

# Cosmos, Chaos and Backbone for a Wider European Order

Michael Emerson

## *Abstract*

*Contrary to hopes following the fall of Communism, a gradual convergence of the wider European area on an enlightened general order is not emerging. But neither does the picture correspond to the "clash of civilisations", which was suggested as an alternative to the utopian "end of history". The ominous trend is rather a widening chasm between "cosmos and chaos".*

*The European Union becomes the cosmos of the European order. The rules of this political and economic order are reasonably well codified. The Council of Europe and the OSCE have added vital components in the political, security and human rights fields to the normative foundations of the European order, which is otherwise based on the EU's "acquis communautaire". The EU has also gradually been learning how to use these other organisations as its agents for the wider European order.*

*The EU now has a large responsibility for strategic developments in the whole of Europe. Its policies towards the wider Europe, beyond its accession candidates, are a mix of bilateral and multilateral activities. These policies towards the wider Europe do not add up to a strategy. A change of policy is now needed, to create a strategy appropriate both to the dominant underlying resources of the EU and to the alarming divergence between the cosmos and the chaos. The chaos already in 1998 showed its powers of contagion, infiltrating western financial markets to the point of threatening the economy of the cosmos itself; tomorrow its mechanisms of infiltration could be different, maybe through millions of refugees, maybe through fresh outbreaks of irredentist nationalism.*

*In a new foreign policy strategy for the wider Europe, the EU should play down its hub and spoke bilateralism and its zoning of the wider Europe in a set of concentric circles. It is ineffective in the outer circles and creates resentment, which adds to the dynamics of chaos. The countries of the wider Europe belong to common multilateral organisations at all levels - pan-European, regional, sub-regional - and these deserve more resources, more priority. However, only the EU, as emerging cosmos, could give backbone to a wider European order, built up in four strategic domains - markets, money, security and institutions. In each one of these there are opportunities for the EU to develop its policies towards the wider Europe on a scale capable of having a real impact. Putting them all together then means synergizing their impact, through establishing the credibility of the EU as strategic actor, which is already the case in the accession countries but not in the wider Europe. This lack of credibility means ineffectiveness, even squandering the resources available to the political leaders of the EU.*

*Political time-tables make a new thrust of policy timely in the next year: the 50th anniversaries of both NATO and the Council of Europe, renewal of the European Parliament and Commission, as of the Russian Parliament and Presidency, preparations for the new Millennium. The Helsinki EU Summit for the end of 1999 is scheduled to take an initiative for EU policies towards its Northern neighbours, especially Russia. The institutions will therefore be reflecting on their fresh agendas, and a strategy for the wider European order is an outstanding candidate for this.*



**Cosmos, Chaos**  
and  
**Backbone for a Wider European Order**

by  
**Michael Emerson**

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# Cosmos, Chaos and Backbone for a Wider European Order

Michael Emerson

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## 1. Cosmos and chaos

There are perils in summing up the condition of a continent of 800 million people with two words ("*cosmos and chaos*" is attributable to Tunander, 1997]. But still there are two powerful underlying trends along these lines in the political, economic and societal behaviour of the European continent, with strategic implications for the external policy of the EU.

Others have in recent years tried to capture the present *condition humaine* in two words: Francis Fukuyama's "*End of History*", which provoked Samuel Huntington's "*Clash of Civilizations*". Both were making arguments of great importance, but both missed the main point for contemporary Europe. The *End of History* was about the collapse of the only alternative ideology to compete seriously with the Western liberal democratic order. The *Clash of Civilisations* challenged this prospect of "eternal peace" with that of religious-cultural conflict, and with Islamic fundamentalism providing the threat closest to Europe. In the processes of trial and error in the evolution of post-Communist Europe, these propositions have proved either illusory or exaggerated.

The Western liberal democratic order has not come to dominate Europe's north-east, or south-eastern peripheries beyond the frontiers of the enlarging European Union. On the contrary this area becomes a vast "arc of instability", with its population of some 400 million people (including Russia, Ukraine, Turkey, non-EU applicant Balkan countries), to which one could add the south and east Mediterranean region of the Barcelona process (but the present paper is confined to Europe).

But nor has this wider European area been taken over by any alternative civilisation or order. There are areas where Islamic fundamentalism is a real force, in some cases locked engaged in murderous conflicts. But it is not in the wider Europe area a dominating force.

The more powerful player for the time being seems to be chaos. Certainly in Russia and the Ukraine government, finance and business morality are chaotic. A recent opinion poll in Russia reports that 58% of the population had their wages or pensions paid at least six weeks late or not all or were unemployed, that 56% of the population thought they would never be caught out in not paying taxes and 90% consider that most officials in Moscow are corrupt, and a large majority consider that corruption is now worse than under Communism. In the Ukraine surveys show the problems of corruption and criminality to be even worse than in Russia, and the country's external insolvency as bad if not worse.

