Trialogue: 48

The Trilateral Commission was formed in 1973 by private citizens of Western Europe, Japan, and North America to foster closer cooperation among these three regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together among these regions.

North American Chairman  European Chairman  Japanese Chairman (Acting)
Paul A. Volcker  Otto Lambsdorff  Kiichi Miyazawa

Subscriptions are available to Trilateral Commission publications. Subscription rates are $20 for one year and $38 for two years.

Mail all orders and payments to:
The Trilateral Commission (North America)
345 East 46th Street—Suite 711
New York, New York 10017

Copyright © 1995 The Trilateral Commission
All Rights Reserved
SECTION 1
Russia
4 Andrei Kozyrev

SECTION 2
New Security
Environments in
Europe and East Asia
14 James B. Steinberg
19 Koji Watanabe
25 Josef Joffe

SECTION 3
Trade and Capital
Flows in a Changing
World Economy
28 Peter Sutherland
31 E. Gerald Corrigan

SECTION 4
Japan’s Economy
39 Minoru Murofushi

SECTION 5
The United States:
New Political and
Policy Currents
44 William V. Roth
47 Tom Foley
50 Martin Feldstein

SECTION 6
Estonia
53 Lennart Meri

SECTION 7
Ukraine
58 Borys Tarasyuk

SECTION 8
Denmark
60 Bodil Nyboe Andersen
63 Poul J. Svanholm
66 Poul Nyrup Rasmussen
68 Tøger Seidenfaden

SECTION 9
Scandinavia
71 Kåre Willoch
75 Kjell-Olof Feldt
77 Gustav Hägglund

SECTION 10
European Unification
81 Etienne Davignon
82 Janusz Onyszkiewicz
84 Jörg Schönbohm
INTRODUCTORY NOTE

THE 1995 ANNUAL MEETING of the Trilateral Commission was held in Copenhagen on April 22-24. This was the first time the annual meeting—which rotates among Europe, Japan and North America, the three sides of the Trilateral Commission—was held in Nordic Europe. With Sweden and Finland having recently joined the European Union (Swedish and Finnish groups were formed in the Trilateral Commission somewhat earlier), this was a particularly appropriate time for us to be in Nordic Europe. In sessions reviewing developments in Denmark, Sweden, Norway and Finland, we learned of both commonalities and differences among the Nordic countries.

As always in our annual meeting, we also reviewed developments in our three regions more generally, with special attention to Europe—in particular the multiple dimensions of European unification. Our session on Japan focused on the effects of the soaring yen and the economic policy and business challenges and opportunities of the current period. Our session on the United States focused on new political and policy currents with the remarkable Republican gains.

We were honored to be addressed by the President of Estonia, Lennart Meri, who also participated in our discussions more generally, and by the Foreign Minister of the Russian Federation, Andrei Kozyrev.

* * *

The Trilateral Commission is based on deep common interests and commitments among our three regions. First, we are all democracies. Second, we are the three main centers of the international economy, with special responsibilities for its healthy functioning in the interest of all countries. Third are broad international security and political responsibilities that follow from our weight in the wider international system. The Copenhagen discussions encompassed each of these three dimensions.

Revitalizing Trilateral Democracies is the title of a draft report by Robert D. Putnam, Jean-Claude Casanova and Seizaburo Sato discussed in Copenhagen and being published separately. As the authors note, one of the major ironies of this decade is that “just at the moment when

OTTO GRAF LAMBSDORFF

IN HIS CHALLENGE to the group at the outset of the Copenhagen discussions, Otto Graf Lambsdorff, the host region’s chairman, posed several basic questions. “Have we—has the world—really grasped by now how radically the global situation has changed since 1990? Do we have any clear idea of how the G-7 countries, the Trilateral countries, should respond to the changes? Will the limitation to the countries and the methods of the G-7 still do?” Graf Lambsdorff noted “profound differences of opinion” opening between our governments and between our publics on Russia policy and in other areas. “Will the EU go on sealing itself off from the world? Will NAFTA and APEC follow suit? Are we still advocating a world of open markets? What do currency upheavals—what does the globalization of financial markets—mean for the world, for the Trilateral countries? Ought the IMF to have acted the way it did in the Mexico crisis? Why did the WTO have to be exposed to such a squabble before Renato Ruggiero was elected?... We will not be able to answer these questions in Copenhagen, but we must face them. With this in mind, I wish all of us some good work!”
liberal democracy has defeated all its enemies on the ideological and geopolitical battlefields, many people in the established democracies believe that our own political institutions are faltering, not flourishing. The report describes these symptoms of distress, and seeks diagnoses and therapies for them that cut across our three regions.

A session on “Trade and Capital Flows in a Changing World Economy” took on issues of international economic management, where our countries are not fulfilling their leadership responsibilities. Peter Sutherland, stepping down as Director-General of the new World Trade Organization, noted that his deepest concerns about the trading system do not stem from policies of developing countries, embracing to an unprecedented extent the principles and policies of a liberal international economy, but from Trilateral countries traditionally the pillars of the system. Likewise on capital flows, E. Gerald Corrigan, former President of the Federal Reserve Bank of New York, noted that OECD countries are net importers of capital from the rest of the world, the opposite of what is needed for the world economy’s long-term health.

Russia was central on our Copenhagen agenda, including discussion of a draft report by Robert D. Blackwill, Rodric Braithwaite and Akihiko Tanaka (being published separately) entitled Engaging Russia. The importance of engaging Russia, the authors argue, rests on the possibilities for political and economic reform in Russia and on the deep interests of our countries in Russia’s external behavior. The agenda for engaging Russia developed in the report concentrates on issues of European political and security “architecture,” on nuclear issues, on involving Russia more deeply in the Asia-Pacific region, and on support for political and economic reform in Russia.

* * *

In a brief note issued at the end of the Copenhagen meeting, the three Chairmen—Otto Graf Lambsdorff for Europe, Kiichi Miyazawa for Japan, and Paul Volcker for North America—emphasized that the end of the Cold War, perhaps contrary to some assumptions, has brought new challenges that only reinforce the need for Trilateral cooperation. It is an essential purpose of the Trilateral Commission to resist centrifugal forces among our countries and to emphasize our common purposes and needs.

SECTION 1
RUSIA

Russia was central on the Copenhagen agenda. Printed below are the remarks of Andrei Kozyrev, Minister of Foreign Affairs of the Russian Federation, who spoke on the second day. Published separately is the report entitled Engaging Russia discussed on the third day.

Foreign Minister Kozyrev spoke in English and on-the-record. He made a number of additions to (and omitted a few parts of) his advance text, distributed in Copenhagen. The text that follows is basically the transcript of the Foreign Minister’s remarks. The advance text has been used for most headings, paragraph divisions, and some other details of presentation. Some minor editing has been done to smooth out the English, without changing the substance.

Otto Graf Lambsdorff introduced the Foreign Minister. “The Trilateral Commission,” he noted, “has always looked for partnership with your great country. We did so through our contacts with the then USSR, and after 1990 we hoped and argued for closer cooperation between Russia and the Trilateral Countries.” At the same time, Graf Lambsdorff added, there are developments that trouble us—“we hear more of a language of confrontation than of partnership, the war in Chechnya, your refusal to sign the Partnership for Peace, and your remarks about the use of force to protect your compatriots in near-abroad countries.”

After his opening remarks, Mr. Kozyrev answered two questions from the floor, from Kiichi Miyazawa and Henry Kissinger. The questions and answers are presented at the end of this text.
Strategy and Partnership

DISTINGUISHED Mr. Chairman, ladies and gentlemen. Thank you for this kind introduction. Really, it's a good moment in time to meet and to discuss things of mutual interest. I am grateful for the invitation to speak at this Trilateral Commission meeting. I have long-standing friendly relations or close professional cooperation with many of those present here, and am sorry there will be probably no time to meet each personally, which I would like to, of course.

This also includes the authors of the report under discussion, entitled Engaging Russia. Yes, I did have the privilege to meet them [in Moscow] and to look through the report, and I congratulate them. In my opinion, Ambassador Braithwaite has managed to incarnate in it his two talents which have made him a brilliant diplomat (we first met in Moscow when he was Ambassador)—that is, his profound knowledge of Russia together with his profound knowledge of both strong and weak aspects of its perception by the West. Ambassador Blackwill, I think, has enriched the report with his strategic vision, which is so characteristic of him.

Traditionally, the Trilateral Commission has been characterized by its ability to foresee drastic turns in the development of the international system and to suggest an effective strategy for action. I believe that at present the community of democratic states, which today includes Russia as well, equally needs a new approach to international affairs. This becomes all the more evident if one compares the two eras of post-war development: the emergence of a bipolar world in 1945-49, and the formation of a post-confrontation world in 1991-95.

Only four years [had] elapsed after the end of World War II when the foundation of a new international system was laid. The United Nations was created and, when the West realized it was not efficient enough in opposing communist totalitarianism, it did not take long to find both strategic responses to key problems and means for their implementation. (That's what I call strategy: a concept adequate to new realities; resources adequate to meet those challenges; and mechanisms again adequate to the challenges.) The North Atlantic Alliance was already being created and the Marshall Plan was in effect. But most importantly, Western leaders of those times, fully aware that security cannot be cheap, managed to resist the temptation of pennywise policies.

Unfortunately, ladies and gentlemen, the comparison is in favor of that time rather than the present. The beginning of the post-confrontation period of the world's development was not accompanied by ideas and strategies of a similar scale. We still abide by the institutional system which was established in a different situation and for different purposes. Four years have already passed since communist regimes collapsed in Russia and Eastern Europe, but leaders of democratic states of the East and West still have to improvise and respond to one crisis after another. This, however, can be a very dangerous thing, which creates mistrust and misunderstanding.

Improvisation, no matter how talented, cannot but reflect simplification and excessive influence of both the domestic and international situation. It creates a surprising effect for others, which, in its turn, makes them act spontaneously. This is the best environment for conflicts with unpredictable consequences.

I give you some examples. The lack of strategy, the lack of resources and mechanisms, the climate of instability and of suspicion is very well-illustrated by the moment I entered this hall. I didn't know that as outstanding a figure as the President of Estonia will be here at the next table. Lennart Meri and I once were (excuse me, Mr. President) both foreign ministers inside the Soviet Union, of different Soviet republics—that is, myself of the Russian Federation and Mr. Meri of Estonia. And then...
we established diplomatic relations under the very unhappy eye of then-President of the Soviet Union Gorbachev. But the truth of the matter is that, I take the liberty to say that as an old friend, he starts this conversation by saying, “I’m glad to see you; but why did you threaten use of force against Estonia?” Did I ever threaten use of force against Estonia? No. Did I ever even mention Estonia in that context? No. That is the climate of uncertainty and suspicion which is created by the lack of a clear, agreed-upon, elaborated strategy.

I believe that the Trilateral Commission could make a major contribution to the development of strategy, of a concept of relations between democratic states which would in fact embody the principles of “no vetoes, and no surprises.” In so doing, it is important to take into account both long-term strategic interests in creating an interdependent world, and the subtle fabric of the philosophy of international policy. I would like to point out the main areas of such efforts.

**The Concept of Partnership and its Mechanisms**

It might seem that the major achievements of the policy of Russia’s partnership with the West and its neighbors are obvious:

- **Conclusion of really important agreements, such as START II and the Agreement on Mutual De-targeting of Missiles.** (I am flying to the United States in a few hours, and for the first time ever, I don’t feel that strategic missiles would be aimed at me there, from Russia. And for the first time ever, sitting in Moscow, I’m sure that no missiles from overseas are targeted at me there. So I am the one to benefit the most, on both sides of the Atlantic—and many here.)

- **The withdrawal of Soviet troops from Central Europe and the Baltic States.** (Yes, these were Soviet troops, because Russia never sent those troops in the first place; but we took the responsibility and we fulfilled the responsibility of the total withdrawal.)

- **The creation of the Commonwealth of Independent States.**

I am convinced that historians will measure the deeds of the leaders of partnership between Russia and the West, including Boris Yeltsin, by precisely those landmark achievements.

So, [the fact of] the matter is that Russia’s “engagement” is already becoming a reality in many respects—but naturally not in the role of a side-liner, but as a partner of equal standing. This seems to me the key and the most central part of the debate [in this meeting] today and tomorrow [when the *Engaging Russia* report will be discussed].

The main conceptual issue of partnership is exactly this: how to develop a new strategy not against Russia (as it used to be during the Cold War) and not excluding Russia (as some try to do now), but together with Russia. This is our choice.

One of the good solutions of the issue has been the conversion of the G-7, the origin of which was witnessed by the Trilateral Commission, into the G-8 in [the] political sphere. Today, in view of the forthcoming Halifax meeting, we are approaching the next stage: a closer engagement of Russia in the discussion of global economic issues. I believe that this time the Trilateral Commission could also make an innovative contribution to the development of G-8 interaction in all fields.

Unfortunately, this approach is not used everywhere. Until now, some kind of “simplification reflex”—if this is correct in English—is felt in the West. What’s the essence of this reflex? It is simplistic interpretation of any move made by Russia. If this move seems to coincide with the prevailing or even very personal approach of some Western leaders, then Russia is considered to be a new and democratic country. But if Russia disagrees or tries to protect its interests, it is considered to be a remnant of the old system, a concession to nationalists, etc. By the way, the position of our national patriots [in Russia] is the mirror reflection of such an approach. If the West
agrees with Russia, it proves our power; if not, it is considered a manifestation of imperialism and Russophobia. [This is] but another byproduct of lack of strategy.

As a result, we have to deal with double standards in many aspects. Our Western partners urge us to make concessions on different international issues for the sake of parliamentary or public opinion in their countries. But when Russian reformers face the same problem in our country, it is usually ignored or called concessions to anti-reformist forces. However, we have much the same problem as you do. And that's the essence of democracy. After all, what do we want? Do we want [a] democratic politburo in Russia, which will deliver everything in accordance with the best scenarios? Or do we want democratic leadership in Russia, which has to win public opinion, and has to listen to public opinion, as other democratic governments have to do?

So let's take into account public opinion and parliaments. We know how difficult it is in the United States, the country I am going to in a few hours. But it is no easier in Russia.

Both in Russia and in the West a part of the society, owing to private corporate interests or old fears and suspicions, is rather slow in getting used to new relationships, or gives in to difficulties related to the establishment of those new relationships.

Peacemaking within the UN serves [as] a good example. Not only Western but our domestic isolationists too urge curtailing the financing of the UN, to end Russia's participation in peacekeeping operations, to withdraw unilaterally from the regimes of sanctions against Yugoslavia, Iraq, and Libya.

Let me be frank: Russian leaders are not enthusiastic about many sanctions regimes either. But we cannot afford lifting them unilaterally, although our budget needs every dollar it can get. Even when the Cold War was at its height, none of the great powers, including the Soviet Union, ever attempted unilateral violations or withdrawals from the sanctions regimes imposed by the UN Security Council. Politicians on either side of the Iron Curtain understood that violation of the UN Security Council decisions would undermine the entire international system.

Unfortunately, some politicians have now lost, it seems, totally or partially, their sense of responsibility for that matter. This is precisely the reason why partnership, on the principles of which we have agreed quickly enough, sometimes does not work or comes too late. Yes, Mr. Chairman, you referred to difficulties which emerge, and you referred to language which we would not dream of when we think of real partnership. But let us be frank: it comes from both sides, and sometimes (many times) only second rather than first from Moscow.

**Development of a Strategy Aimed at Fostering Russian Reforms**

The second area of strategic interaction is the development of a strategy aimed at fostering Russian reforms. Here we face the problem of bringing together promises and real possibilities, and especially that of the psychological impact of such promises on the Russian public. This is not an academic, but rather a purely practical problem.

So many words have been said about the necessity of large-scale assistance to economic reforms in Russia and the CIS, and Baltic States. At first, they created a most optimistic (I would even say romantic) attitude of these societies toward the West. Indeed, there was much more talk about assistance than assistance as such. This undermined not so much the [reform] efforts as the positions of the reformers—and, of course, gave very good arguments for the ultra-nationalistic forces. I will say even more: this is one of the reasons, if not the main reason, for the appearance of the likes of Zhironovski on the Russian political scene. They rose precisely on the wave of disappointment felt by some sectors of the society over the results of partnership with the West, and now they intimidate the West themselves.

At the same time, the results of the last four...
years in the development of the situation in Russia speak for themselves. We did go through critical, even tragic moments, when we really thought that the reforms were in danger. However, one should distinguish between more important and less important things. And the most important thing in the economic field is the real and perhaps already irreversible transition of Russia to a market economy. Suffice it to say that the share of the non-state sector in the Russian economy now amounts to 62 percent—which is more, by the way, than in Italy. And that happens in a country where the notion of non-state property or of private property was not only out of the political vocabulary, but millions of people served sentences in Gulags for only dreaming of private property.

What is most important in the political sphere is an effective democratic constitution, a working system of the separation of powers, and the dedication of the country’s leaders to the principles of free, fair, and multiparty elections. The President of Russia has clearly and unambiguously confirmed that the parliamentary elections would be held in [December] 1995, and the presidential [election] in [June] 1996, as scheduled by [the] constitution.

Finally, what is perhaps the most important is the existence in Russia of an open society undergoing an extremely complex stage of transformation in the conditions of political freedom. Even such a tragedy as the crisis in Chechnya has not been able to change this reality. Whatever is said on this subject in our country or in the West, one fact is undeniable. In the face of a direct challenge to the unity and integrity of Russia, the authorities did not opt for curtailing democracy and maintained openness of information, showed tolerance and respect for the public opinion, even if it does not approve of their actions in many respects. However, these key elements of the new Russian reality are precisely those that are frequently overlooked. Regularly, after each new turn of the Russian domestic policy (which won’t be easy), some commentators feverishly resume their search for a “democratic alter-

Effective Responses of the International Community to Qualitative Changes in the Protection of Human Rights and National Minorities

Another major theme for our joint deliberations is a search for effective responses of the international community to the qualitative changes in the protection of human rights and national minorities. The collapse of the communist regimes removed the “classical” problems of the 20th century: suppression of individual rights by the totalitarian state. But this was replaced by another problem: the rights of national and language minorities in many post-communist countries, and they are in one way or another still overlooked or violated.

We stand for the establishment of effective international and legal mechanisms to settle these problems at the UN or OSCE level. But in situations when the lives of Russian citizens are threatened, we could be forced to use the entire arsenal of means at our disposal to save them, including military force. My recent statement on that issue was received almost as a sensation or as another manifestation of so-

...PERHAPS...

MOST IMPORTANT IS THE EXISTENCE IN RUSSIA OF AN OPEN SOCIETY UNDERGOING AN EXTREMELY COMPLEX STAGE OF TRANSFORMATION IN THE CONDITIONS OF POLITICAL FREEDOM.
called Russian neo-imperialism. Yet, this is just a statement of simple fact and practice existing in international life for a long period and in the present day. This is impeccable both from the point of view of international law and the practice of other states.

Let me give you a few examples. Nobody tried to blame, but congratulated France and Belgium when they brilliantly executed [a] military operation to save the lives of their citizens in Zaire. I can give you another example: we have saved lives of citizens and co-patriots—Russian and French together—in Aden when the country was in the middle of internal strife.

I give you another example, in Tadzhikistan. I was there in the midst of the civil war which raged upon the country, in Dushanbe, the capital. And yes, I received during the night many calls from my colleagues from Western Europe, and all over the world, asking [us] to use Russian troops stationed there to protect their embassies, their journalists, and just citizens. And yes, the operation we have there, the collective force created by the CIS (with very small yet existent observers from the UN and OSCE) is now protecting the citizens of Russia, citizens of Tadzhikistan, our countrymen, some who are called Russian-speakers (which include ethnic Russians, Tadjiks, Uzbekis, in that particular republic, those who use Russian as [their] daily language), and many other people, just people at all, generally, from the gangs and from the civil strife which might cost them lives and property.

I give you another example: Sarajevo, where Russian peacekeepers, French peacekeepers, British peacekeepers, Ukrainian peacekeepers together protect the lives of civilians, some of them probably Russian citizens or of Russian descent, some of them probably French citizens or Francophone, so on and so forth—protect their lives by the use of force under the UN mandate.

So we, of course, prefer [a] UN mandate, we prefer [a] CIS mandate, we prefer [an] OSCE mandate. But there are instances in life, in present life, where force is used and should be used to protect countrymen, citizens, whatever, in special situations.

Where is the line? That is something we should make very clear for all time, including my speech which is referred to recently. There are extremists, there are new imperialists in Russia who claim that the military force should be used to establish a kind of new order in other republics, to re-establish control in other republics, including Russia itself. That is something totally unacceptable, of course—neither for Estonia nor for any other country. But that's where the line is—[between] the use of force for imperial designs, and the use of force as the last resort under very very special circumstances, under UN or any other mandate, and sometimes even unilaterally when there is no mandate but in very very specific situations.

I'm sure that any country, and any foreign minister in any country, would share this interpretation and this view. And of course we cannot, and I would not take as a legitimate approach, to put Russia in a corner and to limit its ability to exercise its natural rights in a situation where others do the same.

Philosophy of International Security in a New Era

The philosophy of international security in a new era is another major problem which requires our joint consideration. Perhaps the need for developing such a philosophy is nowhere felt with such urgency as here in the center of Europe. The threat of a Soviet tank strike has long since been replaced by dangers and risks of "civilian" origin. But this doesn't mean that they have slid into the background. On the contrary: if for most, say, Danes the Soviet military threat was no more than a hypothesis, today's security problems are in the full sense of the word awaiting the Europeans at the doorstep. These are: uncontrolled migration, ethnic conflicts, international crime and money laundering, and the ecological crisis.

As I see it, the origin of most of the threats to European security on the threshold of the
next century is a danger of social and economic instability and the deepening technological gap between different regions of Europe. Hence, the massive growth of xenophobia and aggressive nationalism in the East and in the West. All this contributes to the possibility of a new split on the continent, exacerbating the causes of ethnic conflicts and migration.

Finally, the mechanisms of consultation and coordination of actions between states and some European structures are quite weak in today’s Europe. There are no legally binding rules for common management of security in time of crisis. This fragmentation of legal and political security space in Europe threatens to provoke a feeling of political and psychological isolation and inequitable status among entire nations.

So far we haven’t been able to find responses to those challenges. There are some exceptions, such as a visible improvement of European Bank for Reconstruction and Development activity and the conclusion of the Pact on Stability. However, unfortunately, those are not yet the decisive factors in Europe. It was only with great difficulty that we managed to begin the modernization of the CSCE into the OSCE. Yet once again we face a paradox: Russia, the main initiator of this renovation, had to convince many Western partners of its necessity. I can testify to that: it cost a lot of trouble to persuade some of our partners to upgrade the CSCE.

**NATO Expansion**

Plans to expand NATO serve as an example of attempts to find solutions to European problems of the post-confrontation period using old patterns. This is like trying to go on a new road using the old car. Even if the old car was very good thirty years ago, and probably calls back some romantic memories of using this car, it cannot be used as effectively for new times and new romance.

Why do we speak about that? For us the problem is not that we feel a hostile attitude towards NATO, but that for the major part of Russians the North Atlantic Alliance still remains an alien organization. (I would like to draw your attention to this: it is not “enemy” anymore for the majority of public opinion—of course, there are incurable communists or nationalists who will never take anything—yet it is still “alien,” still something unknown.) It was created during the Cold War to deter the rival bloc, but this bloc does not exist anymore. In this situation, it is not clear against which threat the enlarged NATO is going to protect itself. If it is to protect itself from Russia, then this is fraught with a new split and new dividing lines in Europe. (The predictions of nationalists coming to power in Russia and enlargement as a precautionary measure becomes a self-fulfilling prophecy.) Or, if this threat is posed by new problems of European security—such as terrorism, nationalism, and others—then why not proceed to finding their solution together with Russia?

This is why we consider that the best solution would be a more or less protracted period of partnership between Russia and NATO. During this period, we could overcome completely mutual alienation and, most importantly, we could jointly determine the shape of a new security system in Europe, with NATO and with existing institutions. We should find a place for those institutions, define new roles for those institutions, and be sure that those institutions are not any more alien to each other.

So, to make a long story short, my answer to the question is: partnership, yes; immediate, hasty enlargement [of NATO], no. Let’s give partnership a chance, serious chance—and then see how the whole thing evolves.

But last December our partners made a sudden move in the opposite direction. The concept of an expansion of [the] partnership zone gave way to the idea of fast expansion of NATO itself. I was nearly ambushed in Brussels when I came to inaugurate this thick volume of really substantive programs of cooperation, and [was] then presented with a communiqué which by all reasonable stan-
The shifting of emphasis from Partnership [for Peace] as the mainstream effort, the project for the foreseeable future, to enlargement of NATO with new members before partnership even gained some momentum with any of the countries. There is no country whatsoever in Europe which already engaged itself in substantive partnership.

And is there anyone in this audience who could give me a single example of a practical thing which could be done in a foreseeable future between NATO structures and any of the Eastern or Central European states which cannot be done within the framework of Partnership [for Peace]—and needs to be done necessarily in a new NATO membership relationship? There is no single example whatsoever. Everything—like political consultation and political rapprochement, military consultation and military cooperation, economic cooperation (so far as it is concerned with NATO)—everything is covered by the Partnership programs, especially since they are individual for any country.

"Nevertheless, the enlargement will take some time"—that’s the answer we hear all over the place. “Don’t worry, it takes time—because we [are] not prepared, because there are lots of practical things to be done.” Exactly. Let’s address those practical things. Even if we [in Russia] don’t want to see them as preparatory for new NATO membership and even if some in NATO—or in Central Europe—want to regard them as preparatory, nevertheless all these things could be done, and should be done by definition, under the Partnership for Peace program.

I don’t see what’s the rush. In practical terms, everything considerable and everything pragmatic could be done under the Partnership [for Peace]. But the talk and the fuss around the enlargement of NATO, the shifting of emphasis on to enlargement rather than partnership, brings nothing practical, but it brings a lot of psychological, political damage and difficulty for the larger part of Russian public opinion.

My question is: what for? What’s the purpose? It reminds me of a situation in a mountain when somebody shouts, and the stones start falling. So we have already shouting and falling stones. Some of them even blocking the partnership. Some of them [are] making our lives tremendously difficult, especially in the elections year.

My question again is: what for? Where is pragmatism? Where is attention to mutual difficulties?... [Do we demand a veto] on European or other states’ choice? No. President [Yeltsin] made it very clear, in the very beginning, in Poland. Do we exclude NATO from Europe? No. Do we exclude even enlargement of NATO in the end of the partnership process? Again, no. In December 1991, when the Council for Cooperation between NATO and the new democracies was created, President Yeltsin sent a public letter indicating that we do not exclude, in the end, that Russia might become a member of the new renovated NATO; and it still stands.

So nobody excludes any option, including enlargement [of NATO], even with participation of Russia. But let us do something practical. Let us try a little bit partnership. Let us be serious, even, on the strategy we have developed—the strategy of the Partnership. Sorry for this emotional outbreak. But really, I personally—I never bow to pressure from Nazis, fascists, and others; and it’s just ridiculous that President Yeltsin, who once met tanks on the streets of Moscow, took on the communist regime and the new imperial regime, that he will bow now to pressure from the military—but really, we want just a frank and pragmatic answer: what’s the rush?

I can tell you what is negative, but I can see no pragmatic positive outcome of the rush with enlargement. Who denies enlargement? Nobody. Who denies, again, Russia in NATO? Nobody. But let’s make serious efforts with what we’ve agreed upon and not shift the emphasis. So the moment the emphasis is shifted back to partnership as a serious project, we will inaugurate the program we have prepared and we shall see how the whole thing goes. And I’m sure that, in few years, after the Partnership...
program gains momentum, we will forget like a nightmare the artificially created almost-confrontation which we face now. That's the answer why there is that much confrontational rather than pragmatic-partnership language and talk.

A Strategy for Europe
So what could be the answer? I'm not trying to imagine here a new strategy for a new Europe, but let's try to think together, so to say.

First, the security of a new democratic Europe can be only common and comprehensive, common to us, common to Estonia, joint—but not devised by new NATO members and non-NATO members. We are speaking about Russia; but let's for a moment think what happens in Central Europe itself if old anxieties come to the forefront, if individual countries are left in before the other... like Hungary and Romania, or I can go on. You know, odd pairs of states, would they be happy to see somebody in a military alliance? And let us not forget that NATO is a military alliance. We have no problem with enlargement of the European Union, because it is understandable. Yes, countries want economic cooperation; they want political cooperation. But why do they want military cooperation without our active participation? Again, the answer is: partnership.

