can tell you that I am. And I am for two reasons. One is that I'm not entirely sure of what the Bush administration means by it. And the other is that I think on the other hand, that it does raise a real dilemma in policy. And not just for the US but for the Western community in general.

With respect to the first, I think the debate is inevitably effected by the context in which this issue has occurred. Namely a time when we are talking about whether or not to go after Iraq, and unseat the Iraqi regime. This has led inevitably to questions, certainly which I have; preemption under what circumstances? Is preemption a justification for regime change? Or is preemption simply a recognition of what I think is clearly the case, that we have a different kind of threat now, and that there may be circumstances where we don't think we can wait to see whether a nuclear weapon goes off on our territory.

Now, there is a lot in between those two contingencies. And one of the things that I think needs to be done is to clarify not whether preemption in some abstract sense is good or bad, but how it is or is not legitimate to respond to the different kinds of challenges we now face. One extreme being political, the other being very direct and military.

Now this gets me to the second point, this is a real dilemma, because I think the notion of preemption is certainly one that, I'll put it politely, rests uneasily with existing international law. But it also reflects a real problem that we have. And clarifying that, and clarifying its relationship to international law and international institutions is going to be an important thing to do. It's going to be an important part of evolving a strategy to deal with terrorism and weapons of mass destruction.

My final point is simply to say this is precisely the kind of thing, and I think this was Karl's point earlier, that would be discussed among allies and friends, rather than adopted and published as a matter of settled policy by the US. Preemption is an important issue. I'm glad it's being raised. I'm very sorry it's being raised in quite this way.

Arkady Moshes: Preemption is a big question. I think we are coming close to the answer. The answer is not the one which I like, and this is the source of my schizophrenia.

The question is, whether the new coalition, NATO-Russia coalition, or other coalitions in the world, will be value driven, as suggested or assumed, or interest driven. I think that if they are value driven then there are enormous reasons for skepticism. But if they are interest driven, meaning that when you have a threat down there in the bush, then you can take aboard anybody you want to take. If you can close your eyes on the domestic political situation for the sake of intelligence information, then that's a separate story. And this is an enormous reason of my personal concern. But still the fundamental questions remain, and we have to think more about it.

Atis Lejins: Professor Kaiser will conclude the debate.

Karl Kaiser: I want to conclude with a remark on Mr. Kagan's views that have been quoted here and are rightly being described as a very fashionable set of thoughts in Washington.

I think while it contains a big kernel of truth, the analysis is terribly misleading, both as an interpretation of the past, and even more so as prescription for the future.

It is misleading on the past for the following reason. The United States he describes as the country living in the Hobbesen world, fighting the dragons, is the very country that built up the international legal order after the war, which is based on the United Nations charter, on multilateralism. And it was the US that supported the Europeans all the time in the process of reconciliation and integration. Which he describes as a sort of illusion that the Europeans live in.

It is also misleading in describing the Europeans as living in the illusory world of neo-Kantian thinking. Because why did Germany build up an army of 500,000 soldiers, the largest in Western Europe? Why did all the other West Europeans build up enormous armed forces to fight, you know what kind of war, to deter what was a threat at that time?

What matters, and now I come to the second point as regards the prescription. It's always a mix. You need actually both. You need multilateralism. International law. You need the UN. But you also need the instruments of military force as a means of last resort. We do not disagree on this. It is not true that we have a totally different strategic culture. We both know the emphasis is different. And in any case, if anybody believes that the United States is defined only by Mr. Bush's administration, all I have to listen to, for example, is to the American speakers here, or look at the American debate. America, thank God, is a functioning democracy in which there are lots of different points of views on this subject. And that I think, gives us hope that in the end that as we develop new rules - and we have to adapt the rules, I think that is true - that in the end, we will continue to have the kind of strategic mix that we had in the past, of law, international law, and the means of force, although we may occasionally differ on how to deal with specific crises.

The Economic Dimension of Baltic Security – The Baltic Sea Region in an Enlarged European Union

Prof. MIKA WIDGREN, Turku School of Economics and The Research Institute of the Finnish Economy, ETLA, Helsinki

Atis Lejins: We will now look at the economy which is just as important as security covered in the first session. We remember what President Clinton said about the economy - "it's the economy, stupid!" Perhaps he's more right that we then thought.

Mika Widgren: Thank you. The title of this speech is The Baltic Sea Region in an Enlarged European Union. I have two topics that I'd like to talk about. The first topic is the enlargement itself and its impact on the Baltic Sea region. And then, as the Russian economy is part of the Baltic Sea region, I will give some ideas about how it affects Russia, and then analyze one alternative solution how the European Union, or an enlarged EU, should deal with Russia in its trade relations.

Let me start from, in a sense, stylized facts. The following table* gives trade potentials within what I call the Northern Dimension Area of the European Union. The trade potentials are calculated by economists, by referring to physics and borrowing the gravity equation in order to build a gravity model for international trade.

This simple gravity equation explains world trade very well. The numbers are calculated by using the gravity model, and they are long-term trade potentials as shares of these countries' European trade. We have three columns in the table; the first one is what I call narrow Northern Dimension. A narrow Northern Dimension is simply Sweden, Finland and the Baltic countries. The wide Northern Dimension is the whole Baltic Sea region, including Russia. And then Russia has its own column as well.

We can see that if we start from the very north, and come down to the south of the Baltic Sea region, the numbers go down. The Baltic Sea region is relatively more important for countries like Sweden, Finland, and the Baltic countries than it is for Poland or Germany.

* See tables at end of presentation.

To some extent we can argue that in fact, the Baltic Sea region, although it is a natural trading area, is to a certain degree divided into two parts. Figures on foreign direct investments or trade show this. The division line lies somewhere between Latvia and Lithuania.

Then, another observation from this table is that the potential share of Russian trade is less important for countries like Germany, even for Sweden, but is potentially very important for Finland and the Baltic countries. That, of course, affects the potential economic impact of Eastern enlargement in the area.

If we then see the Baltic Sea region, as a part of the enlarged EU, and try to assess what kind of economic forces we have in an enlarged EU, it is then only natural to evaluate the enlarged EU using the terms of economic geography; the effects can be measured directly from the economic geography literature.

The Baltic Sea region, although it's a natural trading area, nevertheless is still a breviary. When integration becomes deeper in the EU there will be a tendency for economic activity to shift to the core, i.e., Central Europe. In fact if we evaluate the impact of the Eastern enlargement, actually it strengthens the core of Europe, at least relatively speaking. Therefore it is likely that economic activity after the Eastern enlargement will move to the core even more than before.

Then, within the Baltic Sea region, and also in Central Europe, we can see what is called input-output linkages. This is due to the fact that some industrial activities are actually divided into several places within an area. These input-output linkages create trade, intermediate goods are exported and final products are imported. These input-output linkages also effect the location of economic activities.

The best example of input-output linkages in the north is the one between Estonia and Finland, also between Sweden and Estonia. Linkages, in fact, counter the tendency for economic activity to move towards the core.

A third element is comparative advantage. It is fairly easy to argue the comparative advantage of the Baltic Sea region, it differs from the comparative advantage of the core. It works as a counter force to the agglomeration of economic activities gravitating to the core.

Therefore although the Baltic Sea region is a periphery in an enlarged EU, the likely future is not like the one in North Dakota, but rather the Eastern enlargement will make the Baltic Sea region more lively also in the economic sense, as well as in trade.

