

# **The Challenges of a New Europe**

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Last Friday, the European Commission went down to Athens for the usual ceremonies as a new country takes over the six month Presidency of the European Union.

The baton was passed from Denmark to Greece. And later this year it will pass from Greece to Italy.

We have entered a year in which key decisions for the future of Europe will be ratified, and in which other key decisions will be prepared. And they are all connected to the new task that was given us in 1989 – to create a Europe that is whole and free, democratic and dynamic, and – not the least – where peace is secure.

This is by no means something that can be taken for granted.

We only have to look back on the last century.

It started so well.

Globalisation, economic progress and the advance of science had transformed the world. Vienna was an intellectually and culturally vibrant and multi-cultural metropolis dominating large parts of the centre of Europe. Statesmen had agreed to set up an international court to settle disputes. There was a widespread feeling that wars were a thing of the past, and that we had truly entered a golden age of peace and prosperity.

But then things started to go wrong.

The first serious crisis of the new century was the crisis over the Austrian annexation of Bosnia in 1908. The little known area between the lines of mountains along the Adriatic Sea and the broader Danubian plains had been contested by both the Habsburg Empire here in Vienna and the Ottoman Empire in Istanbul for centuries. But in 1878 Austria had taken over governing it, although formally under the sovereignty of the Sultan by the Bosphorus. And in 1908 Austria decided to annex it formally as well.

This upset the delicate balance of power in the Balkans. Here, Vienna and Moscow, but also Paris and London, had been manoeuvring as the Ottoman Empire had gradually receded. Twice, the vast Turkish armies had stood on the gates of Vienna, and all of Europe has rushed to its defence. Now, its tide was slowly receding, and everyone else was fighting for the spoils.

The crisis of 1908 was defused through intense diplomacy. The delicate balance between all the powers – the legacy that had been carried forward ever since the Congress of Vienna in 1815, after the Napoleonic Wars – had been adjusted.

But any time, the balance could be threatened again.

Then, on June 28<sup>th</sup> of 1914, Archduke Frans Ferdinand of Austria was shot and murdered in Sarajevo. A month later Austria declared war on Serbia. Then, everyone started to move. Russia mobilized to support the Serbs. Berlin declared war in Russia to support Austria. France stood by Russia. Britain gave an ultimatum to Germany not to attack Belgium.

Within just days, all of Europe was at war.

Sir Edward Grey – the British Foreign Secretary – stood in his magnificent room in Whitehall and looked out over Regents Park. “The lights are going out all over Europe”, he remarked, “and I doubt we will see them go on again in a lifetime”.

He was right.

Empires crumbled. Endless millions died. The war spread over the world. When it ended, revolutions swept across the continent. Communism took over Russia. Soon, nazism took over Germany. There was an even more devastating war, again spreading over the entire globe. When it ended, the evil of fascism had been defeated, but Russian forces stood in Berlin and Vienna, and the evil of communism spread out over half of Europe. Winston Churchill spoke about an iron curtain descending from Stettin to Trieste, cutting Europe in half, and ushering in the era of the cold war with barbed wire and tens of thousands of nuclear weapons threatening immediate and mutual destruction.

It was not until November of 1989 that the lights started to come on again in all of Europe after all the horrors, all the deaths and all the darkness of the decades since August of 1914. When the wall came down in Berlin, the horror of communism was over, and Europe could start to come together again.

The long, dark night for Europe was over.

Since then, the number one task of politician and statesmen in Europe has been to set up a new order that can secure the peace and prosperity of the continent, not only for today and tomorrow, but hopefully for generations to come.

In Maastricht in late 1991, the then leaders of the then European Community decided to transform their cooperation into a Union, to start to build a common foreign and security policy, to continue from the internal market to an economic and monetary

union that included also a common currency and to open up for membership for all the new democracies of Central and Eastern Europe.

We have seen setbacks, and we have seen successes in the years since then.