The Balkans are a patch-work with conflict, despotism and crimes against humanity jostling alongside progressive elements. Albania in 1997 showed the face of the purest anarchy Europe is likely to see. All the mechanisms of state, of law and order, ceased to work. Banditry was generalised. Ordinary people knew that there was absolutely no authority to which they could turn when threatened. Military depots were ransacked and 650 000 small arms stolen and dispersed into the population. Bosnia's uneasy peace sees emergence of a new disorder - widespread corruption. Kosovo is on the way to becoming the next quasi-protectorate, to prevent further massacres.

The EU's three largest neighbours are all confused over their geo-political and societal destinies. Russia yearns to be a "great power" but is crippled with disorders. The Ukraine says in Brussels that it wants to join the EU, but such remarks do not connect, and its foreign minister goes on to say that his country will turn East again if disappointed by the West. Turkey bitterly resents exclusion from serious negotiations with the EU over accession.

On the other hand the eleven EU candidate countries, from government to the grass roots, understand that they "joining" or "rejoining" Europe. There will be many trials and tribulations in the accession process. Maybe one or other country will not stay the course - as of today Romania looks the most vulnerable. But on the whole these EU accession candidates are converging on the cosmos.

The official hope has been that all the post-Communist transition countries would converge together in terms of some looser definition of the politico-economic order, moving at least in the same direction if not at the same speed. Such is the creed and mission of the Council of Europe and OSCE and EBRD in the wider Europe, as also of the IMF, IBRD and WTO in international economics. The problem is that the pull of the convergence factors is not proving strong enough in the wider Europe to bring something like a civilised order there.

## 2. Rules of the European order

There is no shortage of rules of the European order, or of organisations codifying them. What are the rules, who wrote them and who enforces them? Table 1 gives a summary (details are available elsewhere [Emerson, 1998]).

The EU is often in a lead role, but it also relies on the wider organisations (e.g. the Council of Europe for human rights). But crucially the EU has put together a package of economic and political rules generating synergies such that the whole becomes a cosmos, and its influence can be decisive for the strategic direction and destiny of its member states. Some people may take some of these rules for granted, because they are so deeply built into their societies. But the EU is the mechanism for generalising and extending this order in countries where it could not be taken for granted - indeed where it recently did not exist (Greece, Spain and Portugal, and now the accession countries of Central and Eastern Europe).

For the wider Europe the thinner structure of international organisations is available for all, with some exceptions for dictatorships (Serbia, Belarus). However these organisations have not had power enough to prevent the EU's periphery from becoming an "arc of instability". Let us examine the reasons for this.

<i>Table 1: Eight sets of rules of the European order</i>	
<i>Political, Security</i>	
<i>1. Democratic institutions</i>	<i>Council of Europe, EU</i>
<i>2. Individual human rights</i>	<i>EU, UN, Council of Europe</i>
<i>3. National minorities</i>	<i>UN, OSCE, Council of Europe</i>
<i>4. Inter-state behaviour</i>	<i>UN, OSCE, NATO, WEU, EU</i>
<i>Economic, Social</i>	
<i>5. Market for goods, services, capital</i>	<i>WTO, EU</i>
<i>6. Macroeconomics of money and budgets</i>	<i>IMF, EU/euro</i>
<i>7. Social model</i>	<i>Council of Europe, EU</i>
<i>8. Corporate governance</i>	<i>EBRD, EU, OECD</i>



### 3. Integration and conflict

While the integration processes of Brussels are the subject of serious analyses in the economic and political sciences, such works mostly look at the EU as if it was the only Europe. These works are also biased in being strong on integration but neglecting conflict, its diabolic twin. Europe, however, has unique capacities for both, accounting for 75 million war-related deaths in the 20th century, or 70% of the world total. Integration is in better shape analytically than conflict. Maybe this is because there is more rationality to integration than conflict, even though some scholars have invested heavily in the rationality of conflict.

The schema in Table 2 (detailed elsewhere [Emerson, 1998]) is meant to explain the propensity of nations or communities to integrate together, with three arguments of history, three of economics and three of politics. These are the structural factors making for a greater or lesser interest in integration between given sets of partners. It has been tested on students at the College of Europe in Bruges and Warsaw, where there are complete cross-sections of European nationalities, with similar education. Volunteers were invited to mark their perceptions of their countries' interests in integration with the EU, and in some cases also with Russia - a recent cosmos. Each line was given a value from plus 2 to minus 2, and the totals added. Plus 18 would then be the maximum rated integration propensity, minus 18 the maximum antipathy possible.

*Table 2: Factors determining integration tendencies*

*Demand* - country X's wish to integrate with Y, or with core group Z

*Supply* - willingness of country Y, or core group Z to admit country X

*Explanatory variables*

**I. Historical integration**

1 Geography - watersheds, mountains, river basins

2 Culture - language, religion, alphabet

3 Perceptions - of citizenship, trust, destiny

**II. Economic integration**

4 Markets - benefits and costs

5 Money - benefits and costs

6 Redistribution - benefits and costs

**III. Political integration**

7 Values - commonality or otherwise

8 Power - gains or losses

9 Security - gains or losses

Each of the nine arguments have their own story to tell, indeed their own branches of the social sciences behind them. The three economic arguments - markets, money and redistribution - are the most strictly modelled and indeed quantified. Abundant cost-benefit analyses under each heading are available, even if there are some serious disagreements, for example over monetary integration. The three political arguments - values, power and security - can also each be analysed in an ordered way. But there are ambiguities, for example

one nation that can find the EU enhancing its power whereas another one may perceive a loss of power. The historical factors have well known foundations, at least as regards geography and culture. Here also there are ambiguities: the closest of neighbours can be the best of friends or the oldest of enemies, or even alternate from one to the other. Hence the real importance of subjective perceptions: for example the Franco-German reconciliation, alongside the non-reconciliation of other neighbours, notably in the Balkans .