But there is a caveat, and that's the relation to Russia. When we have a big trading block like the EU which has trade agreements with the rest of the world, we must remember that these agreements are at a lower level than the European Union agreements. In addition these agreements tend to be a hub-and-spoke type of bilateral agreement. But both work in favor of the trading block, the EU.

Accordingly, when the EU has enlarged, then whatever the agreements with the others are, it's likely that they will be hub-and-spoke type of bilateral agreements. The following table shows a big EU in the middle, then we have the spokes, and these spokes are the countries in Europe, but not in the EU.

What is the economic effect of this kind of trade policy architecture? It is that European integration, after the enlargement, and also before the enlargement, may marginalize countries that are outside the EU.

A good example is in fact the Eastern enlargement itself. The Europe agreements are hub-and-spoke type bilateral agreements. Compared to the trading potential, the EU applicant countries do not trade as much with each other as they do with the EU.

This is marginalization and it means that economic activities tend to go from the hub to the spokes, but not between the spokes. In fact it makes the spokes competitors to each other. In Baltic Sea region the most important country in this respect is Russia. As was said before this kind of architecture diverts both trade and also FDI.

What will happen then after enlargement? What are the likely effects on the Russian economy? First of all, EU integration tends to divert trade. It means that when the EU has enlarged, a part of Russia's exports will be diverted away from the new entrants to the EU. That's the trade diversion effect. It hits Russia, but also it is sub-optimal for the EU itself. This is a negative effect of enlargement.

The most important effect, also negative, is what is called the terms of trade effect. It means that Russian exporters must compete harder in the internal market. Which implies that their export prices will go down and if their import prices remain stable it means that their terms of trade deteriorate, which means that they most produce more and sell cheaper. That is why it produces a negative effect for an outsider country.

One more important effect will take place within the EU itself, called the intra-EU pro-competitive effect. That's basically the expansion of the internal markets. It arises from the reduction or decline in trade barriers within the EU, I mean non-tariff barriers. Another effect will be the EMU effect, which makes prices more transparent within the EMU area, which will intensify competition.

From the Russian point of view, it's a bit unclear whether this effect is negative or positive. One can argue that when the internal market works well, then it might have a positive spillover effect on the Russian economy as well. But because the intra-EU firms are becoming more competitive, it may harm Russian exporters.

Then, the fourth one is again an effect within the EU, the intra-EU productivity effect, which is that the enlargement will boost foreign direct investments within the EU. This happened when Spain and Portugal entered the EU.

This is mainly a gain for the new entrant countries. And it's quite likely that it has a negative impact on Russia, since it works like any investment diversion effect. It's a bit similar to trade diversion effects, but now we are talking about investments.

If European integration and enlargement have a positive impact on economic growth, then it means that the demand of the EU will increase, of course, a part of that demand will be for Russian imports, which will have a positive impact on the Russian economy as well. Some studies carried out about four or five years ago showed that this demand effect seemed to dominate. The main result was that the enlargement of the EU will work in favor for Russia. But then investment diversion effects is related to the productivity effect and has a negative effect for the Russian economy.

Thus we have many minuses and a very small number of pluses, which means that on the basis of this list we might expect that the enlargement will have a negative impact on the Russian economy.

But I will show you some results. In this table we have very recent simulation results from the so-called GTAP model, which is a computable general equilibrium model often used to analyze different phases in integration and different changes in agreements.

In this table there are seven different scenarios. Let me just mention that the EU one is the baseline scenario for enlargement. So it only covers trade diversion effects, trade creation within the EU and terms of trade effects.

The second one tries to capture the pro-competitive effects as well. We can call this EU two. It is a scenario where the internal market works very well.

And the third one has productivity effects plus the baseline. It tries to capture the idea of investment diversion, and more FDIs within the EU.

Then FSU zero is politically not feasible scenario. It assumes that Russia will unilaterally liberalize its trade with the EU. But it is there because we wanted to have sort of a benchmark to compare the other scenarios where the Russian economy and European Union integrate more.

The FSU one is, in fact, the baseline scenario for the EU - CIS free trade area. It is not a hub-and-spoke type agreement, but rather a European wide free trade area.

FSU two is the same, but now with these pro-competitive effects on board.

And the third one again is the free trade area scenario with a productivity effect on board.

One way to evaluate the effects is to take output volumes. In EU scenarios, it turns out that the effects both for the new entrants from the Central Eastern European countries and the incumbent EU countries are positive. In relative terms the effects are much bigger for the new entrants, than they are for the incumbent EU countries. This confirms the basic results from nearly all earlier studies concerning the EU enlargement. There are substantial gains for the new entrants and small gains for the incumbent EU countries.

Then when we have a look at the FSU role, which gives the effect for the CIS countries, we can see that in the first scenario it is negative, but the number is very small. In the second scenario it is positive, and then again negative. So the effects of the Eastern enlargement on CIS countries is unclear. On the basis of these numbers we cannot conclude that it is beneficial, but we also cannot conclude that it will mean a loss for the CIS countries.

If we try to interpret these scenarios a bit more carefully then it seems that when the internal market works well, we will have the 2nd EU scenario, which is beneficial for Russia and the CIS countries as well.

Turning to the free trade area idea, we see that in column FSU one, the impact for the incumbent EU countries is positive for Germany and Finland. It is negative for EU North, which covers Denmark, Sweden and Austria. And then it's negative also for the EU South, as well as the Central and Eastern European countries.

In the second version, or in the second alternative, we add the pro-competitive effect into the free trade area, which is, admittedly a somewhat unrealistic assumption. Basically that assumes that the free trade area works as well as the internal market, which is unrealistic. But also in this scenario we have negative impact for the CIS

countries. We highly a negative impact for the Central and Eastern European countries. This time it's only Finland who benefits from this arrangement.

Then the change takes place in the third one, where the most significant change is that now CIS countries gain. That's quite natural because FDIs boost productivity. It means that in the third scenario, the CIS countries first gain FDIs, then they gain productivity, and then they gain from the free trade area. It also means that when we compare the three scenarios it seems that for the CIS countries free trade with the EU is only beneficial if they are able to improve productivity.

It is hard to sell this arrangement to the EU countries, using these figures because it is Finland and Germany who gain. I guess that if we split EU North to three countries, Sweden, Denmark and Austria, I expect that Sweden is likely to be on the positive side. But for the others this sort of arrangement is a loss in economic terms.

And one more thing about these welfare effects which goes beyond the Baltic Sea region is that when we agitate these effects and take the enlarged EU as the red bar, the blue bar as the free trade area, and the yellow bar as the rest of the world, we can see that there is only one arrangement, only one scenario which is beneficial for the world economy. And that's the scenario where we have the internal market that works very well. Otherwise, either we have cases where the yellow bar is above the zero line and the rest of the bars below, or vise versa. We can also see that the free trade area, given productivity growth in CIS countries, it's beneficial for CIS countries but it is not beneficial for the enlarged EU. And the baseline free trade area, which is the fifth one here, is quite funny. We have all three bars below the zero line, meaning world economic welfare is going down.

A quick explanation for this is that maybe CIS countries are not so natural trading partners at least for all European countries, or EU states, Portugal, for example. And that explains why it seems that the free trade area seems to divert trade and that's the main source of these negative effects.

To conclude, I will say that Eastern enlargement, although it strengthens the core of the EU, also strengthens the Baltic Sea region. And that is due to the differences in comparative advantage as well as input-output linkages that we can already see in this region.

