The CEPS-EAC/RAND Conference on European-U.S. Relations Beyond 1992

Thomas Frellesen, Erik Frinking, Erik Jones
The conference papers described in this report were supported by RAND's European-American Center for Policy Analysis.

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Published 1993 by RAND
1700 Main Street, P.O. Box 2138, Santa Monica, CA 90407-2138
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CF-111-EAC
PREFACE

In early 1993 responsibility for the conduct of U.S.-EC relations passed to new leadership on both sides of the Atlantic, with a new administration in Washington and a new EC Commission in Brussels. This crucial transition occurred at a time in which the U.S.-EC agenda was crowded with a number of pressing issues, including the unfinished GATT round, the civil war in the former Yugoslavia, and the overall challenge of promoting democracy and economic revival in Russia and other formerly Communist countries.

Against this background, the U.S. Mission to the European Communities and the Directorate-General for External Relations of the EC Commission asked the RAND European-American Center for Policy Analysis and the Centre for European Policy Studies in Brussels to organize a joint conference on “European-U.S. Relations Beyond 1992.” The conference brought together over sixty scholars, policymakers, journalists, and parliamentarians from both sides of the Atlantic for an intensive discussion of the three main sets of issues on the agenda of European-American relations: trade and economics, the challenge of Central and Eastern Europe, and the transatlantic security relationship.

The conference took place at Corsendonk Priory, Oud Turnhout, Belgium, on March 18-20. These Proceedings summarize the highlights of the discussion. Of the authors, Thomas Frellesen and Erik Jones are staff members of CEPS; Erik Frinking is a staff member of EAC/RAND.

The European-American Center for Policy Analysis is located in Delft, The Netherlands, and is dedicated to research and education on important policy issues facing Europe and North America in the post-Cold War era, and to fostering cooperation between European and American scholars and policy analysts. Those wishing more information about the EAC are urged to contact the Center director, Dr. John Van Oudenaren, at the Netherlands location, or administrator Karen Gardela, at RAND’s Santa Monica office:

European-American Center for Policy Analysis
TU Delft
Landbergstraat 6
2628 CE Delft
The Netherlands

Phone: 31-15-78-54-11
Fax: 31-15-78-17-88

European-American Center for Policy Analysis
RAND
1700 Main Street
P.O. Box 2138
Santa Monica, CA 90407-2138

Phone: 310-451-6978
Fax: 310-393-4818
THE OPENING SPEECH

The introductory speaker opened the discussion of U.S.-European relations with an overview of common misconceptions about the Atlantic partnership, and a deeper look at the real issues of concern for the future.

He noted that two of the cliches of the post-cold war era concerned the ascendancy of “geoeconomics” over geopolitics, and the view that economic competition between the United States and the European Community (EC) could bring conflict to the whole range of Atlantic issues. However, he saw several flaws in both of these arguments.

First, economic competition need not always lead to conflict. Both sides can benefit from mutual competition. This is a truism that lies at the heart of the notion of comparative advantage. The problem with the present discourse on international trade is that too great an emphasis is placed on the “comparative,” and too little on the “advantage.” Second, the need for transatlantic security cooperation has not been diminished by the changes of the recent past. The Soviet Union has disappeared, but there are new threats to contend with, ranging from the reemergence of nationalism to religious fundamentalism and the proliferation of nuclear and conventional weapons.

The speaker went on to concede, however, that there are substantial differences between the present situation and the cold-war period, and that these differences were making transatlantic cooperation more difficult to achieve. In the past there was a basic strategy from which followed a series of mutually acceptable and effective policies. This will not necessarily prove to be case in the future. The situation in the former Yugoslavia provides an important lesson in this regard. While the United States and the countries of Europe share similar interests and objectives in the former Yugoslavia, they also share a growing sense of frustration with their mutual inability to achieve these objectives. It is this frustration which threatens to poison the cooperation between the two
sides of the Atlantic. And it is this type of frustration which threatens the stability of transatlantic relations in the future.

The situation is further complicated by the new primacy of economics. Because security cooperation is no longer a constant source of solidarity within the North Atlantic Community, there is now a tendency to evaluate economic relations on their own terms, outside of the larger context of transatlantic cooperation. To combat this tendency, it is necessary to build a broader constituency on behalf of European-American cooperation—one that will enlist the support of new groups in favor of the Atlantic partnership.

In this context, the speaker described the present institutional framework as one of overlapping communities. There is an Atlantic Community based on security cooperation and the North Atlantic Treaty Organization (NATO) which most directly concerns the security elites and the "military-industrial complexes" of Europe and North America. There is also a European community based on economic cooperation and a series of interactive treaty organizations (EC, European Economic Area [EEA]), which concerns a wide variety of economic interests. Both of these communities must broaden to manage a broader range of competencies and to incorporate a wider diversity of interests. Europe has already begun this process with the negotiation of the Treaty of Maastricht, which provides for a larger voice for the European Community in the area of foreign and security policy. It is necessary to broaden the Atlantic Community as well, enabling it to play a greater role in the pressing political and economic concerns of the future.

With that introduction, the speaker argued that the purpose of the CEPS-EAC/RAND conference was to bring together the Atlantic and European communities—to attempt a fusion of geopolitics and geoeconomics. The speaker acknowledged that the present state of European-American relations was at a "low ebb." In comparison with the 1980s, cooperation across the Atlantic is much diminished. Nevertheless, the speaker argued, it is important to build on the

The dramatic changes in the East sparked a series of initiatives which the speaker described as comparable in creativity to the original development of the Atlantic alliance in the late 1940s and early 1950s. These initiatives dealt with the coordination of aid to the countries of Central Europe, the reform of NATO, a reinvigoration of the Conference on Security and Cooperation in Europe (CSCE), and the peaceful reunification of Germany within NATO. These initiatives culminated in the successful "2 + 4" negotiations, the London and Paris summits, and the U.S.-EC transatlantic declaration.

The collapse of the Soviet Union in 1991 was followed by another set of ambitious initiatives: the EEA; the North Atlantic Cooperation Council (NACC); and the Maastricht Treaty on European Union. As 1991 gave way to 1992, however, the rapid pace of transformation began to slow. The EEA and the Maastricht Treaty ran into unexpected obstacles. The Western European Union (WEU), the Franco-German corps and the NACC faced significant operational challenges. Coordinated assistance to Central Europe proved less successful than anticipated. And assistance to the successor republics of the Soviet Union suffered from a total lack of coordination.

The speaker suggested that this disappointing turn of events resulted from two simultaneous developments. The first is the present downturn in European economic performance. The speaker acknowledged the role of "structural" deficiencies in the European integration process (such as a lack of transparency in decision making) but suggested that concern over the economy was the simplest explanation for problems that the EEA and the Maastricht Treaty had encountered. The second development is the conflict in former Yugoslavia. Here the speaker reiterated that the real problem is one of collective frustration and burdensharing, and not an issue of divergent interests across the Atlantic.
Whatever the reason for the slowdown in adaptation, the speaker insisted that the motive for changing the Atlantic and European communities—the disintegration of the former East bloc—remained. What is required at this moment is a series of new initiatives to break the inertia, and to generate a new momentum for change. The speaker listed three institutional developments that are necessary for the future:

- an institutional expansion of the EC to cover foreign and security policy concerns without duplicating or contradicting the functions of NATO
- an institutional development of NATO to cover the broader range of concerns arising in the post-Cold War period
- an institutional structure that will permit closer association of the countries of Central and Eastern Europe with the Atlantic and European communities.

The speaker then turned to the issue of international trade and economic performance. Taking a broad historical perspective, he argued that one key to international stability is a functioning system for managing interdependence. In the past, this system was embodied in the Bretton Woods arrangement and later the G-7 coordination. In the 1990s, however, new arrangements are required. This has focused attention on the prospects for regional coordination.

The Maastricht Treaty reflects the culmination of the present stage of European regional integration. As such, however, it has sparked concerns within national electorates about the trade-off between autonomy and dependence. The speaker argued that this trade-off is manifest in the difficult character of negotiations among finance ministers, whether within the European or the G-7 frameworks. One response to the dilemmas posed by this trade-off is to slow the pace of integration until national interests converge on a mutually acceptable framework. Alternatively, it is possible to have national interests converge at the regional level—allowing for global coordination to take place between regional interests.
The speaker asserted that it was the latter option which offered the greatest prospects for stabilizing the global economy, and suggested that for this reason regional integration should be seen as compatible with a global multilateral framework. As an example of the convergence of regional interests, the speaker pointed to the similarities between the Clinton economic proposals and the economic convergence guidelines laid out in the Maastricht Treaty and reinforced at the Edinburgh summit of December 1992. Successful achievement of both sets of targets, the speaker argued, would lead to a remarkable convergence of macroeconomic policies on both sides of the Atlantic.

The speaker then looked to the prospects for transatlantic security cooperation, asking whether these prospects were compatible with a healthy NATO. In his view, NATO has three functions:

- the planning and conduct of military operations
- the integration of military command and capabilities
- the promotion of cooperative relations with the former adversaries of the NATO alliance.