Second, the security of citizens is the core of the new European security.

Third, the unity of a democratic Europe means indivisibility of security for European nations. No state has the right to strengthen its own security to the detriment of that of the others.

Fourth, partnership in a new Europe should mean complementary efforts by states and multilateral institutions in building common security. The OSCE and NATO, the European Union and the CIS (as well as numerous regional or subregional organizations) are not rivals, much less mutually exclusive elements of European policy, but are important factors for shaping a genuinely common system of security and cooperation—but [a] new system.

It is fashionable in NATO today to discuss questions beginning with "how" and "why." We, in turn, have suggested our own version of "how" and "why" questions—to be discussed precisely within the all-European framework, with the participation of all the OSCE members:

- How to set up efficient mechanisms to take into account the interest of all the OSCE member states? It might be a system of binding consultations or the involvement of regional organizations in decision-making.

- What specific forms the principle of interdependence of all democratic states of the East and West should take? Possible options: a Euro-Atlantic or a Eurasian Treaty or a Charter of Cooperation.

- What are the ways to ensure the optimum relationship between global, regional and subregional approaches to the solution of European problems? In practical terms, what are the possible specific ways to bring closer such processes as integration within the EC and the CIS, transformation of NATO and enhancing and defining the OSCE role?

- How to adapt and supplement the existing treaty basis of military security for a new Europe? We could think, in particular, of a new, bloc-free agreement, say, CFE II.

- How to accelerate economic development of Eastern Europe and simultaneously create conditions conducive to all-European development? One of the possible ways is to implement projects related to European economic infrastructure for 21st century, such as the establishment of new powerful single energy, telecommunications, and transport systems.

I believe that the Trilateral Commission could devote one of its reports to the search for answers to these and other similar "hows" and "whys."

* * *

...THE MOMENT THE EMPHASIS IS SHIFTED BACK TO PARTNERSHIP AS A SERIOUS PROJECT, WE WILL INAUGURATE THE PROGRAM...
Mr. Chairman, ladies and gentlemen, in several days the world will celebrate the 50th anniversary of the Great Victory over the forces of totalitarianism in 1945. This event overshadows all other smaller issues. Only the main landmarks which really determine the image of the world at the end of the century remain intact. I believe that our endeavors, too, should be measured against those historic landmarks rather than simultaneous changes in the political situation. Keeping the broad perspective in mind will enable us to better understand each other, realize the common nature of our basic interests, and thus, to begin the elaboration of a partnership strategy for a new model of security for the end of this and beginning of the next century. Hopefully, members and experts of the Trilateral Commission will contribute to this effort. This report under discussion is not the end of this work; it is not even the beginning of the end. As Winston Churchill put it, this is just the end of the beginning.

Questions & Answers

Question: This is a very critical moment. You mentioned about “stones falling upon our heads.” At the Budapest OSCE meeting in December, President Yeltsin mentioned something to the effect that the termination of the Cold War may end up being a “Cold Peace.” Do you feel the same way now?

Mr. Kozyrev: I think what President Yeltsin did is wise—he sent a warning—that, yes, there is a chance, there is a danger of the “Cold Peace” rather than the full-scale and full-fledged effort to create a united Europe, if we continue going on without answers to urgent questions, and if we continue to go along without strategy of a real united Europe. And as I said, yes, the stones are already falling. In internal politics in Russia, the nationalists are using the unclear purpose of debate of hasty enlargement of NATO to demonstrate the failure of the present government—including myself. Because it only demonstrates that instead of creating something new (which we promised the Russian people) with our natural partners and allies (democratic countries in Europe and the United States), we are met with the extension of an old mechanism, of a mechanism which was created to counter the Soviet threat. So we need clear answers; we need clear strategy. And then we will avoid the Cold Peace—which is not our preference, not a threat to other countries. But this is something which we could face if we fail to elaborate, agree upon, and effectively install the strategy of united Europe and uniting world.

Question: You asked what is it that could be done in the enlargement of NATO now being discussed that could not be done in Partnership? What could be done is to give political guarantees against military pressure or aggression. If the idea of partnership is developed in the sense that you propose, then Russia will join NATO—that’s the logical evolution. NATO gives no guarantees internally to member states that might be in conflict with each other. And then one could argue (if one has old-fashioned thinking) that one would face a situation of a country of 180 million, extending over eleven time zones, surrounded by a group of small, relatively impotent countries—no longer guaranteed by any arrangement because they would now be part of a general system of collective security. And to the exponents of old-fashioned thinking, this might look, in the hands of less enlightened Russian leaders, as a device for what used to be called hegemony. Now is that a totally unfriendly way to analyze the problem—that it would dissolve an alliance into a vague system of collective security which has no internal guarantees and in which then the specific weight of the individual members would become dominant.

Mr. Kozyrev: That’s exactly, it seems to me, the self-fulfilling prophecy—not only of the Cold Peace, but probably of a new confrontation. Because, again, who is conceivably putting a threat of aggression to a Central European state—like Poland, for instance?

History was mentioned, that both of our
countries should not forget history. A historian would probably point to Napoleon, imperial Germany, imperial Russia. What else? No more than that probably. But the question is: Do we really want to re-create the structure in Europe which would presuppose that Germany again becomes an aggressor—or Russia again becomes an aggressor against Poland? Or do we want to create a structure, to create a mechanism which would engage Germany, Russia, Poland, everybody in a constructive effort to overcome historical anxieties and suspicions—and, yes, into a new collective security mechanism.

My answer is [the] second. Let's try, however difficult and however new this challenge is, to conceive a model of security, and resources and a mechanism for that, which would engage us in a new effort and exclude by itself the coming back of aggressive or imperial Russia or imperial Germany or even imperial France. Otherwise we are doing exactly the wrong thing.

That is exactly the message which is read by a larger part of Russian public opinion: "What do they enlarge for? Who is the potential aggressor?" Russia? Why? Because it's communist? No. It is not communist. And it will probably not fall into communism at the next elections. I do believe that we have the potential and that we will sustain democratic movement at the new elections, which are coming at the end of this year.

But nationalists, of course, they do use this argument. They say: "Whatever you do here in Russia.... Even if you, stupid Kozyrev, contributed to overthrowing communism and the empire, and recognized Estonia, even if you withdraw all your troops from abroad, whatever you do.... Even if you sign the agreement cutting the nuclear arsenals with the United States (like START II), even if you de-target the warheads, whatever you do, you will still be regarded as an enemy. And they will still create and enlarge the military alliance against you. That's the answer to your stupidity, in domestic and in foreign policy. And that's why Mr. Zhirinovski is right: that they will always see us as an enemy, and that we have to mobilize. And while we still have the world's largest nuclear arsenal, let's stop the cutting the stupid democrats imposed on us—and rather reinforce the military arsenal."

That's the question we face at the elections; and that's why we are so alarmed and we are so concerned; and that's why I try to explain to everybody why the stones are already falling. They are already falling—right on [my head] here—very personally I [would] hate to write [in my] memoirs, probably in [the] Gulag, that we missed the opportunity.

[We are about to celebrate] the fiftieth anniversary of the victory over Nazism. What if we [had] start[ed by] telling [the] Germans, "No, whatever you do.... You're going to have forty years of successful democratic development, helped with [the] Marshall Plan, helped with institutions which were created in the right time (and which are not created in the right time for Russia), but nevertheless, whatever you do, we have to keep a kind of alliance we had with the United States against Nazi Germany, against Hitler"? What kind of logic is that? I mean, it's almost the same.

And that was the logic of those who guarded the Berlin Wall in Moscow. Because they said: No, the Berlin Wall will stay there forever because Germans, they are evil people. They will always come back to aggression.

So the answer again is that you cannot suspect people or a country of being evil. You can either create systems which will alienate the country and then it becomes evil, probably—or you try to create a new system which will engage the country. [That is] exactly the meaning of the report: engaging Russia and Russia engaging other countries since we have a chance—and [a] very good chance—of [a] democratic Russia, rather than [an] imperial one. And I would hate to lose the chance only because somebody somewhere needs, for domestic purposes, much talk about enlargement of NATO.
Dual Engagement: U.S. Policy Toward Russia and China

During the Cold War, the fundamental structure of U.S. foreign policy was reasonably straightforward. We built strong security alliances and supported Western Europe and Japan's post-war economic and political reconstruction. This effort was motivated in part by our commitment to promote democratic values and open markets. But it also grew out of our need for strong partners to respond to the challenge posed by two powerful states—the Soviet Union and China—whose ideology not only doomed their own people to repression and despair, but also threatened our security and liberty.

Today, our challenge is different. The importance of our core alliances remains fundamental. But their purpose is no longer to contain or combat a common enemy. Rather it is to work together to advance common interests and to meet a far more complex and diverse range of challenges. Russia and China are no longer our ideological or strategic adversaries. But, by virtue of their size, geography, and potential economic, political, and military power, they can still have a profound impact on the security and well-being of all our citizens—for good and for ill.

For this reason, Secretary of State Warren Christopher has identified the strengthening of productive relations with the world's leading powers as one of the core strategic principles guiding U.S. foreign policy. I need not dwell before this audience on the paramount importance we place on making sure that the ties that bind the United States together with our European and Asian partners remain strong. These alliances are at the core of our foreign policy. Instead, today I want to discuss our strategy toward the two other leading powers, Russia and China—a strategy I might call, following humbly in the shadow of my predecessor and now colleague, Anthony Lake, "dual engagement."

As we approach the twenty-first century, Russia and China are both embarking on treacherous, and often unpredictable, paths of transformation, in domestic as well as foreign policy. Russia has opted for the truly daunting course of building democracy and a market economy for a people who have never experienced either. China seeks to orient its economy away from centralized control to promote growth and prosperity, while retaining an authoritarian political system. Both are struggling to define appropriate foreign, economic, and security policies, torn between the often conflicting impulses of gaining the benefits of participating in Western and global institutions, while protecting their as yet ill-defined national interests.

Our strategy of engagement with these countries takes into account both the similarities and differences in these two transformations. Let me take just a minute to provide a brief assessment of the changes taking place in each country before turning to our policy.

Russia Today
Some three and a half years ago, the Russian people made a fundamental break with their own history by dismantling both the Soviet Union and the brutal communist system that kept it together. Today the rudimentary foundations of a democratic government are in place, but they are buffeted daily by the stresses of an unprecedented and turbulent transition.

New elites and interest groups have joined an intense struggle for power, influence, and wealth that is fought increasingly, but not exclusively, within the bounds of a nascent
constitutional and legal framework.

The unheralded everyday struggles of the average Russian are complicated by growing feelings of vulnerability and confusion. Rampant crime and corruption are leading some to equate democracy with disorder. Yet, while their craving for order has deepened, most Russians would not willingly abandon the new freedoms and opportunities brought by the end of Communist rule.

To the surprise of nearly all observers, the liberalization and privatization of the Russian economy have proceeded at a dizzying pace. In 1994 the burgeoning private sector produced more than half of Russia’s GDP. And Russia’s admittedly chaotic emerging market is being shaped today not solely by government decree, but by the combined forces of some 2,500 commercial banks, 600 investment funds, and 40 million private shareholders.

The path of economic change still faces serious obstacles. Private property is emerging faster than the legal framework needed to guarantee its sanctity. New owners, managers, and investors must contend with punishing taxation, widespread crime and extortion, and bouts of high inflation and currency instability. In the face of constant pressures on the Russian government to provide wasteful subsidies, the recent agreement with the IMF creates a sound basis on which Russia can continue down the essential path of reform and budget discipline.

The collapse of the USSR’s internal and external empires has left a vacuum in Russia’s foreign policy. Without question, history and geography will tug Russia’s leaders in predictable—and sometimes dangerous—directions. But Russia is in the midst of a profound debate about its real national interests.

The Russians have honored their commitments to withdraw their forces from Central Europe and the Baltic states and have pursued a moderate and largely pragmatic stance toward Ukraine. But they must also decide whether, as in the case of arms sales and nuclear exports, they will continue to place short-term, economic advantages over Russia’s enduring security interests as well as its international obligations. And it is unclear whether Russia will respect the security, independence, and sovereignty of all the states of the former Soviet Union while it pursues its declared goal of CIS integration. The signs thus far are mixed.

The increasingly assertive tone of Russia’s leaders on a whole range of foreign policy issues stands in sharp contrast to the intense weakness of today’s Russian state. The Yeltsin government’s disastrous policy in Chechnya may well have been, in part, a misguided attempt to counter perceptions of this weakness. The greatest risk in the near-term is not that Russia may reconstitute its global military potential, but rather that a beleaguered Russia would be increasingly vulnerable to the insecurities and nationalism that have fed Russia’s dangerous isolation in previous eras.

In addition to a series of real and imagined threats from the south, Russia must also contend with the prospect of being isolated between what Duma Foreign Affairs Committee Chairman Vladimir Lukin has described as “two Europes”: the Europe of the European Union, which may soon embrace most of Central Europe and East-Central Europe, and the “Europe” to Russia’s east, the rapidly modernizing, democratic countries of Asia.

**China Today**

China is undergoing a remarkable transformation, growing over the past fifteen years from a rigid, ideologically-driven state, proud but mired in poverty, to a rapidly developing, more outward-oriented country with great hopes for the future.

Economic modernization has been accompanied by immense problems—massive economic and human dislocations, serious corruption, a leadership distanced from its people and grounded in an outmoded party structure, and a military that is concerned about the prospect of public disorder.
But with its double-digit economic growth rates, its military modernization, and its growing activism abroad, China's government conveys a sense of substantial—some might say excessive—self-confidence. In most other Asian nations the reaction has been a growing sense of unease.

There is a broad consensus within the Chinese elite on enhancing the PRC's prestige and influence. But the ongoing process of leadership succession will produce new uncertainties and the possibility of instability. Any likely successors, confident as they may be about long-term historical trends, will be guided by their view of China's history. They will recall not only the hyperinflation and social disorder earlier in this century, but also the numerous political campaigns China endured, including the Cultural Revolution. Just as they will likely seek a stable international environment, they will continue to fear dissent and unrest at home, attaching a level of importance to maintaining order and preserving their control that may well exceed our understanding as well as broadly-based principles of human rights, as at Tiananmen Square in June 1989.

Lacking a credible ideological appeal, China's leaders emphasize nationalistic themes to mobilize support. To all appearances, they are having some success. Mao's words on the eve of victory in 1949 still resonate: "Ours will no longer be a nation subject to insults and humiliation. We have stood up."

**Engaging Russia and China as Great Powers**

Our policy towards these two important countries is not driven by a desire to balance one against the other, but by our conviction that engagement with both is in our interest. Some recommend that we base our relations with Russia and China on classical balance of power considerations. They would take it as a given that Russia is doomed to authoritarianism at home and expansionism abroad and that Confucian culture and Middle Kingdom syn-
dromes will hinder China's emergence as a constructive, democratic partner.

We reject such notions of geopolitical and cultural predetermination. We know that many of the forces shaping Russia's and China's destiny are beyond our capacity to influence. And we recognize that the future of both countries is uncertain. But we do believe it is within our collective capabilities to help shape their choices in directions compatible with our interests and our values. It would be not only self-defeating but irresponsible to forego this historic opportunity to sustain the constructive relations we now have with both these nations.

The United States has a fundamental interest in cooperating with Russia where possible—under whatever regime—on such vital security issues as arms control, regional conflicts, and global non-proliferation. We also have to manage the differences, sometimes quite significant, that we do have. This "pragmatic policy of engagement," as Secretary Christopher has termed it, has produced real dividends for the people of the United States, our allies, and the world. The ongoing process of nuclear reduction and measures to safeguard nuclear materials are but one, albeit central, example. This approach is the basis for the regular meetings between our two Presidents, such as the Summit we will hold following the V-E commemoration next month in Moscow.

We have important issues at stake with Russia that President Clinton will pursue at the Moscow Summit. He will emphasize our strong opposition to Russia's proposed Iranian reactor sale, which poses a direct threat not only to our security and to stability in the Middle East, but to Russia's security as well. And he will continue to press for speedy Russian ratification of the Start II Treaty as well as for full Russian compliance with various arms control obligations, including the CFE Treaty.

We do not underestimate the risks and challenges Russia faces during the transition period. Many of Moscow's most critical for-
eign policy dilemmas lie in sensitive areas close to home. Our engagement—indeed, the engagement of all the nations represented in this organization—can help bring Russia to pursue its interests in ways consistent with international norms.

Our policy of comprehensive engagement with China has created a foundation for building constructive ties in a way that the U.S.-PRC relationship of twenty-five years ago could not. That earlier relationship enhanced the security of both countries, but it was essentially one-dimensional. Only after China adopted its reform policy in the late 1970s and after its emergence as a less ideological state did a more broad-ranging relationship based on pragmatic self-interest become possible.

Still, the PRC’s transformation into a non-revolutionary state did not necessarily mean China would become a status quo power or—as we can see—a democracy. In fact, China’s growing military power means that China’s own strategic orientation has become an important issue for the future.

We do not assume that China harbors hegemonic ambitions or that it will become a “rival” or “threat” to our interests in the region. China can become a force for stability in that region. At the same time, China could choose a course that poses dangers to its neighbors.

In the South China Sea region and in the case of Taiwan, for example, although it espouses a peaceful course, Beijing has stated that it is prepared to use force, if challenged, to support its extensive claims of sovereignty. Today, the issue of China’s long-term role arises with increasing frequency in our conversations with Asians—as often at their initiative as ours.

Of course, China’s reach goes beyond its immediate neighborhood. The PRC’s cooperation will be critical, for example, to prevent the spread of weapons of mass destruction and their delivery systems. Beijing may now be willing to forgo export of any MTCR-class missiles and related technology and equipment. But its record is mixed at best, and questions remain about China’s past activities. Moreover, China’s cooperation with Pakistan’s unsafeguarded nuclear energy programs as well as with Iran’s nuclear efforts causes us deep concern.

An important dividend of our engagement strategy has been the renewal of U.S.-PRC dialogue on a range of proliferation-related issues in addition to our ongoing productive consultations on North Korea. We believe that these dialogues, as well as other conversations, including nascent regional security dialogues such as the ASEAN Regional Forum and the Northeast Asia Security Dialogue, can help assure that concerns are openly addressed rather than letting them fester behind a facade of politesse.

The Case for Promoting Russia’s Integration
As we deal with China’s and Russia’s foreign policies, we are not indifferent to internal political developments. This is not simply because we are troubled by repressive practices on human rights grounds alone—although we are deeply concerned by them—but also because we believe there are important linkages between what happens internally and how nations behave externally.

This explains why there is an important difference in our approach to Russia and China. While we seek to engage both countries across a broad spectrum of issues, Russia’s courageous decision to opt for democracy and its commitment to respect international norms open the door to a strategy of integration into Western institutions. Russia’s membership in the NACC, its expanding relationship with such economic institutions as the OECD, and above all, its participation in the political dimension of the G-7 summits—through what we call the G-7-plus-1—have become possible by virtue of the political and economic freedom that Russia has embraced. As Russia moves further down the path of reform, we will support its fuller
integration into the West.

Russia's integration into European security structures is an important element of our overall strategy. The United States and our NATO allies have charted a vision of an undivided Europe and an important role for Russia within an overall European security structure. This structure includes a strengthened OSCE and a closer relationship between Russia and NATO, both through the Partnership for Peace and through enhanced NATO-Russia links. We believe the most appropriate next step for Russia to develop this relationship is by implementing its Individual Partnership Program and the separate document on NATO-Russian ties.

Despite the urgings of some, we do not rule out a priori that Russia, like any other member of PFP, might one day join NATO. At the same time, it is reasonable to examine, as many Russians themselves have done, whether this is the most appropriate way for Russia to participate in the overall European security structure, given its size and geographical situation astride two continents. For now the question is open, and it will be a long time before Russia's transformation is sufficiently assured to make this issue ripe for NATO's members. As Secretary Christopher has said, each potential member "will be judged individually, according to the strength of its democratic institutions and its capacity to contribute to NATO's goals." Meanwhile, the Partnership for Peace has enduring value, both for those who may become members of NATO and those who follow a different course.

The predicate for broadening and deepening this process of integration is Russia's continued pursuit of economic, political, and foreign policy reform. The Russian government's use of excessive and indiscriminate force against the people of Chechnya is inconsistent with the international code of conduct it endorsed at last December's OSCE Summit in Budapest. For the United States, this was a factor in deciding against supporting an enhanced role for Russia at the G-7 Summit in Halifax.

Despite the questions raised by Chechnya, we believe that democracy is very much alive in Russia. Indeed, the ability of Russia's independent media and those both on the right and the left to criticize President Yeltsin and the Chechnya operation is a healthy sign. President Clinton has made clear the importance we place on upholding the democratic process in Russia—in particular, this fall's parliamentary elections and next year's presidential contest.

In contrast, the leadership of China continues to resist democratization and only has slowly and reluctantly embraced international norms. The President's decision to continue to advance human rights and democratization, even as he severed the linkage with China's MFN, was based on the belief that observance of these principles is the only reliable assurance that over time China's behavior abroad—as well as at home—will be grounded in the rule of law and not the whim of individual leaders. One test of China's ability to make this transition will come in its handling of the reversion of Hong Kong in 1997.

In the economic arena, China's behavior has generated mixed signals about its willingness to abide by international rules, including the terms on which it could enter the WTO. One helpful sign is that, while negotiations with the United States over protection of intellectual property rights were resolved only at the last minute under threat of retaliation, we are seeing growing, if tentative, indications that the agreement is being implemented.

Conclusion

In dealing with both Russia and China, our focus must be on the long run, and on providing positive support to the forces of reform. While we feel deep frustration at our limited progress in securing human rights in China, or ending the fighting in Chechnya, we must make sure that the response we adopt will help achieve our goal. It is tempt-
ing to cut off assistance to Russia in protest over Chechnya. But we need to ask whether it serves our interests to cut off the funds that are helping to dismantle Russia’s nuclear arsenal, or are supporting privatization, legal reform, and freedom of the press.

The United States, along with our allies, has an immense stake in the way we manage our relationships with Russia and China. Although much has changed since the end of the Cold War, one fundamental fact has not. Our ultimate success depends on the close cooperation of the world’s great industrial democracies.

Whatever course Russia and China finally pursue, we know that none of us can assure our security or prosperity alone. President Clinton has made clear his commitment to keeping the United States engaged in the world, and maintaining our partnership with our key allies, principles which have guided the work of this distinguished organization from its inception.

James B. Steinberg is Director of Policy Planning in the U.S. Department of State.

KOJI WATANABE

The New Security Environment in East Asia

The new security environment in East Asia is characterized by an increasing yet restrained role of Japan, a new assertiveness of China, Russia trying to be a major actor in the Asia-Pacific region, the United States reaffirming its central security role as an Asia-Pacific power, and the Korean Peninsula as the focal point of tension and danger.

Europe and East Asia
During and After the Cold War

This sweeping generalization naturally needs further elaboration and some qualifications, but it would be useful before doing so to compare the implications of the end of the Cold War for East Asia and for Europe.

The Cold War was most manifestly waged in Europe in the form of military confrontation between NATO and Warsaw Pact forces, with a divided Germany and the Berlin Wall as its tragic symbol and most potent reality. In East Asia, while two hot wars were fought in Korea and Vietnam, the Soviet military threat was not universally perceived as such. Threat perceptions were diverse and divergent among countries in the region. The Sino-Soviet conflict effectively neutralized the Soviet threat; and the American military presence in Japan and elsewhere in the region had the effect of containing the visible Soviet military presence.

Europe is now celebrating the 50th anniversary of the end of World War II combined with the joy of the end of the Cold War— with Germany reunited, the Warsaw Pact a thing of the past, the Soviet Union dismantled, no authoritarian regime anywhere, and most importantly, no more Russian soldiers outside the CIS. In East Asia, the legacies of the last World War, perpetuated by the Cold War, still persist. The Korean Peninsula remains divided; the Taiwan issue is becoming more sensitive; Communist Parties are still in power in North Korea, China, and Vietnam; and the Northern Territories issue between Japan and Russia remains unresolved, with Russian soldiers still stationed there.

The Korean Peninsula

The Korean Peninsula is probably the one current flashpoint of military danger in East Asia—potentially a very dangerous one, with global implications. For some years the Democratic People’s Republic of Korea has been strongly suspected of pursuing a nuclear weapons program. Under virtually universal pressure, North Korea agreed in October 1994 to halt
and ultimately dismantle its nuclear program. The United States worked very closely with the Republic of Korea and Japan to reach an Agreed Framework with the DPRK for an immediate halt and eventual dismantlement of its graphite-moderated nuclear reactors as well as its spent-fuel reprocessing program. The Agreed Framework also provides, in return, for North Korea to receive two light-water reactors and heavy fuel oil to compensate for electricity which would have been produced by the graphite-moderated reactors. Financing and overseeing the construction of the light-water reactors is the Korean Development Organization (KEDO), an international consortium.

Should North Korea abrogate the Agreed Framework and resume its own nuclear program, putting itself outside the Non-Proliferation Treaty, the effects on peace and stability in East Asia would be ominous, and damage to the nuclear non-proliferation regime almost irrepairable. It is for these reasons that as many countries as possible—particularly those in the European Union—are earnestly asked to join in the KEDO, so that North Korea is persuaded that the KEDO is acting for the whole international community.

In July of last year, Kim Il Sung passed away. Virtually all powers, both real and ideological, were long concentrated in the person of the “Great Leader”; and North Korea has been practically the only remaining autocratic authoritarian state isolating itself from the outside world. The successor regime under Kim Jong II, his son, needs to be watched by the international community with utmost vigilance and care.

While North Korea’s economy is reported to suffer continuous deterioration, particularly food production shortfalls and energy shortages, it is also manufacturing and exporting an improved version of the SCUD SSM. A medium-range missile is being developed and tested with the whole of Japan within its 1500-km range. With an army of one million out of a population of 23 million, and with the largest special forces unit in the region, North Korea is such a source of tension and danger as to warrant alarm and vigilance. Renewed efforts to help her come out of self-imposed isolation are necessary. The North Korean elite has started realizing that the correlation of forces both outside and inside their isolated country is not in their favor and that something has to be done to redress the situation, particularly regarding its economy.

The end of the Cold War has provided the Republic of Korea, North Korea’s southern rival, with long-awaited diplomatic opportunities. It established diplomatic relations with both the Soviet Union and China, and joined the United Nations. Efforts on the part of North Korea to establish diplomatic relations with Japan failed—though it also joined the United Nations, simultaneously with the Republic of Korea. No prospect for diplomatic relations with the United States was visible. It is possible to argue that this prompted North Korean leaders to resort to brinkmanship in March 1993, to declare that it would divorce itself from the non-proliferation regime.

The stakes for the successful implementation of KEDO involve not only non-proliferation. It is also hoped that the process of implementation will proceed simultaneously with improved dialogue and the lessening of tension between South and North Korea, and will prompt North Korea to become less isolated and less self-centered, thus defusing the tension and danger on the Peninsula. The United States has agreed with North Korea to establish liaison offices in Pyongyang and Washington, and it seems likely that Japan and North Korea will resume normalization talks in the near future.

The extremely authoritarian autocracy under Kim Il Sung has been possible only through isolation and a closed-door policy. An open-door policy will inevitably erode the myth and reality of this autocracy, particularly now that both Russia and China are “contaminated” by capitalism. Kim Jong II, whose reputation as an able leader seems to have been positively reassessed since the death of Kim Il Sung, will certainly have a difficult path to follow. It is safe to assume that North Korea will remain for some time a serious potential threat to the
peace and stability of the region—and beyond in view of the proliferation danger associated with its missiles as well as nuclear materials.

**Russia**

Russia is one of the four major actors in the East Asian security scene. Throughout the Cold War period, the Soviet Union was not able to make its military presence acutely felt except during the Vietnam War and in the form of occasional reconnaissance and show-of-force flights by its long-range planes.

A new Russian Asian policy is in the process of formation. But no clear articulation of it is being made, except for wishing a status of major actor in the Asia-Pacific. Russia has been particularly active in developing relations with China, with a strong emphasis on the Chinese market for Soviet weaponry. China is now the biggest buyer of Russian military equipment. Visits between leaders as well as military personnel of the two countries are frequent—including Yeltsin’s visit to China last year and Jiang Zemin’s visit to Moscow this year.