From the Baltic Sea region countries point of view, the trade relation between the EU and Russia, or CIS countries, is crucial. And that's basically due to the fact that free trade could be a mechanism for Russia catching up.

There is some fear that enlargement of the European Union will marginalize the Russian economy and CIS economies in general. But the simulation results show that in fact Eastern enlargement does not necessarily yield economic losses for Russia. Nevertheless it depends on how well the internal market works. There is a sort of dilemma, because we can make the same conclusion for EU-Russian or EU-CIS integration. A free trade area between these two is not necessarily beneficial for anyone except Finland.

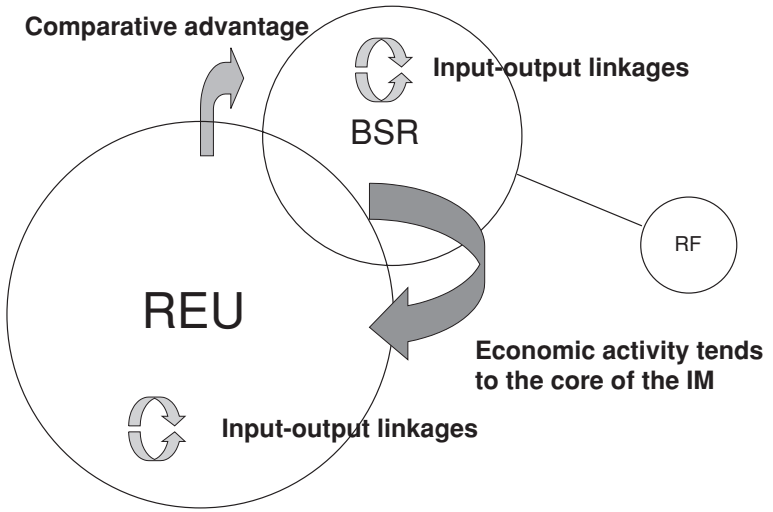
Finally there is one question which I haven't seen any signs of when people talk about the European economic space, but certainly, if there will be some negotiations on free trade or economic space or whatever, there will be tensions between the Northern and Southern dimensions. Because we saw that EU South will loose from this agreement.

Trade potential in Baltic Sea region, % of selected countries' European trade

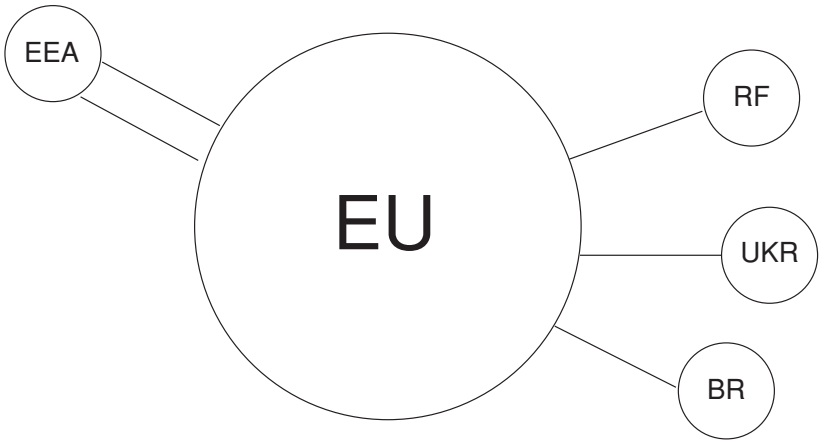
Country	Narrow ND	Wide ND	Russia
Finland	17.0	54.7	20.6
Sweden	10.1	46.7	12.3
Germany	3.3	15.0	4.7
Estonia	17.0	60.4	30.0
Latvia	12.5	53.2	25.6
Lithuania	7.8	48.7	19.8
Poland	9.4	33.6	14.3

Baltic Sea Region is a Natural but Peripheral Trading Area

Baltic Sea Region and the Rest of the EU



Eastern enlargement and outsiders



Economic welfare effects of European integration

Economic welfare

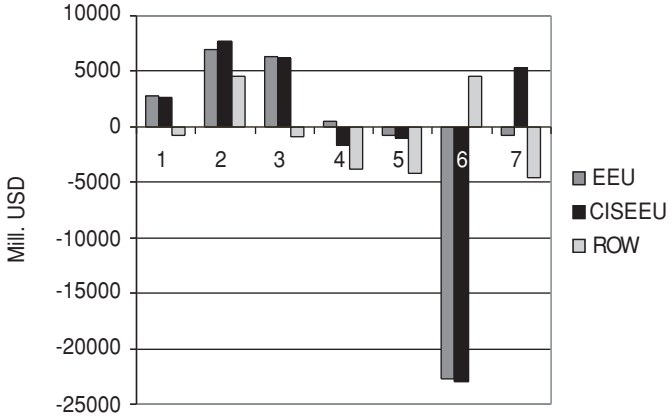
	EU1	EU2	EU3	FSU0	FSU1	FSU2	FSU3
AFTA	-346	405	-429	-853	-955	590	-1052
China	85	101	83	-157	-288	-127	-303
Japan	-264	28	-336	-380	-515	-28	-613
Germany	570	1366	619	1077	943	-2359	945
FSU	**-157**	**758**	**-131**	**-2142**	**-268**	**-196**	**6146**
Finland	41	93	42	246	218	364	226
EU-North	194	1099	208	29	-56	-385	-56
EU-South	257	3699	265	-908	-1652	-3336	-1679
Mediterrean	7	221	10	-301	-298	239	-305
CEEC7	1769	698	5171	-3	-252	-17027	-221
India	-11	7	-16	-47	-82	58	-85
ROW	-69	3042	-78	-2108	-2061	3833	-2177

Output effects of European integration

gdp volume

	EU1	EU2	EU3	FSU0	FSU1	FSU2	FSU3
NAFTA	0.000	0.000	0.000	0.000	0.000	-0.001	-0.001
China	0.003	-0.008	0.003	-0.001	-0.005	-0.022	-0.004
Japan	-0.001	0.000	-0.001	-0.001	-0.001	-0.002	-0.001
Germany	**0.008**	**0.052**	**0.008**	**-0.022**	**-0.016**	**-0.126**	**-0.016**
FSU	-0.007	0.021	-0.006	0.017	0.038	0.377	1.093
Finland	**0.008**	**0.023**	**0.008**	**0.036**	**0.034**	**0.031**	**0.034**
EU-North	**0.004**	**0.061**	**0.004**	**-0.068**	**-0.067**	**-0.325**	**-0.068**
EU-South	**0.006**	**0.051**	**0.006**	**-0.029**	**-0.030**	**-0.075**	**-0.031**
Mediterrean	0.000	0.008	0.000	-0.017	-0.015	-0.001	-0.014
CEEC7	**0.539**	**2.304**	**1.645**	**-0.863**	**-0.846**	**-4.066**	**-0.846**
India	0.001	-0.005	0.001	0.004	0.001	-0.008	0.001
ROW	-0.001	0.011	-0.001	-0.009	-0.009	0.008	-0.009

European integration and economic welfare



Russia and enlarged EU

- European integration may marginalize outside countries that are close to the EU, like Russia
- The effects are likely to be most substantial within the Baltic Sea Region
- Marginalization directs trade and location

Effects of eastern enlargement on Russia

- Trade diversion effect (-)
- Terms of trade effect (-)
- Intra EU pro-competitive effect (+/-)
- Intra-EU productivity effect (-)
- Demand effect (+)
- Investment diversion effect (-)

Conclusions

- Eastern enlargement strengthens the Baltic Sea region, input-output linkages are crucial in the Baltic states' and Russia's catching-up
- For Baltic Sea region trade relations between the EU and Russia are crucial (marginalization)
- Eastern enlargement does not necessarily yield negative welfare effect on Russia
- Dilemma: EU-RF integration is not necessarily welfare enhancing in general and in any case the welfare effects are very unequal
- Norhern vs. Southern Dimension

COMMENT

MARTEN ROSS, Deputy Governor, Central Bank of Estonia, Tallinn

Thank you Mr. Chairman. It's may sound strange, but I would like to start by turning around your initial introduction. Namely that at least from the central bank's point of view and from those that have taken care of macro-policies during last five years, you would say that it's all about politics, not "the economy" as Clinton claimed!