Referring to the planning and conduct of military operations, he suggested that the conflict in former Yugoslavia should not be considered the most important paradigm for future security concerns. Rather, the Yugoslav conflict is unique because it suggested little prospect for escalation. The speaker then argued that perhaps it would be useful if the United States were to clarify its security interests in the form of an official doctrine describing the conditions under which the United States would be likely and willing to use military power in Europe. Such doctrines were promulgated under the Truman, Nixon, Carter and Reagan administrations, and have proved useful in spelling out American national interests.

The reason for a new American doctrine is not to limit the flexibility of American security policy, but rather to provide a framework for the institutional development of transatlantic relations. Such a doctrine would promote a natural division of NATO functions between those threats that will elicit an unqualified American engagement and those threats where American involvement is
optional. The first case would include all aggressions against NATO allies as well as any resort to nuclear weapons, and the second case would include the broad range of alternative scenarios. When American involvement is certain, coordination of military operations would necessarily take place within the context of NATO. When American involvement is optional, the NATO alliance would play a supporting role, while the WEU would take the lead.

The speaker added, however, that the clarification of American national security interests is not the only key to the conduct and planning of military operations. Another issue of similar importance is the likely role of British and German troops within the alliance. Should neither of these countries be willing—albeit for different reasons—to engage its military forces in the interests of European security, it is unlikely that “Europe” will be able to develop as an independent but cooperative pillar of the alliance.

Turning to the second task of NATO, the integration of military command and capabilities, the speaker pointed out that American troop reductions were proceeding at double the pace of those in Europe. Thus, the speaker argued, it is in the American interest to promote the development of specifically European structures within the alliance: a “EUROCOM” to supplement the existing EUCOM is one possible example.

Finally, the speaker argued that the third NATO task—cooperation with former NATO adversaries—requires a careful balancing of interests and abilities within both the Atlantic and European communities. Under the present framework, the eastward extension of the European Community, combined with the emerging bilateral relationship between the United States and Russia, threatens to place unsustainable burdens on both sides of the Atlantic. The EC cannot defend all those countries west of Russia without the help of the United States, nor can the United States assume unilateral responsibility for aiding in the transformation of the Russian economy without the full involvement of Western Europe. Consequently, it is necessary to create a broader community which stretches from Vancouver to Vladivostok—one that draws equally on the economic and security resources of
Europe and the United States, as well as integrates all of the countries of Central and Eastern Europe into a stable multilateral framework.

The speaker then asserted that international trade and economic assistance were the principal instruments for integrating the economies of Central and Eastern Europe. Under the present framework, however, too much is done on the basis of bilateral relations. In order to generate a more stable and sustainable situation, it is necessary to shift the focus of attention from bilateral to multilateral relations. This will require a major effort, similar to that seen in Europe in the immediate postwar period. The speaker went on to point out that there are many parallels between the challenge faced in the early postwar period and those of today: the Greek civil war in the 1940s and the war in Yugoslavia today; Soviet expansionism in the late 1940s and Soviet collapse since 1991; the rehabilitation of Germany after World War II, and that of Russia today. Parallels such as these illustrate the need for the same degree of insight and innovation that led to the creation of the postwar system.

The speaker concluded his discussion by speculating that in the short run the situation may get worse before it gets better. 1993 more closely resembles 1947 than 1949. Nevertheless, he insisted, this should not be reason for pessimism. Rather, it should give cause for hope. Clearly the West is capable of engendering the creativity necessary for the establishment of a lasting solution. For the interim, however, it is important to recognize that such a solution will require broad system changes. The West should avoid the temptation to resort to ad hoc solutions. The time has come to promote the development of the Atlantic and European communities along lines that are both compatible and sustainable, and which can successfully integrate the countries of Central and Eastern Europe into the larger multilateral world system.
SESSION 1: THE ECONOMIC AGENDA

Domestic Adjustment and Global Responsibility

The first speaker divided his presentation into three general categories: macroeconomics; trade and investment; and the role of government in economic affairs. Turning first to macroeconomics, he analyzed the prospects for the transition from the European Exchange Rate Mechanism (ERM) to Economic and Monetary Union (EMU). Although he admitted that this transition was politically rather than economically driven, the speaker questioned whether a functioning economic and monetary union would be in European economic self-interest and thus worth the political benefits it was expected to bring. The problem, he asserted, is that such a union will give undue weight to the danger of inflation. The fact that prime ministers and finance ministers seemed to be talking like central bankers suggested a danger that EMU will suffer from a strong deflationary bias. This is particularly true given the microeconomic rigidities which are characteristic of the European economies.

The speaker went on to point out that this deflationary bias is already evident in the functioning of the ERM. Originally, the function of the ERM was to allow for periodic changes in real exchange rates between participating countries, in order to facilitate adjustments to asymmetric shocks—disturbances that affect one or more members of the region, but not the region as a whole. German unification is a classic example of such a shock. Surprisingly, however, there was no realignment of exchange rate parities. This resulted in placing the burden of adjustment on relative domestic price movements, and has given rise to or at least exacerbated many of the social and economic problems that we are witnessing in the member states of the Community today.

The speaker then asked whether the EMU could be sustained given the necessary burdens it may place on the participating countries. Turning to the example of the United States, the speaker argued that large monetary unions do exhibit significant regional adjustments to economic shocks,
as well as an important movement of productive factors: for example, the migration of industry from the “rust belt” to the “sun belt” in the 1970s. The European Social Charter promises, however, to increase the microeconomic rigidity of the European Community’s member states. Under these conditions, the advisability of EMU is open to question.

Accepting, however, that the political determination to proceed with monetary integration exists, the speaker went on to question what impact EMU would have on the Group of Seven (G-7) framework. Compromise between European finance ministers is already difficult. How would their joint relationship affect macroeconomic cooperation with the United States? The speaker also asked two related questions: Should the composition of the G-7 be changed to reduce the disproportionate influence of Europe within the present institutional framework? And, if European integration is a success, how will this affect convergence between the United States and the EC?

The speaker then turned to international trade and investment. He pointed out that there is today a clear path toward the completion of the Uruguay Round of the General Agreement on Trade and Tariffs (GATT) negotiations. The reason is twofold: first, the EC and the United States have reached an agreement on the difficult agricultural issues; and second, Sir Leon Brittan is an ideal Community representative to bring the round to a successful conclusion. Completing the round would in his view necessarily entail several elements: the acceptance of the market-opening measures as outlined in the Dunkel draft; a sharp restriction on the number of additional modifications to the Dunkel draft; and selected side-payments to alleviate tension in the few contestable issues which remain—an example being the present controversy between the United States and France on the free trade of audio-visual entertainment.

Nevertheless, the speaker cautioned, there are four significant threats to the Uruguay Round:

- a right-wing victory in the French legislative elections that could result in diminished cooperation between France and the EC
• the inadvertent limitation of U.S. room for manoeuvre resulting from regional arrangements like North American Free Trade Agreement (NAFTA), or from electoral commitments made by the Clinton administration which necessitate the resort to protectionist measures

• general opposition from environmental protection advocates who perceive the GATT as a major impediment to the achievement of their own political objectives

• the overall level of tension that has resulted from the accumulation, over the long and drawn-out course of the negotiations, of disputes in particular and otherwise limited areas.

The speaker next looked at the role of East Asia in the multilateral trade system. He argued that presently, United States trade with East Asia is 40 percent larger than trade across the Atlantic. Given the economic growth within the Newly Industrialized Countries (NICs) and the countries of Association of South East Asian Nations (ASEAN), the role of East Asia is likely to continue to increase in the near future. The challenge for both the United States and the EC is to avoid leaving East Asia out of the multilateral trade system as it evolves. One solution, the speaker suggested, is to encourage regional integration as a complement to integration within the multilateral framework.

Turning to the question of transnational investment, the speaker pointed out that in 1991, 60 percent of the direct foreign investment in the United States originated from the European Community, while 40 percent of American foreign direct investment was located in the EC. EC-U.S. investment patterns are symmetrical, and thus differ from the pattern of U.S.-Japan and EC-Japan investment. The Transatlantic Declaration introduced a discussion on investment issues such as taxation, mergers, corporate nationalities, and so forth. Given the spread of transnational enterprises, traditional assumptions about corporate allegiance are likely no longer to be valid. If the EC and the United States could agree on basic investment principles, such principles could be useful for cooperation with Central and Eastern Europe. Finally, there is the question of Japan, where investment flows relative to trade flows are much lower than in EC-U.S. exchanges.
The "role of government" was the last topic this speaker addressed. He argued that there is presently a revolution taking place in the United States concerning the nature of national competitiveness. This revolution began in the early 1980s as traded-goods industries were forced to compete with the disadvantage of a strong dollar. The result was an average 2.9 percent growth per annum in labor productivity, and a sharp change in the structure of industrial wages. A similar change is now taking place in the large service industries, as companies like IBM adjust to the new economic environment. This economic revolution has very important political repercussions, in that it generates pressure for increased government intervention in the economy as well as for increased protection. The dichotomy is between successful protection on the one hand, and successful adjustment on the other. The speaker went on to say that the "good news" is that the growth of the United States work force appears to be slowing, a development which should lessen the pressure for protectionism. The "bad news" is that there are several new points of conflict in international trade—such as the debate with the EC regarding subsidies to Airbus.