But there is no need to convert these complications into obscurantism. The students of the College of Europe were easily able to mark their home countries according to the schema. They knew what they were doing, line by line. For example the French and Irish gave themselves 16 out of 18 plus points for integration with the EU, close to the theoretical maximum. The Central Europeans and Baltics gave themselves similarly very high points for integration with the EU. They were also invited to mark their interest in integration with their former cosmos, Russia (Soviet Union). Estonia, Poland, the Czech Republic and Slovakia marked themselves very positively for integration with the EU (+13 to + 17), but negatively towards Russia (-7). The Ukraine marked itself only slightly positively towards the EU (+4) and slightly negatively towards Russia (-2). Russia marked itself zero looking towards the EU, suggesting a natural tendency to stand alone, but without paranoia or hostility towards the EU.

As to the dynamics of integration and conflict (see Table 3), it seemed easier at first to schematise integration dynamics under the familiar headings of widening and deepening, or - to use names that suggest mechanisms more precisely - “domino dynamics” and “disequilibrium dynamics”. Economists are using the idea of domino effects to represent the widening of both trade and monetary areas. The circles of participants progressively widens, as the successive peripheries find this position uncomfortable. EU integration, economic and political, also thrives on disequilibrium dynamics. Examples are familiar: the single market that leads to the single currency, since otherwise the fragile monetary order breaks down; the monetary union calls for greater democratic accountability, translating into greater power for the European Parliament and calls for its greater democratic legitimacy.

But the dynamics of conflict can also be schematised with domino dynamics and disequilibrium dynamics. The play of alliances is a clear mechanism for the extension of war, so clear in memories of the World Wars that at least there has been restraint this time in the Balkans. The deepening of conflicts happens as retaliation and counter-retaliation escalate “out of control”. With bloodshed the psyche is changed. The weights attached to the nine integration factors in Table 2 are changed drastically. Economic interests are down-graded into insignificance, as vengeance is sought “at any price”, and this trait has of course been on the rampage in the Balkans and Caucasus these last years.

Chaos now also reveals its mechanisms of widening and deepening with a vengeance, and of this we must give a more detailed account.

#### **4. Dynamics of chaos**

Pre-requisites for the development of chaos are systemic weaknesses in the political and economic order, taking the rules of the European cosmos as a reference. The schema in Table 3 summarises the domino and disequilibrium dynamics of chaos in all too recognisable terms. The speed of these dynamics becomes instantaneous with the mechanisms of financial collapse, leading on quite quickly to the collapse of governments and regimes.

Table 3: Dynamics of integration, conflict and chaos

	<i>Integration</i>	<i>Conflict</i>	<i>Chaos</i>
<i>Widening</i>	<i>Domino effect, as the periphery finds exclusion costly.</i>	<i>Domino effect, as alliances come into play.</i>	<i>Domino effect, with contagion through financial markets.</i>
<i>Deepening</i>	<i>Trust builds up, permits step by step deeper integration.</i>  <i>Disequilibrium dynamics, as one integration step calls for further steps for system to remain stable.</i>	<i>Bloodshed effect, change of psyche demands vengeance.</i>  <i>Disequilibrium dynamics, as retaliation and counter-retaliation escalate out of control.</i>	<i>Financial crisis leads to economic disruption and social hardship</i>  <i>Disequilibrium dynamics, as financial instability leads to other economic and political instabilities</i>
<i>Speed of dynamics</i>	<i>Slow, because of reliance on build-up of trust.</i>	<i>Fast, because of first strike advantage.</i>	<i>Instantaneous, i.e. with collapse mechanisms of finance, governments and regimes</i>

In Asia the systemic defects have mainly been identified in the structure, regulation and supervision of the financial sector, in the corporate governance of big business conglomerates, and in democratic accountability at the political level.

In Russia the post-Communist transition has seen emerge reasonable order or at least great improvements in the fields of democracy and human rights. However elsewhere in the system there have been grave defects, notably in standards of corporate governance, in the functioning of the state and weaknesses of civil society. In particular the grave defects of the tax system put the financing of the budget at the mercy of sentiment in the international financial market, which itself was continuously being shocked by the awful machinations of Russian corporate governance.