Why? It's exactly the link between security and the economy that obliges me to make this statement. Humanly I would like to say of course that it is due to our extreme competence in macro-management that has brought about the general credibility of the currency board and the overall successful macroeconomic policies. However, it's not only the humbleness of an Estonian person that saves me from saying that, but rather the plain fact that politics has actually supported and moved forward much of the development in the region during the last five years.

There are two channels that make this effect so important.

Of course one aspect is very simple and clear to everybody, that if there is any potential for armed conflict in the region then it would be difficult to find any sensible investor to look at the region.

Clearly, if developments have decreased the historic potential for armed conflict this is directly affecting the integration by decreasing the risk level in the region and thereby supporting investment and making life otherwise more sunny.

But I think that the direct effect of integration on security is less and less important. It's not that helpful for future analysis anymore. What I have in mind is, that from time to time you hear the arguments: do you really believe that this or that country will attack you? Do you really need therefore NATO or the EU for the economy? Well, probably not. But this is not the point. And it seems that investors particularly also don't regard this direct effect of security to the economy that importantly. It's a clearly indirect effect of the security that investors are interested in. Even if you could say that al-Qaeda members actually were not the most depressed persons of Arab society, still usually the wars are started by hungry people, not well-to-do people. In that respect, of course, you can again say that "it's the economy".

So when you start asking what has supported the economy of the Baltic countries the most during these past five years then of course one aspect has been that we have been able to cut the cost of macro-stabilisation to the society. Why? There are clearly two reasons. One is peace, namely that foreign investors have become confident in the region. The single most important factor behind their confidence is EU integration. Simple arithmetic - you might do this or that bad thing, but ultimately things will be brought into line with good economics because of integration.

Enlargement today is, in economic terms, not so much anymore the issue than what it will bring us after it has taken place. But it is already in the phase where you have to look both forward and backward to understand its importance to our economy. In the sense that if integration will fail in some stage, it will, of course, deteriorate also the economic environment in those elements that have already materialised.

To illustrate this from the monetary policy point of view you could fairly easily point to two phases when interest rates margins decreased considerably. In both cases it has been much more correlated to political developments on the EU front, rather than the economic front. And this is even when, for instance, you would say that Russia still influences real economic cycles. Or at least has influenced real economic cycles considerably in the 1990s. But it hasn't influenced that much FDIs. And investment cycles have clearly been influenced more by political decisions in the EU particularly, less so, perhaps by NATO.

If one asks what is the key question today in economics; then the answer is whether integration continues smoothly. That is because this is still the single most important factor behind macro-stability (or macro-credibility at least). Here, of course, all sorts of public questionnaires or consensus analysis show that it might mean even one third of a difference in growth potential, including social expenditures, etc., if integration would be derailed.

I wouldn't say that there would be a big problem if there is a delay for one or two years for whatever reason. But if, for instance, a big setback comes in the form of a "no" in the referendum, it would definitely immediately effect investor confidence and make macro-stability, in a way, much more costly to the economy, thereby hampering the growth potential.

ALF VANAGS, Director, Baltic International Centre for Economic Policy Studies (BICEPS), Riga

I want to begin my remarks by saying that I remain somewhat surprised at why in policy speeches, policy making, and in conference making we get the juxtaposition of the two enlargements, the NATO enlargement and the EU enlargement. If you look at what is involved, actually there is remarkably little connection between the two. Admittedly on one side, the applicants, or supplicants, are former communist countries. But on the other side, in the EU, you have a number of countries that are not in NATO, and in NATO you have countries that are not in the EU, and for sure one country that will never be in the EU.

Also we had a comment this morning, from Robert Nurick, saying that the EU and the NATO officials should get together. Maybe they should. The fact that he thinks that they should suggests that there is some sort of gap there. But I would also like to point out that, both technically and legally, EU officials do not at the moment have the formal competence to talk to NATO. They do not have a constituency to do so. That is a measure how different these two enlargements are.

If there is a link between the two enlargements, what is it? And what is it especially for those of us who live and work in this Baltic region? I believe that both of these enlargements force us, right here in Latvia, Estonia, Lithuania, willy-nilly, to focus on our relations with Russia. And I believe that is a very good thing. Russia is the geographic hinterland of where we are.

But what will these enlargements do for relations with Russia? A few years ago one would have imagined that the NATO enlargement might have a negative effect. Now with Russia co-opted on to NATO councils, it looks like it will be a positive effect, or at least a neutral effect, or no particular effect.

On the other hand Arkady tells us that, actually, in Moscow, it is not like that at all. In Moscow there are still negative feelings about it. There is the possibility that this imminent enlargement will have a domino effect with Sweden and Finland joining next, though I personally think this is rather unlikely. Then it could be alarming for Russia, despite the current cozy relationship between Putin and Bush.

Now, on the economic side, the EU is essentially about economics, or much more about economics than about security. There is no explicit security element in the EU at all. In economic terms I think the effect is, especially on commercial relations, going to be almost entirely positive. Arkady has described this as euphoria. But it is not at all euphoria. It is a purely and simply a technical matter. If and when, and I

hope it's when the Baltic States join the EU, then there will be just one economic border. All economic and commercial matters, between here and the other side of that border, will be ones between the EU and Russia. There can be no discriminatory tariffs on either side. The tariffs that apply to Russian goods coming into Latvia will be the same as the tariffs that apply to Russian goods going into Portugal or Cyprus. And similarly the other way around.

Russia will not be able to impose economic sanctions even if it wished against the Baltic States because they believe that Latvia is mistreating their Russian minority. Not possible, because Russia would have to apply it to the whole of the EU. That is not to say Brussels will sort out the minorities issues. Not at all, they have to be sorted out here. And I very much hope they will be.

In short the politics will be taken out of bilateral commercial relations completely.

What other things I think are important? I have done some calculations, also using a computable general equilibrium model, not as grand as the one that Mika has, but just Latvia and a few other countries. Mika … I was curious, does your CEE7, include this part of the world? In fact does this part of the world, the Baltic States, appear anywhere in your model?

Mika Widgren: No.

Alf Vanags: I thought so. We have done it for Latvia. And we get results that are generally positive although there is some trade diversion with Russia, but that has a welfare effect of about minus 0.13% of Latvian GDP.

The most interesting thing about the computable general equilibrium model that I did was first of all if you look at the effects of changing the trade regime, we in Latvia have had most of the benefits already. In other words, the biggest impact has come from the Europe agreements, the association agreements with the EU. What remains to come will have a much smaller impact.