The first speaker concluded his discussion by underscoring that while his presentation highlighted potential problems in U.S.-European relations, the interests that both sides of the Atlantic hold in common are far more important than the differences. The difficulty to be faced is really one of developing mutual understanding.

The second introductory speaker agreed that EMU was part of a political design for the EC. Already in 1970 European leaders had envisioned achieving such a design by 1980, but it had been aborted because of economic and political difficulties. Moreover, last year's crisis showed that the necessary flexibility had not been introduced in the European economies to achieve EMU. It was difficult to see how remedies could be found in the near future to do away with the existing microeconomic rigidities. Adjustment was more difficult than in the United States, where labor mobility was much greater. The speaker pointed out that only 2 million people in the EC were
working outside their home country. European policies increasingly benefitted people who were already employed to the detriment of the growing numbers of people excluded from the work force.

On the Uruguay Round, the second speaker was slightly less optimistic than the first. He maintained that the Round could only be completed if the agricultural deal could be kept. For the moment it depended on the United States: the appointments made under U.S. trade representative Mickey Kantor, the extension of the fast-track authority, and the conditions attached to that authority. Market access would also be a substantial element of any deal, and the speaker expressed hope that the United States would not make many changes in the final draft now on the table, which would not be good for the negotiating process. He agreed, however, that the Round could be completed this year. The speaker did not expect additional difficulties with a new French government, but one could never be sure. The tendency to focus on domestic priorities was a phenomenon to be seen on both sides of the Atlantic, as was evident in some of the appointments made in the United States.

The speaker noted that in contrast to their trade with Japan, trade between the EC and the United States was balanced. There was no obvious reason why the United States should be preoccupied with the EC market. He suggested that the U.S. tendency to criticize the EC may be due to the fact that the latter was an “easy victim” as compared to Japan. The EC-U.S. system was working, while that between the EC and Japan and the United States and Japan clearly was not.

With respect to the relationship between investment and trade, the speaker noted that investment drives trade. He saw an evolution towards networking among firms as opposed to traditional trade flows. Larger companies were now under economic pressure and were looking for more flexibility, through new arrangements with other firms.

In conclusion, the speaker argued that much of the disenchantment in Europe was due to internal reasons. In this respect, the United States benefits from a more resilient economic and political system. In the United States, after all, change came with the election of a new
administration. In Europe such quick adjustment is more difficult. Mutual understanding of these differences was important.

Discussion: Macro-economics and Monetary Coordination.

The present crisis

Following the two introductory presentations, a participant pointed out that the industrialized world is suffering from the worst economic crisis since the end of World War II. In view of this, the key questions to be considered are what is to be done, and whether whatever is done requires coordinated action. He expressed support for some form of governmental stimulus to growth.

Another participant pointed out, however, that responding to the recession is complicated by the poor state of government finances in most countries. It is no longer clear whether the traditional prescriptions of macroeconomic demand management continue to operate. Under traditional Keynesian assumptions, there is a clear link between government austerity and economic deflation. Under more “supply-side” oriented assumptions, however, government austerity can stimulate both consumption and investment by lowering interest rates and improving incentives. Thus while it is difficult to muster support for balanced budgets in periods of recession, he argued that it is nonetheless essential to recognize the importance of solving the crisis in government finances. Resolution of this crisis is difficult at the present time, but will become even more difficult in the future.

One participant disagreed that the dilemma facing macroeconomic policy was all that acute. Presently, he observed, the mix of European macroeconomic policies has many of the hallmarks of the Reagan formula in the early 1980s. High government deficits throughout the Community coincide with the tight monetary policy of the Bundesbank. The result is a combination of fiscal expansion and monetary contraction that raises interest rates and exchange rates, and lowers
economic activity. One possible response is to ease monetary policy while continuing the effort to bring government finances under control.

**Structural rigidity and deflationary bias**

A second important point of discussion was the issue of micro-structural diversity and its implications for the deflationary bias of monetary policy within a European Economic and Monetary Union. One participant made the point that monetary integration should have at least a certain degree of microeconomic convergence as a precondition. Such convergence can be promoted using a system of fixed but adjustable exchange rate parities, as in the ERM. Should the participating countries succeed in achieving the convergence criteria outlined in the Maastricht accords, creation of a monetary union should not impose undue economic costs.

Some degree of micro-structural diversity will remain even after Maastricht-style convergence, and this diversity will result in adjustment costs for different regions of the union. Moreover, these adjustment costs will be exacerbated should the EC move toward a Europe-wide wage policy. The greater the flexibility of wages across different regions of the monetary union, the lower will be the adjustment costs imposed by integration.

One participant contended that the problem of unemployment in Europe stems from the inflexibility of national labor markets. Another participant concurred, but argued that labor mobility is not as important as the flexibility of labor markets. Given that the trade unions would like to hold the social dimension of economic policy at the national level, labor market flexibility promises to become an even more important topic in the future. The problem of unemployment will not likely be solved through European integration.

Moreover, there is only limited scope for macroeconomic coordination. Given the ambiguity and uncertainty in current thinking about the effect of supply-side and demand-side measures on the functioning of markets, macroeconomic policy makers face a clear dilemma. The question is
whether monetary integration gives rise to factor mobility, or whether factor mobility provides the necessary conditions for monetary integration. One participant asserted that there is no obvious causal relation between the two. Immobility of factors imposes costs on monetary integration, and flexible exchange rates inhibit factor mobility. This participant went on to make a different but related point about the relationship between economic interdependence and regional integration. Drawing on the analysis of Richard Cooper, he argued that while a given state of integration posed few inherent problems, transition from one state to another—from managed exchange rates to monetary union, for example—was rife with the danger of adverse and destabilizing speculation. It is thus not only necessary to consider the pace of integration, but the timing and process as well.

**Convergence criteria**

If microeconomic rigidity is the most important problem associated with monetary integration, a key question is whether the Maastricht convergence criteria will be effective in reducing such rigidity. One participant admitted that while criteria are necessary for convergence, the public debt targets were clearly overambitious. There is a danger when excessively strict criteria give rise to the opinion that monetary union is either too difficult or too costly to achieve. There is a need both to ensure convergence and to convince the public that the convergence targets lie within reach. Another participant countered, however, that the criteria are oversimplified. True convergence—particularly microeconomic convergence—can only be assessed through consideration of a much broader range of factors.

**Asymmetric shocks**

A question was raised regarding the viability of an economic system marked by both microeconomic and exchange rate rigidity. One participant argued that asymmetric shocks pose a particular danger to such a system. Turning to the example of German unification, he pointed out that this was a severe shock and that it took place in the worst possible system for managed
adjustment. Ordinarily, real exchange rate movements would have cushioned the impact of unification for the partner countries within the EMS, but German insistence on maintaining low inflation effectively exported the costs of adjustment to the rest of the Community. Another participant responded that the turmoil within the EMS should be attributed to a serious underestimation of the cost of German unification. It is not the Bundesbank as such that is imposing such severe adjustment costs on the European economies, but rather the impact of German unification itself.

Another question addressed was whether the EMS failed to provide for periodic exchange rate adjustments in response to external shocks. One participant argued that the failure of the EMS did not result from an institutional flaw in the EMS, but rather from political decisions made at the national level. Exchange rate stability was not the problem per se; rather it was a political failure to make the necessary economic adjustments on the national level. From this observation, the participant concluded that exchange rate stability is a true “public good.” Now that the credibility of the EMS is at stake, so too is the credibility of the movement toward economic and monetary union. Also at stake is the ability to sustain some of the macroeconomic policies traditionally found at the center of the European economy. As a system, the EMS is being forced to choose between lower interest rates and self-destruction. At the very least, greater clarification of the nature of the future EMU is necessary to promote a greater coordination of national monetary policies for the interim.

The political significance of EMU

One participant argued that any discussion of European monetary integration requires at least some understanding of the issue from the historical perspective: while there is still far to go, much ground has been covered over the past decades, and particularly since the founding of the EMS. There is an important political linkage between the “1992” program and the present drive toward EMU. Had there not been a European monetary system, there might never have been a single
market. Another participant agreed that the German offer to share responsibility for European monetary policy is politically very important for the stability of the Community. A third participant observed that cooperation among finance ministers within the EC has developed significantly over the past two decades. While there remains residual conflict from the standpoint of “national” interest, convergence on a joint European interest is increasingly evident.

Nevertheless, one participant pointed out, the politics of EMU suggest limitations as well as strengths. He speculated, for example, that there could be a relationship between the breakup of traditional political party systems in the European member states and the progress toward EMU. The movement toward EMU might weaken or detract from as well as enhance government legitimacy.