But the Asian crisis, extended into Russia, revealed the trigger mechanism for converting the stresses and strains of difficult circumstances into crisis and then chaos. This is again a story of divergence - between the solidity of mature Western capitalism versus the catastrophic vulnerability of the incompletely ordered market economies. The common actor is mobile international capital. It is a story about exchange rates, stock market prices, interest rates and the public debt; about "multiple equilibria", confidence and expectations [see Gros and Thygesen, 1998]. Initially confidence is such that the exchange rate is strong enough to be consistent with monetary stability; the interest rate is low enough to make the public debt serviceable. The economy proceeds on a positive path. But then some shock event, maybe originating entirely outside the country in question, destroys that confidence. The exchange rate drops, unless countered by great increases in the rate of interest, but these are unsustainable for the budget. Thus mobile capital receives the message to exit fast, the

exchange rate collapses, maybe the banks collapse with it, inflation returns; or, the government blocks capital outflow, tries to control prices, defaults on its debt and cuts itself off from the international economy and capital for a long time.

It was the same Korea, already well known to sophisticated Western financial analysts, which two years ago was receiving all the favours of international portfolio investors. Similarly in Russia two years ago, the threshold for an age of lasting economic growth was being passed. Mobile capital moved in on a band-wagon of hype. The stock market index multiplied ten times. Bond yields for Russian official and corporate borrowers came down to LIBOR plus only a few percentage points. Then the Asian crisis shattered confidence in precarious financial and economic structures. Domino dynamics took over with a vengeance. Maybe the Russian business upswing was in 1997 about to take off. But then international capital reappraised its position in risky transition economies and switched from being the bearer of euphoric optimism and the "magic of the market" into being the executioner of collapse and midwife of chaos. Maybe Western bail-outs could save them. So vice-prime minister Nemtsov said that the IMF assistance of Summer 1998 was "entirely predictable" - because the dangers of chaos were too big and credible. The bail-out did not last long. The depth of the disorders was now better understood by markets. In the eyes of western investors the extent of the bandit capitalism, corruption of officialdom and bankruptcy of the state now became a reason not to invest in Russia "at any price". Russian assets became very cheap - "a good time to buy". Such is the view only of a few small "vulture capitalists", as they are charmingly known on Wall Street. But this is hardly a joke for their prey or for members of the Duma. The mechanisms of finance thus feed ideological divergence.

What next? The populations of Russia and the Ukraine are utterly confused, demoralised, without a sense of direction, but certainly a sense of exclusion from the "civilised" Western world and depression over the seemingly hopeless prospects of material improvement. Maybe the natural development for Russia is a new populist leader, who claims to look after national interests better, maybe beats on the nationalist drum, maybe toys with populist monetary policies to pay arrears of wages and pensions and with price controls to hold back the inflation. So far, however, the prospect of hyperinflation was so obvious that the Prime Minister Primakov opted to delay repayment of the internal arrears as well as the external debts. Regional governors have for their part been trying to control prices and exports in their oblast or republic, a sure recipe for further economic decline. Political peace with the Communist dominated Duma has been bought for the time being with policy inertia. Maybe there will be a resurgence of separatist tendencies, especially in some republics with non-Russian populations. Maybe public opinion is now sufficiently inoculated against really dangerous leaders, supposing that democracy continues to hold.

These grave problems cannot be easily overcome. One question is whether the European cosmos is doing itself enough to help bring stability, rather than stand by as the private international economy wreaks havoc, fostering chaos in the "arc of instability". The EU is concerned about its neighbours, but the conventional enlargement process cannot conceivably enlarge to encompass the whole wider Europe. It does not have a strategy for the wider Europe. The normative model of the early post-Communist period - that of an enlightened transition for all, only at different speeds - is not working, with Europe polarising between cosmos and chaos.

## 5. Hubs, spokes and concentric circles

Scholars of geo-politics do discern strategic behaviour by the EU [Buzan,1997]. Their language is about “hubs” and “spokes” and “concentric circles”, typical of the behaviour of a hegemon. The hub is of course the power centre. The spokes are the bilateral ties between it and its nearby partners. The hub is powerful, the neighbours are either small or weak, so the result is this asymmetric bilateralism. Going progressively further away from the hub, the ties become weaker. A pattern of concentric circles emerges, with very close ties for the inner circles verging on inclusion, then weaker ties for countries who may still be candidates for inclusion, then the outsiders. From the centre of the hub this seems a natural order, certainly the easiest to control. But has the hub calculated correctly how the outer rings of the concentric circles are likely to behave?

The outer circles are in fact unhappy about their exclusion. Their condition is tending towards the chaotic, because their own systems are not well ordered. They do not have good alternatives. They are unable, it seems, to create their own cosmos.

Does the hub have strategic options? In fact the EU already finds itself with two systems of relations for the wider Europe, the bilateral and the multilateral. It is the mix of these two systems that can be discussed. The hub has options.

The system of bilateral spokes and concentric circles is very developed. The EU now has no less than a dozen distinct concentric circles of relationships with the wider European area.

No.1 is the European Economic Area, for Norway, Iceland and Liechtenstein. No.2 is for Switzerland, which has the objective of membership in due course. No.3 is for the first group of six accession candidates (Estonia, Poland, Czech Republic, Hungary, Slovenia). So far everybody is happy, except that some of the accession candidates would like to get inside faster than seems likely.