But there is another thing, which I think is going to be very important. And that is the single market, where we will participate fully eventually after some kind of transition period. All the borders in this region will disappear, except the single one with the East. Just in terms of traveling that will be fantastic. Much more important will be the implications for the movement of capital and labor. I do not know if any of the Latvians here have ever tried to get a work and residence permit in Estonia. It is not easy. It takes a long time, and you are part of a quota, which includes countries like Morocco, Ecuador and so on. That is where Latvia is located relative

to the world as a whole. In a single market we shall be able to go and work freely in Estonia as well as in Germany. It is probably easier for a Latvian to work in Germany or the UK right now then it is to work in Estonia. I do not know for sure whether it is the same for Estonians wishing to work in Latvia – but I suspect it is pretty much reciprocal.

All of that will go. And that will have real effects on the economy and the general wellbeing of the people. I know people have said that within EU there is not that much labor mobility as compared with the United States. I think there will be a lot more than people currently predict.

One other remark, which is a comment on Mika's paper, I find it strange that in his scenario seven, everybody except Finland loses out. This is because Russia is just too small to have such an impact. Currently, in terms of its GPD, Russia is about the same size as the Netherlands. Even with productivity growth it will remain a small economy in absolute GDP terms, so I suggest that Mika check his elasticities.

Russia and the EU: a Common European Economic Space? Three Viewpoints

Dr. KSENIA YUDAEVA, Academic Director, Center for Economic and Financial Research, Moscow

What is CEES? The idea of creating such a structure appeared in May 2001, although it is still not clear what is meant by CEES. Previously, EU had the following types of agreements with non-EU countries: Free Trade Agreement (FTA), Partnership and Cooperation Agreement (PCA, EU and Russia already have such an agreement, although it does not work properly), and European Economic Area agreement (EEA). It is not quite clear, whether these structures are politically feasible and economically meaningful in the Russian case, and whether a new structure should be designed in the case of EU and Russia relationship.

What are the Russian interests in the CEES? On the economic side, Russia is clearly interested in improvements of conditions for its non-fuel exports. Currently, metal producers express the most interest in integration with other countries. In the future, Russia may develop comparative advantages in other sectors, which are now strongly protected in the EU, such as agriculture and textiles. Russia, at least its federal government, is interested in attracting FDIs from European countries. The issue of attracting FDIs is more controversial, though, because Russian firms are reluctant to give up some of their property rights to foreign investors, and are rather seeking subsidies than investment. Recently, Russian business developed a new interest in integrating with Europe: large Russian companies are interested in making FDIs into European companies, including companies in the Baltic region. Russia can also be interested in strengthening its economic integration with the EU because of the forthcoming EU enlargement, which might create some problems for transportation of Russian exports, diverting some foreign trade from Russia to the accession countries, and make Russia less attractive for FDIs, because more FDIs will go to Europe. On the political side, Russia has also often expressed an interest in increasing cooperation with the EU for a number of reasons. Clearly, Russians are interested in weakening visa regimes with the European countries. We also often hear that Russians "feel European", which makes cooperation with the EU natural. Security reasons can also be a part of increased interests in integration with the EU. Although in Russia we often here that it would like to increase the level of cooperation with Europe, no Russian concept of what CEES is supposed to be seems to exist. Moreover, the issue of establishing the CEES has not been actively discussed in the press or mass-media so far.

Among other arguments, which are often discussed in relation to Russia-EU relationships is the so-called "anchor for economic reforms" argument. It is often believed, that it was the desire to become a member of the EU, which worked as an expectation coordination mechanism in CEE countries, and which help them to create strong institutions, and, therefore, to successfully reform their economies and to reach stable and high growth rates. Russia in the 1990s did not have such an expectation coordination mechanism, which may have been one of the reasons for its failure to create growth-promoting institutions. If CEES can help to create such a mechanism, it would help to increase the speed of economic growth in Russia. Another Russian problem is poor internal accountability of the President, which originated because of the unbalanced division of powers between the President and the Parliament, envisaged by the current Russian constitution . Getting external accountability may help Russia to make its reform plans more credible, and CEES may become one of the sources of external accountability.

In what case would the CEES be most suitable as an external anchor for Russia? How does CEES compare with WTO, accession to which Russia now seeks, as an external anchor? WTO concentrates mainly on liberalization, not on strengthening of institutions, so it is not a very good reform anchor. If CEES will take mainly the form of the FTA, it will be politically the least difficult to accept, but it will not be able to fully perform its role of an external anchor. However it will boost growth in Russia, and therefore will increase demand for reforms in the medium and long run. If CEES will include elements of EEA than it will be a very broad anchor, although politically it will be the most difficult to agree upon, because it will create the impression of loss of sovereignty by Russia. Other problems with EEA type of agreement is that it can become an "enemy of a good", i.e. discussions of legal changes can delay introduction of trade liberalization measures. Another problem is institutional changes inside the EU itself: shall Russia follow them? Countries, which had EEA agreements with the EU before, complained that they had to adjust to changes in regulations, while they could not influence the process of designing of such changes.

There are other reasons why CEES may in the end not work as a good external anchor for Russia. Russia and EU have different historical backgrounds, and the Russian population have very little familiarity with EU institutions. Hence, EU institutions should be carefully addapted to Russian conditions before implementation. Mukand and Rodrik* claim that failure of Russian growth in comparison with the CEE countries and Asian countries was due to too much copying of European institutions, and too little experimentation with creating Russian specific institutions. If this theory is correct, than too much insistence on legal convergence in the framework of the CEES can be detrimental for growth.

What are the interests of the EU in having a CEES with Russia? Clearly, it is in the EU interests to see Russian economically and politically stable, but why should the EU be interested in economic integration with Russia? It appears to me that with the exception of energy the EU is not yet ready to liberalize its trade regime toward Russian goods. In a sense, the current EU policy is aimed at increasing the Russian Dutch disease problem, not decreasing it: reluctance to liberalize the trade regime toward Russian goods, and claims to equalise Russian internal and external prices works in this direction. This makes quite possible a scenario where the CEES would slow down Russia-EU trade liberalization efforts.

What about economic effects of the CEES? Currently Russia-EU trade is characterized by asymmetry: Russia is a small partner for the EU (about 4% of EU trade), while the EU is a large partner for Russia (33% of exports, 20% of imports, and 50% of exports after the enlargement). Additionally, Russia mainly exports to the EU energy and raw materials, while the EU exports to Russia manufactured goods. What effect can the creation of CEES have on Russia and the EU in this case? Most models which I have seen predict small positive effects both for Russia and the EU. Liberalization of services sector and deepening of the reforms, which will result in increased productivity of Russian firms, are expected to produce much higher gains, than simple trade liberalization. One of the demands of the EU is to equalize Russian internal and external energy prices. What are the predicted effects of this measure? The evaluations differ depending on nationality of the researchers. Foreign economists claim positive effects for Russian economy, while Russians predict increase in inflation and social problems.

There are a number of problems with quantitative analysis of the effects of CEES. Russian economy is not in equilibrium, and completion of reforms may significantly change the comparative advantage of the economy. For example, strengthening of intellectual property rights protection, and development of the financial sector will make some manufacturing sectors, and sectors producing computer programming much more competitive than they are today. Another problem with the models is that they usually do not take the regional structure of the Russian economy into account.

To summarise, there is yet no consensus both inside Russia and inside the EU which type of agreement the CEES should be. The effects of the agreement will largely depend on the design of it: the more reform it will include, the deeper results it will have. However, the issue of loosing sovereignty on the side of Russia, and reluctance of the EU to improve conditions for Russian exports can result in a less efficient agreement.