Russia’s relations with the Republic of Korea are steadily progressing. At the same time, Russia has resumed diplomatic efforts to reactivate its relations with the DPRK, which have fallen to such a low point that there is not even any direct regular Aeroflot flight from Russia to Pyongyang. No important visits have been exchanged in recent years, in contrast to the very frequent exchange of visits between Moscow and Seoul. Russia has not made up its mind whether or not to join KEDO, and makes no secret of its desire to see a Russian-made light-water reactor purchased by the KEDO or by North Korea, an unlikely prospect in view of financing difficulties.

Apart from the desire to act as a great power in East Asia, as elsewhere, Russian policy toward the region is clearly economic. Due to Russia’s limited capabilities to trade in civilian commodities, strong emphasis is put on the promotion of exports of military equipment; the sale of 18 MiG-29s to Malaysia last year was a breakthrough in this respect. It is to be watched carefully to what extent Russia makes inroads into the growing market for military equipment in South East Asia, and whether it aggravates the military build-up in this sub-region, a potentially destabilizing development affecting the peace and security of the region.

Russia has made a formal application for membership in APEC, which is receiving mixed reactions, reflecting relatively little Russian economic involvement in the region. The Far Eastern region in the Russian Federation is relatively underdeveloped; the center of gravity in Russian politics and the economy is still in European Russia, the Urals and Western Siberia. Given a steady outflow of population from its Far East, prospects for Russian economic involvement in East Asia may not increase rapidly. The situation can be redressed if Moscow starts thinking positively about development of the Far Eastern-Siberian region as a priority, which regional governments are urging and which Japan would welcome.

**China**

China in the past decade has been on the whole a positive element in peace and stability in the world in general as well as in East Asia, since China has had to concentrate on its own economic growth. China has boldly carried out economic reform, introducing foreign capital and the market mechanism, while avoiding political reforms and suppressing human rights movements, and maintaining the rule of the Chinese Communist Party.

Since the popular legitimacy of the Party’s rule has for some time rested on its ability to improve the living standard of the people and since this has been possible only through economic reform, the Chinese Communist Party has been suffering from the erosion of its ideological legitimacy—since the economic reforms carried out in China in recent years are a radical departure from a “socialist economy” as commonly defined. Faced with this seemingly impossible dilemma, China has maintained political stability through, to an important extent, the technocratic skill of emerging elites,

---

1995 COPENHAGEN MEETING
many of whom are engineers. But without the charismatic figure of Deng Xiaoping and without the support of the Chinese military, the sort of stability that China has enjoyed would not have lasted.

The Chinese military is given more than its share of the fruits of economic growth, in the allocation of resources and given its ample degree of freedom in dealing with the weapons trade. It is only natural that the military’s voice would be more attentively listened to in a period of leadership change, with Deng Xiaoping soon following Chen Yun, his friend and erstwhile rival, who passed away recently. In this context one should draw attention to the fact that China’s published defense budget has doubled in the past five years, with real growth estimated at about 40 percent. Even though one can point to the fact that modernization of the Chinese military started only recently, there is reason for concern if we realize that American, Russian and Japanese defense spending has either remained level or decreased in the same period.

The Middle Kingdom notion ingrained in the minds and thoughts of the Chinese elite may have started expressing itself in their increasing assertiveness in the international scene. Given the progress of its economy—and being the biggest receiver of foreign direct investment among developing countries, with a population of 1.2 billion in a huge landmass—China is entitled to be assertive on its own. However, if such an assertiveness is rooted in the Middle Kingdom notion and backed by a steady military build-up centered on power projection capabilities, some caution might be in order.

Five potential sources of tension can be cited:

- The Chinese attitude to the Spratly Islands. Virtually all countries in South East Asia including Vietnam also assert territorial claims in this area, and China might take some action disturbing the peace in the South China Sea.

- The effect of the Chinese diaspora—overseas Chinese—in South East Asia. The economic strength and network of overseas Chinese in South East Asia, not to mention elsewhere, is such that ethnic tension might arise depending on Beijing’s attitude to the region.

- The effects on the final settlement of Hong Kong in 1997 of a possibly high-profile Chinese attitude.

- Sino-Russian relations, particularly in the Far Eastern region of Russia and northeast part of China, which differ in population by a factor of ten (8 million vs. 80 million).

- The Taiwan issue.

The Taiwan issue can be the most difficult and intractable for the countries in the region and the international community. The international community as a whole, with very few exceptions, has recognized the Government of the PRC as the sole legitimate government of China—there is only one China. However, Taiwan has managed to achieve truly remarkable economic development and is now among the most industrialized economies, with foreign exchange reserves possibly surpassing those of Japan. With its achievements, wealth and self-confidence, Taiwan also asserts its rightful place in the international community. Should Taiwan adopt a truly democratic process of politics and, through the will of the majority of its citizens, opt for a different legal entity, the issue would become most difficult to deal with. China would not accept any recognition of Taiwan as a separate legal entity, citing the will of 1.2 billion people. One can only hope that wisdom prevails among both Chinese peoples across the Taiwan Strait and they realize a peaceful resolution of the Taiwan issue.

The United States

The United States’ military presence and commitment is considered essential for European security, in the form of NATO. This is also the case for U.S. forces in East Asia, in the form of their forward deployment and bilateral security arrangements including those with Japan and the Republic of Korea. It is in this sense...
gratifying and reassuring that the Pentagon has recently reaffirmed its commitment to maintain a stable forward presence in the region at the existing level of about 100,000 troops for the foreseeable future.

With the potentially volatile situation in the Korean Peninsula, the huge military presence of Russian forces (including strategic nuclear forces) in the Far East, the Chinese military build-up including power projection capabilities, and Japan’s basic policy of military restraint and self-denial of power projection capability, the U.S. military presence in South Korea and Japan and the U.S. Seventh Fleet in the Pacific constitute essential deterrence against any attempt to threaten the peace and stability of the region.

The Gulf War of 1991 has manifestly shown two irrefutable facts about the predominance of U.S. war-fighting capabilities. The victory on the battlefield was one that no other country could have remotely matched. Without American intervention Kuwait would have been completely occupied, threatening Saudi Arabia and other Gulf oil-producing states. At the same time the Gulf War demonstrated that the United States can no longer act alone and has to depend upon material and financial support from allies, including Japan (which contributed $11 billion by raising taxes).

This second aspect is also evident in the host-nation support supplied by both Japan and Korea. In the case of U.S. forces in Japan, Japan assumes virtually all local labor and utility costs. These and other support costs taken together represent contributions of around $5 billion annually.

There has emerged an issue which can be divisive in the Asia-Pacific region and which may have security implications. Some Asian leaders, notably Prime Minister Mahathir of Malaysia, have for some time been proposing to establish an East Asia Economic Caucus (EAECC) consisting of ASEAN, Korea, Japan, and China—namely Asians in East Asia. The United States, defining itself as an Asia-Pacific country, is strongly opposed to such a grouping as discriminatory and divisive, and inimical to the interests of East Asia. The issue has been tackled in various ways over the years. With what appears to be a high-profile approach on trade and humanitarian issues on the part of U.S. government negotiators, there is a potent trend to establish a separate and distinct grouping, albeit informal, among Asian countries. Depending upon how the issue develops, it might have some adverse effects on U.S.-Asian relations.

Japan

The end of the Cold War has had profound effects on Japanese domestic politics. Political reform centered on the electoral system as well as political funding has been carried out, and we await the first general election under the new system. The Cold War divide in Japanese politics—a predominant feature in Government vs. Opposition parties—has virtually disappeared and a process of drastic political realignment is now underway. While there are groups of people wishing to see more active involvement in overseas matters, there are also those people who are inclined to be inward-looking—a “my country, my home” tendency. Nevertheless, the notion of participation in United Nations peace-keeping operations (PKO) by Japanese Self-Defense personnel, initiated in Cambodia in 1993, is no longer considered a dangerous idea and there is a strong view to see more done.

Neither is discussion and study of regional security matters a taboo. In fact some of the international forums for regional security were first proposed by Japan, as in the case of the ASEAN Regional Forum, where ASEAN leaders discuss the security situation in Southeast Asia with their so-called dialogue partners, including the United States, Russia, China, and Japan.

Japan is intensely interested in the situation on the Korean Peninsula—most actively consulting with the United States and the Republic of Korea on the North Korean nuclear issue and ready to offer a substantial con-
tribution to the project which is being offered. Japan is playing a crucial role in the peace and stability of East Asia in the sense that Japan provides a politically stable democracy in an extremely important geo-strategic position facing two major military and nuclear powers and the Korean Peninsula. The Japan-U.S. Security Treaty, under which U.S. forces are stationed in Japan, together with the Japanese Self-Defense Forces constitute the single most important cornerstone of stability in the region. Another vital role is played by Japan through its development assistance, as well as investment and technology transfers, to the developing countries in the region. Japan is currently the largest aid donor in the world in terms of disbursement of financial and technical assistance, and a major portion of such assistance has been directed to countries in the region. China is now the largest Japanese aid recipient. Japan is proud of the fact that Japanese assistance and investment in the region have been among the most strategic factors for the dynamic growth of Asian countries, thus contributing substantially to peace, growth and stability.

Japan's relations with Russia are not bad, but could be and should be better. History has not been very conducive to building friendly relations. The Cold War did not help. There developed a juxtaposition of two mentalities which has made for mutual slighting. The Russians, being a foremost military power, put military strength at the top of their value system and the economic factor very low; whereas the Japanese, being a proud economic power and refusing to be a major military power, put economic strength at the top and the military factor very low. Thus Japan and Russia do not appreciate or respect each other. Throughout the last fifty years, Japan has raised the territorial issue of the four Northern Islands with the Soviet Union. Continued Russian occupation of the Northern Territories is a central issue between our two countries. It is one of two pillars of Japanese policy toward Russia to resolve this territorial issue and conclude the peace treaty, thus completely normalizing our relations. The other pillar of our Russian policy is our part of joint G-7 efforts to assist Russian political and economic reform. Japan is interested in this context in participating in the development of the Far East region of Russia. If Japan is to contemplate a large-scale development effort in Russia, resolution of the territorial issue is essential.

More European Participation in the KEDO Essential

My last word is a personal plea and a plea of the Japanese government regarding one important aspect of Trilateral cooperation. The sort of the Trilateral cooperation essential in the post-Cold War period requires that each pillar have a global outlook. Though some criticize its policy, the United States has a global outlook. Japan for its part tries to be global and assists economic development in Africa and the Middle East and Latin America. Japan is involved in post-Cold War Central and Eastern Europe as an active member of the G-24 and a charter member of the EBRD. Japan was among the first to provide assistance after Chernobyl, as part of Trilateral cooperation; and in the most recent consultative meeting for Ukraine, Japan pledged a $200 million untied credit to Ukraine to deal with Ukraine's nuclear dangers.

Japan would like to see Europe involved and contributing to the solution of serious problems facing other regions, remote though they may be. The case I have in mind is more European participation in the KEDO, whose success or failure will have a far-reaching effect on the global issue of proliferation, to say nothing about its consequences for East Asia. The stakes are so high as to transcend numerous shortcomings and a less-than-ideal process of the formulation. A gesture of solidarity and support is badly needed from European countries. We welcome the participation of the United Kingdom and Finland in the KEDO. I hope and expect many others from Europe to join.

Koji Watanabe is Japan's Ambassador to Russia and former Deputy Minister of Foreign Affairs.
Politics, Psychiatry and Western Grand Strategy Toward Boris Yeltsin’s Russia

Like most of you, I was fascinated by Foreign Minister Kozyrev’s talk yesterday, a talk that appealed to the head and the heart, and was laced with humor to boot. And he spoke to the heart of what concerns us today: Euro-Atlantic security. I just shudder to think how Andrei (“Grimgrom”) Gromyko would have put the same message.

In my own remarks, I would like to respectfully disagree with Mr. Kozyrev.

In essence he asked us to equate

• stroking with strategy, and
• politics with psychiatry

He has asked us to accept two things. One, the premise: If Boris Yeltsin prevails, so will democracy and the market economy in Russia. Two, the policy: Be nice to Boris, so that he can prevail over the enemies of democracy and economic freedom—the paleo- and neo-communists, the chauvinists and neo-imperialists. If not, Russia will go “crazy,” i.e., fall into the hands of these evil and/or unstable characters who will wreak misery on Russia as well as the West.

In other words, our approach is to be a psychiatric one: Be kind, nice and understanding; do not push and provoke so as not to liberate the anti-social tendencies of the patient.

What is wrong with this approach Mr. Kozyrev is asking us to adopt?

First, the underlying theory is flawed. Mr. Kozyrev seems to share the classical Liberal assumption, dating back to the Enlightenment philosophers from Condorcet to Kant, which relates a country’s external behavior to its domestic constitution. To simplify: Good states (republics, democracies) make good foreign policy, bad states (authoritarian, totalitarian) make bad foreign policy.

But neither, as history shows, is necessarily true. On the one hand, democracies (and I won’t name names here in order not to offend most of the audience) can be quite nasty. On the other hand, despotic regimes are not necessarily imperialistic, e.g., Franco’s Spain, Pinochet’s Chile or Fundamentalist Saudi Arabia.

Second, even if the Liberal model is more often right than wrong, it is not in our power to remake a country as old and big as Russia. We could not even do so in Somalia, although we invaded with great force. We certainly cannot do so in Bosnia. Apparently, turning an unsavory regime into a liberal-democratic one requires a world war, as in the case of Japan and Nazi Germany—two nations which had to be crushed in preparation for the moral-political reform, and then occupied for a generation.

Third, as much as we tried since 1990, we did not manage to induce a lasting transformation of Russian foreign policy. We mistook a peculiar, but fleeting phase of Russian/Soviet policy for the real thing—when the country was in a state of shock and disorientation in the aftermath of its capitulation in the Cold War.

This was the time when Moscow consented to German reunification and the withdrawal of its troops from Central Europe, when it refrained from confronting the Western coalition in the Gulf War, when Boris Yeltsin—the communist turned democrat—jumped on a tank in front of the White House to defy—and best—the reactionaries.

Since 1993/94, however, Russia has been reverting to a more traditional role:

• Though the United States has extended the “Strategic Partnership,” and NATO the “Partnership for Peace,” Russia has successively broadened its “No” to NATO enlargement.
...RUSSIA REMAINS A GREAT POWER, AND GIVEN ITS HISTORY AND GEOGRAPHY, IT IS VIRTUALLY BOUND TO BEHAVE AS IT DOES.

• We have given Russia an exalted place in the Bosnia Contact Group, but that has not changed Russia’s stance as implicit protector of Serbia.
• Western good will has not muted the Russian assault against Chechnya, nor has it kept Russia from re-tightening its grasp over its southern periphery.
• Nor has it kept Russia from making anti-Western moves in sensitive places like Iraq or Iran, to the latter of which Russia is set to deliver a nuclear power plant in defiance of American wishes.
• The West’s psychiatric approach has not muted Soviet rhetoric. Indeed, the heat has been going up steadily, all the way to threats of war by Generals Grachev and Lebed.
• Finally, being nice to Boris has not accelerated the process of democracy. Instead of cowing the chauvinists, Yeltsin has begun to coddle them. Instead of wooing the reformers, he seems to have abandoned them.

II

Lest you mistake this list as an indictment of Russia, let me make quite clear that my critique is addressed first and foremost to ourselves: to our temptation to confuse domestic policy with grand strategy and politics with psychiatry. Though I would add that Mr. Kozyrev might even share that misconception. Thus, he may well overrate the West’s ability to help his master and his allies prevail in the battle for domestic power. In any case, as his address demonstrated, he is certainly tempted to play on the presumed causal link between the “Be nice to Boris” injunction and the domestic outcomes in Russia we cherish most.

However, stroking a great power like Russia is not a strategy. We have confused Russia’s temporary disorientation from 1989 to 1993/94 with Russia’s lasting reform in the Western image.

But Russia remains a great power, and given its history and geography, it is virtually bound to behave as it does. Indeed, if I were running Russian foreign policy, I might not behave very differently. I certainly would not want an alliance which, if it is to mean anything, must be directed against Russia to push up against my border, and hence I would also say “nyet” to enlargement.

Hence, it should not come as a surprise that Russia would try to re-gain its lost Soviet empire in the South.

It should not come as a surprise that Russia will seek to re-impose at least a sphere of influence in Eastern Europe where the Soviet empire held sway until 1989.

It should not come as a surprise that Russia would assume a competitive stance in Bosnia, Iraq and Iran. These after all are arenas where Russia has rivaled the West in the 19th and 20th centuries—from the “Great Game” over Afghanistan to the penetration of the Middle East from the 1950s onward.

In short, we should not be surprised that a great power behaves like a great power—that it is driven by the quest for influence, status and position.

III

What follows from this?

First, and most generally, don’t substitute psychiatry for policy. That leads to self-blackmail in the sense that we might not resist where vital Western interests are at stake. At worst, by indulging the “patient,” it encourages precisely the anti-social behavior the therapy was designed to prevent.

Second, engage the Russians on the basis of the oldest law of diplomacy. The Latins called it do ut des, today we call it “reciprocity”: conditional cooperation—my good behavior against yours.

Third, this will not necessarily be helped by a “Be nice to Boris” approach. More often than not, propitiation encourages the wrong side in the domestic debate: those who will interpret appeasement as an inducement to extend their grasp. Indeed, if we really believe in the our ability to shape domestic outcomes, we should turn the theory around.

In other words, if we want to sober up the
Zhirinovskis, a firm stance on vital points might add to realism in Moscow. It will strengthen the hands of the democratic and pro-Western forces if they can show that threatening rhetoric and military adventures will jeopardize Western goodwill and cooperation. Indeed, if we want to help the reformers, let’s rather be nice to the Kovalyevs, the human rights advocates, who feel isolated and betrayed by those in the West who are eager to embrace Yeltsin.

Fourth, and most important, let us gear our policy to Russia’s behavior abroad, not to its hoped-for transformation at home. Let us work on our common strategic interests, such as the draw-down of Russia’s nuclear arsenal or the strengthening of the anti-proliferation regime.

Let us help Russia in preventing the trafficking in Russian nuclear materials.

Let us give aid where we can make sure that the money will speed the transformation of the Russian economy rather than end up in a foreign bank account.

Let us hold out cooperation in order to instill the habits of reciprocity—and hold back where it is denied.

Let us keep NATO intact and preserve a rapid reconstitution capability. Whether enlargement is actually a good way to keep the Alliance cohesive and capable of acting is a question that requires careful thought. We certainly should not push enlargement in order to make a point. And if we want to provide a democratic home for the democratizing nations of Eastern Europe, the European Union, with its powerful implications for economic growth, might actually be the more effective instrument.

Finally, let us treat Russia not as a patient but as a great power. Let us respect Russia’s vital interests, but not foreshadow our own. Let us accept that our interests will sometimes converge and sometimes collide. Russia will never be bound to the West in eternal friendship; great powers never are.

Let us not call this “neo-containment.” I would rather call it realism: a sense that Russia remains a problem of the West, and that the problem requires a much more complicated game than we have played up to now. It is a game of cooperation and competition, of concert and containment. We must not believe, as did the philosophers of the Enlightenment, that the right regime will conduct the right foreign policy and that all conflicts between nations will disappear once we all share the same polity and economy.

The post-postwar period is over. The time for complexity is now: for a mixed game of competition and cooperation that, alas, Western democracies have rarely mastered and never liked.

Josef Joffe is editorial page editor and columnist of the Süddeutsche Zeitung in Munich and Associate of the Olin Institute for Strategic Studies at Harvard University.

...Let us gear our policy to Russia’s behavior abroad, not to its hoped-for transformation at home. Let us work on our common strategic interests...
SECTION 3
TRADE AND CAPITAL FLOWS IN A CHANGING WORLD ECONOMY

PETER SUTHERLAND

Making the Global Trading System Work

I am going to sound a more optimistic note and then set out some concerns about the trading system.

The conclusion of the Uruguay Round was an act of global leadership, which required considerable political sacrifice. In the latter stages of the negotiations there were riots in various parts of the world. In South Korea, a large number of ministers resigned shortly after the Round was concluded. It was extremely difficult to secure the passage of the final agreement through parliaments in various Trilateral countries—and also in many developing countries, whose difficulties were forgotten to some extent in our focus on passage through the U.S. Congress, for example. So I can start by saying that we did have an act of global leadership—albeit some 50 years late, in the sense that we did finally create what was envisaged in the immediate post-war period as the third leg of the Bretton Woods institutions. The creation of the WTO should be a source of some confidence. There was a willingness to deal with rather intractable and difficult political issues and bring the Uruguay Round to a conclusion.*

The question we were facing coming up to 15 December 1993 was whether the multilateral trading system would survive at all. Had the Uruguay Round failed, not merely would we have lost the opportunity to create a new institution, we would also have lost the benefit of the institution that had been operating to a limited extent during the period since the last war—namely the GATT itself. What has now come into existence is an organization which gives us an opportunity—but no more than an opportunity—to develop the trading system effectively in the coming period, subject to rules and disciplines universally applied. The challenge is whether we can make this global trading system actually work.

Greatest Threat to Multilateral System in Trilateral Countries

Developing countries around the world have taken the rhetoric of the developed world at face value. They have, unilaterally in many instances, reformed their economies in a most dramatic way. Examples can be given very easily. In the end of the day the greatest threat to the multilateral system and to the market economy structure during the Uruguay Round was to be found in the developed countries—not in the developing countries. And I believe that the greatest challenge for the future is to be found in the Trilateral countries rather than the developing countries.

I don't in any way denigrate the contribution made to the conclusion of the Uruguay Round by the United States, by the European Union and by Japan. But one needs to underline the fact that threats to the multilateral

*This WTO comes into existence at a time of unparalleled challenge. We have added some two-and-a-half or three billion people within a very short period of time to the market economy structures which formerly covered a much smaller population in the world. We have seen advances in technology and the free flow of capital which could not have been contemplated 15 or 20 years ago. Many of the signs in regard to world trade are extremely positive. World trade grew by nine percent in 1994—almost three times faster than world output, and the fastest rate of growth in world trade on a year-to-year basis in 20 years. Even those who were less dependent on trade in the past have become highly dependent on it today, so a reversal to protectionism would face considerable difficulties. In the United States, for example, traditionally less reliant on trade than the European Union or Japan, the contribution of trade to GDP now stands at 22.5%, whereas ten years ago, it was at 13.3%. This change in the integration of the global economy is, I believe, largely an irreversible fact.
system—and inadequate responses to the liberalization process—have generally come from those areas also. In areas of sensitivity, and in the areas of greatest interest to developing countries, there has been an inadequate response in many ways to the demands by developing countries. One can look at subjects such as agriculture and textiles, at the transition economies (and their legitimate demands) in Central and Eastern Europe, at areas of interest of some Asian countries (particularly in textiles)—and then one understands criticism about the failure to take on the difficult issues in these sensitive areas as fully as they might have been taken on in the conclusion of the Uruguay Round. Of course, in a world of realpolitik one must recognize the difficulties evident in the final endorsement of the package in the parliaments of Europe and the United States—and Japan on the rice issue. Nonetheless, I think it is fair to say that there is increasing concern amongst developing countries that their sacrifice, as some present it, has not been adequately responded to in some areas of greatest interest to them. And that gives rise to a systemic problem into the future.

**A More Inclusive Forum to Provide Preliminary Political Direction**

The systemic problem is that there is a deficit in terms of the structures for world economic management. The development of the multilateral system has been largely motivated and pursued over the years by the developed countries and structures they have set up: the G-7, for example, and in the context of the trade agenda, the Quad. As long as the development of the agenda is presented as primarily a concern of the developed countries, that leads to a certain alienation at an early stage in the debate amongst the developing economies. And when one looks at the new potential trade agenda—issues such as trade and workers' rights, or trade and environment, or the development of anti-dumping policies—one can see that there will be grave difficulty in developing new strategies, new policies, and new directions unless there is a more inclusive form of initial debate, leading towards the consensus which is necessary for the development of new policies within the World Trade Organization.

This raises very difficult questions about the functioning of the OECD as well as the political leadership provided by the G-7. Both the OECD and the G-7 serve a very important purpose: they facilitate discussion amongst the major trading partners in the world, and create conditions which often lead to successful multilateral negotiations. But a sense of “them and us” on the future trade agenda is going to be destructive of any prospects we have for moving forward effectively from this moment on.

I do not believe that the trade agenda during the immediate future is likely to be dramatic. I do not believe that we are going to have a new round in the immediate future. But there is going to be ongoing debate about a number of significant areas of potential policy development. Apart from environment and trade, and internationally recognized labor standards and trade, we also have issues such as immigration policy—which many developing countries are linking to the discussion of, for example, the services liberalization agenda. We also have trade and competition policy, trade and investment policy, and regionalism. All of these agenda items are going to be subjects for debate in the near future. And one would like to see a more inclusive forum for the preliminary political direction given to those debates than can be provided by the existing structures.

Of course, part of the needed change in the future will be a greater integration in the operation and thinking of the World Bank, the IMF, and the World Trade Organization. I think we are at the beginning of a stage of integration which will allow for a more cohesive position being taken by the Bretton Woods institutions. What is less evident is where the political direction will come from, and how it is to be articulated. Within the
WTO structure we have a meeting of ministers of trade probably every two years. We have a limited interface with the financial community at the IMF/World Bank meetings. But we do not have a structure which allows for the development of political initiatives at the highest level other than the G-7 and—almost as a counterbalance to that—the G-15, which is not functioning effectively.

A Point of Dialogue More Representative of the Real World Economy

Isn't it time to think, not of creating new organizations, but of creating a point of dialogue during the coming period which could be more representative of the real world economy as it is today? There have been attempts made in the past—I'm not talking about involving the United Nations in this process—to think of a suitable structure. I think there could be a reasonably intimate political forum for discussion at the highest level which would incorporate more than one side of the debate about future trade and global economic policy. That's absolutely necessary because we have to bring about a situation where the World Trade Organization, in addressing the new agenda, can be seen to do so on behalf of everybody.

Take for example the issue of trade and internationally recognized labor standards, which many in the developing world see as a protectionist mechanism being foisted on them by the developed world, however untrue that may be in certain cases. If that area of debate is not developed in a more inclusive way, the risk is that we will create initial differences in terms of the future agenda which will destroy the potential for further development.

In that regard, I am concerned that there is an inadequate belief by the developed countries (evident in the initial deliberations about the development of the World Trade Organization) as to the role the WTO should play in developing new ideas. The organization will remain an extremely small one. We have less than 200 professionals in the World Trade Organization. There appears to be considerable reluctance to provide any degree of research support within the organization itself for the development of new ideas and new policies. There is an argument that new policies should be articulated exclusively through the OECD. I think that would be a mistake, because it would lead to an aggravation of the division between developing countries and developed countries—which we overcame in the final stages of the Uruguay Round and certainly do not wish to see widen again.

WTO Credibility

The other point I would like to make about the future of the World Trade Organization is that, as an organization without resources, its future is dependent solely and exclusively on its credibility—above all on the credibility of its dispute settlement mechanism. The credibility of the dispute settlement mechanism in turn depends, finally, on the responses of the Trilateral countries to adjudications which will inevitably take place—which will be politically sensitive and difficult to swallow.

So whilst the conclusion of the Uruguay Round was an achievement, the real achievement will be during the next five years when difficult disputes—one can already see them emerging—fall to be adjudicated by the dispute settlement mechanism and the judgments have to be implemented. Whether or not a major player gives the credibility to the organization which it demands, by responding readily and conclusively to an adjudication against it, will be the decisive moment for whether or not we have created a new system which avoids the law of the jungle, supplanting it with the discipline and equity which the new system is meant to provide. That's the ultimate test, particularly for the Trilateral countries.

Regionalism

The development of regionalism in trade has generally, in my view, been a positive adjunct to the multilateral trading system, once the
overall authority of the WTO over such regional developments is accepted. There are currently over 60 free trade (or customs) areas in the world, from the most profound, which is the European Union, down to lesser arrangements of one kind or another. They have generally succeeded in improving the liberalization process rather than retarding it.