The success was the peaceful collapse of the Soviet system and the withdrawal of Russian might to beyond borders of the time before Peter the Great started building a modern Russia in the early 18<sup>th</sup> century. Never in history have we seen such a large collapse of such a powerful empire in such a peaceful way. Historians are likely to see it as nothing less than a miracle.

As the oppression of the evil empire lifted, new forces asserted themselves. Nationalism was obviously the most important. One country after the other in that large area that historically had been between the German and the Russian lands asserted its independence. From Tallinn to Trieste, the new wave of nationalism also brought genuine freedom.

But once again, it was in Sarajevo that we were reminded of the fury that can be unleashed by the dark forces of division. Only weeks has passed since we celebrated the lowering of the red flag from the Kremlin when the shells started to rain down over the city.

Suddenly, we had war again in Europe. Millions were forced to flee as nationalist forces sought to carve out their pure pieces of territory in the multi-ethnic mosaic of this part of Europe. We had to reach for the history books to try to understand the old issues of the new Europe.

There was – and there is – no alternative in order to create peace and stability in this large area of Europe to the gradual extension towards the East, the Northeast and the Southeast of the structures of European and Euro Atlantic integration that had been built in the West in the decades before the new start in 1989.

They wanted to truly become part of the West, and we had to respond by extending our structures towards the East.

In November of last year, the present 19 members of NATO met in Prague and extended an invitation to a further seven countries to join the Euroatlantic system of security. After ratification – including by a two-thirds majority by the US Senate - they will enter as members by May 1 2004.

In December, the present 15 members of the European Union met in Copenhagen and concluded negotiations for accession with no less than 10 new countries. They will – after ratification by no less than 29 parliaments – enter the Union as full members by May 1 2004.

Before that, there will be popular referendums in practically all of these countries. We have never in Europe seen a year with some many referendums as there will be in 2003. Hungary in April. Poland in May. Czech Republic in June. Estonia and Latvia last on the list in September.

This will happen as we see the European Convention in June delivering its proposal for a constitution of the evolving federation of nation states.

The European Union of today is the result of a patchwork of complicated compromise treaties, from the original Treaty of Rome of 1958 to the Treaty of Nice. The resulting text is virtually incomprehensible.

Now, we need a constitutional text that is as clear and as comprehensible as constitutional texts can be. We need a document that spells out to all the 400 million citizens what this evolving federation can do – and what it can't do. And we need a governance structure of this federation of eventually more than 30 states that meets the twin requirements of efficiency and legitimacy.

Not easy. There are bound to be very different points of views as one tries to bring different national, political and legal cultures together with some sort of common framework. History provides no model – what is being done has never been done before. Compromises will have to be made. But either under the presidency of Italy later this year or, more likely, the presidency of Ireland early next year, we will see

the governments of the Union agreeing to the first true constitution of this evolving federation.

I'm using the somewhat charged word federation deliberately. Already today, the European Union is, in my opinion, a federation, although with very limited powers, and also with structures far more confederal in nature. Key policies like customs, trade, agriculture and competition are completely federal in nature. A common central bank and a common currency add to the picture.

I believe we will see a further strengthening of these elements in the Union. And I believe that the new member states will be among those pressing for such new powers to the Union over time. For better or worse, their history has been a history of operating within a larger political framework, and I believe that they over time will be assertive in trying to develop that larger framework.

They want to the West – and they have their own reasons for wanting this West to be strong.

Strong in powers and promise. Not necessarily in expenditure.

The European Union is unlikely ever to develop into a super state in terms of size. Its expenditure is limited to 1,27 % of total GDP, which doesn't really make for much of a bureaucratic monster. The European Commission in Brussels, with all its interpreters, still has fewer employees than the Social Administration of the City of Stockholm. Even if this ceiling over the decades might be lifted, we are certainly not talking about a super spender.

There is no doubting the political importance of this enlargement of the Union. It firmly anchors states in areas that historically have been unstable in the stability structure of the West. And never before have so many new states entered the Union at the same time.