No.4 is for the next five accession candidates (Latvia, Lithuania, Slovakia, Romania, Bulgaria). They are not so happy. Here it seems that the incentive effect from the cosmos varies. After the disappointment of being put into a second group for enlargement, these countries mostly seem to “try harder” to make the grade. The Slovakian people understood and used recent elections to throw out their insufficiently democratic prime minister. The Maltese people have also used recent election to restore a leadership aiming clearly at EU integration. But in Romania it seems that there is a relapse on the part of the political system to more chaotic, drifting ways. The motivating powers of the cosmos here seem to be running out of decisive effect.

No.5 is Turkey, the oldest accession candidate, and increasingly resentful over exclusion. There is already a customs union with the EU, and so in this respect Turkey is still closer than other accession candidates. But now other geo-political options are more discussed, looking to Central Asia, the Caucasus, the Middle East. Domestic political tensions (religion, the army, human rights), interacting with these European disappointments, may become increasingly chaotic.

Next the system of concentric circles becomes a bit more complicated, since it has three sub-regions: the former Soviet Union, the Mediterranean countries of the Barcelona process and the Balkans. Each have their graduations.

No.6 is for the three European countries of the former Soviet Union with whom Partnership and Cooperation Agreements are operational and which envisage the possibility of bilateral free trade with the EU (Russia, Ukraine and Moldova).

No.7 is for those countries of the Barcelona process with which the EU has free trade already (Israel) or plans to do this by 2010 (Morocco, Tunis).

No.8 is for the Balkan countries closest to being considered eligible for a association agreement (Croatia) or generally viewed as progressing towards a semblance of order (Macedonia). The EU now produces half-yearly reports on all the non-accession candidate countries of south-east Europe, assessing their progress towards the conventional political and economic order, and grading their qualifications for multiple graduations of trade and aid advantages (or sanctions).

Then come the next rings of countries from the three groups, namely the Caucasus and Central Asia as No.9 (although this group might itself be split into two), the convalescent countries in the Balkans (Bosnia and Albania) as No.10 and the less progressive countries of the Barcelona process as No.11.

Finally, as ring No.12, come the rogue states and pariahs, presently Serbia, Belarus and Libya. Their leaderships run regimes which are at almost total variance with the rules of the European order. They receive sanction treatment of different severity. Libya is reportedly close to being promoted to ring No.11, if it hands over some terrorists.

This complex system is no more than five years old. It is essentially the EU's response to the end of the Communist period, including its second order reaction to the demand that the Mediterranean should not be ignored in preference to the north and south-east Europe.

## 6. European multilateralism

The other part of system is the set of multilateral institutions. Old organisations have expanded their work and new ones created in the post-Communist period. These developments are themselves quite impressive, except that they have not succeeded in controlling the profound trends. Beyond the EU cosmos, the forces of chaos are proving stronger.

At the *pan-European level* the post-Communist period started with some great pluses. The CSCE, inherited from the days of Brezhnev, proved highly adaptable, becoming of in due course the *OSCE*. But its potential is under-exploited. The *Council Europe* was an even bigger chance, since the new democracies could join quickly, attaching themselves to the invaluable Convention and Court for Human Rights, the Parliamentary Assembly and other activities. History might have merged together the EEC and Council of Europe. Instead the EU can view the Council of Europe almost as its own agency, but one which the new democracies could join without EU membership yet being possible. Also these assets seem under exploited. The *EBRD* was added in 1991, becoming a potentially important agency now in the context of improving corporate governance. The *UN Economic Commission for Europe* has remained active, for example in the field of technical standards.

Secondly, the wider Europe is now being grouped into *three strategic regions*, overlapping the frontiers of the enlarging EU and its outer concentric circles - in the North, South-East and South. The *Barcelona* process for the South (Mediterranean) was initiated in 1995. Barcelona has an ambitious agenda for political and economic cooperation, although its work has been handicapped by the stalled Middle East peace process. The *Royaumont Process* for the South-East (Balkans, Turkey), was founded in 1997 to support civil society initiatives in the Balkan region (media, education etc). But so far it receives little support budgetarily. It complements another project, the US-led *South-East Cooperative Initiative (SECI)*, which aims at business cooperation across the region. Then there is the *Central European Initiative*, originally an Italian and Austrian project, now seeking to promote cooperation from the Baltic (Poland) to the Balkans. This is distinct from the *Central*

*European Free Trade Area (CEFTA)*, which aims at free trade between EU accession candidate countries, and gradually extends its membership. There is also the *Balkan Conference on Stability, Security and Cooperation in South Eastern Europe* bringing together the former Yugoslavia, Albania, Greece, Bulgaria, Romania and Turkey. The Finnish government have proposed that the EU develop a so far unspecified "*Northern Dimension*" to its external policy.

Thirdly there are a set of *sub-regional initiatives*, including those for the "*3 B Seas*"; the *Black, Barents* and *Baltic Seas*. These are natural geographic areas, which cut across the frontiers between the enlarging EU and former Soviet Union, with current concerns like for the environment and transport infrastructure as well as much shared history. The *Black Sea Economic Cooperation* was initiated in 1992, the *Council of Baltic Sea States* also in 1992 and the *Barents Euro-Arctic Council* in 1993. Additional sectors of activity include cooperation over combating crime (Baltic) and in cooperation between local and regional governments (Barents).