Of course, they have the potential to become inward-looking and defensive. The arguments introduced in some recent publications about modern protectionism and pitting bloc against bloc—as in *The Trap*—are extremely dangerous, because they are extremely seductive. They are seductive because they play to the fear of change; they play, particularly in Europe, on high unemployment; and they do not recognize that the jobs added in Europe during the last five years have almost exclusively been related to exports out of Europe to the developing economies.

But I do believe that regional arrangements in local areas—Mercosur is one example in Latin America—have basically been positive and should be fostered, subject to their being ultimately amenable to the disciplines of the WTO. If we did not have a European Union that could speak with one voice (and did speak with one voice) in the latter stages of the Uruguay Round, we would not have concluded the Uruguay Round. It would have been impossible to reach the conclusions we did reach without this mechanism for internal debate leading to consensus within the European Union. Many people have views about the possibilities for APEC which, in my view, are unreal. I do not consider it desirable to create a North Atlantic free-trade area.

* * *

In conclusion, we have set the groundwork for maintenance of reasonable stability of trade. But that can only be maintained if there is an absolute commitment to the principle of non-discrimination (particularly in bilateral agreements) and as long as we recognize that, at the end of the day, it is going to mean swallowing bitter pills. When a decision is taken against the United States or the European Union, they are the ones who will decide whether or not the WTO will live up to the aspiration which we all share for it.

Peter Sutherland was Director-General of the World Trade Organization until April 30, 1995, and had served as Director-General of its predecessor, the General Agreement on Tariffs and Trade (GATT), since 1993.

---

E. Gerald Corrigan

Building Blocks to Strengthen the International Financial System

I. Overview

In looking at the workings of the international financial system over the past dozen years or so, we can see elements of both triumph and tragedy.

- The triumph lies in the fact that the system has held up well despite many serious disruptions, but large-scale official involvement was needed on many occasions to help maintain the system.
- While systemic disruption was avoided, there have been many close calls and many tragedies for individuals, companies and countries. Many observers have a nagging sense of unease that all is not well and that the system is simply too vulnerable.

At the risk of over-simplification, I believe the widespread sense of concern reflects three closely inter-related problems:

First, exchange rates and the exchange rate system are under almost constant attack, even
if the battleground shifts from place to place over time. The resulting volatility—much more seriously, the tendency for exchange rates to overshoot—is plainly distorting behavior and is a major concern to policymakers and practitioners alike.

Second, massive short-term capital flows, often in search of high returns on portfolio investments or quick gains on foreign exchange trades, come and go in ways that are a threat to the stability of markets, institutions and even sovereign states. Indeed, on occasion we have seen the equivalent of "runs" on individual currencies, currency systems and sovereign nations.

Third, in the face of these developments, major questions have arisen as to whether the authorities, including the multinational financial institutions, have the necessary tools to deal with these problems—or, to put it differently, whether fundamental changes are needed in the workings and management of the international monetary and financial system.

Over the course of my remarks, I will seek to shed light on these questions, but do not expect a nice, neat and surgically clean answer. In my judgment, such an answer does not exist. Coming to grips with these issues is going to require an enormous amount of work and an unprecedented amount of coordination among nations.

II. The Fundamentals

Allow me to first put the situation in context and perspective, starting with a number of fundamentals which cannot be ignored. While it is entirely fair to say that the workings of the international financial system are very complex, it remains true that there are certain fundamental relationships that are central to the system. There are also, in my judgment, certain broad-based norms which most observers would embrace as reflective of the directions in which the system should evolve over time.

Turning first to the fundamental relationships, there are several points of particular importance:

First, for individual nations and for the community of nations as a whole, savings must equal investment.

Second, at any point in time, some nations will have excess savings while others will have negative savings. The former must be reflected as a current account surplus while the latter must take the form of a current account deficit.

Third, the current account positions of all countries must net to zero.

Fourth, a primary role of the international financial system—with help from governments and official institutions and working through the proximate modalities of interest rates and exchange rates—is to mobilize and distribute savings across national borders thereby bringing about the netting to zero of individual national current account positions.

Fifth, the manner in which the international financial system goes about the task of channeling scarce savings to their most productive use is absolutely crucial to winning the gains in productivity and living standards that are the cornerstones of future prosperity and tranquility. For example, the promise of $5 trillion of incremental global GDP growth coming out of the Uruguay Round presupposes a massive redeployment of savings and investment on a global scale. To put it very bluntly, that redeployment, and that promise, cannot be achieved unless the international financial system is working well. This is especially true in a setting in which there is neither the financial nor the political support for a larger role for governments and multinational financial institutions in this process. In fact, the role of the public sector in this area will decline.

Sixth, for individual nations and for the community of nations, success in achieving the dual goals of prosperity and tranquillity rests crucially on the macro-economic policy fundamentals, especially in the areas of fiscal and monetary policy. As a corollary to this, it is important to recognize that more often than not, a chronic current account deficit is a symptom of overconsumption and under-sav-
tings, a condition that will not be remedied by exchange rate movements alone without enormous costs to all.

These fundamentals lead to some important normative judgments to which I suspect most observers would subscribe. Among others, these judgments include the following:

First, greater stability in financial markets, nationally and internationally, should permit such markets to perform their core task of mobilizing and allocating savings in a more efficient and effective manner.

Second, the only remotely fail-safe way to increase the supply of savings needed to finance the investment in productive capital and physical infrastructure needed to generate broad-based gains in living standards is to reduce the dis-savings associated with large and deeply entrenched budget deficits, especially in all of the leading industrial countries.

Third, in the ideal order of things, there should be a net transfer of savings from the OECD world to the non-OECD world. Absent such a net transfer (and even allowing for high savings rates in many non-OECD countries), there is the danger that the split between the economic “haves” and “have-nots” will widen further with potentially dire consequences in economic, social, political and perhaps even strategic terms.

Fourth, for all nations, big or small, developed or developing, a greater premium must be placed on creditworthiness and competitiveness as the necessary prerequisites for full participation in the global system of trade and finance. As a corollary to this, those nations that fail to meet the tests of creditworthiness and competitiveness will be swept to the backwaters of economic obscurity and isolation.

Fifth, the promise of a new world order, based importantly on expanded global trade and finance and anchored in greater economic and political freedom, is not a zero-sum game. To the contrary, it is a framework that permits all to be winners; but it also carries with it the threat that all can be losers. That latter possibility is, of course, why it is so vital that we do all we can to insure that institutions and markets can perform their essential tasks in a setting of stability.

With these fundamentals and judgments in mind, allow me to share with you a brief snapshot of where things now stand in that quest for greater stability, prosperity and tranquility.

III. Where Things Stand

In looking at the global economic and financial situation today, contradictions abound. On the one hand, and notwithstanding the traumas of the dollar and Mexico, recent and near-term economic performance and prospects are reasonably good for most nations and many parts of the world. Indeed, with a little luck, 1995 could see patterns of growth and restrained inflation around much of the globe the likes of which we have not seen for many years—even if a few countries are notable exceptions. It is also fair to say that the international financial system, working through global institutions and markets, has played a constructive role in helping to bring about these improved conditions.

However, even if reasonably good performance in the near term is achieved, there are lurking questions as to whether it can be sustained. These questions about sustainability are not without some basis in fact. Let me, therefore, cite a number of examples of conditions and circumstances which should be cause for concern about the future.

- Within the G-7 and the OECD, general government outlays average more than 40% of GDP and, for some countries, are well above that average (Chart 1).
- Within the G-7 and the OECD, budget deficits average 3.5 to 4.0% of GDP, again with some much higher (Chart 2).
- Within the G-7 and the OECD, gross liabilities of governments average 70% of GDP (Chart 3). On a net basis, such liabilities average a more respectable—but still large—40% of GDP (Chart 4).
- Despite Japan's huge current account surplus, the G-7 and the OECD are absorbing savings from the rest of the world (Chart 5).
- The U.S. external deficit and Japan's external surplus—by their absolute size—are simply incompatible with sustained prosperity, not only for Japan and the United States but for the world at large (Chart 6).
- Of the roughly 50 sovereign nations having credit ratings by both Moody's and Standard & Poor's, only 10 have Triple A ratings by both agencies and, sadly, about the same number have less-than-investment-grade ratings by one or both of the agencies.
- In looking at a cross section of 27 non-OECD countries from all parts of the world, about one-third have external debts that are more than 200% of exports.
- In the aftermath of the Mexican crisis, and at least for the time being, access to private international capital flows for a wide range of emerging market countries has been seriously impaired or is not available at terms and conditions that are economically and financially viable for the countries in question.
- The stock of cross-border portfolio investments in the hands of institutional investors and money managers having a "trader mentality" now runs into the hundreds of billions of dollars. Outstanding Brady bonds alone aggregate to $135 billion.
- Finally, the turnover in financial markets is of astonishing proportions. As an example, one of the things that used to (and still does) create sleepless nights for me is the knowledge that the New York Fed processes or settles more than $2 trillion per day in transactions, many if not most of which have an international component.

This small sample of facts and figures does not begin to tell the whole story, but I am sure you can see my point. Namely, the respectable current economic situation notwithstanding, the concerns about sustainability and the sta-
bility of the international financial system are not without foundation. Having said that, the obvious and very large question that arises is: How can we best go about the task of reducing the points of vulnerability in the workings of the international financial system while preserving its obvious elements of genius?

IV. A Building Block Approach to Greater Stability

As I mentioned at the outset, I do not see any single bold stroke on the horizon that can be a decisive, while practical, step in the direction of reducing these points of vulnerability. Rather, what is needed is a carefully constructed building block approach that moves in the right directions and paves the way for a time when the fundamentals may be more compatible with that bolder, grander stroke. Let me briefly outline the central elements of that building block approach to greater stability, after commenting briefly on approaches that, in my view, will not work— at least now.

One such approach would entail a speedy move to a new global exchange rate system. Typically the design of such a new exchange rate system is framed in terms of one form or another of “target zones.”

A more specific variation on this theme is stated in terms of a tripolar system of zones: one yen-based, one ECU-based, and one dollar-based. The tripolar system has little or no appeal to me. Such a system could all too easily: (1) become open within and closed without, (2) undermine all of the multilateral global institutions including the WTO, (3) produce regional tensions with potentially serious geopolitical dimensions, and (4) leave aside many countries and their vast populations that do not naturally fit neatly into one of the three zones.

Like many, I could bring myself to look with favor on some variation of a globally integrated system of target zones, but sadly, I do not see how such a system could be implemented in anything like the current setting. In saying that, I have in mind the economic
and financial fundamentals I spoke of earlier. Indeed, with the de facto collapse of the ERM fresh in mind, it seems to me clear that a necessary pre-condition for serious consideration of any such new exchange rate system is the fact of greater convergence in national policies and performance. Unfortunately, the near-term prospects for such greater convergence are not good and, as illustrated by the European experience, do not come easily even when enshrined in a treaty. Beyond those considerations, it is very important to keep in mind that if nations were to adopt such an exchange rate system, they must have the political will and financial resources to defend the system at all costs. Indeed, were such a new system to come under attack and collapse, the consequences would be unthinkable.

Apart from exchange rate policy, another idea receiving a great deal of attention these days is what I will call the "super stabilization fund." The concept here, of course, is to create a very large standby fund, administered by the IMF, which could be drawn upon by deserving countries in circumstances in which there is a "run" on the country. As contemplated, the resources of the fund could be brought to bear in helping to stabilize situations like the recent Mexican, or perhaps Argentinean, episodes.

As with some of the concepts advanced for alternative exchange rate systems, the super stabilization fund has an element of instant or intuitive appeal. But, upon reflection, it is not something I favor, at least at this time. In part, my concerns are based on the obvious moral hazard problems associated with the approach. Beyond that, it is difficult for me to see how a trigger mechanism for the use of the fund could be, on the one hand, quick enough to be decisive and, on the other hand, deliberate enough to avoid bad precedents while creating sensible elements of conditionality. Finally, and to be very blunt, I don't see a long line of countries standing in line waiting to write the checks needed to finance such a fund, no matter how brilliantly designed. Thus, while I learned long ago to never say never, for now I believe the super stabilization fund should be relegated to the position of "concept of last resort."

Since I am very dubious that we are at the point in time when grand designs are workable, we are left with the more narrow question of what steps can be taken to increase the stability and efficiency of the current system and, in the process, pave the way for more fundamental reforms at a later date. It is in this regard that I believe the building block approach has much to offer. Needless to say, the most essential of those building blocks relate to monetary and fiscal policies. On the monetary side, I feel compelled to acknowledge that in the vast majority of countries my former central bank colleagues are doing a credible job as witnessed by respectable to quite good performance with regard to restraining inflation.

The fiscal side, however, is another story. Not only are deficits far too large, but in most countries fiscal policy has lost much of its relevance as a counter-cyclical policy tool. For now, it is probably asking too much to expect that new elements of flexibility can be introduced into the fiscal arena, but it should not be asking too much to insist that the deficits must be systematically and sharply reduced even if part of that effort entails a government raising fresh revenues. I might add in this regard that in my own country I find it astonishing that both major political parties are advocating tax reduction plans despite the deficit and despite the fact that the U.S. economy is at or near full employment.

While not necessarily related to fiscal policy, I am attracted to the potential role that pension reform can play in building more solid economic and financial fundamentals, especially in countries with low savings rates relative to their domestic investment needs. Here, I have in mind approaches along the broad lines of the Singapore and Chile models in which workers have a direct proprietary interest in a pool of professionally managed finan-
cial assets that are accumulated in the worker's name by employer- and employee-paid contributions. Such arrangements, if properly designed and managed, are capable of (1) generating long-term savings, (2) boosting worker productivity and morale, (3) providing important social and economic gains for the working class, and (4) indirectly improving both competitiveness and creditworthiness.

Under the best of circumstances, fiscal reforms or pension system reforms will take time. In the interim, there are other measures which can be explored with a view toward further strengthening the international financial system and its ability to cope with shocks and disruptions. Among these measures are the following:

First, working through the IMF, I believe there is room for a more rigorous and systematic system of enhanced official surveillance of macro-economic performance and policies that places greater emphasis on macro-financial trends and developments. Indeed, I can readily visualize the design of an early warning system that could help anticipate and head-off problems such as the Mexican case. No such system can be even remotely fail-safe, but it can force national authorities and the IMF to start asking hard questions when amber lights begin to flash. Among other things, such an early warning system would utilize a series of internal and external macro-financial indicators—including a family of external debt and debt service ratios—to complement traditional macro-economic performance and policy indicators. As a part of such a program, the IMF would have to be prepared to work with countries on approaches to dealing with potential macro-financial problems using a variety of financial policies that go beyond the Fund's traditional emphasis on macro-economic policies.

To be effective, such a system of enhanced surveillance would have to entail confidential dialogue at very senior levels between the IMF and the countries in question at the first signs of flashing amber lights. Needless to say, if potentially serious questions were called to the attention of a country, and then effectively ignored, the country would have to understand that it would not be in good standing with the international community in the event of a serious unraveling of its finances. Finally, while the dialogue between the Fund and individual countries must be confidential, market participants should know, and be able to monitor, the family of indicators that make up the early warning system. This, in turn, should encourage greater discipline on the part of cross-border investors. Where it does not, investors are simply going to have to accept their losses when they occur.

Second, while officially sponsored surveillance efforts can be helpful, many countries are going to have to re-double their efforts aimed at managing the full range of issues surrounding their finances. Specifically, more integrated, systematic and policy-sensitive approaches must be developed in asset-liability, debt (internal and external) and cash-flow management that explicitly take account of the full range of short- and intermediate-term risks associated with interest rates, exchange rates, market liquidity and cash-flow risk. Fortunately, the tools for these purposes are available even if they are not yet widely used in the area of sovereign finance. If they were used, huge concentrations of short-term debt instruments, foreign-currency-linked local currency debt obligations, or glaring debt service currency mis-matches could hopefully be avoided or minimized.

In addition, it is possible for sovereigns, large or small, to create incentives and disincentives that can work in the direction of stimulating the "right" kind of cross-border flows without treading on the slippery slope that would lead to capital controls. The Chilean experience in discouraging short-term debt inflows is a case in point.

Finally, many countries—especially the more advanced non-OECD countries—clearly can take steps to further stimulate the development of their internal banking and financial...
systems and in the process increase the efficiency associated with the manner in which the domestic financial system mobilizes domestic savings. More advanced and efficient domestic financial systems can also help in absorbing or cushioning foreign capital inflows or outflows, as well as increase the liquidity of local markets and thereby provide the central bank with greater opportunities to use efficient, indirect policy instruments such as open-market operations.

Third, I believe there are constructive steps that can be taken in the area of supervisory policies as applied to financial institutions which can work in the direction of greater discipline and stability in financial markets. Foremost among these steps would be a comprehensive cross-border scheme of explicit capital charges, associated with market risk and covering the full range of financial instruments and their derivative products. My former colleagues, the Basle Committee, have recently released for public comment a proposal which I believe has considerable merit although it would apply only to banking institutions. It is my hope that the international community of securities regulators can join forces with the Basle Committee in arriving at a common approach that will extend common coverage to banks and securities firms on a global scale.

I am under no illusions that such capital standards, universally applied, will solve all the problems; but they will certainly help even if gaps—as for example with wholly unregulated institutions—remain. These gaps notwithstanding, it seems to me that a systematic approach to capital charges for market risk will be helpful if for no other reason than the fact that it will force both executives and supervisors to look at trading positions and risk-taking in a more disciplined manner while also providing markets and market participants with a more understandable benchmark for judging the risks incurred in these activities by individual firms. Needless to say, enhanced market discipline should follow.

Fourth, in a cooperative effort, the public and private sectors must take further steps to strengthen the stability, integrity and reliability of national and international payment, clearance and settlement systems. Parallel efforts are also needed to ensure that all major exchanges and clearing houses conform to certain rigorous standards of operational, financial, and legal integrity.

The goals of such efforts should, among other things, be to (1) dramatically shrink the timing gaps between the two or more sides of financial transactions, (2) move toward same-day-delivery-against-payment book-entry systems for all securities transactions, and (3) toward same-day final and fully irrecoverable settlement for all exchanges and clearing houses.

These are, admittedly, ambitious goals, but I remain convinced that in the event of a serious disruption in the international financial system, weak payment, clearance, and settlement systems could easily be the vehicle that transmits a shock across institutions, markets, and national borders.

Fifth and Finally, as a part of this overall building block process, private sector financial practitioners are going to have to exercise greater restraint and discipline while at the same time further strengthening their management, control, risk monitoring and risk management systems. I recognize that great strides have been made in this area in recent years but more needs to be done.

In this regard I would call your attention to the recent report issued by the Derivatives Policy Group in the United States. This report outlines a comprehensive series of initiatives voluntarily adopted by the six major U.S. securities firms. The report covers four major areas: (1) management and controls, (2) enhanced statistical reporting to the authorities, (3) assessment of capital in relation to risk, and (4) guidelines relating to counterparty relationships. This report is not the last word on this subject, but it is representative of the range of initiatives that I believe can, and should, be at the center of the management process of finan-
cial institutions that are significant participants in fast-moving international financial markets.

* * *

None of the suggested building blocks outlined above is easy to put securely in place and none is without controversy. However, if the promise of greater stability, greater prosperity, and greater tranquillity is to be realized, the international financial system must be functioning with the precision and dependability of a fine Swiss watch. Beyond that, if we are to satisfy that longing for a more stable monetary and exchange rate system, we simply must strengthen the fundamentals that will allow such a system to work and work well.

There is, of course, a clear common denominator to all of these suggested building blocks; namely, they all cry out for greater cooperation and coordination within and across borders, among national authorities, and between the public and private sectors. On an intellectual level, that need for greater cooperation and coordination is widely, if not universally, accepted. In practice, however, all too often it seems to me that the intellectual consensus is interpreted to mean that cooperation and coordination involve a burden of change on the part of the other party. Plainly, that attitude is not going to produce the results we all seek.

I said at the outset that I had no grand scheme to offer to you. I regret that, but I do hope this analysis and these specific suggestions will serve as useful grist for the mill in helping to move the international financial system in the right direction.

E. Gerald Corrigan, former President and Chief Executive Officer of the Federal Reserve Bank of New York, is Chairman, International Advisors at Goldman, Sachs & Co.

SECTION 4
JAPAN’S ECONOMY

MINORU MUROFUSHI

Japan’s Economy and Trilateral Cooperation in Asia’s Markets

I WOULD LIKE TO SHARE my thoughts on the Japanese economy and its challenges, to provide a businessman’s assessment of Japan’s prospects and especially the outlook for a wider partnership between Japanese, European and North American companies in East Asia.

Current Issues in the Japanese Economy
1. The Kobe Earthquake
First, let me spend a minute on the Kobe Earthquake, which struck at 5:46 in the morning of January 17. The earthquake reached a magnitude of 7.2 on the Richter scale and killed about 5,500 people.

A short time after, I visited Kobe and I met with ITOCHU employees who suffered in the disaster; and they told me that the earthquake was so strong that it was almost like bulldozers bumping into their houses or bombs exploding beneath them. One great blessing was the timing of the earthquake. If it had occurred a few hours later, during the “rush hour,” the impact would have been far more devastating.

I heard that the foreign mass media praised the Japanese people for their calmness and discipline in the aftermath of the disaster. An ITOCHU employee told me that, despite food shortages, people lined up to buy things without creating a disturbance. What impressed her most was a store that was selling food to local people at below normal prices.
The total damage caused by the earthquake is said to be about 10 trillion yen or $120 billion. And we hear the cost of restoration could be 15 trillion yen or $180 billion.

The industrial production capability of Hyogo prefecture, in which Kobe city is located, accounts for about 4% of Japan's GDP. Kobe's port, which handles about a third of Japan's container traffic, was heavily damaged.

About 52,000 people are still homeless and forced to live in school gymnasiums or other shelters. However, thanks to generous aid from abroad and the alacrity with which local business rose from its knees, Kobe is recovering faster than anyone anticipated.

Electricity and gas supplies have returned to normal. The bullet train, the Shinkansen, is back on schedule. Parts of Kobe Port facilities are back in operation. Among companies in the area, Kobe Steel suffered the most damage. But even that company's blast furnaces started work earlier this month.

2. Yen Appreciation

The Kobe earthquake was really a tragic one, but the most serious tremor to shake the Japanese economy has been the rapid appreciation of the yen since the beginning of this year. Consider that at the end of last year, the 100 yen coin was worth one U.S. dollar, now about 80 yen will buy one dollar.

This yen appreciation has seriously hurt Japan's export industries. It is estimated by some Japanese economists that a 10% rise in the yen's value puts downward pressure on the Japanese economy amounting to 0.7% in real GDP growth terms. Before the yen's steep appreciation, the growth rate target that the Japanese government set for this fiscal year was 2.8%, whereas most private sector estimates were around 2%. Thus, a 20% rise in the yen will produce almost zero-growth in the Japanese economy in fiscal 1995.

Mr. Hashimoto, the Minister of MITI, said last week that one-quarter of Japanese medium- and small-size companies surveyed last month said they had no idea how to manage the current situation. In response to a similar survey last September, most companies replied that about 103 yen to the dollar was their break-even point. Last month, they said about 100 yen to the dollar. So Japanese companies can cope with a gradual appreciation of the yen. But not the dramatic rise in value by 22% that we have seen since the beginning of the year.

3. Asset Devaluation and Financial Crisis

As Japan entered the 1990s its bubble economy burst. This resulted in a massive asset devaluation: 8 trillion dollars was wiped off the value of Japan's real estate, and 3 trillion dollars was stripped from the stock market. To put these numbers in context, these losses were double the amount of Japan's GDP. Most Japanese companies and individual investors have been badly damaged.

This asset devaluation also hurt Japan's banks. Since they extended credit to domestic companies on the security of their land and stock, Japanese banks are now suffering seriously from bad debts. This has eroded the financial position of banks, and thus the financial system has become somewhat unstable. A healthy financial system is critical for economic recovery.

Of course all these doubts and uncertainties are reflected in the Nikkei average of Tokyo stock prices, which fell to almost 15,000 yen in the middle of last month. Since the beginning of the year it has plunged by 30%, and by 60% from its peak in 1989.

Economic Reform

Unfortunately, up to now, it seemed impossible to stop the yen's appreciation, partly because of the structural problems that have long distorted the Japanese economy. Japan's political, economic and social system, once the basis of our dynamic development, is now hurting us.

We have a gigantic trade surplus which creates friction with other countries. We have sluggish economic growth, an extraordinary appreciation of the yen, a big price gap between domestic and foreign goods, and an inability
to improve living standards for our citizens. Although I am quite worried right now, I am sure Japan can overcome these challenges.

1. Key Points for Economic Reform

As I have said, it is essential for us to restructure Japan’s economy. In my opinion, there are three major ways to do this. First, we must expand domestic demand so that the economy can grow faster, absorb more imports and be less reliant on exports. These steps would reduce Japan’s current account surplus and strengthen the world trading system.

Second, the government must help revitalize the private sector by getting rid of unnecessary regulations and creating a freer commercial environment.

Third, we must transform our current producer- and manufacturing-oriented society to a consumer-oriented one. This can only be achieved through massive deregulation and expansion of imports through further market liberalization.

2. Deregulation Action Plan and Economic Package

On March 31, the Japanese government announced a 5-year deregulation action plan, and a further economic package to cope with appreciation of the yen on April 14. However, in my opinion, the March deregulation plan fell short of the wide-ranging measures needed to satisfy Japanese business and the world financial markets. So even though the package was accompanied by a cut in the official discount rate, the market ignored it as it failed to demonstrate the resolve needed to reduce Japan’s trade surplus.

The government should have stated a clear message: namely, that it was determined to cut the current account surplus by half within 3 years. Some politicians and government officials worried about expressing clear goals because they worried that even if they set precise targets, external factors, such as movements in oil prices, would make it impossible for Japan to honor any commitment.

But I think that, as long as Japan shows substantial progress towards reducing its current account surplus, the international community will grant Japan leeway. The bottom line is not whether we hit the targets exactly, but rather that everyone can see that we are moving in a determined fashion to cut the current account surplus substantially.

As you can see, the changes that surround Japan’s economy are taking place much faster than the speed of economic reform. This means that it is vital for us to speed up the pace of domestic reform.

Changes in Japanese Corporate Strategies

Japanese corporations have been responding to this evolving economic environment by embracing new corporate strategies and discarding hidebound management structures. Concepts such as "pay for performance" are being introduced into the workplace. The rapid appreciation of the yen has forced managers to think anew about their business practices, including their sourcing policies. For many, the traditional relationship between companies is no longer the solution to their competitive problems. Some companies have responded by shifting their production abroad at lightning speed. The main target for Japanese foreign direct investment has been Asia, especially China. Once our Asian operations were platforms for exports to Europe and North America. But now these operations and goods are satisfying Asia’s fast-growing domestic economies as well as Japanese and other markets.

Japanese investment strategies are a major factor behind the tightening of economic integration in Asia. These strategies are also promoting the internationalization of the Japanese economy and helping the industrialization and economic growth of developing Asia.

Trilateral Cooperation in Asia’s Markets

These changes to the economic environment in Japan and Asia are providing new opportunities for cooperation among European, North American and Japanese companies. As Japan’s
economic and market reforms proceed, the opportunity for European and North American companies to develop mutually beneficial business partnerships with their Japanese counterparts will expand, both in Japan and in other Asian markets.

1. Business Opportunities in Japan

By virtue of its size, the purchasing power of its consumers, and Japan’s location in the fastest-growing region of the global economy, Japan’s market is an important one. For all these reasons, coupled with ongoing market reform, Japan will become a more attractive market for newcomers.

While the Japanese market is not opening as fast as we would prefer, import growth is still impressive. In 1994, imports grew by 19%, and the import ratio of manufactured goods reached 55%. Soon it will reach 60%, which is quite an achievement compared to our past record. North American and European companies are striving to set lower prices and to manufacture goods with specifications more suitable for sale in Japan.

Also, the transformation of Japan’s economy from a manufacturing to a service-based one has been well under way for years. Japan’s software, financial products, medical services and telecommunications industries are rapidly expanding and these sectors will become increasingly attractive to foreign investors and companies seeking Japanese partners.

Consider the opportunities created by the expansion of Japan’s multimedia industry. The Ministry of Posts and Telecommunications estimates that by 2010, multimedia will develop into a 123 trillion yen industry, that’s $1.5 trillion, and support 2.4 million jobs. European and North American corporations with software and management know-how are already tying up with Japanese corporations, my own included, to enter this field.