EMU and the outside world

One participant posed the question of how progress toward EMU is influenced by events taking place outside of Europe. Clearly, the Europeans have an interest in the success of Clinton’s economic reform package—both as a means to stimulate sustainable American growth, and to stabilize international financial markets. Alluding in particular to the rising influence of East Asia and Japan, another participant suggested that perhaps the external influences on the emerging European monetary union should be strengthened. Drawing on the history of the G-7, he argued that the reason for expanding the G-5 was to expose national finance ministers to a broader range of policy issues. This, it was believed, would inhibit them from acting solely in the national interest. With that lesson in mind, it is important that the United States and Japan cooperate closely with any emerging European EMU. This will better ensure that the transition toward EMU does not impose unacceptable costs on Europe’s trading partners. The first test will take place at the upcoming Tokyo summit, at which the non-European industrialized nations will confront the members of the Community with the necessity of stimulating world growth. Moreover, one participant asserted, it is
necessary to consider how the policy decisions taken by the “big three” (Europe, the United States, Japan) will affect the inclusion of East Asia and Latin America in the world economy. It is important that these regions be brought in as partners. It is therefore necessary that the three industrial regions begin to consider their global responsibilities. In that context, European integration is proving to be a considerable distraction, drawing attention away from important events taking place in the rest of the world.

Discussion: Trade and Investment

The role of government

The first speaker drew attention to what he saw as the difference in government philosophies found in the three power centers of the industrialized world. The United States, he argued, has a consumer-based philosophy which allows for only limited government intervention in the marketplace. In Europe, however, the philosophy is based on the principle of social welfare, which gives the government a broader mandate for intervention. In the context of international trade, this contrast results in an obvious conflict of interests as the United States fails to understand the social importance of European industrial subsidies. The typical American response is to choose between either industrial subsidies of its own, or market closure. This conflict is systemic, and will not go away with the passage of time. The “good news” is that the United States and the EC have made progress in categorizing subsidies, and in their removal. Recent agreements on agriculture, aerospace, and steel are good examples of this. In spite of the difference in governmental philosophies, the United States and the EC have expressed a mutual desire to find cooperative solutions and to avoid unnecessary conflicts.

The third governmental philosophy, found in Japan, is proving more problematic—both for the United States and for the EC. This philosophy is based on the primacy of production, and results in the transformation of the Japanese economy into a large and competitive factory for consumer and
producer goods. In order to respond to this particular challenge, there is a need to develop international standards for competition policy. While success in developing such standards is possible, it will require a much more focused agenda than currently exists.

The future of GATT

One participant argued that now is the time to begin looking at the multilateral trade agenda after the completion of the Uruguay Round. He offered two suggestions: First, it is important that the United States and the EC formulate common objectives for the development of the multilateral framework within the GATT—particularly with regard to East Asia and Japan. Second, it is essential that the EC and the United States work to develop mechanisms outside of the purview of the GATT for the resolution of conflicts. This participant referred to the U.S.-Japan semiconductor arrangement as a possible model for new agreements.

The problem of Japan

One participant questioned whether bilateral solutions to trade conflicts represent first-best alternatives. The problem, he argued, is not that Japan has trade surpluses with either the United States or the EC, but that Japan has trade surpluses with both. Perhaps, then, the solution should involve a multilateral negotiation based on “affirmative action” principles. Such principles allow for a shift in the burden of proof from demonstration of wrongdoing to a justification for a prolonged disequilibrium. Under this standard, the United States and the EC would not have to argue that Japan was protectionist per se, but merely that persistent Japanese trade surpluses are abnormal and need to be corrected by concerted action.

To the prospect of multilateral negotiations with Japan, one participant suggested that such an approach would fail to bring sufficient pressure to bear on the Japanese. In terms of changing Japanese behavior, therefore, the multilateral approach would yield inferior results to bilateral
diplomacy. This comment elicited a brief exchange about the nature of political influence in international trade negotiations as well as about the wide diversity in bilateral trade instruments.

**Competition policy**

Three remarks were made by one participant concerning the development of international rules for competition. First, any institutional framework for the discussion of such rules should necessarily include the Organization for Economic Cooperation and Development (OECD), and should include a review of anti-dumping policy as well. Second, the development of Japanese competition policy is hindered rather than facilitated by EC and American pressure on trade issues. Citing a study done by the OECD, this participant argued that the greatest threat to Japanese competition policy emerged in the form of bilateral export restraint agreements administered in Japan on behalf of European and American markets. Third, the present interest in bilateral trade balances represents a depressing regression in the politics of international trade. After the successful development of the postwar multilateral system, it is regrettable that the major industrialized countries should resort to the language of competitive bilateralism.

Another participant pointed out that while the laws for competition in Japanese domestic markets are sound, the enforcement of those laws is problematic. Moreover, he reiterated, the issue is not bilateral surpluses between Japan and a specific trading partner, but multilateral surpluses between Japan and the outside world. The real question concerning access to the Japanese economy is not about competition rules, but about distribution practices and excessive vertical integration of industrial enterprises.

The question was raised as to whether Japanese surpluses result from competitive advantages. The answer offered by one participant was that while in some sectors the Japanese are more competitive than other countries, in others the answer is not so clear. Moreover, the unbalanced nature of Japanese trade has implications for transnational investment as well. Recent research has
shown that minority direct foreign investments in Japan have almost universally resulted in increased Japanese manufacturing exports to the outside world. Finally, the relative closure of Japanese markets does have important implications for the competitiveness of foreign firms. Modern production is a complex process that requires multiple linkages between producers and suppliers. Moreover, it is heavily dependent upon economies of learning. In this environment, competitiveness in a given production line is clearly dependent upon position, market share, and access to “launch” markets. To the extent that Japanese closure deprives European and American firms of these benefits, it also weakens their global competitiveness.

Not all participants agreed with this analysis. One questioned the assumption that Japan’s trade surpluses with the outside world have been a permanent feature of the world economy, and pointed out that for much of the postwar period the Japanese current account was in deficit. He argued that in any case there is nothing to indicate that Japanese balance of payments surpluses have an adverse effect on the level or distribution of global economic welfare. This analysis was supported by another participant who pointed out that Great Britain enjoyed a current account surplus for almost 100 years, and that this was accepted as a stabilizing influence on the world economy.

Transatlantic trade

The participants agreed that U.S.-European relations were at a low point, and that trade relations were the weakest link in the chain. The danger, therefore, is that economic rivalry will poison relations on other fronts. Turning to the issue of protectionism, one participant argued that it is important to distinguish between protection of distressed sectors and protection in the interest of achieving economies of scale. Protection of distressed industries is often motivated by social interests and has important spillovers in international trade. At the moment, however, there appears to be a convergence of philosophies on this issue between the United States and the EC. The United
States is becoming more protectionist, and the EC more liberal. Solutions to the problem can thus be found, but will require collaboration in the interests of both parties.

Protection for the achievement of economies of scale is more problematic. Nevertheless, it should still be possible to find solutions that are acceptable to both parties. Finally, this participant noted that, in the future, there will be increasing interest in negotiating trade disputes between regional blocs. This will allow for more efficient negotiations as well as for greater self-discipline among the negotiating partners.

The single European market

Regarding the single European market, one participant suggested three problems of particular importance: First, it is widely believed in the United States that the completion of the European single market is designed to give a closed competitive advantage to European firms. Second, the tendency toward the creation of regional preferential trading relations is distracting attention from the development of the international trading system through the GATT. Third, extensive reliance on competing industrial policies threatens to promote head-to-head competition of a sort that unambiguously lowers the welfare gains from trade.

These problems are particularly important now because the end of the Cold War has eliminated security issues as a “lubricant” for transatlantic relations, and economic rivalry has weakened the cooperative aspect of transatlantic relations. The solution to this problem is two-fold: the United States and the EC (meaning above all Germany) will have to bring the Uruguay Round to successful completion; and the EC needs to give some strong indication that the single market does not represent a threat to American interests.

In response to this analysis, one participant argued that while the single market was intended to enhance the technological competitiveness of industry in Europe, it did not represent a closed European venture. Rather, the advantages of the single market are equally available to all industries
established within it, regardless of the national origins of the parent companies. Another participant suggested further that European integration resulted in easier market access for third parties. For example, the Common Agricultural Policy, while clearly protectionist, is far more liberal than the policies applied in European countries outside the EC.

This argument was not accepted by all participants. One participant noted that the perception in the United States was that an American company must become “European” if it is to succeed in European markets. The question is not so much what are the opportunities for direct foreign investment in Europe, but what is required in terms of management control, retained shares, and the necessity of making flanking investments.

Conclusions

At this point the chairman asked the two introductory speakers to draw preliminary conclusions from the morning discussion. The second speaker responded with five points. First, the EC and the United States should work to integrate Japan into the multilateral trading system. Second, the conflict between three governmental philosophies should be understood in the context of global pluralism. It is not necessary to force an artificial uniformity, only to provide an efficient means for dispute resolution. Third, it is necessary to study the consequences of government as well as the limits of government intervention. Fourth, it is necessary to finish the Uruguay Round, both as a means to reinforce the multilateral system and in order to move on to the more pressing issues that are emerging on the agenda. Finally, it is surprising and in fact disappointing to hear references to “Fortress Europe” as well as to find such emphasis on bilateral trade balances.

It then fell to the first speaker to conclude the morning’s plenary. Turning first to the Uruguay Round, the speaker noted that the political risks of a failure remained large. It is not simply that the American administration has changed, but that in changing it has offered a convenient excuse for the Round to fail. On the European side, the pivotal player will be Germany. Finally, it should be noted
that a failure to bring the Uruguay Round to a successful conclusion will spark far-reaching changes in the multilateral trading system.