These many organisations and initiatives spawn vast numbers of meetings of foreign and other ministers and officials. Diversity, specialisation and even competition among official bodies have their merits. But still this complex system has to be assessed as a whole. Is it a sufficient basis for helping the wider Europe through the difficult post-Communist transition to the promised land of pan-European integration and civilisation? Until the current crisis the optimistic answer might have been "perhaps". A more realistic answer would be to say that this plethora of initiatives represents the continuing search and unsatisfied demand for pan-European integration. They lack critical mass, coherence, synergy and credibility. They do not add up to strategic impact.

## **7. Backbone for a Wider European Order**

So far the main backbone for the wider European order has been supplied by the US, but this has been essentially *military*, through NATO during the cold war period in relation to the former Soviet Union, and now again through NATO in Bosnia and maybe Kosovo. Elements for the *civilian* political and economic order exist, as already described through the workings of the international organisations. But the problem is that these elements, even when supported by US and EU, have not been decisive.

For the future the issue will be, hopefully, how to get the civilian order to prevail and take deep roots. Here the EU should naturally take up the leading role, because of its proximity, wealth and general representation of modern European civilisation. "Integration" is the creed of the EU, whereas the US Congress expects forays of its troops into the Balkans to comprise "exit" strategies.

How should the EU design a new foreign policy strategy, adapted to the crises - indeed the chaos - of the wider Europe? The EU should play down its hub and spoke bilateralism and its zoning of the wider Europe in a set of concentric circles. It is ineffective in the outer circles don't like it and creates resentment, which fuels the dynamics of chaos. The multilateral organisations common to the EU and the wider Europe - pan-European, regional, sub-regional - deserve more resources, more priority. However, the EU itself will have to take large responsibility for building up a wider European order, since it is the continent's cosmos.

The suggested approach is to concentrate on four strategic blocks:

- markets
- money

- security
- institutions

Together these would define the basic architecture of EU relations with the wider Europe, assembling powers, resources, and incentives sufficient to impact significantly on the course of principal trends in the partner countries of the wider Europe.

**7.1 Markets.** The demands of the countries of the wider Europe to be inside the EU market will be a function of proximity and size, according to well-established gravity model precepts. The small nearby state will be very strongly interested in inclusion, whereas the larger and more distant state will have a weaker interest. For example Croatia will be very strongly interested, whereas Russia's interests will be more remote and inclined towards protectionist solutions.

The EU itself is already following asymmetric trade policies in the wider Europe, offering low or very low (preferential) tariff policies, whereas the partner countries may not yet even be constrained by WTO membership in their tariff policies. In the case of Russia, exports to the EU have become even more concentrated on energy and other raw and basic processed materials, for which tariffs are on the whole low or very low, whereas EU exports of manufactures encounter substantial tariffs.

Customs procedures and tariffs have also in the wider Europe come to acquire some very undesirable aspects, going well beyond the standard trade policy analysis. The newly independent states for the CIS and former Yugoslavia discover that the customs administration is both an icon of national statehood and a mechanism of state corruption, as witnessed by what goes on in the long, long queues of trucks trying to enter Russia or the Ukraine or the smuggling, trafficking and corruption across the frontiers of the small Balkan states.

EU policy is also criticised by most trade policy economists for following a "hub-and-spoke" strategy of negotiating a set of bilateral trade policy deals between itself and each individual partner country. Because of its dominant economic power, EU policies prevail. However it is also very important for the economies of the wider Europe that they trade freely amongst themselves. Some partial initiatives along these lines exist, like the Central European Free Trade Area, and some free trade arrangements among states of the former Yugoslavia and CIS. However the whole matrix of pan-European trade policy relations is a poorly structured and highly complicated mess.

These several arguments add up to a case for a big clean-up of the pan-European trade policy regime. The candidate for consideration is that the EU would take the initiative to propose to the whole of the wider Europe the objective of pan-European, multilateral free trade between the EU (of however many members) and all other countries of the wider Europe. This would be analogous to initiatives developed in the Americas and the Asian-Pacific regions (Russia, having already now joined APEC, would be heading for non-discriminatory free trade with both Europe and the Asian-Pacific regions). The qualities of pan-European free trade, compared to the present situation, are that it would be:

- a strategic flag-ship for an *inclusive* Europe, as a clear, clean policy concept, comprehensible for politicians, business and media;
- sound economics, being multilateral rather than preferential within Europe, and as a useful counter-attack against the corruption economics on the frontiers of the wider Europe;
- easy for the EU to agree to, since it has already given away most of its own tariff protection against the wider Europe;



- associated with a next, deeper stage of market integration, namely expansion of the European Economic Area (i.e. the extended EU single market for non-EU member states), for countries having successfully implemented the free trade stage.

Russia and the Ukraine already have the possibility to negotiate free trade written in to their Partnership and Cooperation Agreements with the EU. It is not clear if and when these countries may really want to activate this possibility. However the EU's position should be clear and simple: if either or both of these countries says it wants free trade the EU should say, yes, we agree, as long as you join the WTO first and also agree to join a pool of participants in multilateral, pan-European free trade at the same time.