What effect CEES can have on the Baltic countries? Currently trade of the Baltic countries is oriented mainly to the EU. Russian exports to these countries is dominated by energy products. At the same time, the degree of similarity of trade structure between Russia and the Baltic countries and Russia and EU countries is quite high, about 20-30%. Baltic countries can win if CEES will result in decrease of tariffs for their products. At the same time the Baltic countries can become host countries for FDIs aimed at exporting to Russia. Fast reform in Russia, though, will make increase of such FDIs less likely. Another small problem for Baltic countries can appear if Russia redirects its transit flows to other countries, such as Finland.

* Mukand, Sharun and Rodrik, Dani. In Search of the Holy Grail: Policy Convergence, Experimentation, and Economic Performance. Mimeo, Harvard University, 2002.

Dr. FRANCOISE LE BAIL, Director, DG Trade A, European Commission, Brussels

A first remark before turning to the theme of the discussion : it is significant that we devote an entire afternoon to the economic relations between Russia and the EU. Not that long ago, political relations and security would have been the dominant if not the only theme of such a seminar on bilateral EU/Russia relations. This in itself says a lot about the change in the EU/Russia relations.
Let's now turn to the Common European Economic Space which is being discussed between Russia and the EU. The previous speaker has made my task easy by underlining that it seems unclear so far what the CEES would be and by going through the various existing formulas which could be used for the construction of such an economic space. It is important to clarify what both parties are aiming at in elaborating this new concept.

First, it is true that we have yet to define the end goal of the CEES. We are at an early stage. What type of association with the Union is possible? Various options are on display.
Accession first i.e complete integration in the EU. What we can say is that this option is not on the agenda of the Russian authorities for both political and economic reasons. It is not either on the agenda of the Union which is the process of finalizing a very challenging enlargement to 10 additional countries in 2004.

Then a European Economic Area of the type we have implemented with EFTA countries : this means an extremely close economic integration. In terms of content, it means the four freedoms, free circulation of goods, services, capital and people. In terms of process, it means, that when the EU changes its economic rules, countries like Norway or Switzerland although they do not have a formal say in the shaping of these new rules, have to adopt them automatically in their own legislation. It is the sort of relations which are possible between countries with a similar level of economic development and which are ready to share part of their economic sovereignty. It is not the EU intention, nor the Russian government intention, to go as far as that in the present discussions we are having about the CEES.

This is why the question of accountability in the relationship which was mentioned by the previous speaker as a possible difficulty for Russia and which is understandable in the type of relationship I just described, should not arise in the framework of the CEES. In the framework of the CEES everything will be negotiated between equal partners, and if we disagree it will simply not happen.

So there is no question of accountability, or no question of one partner submitting his rule or his law to the other partner. To simplify, the idea is not to give Russia the big book of European rules and regulations and say, this is magnificent, go ahead, apply that in your country and everything will be all right. For many reasons both - political and economic - this will not be feasible.

This was the easy part: describing what the CEES is not. The difficult part is to describe what it is. I agree with Mrs. Yudaeva, it remains at this stage difficult to define it in complete details since discussions on the concept are still going on. But progressively, we have a more precise idea of what it will be. And it is by the way, something which is not mentioned in Mrs. Yudaeva's list.
The overall objective is to bring EU and Russian economies closer together in a privileged relationship focussing on approximation of regulation and legislation as well as trade and investment facilitation. We are saying to the Russians : you are in the process of reforming in depth your economy, while you are adopting this reforms, what about looking at the EU rules and regulations? And each time it is useful for you, why not adopt the EU rules in your economic legislation or reglementation? We have already identified 12 sectors where cooperation will boost trade and investment and where the EU and Russia trade interests are strong.

It makes sense, because after enlargement fifty five percent of Russian trade will be directed to Europe. Therefore if Russia wants to export more to Europe, of course it would be useful to have the same standards and norms. So you will have greater facility to export to all European countries the same way the COMECON countries had the same facilities since they had the same norms and standards.
One of the sectors we have identified is financial services. What about having financial services which have similar rules, and there again when we say the same rules and regulations it doesn't mean to the comma, it means approximation.

What about telecommunications? What about having interoperability between the telecom system Russia is going to build and our European telecom system? After all, we are your bigger partners. It does make sense to do this.

This to mention only two sectors among the 12 which have been discussed with Russia so far.

That is the first step toward the CEES. We have not yet finalized the discussions about the final shape of the CEES, but it is very likely that at some stage, the question of a Free Trade Agreement (FTA) will be raised.

It's not raised now since in parallel to the CEES, Russia is negotiating its accession to the World Trade Organization (WTO). And in the same way that for China's accession, it was the Americans who were doing the running for the negotiations because they were the biggest economic partner of China, for Russian accession to the WTO it is the EU that is doing the running for exactly the same reasons.

In a nutshell, when a country wants to accede to the WTO, it needs to open its market to WTO members through bilateral negotiations with each of them. The bilateral negotiations with its main economic trade partner sets the tone for the negotiations with the other WTO members.

We are now negotiating intensively with the Russians on the bilateral part of the WTO. We are progressing, maybe not as fast as the Russians would like us to progress, but progress is definitely there.

In parallel with the market access bilateral accession negotiations to the WTO, the multilateral aspects of these negotiations are taking place in order for Russia to adopt rules and regulations conforming to the WTO. In other words, there will be a sort of examination of Russian trade rules and regulations to make sure they are in conformity with the WTO.

This is presumably where I disagree with Mrs. Yudaeva when she says that WTO accession is not a very strong anchor for reform in Russia. I would argue that becoming a member of WTO is a very strong anchor since it is the best way to lock in reform internally.

In addition, Russia's accession to the WTO should have a crucial effect on investment. The key economic problem of Russia is investment. The level of foreign direct investment in Russia was according to the last figures for 2000 three billion US dollars. The foreign investment level in China for the same year was forty-four billion dollars. This is where the problem lies. It's not that much with enlargement although EU enlargement does attract FDI in Baltic countries as mentioned by a previous speaker, it is with Russia overall inability to attract foreign investors.

Russia's WTO accession will lock in reform and attract more foreign investors in Russia.
Once Russia will have acceded to the WTO, the question of a Free Trade Agreement (FTA) will arise, not before. When we are talking about a FTA it is what I said already to Mr. Widgren earlier : the type of FTAs we are now negotiating with third countries are not simple classical FTAs, consisting only in

tariff reduction. They are much deeper FTAs, which on top of having tariff reductions, have also a lot of rules and regulation attached to it. This is where the economic benefit of such agreements comes from. Simple tariff reduction doesn't create that much benefit. Tariff reduction plus rules and regulations does. But the FTA question is not on the agenda for the time being for the reasons I've explained.

So does that mean that we are not that interested in CEES as mentioned during the discussion? I will argue the contrary; first of all because it is the EU which has launched the idea of the CEES. Russia was a bit taken aback because it was not on its own agenda, and didn't know exactly what it meant. I think now we have clarified what we mean, and we are working together hard to make it progress.

This is not going to happen overnight, because when you are talking about approximation of legislation it is technical, in-depth work, it takes time and it will not happen, to reassure the representatives of the new member states in the room, before enlargement. That's absolutely clear. But it will progress before enlargement. But I cannot visualize negative impact of the CEES on the Baltic countries, and vice versa.

A last word about energy prices. Energy prices are a key issue in our negotiations with Russia, both in the WTO accession negotiations and also in bilateral discussions. I think it is important to clarify the nature of the problem.