With respect to Japan, the speaker noted that there is a necessity for "everyone to move at the same time" in order to create an "end game climate" sufficient to force Japanese concessions on issues concerning agricultural trade. Moreover, it is important to recognize the asymmetry of power regarding Japanese manufacturing exports. To date, the United States has tried a range of policies in its attempts to resolve trade disputes with Japan: currency depreciation, demand management, sectoral arrangements, structural reforms, and market sharing agreements. Each of these policies has disadvantages as well as advantages, and none can be credited with complete success. The central problem in trade with Japan is more cultural than economic. Therefore, it is important that Europe and the United States work together to integrate Japan more closely into the global multilateral framework. Japan must be encouraged to take greater responsibility and to play a larger role in managing the global economy.

The speaker then made a similar point with reference to China. Europe and the United States must act quickly to bring China into the multilateral system. The Asian countries already consider China to be the big player in East Asia and the Pacific Basin. It is important that China begin to recognize global responsibilities as well. Finally, the speaker made a short list of additional conclusions. First, if the West expects an increase in investment in the countries of Central and Eastern Europe, it is essential that those countries find market access in the West. Second, heavy reliance on anti-dumping action is a serious threat to the multilateral system, and it appears that the use of such action is becoming more, rather than less, frequent. Third, it is important that the West begin to consider the multilateral agenda for after the Uruguay Round. Fourth, political support for free trade in the United States is dependent upon a so-called "bicycle theory" of market access: progress toward more open markets must continue or the support for liberal trade will lose momentum or, in the worst case, cease to exist.
In closing, the chairman noted that the group had covered much ground and in doing so had exposed the richness of the economic agenda facing the United States and the EC.
SESSION 2: RECONSTRUCTION IN EASTERN EUROPE AND THE CIS

Introductory plenary: General themes in the transition

The first introductory speaker pointed out that an assessment of the current institutional and political situation was important for judging what could be achieved in promoting change in the former Communist world, and made a number of general points regarding this situation. First, the Bush administration’s 1989 conclusion that the EC was the natural partner for the Central and Eastern European countries was essentially sound. Second, despite current problems, the EC was still viable. Much criticism of the EC had also been made before the negotiation of the Maastricht Treaty, even though the treaty was intended to deal with exactly those problems that the EC was being criticized for. Much depended on the ratification of the treaty. Third, the EC was mainly facing a political crisis that was exacerbated by an economic downturn. This economic crisis might actually speed up the political integration process, since the historical record shows that the Community functions best when under economic pressure.

With respect to Central and Eastern Europe, the speaker found it important to distinguish between three areas. The first area was Central Europe, which was for the EC to deal with through membership. The Edinburgh Council had admitted this principle. The second area was the former Yugoslavia, which the Bush administration had been right to say was primarily a problem for the EC. The speaker maintained that it would be easier for the EC to play this role after the war. In the shorter term, the United States should nudge the EC to action by encouraging it to develop its defense capabilities through the WEU. The third area was the Commonwealth of Independent States (CIS), which was for both the EC and the United States to deal with. The G-7 was not an appropriate forum for doing so, given the Japanese position. The main policy areas for the EC and the United States to focus on were the energy sector, targeted assistance to smaller republics, and encouragement of inter-republican trade and the creation of an interstate bank.
The second introductory speaker agreed that EC institutions were stable and well established, but cautioned that the momentum toward integration had slowed and that the EC recently had moved away from a common foreign and security policy. The current crisis of political leadership and the regime changes taking place were affecting the EC’s capacity to act at a time of urgent problems in the East. There were 2-4 years of opportunity. If the main problems had not been solved by then, instability would increase throughout all of Europe.

This speaker argued that we were witnessing the disintegration of the European order established after World War I, the reassertion of nationalism, and a decline in regional cooperation. While there was growing concern about integration into the EC, the Central and Eastern European countries were to unlikely join until after the integration of the European Free Trade Association (EFTA) countries. The speaker nonetheless agreed that integration would be better sooner rather than later. In the meanwhile, the EC had to open up its markets. Moreover, entry into the EC was not enough: a stable security framework was also needed. A phased approach with parallel movements was recommended. For the Visegrad countries integration into NATO before integration into the EC might even be preferable, and the speaker pointed out that this was how the German problem had been dealt with after World War II.

With respect to Yugoslavia, the speaker predicted that it would be seen as a major failure of Western policy. The impact of the crisis was being underestimated in the United States, where it was mainly considered a tribal war and the strategic stakes were ignored. These included a possible spillover, the encouragement of other dictators, a serious refugee crisis, and the way in which it discredited existing security institutions. The Bush policy of urging the EC to act had been wrong. Greater American involvement would have been better. He was also critical of arguments to the effect that NATO only had limited relevance to the crisis. In his view NATO would have to take a more active role.
The speaker also warned against ignoring other states. He considered the emergence of Ukraine as one of the most important geopolitical developments in recent years. The right of Russia to protect Russian citizens in former republics should not be the sole basis of Western policy. To neglect Ukraine could have the effect that it would continue to look to nuclear weapons as a way to assert its position in Europe and the world.

**Working Group I: The Associated States**

There was agreement in the working group that economic and security issues were linked. There was also general agreement on the need for a convergence plan designed to narrow the distance between Eastern and Central Europe and the EC. The following were the most significant points made.

**The current situation in Central Europe**

Central European participants pointed out that political stability in the area could not be taken for granted, and that there was still the possibility of social unrest and anti-democratic backlashes. Living standards had dropped 25% in the Czech Republic and Slovakia and the social agreement between governments and the people was fragile. The security concerns in the area urgently needed to be addressed. These concerns were not being addressed sufficiently by the West.

**Integration into the EC**

Central European participants also expressed disappointment with the lack of urgency with which the EC was addressing the question of market access for Central European products and the larger question of integration into the EC. These countries were in need of trade. One participant pointed out that the share of Visegrad steel of the EC market was less than 4% and called for a more positive attitude in the West toward trade. A disparity was noted between the solemn declarations by the EC and what was actually offered. Western European participants argued that the political
reality in the EC made further concessions difficult. One Western European participant noted that there was not even a firm commitment in the EC that guaranteed the irreversibility of the existing liberalization. This participant emphasized that the United States and the EC had to realize that the liberalization of trade with the East was also in their own interest, and that the East should not have to beg for it. This participant also criticized a tendency to take for granted that the countries would become full members.

**American views on integration into the EC**

There was general agreement that the EC needed to open its markets further to Central European products. The United States was positive towards the association agreements. Some Americans cautioned, however, that tensions with the United States were a possibility if preferential treatment was given to EC products at the expense of American products. One European participant argued that the United States could not have it both ways. If the EC was expected to do something about the area and eventually integrate these countries into the EC, it was inevitable that to some extent the countries would take on the same level of protection as existed in the EC against non-EC products, especially in areas where there were structural adjustment problems.

**Expansion of NATO**

Central European participants argued that the security threats facing the area should be taken seriously and that the North Atlantic Cooperation Council (NACC) was not an adequate response. Central European countries were therefore hoping for NATO membership. NATO was clearly still relevant, and the United States had an important role to play in solving the Yugoslav crisis, especially given the need to gain Russian support for any settlement. An American participant noted that regional cooperation should come first and that NATO membership should not be considered before the countries in question had solved the issue of security among each other. NATO was not designed to defend groups against each other.
The Russian problem

Some participants argued that the Associated States could not become NATO members, as this would upset Russia. It would be difficult to explain to Russia why NATO was expanding into former Warsaw Pact countries. Others questioned the validity of this argument. Some Russians themselves had expressed interest in joining NATO, and the people most likely to be upset about membership for the Associated States were the ones opposed to Yeltsin. A phased process for granting NATO membership would be a good solution, and clear criteria were needed for managing this process.

Western public opinion

Several Western Europeans and Americans alike argued that the Western public would not be willing to extend security guarantees to Central Europe. Some called for an examination of this issue, however. With the right leadership and a convincing presentation of the issues, public opinion could be changed.

The relevance of WEU

Cooperation with the WEU was considered important, but there was general agreement that it lacked the substance of NATO and therefore was less attractive to Central Europeans. One participant pointed out that the Central Europeans could not be expected, given their history, to rely on Western Europe for their security.

Leadership

There was agreement that better leadership was needed. The EC was encouraged to fight the tendency towards restricting market access. A Central European participant noted that someone had to take initiatives and that the West would have to accept sacrifices. If the opportunity was missed now the threats could become bigger in the future.
Working Group II: The Successor Republics of the Soviet Union

Conceptual Framework

The chairman of the working group began the discussion by posing a series of “conceptual” questions:

- What is the rationale for, and what are the implications of, a division between Central Europe and the states of the former Soviet Union, or between European and non-European Russia? Do such divisions imply an unconscious attempt to exclude Russia from Europe?
- What are the incentives for Russia to play the “European game” if it is explicitly excluded from the outset?
- What is the inherent difference between the Baltic countries and the non-Visegrad three? If a line is drawn to exclude all of the East, does this not condemn those countries to fall under the Russian sphere of influence?

These questions are important, the chairman argued, because they suggest the prospect of a self-fulfilling prophecy. By isolating Russia, the West inadvertently makes Russia feel isolated and threatened.