**7.2 Money.** The conventional view of the euro enlargement process is: converge first, and durably, and then join. But this conventional view, internal to the EU, has not yet adapted to the new situation:

- the euro now exists;
- the demands for inclusion into a wider euro area may develop strongly, and interested countries could go ahead unilaterally by themselves to a large degree, as long as they are not asking for a seat on the ECU (viz. Argentina's current interest in total dollarisation, to replace their dollar currency board system);

the post-Asian/Russian crisis economy is one in which there has been a structural change to the cost-benefit calculus of adhesion to the euro (or dollar). Such calculation may be expressed directly in terms of the enormous rise in the interest rate risk premia attaching to all but the strongest currencies (600 basis points for Argentina, 5100 for Russia), and in precipitating debt service default, and thence exclusion from capital markets.

These arguments are sufficiently new and important that they deserve a more systematic presentation. In thinking about the exchange rate arrangements between the euro and the rest of the (non-EU) Europe, three groups of countries should be distinguished, according to their relative monetary strength.

i) *The very strong countries*, i.e. that could become members of the EU at any time and that fulfil the Maastricht criteria most of the time (e.g. Switzerland and Norway). These would gain from pegging to the euro because the EU is anyway their major trading partner and doing so gives financial markets an anchor for longer term expectations, thus reducing the impact of financial shocks. For these countries the classic criteria of the Optimum Currency Areas approach become relevant, notably to the extent that the economic structure of the country concerned is close to that of the EU. This would be the case for Switzerland, but not necessarily for Norway whose exports are dominated by oil and gas. Even if they had a strictly economic interest in joining the euro area, these countries can afford the luxury to wait and see. Given their strengths they can comfortably survive outside.

ii) *The middling countries*, with moderate inflation rates (now usually below double digit) and fiscal deficits, for example the countries of central Europe. But with rather large current account deficits these countries can be vulnerable to speculative attacks. These countries are also in an intense process of structural change whose outcome is difficult to foresee. They might therefore need some flexibility in their real exchange rate for some time. But the cost of retaining some flexibility in the exchange rate is that this leaves open the threat of speculative attacks, as the example of the Czech Republic has recently shown. This experience also suggests that the cost of such an attack is limited, and does not result in outright catastrophe as in the case of Russia. The costs and benefits of different exchange rate regimes are thus often finely balanced and must be considered case by case.

*Table 4*  
*Post-Asian/Russian crisis economics - cost-benefit calculus over monetary regimes for*  
*Russia or Ukraine*

	<i>Own currency</i>	<i>Currency board</i>	<i>Total dollarisation or euro-isation</i>
<i>Monetary stabilisation</i>	<i>poor/erratic</i>	<i>good</i>	<i>excellent</i>
<i>Interest rate</i>	<i>impossibly high</i>	<i>very high</i>	<i>low</i>
<i>Independence of monetary policy</i>	<i>yes</i>	<i>no</i>	<i>no</i>
<i>Seigniorage</i>	<i>yes</i>	<i>some</i>	<i>no</i>
<i>Debt service capacity</i>	<i>default</i>	<i>limited</i>	<i>restored</i>
<i>Living standards (real exchange rate)</i>	<i>very low</i>	<i>better</i>	<i>much better</i>
<i>Access to capital markets</i>	<i>no</i>	<i>some</i>	<i>yes</i>
<i>Incentives for efficient/honest resource allocation</i>	<i>poor</i>	<i>better</i>	<i>good</i>

iii) *The very weak cases*, namely countries that are very far from fulfilling any of the requirements for EU membership in general (and the Maastricht criteria in particular). These countries usually have large fiscal deficits and high inflation, their currencies are often under pressure and real interest rates are very variable, often patently unsustainably high when the government tries to stabilise the economy. These countries would gain from being able to enter the euro-area, because that would be a way to import sensible macroeconomic policies and decisively gain the confidence of financial markets. Since the alternatives are hyperinflation and/or enormous risk premia on foreign debt, the benefits of this confidence effect and of a stable currency can far outweigh any potential costs of not being able to react to asymmetric shocks with exchange rate changes.

One way for non-EU countries to enter the euro area is to opt for a currency board, as already done by Bosnia, Bulgaria, Estonia and Lithuania. The first three chose the DM as the anchor and are now de facto members of the euro area. A currency board can deliver the benefits of credibility with financial markets and low inflation as the examples of Bosnia, Bulgaria and Estonia show. However, as the experiences of Argentina and Hong Kong show, even currency boards that are run very conservatively can come under attack. While the mechanism of the currency board itself is usually technically unassailable these attacks are

costly because they lead to increases in domestic interest rates, which have a negative effect on demand. Defending a currency board is thus technically easy, but can have a high price in terms of unemployment. Financial markets know this and this is why a currency board is never 100 % credible. This weakness of currency boards has recently prompted the Argentine government to consider plans to switch totally to the US dollar.

The case of Bosnia serves to underline the issue of credibility. In Bosnia the governor of the central bank, appointed by the Western powers, is a New Zealander, whereas overall political authority is vested in the High Representative, backed by NATO forces.