So, as Japanese economic and market reform proceeds, the opportunity for European and North American companies to develop business in Japan, will further expand.

2. Cooperation in Asian Markets

New possibilities for cooperation among us are also emerging in the rest of Asia, as Japanese corporations shift production abroad. Let me pause here to suggest some specific opportunities for business cooperation in Asian markets that have been created by developments in Japan and wider trends in the regional economy.

The first opportunity comes from joint production offshore of goods for sale in Japan. As the yen appreciates, offshore production, particularly in Asia, offers new means to enter Japan’s markets. By forming partnerships with Japanese companies, you can have easier access to Japan. Let me offer a specific example from my own company. In 1990, we and Pittsburgh Plate Glass, the number one manufacturer of flat glass in the United States, formed a joint venture in Japan for marketing flat glass products to Japan. We also built a glass factory in Dalian in China with PPG. The plant was completed last month and the products are being sold within China and exported to Japan.

The second opportunity for business cooperation in Asia is through strategic alliances. Here, companies complement each other’s experience and expertise while sharing the risk of participation in some projects. Given Asia’s steep growth, the possibilities for further alliances between European, North American, and Japanese companies is tremendous. We are committed to high quality and we have a focus on technology. So whether it’s in telecommunications, services or transportation there is great scope for synergy and collaboration.

Another opportunity for business cooperation is to join Japanese companies in using Japanese ODA programs. By using Japanese bilateral ODA loans we can satisfy the growing Asian demand for infrastructure. Most of these loans are untied, so they are fully open to foreign companies. The Asian Development Bank estimates that between now and the year 2000, total infrastructure spending will be $1 trillion. And, in 1993, Japanese bilateral ODA amounted to $8 billion of which 60% went to Asia.
Another opportunity for collaboration is to jointly utilize Export and Import Bank loans combined with trade insurance offered by MITI. The interest rate of the Japanese Export and Import Bank loans is about 2% lower than that available under private bank loans. Export and Import Bank loans are available even when Japanese companies have only a 30% share of the project contract. In other words, up to 70% of Japanese Export and Import Bank loans are available for foreign firms to tap. Furthermore, foreign companies can also possibly combine these measures with loans offered by Export-Import Banks in their own countries.

APEC

Against this background, it is no coincidence that we are embracing the spirit of the Asia-Pacific Economic Cooperation forum. As you know, APEC consists of 18 members, and in November last year, they adopted the Bogor Declaration. By 2010, the developed economies of APEC have pledged to remove all barriers to trade and investment; and in 2020 they will be joined by developing Asia. Of course, substantial liberalization will occur well before these dates.

In November this year, Japan will host the APEC Leadership Meeting in Osaka at which we hope to announce how we will put the spirit of the Bogor Declaration into practice. Liberalization in trade and investment is essential for sustaining the economic growth in the region. We can all benefit from a more business-friendly environment helped in turn by the APEC process.

This is why I am enthusiastic about my role as a member of the Pacific Business Forum. The PBF was set up to provide a business perspective to APEC leaders on the policies needed to further improve the commercial environment in the Asia-Pacific.

I can't emphasize too much, however, that APEC has not—and will not—divide the Asia-Pacific economies from the rest of the world. We are dedicated to strengthening the world trading system and the World Trade Organization.

We see this as the best way to sustain global economic growth.

* * *

I have talked about some of the major problems that Japan faces now. They are serious ones. They require radical solutions. But I am sure that the Japanese people have both the strength and the determination to meet these challenges. We will succeed because we must. We will therefore continue to work hard to improve our economy, which in turn will help sustain global growth. Of course, a healthy mix of competition and cooperation among business is essential to that process. We want to welcome more foreign investment into Japan, into Asia, and together we can create a strong economic foundation for the next century. I hope you will join us in this venture.

Minoru Murofushi is President and Chief Executive Officer of ITOCHU Corporation.
The United States:
New Political and Policy Currents

William Roth

The U.S. Political Landscape:
A Republican Perspective

Roots of the Desire for Change

This is a time of change, mandated by the American people. For the first time in modern history, many Americans do not foresee continuing upward mobility. It's always been the great American dream that your children are going to lead a better life than you. And I think it's fundamentally the loss of that dream that has caused this great change. The American people have become disillusioned and disenchanted with government. They feel insecurity in their jobs. And they're concerned about the loss of values in America.

As far as government is concerned, they don't see government solving problems, but creating problems. It makes no difference whether you're talking about crime, drugs, welfare or education. Government is not seen as helping, but as creating the problem. It took us almost 200 years to reach our first $100 billion budget, back in the days of President Kennedy. But since then that $100 billion has grown to $1.5 trillion. The American people are asking: if we are spending these kind of resources, why aren't we seeing some solutions?

Americans also feel a sense of insecurity in their jobs. Unlike Japan, we've never had a lifetime employment contract. Nevertheless, the average American felt that when he or she went to work for a company, if they did a good job, they probably could stay a long, long time, if not a lifetime. In the old days, if we had a recession, the reduction of the workforce was temporary. A blue-collar worker expected to go back to General Motors or Du Pont or whatever their company once the recession ended. But in recent years, there's been a great change. In recent years, when business has sought to become competitive in this new global economy, blue-collar and white-collar workers, as well as much of management, know that when they lose their job, they will not get a job back at the end of the recession. That's created a sense of insecurity among American workers.

On top of these changing economic issues, there has also been a loss of values. Americans are optimistic, idealistic by nature. It bothers them when they perceive among their countrymen a loss of faith in God, country and family.

All of these factors, in my judgment, have come to bring about a desire for change.

Elections for Change

The last two elections have brought about change. In 1992, the American people rejected a President who a short year before had been remarkably popular. Rarely had a President in his third year enjoyed the kind of popularity George Bush did. Nevertheless, he lost the election, because he was seen as being too focused on international matters and not enough on domestic problems. The fact that the economy did relatively well towards the end of his Administration made no difference. The American people wanted an Administration that would focus on domestic problems, and so we had a new President.

Ironically, the new President found that, even though he emphasized domestic problems in his campaign, it wasn't even a matter of days before he had to concentrate on international issues. More importantly, he soon became controversial. For a combination of reasons, the President, as a person, was not seen as Presidential. The changes he sought
were controversial, whether it was gay rights in the military or radical surgery on our American medical system. These all combined to make his honeymoon short-lived. And again, the fact that the economy was doing reasonably well under Clinton did not do much to help him.

So we come to the 1994 election, when once again there was a mandate for change in the most sweeping Republican victory in modern times. For all practical purposes, the Democrats had controlled the Congress since the '30s, except for two brief periods. No one anticipated the kind of sweep that came about in 1994. Many of us thought the Senate would go Republican, but we didn't see that happening in the House. But not only did we take the Congress, but we took a majority of the governors, including all the big states. Most importantly, great gains were made in the state legislatures. That is where the future of a party lies; and there we made tremendous gains in the South and in the West. Of course, that means a change of power from the East to the South and West, which has serious implications for the future.

So the 1994 election was a mandate for change. And frankly it came about because for the first time the Republicans in the House took an aggressive stance. Their Contract with America promised they would bring about certain changes. Traditionally in the House, the Republicans had taken the position, since they were always a minority, of “go along to get along.” But that never brought about a new majority. Newt Gingrich and his group aggressively proposed a new program and brought about, as I say, the mandate for change in 1994. The American people were saying: “Government is too big; it spends too much; it doesn’t solve any problems. Let’s bring government into the 21st century just like the private sector. Smaller is better.” There was a call to revitalize the states, so they would begin to address and solve some of the problems, instead of bringing everything to Washington and centralizing it there.

Make no mistake. This is a major revolution; and is only just beginning.

The New Congress

In the first hundred days the House Republicans kept their promise. They brought the ten separate items in the Contract with America to a vote, and significant change has come about.

There has been a reform of Congress. For the first time, the laws that apply to the private sector, such as anti-discrimination laws, fully apply to the Congress.

At least in recent years, it has been the practice of Congress to set goals for the states, such as clean air and clean water. These are often expensive goals to achieve. But having bankrupted the Federal government, we just told the states to raise the money to finance these goals. That meant what Washington mandated took priority over what traditionally had been the states’ responsibilities—such as schools, police and firemen. In the first hundred days we passed legislation that will make it much more difficult to have un-funded mandates.

We’re in the process of changing government regulation. It’s estimated that it costs the American family $6,000 a year for the rules and regulations now on the books. This is being changed.

The kind of welfare programs that we’ve known in the past have not worked, and there is going to be change there.

Every one of the ten items has come up for a vote. Two have not been enacted. One, of course, is term limits. The Balanced Budget Amendment lost in the Senate by one vote, but don’t count that out. That still can happen in the Senate before these two years are over.

So indeed, we have had a significant change of direction. I think you will find, for the remainder of the year, that some major efforts will be made to reduce spending. It’s not going to be easy, but there will be significant steps taken. And, just like we had the Kemp-Roth legislation of the Reagan years, there’s going to be a tax cut—because Phil Gramm and Bob Dole, who seek the Republican nomination for President, are not going to let it go by. But I think it will be directed at increasing savings: probably the most important economic need

Most importantly, great gains were made in the state legislatures, that is where the future of a party lies; and there we made tremendous gains in the South and in the West.
of my country is for us to become more of a savings country.

The 1996 Presidential Race
The next Presidential campaign may very well in part turn on the question of tax reform. Everybody, even the President, has come out for change. President Clinton recently said he doesn't rule out a flat tax. There are a lot of Republicans talking about a flat tax, or a consumption tax, or some kind of VAT. I think there will be major tax reform after the next election, because the Presidential election will define what kind of tax change will be made. The American people are tired of income tax reforms which never end up in simplification, but only in more and more complexity.

Let me make a quick prediction as to what's going to happen in the Presidential election. I believe it's the Republicans to lose. Unless there is a great switch, I think we will have a Republican President, and that the Republican to beat is Bob Dole.

Foreign Policy
Let me just touch briefly on foreign policy. I do not believe the United States is going isolationist or protectionist, but there are some trends to be concerned about.

It's a fact that protectionism is growing. The unions are very protectionist. Mexico didn't help. But I think basically the American people understand that jobs, opportunity and growth depend upon our becoming competitive in this new global economy.

There is some reason to be concerned about isolationism, although I do not think it will prevail. Since Vietnam, from the left, you've had those who want us to avoid international intervention. After the defeat of Communism and the end of the Cold War, the same has been true on the right. So on both the left and right you have those who say, "Let's come home and take care of our domestic problems."

Let me give you three figures from a poll taken by the Chicago Council on Foreign Relations last year. Two-thirds of the American public (and nearly all "leaders") still favor an active role for the U.S. in world affairs. Despite the criticism of the United Nations, a clear majority are willing to share international responsibilities, to participate in multilateral organizations. Finally, both the public and the "leaders" have retreated from demanding sharper cuts in the defense budget. A majority are in favor of keeping current levels—a clear sign of intent to remain internationally engaged.

* * *

Let me conclude with a quote from David Broder, a most respected columnist and certainly no Republican ideologue: "What the Republicans have done with their Contract is to force the nation to debate some questions that are urgently in need of airing. How big and ambitious a federal government do Americans want or need? Can Americans require themselves to pay for whatever amount of government they decide they need? Does Congress have the will and the popular support to do it with the President or must they be compelled by an amendment to the Constitution to stop stealing from the next generation? Have states regained sufficient resources and self-confidence to resume the role the founding fathers envisioned? These would be good issues to have on the national agenda at any time. They are particularly timely now, when the Cold War has ended and when a new generation is taking over responsibility for government." With that I most heartily agree.

William V. Roth, Jr., is the senior U.S. Senator (Republican) from the State of Delaware. He was first elected to the Senate in 1970.
The U.S. Political Landscape: A Democrat’s Perspective

I

The Republican Congressional elections campaign in the United States featured the so-called Contract with America, which offered ten objectives which the Republicans promised to vote on within a hundred days after winning the election. I don’t think it had anything to do with the outcome of the campaign—or very little. It came in the midst of the campaign, and Democrats were encouraged by it because they thought it would force Republicans to defend these ten items and create new election issues.

Frankly, I think the Democrats were just rejected. The public decided to focus blame for their dissatisfaction on the President and the Democratic Members of the Congress. All the polls taken immediately after the election suggested only a very small percentage of the public chose Republican candidates because of a preference for Republican proposals and campaign issues. They simply rejected the President and the Congress and went to the other side of the political spectrum in a two-party system.

But if the Contract with America was not a very effective election ploy, it turned out, I think almost accidentally, to be a brilliant post-election strategy. There was the immediate myth that the country had voted for this, that the country had chosen it. *Vox populi, vox Dei.* Having chosen these particular issues, the Republicans were going to keep their promises. And in the first hundred days they had immediate attention from the entire U.S. press.

There is nothing the American press likes so much as a simple quantitative kind of reporting—ten issues, one hundred days. At any time during that hundred days you could analyze how many had or had not been accomplished. And every newspaper and every television station in the United States had the countdown on the Contract with America. Day by day.

Well, the ten items were brought up for a vote, and nine of them actually were passed in the House. One of them was defeated in the Senate. Two have become law. The remaining proposals, I think, face a somewhat uncertain future in the United States Senate*, to say nothing of the possibility of Presidential veto.

We will, I think, see a number of the items of the Contract modified extensively. I hope, for example, that we don’t pass a large tax cut. Restructuring the tax system is another thing. That may indeed be an idea whose time has come. It deserves discussion, and may actually find its way into some implementation in the coming years. But for the United States at this stage—with a very high deficit compared to its savings rate and thus its ability to finance those deficits—to engage in a tax cut (or in a battle between the Republicans and the Democrats on who can cut more) is a great, great error.

II

There is no doubt that the American people have in recent years become dissatisfied with their government. This is not unique. It sent somewhat of a chill through my party when

---

*In our bicameral system, House Democrats are now paying extraordinary compliments to the United States Senate, which is viewed as having a more detached and possibly a more right-thinking attitude about some of the Contract elements than our colleagues in the House. One hears again and again from Democratic Members of the House of Representatives, “God bless the Senate.” I don’t think I’ve heard that phrase much over the last thirty years, but it’s being heard now. Indeed the original idea of the balance between the House and the Senate was, as one of our founding fathers said, “for the Senate to cool the hot tea of the House”—like a saucer in the 18th century was used to cool hot tea. For the most part in the last thirty years, it was the Senate that had the hotter tea, and the House more often was cooling the Senate’s tea.
the ruling party in Canada went from 155 seats to 2, not too long ago. And one can look around the world and see dissatisfaction in almost every parliamentary democracy. In Japan, the ruling party for many years is now in coalition. I mentioned the Canadian situation. The British Conservative Party, against the backdrop of a rising economy, is having great trouble predicting success in the next election. France, Germany, Italy—we could go through the list.

In the United States there has been a particular anger, a particular criticism of Washington, D.C., of the central government. I think this is the result in part of the end of the Cold War. For a long time, the United States government (and other governments) drew some legitimacy and some central purpose in the minds of its citizens from the fact that they were maintaining freedom and defending the West. As the Cold War ended, Americans did begin to turn inward, both on the left and the right. President Bush was at 91% popularity in 1991, and the next year he lost the election. He lost the election with the lowest percentage support of any incumbent President in modern times—an unbelievable turnaround.

Will the new Republican Congress now capture the support and loyalty of the American electorate? Or like President Bush, will it suffer the dissatisfaction of the public at the next election? I don’t think anyone has an answer to that question. President Clinton obviously ran in 1992 on a program of change, but the public was not satisfied that the change it then saw was the change it wanted. Even today, with the ten items of this Contract with America all supported by polls (ranging from 60% to 80% support) and after enacting nine of them in the House of Representatives and declaring a great victory, the public (in current polls) expresses almost 50% dissatisfaction with what Republicans are doing in the House (and 60% dissatisfaction with what the Democrats are doing in the House). About 60% of the public says that politics-as-usual is continuing. It is very difficult to know what the public wants. As one of my colleagues said, the problem isn’t only with the politicians, it’s with the voters, who cannot quite focus on exactly what it is they want their government to do.

Will Rogers said one time, “It isn’t what the public doesn’t know that’s the problem, it’s what they know for sure that isn’t so.” In the middle of the last election campaign, a poll was taken which indicated that a majority of Americans thought the recession was still on, even though the Federal Reserve had raised interest rates about five times by that point to cool off an over-exuberant recovery. Most Americans felt that their taxes had been raised by the Democrats in 1993. We actually did raise taxes on higher-income Americans—$140,000 for a single individual and $180,000 for a married couple, hardly the average person. Yet Americans across the rank and file of the middle class were certain that the Democrats had raised their taxes. A great deal of the credit it goes to the success of Republican rhetoric that this was the biggest tax increase in history, and a shame and a scandal.

III

The future is not clear. Most Republicans are very confident that Bill Clinton will not be the President on January 20, 1997. Indeed, that may be a source of opportunity for the Democrats, because over-confidence is one of the most dangerous of all attitudes in American politics, particularly in recent years (I can assure everyone here). And the President is, if nothing else, someone who believes he has the capacity to be “The Comeback Kid”—to come back from adversity to success. He is a foul-weather sailor. He loves the rough water, and it will be rough—there’s no question about that.

But as Republicans prepare for the coming political campaign, the value of the nomination is so precious that there will be a very bitter—energetic is too weak a word—campaign for the nomination. It will open up divisions within the Republican Party, which (like the Democratic Party) has many internal divisions.
Democrats believe they may have an opportunity if the new Republican Congress goes too far, or is perceived as going too far by an electorate that is essentially rather centrist on most issues. Bill Clinton (and the Democrats with him) may have misread the election of 1992. He was elected as a minority President, with 43% of the vote, but he attempted in some ways to govern as if there was a very large public mandate. Now the Republicans may go too far. Together with the divisions in the Republican Party, this may give President Clinton an opportunity for reelection. I would not by any means count him out.

If I were acting for the President I would try, first of all, to draw Mr. Perot back into the race. That was, after all, one of the reasons that President Clinton was successful in 1992. Third parties are always dangerous to the candidacy they’re closest to. Ross Perot’s constituency, I think, is now almost overwhelmingly likely to vote Republican if there isn’t an alternative—both in Congressional elections and of course in any Presidential bid by Mr. Perot.

On the other hand, Democrats might be worried about the candidacy of Colin Powell, who is enormously admired in the United States. It has been said many times that he will lose some of that admiration and public support the moment he gets into the political arena, if he does so, because it requires him to take positions that are controversial and divisive. But for the moment he’s riding an enormous wave of public sympathy and support. It is thought in the Democratic Party, where the support of minority Americans (African-Americans in particular) is important to the party, that a Colin Powell candidacy (like the candidacy of John F. Kennedy for Roman Catholics in 1960) would at least for the upcoming election draw them away from their traditional Democratic base in large numbers.

IV

So what does the 1994 election mean? Nobody knows for sure, and nobody can say with any great confidence that they do. There’s a lot of myth-making going on; and some of it may have lasting consequences, as myths often do. If the Contract with America appears to be popular when it reaches its final legislative conclusion, and if the myth continues that this is what the people voted for, it will perhaps encourage Republicans and Democrats in the United States to be more European-like. I would say, in offering manifestos and platforms upon which candidates actually run—and which they are actually expected to carry out if elected. If that happens, it will change the character particularly of American Congressional elections, which have been largely personalized and devoid of philosophical or national content.

The election was overwhelmingly domestic in its approach and content, but there is one disturbing element of the Contract with America which calls for the withdrawal of the United States from all peacekeeping operations, which would make UN peacekeeping operations very difficult if not impossible. That has already passed the House of Representatives and is coming to the Senate for consideration—and here again, bless the Senate in its careful analysis of this problem.

We’re in an exciting time in the parliamentary politics of all of the Trilateral nations, the United States not least among them. And it is one which I intend to watch personally with great interest, though with less immediate involvement in the coming two years.

Thomas S. Foley was Speaker of the U.S. House of Representatives in 1989-94, and a Member of the House from 1965 to 1994. He is now a Partner at Akin, Gump, Strauss, Hauer & Feld in Washington, D.C.
The U.S. Economy

What I'd like to do is to comment on the economic implications of the new Congress, and more generally to look at where the U.S. economy is and what policy developments are likely to be with respect to inflation, the dollar and the budget deficit.

The Problem of Inflation
Since we met in Tokyo in April 1994, the experience of the U.S. economy has been very good. Last year we saw real economic growth of more than 4 percent, indeed ending the year with growth of over 5 percent. At the same time we had declining inflation—the Consumer Price Index increase was only 2.6 percent. The unemployment rate has declined to 5.5 percent. So it's a picture of an economy that we would like to take a snapshot of and just hold on to.

That's going to be very, very difficult. Indeed, I think it's going to be impossible. The challenge is to keep the low rate of inflation while the real level of economic growth comes down. But, unfortunately, we're already seeing the inflation rate increasing in the United States. While we had 2.6 percent growth of prices last year, in the first quarter of this year the inflation rate was slightly above 4 percent.

That's no surprise, because we have an unemployment rate which is unsustainably low. When the unemployment rate dropped (as it did last summer) below 6 percent, it was inevitable that, with a lag, inflation would start to increase—and that indeed is what we started to see at the end of the year. Looking ahead, unless the unemployment rate rises back up above 6 percent, perhaps 6 and 1/4 percent, we're going to continue to see the rate of inflation increase. I think we're not going to see that rise in unemployment if we have a growth rate in excess of about 2 percent during the coming year; and while the economy is slowing down, it is the rare forecast that points to that slow a growth of real GDP in the United States. Unless the very recent economic statistics turn out to be a harbinger of a quite substantial slowdown, more than has been broadly expected, the Federal Reserve is going to have to raise interest rates to slow the economy further.

I believe that Alan Greenspan, like his predecessor Paul Volcker, is committed to bringing inflation down. We may not get the soft landing that a lot of people in Washington are hoping for—in which inflation stays low and we avoid any sharp deceleration of growth, or sharp jump in unemployment—but I think we will see Federal Reserve policy which continues to push for a lower rate of inflation over the next several years.

The Dollar
The problem of inflation is exacerbated by what has happened to the dollar—not just relative to the yen and the German mark, but more generally. If you look at what the dollar has done on a very broad trade-weighted basis so far this year, the dollar has declined by about 7 percent. If you look at it relative to when we met a year ago, the dollar is down by about 12 percent.

Anybody has to admit to being surprised at the sharpness with which the dollar has fallen in the last few months. But I don't think there's anything surprising about the trend decline in the dollar. Those of you who have heard my views on the subject in the past know that I am not surprised that the dollar has been gradually coming down over the years. Indeed, the surprise is that for a few years, between mid-1990 and early 1994, the dollar stopped coming down and, on a real trade-weighted basis, actually increased a little bit—about 3 percent. The result was that the U.S. trade deficit and current account deficit started to get larger and larger. So it's not surprising that the dollar has gone through a phase of catching up—of moving back onto the trend of a lower dollar, relative to our trading part-
ners. All in all, the dollar is now just about 10 percent lower than it was four years ago, and that doesn't represent anything very substantial in comparison to the trend that we had before that. The decline to date will help to reduce our very large current account deficit of $160 billion, more than 2 percent of GDP; but frankly it won't get us anywhere close to a trade balance. So I think we're going to see the dollar falling even further in the years ahead.

I think the Treasury understands this. I don't want to pretend to speak for the Administration, but I think they understand that this is not a speculative bubble. This is not contrary to fundamentals. This is not irrational behavior by the markets. Rather, it is a part of a long-term process of correction in an over-valued dollar that will go on until we see our trade account get back into balance—or indeed into surplus.

The Budget Deficit and the New Congress

Let me turn finally to the Congressional revolution that has given the Republicans control of both Houses for the first time in almost a half century. The big question from an economic point of view is: are the policies of this new group in control going to lead to an increase in budget deficits through a massive tax cut? It's true that the deficit problem is not as severe as it was a few years ago. The deficit today is under 3 percent of GDP. It's forecasted by the Congressional Budget Office to rise over the next half-dozen years to about 3.5 percent of GDP. That's a bit better than it was ten years ago. But it still is a very, very serious problem—because of the size of our budget deficit relative to our savings. The savings of households, businesses, and state and local governments are only 6 percent of GDP. So the federal government's budget deficit, even at its current reduced level, is eating up more than half of all of the savings coming from the rest of the economy.

Will the policies that are being discussed in the Congress lead to a larger budget deficit?

My answer to that is "no." And I say that as somebody who is a proven deficit hawk. I don't think we can be confident that the current Congress is going to bring down the size of the budget deficit over the next two years; but we're more likely to see deficit reduction than deficit increases.

Why do I take this contrarian point of view? In part it's because the Senate is very different from the House. The Senate Republicans—the same persons have been in charge on the Republican side in the Senate for a long time—are fiscal conservatives who are not in favor of the tax-cutting agenda that has come through the Contract with America in the House in the last few months. I think we will see much more limited tax-cutting.

There is only one part of the entire tax bill that has passed the House that is really very expensive, and that is a $500 per child credit. I don't know anybody, even on the House side, who is enthusiastic about that. When I talk to key Members of Congress on the House side, they say, "You know, I wasn't there when they put that in the Contract. Somebody else is in favor of that. That wasn't my idea." I think they won't fight very hard to defend it when their elder brethren on the Senate side scale it back, basically out of recognition. I think that what will come out on the Senate side is the kind of pro-saving action which is in the Contract—something Bill Roth has been pushing for a long time—and some form of capital gains tax cut. Neither of those has any significant price tag in comparison to the rest of the proposal. There is also a business investment depreciation change which doesn't seem to have any significant support in the business community, and therefore also is likely to die in the Senate.

But my reason for being optimistic that there is not going to be an enlarged budget deficit (and may well be a shrinking budget deficit) over the next few years is not just that taxes are going to be modified, but that we're seeing the potential for a very unusual marriage between the fiscal conservatives in the

WILL THE POLICIES THAT ARE BEING DISCUSSED IN THE CONGRESS LEAD TO A LARGER BUDGET DEFICIT? MY ANSWER TO THAT IS "NO."
Senate and the new House Members who are really vehemently anti-government, who represent a concern more about cutting back on the size and role of government than they do about the specific budget consequences of that. That combination of House Republicans who want to cut spending and Senate Republicans who want to cut the deficit will work together, or could work well together, to shrink the deficit.

How might it happen? Let me mention three ways. First is something we’ve already seen: going through with a magnifying glass a variety of programs and making specific cuts. That has happened for the current fiscal year’s budget. They haven’t exactly agreed, between the House and Senate, on what that package will be; but each has passed a package of very specific cuts totalling about $15 billion.

Second, and much more important in terms of the potential medium-term savings (savings over the next four, five, six years), is giving back to the states a variety of programs. This includes not just welfare, which makes the headlines, but the Medicaid program, the income-related health insurance program on which the federal government now spends nearly $90 billion a year (about 1.5 percent of GDP). The federal government would give the states block grants to help cover those costs. But those block grants would not continue to grow as fast as federal outlays have on those programs in the past. The states are subject to balanced budget requirements which are quite binding, and the states are in fiscal competition with each other to keep down their level of taxes. I think the combination of all of that would lead to a lower level of government spending—and a lower budget deficit.

Finally, I’m enough of an optimist to believe that we might actually see some entitlement reforms. Politicians are finding it feasible to say, in the light of day, that something has to be done to change our health-care program for the aged, the Medicare program. That doesn’t seem to be as politically suicidal in their minds as it appeared even a year ago. In the area of our retirement programs, the Social Security retirement programs, Alan Greenspan has re-raised an idea that’s been around before, but is now getting a lot of attention—that perhaps instead of complete inflation adjustment, the inflation adjustment might be scaled down by 1 or 2 percentage points. Instead getting the full consumer price increase, there would be a CPI increase minus 1 or 2 percent. That is something that would affect both the indexing of retirement benefits and also the indexing of the income tax. To show you how important that is, after about five or six years, just a 1 percentage point difference in the index would cut our budget deficit by one-third—by a full percentage point of GDP. These ideas have an acceptability and an interest now in the Congress that wasn’t there before.

* * *

So I’m optimistic that we will over the next several years see some progress in continuing to shrink the budget deficit, even if we don’t get the Balanced Budget Amendment. And I think we will also see a Federal Reserve keeping its commitment to bring down the rate of inflation. So if we can only get our private savings rate up, our long-term outlook will be extremely good indeed.