The borders of Europe

One participant noted that there is a tendency to equate the European Community with Europe, and that this tended to confuse the key issues. Clearly, this is not the case. The European Community is an assemblage of middle-sized Western powers. Russia is a continental power in its own right. In this sense, Russian membership in the EC would be comparable to American membership in the EC. Were Russia to join the Community, it would easily dominate the Community’s political center. For the present members, that simply could not be tolerated. Nevertheless, other institutions do exist in which Russia could participate. For example, there is no reason that Russia should be permanently excluded from NATO. In time, perhaps, NATO could
become the military arm of the CSCE. The point is, however, that there is a continental entity centered in Western Europe and there is a continental entity centered in Russia, and that the two entities will remain separate. Another participant concurred, arguing that assistance to Russian reform is the critical issue, and not Russian membership in the European Community. Russia desires to belong to Europe, but not the Community. This participant agreed that it is a mistake to assume that Europe and the Community are the same.

Nevertheless, concern was expressed that the arbitrary exclusion of Russia is very dangerous for the political stability of the continent. This is particularly true given that the present crisis in Russia is more political than economic in nature. Moreover, it would be a mistake to talk about membership in the Community for Ukraine or Belarus if membership for Russia was excluded. Such talk can only serve the conservative opposition in Russian politics, and lead to a reversion to concepts like “sphere of influence” and “continental powers.” Some argued that the Community should allow for concentric circles of association. Others contended that it was important that Russia be allowed membership in the Community as an objective for the future. The prospect of membership would provide important incentives to continue on the path of economic and political reform.

The nature of the Community

One participant pointed out that the European Community is not an international organization which is open to all prospective members. Rather, it is a political union based on common political, historical, and cultural relations. As a union, the Community offers different levels of association to outsiders. As far as membership is concerned, there are four important criteria. First, the applicant must want to join the Community. Second, the applicant should not be permitted to hurt its own interests through membership. Third, the applicant cannot be allowed adversely to affect the
Community's ability to run an efficient and effective union. Fourth, applicants must be considered with regard to their own possible alternatives.

Given these criteria, clearly Russia should be excluded because it would adversely affect the governance of the union. The question then becomes: What alternative arrangements can be devised to satisfy Russian interests in association? Another participant agreed, observing that the main objective for Western reform efforts should be to create a new political and economic system that will enable the successor republics to integrate into the international economy.

The nature of Western assistance

One participant argued that no country should be excluded from international or even European systems. Moreover, he insisted that the West needed to coordinate its efforts for economic and political reform. To do this, he recommended that the West establish a small, streamlined organization like the OEEC (Organization for European Economic Cooperation) with a highly visible political leader. This organization would coordinate technical and financial assistance, and would promote economic cooperation among the countries of Central and Eastern Europe. Another participant suggested that the West should take clear political responsibility for aiding Russian reform efforts. Such responsibility means four things:

First, the West should offer market access for Russian products. Second, Western politicians needed to stop hiding behind the International Monetary Fund (IMF), asking it to make decisions on essentially political matters. Third, Western assistance should be premised on long-term conditionality. Fourth, the West should offer alternative forms of integration into the European and international economies.

This provoked the observation that Western efforts to aid reform in the former Soviet Union have been inconsistent with Western interests in the region. Outside of the important but narrow issue of nuclear control, the West has fallen prey to the free-rider syndrome in the provision of the
public good of stable reform. Without a clear leader, Western efforts have been both slow and weak.

Moreover, a number of questions remain to be answered. For example, given that both sides of the Atlantic have important interests in the former Soviet Union, why has cooperation proven so difficult? Should Western efforts encourage the active participation of Japan? Is there an obvious division between short-term political support and longer-term economic reform? What is the appropriate strategy for Western conditionality? Should the Western powers provide Russia with a short-term social safety net? Is this the "last good chance" for the West to stabilize Russian democracy?

The time frame for action

One participant asserted that the time frame for Western assistance is limited to the next two-to-three months. These will be crucial to political stability in Russia. The most important desiderata is that Western assistance be highly visible and well-targeted. The speaker then enumerated five areas where action is most important: (1) social safety net; (2) defense conversion; (3) small and medium enterprises; (4) balance of payments stabilization; and (5) external debt relief.

Another participant agreed, arguing that for the moment, all attention should be focused on Russia and, to a lesser extent, Ukraine. These two countries are the pivots for success. While the other countries in Central and Eastern Europe are important, efforts in those countries will have little lasting impact should Russia or Ukraine return to the path of dictatorship. That in mind, this participant offered a brief list of reform options to be pursued in the very short term:

- Dramatic political demonstration
  - bring the G-7 meeting to Moscow
  - send Clinton "barnstorming" through Russia
  - have Yeltsin participate fully in the G-7
• Economic assistance
  – give new political guidance to the IMF
  – offer immediate debt relief
  – adopt new means to provide a social safety net
  – distribute mass quantities of Western consumer goods
  – offer investment guarantees

• Technical assistance and nuclear safety

• Military assistance
  – expand technical assistance on nuclear disarmament and control
  – provide housing for military officers
  – promote joint military exercises
  – sponsor largescale military exchanges
  – aid in the conversion of military production
  – engage in a serious discussion of geopolitics with the Russian military.

Another participant cautioned that highly visible political gestures can backfire if not backed by significant economic resources. Moreover, one participant added, political support for Yeltsin should not give rise to an impression in Russia that he has been co-opted by the West.

**Financial assistance and investment guarantees**

It was an open question how much financial assistance would be required. One participant noted with concern that German unification carried an enormously high cost—almost DM 130 billion per year in resource transfers for a population of only 16 million. Extrapolating to a population more than ten times as large suggests the magnitude of the challenge in Russia. Another participant pointed out that private investment was the best and only means for securing the necessary resources. In order to facilitate such investment, however, it is necessary both to identify
potentially profitable sectors and to provide some insurance against political risk. Another participant agreed with this prescription, but argued that no legislative framework could guarantee private investment against a regime change in the former Soviet Union. Therefore, the only recourse is government guarantees. Moreover, this participant reiterated the importance of offering highly visible political assistance to reform efforts in Russia, but also cautioned that this assistance should not give the appearance that Yeltsin has been co-opted by the West.

**Conclusions**

The final participant concluded with five points. First, we should look at what kind of Western initiatives are possible. Second, we need to organize the donors for coordinated action. Third, we need to target assistance at those areas which are likely to offer the greatest gains in productivity. Fourth, we need to provide technical and financial assistance to the public sector. Finally, we need to retain a positive and creative outlook on the situation. The designers of the Marshall Plan never looked back—they worked for the future. The time has come for similar effort.

**Plenary discussion of themes**

The chairmen of the two working groups summarized the discussions. The chairman of Working Group I explained that there had been general agreement that security and economic issues were deeply connected. Prosperity enhanced the feeling of security. Central European participants had expressed disappointment with Western military structures in dealing with current problems. Americans had argued that the isolation of Russia should be avoided and that there was no public support for extending security guarantees. With respect to market opening, there had been a clear difference between EC and American participants. EC participants had argued that internal opposition was difficult to overcome while Americans had encouraged the EC to open its markets further. Central Europeans had maintained that to open markets now would be to grasp the opportunity while it still existed and that helping now would avoid trouble later. The co-chairman
added that there was consensus regarding a tendency toward complacency concerning the associated states, and that specific measures in the next few years would be crucial.

The chairman of Working Group II explained that the discussion had been in two parts. The first had been a conceptual discussion of “drawing lines.” The second had focused on a possible action plan. Problems in the former Soviet Union were considered to be of global significance. There was uncertainty, however, with respect to the role of Japan. Given Japanese opposition to substantial efforts, the G-7 was considered by some participants to be an inappropriate forum for discussions. There had been agreement that new organizational structures were needed along with a leading Western figure. Strong political leadership was necessary. An enormous gap had been noted between the assessment of stakes at issue and the responses they had called forth in the West.

**Plenary discussion**

**Contacts with the opposition in Russia**

A question was raised about whether the West was making efforts to contact the opposition in Russia. One participant argued that it was a mistake to lump all opposition to Yeltsin together, and thought that it would be useful for the West to have contact with moderate elements in the opposition.

**Social safety nets**

It was agreed that public opinion in the West would not accept the provision of large amounts of aid to Russia to create a safety net at a time when benefits were being cut in the West. One participant suggested that support for Russian social programs should be offered in connection with defense conversion. This would make it easier to put forward the argument that aiding Russia served a strategic purpose.
Targeted assistance

In the absence of monetary stability, there is a great risk that aid will be wasted. The focus of Western efforts should therefore be on the energy sector and technical assistance programs. With respect to the 24 billion dollars of assistance already committed, one participant noted that the number was misleading. Much of it was used for bailing out Western banks. This participant also argued that the West missed an opportunity in 1992 to support a stabilization fund and that it is important not to repeat the same mistake next time.

The role of Japan

Given the opposition in Japan to substantial support for Russia, the question was raised whether the EC and the United States could take the lead. Without such a lead it was unlikely that enough pressure would be put on Japan to join the effort. One participant argued that the West should encourage a solution of the territorial dispute between Japan and Russia, but others maintained that the problem would not be solved soon. Another participant argued Japan’s current efforts should not be underestimated, and that even with the Kuriles dispute still unresolved, Japan was providing significant aid to Russia.