But by other measurements, other enlargements have been larger in terms of both population and economy.

The app 70 million people that will join the Union in 2004 will augment its economic strength but no more than somewhat less than 5 %.

But that's only the immediate story. The entry of these economies will alter the economy of Europe. And their impact on Europe as a whole will grow gradually over the coming years.

The countries of Central Europe and the Baltic area have been going through first the collapse of socialism and then the immense efforts of building capitalism during the past decade.

Often, we tend to underestimate the magnitude and the complexity of that task. It looked so easy to get rid of the old. Suddenly, there were free elections, free press and democratic governments.

But to set up the structures required for the rule of the law, and for the proper functioning of a vibrant capitalist economy, is a far more demanding task. But in the years since the collapse of the old, they have set up food standard agencies, telecom regulation bodies, labour safety inspectors, insurance market supervision structures and much else that we tend to take for granted.

And they have adopted the laws and the regulations of the vast internal market that already exists in the West of Europe and that they will now be entering..

There were – not that long ago – lots of books about how to go from capitalism to socialism. But there was literally none on how to go from socialism to capitalism. The textbooks missed what was to be the real task of history. It fell to the European Union to provide the model for the details of the large transition from socialism to capitalism in half of Europe.

Amazed as we should be with the success so far, we should not believe that the process is completed.

Administrative and judicial structures need to be further reformed and strengthened in several of these countries. There are those where corruption is still an issue. Industrial restructuring has by no means been completed in all of them. Issues of agriculture and the quality of rural life will loom very large not only in Poland.

But gradually, we will start looking at the problems in the new countries with the same glasses as we are looking at the problems in the old ones. Then, the picture rapidly changes. The energy market is more liberalized in Poland than in France. Private ownership in the banking sector is stronger in the Czech republic than in Germany. International rankings put Estonia well ahead of Greece in terms of having gotten rid of corruption.

After the collapse of the old economic system, we have seen growth reviving throughout these economies. During the last few years, their growth rates have been significantly higher than in the Euro economies. And most assessments see this as continuing. It is assumed that the structural changes they have been undertaken will gradually increase their growth potential. Estimates by the European Central Bank put their medium-term growth potential in the 4 – 6 % range.

A lot of the integration with the West has already occurred. But we will see it accelerate as membership becomes a reality.

There is no doubt that they stand to benefit very considerably from the transfers that they will get from the old members of the EU during the coming years.

Although the size of these is fairly small for the sending countries – 0,25 – 0,3 of the GDP of the present EU – they will be large for the recipient countries – app 3 – 4 % of their GDP. These are sums that will make the Marshall Plan look modest by comparison.

Growth is necessary in order to start to close the wealth gap that is there between the EU of today and the new members. The 10 new members have a GDP per capita at app 40 % the average level of the present Union. We have every reason to seek to reduce that obvious wealth gap.

It can be done. Although every story is always a different one, it is instructive to look at the case of Ireland and what that country has achieved. It entered the then European Communities in 1973 as its poorest member, with an economic standard at 60 % of the level of the then 12 member countries.

Since then, the beneficial effects of membership in combination with wise policies have propelled Ireland to a position where its GDP per capita is on a level that is 122 % of the average level of the Union, giving it the number two position behind Luxembourg.

It's an extraordinary achievement during no more than a quarter of a century – less than a generation.

There is no reason to suppose that this could not happen in the countries of Central Europe and the Baltic area as well. But it will not be automatic. We must learn from the success of Ireland – but also from the failure during many years of Greece.

Investments are needed. And the logic of the existing situation is that we will see labour move towards the West and capital move towards the East.

The latter is happening. Foreign direct investment (FDI) flows are substantial. First Hungary and then Poland have been in the lead. Now, it's the Czech Republic that is attracting the largest flows. Last year, the inflow of FDI was equivalent to approx 12 % of their GDP, which is a very respectable figure.

We see manufacturing industries migrating from the West to the East.