Martin Feldstein is George F. Baker Professor of Economics at Harvard University and President of the National Bureau of Economic Research. He was Chairman of the President’s Council of Economic Advisors in 1982-84.
II

Before I turn to mathematics, allow me to stop for a moment at our own efforts to enhance security. As any student of international relations knows, the ultimate source of foreign policy is in domestic politics. In Estonia, since 1991, the two major internal factors affecting how we view the outside (as well as how others view us) have been free-market reforms and our re-creation of democracy, otherwise known as the rule of law.

Our performance in the first area has been, if I may say it, quite remarkable. Estonians are rather modest people, so we prefer to refer to ourselves using a term coined by Newsweek magazine as The Little Country That Could. Others say that our economic policies would make even Milton Friedman blush.

These policies have borne fruit. If four years ago over 90% of our trade went East, then today, the bulk of our foreign trade—two-thirds—is with Western countries. We have utilized well the few foreign loans we have taken—and we have loan reserves. Our policy is trade, not aid. Foreign investments continue to double every six months, and exports are up. Our currency, the Estonian kroon is pegged 8 to 1 to the German mark and our foreign currency reserves have more than tripled since the kroon was introduced in 1992. We have a balanced state budget and actual growth in the GDP. Our low taxation and full repatriation of profits for foreigners doing business in Estonia make us increasingly attractive to investors.

Our progress in the second area, that of re-building democracy, has been no less speedy. In the three-and-one-half years since independence was re-established, we wrote and passed by referendum a new constitution to assure that Estonia would be a state based on the rule of law. We have succeeded in re-creating state institutions responsive to the public and answerable to the constitution. We have adopted 430 laws since October 1992—practically all basic laws have been enforced by now.
In March 1995, we conducted our second post-Communist elections, deemed free and fair by international observers. The great changes we have undergone have had domestic political implications, as the election results demonstrate. The people voted overwhelmingly for staying the course of free-market reforms, but with what perhaps could be called a greater social component. It is vital to note that no extremist groups, either those with a Communist legacy or those from the right, got into parliament. Just as important, Estonia’s growing citizenry of Russian origin actively exercised the right to vote. In fact, the one Russian political party standing for elections was one of only seven parties or lists to garner the minimum 5% needed to pass into parliament. There are also representatives of different minorities in several party groups in the parliament.

This is an accomplishment which bespeaks of another great part of our democratic efforts, namely the construction of a fair and just nationality policy based on political participation for all who have demonstrated loyalty to the state. In Estonia, permanently residing foreigners are participating in local elections. The cornerstone of this nationality policy is our citizenship law, which has been hailed as one of the most liberal in Europe.

III

These efforts in both free-market and democratic reforms have left their mark in security terms. Today, we belong to a number of the universal and regional organizations most vital to enhancing security, and are moving closer to others. Not to mention the UN, we are also full members of the OSCE and the Council of Europe. We are moving rapidly toward the European Union. Last year we concluded a Free Trade Agreement with the European Union which foresaw no transition period. More important, however, is our association agreement with the Union, which we initialed just two weeks ago in Brussels and which we will sign in May. I am proud to say that our Europe Agreement is the first among those concluded between the EU and Central European states that has no transition period.

Moreover, we continue to be active participants in NATO’s NACC forum and the Partnership for Peace. The centerpiece of our PFP involvement is peacekeeping. Along with our Latvian and Lithuanian neighbors, we have formed a joint Baltic Peacekeeping Battalion which has captured the imagination of alliance planners. A number of the countries represented here have provided invaluable help in building up the battalion, and it is paying off. Estonia’s first Blue Helmets are due to return soon from Croatia, where they served and trained under the auspices of a Danish company, as has the Lithuanian company.

All of this means that the Brussels and Washington points of the Strategic Quadrangle I referred to earlier are fully operational. In other words, we might be more secure now that we were three-and-one-half years ago. But are we? This abundance of organizations we are now part of, this web that ties us to the West, has even prompted some observers to argue that we have achieved the implicit security guarantees necessary to protect and maintain our sovereignty and independence, and that we need not seek additional assurances.

This is where I disagree. We need to go much further West before my country feels secure. This approach, I might add, does not just come out of our historical place in Europe. On the contrary, there are direct security implications of our pro-Western stance. Both at home and abroad, we have been asked at times why we were and are so interested in full membership in the European Union and NATO.

Why, indeed? The answer is rather straightforward. According to an Associated Press report of 18 April, Russian Foreign Minister Andrei Kozyrev has declared: “In certain cases, the use of direct military force might be necessary to protect our compatriots abroad.” In
visited Tallinn briefly. While there, before a crowd waving American and Estonian flags in our medieval Town Hall Square, he paid tribute to the success of our nationality policy by saying, and I quote, “History teaches us that national independence can in some places stimulate national chauvinism. Yet Estonia's fair implementation of its citizenship law and political participation of Estonian citizens of Russian origin show that Estonia is becoming a state rooted in law, tolerance and based on modern civic values. In this demonstration of tolerance, Estonia is a model for the rest of the world.”

We place great importance on the political dialogue associated with European Union membership and the implications of the Common Foreign and Security Policy for European security and stability. We also see NATO through this filter. The best security, as far as we are concerned, is one based on economic success, but backed by military assurances. For us, every Western dollar invested in Estonia is a dollar spent on defense. In other words, by expanding the EU and NATO, we are creating a kind of enlarged Zone of Prosperity that can benefit all.

This security aspect is why we believe that EU and NATO enlargement should happen according to objective criteria and not on a group-by-group basis. This is not only to our advantage, but will enhance security on the continent as well. If some countries were to join up while others were relegated to a kind of waiting room, we would accentuate the very situation we are seeking to avoid, namely, a potentially unstable politico-security gray zone between Western Europe and Russia which could be seen by some as being “up for grabs.”

This reference to gray zones brings me to the final point of the Strategic Quadrangle, namely to Moscow. As you know, last August 31 our relations with Russia took a decisive turn for the better when the last occupying troops left Estonian soil. Since that time, we have embarked upon a policy we are calling...
Positive Engagement, which means that we have sought to take advantage of the historical opportunity to improve relations with our giant neighbor by lowering the level of rhetoric and working toward normalization. The key to this policy is mutuality, however. If both sides do not engage in civilized behavior in the international arena, we can hardly take advantage of this duty to make peace between ourselves.

Estonia tries to find solutions to the most demanding problems in its relations with Russia. We do not have territorial claims to Russia, but there must be good will on the part of both sides to conclude a border treaty.

IV
I spoke earlier of Estonia's Strategic Quadrangle. There is another kind of quadrangle of a strategic sort with which we are all familiar, and that is the window—speaking more precisely, a window of opportunity. Right now, the states represented here face an historic opportunity to prop open this window to consolidate the gains of 1989 and to ensure that this continent never again has to shiver in cold winds.

To forego this challenge is to shirk duty and lose influence.

Ladies and gentlemen, I would like to recall an open letter signed by a host of political luminaries, many of them members of this organization, and published in September 1993 in The Wall Street Journal, entitled "What the West Must Do in Bosnia." I quote from the letter: "Even if, like Kuwait in August 1990, all Bosnia...were seized, it would be essential for the democracies to make clear, as they did in the case of Kuwait, that violent border changes and ethnic cleansing will not stand. If the West does not make that clear, it will have nothing persuasive to say to the Croats and the Serbs who have already renewed the conflict Serbia started two years ago. Finally the West will have nothing to say to discourage the now serious threats presented by pan-nationalists in the former Soviet Union and elsewhere."

Today, a Jekyll-and-Hyde-like danger lurks in classical democracy. Through CNN, ABC and countless other channels, the present-day world intrudes into bedrooms, living rooms and kitchens, creating the illusion that everyone is a participant in video reality. But television programs do not allow individuals to make their voices heard in the solving of problems.

And problems are not in the jurisdiction of just one electorate anymore. Today, global problems need twenty, thirty, even fifty years to be solved. Unfortunately, immediate needs are often made priorities. The voter continues to elect, above all, the person who can promise his family a new car. And this is the crisis in Western democracy. There is no mechanism that would instill into people worry and concern about their children's future.

The threat of aggression has not disappeared either. Aggression, since prehistoric times, has been an attempt of one population, one tribe, one state, to derive additional energy at the expense of another. Aggression is an extensive policy instead of an intensive one. As a remnant of the Soviet empire, such an extensive policy continues to fester in Russia, but it exists elsewhere as well. Where democracy should be growing, there is instead the threat of terrorists redistributing national resources by extortion.

If not so much for Estonia, or Latvia, or Lithuania, or Ukraine, the collapse of the Soviet Union was a surprise for the West. It is a dangerous fallacy to think, just because the Soviet Union is no more, that the command economy, extensive economy and threat of aggression have also disappeared. Three years ago, perhaps, the nations of the USSR would have embarked gratefully on the path towards a free market economy, which, through hardship, would have taken them to democracy. After all, the free market economy is nothing more than the right and obligation of individuals to take free decisions.
At my rare pessimistic moments it seems to me that this moment three years ago is lost. But is it really? No. The opportunity still exists to choose between the difficult road of democracy, and that of the aggressive command economy, which promises only illusory gains. In order to help to choose, we need to understand the weight of the moral obligation we bear—the obligation that we are bearing today. Three years from now, it will be even harder for the peoples of the Russian Federation to make the right decision.

It may be too late to ask whether the Second World War can happen again. It seems to me that we have, with incredible unani-mity, chosen to ignore the Third World War—a war which broke out with Soviet troops invading Manchuria in August 1945 for no particular reason, followed by communist coups and wars in Korea, Vietnam, Indonesia, Arabia, Africa and Nicaragua. If that was not a world war, ladies and gentlemen, then what is? We Europeans have failed to recognize this war because we are too Euro-centered. We see only wars that destroy cathedrals at Coventry, Cologne or Kiev. And we do not understand that sooner or later the shrug of our shoulders that we have given Rwanda’s one million dead will come back to haunt us. The cycle of wars has never been broken. No one has ever bothered to count all the victims. And in one way or another, the reason behind all this bloodshed has been the violent redistribution of wealth.

We have been waiting for World War Three when it has already been waged. Are we sure that we can recognize World War Four? The forms it can take are legion. Some are lucrative for headline writers, but do not make us worry about the fate of democratic values. Naturally I am referring to the Tokyo Metro, to Oklahoma City, to Yokohama. Democracy will lose this battle if it hides from nuclear or biological extortion or any other sophisticated terrorist attempt. Terrorism is not a pastime. Lenin, for example, was a professional terrorist and founded a state upon such tenets. Why, at the time when oil and electronics industries have become internationally integrated, do we underestimate the ability of terrorists to redistribute global resources?

I do understand the limits of democracy. And it is hard for every national parliament to explain to the electorate why a state has to spend money outside its borders and sometimes even beyond the borders of its continent. But Marshall McLuhan’s vision of the world as a global village is knocking on the door, even as the hedonistic European ponders whether to have turkey instead of the traditional pork roast for Christmas dinner.

Lennart Meri is President of the Republic of Estonia, elected in October 1992. He was Foreign Minister in 1990-92.
SECTION 7
UKRAINE

BORYS TARASYUK

Boris Tarasyuk, First Deputy Foreign Minister of Ukraine since 1992, was a guest throughout the Copenhagen meeting. The following is from his intervention at the beginning of the discussion of the draft report on Engaging Russia.

I would like to say a few brief words about Ukraine, about our vision of the current situation and our place in this discussion with regard to Russia. For quite a long time a lot of people—including in the Trilateral community—associated the Soviet Union with Russia and vice versa. Even after the disruption of the former Soviet Union and the re-emergence of independent Ukraine, in a number of Western capitals until very recently, policy towards Ukraine was formulated through, let us say, Moscow glasses.

Certainly Ukraine and Russia have a lot of similarities. At the same time we have a lot of differences. Among the similarities, I would say that we have a common history, a common destiny, common problems, human interchanges, similar starting points for the development of our independent states, common economic and social goals, common standards. To sum it up, our commonalities are derivative of our long history of living in a single state.

At the same time, we have differences. We have different traditions which are deeply rooted in ancient history. We have different political circumstances and behavior, and recent history is the proof of these differences. Take the issue of the transfer of power from one parliament to another, the transfer of power from one president to another, dealing with the opposition. We have—it's quite obvious—a different geopolitical situation, and this geopolitical situation does dictate different interests. Russia is a Eurasian country, whereas Ukraine is a European country. Russia is a great power, a permanent member of the Security Council, having global interests. Ukraine is not, yet. We have different motivations in the European security system. It's quite obvious we have similar fears as to NATO expansion, but with absolutely different motivations. For Ukraine—which does consider NATO a factor of stability and peace in post-war Europe—it is not a danger in itself if NATO is expanded up to our borders. The problem will arise when NATO expands and on the other side we will have another bloc—that is, the Tashkent Treaty on Collective Security. This situation would certainly not lessen our security concerns.
From the very beginning of the re-emergence of our statehood, we have been facing a number of challenges and difficulties—probably not a single country in the world suffered such tests. For example, the price for oil and gas increased a thousand times in comparison to the very beginning of our independence. What economy could sustain such tests?

From the very beginning of our independence we faced the lack of understanding of Ukraine's motivation. We were accused of all possible sins—some mass media were even comparing Ukraine with Iran or Iraq, which had no justification whatsoever. The only reason was the nuclear weapons which, due to history, we inherited in our territory. Ukraine was not making these huge stockpiles of nuclear weapons. This was just a fact of history.

Because of this, tremendous pressure was put on Ukraine, instead of trying to understand the motivations of Ukraine and to cooperate with Ukraine and to provide timely assistance to Ukraine—rather than losing three years and then trying to make up for the lost time.

Since the trilateral statement of January last year between Ukraine, the United States and Russia, things changed for the better. We started the process of early de-activation of nuclear arsenals in Ukraine, in cooperation with the United States and Russia. We have concluded a bilateral agreement with Russia on the transfer of nuclear weapons to Russia, and this process is going smoothly. We have ratified START I and acceded to the NPT.

So the atmosphere in general terms towards Ukraine changed considerably. We were still criticized for the lack of economic reforms—and rightly so. Until last July, this was a real problem—we had no economic reforms.

After Leonid Kuchma was elected as the President of Ukraine, the economic reforms process was inevitable; and President Kuchma took the responsibility—personal responsibility—for leading this process. As a result, we came to an understanding with the IMF and World Bank on a package of measures to reform our economy, and this process is going on. Recently our parliament adopted the first ever budget with the recommendations of the IMF and World Bank, with a deficit of 7.3%—this is now a law. This year the privatization program includes more than 8,000 large and medium-sized enterprises—quite an ambitious program. Well, the process of economic reforms is going on. It is too early to say that everything is going okay, but the plans and the political will are there.

We are now transforming our society from a totalitarian political system into a free democratic civil society. This is not an easy process but this process is going on. We are reforming our national legislation to conform to legal standards and to prepare ourselves to enter the legal field of Europe. The only reason why the Ukrainian parliament and the president put the legislation of Crimea into conformity with our constitution was to secure, to confirm the rule of law in Ukraine.
Main Features of Danish Economic Development

In the 1990s the Danish economy has shown very good fundamentals: low inflation, a strong currency and a solid surplus on the balance of payments.

But it has not always been like that. In the beginning of the 1980s the Danish economy showed signs of profound disequilibrium. Long-term interest rates exceeded 20 per cent (Chart 1), the inflation rate was over 10 per cent (Chart 2), the budget deficit almost 10 per cent, and the balance of payments had shown a deficit for two decades. In the “Snake” Arrangement and later the EMS, Denmark had used nearly every opportunity to devalue the Danish krone in order to gain a better competitive position (Chart 3). In the beginning of the 1980s the economy was in a vicious circle.

In 1982 the new Conservative/Liberal government was forced to send a new signal and decided that it would keep the currency more stable in the EMS. This policy was soon challenged as Sweden devalued its currency by 16 per cent. But the Danish government—strongly supported by my predecessor Governor Erik Hoffmeyer—decided to stick to its policy and not devalue the Danish krone.

This marked the start of a period of very positive development. As Chart 3 shows, only very few devaluations of the Danish krone took place between 1982 and 1987—and all were part of bigger European realignments.

The change towards a more stable Danish
krone was accompanied by a suspension of wage indexation and a tightening of fiscal policy. This resulted in a steep decline in long-term interest rates and in the inflation rate. The years from 1982 to 1986 were moreover characterized by very positive expectations, and growth was well above the European average, as Chart 4 shows.

Many things had changed very quickly, and the mid-1980s was a period when it was extremely difficult to forecast economic development. Therefore economic growth became too strong and led to bottlenecks and to a catastrophic deterioration in the balance of payments (Chart 5). In 1986 the current account deficit was above 5 per cent of GDP.

In 1986 economic policy had to be tightened and the concept of the stability-oriented economic policy was introduced. A tax reform—effective January 1987—favored savings instead of borrowing by private individuals, resulting in positive real interest rates after tax. A series of restrictive packages was introduced in 1986, the most well-known being decided on in October, during the school holiday called the “Potato holiday.” This was not the most effective part of the restraint program, but subsequently the whole 1986 and 1987 package has often been named the “Potato diet.” The name is good—because the economic reform had the aim of changing a situation where the Danes for 25 years had lived beyond their means.

The restrictive policy was introduced with a very lucky timing because growth in Europe was strong in the last years of the 1980s. Against that background the low growth in the Danish economy resulted in a very rapid change of the economic imbalances.

Chart 5 shows a surplus on the balance of payments already in 1990, and if you look back at Charts 1 and 2 you will see the further decline in long-term interest rates and inflation after 1990.

The price paid for this policy of bringing down inflation was considerable losses in the banking sector but these problems were not
of as large a dimension as in the other Nordic countries. But first and foremost the price was growing unemployment, as shown on Chart 6. When you look at the Danish unemployment figure you have to bear in mind that we have a very high participation rate; and even with high unemployment, around 75 percent of the population in the age group 15 to 64 years is employed (Chart 7).

II

In 1993 a new coalition government led by the Social Democratic Party took over. The foreign-exchange market immediately tested the government's willingness to continue the stability-oriented economic policy of the former government. The new government passed the test and Denmark defended the exchange rate of the Danish krone until the whole ERM system came under attack in July 1993, resulting in the suspension of the narrow band.

In Denmark, we felt that the ERM had served us very well, being an essential part of our economic policy. We have therefore after 1993 continued to stabilize the Danish krone in relation to the former hard-core currencies.

The concept of price stability has gained general approval in Denmark since it has been accompanied by rising real wages (Chart 9).

III

At the time that the Maastricht Treaty was negotiated it was a general wish to preserve the stability-oriented policy that had dominated several European countries up to 1990 and been successful in bringing down inflation. Therefore, part of the criteria for entering Stage 3 of the EMU, the so-called Maastricht criteria or convergence criteria, relates to inflation, exchange rate stability and interest rates. The remaining convergence criteria are related to the budget situation and the government debt. Today, the Maastricht criteria are internationally seen as defining sound economic policies and as such they have become a kind of benchmark for economic policy.

By the Edinburgh Agreement Denmark has
decided not to join the Third Stage of the EMU and the common currency. So we need not fulfill the Maastricht criteria on that account.

But it is a very clear intention of the government to fulfill the criteria in order to show the international financial markets that our opt-out of the Third Stage is not meant to be an end to the stability-oriented economic policy. We will be a small neighbor-country outside a big and strong EMU, and this is an even bigger challenge to economic policy than qualifying for membership. The forecasted data for 1995 show that Denmark will comply with the criteria already this year (Chart 8).

* * *

We hope we will succeed in continuing the stability-oriented policy in the future, and that we will also enter the next century with strong economic fundamentals.

Bodil Nyboe Andersen became Chairman of the Board of Governors of Danmarks Nationalbank (Denmark’s Central Bank) in January 1995. She was a Member of the Board of Governors in 1990-94.

POUL J. SVANHOLM

The Danish Business Sector

The fact that Denmark is a small country is known to everybody. It is, however, also a country which is dependent—apart from oil and gas—upon other countries as regards supplies of all raw materials and a great many finished goods. Thus, we need the rest of the world much more than they need us! This is one of the main reasons why Denmark maintains a very open and very liberal trade system.

Many still regard Denmark as a country dominated by agriculture and tourism. This is a misunderstanding. Even though Denmark was industrialized at a later stage than many other countries, industry has long been the most important sector by far. Today, our manufacturing industry accounts for some 70 per cent of total exports, and Danish industry manufactures a surprisingly wide range of products, both consumer and investment goods.

And Danish industry employs more than three times as many persons as the agricultural sector, although only 20 per cent of total employment is within manufacturing. The main reason for this low share of manufacturing—seen internationally—is a public sector which employs about one-third of the total Danish workforce.

Manufacturing Exports

More than two-thirds of total exports go to countries in the newly enlarged European Union. Obviously, Danish economy and industry depend on the development on the European markets—in particular Germany, which buys 25 per cent of the total exports of manufactured goods. But we do also export to a number of more distant markets. Last year, 6 per cent of industrial exports went to the USA, and about 2 1/2 per cent to Japan. Japan’s share is somewhat higher—about 4 per cent—when meat and other agricultural exports are included.

We meet considerable competition from other countries inside and outside Europe. But, over many years, Denmark has grown accustomed to competition and free trade. Danish industry is in fact able to compete successfully on a free common market, and Denmark is one of only three European countries that has gained total market share in the period from 1980 to 1993.

Company Size

Danish companies are rather small on an international scale. Thus, more than 75 per cent of all Danish manufacturing firms have less than 50 employees. Likewise, only one per
No doubt, Denmark and Europe would be better off with a single European currency. And Danish industry has not given up the hope for Denmark joining an EMU one day...

cent of the firms employ more than 500 people. To some extent, the industrial structure in Denmark differs from the structure as a whole in the European Union. Even the largest Danish enterprises are small by European standards.

However, a number of Danish companies operate on a world-wide basis, and many of these international company groups employ 5-10,000 persons or more. Many will probably be familiar with company names such as F.L. Smidth in cement, Novo Nordisk in pharmaceuticals, Great Northern in telecommunication, Danisco in food ingredients and packaging, or my own company—The Carlsberg/Tuborg Group—in beer. Last but not least should be mentioned the largest company group by far in Denmark—The A.P. Moeller-Maersk Group, which ranks among the world’s largest shipping companies, but which is also very significant within, among others, oil and gas, and retailing.

Advantages as well as disadvantages are entailed in so many small and medium-sized enterprises. One of the disadvantages is that the research and development levels in private business are typically less significant in countries with many small enterprises, and this is the case in Denmark. On the other hand, one of the advantages is that it is often easier for small and medium-sized enterprises to adapt to rapid changes in supply and demand. And we know that small and medium-sized enterprises, relatively speaking, stand to gain the most by a removal of trade barriers and by an enlargement of the European Union.

A vital precondition for an enlargement of the European Union is that it must not stand in the way of continued high priority efforts to reinforce the functioning of the Internal Market.

**European Cooperation**

The Danish business community is a strong advocate of the nation’s full participation in the European Union, and it strongly supports moves that will bring down trade barriers and make the ideal of a free market economy a working reality everywhere, within Europe as well as in the rest of the world.

We are among this world’s free traders as regards trade policy globally and in Europe. It is vital for us that trade barriers are effectively removed. And we are very worried when some parties within the international trade regime advocate incorporating in trade policy environmental and social clauses which could pave the way for more protectionism. Free trade is the key, not so-called fair trade.

Danish industry receives lower state subsidies than colleagues in the rest of the European Union. The Danish banking industry, for instance, which—apart from the Central Bank—is completely without government shareholding, has come through recent years with no subsidies whatsoever from the government. (This in contrast to the situation in Finland, Norway and Sweden, where the governments have been compelled to relieve their private banking industries with extensive support and guarantees.) We have grown accustomed to competing on market terms. Other countries in the European Union as well as in the rest of the world should abolish their subsidies too, in order that we may obtain equal terms.

Also in the field of an Economic and Monetary Union, Danish industry strongly supports European cooperation and integration. The latest months, or even years, have very clearly demonstrated the weaknesses of especially the small European countries against the world’s financial markets. No doubt, Denmark and Europe would be better off with a single European currency. And Danish industry has not given up the hope for Denmark joining an EMU one day, reaping the benefits of lower interest rates and a more stable currency. The private business sector has been a keen advocate of the policy which has linked Danish kroner rather closely to German marks. This has not been without sacrifice, inasmuch as large trading partners—such as the other Scandinavian countries—have carried through substantial currency devaluations.
Stable Labor Market and Education

Denmark is known as a country where employees and management generally work out their differences peacefully. It is an important contribution to the nation's economic stability and welfare. Working hours and conditions for hiring and firing blue-collar workers are not regulated by law, but are subject to collective agreements between labor unions and industry. It is also important for Danish competitiveness that we have a stable labor market and a well-educated labor force. And, indeed, we do have that. The Danish labor market is characterized by few conflicts, a low rate of sickness absenteeism, and a highly qualified and productive labor force.

In Denmark, more than 20 per cent of employees over 24 years of age have completed a university degree or equivalent education courses, and over 70 per cent of the labor force have completed post-compulsory education or a vocational training course beyond basic schooling. However, in comparison to the United States, Japan and some other countries, the Danish educational system may lack a focus on the elite. Too much attention is paid to the broad middle group and particularly weak groups, and too little effort is made to create an outstanding elite in an international perspective.

Politicians Create Problems

It should also be mentioned that, from time to time, politicians make things difficult for Danish industry, especially by heavy taxation. The latest hurdle is plans to introduce internationally uncoordinated eco-taxes on industry, which will distort competition and imply loss of Danish jobs without improving the global environment.

And the large public sector, causing correspondingly high taxation—which in Denmark ranks among the world's highest—is one of the major problems for us, as is also the case for several other European countries.

At present, the Danish level of total wage costs per hour is not alarming by European standards; but in Denmark, high taxes and a very generous social benefit system do not make it worthwhile to take a low-paid job. This could be one of the major problems for the future, in Denmark as well as in several other European countries. A high threshold of minimum wages reduces job creation and labor market flexibility in general, which is becoming more and more important in these years of rapidly increasing internationalization and globalization.

The Global Opening of Markets: Threats or Opportunities?

The increasing trade between the industrialized countries and the upcoming market economies in Eastern Europe and South East Asia is by some people regarded as a major threat to welfare and social stability in the Western world. This pessimistic view is in sharp contrast to the traditional view that free trade is the best way of promoting growth and employment—domestically and globally.

I strongly believe in the traditional view. The opening of global markets for goods and services is an opportunity—not a risk—for enterprises, workers, and consumers. I also believe that the worry about increased competition from the East is really just a symptom of internal problems, especially in the European countries in terms of lack of flexibility and adaptability, particularly in the labor market.

This is indicative of a need for increased labor market flexibility. So, if I should draw attention to one major challenge raised by the opening of world markets, it would be the need for increased flexibility and adaptability.

Poul Johan Svanholm is President and Group Chief Executive of Carlsberg A/S.

...WORRY ABOUT INCREASED COMPETITION FROM THE EAST IS REALLY JUST A SYMPTOM OF INTERNAL PROBLEMS, ESPECIALLY... LACK OF FLEXIBILITY AND ADAPTABILITY, PARTICULARLY IN THE LABOR MARKET.
"Soft Security"

What does the world need most after the Cold War? In my mind it is to develop a new global, regional and national "soft security" policy, before we talk about classical security policy. Do we recognize the magnitude of the social and economic problems we face today? Do we have well-developed international organizations to make decisions on social and economic policies?

Soft security policy is more difficult than classical security policy. That's where ordinary people come in. To have the people with us is a precondition to cooperation on economic and social issues. Without our ability to get people to understand the real problems in the world, and their engagement, we will not as politicians or as governments and nations be able to get to grips with the international problems.

The European Union is in my mind a unique construction which cannot be compared to any other. The most important problem to be dealt with in the coming years in the European Union will be enlargement. The European Union should be enlarged. One of the founding fathers of the European Community, the late French Foreign Minister Robert Schumann, once explained its rationale as making "war not just unthinkable, but also materially impossible." Today, this rationale must be applied to Central and Eastern Europe as well. The very perspective of enlargement should provide the candidates with a clear sense of direction and concrete aims for their political and economic reforms. It should encourage moderate behavior towards neighboring countries and in dealing with national minorities. Thus the perspective of membership already enhances stability.