We all know that Russia is selling its energy internally at a much lower price than it does exporting it. When discussing energy prices with Russia, let's be clear that we are only discussing energy prices for industry. There is no intention to intervene on energy prices for households. But we are saying to the Russians : you are selling your energy far too cheap to your industry and this of course gives your industry an unfair advantage. This is in contradiction with WTO rules.

Secondly our hunch is that cheap energy is in fact the Russian industry's worst enemy. It seems paradoxical because many argue that it is a comparative advantage for Russia, but because energy is so cheap, it is a disincentive to the restructuring of Russian industry. It's a difficult reform to do, we understand this, it will not happen overnight, but it is an essential part of Russia structural reform and we all know that it is not closer relations with the EU only, it's not accession to WTO only which would make Russia richer : it is, of course, Russia's own structural reforms that will make her richer.

To conclude, I will say :

- Yes, the EU has since two years much more intensified relations with Russia.
- Yes, they are of a different nature because they are more economic in essence.
- Yes, the EU is very much interested in a CEES with Russia.
- And yes, the overall picture of what the CEES is going to be is progressively appearing.
- Finally, I am confident that both EU enlargement and the CEES in the longer term will be very beneficial for Russia and for the EU.

Dr. PEKKA SUTELA, Director, BOFIT, Bank of Finland, Helsinki

Here I'm a very much a concerned private citizen who is an outsider in trade policy and other related issues, but who is concerned that the integration of Russia in Europe and the international community is the largest remaining agenda in the reorganization of our economic environment in this part of the world. EU Eastern enlargement is after all very much already in the pipeline. It is issues of the so-called Wider Europe – that is EU relations with neighboring countries that will not become members in the foreseeable future – that will dominate EU foreign policy now.

Having said that, I must say I share many of the concerns that Ksenia had. Starting from the fact that indeed asymmetries between Russia and Europe are not always sufficiently understood. It's not only and not primarily a matter of the fact that as a trade partner Russia's importance for the Union is the same as that of Norway. We are happy in this part of the Europe to remember that the big foreign policy challenges, and security challenges of the Union are not in the Northern Dimension; they are in the southeast and potentially in the Southern Dimension.

From the Russian point of view, because of trade flows, certainly the EU is the natural partner. But in political or security terms only the United States who shares many of the same security concerns that Russia has in Central Asia, and elsewhere, is the natural partner. And I don't think the Union will ever be interested in using their sixty thousand mobile fast reaction forces in Central Asia. This is something that the Russians know very well.

There are other important asymmetries as well. For example, many European enterprises are global players, which choose between Russia, Malaysia and Mexico as investment sites, while this is not really true of any of the Russian companies. For them, internationalisation is still largely a matter of extension to geographic neighbors. This list could be increased.

I think the EU, being primarily preoccupied with other matters, has made a peculiar, somewhat logical, but nevertheless quite peculiar basic decision on the development of EU-Russian relations. The idea being more or less that it should follow the same somewhat quasi-Marxist sequence as the development of the Union itself followed.

First there is a political declaration of interest. For Europe that was made in the late 1940´s, in the case of EU-Russian relations, in the beginning of 1990´s.

Actually, because things don't move very fast in any direction, there are repeated political declarations of interest, with the largest one being the Common European Economic Space.

The confusion between European Economic Area (EEA) and Common European Economic Space (CEES) is somewhat inevitable. The European Economic Area used to be called the European Economic Space before somebody found out "space" is a dark cold inhospitable place to be in. Therefore the "space" was changed into "area". But still, Area and Space sound very alike. As the concept of the Common European Economic Space was put into circulation before its contents had been defined, inevitably people looked for a comparison in EEA.

CEES has to be quite different from EEA for two reasons. Many EU countries do not wish to consider the establishment of the Four Freedoms with Russia in the near future. This particularly holds for the free mobility of labor. Also, Russia will not accept all and any existing and future acquis without a say. This feature of EEA may be just acceptable to Switzerland and Norway. It will not be acceptable to Russia.

After the political declarations, there is sectoral cooperation. Steel and things like that in the case of European integration, energy in the case of EU and Russia. One interesting detail here is, that if I correctly understood it, the EU countries aim to import from Russia at least twice as much gas as Russia will ever be able to export to the European markets. We are down to some interesting adjustment problems here. But perhaps Russian energy companies will be able to boost production to levels unimagined at the moment.

After that there is the idea of turning towards free trade, then perhaps something else, and who knows, membership in the future. This is an idea that repeats itself, just ask Berlusconi. Thus the Russian-EU relationship would follow in the footsteps of how the EU developed over time.

In principle, WTO accession might be the much needed external factor to anchor Russian reforms. But in practice, I really don't see that being the case. Russian negotiators seem to be proceeding from the assumption that there is no deadline for the negotiations. That's what they say. And that this is a technicality. They oppose the idea of seeing WTO accession as a major political issue. This is in stark contrast with the approach that China had when China was using WTO accession as a vehicle for forcing through much needed internal reforms.

The Russians don't seem to be taking this approach, and this is partially understandable, because the immediate benefits of WTO membership to many Russian producers are more than questionable.

Take the example of economic reforms in Latin America in the 1990's. It's very difficult, probably impossible, to prove economically that overall the reforms would have a welfare enhancing impact. Indeed if one looks at foreign trade liberalization in Latin America, as was done by the United Nations Economic Commission for Latin America and Caribbean in a very impressive series of detailed studies a few years ago, one sees that the larger countries in the area are divided into two groups. There are countries like Brazil and Argentina, which as a consequence of trade liberalization, had their export structure shifting even more to resource based exports. This was backward development in a sense. On the other hand, there is Mexico, where now the share of high tech in exports is at least one third or more, and where the speed of growth of exports has been very fast indeed.

I'm afraid that most, at least many Russian decision makers see their country more like Argentina and less like Mexico in terms of ability to adapt and to reap those benefits of improved productivity that Mika Widgren was calling for earlier.

I think Russians simply don't trust themselves enough to make free trade and WTO membership accession the kind of external anchor for policies that would be needed. This applies to free trade with the EU as well.

We are very grateful that the often recurring confusion between the European Economic Area and Common European Economic Space was clarified for us by Francoise Le Bail. But after this clarification, I think it's even less clear what incentives Russia really has to make the Common European Economic Space the kind of policy anchor that Ksenia and others before her had been calling for. Any country, after all, can partially approximate anybody else's legislation. In some cases such legal transplants even succeed in enhancing popular welfare. But policy makers usually need stronger incentives that just promises of possibly higher welfare in the future.

Another mistake that has recently been made by the EU and the United States as well was granting Russia the status of having a market economy. As a political

gesture this sounds very nice. Nobody wants to have a non-market economy, an economy in transition, everybody wants to have a market economy. But if I understand anything at all about it, or if I have been correctly informed about trade policy, the practical implication is that if your enterprise is facing anti-dumping claims, and if your country is regarded a market economy, the reference price to which your export price is compared is taken from the domestic markets of your own country. If your country is a non-market economy, the reference price is taken from some suitable third country. This is the practical trade policy consequence of being a market economy. But there is a problem, as far as Russian exports are concerned.

There is no way any producer of steel, aluminum, or other energy intensive commodities outside of Russia could except that the reference prices for Russian exports of aluminum would be taken from Russian internal prices as long as 90% of aluminum consists of energy, and energy is almost free of charge in Russia.