The economic benefits of full dollarisation or euro-isation are the similar to those resulting from a currency board, but they are more certain. They can be reaped even by countries whose institutional and political weakness would leaves doubts in the market that it could follow the rules of the game of a currency board. Under a currency board regime the country still has a domestic monetary authority, which might cede to government pressure and violate the rules of the currency board, e.g. by giving credit to the government.

Therefore the radical solution of unilateral, total adoption of the euro (or dollar) as the domestic currency offers even more benefits, compared to the currency board, for countries with very weak institutions. The case of Argentina suggests that the idea is one of practical, not just theoretical, interest. But it is not to be thought of as something more for advanced emerging markets such as Argentina, on the contrary. In the case of Russia the currency board proposal indeed meets the objection that the Russian authorities would still be quite free to abandon their commitment to the monetary rule of the currency board, which in present circumstances would mean costly interest rate risk premia. This weakness would not apply in the case of total euro-isation. Moreover, total euro-isation would make the foreign debt burden much more manageable, and could therefore offer real advantages to Western creditors and official credit guarantee agencies (such as the German Hermes).

The key advantage of euro-isation would be its systemic impact, in transforming the political economy inside the country, and thus the chances of healthy economic growth. The banking system is almost everywhere in the wider Europe a key conduit for large scale corruption and political intervention in the economy. A political class that cannot run large deficits and that cannot control the banking system will be forced to create more room for really productive private enterprise. Supporting loss making state enterprises or just favouring politically well connected 'business men' will become more difficult and apparent because it would have to go through the budget. Entrepreneurs will learn quickly to concentrate on managing their enterprises more efficiently, because that will become the main avenue for success. Political connections will count for less. Petty corruption and favouring some enterprises through tax breaks etc. will of course remain, but the sums that can be allocated this way pale in comparison with the wealth that can be controlled through the banking system and large scale inflationary finance.

**7.3 Security.** The EU has hardly begun yet a security policy for the wider Europe, leaving this essentially to the US, NATO and Contact Group diplomacy. Yet the security issues posed in the wider Europe are so evidently important for the EU, that it amounts to an existential issue for the proposed common foreign and security policy. US-led security policy in the wider Europe has natural limits. While uniquely strong in its military aspects, the US cannot handle the issues that arise from geographic proximity or which require synergies through blending together security policies with the whole range of EU competences.

The build up of justice and home affairs (JHA) and defence competences are the prerequisites. In fact the JHA field is now seeing a full flood of developments. But there is a

big hazard for wider Europe policy, that of building the Schengen mechanisms into a fortress Europe for people.

On defence, the loosening up of the British position on EU defence competences at least triggers a new debate. One obvious development would seem to be to give real content to the existing political commitment to have the Combined Joint Task Force (CJTF) capabilities of NATO open to use and leadership in either NATO or EU modes.

The former Yugoslavia and Albania will be entirely surrounded by the enlarged EU. Demands for protection and support both militarily and in the police domain may be of two types:

(a) where the national authorities might ask for assistance from the EU in either or both domains. (Example: Albania in 1997, which the WEU failed to respond to, and again now with the failure to stop the nightly traffic in "speed-boat refugees" across the Adriatic). For this the EU should prepare model packages of "advanced security cooperation", according to which military and/or police resources could be deployed for medium-term periods.

(b) where there is war, or intervention demanded in order to prevent war, or to stop crimes against humanity. As the Bosnian and Kosovo cases show, these are situations when the normal rules of international diplomacy may have to be suspended, and the outcomes are special. The institutions of the territory in question may have to be taken over for a while by the external power, with protectorate regimes. While the US punched through the Dayton constitution for Bosnia, the EU has a large role in its implementation. The evolution of the role of the High Representative there (most recently sacking the elected President of the Sprcka Republic) illustrates what this can mean in operational terms. Kosovo becomes the next testing ground.

For Russia and the Ukraine the optique is, of course, quite different, and centres upon the objective of inclusive relationships as partners. Russia has long been seeking some kind of European Security Council under the aegis of the OSCE, to have a full say in European security policy among a restricted group of the main players. This has been rejected on the Western side as implying or risking some subordination of NATO. However in a quite pragmatic way the Contact Group has been emerging into something along these lines for the Bosnia and Kosovo operations. This comprises the four EU members of G7, the US and Russia. Alternatively, G8 without Canada and Japan. It is informal, non-institutional. It would need at some stage to represent the EU adequately, as the EU's own security policy develops.

**7.4 Institutions.** The demands for membership of the EU already outstrips the preparedness of the EU to accept them. This problem will become more acute. The EU's concern would be mainly for the Council, to avoid either congestion with more small states or political influence from governments without yet stable democratic traditions; but otherwise the EU has every interest in inclusive policies, so as to help stabilise the states in question. This dilemma has to find a solution. A promising approach is to explore more imaginatively formulae for "*virtual membership*" of the EU, based on increasing cases of participation in the Economic and Monetary Union as well deepening security relationships. Going beyond the EEA precedent created for different types of country, there could be new categories of "*membership of the EU*", without necessarily full institutional membership. Categories such as "*sovereign territory of the EU*" or "*autonomous region of the EU*" might be created. Institutional membership could be progressive, in ways not so far tried. Thus there could be members of the European Parliament and some staff appointments in the Commission,