The second and joint job to be done within the European Union is to create new jobs. This is a group of countries which are so interrelated in their economies and at the same time so much less related to the rest of the world. Our possibilities for rational economic policy cooperation within the European Union based upon the Single Market are enormous.

When the time comes, and it will come soon, that the European Union expands its membership to Eastern and Central European countries, it has a price. And to make it possible to convince our populations that they should pay this price, it should be accompanied by sustainable economic growth. That is the combination as I see it. The job we have to do in the European Union is internal and external.
As far as I am concerned, and the Danish government, there will be no first and second divisions as far as new membership of the European Union is concerned. There is only one. The three Baltic states are in my mind in the same division as the Visegrad countries.

Classical Security
I was personally very happy about the decision made last year in January when NATO decided for the development of separable but not separate capabilities which could respond to European requirements. I think that we can see a possible and realistic scenario where the Western European Union in the future could take up humanitarian actions, crisis management and peacekeeping operations under the umbrella of the United Nations Security Council and in coordination, of course, with NATO.

When it comes to NATO enlargement, I think there should be a compromise by also strengthening cooperation with Russia. On Russia and expanding NATO membership, the approach should be: no veto and, on the other hand, no exclusion.

Again here when it comes to applicant countries, there is only one division in my mind. And in this one division again we find the three Baltic states. It would be highly improper and risky if we foresee that many years will pass from the first new member country of NATO until the next and the next and the next.

Social Security
You can have a secure state, but within it you can have insecure people, and eventually this could bring you an insecure state. We can never be sure that sustainable economic growth is automatically to the benefit of all groups in our societies. This underlines the fact that we have to insist upon a balanced internal economic and social policy to the benefit of the broad population.

It is a precondition for popular understanding of international cooperation that we have a socially and economically sustainable policy in our nations. Social security is in my mind not in contradiction to flexibility, the will to seek jobs, education and training, and new chances. It is a precondition for this, not in contradiction to it.

* * *

We have already seen a number of conflicts where the international community has had to step in to stop the violence. But we must also look at the more general question of how to prevent international conflict and violence from developing into a real threat. Strengthening international cooperation on “soft security policy” is in my mind the most important answer. Are my reflections unrealistic and naïve? In essence, my points about “soft security policy”—social and economic cooperation—are necessary for the individual nation and for international society, and thereby neither naïve nor unrealistic.
Tøger Seidenfaden

Denmark in the European Union

Rather than painting a picture of the internal political situation, I would like to put Denmark in the European context. Though we pride ourselves on our very high foreign aid contributions (more than 1% of GNP) and in that way have some impact on a number of poor countries and UN organizations, it is obvious that the single most important commitment of Denmark and the single most important area of contact between Denmark and the outside world is our participation in the European Union.

Constructive in Low Politics, Problematic in High Politics

I think it's fair to say that the Danish contribution since 1972 (when we became a member of the European Union) has been, broadly speaking, constructive in low politics and problematic in high politics.

What do I mean by constructive in low politics? We have been far ahead in terms of legal integration within the Community. The degree of implementation of EU directives and of EU legislation more generally is very high in Denmark—not only legal implementation but actual implementation. European law is, in fact, also Danish law. It is also true that there is very little fraud regarding EU matters in Denmark—which is not the case in all European countries. And our contribution at the level of personnel is perhaps worth noting. In addition to the automatic participation we have in the Council and the Commission, distinguished Danes have been head of the European Court and General Secretary of the Council's permanent organization in recent years. So in terms of low politics, we have been pragmatic and efficient participants in the European Union.

But if you look at high politics—the development of the EU itself, the various treaty changes, and the debate about the future of the Community—the situation is quite different. And it is different to such an extent that it is important not only for Denmark itself but for broader European developments. We have had a problematic relationship with what you might call the "vision thing" in Europe. The Danish relationship to the European Union has been based very narrowly on economic advantage, on market access, and not on the EU's wider foreign policy and political meaningfulness. We have been very reluctant in the political field, in the field of security issues and defense issues. We are leery of integration as such—at least when it is framed in political terms.

We made a dramatically negative contribution to the Maastricht ratification process in 1992-93; and I will spend the few minutes available to me on that case—the case of the Danish contribution, or rather lack of it, to the Maastricht ratification process. I want to give you a sense of what happened, why it happened, and why this is a problem. It was a problem for Europe and could be a problem in the future. But perhaps the impact was not wholly negative—the note on which I will conclude.

The Double Referendum

In this country we had two referendums on ratifying the Maastricht Treaty negotiated in the European Community—on June 2, 1992, and on May 8, 1993. What happened, why did it happen, and why was it important?

What happened, of course, was that in the first referendum on ratification, a clear though narrow majority of the Danish electorate voted "no"—rejected the Treaty.

Why did this happen? There are a number of factors which are worth mentioning. Some of them are unique to Denmark, some of them are part of a broader European pattern. The narrow, Danish aspect was that for the first time the debate about a European
referendum became a political one. Rather than the traditional market, commercial and economic debate, it became a matter of existential values, of political sovereignty, and of our place in the world and in Europe. Our own form of soft nationalism—even though we insist on our smallness, we nevertheless are quite nationalist and quite proud of our achievements—came to the fore in the debate. I think a Danish poet has expressed very well this strand of our national character when he said, “The Danes, of course, are the most modest people on earth—in this way they are also better than all other peoples.”

Another aspect—of broader European significance—was that the traditional opposition from the left in Northern Europe to strong European integration (from believers in a socialist utopia or very worried defenders of the welfare state fearing some kind of leveling down) was joined by reluctance on the right. There was opposition on the extreme right, based on xenophobia and fear of immigrants, but also on the more moderate right, which feared the bureaucracy of Europe, which was influenced by Thatcherist thinking in Great Britain.

The point, however, is that the negative outcome of that referendum created—to an extent which public opinion and certain decision-makers in Brussels were not aware of before it happened or even immediately afterwards—a very serious problem for the European Union, not only a very serious problem (obvious to everybody) for Denmark. It created a very serious problem for the European Union because the European Union is a very legal affair. The great achievement of the European Union is the fact that it is a community of law where European legislation stands on a higher level than national legislation and is, in fact, enforced by a European Court. This is what makes the European Union unique as compared to many other international organizations. In such a collaborative effort, when it is required that a treaty be ratified by everybody—not simply for a country to join but for the treaty to stand—you have a very, very serious legal situation for the Union if Denmark, as indeed happened, had not reversed itself in a second referendum in the following year.

I have not heard any legal specialist from the Commission in Brussels who had a fully thought-out solution to this legal problem. I mention this fact because this could happen again. It could happen in another of the now 15 member countries of the European Community. I believe that after the next treaty change something will have been worked out to deal with this problem, but we haven’t solved it yet—how to deal with the problem of this legal blocking by one small country of the whole European development.

This was a comundrum. It was solved, I would say, in a very Danish way. The Danish people were told: “You have voted ‘no’; you were right to vote ‘no’; therefore you must now vote ‘yes’.” The Danish people thought about this for about twelve months. It was explained to them very carefully: they should now vote “yes!” for all the reasons they had been right to vote “no.” This may seem quite difficult to accomplish in practice, but it was very effectively done by our political class. Seven out of our eight political parties agreed on this policy; one more than originally favored “yes.” They came up with a formula in which Denmark got an agreement—the Edinburgh Compromise—which gave Denmark absolutely nothing in legal terms but a lot in political terms. This was then presented as a confirmation of the wisdom of the Danish people, which would now allow them to reverse themselves. Indeed, the electorats did reverse itself by a quite clear majority—voting by 56% in favor, having voted 51% against in the first vote.

Deep Division between Elite and Electorate

This solved the problem, taking a very narrow view. But in addition to reminding us of the negative outcome of that referendum created... a very serious problem for the European Union, not only a very serious problem... for Denmark.
the difficulties which would follow if this happened again, it has created in Denmark a very strange state of affairs on Europe. Our government and the overwhelming majority of our parliament members would like Denmark to be part fully of European integration, would like Denmark to be a full-fledged member of the third phase of the EMU Treaty. Nevertheless, the electorate does not think so—or is believed not to think so—on the basis of the failed referendum of June 1992. So we have a very deep division on Europe between the electorate and the political elite, the business elite, the media elite, and so on. A lot of people (including myself) are enthusiastically working to overcome this deep division.

We are in that sense perhaps a laboratory for things which are happening or could happen in other countries. The Danish trauma is beginning to emerge in other European countries. It must be pointed out that there will be future referenda in Denmark, and in other countries, and every single one of these referenda can fail. There is thus potential for trouble—not only with regard to how many countries should join to make possible at some point in the last years of this decade the European Monetary Union, but also on the even more complicated matter of the outcome of the Intergovernmental Conference on European Union in 1996 and onwards.

Building the European Union at Bottom a Political Affair

I want to end on a positive note, by pointing out that, despite the enormous legal difficulties raised and only superficially solved, there may be a positive side-effect to the Danish drama for the general European debate about why the Union. That possible beneficial side-effect—especially with the failed referendum in mind—is that there is a much greater realization that this business of building a European Union is at bottom a political affair. It is not only an economic affair, a foreign policy affair, a social affair, a bureaucratic affair. It is a political affair in the very deep and crude sense that if it is not politically accepted, it will not succeed—however rational and necessary it may be from the point of view of the ideals of the founders of the European Community (which I think are closely analogous to those of the Trilateral Commission).

It will not succeed if it is not politically accepted by the electorates—that's obvious. But it is important to note what follows from that: it also has to be acceptable to politicians. It has to give a role to politicians. If it does not give a role to politicians, then a growing number of politicians will see that there is an electorate waiting to be mobilized against Europe. There are people who are alienated from internationalization and globalization and integration, and these people can be mobilized by populist politicians of the right or of the left (or both)—nationalist politicians.

To avoid that, politicians have to be given a role. They have not been truly given a role in the model of European integration—which may be why it has been so successful for several decades. It's been a matter of lobbyists, of civil servants, of technocrats, of intelligent people working on practical problems under, of course, formal political supervision, but only for a few hours at a time between meetings. Now this has to be changed—not necessarily because politicians will make a substantial contribution in terms of content, but because without politicians it will not be accepted.

A perhaps more positive way of expressing the point that politicians have to be given a role is that the issue of democracy has to be put frankly on the agenda. Only if the European Union is democratized—i.e., is given forms of parliamentary accountability and participation by day-to-day, practical, elected politicians who are accountable to their electorates—will it be able to survive in the future. We may not like this; we may find it inefficient; we may worry about its conse-
quences for all kinds of other issues. But it is my profound belief—of course based partly on the Danish experience—that politicians (who provide compromise and conflict resolution) have to be put at the heart of the European construction if it is not to be blocked by one country, by several countries, by one referendum or another. Maybe Denmark—on a very small scale and with the ability to solve the problem pragmatically afterwards—has tested out a crisis which needs to be headed off by people like you, by people in Europe, and by our friends elsewhere.

Tage Seidenfaden is Chief Editor of Politiken, the leading daily newspaper in Denmark.

SECTION 9
SCANDINAVIA

KÆRE WILLOCH

Norway in Scandinavia and Europe

I assume that it is the Norwegian people’s clear “NO” to membership of the European Union that has made my little country’s position in Scandinavia and Europe the object of special attention in this forum. I assure you, no other political issue has been the source of so much controversy in Norway in modern times as the question of Norwegian membership of the EU. Presumably, my job is not to convince this group that the Norwegian people should have said “yes,” although that is certainly my own personal opinion. My task today must be to analyze what Norway’s rejection of EU membership may or may not actually entail. In this context, some of the probable reasons behind the outcome of the referendum may be of interest, not least as a potential platform for future developments.

The Scandinavian Peninsula’s propitious location, i.e. outside Europe’s central areas of conflict, has no doubt contributed to the residual pockets of isolationist and neutralist mentality which still exist among our peoples. Referenda make such currents more important than they would have been under normal decision-making processes in representative democracies, where voters’ preferences are adjusted by parties and parliamentarians prior to final decisions being taken.

Norway’s experience in World War II and being an occupied country shattered the credibility of neutrality for us. Its strategically exposed position on the Soviet border led my country to overcome its last remaining objec-
tions to abandoning neutrality in 1949 and seek security within the safe embrace of NATO. As Norway gained confidence in and experience of the Alliance, membership gained broad support and it is now firmly supported by the vast majority of Norwegians.

Sweden’s choice of a different path can undoubtedly be explained by her significantly different experiences since 1940. During the war, Sweden succeeded in establishing a form of “neutrality” that was based on making concessions to whichever party to the conflict happened to be stronger at the time. By so doing, Sweden managed to stay out of the conflict. This made neutrality equally popular and firmly rooted in Sweden as the NATO policy became in Norway. Throughout the Cold War, Sweden defined neutrality as not supporting any party in the event of an armed conflict, but on the assumption that others would come to her rescue if need be.

Against this historical background, it may seem something of a paradox that an aligned country like Norway would say “no” to the EU while a neutral country like Sweden would say “yes.” The explanation is probably that Sweden “knows which side their bread is buttered on.” Sweden’s verbal political idealism has never been allowed to stand in the way of important economic interests, and certainly the economic motives for membership of the EU were perceived as being stronger in Sweden than in Norway.

Norwegians share a rather widespread view that our oil and gas resources allow us a greater degree of financial independence than our neighbors enjoy. Many people are of the opinion that it is prudent to use our natural-resource-based economic strength to preserve more political sovereignty than the EU gives the impression of allowing. For the sake of order, I would point out that this is not my personal point of view, but rather my perception of the reasons behind the result of the referendum.

In addition, farming and fishing seem somehow to “loom larger” in public opinion in Norway than in most other countries. Virtually all Norwegian farmers and the vast majority of Norwegian fishermen see the EU’s common policies as a threat to their own best interests. Moreover, it is hard to deny that the EU’s shortcomings in the field of fishery resources management could give cause for concern if the EU were to exert more influence over the management of Norwegian resources. Such concern over the management of our fishery resources probably also carried the decisive vote against Norwegian membership of the EC in the 1972 referendum, and certainly not without just cause. I would remind you that even Willy Brandt pointed out that Norway’s “no” in 1972 was to some extent a response to problems created by the EEC, not least that “Brussels pounded through a fisheries market scheme; this was almost viewed as a provocation” (Begegnungen und Einsichten, Hamburg, 1976). And it was not difficult to rekindle fishermen’s skepticism about Brussels in 1994, especially since the EU had not managed to establish an effective marine resources management scheme in the 22 intervening years.

However, it is important to note that during the lively debate preceding the 1994 referendum, even those against EU membership pointed out that they did not favor a neutralist or isolationist attitude. They emphasized that we should continue to pursue close security policy cooperation with both Europe and North America, but contended that EU membership was not necessary in order to do this, largely because of Norway’s association with a number of other organizations, first and foremost our membership of NATO and our associate membership of the WEU.

Some people on the socialist left of Norwegian politics went so far as to say that they would be willing to reconsider their negative attitude towards EU membership if the Union became more pan-European by accepting members from Eastern Europe. That at least offers a ray of hope to those of us who favor Norwegian membership. However, our negotiating position would no doubt be even more complex with several more countries taking their places across the table from us.
As regards economics, those who victoriously opposed EU membership contended that the European Economic Area agreement would ensure Norway sufficient access to the EU market. Both political and financial leaders issued strong warnings against such an ostensibly irresponsible or cavalier attitude. However, those warnings lost their credibility rather quickly after the referendum because so many factors in the Norwegian economy departed drastically and positively from leaders’ predictions.

There is no denying that Norway’s chances of restoring full employment and preserving the welfare state are far more dependent on oil prices and on our ability to avoid inflation and thus improve our competitiveness, than on the unresolved trade policy questions related to the EU. Even if one assumes that oil production will begin to diminish a few years after the turn of the millennium, one can assume that Norway’s economy will demonstrate considerable strength until that time. One can only regret that more is not being done to prepare Norway for the inevitable decline in oil production. However, one must admit that irresponsible shortsightedness is not the exclusive province of those opposed to EU membership.

In any event, economics do not resolve problems of a more political nature. In the future, Norway will simply have to accept that we do not have any particular influence on the outcome of political issues that determine the terms of competition for Norwegian business and industry.

Norway’s economic situation will exacerbate the effects of the lack of Norwegian representation in Europe’s most important decision-making bodies: The EU buys approximately 80% of Norway’s exports, while we buy approximately 3% of the EU’s exports. This does not put Norway, as a small country, in a particularly strong negotiating position, and the situation is aggravated by the fact that we are now virtually without regular trade policy allies. This further intensifies Norway’s need to ensure its defenses against economic problems: It increases the pressures on the country to keep its internal finances in order and to maintain a balance of payments surplus. Our petroleum revenues currently make it possible for Norway to be a net exporter of capital, with the advantages that entails.

Naturally, we hope that the long traditions of Nordic cooperation will give us an avenue of influence into Europe. The idea is that we would help formulate Nordic positions on EU issues, which would then adroitly be pronounced in EU bodies by the Nordic EU members. However, one cannot fail to question the probability of Denmark, Finland or Sweden sacrificing any of their own interests in favor of those of their currently ever-so-affluent “little brother.”

This makes it even more important for Norway to preserve the Nordic Council as a forum for frank discussions about cooperation. In its prime, the Nordic Council was an arena for important discussions between governments and leading parliamentarians from all the Nordic countries, but now it is in danger of becoming a Nordic backbenchers club. A trend in that direction would be extremely regrettable for several reasons: We need viable Nordic cooperation for political reasons, but also and not least to preserve the common culture shared by the Nordic countries, what one might call the Nordic identity, a highly worthwhile emotional factor that politicians must never underestimate in their efforts to achieve material results.

One practical measure for preserving my country’s closeness to her neighbors may be to implement joint Nordic ratification of the Schengen agreement regarding the abolition of frontier controls, which in this case would maintain today’s almost frontier-free status in the Nordic region. One should not underestimate the cooperation-promoting psychological effects of any form of Norwegian association by virtue of such an arrangement. Such an effect would be a bonus above and beyond the practical advantages.

As previously indicated, the security aspects
of EU membership had a limited impact on the outcome of the Norwegian referendum, in spite of most Norwegians being well aware of the need to maintain a consistent security policy. Despite our attempts to develop good neighbor relations with Russia, society at large is painfully aware that being her neighbor still entails a certain risk, particularly in the longer term. I must add that there still are unresolved border problems between Norway and Russia, both in and under the Barents Sea.

Norway's location makes her safety dependent on both Europe and the USA. Should the two main pillars of NATO, Europe and North America, drift apart, Norway could be placed in a very difficult situation. We fear, and we must work to prevent, NATO questions mainly being decided between the EU and the USA, with our role in NATO becoming less important than what we have been accustomed to. We must also bear in mind that economic issues, as well as our interest in global stability, make it natural for Norway to be involved in the preservation and further development of the transatlantic partnership, which unfortunately appears to be receiving less attention from the major political powers.

However, it is also of importance to the defense of Norway that military cooperation with Finland and Sweden be further developed. A glance at the map is enough to convince anyone that security is weakened by having three inherently independent national defense systems in the northernmost part of these countries. Thus one can only hope that Finland and Sweden's membership of the EU will eventually eliminate their inhibitions regarding more systematic cooperation in this area.

With a little goodwill, one might also view Norway's comprehensive commitment to establishing and protecting peace in large parts of the world as a contribution to our own security. The most remarkable example of this to date is Norway's contribution to the peace process between Israel and the Palestinians. Other relevant examples are Norwegian participation in the peace processes in Yugoslavia, Guatemala, El Salvador and Sri Lanka.

The vast majority of Norway's population favors the country paying more per capita for development cooperation, catastrophe help and other peace-preserving measures than virtually any other country. Yet we must never succumb to the delusion that this ensures us sufficient influence in respect of important decisions of more direct relevance to us. There is a certain danger that Norway's global involvement may steal attention from our need for influence in Europe, which in any event is the continent of the greatest importance to us. A tendency to adopt a missionary-like mentality may also undermine the realism of the Norwegian debate.

As for Norway's future role in Europe and Scandinavia, it is important that authority has not fallen into the hands of those who achieved a majority against membership of the EU. For now, those who lost the referendum continue to govern and do not try to hide the fact that they want to link Norway as closely to the EU as possible without membership, and to explore and exploit all opportunities for contact with the EU and its individual member countries. Please note that this policy enjoys broad support in the Norwegian parliament and among the general public. It also serves to confirm that although the voters' "no" to EU membership may translate into a lack of influence and certain practical problems, it was never intended to be a rejection of close cooperation with Europe.

Kåre Willoch was Prime Minister of Norway in 1981-86. He has been County Governor of Oslo and Arkerhus since 1989.
The Sustainability of the Scandinavian Social Model

Underlying Social Contract Ceased to Function When Economic Conditions Deteriorated

To most people, I believe, the Scandinavian Social Model is known for its huge, generous, and expensive Welfare State which, as the saying goes, takes care of our citizens “from cradle to the grave.” I will return to the truth in that in a moment.

But first I should like to point out that the Scandinavian Social Model also has contained something else. And that was a kind of contract between the governments and the social partners, which meant that those partners took it as their responsibility not only to keep wages inside productivity limits but also to cooperate in good faith to make our industry modern and efficient. The government, on its part, pledged to have full employment as the first priority of its economic policy. For some 20 or even 30 years this part of the Social Model worked wonderfully. The Scandinavian countries had between 1950 and the mid-1970s an almost unique mix of fast economic growth, full employment and monetary stability. Those were also the years when the Welfare State was built and became the center of political ambition and public attention.

Since then, things have changed. The Scandinavian countries came to share with other European nations the decline of economic growth and the rise of unemployment. The social contract between the government and the social partners ceased to function as none of them could deliver when economic conditions deteriorated. Political ambitions and public attention had to switch from further development of welfare policies to how they should be adjusted to the fact that the national economy no longer could support them to their earlier extent—or, if you prefer a different wording, to the fact that our citizens no longer were able and willing to carry the tax burden required to keep the Welfare State going.

Quite a few would claim that the welfare policies themselves have played a detrimental role in this process. To mention only those arguments with which I myself agree, high tax rates undoubtedly have affected the propensity to work, save, and invest. And very generous social benefits which compensate fully—or even more than fully—for loss of income in the case of unemployment, sick-leave and parental leave affect people’s motivation to look for new jobs or perform in the ones they have. Also, the strong expansion of public sector employment did, at least in the case of Sweden during the 1980s, deprive the private sector of valuable, well-educated manpower.

So, if you ask whether the Scandinavian Social Model is sustainable, the answer is that its sustainability already is falsified. True, there are differences between the individual countries. Denmark started more than ten years ago to roll back welfare expenditures in order to balance its budget and reduce inflation. Norway has, after a period of austerity in the second half of the 1980s, shown increased confidence in its oil revenues and their capacity to finance the Welfare State. But both Finland and Sweden are now in the middle of slashing benefit levels and restructuring welfare programs.

So, there is no doubt that the Scandinavian Social Model is in transition. It is being reviewed and revised. The interesting question is where it will go.

Well-Founded Public Support and the Need for Reform

Looking ahead and trying to predict what will happen, it is important to note that most wel-
...THE STATE SPENDS TOO MUCH SIMPLY TO PROP UP PEOPLES' INCOMES BUT FAR TOO LITTLE ON THINGS THAT COULD MAKE IT POSSIBLE FOR THE SAME PEOPLE TO EARN THEIR OWN DECENT INCOMES...

...welfare programs enjoy widespread popular support. I believe that two features of our Social Model are held in especially high esteem. One is the principle that health and medical care as well as education on all levels shall be available for all citizens on equal conditions. And these conditions have to be such that no one is excluded from those services for economic reasons. The other is the general nature of our safety net, social insurance systems and family support, so that means- and income-testing is restricted to those cases which cannot be covered by the general systems.

There are a number of reasons that speak for this conception of the good Welfare State. One is that it avoids creating poverty traps—in fact, the Scandinavian Social Model has proved its capacity to establish a society where not only are the really poor very rare but living standards in general are rather evenly distributed. Another is that the general nature of the safety net—that it applies to almost all, irrespective of income and social status—has made the middle classes also feel that they get something back for their taxes, thereby assuring their support for the Welfare State. Also the fact that the State is provider of at least a basic social security contributes to greater personal freedom in the sense that individuals can change occupations and employment without fear of losing earned social benefits.

All in all, I believe that a large majority of Scandinavians look upon our Social Model as a symbol of egalitarian values, a high standard of living, and a relatively peaceful and non-conflictual society. And the support of this model is not confined to the less successful and the needy. In fact, its most devoted supporters seem to come from the middle classes.

But this also to a great extent explains why the political system meets such strong resistance when economic necessity forces reductions of the size and scope of our welfare systems. The great danger is that more contributions from the state, larger doses of welfare payments, will be perceived as a means to raise the general living standard, a substitute for economic growth and higher real incomes. I am afraid that this misconception is rather widespread in my own country and has been allowed to influence our welfare policies.

The real conflict between what our societies need most just now—that is, more growth and more jobs—and the problems of the Welfare State is, to my mind, not governmental deficits and debt. It is that the state spends too much simply to prop up peoples' incomes but far too little on things that could make it possible for the same people to earn their own decent incomes, like education, research, and infrastructure in general.

Where Will the Transition Lead?
So where will the transition lead the Scandinavian Social Model? I think that four elements are crucial. Here I refer to the Swedish case, which, in almost all respects, is the most critical one. Unfortunately, time constraints do not allow me to be very specific.

1. For public services to be supplied according to needs without harmful further tax increases, they have to become much more cost efficient. Some progress has been made but further efforts are necessary—by, e.g., tight budgeting, breaking up of monopolies to create a competitive environment (including the entry of private alternatives), decentralization of decision-making, and so on. On this point one can be reasonably optimistic, as resistance to changes and new ideas gradually abates, especially when it can be demonstrated that higher productivity means a more efficient and consumer-oriented supply of public services.

2. The most important change in the Swedish social security system so far is a lowering of the degree of income compensation. It used to be between 90 and 100 percent of lost income. From next year compensation in all systems is limited to 75 percent.

The next step should be to establish a direct link between individual payments to the system and individual benefits from the system.
This principle will in a few years time apply to the public pension system in Sweden. The idea is, in the first place, to make people personally responsible for the costs of their social security, but also to make it possible for anyone insured to decide when and how to use up one’s social funds.

Another step which should be considered is to privatize certain parts of the health insurance system in order to achieve risk-evaluated fees and thereby increase interest among both employers and trade unions to minimize diseases and injuries caused by working conditions as well as to organize more efficient rehabilitation of such cases.

3. One of the toughest decisions to make is how far up in the income brackets the state should offer tax-financed social security. In Sweden income losses are compensated up to levels which are almost double the average earned income. One way of reducing public expenditure and the need for taxes is therefore to lower the ceiling up to which the state compensates for losses. Above that ceiling the private insurance market can take over. The reason why this requires a certain political toughness, some would say political madness, is, of course, that it unavoidably will infuriate the most influential political constituency—the middle classes.

4. The most difficult part of a transformation of the Scandinavian Social Model will, without a doubt, be if it would appear that the only way back to full employment is to give less weight to egalitarian values which traditionally have been the driving force behind a wage-formation system aimed at reducing differentials in wages and salaries to a minimum. I will not elaborate on the debate about the need for greater flexibility of European labor markets. But it seems clear to me that a very substantial part of this flexibility has to be the willingness of large groups in our societies to accept jobs which pay less than today. And at the same time, in order to fully exploit the growth potentials of the post-industrial economy, other groups, albeit smaller, must be better remunerated than today. In other words, larger inequalities have to be accepted.

I do not know what the outcome will be of a revised Scandinavian model. The only thing that can be said with some certainty is that it will require a rather drastic change of trade union policies. Maybe it is time to bring the old Social Contract back to life but with a new objective—a wage structure that could bring the jobless back to work.

Kjell-Olof Feldt was Sweden’s Minister of Finance in 1982-90 (and Deputy Prime Minister in 1986-90).

GUSTAV HÄGGLUND

Security and Neutrality: European Security from a Finnish Point of View

WITH FINLAND, the European Union received over 1,200 kilometers of common border with Russia. If one were to place this border across continental Europe, it would extend from the Baltic Sea to the Mediterranean.