In practical terms, the status of market economy for Russia cannot have the implications that it is usually supposed to have in trade negotiations. And indeed, when the European Community in early November, just before formally giving Russia the market economy status, amended its regulations on anti-dumping, it referred to "a particular market situation" arising when prices are "artificially low" or there is significant barter or non-commercial processing. In these cases, obviously relevant for Russia, reference prices would still be taken from a third country. The text of the US Commerce Department announcement is also revealing in this regard. What it said was that the status of a market economy means that in most cases the reference price will be taken from inside Russia. In trade policy language most cases should be understood to mean in no important cases. This is what is going on already and which will be going on even more; and in the final analysis the Russians will feel they have been betrayed. We have given this fancy title of market economy to Russia, and then later they were told that it doesn't in practice mean anything.

Perhaps we have too many of these political declarations. We have more or less already forgotten about PCA, which is supposed to be in force. We have a common Russia strategy; only nobody knows whether it's common or a strategy. We have the Northern Dimension, which I won't say anything about. We have all kinds of other political declarations, including the Common European Economic Space. The granting of a market status has hardly made the situation any clearer. And if anyone thinks that the EU has been able to act in a unified manner in its Russia policies, just take a close look at the handling of the Kaliningrad case.

I fully agree with Ksenia that talking too much about fancy declarations and fancy names and too little about practicalities like market access in practice is a harmful thing. But having said that, I must also say that in many cases EU's Russian policies are missing in logical consistency and long-term thinking.

DEBATES

Question: What is meant by foreign direct investments? Many in Russia understand this as somebody giving money, disregarding that the enterprise or shares belong to somebody. And what is business in Russia? Unfortunately in Russia about ninety percent of it is gray. I mean tax-free. Nobody pays tax. And much of it belongs to criminals. What is ownership? To obtain ownership through expropriation is how the state sees it. Or to take it away in a criminal way. Finally – statistics. I can argue a lot about the statistics given by Ms.Yudaeva, because real statistics are different. I assume the statistics have been taken from Russia's customs authorities. But they are a little bit different in reality.

What will happen to transit through the Baltics? I think as soon as in Russia economics will take the upper hand over politics things will begin to move. Water will flow where it is easiest, trade the cheapest way.

Foreign direct investments to Russia will probably grow in future, as soon as the business environment in Russia will be positive and enjoyable for business. Currently capital is being taken away from Russia. According to Forbes magazine the sum since 1988 is about one trillion US dollars. But this capital is coming already back via Greece, from the USA, Switzerland and other countries.

The last question - what is Europe? Where does Europe start and end? I would like to say that Europe starts geographically from the Ural hills. Hence the Baltics are not in Eastern Europe, but rather Central or Northern Europe.

Alf Vanags: I have one question and one small comment. The question is to the EC representative. You don't need the same rules, not even approximately rules, for trade. If you take the European Union and the United States, there are huge amounts of two-way trade and FDI between them, with the occasional kind of hiccup over steel and bananas. But the rules and regulations are completely different. So my question is, what's the hidden agenda on this one?

My comment on Pekka's thoughts about the market economy in Russia. Of course this is political like everything else. That's why it was done. I understand his anti-dumping examples, anti-dumping is a procedure, it's a kind of safety valve procedure for getting rid of all sorts of difficult problems that you might have in trade issues. And of course they'll get round it. And the Russians know fully well that they will get round it and they won't be particularly disappointed. The real point of the market economy status is political. It's a signal saying that according to the

EU, Russia is acceptable as a WTO member. Because if it didn't have that status, it couldn't accede. I think it's as simple as that.

Question: What does the Dutch disease mean in economic terms?

Ksenia Yudaeva: In this particular case this means that in the Russian economy energy production is based too much on the Russian economy. And so it's difficult to develop other sectors and diversify the economy because of this.

Atis Lejins: Lopsided?

Ksenia Yudaeva: Yes.

Explanation from the floor: I can offer an explanation. A very quick one. It comes actually from the discovery of gas in the North Sea next to the Netherlands, which made the Dutch on one hand very rich, and the other hand their exchange rate appreciated thereby badly affecting their industrial sector.

CONCLUDING REMARKS

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First of all I would like to congratulate the organisers, and in particular the Latvian Institute of International Affairs, for a very successful conference. As Atis Lejins was saying in his opening remarks, this autumn is a historic moment. The upcoming summits in Prague and Copenhagen will finalise a major step in Europe's post-Cold War history. They will lead to enhanced security and safety for the new NATO and EU members, and they will mean increased predictability for other nations. Now is the time to look ahead, beyond the two summits, and for this purpose this conference has been very helpful in providing us with a number of insightful and imaginative ideas. Without event trying to summarise the debate, I will make three reflections.

The first reflection is that the European project has yet to be concluded. The process is not over and a number of challenges lie ahead of us. The European integration process will have to continue with regard to Bulgaria's and Romania's EU accession and the Stabilisation and Association Process in the Western Balkans. We need to develop our relationship with the Union's new eastern neighbours – Ukraine, Moldova and Belarus through the New Neighbours Initiative, presently under discussion in the EU and with the Central European candidate countries.

We also need to further develop co-operation with Russia. As was highlighted by many speakers, a successful economic development in Russia based on continued reforms will have major effects on Europe. One would also expect Russian attitudes towards Estonia, Latvia and Lithuania to change the way they have with Poland, Hungary and the Czech Republic after their NATO accession. There also seems to be a misperception in Eastern Europe that the present EU and NATO candidates will become adversaries to Russia and Ukraine once they have joined. This is however not the case; on the contrary they more than the present member states are immediate stakeholders in a positive development in Eastern Europe and will, I am sure, become engaged advocates for continued integration and co-operation efforts.

Secondly, it is of key importance to the security policy debate to include the trade and economic dimension in the analysis, in particular with regard to the ongoing globalisation. Only to look at traditional security aspects would make us draw the wrong, or at least imperfect, conclusions. Just take the example of Russia where President Putin's strategy for the development of Russia is very much built on

economic reform and economic performance. The fact that Russia's trade turnover with the EU will grow to 50 percent after enlargement is of major importance for the future relationship between Russia and the EU. Trade and economic factors are playing an ever growing role in foreign and security policy.

It has been debated to what extent Russia's and Ukraine's WTO accession and the EU-Russia project on a Common European Economic Space (CEES) would anchor the economic reform process or not. Personally, I am convinced that they will at least make major contributions to this effect. The overall importance of political decisions for the economic climate were stressed. Also in this respect WTO accession and the CEES would, I am sure, contribute positively. One could also consider extending the CEES project also to the co-operation between the EU and Ukraine.

Let me, finally, return briefly to the discussion on the Trans-Atlantic Relationship. The present tension needs to be taken seriously. At the same time we should not over-dramatise the situation. The relations between Europe and America are based on a solid platform of common values and objectives as well as on strong inter-linkages. Still, we should cultivate and develop the relationship and adapt it to today's needs. As was underlined by many speakers today, the countries of the Baltic Sea Region remain eager to maintain strong Trans-Atlantic links also after NATO and EU accession. I am sure that there is a scope for development in this respect and interested countries in the region could consider, together, how they best could contribute to the strengthening of this relationship. We could consider how we could draw on our competitive advantages in some specific areas to, for instance, reach out to Eastern Europe, Southern Caucasus and Central Asia, to make additional contributions in the field of non-proliferation of weapons of mass destruction. These issues deserve consideration sooner rather than later.