Public opinion in the West

There was insufficient domestic support in the West for new long-term initiatives to support Russia. One participant noted, however, that President Clinton was well aware of the importance of the problem. Furthermore, public support could be gained through visionary leadership. Others cautioned that it was dangerous to pump up the public and raise expectations about a problem that could only be solved on a long-term basis.

With respect to American public opinion, one participant argued that a United States military intervention in the former Yugoslavia, with American casualties, would undermine Clinton’s capacity to mobilize support for Russia, and therefore was to be avoided.
Western mediation in the Visegrad area

A Central European participant maintained that the West should develop mechanisms to deal with the possible deterioration of relations among Central European countries. There were many issues in the region that could lead to conflict, for example the Danube dam project that had led to a dispute between Slovakia and Hungary.

Crossover issues

For both the former Soviet Union and Central Europe there was a link between economic and security issues in the reconstruction effort. A failure of the G-7 to respond adequately would prove what many suspected: that the United States is no longer interested in European security issues. One participant argued that the separation of all these countries into groups is not a good idea. They must develop in common. Trade between them has already declined dramatically. Others argued that strategic priorities must be set. Russia first, then Ukraine and the Visegrad, then everybody else. Others again disputed this view.

Western hesitation

A Central European participant expressed surprise and disappointment over how much hesitation and uncertainty there is in the West with respect to the former Soviet Union and Central Europe. Leadership, such as had been evident at the time of the Marshall Plan, was needed. If the West did not develop a clear strategic plan, the risks would increase for both the East and the West.
SESSION 3: THE TRANSATLANTIC SECURITY RELATIONSHIP

The introductory speaker agreed with an earlier presentation which highlighted three key functions of NATO: the conduct of military operations; the defense of Europe; and outreach to former adversaries. The speaker added two functions which he found important, namely the collective defense aspect of NATO and the fact that NATO is the leading forum for transatlantic consultations. He agreed that collective defense was no longer the most important issue but it was still of great value. An American presence in Europe made Europe more stable.

In the view of the speaker, the question was how to ensure a continued American presence. He argued that this would be done most effectively if Europe organized itself better and NATO was turned into a two-pillar organization. As the number of American troops in Europe decreased, a more balanced transatlantic relationship could be achieved. This would mean that the American role would be more political. Adjustment to a more political concept of the American presence would be necessary, especially since the U.S. military was still thinking more in terms of combat roles than more general objectives. The speaker added that the decision to deploy forces has now become a political decision. It was no longer a question of collective defense. To intervene outside national territory it was necessary to provide an underpinning of political objectives.

The speaker argued that the EC, with its many dimensions, covered a wider spectrum than NATO. The current American tendency was to see NATO as the main vehicle for its transatlantic relationship, and to shift the emphasis in NATO to a broader range of issues, including economic matters and reconstruction in the East. According to the speaker, the problem was how to establish a balanced transatlantic relationship that would deal with a range of global issues, and not just European security. An attempt had been made to do this in 1973 with the "Year of Europe," but it had failed since Europe had not been ready. The speaker argued that it was possible now to
establish a balanced transatlantic relationship. Whether this should be achieved through a treaty or not was not clear.

A European pillar within NATO was possible. With its recent enlargement, the WEU could speak on behalf of this European pillar. Militarily, such a pillar would mean a minimum of duplication since it would not have an integrated military headquarters system or troops exclusively under its command. Troops would have a double-hatted function, for WEU and NATO. Politically, it would mean that Europe would provide collective input into NATO consultations. The speaker noted that the United States has often argued that such an approach would mean lengthy intra-European discussions to reach a consensus position that the United States would be unable to influence without unravelling the consensus. He argued, however, that it was time for a more constructive American approach on this matter.

The speaker also argued that a new transatlantic contract or “bargain” was needed. This would not be a formal document, but rather a set of obligations defining functions and responsibilities for Europe and the United States. It would spell out what Europe could do itself and what the United States would be expected to provide (counterbalancing nuclear power, providing strategic airlift, and so forth). However, the speaker would not want to promote a clear division of labor. No new American doctrine for Europe was needed.

With respect to the countries of the former Warsaw Pact, the speaker noted that both the CSCE and NACC have expanded their membership. The WEU had also established a forum of consultation with the Visegrad 4 and the Baltic countries. The speaker endorsed this initiative, placing it in the framework of the spirit of Maastricht, since full membership in the WEU was included in the Maastricht treaty as an option for future EC members. The advantage for the participating countries is that the WEU offers a much smaller forum for these countries to express their concerns and ideas.
The WEU could not give these countries a guarantee against aggression, and the WEU should not give them a feeling of false security. He argued, however, against the view that if these countries became members of the WEU and not NATO, that NATO would not be obliged to come to their assistance. Expressing such a view would be damaging to the concept of collective defense.

The speaker acknowledged the importance of halting the proliferation of nuclear and conventional weapons. This was not enough, however, to reshape the alliance. Security is much more than nonproliferation. It would also be divisive if the United States, in its approach to Russia, were to focus only on nonproliferation, while the European countries took on a broader range of concerns. The speaker also argued that the notion of common security, which has not yet been fully defined, will require an element of common defense as an underpinning.

The speaker concluded on a rather optimistic note. He stressed that many problems had been solved over the last few years (including German unification), and that remaining issues were mainly adjustment problems. France was moving closer to NATO. With respect to Yugoslavia, the speaker questioned whether it had been a test case for European integration, as is frequently asserted. The crisis had been a failure not only for Europe but for the United States as well. The problem may simply have been too big for anyone to solve in a timely and effective manner.

Plenary discussion

Future threats

There was agreement that the major threats facing both Europe and America included the military consequences of a possible political disintegration of Russia, in particular the issue of nuclear control; the conflict in the former Yugoslavia, where the EC and the United States did not necessarily have the same view of the threat; and the issue of nuclear proliferation.
The role of NATO

There was agreement, particularly among American participants, that the integrated military command structure of NATO should be acknowledged as an unusually effective device. It had provided important logistics, training, and intelligence capabilities to handle security issues. Given the end of the cold war and current economic trends, an expansion of defense spending was unlikely. Several participants noted that it was important, therefore, not to take action that would weaken the existing integrated structure that served all well. One participant pointed out, however, that this integrated structure had not created the common interest, but was rather a reflection of existing common interests at the time it was created. At present, it could be questioned whether European and U.S. interests were still convergent. If they were not, new structures would be needed that would allow flexibility and make both common and independent action possible.

On this point an American participant argued that it was necessary to design a structure that would allow the United States to opt in and out. In cases of conflict, three different kinds of threats could be distinguished in which NATO should be the leading organization: a direct threat to NATO territory, a conflict with possible spillover effects to NATO territory, or conflicts with possible use of nuclear weapons. These were matters for joint action in the West. For other sorts of threats, the United States should allow the Europeans to take the lead.

While acknowledging the unique structure of NATO, a European participant also criticized the reactions of NATO officials when attempts were made in Europe to mobilize the public to take on greater responsibilities within European institutions. If the United States wanted the EC to take on a greater role, Americans would have to allow for such mobilization.

There was agreement that it was important to examine how NATO should evolve to deal with the new challenges. One participant argued that its current structure was too heavy for small scale
conflicts. Another participant argued that NATO, through its collective consultation process, should be the organization ensuring there is no disagreement among the Western allies.

The role of WEU

An American participant argued that US officials had recognized the importance of a European "pillar" in the integration process, and hoped that it would strengthen the Atlantic Alliance when Europe had more capability to help deal with shared problems. However, some participants noted constraints in developing such capabilities: most European countries have frozen their military spending. However, lower European defense expenditures were not considered a problem by all participants. Some considered it a logical move given the new security environment, in which there was a need for different forces for different conflicts: smaller and more mobile and flexible.

The emergence of another defense organization with major responsibilities worried one of the participants. It had always been hard to answer the question of how NATO would go to war, and this question would not be easier to answer with two organizations. Some participants also doubted whether there would be situations in which WEU could take action without NATO backing, or whether there would be situations in which WEU felt the need to act and NATO did not. Another participant wondered what particular military capabilities would be organized by the WEU in case of a conflict. Furthermore, the proposed division of functions could have questionable practical effectiveness.

Other participants were more optimistic with respect to WEU. One participant argued that structures must exist for common views to develop. The WEU was working on such structures. If Europeans did not even try, the United States was also unlikely to get involved in a future conflict. Another participant pointed out that during the Gulf crisis the WEU had been the vehicle through which some European countries (Spain and Portugal) had been able to join the coalition. Without the WEU they would not have done it.
Relations with Central and Eastern Europe

A Central European participant expressed disappointment with the hesitant approaches of both NATO and WEU to concerns in the East. NACC was not an adequate response. Economic convergence plans were appreciated, but was the WEU making similar plans in the field of security? A division of labor between NATO and WEU with respect to Central Europe was worrying since it was a signal that Central Europe would be left out of the transatlantic community. Another participant saw a comparison between what was happening in Yugoslavia and what could happen in other parts of Central and Eastern Europe where some Russians wanted to restore the former empire. There was agreement about the need for some kind of convergence program for the countries of Central and Eastern Europe in the field of security. One participant argued that NATO’s long-term vocation should be enlargement. The way to deal with Russian fears of isolation would be to say that it was not excluded from the process. Some kind of association with the WEU could complement an enlargement of NATO. Other participants disagreed that the CIS should be drawn into the institutional structures of the West. If separation was encouraged it would happen and this could lead to the isolation of Russia which could turn nationalistic.