For the past 800 years, Finland has often been drawn into east-west conflicts in our part of the world. During the Cold War, we managed to escape them by pursuing a policy of neutrality. In today’s world, we actively try to affect the international political situation in order to avoid any new east-west confrontation. Neutrality is not a valid tool anymore in these efforts. We are against any new dividing lines in Europe.
Accession to the European Union marked a further change in Finland's policy. We are able to be present where a new Europe is designed and created.

* * *

Let me stay awhile with a special focus of my presentation: Finnish-Russian relations and geopolitics. In the European Union security questions related to Finland are connected to our long border with Russia and the developments in Russia as such. This border is today one of the most peaceful in the world and the traffic across the boundary is strictly supervised and regulated—not least thanks to the efficiency of the Russian border guards. The border, however, also means greater economic disparity than anywhere else in Europe. Any disturbance, unrest, or even ecological disaster in Russia can have repercussions on Finland and, through Finland, on the European Union. Therefore, it is very much in the interest of the European Union, and even more so of Finland, to promote stable development in Russia.

Any political conflict between the European Union and Russia would presumably focus also on the Finnish-Russian border. Avoidance of such a political conflict has top priority in Finnish security policy. Our membership in the European Union and observer status in the Western European Union raised no Russian objections. Russia has, however, clearly indicated that Finland's membership in NATO would force Russia to reconsider her policy and to strengthen her military forces in areas adjacent to Finland.

At the moment Finland is not considering joining NATO. We have managed to take care of ourselves alone, both in war and in peace. During the Second World War, Finland was the only country to repel a major Russian offensive, not just once but twice: first in the Winter War of 1939-40 and again during the fierce battles of June-July 1944. Due to these exceptional achievements of our soldiers, Finland was never occupied in World War II. In fact, in the European continent Finland was the only country in the war to avoid occupation. After the war most of the European countries were included in military alliances, either by force or by their own choice, whereas Finland managed her own fate and learned to deal with Russia on her own.

Furthermore, Finland's long experience in the Russian market, good reputation, and advantageous geographical location give us the best qualifications to become a natural gateway between the European Union and Russia. Countries outside Europe have also paid increasing attention to us in this respect.

When joining the European Union, Finland stated military non-alignment and credible independent defense as her security policy. Through this arrangement we support most efficiently stability in Northern Europe and the Baltics. Finland can at short notice (7 days) mobilize a reasonably well-equipped army of half a million soldiers—a force which is rather exceptional in today's Europe. Some 90 percent of each age group of male citizens enter the military service. Conscription provides us at low cost a highly motivated force whose budget allocations can be concentrated on material procurement. A recent purchase of 64 F-18 Hornet fighter aircraft demonstrates our determination to maintain a credible independent defense even in the middle of a deep economic recession. The determination of the Finns is further evidenced by a recent poll asking the most expressive characteristics of the Finns. "The will to defend my country" scored highest on the list.

In the prevailing circumstances all arguments seem to speak for the defense of the eastern perimeter of the Union by the Finns, and by the Finns only. The Finnish government has made it clear, however, that it does not exclude any further options.

We understand that countries with a very different legacy, like the former Soviet satellites or the Baltic republics, long for a safe haven. They fear the reawakening of Russian imperialism and see the current situation as a
window of opportunity to arrange their safeguards against a potential Russian expansion.

In a wider historic perspective the key question for Finland, Europe and the whole world is: Are we witnessing the end of Russian imperialism or just a temporary lull? Should, e.g., Chechnya be seen as evidence of Russian determination or of weakness? The Russian empire has shown astonishing ability to recover from severe setbacks as seen after the Napoleonic wars, after the Crimean war, after the Russo-Japanese war, after World War I, after World War II. Why not after the Cold War as well? On the other hand, all empires in world history have finally eroded, in most cases due to internal reasons. Why should Russia be an exception? We do not know the answer yet.

The worst scenarios have not materialized in Russia. No immediate collapse of the state is foreseen. But the state as a structure is experiencing a period of relative weakness. There are promising signs that a market economy and, e.g., banking systems have started to function. Therefore the efforts of the Trilateral countries to support reform processes in Russia are essential. We have a significant role to play in advancing these efforts.

* * *

Let me say a few more words about the enlargement of NATO. How can one draw a line without indicating a new division of Europe, just like in Yalta? Which countries should be allowed security and which left in the Russian sphere of interest? How can we improve the security situation of the former without worsening that of the latter?

The Partnership for Peace program would seem to provide a tool to enhance security without the problems connected to outright NATO enlargement. Tailor-made and strictly defined security guarantees could be added to this program without isolating Russia. They could commit NATO to assist a partner country in case of an unprovoked attack or grant NATO membership in case of political extortion. Thereby one would avoid the organizational difficulties of a NATO enlargement and the dilution of the organization itself.

Within the Partnership for Peace program the Finnish defense system could be used as a model for the former communist countries. It is democratic, cost-effective, limited to self-defense only, and, of course, battle-proven. It does not threaten anybody but produces maximum defense capacity for every penny. I believe the Finnish system corresponds better to the needs and the economies of East European countries than the Anglo-Saxon model that is superior in power projection but rather expensive.

Gradual integration of Central European and Baltic countries into the European Union is an uncontroversial instrument for projecting political stability and economic prosperity towards the eastern half of Europe. A further extension of the Union would not alienate or isolate Russia. On the contrary, it would lend support and encouragement to the Russian modernizers in their efforts to lift the country from its present economic problems. All in all, a careful step-by-step process would be a safer method than a hasty enlargement of the Atlantic Alliance.

* * *

Besides a new east-west confrontation, which we do not consider obvious, Finland is mainly concerned with the possibility of a local crisis which would have a spillover effect on our territory. There are a multitude of prospective crises in Europe caused by ethnic, religious, cultural and other minority problems. There should be a well-oiled mechanism to manage and contain them in time before they spread out of control.

Many organizations are anxious of crisis management: UN, OSCE, NATO, WEU. The member states are less enthusiastic to give their contribution when it is a question of providing means for actual operations.

In the European Union there seem to be two schools of thought: One supports a division of labor where NATO has the responsi-
bility for collective defense and WEU for crisis management. The other school recommends NATO engagement also in crisis management, especially as crisis management appears to be the only game in town. In Senator Richard Lugar's dictum: "Out of area, or out of business."

So far only NATO has the means for projection of power, including the necessary command and control, intelligence and transportation systems required by the crisis management operations, and that is because of the military capability of the United States. As long as the Americans are willing to engage in this capacity in European crises, everything is fine. The American commitment to Europe is highly appreciated by us all. But can we in the long run rely on the Americans' willingness to intervene in purely internal European conflicts? It is worth remembering that the European Union has after all a larger GDP and more soldiers in arms than the United States. With the exception of a nuclear war, the European Union has all the means to cope with any contingency in Europe, including a Russian conventional attack, provided that the means are properly organized. The Intergovernmental Conference of the Union next year will hopefully accelerate the progress towards a true European conflict management capability. Static energy ought to be converted into power projection.

What role should Finland play as a member of the European Union in security issues? We have started preparatory work for the Intergovernmental Conference of the EU in 1996. We want to contribute to the further development of the Common Foreign and Security Policy of the Union. New ideas are needed. Our main—and formidable—contribution is to maintain tranquillity and friendly relations at the European Union's border with Russia. In addition, Finland has long experience in traditional UN peace-keeping and we can assist in the training of such skills. However, we have not participated in the recent Chapter VII operations, nor do we have forces for such operations. President Ahtisaari and our newly appointed government have expressed their intention to improve Finland's readiness to participate in peace operations. The Partnership for Peace program provides us with a very welcome opportunity to improve the inter-operability of the Finnish forces with our partners. There we have a lot to catch up with, since we have for the past 50 years carefully avoided participation in any combined military exercises due to our policy of neutrality.

* * *

Finland's military non-alignment and independent credible defense certainly correspond to the interest of Finland as well as our neighbors in the prevailing situation. But we cannot hope to avoid conflicts by assuming a position of splendid isolation. We are all in the same boat. Nonalignment should not mean non-commitment. We have to support a stable development and containment of conflicts that might endanger peace in Europe. If the cat gets out of the bag, we are all in trouble—whether allied or non-allied.

General Gustav Hagglund is Commander-in-Chief of the Defense Forces of Finland.
SECTION 10
EUROPEAN UNIFICATION

ETIENNE DAVIGNON

European Monetary Union

I was asked to say a few words about Monetary Union, and how the business community sees what is happening. A summary of my remarks could be: it's an important topic; it's in a confused state; and it's not very clear what is going to happen.

Background
Where do we stand? First, it's important to note that the political and ideological debate over Maastricht and the Monetary Union since the crisis of 1992 and 1993 continues. Those who didn't like Maastricht still don't like it; those who believed that Monetary Union can't function, and were quite happy to see the difficulties in 1992 and 1993, still believe that it cannot be carried out. Others feel that the fact the whole system has not crumbled after 1992 and 1993 indicates that the strength of the basic case for monetary union remains. So the political positions have not changed.

One additional point is that no government today can set aside the question of unemployment and the political pressures that this creates. How much the questions of unemployment and of convergence of economies for Monetary Union will get mixed up remains an open question. These forms of unification would limit the sovereign powers of a state to carry out nationalistic policies. It will be interesting to watch the French election in this regard.

Another element of political importance is that in Spain and Italy, the sigh of relief linked to the devaluation of these two cur- rencies has made it much more complicated to explain why, over the long run, belonging to a hard core of economies which basically converge is in the long-term national interest. This is a much more open debate than it was before.

What is Happening?
What is happening is related to what is written in the Maastricht Treaty, and of course the Maastricht Treaty opens up a very curious situation. You could have Monetary Union by 1 January 1997. But you also could have Monetary Union by 1 January 1999—or you could have Monetary Union later. It is rather difficult to prepare for a fundamental change when you don't know how many countries will be involved and you don't know the date. This creates the element of confusion that I mentioned before.

Adding to the confusion is that, differently from any other major initiative inside the European Community since its creation, no authority has been established to organize the transition. Before, one always had an authority mandated to organize the transition. We do have the EMI, the European Monetary Institute (the forerunner of the future European Central Bank), but its only powers are to prepare the activity of that bank. It has no specific powers in the meantime. We all know how eager central bankers are to share their powers with the rest of the world! They are playing their cards very close to their chests—and the whole question of the organization of the transition is unclear.

How does the business community react to all this? It is clear, in my mind, that the drive towards Economic and Monetary Union remains, in the views of the business community, politically motivated. We have found out that although we don't like it, one can live with flexible exchange rates. They create a lot of problems, but have not completely put a brake on the functioning of the single market—although I believe in the long run they very much would. The business com-
munity is looking for clear evidence that the political will of the governments remains—particularly those governments committed to set up the Monetary Union at a moment when they can do so by their own choice, even if the majority of countries do not meet the conditions to join the Union.

What is Going to Happen?
So what is going to happen? I think we have to look for three signals. First, how strong will the Franco-German core be for speeding up of the process of Monetary Union after the French election? I think the Cannes European Council scheduled for the end of June will give a clear indication of how strong pressure and initiatives taken in this regard will be. This is all the more necessary because initiatives in the other areas are not going to be so easy to come by. In the immediate future, the strongest cement inside the European Community will be the combination of the single market and an absence of doubt that monetary union is coming. That would fundamentally affect the policies of all European countries.

The second signal will be more practical. How much specific preparation is being done for the transition from a number of currencies to a single currency? The practical work which has to be done is complicated and requires time. And the cost is directly linked to the time given for preparation. If we have to do it over a very short period of time, it costs a lot. It is a very clear political indicator to see how we settle the questions of what will the coins look like and what the notes look like. Is it possible to have political answers to this? Here again, Cannes will give a signal.

The third signal is going to be complex. How much will countries which today are not in a position to meet the criteria set down by Maastricht choose to make efforts to achieve these criteria? Or will they decide to postpone the debate so as not to be obliged to make these efforts, and to put a blur over the whole perspective of monetary union?

I have not mentioned the dollar, because I could not have done it in three minutes. The only thing I would like to say is that the present situation is not helpful.

Viscount Etienne Davignon is Executive Chairman of Société Générale de Belgique. He was a Member of the Commission of the European Communities in 1977-85 (Vice President in 1981-85).

JANUSZ ONYSZKIEWICZ

Central and Eastern Europe and European Integration

THE END OF YALTA meant for many countries in Central and Eastern Europe the need to reassess their national interests and security needs, to define their place in Europe. For the 45 years after the Second World War, we had no freedom of movement—we were just satellite countries.

The option which came to mind immediately was to join the process of European integration. After all, we belong to Europe—"we want to be back in Europe" was the battle cry of the democratic opposition in Central and Eastern European countries. The reasons we want to join Europe are not only sentimental—the sense that our culture is basically Western-oriented. There are also other reasons of a very basic nature. Let me quote from the November 1992 document endorsed by the President and by the Polish Government which has the title, "The Tenets of the Polish Security Policy": "We can overcome our civilizations delay and become
an equal partner for the developed nations only through a swift and effective incorporation of Poland into the economic and political process of West European integration. Voluntary isolation and failure to use the opportunity of fast development would undoubtedly lead, in time, to the sidelinining of the Polish economy and pauperization of the society—which in turn could lead to the loss of freedom and sovereignty." This sense not only that we belong to Europe and should be in the European Community, but that Europe needs us, was overwhelming. There was a feeling that Europe simply cannot afford to have the Oder-Neisse line be another Rio Grande, separating two different entities, making a border between poverty and affluence. There are also quite important economic indicators showing that we should aspire to become members of the European Union. Let me just mention that 60% of Poland's foreign trade goes to the European Union. And Poland is a big country. We are nearly 40 million people, we have a very big market, and with our economy growing between 5% and 6% a year, the Polish economy is one of the fastest growing in Europe. So, clearly, we want to join the European Union.

By joining the European Union, we will be allowed to join another structure—the Western European Union. Let's make no mistake: we will opt for full membership in WEU. Poland is far too big a country and far too centrally located to be just a semi-member, having observer status.

In this context one should raise the issue of NATO membership, because clearly one cannot think about being a member of Western European Union—being so centrally located and such a big country—and not being in NATO. I strongly believe that NATO expansion should precede the expansion of both the EU and the WEU.

As Poland would be an asset to the European Union, we would also be an asset to Western European Union and to NATO. For example, Poland has more tanks than Norway, Denmark, Netherlands and Belgium put together—more tanks than Italy, France or the United Kingdom. Poland, a stable country so strategically located, must be seen as an asset also in that respect.

What about Russia? I don't want to go on again with this debate, but let me make only one remark: I think that Russia has a formidable challenge in the Far East. After all, the Chinese economy is growing at the rate of about 12% a year. The Chinese economy, using purchasing-power-parity exchange rates, is now the third largest in the world after America and Japan. Within ten or twenty years, it could be the largest. And there is a migration of Chinese to the Russian Far East. The Russian challenge is there—not in Europe.

I think that the process of European integration should go on with Russian acquiescence and in dialogue with Russia, and it need not produce more tensions which nobody really needs. In the same manner, the process of European integration should not be seen as limited to the expansion of EU, WEU, and NATO. There should be other processes going on which involve such important countries as Ukraine, for example. So, when we talk about the process of European integration, we must think about the whole network of cooperation in different areas which will bring together different countries. Dividing lines which will exist, formally at least, will not be lines across which there is a confrontation but lines across which there is coordination and cooperation.

* * *

Let me conclude with a certain declaration. In Poland, there was a joke about how for true communists, who believed in the iron laws of history, the future was predictable and certain—it's the past which kept changing all the time. I think I have some residual trace of this kind of thinking—because I do believe that Europe will expand and that we will be in Europe. This is certain.

Janusz Onysztkiewicz is a Member of the Polish Sejm. He was Defense Minister in 1992-93.
Common Foreign and Security Policy and the Future Security Structure of Europe

I

IT IS A GREAT PLEASURE TO acquaint this audience with the German ideas on Foreign and Security Policy in and for Europe, which covers all questions related to security—including the eventual framing of a common defense policy, which might in time lead to a common defense. In addition to safeguarding the values, the fundamental interests and the independence of the Union, Europe’s Common Foreign and Security Policy must strengthen security in all ways. This includes the preservation of peace and the strengthening of international security and the promotion of international cooperation. This includes also the development and consolidation of democracy and the rule of law, the respect of human rights and fundamental freedoms.

In November and December 1994, important decisions for Europe’s Foreign and Security Policy were taken under Euro-Atlantic auspices. The WEU Ministerial Council in Noordwijk, the North Atlantic Council in Brussels, the CSCE Summit in Budapest, the European Council in Essen as well as the annual autumn meeting of the defense ministers and foreign ministers of NATO have given new impetus to the process. Basically, all these conferences addressed the same subject: the buildup of a cooperative European security order and in particular the widening and deepening of European integration, the opening up of the EU, WEU and NATO for new members, and the strengthening of the OSCE.

II

The European Union is a decisive force in the process of all-European unification and a central element of the future European security structure. As of 1 January 1995, the EU now has 15 member states including Finland, Sweden and Austria.

We strongly support the efforts being made to give the EU the capacity to play an active role in formulating and executing foreign and security policy. This gives Europe the opportunity to assume responsibility for looking after its own security interests, not only in Europe but also on a global scale—in close partnership with the United States of America.

The initial results of Europe’s Common Foreign and Security Policy are certainly the first steps: besides defining overall strategies vis-à-vis Rwanda and Ukraine and sending observers to the parliamentary elections in Russia, besides the Pact for Stability, the transition to democracy in South Africa, the peace process in the Middle East, the non-proliferation of nuclear weapons, and the provision of humanitarian aid in Bosnia and Herzegovina and the buildup of an administration in
Mostar, the European Union has also developed strategies concerning whole groups of countries (namely in Central and Eastern Europe, in the Mediterranean area, in Asia, Latin America and the Caribbean) and organized a conference with the countries of Southern Africa.

As far as Germany is concerned, deepening and widening the European Union remains an absolute priority. Western Europe's historic political self-renewal after the War must be transferred to Central and Eastern Europe and geared to the challenges of the 21st century.

An essential objective of Germany's presidency of the EU during the second half of 1994 was to establish a lasting connection with the Central European states. At its meeting in Essen in December 1994 the European Council set the course for bringing these states into the fold of Western institutions. Negotiations on accession will begin after the 1996 Intergovernmental Conference at the earliest. This could also include Cyprus, Malta and Slovenia.

Up until then, the structured dialogue between the foreign ministers and the criteria established by the White Paper for preparing new members for accession to the Single Market will give the candidates valuable guidance and assistance. With its PHARE (Poland, Hungary Action for Restructuring of the Economy) initiative, the European Union contributes to financing the reform process and helps its partners to build up as quickly as possible a viable democratic order, to develop their economy and to arrive at stable conditions. The long-term goal is Europe whole and free.

As it is expanding, the EU will have to maintain its inner balance. This will not be an easy task. Institutions and procedures which have developed over the years since the signature of the Treaties of Rome are now put to the test. This means that besides the debate on how and when the EU can and should be expanded, the Western countries are conducting an equally intensive debate on how the previous internal structures of the EU are to be adjusted so that the future challenges can be met.

III

The purpose of the defense component of the EU—the Western European Union—is a European Security and Defense Identity, which is an element in the development of the Common Foreign and Security Policy and should generally lead up to a greater European responsibility in defense issues.

At the last WEU Council of Ministers meeting in Noordwijk, already 27 Defense and Foreign Ministers took cognizance of the initial conclusions concerning the formulation of a Common European Defense Policy, compatible with NATO's policy. Currently these 27 countries are studying the "Common Reflections on the New European Security Conditions." This is truly a historical element of exchange of common values and interests and therefore another step in the preparation for enlargement, besides the participation at the meetings of the Permanent Council and the different working groups.

The European Security and Defense Identity is not a substitute for strong transatlantic ties. It should not weaken these ties, but rather reinforce them. Its development on the one hand and Euro-Atlantic cooperation on the other lead to a necessity for transparency and complementarity. Even if there are closer ties between WEU and EU, NATO—with its transatlantic and nuclear dimensions—must retain its function as the guarantor of European security. An autonomous European defense, existing side by side with the collective defense of NATO, would jeopardize the transatlantic relationship. Collective defense will remain a core function of NATO, but at the same time WEU and NATO should be capable of conducting crisis management on their own.

IV

There is an inseparable logical connection between expansion of the European Union and NATO. The logic of the European processes implies that the members of the European Union should also be members of the North Atlantic Alliance. All new members of the
European Union are entitled to WEU membership. The WEU, however, cannot guarantee the security of its members on its own, and there is an inherent link between the Brussels Treaty and the Washington Treaty. It is not conceivable that future members of the European Union could have a security status inferior to that of the old members, who are also members of NATO. The key word in the whole debate on Europe’s expansion is thus “final congruence of membership.”

It was decided to initiate a process of examination inside the Alliance to determine how NATO will enlarge, the principles to guide this process and the implications of membership. This process has to be understood in the context of both integration and cooperation. Countries which don’t have a realistic prospect of integration need to know that they are by no means excluded from the European process, that cooperation will be deepened and intensified. Integration and cooperation must be complementary so as to avoid the emergence of new divides in Europe.

In our view, the following main points must be the basis for NATO expansion: NATO’s effectiveness as a political and military alliance must be maintained. The aim of expansion is to extend the “zone of stability and security” in Europe; it is not directed against anyone else; rather, both the new members and non-members should benefit from it. The key to NATO’s success is found in the Article 5 guarantees and responsibilities, including the nuclear guarantees. These must be retained. New members must accept all the rights and responsibilities. All members must have the same security guarantee. The integrated military structure must be retained.

NATO expansion is a part of the broader process of the evolutionary development of European security structures. The effects which the processes in NATO, EU and WEU have on each other must be taken into consideration. New members must meet certain conditions: democracy, a free market economy, and a responsible policy of neighborliness. States with ethnic conflicts or with internal or external conflicts (including territorial claims) must have solved these in accordance with OSCE principles before they join.

The Pact for Stability with its more than 100 treaties on good-neighborliness represents the first “Joint Action” of the EU which has made concrete contributions to stability in two OSCE regions: the Baltic region and Central Eastern Europe. The OSCE concept of regional negotiating tables has proved its worth and is thus a suitable means of dealing with other subjects and/or regions as well.

We have to be aware not to give any non-NATO member states a droit de regard or even a right of veto on these important defense-relevant questions. It must be the sovereign decision of each new member state to decide whether or not it wishes the stationing of foreign troops on its territory, for example.

Finally, we have to find appropriate answers on the implications which enlargement will have for states which are either not early candidates or not at all candidates for future Alliance membership. Enlargement could place such countries in what they call a “grey zone.” Therefore, it will be important to define enlargement as a process, to keep the NATO door open after the first accessions, and to maintain active, cooperative relations with countries which do not join the Alliance, in order to avoid drawing new divisions in Europe and to ensure broad, inclusive approaches to cooperative security. We have to underline that there can be no question of “spheres of influence” in the contemporary Europe.

V

The relations between Europe and Russia are of greatest importance not only for NATO and Russia. Therefore our discussions on the question of how to expand should—as agreed previously—and accompanied by a strategy to involve Russia, Ukraine, and other states of Central and Eastern Europe and the CIS that have no immediate prospect, or no prospect at all, for joining the EU, WEU and the Atlantic Alliance.
We have to convince Russia that our proceedings towards expansion are very deliberate, quite measured and cautious. We have to reassure Russia that expansion will help to transfer stability to all of our Eastern neighbors, including Russia.

Russia and EU, WEU and NATO need a solid partnership. Russia must be treated (and perceived to be treated) as a great power and a partner as well; however, above all Russia herself will have to earn and maintain the confidence of her neighbors and partners, whether near or distant.

Europe must go on to convince Russia—and especially its parliamentarians and military—of its objectives and conceptions, and in particular of the constructive role of a new, transformed NATO. In addition, cooperation between NATO and Russia in those areas where the Alliance and Russia have a special competence and responsibility must be complemented by cooperation in other organizations.

Cooperation with Russia takes place also within the framework of the EU, the WEU and the G-7. After signing the partnership and cooperation agreement with Russia, the European Union has also prepared an interim agreement which will settle crucial questions of commerce and trade. The WEU envisages a regular exchange of information with Russia on matters of mutual interest.

But in particular, the OSCE has to play a decisive role. Russia participates as an equal partner and thus has the opportunity to present her ideas on an equal basis to this forum. The OSCE is the political umbrella under which North America and Europe—including Russia of course—are linked on the basis of common values and standards.

It may sound like stating the obvious that each state, bearing in mind the legitimate security concerns of other states, is free to determine its security interest and has the right to choose its own security arrangements, and that each state has the sovereign right to belong or not belong to international organizations and to be or not to be party to treaties, including treaties of alliance. Still, exactly these formulas have been codified in the “Code of Conduct on Politico-Military Aspects of Security” at the CSCE Summit last December by 52 participating states, including Russia.

VI

The United States of America is a European power. America is part of the European security culture. We have learned from the lessons of two World Wars that a stable order in Europe is not possible without the lasting commitment of the United States.

America strongly supports a distinct European political identity and therefore a European foreign and security policy. The United States wants partners that are willing to share responsibilities and burdens on a global basis. Partnership on equal terms is the key for future relations between the USA and Europe.

Only a unified Europe is an equal partner of the United States in political, economic and strategic terms. Attaining this goal is something which the European states must accomplish themselves. Whether they succeed or not will have important implications for future Euro-Atlantic relations. Only if Europe is willing and able to shoulder a larger share of the common burdens and responsibilities, can it expect the United States to continue its commitment in and for Europe.

The foundation for transatlantic relations has changed. NATO as the sole institutional base is no longer sufficient and the future American-European partnership must be developed further. The old transatlantic bargain—protection in return for influence—must be evolved into a new, wider transatlantic community of equal partners. The European Union and North America still constitute the most important axis in global politics. The new challenges can only be tackled successfully if both act together.

In the global strategy of the United States of America, the Euro-Atlantic partnership must remain the foundation and nucleus, and

1995 COPENHAGEN MEETING
The time has come to start defining the structure of a new Trans-Atlantic Covenant.

must be given fresh impetus so that states on both sides of the Atlantic are not tempted to go their own ways. The common challenges make cooperation necessary, and our common basis of shared values and interests makes cooperation possible.

We need a new transatlantic economic and security community that is more than the sum of NATO and a Euro-American region of prosperity. It could be the nucleus of and the driving force behind a northern zone of stability, leading North America, the European Union and Russia into a new, cooperative balance. We must not waiver in our pursuit of this major objective, even if we suffer setbacks as we head towards it.

VII

From my point of view, the Inter-Governmental Conference in 1996 will provide the suitable platform to establish these objectives I have mentioned in the European framework of the EU and WEU. Besides the revision of the Maastricht Treaty with its purely European subjects, the Common Foreign and Security Policy and the WEU—as means to strengthen the European pillar of the Atlantic Alliance—provide the possibility to go beyond the EU-WEU relationship and as a result of the Inter-Governmental Conference to do justice to the importance of the United States both in the process of enlargement of the Euro-Atlantic institutions and for European security.

In 1996-97, a clear Euro-Atlantic signal will have to be issued to the United States in the fields of the Common Foreign and Security Policy and the European Security and Defense Policy. The overall result of the Inter-Governmental Conference should lead to a well-balanced relationship between the development of Europe towards political and monetary union on the one hand and the development of its foreign and security policy on the other.

Only in this manner will it be possible to work towards a transatlantic economic and security community which—while it is build-

The present inter-institutional tasks—such as expansion of NATO and the European Union, Partnership for Peace and the Inter-Governmental Conference in 1996—may not lead to any kind of competition. Instead we should see the future task of our institutions in steering the decision-making process in such a way that it will have positive synergetic effects on the overall objective of ensuring stability and security in the whole of Europe. A pivotal role in this context will fall to the Common Foreign and Security Policy in Europe; it will be able to perform this role by, inter alia, a revision of the Transatlantic Declaration of 1990.

It must therefore be a categorical imperative that in principle each of the political decisions taken in NATO, EU and WEU must be able to contribute to the strengthening of the other organizations and therefore to European Unification.

Jörg Schönbohm is State Secretary in the Ministry of Defense of the Federal Republic of Germany.