Car manufacturing is only the most glaring example. Audi is producing some of its best-selling cars in Hungary, and Volkswagen have been very successful in its work in the Czech Republic. PSA Peugeot Citroen is already building a plant together with Toyota in the Czech Republic, and has now announced that it will build another very large plant in the region. Japanese car firms, which previously have been concentrating on the UK, are now very much looking at the new member states.

More will come. Manufacturing will move east.

But whether labour will move west is a more open question. With borders open during the last decade, there have in fact been coming fewer people from these countries to Western Europe than was the case before. When there is a hope that things will get better tomorrow, and even more so the day after tomorrow, people are far more likely to stay than to move.

Continued good growth prospects – necessary to close the wealth gap – will be dependent on a continued commitment to sound economic policies and continued economic reforms.

In the world of democratic politics, nothing of this can be taken for granted. Indeed, we see the governments in Warsaw and Budapest spending somewhat too freely for short-term political reasons, thus creating fiscal deficits that will start to be sources of real worry very soon.

Being fully a part of the European Union will make a difference. When they entered the Union, they also enter the evolving Economic and Monetary Union. For most of them, introducing the Euro is a declared aim of their policies during the coming years, and thus they will have to enter the system of more or less functioning fiscal discipline that is part of the EMU.

Introducing the Euro and entering the Schengen agreement will be the next big step for all these countries.

They can enter the Exchange Rate Mechanism as soon as they enter the Union. And if they can fulfil the other criteria, and demonstrate exchange rate stability during two years in the Exchange Rate Mechanism (ERM2), they can enter the Euro as well.

This can happen by 2006 at the very earliest. In reality, it is likely to be somewhat later. There are complex issues to be tackled in the process. But there is no doubting their determination to go this route. If you compare the situation of the individual

countries of this region today to the situation of either Spain or Portugal or Greece five years before they become part of the Euro, the Baltic and Central European countries are in fact in better shape than those were. By the end of this decade, most of them – if not all – are likely to be part of the Euro area.

As these ten new members continue their efforts to catch up in terms of integration with the old members through aiming at Euro and Schengen membership, they will simultaneously both be part of the continued attempts at economic reforms in Europe as a whole and in the continued process of enlargement. They will be part of the overall European agenda, shaping it and deciding on its policies and its priorities as it moves forward.

That agenda will continue to be shaped by the great task of setting up the new system of security and stability in Europe – making our continent a zone of both peace and prosperity that hasn't been for many centuries.

I believe that we – after the decisions in Prague and Copenhagen – are perhaps half the way towards that goal. No more – no less.

Half the way in two different ways.

First, when it comes to assuring that the structures we build can really deliver peace and prosperity. We have done a lot during the past decade in these respects, but much more is needed. The common foreign and security policy is still in its infancy. The Lisbon process of fundamental economic reforms has stalled in the last few years.

Second, when it comes to which areas of Europe that are part of our structures of integration and cooperation.

Here, you have only to look at the map.

We have set a 2007 target date for membership for Romania and Bulgaria. Another 30 million people.

We have promised to take a decision on opening membership negotiations with Turkey in December 2004, and be ready to open these negotiations shortly thereafter. The debate on the prospect of Turkey as a future member will be a profound one. It could well be another 80 million people.

We have reaffirmed that we see all the countries in the volatile and conflict-ridden region South of Slovenia and North of Greece as eventually heading for membership. That's app 25 million people.

We can be assured that our new members will soon start to raise questions of whether our strategy of peace through integration should not some day apply to the Ukraine and Moldova as well. Together more than 50 million people.

As we start to close one wealth gap, another one opens up. As we succeed in integrating one country, another one soon lines up.

We are half the way towards building that federation of nation states that will cover all of Europe to the West of Russia and – I believe – the Ukraine, and that will one day stretch from the tundra of the Arctic to the mountains of Anatolia.

Only then can we say that we have truly learnt the lessons of history - and prevented the lights from going out over the one part of Europe or the other.