Yugoslavia

One participant argued that the war is posing a structural threat to the security order in Europe. It could have a corrosive effect on the public willingness to support defense institutions. The engagement of United Nations forces had not solved anything, and the core problem remained the extermination of Muslims. It was a discrediting issue that left open the question of what Europeans and Americans were ready to fight for. This participant suggested that a possible solution could
include the creation of a protectorate in Bosnia and the lifting of the arms embargo to enable the Muslim population to defend itself. Another participant argued that Yugoslavia proved that without the political will to get involved, no organization is going to be effective. The problem was how to devise a consensus for action.

According to an American participant, the Vance-Owen plan would be a test case for whether NATO would be willing to intervene outside its own area; and whether NATO could work with the UN and with Russia and the NACC. In his view it was unclear whether there would be any visible role for WEU. This view was strongly opposed by a European participant. He mentioned three possible tasks for WEU in the conflict: 1) enforcing the sea blockade (with NATO); 2) enforcing the blockade on the Danube (currently being done without NATO); 3) providing relief for Sarajevo.

**EC-U.S. contract**

Some participants considered the idea of a contract between Europe and the United States to be a good one. Other participants were skeptical and asked how it would be implemented in practice, and what would happen if contradictory or conflicting interests emerged between the two parties.
EUROPEAN-U.S. RELATIONS BEYOND 1992
CEPS-EAC/RAND Conference

Sponsored by the Directorate-General for External Relations of the Commission of the European Communities and the United States Mission to the European Communities
Corsendonk Priory, Oud Turnhout, Belgium
March 18-20, 1993

THURSDAY, MARCH 18

18:00 Introduction to the Conference
19:30 Cocktails
20:00 Dinner

FRIDAY, MARCH 19

Session 1: The Economic Agenda

09:00 Introductory plenary session:
   Domestic adjustment and global responsibility
10:00 Working group 1:
   Macro-economic and monetary coordination
   Working group 2:
   Trade and investment
11:30 Coffee break
11:45 Plenary discussion of themes
13:00 Lunch

Session 2: Reconstruction In and Integration of
Eastern Europe and the CIS

14:30 Introductory plenary session: General themes
15:30 Working group 3:
   The Associated States: Poland, Hungary, The Czech Lands, Slovakia,
   Bulgaria, and Romania
Working group 4:
Yugoslavia and the Balkans

Working group 5:
The CIS

17:00 Coffee break

17:15 Plenary discussion of themes

19:30 Cocktails

20:00 Dinner

SATURDAY, MARCH 20

Session 3: The Transatlantic Security Relationship

09:00 Introductory plenary session:
The new security agenda after the cold war

10:00 Working group 6:
Organizing European security

Working group 7:
Common European and American responsibilities beyond Europe

11:30 Coffee break

11:45 Plenary discussion of themes

12:45 Chairmen’s conclusion

13:15 Lunch
EUROPEAN-U.S. RELATIONS CONFERENCE

List of Participants

David Aaron  
Twentieth Century Fund;  
Former Deputy National Security Adviser

Robert Blackwill  
Kennedy School of Government,  
Harvard University

Pavel Bratinka  
Deputy Minister for Foreign Affairs,  
The Czech Republic

Fraser Cameron  
Foreign Policy Adviser,  
Secretariat General, EC Commission

Claudio d’Aloya  
Head of Division, Agriculture, General  
Secretariat of the European Council

Régine De Clercq  
Counsellor, Permanent Representation of  
Belgium to the EC

Pavel Demes  
Adviser to the President of the Slovak Republic,  
Director of the Foreign Policy Department

Filip Dimitrov  
Member of Parliament, Bulgaria

James A. Dobbins  
United States Representative to the EC

Shaun Donnelly  
Director, Office of Regional Economic Affairs,  
European Bureau, U.S. Department of State

Stephen Dubrow  
Counselor for Public Affairs,  
U.S. Mission to the EC

Wim van Eekelen  
Secretary General,  
Western European Union

James Elles  
Member of the European Parliament

Willy Friedmann  
Leiter, Abteilung Aussenwirtschaft,  
Deutsche Bundesbank

David Gompert  
Former Special Assistant to the President for  
National Security Affairs and Senior  
Director for Europe and Eurasia,  
National Security Council Staff
<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
</tr>
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<tbody>
<tr>
<td>Philip Gordon</td>
<td>Visiting Scholar, German Society for Foreign Policy, Bonn</td>
</tr>
<tr>
<td>Eckhart Guth</td>
<td>Head of Unit for Relations with the United States, Directorate-General for External Relations, EC Commission</td>
</tr>
<tr>
<td>Michael Haltzel</td>
<td>Chief, European Division, Library of Congress</td>
</tr>
<tr>
<td>Arthur Hartman</td>
<td>Senior Consultant, APCO Associates</td>
</tr>
<tr>
<td>David Henderson</td>
<td>Senior Fellow, CEPS</td>
</tr>
<tr>
<td>Arnold Horelick</td>
<td>Senior Corporate Fellow, RAND</td>
</tr>
<tr>
<td>A. Ross Johnson</td>
<td>Director, RFE/RL Research, Munich</td>
</tr>
<tr>
<td>Catherine Kelleher</td>
<td>The Brookings Institution</td>
</tr>
<tr>
<td>Michael Kennedy</td>
<td>Senior Economist, RAND</td>
</tr>
<tr>
<td>Vaclav Kodis</td>
<td>Counsellor, Czech Mission to the EC</td>
</tr>
<tr>
<td>Gyula Kodolanyi</td>
<td>State Secretary, Senior Adviser to the Prime Minister of the Hungarian Republic</td>
</tr>
<tr>
<td>Zenon Kowal</td>
<td>Special Counsellor to the Ambassador of Ukraine to the EC</td>
</tr>
<tr>
<td>F. Stephen Larrabee</td>
<td>International Policy Department, RAND</td>
</tr>
<tr>
<td>Kurt Lauk</td>
<td>Member of the Board of Management, VEBA AG</td>
</tr>
<tr>
<td>Carl Lohman</td>
<td>Financial Attache, U.S. Embassy, Bonn</td>
</tr>
<tr>
<td>Peter Ludlow</td>
<td>Director, CEPS</td>
</tr>
<tr>
<td>Simon Lunn</td>
<td>Deputy Secretary-General, North Atlantic Assembly</td>
</tr>
<tr>
<td>David Martin</td>
<td>Vice-President of the European Parliament</td>
</tr>
<tr>
<td>Edward Mortimer</td>
<td>Financial Times</td>
</tr>
<tr>
<td>Knud Munk</td>
<td>Principal Administrator, Economic Services, EC Commission</td>
</tr>
<tr>
<td>Hugo Paemen</td>
<td>Deputy Director-General, EC Commission</td>
</tr>
</tbody>
</table>
Jacques Pelkmans
Enzo Perlot
Zdenko Pirek
Jean Pisani-Ferry
Hans-Friedrich von Ploetz
Seppo Remes
Ivan Silaev
Robert Solomon
James Steinberg
Angela Stent
Marton Tardos
Vladimir Tchernega
Pavel Telicka
James A. Thomson
Benedikt von Tscharner
Jan Truszcynski
Tatiana Valovaya
John Van Oudenaren
Volodymyr Vassylenko
Alexander Vershbow
Gijs de Vries

CEPS
Permanent Representative of Italy to NATO
Investfond, Prague, The Czech Republic
Director, Centre d'Etudes Prospectives et d'Informations International, Paris
Permanent Representative of Germany to NATO
Corporate Vice President, Moscow Office, NESTE OY, Finland
Ambassador of the Russian Federation to the EC
The Brookings Institution
International Policy Department, RAND
Department of Government, Georgetown University
Faction Leader, Alliance of Free Democrats, Hungary
Counsellor, Political Affairs, Russian Embassy to Belgium
Chargé D'Affaires, Czech Mission to the EC
President, The RAND Corporation
Ambassador of Switzerland to the EC
Deputy Head of the Polish Mission to the EC
Counsellor to the Ambassador of the Russian Federation to the EC
Director, European-American Center for Policy Analysis/RAND, Delft, The Netherlands
Ambassador of Ukraine to the EC
Acting U.S. Permanent Representative to NATO
Member of the European Parliament
Robert Zoellick  
Former Counselor, Department of State

John Zysman  
Berkeley Roundtable on International Economy,  
University of California at Berkeley

Jennifer Anthony (rapporteur)  
Thomas Frellesen (rapporteur)  
Erik Frinking (rapporteur)  
Erik Jones (rapporteur)  
Nelly Depayre (CEPS Office and Conference Manager)  
Karen Gardela (EAC Santa Monica Administrator)